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May 27, 2010

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

1. The Nepalese economy is facing profound challenges due to the external shock related to the global crisis and a difficult and uncertain political transition. Weak remittances inflows, a deteriorating trade balance, heightened financial sector vulnerabilities, and the unsettled political environment pose considerable risks to the near-term growth outlook.
2. We are disappointed that progress on important structural reforms, in particular in the financial and public sectors, has been slow and urge the authorities to push ahead with this agenda. Like Mr. von Stenglin and Ms. Holler, we are also of the view that, in principle, an ECF would be better suited to tackle persistent structural weaknesses. We acknowledge that the implementation of such a program in the current circumstances would be very difficult. In light of Nepal's immediate balance of payments needs, we can support the authorities' request for a disbursement under the RCF's shocks window if adequate safeguards are in place to ensure the capacity to repay the Fund. We agree with staff that this RCF could serve as a bridge to an ECF.
3. The Bank of Nepal is to be commended for its macro-prudential measures to contain credit and liquidity risks in the banking sector. Notwithstanding the NRB's recent directives, we are concerned about the increased risks to financial stability as highlighted in the stress tests. We therefore fully agree with staff that the authorities need to act promptly and decisively to safeguard financial stability. We note that staff and authorities have diverging views on the bank licensing policy. *Could staff elaborate on this divergence of views?*
4. We welcome the authorities' prudent fiscal policy stance and the significant efforts made over the last years in mobilizing revenues and reducing external debt. We note that the risk of debt distress is moderate, with public debt remaining below the average for LICs, and we are reassured about Nepal's debt servicing capacity. Although the decline of international reserves in the near-term is worrisome, gross official reserves will tend to grow again in 2011 according to the staff's estimates.

5. We call on the authorities to eliminate the exchange restriction subject to Article VIII. We also note that the NRB imposes restrictions on the quantity of gold that can be imported into Nepal. *Do these restrictions also imply a breach of obligations under Article VIII in staff's view?*