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May 27, 2010

**Statement by Mr. Bakker and Mr. Tomic on Nepal
(Preliminary)
Executive Board Meeting 10/54
May 28, 2010**

1. We commend the authorities for fiscal prudence exercised in the previous years in a sensitive political environment and support the proposed decision on loan disbursement under the Rapid Credit Facility. At the same time, we do not approve the retention of the exchange rate restrictions and urge the authorities to reconsider this policy measure. We expect the authorities to consent to the publication of the staff reports.
2. Despite adequate policy measures taken to offset the crisis impact, Nepal's economy needs deep structural reforms and we welcome indications that Extended Credit Facility negotiations will take place later in the year. While reserve coverage appears to be at relatively satisfactory level, the concern on currency overvaluation, lagging competitiveness and productivity, necessitate the removal of impediments to growth, if both domestic and external stability is to be secured.
3. Should the pre-conditions for structural reforms not materialize, we agree with the staff that modifications to the currency peg to the Indian *rupee* or different arrangements should be considered. Palliative restrictions to curb import might be distortive: they usually fail to deliver the expected external stability and therefore should be avoided.
4. Although financial soundness indicators appear adequate, there is plenty of room for improvements in the financial sector, particularly with regard to strengthening financial supervision. Recent measures, such as stricter licensing policy, introduction of more conservative lending practices, aimed at containing credit and liquidity risks, are encouraging; however, a full-scale implementation has still not materialized. We urge the authorities to apply staff's recommendations on safeguarding financial stability without hesitation.
5. The substantial increase in the revenue-to-GDP ratio, achieved through the continued progress in tax administration in recent years is commendable. Given the need to

preserve fiscal prudence, and in light of the projected decline in imports, we wonder what measures on the revenue side, besides efforts to curb tax evasion and broaden the tax base, may be taken to offset the revenue loss with immediate results. *Staff comments are invited.*