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GRAY/10/1934

May 27, 2010

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

We thank staff for an excellent set of papers and Messrs. Chua and Thapa for their helpful Buff statement.

Nepal has so far managed to maintain a fair degree of macroeconomic stability, a commendable achievement given the long-lasting civil conflict and the difficult political transition. On the positive side we also note that despite modest growth, important social indicators have improved. Given the political turmoil it is understandable that much needed structural reforms have been difficult to implement and progress under the PRSP slow. The global crisis has, however, clearly exposed the structural weaknesses of in the Nepali economy. Tackling these will be key to improve economic diversification and growth, reduce poverty, and reduce vulnerability to shocks. Broad political cooperation will be needed.

We can support the request for a disbursement under the RCF but see an urgent need for a swift transition to an ECF clearly focused on long overdue structural reforms. We take note of Messrs. Chua and Thapa's statement that the authorities consider the RCF as a bridge to an ECF. In our view, a reform oriented ECF would also better play a catalytic role in mobilizing donor support.

As we broadly support staff's assessment, we will limit ourselves to a few comments for emphasis.

The situation in the financial sector is worrisome and the authorities need to act urgently and resolutely to protect financial stability. The recently issued prudential measures by the NRB are welcome but a history of regulatory forbearance and deferral of implementation dates raise concerns about enforcement. Staff has correctly identified additional measures to be taken and we urge the authorities to implement them expeditiously.

While fiscal discipline has been maintained, the composition of spending has become increasingly tilted towards current expenditure. Given Nepal's needs for improvements in infrastructure and investment this trend must be halted and ideally reversed, with stricter prioritization of current spending and enhancing the implementation capacity with respect to

capital spending. We support the provision of Fund TA to achieve this.

We agree that the peg has served Nepal well and that maintaining it seems appropriate as a short-term aim. However, this requires a monetary policy and liquidity management that support the peg. Exchange restrictions would not be a first best solution to reserve pressures, and we ask the authorities to reconsider the measures taken in this area and comply with the obligations under Art.VIII.

Finally, we urge the authorities to consent to the publication of the reports.