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May 27, 2010

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

We thank the staff for a concise and insightful report, which conveys economic developments and policy challenges in a useful manner. The policy recommendations and program parameters outlined in the report and in Messrs. Chua and Thapa's insightful buff statement are sound and pragmatic. We support the authorities request for a disbursement under the Rapid Credit Facility (RCF) in the amount of SDR28.52 million.

**On fiscal policy**, past fiscal discipline bodes well for the authorities' commitment to succeed under this program. We commend the authorities for having maintained a stable macroeconomic environment for many years, all the more impressive when evaluated against the fragile political situation. Nevertheless, despite Nepal being situated between two strong economies (India and China) as pointed out by Messrs. Prader and Abel, and in positive political transition, the crisis has led to slower remittances and lower exports, reducing growth and fiscal revenues and leading to higher levels of capital outflow. Fiscal reforms to bolster tax revenues will be important to bring the authorities back into balance.

**On monetary policy and exchange rate matters**, while we agree with the staff that Nepal's peg to the Indian rupee is an appropriate monetary arrangement, supporting a high and increasing level of economic integration between the two economies as well as serving as a reasonably effective nominal anchor, we would encourage the authorities to consider reviewing the level of the peg in light of it being overvalued in real terms. While we understand it may not be appropriate at this time to revise in view of the transitory political situation, as a means of enhancing competitiveness for growth purposes one should, as a principle, not be deterred from revisiting this level. We agree with staff that import and exchange rate restrictions are not appropriate tools.

**On the financial sector**, we share the concerns expressed by Mr. Von Stenglin and Ms. Holler about high risk taking, high credit concentration and vulnerabilities of capital and liquidity. In addition to the prudential measures taken to stabilize the financial sector, we would encourage the authorities to continue to seek technical assistance, as needed, from the IMF, WB and others, to ensure appropriate medium and longer term prudential and legal

measures are being put in place (in addition to addressing the short-term measures). Contingency planning for the financial sector is an important area to bolster expertise in.

With this, we wish the authorities every success.