NEPAL RASTRA BANK

ECONOMIC REPORT

2002/03

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Acronyms

ACU	:	Asian Clearing Union
ADB	:	Asian Development Bank
ADB/N	:	Agricultural Development Bank of Nepal
AIC	:	Agriculture Inputs Corporation
BOP	:	Balance of Payments
CIT	:	Citizens Investment Trust
CPI	:	Consumer Price Index
CRR	:	Compulsory Reserve Ratio
CRRDB	:	Central Region Rural Development Bank
DICGC	:	Deposits Insurance and Credit Guarantee Corporation
EPF	:	Employees' Provident Fund
ERRDB	:	Eastern Region Rural Development Bank
FDI	:	Foreign Direct Investment
FINCOOP	:	Financial Cooperatives
FINGO	:	Financial Non-governmental Organization
FWRRDB	:	Far Western Region Rural Development Bank
FY	:	Fiscal Year
GDP	:	Gross Domestic Products
GWH	:	Giga Watt Hours
IMF	:	International Monetary Fund
L/C	:	Letter of Credit
LPG	:	Liquefied Petroleum Gas
M1	:	Narrow Money
M2	:	Broad Money
MT	:	Metric Tonnes
MWRRDB	:	Mid-Western Region Rural Development Bank
NBFI	:	Non Banking Financial Institution
NBL	:	Nepal Bank Limited
NDA	:	Net Domestic Assets
NEPSE	:	Nepal Stock Exchange
NFA	:	Net Foreign Assets
NIDC	:	Nepal Industrial Development Corporation
NOC	:	Nepal Oil Corporation
NPA	:	Non Performing Assets
NRB	:	Nepal Rastra Bank
WPI	:	Wholesale Price Index
OBIs	:	Other Banking Institutions
PSB	:	Postal Saving Bank
RBB	:	Rastriya Banijya Bank
RDB	:	Rural Development Bank

RM	:	Reserve Money
SDR	:	Special Drawing Rights
SFDP	:	Small Farmer Development Project
SITC	:	Standard International Trade Classification
TD	:	Time Deposits
VAT	:	Value Added Tax
VDC	:	Village Development Committee
WRRDB	:	Western Region- Rural Development Bank
WTO	:	World Trade Organization

WORLD ECONOMIC

AND

FINANCIAL DEVELOPMENT

World Economic and Financial Development

The widespread signs of global recovery improved investors' confidence around the world in 2003. The world economic expansion gathered momentum further along with the pace of rapid globalization and economic integration. The aggregate demand, however, was weakened by geopolitical uncertainties.

The global economic situation is expected to be favourable because of economic recovery taking place in USA as well as Japan and improvements in the market expectation in the Euro area together with a higher growth in China and India.

In spite of difficulties faced by the major industrial countries, the emerging market and transitional economies grew at a faster rate. Latin America suffered for most of the period due to global financial markets as well as domestic concerns that reduced capital inflows. In Asia and Central and Eastern Europe, growth normally remained quite robust, reflecting favorable external and internal factors. Asian countries benefited from major expansion in the regional trade, increasingly with China, whereas the European economies in transition were successful in diversifying their export markets. China, in particular, continued to grow strongly, securing an important destination for exports of other economies in the region.

The Central and Eastern Europe performed well despite the slowdown in advanced economies and Euro area. Activities in many countries of this region were boosted by positive FDI inflows in anticipation of entry into the European Union. Higher oil prices in the latter part of 2002 spurred growth in the oil exporting countries that also comprised the former Soviet Union like Azerbaijan, Kazakhstan, and Russia. The strong increase in the aggregate demand in these countries supported growth in other countries of the region.

World output grew by 3.9 percent in 2003 from that of 3.0 percent in 2002. In-2003, advanced economies' output grew by 2.1 percent, followed by newly industrialized Asian economies at 3.0 percent and other advanced economies at 1.9 percent. The countries of Euro area, China and India performed well in 2003 with the output growth of 0.4 percent, 9.1 percent and 7.4 percent, respectively.

The volume of world trade rose by 3.2 percent in 2002. This rate further rose to 4.5 percent in 2003. The developing economies and economies in transition performed well in world trade than that by advanced economies. Advanced economies' export is expected to rise by 2.8 percent and that of developing countries by 9.1 percent in 2004. The tremendous growth of both export/import trade volume in most of the emerging market developing economies and economies in transition led to an impressive growth of trade volume in the world trade.

Inflationary pressure remained subdued globally and wage increased moderately. Consumer price index (CPI) increased by 1.8 percent in advanced economies while in the European Union and newly industrialized Asian economies, the CPI increased by 2.0 percent and 1.4 percent, respectively in 2003. It is estimated that the inflation for advanced economies would remain at 1.7 percent in 2004. This figure for European Union and newly industrialized economies would remain at 1.7 percent and 2.1 percent, respectively. Thus, the data reveal that global inflation has remained fairly stable at low levels over the last year.

The net private capital flows in the world stood at US$ 131.2 billion and is estimated to remain at US$ 162.9 billion in 2004. The direct investment and portfolio investment has been estimated to remain at US$ 135.5 billion and US$ 43.9 billion, respectively, in 2004. In this perspective, emerging Asia succeeded to attract the lion's share of private capital flows followed by western hemisphere and central and eastern Europe in 2003. It is estimated that these economies would attract US$ 56.0 billion, US$ 34.6 billion and US$ 18.2 billion worth private capital flows in 2004. The direction of FDI and other flows reflected country specific fundamentals, too. Most of the FDI flows to East Asia were concentrated in China, attracted by the opportunities offered by WTO accession and China's transformed role in the world economy.

Unemployment problem remained severe in Euro area and other advanced economies in comparison to the newly industrialized Asian economies in 2003. It is estimated that the situation would be more severe in 2004 for advanced economies and Euro area and unemployment figure would stand at 6.5 percent and 8.3 percent, respectively, in these economies. However, this rate for newly industrialized economies is expected to remain at 4.3 percent in 2004.

Fiscal deficit has widened in major advanced economies. For example, Japan's net debt remained at 79.6 percent of her GDP followed by Euro area (60.0 percent), Germany (58.0 percent), Canada (51.1 percent) and USA (49.7 percent) in 2003. It is estimated that this figure for Japan will go up to 85.9 percent in 2004 followed by Euro area (60.2 percent), Germany (60.0 percent) and USA (50.0 percent).

International Reserves and Use of Reserves

Total international reserves stood at Special Drawing Rights (SDR) 2.2 trillion at the end of 2003. These reserves were SDR 1.9 trillion in 2002. In 2003, non-gold reserves reached SDR 100 billion compared to SDR 97 billion in 2002. Of the total international reserves in 2003, the developed countries accounted for 31 percent while the developing countries held 61 percent.

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AN OVERVIEW OF ECONOMIC AND FINANCIAL PERFORMANCE

An Overview of Economic and Financial Performance

Fiscal year (FY) 2002/03, the first year of execution of the Tenth Plan, experienced a resurgence of economic growth compared to last fiscal year. Real gross domestic products (GDP) at producers' prices and factor cost witnessed growth of 3.0 percent and 2.6 percent respectively. The accommodative monetary policy stance of the previous year continued in the review year, too. Among the monetary aggregates, narrow money (M_1) and broad money (M_2) rose by 9.8 percent and 8.6 percent respectively. The revised estimate of government budgetary operation showed a deficit of Rs. 11.4 billion, which was lower than that of the last year. Total expenditure increased by 2.7 percent while total resources grew by 12.8 percent. A slight pressure was experienced on price front with an inflation of 4.8 percent. The performance of external sector remained mixed. Trade deficit expanded by 23.1 percent, current account was in surplus by Rs. 11.6 billion and overall BOP remained in surplus by Rs. 4.4 billion. Gross foreign exchange reserve rose from Rs. 105.9 billion in mid-July 2002 to Rs. 108.2 billion in mid-July 2003. The nominal exchange rate of the Nepalese rupee with the Indian rupee remained constant but appreciated vis-à-vis the US$. Various financial sector reform measures like reengineering of Nepal Rastra Bank (NRB), restructuring of Nepal Bank Limited (NBL) and Rastriya Banjijya Bank (RBB), revisions to directives/regulations issued to commercial banks etc. were undertaken in the review year. The number of companies listed in Nepal Stock Exchange (NEPSE) Limited increased from 96 in mid-July 2002 to 108 in mid-July 2003 whereas the NEPSE index slipped down to 204.9 from 227.5. The market capitalization as well as turnover declined significantly.

On the national income and production front, the real GDP at producers' price witnessed a growth of 3.0 percent to Rs. 299.5 billion as against a decline of 0.6 percent last year. Revival of the industry and services sector and a marginal increase in the agriculture sector contributed to the increase in GDP. The industry and services sectors increased by 2.2 percent and 3.1 percent respectively as against a decline of 2.9 percent and 1.3 percent respectively in the previous year. However, the agriculture sector increased by 2.4 percent compared to an increase of 2.2 percent in the previous year. The growth rate of nominal GDP at producers' prices and factor cost stood at 7.4 and 7.1 percentages respectively compared to the growth of 2.9 percent and 3.1 percent last year. The ratio of consumption and investment to the nominal GDP at producers' prices stood at 88.6 percent and 26.9 percent respectively whereas the ratios of gross domestic savings and gross fixed capital formation to the same stood at 16.4 percent and 11.3 percent respectively this year.

The contribution of agriculture sector to GDP stood at 38.9 percent whereas that of non-agriculture sector to the same stood at 61.1 percent.

This year, the Central Development Region of the country suffered from floods and landslides while the Mid and Far Western Development Regions experienced drought. As a consequence, the production of paddy declined by 0.8 percent whereas, the production of maize, wheat, barley and millet grew by 3.9 percent, 6.8 percent, 3.0 percent and 0.1 percent respectively. Among the principal cash crops, the production of sugarcane, potato and jute went up by 4.2 percent, 4.0 percent and 0.5 percent respectively. The production of tobacco and oil seeds declined by 8.1 percent and 7.4 percent respectively. Production of fruits grew by 9.3 percent and the production of pulses, vegetables and other crops witnessed a growth of 2.6, 1.7 and 2.0 percentages respectively. The production of meat, milk and eggs grew by 2.4 percent, 3.2 percent and 3.5 percent respectively whereas fishery witnessed a growth of 4.4 percent.

After the commencement of Kaligandaki 'A' Hydroelectric Project, the largest in the country, electricity, gas and water sub-sector witnessed a growth of 6.4 percent. The production of the construction sub-sector grew by 1.7 percent, which could be attributed to the rise in private residential construction in the capital city as well as other urban areas of the country. The production of the mining and quarrying sub-sector grew by 1.9 percent and the production of the manufacturing sub-sector grew by 2.0 percent.

Deteriorating law and order situation throughout the year, slowdown in the industrial production, competition with the cheap and inferior imported goods resulted in a decline in the production of the industrial goods.

In the review year, production of services sector grew by 3.1 percent. The production of transportation, communication and storage sub-sector grew by 3.7 percent, that of trade, restaurant and hotel sub-sector grew by 3.7 percent, that of finance and real estate sub-sector grew by 2.8 percent, and that of community and social services sub-sector grew by 2.4 percent. The production of trade, restaurant and hotel sub-sector improved in the review year. Because of the frequent strikes, Maoists attacks on physical infrastructure, deteriorating law and order situation, SARS epidemic in the many countries of the world, war against terrorism by the US etc, the production of services sector could not grow as expected.

Tourism in the country was hit hard by the deteriorating law and order situation, terrorist activities in the international spectrum, SARS epidemic and global economic slow-down. As a result, the total tourists' inflow in 2002 fell down by 26.7 percent to 216 thousands. In 2002, the inflow of Indian tourists grew by 2.2 percent to 65.8 thousands. However, the inflow of the tourists from countries other than India came down at a high rate of 35.8 percent to 150.9 thousands. The indices relating to tourism showed mixed results in 2002. In 2002, the average period of stay of tourist remained at 12 days while the hotel capacity rate grew by 4.0 percent.

On the monetary front, M_1 and M_2 registered a lower and a higher growth respectively in FY 2002/03, compared to that of the last year. M_2 rose by 9.8 percent amounting to Rs. 245.9 billion in mid-July 2003. The increased accumulation of net foreign assets (NFA) during the review year was responsible for the higher growth of M_2. In the review year, M_1, on the other hand, grew by 8.6 percent.

NFA (after adjusting foreign exchange valuation) increased by 4.9 percent and amounted to Rs. 91.4 billion in mid-July 2003. The increased inflows from exports, services, net and remittances were the factors responsible for the growth of NFA in the review year.

Domestic credit registered a growth of 10.2 percent during the review year and aggregated Rs. 228.4 billion in mid-July 2003. Although the monetary sector's claims on the private sector increased significantly, domestic credit increased by a slightly lower rate compared to that of the previous year. The monetary sector’s claims on private sector expanded by 13.2 percent during the review year because of the rise in import credit and the launching of various credit programmes such as car loan, housing loan and educational loan by the commercial banks.

Net claims on government, another component of domestic credit, rose by 5.5 percent during the review year. The significant decline in development expenditure was responsible for the lower level of internal borrowing of the government in the review year. The lower level of internal borrowing in general and the government cash balances with the NRB in particular resulted in the decelerated level of borrowing from the monetary sector by the government in the review year. The claims on non-financial government enterprises, on the other hand, declined by 7.9 percent. However, such claims went up by only 4.2 percent during the review year.

Net Domestic Assets (NDA) (after adjusting foreign exchange valuation) exhibited a growth of 13.0 percent this year. A deceleration in net non-monetary liabilities accounted for the rise in NDA.

Time deposits grew significantly by 10.4 percent. The slowdown in the securities market, the paucity of alternative investment opportunities and increasing trend in remittances contributed to the notable rise in time deposits.

In the review year, net non-monetary liabilities (after adjusting foreign exchange valuation) increased by 5.0 percent. The lower growth in net non-monetary liabilities was attributed to the losses in the exchange equalization fund of the NRB arising from the appreciation of the Nepalese rupee vis-à-vis the US dollar.

In the review year, the total assets/liabilities of commercial banks rose by a significantly higher rate of 16.4 percent. The crucial factors responsible for the significant rise in total assets/liabilities of commercial banks in the review year were the higher growths of both deposits on the sources side and loans and advances on the uses side.

Total deposits of commercial banks registered a higher growth of 10.3 percent in the review year. Among the components of total deposits, demand deposits and margin deposits went up by 19.2 percent and 3.5 percent, respectively. Similarly, savings deposits and fixed deposits recorded an increase of 16.0 percent and 1.3 percent. Savings, fixed, demand and margin deposits constituted 48.0 percent, 37.2 percent, 13.9 percent, and 0.9 percent, respectively, of total deposits in mid-July, 2003.

Commercial banks' borrowing from the NRB declined to Rs. 947.4 million in mid-July 2003. The lower level of use of the refinancing facility against sick industry loans by commercial banks accounted for the decrease in the outstanding borrowing of commercial banks from the NRB in the review year. Foreign liabilities of commercial banks amounted to Rs. 134.2 million in mid-July 2003. On the liabilities side, other liabilities grew by 33.8 percent in the review year. This significant increase in commercial banks' other liabilities was attributed to the increase in the loan loss provisioning of commercial banks.

On the uses front of commercial banks' fund, liquid funds decreased by 12.0 percent in the review year and aggregated Rs. 41.3 billion in mid-July, 2003. Factors such as reduction in compulsory reserve ratio (CRR), the decreased interest rates in the international markets and the increase in the marketable government securities were responsible for the reduction in liquid funds of commercial banks. Among the components of the liquid funds, foreign currency in hand increased by 17.0 percent in the review year. Similarly, cash in hand and balance with the NRB declined by 3.8 percent and 2.9 percent, respectively. The cut in CRR by 1 percentage point in mid-July 2002 was responsible for the decline in commercial banks' balance with the NRB. Likewise, balance held abroad and cash in transit exhibited a decline of 16.7 percent and 58.9 percent respectively in the review year.

In the review year, a growth of 16.4 percent of commercial banks' loans and advances was recorded. Of the total loans and advances, commercial banks' claims on government rose by 35.4 percent. The offloading of the government securities by the NRB on the one hand and the lack of alternative use of commercial banks' funds on the other led to the significant growth in commercial banks' claims on the government in the review year. The claims on non-financial government enterprises declined by 7.9 percent. Claims on financial enterprises went up by 6.1 percent.

Commercial banks' claims on the private sector increased by 13.8 percent. This noteworthy rise in the commercial banks' claims on the private sector was brought about by the increase in imports as well as the introduction of different credit programmes by the commercial banks. In the review year, foreign bills purchased and discounted decreased by 11.4 percent. Finally, other assets of commercial banks went up by 59.5 percent in the review year.

On the fiscal front, public statement of income and expenditure for FY 2002/03 was released with the objectives of investment for peace, accelerating peace and poverty reduction programme and expanding and consolidating the reform programmes. The budget estimated total expenditure, net of loans and investment, for FY 2002/03 at Rs. 86.2 billion, 20.2 percent higher than that of last year's actual. The total expenditure was estimated at Rs. 49.1 billion.

Of total expenditure 55.9 percent and 44.1 percent were allocated for regular and development expenditure respectively. The increase in internal security expenses, debt servicing and social obligations caused the increase in regular expenditure by 16.4 percent compared to that of the last year.

Of the total regular expenditure, 28.8 percent was allocated for social services, 27.9 percent for defense and security, 16.3 percent for interest payment, 9.7 percent for general administration and constitutional bodies, 6.6 percent for economic services and 27.0 percent for miscellaneous.

Of the total development expenditure, 55.1 percent budget was allocated for different development projects and programmes, 43.6 percent for social services 0.7 percent for economic administration and planning and 0.6 percent for unclassified expenditure.

Budget of FY 2002/03 targeted to mobilize revenue amounting Rs. 55.6 billion. Of this, 82.6 percent was estimated from taxes and the rest from non-tax sources. To achieve the target of revenue, the budget aimed at bringing all income generating activities into tax net, creating investment friendly environment, making tax administration transparent and reliable. The budget planned to modernise the customs valuation based on transaction value and implementing effective measures to control revenue leakage.

As per the revised estimates of government budgetary operations, a deficit of Rs. 11.4 billion was observed. The revised estimate showed a decline in total expenditure by 14.6 percent compared to that of budget estimate. Of the total revised expenditure, regular expenditure stood at 4.3 percent lower than the budget estimate and 11.4 percent higher than that of the previous year's estimate. Similarly, the revised estimate in development expenditure stood at 27.6 percent below the budget estimate and 11 percent lower than that of last year's estimate. Of the revised estimate of total resources, revenue was 3 percent lower of the budget estimate and 11.0 percent higher than that of the last year's estimate.

National urban CPI based inflation (base year = 1995/96) on annual average basis registered a rise of 4.8 percent. On point-to-point basis, the price index for food and beverages group increased by 5.2 percent and that for non-food and service group by 6.9 percent. Similarly, the region-wise point-to-point indices for Terai, Hills and Kathmandu Valley increased by 6.8, 5.4 and 5.2 percentages respectively.

The National Wholesale Price Index (WPI) (Base Year: 1999/00 = 100) on annual average basis, registered a rise of 3.8 percent. Group-wise indices for agricultural commodities, domestic manufactured commodities and imported commodities moved up by 3.8 percent, 2.8 percent and 4.3 percent respectively. Such indices had increased by 7.6 percent, 5.5 percent and 0.6 percent respectively during the same period last year.

During FY 2002/03, the performance of the external sector of the economy remained mixed. Total imports increased at a rate higher than that of total exports. As a result, trade deficit expanded significantly. Balance on trade, services and income was significantly negative. Due to large inflow of private remittances current account was in surplus by Rs. 11.6 billion. Similarly, overall balance of payments (BOP) remained in surplus by Rs. 4.4 billion.

Total trade in nominal value increased by 12.9 percent to Rs. 174.3 billion. Total trade/GDP ratio stood at 38.6 percent. Trade with India occupied 55.9 percent and that with other countries covered 44.1 percent. The import coverage of exports declined to 40.2 percent from last year's level of 43.7 percent.

Total exports increased by 6.4 percent to Rs. 49.9 billion in the review year and maintained the ratio of 11.1 percent with GDP. Exports to India decreased by 5.5 percent while that to other countries increased by 23.8 percent compared to that of last year.

Total imports increased by 15.8 percent to Rs. 124.4 billion and maintained a ratio of 27.7 percent with GDP. Imports from India increased by 25.3 percent while that from other countries increased marginally by 5.2 compared to that of last year.

Due to relatively large base of imports, trade deficit expanded significantly by 23.1 percent to Rs. 74.4 billion in the review year. While trade deficit with India expanded by 55.2 percent, it decreased by 5.8 percent with countries other than India.

The overall BOP position of the country remained at a surplus of Rs. 4.4 billion. Improved services account and substantial inflow in transfer account offset the trade deficit and resulted in a surplus in current account. The surplus in current and capital account together with miscellaneous capital inflow contributed overall BOP to be favourable.

Foreign exchange holding with the banking system stood at Rs.108.2 billion in mid-July 2003 comprising 89.6 percent convertible currency and 10.4 percent inconvertible.

Seven different loan agreements amounting a total of Rs. 15.8 billion were signed with donors in FY 2002/03. Similarly, foreign grant agreements amounting Rs. 27.4 billion were also signed.

In FY 2002/03, the weighted annual average rate of 91-day treasury bills declined to 3.48 percent from 4.7 percent in FY 2001/02 . Similarly, the weighed annual average rate of 364-day treasury bills came down to 4.7 percent from 5.2 percent in FY 2001/02. Likewise, the weighted annual average interbank transaction rate also went down to 3.6 percent from 4.2 percent in FY 2001/02.The decline in short term money market interest rates was mainly attributed to the excess liquidity position with the commercial banks arising primarily from the NRB's intervention in the foreign exchange market. The net injection of liquidity through the NRB's foreign exchange intervention amounted to Rs. 24.3 billion in FY 2002/03.

With regard to open market operations in domestic bills, the cumulative outright purchase and sale of treasury bills amounted to Rs. 20.1 billion and Rs. 53.7 billion in the review year. Thus, the turnover of cumulative net withdrawal of liquidity amounted to Rs. 33.6 billion. As in the previous years, the commercial banks also undertook repo borrowing in the review year. Consequently, the turnover of repo borrowing of commercial banks from the NRB amounted to Rs. 45.9 billion during the review year. In aggregate, the total net injection of liquidity in turnover terms amounted to Rs. 12.3 billion during the review year.

The total outstanding refinancing of NRB to banks and financial institutions stood at Rs. 1.4 billion in mid-July 2003, showing repayments in excess of fresh refinancing to banks and other financial institutions. Of the total refinancing, the outstanding refinancing availed by the commercial banks against sick industry loans was Rs. 251.2 million in mid-July 2003. Although there was significant demand from the industries for this refinancing facility, the facility could not be used as per the target since the industries could not meet the criteria laid down by the Sick Industries Rehabilitation Committee.

The performance of other banking institutions namely Agricultural Development Bank (ADB/N) and Employees Provident Fund (EPF) in terms of loan disbursement and repayment improved while that of Nepal Industrial Development Corporation (NIDC) decreased in FY 2002/03 compared to that of the last year. Total assets and liabilities of finance companies increased substantially. Likewise, sources and uses of funds of cooperatives with limited banking transactions also increased significantly in the review year. Stock market activities also recorded a mixed trend. Market capitalization and paid up capital of listed companies increased while the share price index and annual turnover decreased substantially in the review year.

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REAL SECTOR DEVELOPMENT

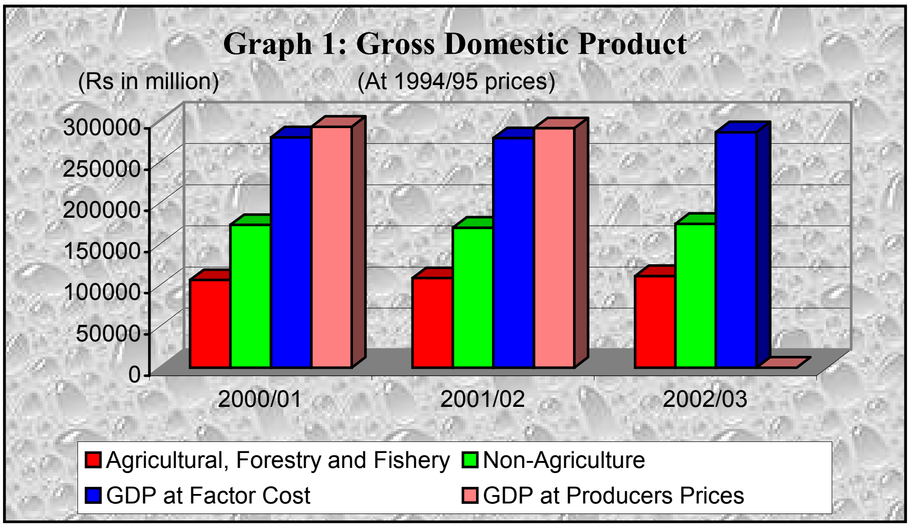
Real Sector Development

Overall GDP Growth

The performance of the Nepalese economy in terms of GDP remained satisfactory in FY 2002/03 compared to the same period last year. The real GDP at factor cost increased by 2.6 percent to Rs. 286.0 billion and at producers prices increased by 3.0 percent to 299.5 billion as against a decline of 0.3 percent and 0.6 percent respectively in the previous year.

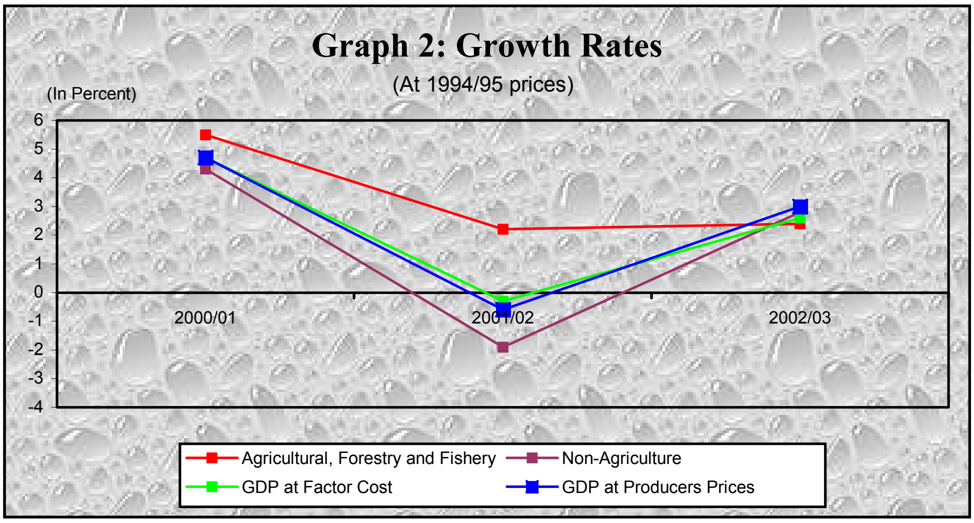
The real agriculture GDP at factor cost grew by 2.4 percent compared to a growth of 2.2 percent in the previous year, while the non-agriculture GDP grew by 2.8 percent as against a decline of 1.9 percent in the previous year.

The electricity, gas and water sub-sector showed a higher growth rate of 6.4 percent followed by trade, restaurant and hotel (3.7 percent), transport, communication and storage (3.7 percent), finance and real estate (2.8 percent), community and social services (2.4 percent), manufacturing (2.0 percent), mining and quarrying (1.9 percent) and construction (1.7 percent).



The share of agriculture sector to the real GDP declined marginally by 0.1 percentage point to 38.9 percent while the share of non-agriculture sector increased correspondingly to 61.1 percent in FY 2002/03.

In the review year, the nominal GDP at producer's prices increased by 7.4 percent to Rs. 453.6 billion and that at factor cost increased by 7.1 percent to Rs. 434.2 billion. The nominal GDP at producer's prices and factor cost had increased by 2.9 percent and 3.1 percent respectively in the previous year. The nominal GDP of agriculture and non-agriculture sector increased by 6.2 percent and 7.7 percent respectively in the review year. The respective growth rates in the previous year were 6.0 percent and 1.2 percent respectively.



Consumption, Investment and Savings

Total consumption in FY 2002/03, increased by 8.3 percent due to an increase in both the public and private consumption. The ratio of total consumption to GDP increased marginally by 0.6 percentage points to 88.6 percent resulting in the domestic savings to GDP ratio to 11.4 percent. The gross domestic savings increased by 1.6 percent to Rs. 51.5 billion as against a decline of 17.6 percent in the previous year. The total investment, in the review year, increased by 12.9 percent to Rs. 122.1 billion compared to 9.5 percent increase in the previous year. The investment to GDP ratio increased by 1.3 percentage points to 26.9 percent in the review year.

The real per capita GDP in FY 2002/03 increased by 5.9 percent to Rs. 12937.6 as against a decline of 2.7 percent in the previous year. Likewise, the nominal per capita GDP increased remarkably by 10.1 percent to Rs. 19597.0 compared to a marginal increase of 0.4 percent in the previous year.

Agricultural Production

Agricultural production did not remain satisfactory in the review year due to unfavorable weather condition in the different parts of the country. The overall production index of principal food grains and cash crops increased merely by 0.7 percent in the review year compared to 1.9 percent rise in the previous year. The production of livestock, other crops and fishery, however, remained normal in the review year.

Foodgrains

Weighted production index of principal food grains in FY 2002/03, went up by 1.2 percent compared to 0.7 percent increase in the previous year. The total production of principal food grains stood at 7360 thousand metric tonnes (MT) in the review year. The production of paddy decreased by 0.8 percent to 4133 thousand MT in the review year due to unfavorable weather condition in the western parts of the country. In the previous year, the production of paddy had decreased by 1.2 percent. However, the maize production, in the review year, increased by 3.9 percent to 1569 thousand MT compared to 1.8 percent increase in the previous year. In FY 2002/03, the production of wheat, barley and millet increased by 6.8 percent to 1344 thousand MT, 3.0 percent to 32 thousand MT and 0.1 percent to 283 thousand MT respectively. In the previous year, the production of wheat and barley had increased by 8.7 percent and 0.7 percent respectively, while the production of millet had declined by 0.1 percent.

Cash Crops

The production of major cash crops in the review year remained less satisfactory due to unfavorable weather condition. The production index of the principal cash crops comprising sugarcane, oil seeds, tobacco, jute and potato went up just by 1.7 percent compared to a higher growth of 7.7 percent in the previous year.

The production of sugarcane, potato and jute increased by 4.2 percent to 2343 thousand MT, 4.0 percent to 1531 MT and 0.5 percent to 17 thousand MT respectively. The corresponding growth rates in the previous year had been 1.6 percent, 12.1 percent and 3.4 percent respectively. However, the production of oilseeds declined by 7.4 percent to 125 thousand MT as against a rise of 2.0 percent in the previous year whereas the production of tobacco declined again by 8.1 percent to 3.5 thousand MT compared to a decline of 5.3 percent 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. Such a growth rate remained at the same level in the previous year. The production of fruits increased remarkably by 9.3 percent to 518 thousand MT in the review year as against a decline of 2.8 percent in the previous year. The production of pulses and vegetables increased by 2.6 percent to 257 thousand MT and 1.7 percent to 1767 thousand MT respectively in FY 2002/03. The comparable rates had been 2.9 percent and 5.1 percent respectively in the previous year.

The livestock sector which contributes around 28 percent to the agricultural GDP, witnessed a positive growth in the review year. The production of milk, meat and eggs increased by 3.2 percent to 1196 thousand MT, 2.4 percent to 204 thousand MT and 3.5 percent to 557 million respectively. The comparable growth rates had been 3.1 percent 2.3 percent and 6.1 percent respectively in the previous year. Similarly, the production of fishery increased by 4.4 percent to 36.5 thousand MT in the review year compared to an increase of 5.2 percent in the previous year.

Area Under Principal Crops

In FY 2002/03, the total area under cereal and cash crops increased marginally by 0.7 percent as against a decline of 0.4 percent in the previous year. Of the total cultivated area, the area under cereal and cash crops increased by 0.5 percent to 3314 thousand hectares and 2.2 percent to 403 thousand hectares respectively. As such, the area under paddy, maize, wheat and millet increased by 1.8 percent, 1.2 percent, 0.3 percent and 0.4 percent respectively. The area under barley, however, declined by 0.8 percent.

Among the cash crops, the cultivated area under potato increased significantly by 6.8 percent, whereas the area under sugarcane and jute increased by 1.6 percent and 0.9 percent respectively. However, the area under oil seeds and tobacco declined by 0.6 percent and 5.6 percent respectively.

On the compositional front of total cultivated area in the review year, as much as 89.2 percent was under principal cereal crops and the remaining 10.8 percent was under cash crops. The area under paddy alone occupied 46.6 percent of the total cultivated area under principal cereal crops while the area under oil seeds occupied 46.4 percent of the total cultivated area under cash crops.

Productivity of Principal Crops

With regard to productivity, a mixed result has been observed in both principal cereal crops and cash crops in FY 2002/03. Cropwise, the productivity of maize, wheat and barley improved to 1.87 MT, 2.0 MT and 1.15 MT per hectare respectively. The corresponding yields per hectare in the previous year had been 1.83 MT, 1.89 MT and 1.13 MT respectively. However, the productivity of paddy declined marginally to 2.67 MT per hectare compared to the yield of 2.75 MT per hectare in the previous year. The productivity of millet remained constant at 1.15 MT per hectare in both the years. Among the cash crops, the per hectare productivity of sugarcane in the review year improved to 38.77 MT per hectare. However, the productivity of oil seeds, tobacco, jute and potato declined marginally to 0.66 MT, 0.96 MT, 1.43 MT and 10.92 MT per hectare respectively in the review year (Table 3 and 4)

Livestock Population

During the review year, total livestock population (in number) increased by 2.9 percent to 42 million compared to a higher growth of 4.6 percent in the previous year. The population of buffaloes, goat and fowl increased by 3.8 percent to 38 million units, by 2.8 percent to 67 million units and 4.2 percent to 222 million units respectively. However, the population of cattle, sheep, pigs and ducks declined by 0.4 percent to 69 million, 1.4 percent to 8 million, 0.2 percent to 9 million and 0.1 percent to 4 million units respectively (Table 3 -A).

Irrigation and Agricultural Inputs

The area under irrigation in FY 2002/03 declined remarkably by 46.5 percent to 9.5 thousand hectare. The total supply of chemical fertilizers through Agriculture Inputs Corporation (AIC) increased remarkably by 77.3 percent to 38950 MT in the FY 2002/03. The supply of nitrogen increased by 84.2 percent to 21838 MT, while the supply of phosphorus and potash increased by 61.4 percent to 15332 MT and 191.8 percent to 1780 MT respectively in the review year. The sale of improved seeds declined by 26.2 percent to 2053 MT as against an increase of 45.5 percent in the previous year.

The disbursement of agricultural credit by the ADB/N increased by 13.8 percent to Rs. 10.1 billion in the review year. The credit disbursed to agricultural production, agro-business and agro-industry, marketing and warehouse construction increased by 8.9 percent, 5.0 percent and 19.2 percent respectively. However, credit disbursement to farm mechanisation and irrigation declined by 11.9 percent in the review year (Table 5a).

Manufacturing

The overall situation of industrial sector was not satisfactory in FY 2002/03 due to internal security problem and global tension by terrorism. Consequently, the production index of 33 industrial goods (base year 1986/87=100) declined by 7.1 percent as against an increase of 2.6 percent in the previous year. However, based on the export figure, the production of non-indexed items like readymade garments, woolen carpet and pashmina showed mixed results. As such, the production of readymade garment increased remarkably by 51.6 percent in the review year as against a decline of 40.3 percent in the previous year. The production of woolen carpet and pashmina declined by 14.6 percent and 7.4 percent respectively in FY 2002/03. Both had declined by 27.7 percent and 69.8 percent respectively in the previous year.

Among 15 manufacturing groups under the index, production of 8 groups increased at the rates ranging from 2.6 percent to 13.8 percent, while the production of other 7groups declined at the rates ranging from 1.3 percent to 16.8 percent in the review year. As such, manufacturing of cutlery, H. tools exc. mac.

equp. (13.8 percent), other non-metallic mineral product (10.9 percent), manufacturing of Electrical, Ind. Mac. Appliances (10.6 percent), manufacturing of textile (9.7 percent), beverage industries (6.2 percent) and footwear manufacturing (5.6 percent) witnessed relatively higher growth rates. However, the paper and paper products witnessed an increase of 2.6 percent.

Product-wise, 21 items registered a positive growth while 11 items showed a negative growth. The production of the items such as noodles, sugar, tea, animal feeds, synthetic clothes, jute goods, squash, soft drink, shoes, beer, cement, bricks and tiles, iron rod angles, steel utensils, GI/HB Wires, ACSR conductor / PVC cable and dry cell battery showed relatively higher growth of more than 5 percent. The production of biscuits, liquor, paper and detergent powder registered lower growth of less than 5 percent. While the production of vegetable ghee, cigarette, bidi, processed leather, soap, matches, plastic goods, cotton clothes, plywood, straw board and slipper declined at rates ranging from 1.3 percent to 24.0 percent.

During the review year, the production of noodles, sugar, jute goods, cement, bricks and tiles, and iron rod angles and ACSR conductor/PVC cable increased due to an increase in both the domestic demand as well as the export to the neighboring countries. The production of vegetable ghee, cotton clothes, straw board, plywood, matches and slipper declined due mainly to quota system, closure of some industries, deteriorating law and order situation and cheaper and illegal imports from neighboring countries.

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 52.5 percent to Rs 36.7 million in FY 2002/03. Similarly, credit disbursement to manufacturing sector, hotel and service sector declined by 16.5 percent, 42.4 percent and 64.2 percent respectively.

Tourism

The performance of tourism sector measured in terms of tourist arrivals, average duration of stay and per capita expenditure showed the least satisfactory results in the calendar year 2002. The number of tourist arrivals by air registered a decline of 27.9 percent to 216 thousand persons in comparison to 35.4 percent decline last year. The number of tourist arrivals declined due mainly to abnormal internal security system as well as external factors. The number of tourist arrivals by air from India increased marginally by 2.0 percent. However, the number of tourists from other countries declined remarkably by 36.1 percent which was attributed to internal insurgency, war against terrorism and global slowdown. The share of Indian tourists in the total tourist arrivals increased to 30.4 percent from the previous year's level of 21.5 percent while the share of other countries tourists in the total tourist arrivals declined correspondingly to 69.6 percent from the previous year's level of 78.5 percent.

The per capita expenditure of the tourist went up by 5.2 percent to Rs. 36117. Likewise, the hotel bed capacity (i.e., number of hotel beds) increased by 3.4 percent. However, the average duration of stay declined marginally by 0.8 percent to 11.9 days.

Petroleum Product

Nepal Oil Corporation (NOC) imported 68482 kiloliters of petrol, 301672 kiloliters of diesel, 351696 kiloliters of kerosene and 56079 MT of liquefied petroleum gas (LPG) in the review year compared to 63578 kiloliters of petrol, 287657 kiloliters of diesel, 390113 kiloliters of kerosene and 48757 MT of LPG in the previous year. The import of petrol, diesel and LPG increased by 7.7 percent, 4.9 percent and 15.0 percent respectively in the review year compared to the corresponding imports of the previous year. However, the import of kerosene declined by 9.9 percent compared to that of the previous year's imports. Similarly, the NOC sold 67456 kiloliters of petrol, 299973 kiloliters of diesel, 348683 kiloliters of kerosene and 48757 MT of LPG in FY 2002/03. In the previous year, 63271 kiloliters of petrol, 286233 kiloliters of diesel, 386593 kiloliters of kerosene and 48758 MT of LPG was sold. The sale of petrol and diesel in the review year witnessed increments of 6.6 percent and 4.8 percent respectively compared to the sales in the previous year. However, the sale of kerosene declined by 9.8 percent in the review year compared to that of previous year. But the sale of LPG in the review year remained constant at the level of previous year.

Electricity

The hydro-power generation (including import) increased by 9.4 percent to 2261.13 Giga watt hours (GWH) in the review year compared to 2066.33 GWH last year. During the review year, Nepal imported 149.88 GWH electricity. In the previous year, such import was 237.78 GWH. Likewise, Nepal exported 186.29 GWH electricity to India in the review year compared to the exports of 142.9 GWH electricity in the previous year.

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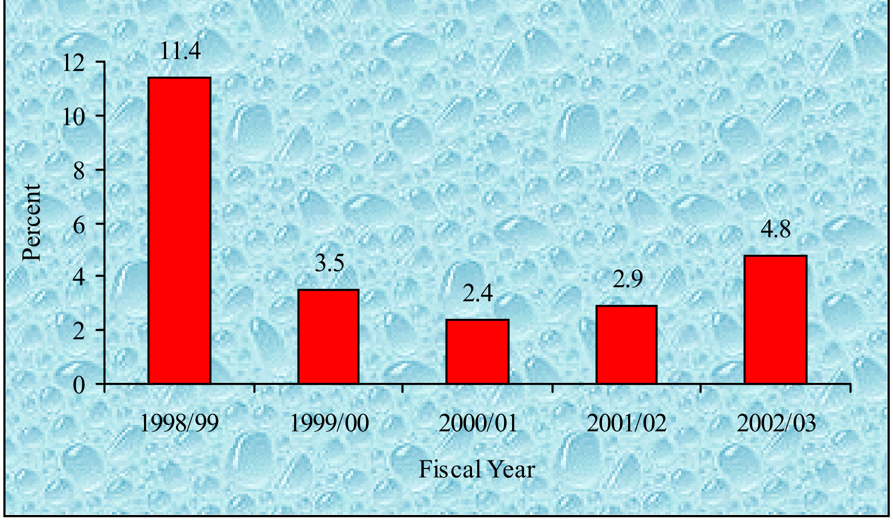
INFLATION

Inflation

Consumer Price Index

Inflation as measured by the National Urban CPI, on annual average basis, rose by 4.8 percent during FY 2002/03, compared to an increase of 2.9 percent during the same period last year. The increase in the prices of petroleum products, oil and ghee as well as grains and cereals products was mainly attributable for such an increase in the overall price index.

Graph 3: Annual Inflation



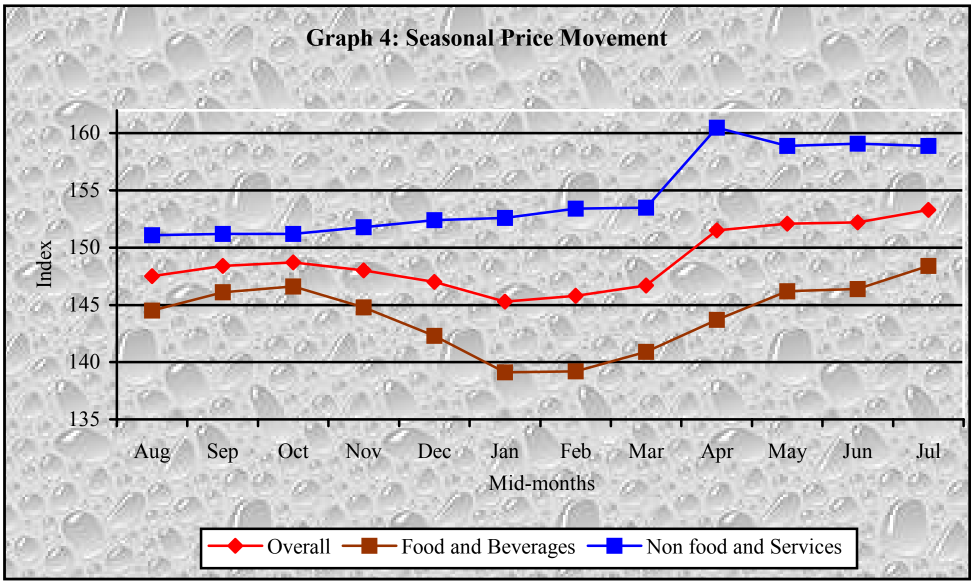
On point-to-point basis (mid-July 2002 and mid-July 2003), the overall price index increased by 6.1 percent compared to 3.5 percent rise during the corresponding period last year. Likewise, the indices for food and beverages group and non-food and services group increased by 5.2 percent and 6.9 percent compared to an increase of 4.5 percent and 2.4 percent respectively last year.

During the review year, on annual average basis, the index for food and beverages group increased by 4.4 percent compared to an increase of 3.7 percent in FY 2001/02 and the index for non-food and services group rose by 5.0 percent compared to a rise of 2.1 percent in the preceding year.

Regionwise, the index of Terai increased with a faster pace (5.7 percent) than indices of Kathmandu Valley (3.8 percent) and Hills (3.8 percent). In the previous year, such indices had increased by 3.4 percent, 2.0 percent and 2.5 percent respectively.

Seasonal Price Movement

The seasonal price fluctuations in the review year can be divided into three distinct phases as depicted by the monthly price movement.



As shown in the above chart, the overall index rose gradually during the period mid-August to mid-October and reached 148.7 points, declined during the period mid-November to mid-January reach 145.3 points again increased gradually during mid-February to mid-July and finally reached 153.3 points (see chart) at the end of the period.

The overall index rose by 0.8 percent during mid-August to mid-October. In this period, the price indices for the food and beverages and non-food and services groups went up by 1.5 percent and 0.1 percent respectively. During the period mid-September to mid-January, the overall index decreased by 1.8 percent, of which food and beverages group index declined by 3.9 percent, while the non-food and services group index increased by 0.5 percent. For the period mid-February to mid-July, the price level increased by 5.1 percent. During the period, the food and beverage group index rose by 6.6 percent and the non-food and services by 3.6 percent.

The government revised (upward) the prices of petroleum products in March 2003. Such upward revision has had an impact in the index of mid-April 2003. The index of food and beverages group was lowest on mid-January and highest on mid-

July. Mid-January is the harvesting and marketing season for paddy and for most vegetables and fruits. Rice, vegetables and fruits cover 22.0 percent weight in the National Urban Consumer Price Index.

Price Movement of Sub-groups of Commodities

All the indices under food and beverages group increased except spices and sugar and related products during the review year. The increase was within the range of 0.5 percent to 19.6 percent. Notable increase was in the indices of oil and ghee (19.6 percent), grains and cereals products (8.2 percent) and beverages (6.9 percent). The indices for other sub-groups such as restaurant meals (3.5 percent), meat, fish and eggs (3.3 percent), pulses (1.1 percent), milk and milk products (1.0 percent) and vegetables and fruits (0.5 percent) increased whereas the indices of spices (8.8 percent) and sugar and related products (7.0 percent) declined.

The index for grains and cereals products surged up by 8.2 percent compared to 2.1 percent increase in the preceding year. Such increase was mainly attributable to the weak supply situation of these commodities.

A remarkable price rise was observed in oil and ghee sub group. During the review year, the index of this group surged up by 19.6 percent compared to 8.3 percent increase during the preceding year. The increase in the prices of edible oil, soybeans and oil seeds in domestic as well as international markets were mainly attributable for such an increase in the index.

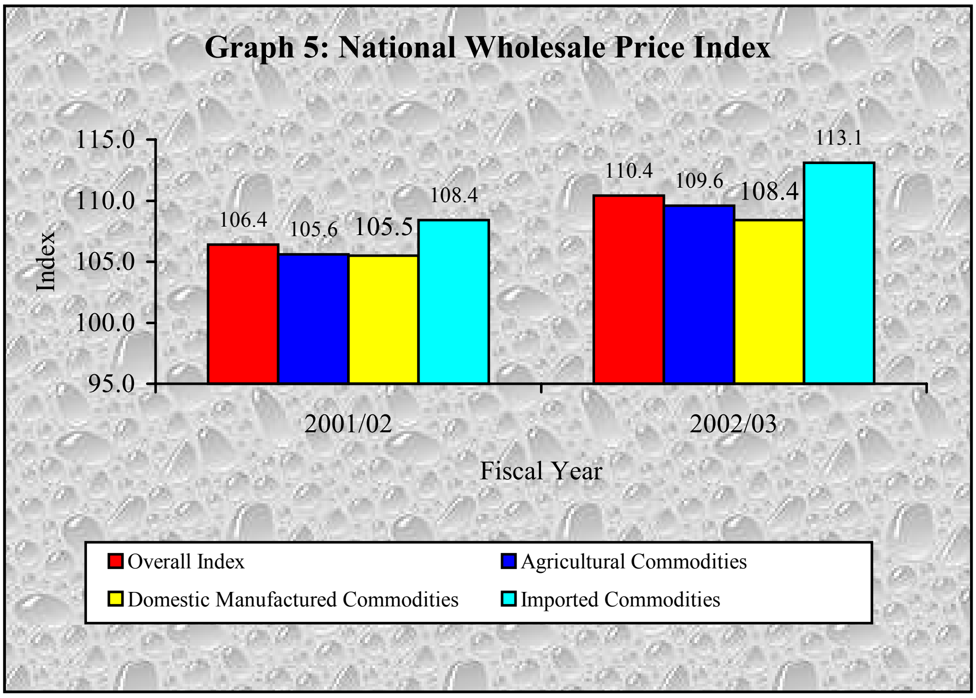
The indices for spices as well as for sugar and related products declined by 8.8 percent and 7.0 percent respectively compared to the rise of 2.0 percent and 5.9 percent respectively last year. The main reason for such decline was the smooth supply situation of these commodities as a result of the increase in the production of sugar and spices by 12.0 percent and 2.0 percent respectively.

The index for non-food and services group rose by 5.0 percent compared to 2.1 percent rise in the preceding year. A relatively higher price rise was observed in the groups, such as education, reading and recreation (9.3 percent), fuel, light and water (8.3 percent) and transport and communication (6.0 percent). Similarly, the indices for medical and personal care (4.3 percent), tobacco and related products (2.9 percent), cloths, clothing and sewing services (1.4 percent), and footwear (1.1 percent) also increased during the review year.

A continuous increase in the prices of petroleum products, reading materials, education fee, doctor's fee and cigarettes was mainly attributable for such an increase in the index of non-food and services group. The upward revision in the prices of petroleum products made on March 25, 2003 was another contributory factor that exerted upward pressure in the index of this group.

National Wholesale Price Index

The National WPI (base year: 1999/00 = 100) on annual average basis, increased by 3.8 percent in FY 2002/03 compared to a rise of 4.9 percent in the preceding year. Group-wise indices for agricultural commodities, domestic manufactured commodities and imported commodities moved up by 3.8 percent, 2.8 percent and 4.3 percent respectively. Such indices had increased by 7.6 percent, 5.5 percent and 0.6 percent respectively during the same period last year.



During the review year, the subgroup indices under the agricultural commodities group, on point-to-point annual basis, depicted a mix trend. The indices of food grains, livestock production, fruits and vegetables and pulses increased by 8.9 percent, 5.2 percent, 4.9 percent and 2.8 percent respectively whereas the indices of cash crops and spices decreased by 5.6 percent and 5.3 percent respectively. The indices of food related products, beverages and tobacco, construction material and others increased by 3.8 percent, 3.6 percent, 0.5 percent and 2.5 percent respectively under the domestic manufactured commodities group. Likewise, under the imported commodities, petroleum products and coal (12.1 percent), chemical fertilizers and chemical goods (1.7 percent), transport vehicles and machinery goods (1.4 percent), drugs and medicine (1.2 percent), textile related products (3.8 percent) and others (3.9 percent) increased whereas the index for electric and electronic goods declined by 1.6 percent.

Wholesale Price Indices of Some Important Commodities

Food Grains

In FY 2002/03, the index of food grains remained at 95.3 points, higher by 8.9 percent than that of last year. During the review year, the indices of rice, maize and wheat increased by 6.1 percent, 12.9 percent and 14.6 percent respectively. Such indices had increased by 2.3 percent, 20.6 percent and 13.8 percent respectively last year. The decrease in production of paddy in conjunction with a weak supply situation resulted for such an increase in the prices of food grains in the review year.

Construction Materials

The index of construction materials increased by 0.5 percent in the review period compared to 5.0 percent increase last year. The indices of iron rod (10.9 percent), GI/HB wires (8.9 percent), bricks (7.8 percent) and cement (1.3 percent) increased whereas the indices of corrugated sheets (10.2 percent) and electric wires (0.3 percent) declined.

Petroleum Products

In the review year, the index of petroleum products increased by 12.3 percent in contrast to a decrease of 2.4 percent last year. The upward revision of the prices of petroleum products made by the government on 25th March 2003 contributed significantly in exerting an upward pressure in the index of this sub-group.

Chemical Fertilizers

The index of chemical fertilizers increased by 0.9 percent in the review year compared to a sharp increase of 11.8 percent last year. The government controls the prices of chemical fertilizers sold by AIC. Directly or indirectly the prices of chemical fertilizers in the private sector is dominated by the government prices.

Wages

In the review year, the wage rate of different kinds of labourer depicted an increasing trend. The growth rate in the wage of agricultural labourer remained higher than those in the wage of construction labourer. As such, the growth rate of the wage of agricultural labourer increased by 11.1 percent compared to an increase of 10.1 percent in such rate of construction labourer. The town-wise wage rate is given below.

Town-wise Average Wage Rate

(In Rupees)

S.No.	Groups & Sub-groups	Unit	FY 2001/02				FY 2002/03			
			KTM	BRT	BRJ	BHR	KTM	BRT	BRJ	BHR
1.	**Agricultural Labourer:**									
	1.1 Male	Daily	130.0	85.0	78.3	60.0	135.0	85.0	83.3	60.0
	1.2 Female	Daily	75.0	50.0	75.0	60.0	80.0	51.6	83.3	60.0
2.	**Construction Labourer:**									
	2.1 Mason									
	2.1.1 Skilled	Daily	310.0	171.7	150.0	180.0	316.7	174.7	155.8	189.2
	2.1.1 Semi Skilled	Daily	235.0	136.7	123.3	151.7	241.7	150.5	126.7	158.7
	2.2 Carpenter:									
	2.2.1 Skilled	Daily	310.0	173.3	170.0	186.7	316.7	175.5	183.3	194.2
	2.2.2 Semi Skilled	Daily	235.0	140.0	130.0	151.7	241.7	151.1	140.0	158.7
3	**Labourer:**									
	3.1 Male	Daily	145.0	100.0	93.3	85.0	150.0	100.5	93.3	90.4
	3.2 Female	Daily	128.0	86.7	93.3	79.0	133.3	86.7	93.3	84.6

KTM = Kathmandu BRT = Biratnagar BRJ = Birgunj BHR = Bhairahawa

The wages of different types of labourer remained higher in Kathmandu. The lowest wage rate for agriculture labourer and construction labourer was recorded in Bhairahawa, whereas the lowest wage rate for mason and carpenter was seen in Birgunj. The average growth rates for different kinds of labourer in Birgunj, Bhairahawa, Kathmandu and Biratnagar recorded were 5.0 percent, 3.9 percent, 3.5 percent and 3.1 percent respectively.

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EXTERNAL SECTOR DEVELOPMENT

External Sector Development

Policy Development in International Trade and Payments

Some policy measures were adopted during FY 2002/03 for the promotion of the external sector of the economy. For example, time duration for the payment of letter of credit based on deferred payment (usance credit) was extended to one year. Some liberal policies were taken with regard to the repatriation of dividend of foreign investment. Accordingly foreign investors could repatriate their dividend directly from commercial banks. For this, initially concerned foreign investors need to apply once to the NRB in a given format. After that, the NRB provides a permanent exchange license to the related commercial banks, by which they are authorized to exchange the dividend amount. However, such exchange details must be submitted to the NRB by the related banks.

In order to give more incentive for the inflow of remittances in convertible currencies, related units licensed by the NRB, are granted 15 paisa commission in addition to the existing buying rate, provided they deposit such foreign currencies in the Agency Account of the banking office of the NRB.

As the Reserve Bank of India had informed not to accept Indian Rupees above 100 denomination from Nepal, 500 denomination Indian Rupees are prohibited to exchange in Nepal effective from mid-July 1994. Now, India has also circulated 1,000 denomination notes and such notes are also not accepted by the Reserve Bank of India. Therefore, the exchange of such notes is also prohibited in Nepal effective from February 2003.

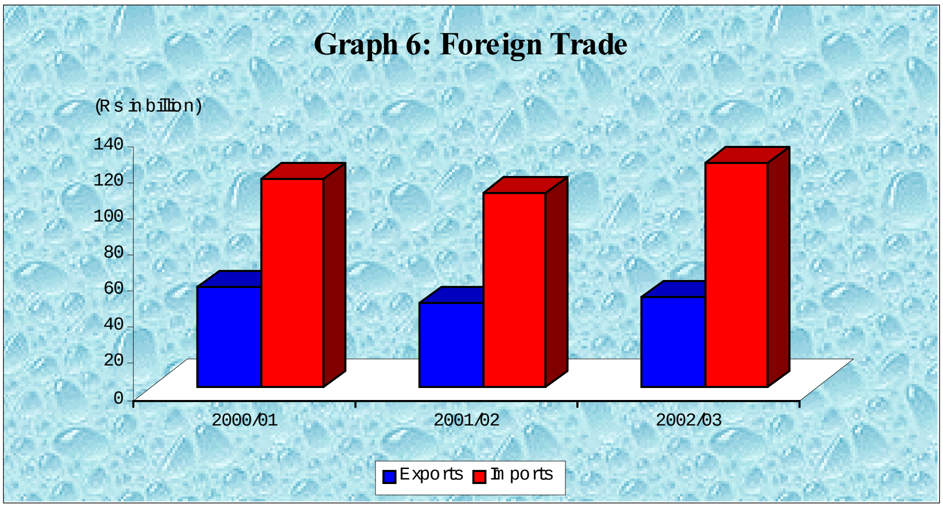
While opening import L/C, names of goods, brand, model number, country of origin, harmonic code number, unit price, quantity and total price must be mentioned, in the proforma invoice, indent or sales contract as well as in letter of credit. In order to make compatible with the international standard, harmonic code numbers are required to be in 8 digits.

During the review year, NRB intervened in the foreign exchange market altogether 26 times, selling a total of US$ 7.8 million in two times and purchasing a total of US$ 323.05 million in 24 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 increased at a rate lower than the total imports. Therefore, trade deficit expanded compared to that in the previous year. In the review year, net service income increased markedly. However, balance on trade, services and income was significantly negative. Due to large inflow of private remittances current account was in surplus by Rs 11.6 billion. Similarly, overall balance of payments (BOP) remained in surplus of Rs. 4.4 billion.

Merchandise Trade

During the review year, total trade in nominal value increased by 12.9 percent to Rs. 174.3 billion as against a decrease of 9.9 percent a year ago. Such a growth in total trade was attributed to the rise 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 38.6 percent, which was 36.6 percent last year. Similarly, in terms of US dollar, total trade registered an increase of 11.6 percent compared to a decrease of 13.6 percent in the previous year. The composition of total trade showed that trade with India occupied 55.9 percent and that with other countries covered 44.1 percent during the review year. The respective shares last year were 54.8 percent and 45.2 percent. The import sustainability of exports during the review year declined to 40.2 percent from 43.7 percent in the preceding year. Import sustainability of export to India decreased to 37.3 percent while that to other countries increased to 44.0 percent. The corresponding figures for the previous year were 49.4 percent and 37.4 percent.



During FY 2002/03, total exports increased by 6.4 percent and reached Rs. 49.9 billion. Last year, total exports had decreased by 15.6 percent to Rs 46.9 billion. As percent of GDP, exports accounted for 11.0 percent during the review year compared to 11.1 percent in the previous year. Regionwise, exports to India decreased by 5.5 percent compared to a growth of 7.4 percent a year ago, whereas that to other countries increased by 23.8 percent compared to a sharp decrease of 35.9 percent in the preceding year. Major commodities that were responsible for the decrease in export to India were pulses, vegetable ghee, toothpaste, Pashmina, copper wire rod, soap, catechue, rosin and polyester yarn. However, exports of jute goods, marble slab, cattle-feed, ginger, thread, skin, cardamom, noodles, M.S.pipe, herbs and plastic utensils, etc. to that country increased during the review year. Major commodities that contributed to the increase of exports to other countries were handicraft goods, readymade garments, silver and jewelleries, Nepalese paper and paper products. But export of woollen carpet, Pashmina, hide and skin, leather goods and nigerseed decreased.

In dollar terms, total exports increased by 5.1 percent to US $ 641.9 million in FY 2002/03 in comparison to 19.0 percent decrease amounting US $ 610.6 million in the preceding year. In dollar terms, exports to India recorded a decline of 6.6 percent compared to a growth of 3.0 percent a year ago, whereas that to other countries showed an increase of 22.3 percent as compared to a decline of 38.4 percent in the previous year. Of the total, exports to India accounted for 52.9 percent whereas other countries occupied 47.1 percent. The respective shares were 59.6 percent and 40.4 percent a year ago.

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 35.6 percent of the total exports by recording a growth of 2.3 percent, whereas with a growth of 37.3 percent, miscellaneous manufactured articles (SITC-8) secured a second position with 34.6 percent share in total exports. The share of manufactured goods classified chiefly by materials and miscellaneous manufactured articles were respectively 37.1 percent and 26.8 percent in the previous year. Exports of food and live animal (SITC-0) covered 12.2 percent of total exports this year as against 10.9 percent share in the previous year and remained in third position. The Animal and vegetables oils and fats (SITC-4) accounted for 8.6 percent of total exports compared to 15.8 percent share in the previous year. Chemicals and drugs (SITC-5) recorded a 6.6 percent share compared to the preceding year's share of 7.0 percent. The relative share of exports of primary commodities (SITC 0-4) decreased by 5.6 percent to 22.7 percent from 28.3 percent of the previous year, whereas that of manufactured and capital goods (SITC 5-9) increased by 14.7 percent to 77.3 percent from 71.7 percent of the previous year. Sectorwise, increase in exports to third countries contributed significantly to the increase in total exports during the review year.

Total imports during the review year increased by 15.8 percent to Rs. 124.4 billion as against a decrease of 7.2 percent in the previous year. Such an increase in total imports could largely be attributed to increase in imports from India. During the review year, imports from India increased by 25.3 percent to Rs. 70.9 billion compared to a minimal growth of 3.5 percent a year ago. Import from other countries during the review year increased by 5.2 percent to Rs. 53.4 billion compared to a decline of 16.8 percent in the previous year. In dollar terms, total imports increased by 14.4 percent during the review year as compared to a decline of 10.9 percent in the previous year. Imports from India in dollar terms experienced an increase of 23.8 percent during the review year compared to a decline of 0.7 percent in the preceding year and that from other countries rose by 4.0 percent compared to a decline of 20.1 percent a year ago.

The value of total imports in relation to GDP increased to 27.4 percent in the review year from 25.4 percent a year ago. The relative share of imports from India in total imports went up to 57.0 percent from 52.7 percent while that from other countries decreased to 43.0 percent from 47.3 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 37.3 percent and 62.7 percent respectively. The respective shares last year were 34.3 percent and 65.7 percent. Commoditywise, imports from India revealed a significant increase in thread by 46.1 percent, chemicals by 83.0 percent, other machinery and parts by 45.0 percent, textiles by 29.5 percent, agriculture equipment and parts by 96.7 percent, petroleum products by 35.3 percent, live animals by 19.7 percent, readymade garments by 5.3 percent, and hot rolled sheets in coil by 184.3 percent. Imports of commodities from India which went down were, tobacco (10.5 percent) vehicle and spare parts (9.4 percent), papers (8.1 percent) and cumin seeds and peppers (29.6 percent). Regarding imports from third countries, major items, which showed a rise were raw wool (58.7 percent), telecommunications equipment and part (121.3 percent), polythene granules (38.3 percent), readymade garments (31.5 percent), crude soybean oil (31.3 percent), zinc ingot (56.4 percent) and textiles (11.9 percent). Commodities which showed a marked decline during the review year were gold and silver (64.6 percent), raw silk (55.3 percent), copper wire, rod, scrapes and parts (58.3 percent), chemical fertilizer (68.7 percent), thread (22.2 percent), medicine (9.0 percent), medical equipments and tools (25.8 percent), and crude palm oil (13.2 percent).

Due to relatively a large base of imports, trade deficit during the review year expanded markedly by 23.1 percent to Rs. 74.4 billion. In the previous year, trade deficit rose by 0.7 percent to Rs. 60.4 billion. In dollar terms, such deficit increased by 21.7 percent, which in the previous year had decreased by 3.4 percent. Regionwise, due to a decrease in exports and significant increase in imports, trade deficit with India expanded by 55.2 percent. Trade deficit with India a year ago was at the level of previous year. Trade deficit with countries other than India decreased by 5.8 percent compared to a marginal rise of 1.3 percent during the previous year. Of the total trade deficit, 59.8 percent was with India and 40.2 percent was with other countries. The corresponding shares in the previous year were 47.4 percent and 52.6 percent.

Balance of Payments

During the review year, the overall BOP position of the country remained at a surplus of Rs 4.4 billion. Since there was no import of petroleum products from other countries and thereby no export of the same to India, total exports in BOP statistics decreased by 12.5 percent whereas total imports increased by 8.7 percent. This resulted in a significant expansion of trade deficit this year. However, improved service account and substantial inflow of transfer amount offset the trade deficit and resulted in a surplus in current account. The surplus in current and capital account together with miscellaneous capital inflow contributed overall BOP to be favourable during the review year.

As regards the current account, trade deficit increased by 31.7 percent to Rs. 70.3 billion in the review year compared to a contraction of 5.5 percent in the preceding year. Total exports (at f.o.b. value) decreased further by 12.5 percent to Rs. 50.8 billion compared to a decrease of 16.9 percent a year ago. Total imports increased by 8.7 percent to Rs. 121.1 billion which in the previous year had decreased by 11.8 percent.

On the services side, gross receipts increased by 12.8 percent to Rs. 26.5 billion compared to a decrease of 21.2 percent in the preceding year. The increase in such receipts attributed to the increase in income under subheads - travel by 35.7 percent and other services by 36.7 percent. However, receipts under government n.i.e. decreased by 25.5 percent. On the payments side, payments on transportation decreased by 2.7 percent and travel increased by 7.7 percent. However, payments on other services decreased by 6.1 percent. As a result, total payments decreased by 0.5 percent to Rs. 19.5 billion compared to a decline of 4.6 percent a year ago. Consequently, net services income went up to Rs. 7.0 billion with a rise of 79.0 percent compared to a decrease of 57.7 percent in the previous year. Despite the improved performance in services account, balance on goods and services remained negative by 28.0 percent amounting to Rs 63.2 billion compared to a negative balance of Rs 49.4 billion in the previous year. During the review year, receipts under income account increased by 4.4 percent to Rs 4.5 billion and payment also rose by 5.3 percent to Rs 5.2 billion. Thus balance on goods, services and income still remained negative by Rs 64.0 billion during the review year.

On the current transfers front, net receipts increased by 10.8 percent and reached Rs. 75.5 billion during the review year compared to a rise of 4.0 percent in the preceding year. Grants, which had increased by 5.0 percent in the previous year, further rose by 9.4 percent in the review year. Similarly, workers' remittances increased by 14.0 percent as against a marginal increase of 0.7 percent in the previous year. Pensions decreased by 11.4 percent whereas other transfer (Indian excise refund) increased by 40.6 percent. In this way, total current transfer credit increased by 10.8 percent amounting to Rs 77.8 billion. As a consequence of the above developments, the current account recorded a surplus of Rs 11.6 billion this year compared to a surplus of Rs. 18.2 billion in the previous year. The current account balance in the review year was about 2.6 percent of the nominal GDP. Such balance was 4.3 percent of GDP a year ago.

On the capital account, capital transfer of Rs. 5.4 billion was received during the review year compared to an inflow of Rs 5.7 billion a year ago. Under financial account trade credit assets decreased by Rs 1.0 billion whereas other assets increased by 35.7 billion. On the liability side, trade credit increased by Rs 16.9 billion. Government drawing was Rs 5.2 billion, whereas amortization was Rs 5.7 billion. In the preceding year, such drawing and amortization were recorded at Rs 8.0 billion and Rs 5.1 billion respectively. Currency and deposit liability decreased by Rs 0.4 billion compared to an increase of Rs 0.5 billion a year ago. Similarly, miscellaneous capital inflow was Rs 4.2 billion this year, compared to an inflow of Rs 10.6 billion in the preceding year. Reserve assets and related items during the review year recorded an increase of Rs 4.0 billion compared to a decrease of Rs 2.9 billion. In this way, change in net foreign assets during the review year remained favourable by Rs 4.4 billion compared to a deficit of Rs 3.3 billion in the preceding year.

Income and Expenditure of Convertible Foreign Exchange

During FY 2002/03, transaction on convertible foreign exchange resulted in a surplus of Rs. 17.3 billion which was higher by 242.0 percent over the surplus of the previous year.

In the income side, total income increased by 29.6 percent to Rs. 98.7 billion mainly attributing to the increased income under remittances, merchandise exports, interest receipts and tourist expenditures. In the expenditure front, total expenditure rose by 14.5 percent amounting to Rs. 81.4 billion. Such an increase in expenditure was mainly attributed to the increase in expenditure under merchandise imports and services. In the previous year, total income had decreased by 15.2 percent amounting Rs. 76.2 billion whereas total expenditure had gone down by 13.9 percent amounting Rs. 71.1 billion, and thus, resulting in a surplus of Rs. 5.0 billion.

Foreign Assets and Liabilities of the Banking Sector

NFA of the banking sector in the review year recorded a marginal increase of 3.4 percent (Rs. 3.0 billion) to Rs. 91.4 billion compared to a lower increase of 0.7 percent in the previous year. In US dollar terms, such assets increased by 7.9 percent (US$ 89.2 million) to $ 1.2 billion compared to a decrease of 3.6 percent in the previous year. Similarly, gross foreign assets, in the review year increased marginally by 2.2 percent (Rs. 2.3 billion) to Rs. 109.3 billion as against an increase of 0.8 percent (Rs. 0.8 billion) in the preceding year. However, in dollar terms, gross foreign assets increased by 6.6 percent (US$ 90.6 million) to US$ 1.5 billion compared to a decline of 3.6 percent (US$ 50.8 million) a year ago. Regarding the overall foreign liabilities of the banking sector, a decrease of 3.6 percent (Rs. 0.7 billion) to Rs. 17.9 billion was registered compared to the previous year's growth of 1.0 percent (Rs. 0.2 billion). In dollar terms, an increase of 0.5 percent (US$ 1.3 million) to US$ 239.5 million was recorded during the review year compared to a decline of 3.3 percent (US$ 8.2 million) a year ago.

Foreign exchange holding as at mid-July 2003 with the banking system stood at Rs. 108.2 billion, comprising 89.6 percent convertible currency and 10.4 percent inconvertible currency. Such foreign exchange holding in the previous year was recorded at Rs. 105.9 billion comprising 75.8 percent convertible currency and 24.2 percent in-convertible currency.

Agency-wise, the NFA of the Monetary Authorities grew by 8.1 percent (Rs. 6.6 billion) to Rs. 87.7 billion as against an increase of 8.2 percent (Rs. 6.1 billion) in the preceding year. Gross foreign assets of the Monetary Authorities in the review year grew by 7.6 percent (Rs. 6.2 billion) to Rs. 88.0 billion compared to an increase of 7.4 percent (Rs. 5.7 billion) in the previous year.

In US dollar terms, the official gross foreign assets in the review year was equivalent to US dollar 1.2 billion, which reflected a growth of 12.3 percent (US$ 129.2 million) as against a rise of 2.8 percent (US$ 28.6 million) in the previous year. The gross foreign assets of the Monetary Authorities accounted for 80.5 percent of total gross foreign assets of the banking sector for the review year compared to 76.4 percent in the previous year. Monthwise, such official foreign assets showed a mixed trend. On an average, the gross official foreign assets of Monetary Authorities amounted to Rs. 83.4 billion showing a growth of 3.5 percent (Rs. 2.8 billion) over the average foreign assets in the previous year (Rs. 80.6 billion).

Convertible currency holding of the NRB grew by 35.4 percent (Rs. 20.1 billion) during the review year. Inconvertible currency holding decreased by 57.4 percent (Rs. 13.8 billion) in the review year. In the previous year, the growth of convertible currency was positive by 7.0 percent (Rs. 3.7 billion) and that of inconvertible currency was also positive by 8.3 percent (Rs. 1.8 billion). During the review year, gold recorded a decrease of 4.2 percent and IMF gold tranche recorded a nominal increase of 0.3 percent, compared to a respective growth of 4.5 percent and 10.8 percent in the previous year, whereas SDRs increased by 150.0 percent compared to a decline of 74.2 percent in the previous year. On the liabilities side of the NRB, foreign liabilities declined further sharply by 46.2 percent in the review year compared to a decline of 40.6 percent a year ago.

As at mid-July 2003, foreign assets held by commercial banks declined by 15.6 percent (Rs. 3.9 billion) to Rs. 21.3 billion. Such assets had a negative growth of 16.1 percent (Rs. 4.8 billion) a year ago. Commercial banks' total liabilities decreased by 2.0 percent (Rs. 0.4 billion) compared to a growth of 3.8 percent (Rs. 0.7 billion) in the previous year.

Foreign Aid Agreements

During FY 2002/03, seven loan agreements amounting to Rs. 15.8 billion were signed with the donors. Out of these seven agreements, one was bilateral with Belgium amounting to Rs. 0.1 billion while six were multilateral with different agencies amounting to a total of Rs. 15.7 billion. Multilateral donor agencies were

Asian Development Bank (ADB) (four agreements) and International Development Association (IDA) (two agreements).

During FY 2002/03, foreign grant agreements amounting to Rs. 27.4 billion were signed with ten countries and six donor agencies under bilateral and multilateral basis amounting to Rs 15.2 billion and Rs 12.2 billion respectively. The total amount this year was 17.2 percent (Rs. 4.0 billion) higher than that of the previous year.

Among the donor countries Denmark, Japan, U.K., U.S.A., Netherlands and Switzerland were the premier donors to Nepal. In terms of amount, Denmark ranked the largest donor providing Rs. 3.0 billion (11.1 percent) Japan ranked second providing Rs. 2.8 billion (10.2 percent), U.K. was in the third position agreeing to provide Rs. 2.4 billion (8.7 percent). U.S.A. was to provide Rs. 2.2 billion (7.9 percent) and ranked the fourth position. Netherlands ranked fifth providing Rs 1.7 billion (6.3 percent). Switzerland agreed to help Rs 1.5 billion (5.6 percent) and ranked sixth position. Other donors were Germany, Norway Australia and India who signed the grant agreements amounting altogether to Rs. 1.6 billion (5.8 percent). Multilateral agreements were signed with six different donor agencies. Among these agencies World Food Programme (WFP) was the largest donor agreeing to provide Rs. 6.1 billion (22.2 percent of total grants). Second agency was United Nations Population Fund (UNFPA) which agreed to provide Rs 2.8 billion (10.1 percent). World Bank ranked third providing Rs 1.9 billion (6.9 percent), EC agreed to provide Rs 1.2 billion (4.6 percent). Other multilateral donors were ADB and FAO who agreed to provide Rs. 0.2 million (0.8 percent).

Transaction with the IMF

During FY 2002/03, transaction with the International Monetary Fund (IMF) resulted into a net balance of SDR 11967 indicating a net inflow with the total receipts of SDR 179973 and payments amounting to SDR 168006. The total receipts of SDR 179973 was an aggregate of purchase of SDR 15442, burden sharing SDR 68393, interest on SDR holding SDR 14461, quoting cover payment purchase SDR 58500 and remuneration SDR 23177 during the review year. Similarly, Nepal paid a total of SDR 168006 comprising cumulative charge of SDR 47101, SDR charge SDR 85192 and assessment charge SDR 35713.

IMF Liabilities

The total liabilities to the IMF amounted to Rs. 60.1 million (SDR 0.6 million), as at the end of FY 2002/03. This amount was lower by Rs. 382.3 million (SDR 3.9 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. 382.3 million (SDR 3.9 million) to Rs. 60.1 million (SDR 0.6 million) during the review year.

Transaction under Asian Clearing Union

The total transaction, which was settled through Asian Clearing Union (ACU), amounted to Rs. 1,002.3 million (ACU dollar 13.23 million) during the calendar year 2003 (January-December). The amount was higher by Rs. 998.1 million (ACU dollar 13.18 million) against that of the previous year. Total exports of goods settled under the ACU registered a rise of Rs. 529.3 million (ACU dollar 7.00 million) to Rs. 531.1 million (ACU dollar 7.01 million). Similarly, total imports increased by Rs. 468.8 million. In ACU dollar terms, imports transactions were higher by Rs 6.2 million. The overall balance of transaction recorded a positive balance of Rs. 56.9 million (ACU dollar 0.79 million) in the review year compared to a negative balance of Rs. 0.6 million (ACU dollar 0.01 million) in the preceding year.

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FISCAL SECTOR DEVELOPMENT

Fiscal Sector Development

During FY 2002/03, the revised estimates of the government budgetary operation reflected a fiscal deficit of Rs.11.4 billion (Table 37), which was 31.0 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 than the growth rate of total resources (12.8 percent) by 10.1 percentage points. The total expenditure and total resources as percent of GDP were 16.5 percent and 13.7 percent respectively. The fiscal deficit[*] was 2.5 percent of the GDP in FY 2002/03, which was marginally lower (by 1.4 percentage points) than that of the previous year.

On July 8, 2002 the government released the public statement on income and expenditure (the budget) for FY 2002/03. The FY 2001/02 had experienced the negative economic growth, first time in last 20 years, unsatisfactory performance in revenue mobilization, decline in foreign cash grant, development expenditure, the total government expenditure and decline in external loan receipts too. All these happened due to mainly the security problems. In this situation, the income and expenditure (budget) was prepared and to address the challenges the budget was focused on the following objectives:

- Investment for peace,
- Accelerating the pace of poverty reduction programme, and,
- Expanding and consolidating the reform programmes.

To achieve the above-mentioned objectives, the budget had taken, following policy measures and programmes:

- Allocating sufficient budget for security programmes, strengthening physical resources and other facilities required by the security agencies and ensuring law and order to the citizens.
- Ensuring the fungibility of resources set aside for development programmes to be used for development itself.
- Bringing dynamism in the overall economy by enhancing effectiveness in the implementation of development projects.

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

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

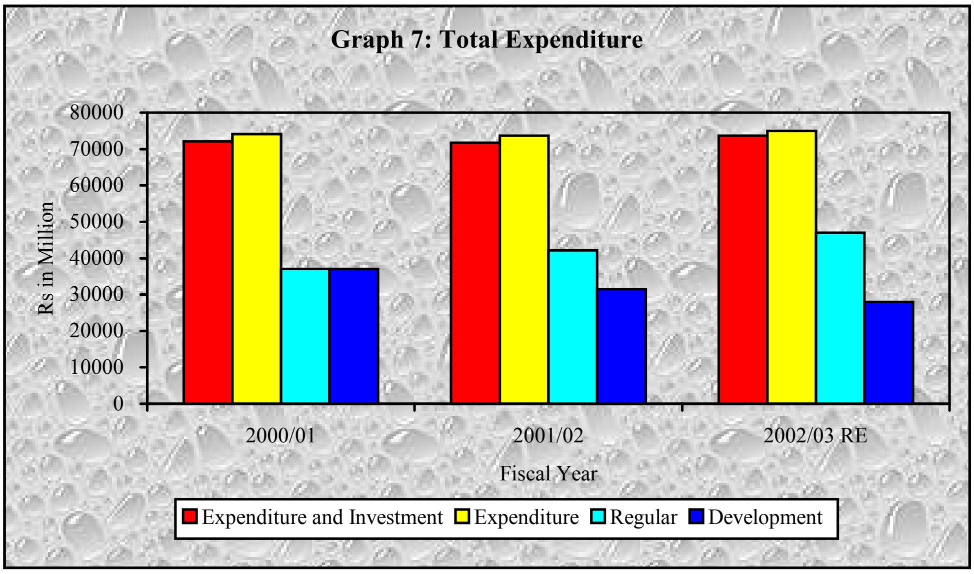
- Prioritizing all the poverty alleviation oriented programmes for their effective implementation.
- Implementing the targeted programmes and projects effectively by coordinating the targeted programmes through Poverty Alleviation Fund.
- Declaring the Charter on citizen's rights in order to strengthen the responsibility of poverty alleviation.
- Linking the block grants to be provided to the local bodies with the level of poverty and developing a mechanism of providing more grants to the local bodies remaining in a situation of great deprivation.
- Making budgetary provisions to conduct various targeted programmes to improve the living standards of deprived, downtrodden, backward class and regions, woman and children.
- Developing a monitoring system whether the actual target group has received the amount allocated for such programmes or not and also developing the community auditing system of such programmes.
- Making the provision of writing off the interest in excess of principal to those farmers who had barrowed up to Rs. 40,000 from the ADB/N before 1994 and pay interest equivalent to the principal.
- Exempting the whole amount of interest due to the farmers borrowing up to Rs.10,000, if they could repay the whole amount of loan within mid-January 2003.
- Raising the ratio of rebate from 10 percent to 15 percent for the next fiscal year to encourage the borrowers to pay the outstanding interest in time.
- Implementing special relief provisions through the ADB/N in order to provide the relief to the indebted farmers and entrepreneurs and the farmers borrowing small credits, who have been dislocated following the terrorist attacks.
- Providing loans at concessionary rate through the Poverty Alleviation Fund in order to impart skill-oriented trainings and run business from various government and non-government agencies to those who want to live peacefully by abandoning terrorist activities.
- Allocating necessary budget for reconstruction, repairs and maintenance of the development structures, administrative, educational and industrial institutions damaged by terrorists and rehabilitation of the displaced as well as those people who wish to lead a peaceful life by giving up the wrong path of murder and terror.
- Making "Woman Scholarship" programme easily accessible in order to ensure the educational opportunity to all girl children, especially those belonging to backward and downtrodden classes.

- Continuing the special Agriculture Production Programme to increase agriculture production by supplying fertilizer and seeds in the remote hilly districts deprived of road facility.
- Continuing the collateral free lending programme and vocational skills development programme for the blind and disable.
- Making an arrangement to construct 24000 biogas plants in 65 districts to increase the poor farmer's access by widely expanding biogas technology.
- Making provision of loan facility up to Rs. 100 thousand from commercial banks to a minimum of one hundred thousand youths for foreign employment without collateral and against the guarantee of the job-providing company and institution. People from the terrorist affected areas, from poor, downtrodden and ethnic groups will be given the priority for foreign employment.
- Providing electricity facility to 5000 additional households of 47 districts under micro-hydro scheme.
- Continuing the employment oriented training programmes on information technology.
- Adopting flexible labor and exit policy for industries that have received new license for investment, that are export oriented in nature or are established in export promotion zone and information technology park.
- Making the provisions for soft loan for such industries, which have possibility of rehabilitation. A sum of Rs.1.5 billion has been set aside by the Nepal Rastra Bank for this purpose.
- Setting up a One Stop Service Center in the Department of Industry to provide services to the investors from one place within the stipulated time.
- Organizing various promotional fairs at regional, national and international level to observe the year 2003 as the Export Year and making export trade reliable and sustainable with the participation of the private sector.
- Establishing Assets Management Company and initiating the action to manage bad debt and operating the Debt Recovery Tribunal for the effective recovery of the bank loans.
- Initiating the process to establish Insurance Fund as a joint venture of His Majesty's Government, insurance committees and companies to protect the destruction of property by the terrorist.
- Making the provisions for contracting out the service of mailing, cleaning, guarding, gardening etc of the government offices.
- Channelizing the resources allocated to agriculture extension services, sub-health post, basic and primary education through local bodies.

- Floating Melamchi Development Bonds to customers of Nepal Drinking Water Corporation to generate the resources to implement the project.
- Preparing a Comprehensive Anti Corruption Strategy and implementing it for corruption control.
- Providing additional resources for the capacity building programmes for elected local bodies, NGOs, and community based organization at village level.
- Continuing Civil Service Administration Reform Programmes in line with the policy of making civil service neutral, responsible, accountable and efficient. Eliminating unnecessary vacant positions of civil service, which are not yet fulfilled by Public Service Commission by October 2002 after necessary review.
- Not allowing Public Corporations running in losses to create new positions and recruitment.
- Making available additional manpower and sufficient resources for constitutional and administrative entities involved in the implementation of laws relating to corruption control.

Budget estimates for FY 2002/03

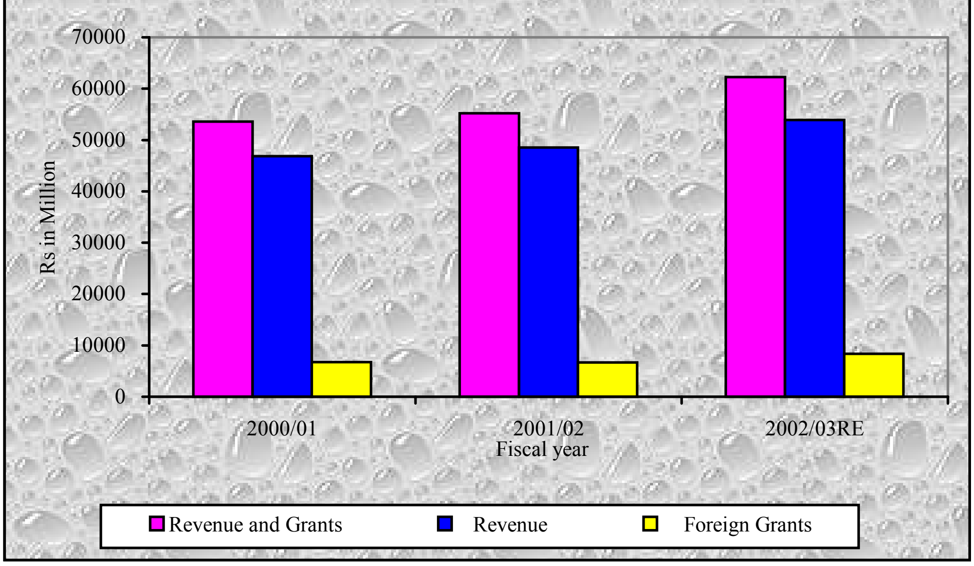
The budget estimated total expenditure, net of loans and investment, for FY 2002/03 at Rs.86.2 billion (Table 37). It was 20.2 percent higher than that of the previous year's actual. The total expenditure was estimated at Rs.87.7 billion. Of



this, Rs.49.1 billion (55.9 percent) was allocated for regular and Rs.38.7 billion (44.1 percent) for development. The regular expenditure was higher by 16.4 percent than that of the previous year, while development expenditure was higher by 22.9 percent over that of the preceding year. The increase in internal security expenses, debt servicing and social obligations were the major factors for the increase in the regular expenditure.

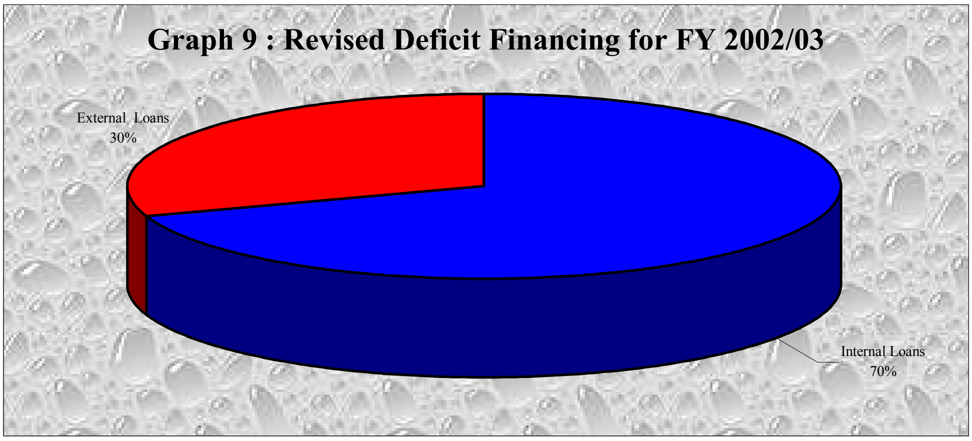
Total resources (revenue and grants), were projected to increase by 27.0 percent to Rs.70.2 billion. Of this, revenue receipt was estimated at Rs.55.6 billion which was 14.5 percent higher than that of the previous year and foreign grants was estimated at Rs.14.6 billion which was 117.8 percent higher than that of the previous year. As a result, fiscal deficit was estimated at Rs.16.1 billion, which was 2.6 percent lower than the previous year's actual. Of the total fiscal deficit, 60.3 percent (Rs.9.7 billion) was proposed to finance through internal loan and the rest 39.7 percent (Rs.6.4 billion) through external loan. External financing (grants and loans) of the development expenditure, therefore, stood at 54.1 percent in the review year.

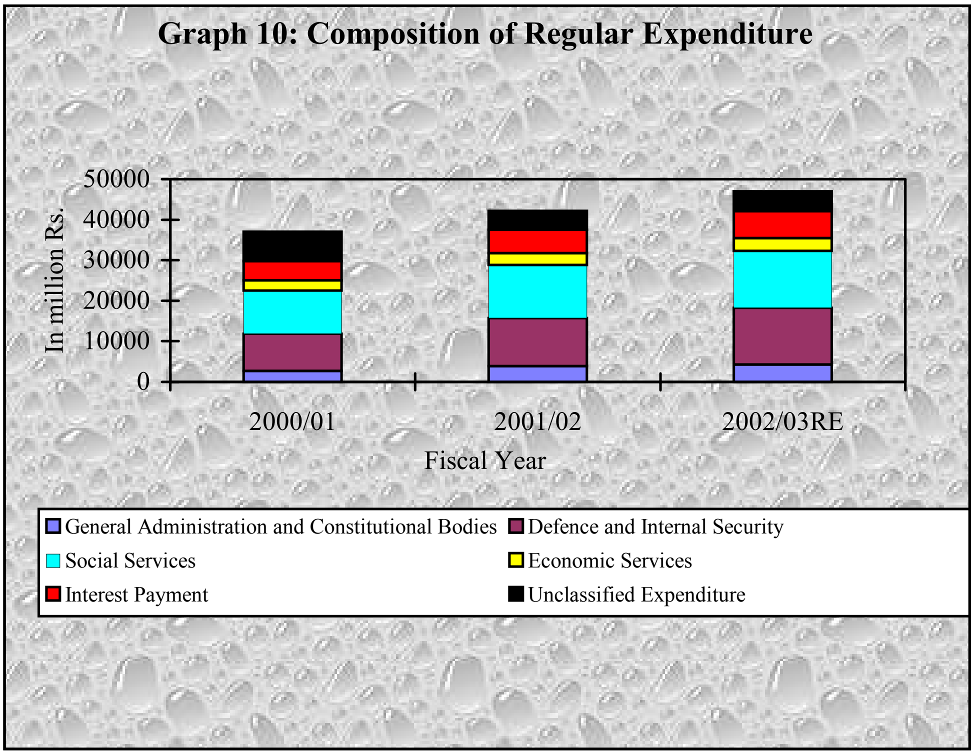
Graph 8: Revenue and Grants



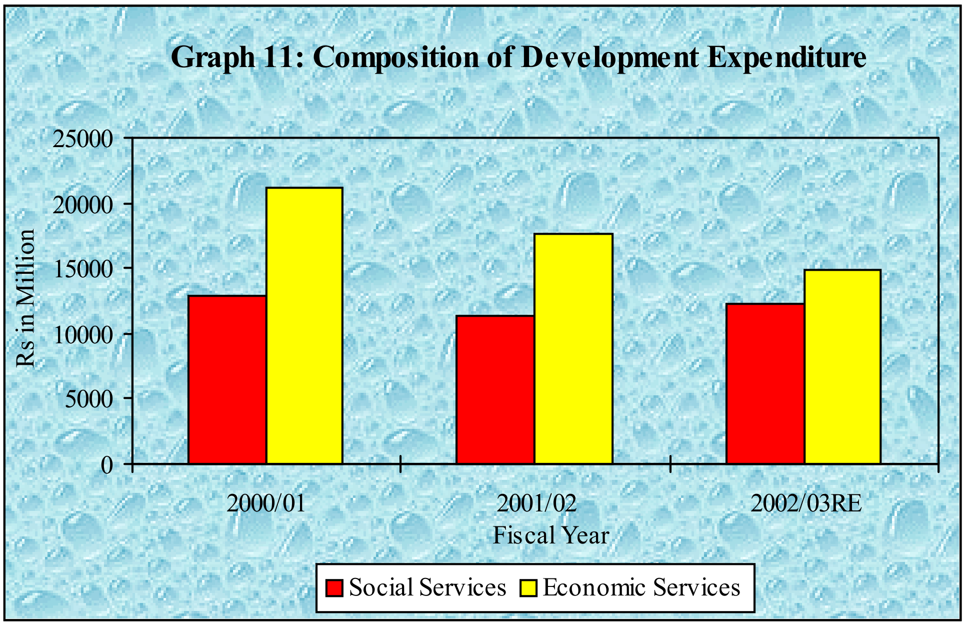
Of the total regular expenditure, Rs.14.1 billion (28.8 percent) was allocated for social services which was 8.1 percent higher than that of the previous year's level (Table 39). The growing need for the maintenance of law and order situation as well as increasing liabilities of interest payment to both internal and external loans forced the government to increase the budget allocation for defense and internal security by 15.0 percent to Rs.13.7 billion and for interest payment by 38.7

percent to Rs.8.0 billion constituting 27.9 percent and 16.3 percent of the total regular expenditure respectively. Of the total amount allocated for regular expenditure, 9.7 percent was allocated for general administration and constitutional bodies, 6.6 percent for economic services and 27.0 percent for miscellaneous heading.

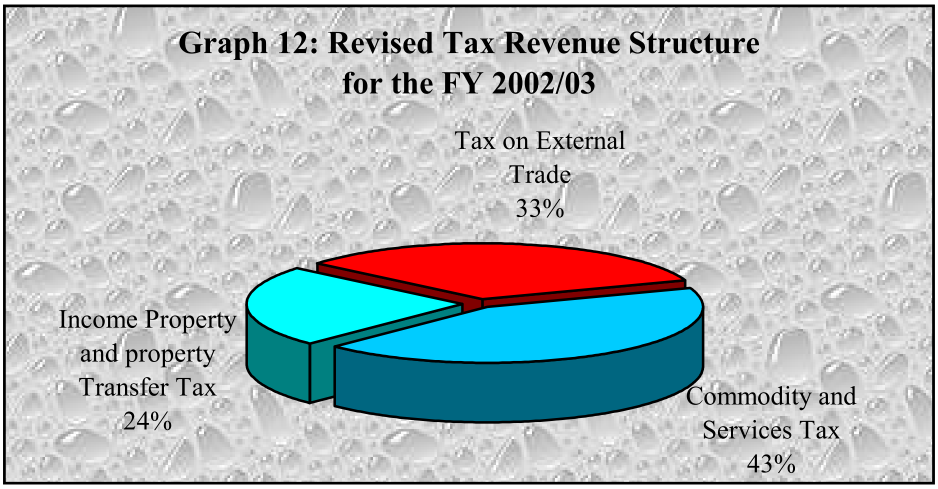




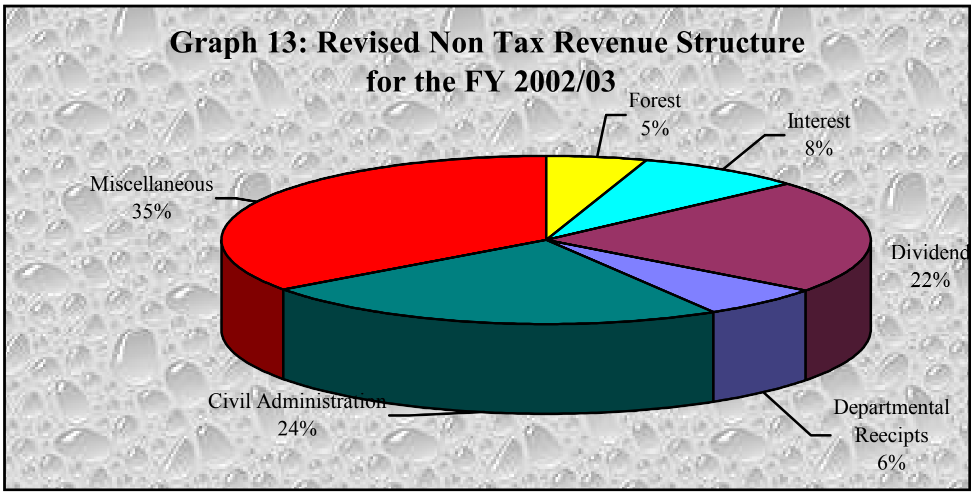
On the development side the budget allocated for economic services such as development of some large projects like Nepal Irrigation Sector Project, Bagmati Irrigation Project, Praganna Irrigation Project, Sunsari-Morang Irrigation Project and other irrigation projects, Construction of Kali Gandaki -"A", Middle-Marsyangdi and other hydro electricity projects, B.P. Highway (Banepa-sindhuli-Bardibas), Rural Electrification and Distribution Projects and other development projects and programmes constituted 55.1 percent of the total development expenditure which amounted to Rs.21.3 billion (Table 40). This amount was 20.5



percent higher than that of the previous year's level. Likewise, of the total development expenditure, 43.6 percent (Rs.16.9 billion) was allocated for social services, 0.7 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 49.2 percent in the review year.



On the revenue side, the budget had targeted to mobilize revenue amounting to Rs.55.6 billion. Of this Rs.45.9 billion (82.6 percent) was estimated from taxes, and the remaining Rs.9.7 billion (17.4 percent) from non-tax sources (Table 38). Of the total tax revenue, the highest share of 40.2 percent (Rs.18.5 billion) was projected to be mobilized from commodity and services taxes. This was followed by tax on external trade which amounted to Rs.15.8 billion (34.3 percent) and tax on income and property transfer amounted to Rs.11.7 billion (25.5 percent). Of the total non-tax revenue, dividend was estimated to constitute a significant portion of 29.8 percent (Rs.2.9 billion). This was followed by the administrative fees and charges which constituted by 26.4 percent. Other sources of non-tax revenue included the miscellaneous sources, which includes royalty, sales of government property, donation and miscellaneous income; constituted 19.9 percent, interest receipts (11.0 percent), departmental receipts (7.6 percent) and income from forest (5.2 percent). The departmental receipts included public utilities like drinking water, irrigation, electricity, postal services, food and agriculture, education, transport and others.



Revenue Policy and Changes in the Tax Rates

In order to achieve the above-mentioned target of revenue mobilization, the budget for FY 2002/03 focused on bringing all income generating activities into the tax net. The budget also proposed to create investment friendly environment, to make necessary adjustments in the tax rates and to provide due protection to the industries established within the country. Similarly, the budget also aimed at making the tax administration transparent and reliable. The budget planned to modernize the customs valuation based on the transaction value and implementing effective measures to control revenue leakages. With these strategies, the following measures were taken.

Indirect Tax

- Making the provision mandatory to show the portion of VAT amount in the gross selling price of goods on the invoice instead of showing it separately.
- Developing a regular monitoring body including representative from Inland Revenue Department, consumers, and Chamber of Commerce and FNCCI to encourage the issuance of invoice at the time of transaction.
- Establishing a "Call Center" free of charge on a trial basis in Kathmandu valley to provide tax information, suggestion and other specific services to the taxpayers.
- Continuing the programme of honoring commercially important persons (CIP) and also honoring further10 individual taxpayers next year.
- Making clear and specific the responsibilities and role of the tax officers.

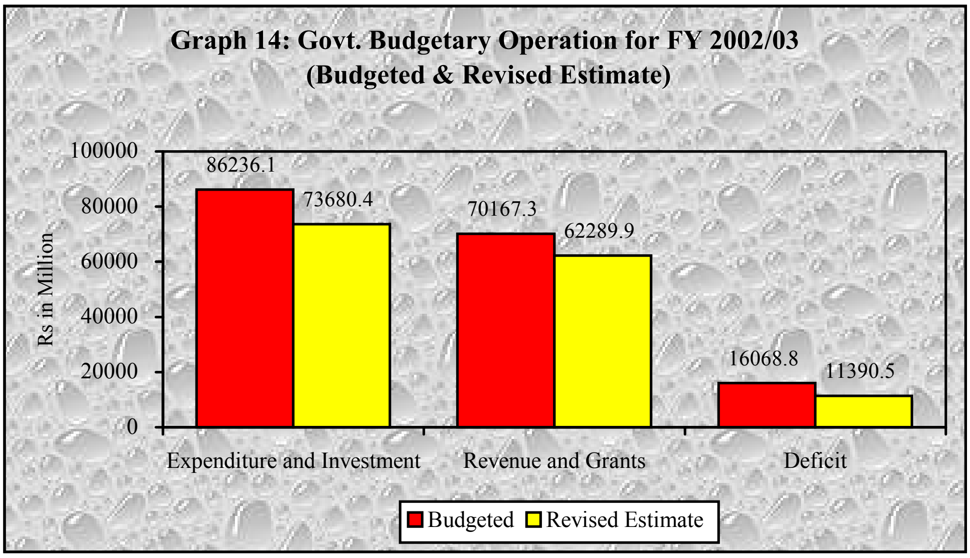
- Making a provision of "Weekly Public Hearing" in the presence of Director General of the Inland Revenue Department and the Customs Department to respond immediately to the complaints grievances, and other problems of the tax payers.
- Developing a guideline to review the valuation and self-declaration of commodities and making systematic the flow of information among the customs offices.
- Making provisions to handle directly the matters relating to customs clearance (customs duty and VAT exemption) of approved list of equipment and other goods of such project to facilitate the implementation of foreign aided projects.
- Increasing the customs duty on goods to be imported from India under the D.R.P. system.

Direct Tax

- Increasing the income tax exemption for individual and family to Rs. 65 thousand and Rs. 85 thousand from Rs. 55 thousand and Rs.75 thousand, respectively.

Revised Budget estimate for FY 2002/03

The revised budget estimate for FY 2002/03 showed a decline in the total expenditure and investment by 14.6 percent compared to budget estimate. Similarly the total resources (revenue and grants) also were reduced by 11.2 percent compared to the budget proposal (Table 37). The total expenditure and investment stood at Rs.73.7 billion and total resources at Rs.62.3 billion resulting in the decline in the revised deficit by 29.1 percent (Rs.11.4 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 by 2.7 percent and 12.8 percent respectively. Of the total revised expenditure and investment, regular expenditure stood at Rs.47.0 billion which was 4.3 percent lower than the budget estimate and 11.4 percent higher than that of the previous year. The expenditure incurred for the internal security and interest payment led to such an increase in the regular expenditure. The revised estimate in development expenditure stood at Rs.28.0 billion which was 27.6 percent below the budget estimate and 11.0 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.53.9 billion (86.6 percent). It was lower than the budget estimate by Rs.1.7 billion (3.0 percent). However, it remained at 11.0 percent higher than the previous year's level (Table 37). Foreign grants, another important component of total resources contributed Rs. 8.4 billion and constituted 13.4 percent of the total resources. The revised estimate of the foreign grants was short of budget target by 42.5 percent due to government's weak implementation of development projects owing to the problem of law and order situation.

Of the total deficit amounting to Rs.11.4 billion, Rs.7.9 billion (69.7 percent) was financed through internal loans and Rs.3.5 billion (30.3 percent) was met through foreign loans.

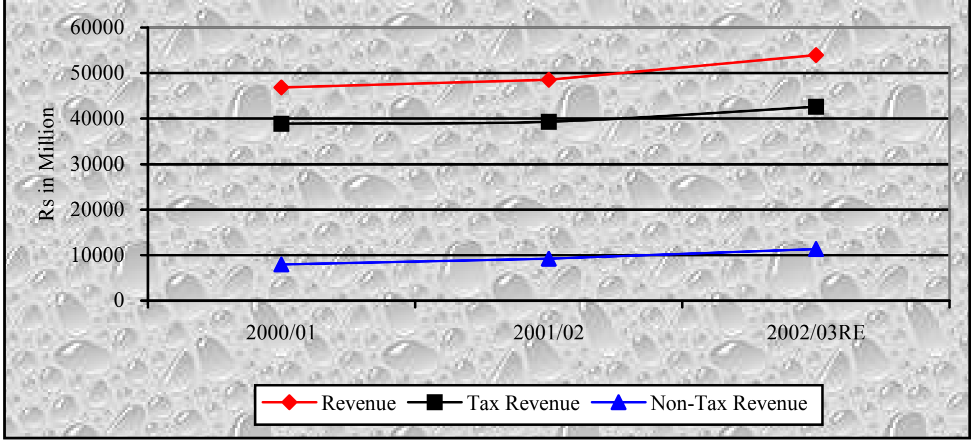
Revenue

During the review year, Rs.42.6 billion (79.0 percent) of the total revised revenue was estimated from the taxes and the remaining Rs.11.3 billion (21.0 percent) from non-tax sources. Compared to the previous year's level the revised figure of tax revenue was higher by 8.4 percent while non-tax revenue was higher by 22.5 percent. The revised estimate of the tax revenue depicted an achievement of 92.8 percent of its budget target and non-tax revenue showed 116.8 percent higher than the budget target.

The revised estimate for almost all the taxes revealed a lower performance than that of the budget target except excise duties, investment and other taxes, house and land registration tax (Table 38). The revised figure from external trade tax stood at Rs.14.2 billion which was a short of 10.0 percent from the budget estimate but 13.5 percent higher than that of the previous year. Likewise, tax on commodity and services fell short of target by only 0.5 percent

The composition of the tax revenue for FY 2002/03 also depicted the usual scenario dominated by indirect tax in which customs duty and VAT played a major role. In the revised estimate of the total tax revenue, customs duty, as usual, contributed the highest share (33.3 percent) followed by VAT (31.9 percent) and excise duty (11.2 percent). The revised estimate of import duty increased by 14.9 percent compared to the previous year but fell short of the budget target by 8.6 percent. The revised estimate of VAT showed a growth of 10.7 percent compared to last year and remained short of the target by 1.1 percent. The revised estimate of excise duty observed a marked growth of 20.2 percent over that of the preceding year.

Graph 15: Comparative Trend of Government Revenue

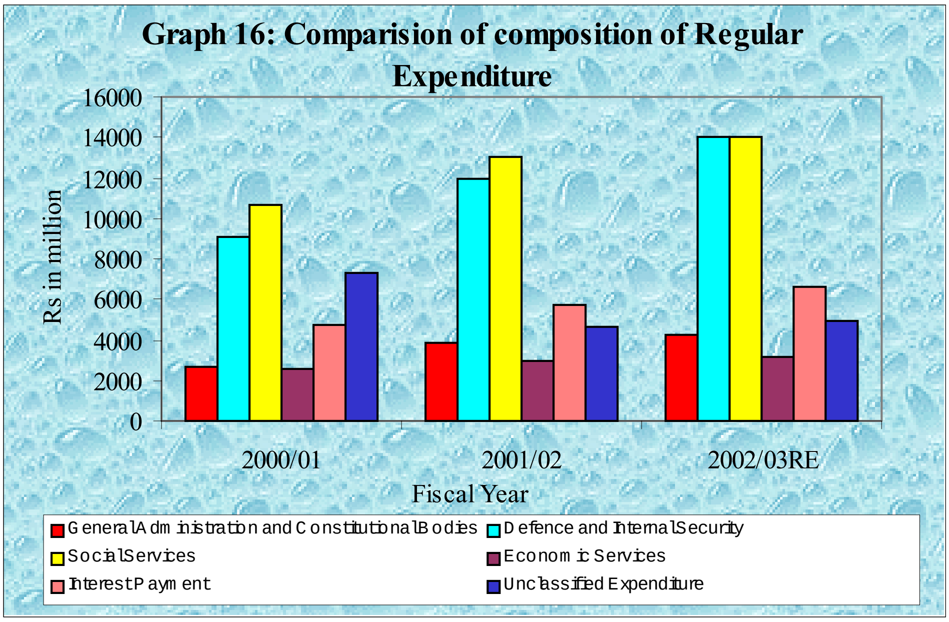


The revised estimate of revenue from the house and land registration surged up by 41.5 percent compared to that of the previous year and exceeded the budget target by 45.5 percent. The revised estimate of vehicle tax increased by 12.6 percent but remained below the target by 16.0 percent.

With regard to non-tax revenue, the revised estimate of the revenue receipts from departmental receipts, administrative fees and charges and miscellaneous headings reflected a satisfactory achievement but the revenue receipts from interest and dividend declined compared to the previous year. Revenue receipts from the forest, administrative fees and charges, and miscellaneous of the non-tax sources remained higher than budget target while the revenue receipts from other headings remained below the budget target.

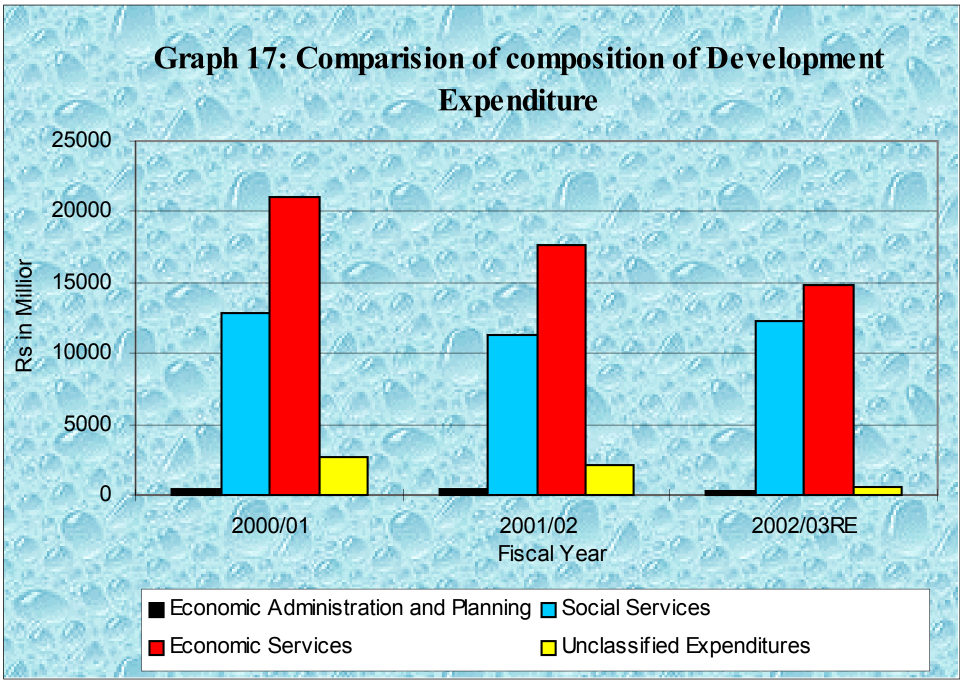
Regular Expenditure

The revised regular expenditure during FY 2002/03 witnessed an increase of 11.4 percent to Rs.47.0 billion compared to a growth of 16.4 percent in the previous year. This expenditure was lower than the budget estimate by 4.3 percent. During the year, the larger increase in regular expenditure attributed to the jump in expenditure in internal security and miscellaneous. During the review year, expenditure in economic services under regular expenditure increased by 6.6 percent to Rs.3.1 billion compared to a growth of 9.8 percent in the previous year. Similarly, the revised expenditure in social services accelerated by 7.4 percent to Rs.14.0 billion compared to an increase of 8.1 percent in the preceding year. During the review year miscellaneous expenditure (interest payment and unclassified expenditure) under regular expenditure increased by 10.9 percent to Rs.11.5 billion in comparison to a high growth of 27.7 percent in the previous year. Of the total regular expenditure miscellaneous expenditure absorbed 24.5 percent whereas interest payment alone constituted 14.1 percent of the total regular expenditure.



Development Expenditure

The revised estimate of the development expenditure stood at Rs.28.0 billion. This amount was lower than the budget estimate by 27.6 percent and lower than that of the previous year by 11.0 percent. (Table 40) The revised estimate on economic services stood at Rs.14.9 billion, which was only 69.7 percent of the corresponding budget estimate and 16.0 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 43.7 percent of the budget estimate followed by communication (58.9 percent), land reform and cadastral survey (66.1 percent), electricity (60.9 percent), industry and mining (70.2 percent), irrigation (76 percent), and transport (86.5 percent).



The revised estimate of the development expenditure on social sector stood at Rs.12.3 billion (Table 40) reflecting a growth of 9.2 percent from the previous year's level and fell short of the budget estimate by 26.8 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 local development increased by 33.2 percent followed by drinking water by 26.5 percent and health by 5.1 percent. However, expenditure on other social services (which includes women, children and social welfare, sports and housing) and education showed a decline by 27.3 percent and 17.5 percent respectively as compared to the previous year.

The revised estimate of the expenditure on economic administration and planning stood at Rs.248.8 million. This was lower than the target by 11.6 percent and than the previous year's level by 40.7 percent. Unclassified expenditures, the remaining components of the development expenditure also declined by 72.5 percent 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 53.0 percent, 44.1 percent, 0.9 percent and 2.0 percent respectively of the total development expenditure.

Public Debt

The total outstanding debt (both internal and external) amounted to Rs.303.0 billion (external debt as per at mid-March 2003) which was higher by 3.2 percent as compared to the previous year. The share of the external debt in the total outstanding debt declined to 72.1 percent in the review year from 74.9 percent in the previous year, while that of the internal debt increased to 27.9 percent from 25.1 percent. The outstanding debt to GDP ratio decreased from 69.5 percent in the preceding year to 66.8 percent in the review year.

The outstanding external debt at mid-March, 2003 amounted to Rs.218.4 billion, lower by 0.8 percent compared to that of the July 2002. Similarly, the outstanding internal debt amounted to Rs.84.6 billion, which was higher by 15.0 percent compared to that of the previous year.

Ownership Pattern of Internal Debt

Nepal Rastra Bank holdings of government bonds (excluding Treasury Bills) stood at 21.8 percent of the total bonds, which was lower by 5.4-percentage point from the previous year level (Table 43). While the ownership of the individuals increased to 26.3 percent during the review year followed by commercial banks (23.2 percent), Financial Institution (13.4 percent), Employees Provident Fund (10.8 percent), and private business enterprises (1.1 percent). However, the ownership of non-profit organizations and government business enterprises decreased to 2.1 percent and 1.3 percent respectively compared to the previous year.

In the review year, total outstanding amount of treasury bills increased by 18.9 percent to Rs.48.9 billion compared to the previous year (Table 44). The share of Nepal Rastra Bank in treasury bills decreased to 32.4 percent in the review year from 37.1 percent in the previous year while that of commercial banks increased to 63.8 percent and financial institutions decreased to 1.9 percent during the review year compared to 56.0 percent and 1.9 percent share last year. However, the ownership of other Institutions decreased to 1.9 percent from 3.3 percent in the previous year.

●

MONEY AND CREDIT SITUATION

Money and Credit Situation

Monetary Policy Developments

Monetary Policy Stance

For the first time in its history, NRB announced its annual Monetary Policy and Programme for the fiscal year 2002/03 on July 16, 2002. This was done in accordance with the requirement as mandated in the new NRB Act, 2002. The main focus of the monetary policy stance as spelled out in the annual Monetary Policy and Programme for FY 2002/03 was to ease monetary conditions further without jeopardizing the overall macroeconomic stability. The accommodative monetary policy stance was adopted against the background of the prevailing general economic conditions. Overall economic activities remained sluggish leading to a negative economic growth of 0.6 percent in FY 2001/02. A number of factors such as the global economic recession, the Royal Palace massacre, the September 11 incident in the US, the spread of the SARS virus and the internal insurgency had cumulatively contributed to the slowdown in the economic activities. However, inflation was low at 2.9 percent in FY 2001/02. The overall BOP position, on the other hand, was in deficit primarily owing to the distress in industrial and tourism sectors arising from both internal and external shocks. In response to the low level of inflation on the one hand and the industrial and tourism distress on the other, the accommodative monetary policy stance was adopted for FY 2002/03.

Monetary Policy Goals

The basic thrust of the monetary policy stance was to help reverse the economic growth cycle from downturn to upturn to the extent possible. This was to be accomplished through the adequate provision of liquidity. The monetary easing was also required to maintain the financial sector stability, one of the primary goals of monetary policy. The distress in the industrial and tourism sectors, which, in turn resulted in the stress in the financial sector necessitated the monetary easing in terms of adequate provision of liquidity and low interest rate regime. The lessening of the industrial and tourism distress was expected to help improve the country's BOP position to some extent. Despite the monetary easing, the maintenance of the fixed exchange rate regime was expected to contain inflation.

Projection of Policy Variables

In line with these objectives, M_2 was projected to increase by 12.0 percent in FY 2002/03 as compared to 4.4 percent growth in the preceding year. Likewise, M_1 was estimated to rise by 11.8 percent in FY 2002/03 as compared to 9.3 percent increase in FY 2001/02. The projected monetary expansion was expected to facilitate a modest 4.0 percent economic growth in FY 2002/03. Inflation was expected to hover around 4.0 percent and a reasonable surplus of Rs. 3.5-4.0 billion in the BOP was anticipated.

Monetary Policy Instruments

With a view to achieving the ultimate objectives of monetary policy and also maintaining the growth of monetary aggregates at the targeted levels, some changes in monetary policy instruments were effected in FY 2002/03. The cut in CRR was proposed in two stages: one percentage point cut in the beginning of the fiscal year in the first stage and a further one percentage point cut in the middle of the fiscal year in the second stage. The first stage cut in CRR was implemented in the beginning of the fiscal year itself. The cut in CRR facilitated the release of about Rs. 1.7 billion free reserves for extending loans and advances. The second phase cut in the CRR was linked with the expected reduction in lending rates by the commercial banks and developments in the prices and BOP front. As reduction in lending rates by the commercial banks did not occur as envisaged and inflation also began to climb up, the proposed second phase cut in the CRR was not executed in FY 2002/03.

As a policy step of gradually doing away with the directed credit programmes and refocusing on indirect instruments of monetary policy, a step was taken to progressively phase out the priority sector-lending requirement within a five-year time period. To begin with, a two percentage points cut in the priority sector-lending requirement was effected in FY 2002/03. Although the priority sector-lending requirement will be completely phased out after FY 2006/07, the deprived sector requirement will remain intact.

However, to fulfill the credit gap arising out of the gradual phasing out of the priority sector lending requirement, the NRB took an unprecedented policy step of earmarking Rs. 100 million out of its profit for Rural Self-Help Fund in FY 2002/03 and decided to deposit funds equivalent to 5 percent of its net profit thereafter. This step was also taken to make provision for the long-term capital for the stipulated priority sectors of the rural economy.

In order to encourage commercial banks to compete for deposit mobilization and credit expansion benefiting both depositors and borrowers with respect to interest rates, the NRB decided to remove restrictions on interest rate spread fixed at 5.0 percent for the time being.

To provide some relief to industrial and tourism sectors through the commercial banks and development banks, a provision of refinancing for their sick industry loans was introduced in FY 2001/02. The refinancing facility amounting to Rs. 1.1 billion was made available to the sick industrial units through these banks. This policy was continued for FY 2002/03 and the refinancing facility amounting to Rs. 1.5 billion was sanctioned for this purpose. However, unlike in the preceding year, the actual disbursement of such refinancing facility was much lower due to the failure of claimants meeting the set criteria.

Evaluation of Monetary Policy Stance

In terms of the ultimate goals of monetary policy, the result was rather mixed. The actual economic growth remained at 3 percent which was lower than the targeted growth of 4.0 percent basically due to the lack of improvement in non-economic factors. The actual inflation at 4.8 percent also exceeded the targeted level of 4.0 percent owing to the increase in prices of food-related items emanating from the drought situation as well as the rise in the prices of petroleum products including edible oil at the international level, among others. However, the BOP surplus position remained at the satisfactory level of Rs. 4.4 billion, matching the target of Rs. 3.5-4.0 billion. Especially, increased private sector remittances contributed to this surplus. Moreover, the initiation of a number of financial sector measures also helped improve the financial sector stability in FY 2002/03.

As regards the intermediate target variables, the actual growth of M_2 remained at 9.8 percent which was below the target of 12 percent set for FY 2002/03. Likewise, M_1 registered a growth of 8.6 percent which was also less than the target set at 11.8 percent for FY 2002/03. As compared to the past, the much decelerated level of government borrowing from the monetary sector on the sources side contributed to the lower growth of monetary aggregates in FY 2002/03 than that initially projected. The less than expected growth of real GDP was responsible for the lower than targeted growth of monetary aggregates on the demand side. As pressure on the price front was building up during the second half of FY 2002/03, the growth of reserve money (RM) was brought down to 2.5 percent from the targeted growth of 11.5 percent through the conduct of open market operations, leading to the substantial reduction in NRB's holding of government debt stocks. The latter, in turn, resulted in a significant reduction in NDA, the operating target of monetary policy in FY 2002/03, from the negative of Rs. 2.1 billion in mid-July 2002 to the negative of Rs. 6.7 billion in mid-July 2003.

Review of Monetary and Banking Sector

Banking Survey

The total liquid liabilities (L1) of the banking sector, consisting of monetary authorities, commercial banks and other deposit taking institutions, rose by 10.3 percent (Rs. 25.0 billion) during the review year and aggregated Rs. 267.3 billion as at mid-July 2003. Such liabilities had increased by a lower rate of 5.2 percent (Rs. 12.0 billion) a year earlier. Of the total liabilities of the banking sector, the share of time and saving deposits of other banking institutions (OBIs) (excluding OBIs' time and saving deposits held at commercial banks) was 9.3 percent in mid-

July 2003 compared to 8.2 percent in mid-July 2002. The increase in coverage of the OBIs was responsible for the rise in the share of deposits of OBIs during the review year.

Table A
Banking Survey
(As of mid-July)

Rs in Million

Particulars	2001 Jul	2002 Jul	2003 Jul	Change 2001/02 Amount	Change 2001/02 Percent	Change 2002/03 Amount	Change 2002/03 Percent
1. Foreign Assets, Net	**83616.1**	**84501.9**	**87850.6**	**885.8**	**1.1**	**3348.7**	**4.0**
Net Foreign Assets(MS)	87798.1	88419.2	91407.0	621.1	0.7	2987.8	3.4
Foreign Assets	106190.7	106996.3	109306.3	805.6	0.8	2310.0	2.2
Foreign Liabilities	18392.6	18577.1	17899.3	184.5	1.0	-677.8	-3.6
Net Foreign Assets(OBI)	-4182.0	-3917.3	-3556.4	264.7	-6.3	360.9	-9.2
Foreign Assets	0.0	0.0	0.0				
Foreign Liabilities	4182.0	3917.3	3556.4	-264.7	-6.3	-360.9	-9.2
2. Net Domestic Assets	**146739.9**	**157812.3**	**179429.2**	**11072.5**	**7.5**	**21616.8**	**13.7**
A. Domestic Credit	218254.7	242270.9	269472.0	24016.2	11.0	27201.1	11.2
i. Claims on Government	52452.6	62858.8	65117.9	10406.2	19.8	2259.1	3.6
Claims on Govt(net)(MS)	49191.1	59576.5	62825.0	10385.4	21.1	3248.5	5.5
Claims on Govt(MS)	49191.1	59576.5	63286.7	10385.4	21.1	3710.2	6.2
Govt Deposits (MS)	0.0	0.0	461.7				
Claims on Govt (OBI)	3261.5	3282.3	2292.9	20.8	0.6	-989.4	-30.1
ii. Claims on NBFI	49.7	132.4	44.0	82.7	166.4	-88.4	-66.8
Claims on NBFI (MS)	49.7	132.4	44.0	82.7	166.4	-88.4	-66.8
Claims on NBFI (OBI)							
iii. Claims on Nonfinancial Govt. Enter.	2223.0	3076.0	2833.2	853.0	38.4	-242.8	-7.9
Claims on Non-Fin. Govt. Ent.(MS)	2223.0	3076.0	2833.2	853.0	38.4	-242.8	-7.9
Claims on Non-Fin. Govt. Ent.(OBI)							
iv. Claims on Private Sector	163529.4	176203.7	201476.9	12674.3	7.8	25273.2	14.3
Claims on Private Sector(MS)	126757.9	133315.3	150956.9	6557.4	5.2	17641.6	13.2
Claims on Private Sector(OBI)	36771.5	42888.4	50520.0	0.0	0.0	7631.6	17.8
B. Capital and Other Items(net)	71514.8	84458.6	90042.9	12943.8	18.1	5584.3	6.6
Capital and Other Items (net) (MS)	61215.3	71753.8	73939.6	10538.5	17.2	2185.8	3.0
Less Claims on OBI (MS)	-9649.7	-11222.7	-11784.7	-1573.0	16.3	-562.0	5.0
Time and Saving Deposits of OBI at MS	1236.1	1632.3	3480.5	396.2	32.1	1848.2	113.2
Capital and Other Items(net)(OBI)	18713.1	22295.2	24407.5	3582.1	19.1	2112.3	9.5
3. Liquid Liabilities (L1)	**230355.9**	**242314.3**	**267279.8**	**11958.4**	**5.2**	**24965.5**	**10.3**
A. Broad Money (M2)	214454.1	223988.3	245911.3	9534.2	4.4	21923.0	
Money Supply (M1)	70576.9	77156.2	83754.1	6579.3	9.3	6597.9	8.6
- Currency	48295.1	55658.3	56885.2	7363.2	15.2	1226.9	2.2
- Demand Deposits	22281.8	21497.9	26868.9	-783.9	-3.5	5371.0	25.0
Time Deposits (MS)	143877.2	146832.1	162157.2	2954.9	2.1	15325.1	10.4
B. Less Time and Saving Deposits of OBI (at MS)	1236.1	1632.3	3480.5	396.2	32.1	1848.2	113.2
C. Time and Saving Deposits (OBI)	17137.9	19958.3	24849.0	2820.4	16.5	4890.7	24.5

Note: In this table, MS refers to those items that are derived from the Monetary Survey; OBI to Other Banking Institutions and NBFI to Non-bank Financial Institutions.

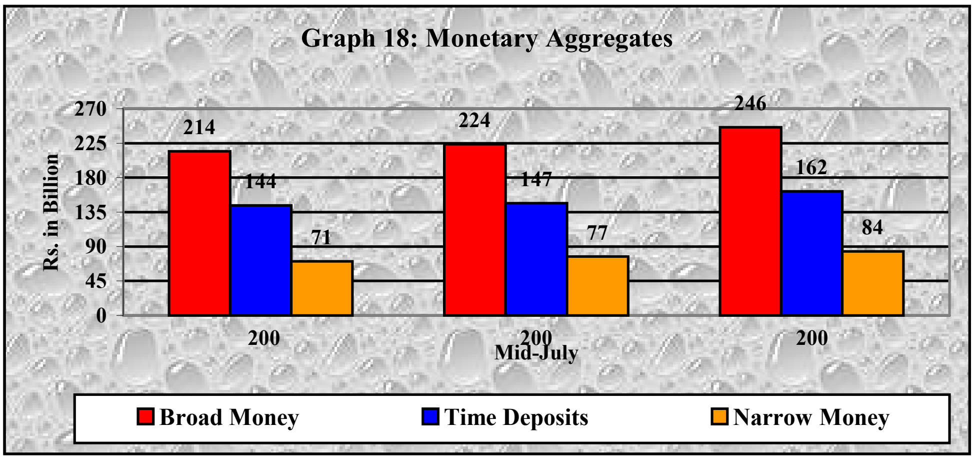
Among the expansionary factors of liquid liabilities, the NFA of the banking sector went up by 4.0 percent (Rs. 3.3 billion) during the review year and amounted to Rs. 87.9 billion as at mid-July 2003 in comparison to an increase of 1.1 percent (Rs. 885.8 million) a year earlier. While the shares of NFA of the monetary sector fell slightly from 104.6 percent in mid-July 2002 to 104.0 percent in mid July 2003, the shares of OBIs were posted at negative levels of 4.0 percent and 4.6 percent in mid-July 2003 and mid-July 2002, respectively. Since OBIs were not able to undertake foreign asset transactions but could resort to foreign borrowings, the share of NFA of OBIs remained at negative levels.

Domestic credit, another expansionary factor of liquid liabilities, rose by 11.2 percent (Rs. 27.2 billion) in the review year as compared to an increase of 11.0 percent (Rs. 24.0 billion) in the previous year. The rise in domestic credit was primarily due to the significant rise in the claims on private sector in the review year as compared to that of the previous year. The claims on private sector registered a growth of 14.3 percent (Rs. 25.3 billion) in the review year and amounted to Rs. 201.5 billion as at mid-July 2003. Such claims had gone up by just 7.8 percent (Rs. 12.7 billion) in the previous year. The share of claims on private sector in total domestic credit increased by 2.1 percentage points to 74.8 percent as at mid-July 2003 from 72.7 percent as at mid-July 2002. The claims on government, another component of domestic credit, increased by a lower rate of 3.6 percent (Rs. 2.3 billon) in the review year as compared to the increase of 19.8 percent (Rs. 10.4 billion) in the previous year. The share of claims on government in total domestic credit fell by 1.7 percentage points to 24.2 percent in mid-July 2003 from 25.9 percent as at mid-July 2002. The claims on non-bank financial institutions declined by 66.8 percent (Rs. 88.4 million) in the review year and amounted to Rs. 44.0 million as at mid-July 2003 compared to a rise of 166.4 percent (Rs. 82.7 million) in the previous year. The decline in the claims on non-bank financial institutions was attributed to the repayment made by Citizen Investment Fund to the Bank of Kathmandu Limited during the review year. The claims on nonfinancial government enterprises, on the other hand, declined by 7.9 percent (Rs. 242.8 million) in the review year and aggregated Rs. 2.8 billion as at mid-July 2003 in comparison to the growth of 38.4 percent (Rs. 853.0 million) a year earlier.

Capital and other items net, the contractionary factor of liquid liabilities, rose by 6.6 percent (Rs. 5.6 billion) during the review year and aggregated Rs. 90.0 billion as at mid-July 2003. Such items had gone up by 18.1 percent (Rs. 12.9 billion) in the previous year. The increasing loss of commercial banks was the primary factor responsible for the deceleration in capital and other items, net. The acceleration in domestic credit together with the deceleration in capital and other items, net led to the increased rate of growth of NDA. As a result, NDA augmented by 13.7 percent (Rs. 21.6 billion) in the review year and stood at Rs. 179.4 billion as compared to an increase of 7.5 percent (Rs. 11.1 billion) in the previous year.

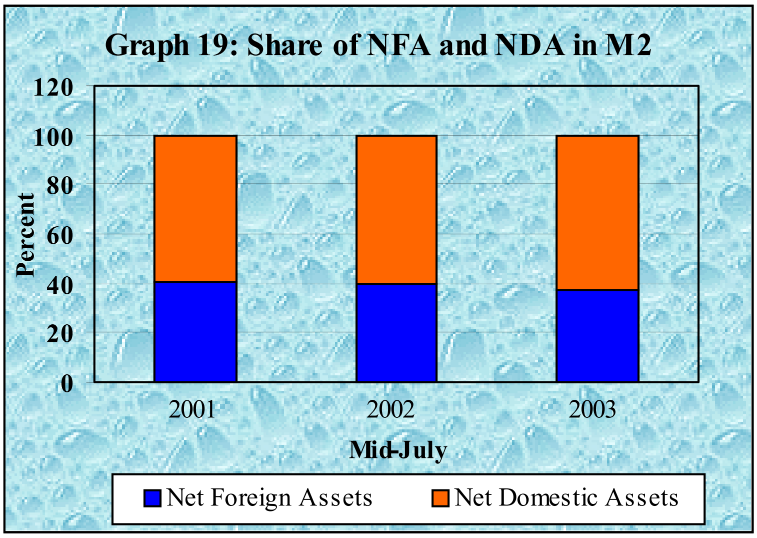
Monetary Survey

Monetary Aggregates: Of the monetary aggregates, while M_2 registered a higher growth, M_1 registered a lower growth in FY 2002/03 as compared to the previous year. Compared to the lower rate of growth of 4.4 percent (Rs. 9.5 billion) in FY 2001/02, M_2 rose by 9.8 percent (Rs. 21.9 billion) in FY 2002/03 and amounted to Rs. 245.9 billion as at mid-July 2003. The increased accumulation of NFA during the review year was responsible for the higher growth of M_2. During the review year, M_1, on the other hand, grew by 8.6 percent (Rs. 6.6 billion) compared to a relatively higher rate of 9.3 percent (Rs. 6.6 billion) in the preceding year. RM grew by a lower rate of 2.5 percent (Rs. 2.0 billion) in the review year compared to a growth of 11.9 percent (Rs. 8.4 billion) in the previous year.

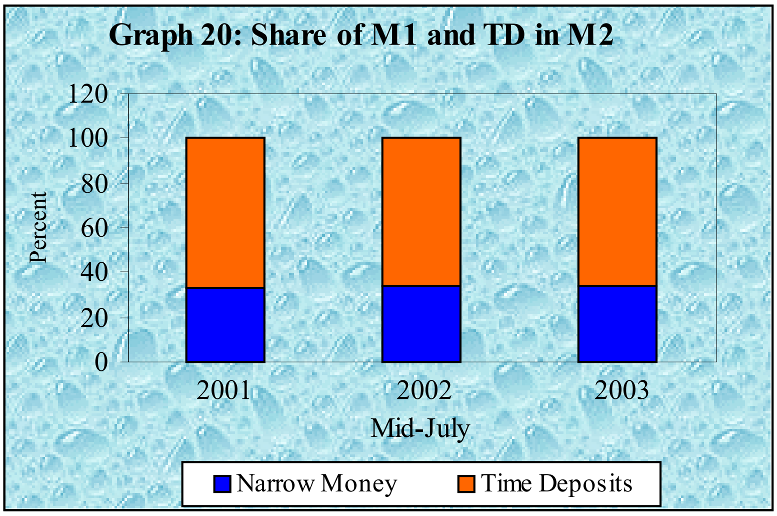


Components of M_1 and M_2 : Owing to a lower rate of growth of currency held by public, M_1 rose by a slightly lower growth of 8.6 percent (Rs. 6.6 billion) in the review year in comparison to 9.3 percent (Rs. 6.6 billion) in the preceding year, and aggregated Rs. 83.7 billion as at mid-July 2003. The currency held by public increased by 2.2 percent (Rs. 1.2 billion) in the review year and amounted to Rs. 56.9 billion at the end of the fiscal year. In the previous year, the currency held by public had risen by 15.2 percent (Rs. 7.4 billion). On the other hand, demand deposits, another component of $M_{1,}$ rose by 25.0 percent (Rs. 5.4 billion) in comparison to a decline of 3.5 percent (Rs. 783.9 million) in the preceding year and aggregated Rs. 26.9 billion at the end of the fiscal year. An instrumental factor was the significant increase in the demand deposits by the NOC at the Standard Chartered Bank Nepal Limited for a short period prior to its payment for imports.

Because of the increase in the rate of growth of NFA in the review year as compared to the decline in the previous year, M_2, a measure denoting the overall liquidity in the monetary sector, posted a higher growth of 9.8 percent (Rs. 21.9 billion) in the review year and stood at Rs. 245.9 billion as at mid-July 2003 in comparison to a relatively lower growth of 4.4 percent (Rs. 9.5 billion) in the previous year.

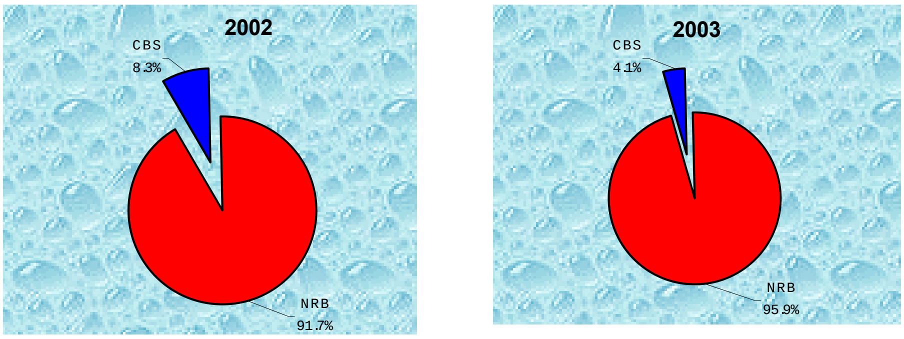


The share of NFA in M_2 has been going down over the years. It fell from 40.9 percent in FY 2000/01 to 39.5 percent in FY 2001/02 and further to 37.2 percent in FY 2002/03. Conversely, the share of NDA has been taking an upward trend. It increased from 59.1 percent in FY 2000/01 to 60.5 percent in FY 2001/02 and further to 62.8 percent in FY 2002/03. With regard to the demand side of monetary liquidity, M_1's share stood at 34.1 percent in FY 2002/03 as compared to 34.4 percent and 32.9 percent in FY 2001/02 and FY 2000/01, respectively. Conversely, the share of time deposits stood at 65.9 percent in FY 2002/03, 65.6 percent in FY 2001/02 and 67.1 in FY 2000/01.



Expansionary Factors of Money Supply: NFA (after adjusting foreign exchange valuation) grew by 4.9 percent (Rs. 4.4 billion) during the review year and aggregated Rs. 91.4 billion as at mid-July 2003. In the preceding year, such assets had declined by 3.8 percent (Rs. 3.3 billion). The increased inflows from services, net and remittances were the factors responsible for the growth of NFA during the review year. Of the total NFA, NRB's share rose to 95.9 percent as at mid-July 2003 from 91.7 percent in the previous year. Conversely, the share of commercial banks went down to 4.1 percent as at mid-July 2003 from 8.3 percent, a year ago.

Graph 21: Net Foreign Assets of Monetary Sector
(As of mid-July)

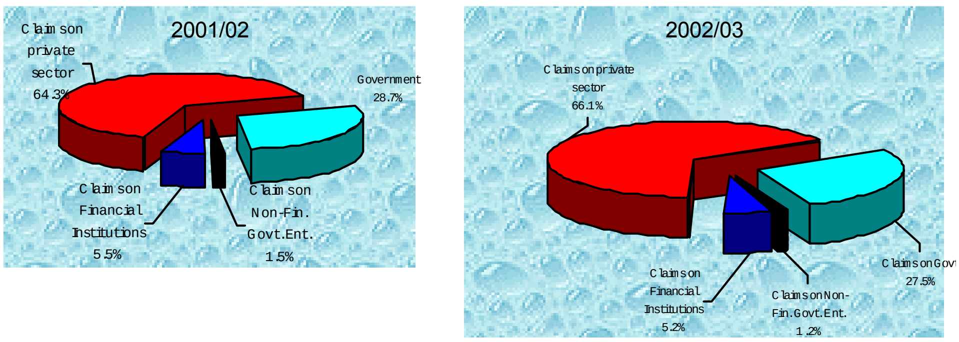


Domestic credit, another expansionary factor of money supply, registered a growth of 10.2 percent (Rs. 21.1 billion) during the review year and aggregated Rs. 228.4 billion as at mid-July 2003. In the previous year, such credit had registered a slightly higher growth of 10.4 percent (Rs. 19.5 billion). Although the monetary sector's claims on the private sector increased significantly, domestic credit increased by a slightly lower rate compared to the previous year because of the decline in the claims on non-financial government enterprises and the deceleration of the net claims on government and claims on financial institutions. The monetary sector's claims on private sector expanded by 13.2 percent (Rs. 17.6 billion) during the review year compared to a lower growth of 5.2 percent (Rs. 6.6 billion) a year earlier because of the rise in import credit and the launching of various credit programmes such as car loan, housing loan and educational loan by the commercial banks.

Net claims on government, another component of domestic credit, increased by 5.5 percent (Rs. 3.3 billion) during the review year in comparison to an increase of 21.1 percent (Rs. 10.4 billion) in the previous year. The decline in development expenditure was the factor responsible for the lower level of internal borrowing of the government during the review year. The overall lower level of internal borrowing in general and, unlike the excessive overdraft borrowing in the past, the government cash balances with the NRB in particular resulted in decelerated level of borrowing from the monetary sector by the government during the review year. The claims on non-financial government enterprises, on the other hand, fell by 7.9 percent (Rs. 242.8 million) during the review year as compared to a significant growth of 38.5 percent (Rs. 853.0 million) a year earlier. However, in comparison to a higher growth of 17.1 percent (Rs. 1.7 billion) of the claims on financial institutions in the preceding year, such claims increased by just 4.2 percent (Rs. 473.6 million) during the review year. The repayment of some loans to the NRB by NIDC and the Rural Development Banks (RDBs) was responsible for the decelerated growth of claims on financial institutions.

The sectoral breakdown of the total domestic claims showed that the share of net claims on government declined to 27.5 percent as at mid-July 2003 from 28.7 percent a year ago. The share of claims on non-financial government enterprises also fell slightly to 1.2 percent in FY 2002/03 from 1.4 percent in the previous year. Similarly, the share of claims on financial institutions stood at 5.2 percent in FY 2002/03 compared to 5.5 percent in FY 2001/02. Finally, the share of claims on private sector increased slightly to 66.1 percent in FY 2002/03 from 64.3 percent in the previous year.

Graph 22: Sectoral Classification of Domestic Credit



Contractionary Factors of M_1: During the review year, net non-monetary liabilities (after adjusting foreign exchange valuation) increased by 5.0 percent (Rs. 3.6 billion) and stood at Rs. 73.9 billion in comparison to a growth of 10.7 percent (Rs. 6.6 billion) a year earlier. The deceleration in net non-monetary liabilities was attributed to the losses in the exchange equalization fund of the NRB arising from the appreciation of the Nepalese rupee vis-à-vis the US dollar.

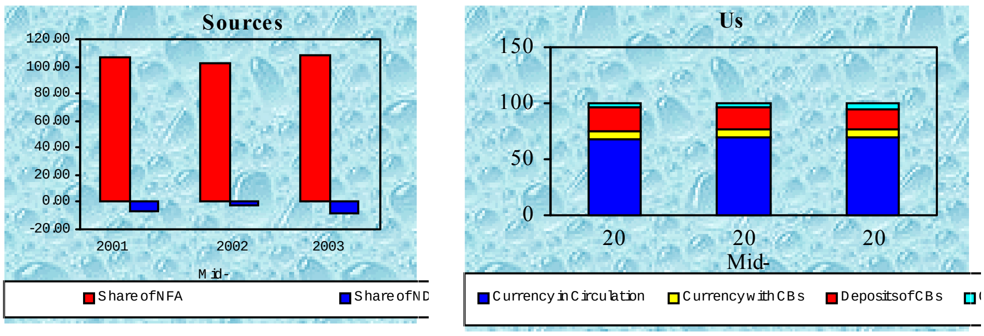
Time deposits, another contractionary factor of narrow money, grew by 10.4 percent (Rs. 15.3 billion) during the review year and amounted to Rs. 162.2 billion as at mid-July 2003. Such deposits had registered a relatively lower growth of 2.1 percent (Rs. 2.9 billion) in the previous year. The slowdown in the securities market, the paucity of alternative investment opportunities and increasing trend in remittances were responsible for the notable rise in time deposits.

Reserve Money

During the review year, RM rose by 2.5 percent (Rs. 2.0 billion) and aggregated Rs. 81.0 billion as at mid-July 2003. In the previous year, RM had risen by a significant rate of 11.9 percent (Rs. 8.4 billion). Of the sources side of RM, while the share of NRB's NFA increased to 108.3 percent in the review year from 102.7 percent in the previous year, the share of NDA stood at negative levels of 8.3 percent and 2.7 percent, respectively, in the review year and the previous year.

With regard to the uses side of RM, currency in circulation registered a growth of just 2.2 percent (Rs. 1.2 billion) in the review year compared to the growth of 15.2 percent (Rs. 7.4 billion) in the previous year. The deceleration of currency in circulation was due to the security problems that led to the decline in currency holdings with the public. Similarly, currency held by commercial banks declined by 3.8 percent (Rs. 185.6 million) in the review year compared to a significant growth of 19.2 percent (Rs. 792.0 million) in the previous year. The deposits of commercial banks declined by 2.9 percent (Rs. 461.8 million) during the review year and amounted to Rs. 15.7 billion as at mid-July 2003. Such deposits had increased by 1.0 percent (Rs. 167.4 million) in the previous year. Other deposits, on the other hand, registered a significant growth of 63.6 percent (Rs. 1.4 billion) during the review year in comparison to the growth of just 3.7 percent (Rs. 80.5 million) a year earlier.

Graph 23: Sources and Uses of Reserve Money

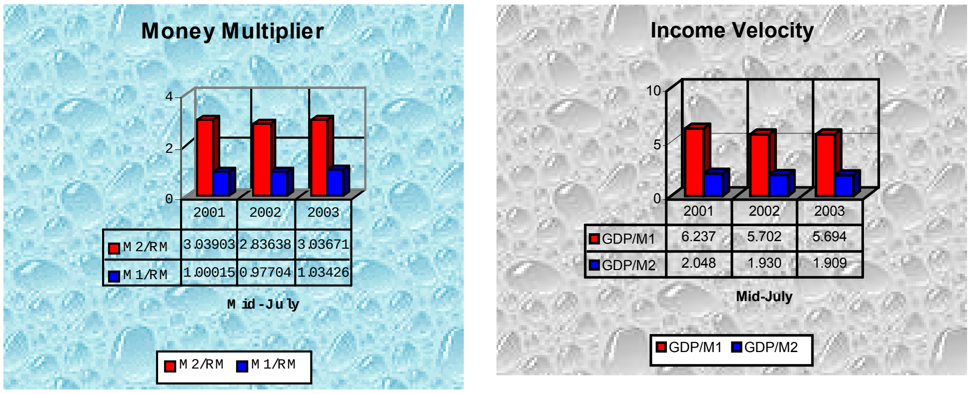


During the review year the share of currency as at mid-July 2003 in circulation in RM went down slightly by 0.3 percentage points to 70.2 percent from 70.5 percent a year earlier. The share of currency held by commercial banks fell by 0.4 percentage points to 5.8 percent during the review year from 6.2 percent at the end of FY 2001/02. The share of deposits of commercial banks stood at 19.4 percent as at mid-July 2003 compared to 20.5 percent as at mid-July 2002. Finally, the share of other deposits in RM rose from 2.8 percent at the end of FY 2001/02 to 4.5 percent at the end of FY 2002/03.

Money Multiplier

Both narrow and broad money multipliers depicted upward movements in the review year in comparison to the previous year. Broad money multiplier rose to 3.0367 in the review year from 2.8364 in the previous year. Narrow money multiplier went up to 1.0343 as at mid-July 2003 from 0.9770 in the corresponding month of the previous year. A significant increase in demand deposit with commercial banks reflecting the rise in bank loans to the private sector relative to their total reserves was the factor responsible for the upward increment in the value of money multipliers during the review year.

Graph 24: Money Multiplier and Income Velocity of Money



Income Velocity

Income velocity of both M_1 and M_2 exhibited declining trend during the review year. While income velocity of M_1 fell to 5.694 in the review year from 5.702 a year earlier, income velocity of M_2 went down to 1.909 in the review year from 1.930 in the previous year. The fall in interest rates was responsible for the decline in income velocity in monetary aggregates.

Monetary Policy Outlook for FY 2003/04

The Nepalese economy is expected to grow by about 4.5 percent in FY 2003/04. Inflation is projected to be around 5 percent. Robust growth in inflows from private remittances is likely to result in a reasonable level of surplus in the country's BOP. In keeping with these ultimate objectives of monetary policy, while the growth of M_2 is projected at 11.2 percent, the growth in M_1 is expected to go up by 9.2 percent. The projected growth in monetary aggregates is expected to help maintain the monetary balance in FY 2003/04.

●

FINANCIAL DEVELOPMENT

Financial Development

Financial Institutions

Commercial Banks

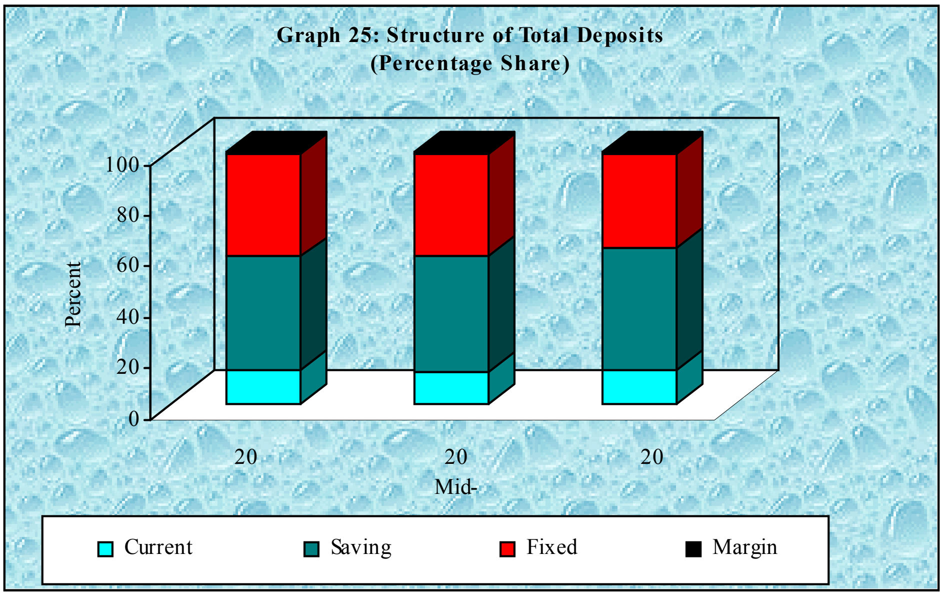
An important prerequisite for the stability and profitability of a commercial bank is the management of the structure of its assets and liabilities. Thus, it is the aim of every commercial bank's management to optimize the portfolio of assets and liabilities with regard to its specific business policy. The principal components of the commercial banks' assets and liabilities are discussed below.

Total Assets/Liabilities

During the review year, the total assets/liabilities of commercial banks rose by a significantly higher rate of 16.4 percent (Rs. 41.1 billion) compared to a growth of merely 2.2 percent (Rs. 5.4 billion) in the previous year. The crucial factors responsible for the significant rise in total assets/liabilities of commercial banks during the review year were the higher growth of both deposits on the sources side and loans and advances on the uses side.

Liabilities Side

Deposits: Total deposits of commercial banks registered a higher growth of 10.3 percent (Rs. 19.0 billion) during the review year as compared to a growth of just 1.4 percent (Rs. 2.5 billion) a year earlier. Among the components of total deposits, demand deposits and margin deposits went up by 19.2 percent (Rs. 4.6 billion) and 3.5 percent (Rs. 62.1 million), respectively, during the review year as compared to a decline of 3.6 percent (Rs. 880.0 million) and 14.8 percent (Rs. 310.1 million), respectively, a year earlier. While the rise in demand deposits was mainly due to the increase in current deposits of NOC with the Standard Chartered Bank Nepal Limited for a short period prior to its making payment for oil imports, the rise in margin deposits was ascribed to the upsurge in imports by 17.2 percent in FY 2002/03 compared to a decline of 7.2 percent in FY 2001/02. Similarly, savings deposits and fixed deposits recorded an increase of 16.0 percent (Rs. 13.4 billion) and 1.3 percent (Rs. 974.7 million) compared to a lower rate of growth of 3.5 percent (Rs. 2.8 billion) and 1.2 percent (Rs. 884.9 million), respectively, in the previous year. The rise in remittances, the slowdown in securities markets as well as the lack of alternative investment opportunities were responsible for the augmentation in savings and fixed deposits. Savings, fixed, demand and margin deposits constituted 48.0 percent, 37.2 percent, 13.9 percent, and 0.9 percent, respectively, of total deposits as at mid-July, 2003 compared to 45.6 percent, 40.5 percent, 12.9 percent and 1.0 percent, respectively, a year earlier.



Borrowings from NRB: The commercial banks' borrowing from the NRB declined to Rs. 947.4 million as at mid-July 2003 compared to Rs. 1.0 billion a year ago. The lower level of use of the refinancing facility against sick industry loans by commercial banks accounted for the decrease in the outstanding borrowing of commercial banks from the NRB during the review year. Foreign liabilities of commercial banks amounted to Rs. 134.2 million as at mid-July, 2003 compared to Rs. 228.4 million in the corresponding month of the previous year.

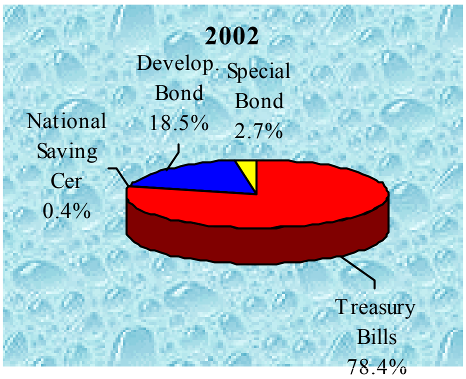
Other Liabilities: Other liabilities grew by 33.8 percent (Rs. 22.3 billion) during the review year compared to the much lower growth of 2.5 percent (Rs. 1.6 billion) a year earlier. This significant increase in commercial banks' other liabilities was attributed to the rise in the loan loss provisioning of commercial banks of which NBL and RBB accounted for Rs. 10.7 billion and Rs. 19.5 billion, respectively.

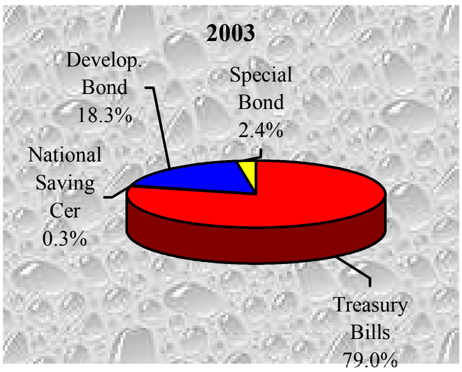
Assets Side

Liquid Funds: Liquid funds fell by 12.0 percent (Rs. 5.6 billion) during the review year and aggregated Rs. 41.3 billion as at mid-July, 2003. In the previous year, such funds had declined by 7.3 percent (Rs. 3.7 billion). Among the components of the liquid funds, foreign currency in hand increased by 17.0 percent (Rs. 104.7 million) during the review year in comparison to a decline of 7.4 percent (Rs. 49.0 million) a year earlier. Similarly, cash in hand and balance with the NRB declined by 3.8 percent (Rs. 185.6 million) and 2.9 percent (Rs. 461.8 million), respectively, in the review year compared to an increase of 19.2 percent (Rs. 792 million) and 1.0 percent (Rs. 167.4 million) in the previous year. Likewise, balance held abroad and cash in transit exhibited a decline of 16.7 percent (Rs. 3.9 billion) and 58.9 percent (Rs. 1.2 billion) during the review year in comparison to a decline of 15.4 percent (Rs. 4.2 billion) and 15.3 percent (Rs. 363 million), respectively, in the previous year. The reduction in overall liquid funds of commercial banks during the review year was attributed to factors such as reduction in CRR, the declining trend in interest rates in the international markets and the increase in the interest rates in marketable government securities.

Loans and Advances: During the review year, a growth of 16.4 percent (Rs. 28.5 billion) of commercial banks' loans and advances was recorded as compared to a growth of 7.7 percent (Rs. 12.4 billion) a year earlier. Of the total loans and advances, commercial banks' claims on government rose by 35.4 percent (Rs. 10.3 billion) during the review year as compared to the growth of 14.8 percent (Rs. 3.8 billion) a year earlier. The offloading of the government securities by the NRB on the one hand and the lack of alternative use of commercial banks' funds on the other led to the significant growth in commercial banks' claims on the government during the review year. Among the different government debt stocks held by the commercial banks, the share of treasury bills rose slightly from 78.4 percent as at mid-July 2002 to 79.0 percent as at mid-July 2003. The share of development bond fell slightly to 18.3 percent in the review year from 18.5 percent in the preceding year. The shares of national savings certificates and special bonds stood at 0.3 percent and 2.4 percent as at mid-July 2003, respectively, from the previous year's shares of 0.4 percent and 2.7 percent, respectively.

Graph 26: Structure of Government Securities held by Commercial Banks (Mid-July)





During the review year, claims on non-financial government enterprises declined by 7.9 percent (Rs. 242.8 million) in comparison to a significant growth of 38.5 percent (Rs. 853.0 million) a year earlier. Repayment of some loans by Birganj Sugar Factory Limited and National Trading Limited resulted in the decline of loans to nonfinancial government enterprises. Claims on financial enterprises went up by 6.1 percent (Rs. 586.7 million) during the review year compared to a growth of 21.0 percent (Rs. 1.7 billion) in the previous year.

Commercial banks' claims on the private sector increased by 13.8 percent (Rs. 18.0 billion) during the review year compared to a lower growth of 5.4 percent (Rs. 6.7 billion) a year earlier. This noteworthy rise in the commercial banks' claims on the private sector was brought about by the increase in imports as well as the introduction of various consumer credit programmes by the commercial banks.

Foreign Bills Purchased and Discounted: During the review year, foreign bills purchased and discounted fell by 11.4 percent (Rs. 150.9 million) in comparison to a larger decline by 29.6 percent (Rs. 557.1 million) in the preceding year.

Other Assets: Other assets of commercial banks went up by 59.5 percent (Rs. 18.2 billion) in the review year as compared to a decline of 9.7 percent (Rs. 3.3 billion) in the preceding year.

Commercial Banks' Credit by Sector

In this section, data of commercial banks have been analyzed only beginning mid-December 2002 as per new format of the call report form that makes a classification of 13 sectors: (a) agriculture, (b) mines, (c) production, (d) construction, (e) metal production, machinery & electrical tools & fitting, (f) transportation equipment production & fitting, (g) transportation, communications & public services, (h) wholesaler & retailers, (i) finance, insurance & fixed assets, (j) service industries, (k) consumable loan, (l) local government and (m) others. Accordingly, while analyzing the sector-wise credit, credit to the agricultural sector declined by 13.1 percent (Rs. 561.8 million) as at mid-July 2003 as compared to mid-December 2002. Similarly, credit to the production sector rose by 7.1 percent (Rs. 2.8 billion) and aggregated Rs. 42.9 billion as at mid-July 2003. While there was an increase in credit to the transportation, communications and public services sector by 16.1 percent (Rs. 903.4 million) as at mid-July 2003 from mid-December 2002, an increase in loan to the wholesaler and retailers sector by 11.6 percent (Rs. 2.9 billion) was also registered during the same period. Similarly, loans to the service industries sector went up by 6.0 percent (Rs. 695.3 million) as at mid-July 2003 compared to the figure of mid-December 2002.

Table B

Sectorwise Outstanding Credit of Commercial Banks*

Rs in Million

Mid-Month	Agricul-ture**	Mines	Production	Construc-tion	Metal Production Machinery & Electrical Tools & fitting	Transportation Equipment Production & Fitting	Transportation, Communications & Public Services
	1	2	3	4	5	6	7
2002 Dec	4296.3	376.4	40080.0	2308.1	1664.9	1304.7	5620.0
2003 Jan	4167.1	394.0	42046.2	2137.1	1315.7	1317.7	5632.4
2003 Feb	4001.5	484.8	41669.6	2324.5	1425.1	1295.3	5587.5
2003 Mar	3746.5	491.6	41791.2	2447.6	1371.2	1356.3	5840.3
2003 Apr	3635.2	502.3	41896.9	2548.4	1345.5	1300.1	5856.6
2003 May	3704.4	503.1	42491.9	2707.7	1338.1	1322.6	6190.6
2003 June	3709.8	388.4	42745.2	2745.1	1358.8	1191.6	6410.9
2003 July	3734.5	399.4	42910.5	2729.2	1430.1	1359.8	6523.4

Mid-Month	Wholesaler & Retailers	Finance, Insurance & Fixed Assets	Service Industries	Consumable Loan	Local Government	Others	Total
	8	9	10	11	12	13	14
2002 Dec	24683.0	3896.0	11516.8	3572.6	2.6	15331.2	114652.6
2003 Jan	24573.4	3692.4	11034.4	3685.0	2.0	15299.6	115297.0
2003 Feb	25383.6	3979.0	11003.1	3658.8	2.0	15934.5	116749.5
2003 Mar	25124.5	3549.3	11607.6	3607.1	2.0	15338.1	116273.2
2003 Apr	25830.8	3616.1	11643.9	3679.8	2.0	15605.0	117462.6
2003 May	25721.0	3557.5	11710.1	3671.6	1.5	16837.2	119757.3
2003 June	27332.2	3523.5	11820.1	3620.2	148.7	15142.6	120137.0
2003 July	27555.3	4250.3	12212.5	3364.6	1.5	14283.5	120754.5

* Sectoral classification as per new call report forms.

** Excluding the amount deposited by commercial bank branches of Agricultural Development Bank to their Head Office.

Of the total commercial bank credit as at mid-July 2003, the share of production sector was 35.6 percent, followed by wholesalers and retailers sector at 22.8 percent and service industries sector as at 10.1percent. The share of production, wholesalers and retailers and service industries sector at mid-December 2002 was 35.0 percent, 21.5 percent and 10.0 percent, respectively. The share of agricultural sector was just 3.1 percent and 3.8 percent as at mid-July, 2003 and mid-December, 2002, respectively. The share of others declined slightly to 11.9 percent as at mid-July 2003 from 13.4 percent a year ago.

Priority Sector Lending

To make credit available to small agricultural, industrial and services sector and create income and employment opportunities, the NRB had directed the commercial banks to extend a certain percentage (ranging from 7.25 percent to 10.00 percent) of their total outstanding loans to the priority sector. Almost all the commercial banks satisfied the priority sector lending requirement. The total loan extended to the priority sector during FY 2002/03 amounted Rs. 22.6 billion which was 20.9 percent of their total outstanding loans of six months ago. This lending of commercial banks to the priority sector had totaled Rs. 16.3 billion as at mid-July 2002 which constituted about 14.4 percent of their outstanding loans of six months ago.

Deprived Sector Lending

The NRB has also directed the commercial banks to provide some part of their priority sector loans to the deprived sector. As per the aging of commercial banks, the deprived sector lending requirement is discriminatory ranging from 0.25 percent to 3.00 percent. With reference to this provision, the loans extended by commercial banks aggregated Rs. 3.7 billion as at mid-July 2003 that formed 3.4 percent of their six-month prior total outstanding credit. The deprived sector lending amounted to Rs. 3.5 billion as at mid-July 2002 equivalent to 3.3 percent of their six-month prior total outstanding loans.

Commercial Banks' Deposit and Lending Rates

As per the Monetary Policy and Programme for FY 2002/03, the provision of maintaining the weighted average interest spread at or below 5 percent was done away with. Commercial bank's excess liquidity, to some extent, affected the movement in interest rate during the review year. Consequently, there was a decline by 0.25 percentage points in the higher limit of interest rate on savings deposits as this rate fell slightly to 2.5-6.0 percent in mid-July 2003 from 2.5-6.25 percent in mid-July 2002. The one-year fixed deposit interest rate was 3.0-7.0 percent in mid-July 2003 compared to 3.5-7.0 percent a year earlier.

Table C

Interest Rate Structure of Commercial Banks*

(As of Mid-July)

Particulars	Percent per Annum		
	2001	2002	2003
1. Deposits Rates			
Savings Deposits	3.5-6.5	2.5-6.25	2.5-6.0
One Year Fixed Deposits	4.5-7.75	3.5-7.0	3.0-7.0
2. Lending Rates			
Industrial	7.0-15.0	7.0-14.5	8.5-14.0
Commercial	7.0-16.0	7.0-16.0	7.5-16.0
Priority Sector	12.5-14.5	12.0-14.0	4.0-14.5
Export	7.0-12.5	6.5-12.0	4.0-12.5
Overdrafts	10.0-18.0	11.0-17.0	10.0-17.0

* Unweighted.

A mixed trend was noticed in the lending rates of commercial banks. The lending rate on export bills fell to 4.0-12.5 percent in mid-July 2003 from 6.5-12.0

percent a year earlier. The industrial lending rate was 8.5-14.0 percent in mid-July 2003 compared to 7.0-14.5 percent in mid-July 2002. Thus, the lower limit of industrial lending rate increased by 1.5 percentage points while the higher limit declined by 0.5 percentage points. With respect to interest rate on commercial loans, there was an increase in the lower limit by 0.5 percentage as this rate stood at 7.5-16.0 percent in mid-July 2003 compared to 7.0-16.0 percent in mid-July 2002. With respect to overdraft, there was a decline in the lower limit by 100 basis points. Consequently, the interest rate on overdraft was 10.0-17.0 percent in mid-July 2003 compared to 11.0-17.0 percent in mid-July 2002.

Other Banking and Non-Bank Financial Institutions

OBIs include all deposit taking financial institutions other than commercial banks *viz.;* 18 development banks, 5 RDBs, 57 finance companies, 34 financial cooperatives (FINCOOPs), 40 financial non-government organizations (FINGOs) and 116 postal saving banks (PSBs). Similarly, the non-bank financial institutions (NBFIs) are those financial institutions which do not accept public deposits, but they have important role in the financial system in channelising financial resources from surplus units to deficit units in the economy. The NBFIs comprise 18 insurance companies including Deposit Insurance and Credit Guarantee Corporation (DICGC), EPF and Citizen Investment Trust (CIT). Such financial institutions collect public savings in different forms such as insurance premiums by insurance companies, employees' provident fund by EPF and voluntary savings by CIT. In addition, NEPSE has been helping investors in buying and selling securities such as company shares, debentures, and private bonds that have been previously issued in the primary markets. Private bond market activities are virtually non-existent and secondary market activities are mainly dominated by share transactions in the NEPSE.

Other Banking Institutions

All development banks except ADB/N and NIDC are in operation under Development Bank Act, 1996. The ADB/N and NIDC were established under two separate special Acts. Similarly, finance companies and FINCOOP also function under different Acts. The ADB/N performs the twin functions of commercial banking and development banking.

Total outstanding loans of OBIs[#] increased by 14.3 percent (Rs. 4.7 billion) in FY 2002/03 compared to an increase of 10.4 percent (Rs. 3.1 billion) in the preceding year. The total outstanding loans of OBIs as at mid-July 2003 remained at Rs. 37.8 billion. Of the total loan outstanding, the ADB/N accounted for 49.3 percent, finance companies 38.3 percent, NIDC 5.1 percent, co-operative societies

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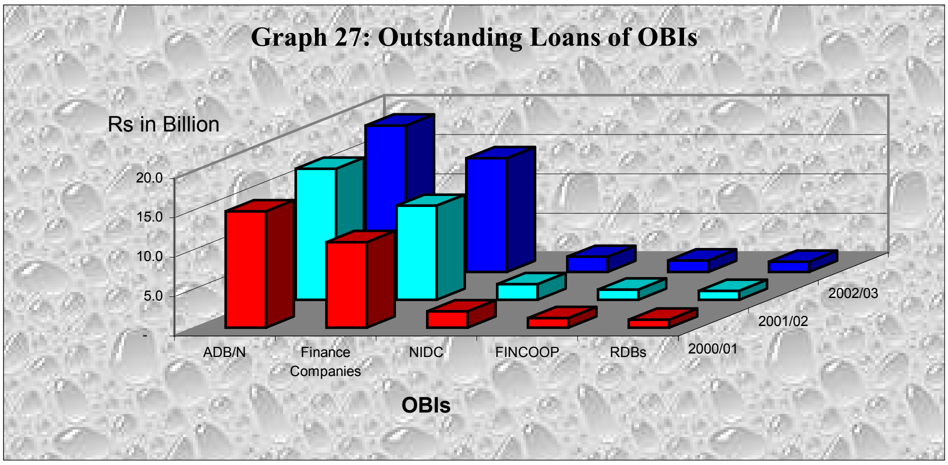
[#] Include NIDC, finance companies, cooperative societies (with limited banking transactions), RDBs and non-commercial banking transactions of ADB/N.

(with limited banking transactions) 3.8 percent and rural development banks 3.5 percent.



Sources and Uses of Funds of OBIs

The aggregate sources of funds of OBIs recorded a growth of 17.1 percent (Rs. 11.9 billion) to Rs. 81.7 billion in FY 2002/03 compared to an increase of 21.8 percent (Rs. 12.5 billion) in the previous year. In the review year, deposits of OBIs, after netting out of the ADB/N commercial banking deposit, went up by 24.5 percent (Rs. 4.84 billion) to Rs. 24.8 billion compared to an increase of 16.5 percent (Rs. 2.8 billion) in the previous year. Of the total OBIs deposits as at mid-July 2003, ADB/N held the largest share of 49.9 percent (Rs. 23.8 billion), finance companies 34.6 percent (Rs 16.5 billion), co-operative societies 4.0 percent (Rs. 1.9 billion), NIDC 1.1 percent (Rs. 522.5 million) and rural development bank 0.9 percent (Rs. 451.6 million). In the review year, aggregate borrowing of these institutions increased by 5.2 percent (Rs. 399.7 million) to Rs. 8.1 billion against a decrease of 2.0 percent (Rs. 155.7 million) in the previous year. Domestic borrowing increased by 20.6 percent (Rs. 760.6 million) to Rs. 4.6 billion and foreign borrowing decreased by 9.2 percent (Rs. 360.9 million) to Rs. 3.6 billion. In the previous year, domestic borrowing had increased by 3.0 percent (Rs. 109.0 million) to Rs. 3.8 billion and foreign borrowing had gone down by 6.3 percent (Rs. 264.7 million) to Rs. 3.9 billion. Similarly, other liabilities of OBIs increased by 20.7 percent (Rs. 3.2 million) to Rs. 18.6 billion in the review year.

On the uses side, the aggregate cash and bank balance and investment of OBIs increased by 7.0 percent (Rs. 501.5 million) to Rs. 7.7 billion and 17.8 percent (Rs. 938.8 million) to Rs. 6.2 billion respectively. Of the total investment of OBIs outstanding as at mid-July 2003, Government securities accounted for 36.9 percent (Rs. 2.3 billion), fixed deposits and others 56.0 percent (Rs. 3.5 billion) and shares 7.1 percent (Rs. 411.5 million). In the review year, loans and advances of these financial institutions grew up by 17.8 percent (Rs. 7.6 billion) to Rs. 50.5 billion compared to an increase of 16.6 percent (Rs. 6.1 billion) in the preceding year. As at mid-July 2003, ADB/N had the largest share of 49.3 percent in total outstanding loans of these institutions followed by finance companies (38.3 percent), NIDC (5.1 percent), cooperative societies (3.9 percent) and RDBs (3.5 percent). The purpose-wise distribution of outstanding loans and advances of these institutions as at mid-July 2003 revealed that 25.4 percent (Rs. 18.6 billion) went to agricultural sector, 14.0 percent (Rs. 4.2 billion) to housing sector, substantial amount of 61.2 percent (Rs. 25.6 billion) went to other sectors and the remaining nominal percent to industrial purposes. Other assets of OBIs went down sharply by 19.7 percent (Rs. 2.8 billion) to Rs. 17.3 billion in the review year.

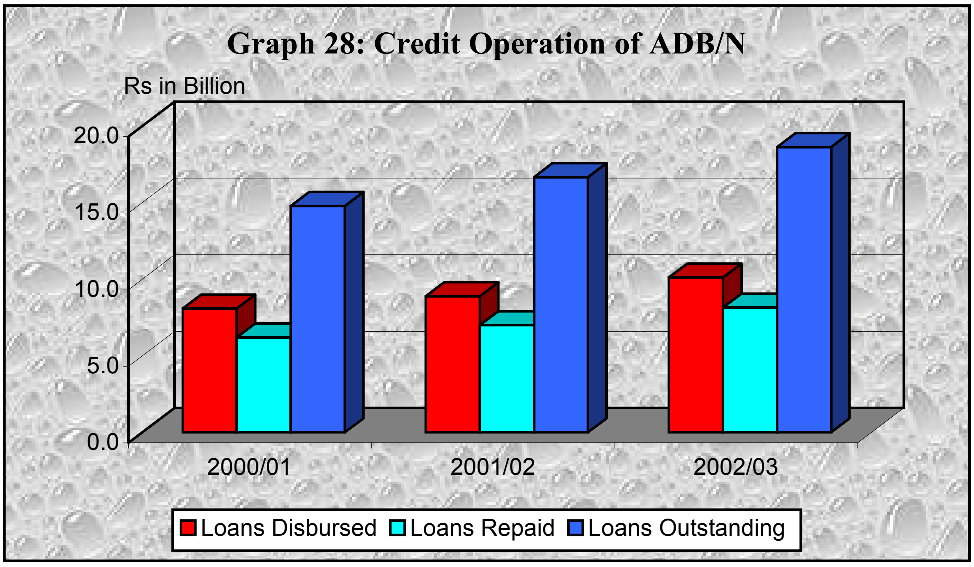
Agriculture Development Bank

The ADB/N was incorporated in 1968 with an objective of ensuring agriculture credit to farmers and cooperatives for the overall development of agriculture sector in order to improve the living standard of farmers. With the establishment of the bank, small farmers also have easy access to bank loans for financing their small projects and it is also believed that easy loan access has helped increase productivity in agriculture sector. The bank has been lending to individual farmers and cooperative societies for financing agriculture production, farm improvement, irrigation and allied purposes like business and industrial projects based on agriculture. The bank is the largest vehicle to impart agriculture credit and has a wide branch network all over the country. It collects public deposits through its commercial banking branches located in urban areas and also invests in rural areas in targeted sectors. It provides short, medium and long term loan financing for agriculture inputs, product processing and marketing of agricultural products. Share capital, public deposits, and domestic and foreign borrowings are the main financial sources of ADB/N.

Despite the government and NRB being the major share holders, the bank is in financially impaired position due to its increasing non-performing assets. However, the bank has adopted stringent measures to speed up its loan repayments since the last couple of years. Restructuring measures are being initiated in the bank under the financial sector reform program.

The total loan disbursement of ADB/N increased by 13.8 percent (Rs. 1.2 billion) to Rs. 10.1 billion in FY 2002/03 compared to an increase of 9.8 percent (Rs. 799.1 million) in the previous year. Of the total loan disbursed in the year, 37.8 percent (Rs. 7.1 billion) was earmarked for agro-industry, marketing and warehouse construction, 19.9 percent (Rs. 3.7 billion) for agriculture production, 20.2 percent (Rs. 3.8 billion) for agro-business, 15.8 percent (Rs. 2.9 billion) for farm improvement and irrigation and the remaining 6.3 percent (Rs. 1.2 billion) for miscellaneous purposes. Similarly, the total loan repayment of ADB/N went up by 16.5 percent (Rs. 1.2 billion) to Rs. 8.2 billion in the review year compared to an increase of 12.9 percent (Rs. 799.3 million) in the previous year. The total loan outstanding of ADB/N increased by 11.8 percent (Rs. 2.0 billion) to Rs. 18.6

billion in the review year compared to an increase of 12.8 percent (Rs. 1.9 billion) in the previous year.



Of the total outstanding loan of Rs. 18.6 billion as at mid-July 2003, agro-industry, marketing and warehouse construction accounted for 37.8 percent, agro-business 20.2 percent, agriculture production 19.9 percent, farm improvement and irrigation 15.8 percent and miscellaneous purposes 6.3 percent. Borrower-wise, outstanding loan with individuals and cooperatives remained at 96.7 percent and 3.3 percent respectively.

Maturity-wise, of the total loan outstanding as at mid-January 2003, 50.7 percent (Rs. 9.44 billion) consisted of medium term loan followed by 43.5 percent (Rs. 8.10 billion) short-term and 5.8 percent (Rs. 1.09 billion) long-term.

Sources and Uses of Funds of ADB/N

Sources of Funds: Total sources of funds of ADB/N increased by 13.2 percent (Rs. 4.9 billion) to Rs. 41.8 billion in FY 2002/03 as against an increase of 14.9 percent (Rs. 4.8 billion) in the previous year. The paid up capital of ADB/N increased by 1.9 percent (Rs. 28.9 million) to Rs. 1.7 billion in the review year. Reserves increased by 8.2 percent (Rs. 24.7 million) in the review year as against a growth of 14.5 percent (Rs. 38.4 million) in the preceding year. Total borrowing decreased by 8.7 percent (Rs 386.6 million) to Rs 4.1 billion in the review year compared to a decline of 12.8 percent (Rs 650.6 million) in the previous year. Foreign borrowing went down by 10.6 percent (Rs 361.4) to Rs. 3.0 billion in the review year compared to a fall of 7.3 percent (Rs. 266.8 million) in the preceding year. Borrowing from NRB and commercial banks decreased marginally by 0.1 percent and 3.2 percent, respectively.

Overall deposit of ADB/N increased by 15.1 percent (Rs. 3.1 billion) to Rs. 23.9 billion in the review year compared to an increase of 17.1 percent (Rs. 3.1 billion) in the previous year. Of the total deposit, current, savings, fixed and other deposits accounted for 5.3 percent, 53.7 percent and 36.9 percent, and 4.1 percent, respectively.

Uses of Funds: Cash and bank balances constituted 9.5 percent of the total funds available which increased by 9.7 percent in the review year. The bank's total loan outflows to agricultural and commercial activities went up by 15.8 percent (Rs. 3.6 billion) to Rs. 26.7 billion compared to an increase of 13.3 percent (Rs. 2.71 billion) in the previous year.

Total investment of ADB/N declined by 18.4 percent (Rs. 430.1 million) to Rs. 1.9 billion in the review year compared to a fall of 9.7 percent (Rs. 250.2 million) in the preceding year. Of the total investment, the proportion of government securities, fixed deposits and shares consisted of 50.8 percent, 42.0 percent and 7.2 percent, respectively.

Small Farmers Development Programme

The total number of Small Farmer's Development Projects (SFDPs) at the end of FY 2002/03 stood at 154. In the review year, total savings collected under the programme increased marginally by 0.9 percent (Rs 0.6 million) to Rs. 65.2 million compared to a fall of 15.7 percent (Rs. 12.0 million) in the preceding year. The number of farmers benefiting from the programme stood at 83,093 as at mid-July 2003, showing a significant decline of 19.4 percent from the previous year's level. ADB/N has been handing over SFDPs gradually to local groups since the last couple of years.

In the review year, total loan disbursement under this programme fell by 10.6 percent (Rs. 44.0 million) to Rs. 369.3 million compared to a decline of 16.1 percent (Rs. 79.4 million) in the preceding year. Of the total loan disbursed, agriculture production accounted for 33.4 percent (Rs. 123.5 million), agro-business 33.0 percent (Rs. 121.8 million), agro-industry, marketing and warehouse construction 17.2 percent (Rs. 63.7 million), farm improvement and irrigation 15.0 percent (Rs. 55.4 million) and other purposes 1.3 percent (Rs. 4.9 million).

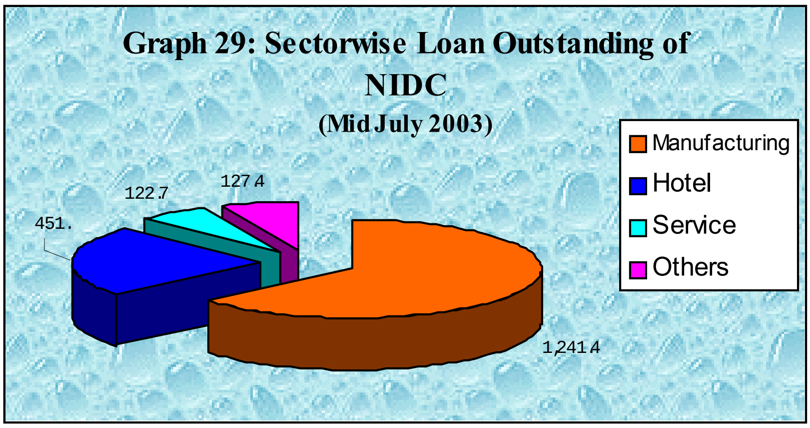
Loan repayment under this programme fell marginally by 1.2 percent (Rs 4.4 million) to Rs. 354.2 million compared to a decline of 9.9 percent (Rs. 39.4 million) a year earlier. As a result, total outstanding loan marginally increased by 0.8 percent (Rs. 15.1 million) to Rs. 841.5 million in the review year compared to an increase of 2.9 percent (Rs. 54.7 million) in the preceding year.

Nepal Industrial Development Corporation

NIDC was established in 1959 with a view to encourage industries established in private sector by providing financial and technical assistance. It extends loans against adequate security and also makes share participation in private industry for their establishment, improvement, expansion and modernization. The NIDC has been facing liquidity problem since the last few years because of a large amount of distressed assets. It, therefore, has heavily curtailed its disbursements because of the paucity of funds. However, NRB has given approval to the Corporation for managing financial resources by accepting institutional deposits. A study has been completed for its financial and operational restructuring under financial sector reform programme.

Loan disbursements of NIDC in FY 2002/03 totalled Rs. 36.7 million reflecting a further decline of 52.5 percent (Rs. 40.5 million) over FY 2001/02. Of the total loan disbursed in the year, 35.5 percent (Rs. 26.4 million) went to manufacturing sector, 17.2 percent (Rs. 12.8 million) to service sector, 10.1 percent (Rs. 7.5 million) to hotels and the remaining 37.2 percent (27.6 million) to other purposes. Similarly, the total loan realization of NIDC declined significantly by 45.5 percent (Rs. 75.2 million) to Rs. 165.2 million in the review year compared to a fall of 31.2 percent (Rs. 74.8 million) in the previous year. As a result, financial position of the corporation further deteriorated and the lending activities almost went into doldrums similar to the previous year.

Outstanding loan of NIDC further went down by 2.7 percent (Rs. 53.3 million) to Rs. 1.9 billion in the review year compared to a decline of 4.2 percent (Rs. 88.0 million) a year earlier. Of the total outstanding loans of NIDC in FY 2002/03, manufacturing accounted for 63.9 percent (Rs. 1.2 billion), hotels 23.2 percent (Rs. 451.5 million), services 6.3 percent (Rs. 122.7 million) and miscellaneous purposes 6.6 percent (Rs. 127.4 million).



Graph 29: Sectorwise Loan Outstanding of NIDC
(Mid July 2003)

Sources and Uses of Funds of NIDC

Sources of Funds: The total sources of funds of NIDC increased by 5.9 percent (Rs. 300.5 million) to Rs. 5.4 billion in the review year as against an increase of 87.6 percent (Rs. 2.4 billion) in the preceding year. In the review year, paid up capital and reserve fund of the Corporation remained stagnant.

Fixed deposit liability of NIDC, compared with the preceding year, increased by 29.8 percent (Rs. 120.0 million) to Rs. 522.5 million in the review year. Total borrowing of NIDC decreased by 9.1 percent (Rs. 128.9 million) to Rs. 1.3 billion in the review year. NIDC partially repaid its loan to NRB and total borrowing from NRB decreased by 14.3 percent to Rs. 773.4 million. The respective shares of NRB, the Government and external sector in the total outstanding borrowing were 60.0 percent (Rs. 773.4 million), 18.2 percent (Rs. 234.6 million) and 21.8 percent (Rs. 281.3 million) in FY 2002/03. In the review year, other liabilities of NIDC increased by 11.9 percent (Rs. 309.4 million) to Rs. 2.9 billion.

Uses of Funds: Aggregate investment of NIDC remained at Rs. 183.0 million comprising of 90.3 percent in company shares and the remaining 9.7 percent in NCM mutual fund. Bank balances increased by 18.0 percent (Rs. 31.4 million) to Rs. 206.3 million as at mid-July 2003 as against a decrease of 25.6 percent (Rs. 60.1 million) in the corresponding period of the preceding year. Similarly, industrial loan went down by 2.5 percent (Rs. 53.1 million) to Rs 2.1 billion as at mid-July 2003 compared to an increase of 41.4 percent (Rs 615.9 million) in the corresponding period of the previous year. Other assets of NIDC increased by 12.2 percent (Rs. 319.8 million) to Rs 2.9 billion the review year compared to 3 times (Rs. 1.7 billion) increase in the preceding year.

Other Development Banks

Development banks are incorporated as public limited companies and are into operation under the Development Bank Act, 1997. The major objective of establishing development banks is mobilizing more financial resources and availing technology needed for the establishment, development, expansion, and enhancement of capacity and productivity of private sector enterprises. Development banks are allowed to collect deposits subject to compliance with regulations issued by NRB and advance loans for fixed and working capital as required by the private enterprises.

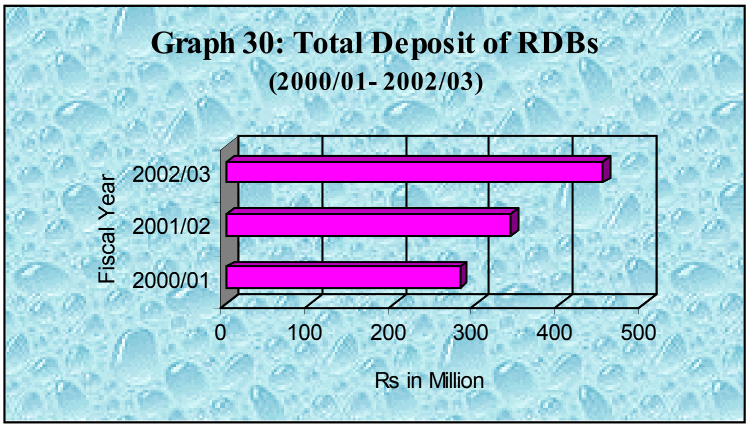
Sources and Uses of Funds of Other Development Banks

The total sources of funds of other development banks increased significantly by 31.4 percent (Rs. 1.3 billion) to Rs. 5.3 billion as at mid-July, 2003 compared to that of the previous year. The sources of funds in the review year consisted of capital funds 9.9 percent (Rs. 519.9 million), deposits 82.2 percent (Rs. 4.3 billion), borrowing 1.6 percent (Rs. 86.2 million) and other liabilities 6.3 percent (Rs. 331.6 million). On the uses side, liquid funds recorded a substantial growth of 92.2

percent (Rs. 557.8 million), investments 34.5 percent (Rs. 99.0 million), loans and advances 14.0 percent (Rs. 412.3 million) and other assets 112.3 percent (Rs. 191.2 million). Of the total investment, government securities accounted for 50.3 percent (Rs. 194.0 million), share and debenture 36.1 percent (Rs. 139.1 million) and other investment 13.7 percent (Rs. 52.7 million). Loans and advances went up by 14.0 percent (Rs. 412.3 million) to Rs. 3.4 billion in the review year.

Rural Development Banks

With an objective of providing micro-credit services to the rural poor women under group guarantee without collateral, one each rural development bank has been established in each development region of the country. By mid-July 2003, RDBs disbursed, in aggregate, loans amounting to Rs. 9.0 billion to 152719 members. Of the total loan disbursed, Rs. 6.8 billion was repaid and Rs. 1.3 billion remained as outstanding. RDBs provided services through 4803 centers in 43 districts of the country. RDBs collected deposits of Rs. 318.0 million, of which, 88.1 percent (Rs. 280.2 million) was from group savings and the remaining 11.9 percent (Rs. 37.8 million) from personal savings.



Eastern Region Rural Development Bank

Eastern Region Rural Development Bank (ERRDB) has been operating in 9 districts of the region with its head office at Biratnagar. By mid-July 2003, it disbursed a total loan of Rs. 3.9 billion to 49233 borrowers. It has altogether 1375 centers and 53270 members, comprising of 11274 groups formed within 262 Village Development Committees (VDCs). Of the total loan disbursed, Rs. 3.0 billion was repaid and Rs. 386.0 million remained as outstanding as at mid-July, 2003. In the period, total saving deposits of this bank reached Rs. 132.9 million. Of the total savings deposits, 91.8 percent (Rs. 122.0 million) group savings accounted for 91.8 percent and the remaining 8.2 percent (Rs. 10.9 million) was accounted for by personal savings.

Central Region Rural Development Bank

Central Region Rural Development Bank (CRRDB) has been operating in 12 districts of the region with its head office at Janakpur. By mid-July 2003, it disbursed a total loan of Rs. 1.3 billion to 36274 borrowers. It has altogether 1172 centers and 37357 members, comprising of 7712 groups formed within 246 VDCs. Of the total loan disbursed, Rs. 82.5 million was repaid and Rs. 12.1 million remained as outstanding as at mid-July, 2003. In this period, total saving deposits of the bank reached Rs. 72.7 million. Of the total saving deposits, group savings accounted for 94.2 percent (Rs 68.5 million) and the remaining 5.8 percent (Rs. 4.1 million) was accounted for by personal savings.

Western Region Rural Development Bank

Western Region Rural Development Bank (WRRDB) has been operating in 13 districts of the region with its head office at Butwal. By mid-July 2003, it disbursed a total loan of Rs. 2.0 billion to 38942 borrowers. It has altogether 1111 centers and 40140 members, comprising of 8038 groups formed within 273 VDCs. Of the total loan disbursed, Rs. 1.7 billion was repaid and Rs. 349.0 million remained as outstanding as at mid-July, 2003. In this period, total savings deposits of this bank reached Rs. 101.0 million. Of the total saving deposits, group savings accounted for 88.9 percent (Rs. 89.9 million) and the remaining 11.0 percent (Rs. 11.1 million) was accounted for by personal savings.

Mid-Western Region Rural Development Bank

Mid-Western Region Rural Development Bank (MWRRDB) has been operating in 4 districts of the region with its head office at Nepalgunj. By mid-July 2003, it disbursed a total loan of Rs. 709.6 million to 16515 borrowers. It has altogether 551 centers and 19485 members, comprising of 3897 groups formed within 102 VDCs. Of the total loan disbursed, Rs. 553.8 million was repaid and Rs. 37.2 million remained as outstanding as at mid-July, 2003. In this period, total saving deposits of this bank reached Rs. 60.3 million. Of the total saving deposits, group savings accounted for 96.2 percent (Rs. 58.0 million) and the remaining 3.8 percent (Rs. 2.3 million) was accounted for by personal savings.

Far-Western Region Rural Development Bank

Far-western Region Rural Development Bank (FWRRDB) has been operating in 5 districts of the region. with its head office at Dhangadhi. By mid-July 2003, it disbursed a total loan of Rs. 822.1 million to 11755 borrowers. It has altogether 594 centers and 19198 members, comprising of 3419 groups formed within 83 VDCs. Of the total loan disbursed, Rs. 99.2 million was realized and Rs. 8.1 million remained as outstanding as at mid-July, 2003. In this period, total saving deposits of this bank reached Rs. 50.4 million. Of the total saving deposits, group savings accounted for 97.0 percent (Rs. 48.9 million) and the remaining 3.0 percent (Rs. 2.3 million) was accounted for by personal savings.

Sources and Uses of Funds of RDBs

Aggregate sources of funds of five RDBs went up by 15.7 percent (Rs. 298.7 million) to Rs. 2.2 billion in FY 2002/03 compared to an increase of 4.0 percent (Rs. 72.9 million) in the preceding year. In the review year, whereas capital funds increased by 7.7 percent (Rs. 14.4 million) to Rs. 201.5 million, deposit and borrowing went up by 32.4 percent (Rs. 110.5 million) to Rs. 451.6 million and 12.2 percent (Rs. 143.9 million) to Rs. 1.3 billion respectively. Of the total borrowing of RDBs outstanding as at mid-July 2003, 96.3 percent consisted of borrowing from domestic financial institutions, 3.0 percent from Nepal Rastra Bank and the remaining 0.7 percent from other sources.

In the review year, liquid funds of RDBs surged up by 26.7 percent (Rs. 44.5 million) to Rs. 211.3 million and investment increased by 15.3 percent (Rs. 71.3 million) to Rs. 537.4 million. Of the total investment, 98.0 percent was fixed deposits in banks and financial institutions, 1.4 percent government bonds and the remaining 0.6 percent other financial assets. Loans and advances of the RDBs went up by 14.2 percent (Rs. 163.2 million) to Rs. 1.3 billion in the review year compared to an increase of 14.6 percent (Rs. 145.6 million) in the previous year. Of the RDBs' total loans and advances outstanding as at mid-July 2003, group loans accounted for 63.6 percent (Rs. 832.2 million) and the remaining 36.4 percent (Rs. 476.9 million) was accounted for by other loans. Of the total uses of funds of RDBs, loans and advances accounted for by 59.3 percent, investment 24.4 percent, liquid fund 9.6 percent and other uses of fund 6.7 percent.

Finance Companies

Finance companies came into operation under the Finance Company Act, 1986. They are registered as limited companies at the office of the registrar of companies according to the provisions made in the Company Act, 1965. A finance company can accept time deposit of the maturity of minimum 3 months to maximum 6 years to a maximum limit of twelve times of the primary capital of the company. Finance companies advance loans to individuals, firms, companies or institutions. Such companies are allowed by the Act to undertake lease financing, offering credit for purchasing or construction of residential houses. They can also perform merchant banking activities with prior approval of NRB. These companies are popular among low-income and medium class people for financing hire purchases, vehicles, machinery, tools, equipments, durable household goods etc. As a consequence of the financial liberalization policy, finance companies are mushrooming in the Kathmandu Valley whereas their presence is very thin out of the valley.

Sources and Uses of Funds of Finance Companies

The aggregate sources of funds of finance companies recorded a growth of 19.9 percent (Rs. 3.7 billion) to Rs. 22.1 billion in FY 2002/03 compared to an increase of 16.8 percent (Rs. 2.7 billion) in the previous year. As 3 more finance companies came into operation in the review year, the total number of finance companies reached 57 at the end of the FY 2002/03 as against 54 in the previous year.

Public deposit, the major source of funds of finance companies, consisted of 74.7 percent of their total resource in FY 2002/03. In the review year, capital funds went up by 20.4 percent (Rs. 543.1 million) to Rs. 3.2 billion compared to an increase of 38.0 percent (Rs. 733.2 million) a year earlier. Deposit liability increased by 22.7 percent (Rs. 3.1 billion) to Rs. 16.5 billion compared to an increase of 15.4 percent (Rs. 1.8 billion) in the previous year. Finance companies borrowed funds from commercial banks only. Their aggregate borrowing decreased by 45.1 percent (Rs. 110.5 million) to Rs. 134.3 million in the review year compared to an increase of 13.9 percent (Rs. 29.8 million) in the previous year. Other liabilities also decreased by 2.0 percent (Rs. 37.0 million) to Rs. 1.8 billion in FY 2002/03 compared to an increase of 9.6 percent (Rs. 160.4 million) in the preceding year.

On the uses side, aggregate liquid funds of finance companies decreased by 6.6 percent (Rs. 188.4 million) to Rs. 2.7 billion in the review year compared to an increase of 39.7 percent (Rs. 813.9 million) in the preceding year. Aggregate investment surged up by 47.4 percent (Rs. 769.0 million) to Rs. 2.4 billion in the review year compared to an increase of 28.0 percent (Rs. 355.4 million) in the preceding year.

Loans and advances accounted for 65.4 percent of the total sources of funds of finance companies. In the review year, loans and advances of finance companies recorded a growth of 21.1 percent (Rs. 2.5 billion) to Rs. 14.5 billion compared to an increase of 10.1 percent (Rs. 1.1 billion) in the previous year. Of the total loans and advances, term loan accounted for 47.0 percent (Rs. 6.8 billion), housing 29.1 percent (Rs 4.2 billion), hire purchases 17.1 percent (Rs 2.5 billion), leasing and the remaining 1.0 percent (Rs 148.8 million) was accounted for by other purposes. Other assets of finance companies increased by 27.7 percent (Rs. 559.0 million) to Rs. 2.6 billion in the review year compared to an increase of 24.9 percent (Rs. 401.9 million) in the preceding year.

Financial Cooperatives

FINCOOPs 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 their members only. They are authorized to carry on limited banking transactions among their members with prior approval of NRB.

Sources and Uses of Funds of FINCOOPs

The aggregate sources of funds of cooperative societies (with limited banking transaction) revealed a growth of 15.9 percent (Rs. 363.8 million) to Rs. 2.7 billion in FY 2002/03 compared to an increase of 12.8 percent (Rs. 260.8 million) in the previous year. Capital funds of these cooperatives witnessed a growth of 10.6 percent (Rs. 26.1 million) to Rs. 273.0 million and deposits increased by 22.5 percent (Rs. 353.8 million) to Rs. 1.9 billion in the review year. Aggregate borrowing of these institutions increased by 13.1 percent (Rs. 7.1 million) to Rs. 66.4 million in the review year. The outstanding balance of borrowing is composed of the borrowings from NRB (0.6 percent), commercial banks (92.3 percent), and RDBs and Finance Companies (7.1 percent). The other liabilities of these cooperative societies decreased by 4.6 percent (Rs. 18.9 million) to Rs. 394.6 million in the review year.

On the uses side, the aggregate liquid funds went down by 13.3 percent (Rs. 59.5 million) to Rs. 389.1 million and investment went up by 33.4 percent (Rs. 63.1 million) to Rs. 251.9 million. Of the total investment outstanding government securities accounted for 19.1 percent (Rs. 48.2 million), fixed deposits accounted for 21.7 percent (Rs. 54.5 million) and other investment accounted for 59.2 percent (Rs. 149.2 million) as at mid-July 2003. Similarly, loan and advances of the societies increased by 11.4 percent (Rs. 149.7 million) to Rs. 1.5 billion as at mid-July 2003 compared to an increase of 7.6 percent (Rs. 92.3 million) in the previous year. Of the total loan and advances, 41.6 percent (Rs. 609.3 million) went for commercial purposes, 4.4 percent (Rs. 64.5 million) for production purposes, 3.4 percent (Rs. 49.6 million) for fixed deposit receipts (FDR) and the remaining 50.6 percent (Rs. 739.8 million) for other purposes. The other assets of the societies also increased by 23.8 percent (Rs. 54.8 million) to Rs. 532.1 million in the review year.

Financial Non-Govermental Organizations .

NGOs involved in mobilizing financial resources with the prior approval of NRB are called FINGOs. FINGOs are non-profit making institutions. These institutions also act as financial intermediaries. Because of serious insecurity problems, many commercial bank branches in rural area have been either closed down or merged with other branches. FINCOOPs and FINGOs are substituting the merged branches of commercial banks. FINGOs borrow funds from foreign sources and collect fees from their members and function as financial intermediaries. The number of NRB licensed FINGOs reached 40 in mid-July, 2003.

Sources and Uses of Funds of FINGOs

Membership fees, grants, accumulated profit and borrowings are the major sources of funds of FINGOs. The aggregate sources of funds of FINGOs increased significantly by more than 60.4 times (Rs. 2.4 million) to Rs. 129.3 million in the FY 2002/03 compared to that of previous year. Of the total sources, 4.9 percent

(Rs. 6.3 million) constituted capital funds, 4.3 percent (Rs. 5.6 million) staff welfare funds, 12.5 percent (Rs. 1.6 million) risk bearing funds, 3.3 percent (Rs. 4.3 million) accumulated profit, 70.5 percent (Rs. 9.1 million) borrowings from domestic and foreign institutions and 15.7 percent (Rs. 2.0 billion) constituted other sources.

FINGOs maintained 14.3 percent (Rs. 1.9 million) of their total sources in liquid fund as cash in hand and balance with domestic banks. A major share of 37.7 percent (Rs. 48.8 billion) of the total sources of funds of FINGOs was utilized in micro financing, 38.8 percent (Rs. 50.2 million) in investment and remaining 9.1 percent in other uses.

Non-Bank Financial Institutions

Insurance Companies

Altogether 18 insurance companies including DICGC are in operation in Nepal. They issue life, fire and marine insurance policies against various types of risks and collect a large amount of funds in the form of premium. The aggregate premium collected by insurance companies in FY 2002/03 increased by 37.6 percent (Rs. 1.1 billion) to Rs. 2.4 billion compared to an increase of 36.7 percent (Rs. 785.8 million) in the previous year. Of the total premium collected in the review year, 59.0 percent (Rs. 2.4 billion) constituted premium from non-life insurance and the remaining 41.0 percent (Rs. 925.0 million) was from life insurance. In addition, insurance companies earned an income of Rs. 840.0 million in the review year by investing funds in HMG securities, shares and fixed deposits.

Sources and Uses of Funds of Insurance Companies

Aggregate sources of funds of insurance companies increased by 25.2 percent (Rs. 2.8 billion) to Rs. 13.8 billion in FY 2002/03 compared to an increase of 20.8 percent (Rs. 1.9 billion) in the preceding year. Of the total sources, 71.1 percent (Rs. 9.8 billion) constituted funds from life insurance and the remaining 28.9 percent (Rs. 4.0 billion) was from non-life insurance. Insurance funds, as the major source of funds of insurance companies occupied 55.6 percent (Rs. 7.7 billion) share in the total sources. Other sources included paid up capital 7.9 percent (Rs. 1.1 billion), reserve funds 10.3 percent (Rs. 1.4 billion) and other liabilities 26.2 percent (Rs. 3.6 billion).

On the uses side, investment occupied the highest rank with 87.3 percent (Rs. 12.0 billion) share in total uses. Cash and bank balances occupied 2.8 percent (Rs. 380.0 million), fixed assets 1.5 percent (Rs.210.0 million) and other assets 8.4 percent (Rs. 1.2 billion).

Deposits Insurance and Credit Guarantee Corporation

The DICGC was established in 1974 as a private limited company under the Company Act 1964. The main objective 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 envisaged 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 investment on government securities.

The amount of credit guaranteed by the DICGC to the priority sector loans extended by commercial banks decreased by 8.7 percent (Rs. 303.2 million) in FY 2002/03 and stood at Rs. 3.2 billion at mid-July 2003. Of the total credit guaranteed by DICGC, Rastriya Banijya Bank accounted for the highest share of 35.1 percent followed by Nepal Bank Limited 21.7 percent, Nepal SBI Bank Ltd. 13.1 percent, Himalayan Bank Ltd. 6.0 percent, Nepal Investment Bank Ltd 5.8 percent, Lumbini Bank Ltd. 5.6 percent, Bank of Kathmandu 5.2 percent, Nepal Arab Bank Ltd 3.7 percent, Nepal Credit and Commerce Bank 2.2 percent and ADB/N 1.7 percent.

Purpose-wise, of the total credit guaranteed, services sector accounted for the largest share of 38.6 percent followed by agricultural sector 28.2 percent and industrial sector 30.3 percent. Region-wise, of the total credit guaranteed, 67.0 percent went to the Central Development Region, 17.7 percent to the Eastern Development Region, 9.9 percent to the Western Development Region, 6.0 percent to the Mid-Western Development Region and the remaining 4.1 percent to the Far-Western Development Region.

Employees' Provident Fund

EPF is an autonomous body incorporated under the Employees Provident Fund Act, 1962 merging the earlier Army Provident Fund and Civil Servants Provident Fund. EPF mobilizes savings collected through compulsory provident fund contributions on the part of employers and employees, among others, in civil, army and police services. In FY 2002/03, total loan disbursement of EPF surged up by 48.4 percent (Rs. 1.8 billion) to Rs. 5.4 billion compared to an increase of 42.2 percent (Rs. 1.1 billion) in the preceding year. The total loan repayment of EPF went up by 59.4 percent (Rs. 335.3 million) to Rs. 899.7 million in the review year against a decrease of 3.7 percent (Rs. 21.5 million) in the previous year. In the review year, outstanding loan of EPF increased by 46.7 percent (Rs. 4.5 billion) to Rs. 14.0 billion compared to an increase of 46.8 percent (Rs. 3.1 billion) in the previous year.

Sources of Funds of EPF

Total sources of fund of EPF recorded a growth of 17.4 percent (Rs. 5.3 billion) in the review year and stood at Rs. 35.6 billion as at mid-July, 2003 compared to an increase of 15.6 percent (Rs. 4.1 billion) in the previous year. During the review year, total provident fund collected went up by 18.0 percent (Rs. 4.9 billion) to Rs. 32.3 billion compared to an increase of 15.3 percent (Rs. 3.6

billion) in the previous year. However, reserves and other provision decreased by 4.9 percent (Rs. 113.0 million) to Rs. 2.2 billion and other provision declined by 69.0 percent (Rs. 465.0 million) to Rs. 1.1 billion respectively.

Uses of Funds of EPF

On the uses side, total loan increased significantly by 42.6 percent (Rs. 4.2 billion) to Rs. 14.0 billion in the review year compared to an increase of 45.5 percent (Rs. 3.1 billion) in the preceding year. Of the total outstanding loan, the share of employees and institutions accounted for 74.1 percent (Rs. 10.4 billion) and 25.9 percent (Rs. 3.6 billion) respectively. Similarly, total investment of EPF increased by 4.4 percent (Rs. 814.0 million) to Rs. 19.4 billion in the review year compared to an increase of 3.5 percent (Rs.628.0 million) in the previous year. Of the total outstanding investment of EPF, fixed deposits accounted for 78.6 percent (Rs. 15.3 billion), HMG securities accounted for 20.2 percent (Rs. 3.9 billion) and share investment accounted for 1.2 percent (Rs. 231.0 million) in mid-July, 2003. In the review year, the cash and bank balances went up by 23.7 percent (Rs. 197.0 million) to Rs. 1.0 billion compared to a significant increase of 77.9 percent last year. Fixed assets increased by 12.5 percent (Rs. 44.0 million) to Rs. 397.0 million and the other assets of EPF increased by 8.2 percent (Rs. 60.0 million) to Rs. 796.0 million in the review year.

Citizen Investment Trust

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

Sources and Uses of Funds of CIT

Total sources of fund of CIT increased by 50.9 percent (Rs. 868.2 million) to Rs. 2.6 billion in FY 2002/03 compared to an increase of 50.8 percent (Rs. 574.8 million) in the preceding year. The major sources of funds of CIT include paid up capital, reserve fund, funds from voluntary contributions and other liabilities. Funds from employees' voluntary contributions alone constituted 94.9 percent (Rs. 1.0 billion) of the total sources. Paid up capital accounted for 1.6 percent (Rs. 40.0 million), reserve fund 0.8 percent (Rs. 21.0 million) and other liabilities 2.7 percent (Rs. 70.7 million) in the review year.

The CIT used 47.5 percent (Rs. 1.2 billion) of the total sources in investment. Other uses consisted of cash and bank balances 25.6 percent (Rs. 658.6 million), loans and advances 23.9 percent (Rs. 615.8 million), fixed assets 0.1 percent (Rs. 2.6 million) and other assets 2.9 percent (Rs. 7.5 million).

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FINANCIAL SECTOR REFORMS AND REGULATORY MEASURES

Financial Sector Reforms and Regulatory Measures

Financial sector reforms are vital for enhancing growth, efficiency and maintaining stability as well as sustainability of the overall economy and financial sector. Nepal began to initiate the financial sector reforms since 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. Although more needs to be done, the financial sector in Nepal is getting stronger today compared to what it was a few years ago. Moreover, as Nepal is in the process of joining the WTO soon, it is indispensable for the NRB to continue according priority to its financial sector reform programme. Some of the major reform measures undertaken in FY 2002/03 are highlighted below.

Financial Sector Technical Assistance Project

Under the loan assistance of the World Bank and grant assistance of the DFID of the Government of the United Kingdom, programmes such as the re-engineering of the NRB, restructuring and ownership reform of the RBB and the NBL and capacity-building in the financial sector have been incorporated under the Financial Sector Technical Assistance Project. The financial sector reform measures undertaken under this Project are highlighted below.

Reengineering of the NRB: With regard to the appointment of the human resource advisor, accounting and auditing advisors/consultants required for the NRB Reengineering Programme, the American firm IOS Partners was selected as the consultant for this job. An agreement was made between the NRB and the IOS Partners after which the consultant started its work relating to the NRB reengineering effective March 1, 2003. To expedite the work related to re-engineering and to assess the suggestions provided by the consultants, a NRB Reengineering Steering Committee was constituted. The Committee has already begun its work. Likewise, the NRB Reengineering Team also submitted the Diagnostic Reports and the reports pertaining to the salary review. Similarly, steps are being undertaken for bringing about improvement in the NRB's organizational framework and job description as well as manpower projections. Preparations are also underway for developing the Off-Site Surveillance Manual. Moreover, in line with the voluntary retirement scheme (VRS) launched by the NRB, the officer-level and the assistant-level staff numbering, 57 and 285, respectively, have retired under this scheme.

Besides this, to strengthen the inspection and supervision capability of the bank, an inspection and supervision manual of international standard has already been implemented.

Restructuring of Nepal Bank Limited and Rastriya Banijya Bank: To resolve the overriding problems of NBL, the management group of ICC Consulting Firm of Bank of Scotland (Ireland) Ltd. started its work effective July 20, 2002. A chief executive officer was appointed from the Firm's side, supported by 4 foreign and 4 local experts. Moreover, 7 chartered accountants were also recruited. The bank's auditing for the past three years, FY 1999/00 through FY 2001/02 was completed and the financial details of FY 2001/02 were made available to the NRB. In the one-year period, the management group of the NBL has submitted the report relating to financial position of the Bank, the budget plan for FY 2002/03 and the management plan for expediting the future reforms programme to the NRB and the World Bank. Concurrence was also received from both of these institutions. The management group has also submitted the detailed Human Resource Development Plan. With regard to computerization of banking transactions, tender has already been called for the purchase and installation of computer hardware and software and the negotiation process is underway. Credit policy guidelines of international standard and guidelines on asset and liability management have been framed and implemented. While the credit policy guideline defines the loan products, system for appraisal, collateral requirements, credit approval process, credit administration and problem loan management, the guidelines on asset and liability management encompass the procedures for conducting the gap analysis and preparing maturity ladder, among others. The credit portfolio review has been conducted and the loan recovery and restructuring process, among others, are underway. The new management has recovered Rs. 2.0 billion of the non-performing loan.

After Deloitte Touche Tohmatsu of the United States breached the contract agreement, Mr. Bruce F. Henderson was appointed the Chief Executive Officer of RBB on December 21, 2002 after which he assumed his responsibilities effective January 16, 2003. Under the guidance of Mr. Henderson, foreign and local consultants were appointed. The management team of the RBB has already prepared and implemented the management plan, the Budget Plan, and the reclassification of the accounts head. It has also recovered Rs. 1 billion out of the bad loans.

For monitoring and supervising the work and progress of the management team of the two large banks (NBL and RBB), a Monitoring and Surveillance Team has been formed. Moreover, to provide directives to the Team and to implement the directives of the high-level coordination committee, there is a provision of a Monitoring and Surveillance Committee at the NRB.

Policy Formulation and Development Related to Commercial Banks

(a) *Revised Regulations/Directives:* In the process of amending the existing regulatory directives as and when required, some unclear sections of the regulations/directives have been clarified, some have been abolished while others have been revised during FY 2002/03. Some of the major directives issued are as follows:

- The provision relating to the interest rate spread, that is, the difference between the interest rate on loans and interest rate on deposits at 5.0 percent, would be abolished.
- The shares of promoters of banks and financial institutions can be placed as collateral only after their coming into operations and after a period of three years when the shares are allocated to the public and listed in the stock exchange.
- The Chief Executive Officer of the commercial bank is not entitled to become a member of the audit committee but can be invited as an invitee if required.
- The directors of banks and financial institutions can work as guardians or advisors only in banks and financial institutions undertaking micro-credit transactions.
- Loans provided by commercial banks to SFDB would be treated as loan to the deprived sector. The SFDB should lend that fund as wholesale credit to Small Farmers Cooperatives Ltd. and other institutions undertaking micro-credit transactions.
- Banks and financial institutions are prohibited to issue financial guarantee except in the case when the single obligor limit is exceeded.
- Banks and financial institutions' investment in the Credit Information Bureau can be shown in profit and loss account as expenses. For this, Investment Adjustment Fund is not required to be maintained.
- Existing sections of directives relating to banks' paid-up capital, swap credit, loan-loss provisioning, various aspects of corporate governance, loan rescheduling and restructuring, etc have also been revised.

(b) Beginning FY 2002/03, the following arrangement has been made for the gradual phasing out of the investment of commercial banks in the priority sector:

Fiscal Year	***Minimum Investment in Priority Sector*** ***(As Percent of Total Credit)***
2002/03	7
2003/04	6
2004/05	4
2005/06	2
2006/07	2

From FY 2007/08 onwards, it will not be mandatory for commercial banks to invest in priority sector but investment arrangement in the deprived sector would remain unchanged.

(c) With regard to establishment of a new commercial bank, permission was granted to Siddhartha Bank Limited in FY 2002/03 after which the bank started operations effective December 23, 2002.

(d) During FY 2002/03, a technical services agreement took place between Laxmi Bank Limited and Hatton National Bank of Sri Lanka. Similarly, the Bank of Ceylon of Sri Lanka withdrew its share investment from the Nepal Bank of Ceylon Limited in FY 2002/03.

Implementation of Monetary Policy and Programme for FY 2002/03

An indicated earlier, NRB, in accordance with the provision made in NRB Act 2002, announced for the first time the annual Monetary Policy and Programme for the FY 2002/03 on July 16, 2003. The measures announced have already been spelled out in *Economic Report of FY 2001/02*. Some of the major reform measures implemented in FY 2002/03 are highlighted below:

- With the abolishment of the average weighted interest rate spread of 5 percent, the interest rate structure of commercial banks has become more competitive without increasing the spread.
- In order to promote professionalism in the operation of banks and financial institutions and avoid conflict of interest in the pursuit of making inspection and supervision effective for financial sector stability, the NRB has withdrawn its directors from the commercial banks and development banks. Similarly, HMG has called back its representatives from commercial banks, excepting from those which it fully or partly owns.
- For managing the non-banking assets of the banking system, the draft ordinance relating to the Assets Management Company (AMC) has already been submitted to HMG/N. With respect to the capital of such company, excluding HMG and the NRB, 11 commercial banks have shown interest to

invest. Furthermore, formulation of the laws and by-laws of such company is also underway.

- With the aim of strengthening and expediting the financial sector reform programmes on a priority basis, the draft of Banks and Financial Institutions Ordinance, whose objective is to bring about legal consistency in all deposit-taking banks and financial institutions, was submitted to HMG/N, Ministry of Finance. Likewise, the draft ordinances pertaining to Anti-money Laundering, Secured Transactions and Insolvency were also submitted to HMG/N.
- The Debt Recovery Tribunal was constituted by HMG/N on June 19, 2003 as per the provision made in the Bank and Financial Institutions Debt Recovery Act, 2002. The proportion of NPA of commercial banks is expected to go down after the Tribunal started operating since July 17, 2003.
- Credit Information Regulations, 2003 was issued for strengthening the credit information system from the legal perspective. Moreover to make the Credit Information Centre effective, measures are being taken to develop the Centre as an autonomous institution in line with the Company Act. Similarly, Inspection and Supervision Regulations, 2003 and On-site Supervision Directives, 2003 have already come into operations since mid-March 2003.
- Out of Rs. 1.5 billion allocated for refinancing to sick industries with 55 percent to industry and 45 percent to the hotel business, a total facility of about Rs. 505 million was approved by the NRB to 9 commercial banks for disbursement to 41 industrial firms and hotels. As the industries could not satisfy the conditions laid down by the Sick Industries Revitalization Committee, this refinancing facility could not be utilized as per the target.
- A sum of Rs. 100.0 million from NRB's profit of FY 2001/02 was allocated to the Rural Self-help Fund, particularly to fulfill the long-term capital requirement for specified priority sectors such as tea, cardamom and cold storages, among others.
- As per the ongoing five-year structural programme in RDBs under which a policy was laid down for the privatization of the profitable Rural Development Banks, a decision was undertaken on June 10, 2003 concerning the privatization of WRRDB in which 51 percentage points out of NRB's 61 percent share would be transferred to the private sector. While transferring the NRB's share, priority would be would be given to the group member and employees of the WRRDB.

BANKING INSPECTION AND SUPERVISION

Banking Inspection and Supervision

The NRB is both a regulator and supervisor responsible for safeguarding the soundness of banks and encouraging competition among them. With the objective of making the banking inspection and supervision more efficient and mitigating the inefficiencies of the banking system, the following measures were undertaken by the NRB during FY 2002/03.

On-Site Inspection

The on-site inspection of banks and banks' branches undertaken in FY 2002/03 was as follows:

a) Under the overall on-site inspection, among the joint-ventures and private sector banks, the on-site inspection of Standard Chartered Bank Nepal Limited, Laxmi Bank Limited, Siddhartha Bank Limited, Nepal Investment Bank Limited, Nepal Industrial and Commercial Bank Limited and Everest Bank Limited, was completed and the on-site inspection of Bank of Kathmandu Limited was underway.

b) Under the branch inspection, inspection of 12 branches of NBL and 14 branches of RBB was undertaken.

c) For exhibiting improvements in the different aspects as pointed out in the Inspection Report, the NRB has been monitoring the branches on a regular basis and assigning its staff for on-site supervision as and when required. Accordingly, on-site monitoring inspection of 7 branches each of NBL and RBB was conducted.

d) Special inspection of three branches of Nepal Bangladesh Bank Limited, two branches of Bank of Kathmandu Limited and one branch each of Nepal SBI Bank Limited, NBL, and RBB was undertaken.

As per the practice of discussing with the chiefs of the related banks on different issues, irregularities and remedies as pointed out in the Inspection Report, during FY 2002/03, Chief Executive Officer of Nepal Credit and Commerce Bank Ltd. and the directors of Kumari Bank Limited were called once and twice, respectively, to the Bank and discussions relating to these issues were held.

Off-site Supervision

Excluding the NBL and the RBB, off-site reports of all the commercial banks have been prepared. Based on the remarks of the off-site report, additional actions have been undertaken and directives have been given. The following major actions were initiated and the directives were given to the banks.

(a) *Nepal Industrial and Commercial Bank Ltd*

- (i) To incorporate interest income as per the format of the NRB.
- (ii) To improve on the points as outlined by the auditor.
- (iii) To accord more attention to loan and interest recovery as there was a rise in the non-performing loan.
- (iv) To provide the justification for the decision undertaken by the Board's Credit Committee to renew the loans that had matured 6-7 months ago at the end of the fiscal year only.

(b) *Nabil Bank Limited*

- (i) To make adequate provision in the staff gratuity fund from the coming fiscal year onwards and, as per general accounting practice, such fund to be recorded under the profit and loss account instead of appropriation account (as the Bank used Rs. 20 million from this account).
- (ii) To note the decline in profit of Rs. 11 million due to the change in depreciation policy as per the Income Tax Act 2002 in the financial report.
- (iii) To arrange adequately for the shortfall of Rs. 720,352 in the forthcoming third quarter as per the NRB's directive.
- (iv) As the bank had written-off loans equivalent to Rs. 442.0 million, details relating to the concerned firms' directors, proprietors, measures undertaken for recovering such loans, basis for acceptance of the loan, details of collateral, etc. had to be clearly indicated.

(c) *Standard Chartered Bank Nepal Limited*

- (i) To hold the Board meeting on a regular basis as per the Commercial Bank Act, 1974.
- (ii) To improve on the different aspects as suggested by the auditor as soon as possible.
- (iii) To provide the justification and details under 'Others' of 'Employee Expenses' amounting to Rs. 19 million for FY 2001/02.

(d) *Nepal SBI Bank Limited*

- (i) To arrange for the required capital charge if the credit to one group exceeded the limit and if not corrected by mid-January 2003.
- (ii) To make provisioning of an additional Rs. 9.2 million in the next quarter as a shortfall was noticed in the loan-loss provisioning.
- (iii) Since while computing risk weighted assets, the net loan was found to be calculated by deducting loan loss provisioning from the total gross lending and bills purchased, from now onwards the bank is required to

calculate the net loan by assigning weighted risk to total outstanding loans and bills purchased.

(iv) To reconcile the agency and branch accounts on a regular basis and to show in a separate account the amount that has not been reconciled for six months.

(v) To implement a new depreciation policy as the prevailing depreciation policy of the bank was unscientific.

(e) *Kumari Bank Limited*

(i) To notify the NRB on the policy relating to the investment of the bank on shares and securities of other organized institutions after preparing it in written form, having it passed by the Board and implementing it.

(ii) To submit clarifications as fund-based credit disbursement has exceeded the limit.

(iii) To improve on the major weaknesses as pointed out by the auditor as soon as possible.

(f) *Nepal Investment Bank Limited*

(i) To incorporate the amount that has not been reconciled and provide justifications as to why the figures in the bank's profit and loss account does not tally with the figures of the attached appendices in the annual report.

(ii) To improve on the remarks expressed by the auditor and inform the NRB accordingly.

(g) *Bank of Kathmandu Limited*

(i) To maintain loan loss provisioning in the quarter ending mid-March and reclassify as per directive No. 2 of the NRB's reclassification since while reclassifying the bad loan of Biswas Garment Industries only Rs. 0.97 million was set aside for loan loss provisioning instead of the cent percent loan loss provisioning of Rs. 194.6 million.

(ii) Not to announce or distribute any dividend as the bank did not maintain the loan loss provisioning as per the directive of the NRB.

(iii) To improve on the weaknesses as shown by the auditor and inform the NRB accordingly.

(h) *Himalayan Bank Limited*

(i) To diversify such investment and incorporate it in the investment policy as the bank had invested upto 98 percent into one agency bank.

(ii) To recover the loan from the parties owning more than 1 percent of the bank's share and to regularize it as per NRB's directive No. 6.

(iii) Since all credits are to be written off while accounting non-banking assets, attention has been drawn towards the appropriateness of recognizing interest income.

(iv) To justify the reclassification of bridge gap loan as good loan after extending its repayment period.

(i) *Nepal Credit and Commerce Bank Limited*

(i) To adequately increase the core capital as required by the NRB by the end of FY 2002/03 since there was a shortfall of Rs. 150 million in core capital.

(ii) To prepare a capital plan as mentioned above for adequate core capital and submit it to the NRB.

(iii) To issue one rights share for the prevailing two shares maintaining core capital adequacy and to seek permission from the NRB for distribution of the allotted shares to the public after the payments are made.

(iv) To maintain the maximum deposit collection threshold at Rs. 43 million.

(v) Not to make use of interbank borrowing for any other purpose other than meeting the cash reserve requirement for a maximum period of 7 days.

(vi) To conduct banking operations and bring about efficiency as per the commitment of the Directors and no members of the board to be removed without the permission of the NRB.

Besides the above, as the cash reserve requirement was not met, various commercial banks were fined totaling Rs. 0.44 million during the period between mid-July 2002 to mid-July 2003.

Control over Commercial Banks

Under the provision made in sub-clause (1) of clause 86 of the NRB Act, 2002, the NRB has taken control over the management of the NBL since March 14, 2002 and the bank is operating through the management committee formed under sub-clause (2) of the same clause. As the financial condition of the NBL has improved, the control over the bank has been extended for the next two years under the same committee. Similarly, under the provision made in sub-clause (1) of clause 86 of the NRB Act, 2002, the NRB has taken the management of the Lumbini Bank Limited under its control since March 20, 2002. The bank is functioning under the management committee formed under sub-clause (2) of the same clause. The financial condition of this bank has improved since then. The control over the bank has been extended for a maximum period of one year so that the sale and distribution of shares allotted to the public could take place in order for the Board of Directors, including the representatives from the ordinary shareholders, to function.

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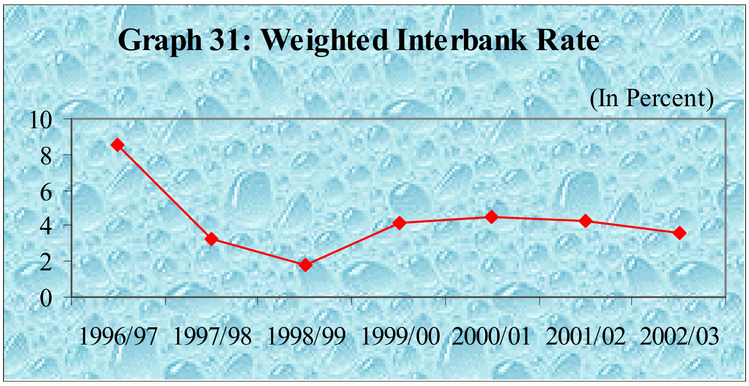
FINANCIAL MARKETS

Financial Markets

The financial market conditions remained steady during FY 2002/03. Although there were some fluctuations in the liquidity position, the foreign exchange position remained comfortable during the review year.

Interbank Transactions

Throughout the review year, the commercial banks had an excess liquidity. The excess liquidity amounted to Rs. 6.5 billion at the end of the review year compared to Rs. 7.4 billion a year earlier. Some commercial banks facing liquidity crunch resorted to interbank borrowing. With the expansion of banking sector, the interbank transaction has been fluctuating over the years. The interbank transaction was Rs. 5.2 billion in mid-July 2003 compared to Rs. 945 million mid-July 2002. In line with the fluctuations in the liquidity position, there were also fluctuations in the interbank transaction rate, the lowest being 2.5 percent in mid-September 2002 and the highest being 4.5 percent in mid-July 2003. The weighted average annual interbank transaction declined by 0.6 percentage point to 3.6 percent at the end of the review year compared to 4.2 in the previous year.

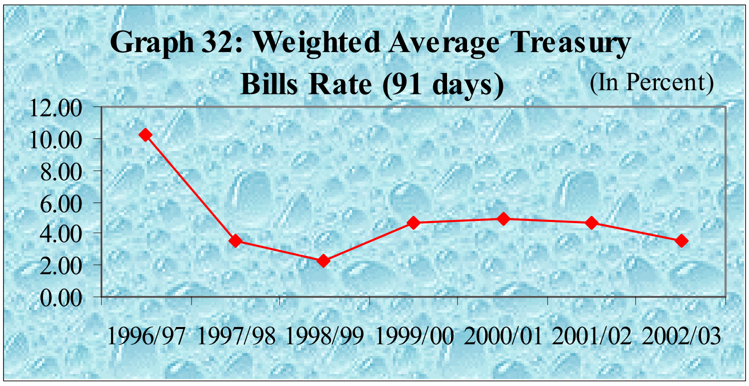


Foreign Exchange Intervention

During FY 2002/03, the NRB intervened 26 times in the foreign exchange market, purchasing foreign currency 24 times amounting to Rs. 24.9 billion and selling foreign currency 2 times amounting to Rs. 610.7 million. Consequently, during the review year liquidity amounting to Rs. 24.3 billion was injected into the market.

Government Securities Transactions

Among the different government securities instruments, the weighted annual average rate of 91-day treasury bill was 3.48 percent in FY 2002/03 compared to 4.71 percent a year earlier. During the review year, the treasury bill rate reached its maximum of 4.10 percent in mid-January and minimum of 1.67 percent in mid-June. Likewise, the weighted annual average rate of 364-day treasury bill fell to 4.71 percent in FY 2002/03 from 5.2 percent in FY 2001/02.



During the review year, the government mobilized Rs. 1.8 billion and Rs. 6.4 billion by issuing treasury bills and development bonds, respectively. Similarly, national savings certificates amounting to Rs. 400.0 million and citizen saving certificates amounting to Rs. 303.0 million were also mobilized.

Liquidity amounting to Rs. 12.3 billion was mopped up during FY 2002/03 in comparison to Rs. 26.5 billion in the previous year from secondary market trading of government securities. The repo transaction amounted to Rs. 46.0 billion in cumulative terms in the review year in comparison to Rs. 58.1 billion a year earlier.

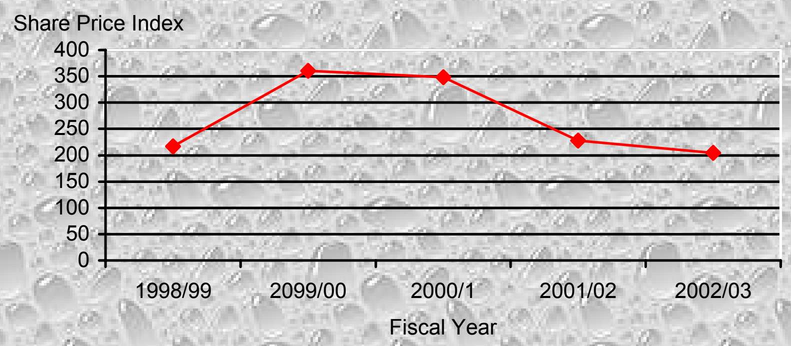
Stock Market

The number of companies listed in the Nepal Stock Exchange Ltd. increased from 96 to 108 in FY 2002/03 because of the listing of 12 new companies. The NEPSE Index slipped down from 227.5 of mid-July 2002 to 204.9 in mid-July 2003. Market capitalization as well as turnover fell significantly in the review year.

The paid up value of the listed shares increased substantially by 37.1 percent (Rs. 3.2 billion) to Rs. 11.9 billion in FY 2002/03 compared to an increase of 9.3 percent (Rs. 741.2 million) in the preceding year.

The average monthly turnover declined by 62.6 percent (Rs. 80.0 million) to Rs. 48.0 million in FY 2002/03 against a decrease of 34.3 percent (Rs. 67.0 million) in the previous year. An average daily share turnover of Rs. 2.4 million was observed in the review year compared to an average daily turnover of Rs. 6.3 million in the previous year. Meanwhile, the volume of shares traded in the stock market went down substantially by 62.6 percent (Rs. 965.0 million) to Rs. 576.0 billion in the review year. The share prices showed a downward tendency in the review year resulting in the fall of the share price index from 277.5 of mid-July 2002 to 204.9 in mid-July 2003. The market turnover in the review year fell significantly due to uncertainty prevailed in business environment attributable to deteriorating law and order situation in the country.

Graph 33: NEPSE Index at mid-July
(1998/99-2002/03)



The market capitalization of listed shares, which stood at Rs. 34.7 billion at mid-July 2002 increased marginally by 1.5 percent (Rs. 536.4 million) to Rs. 35.2 billion at mid-July 2003. The market capitalization to GDP, total turnover to paid up value of listed shares and total turnover to market capitalization ratios remained at 7.8 percent, 4.8 percent and 1.7 percent respectively in the review year, whereas these ratios were 8.2 percent, 17.9 percent and 4.5 percent respectively last year. The ratio of total turnover to paid up value of listed share decreased substantial due mainly to an increase in paid up capital of the listed companies, particularly commercial banks, development banks and finance companies as the regulatory effect of NRB while turnover decreased in the review year due to market slowdown.

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MICROFINANCE INSTITUTIONS
AND
REFINANCE

Microfinance Institutions and Refinance

Microfinance is the provision of a wide range of financial services such as deposits, loans, payment services, money transfers and insurance to the poor and low-income households and, their microenterprises. It can be a crucial component of an effective poverty reduction strategy. Improved access and efficient provision of savings, credit and insurance facilities especially can help to smoothen their consumption, manage their risks appropriately, built their assets gradually, develop their microenterprises, enhance their income earning capacity, and enjoy an improved quality of life. In Nepal, during the past few years, many micro-credit programmes and projects aimed at alleviating poverty and creating gainful employment opportunities have been developed and implemented. The progress of some of these programmes during FY 2002/03 is reviewed below.

Production Credit for Rural Women (PCRW)

This project was undertaken in FY 1981/82 with the goal of uplifting the socio-economic conditions of rural women by providing them institutional loans so as to undertake income and employment-generating activities. As of mid-July 1998, 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 the implementation period of this project is over, the loan recovery process of the participating banks is going on and the NRB has repaid the principal and the interest amounting to Rs. 57.7 million and Rs. 31.5 million, respectively, to HMG/N as of mid-July 2003. As of mid-July 2003, the disbursed loan amounting to Rs. 171.2 million loan was yet to be recovered from the participating banks.

Micro-Credit Project For Women (MCPW)

This project came into operations with the signing of the loan agreement between HMG/N and the ADB 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. The implementation period of this project expired in 2002. The NRB had paid interest and principal amounting to Rs. 23.1 million to HMG/N as of mid-July 2003. As per the programme, the participating banks, the RBB and the NBL, repaid the outstanding loan that was yet to be recovered.

The Third Livestock Development Project (TLDP)

Under the loan agreement between HMG/N and the ADB on December 23, 1996, the primary objective of this project was to raise livestock productivity and consequently uplift the living standard of the people involved in this business.

There were 19 participating financial institutions that signed an agreement with the NRB including 2 commercial banks, 3 development banks, 4 rural banks replicates, 8 cooperative enterprises and 2 non-government enterprises with the NRB. Under this project, as of mid-July 2003, the NRB had already refunded Rs. 150.9 million to 17 financial institutions. Although the tenure of the project was only upto July 2003, it has been extended for one year upto July 31, 2004.

Western Terai Poverty Alleviation Project (WTPAP)

Under the loan agreement between HMG/N and IFAD on December 12, 1997, this project has been operating since FY 1998/99 by providing microfinance to the deprived community through a total number of 16 branches of WRRDB, MWRRDB, FWRRDB, Nirdhan Utthan Bank and Rural Self-help Fund. The project contributed to economic and social uplfiftment of this community and also made the participating branches self-sustained. Under the auxiliary loan agreement between HMG/N and the NRB, there is a provision whereby the NRB will receive an equivalent amount of US$ 3.4 million from HMG/N at 3 percent rate of interest and distribute this amount to the rural development banks and other replicates at 4 percent rate of interest. As per the project agreement signed between HMG/N and the NRB on November 30, 1998, as of mid-July 2003, with incremental loan investment of Rs. 131.4 million on the participating banks, Rs. 27.9 million has been repaid with the balance being Rs. 103.4 million. So far, credit has been provided to about 20,000 of these families against the target of 28,833 deprived families.

The Community Groundwater Irrigation Sector Project (CGWISP)

Priority has been accorded by the 20-year long-term Agricultural Perspective Plan on increasing agricultural productivity to raise the income of small and marginal farmers. Against this background under the loan agreement of November 17, 1998 between HMG/N and the ADB, this project was conducted in 12 Terai districts of Eastern and Central Region of the kingdom. Of the credit provided to the farmers for installation of shallow tubewells and crop production, about 657,000 individuals (of which 50 percent below the poverty line) from 110,000 marginal families were estimated to have benefited from the project. As of mid-July 2003, while ERRDB, MWRRDB, Sahara Nepal Savings and Loan Cooperative Ltd., Jhapa, and Diprox Development Bank have worked as participating financial institutions, Arunodaya Savings and Loan Cooperative Institution, Mahuwan, Prason and Agriculture Upkar Savings and Loan Cooperative Institution, Madi, Parsa have been selected as participating financial institutions for Parsa and Chitwan district, respectively. Furthermore, a policy of selecting new institutions on a bi-annual basis has also been framed. Under this project, as of mid-July 2003, Rs. 23 million has been invested in 954 shallow tubewells comprising 950 on a groupwise basis and 4 on an individual basis through the participating institutions. Irrigation facility has been provided to about 4,500 hectares of land that has directly benefited 4,357 marginal farmers.

Rural Self-Reliance Trust

The Rural Self-Reliance Trust started its operations after receiving a total capital of Rs. 20 million during FY 1990/91 and FY 1991/92. As of mid-July 2003, it disbursed loans equivalent to Rs. 60.4 million through 49 non-government organizations in 26 districts and 141 cooperatives in 37 districts. Out of the above loan, the Trust had recovered the loan amounting to Rs. 44.0 million and the loan outstanding was Rs. 16.4 million. The credit recovery rate was 91.4 percent. As at mid-July 2003, 8,046 households from 44 districts benefited directly.

Rural Development Banks

With the primary goal of uplifting the living standards of poor women of the rural areas, as of mid-July 2003, the RDBs operating in the five development regions disbursed the loan amounting to Rs. 7.7 billion to 169,572 rural women members and recovered Rs. 6.6 billion. These banks provided micro-credit programs to 966 village development committees of 43 districts through 4,799 centres. With the initiation of structural reform programme, the WRRDB has made some profits. After the make up of total accumulated loss by NRB and HMG/N, gradual improvement has been noticed in the financial position of all the rural development banks excepting the FWRRDB. Various measures have already been undertaken for productivity improvement and cost reduction to make these banks self-reliant. With the objective of gradually privatizing the profitable rural development banks, the measures have been initiated at the WRRDB and the process of transferring NRB's 51 percentage points out of its 61 percent share from this bank has already begun. The selection process of recruiting qualified and experienced individuals for the post of executive director through open competition is at its final stage. Similarly, some works have been initiated in order to bring consistency in the Employees Rules and Regulations of all the five rural development banks.

Revolving Line of Credit Facility to Rural Development Banks

Under the refinance/revolving line of credit facility provided by the NRB to banks and financial institutions, the NRB has made available, without increasing the limit set down under the facility under which the banks could withdraw or deposit at one time or at different times, Rs. 20 million to WRRDB, Rs. 10 million each to MWRRDB and FWRRDB and Rs. 50 million to WRRDB. As of mid-July 2003, Rs. 20 million, Rs. 5 million and Rs. 15 million was yet to be recovered from ERRDB, MWRRDB and FWRRDB, respectively.

Refinance to ADB/N and NIDC

With a view to supporting commercial farming, refinance facility was provided to ADB/N from FY 1996/97 to FY 2002/03 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.

In order to support the uncontrollable financial position of NIDC, the NRB rescheduled the repayment period of the refinance provided to NIDC and extended it to FY 2009/10. As of mid-July 2003, the NRB had yet to recover refinance amounting to Rs. 773.3 million. Besides this, out of total of NRB's investment in NIDC debenture, Rs.50 million was yet to be recovered as of mid-July 2003. Further, investment in the shares of NIDC by the NRB amounted to Rs. 47.4 million as of mid-July 2003.

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