

# 4th FNCCI Business Outlook Survey

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**FNCCI**

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## 1. HIGHLIGHTS OF THE FOURTH FNCCI BUSINESS CONFIDENCE SURVEY

- The FNCCI Business Confidence Index (FNCCI BCI) for the period of August 2014 to January 2015 reached 58.0 as compared to the 55.8 in the third survey, which covered the period of February to July 2014. This indicates that the business confidence has increased in the review period.
- The confidence level of the private sector on Nepalese economy has been on the rise since the first survey was conducted in June 2012. This can be contributed to the improving political environment where the country has witnessed some positive movement like, successful completion of second Constituent Assembly election, visit of the Indian Prime Minister in 17 years, signing of Power Trade Agreement between Nepal and India, signing of Power Development Agreement with two leading promoters of hydropower, among others.
- The sectoral break ups- that is, agriculture, industry and service, also shows that the confidence has risen in the review period. The businesses involved in the agriculture sector (59.1) have higher confidence level than those involved in services (58.2) and manufacturing (57.4) sector.
- In the fourth survey, data was collected from a sample of 302 respondents from all over the country. The survey covered 24 districts from the five development regions of Nepal and the survey was conducted on November and December 2014.
- Of these respondents, 55.3 percent are involved in the services sector, while about 36.4 percent and 8.3 percent are involved in manufacturing and agri-business sectors.
- 64.3% of the respondents think that **production** will rise in future, while 47.1% of the respondents felt that it has remained the same in the review period.
- 51.2% of the respondents think that **employment** will increase in future, while 61.9% felt that it has remained unchanged in the review period.
- 67.7% of the respondents thought that **cost of production** has gone up in the review period and 65.7% feels that it will further go up in coming months as well.
- 44.0% of the respondents said that their **profitability** has remained the same in the review period while only 51.4% expects it to increase in coming months.
- 50.0% responded that **export** has remained the same in the review period while 52.4% expect it to rise in future. Similarly, in **import**, 48.6% has felt that it has remained the same and 49.7% expect it to rise in coming months.
- When respondents were asked to compare about the **overall business environment in Nepal** between third and fourth survey, 51.0% responded that it has remained the same as in the previous survey while 63.8% expected that it would become better.
- 48.2% of the respondents think that **taking loan from the bank** has become easier in the review period while 54.5% expect it to become easier in future.
- A majority of respondents (64.2%) said that the **rate of inflation** has increased in the review period while 52.5% expect it to increase coming months.
- When respondents were asked to compare the **overall economic condition of the country** between third and fourth survey, 56.4% said that it has remained the same as in the previous survey while 54.8% expected that it would improve.
- A majority of respondents thinks that inadequate supply of electricity is the top most critical challenge for Nepalese economic growth. Similarly, they have also considered corruption and lack of good governance as other binding constraints for economic growth in Nepal.

## 2. FOURTH FNCCI BUSINESS CONFIDENCE INDEX

The fourth FNCCI business confidence index, covering the period of August 2014-January 2015, was conducted on November-December 2014, stood at 58.0 points, surpassing the cut-off mark of 50, which indicates that the private sector has shown a 'moderate confidence' on the Nepalese economy.

When the first survey was conducted in June 2012, the economy was facing various political and economic challenges. Constitutional Assembly was dissolved during the same time indicating further political instability in the country. This was also reflected in the confidence index as it stood at 39.7, indicating the low confidence level.

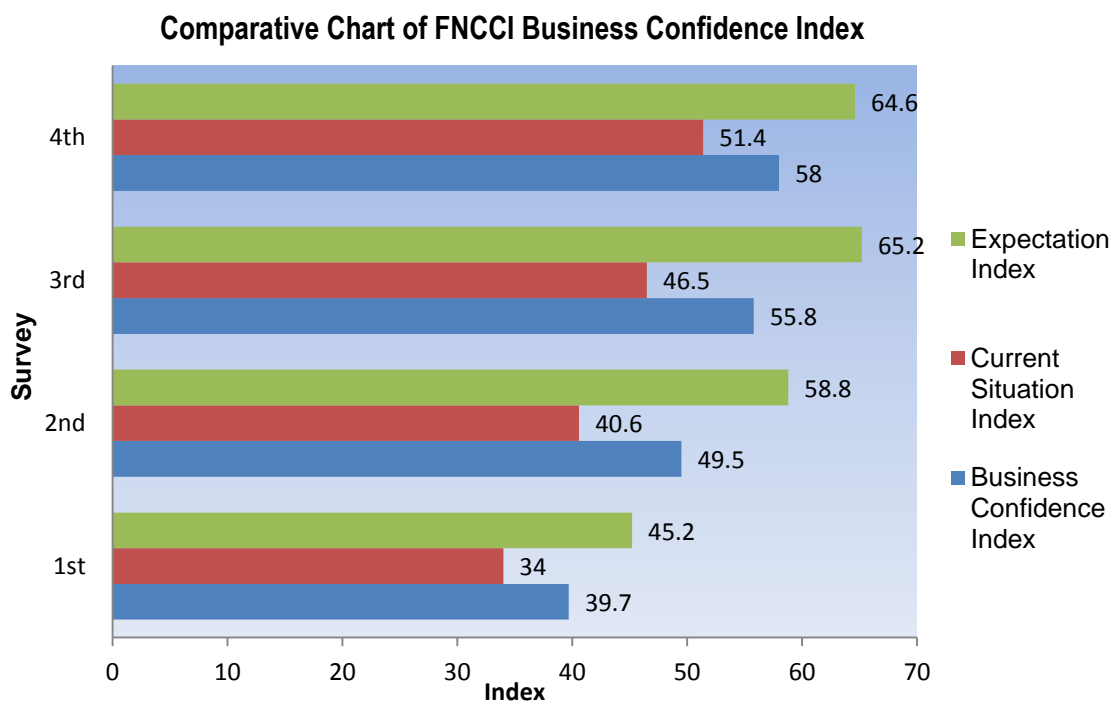
Since then, a lot of positive changes had occurred in the country, especially in the political and economic front. The 2<sup>nd</sup> Constitutional Election has been successfully concluded and the democratically elected government is now in place, indicating a political stability in the country. Political parties have taken the economic agenda as a focused area which is reflected in their election manifestos. Investment commitments- both from local and foreign, have also increased in the recent times.

For the first time in 17 years, Nepal has successfully hosted the visit of Prime Minister of India, which has created positive vibes on Nepalese economy. Nepal has also signed the Power Trade Agreement with India. Power development agreements have been signed for development of mega hydro projects. These activities have positive vibration in the economy and thus well reflected in the Fourth FNCCI Business Confidence Index as well.

The chart below shows the comparative overall business confidence index of the last four surveys conducted by the FNCCI. It depicts that the business confidence has been increasing since the first survey was conducted in 2012.

The Current Situation Index (CSI)- which provides the confidence level on the present situation, has crossed the cut-off mark of '50' for the first time, indicating the optimism of the private sector towards contemporary economic situation of the country.

In every survey, the Expectation Index (EI)- which provides confidence on the future expectation has been greater than the CSI, indicating that Nepalese private sector has always indicated positive attitude and optimism towards future.



### Sector-wise Breakdown

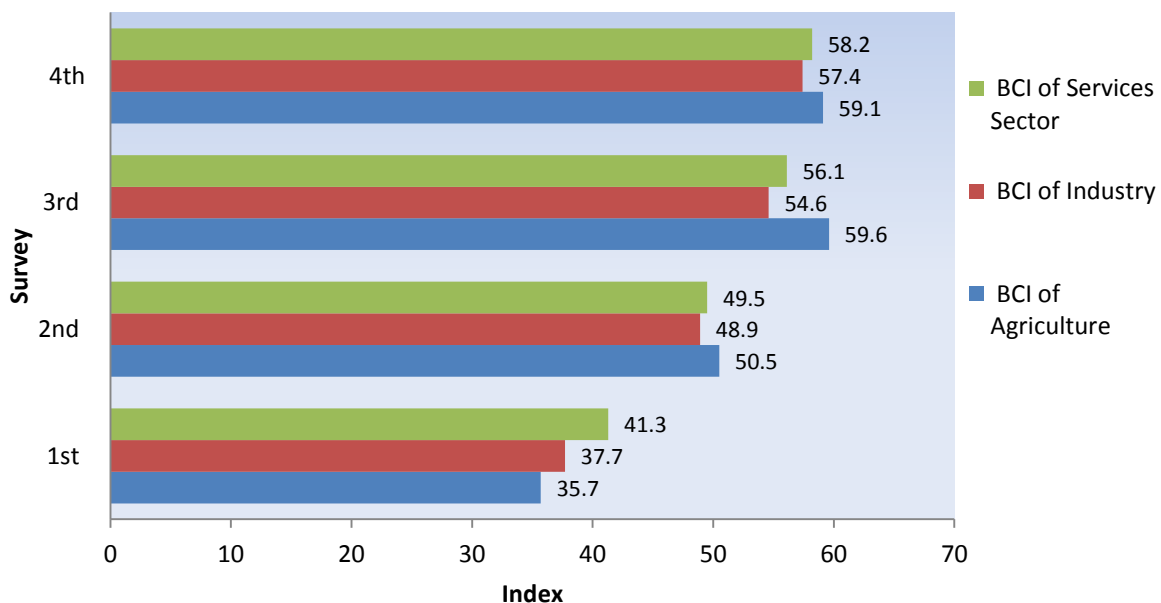
The survey covered 24 districts from five development regions of Nepal and a total number of 302 business firms/companies participated in the survey.

These participants are divided broadly into three sectors: Agriculture, Industry and Services. Of these, about 55.3 percent are involved in the services sector, while about 36.4 percent and 8.3 percent are involved in manufacturing and agriculture sector.

The respondents involved in the services sectors seem to be more confident in comparison with the respondents involved in the other two sectors. The FNCCI BCI for the agriculture sector stood at 59.1 whereas that of service sector and industry stood at 58.2 and 57.4 respectively. Nevertheless, all the sectors have crossed the cut-off mark of '50' indicating the 'moderate confidence' on the economy.

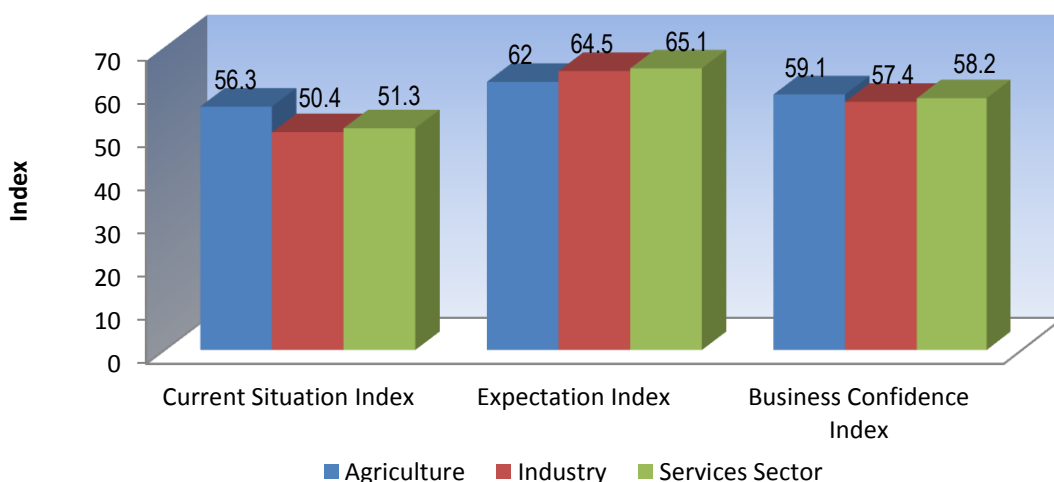
The bar diagrams below presents the comparative picture of the sector-wise breakdown in the last four surveys.

**Sector-wise Breakdown of the FNCCI BCI**



Respondents from all three sectors have shown the 'moderate confidence' in both the current situation index (CSI) and the expectation index (EI). In the CSI, respondents from the manufacturing sector have shown marginally high moderate confidence, as its index stood at 50.4 only. Meanwhile, respondents from the services sector have shown more optimistic views on Nepalese economy, as its EI stood at 64.5. The bars diagram below further shows the situation of the current survey.

**Sector-wise Current Situation and Expectation Index**



The questions in the survey were based on various indicators or aspects of business and the investment climate of the country. The major indicators included in the survey were: production or output level of the company/firm, employment, cost of production, profitability of the company/firm, export, import, inflation, ease in obtaining bank loans, overall business environment and overall

economic condition of the country. Based on these indicators, the composite business confidence index was calculated through diffusion index.

Of all the indicators, the private sector has shown huge confidence on getting loans from financial institutions. The confidence index for getting loans from bank stood at 71.1, indicating the improved perception on the financial institutions in Nepal. This is in line with the availability of liquidity in the market and reduction of the interest rate in the survey period.

As expected, private sector has shown 'very low confident' on two indicators- cost of production and inflation rate. The confidence surveys have shown that they have hardly any confidence on cost of production and inflation rate going to decline.

However, the private sector has shown a 'moderate confidence' on the overall business environment in Nepal and Nepalese economic situation itself. The encouraging activities, mainly in economic front, taking place in the country during the survey period might have been reflected in their confidence level. The index of each indicator, of the current survey, is provided in the table below.

Summary Table of the Fourth FNCCI BCI

Indicators	Current Situation Index	Expectation Index	Business Confidence Index
Production	61.2	78.2	69.7
Employment	59.1	73.0	66.1
Cost of Production	18.1	20.6	19.7
Profitability	46.6	70.3	58.4
Export	56.6	71.7	64.0
Import	68.4	69.6	69.0
Ease of getting Bank loan	69.0	73.3	71.1
Inflation Rate	22.2	30.5	26.2
Overall Business Environment	60.7	80.8	70.8
Overall Economic Condition	59.5	80.2	69.8
Composite Index	51.37	64.61	58.0

### 3. ECONOMIC OUTLOOK

In FY 2013/14, Nepal's GDP growth reached around 5.2%, which was higher than the last six years' period. Favorable weather, improved investment environment, timely release of budget are attributed for such growth by the Government. For the next FY, i.e. 2014/15, the government has targeted the growth of 6%. But both the World Bank Group and the Asian Development Bank have forecasted Nepal's GDP growth to reach around 4.8% for the next fiscal year, which is lower than the government's target.

The structure of the Nepalese economy has also been changing gradually, with a contribution of primary, secondary and tertiary sector to GDP of around 33.7%, 14.1% and 52.3% respectively in FY 2013/14. The per capita GNI has reached to around USD 703 in the same fiscal year. Likewise, the average consumer price index based inflation rate of FY 2013/14 was about 9.0%.

In FY 2013/14, Nepal's international trade has increased by around 20%, while comparing to the preceding fiscal year. The export has increased by 18.1% and import has increased by 20% during the same period, as a result, trade deficit to GDP ratio reached to around 32% in the FY 2013/14.

The year 2014 has witnessed a lot of positive activities both in the economic and political front. The official visit of Prime Minister of India on August 2014- which had happened after the period of 17 years - has created a positive impact in Nepalese economy. Likewise, Nepal also successfully hosted the 18th SAARC Summit in Kathmandu with focus on regional cooperation.

The year 2014 has been particularly very eventful for the hydro sector. The Power Trade Agreement between Nepal and India was signed during this year while Nepal Government has also successfully signed the power development agreement with two major hydro developers- GMR and Sutlej for development of Upper Karnali (900 MW) and Arun III (900 MW) respectively. Likewise Pancheshwar Development Authority was also set up for the development of Pancheshwar multipurpose hydro project.

#### Economic Situation

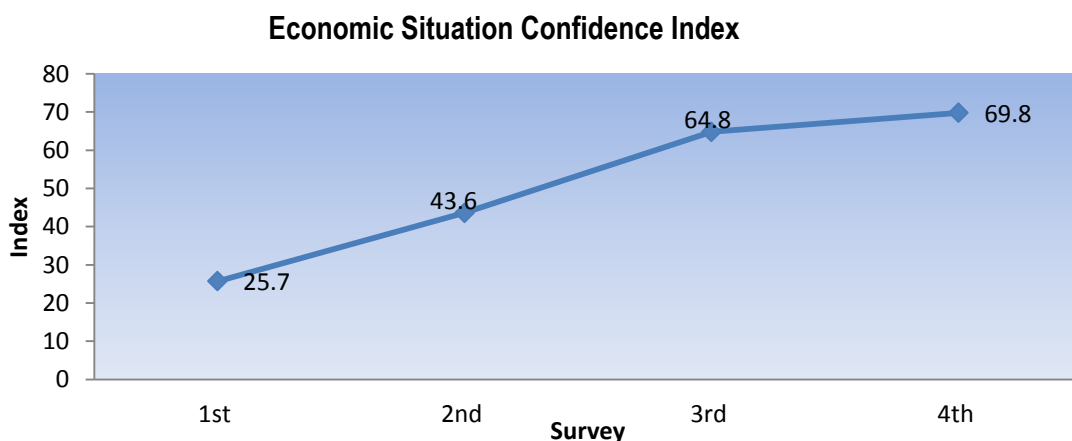
The survey revealed that, in the review period, private sector has shown a moderate level of confidence on the economic situation of Nepal, which stood at 69.8. In the first two surveys, during the end of the first Constituent Assembly, private sector's confidence was not that high. But, after the peaceful and successful completion of the election of the second Constitution Assembly, private sector's confidence has been on the rise.



Business confidence level seems to be changing with the change in political environment. When the survey was being conducted, there was still the hope that the constitution drafting will be completed in time.

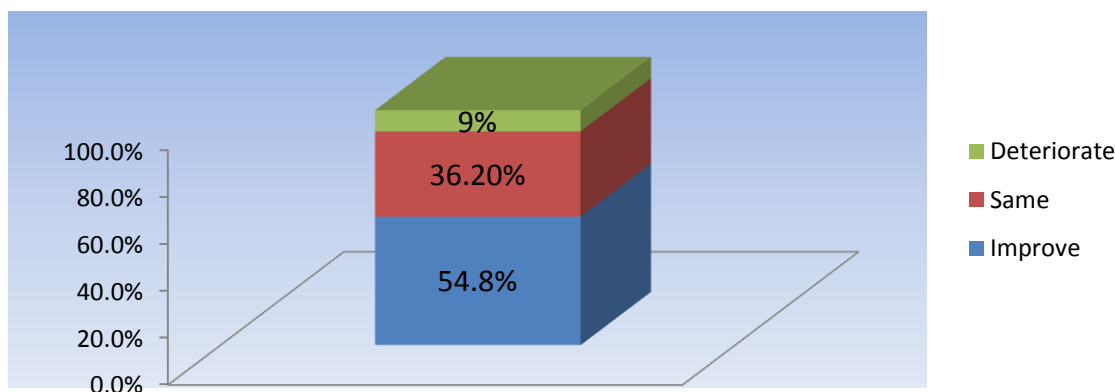
The report by World Economic Forum also suggests that Nepal's economic environment is improving in recent years. In its Global Competitiveness Rank for 2014-15, Nepal's score in the 'macro-economic environment' is 5.4 points in the total points of 7. In this pillar, Nepal's rank has increased to 37 from 41.

These all events and reports have created positive vibes among investors and business community, which is reflected in the rising confidence level. The graph below shows the trend of confidence index of the private sector on economic condition in the last four surveys.



In line with their confidence level, private sector has also shown their optimism towards the future of the economic condition in Nepal. When they were asked about their views on economic situation in future, more than fifty percent has said that it will further improve while only less than ten percent said that it will deteriorate.

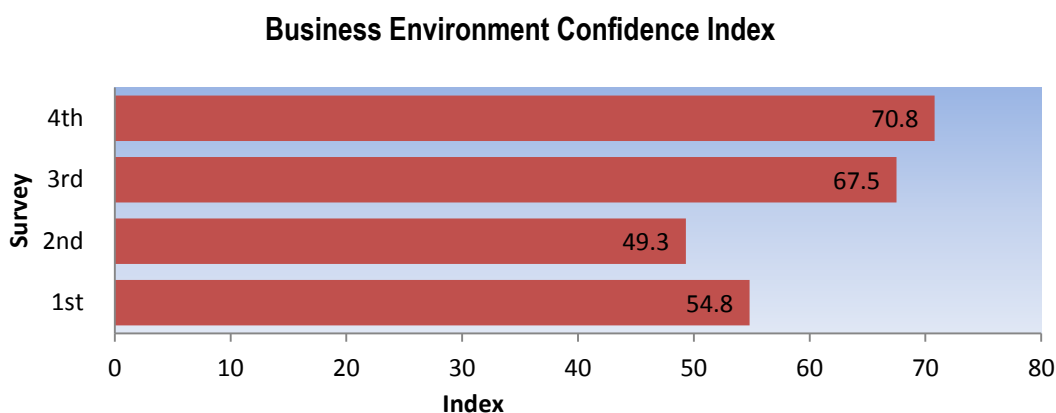
**Respondents' expectation on overall economic situation in percent**



## Business Environment

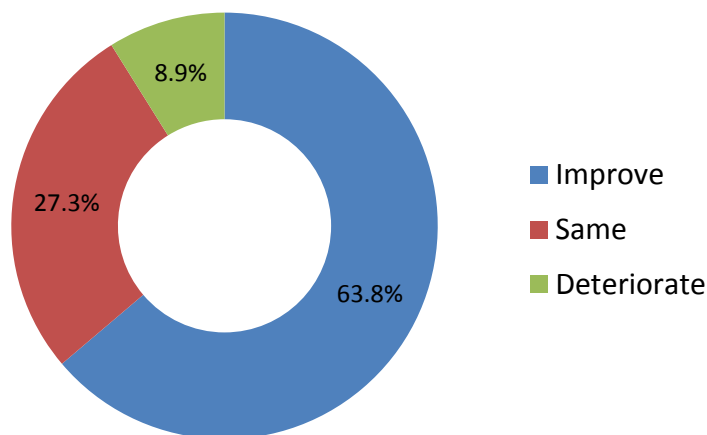
Four years back, Nepal ranked in 116th position in the ease of doing business published by the World Bank. But today, i.e. in 2015, Nepal's ranked has improved to 108th position scoring 60.33 points. This suggests that the business environment has improved in the last five years.

Most of the entrepreneurs that we have come across have also shared the same opinions. They also felt that the business environment has been much better than five years back. The survey also revealed the same. The entrepreneurs have shown highly 'moderate confidence' in this regard. The business environment confidence index stood at 70.8.



When they were asked about their future expectation about the business environment, about 63.8% said that the environment would further improve in coming days. This also indicates the rising confidence on the business environment.

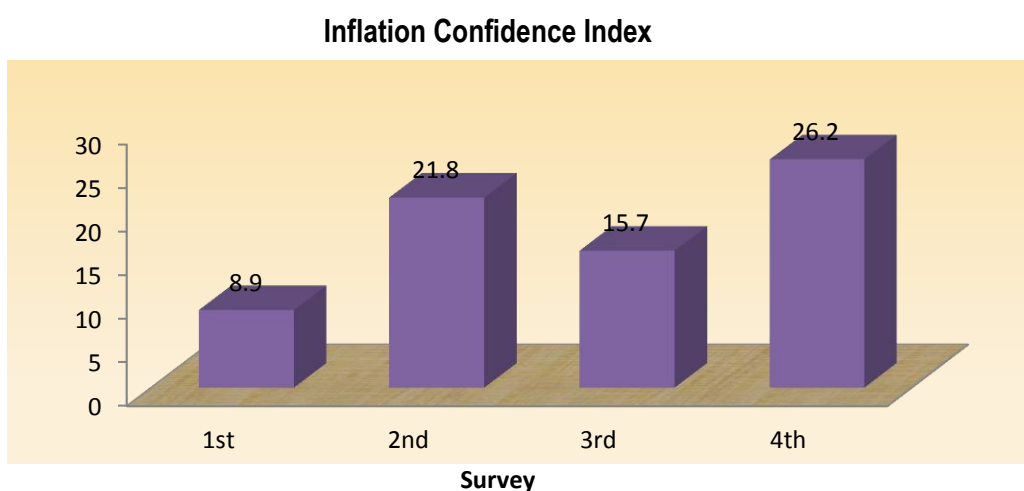
**Respondents' expectation on overall business environment in percent**



## Inflation

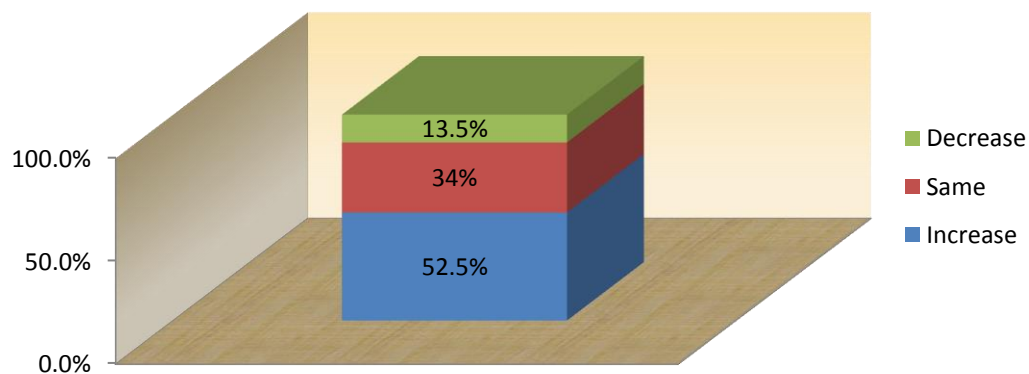
Entrepreneurs, like the general public, have always been pessimistic about the inflation situation in Nepal. Though the Central Bank, the sole authority to manage inflation in Nepal, has stated the inflation is under control in recent years, entrepreneurs have the opposite views.

In the review period, their confidence level on inflation has been 'low' at 26.2, though, it was an increment from the last survey. It also indicates that entrepreneurs' confidence is rising over the recent times, which means they also believe that inflation has somewhat moderated in the last few months.



But in contrast to their rising confidence, they, however, expected that the inflation level would increase in Nepal in coming days. When asked about their expectation, 52.5% believed that inflation would rise, while only 13.5% said that it would further decrease in next six months period.

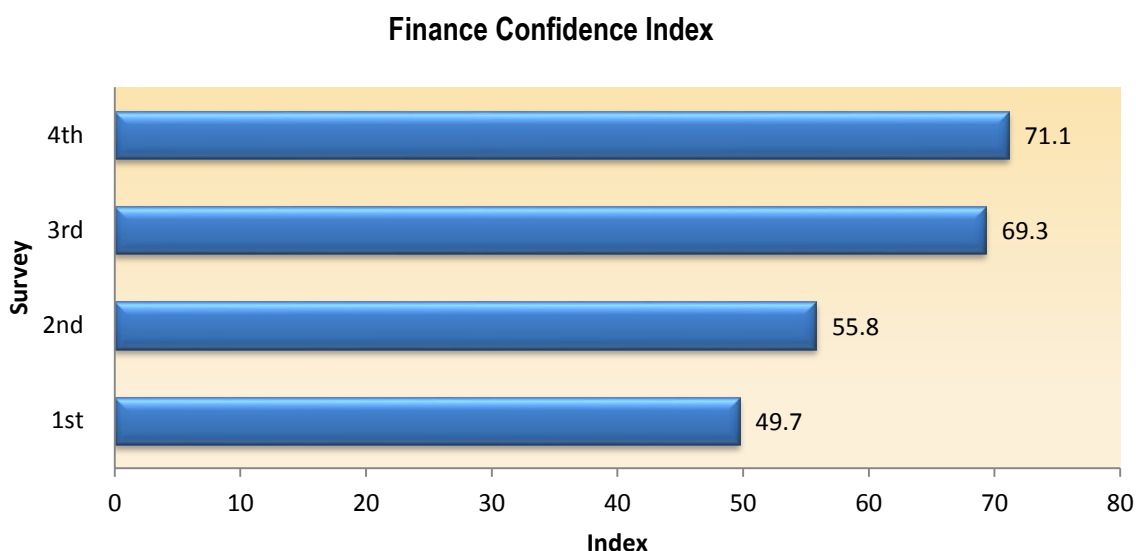
### Respondents' expectation on changes in rate of inflation in percent



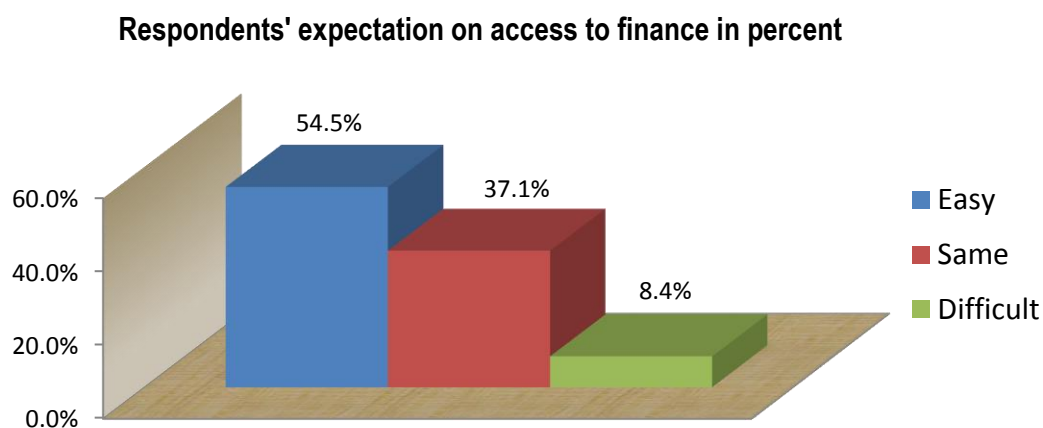
## Access to the Finance

Often, private sector has complained about the difficulty in getting loans from the financial institutions. In the past, due to liquidity crunch, getting loans from the bank itself was the daunting task. But, in the recent times, due to an increment in remittance and deposit mobilization, private sector has been facing this problem much less than in the past.

Since the first survey, the confidence of the private sector is in the upward trend, indicating that the situation has been improving. The access to finance confidence index stood at 71.1, showing that private sector has 'moderate confidence' in this aspect. The table below shows the confidence of the private sector on ease of access to the finance in the last four surveys.



When asked how they presume the situation in getting loans from the bank would fare in coming days, most of the respondents showed optimism in this aspect, as 54.5% said it would be easier to get loans from banks in future. While, less than 9% opined it would be more difficult.



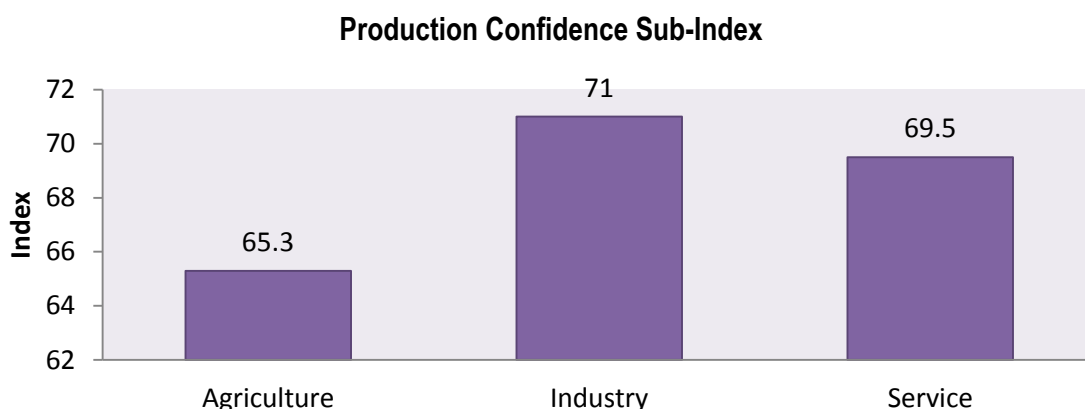
## 4. BUSINESS PROSPECTS

The prospects for production, employment, cost of production, profitability, exports and imports are vital elements that affect overall business confidence. Here we briefly analyze these indicators.

### Production/Output

The survey revealed that the entrepreneurs are confident of increase in the production/output of their company/firm. The confidence index for the production stood at 69.7. Though the overall production confidence index has lowered from the last survey, nevertheless, it is still in the band of 'moderate confidence'. In the last survey, this index stood at 72.0.

Interestingly, entrepreneurs, who are involved in the manufacturing sector have shown more confidence than those involved in other sectors, this time. In previous surveys, the manufacturing sector has been showing the least confidence in comparison with other sectors. This time, industry sector's production confidence index stood at 71.0. The chart below shows the breakdown of production confidence sub-index by three sectors.



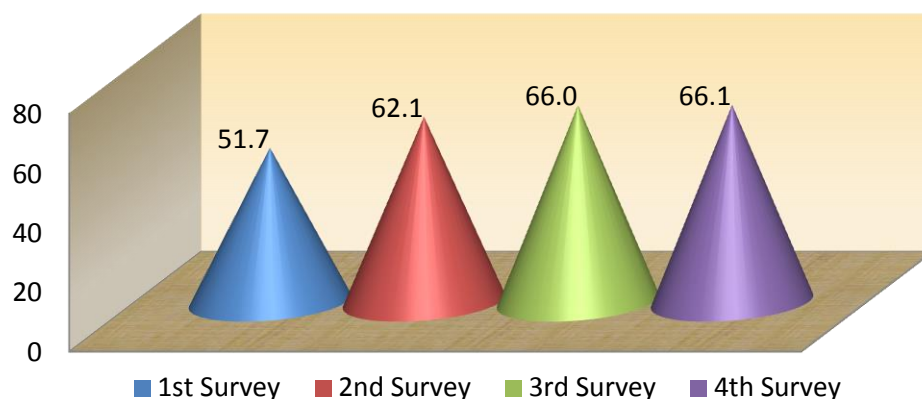
With the improved business and economic environment, perceptions of the private sector are also changing. When asked about their opinion on changes in production/output of their business, 64.3% opined that production of their business would increase in the future while only 7.9% expected it to decrease. This perception reflects the growing optimism of businesses.

### Employment

Every year more than 500,000 new entrants enter into the labor market in Nepal. But because of less opportunity in the country, out of this, every year, about 400,000 labors go to foreign country for better employment opportunity. With the improved economic environment in Nepal, it is expected

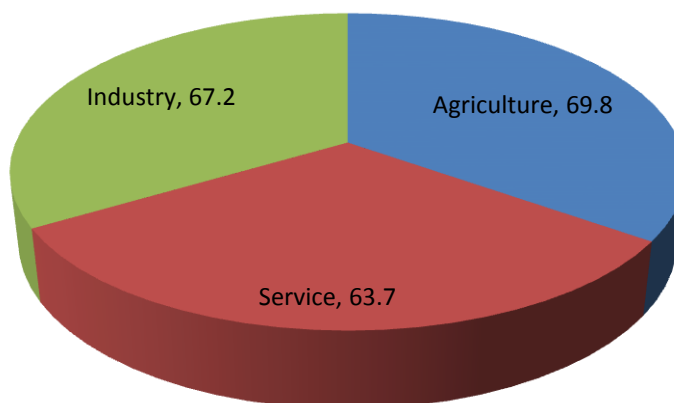
that more jobs opportunity will be created in Nepal in coming days, as we have already seen the rising commitments of investment- both from domestic as well foreign, in recent time.

The survey also revealed that the private sector sees a marginal improvement in employment situation. In the fourth business confidence survey, the employment confidence index stood at 66.1, which is a marginal increment of 0.1 point from the last survey. The chart below shows the comparative confidence index of employment in the last four surveys.



In case of the sectoral breakdown, the survey revealed that business people involved in agriculture are more confident of creating job opportunities followed by service sector and industry. The chart below shows the breakdown of employment confidence sub-index by these three sectors.

**Sector-wise Employment Confidence Index**



When entrepreneurs were asked about their opinion on the situation of creating more jobs in Nepal in near future, half of the entrepreneurs opined positively while only few entrepreneurs opined negatively regarding the more job creation opportunity in Nepal. Meanwhile, 43.2 percent opined that the situation would remain same.

## Cost of Production

One of the major constraints for Nepal's dismal performance in the international market as well as in domestic market is the high cost of production. Because of this, Nepal is losing its competitiveness in the market, as a result our export is not so encouraging and domestic market is surged by imported goods.

Lack of quality and adequate infrastructure; lack of skilled manpower; recurring labor problems; policy inconsistencies and political instability is fuelling the supply-side constraints, which ultimately incurs in the high production cost. Because of the rising cost of production, private sectors are more interested in doing trade rather than establishing manufacturing units.

The survey revealed that the private sector has a 'very low confidence' on cost of production going down. The fourth production cost confidence index stood at 19.7, indicating that the private sector does not perceive that the production cost will decline. However, the index of the current survey is a marginal increment from the last survey.

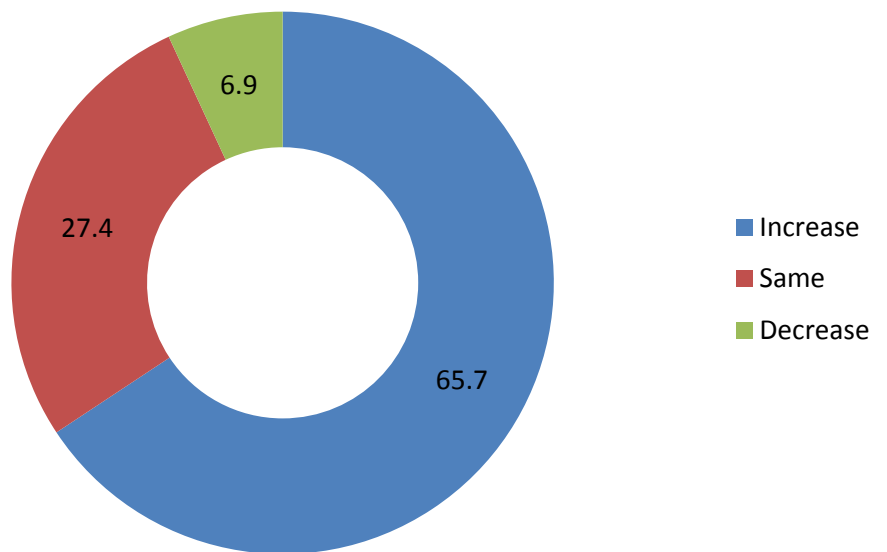
In the sectoral breakdown, the fourth survey revealed that business people involved in the manufacturing sectors are less confident on the cost of production index, whereas they are the ones who have shown more confidence on the output index. The table below shows the sectoral breakdown of production cost confidence sub-index.

**Sector-wise Production Cost Confidence Sub-Index**

Sector	Index
<b>Agriculture</b>	23.4
<b>Industry</b>	15.0
<b>Service</b>	22.5

When they were asked about their expectation on situation in cost of production in the future, 65.7% expected the cost of production to increase more in the future while 6.9% expected it to decrease. Meanwhile, 67.7% said that the cost of production has increased.

**Respondents' expectation on changes in cost of production in percent**



**Profitability of the company/firm**

Despite the high confidence on production, entrepreneurs still have a 'moderate confidence' on profitability, as they still believe that their business will not yield a satisfactory profit. The profitability confidence index, this time, stood at 58.4.

In the sector-wise breakdown, the survey revealed that business people involved in the service sector are more confident of increment in profitability followed by agriculture and manufacturing sector. The table below shows the breakdown of profitability confidence sub-index by these three sectors.

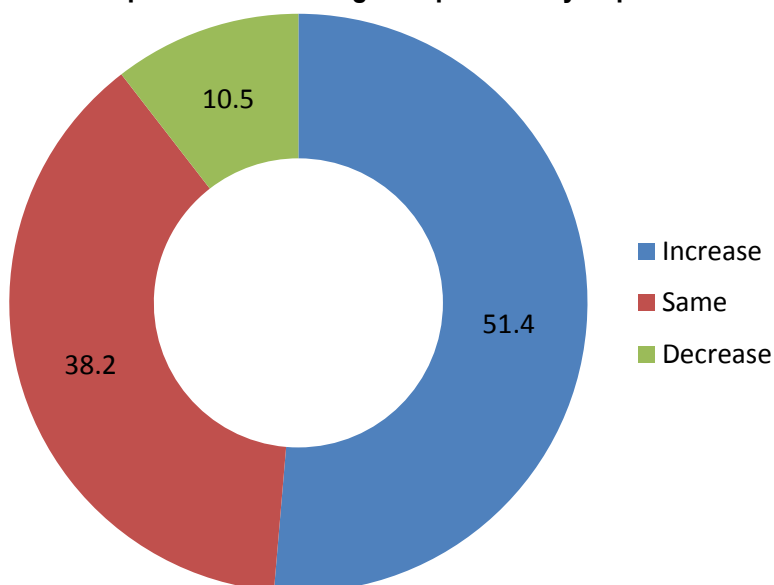
**Sector-wise Profitability Confidence Index**

Sector	Index
Agriculture	59.4
Service	59.7
Industry	56.3

Meanwhile, when entrepreneurs were asked about their opinion on the situation of profitability of their business, 51.4% opined that their business profit would increase in near future and 10.5% said it would decrease.



Respondents' expectation on changes in profitability in percent



## 5. FOREIGN TRADE

In the last fiscal year, Nepal's international trade has increased by around 20%. But, in the six months period of current fiscal year, i.e. 2014/15, the merchandise export has decreased by 3.9% to NRs. 43.39 billion as compared to the same time period in the preceding FY. In this period, export to India has decreased by 8.1%, while export to China and other countries has increased by 16.9% and 3.0% respectively.

The top export products to the third countries were woolen carpet (3.5 billion), readymade garment (2.0 billion) and pashmina (1.3 billion). While top export products to India were zinc sheet (3.1 billion), textiles (2.7 billion), polyester yarn (2.4 billion), jute goods (1.9 billion) and juice (1.7 billion). Export to China is mostly dominant by tanned skin, handicraft products, and woolen carpet.

Similarly, during the same period, merchandise import has increased by 13.3 percent to NRs. 378.22 billion. The import is dominated by China, as import from China grew by 48.1% followed by India at 9.3% and other countries at 8.3%.

The top import products from India were petroleum products (56.5 billion), vehicles & spare parts (20.9 billion), MS billet (15.8 billion), medicine (8.9 billion) and other machinery & parts (8.5 billion). Similarly, top imports from China were telecommunication equipment & parts (8.1 billion), other machinery & parts (4.7 billion), chemical fertilizer (3.9 billion), electrical goods (2.9 billion) and readymade garment (2.8) billion. From other countries, Nepal mainly imports silver (12.9 billion),

crude soyabean oil (6.6 billion), polythene granules (3.6 billion), other machinery and parts (2.9 billion) and crude palm oil (2.7 billion)

The export-import figure shows that Nepal imports more garments products than it exports to the third countries. It also shows that Nepal imports mostly the vehicles, machinery parts and raw materials. The increment in imports has resulted in the trade gap of NRs. 334.83 billion. The export-import ratio has declined to 11.5 in the same period.

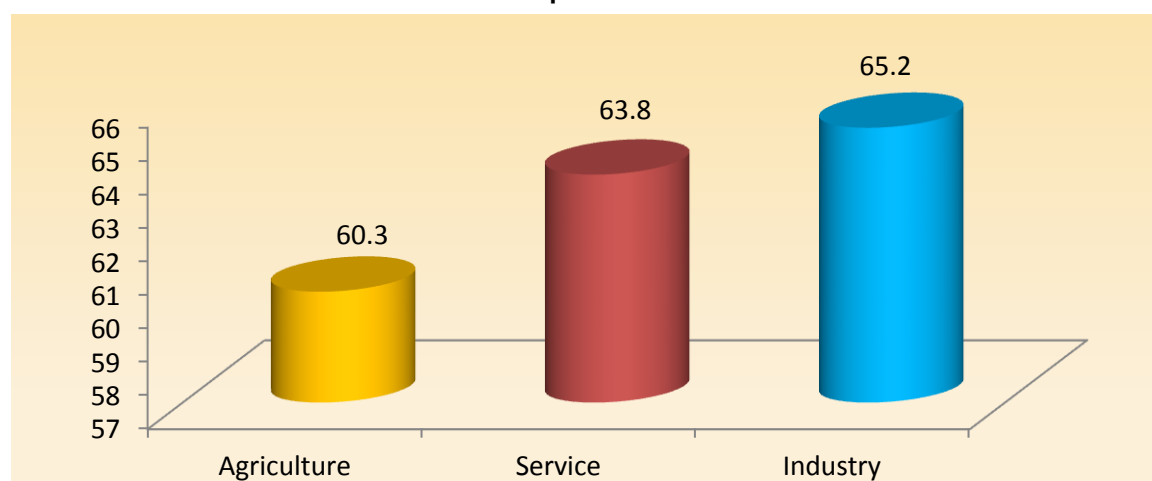
Despite having a favorable market access, Nepal's export performance has been poor, because of various constraints like, limited export product, limited destination, absence of economies of scale, weak and inadequate infrastructure, and other supply-side constraints.

## Export

Despite the weak performance on export trade, the fourth survey revealed that entrepreneurs still have a 'moderate confidence' on export confidence index. The index stood at 64.0. Nevertheless, the confidence has decreased from the last survey, which was at 64.5.

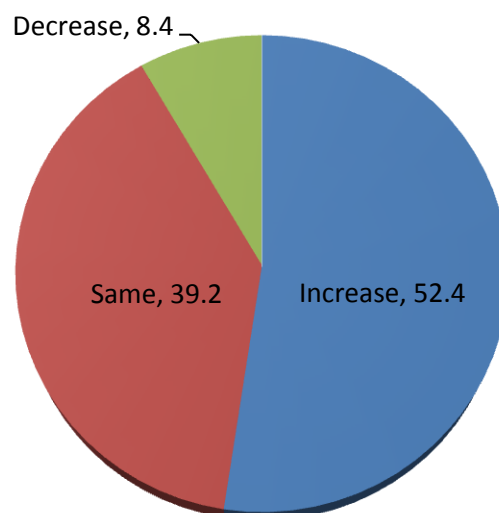
In the sector-wise breakdown, the survey revealed that entrepreneurs involved in the manufacturing sector are more confident of the better export performance followed by service and agriculture sector. The chart below shows the breakdown of export confidence index by these three sectors.

**Sector-wise Export Confidence Index**



When they were asked about their perception on performance of export in near future, 52.4% expected that the export will increase while 8.4% expected it to decrease during the same time. Meanwhile, 50.0% said that the export has remained the same in the last six months

**. Respondents' expectation on changes in export performance in percent**



**Import**

Likewise, the fourth survey also revealed that entrepreneurs have shown a 'moderate confidence' on import confidence index. The index stood at 69.0, which has increased from the previous survey from 68.1.

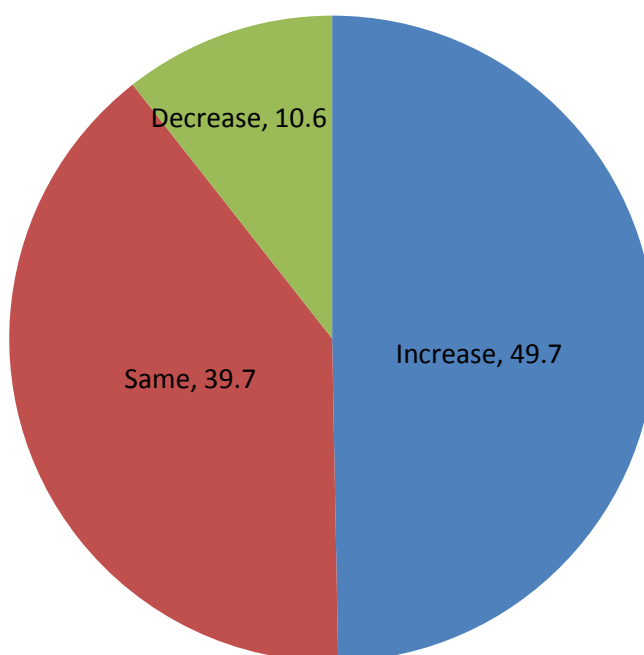
In the sector-wise breakdown, the survey revealed that business people involved in the service sector are more confident on import's performance followed by industry and agriculture sector. The table below shows the breakdown of import confidence index by these three sectors.

**Sector-wise Import Confidence Index**

Sector	Index
Agriculture	62.7
Service	70.1
Industry	67.0

When they were asked about their expectation on import performance in the near future, 49.7% expected that the import will increase while 10.6% expected it to decrease during the same time. Meanwhile, 48.6% said that the import has remained the same in the last six months

Respondents' expectation on changes in import performance in percent



## 6. CHALLENGES OF NEPALESE ECONOMY

Last fiscal year, Nepal recorded the economic growth of 5.2%, which was higher than the growth of last six years' period. Favorable climates, improved investment environment, timely release of budget are attributed for such growth by the Government. For the current fiscal year, i.e. 2014/15, the government has targeted the growth of 6%. But recently the Central Bank of Nepal, during its mid-term monetary policy review, stated that the GDP growth would reach at around 5% only. Both, the World Bank and the Asian Development Bank have forecasted that Nepal's growth will reach around 4.8%. So, it is sure that the government will not achieve its targeted growth for this FY.

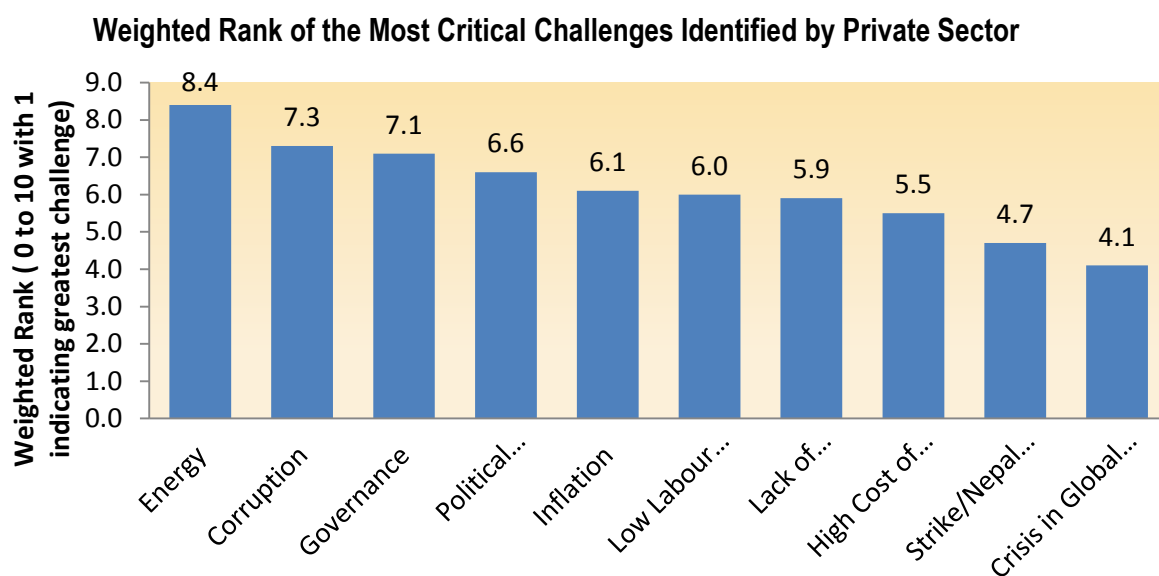
In the past decade, Nepal has not registered a sustained economic growth. The recently published report by the UNCTAD stated that, between 2000 and 2011, the average annual growth rate of real GDP of Nepal was 1.85, which is far lower than that of other LDCs in the South Asian region like Bangladesh (4.58), Cambodia (6.98), Lao PDR (6.86) and Myanmar (11.22) during the same period. This low average economic growth is the major challenge for Nepal in achieving its target of graduation from the LDC status to the Developing Countries status by 2022.

To achieve the high sustained economic growth, Nepal should target private investment (both domestic and international) to improve productivity and competitiveness of the industrial sector. The share of manufacturing sector in the GDP has decreased from a little less than 10 percent in 2000 to 6 percent in 2014. The level of capital expenditure in Nepal is among the lowest in the South Asia region. In 2013/2014, Government was able to use 71.6% of annual budget estimated.

When entrepreneurs were asked to identify the constraints of Nepalese economy, the weighted rank indicates that inadequate supply of energy is the biggest constraint for growth.

It is said that corruption is not just a moral issue but also a powerful inhibitor to economic progress in a poor country like Nepal. Corruption erodes the fairness, accountability and competitiveness. It inflicts added cost on the businesses and the economic development. Entrepreneurs consider that corruption is the second most critical challenges for economic growth in Nepal. Likewise, lack of good governance, political instability and inflation are the top five critical constraints.

The bar chart below shows the rank of the major economic challenges of Nepal. In order to achieve high sustainable economic growth, these challenges should be addressed. Unless, Nepal addresses these problems, it is very challenging for Nepal to achieve a sustained growth.



### Coverage and Methodology

FNCCI's 4th Business Confidence Survey was conducted during the months of November and December 2014. It covers the period of August 2014 to January 2015. A total of 302 responses were received from all over the country. The survey covered all size of enterprises from all three sectors, namely agriculture, industry and services. 55.3% of the respondents were from services sector, 36.4% were from the manufacturing sector and 8.3% were from the agri business sector.

The FNCCI BCI is calculated by converting the qualitative answers given in the survey to quantitative data by assigning points to each response. For each response, 1 point was assigned for

the most optimistic response, 0.5 for an average response, and 0 points for the least optimistic response. The sum of these points is known as the diffusion index. For each question, the diffusion index was calculated.

The BCI for each indicator or category was calculated from the raw diffusion index of that cohort separately. Each question, indicator, or aspect had two parts: evaluation of the current situation and evaluation of future expectations. To calculate the total BCI for each aspect, aggregation was used. The grand aggregate of all individual cases was the final BCI.

In the 1st Confidence Survey, the responses were placed in quartiles to judge the BCI level which is being followed in this survey as well. The quartile is as follows:

<b>Very Low Confidence</b>	<b>BCI &lt;25</b>
<b>Low Confidence</b>	<b>BCI 25-50</b>
<b>Moderate Confidence</b>	<b>BCI 50-75</b>
<b>High Confidence</b>	<b>BCI &gt;75</b>





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