

CHAPTER – ONE

INTRODUCTION

1.1 General Background

Nepal is a small developing landlocked country with a very unique geographical setting. It is surrounded by India from East, west and south and by the people's republic of China in the North side. It occupies an area of 1, 47,181 square kilometres and runs along 885 Km from the east to the west and 193Km along North to South in average. The most important productive assets of the country include the land with the wide climate and altitudinal variations, the perennial rivers, forests and the Himalayas. The total population according to the census data published in 2011 is 2, 54, 94,504. The population of Nepal is increasing annually at a rate of 1.35 percent according to the census which heavily depends on agriculture. This sector provides employment to about 80 percent of the country. The subsistence agriculture is implying low productivity.

Nepal is trying its best to develop the economy. Economic development is the prime objective of the developing countries like Nepal. Economic development is a multidimensional and complex process. To accelerate economic growth, it is necessary to gear up real economic growth; indeed it is impossible to alleviate Poverty without sustainable economic growth.

The banking history in Nepal is not old. The modern banking system in Nepal began only after the establishment of Nepal Bank Limited (NBL) in 1937 AD. Prior to the establishment of NBL there was no organized financial institution in Nepal. At that time barter system was prevalent. Generally acceptable goods were brought in use as a medium of exchange. Difficulties of barter systems gave birth to money and the former system was eliminated with the development of money. The population was heavily dependent upon agriculture and in the absence of any organized institution providing credit to support agriculture and other necessities, people had to rely on borrowing from the dishonest moneylenders who even used to practice the capitalization of interest upon failure to repay on time. The activities of these money lenders and local banker were localized and operated in a small area and could not

develop in modern lines. The concept of saving in cash was virtually non-existent. Hence in the absence of any financial institution, people used to keep their saving in the form of land and precious metals, such as gold and silver.

After the establishment of NBL, it began to play a limited role in creation of the banking habits among the people helping the trade, industry and even to government. This bank also performed some of the Central Banking functions except for issuing of paper currency and Coins. NBL remained the Sole organization in the banking activities for 19 years up to 1956 AD.

However, there was no organized institution to look after the financial needs of other sectors of the economy especially agriculture and banking need of the country before establishment of NRB. Later, a number of Banking and Financial Institutions were established. NRB was established by NRB act 1955 as a non-profit making organization fully subscribed by the government. The establishment of this bank had coincided with Nepal's first 5 – year plan, which aimed at the country's socio-economic development. As the country's Central Bank, this bank has the right to issue Currency Notes and Coins and is responsible for managing the country's foreign exchange reserves. The bank's other important functions include development of banking system and advices to the government on financial and economic matters, mobilizing capital and managing public debt.

Economic growth and development have been considered as primal objective of economic planning in Nepal since the beginning of the first 5 year plan in 1956. Objective of the plan was to increase production, employment and to improve the living standard of the people. To fulfil these objectives of planning it was necessary that banking activities especially the loan was to be regulated as per priority.

There were different efforts for the economic development of Nepal. The organized effort for economic development in Nepal, began from 1956 when two major steps were taken simultaneously in both planning and monetary fields. While NRB was created for efficient monetary management; the organized effort for economic development was made through the adoption of first five year plan. NRB specially centralized its role for the development of Banking, Financial institutions and Nepalese Economy. For this purpose a Banking Development Committee was

formulated to advice for establishing its branches in the nation, NRB itself started a Broad feasibility study for expansion of branches and created a Banking Development Fund of RS 25 lakhs in 1965/66. NRB as the bank of banks and the government bank has been granted the full authority to develop and monitor the banking system in the country. Commercial banks and financial institutions have to strictly follow the rules and the regulations issued by NRB.

The central Bank has authority to formulate and implement the Nepalese monetary policy. NRB began exercising monetary policy since mid-1960s with instruments like credit control regulations, interest rate administration, margin rates, refinance rate and cash reserve ratio. Effective exercise of cash reserve requirement and bank rate as active monetary policy tools evolved even later since late 1990s. The basic objectives of monetary and credit policies hard to attain all of them, many of them conflicting to each other.

NRB Act 2002 has stipulated a wide range of policy objectives for the bank. The monetary policy objectives range from maintaining the stability in price and balance of payments for sustainable development of the economy, promoting stability and liquidity required in banking and financial sector, developing a secure, healthy and efficient domestic payment system to promoting entire banking and financial system. Of these objectives, monetary policy has been actively used to ensure the financial sector stability in recent years.

After the initiation of Democracy in 1989, NRB adopted a more liberal attitude in opening of Banks and Financial Institutions. It also followed market oriented liberal economic policy for competitive banking system to attract private sector as well as foreign investors with their capital and technology in banking business. In the present situation, number of Bank and Financial Institutions are increased. The condition of number of Banks and financial institutions As of 2013 is –Commercial Banks 31, Development banks 88, Finance companies 70, Institutions licensed by NRB for limited banking transaction 16, NGO licensed from NRB 36, Insurance companies 25, Employee saving fund 1, Citizen Investment Fund 1 and Postal Saving Bank 1.

1.2 Statement of the Problem

Nepal is a developing country with per capita income of about US \$1347.62(Qatar highest \$105091.42) in the record of 2013 according to the GLOBAL FINANCE MAGAZINE. There is no concentrated effort on monetizing the economy. There are still such places in the nook and corner of the country where business is run in barter system.

Being a developing country, Nepal is facing scarcity of capital resources needed for economic development. Each country wants to increase production, employment, living standard of its people and capital resources. But developing countries are far from such increment due to lack of capital. To fulfil these objectives, country has depended upon the bank. NRB is an apex bank from which the loan is regulated to Government, Banks and Financial institutions. And from these Banks and Financial Institutions Nepalese people were getting loans and other facilities.

In Nepal, banks have not succeeded much in mobilizing capital for production uses due to different reasons. In a developing country, a large percentage of population is illiterate and they do not have banking habit and do not know the importance of banking system. So the main problem is lack of banking development itself. Because of these reasons people do not deposit their saving in the bank. The bank deposit per person in Nepal is much lesser as comparison to other countries. Consequently, most of the people prefer to take loans from the moneylender or private persons rather than from the bank in rural as well as urban areas, paying high interest rate than that fixed by the Banks and Financial Institutions.

The liberal economic policy of NRB cannot force the Commercial Banks and Financial Institutions to open new branches in rural areas. Unless Commercial Banks branch expansion trend is made uniform, scattered local resources cannot be mobilized for the development of the country. In this regard NRB is expected to take a lead through various measures for banking and financial development in the country.

1.3 Objectives of the Study

NRB has various activities and objectives. It was established in 1956 with the main objectives of overall economic development of Nepal. The main objective of this thesis is to study the role of NRB in Nepalese economy. To achieve the above mentioned objective, the study has following sub-objectives.

-) To review the Nepalese Banking, Financial and Currency system.
-) To describe the role of NRB in the economic development of Nepal.

1.4 Significance of the Study

Central Bank is an important instrument for acceleration the process of development in developing countries. In Nepal NRB has been granted full authority for economic development. It is known that Nepal is a country of villages where about 90 percentages of total populations are inhabited. National development is not possible without developing the village. There are large number of Banks and Financial Institutions in rural sector; they are giving banking services to each and every people as a NRB service. Thus, there is need to review the role of NRB on the subject of banking and financial development for the economic development of Nepal.

1.5 Limitation of the Study

Every research work has some limitation of its own. Similarly this proposed study also has some limitations, which are mentioned as follows:

-) Data and information are collected from the published documents and hence no validity and reliability is assured.
-) Only role of NRB on economic development of Nepal with respect to Banking, financial and currency system are reviewed.

CHAPTER – TWO

REVIEW OF LITERATURE

2.1 Theoretical Review

The development history of central Banking is a recent Phenomenon. Central banking had been established between 19th and 20th centuries. Certain Institutions had performed the central banking activities before 19th century. Initially, the central banks were privately owned and privately managed joint stock banks. But now they have been nationalized. They are owned by the state. The major countries which established the central banks in 19th century are France (1800), Netherland (1814), Russia (1860), Germany (1875), Japan (1882), and Bank of England with the passing of the bank of charter Act, 1882. The Federal Reserve System in the USA was established in 1913. Nepal Rastra Bank was established in 1956 by the NRB Act, 1955.

Dhungel (2002) stated that Nepal Rastra bank (NRB), the central bank of Nepal, was established in 1956 under the Nepal Rastra Bank Act, 1955, to discharge The central Banking responsibilities including guiding the development of the embryonic domestic financial sector since inception. There has been a significant growth in both the number and activities of the domestic financial institutions afterwards. To reflect this dynamic environment, the functions and objectives of the bank have been recast by the new NRB Act of 2002.

Dekock, cited in Ahuja (2008) says that the Guiding principle of a central bank is that it should act only in the public interest and for welfare of the country and without regard to profit as primary consideration. The central bank is thus not a profit hunting institution. It does not act as rival of other banks. In fact, it is monetary authority of the country and has to function in a manner so as to promote economic stability and development. The functions of NRB have increased enormously in recent years. Not only does the NRB regulate credit and money supply in the country but it promotes economic development and price stability. Guiding principles of the Nepal Rastra Bank are to operate its most instruments in a way that serves the objectives of economic policy laid down by the Government and Planning Commission.

Ahuja (2011) explains the functions of the central bank as -It acts as a note Issuing agency, banker to the state, the banker's bank, controls credit, it acts the lender of the last resort, and manages the exchange rate.

Mathema, (2006) writes that Development, for that matter, economic development, is a gradual and continuous process. The process is harmonious and cumulative. There is every possibility for continued economic progress in the world since mankind has the ability to overcome the limitation on growth imposed by material environment, capital technology, and skilled labour. By pursuing appropriate economic and social policy, these developing countries can outweigh the problems (Low levels of living, inequality of income, poor health, poor education, low levels of productivity, high rates of population growth and dependency burdens, unemployment and underemployment, etc.) confronting them.

Poudyal (2011)) states the functions of the Central Bank as-

- 1) **Traditional functions:** Note issue, Banker's Bank, Banker, Agent and Advisor to the Government, Lender of last resort, Clearing House, Custodian of Foreign Exchange Reserve, Credit Control
- 2) **Developmental functions:** Central Bank has a great responsibility over development of underdeveloped countries like ours, which are as follows: Economic growth of the country by adequate amount of money supply, Economic stability, Development of financial institutions for the development of leading sectors of the economy such as agriculture sector, industrial sector, foreign sector, manufacturing sector, etc., provides the data of macroeconomic variable such as inflation, balance of payment account, financial statistics, etc. which are very essential for policy makers and planners. Central bank also organizes research programs related to the economic development of the country, training facilities.
- 3) **Other promotional functions:** Maintains sound relationship with international monetary institutions like World Bank, IMF, and ADB etc. It can also provide guidelines to the government for formulating the development programs.

The basic issues of Central bank as by him are- Independence of central Bank (Legal Independence, Goal Independence, Operational Independence and Management Independence), Transparency of Central bank, Accountability of Central Bank, Credibility of Central Bank and Monetary policy formulated by the central bank on the regular basis.

Objectives of the central bank are – Neutrality of money, Price stability, Economic growth, Exchange rate stability and Full employment.

2.2 Empirical Review

Shrestha, (2012) has clearly viewed that all the CBs branches and financial institutions are established only in urban areas from where the huge population living in rural areas cannot get any banking facilities on one side and on the higher numbers of institutions established in urban areas are facing caught throat competition which may lead to the question of their existence. He has viewed that CBs should establish branches as per need of the nation. He has emphasized that appropriate policy to establish branches in the rural areas should be followed. CBs and the financial institutions carrying similar functions should not be allowed to establish in close vicinity. To encourage the banks to establish branches in rural areas, NRB should extend certain incentives to them.

Buda, (2013) opines that Banks play a role in Nepal's monetary transmission mechanism. Empirical result shows that the bank lending decreases by monetary tightening. Bank size is found to have significant Impact on loan supply in Nepal. Similarly liquidity in the case of private sector banks is also playing significant role in bank lending in response to monetary policy changes. But, capitalization is found to have no significant impact on bank lending. The bank loan supply is also found to be significantly affected by gross domestic product.

Shrestha, (1979), has observed that the establishments of commercial banks branches are guided by the profit. They were not interested to open their branches in remote areas where there are not adequate volume of business. However, Nepal is a least developed country of the world where about 50 percent of the population lives below absolute poverty line and economy basically depends upon agriculture. The scattered

meagre saving the rural people should be collected through the creation of banks branches. For this, NRB should encourage the commercial banks to pen their branches in remote areas by adopting more liberal policy and loss arisen in the operation should be subsidized by NRB.

Sapkota, (1981) puts her view that in order to provide adequate banking to the people in non-banked remote areas, ADB/N should also act as a CB. Similarly, in the place where there no branches of ADB/N and where as a CB's branches exist the later should be act as an agent of farmer to collect the deposit and mobilize it in needy. This consideration is irrelevant as NRB has already directed CBs to invest to certain percentage of their deposits in priority sector and ADB has been allowed to directly enter the general banking business (with certain restrictions) in selected urban areas to channelize funds to the agriculture sector from the beginning of 1984 AD.

Shrestha, (1975) has observed that CBs are still following their traditional lending policies. They extended the loans on the basis of securities. But the people in our country are unable to provide sufficient securities. Therefore, the NRB should change the traditional lending policies.

Kalathoki, (2000), in his dissertation has concluded that NRB's role in banking development in the country has not been effective His major suggestions are:

- a) NRB should increase the facilities for the CBs. After providing more facilities if they hesitate to open the branch in rural areas, some other action should be initiated. In the remote area where the branches of ADB/N are step-up, they should also act as a CB that will help to collect more deposit, and credit extension.
- b) To increase more bank deposit; Deposit Insurance Scheme, Workers' Saving Scheme will be beneficial. The insurance Scheme will prove safe for depositor. Again for unbanked areas the management of weekly or monthly moving bank will also be helpful for deposit collection & increasing the banking habit of the people in rural areas.
- c) NRB should persuade the banks to maintain the spread gap of 5% & it should also reintroduce the loss compensation scheme and interest free loan to the newly established CBs especially in remote area at least for certain year. It

should be also to manage various training program as per the requirement of the CBs to make their staff able to satisfy their customer and increase their efficiency.

He suggested further, there should be regular meeting & communication with the banks to sort out the problems and make programs successful. He suggested for deposit collection but now, the main problem is, there is not good investment opportunity in the market.

Adhikari, (2014) states that during the 90's the trend of commercial banks' branches expansion seems low than past due to the liberal policy followed by government and also NRB. Thus it is necessary to change the present policy of NRB for rapid branch expansion of commercial banks.

Bajracharya, (1989) has observed that NRB should encourage the commercial banks to extend long term credit in addition to short and medium term credit so that the amount of credit will increase on one hand and large industries will be established on the other. If the commercial banks find their resources insufficient for investment, more deposit should be collected by raising interest rate on deposits.

Shrestha, (1975) has observed that the commercial banks are still following their traditional lending policies. They extended the loans on the basis of securities. But the people in our country are very poor and are unable to provide sufficient securities. Therefore NRB should change the traditional lending policies. At present, commercial banks are offering a variety of credit model or scheme to the rural poor people. Viz. small farmer Development Program, Intensive Banking Program, banking with Poor, Grameen Bank, Financial System, deprived Sector Credit etc. through group securities. This proves NRB has already made an effort to avail credit to the people without precious securities. In this context the problem of getting loan due to lack of securities seems the secondary problem. While the lack of education and a proper banking habit among the people is the most important one. This is how the studies of the past are not so relevant in this changed context. This present study is carried out to fill the gap arisen out of changed context with updated information.

Dali, (1974) opines that NRB has directed the Commercial Banks to invest 5 percent of their total deposit liabilities in rural sector effective from April 14th, 1974. The rural financing need had been long felt but only 5 percent investment in this sector does not seem to be adequate. At least 20 percent or 25 percent investment is needed.

CHAPTER – THREE

RESEARCH METHODOLOGY

3.1 Introduction

In this thesis, the study is basically concerned with describing the role of NRB in the economic development of Nepal and reviewing the Nepalese Banking, Financial and Currency System. So the purpose of this topic is to outline the method followed in the process of analysing the data.

3.2 Research Design

This thesis is primarily concerned with the role of NRB in the economic development of Nepal as well as the banking, Financial and Currency system in Nepal. To attain the above-mentioned objectives descriptive as well as tabulation method is used.

3.3 Nature and Sources of Data

The study is primarily based on the secondary sources of data. So, the necessary data for the study are collected mainly from the concerned institutions. The study is concerned with the role of NRB in the economic development Nepal. For the purpose, commercial banking statistics, annual reports, financial institutions statistics, quarterly economic bulletins, economic survey, related books and articles, various funds and their uses, NRB's indirect influence, Acts, laws, bylaws, rules, regulations, decision and review of them and other secondary sources of information compiled from the Banking Operation Department are the basic source of data.

3.4 Method of Data Collection

In this study, Primary and secondary data are used. Books of NRB, publications of NRB and many other related materials have been studied. After the study, the facts related to this thesis were noted down for the clear idea on the subject matter. The collected data are arranged systematically in the particular tabular form according to the need of the study. Likewise, for the purpose of the study, primary data has also been collected whenever possible. The primary data are collected through discussion

with the personnel's of NRB, Commercial Banks and Financial Institutions. The information gathered from the informal discussion is also included in this study.

3.5 Data Processing Procedure

The following procedures are used in this study:

- a) The data required for the study are identified.
- b) Collected data are presented in tabular form, necessary processing done according to the need of the study.
- c) Presented data are analyzed using descriptive methods.

On the basis of analysis, summary and conclusion were deduced and suitable recommendations were made.

CHAPTER – FOUR

THE NEPALESE ECONOMY

4.1 Introduction

Nepal is among the poorest and least developed countries in the world. Nepal has nearly one fourth of its population living below the poverty line. Industrial activity mainly involves the processing of agricultural products including Jute, sugarcane, tobacco, and grain. Political instability and difficulties in development of nation has led to decrease in tourism, a key source of foreign exchange. Nepal has considerable scope for exploiting its potential in hydropower and tourism areas. Prospects of foreign trade or investment in other sectors has remained poor, however, because of small size of economy, technological backwardness, remoteness, landlocked geographical location, political instability and weakness in natural disaster in the country.

4.2 Current Macroeconomic Situation of Nepalese Economy

The Current macroeconomic situation of Nepalese economy is presented below in details. NRB reports the following data trend in this way-

The study of GDP of Nepal between the years 2005/2006 to 2011/12 shows that there is not a particular pattern of its growth. In 2005/2006, G.D.P. growth rate is 3.36 which is 514486 million rupees in the year. In the interval the maximum growth is noticed during the year 2007/2008. Which is 6.10. Most recently in 2011/2012 the GDP growth rate is 4.63 which is 672326 million rupees. The reason behind this low value as well as low G.D.P. growth rate is subsistence undeveloped agriculture sector, lack of industrial development, lack of investment in productive sector etc. These facts have been shown by the following table:

Table 4.2.1

Gross Domestic Product at Constant Price, 2005/2006-2011/12

Year	GDP	GDP(Rs. In million)
2005/2006	3.36	514486
2006/2007	3.41	532038
2007/2008	6.10	564517
2008/2009	4.53	590107
2009/2010	4.82	618529
2010/2011	3.88	642553
2011/2012	4.63	672326

Source: Central Bureau of Statistics, Kathmandu

(a) Monetary Aggregates

Broad money (M2) increase rate was very high up to 2000. But afterwards the trend is continuously declining. M2/GDP has been continuously increasing over the years reflected in financial Deeping of the economy. The share of NFA in M2 has been declining over the years. Time deposit, a component of M2 witnessed a deceleration over the years. Due to slow economic growth. The ratio of time deposit to M2 has been increasing implying the availability of long term loanable fund in the banking system. In terms of GDP, time deposit also registered an increasing trend. Domestic credit also shows an increasing pattern over the years although the growth is quite irregular. The detail records of monetary survey since 1960 has been presented in the following table:

Table: 4.2.2
Monetary Survey

Subjects	1960	1970	1980	1990	2000	2005	2010	2011	2012	2013	2014	2015
Net Foreign Assets	171.9	1007.2	2231.9	9338.9	80467.5	107883.5	216355.9	221265.6	383772.1	551299.1	626795.9	633282.2
Net Domestic Assets	28.1	-31.9	3053.4	22213.5	105653.3	186085.0	503243.2	700054.4	746530.2	863931.2	998500.3	1024121.5
Domestic Credit	28.4	96.8	4305.8	29661.6	158001.1	275786.5	654666.4	910224.9	994691.5	1157769.2	1358940.4	1388558.6
Net Claim on Govt.	-3.9	-201.2	1258.3	13940.2	38242.6	59892.6	136812.8	163439.4	162882.1	117615.5	81547.2	82073.5
Broad Money (M2)	200.6	975.3	5285.3	31552.4	186120.8	293968.5	921320.1	1130302.3	1315376.3	1433481.4	1625296.2	1657403.7
Money Supply (M1)	174.1	763.3	2830.4	14223.0	60979.7	97479.6	222351.3	263705.7	301590.2	328484.0	354488.7	360683.2
Currency	109.5	531.4	1799.3	9718.2	42143.0	68352.1	141931.5	170491.7	195874.2	216818.1	242871.5	245971.1
Demand Deposit	64.6	231.9	1031.1	4504.8	18836.8	29127.5	801479.9	93214.0	105715.9	111665.9	111617.2	114712.1
Time Deposit	26.5	2012.0	2454.9	17329.4	125141.1	196488.9	698968.8	866596.6	1013786.1	110997.3	1270807.5	1296720.6

Source: NRB, “**Quarterly Economic Bulletin**”, Volume 49, MID-JANUARY 2015, NUMBER 2

(b) Economic Indicators:

Amidst the high economic growth achieving two giant states, Nepal's economic growth rate is insignificant. The economic growth rate over the past few years indicates around 4 percent of average economic growth which is dissatisfactory for the developing states like ours. Although the targets are high due to unfavourable situations pertaining in the economy our achievements are always low. Due to low growth in the agricultural sector and insufficient growth in non-agricultural sector, our growth rate is not satisfactory.

Although the poverty is declining, people living below the line of poverty is significant (23.8 percent) till the end of FY 2012/13. 18 percent is the goal of the present 13th interim plan (2013/14-2015/16). Employment growth rate also is in very small figure. Every year about half a million people enter the employment market but the employment growth rate is around 3 percent for the last few years. Agricultural sector growth went on rising from 2 percent to maximum of five percent in the year 2011/12 but again declined to 1.3 percent in 2012/2013. The non- agricultural sector growth rate is better in comparison to growth of agricultural sector. Over the past few years its average growth rate is 4.2 percent. These facts have been presented by the following chart:

Table: 4.2.3
Economic Indicators

Statement	Status of 2009/10	Targets of type	Achievements of time period			
			2010/11	2011/12	2012/13	Average Growth
Economic growth rate (%)	4.3	5.5	3.9	4.5	3.6	4.0
Agricultural Sector growth (%)	2.0	3.9	4.5	5.0	1.3	3.6
Non-agriculture sector growth rate (%)	5.4	6.4	3.6	4.2	5.0	4.2
Population living below the poverty line (%)	25.4	21	25.2	24.4	23.8	-
Employment growth rate (%)	3.0	3.6	2.9	2.9	2.9	2.9

Source: **National Planning Commission**, Nepal

(c) Government Budgetary Situation

Despite protracted political conflict and instability, we have been able to achieve significant progress in several fronts due to policy and programs initiated in the beginning of last two decades. The poverty level which was at 49 percent during the beginning of the 8th Plan period has now reduced to 23.8 percent. Similarly, improvements in human development indicators, infrastructure development, expansion of transport networks, widespread communication, quality and quantity improvements in social services, private sector's strong presence, expansion of cooperatives and self-initiated developments at local levels are the impressive achievements of the same period. The agricultural sector that contributes one-third to country's Gross Domestic Product could not be modernized and commercialized yet. The industrial sector that was expanded as the result of the reforms Carried out after the first People's Movement, had contributed up to 9 Percent in GDP in the FY2000/01, which is now limited to 6 percent. Because of this, export has become stagnant and the country is becoming more import-oriented. Now the export-import ratio has gone down to 13 percent though export had borne almost half of the import in the FY 2000/01.

The size of budget of Nepal is rising continuously over the past few decades. Starting from few millions in 1952 it has reached to around 600 billion in the fiscal year 2014/15. This is the huge rise in the size of budget of Nepal. Current amount of budget of Nepal in the FY 2014/15 is 618.1 billion in which 64.5 percent is current expenditure and 18.9 percent is capital expenditure. This budget has expected 6 percent of economic growth rate and Inflation rate 8 percent.

(d) External Trade

External trade (Imports/Exports) share with India is always maximum in comparison to foreign state. As neighbouring country, Nepal has cultural, social, economic as well as political intimacy with India. Over the past few decades Nepal's external trade has been increasing. There is high import, low export. In 2015/16 around 43 billion exports was made whereas about 378 billion import was made. In the case also trade with India is remarkable. The external trade data show that our foreign trade is always

in imbalance. In 2015/16 there was 334 billion trade deficit. These facts have been illustrated by the following table:

Table 4.2.4

Foreign Trade Records

In million rupees

FY	Exports, f.o.b.			Imports, c.i.f.			Trade Balance		
	Total	India	Other Countries	Total	India	Other countries	Total	India	Other Countries
1990/91	7387.5	1552.2	5835.3	23226.5	7323.1	15903.4	-15839.0	5770.9	10068.1
1995/96	19881.1	3682.6	16198.5	74454.5	24398.6	50055.9	-54573.4	-20716.0	-33857.4
2000/01	55654.1	26030.2	29623.9	115687.2	54700.9	60981.3	-60033.1	28670.7	-31362.4
2005/06	60234.1	40714.7	19519.4	173780.3	107143.1	66637.2	-113546.2	-66428.4	-47117.8
2010/11	64338.4	43360.4	20978.1	396175.5	261925.2	134250.3	-331837.0	-218564.8	-113272.2
2015/16	43391.0	27163.9	14659.4	378217.0	241043.3	83594.7	-334826.0	-213879.4	-68935.3

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY2015

(e) Balance of Payments:

Nepal began compiling the balance of payments (BOP) statistics from 1974/75. Except for a few years deficit in BOP, a surplus has been recorded in the BOP in the remaining years. The situation of BOP indicates the foreign exchange transaction of the country as a whole. The following table shows the value of BOP in various years since FY 2007/8 to FY 2013/14. Nepal’s balance of payment situation has been presented in the following table:

Table 4.2.5

Balance of Payments

Particulars		(Rs. in million)							Percentage Change	
		2007/08	2008/09	2009/10	2010/11	2011/12	2012/13 ^R	2013/14 ^P	2012/13	2013/14
A.	Current Account	23,679.6	-41,437.3	-28,135.2	-12,936.4	75,979.2	57,060.7	89,845.0	-24.9	57.5
	Goods: Exports, f.o.b.	61,971.1	69,906.8	63,177.5	68,701.5	81,511.8	85,989.8	100,960.6	5.5	17.4
	Goods: Imports, f.o.b.	-217,962.8	-279,227.8	-366,692.5	-388,371.4	-454,653.1	-547,294.3	-696,373.3	20.4	27.2
	Balance on Goods	-155,991.7	-209,321.0	-303,515.0	-319,669.9	-373,141.3	-461,304.5	-595,412.7	23.6	29.1
	Services: Credit	42,236.1	52,830.1	51,120.5	53,012.5	72,351.5	95,190.8	125,061.2	31.6	31.4
	Travel	18,653.1	27,959.8	28,138.6	24,610.7	30,703.8	34,210.6	46,374.9	11.4	35.6
	Government, n.i.e.	13,301.8	12,734.4	6,635.6	5,534.6	10,071.4	18,389.7	24,352.8	82.6	32.4
	Other	10,281.2	12,135.9	16,346.3	22,867.2	31,576.3	42,490.5	54,333.5	34.9	27.6
	Services: Debit	-53,328.1	-63,308.1	-67,505.8	-61,687.1	-58,294.5	-87,605.0	-104,179.0	50.3	18.9
	Transportation	-22,675.9	-22,116.2	-22,964.6	-18,604.7	-22,292.3	-33,276.7	-39,822.0	49.3	19.7
	Travel	-20,862.0	-31,396.3	-32,288.2	-27,642.9	-25,769.7	-39,611.9	-42,175.6	53.7	6.5
	Other	-10,425.9	-10,776.0	-10,378.5	-14,284.9	-8,666.1	-13,538.5	-20,555.7	56.2	51.8
	Balance on Goods and Services	-167,083.7	-219,799.0	-319,900.3	-328,344.5	-359,084.3	-453,718.7	-574,530.5	26.4	26.6
	Income: Credit	13,447.7	16,506.6	14,917.9	17,504.0	22,521.3	23,320.1	39,539.8	3.5	69.6
	Income: Debit	-5,500.9	-4,757.1	-5,800.5	-9,954.6	-10,229.9	-10,241.3	-6,664.6	0.1	-34.9
	Balance on Goods, Services and Income	-159,136.9	-208,049.5	-310,782.9	-320,795.1	-346,792.9	-440,639.9	-541,655.3	27.1	22.9
	Current Transfers: Credit	185,462.9	257,461.3	287,770.6	311,156.7	427,805.7	505,068.2	634,854.8	18.1	25.7
	Grants	20,993.2	26,796.2	26,673.6	25,780.0	36,227.1	34,180.5	48,519.8	-5.6	42.0
	Workers' Remittances	142,682.7	209,698.5	231,725.3	253,551.6	359,554.4	434,581.7	543,294.1	20.9	25.0
	Pensions	18,789.9	17,755.4	25,850.7	28,993.4	28,343.6	35,326.7	41,373.1	24.6	17.1
	Other	2,997.1	3,211.2	3,521.0	2,831.7	3,680.6	979.3	1,667.8	-73.4	70.3
	Current Transfer: Debit	-2,646.4	-7,974.5	-5,122.9	-3,298.0	-5,033.6	-7,367.6	-3,354.5	46.4	-54.5
B.	Capital Account (Capital Transfers)	7,912.5	6,231.0	12,578.3	15,906.1	18,241.7	10,348.3	17,063.5	-43.3	64.9
C.	Financial Account (excluding Group E)	11,032.6	21,201.7	7,846.6	3,212.5	28,912.8	12,496.3	10,481.8	-56.8	-16.1
	Direct Investment in Nepal	293.9	1,829.2	2,852.0	6,437.1	9,195.4	9,081.9	3,194.6	-1.2	-64.8
	Other Investment: Assets	-11,396.1	-17,675.1	-18,253.9	-25,762.2	-15,719.6	-22,846.4	-21,331.6	45.3	-6.6
	Other Investment: Liabilities	22,134.8	37,047.6	23,248.5	22,537.6	35,437.0	26,260.8	26,618.8	-25.9	1.4
	Trade Credits	12,483.6	19,554.6	21,968.9	18,292.5	26,442.3	14,434.6	23,686.1	-45.4	64.1
	Loans	3,391.5	-2,899.0	-3,933.5	2,612.0	1,036.8	-1,281.8	3,526.2	-223.6	-375.1
	General Government	3,455.9	-2,832.4	-3,901.5	2,631.6	1,047.6	-1,218.9	3,741.6	-216.4	-407.0
	Drawings	11,325.5	7,287.9	6,841.6	13,849.2	13,445.3	13,701.0	18,494.6	1.9	35.0
	Repayments	-7,869.6	-10,120.3	-10,743.1	-11,217.6	-12,397.7	-14,919.9	-14,753.0	20.3	-1.1
	Other Sectors	-64.4	-66.6	-32.0	-19.6	-10.8	-62.9	-215.4	482.4	242.4
	Currency and Deposits	6,259.7	20,392.0	+1,031.3	1,231.7	8,446.2	14,301.1	2,733.4	69.3	-80.9
D.	Miscellaneous Items, Net	-6,690.3	-3,719.6	3,353.3	-860.8	16,939.1	3,335.4	12,470.3	-80.3	273.9
	<i>Total Group A through D</i>	<i>35,934.4</i>	<i>65,150.4</i>	<i>-4,357.0</i>	<i>5,321.4</i>	<i>140,072.8</i>	<i>83,240.7</i>	<i>-129,860.5</i>	<i>-40.6</i>	<i>-256.0</i>
E.	Reserves and Related Items	-35,934.4	-65,150.4	4,357.0	-5,321.4	-140,072.8	-83,240.7	-129,860.5	-40.6	56.0
	<i>Change in Net Foreign Assets (-Increase)</i>	<i>-29,674.7</i>	<i>-47,723.4</i>	<i>3,110.3</i>	<i>-4,089.7</i>	<i>-131,626.6</i>	<i>-68,939.6</i>	<i>-127,127.1</i>	<i>-47.6</i>	<i>84.4</i>
	Gross Foreign Exchange Reserve	212,623.5	286,535.5	268,888.7	272,153.1	439,456.7	533,297.0	665,407.0	21.4	24.8
	Import Capacity (Equivalent Month)									
	Merchandise	11.7	12.2	8.7	8.4	11.6	11.7	11.5	-	-
	Merchandise and Services	9.4	10.0	7.4	7.3	10.3	10.1	10.0	-	-
	Official Exchange Rate Per US\$ (Annual Buying Average in Rs.)	64.7	76.6	74.2	72.1	80.7	87.7	98.0	-	-

R = Revised
P = Provisional

Source: NRB, A glimpse of Nepal's Macroeconomic Situation 2014, NRB, Kathmandu, Nepal.

4.3 Objective, Goals, Strategy and Priorities of the Thirteenth Plan in Nepal

Background

Nepal is considered a least developed country, but if development efforts are accelerated and political commitment is forthcoming, Nepal may be upgraded to a developing country by the next decade. Out of the three essential indicators for a developing country, Nepal has already achieved one, so it needs to achieve just one more to improve its status. The objectives, goals, strategy, and priorities of the TP are all oriented towards securing this upgrade in status as well as to attaining the millennium and SAARC development goals; promoting sustainable development, human rights and adaptation to climate change; alleviating poverty by promoting a green economy; and addressing regional and international commitments.

Long-Term Vision

To upgrade Nepal from a least developed to a developing country by 2022.

Objective

To bring about a direct positive change in the living standards of the general public by reducing the economic and human poverty prevalent in the nation.

Goal

The main goal is to decrease the proportion of the population living below the poverty line to 18 percent. Other goals are as follows.

Table: 4.3.1**Quantitative Targets of the Three Year Plan 2013/14-2015/16**

S.No.	Indicators	Status of FY 2012/13	Targets
1	Annual average economic growth rate (%)	3.6	6.0
2	Annual average agricultural growth rate (%)	1.3	4.5
3	Annual average no- agricultural growth rate (%)	5.0	6.7
4	Annual average growth rate in employment (%)	2.9	3.2
5	Life expectancy at birth (in years)	69.1	71.0
6	Population (in millions)	27.2	28.3
7	Population growth rate (%)	1.35	1.35
8	Maternal growth rate per 100,000)	229.0	134.0
9	Population with access to drinking water (%)	85.0	96.25
10	Population with access to sanitation (%)	62.0	90.25
11	Net Enrolment rate at the primary level (Grade 1-5) (%)	95.3	100.0
12	Number of district headquarters with road connectivity	73.0	75.0
13	Density of mobile phones and telephones (per 100)	71.5	100
14	Installed capacity of electricity generation (in MW)	758.0**	1426
15	Population with access to electricity (%)	67.3	87.0
16	Irrigation (in hectares)	13,11,000	14,87,275
17	Forest coverage area (%)	39.6	40.0
18	Total length of road transport (km)	25,133	28,133

Source: **National Planning Commission, Nepal**

* The district headquarters of Humla is to be connected to the Chinese autonomous province of Tibet.

** A total of 758 MW of electricity is connected to the national transmission network, including 705 MW from hydropower and 53 MW from thermal power. The 35 MW generated from alternative energy is not yet linked to the national transmission network.

It is projected that by the end of the interim plan, the current human development index of 0.463 will have risen to 0.508, the per capita gross national income will have increased to USD 902 from the current USD 721, the human asset index will have reached 66.0 from the current 62.2, and the economic vulnerability index will have declined to 26.95 from the current 27.8.

Strategy

1. Achieve inclusive, broad-based and sustainable economic growth by enhancing the contributions of the private, government and cooperative sectors to the development process.
2. Develop physical infrastructure.
3. Enhance access to social services and improve the use and quality of those services.
4. Enhance good governance in the public and other sectors.
5. Empower targeted groups and sectors both socially and economically.
6. Implement development programmers which support climate change adaption.
7. Priorities pursuant to achieving its objective, the APTP have identified the following priority areas.
 - Developing hydropower and other energies
 - Increasing the productivity, diversification and commercialization of the agricultural sector
 - Developing the basic education, health, drinking water, and sanitation sectors
 - Promoting good governance
 - Developing roads and other physical infrastructure
 - Developing the tourism, industrial, and trade sectors, and
 - Protecting natural resources and the environment.

4.4 Characteristics of Nepalese Economy

Nepal is one of the least developed among the developing countries of the world. A search into the nature and conditions of Nepalese economy reveals following characteristics:

i) Widespread poverty

Poverty is rampant in Nepal. Although there has been a lot of efforts by NG for addressing this problem in Nepal; still 23.8 percent of people are under the line of poverty which is caused by backwardness in agriculture, unequal distribution of land, Low economic growth, lack of good governance, lack of resources, political instability, traditional social belief, high population growth etc. The following table illustrates the poverty situation in Nepal:

Table 4.4.1

Poverty in Nepal

S. No.	Plan	Period of time	Goal of poverty alleviation (%)	Achievements (%)
1	8 th plan	1996/97-2001/02	42	42
2	9 th plan	2001/02-2005/6	32	38
3	10 th plan	2005/6-2009/10	32	30
4	11 th plan	2009/10-2011/12	24	25.4
5	12 th plan	2011/12-2013/14	21	23.8
6	13 th plan	2013/14-2015/16	18	-

Source: **National Planning Commission, Nepal**

ii) Rapid population growth

In Nepal population is rapidly growing. In comparison to the last population census the latest census shows 14.44 percent of population growth. The population change and population growth has been presented by the following table:

Table 4.4.2

Population Statistics of Nepal

S. No.	Year (B.S.)	population	Added population (%)	Yearly population growth rate	Population doubling time	Sex ratio	Population density
1	2009-11	8256625	31.4	2.28	31	96.8	56
2	2018	9412996	14.0	1.64	42	97.0	64
3	2028	11555983	22.77	2.05	34	101.4	79
4	2038	15022839	30.0	2.62	26	105.0	102
5	2048	18491097	23.09	2.08	33	99.5	126
6	2058	23151423	25.2	2.25	31	99.8	157
7	2068	26494504	14.44	1.35	52	94.16	180

Source: **Central Bureau of Statistics, Nepal**

iii) Low income level

Nepal is a developing country with per capita income of about US \$1347.62(Qatar highest \$105091.42) in the record of 2013 according to the GLOBAL FINANCE MAGAZINE.

iv) Extreme Disparity

There is extreme disparity in the distribution of wealth and income.

v) Dependence on Agriculture

Two third of the population are dependent on agriculture and agriculture only contributes one third in GDP of the country

vi) Dependence on foreign aid

Most of the developmental works are dependent on foreign aid.

vii) Idle resources

Although Nepal is rich in many natural utilization they are idle. Nepal is second richest in hydropower but is facing load shedding heavily.

Furthermore, Trade imbalance (high import), Unemployment, Lack of industries, Lack of saving and capital and Lack of infrastructures are also characteristics of Nepalese economy.

CHAPTER – V

BANKING AND FINANCE IN NEPAL

5.1 Introduction

The history of financial system of Nepal began in 1937 with the establishment of the Nepal bank limited as the first commercial bank of Nepal with the joint ownership of government and general public. Nepal Rastra bank was established after 19 years since the establishment of the first commercial bank. A decade after the establishment of NRB, Rastryya Baniija bank, a commercial bank under the ownership of Government of Nepal was established.

In the context of banking development, the 1980s saw a major structural change in financial sector policies, regulation and institutional developments. Government emphasized the role of the private sector for the investment in the financial sector. With the adoption of the financial sector liberalization by the government in 1980's, the door was opened for foreign banks to open Joint Venture Banks in Nepal. As a result, various banking and non-banking financial institutions have come into existence. Nabil Bank limited, the first foreign joint venture bank of Nepal, started operating in July 1984. During two decades, Nepal witnessed tremendous increment in number of financial institutions. Nepalese banking system has now a wide geographic reach and institutional diversification.

Consequently, by the end of mid- July 2014, altogether 204 banks and non-bank financial institutions licensed by NRB are in operation. Out of them, 30 are “A” class commercial banks, 84 are “B” class development banks, 53 are “C” class finance companies, and 37 are “D” class micro-credit development banks, 16 saving and credit co-operatives and 30 NGOs. In mid-July 2014, the total banks branches reached 3456 with the population of nine thousand seven hundred and ninety one per branch. Present development of financial institutions in Nepal is reflected in the table below:

5.2 Banks and Financial Institutions in Banking History of Nepal

History of banking starts since 1994. karkit 30 B.S. in Nepal. Nepal Bank Limited was the first bank in our banking history. Later, by NRB act 2012, Nepal Rastra Bank was established in 2013 B.S. In 2016 NIDC was established then during Panchayat Regime ADB, RBB and various private banks and financial institutions were established. Since peoples' revolution 2046, according to privatization and liberalization policy of government and NRB, various banks and financial instructions were established abundantly.

Only 3 commercial banks in 1985 were in existence in 1985. Their number rose rapidly after liberalization policy of NRB afterwards. Their number became maximum (32) in 2012 and reduced to 30 in 2014 again. Likewise 2 development banks in 1985 followed the similar trend as commercial banks and finally remained 84 till 2014. Finance companies' number also became maximum in 2012 and then decreased and maintained 53 in number till 2014. But Micro finance development banks' number has been increasing continuously since 1985 till 2014. Saving and credit co-operatives' number also follows the similar trend as commercial banks. NGO's number also reached maximum (47) in 2007 and again reduced continuously to 30 till 2014. Till 2014 the total number of financial institutions is 250, which was only 5 in 1985. This drastic increase in number of banks and financial institutions for the last few decades due to the policy of NRB, has helped in the conversion of traditional Nepalese economy into modern one. These facts have been depicted in the following table:

Table 5.2.1

Banks and Financial Institutions of Nepal

Types of Financial Institutions	Mid- July													
	1985	1990	1995	2000	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Commercial Banks	3	5	10	13	17	18	20	25	26	27	31	32	31	30
Development Banks	2	2	3	7	26	28	38	58	63	79	87	88	86	84
Finance Companies			21	45	60	70	74	78	77	79	79	69	59	53
Micro Finance Development Banks			4	7	11	11	12	12	15	18	21	24	31	37
Saving & credit Co-operatives Limited Banking Activities			6	19	20	19	17	16	16	15	16	16	15	16
NGOs (Financial Intermediaries)				7	47	47	47	46	45	45	38	36	31	30
Total	5	7	44	98	181	193	208	235	242	263	272	265	253	250

Source: Nepal Rastra Bank, **Bank and Financial Institutions Regulation department**

5.3 Distribution of Banks and Financial Institutions

Banks and financial institutions are basis for the overall economic development of the country. On that reason since past decades the numbers of banks and financial institutions have considerably increased. Since adopting liberalization policy of Nepal Rastra Bank, The number as well as distribution of banks and financial institutions is encouraging. Although the distribution of banks and financial institutions is having concentrated in urban as well as district headquarters, the efforts and policies of NRB is crucial in the way towards the even distribution of them.

5.3.1 Commercial Bank Branches by Area

In Kathmandu valley the branches of commercial banks is highly concentrated. It seems that the number of their branches is nearly equal to the number of the branches of the banks in total hilly areas in 2015. But the number of branches of commercial banks in whole Terai region is in abundant number. It is 681 in 2015 in Terai region of Nepal. So, we can conclude that although the number of branches of commercial banks in Nepal is sharply rising since 1955 till now, the distribution of them is quite unequal. These facts have been presented through the following table:

a) Commercial Banks Branches by Development Regions

Eastern Development Region

In 1986 the branches of commercial banks were 38 and it went on increasing except in 2006. Finally in 2015 the number became maximum (85). These facts have been presented through the following table:

Table 5.3.1.1

Branches of Commercial Banks in Eastern Development Region

Year	1986	1991	1996	2001	2006	2011	2012	2013	2014	2015
Hills	38	42	41	29	22	42	65	74	83	85
Terai	61	63	67	67	62	143	190	200	221	222

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY 2015

Central Development Region

The branches of commercial banks went on rising excessively in the Hilly regions than in the Terai region. The reason behind it can be attributed by the fact that the Kathmandu valley is in the Hilly region of this development region. The number reached to 616 in 2015 from 94 in 1986. In Terai except in 2006 the number of branches of commercial banks is rising. It reached to 201 in 2015 from 55 in 1986.

These facts have been presented through the following table:

Table 5.3.1.2

Branches of Commercial Banks in Central Development Region

Year	1986	1991	1996	2001	2006	2011	2012	2013	2014	2015
Hills	94	110	110	119	124	466	544	575	614	616
Terai	55	61	65	68	53	121	161	173	198	201

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY2015

Western Development Region:

In hills except in 2001 and 2006 period there is rise of the number. In Terai also we can find the rise in the number of their branches except in 2006 where fall in their number is noticed in the rising trend. These facts have been presented through the following table:

Table: 5.3.1.3

Branches of Commercial Banks in Western Development Region

Year	1986	1991	1996	2001	2006	2011	2012	2013	2014	2015
Hills	51	57	58	45	49	129	161	167	166	178
Terai	29	28	29	36	31	73	95	97	107	108

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY2015

Mid-western Development Region

The pattern of rise in the number of commercial Banks's branches is similar as above in this development region as well. These facts have been presented through the following table:

Table: 5.3.1.4

Branches of Commercial Banks in Mid-Western Development Region

Year	1986	1991	1996	2001	2006	2011	2012	2013	2014	2015
Hills	11	12	12	08	06	06	14	18	23	23
Terai	18	18	17	16	13	51	74	80	84	86

Source: NRB, “**Quarterly Economic Bulletin**”, Volume 49, MID-JANUARY2015

Far-western Development Region

In this region number of branches of commercial banks were noticed in Hilly region whereas the rise in the expansion of branches of commercial banks from 12 in 1986 to 64 in 2015 was noticed except in 1996 and 2006.

Table 5.3.1.5

Branches of Commercial Banks in Far-Western Development Region

Year	1986	1991	1996	2001	2006	2011	2012	2013	2014	2015
Hills	-	-	-	-	-	-	-	-	-	-
Terai	12	14	13	15	11	43	57	60	64	64

Source: NRB, “**Quarterly Economic Bulletin**”, Volume 49, MID-JANUARY2015

Finally, we can conclude that the number of commercial banks is decreased in 2006 in all the regions where as the increasing pattern of the branches is noticed in most of the remaining years. All these facts have been presented by the following table:

Table 5.3.1.6
Branches of Commercial Banks by Development Regions

Development Regions	Year																			
	1986		1991		1996		2001		2006		2011		2012		2013		2014		2015	
	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai	Hills	Terai
Eastern Development Region	38	61	42	63	41	67	29	67	22	62	42	143	65	190	74	200	83	221	85	222
Central Development Region	94	55	110	61	110	65	119	68	124	53	466	121	544	161	157	173	614	198	616	201
Western Development Region	51	24	57	28	58	29	45	36	49	31	129	73	161	95	167	97	166	107	178	108
Mid- Western Development Region	11	18	12	18	12	17	8	16	6	13	6	51	14	74	18	80	23	84	23	86
Far - Western Development Region	-	12	-	14	-	13	-	15	-	11	-	43	-	57	-	60	-	64	-	64

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY 2015

b) Commercial banks branches by Ecological belts:

There were only 56 branches of commercial banks in 1986 in Kathmandu valley where as their number reached 488 in 2015 mid-January. Similarly in hills 167 branches of commercial banks in 1986 increased to 483 in mid-Jan 2015 likewise in Terai their number changed to 681 from 170 in the same period of time. These facts suggests that the number of branches of commercial banks although is concentrated in Kathmandu valley in

Hills and Terai also there have been considerable number of their branches. These facts have been presented through the following table:

Table 5.3.2.1

Distribution of Branches of Commercial Banks by Ecological Belts

Ecological Belt	Year										
		1986	1991	1996	2001	2006	2011*	2012	Mid oct 2013	Mid oct 2014	Mid Jan 2015
Kathmandu Valley	Kathmandu	39	47	47	61	71	296	336	349	368	370
	Bhaktapur	5	6	7	8	7	29	31	33	35	35
	Lalitpur	12	12	13	14	16	67	77	78	83	83
	Total	56	65	67	83	94	392	444	460	486	488
Hills		167	192	190	145	126	288	404	436	478	483
Teari		170	184	191	202	170	431	577	610	674	681
Total		393	441	448	430	1290	1111	1425	1506	1638	1652

* Including only Commercial banking branches of ADB/N

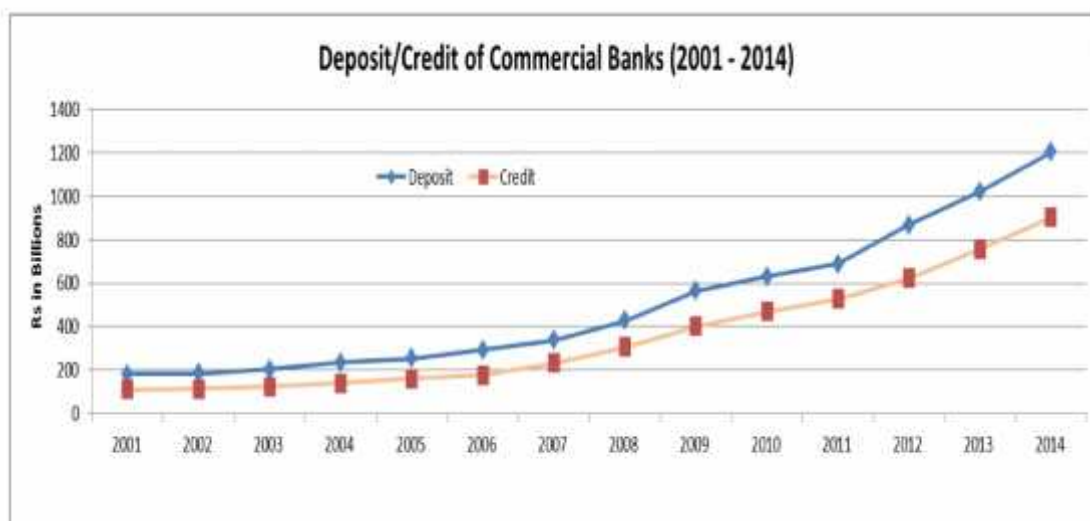
Source: QUARTERLY ECONOMIC BULLETIN Volume 49, mid- January 2015 Number

5.3.2 Banking and Financial Statistics

The study of Deposit/Credit of commercial Banks from 2001 to 2014 tells that i) Deposit is higher than credit over all the years under study. ii) In the beginning both the deposit and credit of the commercial banks was around Rs.200 billion and Rs 150 billion respectively. Afterwards both the deposit and credits were rising. The moderate rise of them occurred during the interval of 2007 to 2011 and maximum rise in their values was noticed during the interval 2011 to 2014. These facts has been presented through the following graph-

Graph -1

Deposit/Credit of Commercial Banks

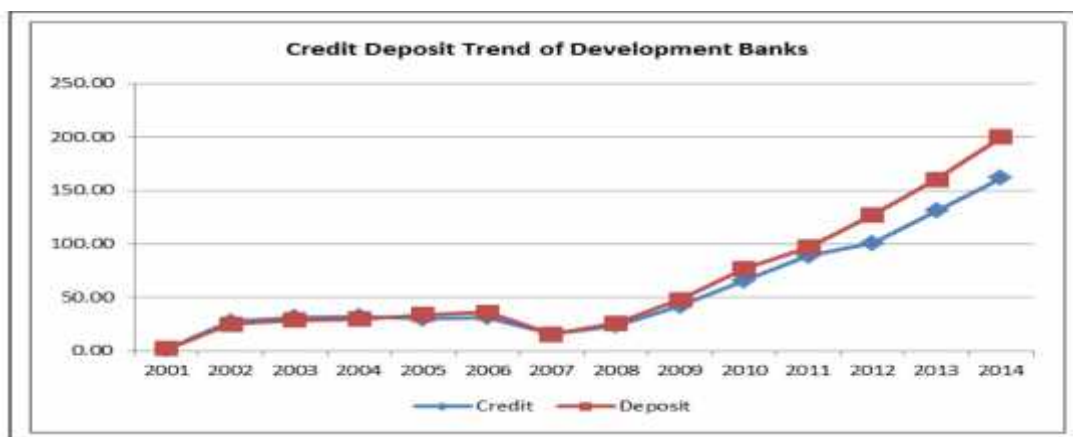


Source: NRB, **Banking and Financial Statistics**, Mid July, 2014, No.60

Similarly from the year 2001 to 2014 the credit and deposit trend of Development bank is rising except in the period of 2006 to 2007. The difference on the credit and deposit is noticed remarkable in the years following 2008 onwards. These facts has been presented through the following graph-

Graph-2

Credit/Deposit Trend of Development Banks

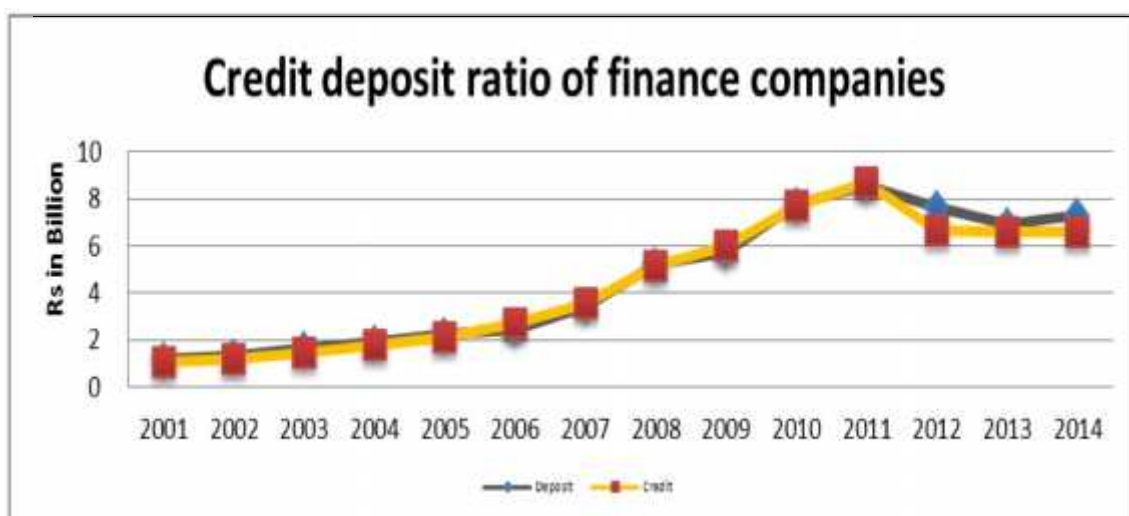


Source: NRB, **Banking and Financial Statistics**, Mid July, 2014, No.60

Likewise, It is found that from 2001 to 2005 and 2011 to 2014 the deposit of finance companies was little higher than credits whereas credit seems to be higher than deposits in the periods 2005 to 2007 and 2008 to 2010. These facts have been illustrated in the following graph:

Graph-3

Credit/Deposit Ratio of Finance Companies



Source : NRB, **Banking and Financial Statistics**, Mid July, 2014, No.60

5.4 Nepalese Currency System & NRB

a) Introduction

In the ancient time barter system was prevalent. Difficulties were yielded in barter system with complexity of economic transactions. Generally acceptable goods were brought in use as a medium of exchange. But those goods were proved unpractical as a medium of exchange. As a result, money/currency was invented. Thus, difficulties of barter systems gave birth to money and the barter system was eliminated with the development of money.

At the beginning, metallic coin appeared in use. Nowadays paper money (Currency Notes) is regarded as popular and convenient medium of exchange. Moreover credit money has also been brought in use in order to simplify and facilitate monetary system of modern complex economic structure. But credit money is not popular in developing country as is in developed country.

Within the present boundary of Nepal, 'there were some independent kingdoms during ancient and medium period that might have issued their coinage'. Monetary history of Nepal is as old as its history. Systematically speaking the coins of Nepal can be classified into three board division viz. the first group consists of ancient coins of the time of the Lichchhavi, second started during the Malla rules and the third one is the modern coin of Shah Dynasty Rule.

It is not found that Lichchhavi Kings issued the coins in their name except two Kings i.e. Mandeva (Mananka) and Gunakamadeva (Gunanka). Mandeva was the First Lichchhavi King who started the tradition of writing inscription on stone etc. It is mysterious that out of sixteen Lichchhavi Kings, we find coin in the names of merely two Kings. It may be appropriate to mention that coins were issued in the name of secondary Lichchhavi rulers like Amsubarma and Jishnu Gupta etc.

During the first few generations, the Lichchhavi Kings did not feel the necessity of issuing their own currency. Perhaps the need was not felt because of the undeveloped economy, but in the last quarter of the 6th century, during the time of Shiva Dev, Nepal was having increased trade intercourse with India in one hand and with Tibet

and China on the other hand. This compelled the rulers of Nepal to issue their own coins. The major Lichchhavi Coinage are Manank, Gunank, Vairavena, Amsuvurma's Coin, Jishnu Gupta's Coin and Pashupati Coin.

b) Coins of the Malla dynasty of Newar Kings

The coinage of the Newar Kings is of an entirely different character compared with the previous coins of Nepal already noticed. With the exception of the King Jaya Prakash (1736 AD), who coined gold as well as silver, the coinage is entirely a silver coinage. The mohars, with the exception of lighter coins of one or two Kings, vary in weight between 80 and 90 grams.

According to Vamsavali, Ratna Malla, the first king of the separate kingdom of Kathmandu, having brought copper from Tamllakhani, introduced pice (paisa) into the currency instead of sukichas viz. quarter Mohars, fourth eight pice (paisa). In the Vamsavali, it is recorded that, Mahendra Malla went to Delhi with a present of a swan and hawks for the emperor, who, being much pleased there with, granted him permission to strike coin in his own name. He struck the coin and called it mohar, and made it currency in every part of his country.

c) The Gorkha Coinage

Prithivi Narayan Shah, after his conquest of the country, adopted the Newar System of coinage based on the standard of a Silver Mohar, and with the same fractional parts. Pratap Singh Shah, in his coin also used the Lion as a rebus for the name 'Simha'. The Gorkha's Coin also bears the symbols of the Sun and Moon as the Gorkha claim to be descended from both Solar and Lunar races.

In the Gold Coinage however, the Gorkha kings introduced coins of new domination and of new design. The Copper Coinage of Surendra Bikram Shah and Prithivi Bikram Shah were new, with their devices and in the latter a new symbol is introduced in the Paduka (Foot Prints of lord Bishnu) and the crossed khukuris, the National Gorkha Weapon.

The installation of 'KausiToshaKhana' as a banking agency during the regime of King Prithivi Narayan Shah could lay claim to be regarded as the first step

towards the initiation of banking development in Nepal. It was converted into Sadar Muluki Khana. Later in Rana regime coins of gold, silver and copper were used. With the objective of bringing own National Currency in use within country under the Prime Ministership of Juddha Shamsar JBR, Sadar Muluki Khana issued the first currency notes of Rs. 1, 5, 10 and 100 denominations on 1st Ashwin 2002 BS.

Though issuance of Currency Notes started since 1st Ashwin 2002 BS, the Dual Currency System of Nepal and India continued. In other words, even after the 'Sadar Muluki Khana Adda' started to issue currency notes from 1945 AD the use of IC was still common practice except in some hilly regions and in the Kathmandu valley.

Most people used to transact in Indian Currency. People received credit from the NBL in IC. Fixed deposit accounts were to be opened in Indian Currency. Even government employees received their salary in IC and government revenue was collected in IC. NRB was established on April 26, 1956 AD as a central Bank. 'Foreign Exchange Regulation Act 1963' was brought into effect. By the year 1966, that is one decade after the Central Bank came into existence, the dual currency system was completely eradicated and Nepalese Currency became the legal tender of the country. In Falgun 7, 2017 BS the NRB issued Nepali Currency Notes for the first time. Nowadays, Taksar Department strikes coins. NRB issues notes on the basis of proportional reserve system. The Taksar Department was coincided in NRB since 2041 BS. The authority and liability of striking coins have been also given to NRB".

5.4.1 Pre- NRB Establishment Situation

The Nepalese Currency system was very different at the time of pre-NRB establishment situation. At that time, Kathmandu had little control over its foreign currency holdings. Indian rupee was the prevalent medium of exchange in most parts of the country. Nepalese Currency was used mostly in the Kathmandu Valley and the surrounding hilly areas. The existence of a dual currency system made it hard for the government to know the status of Indian currency holdings in Nepal. The exchange rates between Indian and Nepalese rupee was determined in the marketplace. Between 1932 and 1955, the value of 100 Indian rupees varied between Rs 71 and Rs 177. The government entered the currency market with a form of fixed exchange rate between the two currencies in 1958. An act passed in 1960 sought to

regulate foreign exchange transactions. Beginning in the 1960s, the government made special efforts to use Nepalese currency inside the country as a medium of exchange. As it was practically impossible to do away with the circulation of Indian Rupees at once, it was to be accomplished in phases. Consequently the circulation of Indian Currency was declared illegal first in Kathmandu Valley and later in most of the hilly regions except Illam, Baitadi and Doti. Subsequently those regions also were brought under the domain of Nepalese Rupee. It was only in 17 Sept, 1966 that Nepalese Currency was made the sole medium of exchange and Dual Currency System was scrapped forever.

There were not factual situation prevailing in the country. Some relevant factual situations at the time of NRB's establishment were:

- a) No license of authorization was required for conducting foreign currency business.
- b) Exchange rate for Indian Rupees used to fluctuate frequently.
- c) For purposes other than trade it was required to procure Indian Currency at the free market rates.
- d) No restriction was imposed on purchase and sale of foreign currency i.e. Indian Rupees.

Against the above backdrop which was prevalent at the time of NRB's establishment, the authorities' attention was focused on the following objectives:

- a) To do away with the situation of Dual Currency System.
- b) To gain the confidence of the people in the Local Currency.
- c) To bring stability to the exchange rate mainly IC/NC rate.
- d) To regulate the foreign currency transactions.
- e) To manage the external reserves of the Country.

5.4.2 Situation after the Establishment of NRB

Before the Bank issued Currency Notes, Metallic Money was very much in circulation in the country. However, after the Bank started issuing more Currency Notes, the circulation of Metallic Money gradually declined. These days the Bank has

adopted the policy of replacing Currency Notes of small denominations by issuing coins.

As the Central Bank of the country, NRB has the exclusive right to issue Currency Notes which are legal tender all over the state. The issuance of notes, therefore, is one of the core functions of the Bank. For issuance of the Currency Notes, sufficient reserves are maintained as per section 18 (20 of NRB Act, 1955). HMG is liable to guarantee the payment of the Currency Notes issued by the bank in case the latter fails to do so. Nepalese Rupees are found in denominations of 1000, 500, 250, 100, 50, 25, 20, 10, 5, 2 and 1. Coins are found in denominations of 5 paisa, 10 paisa, 25 paisa, 50 paisa, 1 rupee, 2 rupee and 5 rupee. One rupee equals to 100 paisa. Recently Currency Notes having decentralized windowed security thread using Silver Metallic ink have been introduced to ensure additional security.

Thus, Nepalese Currency System has been developing gradually since ancient time. Different types of coins were struck in different times, which have a unique historical value. For the sake of convenience even in Nepal, Currency Notes started to be issued since 1945. Nowadays NRB issues notes and strikes Coins according to need so that Nepalese Economy runs smoothly and steadily.

5.4.3 Foreign Exchange Rate of Nepalese Currency

The Nepalese exchange rate policy is aimed at supporting the peg with the Indian rupee. The peg has enabled the domestic economy to benefit from its close economic ties with India. These ties include extensive trade links, free labor mobility through porous borders, and formal business links and informal family relations. Importantly, the peg abolishes exchange rate risk in the large volume of current and capital account transactions with India. It is felt that the peg provides credibility to policy by importing stable monetary conditions from India. The rupee appreciated by 5.4 percent against the US dollar in mid-July 2005 compared to the corresponding period of the previous year.

Exchange rates are published in daily newspapers such as The Rising Nepal, The Kathmandu Post etc. Exchange Rate of Nepalese Currency is determined by the Nepal Rastra Bank.

In the beginning of the year 2015, the exchange rate of US dollar is 99.13 Nepali rupees which is highest since 1995, the reference period of the study. The exchange rate of sterling pound is maximum in the year 2014 which is NRS 164.61 .Nepali currency is appreciated with Japanese Yen to NRS 0.84 in 2015, which had reached to 1.12 NRS as a result of depreciation in the year 2012. The exchange rate of Euro had reached to maximum of 130 NRS in the year 2014. In 2015 it is depreciated against Nepali currency. The exchange rate of Chinese Yan has become maximum in our study period to 16 NRS in 2015.

The exchange rate of Nepalese rupee vis-à-vis the Indian rupee is constant from beginning of the Panchayat regime in Nepal. This pegged exchange system between Nepal and India has helped to maintained stability in business and other transaction between the two countries. The following table illustrates the exchange rates of Nepalese currency:

Table 5.4.3.1
Foreign Exchange Rate of Nepalese Currency (Buying Rate Only)

Year (mid-July)	US\$	Pound Sterling	Japanese Yen	Swiss Franc	Canadian Dollar	Australian Dollar	Swedish Kroner	Indian Rs	Euro	Chinese Yan
1995	50.45	8048	0.5740	43.41	37.11	36.95	7.03	1.6	0.00	0.00
1996	56.25	87.45	0.5110	44.82	41.04	44.66	8.39	1.6	0.00	0.00
1997	56.75	95.90	0.5000	38.71	41.44	41.92	7.32	1.6	0.00	0.00
1998	67.60	110.34	0.4800	44.54	45.60	42.07	8.42	1.6	0.00	0.00
1999	68.15	106.78	0.5660	43.41	46.04	44.88	7.94	1.6	0.00	0.00
2000	70.40	105.64	0.6520	42.47	47.52	41.18	7.90	1.6	65.85	0.00
2001	74.65	104.61	0.6010	42.05	48.66	37.75	6.88	1.6	63.57	0.00
2002	78.00	121.41	0.671	52.82	50.89	43.84	8.43	1.6	77.65	0.00
2003	74.75	120.29	0.635	54.35	54.34	49.04	9.23	1.6	84.30	9.03
2004	74.14	137.57	0.678	60.08	56.29	53.08	9.96	1.6	91.64	8.96
2005	70.35	124.00	0.629	54.56	58.34	52.96	9.08	1.6	84.98	8.50
2006	74.10	136.17	0.64	60.09	65.43	55.57	10.20	1.6	93.82	9.27
2007	64.85	131.45	0.53	53.80	61.93	56.26	12.00	1.6	89.27	8.57
2008	68.50	135.89	0.64	66.97	67.76	66.29	11.47	1.6	108.72	10.02
2009	78.05	126.78	0.84	71.99	67.77	61.28	9.93	1.6	109.07	11.42
2010	74.44	113.71	0.85	70.63	71.88	65.34	10.08	1.6	94.79	10.99
2011	70.95	114.54	0.90	86.93	73.85	75.71	10.88	1.6	100.34	10.98
2012	88.60	136.62	1.12	89.91	86.97	89.96	12.60	1.6	107.98	13.89
2013	88.02	143.56	0.96	100.36	91.39	85.96	14.26	1.6	124.08	15.48
2014	95.90	164.61	0.94	107.51	89.35	89.91	14.11	1.6	130.56	15.45
2015	99.13	150.07	0.84	97.38	82.80	80.81	12.39	1.6	116.94	16.00

Source: NRB, “Quarterly Economic Bulletin”, Volume 49, MID-JANUARY 2015, NUMBER 2

Table 5.4.3.2**Nepalese Currency in Circulation**

(In million Rupees)

Year	Notes in circulation	Coins in circulation	Currency in circulation
2005	72808.1	749.0	73557.1
2006	83000.8	834.1	83834.9
2007	89847.9	1065.2	90913.0
2008	111485.5	1341.6	112827.1
2009	139385.1	1389.4	140774.5
2010	157549.1	1429.1	158978.2
2011	163892.3	1470.7	165363.0
2012	199170.3	1675.4	200845.7
2013	250340.9	1746.4	252087.3
2014	266890.0	1777.3	268667.3
2015	279288.3	1806.3	281094.6

Source: **Quarterly Economic Bulletin**, Nepal Rastra Bank, Kathmandu, Volume 49,
MID-JANUARY 2015 NUMBER 2

5.5 Monetary Policy

In a normal situation monetary policy is one of the economic policies at the disposal of the authorities purported to influence the economic goals such as income, prices, employment and the balance of payments through its effect on intermediate target variables such as the quality of money, bank credit, bank deposit, interest rate, etc.

5.5.1 Evolution of Monetary Policy

Evolution of monetary policy of Nepal took place at a time when monetary deepening was very low, when there were only a few financial institutions, and when the degree of monetization was very low. The economy was mostly of subsistence nature with agriculture contributing more than 90 percent of the economic activities. Till mid-

1960s, narrow money to Gross Domestic Product (GDP) ratio was 8 percent only and broad money to GDP ratio was less than 10 percent compared with 20 percent in India and 23 per cent in Sri Lanka. Financialization of assets was very low even till the end of 1960s.

5.5.2 Objectives of Monetary Policy for FY 2014/15

- i) To strengthen banks and financial institutions which are mediums of implementation of monetary policy.
- ii) Consumer inflation rate is aimed to limit at 8 %. To maintain foreign exchange reserve to be sufficient enough to import goods/ services for at least 8 months. To manage necessary monetary liquidity to achieve the economic growth rate of 6 % as targeted in the budget of FY 2014/15.
- iii) To maintain financial sector stability, financial access and financial inclusion. Starting of Implementation of financial sector development strategy in the FY 2014/15.
- iv) To manage liquidity in the banking sector, tight monetary policy is pursued so that price, external sector, financial stability, share markets, real estate transacting run smoothly.

CHAPTER – VI

ROLE OF NEPAL RASTRA BANK IN NEPALESE ECONOMY

6.1 Introduction

The Bank discharges the central banking responsibilities including guiding the development of the embryonic domestic financial sector as explained above. The financial sector of Nepal has been taking a significant growth in the present stage as there has been large increase in their activities. Similarly, in the present stage Nepal is more integrated with the global economy as evidenced by high levels of trade as a percentage of, gross domestic production (GDP) and a membership in international trading organization (WTO) in 2004.

The basis for establishment of Nepal Rastra Bank was rooted in rudimentary financial and monetary system of Nepal in 1950s which was characterized by an environment of dual currency both Nepalese currency and Indian currency circulating side by side. The exchange rate between both currencies was also highly unstable. There was only one commercial bank present in the formal domestic financial sector (Nepal bank limited) at that time reflecting the lack of monetization and the low level of development of the Nepalese financial sector. Further, there was insignificant interaction with the outside world other than India and China (Tibet). Keeping this situation in view, the objectives of the bank as provided by the Nepal Rastra Bank Act 1955, were to widen the circulation of domestic currency; stabilize the exchange rate of the Nepalese currency vis-a vis the Indian currency; expand the banking network in the country; and evolve policy instrument for monetary management.

The central banking system and the implementation of stated objective started to take motion with the establishment of the NRB on April 26, 1956. The journey of NRB from its establishment can be broken down into decades and decade wide actions are presented below:

The decade of establishment (1956-66) saw the bank occupied with two main challenges of the nation, one removing the dual currency system from the nation and

the next to foster the development of financial sector to lay down the foundation for relationship with international organizations. The efforts of Nepal Rastra Bank were then primarily focused on increasing the circulation of the Nepalese currency throughout the country by expanding the branches of the bank. Similarly, Nepalese currency was also made available through the establishment of the currency chest in the commercial banks. Further, the bank had also initiated efforts to stabilize the exchange rate between the Nepalese currency Vis-a vis Indian currency. For the latter, the foreign exchange regulation act 1963 was enacted which empowered the Nepal Rastra Bank as the custodian of the country's foreign exchange reserves.

By the end of the first decade, the bank had succeeded in ending the wide circulation of Indian currency in Nepal. Likewise, during this decade the foundation for relationship with international organization was set through commencing relations with such institutions as international Monetary Fund (IMF) and the Works Bank (WB).

In the second decade (1966-76) the bank had noted a period of expansion and consolidation in the domestic financial sector. The evolution of monetary instruments and guidelines of the Neapl Rastra Bank related with credit control; credit limit; and directed credit programs was noted during the decade. Further, Nepal at that time followed and inward looking, Import- substituting industrialization policy.

In order to diversify and promote exports, both commodity-wise as well as country-wise, the trade regimes was based in an incentive system named as bonus voucher, which entitled exporters additional incentives. Further, international relations has been also established with Asian development bank(ADB); south east Asia, New Zealand and Australia central banker's forum (SEANZA) and Asian clearing union(ACU) in 1966,1968 and 1975 respectively.

Similarly in the third decade (1976-86) of NRB saw a massive expansion and more active role of the bank in development financing, along with growing emphasis on domestic and foreign joint venture private sectors investment in the financial sector. Policy measures taken during this decade ranged from down word revision in the interest rate structure to credit ceilings and directed credit programs. The focus at this period was on widening institutional set up for monetary depending and formulating

directed credit programs to provide institutional facilities to targeted sectors, regions and groups of the society.

The continuation of previous trade policies were also given. The trade policy by the government of Nepal with Nepal Rastra Bank having provided a dual exchange rate system and an auction system in regard to foreign exchange allocation. Likewise, international relations had also been established with Asia Pacific Rural and Agricultural Credit Association for Regional cooperation (SAARC) in 1977, 1982 and 1985 respectively.

The fourth decade of Nepal Rastra Bank (1986-96) witnessed further financial liberalization; restructuring and economic stabilization along with the liberalization policy of the government of Nepal. Liberal economic policies were initiated in the wake of balance of payment (BOP) crisis in the early 1980s. These reforms were undertaken under the regime of Structural Adjustment Program (SAP) with the financial support of the international monetary fund in 1987. This decade also witnessed a major change in the policy measures such as deregulation of interest rate in 1989; moving from direct to indirect methods of monetary control, emphasizing open market operations the main policy tool, abolishing the provision of statutory liquidity ratio of the Nepalese currency against convertible currencies and full convertibility of the Nepalese currency in the current account.

Thus, during the second, third and fourth decades of its establishment, Nepal Rastra Bank was able to steer the deepening of financial sector with a changing role from provision of financial service to regulation and supervision of financial institution in a more open and liberalized system.

The first part of the 5th decade was characterized by greater financial sector deregulation and liberalization along with emerging challenges namely: growing financial sector fragility; increased non-performing assets in the two large commercial banks of Nepal viz. Rastriya Banijya Bank (RBB) and Nepal Bank Limited (NBL); and increasing depth and sophistication of the financial system through integration in the global economy. The latter part of this decade was thus characterized by financial sector reform aimed at improving the efficiency and effectiveness of the domestic financial sector to face challenges encountered by the ongoing global transformation.

the domestic financial sector reform had three major components namely: 1) re-engineering of Nepal Rastra Bank; 2) restructuring of Rastriya Bajijya Bank and Nepal bank Limited and 3) Capacity building in the financial sector. These components are aimed at accomplishing all the programs of financial sector strategy paper of HMG/N publicly announced on November 22, 2000. Due to these efforts the number of financial institutions is being abundantly increased.

The financial sector reforms in the latter part of the fifth decade were initiated under the supportive help of the international monetary fund supported poverty reduction growth facility (PRGF). In addition, there has been a number of initiatives to meet the increasing challenge of regulation and supervision of the domestic financial institutions ordinance and the debt recovery act, along with establishment of a debt recovery tribunal and amending the public debt act and the foreign exchange regulation act. Likewise international relations had been established with the world trade organization (WTO) the Bay of Bengal initiative for multi-sectorial technical and economic cooperation (BIMSTEC) as well as having agreed to a framework for a South Asian Free Trade Agreement (SAFTA) all in 2004.

The most salient achievement of financial reform is the enactment of the Nepal Rastra Bank act 2002, which addresses the challenges brought by the evolving financial sector and also focuses the role of the bank on effective monetary management for domestic financial sector stability. These are explicitly laid down by the act as the bank's primary functions which are: to formulate necessary monetary and foreign exchange policies in order to maintain the stability in price and consolidate the balance of payments for sustainable development of the economy of the kingdom of Nepal, to develop a secure, healthy and efficient system of payments; to make appropriate supervision of the banking and financial system in order to maintain its stability and foster its healthy development; and to further enhance the public confidence on entire banking and financial system of Nepal; As the Nepal Rastra Bank Act, 2002 mandates the bank has been bringing out the annual monetary policy of the bank which provides the policies, strategies and actions and had first come out in 2002. The Nepal Rastra Bank Act 2002, determines the present organizational structure of the bank. At the top level the bank is governed by a board of directors consisting of seven members. The governor of Nepal Rastra Bank (as Chairman), the

secretary to the ministry of finance of government of Nepal, both deputy governors and three other appointees of the government of Nepal are the members. Those appointees are reputed economists and the policy makers of the nation. The board of directors is responsible for necessary formulation of bank related rules regulation legislation and overall management of the bank. Directly under the board there exist an audit committee which is headed by a non-executive board member. The internal audit department reports to the board through the audit committee. The act has also a provision for management committee which will be presided by the governor for the execution and implementation of necessary decisions taken by the board of directors and the top management of the NRB, the information is disseminated by the governor's office. The two- deputy governors execute the regular affairs of the bank.

In this way, Nepal Rastra Bank is functioning as a guide of the Nepalese economy from its establishment. The economic condition of Nepal is being stronger under the guidance and leadership of Nepal Rastra Bank on domestic financial system.

NRB as the Central Bank of Nepal was established under the first 5- year plan in 1956 with the following objectives-

-) To ensure facilities and maintain economic interest of the general public of safeguarding the issue of Paper Currency.
-) To secure countrywide circulation of Nepalese currency.
-) To mobilize capital for economic development and stipulation in trade and industries.
-) To achieve stability in its exchange rate.
-) To develop banking system in the country.

In 2002, NRB's objectives were reformed with NRB Act 2002. It has the following objectives:

-) To formulate necessary monetary and foreign exchange policies in order to maintain the stability of price and balance of payment for sustainable development of economy, and manage it;
-) To promote stability and liquidity required in banking and financial sector;
-) To develop a secure, healthy and efficient system of payment;

-) To regulate, inspect, supervise and monitor the banking and financial system;
-) To promote entire banking and financial system of the Kingdom of Nepal and to enhance its public credibility;
-) The bank shall, without any prejudice to the objectives referred under first point above extend co-operation in the implementation of the economic policies the government of Nepal

6.2 Role of NRB in Economic Development of the Country

NRB was established in 1956 as the Central Bank of the country. It supervises all Commercial Banks and other Financial Institutions. The major functions of NRB are:

1. To issue Nepalese currency;
2. To operate government accounts and provide advice regarding financial transactions of the Government;
3. To mobilize capital and manage public loans for development of the country;
4. To recommend to the Government ,exchange rates for Nepalese and Foreign Currencies and to formulate regulations regarding Foreign Currency control;
5. To advice Commercial Banks and Financial Institutions on banking management;
6. To fix interest rates on deposits received and investments made by commercial Banks;
7. To determine bank rates for the purchase of bills of exchange and for the repayment or purchase of business documents as allowed by the rules and
8. To conduct other transactions for facilitating Government Financial Operations.

The main objective of central bank is to maintain monetary stability. To fulfill such objective, Nepal Rastra Bank has been given related authority and responsibility to maintain monetary stability by the Nepal Rastra Bank Act 2058. Apart from the above mentioned functions there are other functions of NRB as follows:

Monetary Market

When the Nepal Rastra Bank was established, the development of monetary market in Nepal was far poor. Most of the transactions were carried out in Indian currency including the salary provided by the government. Only one bank i.e. Nepal Bank Limited was in operation. Therefore, to overcome such difficulties and for the appropriate development of monetary market, Nepal Rastra Bank was established.

Industrial Finance

The economic development of the nation highly depends upon the development of industrial sectors. For the development of industries, they need facilitative and long-term financing for the capital requirement. To fulfil such requirement of financing, NIDC was established in 2016. Nepal Rastra Bank has been contributing to mobilize industrial finance by providing the facility of rediscount, re-credit, by purchasing debentures issued by NIDC etc. Similarly for the development of small and cottage industry, Nepal Rastra Bank NRB makes various arrangements with the help of Government of Nepal or with the assistance of foreign donor of institution or country. Nepal Rastra Bank NRB act has also provided provision of investment in priority sectors and investment in productive sector.

Rural Finance

In Nepal, nearly 80% of the total population is in rural areas. Therefore, national economic development is not possible unless the rural area is developed. Similarly, the people in the rural area need to be participated in the economic activities for overall development. For such purpose i.e. to mobilize rural finance Nepal Rastra Bank makes various arrangements to make investment in agriculture, farming, small and cottage industries and to mobilize saving in that area. Still much of the population in rural area depends upon unorganized loan at high interest rate. To provide institutionalized loan, Nepal Rastra Bank NRB has made arrangements to launch projects like micro financing for women, poverty alleviation, and rural finance.

Inflation

Generally, the increase in price level of aggregate of commodity during interval of time is called inflation. Inflation may be caused due to various elements like increase in production entrepreneur, increase in the supply of money, increase in the credit etc. Among these elements, Nepal Rastra Bank NRB can influence some elements like phenomenon of supply of money, credit creation and control etc. Nepal Rastra Bank NRB therefore needs to make positive influence to the expansion of monetary market by which the employment and economic growth can be increased.

Foreign Exchange

The central bank also functions as the custodian of country's foreign exchange reserves. This function helps the central bank to overcome the difficulties regarding balance of payments. The exchange rate can be stabilized with the help of this role or function. In order to maintain stability in the foreign exchange rate, the central bank buys foreign currencies in the market as the value of foreign currencies falls. This action decreases the supply of the foreign currencies in the market and thus the falling value of foreign currencies is controlled.

In case, the value of foreign currencies is increased suddenly. Such condition is not favorable for smooth economic development of a country. In this condition, central bank sells foreign currencies in market. When the supply of foreign currencies is increased, the value of such currencies will automatically be stabilized in the money market. In Nepal, Nepal Rastra bank play the role as the custodian of foreign exchange reserve. All types of public transactions of foreign currency are prohibited by act in Nepal. So foreign currencies cannot be used as the means of payment in local transactions. People having foreign currencies should exchange with Nepalese currencies to pay for local transaction.

Such foreign currencies are provided to those only, who have to make payment to foreign countries for import business, who are going abroad for tour, study, medical care or any other purposes. Such provision makes the Nepal Rastra bank more successful in controlling the rate of foreign exchange.

Although the management of foreign currency is also a part of monetary policy, it has a substantial role for the national economy. For those countries like Nepal, which has high amount of trade deficit, it needs substantial amount of foreign currency reserve for such purpose. For the continuous supply of the foreign goods, foreign exchange, which is acceptable to the foreign exchange market, is necessary. Previously, Nepal Rastra Bank carried out the total arrangement about the foreign currency, but with the adoption of liberal economic policy, Nepal Rastra Bank NRB has allowed the commercial banks to make transactions of such foreign currency. In one way, Nepal Rastra Bank makes various arrangement for the proper utilization of foreign currency, and in another way it reserves such currency.

Similarly Control of credit, Publication of economic indicators and Training facilities to the bankers are other functions of NRB.

The NRB is playing important role in the economic development of Nepal. For the role of NRB in economic development of LDCs, the central banks in the LDCs have important role to play in promoting economic development. Hence the NRB of many LDCs have been given wide powers to promote the growth of the economy. Sometimes the Central Banks in the LDCs have set out the guidelines to follow for some definite pattern of economic policies. In many cases the LDCs have also taken steps to promote the integration of the dual money markets. Many Central Banks in the LDCs have to take steps in publishing information regarding the state of the economy and in promoting research in money and banking.

In recent years, the NRB has played an active role in promoting banking and financial institutions to make them responsive to the growing need of bank and finance a related services. Further, the Agriculture Projects Services Centre (APROSC) and Credit Guarantee Corporation (CGC) has established with the active participation of the NRB. The role of NRB.

6.2.1 Developmental function of Nepal Rastra Bank

Except regulatory functions of NRB like issue of currency note, Banker to the government, Transactions in Foreign Exchange, Banker's Bank, Controller of credit, it has the following developmental functions as well:

- a) Share participation in different Institutions;
- b) Banking Development Scheme;
- c) Development and Extension of the capital market;
- d) Training to personals involved in the banking fields;
- e) Refinance to Banks and Financial Institutions;
- f) Economic survey;
- g) Supervision of the banks;
- h) Agricultural financing;
- i) Industrial financing;
- j) Financing in the priority sectors;

6.2.2 NRB as a Regulatory Mechanism

One of the important roles of the NRB is to regulate the activities of the Commercial Banks and Financial Institutions. The high degree of imperfection, in the financial markets calls for the need for regulation of banking industry even in a liberalized and deregulated economic environment. Regulations play a role of containing the risk of investors misappropriating the money of savers and maintain and promote the public confidence in the banking system. The regulatory framework in the banking industry is also necessary because absence of regulations may lead to anarchy in the banking system. In this regard, the role of regulator lies in insuring proper and adequate information conveyed to the savers. Publishing annual financial statements of banks is one of the best ways of providing information to the depositors and other interested parties.

Annual financial statements of every bank are subject to audit by legal auditors appointed by the annual general meeting. The legal auditor of a bank conducts the audit in accordance with the applicable auditing standards and requirements of applicable regulations. The auditor expresses his opinion on the financial statements

of the bank as to whether or not the financial statements are true and fair. Such an opinion helps in enhancing the credibility of the financial statements, which may be used by the depositors as well as regulators in making certain decisions. Audit of annual accounts by an independent auditor also helps in promoting confidence in the banking system.

Banks can publish their financial statements only after obtaining approval from NRB. This implies that financial statements audited by the bank auditor are subject to further analysis by the bank regulator. While publishing financial statements, banks are required to attach the instructions given to the banks by NRB, if any. The bank auditor and bank regulator have common objective of examining the financial soundness of the bank. But, the relationship between the bank auditor and bank regulator has not always been smooth as the latter raises serious observations on the financial statements already audited by the former.

Audit report submitted by the auditor can be classified into two types: i) Clean report and ii) Qualified report. A clean audit report is the unqualified report of the auditor. A qualified audit report is one in which the auditor expresses his strong condition on the truth and fairness of the financial statements presented by the management.

NRB has the practice of issuing instructions to the Commercial Banks if it has serious observations on their financial statements submitted for seeking approval to publish the same. Such instructions can be classified into two types: i) Instruction affecting the financial positions and operation results of the bank and ii) instructions not having adverse effect on the financial positions and operational results of the bank.

While granting approval to publish financial statements of banks for fiscal year 2001/2002, NRB has issued instructions to the majority of the banks, the compliance of which will disfigure their financial positions and operating results. Such instructions includes making additional provision for loan loss and reversal of interest suspense account. Generally, NRB has been allowing banks to rectify such deficiencies in the financial statements of forthcoming fiscal year. This practice provides a great relief to the banks from revising the financial statements which are already audited. But, clean report of auditor and qualified comments of NRBs on same financial statements confuses the readers of the financial statements.

A question may arise as to why two examiners of financial statements – bank auditor and NRB differ on the fairness of same financial statements. One may argue that financial statements serve a variety of purposes and regulatory need is one of such purposes. Therefore, bank regulator has narrower approach on examining the financial statements as compared to the approach of statutory auditor. An audit involves the exercise of professional judgment, depending upon the circumstances of the case. Financial statements include information based on judgment and the estimate made by the management and examined by the statutory auditor. The controls and the accounting policies the bank uses when preparing information for the banking regulator may not be the same as verified by the statutory auditor for his audit purpose.

There may be more arguments in favour of the auditor's opinion on the bank's financial statements. The economics of practice do not afford the luxury of detailed and complete reviews of documentation and transactions. The work done for the audit report is based on selective testing, very often with reliance placed on systems of internal control. On the other hand, the regulator, not burdened with the responsibility of an opinion on the financial statements taken as a whole, is able to focus with some intensity on the critical, high-risk areas.

But, however, the aforementioned arguments may not be enough to justify the work of auditor. The provisions on loans are required to be made on aging basis and the interest income is to be accounted on cash basis. There is not room for subjective judgment on determining these variables. Therefore, there is a need to bridge the understanding gap between the bank regulator and an auditor and a bond of mutual trust must be built up between these parties. The combined effort of both the parties will contribute to strengthening the banking system.

6.2.3 NRB as a Growth Promoting Agency

The concept of central Bank has been changing rapidly during recent years in terms of its role and policies, its relation with other banks, Financial Institution, Government and Non-bank financial institutions, its attitude toward economic development, etc.

The traditional type of a central Bank was mainly responsible for the internal and external stabilization of monetary unit whereas the modern CBs in LDCs deviate mostly from that line and they have been the potential developmental agency rather than being only the stabilization devices.

We have not been able to start the engine of self-sustained growth and to determine the growth path along which development movement takes place. As the dependence on foreign aid is increasing during recent years that has to be completed by a higher rate of domestic savings for enhancing the development activities. But since most of the population is below poverty line the burden of tax can be added only at the cost of subsistence. The present inflationary situation is no doubt, distributing income from the poor to the rich, villages to town and so on. One can argue that the higher and urban n income community is being extravagant and conspicuous and that is leading to higher importation inviting again and again the serous balance of payment problem. Keeping that paradoxical situation aside were required to be very strict and clear with regard to policy affair. If wastage of resources remains unchecked future community will not only suffer but also the developmental problem will become more and more serious, creating self-generating problem forever. Banking and financial Institutions can at their best provide the opportunity for saving voluntarily and these can be used as a means of mobilization and channelization. The financial institutions through their incentive rate attract and bring borrowers and lenders together.

Central Bank in LDCs, like ours, can design this institutional framework and create financial infrastructure, which is fundamental for generating growth in the country. Usually central banks in many LDCs are performing, as the developmental agency with the following functions.

- i) They are assisting in the creation of specialized financial institutions by subscribing to their equity capital and thereby are raising the credit supplying strength of concerned institutions.
- ii) They are guaranteeing the bonds issued by development banks to enable them to attract capital from inside and outside of the country.
- iii) They are formulating such type of monetary policies which divert bank credits to prefer such productive areas such as trade, industry, agriculture etc.

- iv) They are helping in the creation of financial infrastructure by laying the foundation of securities markets so as to buildup socio-economic framework conducive to economic development.
- v) They are keeping their fingers on economic pulse of the different sectors of the economy.

NRB was endowed with the powers of a banker's bank after 1966. As the country is developing, its role in Nepal is different from that of traditional bank. The NRB Act lays down the purposes of the bank as regulating the issue of paper money, securing country wide circulation of Nepalese Currency, achieving stability in exchange rate, mobilization of capital for economic growth, developing banking system in the country, etc.

The NRB is issuing and managing Nepalese Currency since the time of its establishment but it became a banker's bank only after the amendment of the Act in 1962 and 1966. Between these periods NRB was mainly concerned with countrywide circulation of Nepalese currency. In reference to that it tried to control the supply of Indian Currency and maintain its convertibility in the initial years-during early sixties, and as NRB became the member of IMF and IBRD in 1961 it fixed the rate of foreign exchange, managed and regulated it and was concerned with advising government in these matters. Today NRB implements the following policies:

- i) Increase the growth rate by providing institutionalized credit on easy terms to priority sectors such as agriculture, industry, trade, etc.
- ii) Extend the banking facilities throughout the country so as to monetize the economy by helping the establishment of the branches of Commercial Bank.
- iii) Coordinate the policies and functions of banking and non-banking institutions with that of NRB for the smooth functioning of the economy.

These policies basically reflect that objectives that are wider than those of developed countries including the regulation of money and capital market, promotion of economic life, maintenance of high level of employment, stabilization of monetary unit, etc. But since the success of the monetary policy depends upon the use and exercise of Fiscal policy, both policies should be treated not as the substitute for each other but as complementary to each other. In this respect NG and NRB should work in

harmony. NG should not misuse its power of influencing NRB activities and should not try to exercise undue influence over it. That is to say, NRB's suggestions in monetary affairs must be influential and should get due weight. NRB as a growth-promoting agency also carries out the following developmental roles:

6.2.4 Promotion and Development of Capital, Money and Credit Market

Unless the country develops its capital and money market, the economic and financial development is impossible. The institutions dealing in capital fund and credit supply such as Commercial Banks and Development Banks are the pre-requisite for stimulating the development process. These institutions meet the financial needs in the country by mobilizing the resources scattered throughout the country. The NRB since its very inception has helped and supported these institutions in financial matters.

NIDC and ADB have been established in the country, whose concern is to arrange medium and long-term share. The NRV is providing financial facilities and has undertaken in equity participation. Not only it has been promoting these institutions and through them mobilizing saving but also it has been giving the direction as to where these savings are to be channelled. By giving refinance facilities to these institution NRB has strengthened their financial position and has supplied credit to the priority sector. Again, the NRB has given refinance facilities to National trading Ltd., Oil Corporation, Jute Corporation and Food Corporation.

Further, the NRB has helped, by means of equity participation, in the establishment of security market under NIDC which aims at the provisions such as to develop stock-exchange marker, to induce capitalization of investable fund to underwrite the share and debentures of the company and corporations, to buy and sell the securities of company and corporations, to buy and sell the securities issued by government, semi-government and other bodies.

The NRB has not only directed the banks to open branches but it has also regulated their credit operations. The long term objective of the NRB has been providing at least one Commercial Bank branch in ach district. The NRB has constituted a

‘Banking development Fund’ and the fund will be used to compensate the losses arising from opening new branches.

6.2.5 Monetary Management

NRB has been exercising monetary policy since 1960s with instruments like credit control regulation, investment rate administration, margin rates, refinance rates and cash reserve ratio. These instruments were not sufficient to control credit in financial sector of the economy. Thus, by the beginning of 1970's, NRB had also fixed credit ceiling for commercial banks and other financial institutions as a tool of monetary policy.

In the initial phase of Nepal Rastra bank the monetary policy instruments were of direct type and shift from direct to indirect policy instruments began from the FY 1984. The complete graduation to indirect monetary policy instruments begins from the third year of SAP in FY 1989/90. This was the year when NRB fully deregulated interest rates and did away with credit ceiling and relied on indirect instruments such as open market operations (OMOs).

Since 1989, interest rate policy has been conducted primarily through moral suasion aimed at lowering lending rates while discouraging significant increase in yields on treasury bills. NRB had issued a directive on July 30, 1998 to commercial banks to limit the interest spread to 5 percent. The main goals of monetary policies are implemented through monetary policy variables. The main monetary policy variables at the disposal of monetary authority for achieving policy goals like growth, stability and BOP surplus are the quantity of money, bank credit and interest rate.

Keynesian economists prefer interest rate as the proper monetary policy variables whereas monetarists opt for money supply as the appropriate policy variable. Many others, from Neo-Keynesians and Radcliff economists to open economy monetarists, advocate for credit as the appropriate policy variable. Although the supply of money and interest rate are interlinked, the central bank cannot determine both of them and hence has to choose one of them as a monetary policy variable.

In the Nepalese context, money supply is supposed to be the superior policy variable than interest rate on several counts. First it is directly linked with policy goals like money income, prices and BOP and easy to manipulate by NRB than interest rate. In the present situation NRB is focusing toward indirect policy instruments like bank rate, CRR and open market operations (OMOs) than direct ones to achieve the policy goals like growth price stability and BOP surplus. As the NRB act 2002 mandates NRB to be fully autonomous to formulate and implement monetary policies with various strategic frameworks should be made public each year.

The NRB is using its means of monetary management quantitatively and selectively for the achievement of broad economic goals of the country. But the scope is still very narrow because of small size of the money market, low degree of control over the money and capital market, uncontrollable influence of foreign trade on the national economic activities, low stage of the development of organized money and capital market, inelastic structure of the economy i.e. weak influence of interest rate on investment decisions for raising the level of output, employment, etc.

We should be more aware of the country's economic situation and search for more appropriate and direct method of monetary management.

CHAPTER – VII

SUMMERY, CONCLUSION AND RECOMMENDATIONS

7.1 Summary and Conclusion

Nepal is one among the poorest countries of the world. Population is growing at a rate of 1.35 percent per annum. About 83 percent people are living in rural areas. The conditions prevailing in the rural areas may be taken as broadly indicating the overall situation as a whole. In the discussion about current macroeconomic situation for Nepal it is found that both narrow money and broad money increased, stock exchange transactions as well as the NEPSE index increased, government expenditure, on cash basis is increased, BOP deficit is increasing.

In the initial years the NRB was concerned mainly with the problem of organization and consolidation of the traditional functions. The NRB, in order to maintain a sound monetary situation and to extend banking facilities, has been making various efforts and adopting the policies that will be for the economy. For the development of Nepalese economy there should be development of banking system in urban as well as rural areas.

In the ancient time barter system was prevalent. Though currency notes were started to be issued since 1945, the dual currency system continued. The use of IC was still common practice except in some hilly regions and in Kathmandu valley. After the existence of the central bank, the dual currency system was completely eradicated and Nepalese currency became legal tender of the country. He note issue, therefore, is one of the core functions of the Bank. Nowadays NRB issues notes and strikes coins according to the need, since the beginning, NRB has been playing the vital role for the development and expansion of financial system in the country. As of 2014, the financial system consisted of 30; 84; 53 and 37 of grade A, B, C, and D respectively. Branches 1547,818,239 and 826 of grade A, B, C and D respectively. In this regard in average 7,724 people get banking facility per financial institution branch.

Financial sector plays a crucial role in the economic growth of the country. It is regarded as the engine of growth. As the apex financial institution of the country,

NRB has a big role to play. The insurance Board and securities Board also have to play their role to expand securities services. The Nepalese commercial banks and especially RBB and NBL are at deterioration. NG, NRB and the World Bank are very serious to turn them into sound and efficient banking institutions.

The rate of inflation was 9.1 percent in the end of FY 2014/15. Pressure on inflation is building up. Reasons of this high inflation are-high price hike in food and beverages (12%) and price rise at 7% of non-food and services category. Weak supply system, energy crisis, devaluation of Nepalese currency, price rise of petroleum and Indian inflation caused inflationary pressure in Nepal. Further rise in expenditure from income in the past 3 years by 14.9 % in average but low productivity in comparison to the expenditure is another reason for the inflationary pressure.

The central bank of 21st century, as a monetary authority of the country, cannot simply confine within the domain of domestic monetary affairs for the purpose of formulating and implementing an effective monetary policy. In a developing country like Nepal, the importance of the Central Bank lies in its capacity to assist the process of economic development. The NRB is performing the twin functions that are regulatory and developmental. In the regulatory functions the main functions are issuing notes, controlling credit transaction for foreign exchange, banker of government etc. In the developmental functions the main functions are share participation, banking development survey, supervision, training, refinancing to Banks and Financial Institutions etc.

7.2 Recommendations

Following recommendation are made on the basis of the study and analysis of collected data;

- i) Although the number of Nepalese banks and financial institutions have grown up rapidly over few decades, the even distribution of them throughout the country and investment towards productive, agricultural and industrial sectors are to be pragmatically assured by the policy of NRB.
- ii) Due to underdeveloped economy, the evaluation of currency is not praiseworthy. To manage this situation foreign trade, well-managed foreign

employment, conversion of the country's economy into modern one are essential. Furthermore for accurate Nepalese exchange rate, the pegged exchange rate between Nepal and India should be reviewed.

- iii) Role of central bank for developing economy for economic development is more important than regulatory functions. So increased in share participation in different institutions, extension of capital market, well management to banks and financial institutions, reliable economic research are to be expected.
- iv) We should be more aware of the country's economic, monetary and financial situation and search for more appropriate direct method to maintain them.
- v) Most of the people in our country are illiterate. They do not have confidence upon the bank for deposits and loans. The NRB by educating the illiterate people by means of advertisement, telefilms, posters etc. can build a sense of confidence and trust towards the banking institutions in the rural as well as urban areas.
- vi) The relation of NRB with Banks, financial institutions, government and non-bank financial institutions always keeps in close touch with its movement, which helps for the economic development of Nepal.
- vii) NRB should be strongly committed for the reform of the financial sector in general and RBB, NBL, ADB and NIDC in particular. Much depends on the proper implementation of the financial sector reform program. The financial sector invites financial crisis which may easily transfer to other sectors of the economy. At such, we have to be extra cautious for the financial liberalization and reforms of the financial sector.
- viii) The NRB should give attention for the development of money and capital market which are still in infant stage. The development of these markets will mobilize the scattered resources for economic development. So, the NRB should provide both economic and administrative help to the security marketing corporation to fulfill its objectives.
- ix) To develop the NRB into a modern central bank, capable in maintaining economic sector stability it should update the information technology, supervisory capability and human resource management. The NRB should have a clear and prudential guiding and leading role for the growing

financial sector in the days to come, which will facilitate it becoming more competitive.

- x) There should be regular meeting and communication with the Banks, financial institutions, and government and non-bank financial institutions to sort out the problems and to make the programs successful for the economic development of Nepal.

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