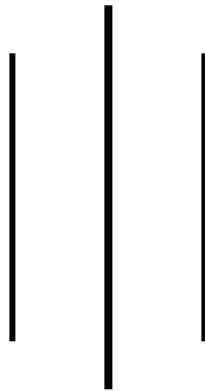
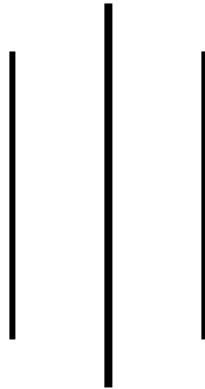


ECONOMIC SURVEY



FISCAL YEAR 2006/07



**GOVERNMENT OF NEPAL
MINISTRY OF FINANCE
2007**

FOREWORD

It is my pleasure to present to the Legislature-Parliament a report of the economy of Nepal for the Fiscal Year 2006/07. The Economic Survey, covering the period of the first eight months of the current fiscal year, includes statistical narration as well as retrospective analysis of the major gains, impacts and developments witnessed in various sectors of the national economy. The Survey presents analytical review of the achievements, problems and challenges pertaining to the execution of existing policies and programs in the broader areas of the macro-economy such as domestic production, public finance, monetary/financial operations, external transactions as well as in other major areas of the country's socio-economic development and structural economic reforms.

The Central Bureau of Statistics has come out with a new series of National Accounts Statistics beginning FY 2006/07, taking FY 2000/01 as the benchmark year. Based on those new series, the Survey has presented new data since FY 2000/01. Data relating to various sectors of the economy such as agriculture, industry, tourism, education, health and other production-related activities received from the concerned agencies in the estimated, refined and updated forms have been presented on the basis of their availability. In doing so, some additional information has also been put in the text. With a view to making analyses of the data more systematic, simple and meaningful, some changes have also been initiated in the style of presentation.

It is my belief that the Survey would prove informative and useful to the Honorable Members of the Legislature-Parliament and other representatives of the people as well as intellectuals, professionals, economists, research scholars, teachers, students, industrialists, businessmen and the interested citizens for obtaining inputs and information about Nepal's current economic architecture and development challenges and prospects. Based on the careful scrutiny of the information and its rigorous analysis, the readers at large and the concerned stakeholders in particular will be able to engage in active policy discourse, analyses and assessments for achieving development objectives through broad-based, high and sustainable economic growth.

I would like to thank all officials of the Ministry of Finance who were involved in the preparation of the Survey. In particular, I express thanks to the staff in the Economic Affairs and Policy Analysis Division of the Ministry and the designated officials of the Nepal Rastra Bank who immensely contributed to bringing this out in this form. My thanks also go to the concerned agencies for availing us the necessary data, information and details for the Survey.

July 2007

Dr. Ram Sharan Mahat
Finance Minister

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Acronyms

ACU	- Asian Clearing Union
ADB/N	- Agriculture Development Bank Limited
ADS-BS	- Automatic Dependent Surveillance Broadcast System
AFIS	- Aeronautical Flight Information System
AIP	- Aeronautical Information Publication
AOC	- Air Operation Certificate
BIMSTEC	- Bay of Bengal Initiative for Multi- Sectoral Technical and Economic Cooperation
CAAC	- Civil Aviation Authority of China
CB	- Cross Back Exchange
CBO	- Community Based Organization
CDMA	- Code Division Multiple Access
CFIT	- Control Flight into Terrain
CRR	- Cash Reserve Ratio
CTEVT	- Council for Technical Education and Vocational Training
DFID	- Department for International Development, UK
DPMAS	- District Poverty Monitoring and Analysis System
EDV	- Electronic Diversity Visa
EPZ	- Export Processing Zone
FISIM	- Financial Intermediation Services Indirectly Measured
GDP	- Gross Domestic Product
GHC	- Grievance Hearing Cell
GMPCS	- Global Mobile Personal Communication System
GNI	- Gross National Income
GPS	- Global Positioning System
HA	- Hectares
ICAO	- International Civil Aviation Organization
ILS	- Instrument Landing System
IMF	- International Monetary Fund
ISIC	- International Standards Industrial Classification
KG	- Kilo Gram
LDO	- Light Diesel Oil
LMFF	- Liquidity Monitoring and Forecasting Framework
LOA	- Letter of Agreement

MD	- Master of Medicine
MT	- Metric Tons
MTEF	- Mid-Term Expenditure Framework
MTO	- Mineral Turpentine Oil
NAC	- Nepal Airlines Corporation
NBL	- Nepal Bank Limited.
NCASTP	- National Civil Aviation Security Training Programme
NDHS	- Nepal Demographic and Health Survey
NIDC	- Nepal Industrial Development Corporation
NLSS	- National Living Standards Survey
NPA	- Non-Performing Assets
NRB	- Nepal Rastra Bank
NSIC	- Nepal Standard Industrial Classification
OMO	- Open Market Operation
PABX System	- Public Telephone Exchange System
PBM	- Performance-Based Monitoring
PCO	- Public Call Operator
PMAS	- Poverty Monitoring and Analysis System
PMEU	- Programme Monitoring and Evaluation Unit
PMTCT	- Prevention of Mother to Child Transmission
PPP	- Public-Private Partnership
PRSP	- Poverty Reduction Strategy Paper
PSTN	- Public Subscriber Telephone Network
RBB	- Rastriya Banijya Bank
RCAG	- Remote Control Air Ground
SAFTA	- South Asian Free Trade Area
SAPTA	- South Asian Preferential Trade Agreement
SITC	- Standards International Trade Classification
SLF	- Standing Liquidity Facility
SMD Process	- Strengthening Maintenance and Development Process
SNA	- System of National Accounts
STI	- Second Tier Institution
TOR	- Terms of Reference
UDLE/RUPP	- Urban Development through Local Efforts / Rural-Urban Partnership Programme
UNDP	- United Nations Development Programme
VOR/DME	- Very High Frequency Omni Range / Distance Measuring Equipment

- V-SAT - Very Small Aperture Terminal
- WLL - Wireless Loop
- WTO - World Trade Organization

Executive Summary

1. World output growth rate reached 5.4 percent in 2006. Of this, advanced economies' growth rate stood at 3.1 percent while the emerging and developing economies grew by 7.9 percent. In 2007, the growth rate is projected to come down to 4.9 percent, of which the advanced economies will grow by 2.5 percent while the emerging and developing economies will maintain 7.5 percent. Nepal's immediate neighbors, India and China, achieved growth rates of 9.2 percent and 10.7 percent respectively in 2006, but the following year will see a slight slump with 8.4 percent and 10.0 percent respectively. Talking of South Asia as a whole, the region witnessed an encouraging growth rate of 8.7 percent in 2006, whereas in 2007, it is projected to marginally come down to 8.1 percent. As regards the price rise, it reached 2.3 percent in advanced economies and 5.3 percent in the rest of the countries in 2006, and is projected to remain 1.8 percent and 5.4 percent respectively in 2007.
2. Nepal's economic growth rate remained below 5.0 percent in the last six years because of the country's precarious economic circumstances. In FY 2005/06, Nepal's GDP growth rate stood at a meager 3.3 percent of which the agricultural sector's growth was 1.1 percent and the non-agricultural sector's higher, at 4.6 percent. The growth rate further decelerated in FY 2006/07 to 2.5 percent, with the agricultural sector's marginal growth of 0.7 percent against the non-agricultural sector's 2.5 percent. The extremely unfavorable weather, among other things, caused this high decline in agricultural production, especially that of the paddy. The impact could clearly be seen on the overall agricultural production index which increased by a mere 0.4 percent in 2006/07 against the increase of 1.1. percent in the preceding year. Conversely, the production index of the major industrial products grew by 2.1 percent this year compared to the growth of 1.9 percent last year. In the current FY 2006/07, GDP growth rate at current producers' prices is estimated to remain 11.1 percent, the highest at current prices since FY 2000/01 (the benchmark year for the new series of the National Accounts Statistics).
3. FY 2006/07 in comparison to FY 2005/06 noticed higher growth rates in sectors such as real estate and professional services (8.7 percent this year against 1.1 percent last year), transport, communications and storage (8.1 percent this year against 4.4 percent last year), education (5.6 percent this year against 2.7 percent last year), and industry (2.2. percent this year against 2.0 percent last year).
4. The sectors that recorded dismal performance in FY 2006/07 compared to FY 2005/06 include agriculture (as noted above), wholesale and retail trading (-2.6

percent this year against 3.7 percent last year), construction (1.5 percent against 7.3 percent), hotels and restaurants (2.8 percent against 6.0 percent), electricity, gas and water (3.2 percent against 3.6 percent), public administration and defense (3.6 percent against 6.9 percent), other community, social and individual services (5.0 percent against 7.5 percent), health and social services (5.2 percent against 7.0 percent), quarrying (6.0 percent against 7.6 percent) and financial intermediation (8.6 percent against 16.5 percent).

5. A review of the share of the major production sectors in GDP at real prices in FY 2006/07 testifies to the growing predominance of the services sector in the economy. Viewed sector-wise, agriculture stands with 36.1 percent contribution to the GDP at real prices in FY 2006/07; wholesale and retail trade with 13.1 percent; transport, communications and storage with 8.7 percent, industry with 7.8 percent, real estate and professional services with 7.5 percent, construction with 6.1 percent, and education with 5.9 percent. The increase in services sector's contribution reflects the changing feature of economic development. Compared to its growth rate of 4.7 percent in FY 2005/06, it has recorded a phenomenal growth rate of 9.0 percent in the following year, thus increasing its total share in GDP from 46.4 percent last year to 47.1 percent this year.
6. The proportion of Gross Domestic Saving (GDS) to GDP remained 7.9 percent in FY 2005/06, which increased to 9.4 percent in the succeeding year. Similarly, the proportion of Gross National Saving (GNS) to GDP increased from 28.2 percent in FY 2005/06 to 28.6 percent in the following year. Though the proportion of total investment to GDP slightly declined from 26.0 percent in FY 2005/06 to 25.3 percent in the following year, the surplus of GNS over total investment in proportion to GDP increased from 2.2 percent last year to 3.3 percent this year, reflecting an improvement in the resource balance.
7. High revenue growth is one of the major achievements in FY 2006/07. In FY 2005/06, revenue grew by 3.1 percent and its proportion to GDP stood at 11.2 percent. This year, it increased by 19.5 percent and its proportion to GDP rose to 12.0 percent. The proportion of tax revenue to GDP increased from 8.9 percent last year to 9.7 percent this year. The budget deficit remains under control, and the proportion of the outstanding public debt (both domestic and external) to GDP has come down to 46.2 percent this year from 50.1 percent last year.
8. The net capital investment of public enterprises (PEs) increased by 4.4 percent to the tune of Rs. 196 billion 670 million this year. The proportion of operating profit to net capital investment also increased from 0.9 percent last year to 5.0 percent this year. However, still a few PEs remain without updated audit reports and there is also a need for settling and harmonizing the accounts of the

government and the PEs regarding the former's share and loan investments into the latter.

9. Consumer price rise is estimated to have decreased to 6.6 percent in FY 2006/07 from 8.0 percent in FY 2005/06. Wholesale Price Index, however, is likely to go up from 8.9 percent last year to 9.0 percent this year. Similarly, the GDP Price Deflator is also projected to grow from 6.4 percent last year to 8.3 percent this year.
10. In the banking sector, the total deposits are projected to increase to 17.4 percent in FY 2006/07 from 16.1 percent in FY 2005/06. The proportion of total deposits in the banking sector to GDP has increased from 41.6 percent last year to 43.6 percent this year. The share of outstanding private sector credit in the total banking sector credit took an upturn from 69.8 percent last year to 75.3 percent this year. Likewise, the proportion of narrow money supply to GDP slightly grew from 17.5 percent last year to 17.7 percent this year, whereas the proportion of broad money supply to GDP recorded considerable increase from 53.6 percent last year to 55.9 percent this year. This shows the progress in financial intermediation.
11. On foreign trade, the proportion of trade deficit to GDP remained 17.6 percent last year, which has marginally come down to 17.5 percent this year. The remittances earned by the Nepali employees abroad recorded good progress, with an estimated increase from Rs. 97 billion 690 million last year to Rs. 102 billion 10 million this year. On external transactions, the BOP position remains in surplus. As a result, total foreign exchange reserves increased from Rs. 165 billion 130 million (US\$ 2 billion 220 million) at the end of FY 2005/06 to Rs. 171 billion 370 million (US\$ 2 billion 420 million). This reserve would be sufficient to finance 11 months of imports of good and 9 months of imports of goods and services combined.
12. While the number of tourists fell by 2.6 percent to 3,75,398 between December 2004 and December 2005, it reached 3,93,949 between December 2005 and December 2006, registering an increase of 4.9 percent. In the first six months of FY 2006/07, the number of air travelers, both foreign and the Nepalese, stood around 800,000.
13. On the road transport sector, the first eight months of FY 2005/06 witnessed the construction of blacktopped, graveled and fair-weather roads totaling the length of 17,297 km; it reached 17,609 km during the same period in FY2006/07.
14. The number of primary, lower secondary and secondary schools remained 34,543 in the academic year 2005, which increased to 42,110 in the following academic year. In the similar vein, the number of enrolled students increased

from 64,63,000 in academic year 2005 to 64,96,000 in academic year 2006. The number of teachers remained 1,30,626 in academic year 2005, which increased to 1,41,605 in the following academic year. Of the total teachers, the number of those trained grew from 52,305 to 82,498 during the same comparable years.

15. Progress has been noted in the health sector as well. The number of health institutions including the hospitals, for instance, increased from 6,796 in July 2006 to 6,944 during the first eight months of FY 2006/07. The skilled human resources in the health sector also noticed an increase: from 90,849 to 91,744 during these comparable years.
16. Nepal confronts with a number of economic challenges at present: low economic growth, low per capita income, higher level of poverty, poor social indicators, underdeveloped physical infrastructure, and high-cost economy leading to higher cost of production and so on. While the world economy in general and the emerging and developing economies, India and China at our doorsteps in particular, are moving fast along the trajectory of economic growth, Nepal still finds itself grappled with a host of problems that demand early and effective solutions to ensure an inclusive, just and high economic growth on a sustainable basis. To attain a discernible progress in poverty reduction, economic agenda should be accorded fitting priority coupled with the institutionalization of sustainable peace and democracy in the country.