FINANCIAL STABILITY REPORT

Nepal Rastra Bank

Central Office

Baluwatar, Kathmandu

July, 2018

FINANCIAL STABILITY

REPORT

(Issue No. 10)

Nepal Rastra Bank
Baluwatar, Kathmandu

Disclaimer

This *Tenth issue* of the Financial Stability Report is based on the provisional data of Bank & Financial Institutions (BFIs) and other financial institutions as of mid-July 2018. Data used in its analysis may thus differ from the most recent statistics or audited final data published by BFIs. All the findings, interpretation and conclusions expressed in this report do not necessarily reflect the views of Nepal Rastra Bank or its Board of Directors. The colors, boundaries, denominations or any other signs and symbols used in the report do not imply any metamorphic judgments. This report, unless or otherwise stated elsewhere, covers the developments and risks during the year to mid-July 2018. All the data and information in this report are retrieved from NRB depository, unless stated.

Nothing herein shall constitute or be considered to be a limitation upon or waiver of the provisions of existing rules, regulations and legislations.

Published by:
Nepal Rastra Bank
Central Office
Banks and Financial Institutions Regulation Department
Financial Stability Unit
Baluwatar, Kathmandu
Nepal
Ph: 977 1 4411407
Fax: 977 1 4414552
Email: fsu@nrb.org.np

Contents

Statistical Annex

List of Figures

List of Tables

Acronyms

ADBL	Agriculture Development Bank Limited
AE	Advanced Economies
ANNA	Association of National Numbering Agencies
ASBA	Application Supported by Blocked Amount
ATM	Automated Teller Machine
BAFIA	Bank and Financial Institution Act
BFIs	Bank and Financial Institutions
BoD	Board of Director
CAR	Capital Adequacy Ratio
CB	Commercial Banks
CBS	Central Bureau of Statistics
CCB	Capital Conservation Buffer
CD Ratio	Credit to Deposit Ratio
CEO	Chief Executive Officer
CIT	Citizen Investment Trust
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
CSR	Corporate Social Responsibility
DBSD	Development Bank Supervision Department
DCGF	Deposit and Credit Guarantee Fund
DoC	Department of Cooperatives
ECB	European Central Bank
FI	Financial Institution
EMDE	Emerging Market and Developing Economies
EMEs	Emerging Market Economies
EPF	Employee Provident Fund
FINGO	Financial Non-government Organization
FEMD	Foreign Exchange Management Department
FSAP	Financial Sector Assessment Program
FSI	Financial Soundness Indicators
GBBs	Grameen Bikash Banks
GDP	Gross Domestic Product
GFSR	Global Financial Stability Review
GoN	Government of Nepal

IMF	International Monetary Fund
INR	Indian Rupees
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
IRC	Interest Rate Corridor
ISIN	International Securities Identification Number
LCR	Liquidity Coverage Ratio
LCY	Local Currency
LLP	Loan Loss Provision
LMFF	Liquidity Monitoring and Forecasting Framework
LoLR	Lender of Last Resort
LTV	Loan to Value Ratio
MFIs	Microfinance Financial Institutions
NBA	Non-Banking Assets
NBL	Nepal Bank Limited
NEPSE	Nepal Stock Exchange
NSFR	Net Stable Funding Ratio
NGO	Non-Government Organization
NIDC	Nepal Industrial and Development Corporation
NPA	Non-Performing Assets
NPLs	Non-Performing Loans
NRB	Nepal Rastra Bank
PCA	Prompt Corrective Action
PIRD	Problem Institution Resolution Division
RBB	Rastriya Banijya Bank
ROA	Return on Assets
ROE	Return on Equity
RSRF	Rural Self Reliance Fund
RWA	Risk Weighted Assets
SOBs	State Owned Banks
SEBON	Security Board of Nepal
SLF	Standing Liquidity Facility
SLR	Statutory Liquidity Ratio
SOL	Single Obligor Limit
US	United States
WEO	World Economic Outlook

Foreword

Nepal Rastra Bank (NRB), the Central Bank of the Federal Democratic Republic of Nepal has an objective as mentioned in Nepal Rastra Bank Act, 2002 (2058 B.S.) is to maintain stability of the banking and financial sectors. In order to ensure this, NRB has been focusing on assessing risks and vulnerabilities of the domestic financial system and implementing international standard prudential regulations and supervision.

In this regard and to convey activities in a transparent manner as well as to stabilize expectations, NRB has been publishing financial stability reports annually since 2012. The reports identify the key risks, issues and challenges of Nepalese financial system with steps taken by NRB for the management of those. During the review period the domestic banking sector witnessed growth in terms of paid up capital and coverage throughout the country, the share market showed bearish trend and real estate transactions had declined. The size of total assets and liabilities of the Banks and Financial Institutions (BFIs) had continued to increase. Similarly, non-BFIs (NBFIs) had also witnessed huge increment. It is noteworthy that with effective implementation of prudential regulation/supervision by this bank, the domestic banking system has reduced its high exposures in real estate and other unproductive sectors.

The current issue of this report focuses on the trends of macroeconomic indicators, performance of BFIs and NBFIs in Nepal (including their liquidity and capital adequacy), the risk as well as resilience of these sectors along with capital market developments. Stringent micro-prudential regulation and supervision, judicious application of macro-prudential oversight and broad-based financial inclusion, have all contributed significantly to the stability of the domestic financial system. With an expanded structure of the nepalese financial sector, NRB has moved towards Basel III capital and liquidity framework in the domestic banking sector to achieve a desired level of financial system stability. This report contains the analytical review of the domestic banking and financial system and the achievements accomplished through the implementation of key regulations/policies.

For preparing this high quality report, I would acknowledge the dedication and efforts of officials in the bank, Financial Stability Oversight Committee, Financial Stability Sub-committee and the Financial Stability Unit. I believe that this report will be essential to the stakeholders for facilitating them in obtaining important insights of Nepalese financial system and will provide awareness of emerging risks and fragilities in the financial system. I am also confident that this report would serve as a useful reference for those having interest on the financial system of the country.

(Dr. Chiranjibi Nepal)

Phone: 977-1-4410386 Fax: 977-1-4410159 Post Box: 73 Website: www.nrb.org.np Email: ofg@nrb.org.np

Executive Summary

World economy grew at 3.7 percent in 2017 and is expected to expand at the same rate for both 2018 and 2019 according to World Economic Outlook (WEO) October 2018. Advanced economy grew 2.3 percent in 2017 and is expected to grow at 2.4 percent in 2018 and 2.1 percent in 2019. Emerging market and developing economies grew 4.7 percent in 2017 and is projected to expand at the same rate in both 2018 and 2019. For 2018-19, the growth rates are expected to scale up in Commonwealth of Independent States, Latin America and the Caribbean and Sub-Saharan Africa, and expected to slowdown in Emerging and Developing Europe, European Union, and Emerging and Developing Asia.

According to WEO October 2018, inflation remained at 1.7 percent for Advanced Economies and 4.3 percent for Emerging and Developing Economies in 2017. The inflation forecast for Advanced Economies is 2 percent for 2018 and 1.9 percent for 2019 whereas such forecast for Emerging and Developing Economies is 5.0 percent for 2018 and 5.2 percent for 2019 on account of expected higher energy prices in these years. However, core inflation remained very different across the advanced countries. In Nepal, annual average consumer price inflation decreased to 4.2 percent in 2017/18 from 4.5 percent in the previous year. The normal supply situation and lower global prices including that of India contributed to inflation easing in the review year. While the average food inflation increased to 2.7 percent in 2017/18 from 1.9 percent in the preceding year, the nonfood inflation decreased to 5.3 percent in the review year from 6.5 percent a year ago.

Central Bureau of Statistics (CBS) estimated the growth of real GDP (at producers' price) at 6.3 percent in 2017/18 compared to 7.9 percent in 2016/17. Similarly, the real GDP at basic price is estimated to grow 5.9 percent compared to a growth of 7.4 percent in the previous year. GDP grew at a healthy rate despite unfavorable weather condition due to expansion of electricity, power and gas sector, pick up in construction activities, improved output of industrial sector and increased tourist arrivals among others.

Merchandise exports grew 11.1 percent in 2017/18 to Rs. 81.19 billion compared to a growth of 4.2 percent in 2016/17. Total merchandise exports as percentage of GDP shrank to 2.7 percent in the review year from 2.8 percent in the previous year. Merchandise imports increased by 25.5 percent to Rs. 1242.83 billion in the review year as against a growth of 28.0 percent in the previous year. Total import-to-GDP ratio increased to 41.3 percent in the review year from 37.5 percent of the previous year. Merchandise trade deficit widened 26.7 percent to Rs. 1161.64 billion in 2017/18. The export-import ratio declined to 6.5 percent in the review year from 7.4 percent in the previous year. Total merchandise trade deficit as percentage of GDP jumped to 38.6 percent in the review year from 34.7 percent of the previous year

The total services receipts increased to 12.1 percent and expenses rose to 12.9 percent in the review period. As a result, net services surplus stood at Rs. 2.07 billion in the review year compared to Rs. 2.89 billion in the previous year.

The workers' remittances increased by 8.6 percent to Rs. 755.06 billion in the review year compared to a growth of 4.6 percent in the previous year. The ratio of workers' remittances to-GDP declined to 25.1 percent in 2017/18 from 26.3 percent in 2016/17. The net transfer receipts increased by 1.5 percent to Rs. 864.67 billion in the review year. Such receipts had increased by 9.5 percent in the previous year.

Global Financial Stability Report October 2018 finds that the regulatory frameworks have been enhanced and banking system has become stronger but the resilience of global financial system is yet to be tested with the emergence of new vulnerabilities that have arisen after the global financial crisis. It further asserts that the short term and medium term risks to global financial stability have increased due to easy financial conditions contributing to the buildup of financial vulnerabilities. It further asserts that global financial conditions have marginally tightened and the divergence between the advanced and emerging economies has grown. Continuation of global economic expansion in advanced economies has been accommodative till date. Financial conditions of emerging economies have tightened due to higher external financing costs, rising idiosyncratic risks and escalating trade tensions. All these upswings and downswings in advanced and emerging market economies have jointly created threat to the world economic stability.

Nepalese banking system is undergoing restructuring and consolidation, particularly through the merger/acquisition and paid-up capital increment. As of mid-July 2018, the total number of banks and financial institutions stood at 151 comprising commercial banks 28, development banks 33, finance companies 25, and microfinance development banks 65. Besides, 40 other financial intermediaries licensed by NRB, 39 insurance companies (including 20 life, 18 non-life and 1 reinsurance company) and several non-bank financial institutions such as EPF, CIT and Postal Saving Bank are also in operation.

The share of banks and financial institutions in total assets and liabilities of the financial system stood at 77.68 percent in mid-July 2018. The commercial banks remained the key player in the financial system occupying 64.29 percent of the system's total assets followed by development banks (7.76 percent), finance companies (1.99 percent) and micro finance financial institutions (3.64 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.05 percent share, followed by insurance companies (5.39 percent), CIT (2.36

percent), and Reinsurance Company (0.21 percent) as of mid-July 2018. The share of cooperatives in total financial system stood at 8.04 percent in mid-July 2018 compared to 9.68 in mid-July 2017.

Total assets of BFIs increased by 18.81 percent and reached to Rs. 3575 billion. Commercial banks had provided 16.25 percent of their total loan to priority sector which includes 8.16 percent in agriculture, 3.94 percent in hydropower and energy sector and 4.15 percent in tourism sector. Commercial banks have lent 8.16 percent in agriculture which is less than the regulatory limit of 10 percent. Similarly, commercial banks have lent 8.09 percent in energy and tourism sector, which is less than the regulatory limit of 15 percent.

The overall deprived sector lending by BFIs as of mid-July 2018 remained 6.28 percent where commercial banks, development banks and finance companies have lent 5.94 percent, 9.47 percent and 5.46 percent respectively. In mid–July 2018, the capital fund of BFIs increased by 19.88 percent to Rs. 370.01 billion from Rs. 308.65 billion in mid–July 2017. The overall CAR of BFIs in mid-July 2018 stood at 15.15 percent which was 15.40 percent in the previous year.

NPL of BFIs stood at Rs. 38.51 billion in mid-July, 2018 compared to Rs. 36.10 billion in mid-July 2017. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2018 indicating the banking sector's resilience in large. NPL to total loans of banking industry stood at 1.60 percent of total loan comprising 1.39 percent of commercial banks, 1.09 percent of development banks and 10.83 percent of finance companies.

Credit flows from BFIs increased by 21.47 percent in mid-July, 2018 compared to a year ago. Such increment was 18.60 percent in mid-July, 2017. Credit of commercial banks, development banks, and finance companies grew by 21.69 percent, 17.93 percent and 16.68 percent respectively in mid- July, 2018.

Deposits of BFIs increased by 18.96 percent in mid-July 2018. The deposit growth of commercial banks, development banks and finance companies registered 18.07 percent, 26.08 percent, 21.92 percent respectively in mid-July 2018.

The overall profitability of banking sector has increased by 12.20 percent in mid–July 2018 and reached Rs. 61.34 billion. The growth rate of profitability of banking sector in the last year was 11.57 percent. The commercial banks posted the highest share of profitability of the banking sector accounting 87.44 percent of the total in mid-July 2018.

After the issuance of the "Bank and Financial Institutions Merger By-laws, 2011", 162 BFIs have merged with each other forming 41 BFIs as of mid-July 2018. In the review period, 19 BFIs have merged and acquired to form 9 BFIs. As of Mid July, 2018, the branch network of commercial banks reached 3023 followed by development banks (993), Finance companies (186) and Micro Finance Financial Institutions (2450). On an average, a BFI branch, excluding the branches of “D” class financial institutions, has been serving to approximately 6858 people. The banking service served population comes down to 5227 people per branch when branches of "D" class are also included.

The state owned commercial banks comprise 15.14 percent share in total deposit of commercial banks. Their market share in terms of total assets, total deposit and loan & advances of all BFIs stood at 13 percent, 15.14 percent and 12.42 percent respectively in mid-July 2018. As of mid-July 2018, capital fund of three state owned banks, namely, NBL, RBB and ADBL stood at Rs. 11.45 billion, Rs. 14.30 billion and Rs. 21.78 billion respectively.

In mid-July 2018, share of commercial banks in total assets and liabilities of NRB regulated BFIs increased to 83.42 percent from 82.75 percent in mid-July 2017. Similarly, ratio of total assets and liabilities of commercial banks to GDP increased to 103.23 percent in mid-July 2018 from 100.8 percent a year ago. The dominance of commercial banks in total banking sector in terms of assets and liabilities as well as in terms of balance sheet component has broadly remained stable. The total assets and liabilities of commercial banks increased by 18.43 percent to Rs. 3068.6 billion in mid-July 2018 from Rs. 2584.6 billion in mid-July 2017.Total deposit and credit of commercial banks stood at 82.20 percent and 70.24 percent of GDP respectively in mid-July 2018 compared to 80.53 percent and 66.10 percent of GDP respectively in mid-July 2017. Total deposits grew by 18.07 percent to Rs. 2471.51 billion in 2017/18 compared to the growth of 18.63 percent in the previous year. Total credit flow grew by 21.68 percent and reached to Rs. 2112.33 in mid-July 2018.

Development banks total deposits have increased by 23.33 percent to NPR 301.97 billion in 2017/18 while gross loans have increased by 19.06 percent to NPR 253.24 billion. Development banks seem to have performed quite well in 2017/18. They have grown at a brisk pace such that growth rate in their deposits has been greater than that in their lending, they have put in more capital and have further improved the already good quality of their loan portfolio. Total assets of development banks have increased by 21.01 percent to NPR 374.81 billion during this period.

Share of finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by their low deposit to GDP ratio which stood at 2.11 percent in mid-July 2018. Such ratio was 2.01 percent in mid-July 2017. The total assets and liabilities of finance companies increased by 22.83 percent to Rs. 83 billion in mid-July 2018 compared to mid-July 2017. Finance companies mobilized aggregate deposit of Rs. 62 billion in mid-July 2018, an increment of 23.79 percent compared to mid-July 2017.

As of mid-March 2018, deposits of cooperatives totaled Rs. 311.23 billion while their total credit stood at Rs. 276.45 billion. There are altogether 38 (20 non-life and 18 life) insurance companies as of mid-July 2018. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 40.03 percent to Rs.260.30 billion in 2017/18. According to unaudited figures of mid-July 2018, The total assets/liabilities of Employees Provident Fund (EPF) increased by 16.27 percent to Rs. 292.16 billion in 2017/18. Likewise, the funds collected by the EPF grew by 14.17 percent to Rs. 278.75 billion in the review period.

Short term and long term interest rates in the financial market remained relatively high in 2017/18 in comparison to 2016/17. Nepalese currency depreciated by 6.30 percent against US dollar during the end of 2017/18 compared to an appreciation by 3.63 percent in the same period of the previous year. The exchange rate of one US dollar stood at Rs. 109.34 in mid-July 2018 compared to Rs. 102.86 in mid-July 2017. The NEPSE index plunged by 23.4 percent to 1,212.36 points in mid-July 2018compared to mid-July 2017. The Float index which was 116.14 points in mid-July 2017 decreased by 25 percent to 87.15 points in mid-July 2018.

CHAPTER - ONE
MACROECONOMIC DEVELOPMENT

GLOBAL ECONOMIC GROWTH

World economy grew at 3.7 percent in 2017 and is expected to expand at the same rate for both 2018 and 2019 according to World Economic Outlook (WEO) October 2018. Downside risks to global growth have risen with the tightened global financial conditions and increased trade tensions among major economies.

Breaking down, advanced economy grew 2.3 percent in 2017 and is expected to grow at 2.4 percent in 2018 and 2.1 percent in 2019. The expansion of the US economy is expected to boost the growth rate of advanced economy in 2018. Emerging market and developing economies grew 4.7 percent in 2017 and is projected to expand at the same rate in both 2018 and 2019. For 2018-19, the growth rates are expected to scale up in Commonwealth of Independent States, Latin America and the Caribbean and Sub-Saharan Africa, and expected to slowdown in Emerging and Developing Europe, European Union, and Emerging and Developing Asia. The growth rates are mainly determined by the higher oil prices (for exporters), higher oil import bills (for importers), tighter financial conditions, geopolitical tensions, country-specific factors such as weather, etc.

Among the Advanced Economies, the expansion of the US is expected to be 2.9 percent in 2018 as fiscal stimulus continues and 2.5 percent in 2019 on account of trade measures. Likewise, the growth rate in Euro Area is expected to be 2.0 percent in 2018 and 1.9 percent in 2019 on account of slower export growth. The growth rate is expected to scale up in the United Kingdom, stabilize in Germany and France, and scale down in Italy, Spain, Japan, Canada and other Advanced Economies from 2018 to 2019.

Among the Emerging and Developing Economies, the growth rate of China is expected to remain at 6.6 percent in 2018, and 6.2 percent in 2019 on account of trade measures. India’s growth rate is forecasted to remain at 7.3 percent in 2018 and 7.4 percent in 2019. The growth rates of some emerging economies such as Brazil, Russia, South Africa, and Mexico are expected to scale up in 2019 compared to 2018.

Table: 1.1 Overview of the World Economic Outlook Projection

	Year over Year			
	Estimate		Projections	
	2016	2017	2018	2019
World Output	**3.3**	**3.7**	**3.7**	**3.7**
Advanced economies	**1.7**	**2.3**	**2.4**	**2.1**
United States	1.6	2.2	2.9	2.5
Euro Area	1.9	2.4	2.0	1.9
Germany	2.2	2.5	1.9	1.9
France	1.1	2.3	1.6	1.6
Italy	0.9	1.5	1.2	1.0
Spain	3.2	3.0	2.7	2.2
Japan	1.0	1.7	1.1	0.9
United Kingdom	1.8	1.7	1.4	1.5
Canada	1.4	3.0	2.1	2.0
Other Advanced Economies[1]	2.3	2.8	2.8	2.5
Emerging Markets and Developing Economies	**4.4**	**4.7**	**4.7**	**4.7**
Commonwealth of Independent States	0.4	2.1	2.3	2.4
Russia	-0.2	1.5	1.7	1.8
Excluding Russia	2.0	3.6	3.9	3.6
Emerging and Developing Asia	6.5	6.5	6.5	6.3
China	6.7	6.9	6.6	6.2
India	7.1	6.7	7.3	7.4
ASEAN-5[2]	4.9	5.3	5.3	5.2
Emerging and Developing Europe	3.3	6.0	3.8	2.0

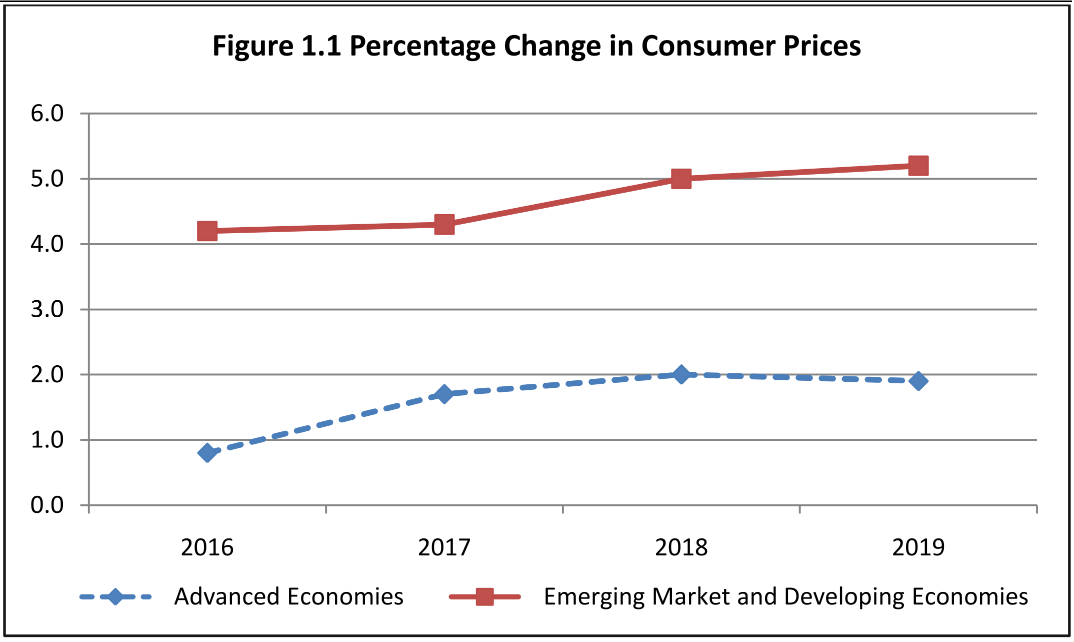
Latin America and the Caribbean	-0.6	1.3	1.2	2.2
Brazil	-3.5	1.0	1.4	2.4
Mexico	2.9	2.0	2.2	2.5
Middle East, North Africa, Afghanistan, and Pakistan	5.1	2.2	2.4	2.7
Saudi Arabia	1.7	-0.9	2.2	2.4
Sub-Saharan Africa	1.4	2.7	3.1	3.8
Nigeria	-1.6	0.8	1.9	2.3
South Africa	0.6	1.3	0.8	1.4
Memorandum				
Low-Income Developing countries	3.6	4.7	4.7	5.2
World Growth Based on Market Exchange Rates	2.5	3.2	3.2	3.1
Consumer Prices				
Advanced Economies	0.8	1.7	2.0	1.9
Emerging Market and Developing Economies[3]	4.2	4.3	5.0	5.2

Source: World Economic Outlook Update, October 2018.

1-Excludes the G7 (Canada, France, Germany, Italy, Japan, United Kingdom, United States) and euro area.
2-Indonesia, Malaysia, Philippines, Thailand, Vietnam.
3- Excludes Venezuela but includes Argentina from 2017 onward.

Inflation

According to WEO October 2018, inflation remained at 1.7 percent for Advanced Economies and 4.3 percent for Emerging and Developing Economies in 2017. The inflation forecast for Advanced Economies is 2.0 percent for 2018 and 1.9 percent for 2019 whereas such forecast for Emerging and Developing Economies is 5.0 percent for 2018 and 5.2 percent for 2019 on account of expected higher energy prices in these years. However, core inflation remained very different across the advanced countries.

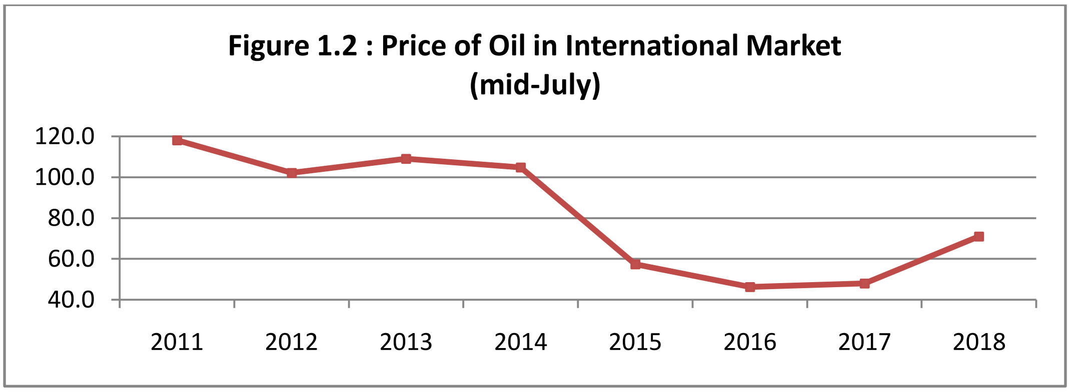


Source: World Economic Outlook Update

**Excludes Argentina and Venezuela ; P= Projected*

Crude Oil

The price of Brent Crude oil increased 48.3 percent in mid-July 2018 compared to mid-July 2017. Such growth was 3.5 percent in the corresponding period of the previous year. The price of a barrel of Brent Crude fluctuated, in US dollar terms, between 47.47 and 80.42 averaging 64.7 during 2017/18. In 2017, daily global oil demand was 97 million barrel relative to supply of 96.6 million barrel, which resulted in a daily short supply of 0.5 million barrel. In contrast, there was an excess oil supply of 0.4 million barrel per day in 2016.



(Source: http://www.eia.gov/dnav/pet/hist/)

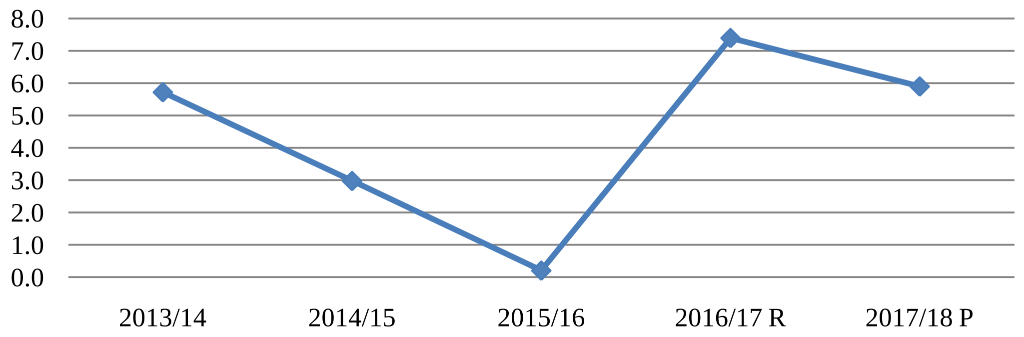
DOMESTIC MACROECONOMIC DEVELOPMENT

Nepalese economy maintained its higher growth momentum in 2017/18 despite unfavorable weather conditions. Consumer price inflation remained well within control and balance of payments recorded surplus but the current account deficit soared posing risk to external sector stability. The surge in current account deficit was on account of the elevated level of import of petroleum products, transport equipments and parts, and industrial goods. Actual budget expenditure remained 80.5 percent of total budget estimate in 2017/18. Inter-governmental Fiscal Arrangement Act, 2017 has been enacted to provide necessary provisions regarding revenue rights, revenue sharing, grants, loans, budget arrangements, public expenditures, and fiscal discipline of the federal, provincial and the local governments. Both credit and deposit growth picked up in 2017/18.

Economic Growth

Central Bureau of Statistics (CBS) estimated the growth of real GDP (at producers' price) at 6.3 percent in 2017/18 compared to 7.9 percent in 2016/17. Similarly, the real GDP at basic price is estimated to grow 5.9 percent compared to a growth of 7.4 percent in the previous year. GDP grew at a healthy rate despite unfavorable weather condition due to expansion of electricity, power and gas sector, pick up in construction activities, improved output of industrial sector and increased tourist arrivals among others.

Figure 1.3 : GDP Growth Rate at Basic Prices
(in percentage)



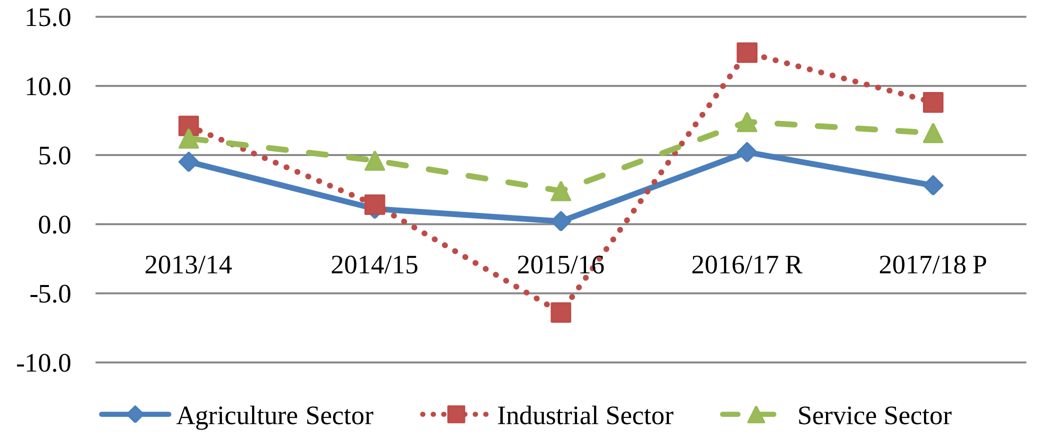
R= Revised; P=Preliminary
Source: Central Bureau of Statistics

In the review year, the agriculture sector exhibited a low growth of 2.8 percent mainly due to unfavorable weather condition which caused reduction in production of paddy and legumes. Non-agricultural sector grew by 7.1 percent compared to the growth of 8.5 percent in 2016/17.

Industrial sector grew by 8.8 percent in the review year on account of the regular power supply and improved investment climate. Such growth was 12.4 percent in the previous year.

In the review year, the service sector grew by 6.6 percent mainly due to increased tourists' inflow, expansion of trade and communication sector. Such growth was 7.4 percent in the previous year.

Figure 1.4: Sectoral GDP Growth (in percentage)



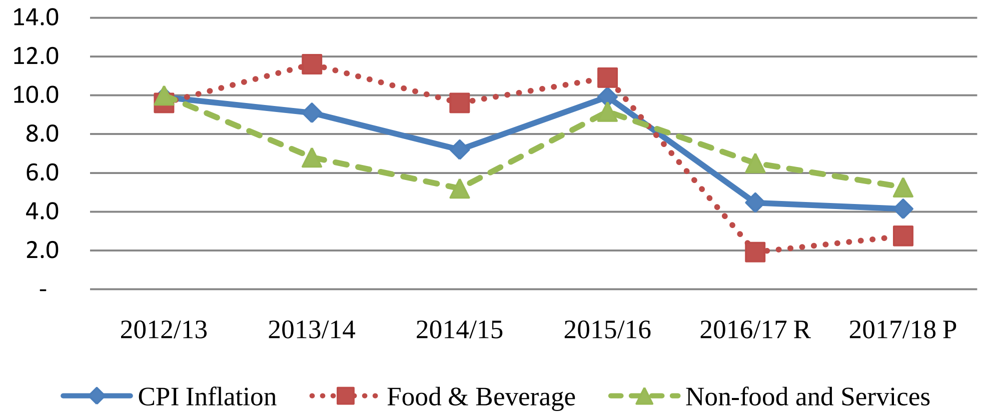
R= Revised; P=Preliminary
Source: Central Bureau of Statistics (CBS)

Inflation

The annual average consumer price inflation decreased to 4.2 percent in 2017/18 from 4.5 percent in the previous year. The annual average inflation of 2017/18 has been the lowest since 2003/04, which was 4.0 percent. Further, the inflation rate of 4.2 percent has been lower than its target of 7.0 percent in 2017/18. The normal supply situation and lower global prices including that of India contributed to inflation easing in the review year. While the average food inflation increased to

2.7 percent in 2017/18 from 1.9 percent in the preceding year, the nonfood inflation decreased to 5.3 percent in the review year from 6.5 percent a year ago.

Figure 1.5: Change in Consumer Price Index (in percentage)

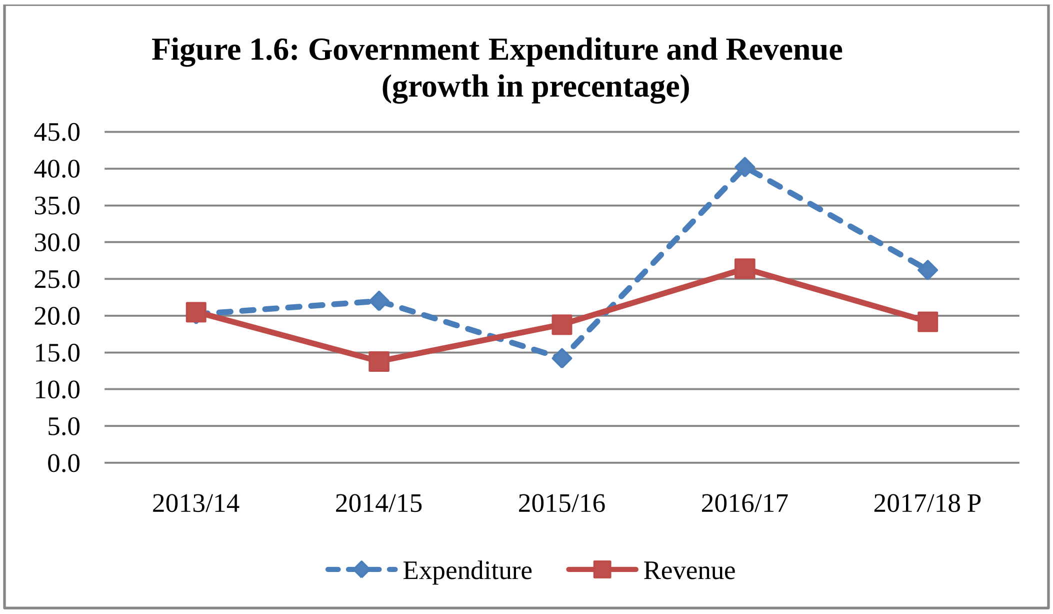


R= Revised; P=Preliminary
Source: Nepal Rastra Bank (NRB)

Government Finance

The government revenue increased 19.2 percent to Rs. 726.08 billion in 2017/18. The revenue collection is 99.5 percent of its budget target of Rs. 730.06 billion. The revenue had risen by 26.4 percent to Rs. 609.12 billion in 2016/17. Revenue-to-GDP ratio increased to 24.1 percent in the review year from 23.0 percent in 2016/17. Of the total revenue, the share of tax revenue and non-tax revenue stood at 90.1 percent and 9.9 percent respectively in the review year. In the previous year, the shares of tax and nontax revenue in the total revenue were 89.9 percent and 10.1 percent respectively.

Government expenditure, on cash basis, increased 26.2 percent to Rs. 1029.02 billion in 2017/18 compared to an increase of 40.2 percent to Rs. 815.70 billion in 2016/17. During the review year, recurrent expenditure increased 32.4 percent to Rs. 680.31 billion compared to a growth of 40.9 percent in the preceding year. Such expenditure stood at 84.7 percent of its budget estimate. Likewise, capital expenditure increased 20.4 percent to Rs. 239.91 billion compared to its growth of 72.2 percent in the previous year. The capital expenditure in the review year accounted for 71.6 percent of its budget estimate of Rs. 335.18 billion. Financial expenditure increased 5.8 percent to Rs. 108.80 billion. The financial spending accounted for 77.6 percent of its budget estimate.



P=Preliminary
Source: Nepal Rastra Bank (NRB)

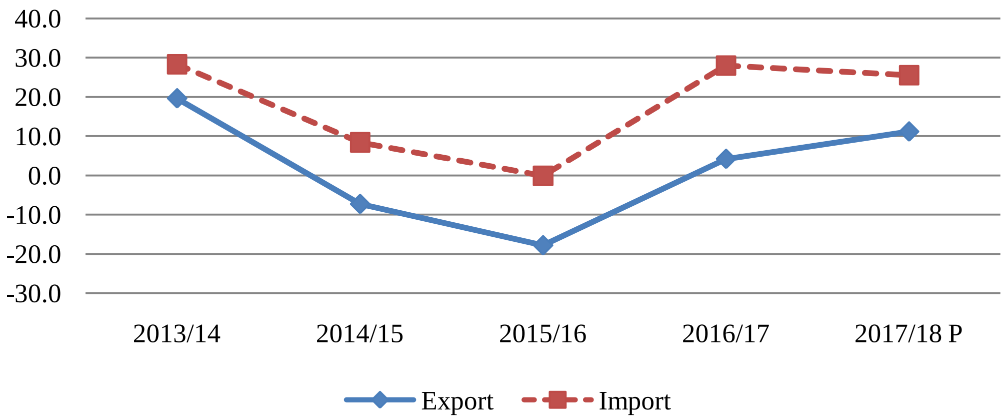
External Sector

Merchandise exports grew 11.1 percent in 2017/18 to Rs. 81.19 billion compared to a growth of 4.2 percent in 2016/17. In the review year, exports to India, China and other countries increased 12.4 percent, 43.3 percent and 7.5 percent respectively. Total merchandise exports as percentage of GDP shrank to 2.7 percent in the review year from 2.8 percent in the previous year.

Merchandise imports increased by 25.5 percent to Rs. 1242.83 billion in the review year as against a growth of 28.0 percent in the previous year. In the review year, imports from India, China and Other countries increased 27.8 percent, 25.5 percent and 19.3 percent respectively. Total import-to-GDP ratio increased to 41.3 percent in the review year from 37.5 percent of the previous year.

Merchandise trade deficit widened 26.7 percent to Rs. 1161.64 billion in 2017/18. The export-import ratio declined to 6.5 percent in the review year from 7.4 percent in the previous year. Total merchandise trade deficit as percentage of GDP jumped to 38.6 percent in the review year from 34.7 percent of the previous year.

Figure 1.7: Growth Rate of Export and Import (in precentage)



P=Preliminary
Source: Nepal Rastra Bank (NRB)

The total services receipts increased to 12.1 percent and expenses rose to 12.9 percent in the review period. As a result, net services surplus stood at Rs. 2.07 billion in the review year compared to Rs. 2.89 billion in the previous year.

The workers' remittances increased by 8.6 percent to Rs. 755.06 billion in the review year compared to a growth of 4.6 percent in the previous year. The ratio of workers' remittances to-GDP declined to 25.1 percent in 2017/18 from 26.3 percent in 2016/17. The net transfer receipts increased by 1.5 percent to Rs. 864.67 billion in the review year. Such receipts had increased by 9.5 percent in the previous year.

Capital transfer of Rs. 17.72 billion and foreign direct investment (FDI) inflows of Rs. 17.51 billion were recorded in the review year. In the previous year, capital transfer and FDI inflows were Rs. 13.36 billion and Rs. 13.50 billion respectively.

The gross foreign exchange reserves increased by 2.1 percent to Rs. 1102.59 billion as at mid-July 2018 from Rs. 1079.43 billion in mid-July 2017. The share of Indian currency in total reserves stood at 23.8 percent as at mid-July 2018.

Foreign assets and liabilities of the country stood at Rs. 1138.24 billion and Rs. 819.97 billion respectively as at mid-July 2018. Accordingly, the net IIP remained in surplus of Rs. 318.27 billion as at mid-July 2018. Such surplus was Rs. 430.76 billion as at mid-July 2017.

Monetary Situation

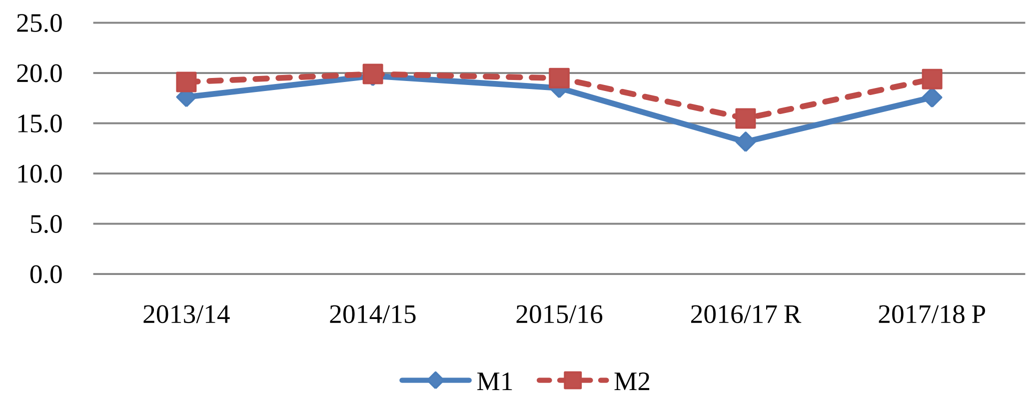
The growth of broad money (M2) was relatively higher at 19.4 percent in the review year compared to 15.5 percent in the previous year. Similarly, narrow money (M1) increased 17.6 percent in review year compared to the growth of 13.1 percent in the previous year.

The net foreign assets (NFA after adjusting foreign exchange valuation gain/loss) increased by Rs. 960 million (0.1 percent) in the review year compared to an increase of Rs. 82.11 (8.6 percent) billion in the previous year. Reserve money increased 8.1 percent in the review year compared to a rise of 20.1 percent in the previous year.

Domestic credit expanded by 24.9 percent in the review year compared to a growth of 20.6 percent in the previous year. Claims of monetary sector on the private sector increased by 22.3 percent in the review year compared to a growth of 18.0 percent in the previous year.

Deposits at banks and financial institutions (BFIs) increased by 19.2 percent in the review year compared to an increase of 14.0 percent in the previous year. Of the total deposits at BFIs, share of demand, saving and fixed deposits remained 9.3 percent, 34.5 percent and 44.8 percent respectively in mid-July 2018. Such share was 8.7 percent, 35.4 percent and 43.2 percent respectively in mid-July 2017.

Figure 1.8: Money Supply Growth
(in percentage)



R= Revised; P=Preliminary
Source: Nepal Rastra Bank (NRB)

Liquidity Situation

In the review year, Rs. 107.34 billion liquidity was injected through open market operations on a cumulative basis. BFIs used Rs. 38.33 billion standing liquidity facility (SLF) in 2017/18. Similarly, NRB injected net liquidity of Rs. 422.34 billion through the net purchase of USD 4.05 billion from foreign exchange market. NRB mopped up Rs. 195 billion through open market operations.

The NRB purchased Indian currency (INR) equivalent to Rs.522.03 billion through the sale of USD 4.76 billion, Euro 59 million and GBP 110 million in the review year. INR equivalent to Rs.451.89 billion was purchased through the sale of USD 4.12 billion and Euro 120 million in the previous year.

CHAPTER - TWO

FINANCIAL SYSTEM PERFORMANCE AND STABILITY

Global Financial Stability Overview

Global Financial Stability Report October 2018 finds that the regulatory frameworks have been enhanced and banking system has become stronger but the resilience of global financial system is yet to be tested with the emergence of new vulnerabilities that have arisen after the global financial crisis. It further asserts that the short term and medium term risks to global financial stability have increased due to easy financial conditions contributing to the buildup of financial vulnerabilities. It further asserts that global financial conditions have marginally tightened and the divergence between the advanced and emerging economies has grown. Continuation of global economic expansion in advanced economies has been accommodative till date. Financial conditions of emerging economies have tightened due to higher external financing costs, rising idiosyncratic risks and escalating trade tensions. All these upswings and downswings in advanced and emerging market economies have jointly created threat to the world economic stability.

The report also notes that emerging market economies remain vulnerable to spillovers from monetary policy normalization in advanced economies. Also, the impact of rising US interest rate and stronger dollar along with the intensification of trade tensions has further made the economies vulnerable to financial instability. The report further assesses that the near term risks to financial stability have increased in the first six months of 2018, which was further enhanced with the sharper tightening of financial conditions in advanced economies. Thus, there is ever increasing concern about the resilience and policy credibility in emerging markets, which may lead to further capital outflows and rising global risk aversion.

The report focused on analyzing the decade after the financial crisis and assessing whether the corrective actions in response of the crisis is sufficient enough to build a resilient economy for any other such crisis. The crisis forced the regulator and supervisor to change their perspective on growth and stability. New standards, tools, and practices were developed and implemented all over the world after the crisis, primarily to overcome the crisis and secondarily to prevent accumulation of situation, which can lead to another crisis. As per the assessment of GFSR, much progress has been made in reforming the global financial rulebook with new standards for more resilient financial system, specifically the one which is less leveraged, more liquid and better supervised.

With the evolution of financial system, which is more resilient to the traditional threats, new threats to financial stability have emerged and regulators as well as the supervisors are expected to be vigilant to such threats, so that proactive measures rather than the reactive ones can be used to stabilize and strengthen the economies.

According to GFSR October 2018, though we have successfully sustained the financial crisis that occurred before a decade but increasing complexities in global economy will not let the policy makers to take rest as new threats, vulnerabilities and issues are just popping up time and again. So, if they are not given proper attention and treatment in time, it could further lead our way to another one. Thus the way forward as per the report is stated as below:

1. Complete the global regulatory reform agenda which are yet to be implemented completely even after a decade after crisis. The incomplete aspects of the agenda are solvency framework for insurers, the leverage ratio and outstanding items on liquidity agenda. Similarly, continuation of intensified supervision of systemically important institutions and continual improvement of macro prudential oversight and policy tools is also essential. Cross border cooperation in data sharing, systemic risk oversight and corporate governance ensuring control over excessive risk taking are to be further strengthened. Along with the above, improvement in oversight and regulation of shadow banking should be given apt priority mostly in emerging economies.

2. Address the consequences of the post crisis regulatory agenda which were set to increase resilience of global financial system which was deeply affected during the crisis. The pros and cons of regulatory agenda are to be evaluated carefully, so that no new risks arise out of the agenda set to stabilize the economy. Proper assessment of the consequences will not only help to evaluate the whole process but also provide proper perspective towards the past situation which may have been blurred in the past due to urgency to find the solution and achieve stability.

3. Confront new risks of post crisis situation which did not exist before crisis. New financial technology is the source of immense opportunities and challenges. Cyber security risks have now been the most vulnerable risks among all other risks and the world is yet to prepare itself for the adequate mitigation of such risks. So, it is high time for all the economies to join hands to mitigate this and many other risks which has arisen after the crisis and the world is yet to define apt measures to ensure the stability of financial system in between the threat of these post crisis risks.

Overview of Nepalese Financial System

Size of the Overall Financial System

Nepalese financial system has been regulated by different regulators in the sectors of banking, insurance, securities markets, contractual saving institutions and other service sectors. NRB, as the central bank, regulates commercial banks, development banks, finance companies, micro finance financial institutions, FINGOs and cooperatives carrying out limited banking activities. Besides, NRB also provide approval to eligible institutions to work as hire purchase companies. The contractual saving institutions comprises of Employee Provident Fund (EPF) and Citizen Investment Trust (CIT) operating under the regulatory jurisdiction of Ministry of Finance. The Securities Board of Nepal (SEBON) regulates securities market which comprises of stock exchange, listed companies, central securities depository, stockbrokers, merchant bankers, credit rating agency, mutual funds, Application Supported by Blocked Amount (ASBA) members and depository participants. The financial system also includes insurance companies under the purview of Insurance Board and cooperatives established under Cooperative Act, which falls under the purview of Department of Cooperatives.

Following the financial liberalization policy adopted since the mid-1980s, there has been proliferation in the number of BFIs in the last few decades. The growth in the number of BFIs has moderated after NRB imposed moratorium on licensing. For the last three years, banking system is undergoing restructuring and consolidation, particularly through the merger/acquisition and paid-up capital increment. As of mid-July 2018, the total number of banks and financial institutions stood at 151 comprising commercial banks 28, development banks 33, finance companies 25, and microfinance development banks 65. Besides, 40 other financial intermediaries licensed by NRB, 39 insurance companies and several non-bank financial institutions such as EPF, CIT,DCGF, and Postal Saving Bank are also in operation.

Table 2.1: Number of BFIs and Other Institutions

Banks and Financial Institutions	Mid-July	Mid-July	Mid-July	Mid-July
	2015	2016	2017	2018
Commercial Banks	30	28	28	28
Development Banks	76	67	40	33
Finance Companies	47	42	28	25
Microfinance Financial Institutions	38	42	53	65
Sub-Total	**191**	**179**	**149**	**151**
NRB Licensed Cooperatives	15	15	15	14
NRB Licensed FINGOs (with limited banking activities)	27	25	25	24
Insurance Companies	26	26	26	38
Reinsurance Company	1	1	1	1
Sub Total	**69**	**67**	**67**	**77**
Securities Market Institutions				
Stock Exchange	1	1	1	1
Central Depository Company	1	1	1	1
Stockbrokers	50	50	50	50
Merchant Bankers	16	17	24	25
Mutual Funds	5	6	9	9
Credit Rating Agencies	1	1	1	2
Depository Participants*	53	66	65	70
ASBA BFIs*	0	0	0	65
Sub-Total	**74**	**76**	**86**	**88**
Employees Provident Fund (EPF)	1	1	1	1
Citizen Investment Trust (CIT)	1	1	1	1
Postal Saving Bank	1	1	1	1
Deposit and Credit Guarantee Fund	1	1	1	1
Credit Information Center Limited(CICL)	1	1	1	1
Total	**339**	**327**	**307**	**321**

***** *BFIs repeated as ASBA BFIs and Depository Participants not included in Total.*

Table 2.2: Structure of the Nepalese Financial Sector (Assets/ Liabilities or Sources/Uses)

Financial Institutions	**Mid-July** *(Amount In Billion Rupees)*				
	2014	**2015**	**2016**	**2017**	**2018**
Commercial Banks	1,467.15	1,774.50	2,184.81	2,621.23	3,104.27
Development Banks	255.37	300.64	350.84	305.07	374.70
Finance Companies	110.34	108.00	103.44	82.60	96.01
MFIs	49.39	70.88	100.77	133.91	175.61
Cooperatives	233.71	265.55	385.72	396.53	388.13*
Contractual Saving Institutions					
Employees Provident Fund	170.63	195.90	224.85	251.28	292.16
Citizen Investment Trust	54.62	67.67	83.01	99.10	114.06
Insurance Companies	101.09	129.45	158.24	185.89	260.31
Reinsurance Company	-	6.15	6.26	6.85	10.04
Mutual Fund	-	-	-	9.75	12.95
Total	**2,442.33**	**2,918.77**	**3,597.96**	**4,092.10**	**4,828.25**
Market capitalization (NEPSE)	1,057.16	989.40	1,889.45	1,856.82	1,435.13
Total (incl. market capitalization)	**3,499.50**	**2,918.77**	**5,487.40**	**5,952.09**	**6,263.39**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Commercial Banks	60.07	60.80	60.72	64.00	64.29
Development Banks	10.46	10.30	9.75	7.45	7.76
Finance Companies	4.52	3.70	2.88	2.02	1.99
MFIs	2.02	2.43	2.80	3.27	3.64
Cooperatives	9.57	9.10	10.72	9.68	8.04
Contractual Saving Institutions					
Employees Provident Fund	6.99	6.71	6.25	6.14	6.05
Citizen Investment Trust	2.24	2.32	2.31	2.42	2.36
Insurance Companies	4.14	4.44	4.40	4.54	5.39
Reinsurance Company	-	0.21	0.17	0.24	0.21
Mutual Fund	-	-	-	0.24	0.27
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

**Based on first 8 Month's data of FY 2017/18*

Banking sector has been dominating the financial system of Nepal. The share of banks and financial institutions in total assets and liabilities of the financial system stood at 77.68 percent in mid-July 2018. The commercial banks remained the key player in the financial system occupying 64.29 percent of the system's total assets followed by development banks (7.76 percent), finance companies (1.99 percent) and micro finance financial institutions (3.64 percent). In case of contractual saving institutions, EPF is a dominant institution having 6.05 percent share, followed by insurance companies (5.39 percent), CIT (2.36 percent), and Reinsurance Company (0.21 percent) as of mid-July 2018. The share of cooperatives in total financial system stood at 8.04 percent in mid-July 2018 compared to 9.68 in mid-July 2017.

Figure 2.1: Structure of Assets Holding in Financial System

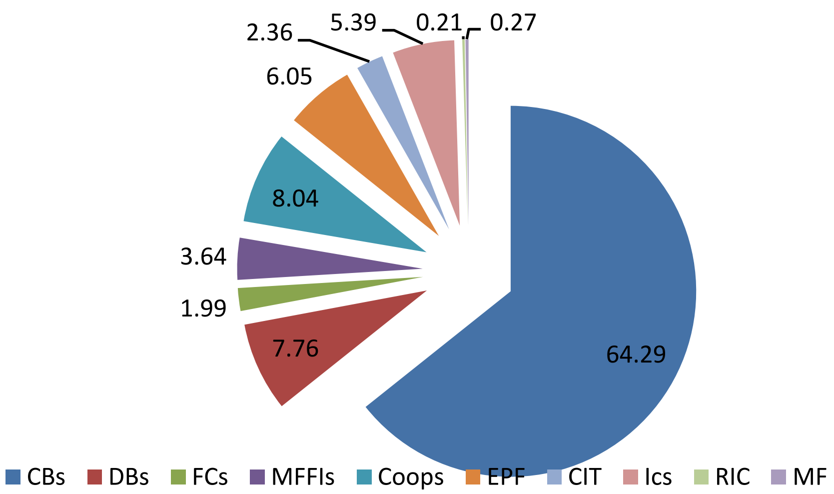
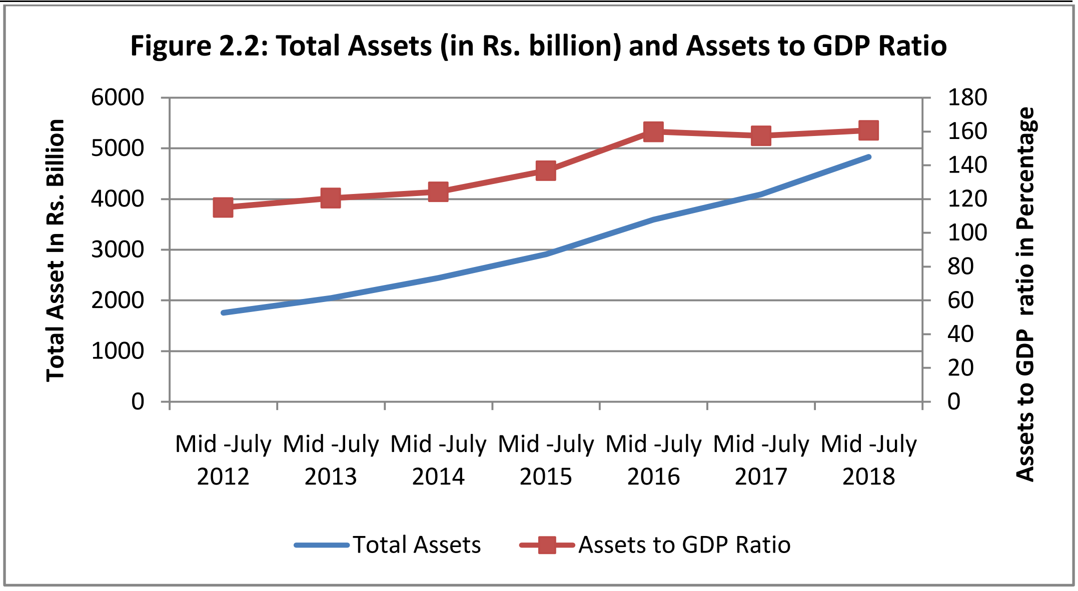


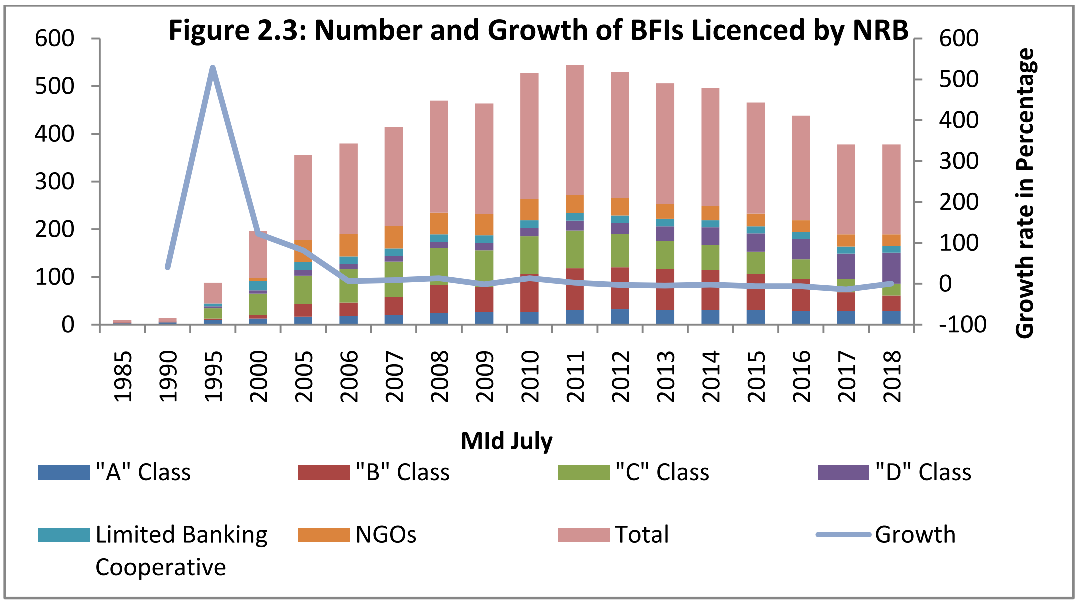
Figure 2.2 depicts the increasing size of Nepalese financial system. The ratio of total assets of the financial system to GDP, which has been continually rising, reached 160.56 percent in mid-July 2018.

Total assets and liabilities of commercial banks remained at 103.23 percent of GDP followed by development banks (12.46 percent), finance companies (3.19 percent), MFIs (5.84 percent) and Cooperatives (12.91percent). Further, such ratio for contractual saving institutions stood at 14.28 percent comprising 6.05 percent of EPF, 2.36 percent of CIT, 5.39 percent of insurance companies, 0.21 percent of Reinsurance Company and 0.27 percent of mutual fund in mid-July 2018.



Structure and Performance of Banks and Financial Institutions

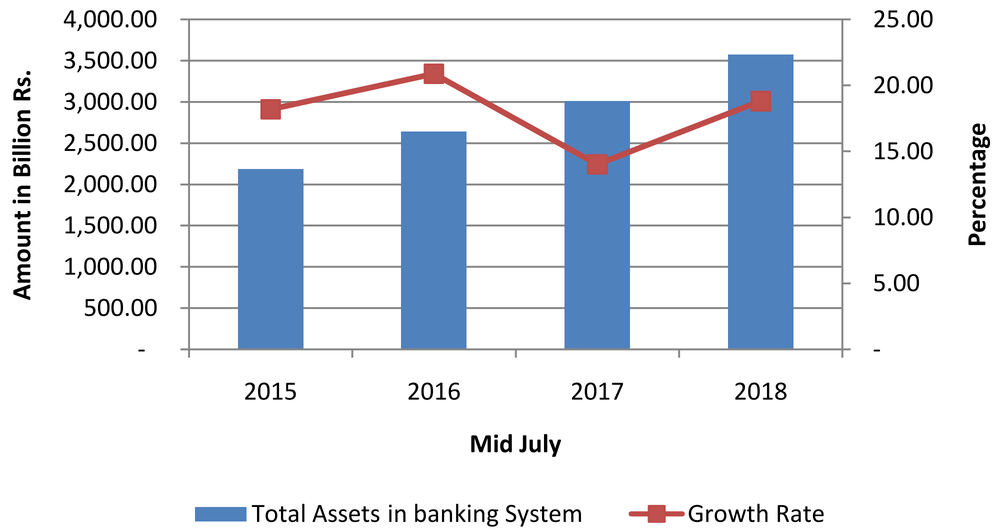
Nepalese banking system has changed significantly, both in terms of number and structure, since 1985. Along with the pace of financial liberalization, the number of BFIs reached its peak in 2011 to 218 from only 3 in 1985. While the global financial system was ridden with a crisis, new financial institutions were rapidly emerging in Nepal with the argument and support that Nepalese economy is not exposed to international financial markets.



Assets Growth in Nepalese Banking System

The total assets and liabilities size of BFIs have continued to increase. As of mid-July 2018, total assets of BFIs increased by 18.81 percent to Rs. 3575 billion compared to Rs. 3009 billion a year ago. Though moratorium has been placed on the licensing of new BFIs, there has been significant expansion of the balance sheet of BFIs mainly due to the increase in deposits and credits. Increase in deposits is mainly driven by remittance inflows. The liabilities side of the balance sheet has inflated on account of the increase in paid up capital and reserves through issuance of right shares, bonus share and increase in profit. Similarly, the government has injected a large amount of capital in state owned banks.

Figure 2.4: Total Assets in Banking System



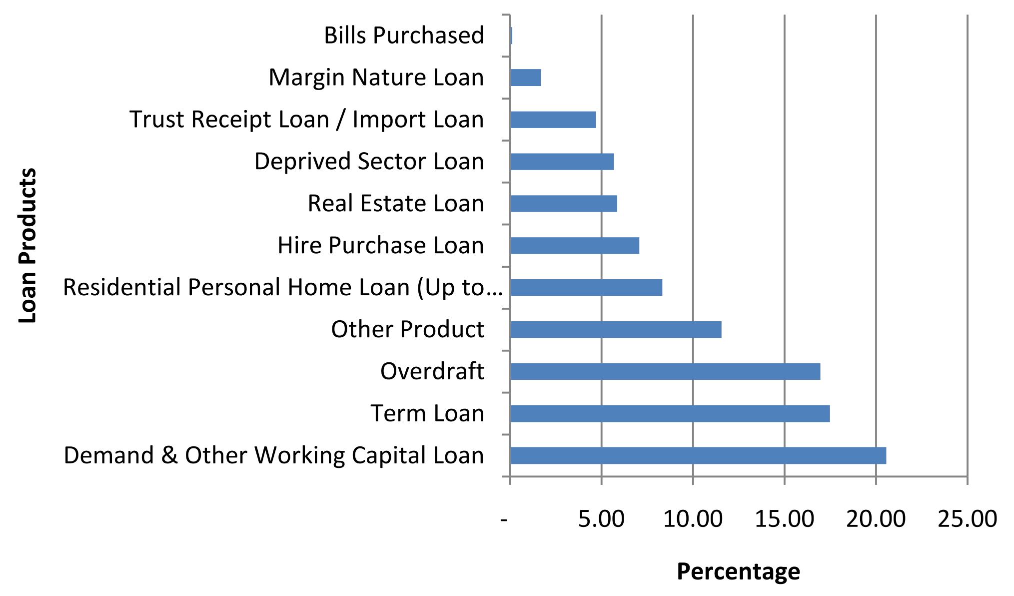
As of mid-July 2018, the five large commercial banks (LCBs) collectively accounted for 25.05 percent of total banking system assets and 28.85 percent of total commercial bank assets. As of mid-July 2018, the five large commercial banks, RBB, NIBL, NIC, NABIL, and ADBNL had total assets size of Rs. 213.84 billion, Rs. 182.59 billion, Rs. 172.93, Rs. 169.65 billion, and Rs. 156.51 billion respectively. This implies a high concentration of banking assets to few banks in Nepal. The failure of any of these large banks is, therefore, likely to have a large impact on the financial stability of Nepal.

Credit Distribution in Banking Sector

A large part of BFIs lending is concentrated in eight key areas of economic activities. Of the total credit outstanding as of mid-July 2018, trade (wholesaler & retailer) accounted for 21.96 percent, followed by agriculture, forestry and beverage production related (17.15 percent), other services (13.53 percent), construction (10.45 per cent), finance, insurance and real estate (8.38 percent), consumption (6.86 percent), agricultural and forest related (4.76 percent), other services (4.37 percent). Concentration of lending to a few sectors would expose bank to credit risk. Though NRB has made mandatory provision of lending in priority sector to support economy, BFIs have not been able to lend to the priority sector as per expectation.

Product-wise, BFIs have made highest lending in demand and working capital loan (20.56 percent) followed by term loan (17.48 percent) and overdraft (16.96 percent). The real estate loan has come below the regulatory requirement of 10 percent, standing at 5.86 percent in mid- July, 2018. Figure 2.5 depicts the product-wise lending of BFIs as of mid-July 2018.

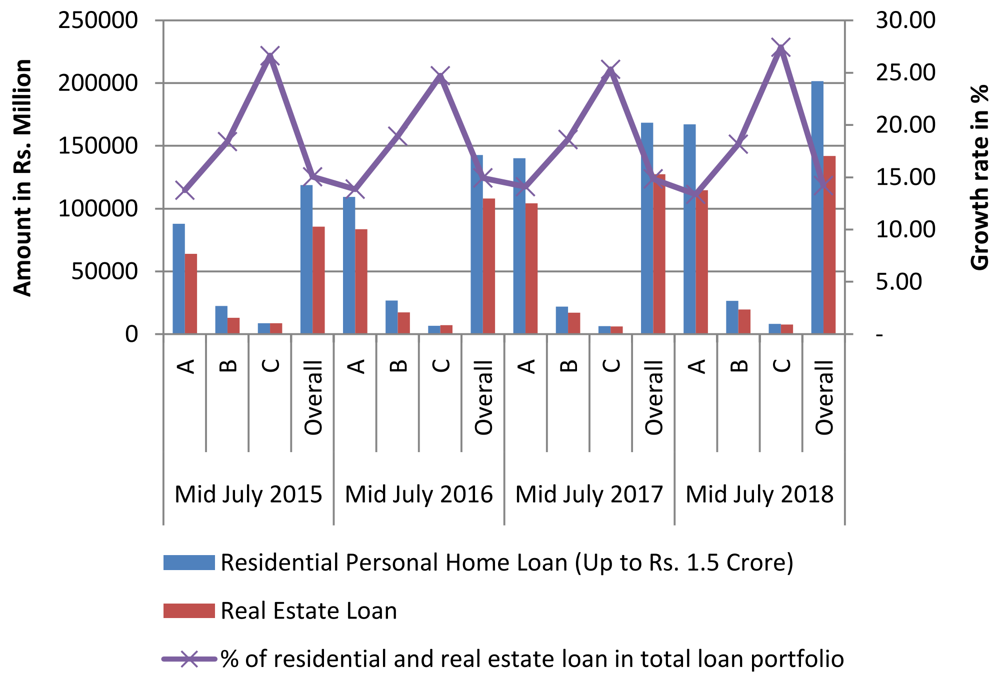
Figure 2.5: Productwise Lending of BFIs



Real Estate Lending

NRB has deployed some macro prudential measures to address real estate lending such as caps on real estate loans, loan-to-value ratio and sectoral capital requirements. NRB has directed BFIs to limit their real estate and housing loan exposure to 25 percent of their total loans. The BFIs are also required not to issue loans exceeding 50 percent of fair market value of the collateral/project outside of Kathmandu valley and 40 percent inside Kathmandu valley. The maximum loan-to-value (LTV) ratio for residential housing loan is 50 percent for Kathmandu valley and 60 percent for places outside Kathmandu valley. As for the real estate sector (which does not include the housing sector) BFIs are to reduce their respective exposure to 10 percent. However, NRB has granted some relaxation on residential home loan whereby BFIs can lend up to Rs. 10.50 million for personal residential home loan.

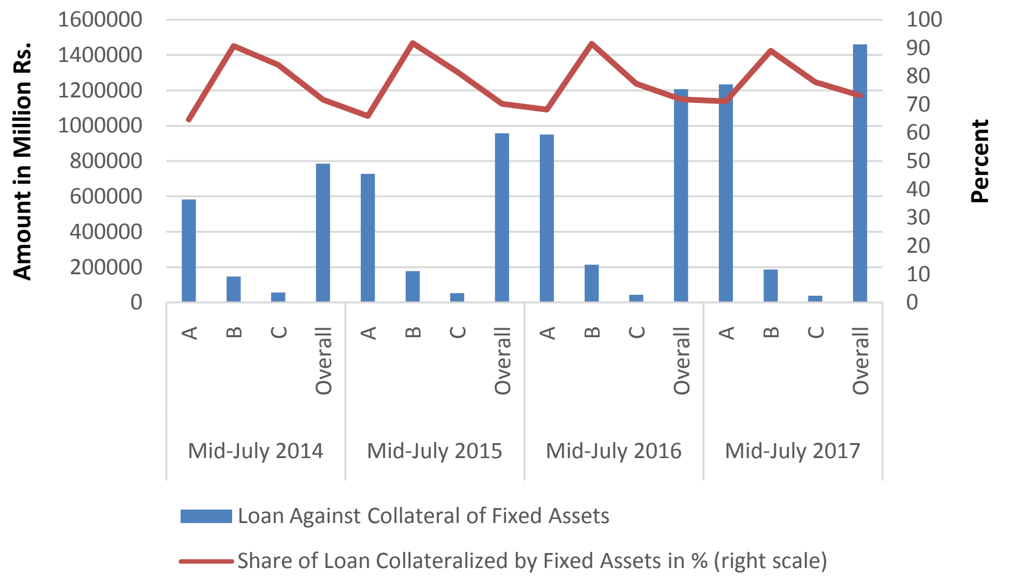
Figure 2.6: Real Estate Exposure of BFIs



The banking system has reduced its high exposures in real estate after the introduction of some additional macro prudential measures. The direct real estate exposure amounted to Rs. 142.01 billion which accounts for 5.86 percent of total loan in mid-July 2018. Such exposure was about Rs. 127.32 billion (6.38 percent of the total outstanding loan) in mid-July 2017.

Commercial banks' direct exposure to real estate and housing loan has declined from 19.40 percent in mid-July 2010 to 13.35 percent in mid-July 2018. Development banks and finance companies have lent 18.15 percent and 27.41 percent, respectively, of their total loan portfolios to real estate and housing in mid-July 2018.

Figure 2.7: Loan Against Collateral of Fixed Assets



Bank and financial institutions have lent 73.83 percent of their total loan against collateral of fixed assets. Commercial banks have lent 71.82 percent and development banks and finance companies have lent 89.26 percent and 79.40 percent respectively.

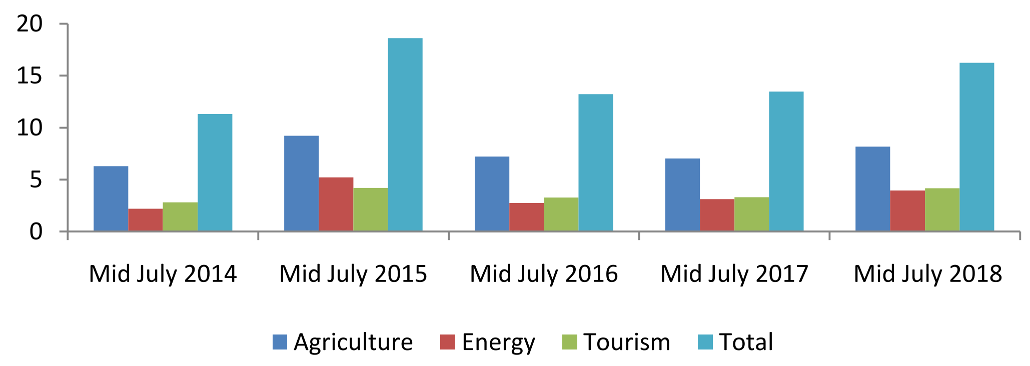
Directed Lending:

Productive Sector Lending

In order to facilitate the sustainable economic growth of the country, NRB has directed BFIs to lend certain percent of their loan portfolio to the designated productive sector of the economy. Class "A" banks are required to lend at least 25 percent of their total loan to productive sector like agriculture, energy, and tourism among which they are required to flow at least 10 percent of their credit to agriculture, 15 percent to hydropower and tourism. Likewise, class “B” and class “C” BFIs are required to lend at least 15 percent and 10 percent, respectively, of their total lending to productive sector. The main objective of this policy is to ensure the availability of adequate funding for sectors like agriculture, hydropower and tourism which are the key drivers of economic growth.

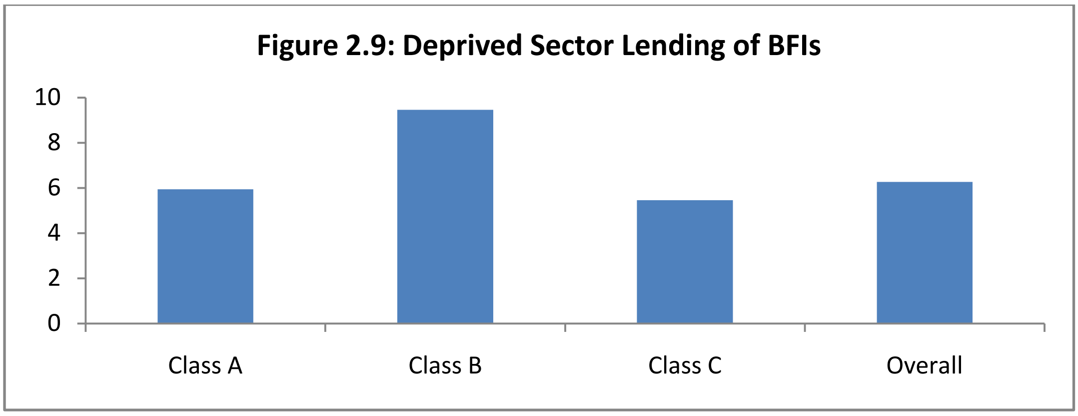
The monetary stance of NRB is designed to ensure the adequate credit for productive investments to support the attainment of the government’s GDP growth target. As on mid-July 2018, the commercial banks had provided 16.25 percent of their total loan to priority sector which includes 8.16 percent in agriculture, 3.94 percent in hydropower and energy sector and 4.15 percent in tourism sector. Commercial banks have lent 8.16 percent in agriculture which is less than the regulatory limit of 10 percent. Similarly, commercial banks have lent 8.09 percent in energy and tourism sector, which is less than the regulatory limit of 15 percent. This shows that commercial banks are yet to fulfill the minimum regulatory requirement in priority sector lending. Though the policy introduced by NRB has been able to boost the lending in productive sector, achievement has not been as expected.

Figure 2.8: Productive Sector Lending of Commercial Banks (In percentage of total loan)



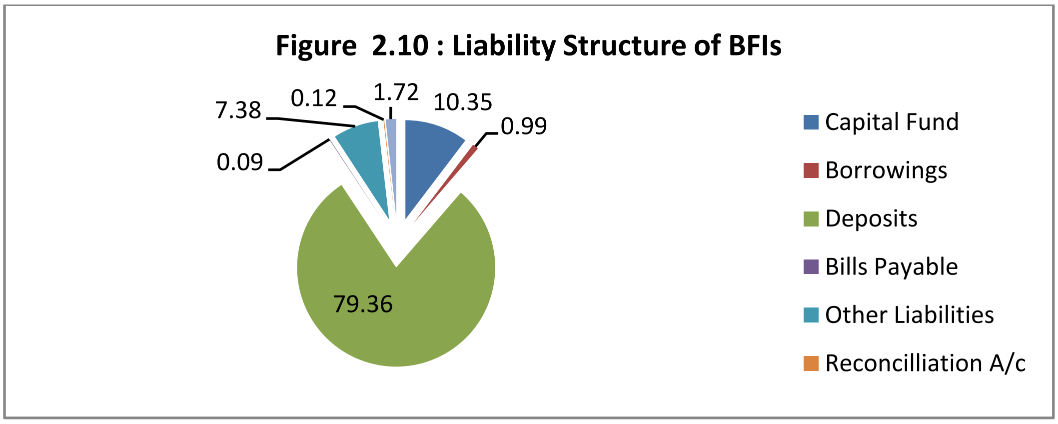
Deprived Sector Lending

BFIs are required to disburse certain percent of their total loan portfolio to the deprived sector as stipulated by NRB. With the objective of gradual increment in the size of deprived sectors of the economy, NRB has fixed such lending requirement rate 5 percent for class “A”,”B” and "C". The overall deprived sector lending by BFIs as of mid-July 2018 remained 6.28 percent whereas commercial banks, development banks and finance companies have lent 5.94 percent, 9.47 percent and 5.46 percent respectively.



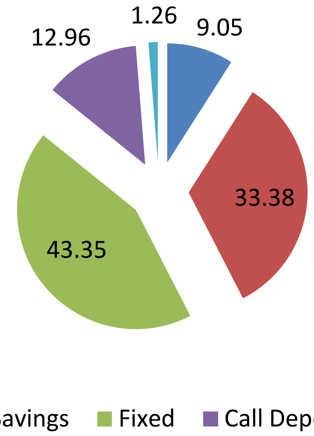
Liability Structure of the Banking Sector

Deposits are the largest source of external funds in the banking sector. The share of total deposits is 79.36 percent of the total liabilities as of mid-July 2018. As of mid-July 2018, total deposit increased by 18.96 percent against 13.16 percent in mid-July 2017. Likewise, capital fund increased by 10.35 percent mainly due to capital increment plan of Nepal Rastra Bank, borrowings increased by 11.49 percent compared to a decline of 25.74 percent in mid-July, 2017, whereas other liabilities increased by 17.70 percent in mid-July 2018.



The share of saving deposits, fixed deposits, call deposits, current deposit and other deposit stood at 33.38 percent, 43.35 percent, 12.96 percent, 9.05 percent and 1.26 percent respectively in mid-July 2018. The relative proportions of such deposits remained at 34.24 percent, 41.86 percent, 13.98 percent, 8.57 percent and 1.35 percent respectively in mid- July 2017. The slight change in deposit structure is mainly driven by the increase in deposit rates following the liquidity crunch in the financial sector during the review period.

Figure 2.11 : Deposit Liabilities by Account Type



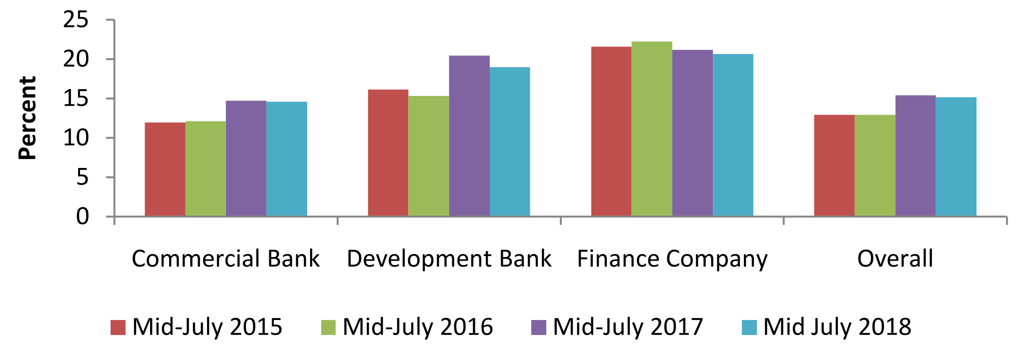
The total deposits of BFIs reached Rs. 2836.93 billion in mid-July 2018 from Rs. 2384.81 billion a year ago. The share of top five BFIs stands at 25.08 percent of the total deposits of the banking system depicting a significant concentration of deposits in few institutions. Such concentration ratio of deposit was 25.16 percent in the previous year. Among top five banks, one is state owned and four are private commercial banks.

Financial Soundness Indicators

Capital Adequacy

In mid–July 2018, the capital fund of BFIs increased by 19.88 percent to Rs. 370.01 billion from Rs. 308.65 billion in mid–July 2017. Such increment was 43.63 percent in the previous year. The capital fund is composed of paid-up capital (Rs. 282.20 billion), statutory reserves (Rs.63.76 billion), retained earnings (Rs. 1.9 billion in negative figure) and other reserves (Rs. 25.99 billion). In mid-July 2018, the CAR of commercial banks registered 14.61 percent, development banks recorded 18.99 percent and finance companies stood at 20.65 percent. The overall CAR of BFIs in mid-July 2018 stood at 15.15 percent which was 15.40 percent in the previous year. The excess of capital adequacy ratio over the minimum requirement of banking system was mainly due to the consolidation among development banks and finance companies through merger and acquisition as well as the capital increment decision of NRB. The overall CAR of BFIs remained well above the standard requirements set by NRB which indicates that the banking system's capital soundness is in strong position.

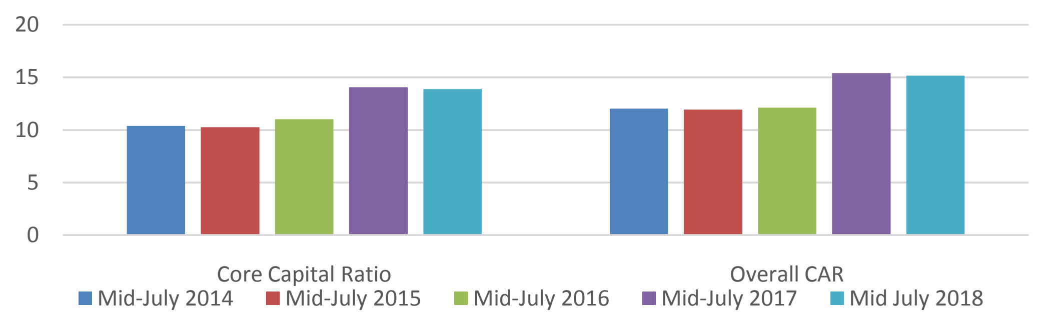
Figure 2.12: CAR of BFIs



In mid-July 2018, commercial banks' compliance with the minimum Capital Adequacy Ratio (CAR) is 100 percent. As evident from Figure 2.12, all banks complied with the minimum CAR in mid-July 2018. During the period of 2011-2014, state owned banks (SOBs), Nepal Bank Limited (NBL) and Rastriya Banijya Bank (RBB) were the only two commercial banks which were non-compliant with required CAR. With the injection of capital, RBB in mid-July 2015 met capital adequacy ratio with Tier 1 capital 9.9 percent and CAR ratio 10.3 percent.

The aforementioned analysis highlights that the capital adequacy ratios of commercial banks are higher than regulatory standard over the period of mid-July 2014 to mid-July 2018. For instance, overall CAR of the commercial banks in mid-July 2018 is 14.61 percent compared to 10.6 percent in mid-July 2011.

Figure 2.13: Core Capital and Overall CAR of Commercial Banks

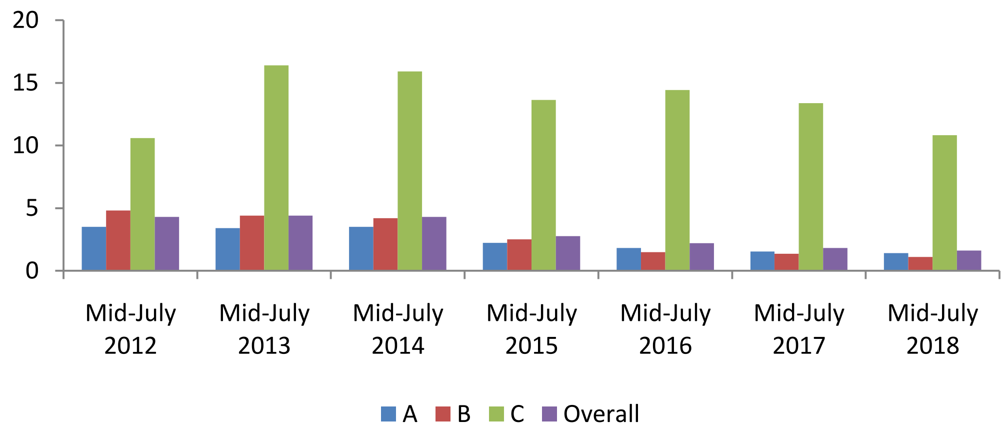


Assets Quality

NPL of BFIs stood at Rs. 38.51 billion in mid-July, 2018 compared to Rs. 36.10 billion in mid-July 2017. In terms of ratio of NPL to total loans, the banking sector showed improvement in assets quality and sufficient provisions during the period of 2012-2018 indicating the banking sector's resilience in large. NPL to total loans of BFIs decreased by 0.21 percentage point and stood at 1.60 percent in mid-July 2018 compared to 1.81 percent a year ago. NPL to total loans of commercial banks decreased by 0.13 percentage point on y-o-y basis standing at 1.39 percent in mid-July 2018.

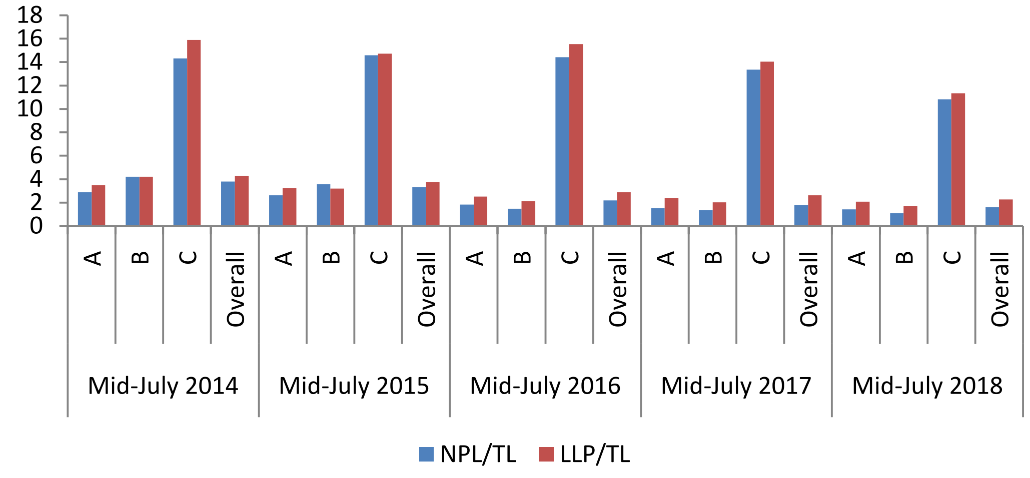
None of the commercial banks have NPL above 5.00 percent in mid-July, 2018. Likewise, NPL ratio of development banks decreased by 0.27 percentage point to 1.09 percent in mid-July, 2018 as compared to 1.36 in mid-July 2017. The NPL ratio of finance companies is still in double digit which stands at 10.83 percent in mid-July 2018.

Figure 2.14: NPL Status of BFIs



NRB has introduced "watch list" as the new category of loan provision to discourage the practice of loan ever-greening through stringent measures of credit monitoring. According to this directive, any loan that has crossed the repayment deadline by a month will come under the "watch list". Also, short-term loans and operating loans whose deadline has been extended temporarily without renewal should be categorized under "watch list". Likewise, loans extended to a borrower whose loans from another bank have turned non-performing, and loans provided to a firm whose net worth and cash flow have remained negative for the past two years despite regular payment of principal and interest should also be categorized under the “watch list”. In mid- July 2018, BFIs watch list provision to total loan remains at 1.85 percent.

FIgure 2.15: Provision Versus Actual Loan Loss(as a percentage of total Loan)



As of mid-July 2018, LLP of banking system amounting Rs. 55.01 billion is sufficient to cover the outstanding NPL.

In the banking system, the loss loan is Rs. 23.04 billion in mid-July 2018 compared to Rs. 24.15 billion in mid-July 2017. The ratio of loss loans to NPL has declined to 59.83 percent in mid-July 2018 from 66.88 percent a year ago. This reflects the improvement in assets quality of the banking system. However, it is a matter of concern that a bulk of NPL is loss loan.

The NPL under sub-standard and doubtful categories constituted 22.28 percent and 16.06 percent, respectively, in mid-July 2018. The ratio of restructured/rescheduled loans to total NPL remained around 1.83 percent in FY 2017/18.

NRB’s directives related to lending to high risk sectors, single obligor limit, priority sector lending, and blacklisting of loan defaulters, and similar other measures should help to further improve the classified loans situation in the country.

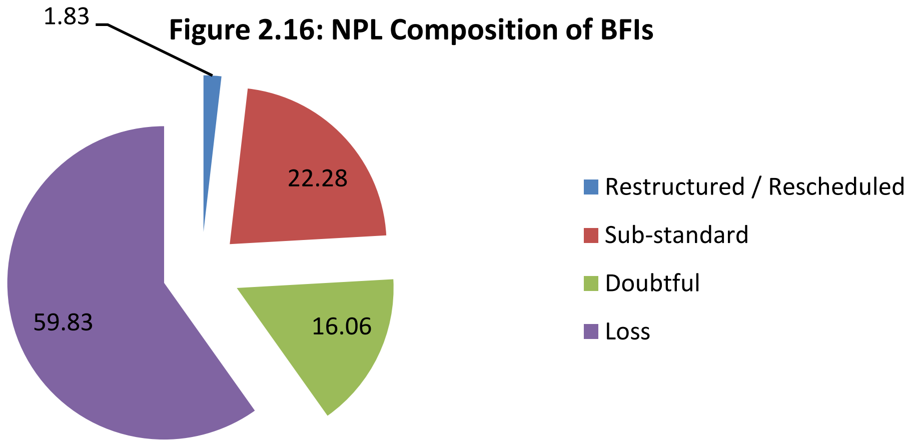


Figure 2.16: NPL Composition of BFIs

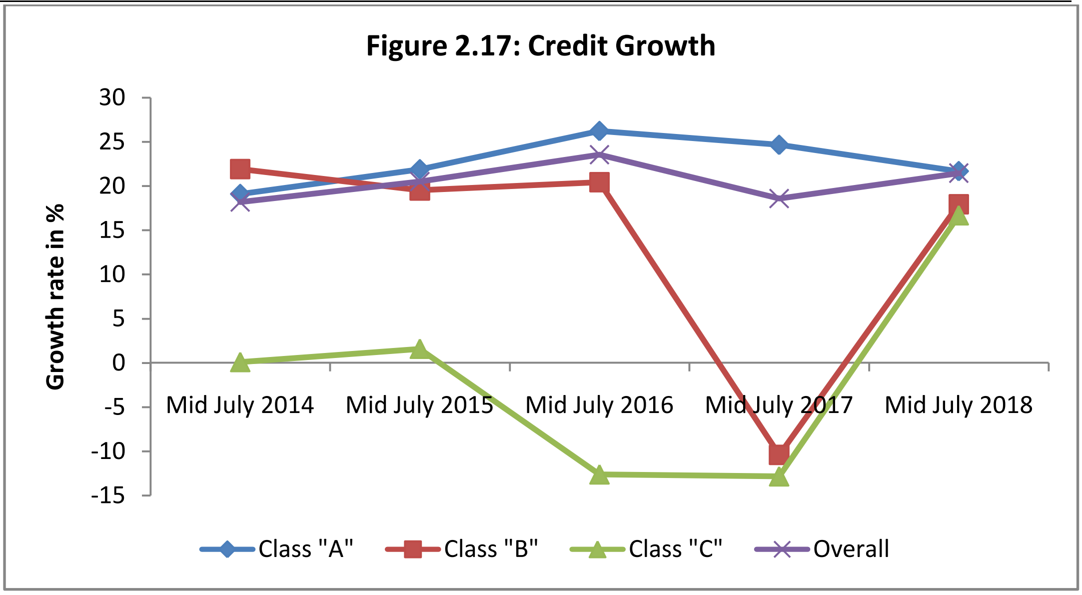
Leverage Ratio

Basel Committee on Banking Supervision has introduced leverage ratio which is complementary to the risk-based capital framework and aims to restrict the build-up of excessive leverage in the banking sector. The leverage ratio is defined as eligible Tier 1 capital divided by total assets and off balance sheet items which could originate pro-cyclicality that can originate from excessive lending that are inappropriate to measure risk weighted assets. A low ratio indicates a high level of leverage. To reduce pro-cyclicality and keep leverage ratios more stable the Basel III has set a minimum leverage ratio of 3.0 percent at all times whereas NRB has set a minimum leverage ratio of 4.0 percent at all times.

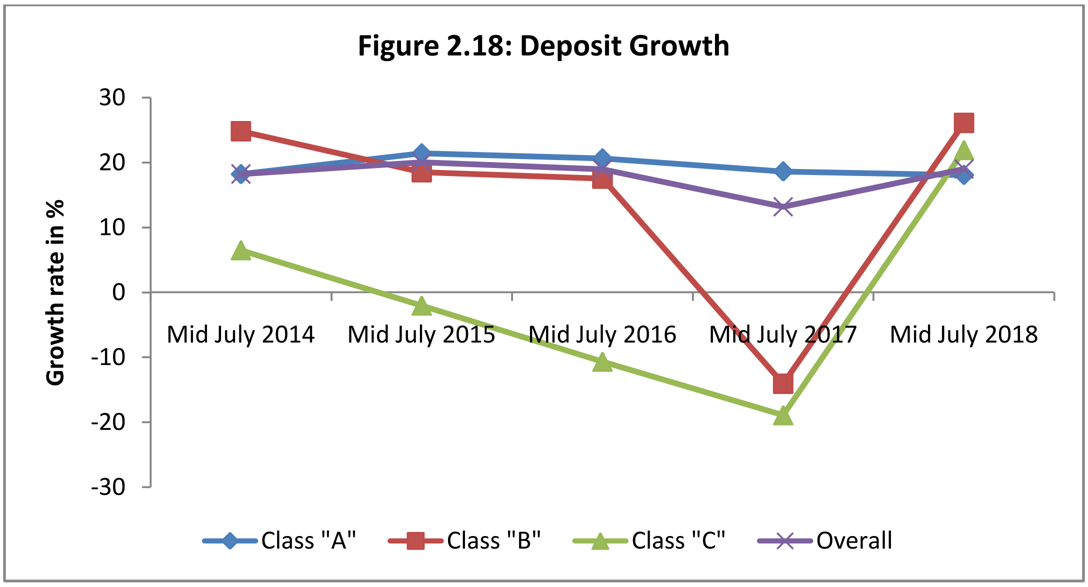
Credit and Deposit Growth

Credit flows from BFIs increased by 21.47 percent in mid-July, 2018 compared to a year ago. Such increment was 18.60 percent in mid-July, 2017. The increase in credit growth rate is mainly due to increase in source of funds of BFIs in the last year and increase in credit demand as a result of improvements in investment climate.

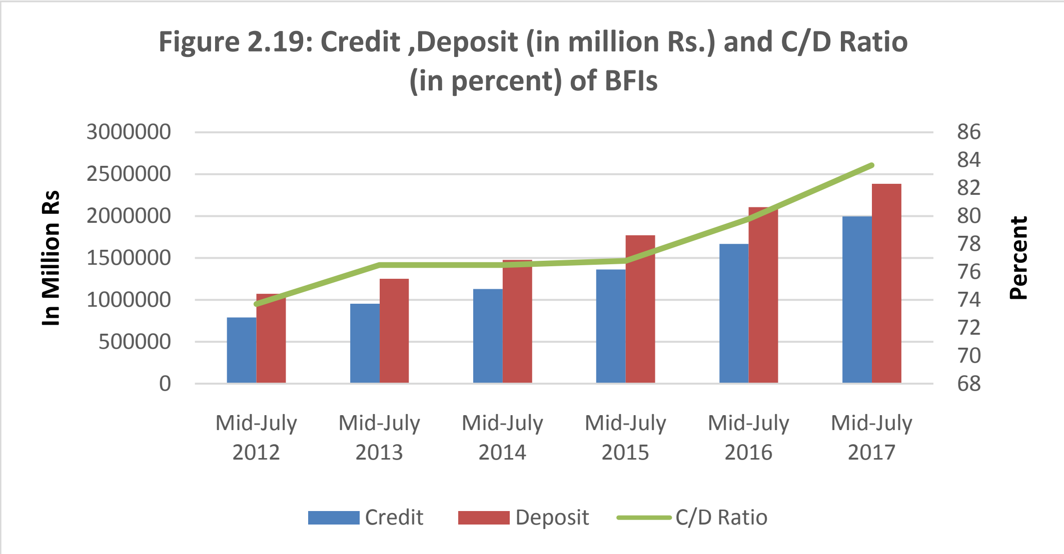
The trend of credit growth and deposit growth of "A", "B" and "C" class financial institutions is presented in Figure 2.17 and Figure 2.18 respectively. The figure shows sharp decline in credit and deposit growth rate in Mid-July, 2017 for development banks and finance companies, whereas the credit and deposit growth in commercial banks and overall system shows only slight decline. This is due to merger and acquisition of development banks and finance companies into commercial banks.



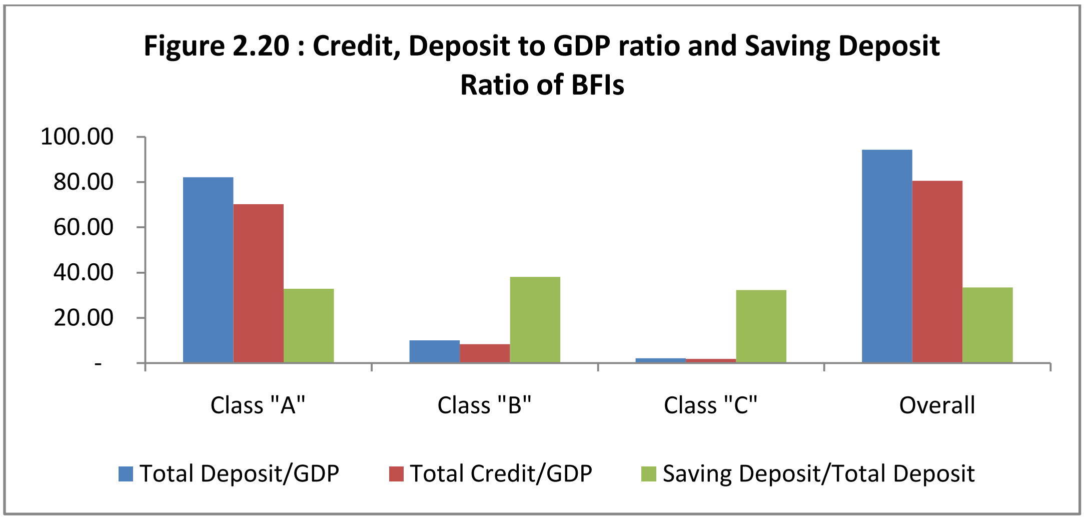
Credit of commercial banks, development banks, and finance companies grew by 21.69 percent, 17.93 percent and 16.68 percent respectively in mid- July, 2018.



Deposits of BFIs increased by 18.96 percent in mid-July 2018 as compared to mid-July 2017. The deposit growth of commercial banks, development banks and finance companies registered 18.07 percent, 26.08 percent, 21.92 percent respectively in mid-July 2018.



There has been increment in overall credit to deposit (C/D) ratio to 85.41 percent in mid-July 2018 from 83.64 in mid-July 2017. The C/D ratio of finance companies stood at 90.22 percent, development banks 83.90 percent and commercial banks 85.47 percent.

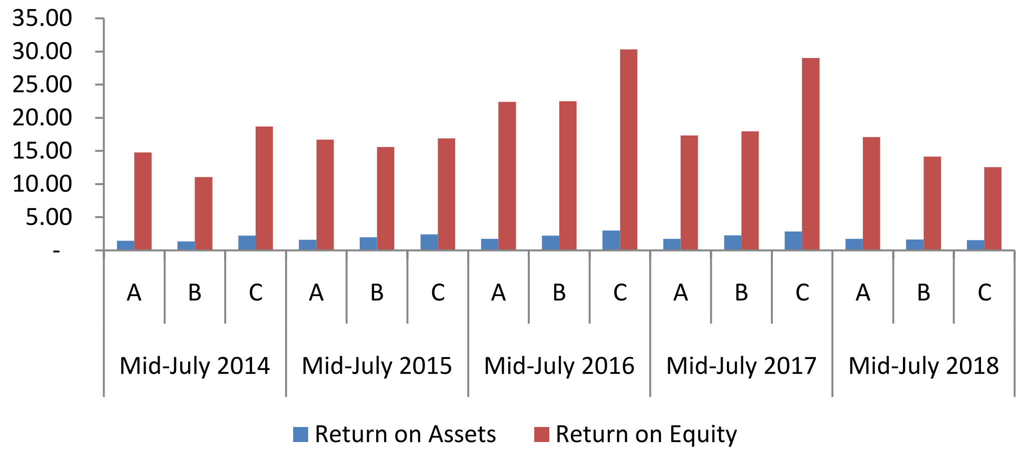


As of mid-July 2018, the ratio of total deposit to GDP reached 94.34 percent while the share of commercial banks, development banks and finance companies in total deposits stood at 82.19 percent, 10.04 percent and 2.11 percent, respectively. Likewise the ratio of total credit to GDP reached 80.57 percent while the share of commercial banks, development banks and finance companies in total credit stood at 70.24 percent, 8.42 percent and 1.91 percent, respectively.

Profitability

The overall growth rate of profitability of banking sector has slightly increased in the review period. The overall profitability of banking sector has increased by 12.20 percent in mid–July 2018 and reached Rs. 61.34 billion from Rs. 54.67 billion in mid-July 2017. The growth rate of profitability of banking sector in the last year was 11.57 percent. The commercial banks posted the highest share of profitability of the banking sector accounting 87.44 percent of the total in mid-July 2018.

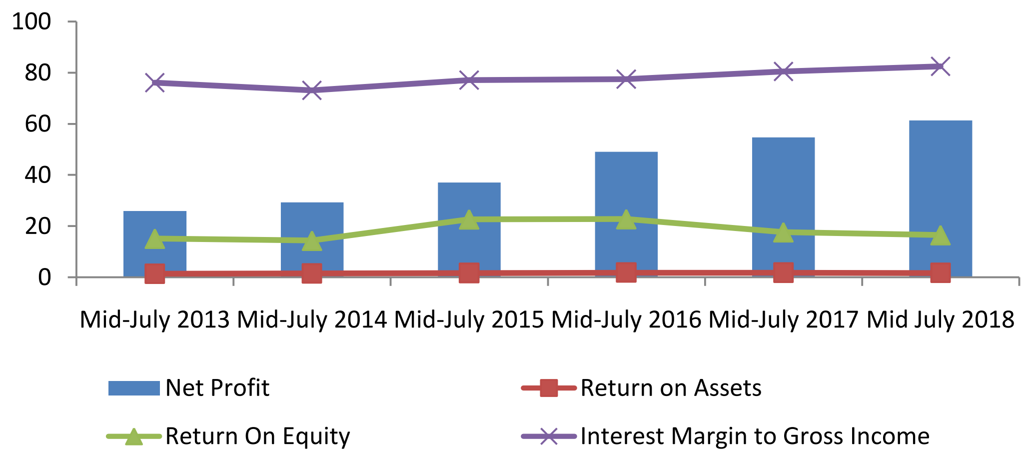
Figure 2.21: Classwise Profitability of BFIs



The Return on Equity (ROE) of bank and financial institutions have reduced in 2017/18 mainly due to increase in capital. The ROE of commercial banks stood at 17.07 percent whereas development banks and finance companies stood at 14.14 percent and 12.54 percent respectively. Such ratio was 17.32 percent, 17.95 percent and 28.99 percent respectively in the previous year.

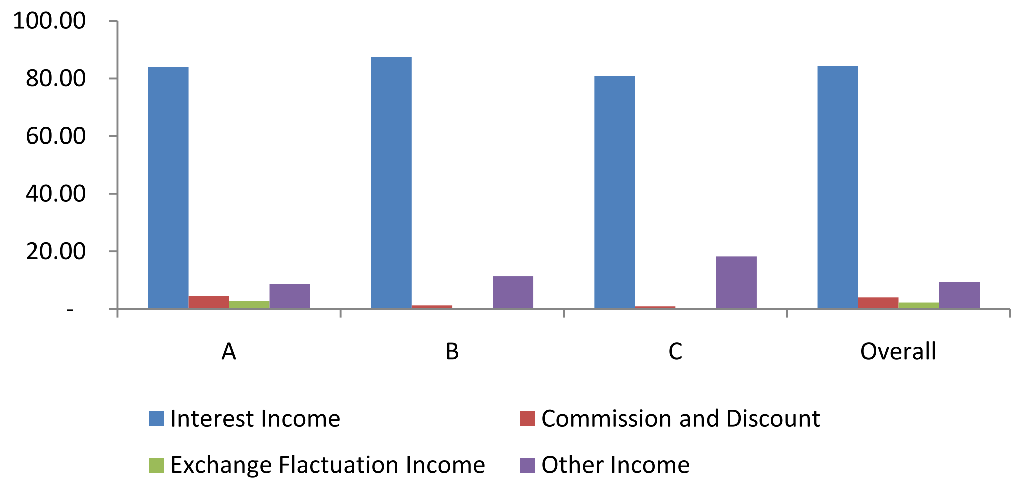
The interest margin to gross income stood at 82.49 percent in mid-July 2018 which was 80.49 percent in mid-July 2017. The net profit of BFIs grew by 12.20 percent in mid-July 2018 from the growth of 11.57 percent in mid-July 2017. ROA decreased to 1.72 percent from 1.82 percentage. Similarly, ROE also decreased to 16.58 percent from 17.71 percent in mid-July 2018 as shown in Figure 2.22.

Figure 2.22 : Net Profit (in billion), ROE, ROA and Interest Margin to Gross Income (In percent)



Interest income comprised the biggest share, 84.34 percent, in total income of BFIs in 2017/18. Of the total interest income, interest on loan and advance constituted 93.72 percent and interest on call accounts constituted 1.39 percent. Commission based income contributed only 4.04 percent to the total income. Banking sector, thus, is still highly dependent on traditional activities of lending and deposit mobilization. The gain from exchange fluctuation was 2.34 percent and other income was 9.28 percent of the total income of BFIs in 2017/18.

Figure 2.23: Income Distribution of BFIs



Liquidity

Liquidity ups and downs have been an issue in the financial sector for the last two years and more mainly due to higher growth of credit relative to deposit mobilization. With an increase in the paid-up capital, banks have been aggressive in lending in order to maintain their profitability. However, they have not been able to generate adequate loanable fund following the sluggish growth of remittances and weak expenditure capacity of the government. NRB has been using credit to deposit (CD) ratio, net liquid assets to total deposits, and liquid assets to total assets as gross measures to monitor the liquidity condition in the banking system.

Total liquid asset to deposit ratio of BFIs stood at 25.91 percent in mid-July 2018 compared to 26.74 percent in mid-July 2017. The total liquid asset to deposit ratios for "A", "B" and "C" class institutions are recorded at 24.85 percent, 32.35 percent and 36.74 respectively in mid-July 2018. Such ratios were 26.00 percent, 31.52 percent and 34.27 percent respectively in mid-July 2017. Hence, the ratios for all BFIs stood above the regulatory requirements thereby increasing the cost of fund for BFIs.

As at mid-July 2018, the credit to deposit ratio of BFIs stood at 85.41 percent compared to 83.64 percent in mid-July 2017. The credit to deposit ratios for "A", "B" and "C" class institutions stood at 85.47 percent, 83.90 percent and 90.22 percent respectively in mid-July 2018. Such ratios were 82.93 percent, 87.55 percent and 94.27 percent respectively in mid-July 2017.

Figure 2.24: Liquidity in BFIs

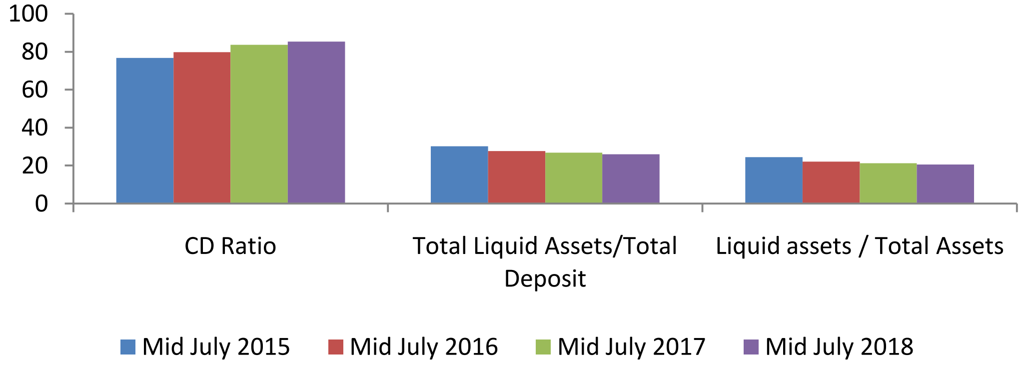


Table 2.3: Financial Soundness Indicators of BFIs (in percent)

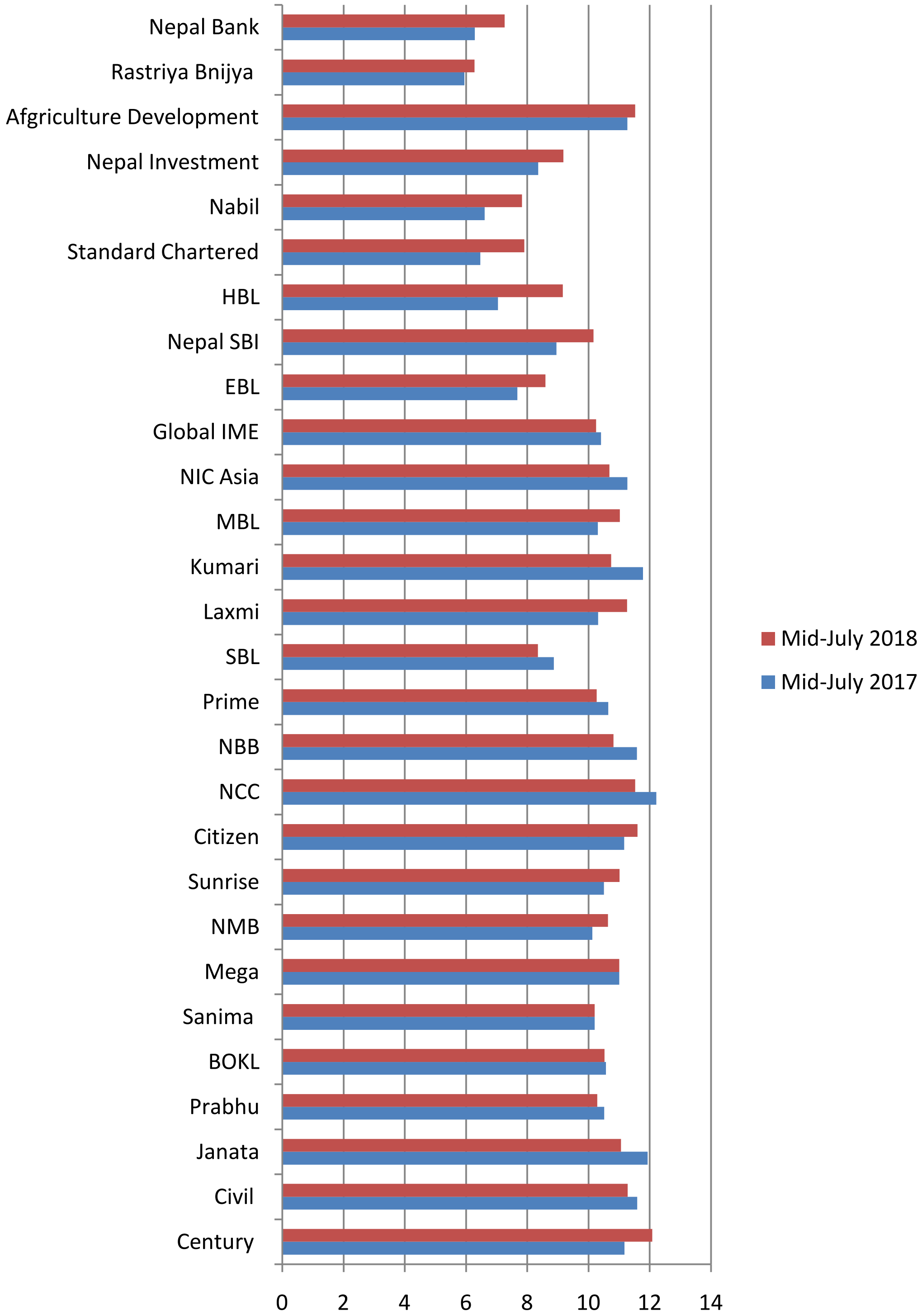
Indicators	Class "A"		Class "B"		Class "C"		Overall	
	Mid-July		Mid-July		Mid-July		Mid-July	
	2017	2018	2017	2018	2017	2018	2017	2018
Credit and deposit related indicators								
Total deposit/GDP	80.53	82.19	9.21	10.04	2.01	2.11	91.75	94.34
Total credit/GDP	66.78	70.24	8.06	8.42	1.89	1.91	76.74	80.57
Total credit/ Total deposit	82.93	85.47	87.54	83.9	94.28	90.22	83.64	85.41
LCY credit/LCY deposit and core Capital	79.57	77.07	76.82	72.78	76.00	77.88	79.17	76.81
Fixed deposit/Total deposit	42	43.33	39.37	41.36	47.67	53.63	41.86	43.35
Saving deposit/Total deposit	33.59	32.84	39.69	38.05	35.51	32.27	34.24	33.38
Current deposit/Total deposit	9.52	10.08	2.05	2.41	0.17	0.44	8.57	9.05
Call Deposit /Total Deposit	13.63	12.48	18.42	18.08	7.23	7.02	13.98	12.96
Other Deposit/Total Deposit	1.26	1.26	0.39	0.09	9.05	6.65	1.35	1.26
Assets quality related indicators								
NPL/ Total loan	1.54	1.41	1.36	1.09	13.37	10.83	1.89	1.6
Total LLP/Total loan	2.39	2.09	2.01	1.73	14.03	11.35	2.63	2.27
Res. Per. H. Loan (Up to Rs. 15 mil.)/Total Loan	8.07	7.92	10.51	10.43	12.84	14.05	8.44	8.32
Real estate exposure/Total loan	6.00	5.43	8.09	7.73	12.45	13.36	6.38	5.86
Deprived sector loan/Total loan	5.95	5.94	9.11	9.47	5.15	5.46	6.26	6.28

Indicators	Class "A"		Class "B"		Class "C"		Overall	
	Mid-July		Mid-July		Mid-July		Mid-July	
	2017	**2018**	**2017**	**2018**	**2017**	**2018**	**2017**	**2018**
Cash and bank balance/Total deposit	15.19	12.57	17.42	16.53	20.05	19.49	15.52	13.15
Investment in Gov. security/Total deposit	9.97	11.57	1.82	2.54	2.53	3.7	8.99	10.43
Liquid assets/Total assets	20.77	19.78	24.73	26.06	21.63	24.32	21.19	20.56
Total liquid assets/Total deposit	26.00	24.85	31.52	32.35	34.27	36.74	26.74	25.91
Net liquid assets/Total Deposit	24.59	23.49	31.15	32.1	31.84	34.9	25.40	24.66
Capital adequacy related indicators								
Core capital/RWA (percent)	13.35	13.32	19.43	17.93	20.21	19.78	14.07	13.89
Total capital/RWA (percent)	14.72	14.61	20.44	18.99	21.19	20.65	15.4	15.15
Wt. Avg. interest rate on deposit	6.15	6.49	-	-	-	-	-	-
Wt. Avg. interest rate on credit	11.39	12.29	-	-	-	-	-	-

Base Rate of BFIs

NRB introduced base rate for commercial banks in 2013 and for development banks and finance companies in 2014 advising the BFIs not to lend, in general, below the base rate. The base rate system will also facilitate BFIs in setting their floating interest rate as the cost of funds can act as an effective reference rate. BFIs are required to publish their base rate on monthly basis on their website and quarterly basis on national daily newspaper for public consumption. The introduction of base rate is believed to enhance transparency in interest rate setting for different products; protect the clients' interest, promote the healthy competition and sustainability of BFIs, and strengthen the monetary transmission mechanism.

Figure 2.25: Base Rate of BFIs



Interest Rate Spread

Interest rate spread is one of the major indicators reflecting the cost of financial intermediation. The spread, at any given time, is generally function of many factors such as, expenses on deposits, the general level of competition in the banking sector, the amount of credit risk, the managerial efficiency of the concerned banks, and so forth. High spread is usually interpreted as an indicator of low efficiency and lack of competitiveness, which adversely affects domestic real savings and investment, leading to significant amelioration of growth. Due to high interest spread rate in the banking system, NRB has started monitoring the spread rate since mid-July 2014.

NRB has directed "A" class banks to bring their interest spread rate within 4.5 percent and "B" and "C" class financial institutions within 5.00 percent by mid-July 2019. BFIs have also been directed to publish their interest spread on monthly basis. As evident from the figure 2.26, the overall interest spread of the commercial banks stood at 3.85 percent whereas the interest spread of the state owned banks remained at 6.04 percent as of mid-July 2018. Nepal Bank Ltd. has registered the highest interest rate spread of 6.79 percent among commercial banks followed by Agriculture Development Bank with interest rate spread of 5.81 percent. Civil Bank Ltd has the lowest interest rate spread of 1.97 percent in the same period. All the state owned banks have the spread of more than 5.00 percent in mid-July 2018.

Figure 2.26: Net Interest Spread of Commercial Banks in percentage point

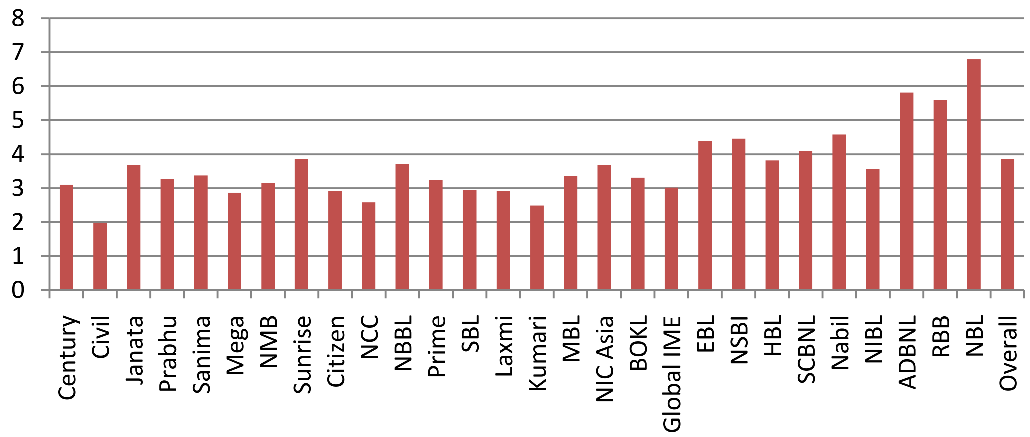
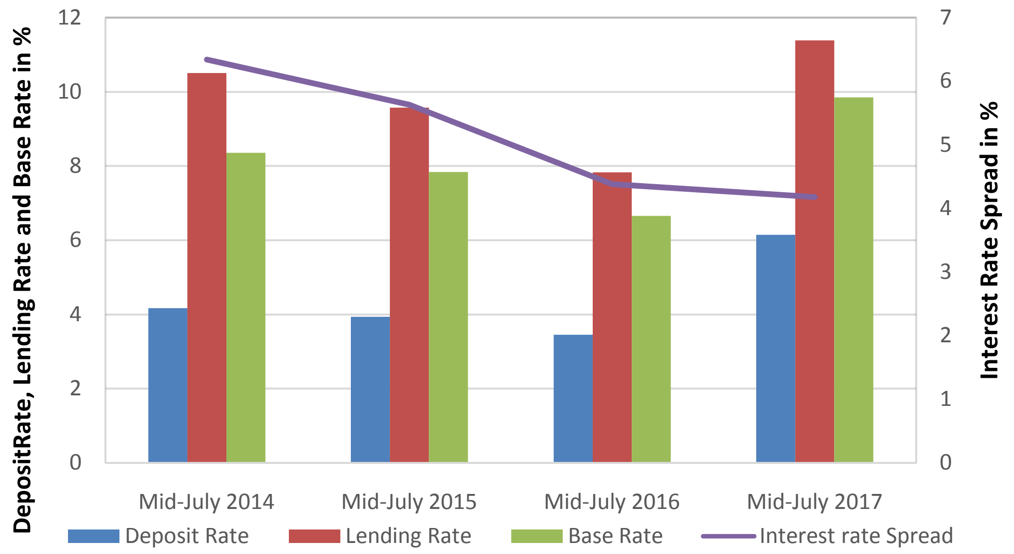


Figure 2.27: Deposit Rate, Lending Rate, Spread Rate & Base Rate of Commercial Banks



Banking Sector Consolidation: Merger & Acquisition

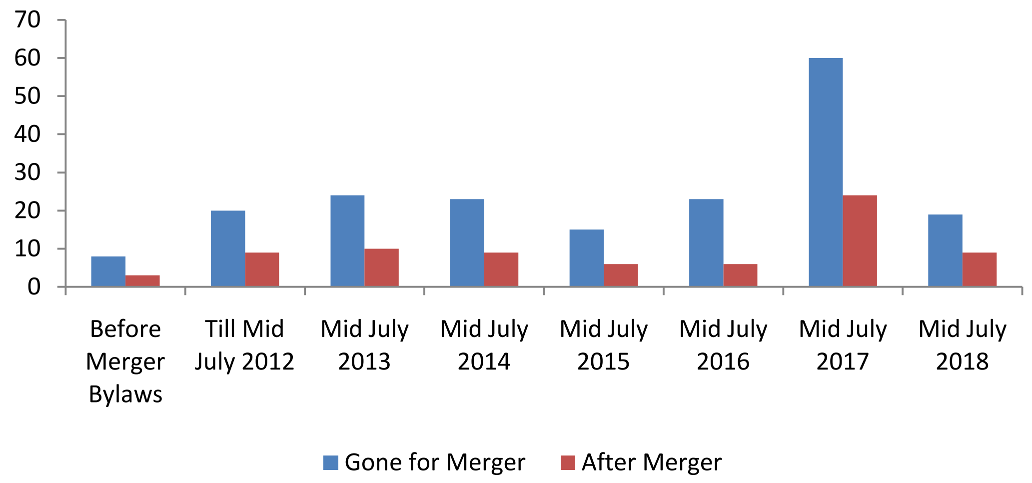
Consolidation is taken as one of the tools to enhance the capital base, achieve operational efficiency and strengthen the resilience of BFIs. Merger and acquisitions are considered one of the effective means of financial consolidation. Increasing capital and asset bases through consolidation would enable BFIs to mobilize lower cost, long term funds and build greater resilience to shocks. The synergies that could be generated through consolidation would help make available a wider array of products to customers. Diversifying the products offered and in turn, the customer base would help diversify risks, thereby helping them to become more resilient. Having a smaller number of larger and stronger BFIs would create an industry that is fully compliant with the Central Bank's supervisory and regulatory norms.

NRB has taken consolidation in the financial sector as an important reform measure for building strong and competitive financial environment. In Nepal, financial sector consolidation is facilitated by the merger & acquisition. To strengthen the health and competency of BFIs, NRB has given high priority to merger between licensed financial institutions. It includes specific process of merger with several incentives, regulatory relaxations and indirect provision of forceful merger. NRB, through consolidation among BFIs, has expected to yield the benefits of becoming larger institutions, enhancing their capacity for providing modern financial products, enhance strong corporate governance culture, strengthen capital base and ability to introduce new products and use enhanced IT platforms, provides economies of scale and scope, lower the cost of funds and builds resilience to domestic and external shocks.

Merger and Acquisition

The number of BFIs opting for merger has been increasing after the introduction of merger policy. As of mid July 2018, 162 BFIs have merged resulting in the formation of 41 BFIs. In the review period, 19 BFIs have merged and acquired to form 9 BFIs. In FY 2017/18, 60 BFIs were merged and acquired to form 24 BFIs.

Figure 2.28: Status of BFIs Merger



Financial Access and Inclusion

Financial inclusiveness is understood as providing and ensuring reliable and affordable financial services to all segment of society. Access to finance is particularly very important for disadvantaged and low income segments of society, as it provides opportunities for them to save and invest, and to protect themselves from various risks such as natural disasters, illnesses and loss of livelihoods. Access to finance is expected to enable the poor and low income people be self-reliant and break the vicious cycle of poverty. Increasing financial access and inclusion has been focal point for all regulatory institutions in Nepal. They have been operating various programs directed to increase financial access and inclusion in the country.

Financial Inclusion and Efforts of NRB

Recognizing the need for inclusive growth policy for Nepal, NRB in coordination with the government of Nepal, has taken a number of policy measures to ensure reliable and affordable financial services to the poor people in the country. NRB has been endeavoring to extend financial access and inclusion through various incentives directed towards banks and financial institutions. Financial Policy of establishing a branch of commercial banks in every local level of government, gradual increment in deprived sector lending requirement for licensed Banks and Financial Institutions (BFIs), mandatory requirements for them to invest certain percentage of their total credit in the priority sector, liberal branch opening policy in local municipality (except their center), special refinance facility to cottage and small industries, interest free loan to extend bank branches in all local levels, establishment of Rural Self Reliance Fund for subsidized credit to the poor and marginalized population, directives on consumer protection, simplified provision to extend financial services through branchless banking and mobile banking services, and policy regarding financial literacy are some of the policy measures directed towards ensuring financial inclusion and inclusive growth in the country. For the expansion of economic activity, financial access plays a vital role. In this connection Government of Nepal has announced a policy to open a bank account for each citizen.

NRB has put forward the overarching goal to increase access to financial services in the country. In order to achieve this goal NRB has pursued various policies and programs: (I) polices and regulatory environment that allows BFIs to offer financial services in all local levels (ii) develop financial infrastructure that have capacity to provide high quality financial services (iii) innovative models of financial service provision that are used effectively to extend outreach to underserved regions and groups and (iv) increased capacity of clients to understand and utilize financial services effectively.

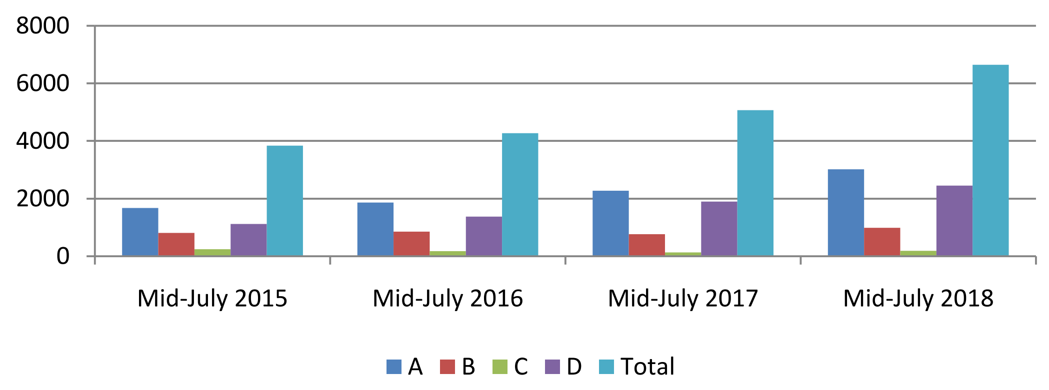
In addition to these, NRB has been also taking initiatives on financial literacy programs and financial consumer protection which is expected to enhance the banking habits of the people of unbanked areas.

Table 2.4: Branches of BFIs

Financial Institutions	Number of Branches		Share (in percent)	
	Mid-July 2017	Mid-July 2018	Mid-July 2017	Mid-July 2018
Commercial Banks	2274	3023	44.87	45.44
Development Banks	769	993	15.17	14.93
Finance Companies	130	186	2.57	2.80
MFIs	1895	2450	37.39	36.83
Total	**5068**	**6652**	**100.00**	**45.44**

Financial access has been increasing with the expansion of branch network of financial institutions. As of mid-July 2018, the branch network of commercial banks reached 3023 followed by development banks (993), Finance companies (186) and Micro Finance Financial Institutions (2450). The number of branches of the respective categories of BFIs stood 2274, 769, 130 and 1895 respectively as of mid-July 2017. With the direction of Nepal Rastra Bank to open at least one commercial bank branch along with the increase in branches of other BFIs to expand the market, the total number of bank branches of BFIs increased by 1582 (45.44 percent) and reached to 6652 in mid-July 2018 from that of 5068 in mid-July 2017. In mid-July 2018, on an average, a BFI branch, excluding the branches of “D” class financial institutions, has been serving to approximately 6858 people;. The banking service served population comes down to 5227 people per branch when branches of "D" class are also included.

Figure 2.29: Number of BFIs Branches



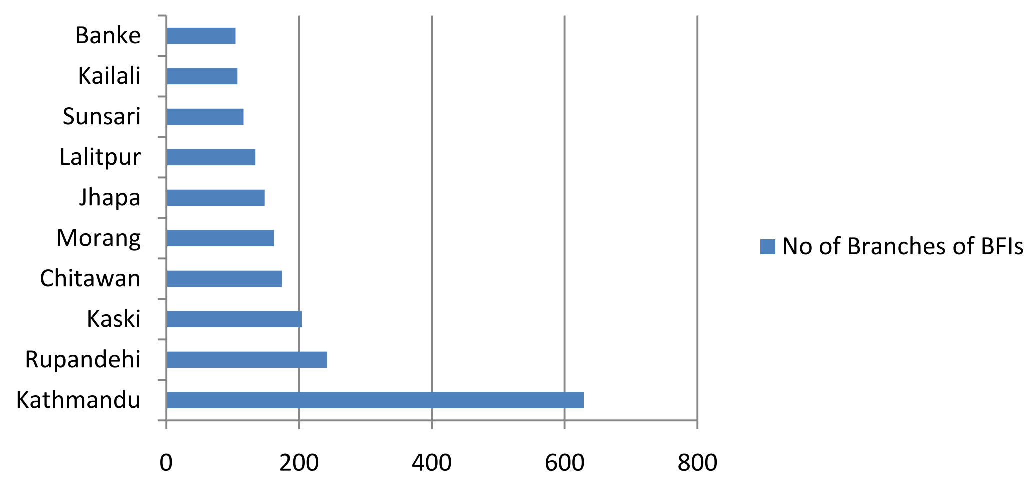
Increase in number of branches indicates the increase in financial outreach or financial access, which is also considered as one of the indicators of financial inclusion. Despite the growth in number of BFIs and their branches, financial service providers are still mainly concentrated in urban or semi- urban areas where geographical access is relatively easy.

Table 2.5: Provincial Allocation of BFI Branches

Province	BFIs			Total	Share (in percent)	Population (per branch)
	A	B	C			
Province No 1	486	135	38	659	15.68	7,300
Province No 2	359	56	18	433	10.30	13,780
Province No 3	1031	258	72	1361	32.39	4,504
Gandaki	345	219	24	588	13.99	4,221
Province No 5	481	265	29	775	18.44	6,532
Karnali	122	9	3	134	3.19	11,665
Province No 7	199	51	2	252	6.00	11,124
Total	3023	993	186	4202	100.00	6,858

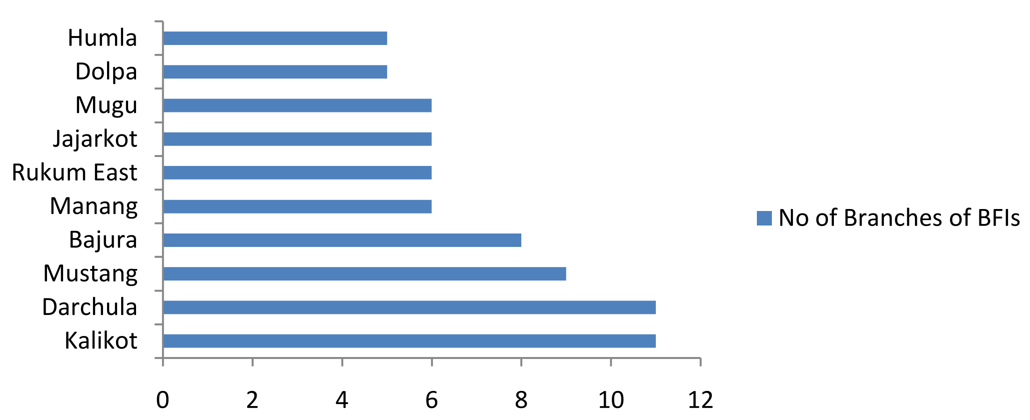
Looking upon the province wise distribution, the majority branches of BFIs are situated in Province No 3, totaling 1361 (32.39 percent), followed by Province No 5 with total of 775 (18.44 percent) and Province No 1 with total of 659 (15.68 percent).

Figure 2.30 :Top 10 Districts as per branch presence



Kathmandu is highly concentrated district in terms of number of BFIs presence, followed by Rupandehi and Kaski. Despite continuous efforts from the NRB in increasing the outreach of financial services in remote areas, the result is still not satisfactory in terms of branch expansion in Karnali Province. Humla and Dolpa still have only 5 BFIs branches each and are the areas with lowest presence of BFIs as of mid-July 2018.

Figure 2.31: Bottom 10 Districts as per branch presence



Investment in information technology (IT) based systems is vital to improve banking efficiency and service delivery in this competitive age. The resulting greater efficiency and outreach will help promote financial inclusion, reduce intermediation costs thereby improving the bottom line of the financial services. The growth observed in total numbers of ATM terminals, number of debit cards, credit cards along with the increase in number of internet banking and mobile banking customers depicted in table 2.6 shows that banking is getting more automated and technology oriented.

Table 2.6: Use of Financial Services

Particulars	Class "A"	Class "B"	Class "C"	Total
No. of Deposit Accounts	19295273	3758614	490972	23544859
No.of Loan Accounts	953310	310405	37295	1301010
No. of Mobile Banking Customers	4711097	351796	23176	5086069
No. of Internet Banking Customers	816074	14634	3594	834302
No. of ATMs	2552	209	30	2791

No. of Debit Cards	5307970	206589	29694	5544253
No. of Credit Cards	104721	0	0	104721
No. of Prepaid Cards	96816	0	0	96816

Branchless banking has been developed to address the payment needs of people who do not have access to the financial system. Branchless banking is a cheaper means of banking system which can be operated in the remote districts whilst mobile phone based payment systems have been introduced to enhance convenience in making payments at merchandise outlets. In mid-July 2018, branchless banking centers numbered 1285. BFIs are encouraged to serve through branchless banking in remote areas where the branch operation is not viable due to high cost of financial intermediation.

In order to facilitate electronic payment mechanism in Nepal, Nepal Rastra Bank has been focusing on developing various regulations. Currently, Nepal's payment and settlement landscape is made up of the following Policy and Operational Framework:

- Nepal Payment System Development Strategy - 2014
- Payment Systems Oversight Framework - 2018
- Payment and Settlement Bylaws - 2015
- Licensing Policy for Payment Related Institutions - 2016

Banks and Financial Institutions must obtain license from Nepal Rastra Bank in order to perform any electronic transactions. As on Mid July, 2018, 41 institutions have obtained license to perform electronic transactions, detail of which is presented in table 2.7.

Table 2.7: Licensed Institution to Perform Electronic Payment
As on Mid July, 2018

S.N.	Category	Number
1	Commercial Bank ("A" Class)	28
2	Development Bank ("B" Class)	4
3	Finance Company ("C" Class)	4
4	Payment System Operator (PSO)	3
5	Payment System Provider (PSP)	2

Demat account has been made mandatory in public offerings with effect from mid-July 2016 in Kathmandu valley and from mid-January 2017 all over the country. As a result, the number of demat accounts has been increasing significantly during the review period. The situation of demat accounts in the last three years is presented in Table 2.7.

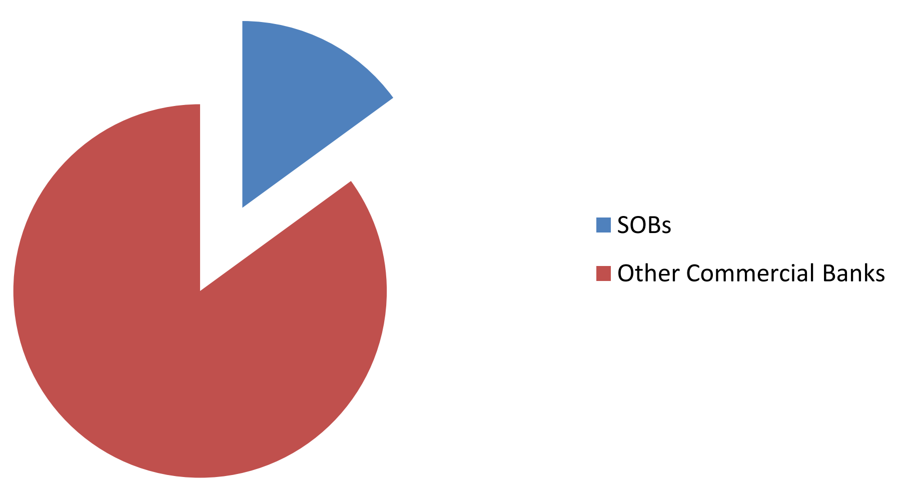
Table 2.7: Demat Accounts

Description	Fiscal Year			Percent Change		
	2015/16	**2016/17**	**2017/18**	**2015/16**	**2016/17**	**2017/18**
Number of Demat Accounts	392,359	870,702	1,296,572	858.52	121.91	48.91

Performance and Reform of State Owned Banks (SOBs)

Nepal Bank Limited (NBL), Rastriya Banijya Bank (RBB) and Agriculture Development Bank Limited (ADBL) are the three state owned commercial banks, which occupied 15.45 percent share in GDP in terms of total assets & liabilities. The share of total assets & liabilities of BFIs to GDP reached to 118.88 percent in mid-July 2018 reflecting the increment in financial deepening. The total assets of state owned banks (SOBs) reached to Rs. 475.29 billion in mid-July 2018 from Rs.459.94 billion in mid-July 2017. The total share of SOBs on total assets of commercial bank is 14.97 percent in mid-July 2018.

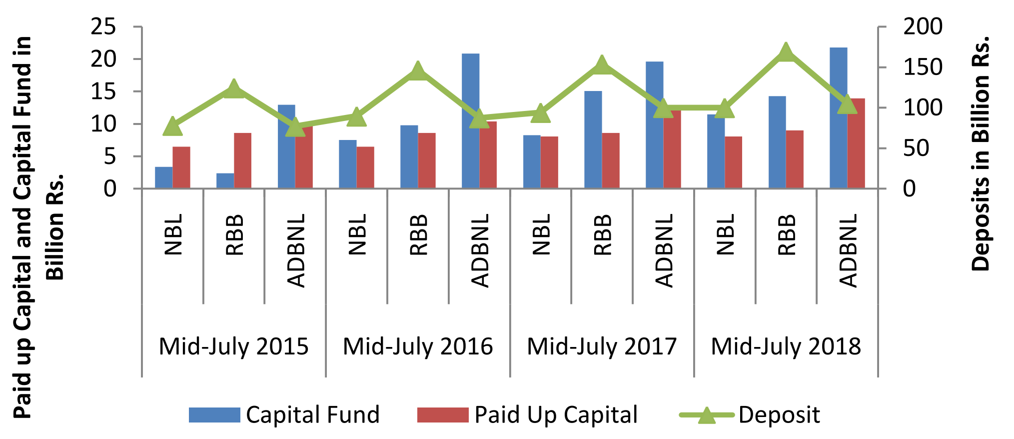
Figure 2.32: Share of SOBs in Total Assets of CBs



The state owned commercial banks comprise 15.14 percent share in total deposit of commercial banks. Their market share in terms of total assets, total deposit and loan & advances of all BFIs stood at 13.00 percent, 15.14 percent and 12.42 percent respectively in mid-July 2018. Among these banks, financial and regulatory position of ADBL, especially in terms of capital base and capital adequacy remains at satisfactory level. The asset quality of NBL and RBB has been gradually improving in the review period.

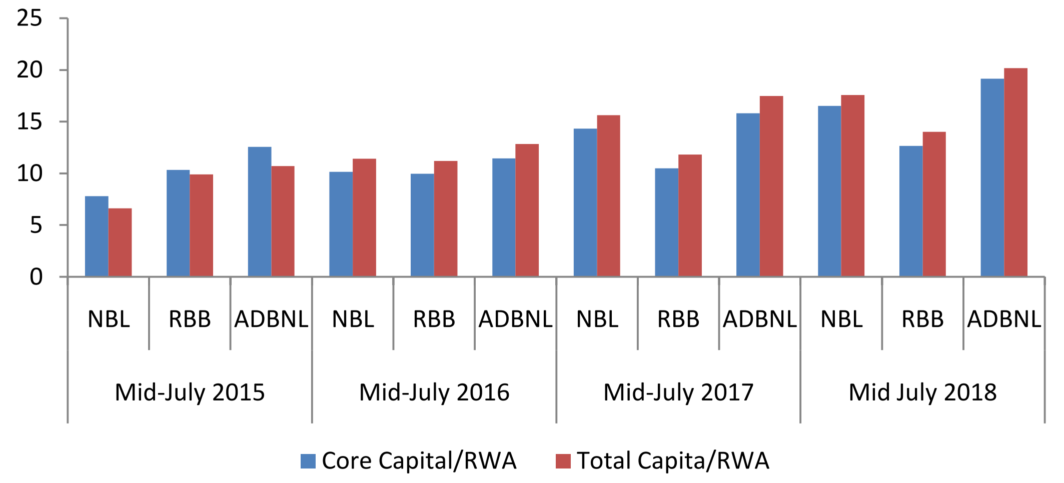
As of mid-July 2018, capital fund of three state owned banks, namely, NBL, RBB and ADBL stood at Rs. 11.45 billion, Rs. 14.30 billion and Rs. 21.78 billion respectively. The figure was Rs. 8.25 billion, 15.08 billion and 19.63 billion respectively for NBL, RBB and ADBL in mid-July 2017, showing a slight improvement in the capital base of SOBs.

Figure 2.33: Paid up Capital, Capital Fund and Deposits of SOBs



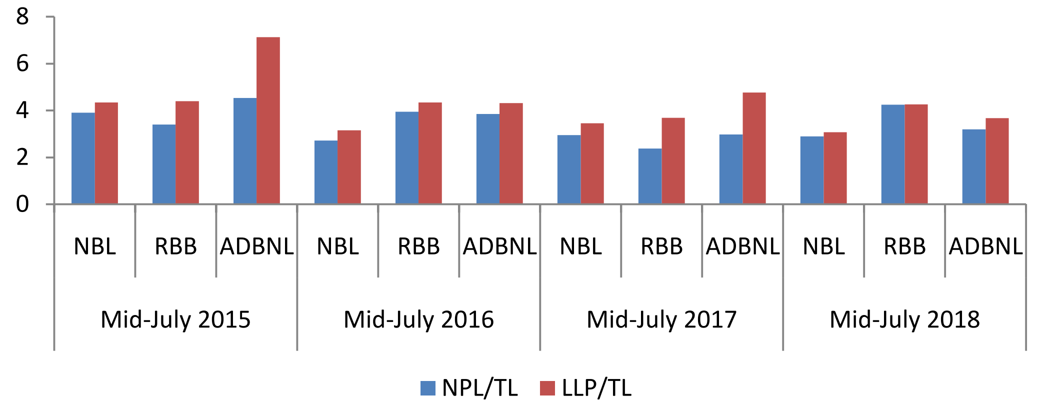
The core capital and total capital-to-risk weighted assets of ADBL stood at 19.16 percent and 20.18 percent in mid-July 2018. Such capital was 15.82 percent and 17.47 percent respectively in mid-July 2017. Likewise, reform of two SOBs lead the improvement in core capital and total capital. Both RBB and NBL have already met the minimum capital requirement. The core capital and total capital-to-risk weighted assets of NBL stood at 16.52 percent and 17.58 percent respectively. Similarly core capital and total capital-to-risk weighted assets of RBB stood at 12.65 percent and 14.02 percent respectively in mid-July 2018. Improvement in capital adequacy ratio of SOBs indicates improved resilience.

Figure 2.34: Capital Adequacy of SOBs



The NPL ratio of state owned banks has deteriorated from 2.73 percent in mid-July 2017 to 3.54 percent in mid-July 2018. As on mid- July 2018 the NPL ratio of ADBL, RBB and NBL stands at 3.20 percent, 4.25 percent and 2.90 percent respectively implying a deterioration in the assets quality. Such ratios were 2.97 percent, 2.37 percent and 2.95 percent in mid-July 2017. The NPL ratio of all state owned banks is below the regulatory limit in the review period but due consideration is to be given in the increase in NPL of SOBs. Though there has been increase in NPL of SOBs, NPL of majority of other commercial banks have been decreasing. Consequently, overall NPL of commercial banks has come down to 1.39 percent from 1.81 percent during the review period.   .

Figure 2.35: NPL and LLP Ratios of SOBs



Since state owned banks hold a major portion of share in total banking sector, the ups and downs in performance of these banks can alter the financial soundness indicators of the whole banking system. Therefore, timely reform of these BFIs is imperative to improve the performance indicators of financial sector and maintaining the financial stability.

CHAPTER – THREE

PERFORMANCE OF FINANCIAL INSTITUTIONS

Performance of Commercial Banks

Nepalese financial system comprises dominant share of BFIs. Moreover, among the BFIs, commercial bank holds significant share in total assets (Rs. 3068.6 billion as of mid-July 2018). In mid-July 2018, share of commercial banks in total assets and liabilities of NRB regulated BFIs increased to 83.42 percent from 82.75 percent in mid-July 2017. Similarly, ratio of total assets and liabilities of commercial banks to GDP increased to 103.23 percent in mid-July 2018 from 100.8 percent a year ago. The dominance of commercial banks in total banking sector in terms of assets and liabilities as well as in terms of balance sheet component has broadly remained stable. The total assets (or liabilities) of commercial banks increased by 18.43 percent to Rs. 3068.6 billion in mid-July 2018 from Rs. 2584.6 billion in mid-July 2017.

Deposits and Credits

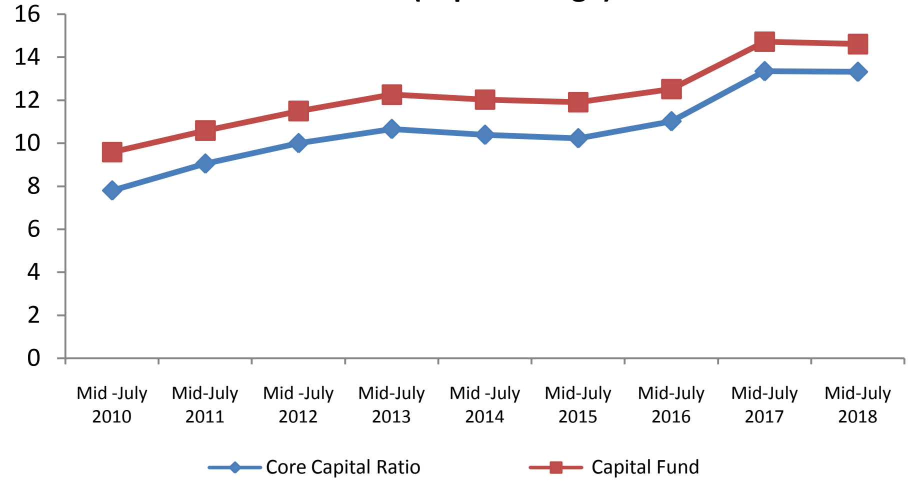
Total deposit and credit of commercial banks stood at 82.20 percent and 70.24 percent of GDP respectively in mid-July 2018 compared to 80.53 percent and 66.10 percent of GDP respectively in mid-July 2017. Total deposits grew by 18.07 percent to Rs. 2471.51 billion in 2017/18 compared to the growth of 18.63 percent in the previous year. Total credit flow grew by 21.68 percent and reached to Rs. 2112.33 in mid-July 2018.

Besides loans and advances, investment in government securities has emerged as the second best option for commercial banks to utilize their excess liquidity. Investment in government securities increased by 36.96 percent, on y-o-y basis, to Rs. 285.84 billion in mid-July 2018.

Capital

The capital fund of commercial banks rose by 21.07 percent to Rs. 385.49 billion in mid-July 2018 from Rs. 318.40 billion a year ago. Of the total capital fund, paid up capital and statutory reserves rose by 24.86 percent and 20.03 percent respectively whereas other reserves decreased by 22.19 percent in 2017/18. Moreover, in mid-July 2018, all the commercial banks have maintained the mandatory Capital Adequacy Ratio. Total Capital fund to risk weighted exposure of commercial banks has slightly dipped to 14.61 percent in mid- July 2018 from 14.72 percent in mid-July 2017.

Figure 3.1 : Capital Adeqacy of Commercial Banks (in percentage)



Assets

The aggregate NPL to total loan ratio of commercial banks decreased to 1.39 percent in mid-July 2018 from 1.56 percent in mid-July 2017. The three state-owned banks in total have NPL ratio of 3.54 percent whereas that of private commercial banks is only 1.03 percent in mid-July 2018. As of mid-July 2017, average NPL ratio of three state owned commercial banks was 2.73 percent, whereas such ratio for private commercial banks was 1.34 percent. Credit quality of private commercial banks on aggregate has slightly improved, while state owned commercial banks has evidenced fall in the credit quality.

Table 3.1: Major Financial Indicators of Commercial Banks (in percentage)

Indicators	(Ratios (%)
Tier 1 & Tier 2 Capital /RWE	14.61
Tier 1 Capital/RWE	13.32
NPL/Total Loan	1.39
Return on Equity	17.07
Net Interest Spread	3.85
Total Credit to Total Deposit	85.47
Total Liquid Assets/Total Deposit	26.20
Base Rate	9.77

The existing provision of NRB Unified directive requires commercial banks to invest at least 25 percent of total loan and advances (6 months earlier) in agriculture, hydropower/energy and tourism sector. The total loans of commercial banks in agriculture, hydropower/energy and tourism sector accounts for 9.54%, 10.75% and 5.25 % respectively.

Product-wise loan comparison with the previous year reveals that commercial banks were less motivated to invest in real estate lending as such lending has decreased by 8.50 percent in mid-July 2018. Product wise loans in terms of term loan, overdraft loan, demand and other working capital loan represents 17.46 percent, 16.53 percent and 22.74 percent respectively of the total loan in mid-July 2018. Such ratios were 16.20 percent, 17.90 percent and 22.20 percent respectively in mid-July 2017. There was noticeable growth in residential and slight dip in hire purchase loan, which shows that banking sector, especially CBs, still venture such loans (retail lending) as lucrative for short term profitability and performance. Similarly, commercial banks have disbursed 5.41 percent of their total loan in deprived sector as of mid-July 2018. Loan against properties have shown increasing trend in the review period. Out of total loan, 61.70 percent are backed by collateral of properties in mid-July 2018 compared to 60.90 percent a year ago.

Profitability

Net Profit of the commercial banks posted annual growth of 16.26 percent to Rs. 53.62 billion in 2017/18 compared to the growth of 19.15 percent in the previous year. All commercial banks registered positive profit during the review period. Contribution of interest income was 83.82 percent of the total income in the review period, a slightly increase from 79.44 percent of the previous year.

Stress Testing of Commercial Banks

Credit Shock

Stress test results show that there is growing risk in credit among commercial banks. Stress testing results based on data of mid-July 2018 obtained from 28 commercial banks revealed that a combined credit shock of 15.00 percent of performing loans degraded to substandard, 15.00 percent of substandard loans deteriorated to doubtful loans, 25.00 percent of doubtful loans degraded to loss loans and 5.00 percent of performing loans deteriorated to loss loans categories which would push the capital adequacy ratio of 24 commercial banks below the minimum regulatory requirements (including conservation buffer) of 11.00 percent. The numbers of such banks were 23 in mid-July 2017.

Stress testing results under the scenario of all non-performing loans under substandard category downgraded to doubtful and all non-performing loans under doubtful category downgraded to loss underscores a pessimistic scenario as the number of banks capable of withstanding such shock without deteriorating capital adequacy to below 11.00 percent came to none, down from previous reading of one in mid-July 2017. Similarly, stress testing results under the scenario of 25.00 percent of performing loans of real estate and housing sector directly downgraded to substandard showed same result i.e. none of the bank meet minimum requirement of 11.00 percent. However, another scenario of 25.00 percent of performing loans of real estate and housing sector directly downgraded to loss loans showed some respite. Under this scenario, capital adequacy ratio of 2 commercial banks will come below the required level of 11.00 percent, which were 3 as on mid-July 2017. The result showed that majority of commercial banks maintained their resilience towards realty sector during the fiscal year.

In an another credit shock test, under the scenario of top two large exposures (loans) downgraded from performing to substandard category, the capital adequacy ratio of 3 commercial banks would fall below the required level whereas the number of such commercial banks was 2 in mid-July 2017. This scenario shows that there is slight deterioration in the performance due to increased dependency on top two borrower's exposure.

The overall credit shock scenario revealed that banks' credit quality has been improving as per the expectation due to various measures taken during the review period. However, banks are likely to face a difficult situation in case of slowdown in credit recovery, downgrade of loans to loss category of NPLs and increase in provisioning if the current situation moves to negative side.

Liquidity Shock

The stress test under scenario of withdrawal of customer deposits by 2, 5, 10, 10 and 10.00 percent for five consecutive days' results showed that 24 out of 28 commercial banks are vulnerable towards liquidity crisis.

Eight banks were prone to liquidity shock of withdrawal of 5.00 percent of deposits in a single day, while 21 banks' liquidity ratio would drop below 20.00 percent after withdrawal of 10 percent deposit in a single day. The number of banks seeing their liquidity ratio drop below 20.00 percent would grow to 24 if the single day deposit withdrawal increased to 15 percent. The number of banks prone to liquidity shock under single day deposit withdrawal of 5, 10 or 15 percent were 5, 14 and 23 respectively on mid-July 2017.

With the shock of withdrawal of deposits by top 2, 3 or 5 institutional depositors, liquid assets to deposit ratio of 18, 22 and 20 commercial banks would be below 20.00 percent in mid-July 2018. The numbers were 11, 18 and 23 in mid-July 2017. However, none of the commercial bank was vulnerable in case of deposit withdrawals from top 2, 3 individual depositors and 4 commercials banks were vulnerable among all commercial banks in case of deposit withdrawals from top 5 individual depositors. One commercial bank was vulnerable in case of deposit withdrawals from top 5 individual depositors in mid-July 2017.

Market and Combined Credit and Market Shock

The stress testing result under market shock revealed that 28 commercial banks have maintained enough CAR to absorb the interest rate shock and maintain it above the regulatory requirement. The interest rates were calibrated by changes in deposit and credit interest rates from 1.00 to 2.00 percent.

Similarly, commercial banks were found to be safe from exchange rate risks as the net open position to foreign currency was lower for all 28 of them. Furthermore, since commercial banks have nominal equity investments, the impact of fluctuation in equity price is near to zero.

When going through market shock, all commercial banks could maintain their capital adequacy ratio above the regulatory requirement of 11.00 percent.

The banks did not bear interest rate risks as they pass it directly to their clients; so, they are found to be less affected by interest rate shock as well.

The combined credit and market shocks based on a scenario of 25.00 percent of performing loan of real estate and housing sector directly downgraded to substandard category of NPLs and fall of the equity prices by 50.00 percent showed that CAR of one bank would fall below 11 percent. However, under a more adverse scenario of 15.00 percent of performing loans deteriorated to substandard, 15.00 percent of substandard loans deteriorated to doubtful loans, 25.00 percent of doubtful loans deteriorated to loss loans and the equity prices fall by 50.00 percent, the CAR of 16 banks would remain above the regulatory minimum level and CAR of 12 banks would fall below regulatory limit of 11.00 percent.

Performance of Development Banks

Development banks seem to have performed quite well in 2017/18. They have grown at a brisk pace such that growth rate in their deposits has been greater than that in their lending, they have put in more capital and have further improved the already good quality of their loan portfolio. As a result, development banks are in a relatively comfortable position with respect to liquidity, loanable funds and capital adequacy though their profitability has declined compared to last year.

Base rate of development banks has increased over this time period, owing mainly to prevailing high interest conditions and their interest rate spread has decreased over this time period though it is still above the regulatory requirement of 5%.

Mergers and acquisitions (M&A) have continued this year as well such that the number of development banks has decreased by seven this year owing to M&As.

National level development banks have been found to be largely resilient to various shocks as per results of standard stress tests.

Deposits and Credits

Total deposits have increased by 23.33 percent to NPR 301.97 billion in 2017/18 while gross loans have increased by 19.06 percent[1] to NPR 253.24 billion. However, these figures have to be understood in the context of mergers and acquisitions which occurred during 2017/18. During the review period, 13 development banks were involved in merger or acquisition process such that the number of development banks declined by seven including three development banks that got merged with/acquired into the commercial bank industry.

Hence, per development bank growth figures seem better suited for the purpose of understanding growth rates during the review period. Using per development bank measures, total deposits increased by 37.43 percent while gross loans increased by 33.16 percent in 2017/18.

Credit to deposit ratio decreased by 3.76 percentage points during 2017/18 while credit to deposit and core capital ratio decreased by 1.89 percentage points during

[1] 2017 mid-July figures do not include data for the then problematic Corporate Development Bank and Narayani Development Bank, while 2018 mid-July figures include data for both of these financial institutions.

this period. These declines could be attributed to the greater growth rate of per development bank deposit compared to per development bank loans as well as to increase in core capital of development banks during this time period.

As of mid-July 2018, credit to deposit and core capital ratio of national level and other development banks stood at 72.03% and 71.51% respectively.

Assets

Total assets of development banks have increased by 21.01 percent to NPR 374.81 billion during this period. More representative per development bank figure indicates that this growth rate stood at 35.11 percent on point to point basis.

Non-performing loans which stood at NPR 2.65 billion as on mid-July 2018, accounted for 1.05 percent of total loans. This means that non performing loans as a percentage of total loans have decreased by 18 basis points during FY 2017/18.

As of mid-July 2018, non-performing loan percentage of national level and other development banks stood at 1.09 percent and 0.89 percent respectively.

Capital

Core capital to risk weighted assets (RWA) figure has increased by 3.86 percentage points to 22.73 percent while Capital fund to RWA figure has increased by 3.93 percentage points to 23.72 percent during FY 2017/18.

Current regulations require minimum 6 percent tier1 capital to RWE and minimum 10 percent total capital fund to RWE for national level development banks. Similarly, they require minimum 5.5 percent core capital to RWA and minimum 11 percent capital fund to RWA for other development banks. Therefore, development banks seem to be in a comfortable position with respect to capital adequacy requirements.

The increase in capital adequacy was largely driven by an increase in paid-up capital via issuance of right shares, bonus shares and through mergers and acquisitions among development banks.

As on mid-July 2018, core capital to RWE and RWA ratio of national level and other development banks stood at 24.06 percent and 20.71 percent respectively while capital fund to RWE and RWA ratio stood at 25.12 percent and 21.57 percent respectively.

Profitability

Total net profit of development banks declined by 8.34 percentage during FY 2017/18. However, when considered in a per development bank basis, net profit increased by 5.76 percent.

Return on Equity (ROE) decreased by 2.64 percentage points during FY 2017/18 while Return on Assets (ROA) decreased by 57 basis points during this period. This decline in returns could be attributed to the greater pace of increase in capital compared to the increase in net profits on a per development bank basis.

As on mid-July 2018, ROE of national level and other development banks stood at 12.42 percent and 12.52 percent respectively while ROA stood at 1.58 percent and 2.00 percent respectively.

Table 3.2: Major Indicators of Development Banks (as of mid-July 2018)

Particulars	Ratios (in percent)
Core Capital to RWA (RWE in case of National Level)	22.73%
Capital Fund to RWA (RWE in case of National Level)	23.72%
Credit to Deposit (LCY) Ratio	83.86%
Credit to Deposit (LCY) & Core Capital	72.03%
Non-Performing Loan to Total Loan	1.05%
Liquid Assets to Total Deposits	32.42%
Weighted Average Interest on Credit	14.64%
Weighted Average Interest on Deposit	9.04%
Weighted Average Interest on Govt. Sec.	4.69%

Base Rates and Spread Rates

The average base rate of development banks increased by 1.87 percentage points to 12.42 percent during FY 2017/18 while interest rate spread decreased by 74 basis points to 5.30 percent. This increase in base rate of development banks is attributed to the increase in weighted average interest on deposit by 1.61 percentage points during this time period.

As on mid-July 2018, average base rate of national level and other development banks stood at 12.54 percent and 11.43 percent respectively while the interest rate spread stood at 5.12 percent and 5.76 percent respectively.

Stress Testing of Development Banks

Stress tests results indicate that national level development banks are quite resilient to various kinds of shocks which might befall them. Results indicate that national level development banks have adequate buffer capital to absorb various shocks as detailed below:

Credit Shock

Standard credit shock test results indicated that all national level development banks would be able to withstand all but one among nine standard credit shocks to which they were subjected in stress testing scenario. Only one out of eleven national level development banks would not comply with the minimum capital adequacy ratio requirement if 5 percent of its performing loans deteriorated to loss loans.

Liquidity Shock

Standard liquidity shock test results also suggested that national level development banks were in a quite comfortable position. Results indicate that only one national development bank would see its capital adequacy dip below minimum level if there were a withdrawal of deposits by 2%, 5%, 10%, 10% and 10% for five consecutive days.

Similarly, if there were a withdrawal of deposit by 5%, 10%, 15% and 20%, the number of development banks whose liquid assets to deposit ratio would fall below the regulatory minimum of 20% stood at 0, 2, 7 and 11 respectively.

Similarly, none of the national level development banks were found to have their liquid assets to deposit ratio fall below the regulatory minimum of 20% if top 1-5 institutional or individual depositors withdrew their deposits.

Other Shocks

All national level development banks were found to be resilient to standard interest rate, exchange rate and equity price shocks such that none of the national level development banks would have their capital adequacy ratio fall below the regulatory minimum of 10 percent following these shocks.

Table 3.3: Summary Results of Stress Testing of National Level Development Banks			
As of Asar end, 2075			
	Number of Banks with CAR		
Events	**< 0%**	**0% - <10%**	**>=10 %**

		Pre Shock	0	0	11
A. After Credit Shock			**Post Shocks**		
			< 0%	**0% - <10%**	**>=10 %**
C1	15 Percent of Performing loans deteriorated to substandard		0	0	11
	15 Percent of Substandard loans deteriorated to doubtful loans		0	0	11
	25 Percent of Doubtful loans deteriorated to loss loans		0	0	11
	5 Percent of Performing loans deteriorated to loss loans		0	1	10
C2	All NPLs under substandard category downgraded to doubtful.		0	0	11
	All NPLs under doubtful category downgraded to loss.		0	0	11
C3	25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to substandard category of NPLs.		0	0	11
C4	25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to Loss category of NPLs.		0	0	11
C5	Top 5 Large exposures downgraded: Performing to Substandard		0	0	11
B. After Market Shocks			-	-	-
(a) Interest Rate Shocks			**< 0%**	**0% - <10%**	**>=10 %**
IR-1a	Deposits interest rate changed by 1.0 percent point on an average.		0	0	11
IR-1b	Deposits interest rate changed by 1.5 percent point on an average.		0	0	11
IR-1c	Deposits interest rate changed by 2.0 percent point on an average.		0	0	11
IR-2a	Loan interest rate changed by -1.0 percent point on an average.		0	0	11
IR-2b	Loan interest rate changed by -1.5 percent		0	0	11

	point on an average.			
IR-2c	Loan interest rate changed by -2.0 percent point on an average.	0	0	11
IR-3	Combine Shocks (IR-1a & IR-2a)	0	0	11
(b) Exchange Rate Shocks				
ER-1a	Depreciation of currency exchange rate by 20%	0	0	11
ER-1b	Appreciation of currency exchange rate by 25%	0	0	11
(c) Equity Price Shocks				
EQ-1	Fall in the equity prices by 50%	0	0	11
C. After Liquidity Shocks		-	-	-
Events				
L-1a	Number of BFIs illiquid after on 1st day while withdrawal of deposits by 2%		0	
	Number of BFIs illiquid after on 2nd day while withdrawal of deposits by 5%		0	
	Number of BFIs illiquid after on 3rd day while withdrawal of deposits by 10%		0	
	Number of BFIs illiquid after on 4th day while withdrawal of deposits by 10%		0	
	Number of BFIs illiquid after on 5th day while withdrawal of deposits by 10%		1	

Number of Banks with Liquid Assets to Deposit Ratio		**< 0%**	**0% - <20%**	**>=20 %**
	Pre-shocks	0	0	11
		After Shocks		
L-2a	Withdrawal of deposits by 5%	0	0	11
L-2b	Withdrawal of deposits by 10%	0	2	9
L-2c	Withdrawal of deposits by 15%	0	7	4
L-2d	Withdrawal of deposits by 20%	0	11	0

L-3a	Withdrawal of deposits by top 1 institutional depositors.	0	0	11
L-3b	Withdrawal of deposits by top 2 institutional depositors.	0	0	11
L-3c	Withdrawal of deposits by top 3 institutional depositors.	0	0	11
L-3d	Withdrawal of deposits by top 4 institutional depositors.	0	0	11
L-3e	Withdrawal of deposits by top 5 institutional depositors.	0	0	11
L-4a	Withdrawal of deposits by top 1 individual depositors.	0	0	11
L-4b	Withdrawal of deposits by top 2 individual depositors.	0	0	11
L-4c	Withdrawal of deposits by top 3 individual depositors.	0	0	11
L-4d	Withdrawal of deposits by top 4 individual depositors.	0	0	11
L-4e	Withdrawal of deposits by top 5 individual depositors.	0	0	11

Performance of Finance companies *

Share of finance companies in the overall economic activity is smaller in comparison to A and B class FIs, as shown by their low deposit to GDP ratio which stood at 2.11 percent in mid-July 2018. Such ratio was 2.01 percent in mid-July 2017. The total assets (or liabilities) of finance companies increased by 22.83 percent to Rs. 83 billion in mid-July 2018 compared to mid-July 2017. Finance companies mobilized aggregate deposit of Rs. 62 billion in mid-July 2018, an increment of 23.79 percent compared to mid-July 2017.

Loan and advances of finance companies stood at Rs. 53 billion in mid-July 2018, which was 1.91 percent of GDP compared to 1.89 percent of GDP in mid-July 2017. The investment of finance companies increased to Rs. 4.42 billion in mid-July 2018 from Rs. 2.91 billion a year ago. Investment in government securities accounted for 53.00 percent whereas 45.00 percent of total investment was on share investment and rest on other investment.

Capital fund of finance companies stood at Rs. 14.02 billion in mid-July 2018 which is 21.44 percent of their risk weighted exposure. In mid-July 2017 such ratio was 21.25 percent amounting to Rs. 11.3 billion.

The credit to deposit and core capital ratio of finance companies registered 69.80 percent in mid-July 2018, which is below the prescribed limit of 80 percent. Such ratio was 72.13 percent in mid-July 2017. Total non-performing loans of finance companies was 2.91 percent of total loan and advances in mid-July 2018 compared to 3.08 percent in mid-July 2017. Non-banking assets of finance company has increased by 15.15 percent to Rs. 0.38 billion in mid-July 2018 from Rs. 0.33 billion in mid-July 2017. Loan loss provision reached to Rs. 1.8 billion in mid-July 2018 from that of Rs. 1.7 billion in mid-July 2017.

Finance companies, as a whole, are in profit as reflected by their positive ROA[2] (1.62 percent) and ROE[3] (9.74 percent).

Net liquid assets to total deposit of finance companies stood at 35.17 percent in mid-July 2018 which implies that finance companies are in comfortable position in terms of liquidity. Out of total loan and advances, construction comprises the highest share 15.30 percent, followed by wholesale and retail sectors 13.70 percent, agriculture and forest related sector 6.40 percent in mid-July 2018. Share of fishery is minimal with 0.10 percent of the total, while 25.50 percent of the loan is provided to unclassified sectors. Likewise, the share of demand & other working capital loan and term loan are 13.96 percent and 14.5 percent respectively. The share of deprived sector loan stood at 6.11 percent, higher than the minimum requirement of 4 percent. In mid-July 2018 real estate loan had 10.00 percent share in total loan and advances.

Total number of finance companies which stood 28 in mid-July 2017 decreased to 25 in mid-July 2018 as 3 finance companies got merged with other BFIs in the review period. As of mid-July 2018, five finance companies are in problematic status and under resolution process. In mid-July 2017, seven finance companies were in problematic status. In the review period, two finance company got resolved/released from problematic status and resumed their operation.

[2] Return on Assets
[3] Return on Equity
* Excluding five Problematic Finance Companies which are under resolution process

Stress Testing of Finance Companies

NRB has mandated all the national-level finance companies to conduct stress tests and to report it to NRB on a quarterly basis. Stress testing result of 17 national-level finance companies found that finance companies remained less vulnerable to individual credit shocks and liquidity shocks in aggregate. However, for 2 finance companies, capital adequacy ratio decreased to less than 10 percent after combined credit shocks. In the same way for 6 finance companies, liquidity ratio decreased to less than 20 percent after withdrawal of deposits by 20 percent. Position of finance companies after stress testing scenarios is shown in the following table.

Table 3.4: Summary Result of Stress Testing of Finance Companies

Criteria	**Number**
No. of Finance Companies with CAR below 10 percent before shocks	**0**
A. Credit Shock	
No. of FCs having CAR<10 percent	
15 Percent of Performing loans deteriorated to substandard	0
15 Percent of Substandard loans deteriorated to doubtful loans	0
25 Percent of Doubtful loans deteriorated to loss loans	0
5 Percent of Performing loans deteriorated to loss loans	2
All NPLs under substandard category downgraded to doubtful.	0
All NPLs under doubtful category downgraded to loss.	0
25 Percent of performing loan of Real Estate & Hosing sector loan directly downgraded to Loss category of NPLs.	1
Top 5 Large exposures downgraded: Performing to Substandard	1
B. Liquidity Shock	
No. of Finance Companies having Liquidity Ratio<20 percent	
Withdrawal of deposits by 5 percent	0
Withdrawal of deposits by 10 percent	2
Withdrawal of deposits by 15 percent	4
Withdrawal of deposits by 20 percent	6
Withdrawal of deposits by top 2 institutional depositors.	0
Withdrawal of deposits by top 3 institutional depositors.	1

Withdrawal of deposits by top 5 institutional depositors.	2
Withdrawal of deposits by top 2 individual depositors.	1
Withdrawal of deposits by top 3 individual depositors.	1
Withdrawal of deposits by top 5 individual depositors.	1

Note: Above mentioned data does not include data regarding 5 Problematic Finance Companies which are under resolution process.

Performance of Microfinance Financial Institutions

As of mid-July 2018, there were altogether 65 microfinance financial institutions (MFIs) operating as "D" class financial institutions. Among them, 4 are wholesale lending microfinance financial institutions, viz, RMDC, RSDC, Sana Kisan microfinance financial institutions and First Microfinance financial institution. The number of branches of all MFIs reached to 2450, creating employment for 11,557 as of mid-July 2018. In Comparison to previous year, the total members of MFIs increased by 22.16 percent and reached to 2,856,859 in mid-July 2018. The total outstanding loan of MFIs as of mid-July 2018 raised by 37.09 percent to Rs. 145.95 billion as compared to Rs. 106.46 billion in previous year.

Table 3.5: Key Performance Indicators of MFIs

(Amount in Rs. '000')

S.N.	Particulars	Mid-July 2017	Mid-July 2018	Change %
1	No. of MFIs	53	65	22.64
1.2	No. of Wholesale MFIs	4	4	0.00
2	No. of Branches of MFIs	1895	2,450	29.29
2.1	No. of Branches of Wholesale MFIs	11	11	0.00
3	Total Members of MFIs	2338618	2,856,859	22.16
4	Total Capital of MFIs	15,993,991	21,263,633	32.95
4.1	Capital of Wholesale MFIs	3,835,848	5169155	34.76
5	Total Paid-up Capital of MFIs	7,739,787	11,182,470	44.48
5.1	Paid-up Capital of Wholesale MFIs	1,705,770	2399897	40.69
6	Total Assets of MFIs	133,913,749	175,610,062	31.14
7	Total Loan and Advances of MFIs	106,463,012	145,951,477	37.09
7.1	Loans and Advances of	24,090,809	29435000	22.18

	Wholesale MFIs			
8	Total Savings in MFIs	34,396,259	49,548,794	44.05
9	Total Borrowings of MFIs	66,878,993	87,683,689	31.11
9.1	Borrowings of Wholesale MFIs	20,955,844	26,424,587	26.10
10	Total Overdue (Loan & Interest) of MFIs	1,662,245	2,371,253	42.65
10.1	Overdue (Loan & Interest) of Wholesale MFIs	29,940	12,713	-57.54
11	Total Loan Loss Provision of MFIs	1,696,099	2,391,710	41.01
11.1	Loan Loss Provisions of Wholesale MFIs	320092	383642	19.85

As of mid-July 2018, total capital of MFIs increased by 32.95 percent and reached to Rs. 21.26 billion compared to the same period of the last year. Out of total capital, capital of wholesale MFIs stood at Rs. 5.17 billion. The total paid-up capital of MFIs increased by 44.48 percent and reached to Rs. 11.18 billion. The ratio of paid-up capital to total capital stood at 52.59 percent. The paid-up capital of wholesale MFIs stood at Rs. 2.40 billion. Based on risk-weighted asset, MFIs are required to maintain at least 4.00 percent as core capital and 8.00 percent as the capital fund.

In review period, total asset of MFIs increased by 31.14 percent and reached to Rs. 175.61 billion. In this category, the share of wholesale MFIs assets stood at 19.58 percent. Loan and advances registered a growth rate of 37.09 percent and reached to Rs. 145.95 billion. Out of the total loans and advances; the wholesale loan shared 20.17 percent while individual loans shared the rest. The ratio of loan and advances to the total assets stood at 83.11 percent. MFIs have not booked any asset as non-banking assets during the review period.

Total savings mobilized by the MFIs increased by 44.05 percent and reached to Rs. 49.55 billion in the review period. As compared to the total liabilities of these institutions, the share of savings remained at 28.22 percent. Out of total savings, public deposits shared only 4.90 percent which was collected by two microfinance institutions, viz. Chhimek laghubitta bittiya sanstha limited and Nirdhan Utthan laghubitta sanstha ltd., and the rest is collected from the members of 59 retail microfinance institutions. Total borrowings of these MFIs during the review period increased by 31.11 percent and reached to Rs. 87.68 billion. Out of the total borrowings, wholesale MFIs borrowed 26.42 billion, which comprises 30.14 percent of total borrowing respectively. As compared to total liabilities of MFIs, the share of borrowed amount remained at 49.94 percent.

The total amount of overdue loan, including interest, of these institutions increased by 42.65 percent and reached to Rs. 2.37 billion as compared to the same period of the last year. The overdue of wholesale MFIs stood at Rs. 12.07 million. Likewise, the amount of loan loss provision of these MFIs increased by 41.01 percent and reached to Rs. 2.39 billion during the review period.

Financial Literacy, Financial Inclusion, Access to Finance

NRB has been involved in various activities to promote financial literacy in the country. Several financial literacy materials were disseminated in 2018. As NRB is affiliated with different international organizations like Alliance for Financial Inclusion (AFI), Child and Youth Finance International (CYFI) etc., to promote financial inclusion and financial literacy in the country; various financial literacy-programs were conducted in 2018 as well. As a member of AFI, NRB has made some commitments towards financial inclusion under the 'Maya Declaration 2013' and most of the commitments in this concern have been fulfilled.

With regard to financial literacy, NRB has been celebrating the global financial literacy week called 'Global Money Week' announced by the CYFI each year since 2013. To mark this occasion various promotional events like financial literacy rally comprising of students, teachers, BFIs, Cooperatives, NGOs, donor agencies, etc. were organized. Interaction programs on financial literacy focusing child and youth, distribution of different financial literacy materials, different Radio and TV programs were also conducted during this week.

- A special school-visit program, entitled 'NRB with Students' has been initiated by the NRB on financial literacy since 2013/14. During this on-going program, a team of NRB visits different schools to organize a brief presentation on financial literacy and distributes the financial literacy materials to the students. NRB has already organized a number of such programs in different schools throughout the country. Most of these programs were chaired by the high-level authorities of NRB, including Governor himself in many occasions. NRB has also been working closely with the Ministry of Education to incorporate the issues of financial literacy in formal educational curriculum. A separate window has been developed within the web-site of NRB regarding the financial literacy. Nepal Financial Inclusion Portal for financial inclusion has been launched on 30 September, 2018. This portal helps to provide information about financial access and inclusion in Nepal. SEBON as well as the FNCCI also help educate people including investors, entrepreneurs and businesspersons, students and academicians through various programs.

- The level of financial access is in increasing trend with the increase in number of BFI branches. In addition to physical reach, banks and financial institutions have been enlarging their scope of operation in the form of mobile banking and internet banking as well. With the objective of establishing at least one commercial bank branch in each local body, circular has been issued and commercial banks have made their presence in 684 local levels out of total 753 till mid-November 2018. Commercial Banks are in process of opening their branches in remaining 69 local levels.

Issues and Challenges

Financial inclusion and financial literacy have been the key areas that the central bank has been focusing on lately. It is often discussed in various platforms that the number of BFIs in Nepal is more than required. However, there are several local levels which do not have presence of a single commercial bank branch yet. This scenario represents the harsh reality of urban centric banking in Nepal. These are not only limiting the opportunities for BFIs but also providing scope for informal economy and shadow banking. Limited financial access is directly linked with the financial illiteracy. Banking is rather a skill which can be better understood by doing it rather than studying it. Since there is limited scope of banking in terms of geographical coverage, more people are yet to reap the fruits of banking. This has been a concern for all the regulatory authorities of Nepal, including NRB. Thus, huge resources have been directed to resolve this situation, and the situation has been improving gradually, though not in expected pace.

Shadow banking practices, especially those involving larger cooperatives around the urban areas has posed challenges to the financial system. Effective mid-July 2018, all the cooperatives licensed by NRB to conduct limited banking activities have been removed from the supervisory and regulatory ambit of NRB and handed over to the local government. This handover is expected to ensure close monitoring of the cooperatives in the long run. This could also increase risk in the system as the deposit mobilization of cooperatives is being increased rapidly. Lack of stringent regulatory and supervisory mechanism for various types of cooperatives can pose serious threat to the financial health of the economy. Thus, saving and credit activities of larger cooperatives in urban areas should be monitored closely on a regular basis. There is a need of a strong cooperation and coordination among the local governments to ensure the compliance of minimum financial standards by the larger cooperatives specially operating in urban and accessible areas.

Corporate governance in BFIs is another area that is directly associated with the financial stability of the economy. Though this area was not given much importance few years back, it is one of the major areas of concern for the regulators today. Issues in corporate governance not only pose threat to a single BFI but also can have cyclical impact on the economy as a whole. Thus, various stringent measures have been put in place to prevent risk to financial stability from the lack of corporate governance.

BFIs in Nepal have largely been accommodated within the national boundary in terms of risks. However, the scenario is changing slowly with the incorporation of various tools related to foreign parties. Now, the banks can take loans from across nations as well, including India, which on the one hand has broadened the scope of source of funds for them but on the other hand has exposed itself to international market, which now will make more of a direct impact rather than the indirect one as the previous crisis. Thus, the central bank should be proactive enough to assess the risks from international market and prepare the tools to manage the risks in time of necessity.

CHAPTER - FOUR

COOPERATIVES AND OTHER FINANCIAL INSTITUTIONS

Performance of Cooperatives

NRB Licensed Cooperatives

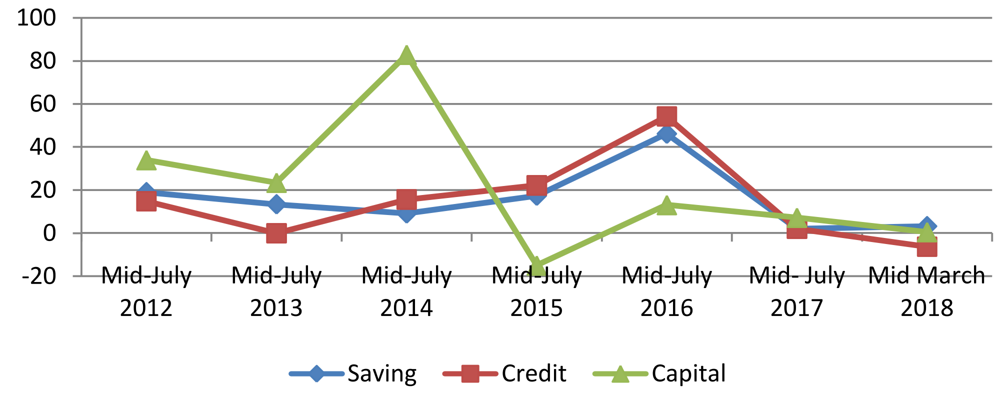
The number of cooperatives licensed by the NRB to conduct limited-banking activities stood at 14 as of mid-July 2018. However, all NRB licensed cooperatives have been removed from regulatory and supervisory ambit of Nepal Rastra Bank from 2075/76 onwards. These cooperatives are now within the regulatory jurisdiction of Department of Cooperatives. Thus, there is no NRB licensed Cooperatives from 17 July 2018.

Government Registered Cooperatives

According to statistics from Department of Cooperatives, 34,512 cooperatives comprising 6.45 million members are operating throughout the country as of mid-July 2018.

Financial Highlights of Cooperatives

Figure 4.1: Capital, Deposit and Credit growth of cooperatives (in percentage)



As of mid-March 2018, deposits of cooperatives totaled Rs. 311.23 billion while their total credit stood at Rs. 276.45 billion. Deposits of cooperatives grew by

3.17 percent in Mid March 2018, in comparison to Mid July 2017 , whereas credit declined by 6.36 percent during the same period. Cooperatives have total capital of Rs. 76.90 billion.

Table 4.1: Key Figures of Cooperatives (As of Mid-July 2018)

Indicators	Figures
No. of Cooperatives	34,512
Members (Nos.)	6.45 Million
Total Staff (Nos.)	61,122*
Total Capital (in Rs.)	76.90 Billion
Deposit (in Rs.)	311.23 Billion*
Credit (in Rs.)	276.45 Billion*
Credit to Deposit Ratio	88.82%*
Credit to Capital and Deposit Ratio	70.73%*

Source: Economic Survey 2017/18

**First 8 month's data of FY 2017/18*

The number of cooperatives has slightly declined in 2017/18. The Department of Cooperatives has been adopting stringent policies for registration of new cooperatives, particularly for savings and credit cooperatives, as most of the cooperatives involved in saving and credit operation were found to be operating without following the Cooperative Standard issued by the department. Similarly, the department has been cautious over registration of new multipurpose cooperatives. Similarly, after implementation of federalism, regulatory authority related to cooperatives have been transferred to the local levels from Department of Cooperatives, which has created hindrance in data collection of the cooperative sector.

Table 4.2: Growth of Cooperatives over the Years

Fiscal Year	Number	Growth (Number)	Growth Rate
1997-98	4349	-	-
1998-99	4860	511	10.51%
1999-00	5671	811	14.30%
2000-01	6484	813	12.54%
2001-02	7074	590	8.34%
2002-03	7445	371	4.98%

2003-04	7598	153	2.01%
2004-05	8045	447	5.56%
2005-06	8530	485	5.69%
2006-07	9720	1190	12.24%
2007-08	11302	1582	14.00%
2008-09	15813	4511	28.53%
2009-10	20102	4289	21.34%
2010-11	23301	3199	13.73%
2011-12	26500	3199	12.07%
2012-13	29526	3026	10.25%
2013-14	31177	1651	5.30%
2014-15	32663	1486	4.77%
2015-16	33599	936	2.87%
2016-17	34646	1047	3.12%
2017-18	34512	-134	-0.39%

Source: Department of Cooperatives

Financial Non-Government Organizations

The FINGOs are registered under the Institutions Registration Act, 1977 at the office of the chief district officer and are carrying out microfinance activities with the permission of NRB as per the provision of the Financial Intermediary Act, 1999. As directed by the NRB, all of these FINGOs are in the process of transforming themselves into 'D' class MFIs.

Rural Self-Reliance Fund (RSRF)

The Rural Self Reliance Fund (RSRF) was instituted in 1991 with the joint efforts of NRB and the Government of Nepal. The objective of the RSR Fund is to work for poverty reduction by the means of wholesale lending to those cooperatives which are involved in providing concessional loans to the poor and deprived members for conducting income generating activities. The total capital of the Fund as of mid-July 2018 reached Rs. 793.4 million with Rs. 540.0 million contributed by the government and Rs. 253.4 million by the NRB. The loan-limit per individual borrower has been set at Rs. 100 thousand. As of mid-July 2018, total loan of Rs. 2.43 billion has been disbursed through this Fund to 1189 institutions throughout 70 districts of Nepal, benefitting some 61 thousand low-income households. In 2018, the bank could recover Rs. 2.20 billion including principal and interest amount out of Rs. 2.31 billion to be recovered at the recovery rate of 95.38 percent whereas it was 94.97 percent in previous year.

OTHER FINANCIAL INSTITUTIONS

Insurance Companies

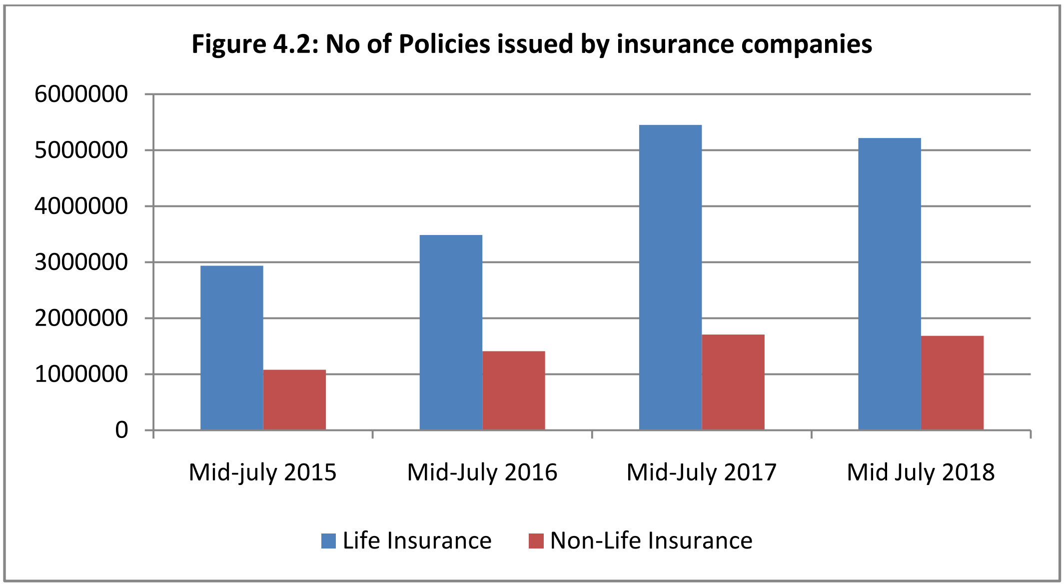
There are altogether 38 (20 non-life and 18 life) insurance companies as of mid-July 2018. The data received from Insurance Board of Nepal, reveals that total assets/liabilities of insurance companies rose by 40.03 percent to Rs.260.30 billion in 2017/18. Total assets of life insurance companies' and non-life companies' expanded by 207.95 percent and 67.36 percent respectively.

Table 4.3: Sources and Uses of Funds of Insurance Companies (in billion Rs.)

Sources	**Life**			**Non-Life**		
	2015/16	**2016/17**	**2017/18**	**2015/16**	**2016/17**	**2017/18**
Paid-up Capital	6.24	8.30	25.56	4.75	6.22	10.41
Reserve Funds	115.69	138.41	180.12	21.07	24.41	23.62
Other Liabilities	7.95	4.35	10.92	4.23	4.2	9.67
Total	**129.88**	**151.06**	**216.60**	**30.05**	**34.83**	**43.70**
Uses	**Life**			**Non-Life**		
Cash and Bank	2.36	2.25	3.75	3.18	2.37	3.15
Investment	117.98	138.83	196.23	16.82	22.42	31.54
Fixed Assets	1.66	1.64	2.20	1.1	1.36	1.42
Other Assets	7.89	8.34	14.42	8.96	8.67	7.59
Total	**129.88**	**151.06**	**216.60**	**30.05**	**34.83**	**43.70**

Source: Beema Samiti (Insurance Board)

While the coverage of insurance penetration is very low in comparison to other financial services in Nepal, there have been some sign of significant growth in recent years. Number of policies which rose significantly after the devastating earthquake of April 25, 2015 slightly declined in the review year..



Source: Beema Samiti (Insurance Board)

Reinsurance Companies

There is only one reinsurance company in Nepal which was formally established in November 7, 2014. Before its establishment, there was an institution called Insurance Pool Nepal to make arrangement of reinsurance for bearing the claims of risk emanating from riot, strike, malicious, damage & terrorism (RMSDT). The reinsurance company, presently, has been carrying out various reinsurance portfolio mostly in non-life part. The total assets/liabilities of reinsurance company rose by 46.42 percent to Rs. 10.04 billion during fiscal year 2017/18.

Employees Provident Fund (EPF)

The total assets/liabilities of Employees Provident Fund (EPF) increased by 16.27 percent to Rs. 292.16 billion in 2017/18. Likewise, the funds collected by the EPF grew by 14.17 percent to Rs. 278.75 billion in the review period. Similarly, it has reserve created from the profit worth of Rs. 9.96 billion.

As of mid-July 2018, uses of EPF comprised of cash and bank balance, investment in government saving bonds, investment in fixed deposit, investment in shares, project loans, lending to contributors, investment in fixed assets, assets on construction, miscellaneous assets. In case of fund utilization, 57.25 percent of the fund is used in lending to contributors, whereas, 18.72 percent is used in investment in fixed deposits, and remaining is invested in other investment areas as mentioned above. The fund has been utilizing almost its total fund with loan and investment to total fund ratio at 98.75 percent. Its cash and bank balance stands at Rs. 0.35 billion. Though cash and bank balance seems to be on lower side, EPF has investment in equity shares, which are highly liquid and can be used to support its liquidity requirements.

Table 4.4: Key Indicators of EPF mid- July, 2018 (unaudited)

Indicators	Amount (Billion Rs.)
Sources of Fund	
Provident Fund	278.75
General Reserve and Funds	9.96
Liabilities	1.14
Provisions	2.31
Uses of Fund	
Cash and bank	0.35
Investment in Government Saving Bonds	14.46
Investment in Fixed Deposits	54.69
Investment in Equity Shares	5.49
Project Loan	45.90
Lending to Contributors	167.27
Investment Properties (Investment in Fixed Assets)	0.70
Property, Plant and Equipment (Fixed Assets)	0.45
Assets under construction	0.01
Miscellaneous Assets	2.84
Loan and Investment to Total Fund Ratio	98.75
Loan and Investment to Provident Fund Ratio	103.50
Liquidity Ratio (Cash and bank to Total Fund)	0.12

Source: Karmachari Sanchay Kosh (Employee Provident Fund)

Citizen Investment Trust (CIT)

Citizen Investment Trust (CIT) is another institutional fund mobilizer with mentionable market share. As of mid-July 2018, net fund collections of CIT stood at Rs. 114.06 billion, recording a growth of 21.92 percent from Rs. 93.55 billion in mid-July 2017. Apart from its capital, reserve and other liabilities of Rs. 6.45 billion, regular contributions from members are the only and major source of fund for CIT. Uses of fund of the Trust, which are diversified in four broad categories, stood at Rs. 77.82 billion.

CIT has been heavily dependent on BFIs for its fund mobilization. Out of total funds, 62.43 percent has been placed on fixed deposits at BFIs. While fixed deposit accounts 91.51 percent of total investment of CIT, loan and advances to participants accounts 22.83 percent. Considering the nature of the funds, which have longer term prospect, it can be utilized for long term projects with high return.

Table 4.5: Key Figures of CIT mid- July, 2018

Indicators	**Figures (Billion Rs.)**
Sources of Funds	
Paid up Capital	0.903
Reserve Fund	3.74
Fund Collection	107.61
Other Liabilities	1.81
Total	**114.06**
Uses of Fund	
Cash and Bank Balances	1.83
Investments	**77.82**
a) Fixed Deposits	71.21
b) Governments Bonds	1.81
c) Shares	3.83
d) Debentures	0.97
Loan and Advances	26.04
Fixed Assets	0.82
Other Assets	7.56
Total	**114.06**

Source: Nagarik Lagaani Kosh (Citizen Investment Trust)

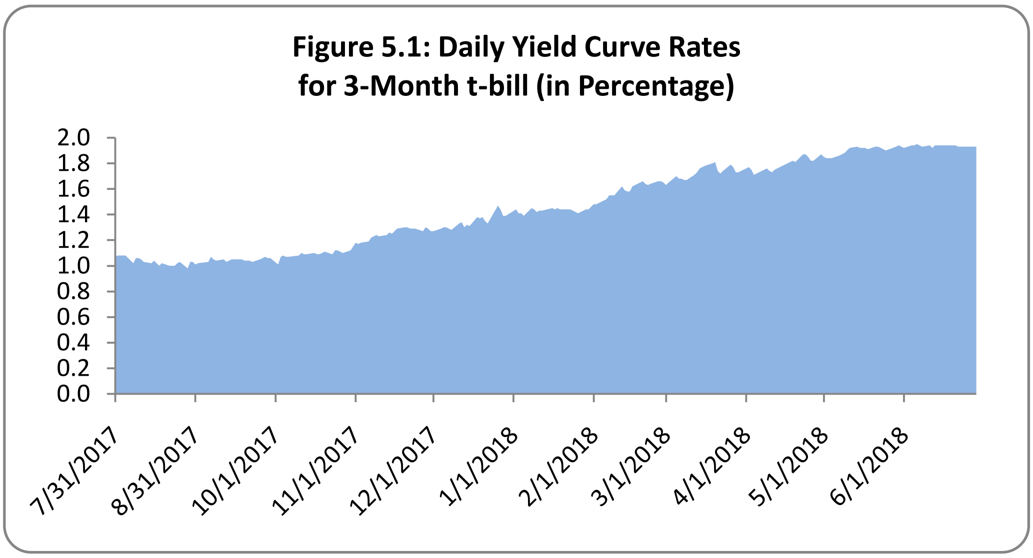
CHAPTER - FIVE

FINANCIAL MARKETS

Global Financial and Money Market Perspectives

3 Month US Government Treasuries

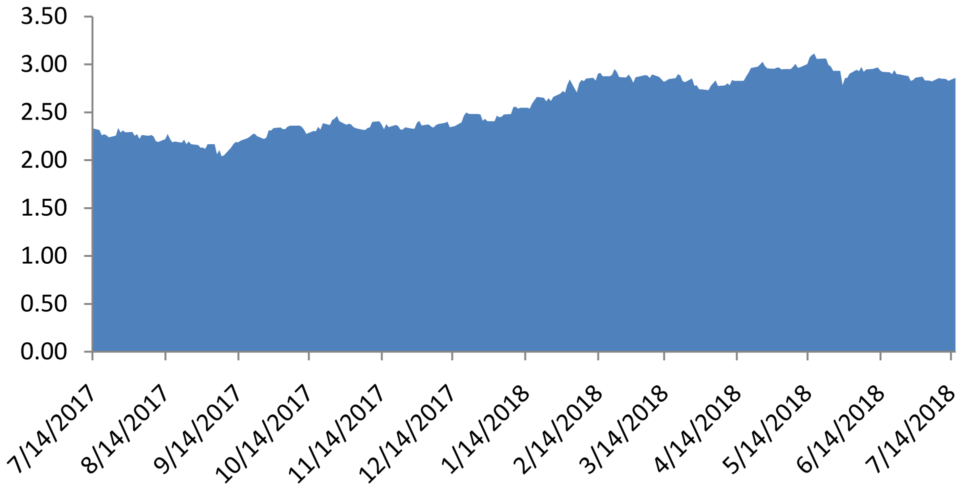
Yields on US government treasuries picked up gradually in 2017/18 mainly due to continuous hike in US federal funds rate. The Fed hiked interest rates three times (December 2017, March 2018 and June 2018) in the review year to 2.00 percent. The yield on three month T-bills that averaged at 1.07 percent in the beginning of the review year further dipped to 0.98 percent at August-end but picked up gradually in the remaining period. The three month T-bill yield curve showed the lowest yield of 0.98 percent on 28 August, 2017 and the highest return of 1.95 percent on 6 June 2018.



10-Year US Government Treasury note

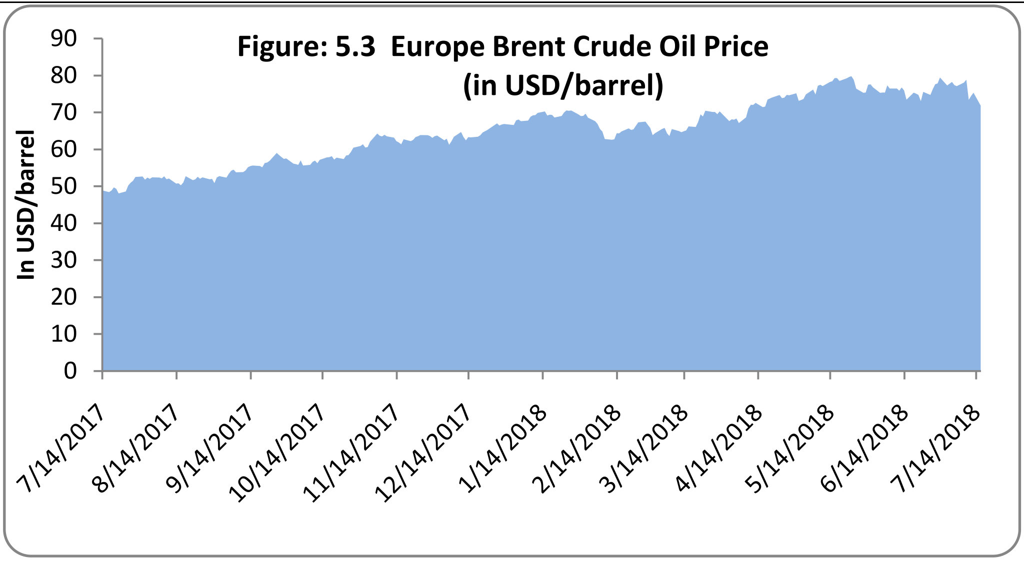
Contrary to the yield on short term security, the yields on long term securities though inched up gradually remained stable in the review year. The yield remained broadly stable at around 2.30 percent in the first six months and hovered around nearly 2.5 percent in the next three months. The yield then grew gradually and reached the peak of 3.00 percent on 17 May, 2018. From January onwards, the yield fluctuated in upward trend leading to 3 percent and above. In the review period the lowest yield reached 2.03 percent on 17 September, 2017 and highest 3.112 percent on 17 May, 2018.

Figure 5.2: Daily Yield Curve Rates for 10-Year Treasury Note (in percentage)



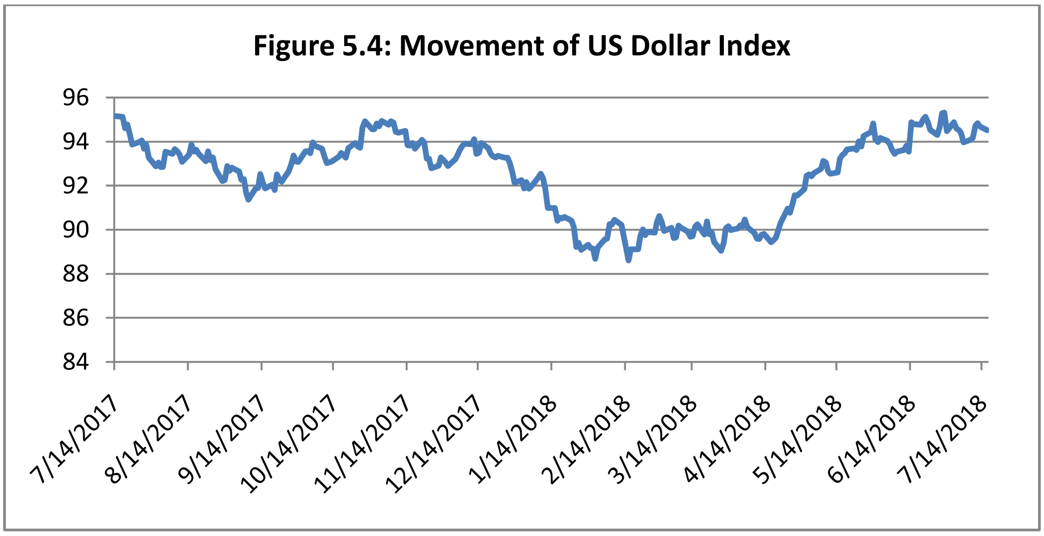
Crude Oil

Brent crude oil, the main international benchmark, was trading between US dollars 48 to 79 per barrel during the review period. The crude oil prices reached the highest level of US dollar 79.8 per barrel on 23 May, 2018 with the lowest point being US dollar 48.06 on 21 July, 2017. The crude oil price, though fluctuating in the short term, was broadly on a rising trend in the review year. Generally, oil prices fluctuate because of changes to supply and demand, but there are multiple factors at play like weather events, supply interruptions, broader demand trends such as the emergence of renewable energy, OPEC decisions, or other events that can have an immediate effect on supplies that can affect those fundamentals. The disruption in oil supply across the world as a result of terrorism, strikes, sabotage or lack of maintenance were all sharp reasons for price fluctuations in the review year.



Dollar Index

The U.S. Dollar Index is an index measure of the value of the United States dollar relative to a basket of foreign currencies including Euro, Japanese Yen, Pound Sterling, Canadian Dollar, Swedish Kroner and Swiss Franc. The US dollar index swung between gains and losses in the review year due to lack of clear clue. The index went as low as 88.59 on 15 February, 2018 to the highest 95.312 on 28 June, 2018. The dollar saw a high level of volatility with the Fed's rate hikes as well geo-political tensions in Middle-East, Russia and North Korea and trade war with China.

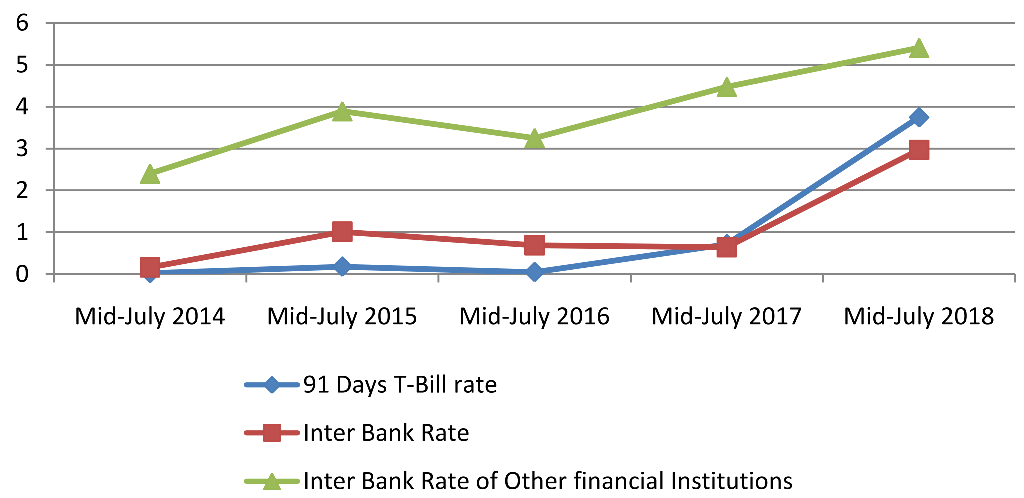


Domestic Financial Market

Money Market

Short term and long term interest rates in the financial market remained relatively high in 2017/18 in comparison to 2016/17. The weighted average of 91-day Treasury bill rate increased to 3.74 percent in the last month of 2017/18 from 0.71 percent a year ago. The weighted average inter-bank transaction rate among commercial banks that was 0.64 percent a year ago increased to 2.96 percent in the review month. Likewise, the weighted average inter-bank rate among other financial institutions increased to 5.40 percent from 4.47 percent a year ago.

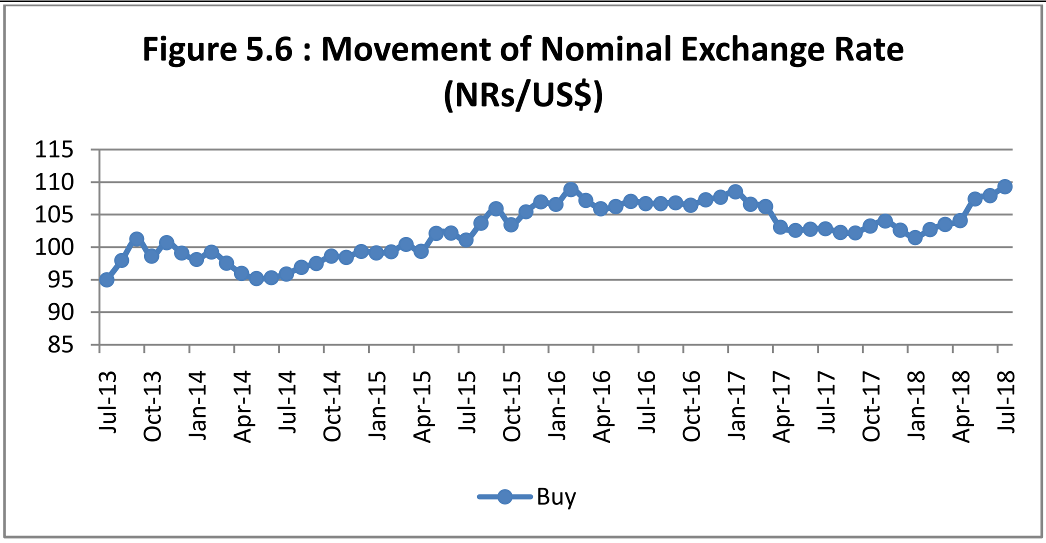
Figure 5.5: Weighted Average T-bill rate and Inter Bank Transaction rate



Weighted average interest rate spread of commercial banks decreased to 3.85 percent in the review month from 5.2 percent a year ago and the average base rate increased to 10.01 percent from 9.9 percent a year ago.

Dollar-Rupee Exchange Rate

Nepalese currency depreciated by 6.30 percent against US dollar during the end of 2017/18 compared to an appreciation by 3.63 percent in the same period of the previous year. The exchange rate of one US dollar stood at Rs. 109.34 in mid-July 2018 compared to Rs. 102.86 in mid-July 2017.



Securities Markets

In recent years Nepalese Securities market has undergone through significant structural and policy reforms. In 2017/18, various reforms and development initiatives were undertaken by SEBON such as full-fledged dematerialized trading of securities, implementation of C-ASBA system which enabled the access to the primary market services in 77 districts with more than 2500 branches of 65 banks and financial institutions. Also 2 merchant bankers and stock broking businesses expanded with 41 branches and 8 branches respectively outside of the Kathmandu valley in the review period. The trend of securities market participants is presented in Table 5.1.

Despite various initiatives undertaken by SEBON for the development and expansion of the securities markets in 2017/18, most of the secondary market indicators such as NEPSE index, market capitalization, turnover decreased due to increased supply of securities through further public offerings (FPOs), right share issuance and mutual funds issuance. The supply of securities in the secondary market increased by 21.3 percent in 2017/18 compared to 2016/17.

Primary Market

In the last three fiscal years, corporate bodies increasingly mobilized the funds through IPOs, FPOs, right offerings, bonus shares, debenture and various schemes of mutual funds. In 2017/18, funds amounting to Rs. 8.03 billion mobilized through initial public offerings (IPOs), Rs 25.07 billion through the issue of right shares, Rs. 11.05 billion through the issue of FPOs and Rs. 4.08 billion through issue of mutual funds schemes. Thus, a total of Rs.53.30 billion funds was mobilized in the 2017/18, a decline of 10.3 percent compared to total funds mobilization of Rs. 59.39 billion in 2016/17. Decrease in right offerings was the main reason for the decline of funds mobilization in the primary market. In the recent years real sector companies like hydropower companies have increasingly raised funds from the primary market. In the 2017/18, one cement company from the real sector also issued ordinary shares at premium price in the primary market.

In 2017/18 one commercial bank issued debenture amounting to Rs. 3 billion; of this, 80 percent was made private placement and remaining 20 percent was issued for public. Before this, five listed companies issued the debenture amounting to Rs. 2.9 billion in the FY 2015/16. Long back in FY 2007/08 one listed company issued the preference share amounting to Rs. 0.4 billion. The trend of primary market is presented in Table 5.1. and Table 5.2.

Table 5.1: Number of Securities Issue in Primary Market

SN	Particulars	Fiscal Year			Percentage Change	
		2015/16	**2016/17**	**2017/18**	**2016/17**	**2017/18**
1	IPOs	14	17	21	21.4	29.4
2	Right Offerings	37	76	55	105.4	-27.6
3	FPOs	3	4	6	33.3	25
4	Debentures	-	-	1	-	-
5	Mutual Funds	1	4	4	300	0
Total		**55**	**101**	**87**	**83.6**	**-13.9**

Source: Securities Board of Nepal (SEBON)

Table 5.2: Amount of Securities Issue in Primary Market

Amount in Rs. billion						
SN	Particulars	**Fiscal Year**			**Percentage Change**	
		2015/16	2016/17	2017/18	2016/17	2017/18
1	IPOs	2.76	1.51	8.3	-45.3	449.7
2	Right Offerings	9.4	45.64	25.7	385.5	-43.7
3	FPOs	5.83	7.99	11.5	37	43.9
4	Debentures	-	-	3	-	-
5	Mutual Funds	1	4.25	4.8	325	12.9
	Total	**18.99**	**59.39**	**53.3**	**212.7**	**-10.3**

Source: Securities Board of Nepal (SEBON)

Secondary Market

The major indicators of the secondary market deteriorated in 2017/18 relative to 2016/17. The number of listed companies decreased due to merger and acquisition activities among BFIs in 2017/18. The turnover and number of transactions which increased tremendously in 2016/17 decreased significantly in 2017/18. In 2017/18, total turnover decreased by 40.8 percent to Rs.121 billion from Rs. 205.02 billion in 2016/17. In 2017/18, average daily turnover was Rs. 0.52 billion, a decrease of 41.6 percent as compared to Rs. 0.89 billion in 2016/17. The market capitalization reached Rs 1435.14 billion in mid-July 2018 , a decrease of 22.7 percent compared to a year ago.. Similarly, float market capitalization also decreased by 24.6 percent to Rs. 483.9 billion compared to mid-July 2017. The NEPSE index also plunged by 23.4 percent to 1,212.36 points in mid-July 2018 compared to mid-July 2017. The Float index which was 116.14 points in mid-July 2017 decreased by 25 percent to 87.15 points in mid-July 2018. The trend of secondary market is presented in Table 5.3

Table 5.3: Secondary Market

SN	Indicators	Unit	Fiscal Year			Percentage Change	
			2015/16	2016/17	2017/18	2016/17	2017/18
1	Number of Listed Companies	Number	229	208	196	-9.2	-5.8
2	Annual Turnover	Rs in billion	164.65	205.02	121.4	24.5	-40.8
3	Average Daily Turnover	Rs in 10 million	70.66	89.14	52.1	26.2	-41.6
4	Traded Securities	No. in 10 million	30.36	39.29	29.4	29.4	-25.2
5	Number of Transaction	No. in 10 million	0.84	1.36	1.31	61.7	-3.4
6	Number of Listed Securities	No. in 10 million	210.54	296.59	359.87	40.9	21.3
7	Market Capitalization	Rs. billion	1890.13	1856.82	1435.14	-1.8	-22.7
8	Float Market Capitalization	Rs. billion	632.66	641.69	483.9	1.4	-24.6
9	Turnover/Market Capitalization	Percentage	8.71	11.04	8.5	26.8	-23.4
10	Market Capitalization/GDP	Percentage	84.1	71.44	47.7	-15.1	-33.2
11	Float Market Capitalization/GDP	Percentage	28.15	24.69	16.1	-12.3	-34.8
12	NEPSE Index	Points	1718.15	1582.67	1212.36	-7.9	-23.4
13	NEPSE Float Index	Points	125.41	116.14	87.15	-7.4	-25.0
14	NEPSE Sensitive Index	Points	369.07	336.04	255.20	-8.9	-24.1
15	NEPSE Sensitive Float Index	Points	108.99	104.17	77.92	-4.4	-25.2

Source: Nepal Stock Exchange Ltd.(NEPSE)

CHAPTER - SIX

FINANCIAL SECTOR POLICIES AND INFRASTRUCTURES

Financial Sector Policies

- Financial Sector policies have been driven towards long term and sustainable economic development of the country. In this direction, incorporation of infrastructure development bank has been conceptualized, which will provide enough capital to big infrastructural projects that will be carried out in the country during the economic development. In the initial phase, the bank is supposed to fulfill the capital gap of huge infrastructural projects and support smooth operation and timely completion of those projects.
- In order to ensure financial stability, focus of policy has been driven to identification of systemically important banks in the country as well as big branches of the banks, which require close monitoring and pose major threat to the health of the system. In this direction, identification of domestically systemically important banks is in process and regulatory and supervisory amendments required for those institutions is also being studied.
- Merger between the financial Institutions is also being encouraged by the central bank in order to strengthen the capacity of BFIs. The policy has not been successful enough as per expectation of the central bank, nevertheless, it has been able to reduce the number of institutions. NRB is always open for the institutions to go into merger or acquisition, however has not forced any institutions to go for them.
- With the implementation of BASEL III, credit rating of institutions has been essential. Thus, credit rating agencies now have scope in Nepalese banking. However, only two credit rating agencies have been registered in Nepal as of mid-July 2018 and they are under regulatory jurisdiction of SEBON.
- "B" and "C" Class Financial Institutions are required to follow Nepalese financial Reporting Standards (NFRS) in their financial statements from

Mid July, 2019. "A" class banks have been following the standard since Mid July, 2018.

Financial Sector Regulations

Implementation of BASEL III in Nepal

In order to enhance the financial stability, Nepal Rastra Bank has been adopting various international good practices. Accordingly, regulatory provisions of Basel III are being implemented. Commercial banks are required to meet minimum capital adequacy based on BASEL –III with effect from mid-August, 2016. Nepal Rastra Bank has already issued circular in this regard and has already instructed the commercial banks to calculate their capital fund either under BASEL - II or BASEL - III till mid-January, 2017. After that period, they have to calculate their capital fund according to Capital Adequacy framework, 2015 published by NRB which is based on Basel-III.

BASEL III will be implemented at national level development banks and national level finance companies gradually.

BASEL II has been fully implemented in national level development banks. National level development banks are required to calculate their capital fund according to Capital Adequacy framework, 2007 (updated 2008) in contrast, other development banks and finance companies are required to report under Basel I. Meanwhile, NRB has directed national level finance companies to report their capital fund in parallel way under the provisions of Basel I & Basel II.

In order to enhance the quality and level of capital NRB has been focusing on common Equity. Commercial banks should maintain minimum common equity tier 1 capital ratio of 4.5 percent based on Basel III requirement. There has been provision requiring banks to maintain capital conservation buffer equal to 2.5 percent of total risk weighted assets. Likewise, National level development banks are required to maintain minimum tier 1 capital of 6 percent and other development banks and finance companies are required to maintain minimum tier 1 capital of 5.5 percent. However, the national level finance companies are also required to maintain 6 percent of tier 1 capital as they are in parallel run of Basel I and Basel II.

In order to enhance the risk absorption capacity of banks by strengthening the capital base, a provision is made for commercial banks to maintain capital conservation buffer (CCB) equal to 2.5 percent of total risk weighted assets. Instruments under common equity tier 1 capital will be used for such calculation. BFIs failing to maintain such buffer will be allowed to distribute profit only after allocating for capital conservation buffer (CCB). The capital conservation buffer is designed to ensure that banks build up capital buffer during normal times (i.e. outside periods of stress) which can be drawn down as losses as incurred during a stressed period. The requirement is based on simple capital conservation rule to avoid breaches of minimum capital requirements. The framework of capital conservation buffer is expected to strengthen the ability of banks to withstand adverse economic environment conditions, will help increase banking sector resilience both going into downturn, and provide the mechanism for rebuilding capital during the early stages of economic recovery. The CCB has been introduced in 2016 and will be fully effective on mid-July 2019. In the first round, it will execute 1.25 percent by 2016, 1.5 percent by 2017, and 2.0 percent by 2018 on top of the capital adequacy ratio.

NRB has introduced counter cyclical buffer in “Capital Adequacy Framework, 2015” to ensure that banking sector capital requirements take account of the macro-financial environment in which banks operate. Its aim is to protect the banking sector form periods of excess aggregate credit growth that have often been associated with the build up of system wide risk. Therefore, to minimize the adverse impact of pro-cyclicality and fluctuations in macroeconomic variables on financial sector, this provision has been made for banks to maintain an additional counter cyclical buffer up to maximum 2.5 percent age point of total risk weighted assets by mid-July 2017.

Commercial banks are required to maintain minimum Tier 1 leverage ratio of 4 percent. The banks are required to maintain the leverage ratio on a quarterly basis. Non-risk-based leverage ratio that includes off-balance sheet exposures will serve as a backstop to the risk-based capital requirement. Also helps contain system wide build up of leverage.

Basel III Liquidity Framework

Global financial crisis began with the liquidity problems in some banks. Many banks with adequate capital levels also experienced difficulties because of their poor practices in liquidity management. Importance of robust liquidity risk management was felt necessary during the crisis. BCBS issued guidelines, "Basel III: International framework for liquidity risk measurement, standards and monitoring (December 2010). BCBS has established some principles for Sound Liquidity Risk Management and Supervision. In addition to the principles, Basel III introduced two ratios for liquidity monitoring and management in banks; (i) Liquidity Coverage Ratio (LCR) &, (ii) Net Stable Funding Ratio (NFSR).

LCR is introduced to promote short-term resilience by requiring sufficient high-quality liquid assets to survive acute stress lasting for 30 calendar days. The bank which maintains the ratio more than hundred percent during the short period of time is considered to be the sound bank in terms of short-term liquidity. NRB has developed its own liquidity monitoring framework for the short-term liquidity monitoring of the banks. NRB will fully implement LCR by end of 2017 which requires Commercial Banks to maintain 100 percent LCR.

NSFR is aimed at promoting resilience over longer term through incentives for banks to fund activities with more stable sources of funding. The ratio is developed to address the maturity mismatch between liabilities and assets in the financial sector and to make sure that banks have sufficient stable funding to withstand a yearlong liquidity crisis. NRB will introduce minimum standard based on BASEL III by end of 2017, and fully implement NFSR by 2019.

Uniform Chart of Accounts

Commercial banks in Nepal do not have a standardized chart of accounts (CoA) since it is presently not prescribed by the regulatory framework. Instead, each Nepalese bank has its own COA in place, which has to be upgraded/ changed in order to align to the new Nepal Financial Reporting Standard (NFRS) requirements. Nepal Rastra Bank (NRB), as the regulator, has issued Directive No. 4 which contains the accounting policies and formats of financial statements for the banks and financial institutions falling under its jurisdiction. NRB has also issued Directive No. 9 which contains a list of itemized accounts (also termed as "regulatory COA"). But this "COA" represents a basis for regulatory and prudential reporting but not for financial accounting and reporting purposes.

In the current scenario wherein each bank produces financial statements based on its own customized chart of accounts, the supervisory authority is unable to monitor the adequacy of the financial statements and their harmonization with the NFRS during off-site supervision. In addition, the lack of consistent format undermines the comparability of the financial statements of different BFIs. The supervisory authorities thus have to place reliance on the submitted financial statements and all other regulatory reports, without having tools to carry out “logical” monitoring and subsequently take actions. In such circumstances, a lack of both reliable and comparable data can pose risk for regulators and supervisors and can lead to inadequate assessments of the financial conditions of the banks as well as inadequate policy responses. Globally, transition from the local generally accepted accounting practices to the IFRS accounting has been challenging in most countries especially in the banking sector, since the accounting measurement and policies as well as the MIS had to change enormously. Inadequate transition to the new environment can lead to inaccurate and unreliable financial and supervisory reporting, which, in turn, can have an adverse impact on prudential policy, effective banking supervision and, ultimately, on maintaining financial stability. In order to minimize these risks, it is of utmost importance to provide relevant guidelines and detailed instructions to all banks on uniform way of transition. This includes not only the publication of accounting standards and model financial statements, but standardization of the classification, recording and disclosure of transactions under each category in the financial reports. Thus, commercial banks in Nepal are directed to follow Uniform Chart of accounts prescribed by NRB form FY 2076/77 onwards.

Environmental and Social Risk Management (ESRM) Guideline

Banks and Financial Institutions are well placed to help the private sector adapt to new economic realities linked to environmental and social (E&S) sustainability such as climate change, changing communities, and increased resource scarcity, by increasing green financing and inclusive lending which also contributes to national sustainable development agendas. In addition, BFIs around the globe are taking proactive steps to address the management of environmental and social risks within their own business operations by managing E&S risks in their portfolio and reducing their own carbon footprint. However, BFIs in Nepal are well behind in this aspect and in order to address this backwardness and make the BFIs well aware about the environment in which they are operating, NRB has directed banks to follow a guideline specifically focused on environmental and social risk management while conducting all of their activities.

The core objective of the ESRM Guideline is to require BFIs to integrate Environmental & Social risk management into the overall credit risk management process in order to fully inform the credit authority of E&S risks prior to the financing decision regarding individual transactions. Major features of ESRM Guideline are:

• Focus on environmental, social, and climatic risks, related to the business activities of the BFI's client, which are becoming increasingly relevant and crucial for Nepal.

• The Guideline defines its scope of applicability to various type of financing (i.e., SME finance, commercial leasing, Business Working Capital Finance/Term Finance, project finance).

• The Guideline requires all B/FIs engaging in the types of transactions mentioned above to develop and implement an Environmental and Social Management System (ESMS) consistent with local environmental and social laws and regulation and overtime with recognized international standards such as IFC's Performance Standards on Environmental and Social Sustainability and the Equator Principles

• The Guideline incorporates E&S Risk Management Tools and Templates to enable non-technical B/FI staff to oversee and facilitate the management of E&S risk.

• The Guideline describes the necessary organizational roles and responsibilities built on the principles of integrating E&S risk management into the BFI's overall credit policy.

Recent Regulatory Reforms

- Nepal Rastra Bank has relaxed the credit limit against the collateral of shares. BFIs are limited to extend margin nature loans up to 40 percent of their core capital. In addition, BFIs can lend against the collateral of common shares only up to 65 percent of the average closing price of ordinary shares for the last 180 days or the prevailing market value of the shares, whichever is less. Similarly, commercial banks can open up a brokerage firm as a subsidiary company.

- Banks have been directed to open branches in 753 local levels, which are designed on the basis of the federal structure.
- BFIs are allowed to lend only up to 50 percent of the book value of private vehicles as loan to value of private vehicles have been brought down to 50 percent from 65 percent by NRB. It is an attempt to decrease unproductive sector lending of BFIs.
- Seven different loan products have been introduced under Subsidized Loan Procedure 2075. In addition to existing subsidized loan to agriculture and animal husbandry, these products include loans to educated unemployed, foreign employment returnees, marginalized and poor people, women entrepreneurs, students seeking higher education, and housing loan to earthquake victims. Loan amount on these products range from Rs. 0.3 million to Rs. 100 million. Subsidy ranging from 2 percent to 6 percent is available to the borrowers on such loans.
- NRB made mandatory to depositors to show their identification card if they are depositing cash in other's bank account exceeding Rs. 0.1 million. BFIs may not accept cash if depositors fail to show identification documents.NRB introduced this policy as part of its efforts to prevent money laundering and terrorism financing. This policy will prevent financial system getting abused by the ill-gotten money.
- Commercial banks are to limit their interest rate spread within 4.5 percent within mid-July 2019 and development banks and finance companies are required to limit their interest rate spread within 5 percent within mid-July 2019.
- "A", "B", and "C" class financial institutions are required to invest at least 5 percent of their total loan investment in deprived sector. Similarly, commercial banks are required to invest at least 25 percent in productive sector, whereas development banks and finance companies are required to invest at least 15 percent and 10 percent respectively in productive sector.
- Personal overdraft and other loans without clear purpose have been limited within the cap of Rs 5 Million.
- Risk Management Guideline has been revised to address the changes in the banking environment and to achieve the below objectives:

- To promote better risk culture at all levels of the financial institution.
- To provide minimum standards for risk management practices.
- To improve financial soundness of individual financial institutions and stability of the overall financial sector.
- To encourage financial institutions to adopt and implement a sound risk management framework.
- To introduce important risk management tools and techniques for assessment and necessary treatment of various risks.

Annex-1
Structure of Nepalese Financial Sector (Assets/Liabilities)

In Billion Rupees

Financial Institutions	Mid-July				
	2014	**2015**	**2016**	**2017**	**2018**
Commercial Banks	1,467.15	1,774.50	2,184.81	2,621.23	3,104.27
Development Banks	255.37	300.64	350.84	305.07	374.70
Finance Companies	110.34	108.00	103.44	82.60	96.01
MFIs	49.39	70.88	100.77	133.91	175.61
Cooperatives	233.71	265.55	385.72	396.53	388.13*
Contractual Saving Institutions					
Employees Provident Fund	170.63	195.90	224.85	251.28	292.16
Citizen Investment Trust	54.62	67.67	83.01	99.10	114.06
Insurance Companies	101.09	129.45	158.24	185.89	260.31
Reinsurance Company	-	6.15	6.26	6.85	10.04
Mutual Fund	-	-	-	9.75	12.95
Total	**2,442.33**	**2,918.77**	**3,597.96**	**4,092.10**	**4,828.25**
Market capitalization (NEPSE)	1,057.16	989.40	1,889.45	1,856.82	1,435.13
Total (incl. market capitalization)	**3,499.50**	**2,918.77**	**5,487.40**	**5,952.09**	**6,263.39**
Percentage Share (Excluding NEPSE Market Capitalization)					
Financial Institutions					
Commercial Banks	60.07	60.80	60.72	64.00	64.29
Development Banks	10.46	10.30	9.75	7.45	7.76
Finance Companies	4.52	3.70	2.88	2.02	1.99
MFIs	2.02	2.43	2.80	3.27	3.64
Cooperatives	9.57	9.10	10.72	9.68	8.04
Contractual Saving Institutions					
Employees Provident Fund	6.99	6.71	6.25	6.14	6.05

Citizen Investment Trust	2.24	2.32	2.31	2.42	2.36
Insurance Companies	4.14	4.44	4.40	4.54	5.39
Reinsurance Company	-	0.21	0.17	0.24	0.21
Mutual Fund	-	-	-	0.24	0.27
Total	**100.00**	**100.00**	**100.00**	**100.00**	**100.00**

**Based on first 8 Month's data of FY 2017/18*

Annex-2
Aggregate Statement of Assets and Liabilities of BFIs
(Aggregate)

In Million Rupees

Liabilities		Mid-July 2015	2016	2017	2018
1	**CAPITAL FUND**	162992.51	214892.48	308651.74	370014.44
	a. Paid-up Capital	140794.10	163370.74	225313.64	282196.04
	b. Statutory Reserves	37149.85	43680.58	53665.23	63755.69
	c. Retained Earning	-27802.05	-11166.95	-3005.23	-1931.93
	d. Others Reserves	12850.60	19008.11	32678.11	25994.64
2	**BORROWINGS**	21355.96	42822.19	31800.16	35452.57
	a. NRB	3291.48	6855.13	7094.37	12121.92
	b. "A"Class Licensed Institution	5504.53	20083.07	9094.04	8582.53
	c. Foreign Banks and Fin. Ins.	0.00	0.00	0.00	0.00
	d. Other Financial Ins.	1119.81	5111.62	5299.38	2435.75
	e. Bonds and Securities	11440.14	10772.37	10312.37	12312.37
3	**DEPOSITS**	1771946.15	2107502.69	2384806.95	2836930.01
	a. Current	158746.16	185135.30	204360.95	256808.59
	b. Savings	714466.16	875419.91	816572.17	947024.22
	c. Fixed	513283.02	617634.95	998258.72	1229730.70
	d. Call Deposits	363041.66	401829.34	333350.39	367596.88
	e. Others	22409.16	27483.20	32264.72	35769.62
4	**Bills Payable**	1729.91	3927.13	2219.17	3108.92
5	**Other Liabilities**	188093.19	206694.45	224201.08	263876.38
	1. Loan Loss Provision	51482.56	48593.77	52553.17	55008.99
	2. Interest Suspense a/c	31256.97	32000.69	34891.97	37704.55
	3. Others	105353.66	126099.99	136755.94	171162.84
6	**Reconcillation A/c**	280.36	13817.41	2358.50	4265.20
7	**Profit & Loss A/c**	36755.88	49443.18	54882.04	61337.97
TOTAL		**2183153.96**	**2639099.54**	**3008919.66**	**3574985.48**
Assets					
1	**LIQUID FUNDS**	353397.28	385746.01	423242.12	439298.52
	a. Cash Balance	48642.45	56937.25	64372.60	74892.95
	Nepalese Notes & Coins	47305.51	55937.33	63282.78	72207.99
	Foreign Currency	1336.94	999.92	1089.82	2684.96
	b. Bank Balance	237957.23	262419.81	305795.05	298098.38
	1. In Nepal Rastra Bank	165070.53	180498.18	233256.83	218135.41
	2. "A"Class Licensed Institution	37838.00	41730.30	38882.05	41054.74
	3. Other Financial Ins.	6882.80	8437.01	6368.76	7556.64
	4. In Foreign banks	28165.90	31754.32	27287.42	31351.59

	c. Money at Call	66797.60	66388.94	53074.46	66307.19
2	**INVESTMENTS**	206160.48	238675.86	232706.63	331231.04
	a. Govt.Securities	182112.29	196070.31	214380.95	295853.80
	b Others	24048.18	42605.55	18325.68	35377.25
3	**SHARE & OTHER INVESTMENT**	85675.60	131777.67	129938.39	109664.75
4	**LOANS & ADVANCES**	1345671.32	1669203.04	1976879.74	2419841.87
	a. Private Sector	1230999.56	1542024.97	1923942.40	2355915.45
	b. Financial Institutions	30678.62	121291.82	44543.48	58055.79
	c. Government Organizations	83993.14	5886.25	8393.85	5870.64
5	**BILLS PURCHASED**	14548.03	11601.52	17198.72	2955.87
6	**LOANS AGT. COLLECTED BILLS**	1132.63	1075.28	570.71	128.63
7	**FIXED ASSETS**	31732.63	35044.21	40633.93	47763.06
8	**OTHER ASSETS**	135346.49	144135.22	166139.11	206833.99
	a. Accrued Interests	32792.14	34038.25	37665.70	43308.52
	b. Others	102554.35	110096.97	128473.40	163525.47
9	**Expenses not Written off**	392.16	319.21	279.01	264.06
10	**Non Banking Assets**	5250.92	4797.21	4465.45	4614.27
11	**Reconcillation Account**	2947.32	16089.93	16631.18	12388.71
12	**Profit & Loss A/c**	899.11	634.40	234.67	0.72
TOTAL		**2183153.98**	**2639099.55**	**3008919.66**	**3574985.49**

Annex-3
Profit and Loss Statement of Bank and Financial Institutions

In Million Rupees

Particulars	Mid-July			
	2015	2016	2017	2018
1 Interest Expenses	67271.02	64943.04	97850.70	167966.94
1.1 Deposit Liabilities	65418.33	63252.25	95608.58	165253.99
1.1.1 Saving A/c	22494.48	21234.79	23525.99	39005.05
1.1.2 Fixed A/c	31594.10	31710.65	55650.88	112317.02
1.1.2.1 Upto 3 Months Fixed A/c	1995.01	1914.75	2495.80	8397.90
1.1.2.2 3 to 6 Months fixed A/c	1043.26	1240.54	2672.64	6798.97
1.1.2.3 6 Months to 1 Year Fixed A/c	14308.11	15369.26	29697.33	57784.49
1.1.2.4 Above 1 Year	14247.72	13186.09	20785.12	39335.65
1.1.3 Call Deposit	11302.25	10301.47	16429.74	13817.98
1.1.4 Certificate of Deposits	27.50	5.34	1.97	113.93
1.2 Others	1852.69	1690.79	2242.12	2712.96
2 Commission/Fee Expense	509.46	546.23	600.94	612.76
3 Employees Expenses	21218.85	22715.53	26627.48	31472.44
4 Office Operating Expenses	17624.25	18123.58	20754.59	25516.90
5 Exchange Fluctuation Loss	64.81	197.03	108.69	125.33
5.1 Due to Change in Exchange Rates	64.83	182.01	88.16	102.33
5.2 Due to Foreign Currency Transactions	-0.01	15.02	20.54	23.00
6 Non-Operatiing Expenses	89.80	106.14	33.54	58.45
7. Provision for Risk	12781.47	9649.95	12762.76	15147.02
7.1 Loan loss Provision	11018.41	8451.80	11477.45	12874.70
7.1.1 General Loan loss Provision	4071.38	5107.97	7035.80	6484.42
7.1.1.1 Pass Loan Loss Provision	3210.53	4530.40	6256.87	5678.68
7.1.1.2 Watch List Provision	860.85	577.57	778.93	805.74
7.1.2 Special Loan Loss Provision	6627.48	3028.49	4375.25	6216.13
7.1.3 Additional Loan Loss Provision	319.54	315.34	66.40	174.15
7.2. Provision for Non-Banking Assets	1429.51	1012.22	1053.41	1255.16
7.3. Provision for Loss on Investment	101.98	14.53	185.90	715.51
7.4. Provision for Loss of Other Assets	231.58	171.40	46.00	301.66
8 Loan Written Off	439.90	355.03	996.12	971.19

9 Provision for Staff Bonus	4053.16	5851.53	6656.78	7981.80
10 Provision for Income Tax	12158.39	17591.64	20370.63	24582.73
11 Others	495.79	61.16	55.62	28.87
12 Net Profit	37039.32	49004.93	54665.43	61337.25
TOTAL EXPENSES	**173746.23**	**189145.80**	**241483.28**	**335801.69**
Income				
1. Interest Income	134011.48	146483.09	194358.11	283227.23
1.1. On Loans and Advance	127175.43	138782.71	181923.38	265445.85
1.2. On Investment	2309.29	3487.02	5875.27	10903.10
1.2.1 Government Bonds	1982.25	3005.11	4830.38	9359.75
1.2.2 Foreign Bonds	76.54	136.72	153.35	186.01
1.2.3 NRB Bonds	160.24	199.66	776.75	1030.65
1.2.4 Deventure & Bonds	90.26	145.54	114.78	326.70
1.3 Agency Balance	716.42	589.35	1021.51	987.51
1.4 On Call Deposit	2633.89	2513.39	3475.05	3927.59
1.5 Others	1176.47	1110.61	2062.91	1963.17
2. Comission & Discount	8935.14	9828.97	11806.85	13569.38
2.1 Bills Purchase & Discount	248.42	300.48	239.80	117.08
2.2 Comission	7494.65	8074.48	9864.84	11380.96
2.3 Others	1192.07	1454.01	1702.22	2071.34
3 Income From Exchange Fluctuation	4761.74	5708.82	6248.97	7849.70
3.1 Due to Change in Exchange Rate	983.31	1342.09	706.74	1536.71
3.2 Due to Foreign Currency Trans.	3778.43	4366.73	5542.23	6312.99
4 Other Operating Income	7326.73	9123.21	10772.31	13392.38
5 Non Operating Income	4743.47	4775.86	3783.15	2491.29
6 Provision Written Back	11842.55	11550.65	12883.40	14545.42
7 Recovery from Written off Loan	1508.63	1276.09	1504.14	**672.99**
8 Income from Extra Ordinary Expenses	157.81	231.44	108.16	53.31
9 Net Loss	458.66	167.67	18.20	0.00
TOTAL INCOME	**173746.22**	**189145.79**	**241483.29**	**335801.70**

Annex-4
Major Financial Indicators of Microfinance Financial Institutions

In Million Rupee

Liabilities		Mid-July			
		2015	**2016**	**2017**	**2018**
		1	**2**	**3**	**5**
1	**CAPITAL FUND**	6147.3	8684.9	12592.8	17420.2
	a. Paid-up Capital	3987.3	5436.5	7721.3	11159.1
	b. Statutory Reserves	750.3	1214.8	1747.6	2450.9
	c. Retained Earning	8.9	363.6	1179.5	1379.0
	d. Others Reserves	1400.8	1670.0	1944.5	2431.3
2	**BORROWINGS**	38244.9	52434.4	66772.7	87707.0
	a. NRB	306.6	91.1	554.8	2069.5
	f. Others	37938.3	52343.3	66217.9	85637.4
3	**DEPOSITS**	15775.5	24095.3	34344.1	49548.6
4	**BILLS PAYABLE**	0.0	0.8	2.0	1.3
5	**OTHER LIABILITIES**	5205.7	7205.0	10366.3	13551.5
	a. Loan Loss Provision	986.0	1345.6	1716.1	2390.8
	b. Interest Suspense a/c	575.3	652.7	938.5	1121.4
	c. Others	3644.3	5206.8	7711.8	10039.4
6	**RECONCILIATION A/c**	2330.2	5031.9	5779.8	3480.3
7	**PROFIT & LOSS A/c**	2524.8	3318.2	3907.2	4038.7
Total		**70228.2**	**100770.6**	**133765.0**	**175747.6**
	Assets				
1	**LIQUID FUNDS**	6597.2	11096.2	12497.7	16314.2
	a. Cash Balance	62.2	75.5	93.9	147.3
	b. Bank Balance	3900.5	6327.0	6243.3	9189.8
	c. Money at Call	2634.4	4693.6	6160.5	6977.2
2	INVESTMENT IN SECURITIES EXCEPT SHARES	116.2	38.7	42.7	42.7
3	**SHARE & OTHER INVESTMENT**	2350.1	2809.8	2658.1	2564.7
4	**LOANS & ADVANCES**	54915.5	77232.9	106540.9	145943.8
	Institutional	14853.5	19194.3	24131.1	30596.9
	Individual	40062.0	58038.6	82409.8	115346.8
5	**FIXED ASSETS**	775.2	961.1	1219.2	1471.9
6	**OTHER ASSETS**	3205.4	3598.2	4766.1	5735.3
7	**EXPENSES NOT WRITTEN OFF**	7.2	4.5	11.2	7.1
8	**NON BANKING ASSETS**	0.0	0.0	0.0	0.0
9	**RECONCILIATION A/c**	2215.3	5017.3	5959.5	3609.0
10	**PROFIT & LOSS A/c**	46.2	11.9	69.6	56.6
Total		**70228.2**	**100770.6**	**133765.0**	**175745.2**

Annex-5

Sector wise, Product wise and Security wise credit flow from BFIs

In Million Rupee

Particulars	Mid-July			
Sectorwise	**2015**	**2016**	**2017**	**2018**
Agricultural and Forest Related	61783.87	76816.32	87899.16	115385.84
Fishery Related	3355.59	1980.46	2328.51	2725.01
Mining Related	3525.74	3404.03	3950.19	5033.27
Agriculture, Forestry & Bevarage Production Related	255534.57	296097.02	329835.00	415538.69
Construction	152480.40	182851.94	213028.75	253186.93
Electricity,Gas and Water	34540.43	46417.77	63520.59	86863.05
Metal Products, Machinary & Electronic Equipment & Assemblage	16208.31	19473.46	25044.82	33148.29
Transport, Communication and Public Utilities	48451.67	67489.25	76264.31	83254.65
Wholesaler & Retailer	297286.58	374322.54	436442.74	532010.61
Finance, Insurance and Real Estate	107293.66	135000.17	166374.23	203050.35
Hotel or Restaurant	44028.90	54426.26	66900.15	91145.89
Other Services	63957.60	72146.41	90250.94	105969.22
Consumption Loans	101450.14	120843.49	158359.29	166318.73
Local Government	1714.14	1654.98	1568.65	1553.54
Others	169740.36	228955.74	272881.84	327742.30
TOTAL	**1361351.97**	**1681879.83**	**1994649.17**	**2422926.38**
Productwise				
Term Loan	223149.61	272694.42	320735.49	423647.60
Overdraft	245994.73	294326.89	361906.83	410910.51
Trust Receipt Loan / Import Loan	55141.88	72678.07	64530.02	113868.62
Demand & Other Working Capital Loan	293603.14	365785.23	404195.22	498115.75
Residential Personal Home Loan (Up to Rs. 1.5 Crore)	118861.54	142815.41	168383.92	201681.80
Real Estate Loan	85678.07	108071.88	127318.70	142005.39
Margin Nature Loan	24084.77	37681.04	41170.06	41128.86
Hire Purchase Loan	80966.96	110094.35	150400.06	171054.03
Deprived Sector Loan	63889.82	81239.19	111984.61	137728.27
Bills Purchased	13511.29	12530.80	17354.17	2858.75
Other Product	156470.18	183962.55	226670.09	279926.81
Total	**1361351.98**	**1681879.83**	**1994649.17**	**2422926.38**
Collateral wise				
Gold and Silver	31374.67	30642.25	37466.92	38070.33

Government Securities	784.73	1014.67	997.94	470.42
Non Governmental Securities	18776.93	29668.70	34634.94	37124.14
Fixed Deposit Receipts	9824.90	10553.39	22175.52	18557.51
Own	8925.88	9577.14	20780.98	17907.40
Other Licensed Institutions	899.02	976.25	1394.55	650.11
Collateral of Properties	1131830.49	1463645.87	1734997.03	2136643.17
Fixed Assets	957231.98	1207217.80	1459790.48	1788776.33
Current Assets	174598.50	256428.07	275206.55	347866.84
Against security of Bill	13969.01	15710.45	15873.63	18166.44
Domestic Bills	3532.80	3525.87	798.38	826.25
Foreign Bills	10436.21	12184.58	15075.25	17340.19
Against Guarantee	40479.05	52993.07	63293.16	78284.15
Government Guarantee	2385.24	2364.19	2560.01	2348.23
Institutional Guarantee	27833.31	33209.50	42758.93	55644.51
Personal Guarantee	2350.72	4054.12	5340.32	6080.54
Collective Guarantee	3581.03	4855.55	5828.86	7085.62
International Rated Foreign Bank's Guarantee	93.08	4226.93	1469.32	1681.66
Other Guarantee	4235.68	4282.79	5335.71	5443.59
Credit Card	427.58	416.03	905.78	1257.07
Others	113884.53	77235.40	84304.25	94353.16
Total	**1361351.89**	**1681879.83**	**1994649.17**	**2422926.38**

Annex-6
Major Financial Indicators
as on Asar End, 2075 (Mid-July, 2018)

		Class "A"	Class "B"	Class "C"	Overall
A. Credit, Deposit Ratios (%)					
1	Total Deposit/GDP	82.19	10.04	2.11	94.34
2	Total Credit/GDP	70.24	8.42	1.91	80.57
3	Total Credit/ Total Deposit	85.47	83.90	90.22	85.41
4	Lcy Credit/Lcy Deposit & Core Capital	77.07	72.78	77.88	76.81
5	Fixed Deposit/Total Deposit	43.33	41.36	53.63	43.35
6	Saving Deposit/Total Deposit	32.84	38.05	32.27	33.38
7	Current Deposit/Total Deposit	10.08	2.41	0.44	9.05
8	NPL/ Total Loan#	1.41	1.09	10.83	1.60
9	Total LLP/Total Loan	2.09	1.73	11.35	2.27
10	Deprived SectorLoan/Total Loan $#	5.94	9.47	5.46	6.28
B. Liquidity Ratios (%)					
1	Cash & Bank Balance/Total Deposit	12.57	16.53	19.49	13.15
2	Investment in Gov. Security/Total Deposit	11.57	2.54	3.70	10.43
3	Total Liquid Assets/Total Deposit	24.85	32.35	36.74	25.91
C. Capital Adequacy Ratios (%)					
1	Core Capital/RWA	13.32	17.93	19.78	13.89
2	Total Capital/RWA	14.61	18.99	20.65	15.15
D. Financial Access					
1	No. of Branches **	3023	993	186	4202
2	No. of Deposit Accounts	19295273	3758614	490972	23544859
3	No.of Loan Accounts	953310	310405	37295	1301010
4	No. of Branchless Banking Centers	1284	1	0	1285
5	No. of Branchless Banking Customers	130553	107	0	130660
6	No. of Non-operated Branchless Banking Centers	189	0	0	189
7	No. of Mobile Banking Customers	4711097	351796	23176	5086069
8	No. of Internet Banking Customers	816074	14634	3594	834302
9	No. of ATMs	2552	209	30	2791
10	No. of Debit Cards	5307970	206589	29694	5544253
11	No. of Credit Cards	104721	0	0	104721
12	No. of Prepaid Cards	96816	0	0	96816

Note:

Bank balance includes money at call

Nominal GDP (At Producer's Price) for 2017/18 Rs. 30,07,246 million(Preliminary)

$# 6 months prior Total Loan is taken to calculate Deprived Sector Lending

** Excluding Extension Counters and Microfinance Units

- Adjustments are not included in Credit Deposit Ratio Calculation.
- Negative core capital has been excluded in calculation of Capital Adequacy Ratios

Annex - 7

Composition of Financial Stability Oversight Committee

Name and Designation	Status
Mr. Chintamani Siwakoti, Deputy Governor	Chairperson
Mr. Maheshwor Lal Shrestha, Executive Director, Bank Supervision Department	Member
Mr. Bhuban Kadel, Executive Director, Development Bank Supervision Department	Member
Mr. Dev Kumar Dhakal, Executive Director, Payment Systems Department	Member
Mr. Sunil Udash, Executive Director Finance Company Supervision Department	Member
Mr. Gunakar Bhatta, Executive Director Research Department	Member
Mr. Bam Bahadur Mishra, Acting Executive Director, Bank and Financial Institution Regulation Department	Member
Ms. Sarita Bhatta Adhikari, Acting Executive Director, Foreign Exchange Management Department	Member
Mr. Daya Ram Sharma Pangeni, Acting Executive Director Micro-Finance Promotion and Supervision Department	Member
Mr. Narendra Singh Bista, Director, Bank and Financial Institutions Regulation Department	Member Secretary
Registrar, Department of Cooperative	Invitee Member
Chairman, Insurance Board	Invitee Member
Chairman, Security Board of Nepal	Invitee Member
Administrator, Employee Provident Fund	Invitee Member
Executive Director, Citizen Investment Trust	Invitee Member
Related Sectors Experts (maximum 2)	Invitee Member

Annex - 8

Composition of Financial Stability Sub-Committee

Name and Designation	Status
Mr.Narendra Singh Bista, Director, Bank and Financial Institutions Regulation Department	Coordinator
Ms. Pushpa Adhikary, Deputy Director, Development Bank Supervision Department	Member
Mr. Nanda Kumar Dhakal, Deputy Director, Research Department	Member
Mr. Prem Lal Gyawali, Deputy Director, Foreign Exchange Management Department	Member
Ms. Prativa Adhikary , Deputy Director, Finance Company Supervision Department	Member
Mr. Lumakant Bhattarai, Deputy Director, Micro Finance Promotion and Supervision Department	Member
Ms. Bina Dhakal Paudel, Deputy Director Bank Supervision Department	Member
Mr. Tek Raj Bhandari, Deputy Director Payment Systems Department	Member
Mr. Kedar Prasad Pokharel, Deputy Director Bank and Financial Institutions Regulation Department	Member Secretary