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May 27, 2010

Statement by Mr. von Stenglin and Ms. Holler on Nepal
(Preliminary)
Executive Board Meeting 10/54
May 28, 2010

We thank staff for their well-written papers and Mr. Chua and Mr. Thapa for their helpful Buff statement. The impact of the global economic crisis led to slower growth in remittances, lower exports, slower economic growth and outflow of capital as a sign of less confidence in the economic situation of Nepal. As imports increased strongly over the last years, the month of imports covered by the reserves declined to five month, although the level of reserves is still higher than in the recent past. Nepal is facing economic challenges, especially in the financial sector. Against this backdrop, in our view an ECF would be better suited to support confidence and policies to tackle structural weaknesses. However, as implementation of such a program faces some difficulties in time of political transition, **we can support the proposed arrangement.** *With a view to capital flight, could staff comment on the application of Article VI?*

The situation in the financial sector with high risk taking, high credit concentration and vulnerabilities of capital and liquidity is worrisome. Experiences from the recent past underline that an expansion and a deepening of the financial system should always be accompanied by a strong and credible regulatory and supervisory framework. We welcome the authorities' commitment to address these issues, e.g. with the Banks and Financial Institutions Act (BAFIA). Technical assistance for contingency planning can further contribute to strengthening the financial sector.

We commend the authorities for their fiscal discipline in the past and welcome their further commitment as affirmed by Mr. Chua and Mr. Thapa. Reforms on the revenue side like curbing tax evasion and broadening the tax base and a sustainable spending structure between current and capital spending are essential parts in this. *Could staff give some information on the particularly large increase in current and capital spending in 2009/10?*

Maintaining macroeconomic stability and boosting confidence is crucial in the current situation. The exchange rate peg to anchor inflation combined with prudent liquidity management, fiscal discipline as well as financial sector and structural reforms should be the way forward to achieve this goal and prevent large capital outflows. We agree with staff that import and exchange rate restrictions are not appropriate policy tools and should be reconsidered. *Could staff comment on further exchange rate restrictions apart from quantitative limits mentioned in Supplement 3 of the report?*