CONTENTS

		Page	No.	
Decle	ration	i		
Ackno	owledgements	ii		
Assur	mptions and Conventions	iv		
Acror	nyms Used	V		
Contents				
List of Tables				
List o	f Figures	xvii		
List o	f Appendices	xix		
Execu	itive Summary	xx		
Chap	oter 1			
Intro	duction, Objectives and Research Methodology	1-22		
1.1	Overview of Foreign Exchange Management in Nepal	1		
1.2	Exchange Rate and the Foreign Exchange Market 2			
1.3	Significance of the Study 6			
1.4	A Brief Overview of Nepal's Economy 7			
1.5	Objectives of Foreign Exchange Management in Nepal 11			
1.6	Regulation of the Foreign Exchange Market 12			
1.7	Structure of Nepal's Foreign Exchange Market 13			
1.8	Statement of Problem 15			
1.9	Objectives of the Study	17		
1.10	Research Design	18		
	1.10.1 Research Methodology	19		
	1.10.2 Nature and Sources of Data/Information	19		
	1.10.3 Scope of the Study	19		
	1 10 4 Population and Sample	20		

1.10.5	Data Pr	rocessing	20	
	1.10.6	Method of Analysis	20	
1.11	Scheme	e of the Study	21	
Chap	ter 2			
Revie	w of Lit	terature	23-54	
2.1	Exchange Rate			
	2.1.1	Classification of Exchange Rate Arrangements	25	
	2.1.2	Chilean Peg Experience: Lessons for Nepal	28	
2.2	Foreign	Exchange Market Intervention	30	
2.3	Dynam	Dynamics of International Trade and Payments		
	2.3.1	Features of Nepalese International Trade	34	
	2.3.2	Exchange Rate Policy and the Trade Deficit	35	
2.4	Foreign Exchange Reserves Management			
	2.4.1	Definition, Features and Importance	36	
	2.4.2	Need and Motives of Holding Foreign Exchange Reserves	36	
	2.4.3	Reserves Accumulation in Full Convertibility	37	
	2.4.4	Costs of Holding Reserves	38	
	2.4.5	Impact of Holding Surplus Reserves	39	
	2.4.6	Reserves Adequacy	39	
	2.4.7	Measuring Reserves Adequacy	40	
	2.4.8	IMF's Revised Guidelines for Effective Reserves Manageme	ent 44	
	2.4.9	Some Strategic Issues on Reserves Management	45	
2.5	Regulatory and Institutional Mechanism of Foreign Exchange Management in Nepal			
	2.5.1	Regulatory Mechanism	51	
	2.5.2	Institutional Mechanism	52	
2.6	Concluding Note 54		54	

Chapter 3

Evol	ution of	the Exchange Rate Regime in Nepal	55-101		
3.1	The Ev	55			
	3.1.1	Flexible Exchange Rate Arrangement with INR before 196	50 57		
	3.1.2	Pegged Exchange Rate Arrangement with INR after 1960	61		
3.2	Use of Exchange Rate for Managing Foreign Exchange				
	3.2.1	Bonus System, 1963-1977	66		
	3.2.2	Dual Exchange Rate with USD, 1978-1981	66		
	3.2.3	Forward Exchange Rate Facility, 1983- 1992	68		
	3.2.4	Import License Auction System, 1986-1992	68		
	3.2.5	Partial Convertibility in the Current Account, 1992-1993	69		
	3.2.6	Full Convertibility in the Current Account/OGL System,			
		1993 to Date	69		
3.3	Evaluation of the Sustainability of Pegged Exchange Rate Regime				
	with IN	with INR			
	3.3.1	Factors Affecting the Choice of Exchange Rate Regime in			
		Nepal	70		
	3.3.2	Reasons for Pegging with INR	72		
	3.3.3	Sustainability of the Peg	73		
	3.3.4	Possibility of a Floating Exchange Rate Regime with INR	74		
3.4	Overview of Nominal Exchange Rate of NPR 74		74		
3.5	Real Exchange Rate (RER) of NPR with INR and USD, Nominal Effective Exchange				
	Rate (NEER) and Real Effective Exchange Rate (REER) 78				
	3.5.1	Real Exchange Rate (RER) of NPR with INR and USD	78		
	3.5.2	Nominal Effective Exchange Rate (NEER) of NPR	80		
	3.5.3	Real Effective Exchange Rate (REER) of NPR	81		
3.6	Relationship of Exchange Rate with Trade Deficit and Foreign				
	Exchange Reserves: An Empirical Analysis				
	3.6.1	Methodology	84		
	3.6.2	Description of Data	85		
	3.6.3	Unit Root Test	85		
	3.6.4	Estimation and Analysis	86		

	3.6.5	Foreign Exchange Reserves and Exchange Rate	87
	3.6.6	Trade Deficit and Exchange Rate	88
	3.6.7	Results	90
3.7	Major	ssues in Nepal's Exchange Rate	91
	3.7.1	Unofficial Exchange Rate of INR in the Informal Market	91
	3.7.2	Dual Policies on Exchange Rate Determination	96
	3.7.3	Feasibility of Managed Floating of NPR	97
	3.7.4	Possible Future Change-Capital Account Convertibility	99
3.8	Conclud	ling Note	100
Chap	ter 4		
Forei	gn Exch	ange Market Intervention in Nepal	101-126
4.1	Introdu	ction	101
4.2	Legal Fr	amework for Intervention	102
4.3	Objectives of Intervention		104
4.4	Foreign	Exchange Market Intervention Procedure	105
	4.4.1	Preconditions	105
	4.4.2	Counterparties	106
	4.4.3	Determination of Intervention Rate	107
	4.4.4	Deal Confirmation	107
	4.4.5	Encourage Interbank Transactions	107
	4.4.6	Sale Interventions not for Trading with NRB	108
4.5	Sensitivity of the Intervention Strategies and Policies		109
4.6	Frequency and Volume of Intervention Transactions 1		
4.7	Intervention Volume as Percent of GDP 1		
4.8	Inflow of Remittance and USD Purchased Under Intervention 12		
4.9	Broad Money (M2) and Foreign Exchange Market Intervention 13		
4.10	USD Purchased via Intervention and USD Sold to Purchase INR 1		
4.11	Effectiveness of Foreign Exchange Market Intervention 12		
4.12	Concluding Note 12		

XI

Chapter 5

=		Nepal's Integration with the Outside World in Ter I Trade and Payments	ms of 126-157
5.1	Evolutio	on of Nepal's International Trade	126
	5.1.1	Major Trading Partners	130
	5.1.2	Indo-Nepal Trade	132
	5.1.3	Trade with Countries Other than India	140
5.2	Legal ar	nd Policy Arrangements	143
	5.2.1	Bilateral, Regional and Multilateral Trade Agreements	143
	5.2.2	Trade Policy 2009	145
	5.2.3	Foreign Investment and Technology Transfer Act 1992	147
5.3	Balance	of Payments (BOP) Situation	148
5.4	Paymer	nt and Settlement System in Nepal	151
	5.4.1	Infrastructure and Components	151
	5.4.2	Current Status	152
	5.4.3	Payment and Settlement System for INR	153
	5.4.4	Payment and Settlement System for Convertible Curren	cies 153
	5.4.5	Asian Clearing Union (ACU)	154
	5.4.6	Cross Border Payment	155
	5.4.7	Role of NRB	156
5.5	Conclud	ling Note	157
Chap	ter 6		
Forei	gn Exch	ange Reserves Management in Nepal	L 58-211
6.1	Introdu	ction	158
	6.1.1	Investment Policy Goals	159
	6.1.2	Strategic Objectives	160
	6.1.3	Scope	161
6.2	Instituti	onal Arrangement in NRB for Reserves Management	162
	6.2.1	Role of NRB Board of Directors	163
	6.2.2	Role of Governor	164
	6.2.3	Role of Investment Committee	165

	6.2.4	Role of Foreign Exchange Management Department	166
	6.2.5	Role of Investment Sub-Committee	172
6.3	NRB's	Investment Guidelines and Major Policy Provisions	173
	6.3.1	Investable Instruments	174
	6.3.2	Investable Currencies	175
	6.3.3	Minimum Liquidity Requirement	176
	6.3.4	Duration of Portfolio	176
	6.3.5	Portfolio Management	177
	6.3.6	Accounting and Auditing of Reserves Transactions	178
	6.3.7	Public Availability of Information on Reserves	179
	6.3.8	Risk Assessment of Investment Transactions	180
6.4	Data A	nalysis	183
	6.4.1	Trend of Reserves Accumulation	183
	6.4.2	Composition of Reserves	185
	6.4.3	Sources and Uses of Reserves	188
	6.4.4	Investment Portfolio	192
	6.4.5	Return on Reserves	195
	6.4.6	Management of INR in Nepal	198
	6.4.7	Managing Monetary Gold	202
	6.4.8	Measuring Reserves Adequacy	203
6.5	Conclu	iding Note	210
Chap	oter 7		
Find	ings, Co	onclusions and Recommendations	212-234
7.1	Summ	ary	212
7.2	Finding	gs	215
	7.2.1	Exchange Rate Regime	215
	7.2.2	Foreign Exchange Market Intervention	217
	7.2.3 Dynamics of Nepal's Integration with the Outside We		orld
		in Terms of International Trade and Payments	217
	7.2.4	Foreign Exchange Reserves Management	219
7.3	Conclusions		220

	7.0.4		222
	7.3.1	Exchange Rate Regime	220
	7.3.2	Foreign Exchange Market Intervention	222
	7.3.3	Dynamics of Nepal's Integration with the Outside World	d
		in Terms of International Trade and Payments	222
	7.3.4	Foreign Exchange Reserves Management	223
7.4	Recommendations		224
	7.4.1	Exchange Rate Regime	224
	7.4.2	Foreign Exchange Market Intervention	225
	7.4.3	Dynamics of Nepal's Integration with the Outside World	d
		in Terms of International Trade and Payments	227
	7.4.4	Foreign Exchange Reserves Management	228
7.5	Limitati	ons	233
7.6	Directio	ons for Further Research	233
Appe	ndices		234-253
Biblio	Bibliography		