**EXECUTIVE BOARD MEETING**

SM/20/53

February 28, 2020

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| To: | Members of the Executive Board |
| From: | The Secretary |
| Subject: | **Nepal—Staff Report for the 2020 Article IV Consultation** |

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|---|---|
| Board Action: | Executive Directors' **consideration** (Formal) |
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INTERNATIONAL MONETARY FUND

# NEPAL

## STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION

February 27, 2020

## KEY ISSUES

**Context.** Recent strong growth has been supported by greater political stability, more reliable electricity supply, and earthquake reconstruction. Nepal has seen significant poverty reduction, but vulnerabilities remain, exacerbated by climate related shocks. Fiscal federalism is expected to improve service delivery and accountability, though faces challenges from weak capacity of subnational governments.

**Outlook and risks.** For FY2019/20, growth is expected to ease to 6 percent, due to slower growth in India, sluggish remittance inflows, and weaker agricultural production. There has been a welcome narrowing of the current account deficit and stabilization of gross official reserves. Nonetheless, downside risks remain, related to a further slowdown in remittances and the financial-sector.

**Main policy recommendations.** The policy mix should be geared at containing external pressures and protecting financial stability, while preserving fiscal sustainability.

- A neutral fiscal stance—which would entail under-execution of the budget as observed in previous years—would help contain external and domestic pressures. The overall expenditure envelope of subnational governments should be aligned with available funding, with tight limits on any subnational borrowing.

- Credit growth should be kept in check by maintaining macroprudential measures. The central bank should continue to closely monitor asset quality of banks and improve monitoring of concentration risk.

- The interest rate framework should be strengthened to reduce volatility in short-term interest rates.

- The authorities should stand ready to tighten fiscal and macroprudential policies if balance of payments pressures reemerge or if credit growth increases sharply.

- To boost medium-term growth prospects, structural reforms that encourage timely implementation of high-quality investment projects, in particular FDI, are critical.

Approved By
**Anne-Marie Gulde-Wolf (APD) and Maria Gonzalez (SPR)**

Discussions took place in Kathmandu during January 5-17, 2020. The staff team comprised Ms. L. Jaramillo Mayor (Head), Mr. P. Blagrave, Mr. K. Min, Ms. J. Yoo (all APD), Mr. M. Bazarbash (MCM), and was assisted by Mr. L. Breuer (Senior Resident Representative for Bhutan/India/Nepal) and Ms. Dulal (local office). Ms. Mahasandana and Ms. Pandit (both OED) also participated in the mission.
Mr. N. Singh and Mr. K. Rivas (both APD) supported the preparation of this report.

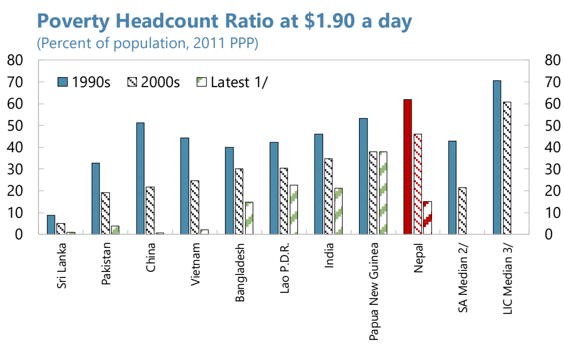
## CONTENTS

**APPENDIX**

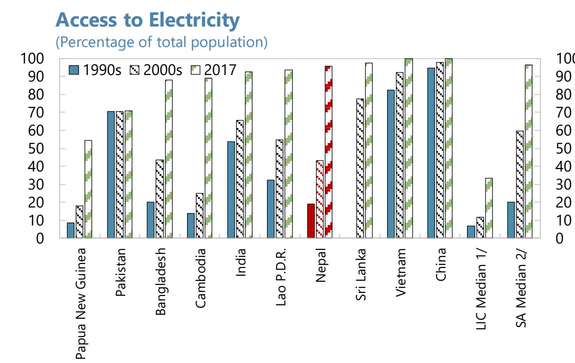
# BACKGROUND

**1. Nepal's recent strong growth performance has been supported by greater political stability, more reliable electricity supply, and earthquake reconstruction.** The single-party government holds a strong majority in Parliament, providing an opportunity for greater political stability and to push reforms that strengthen inclusive growth, which has helped improve the business environment. Electricity imports from India and greater domestic generation have contributed to stable electricity supply and broader access (Text Figure1). Currently, over 90 percent of the population has access to electricity, compared to less than 50 percent a decade ago. Following massive earthquakes in 2015, the National Reconstruction Authority reports that 69 percent of the reconstruction of private housing, schools, health institutions, heritage sites, and government buildings has been completed as of December 2019.[1]

**Text Figure 1. Poverty and Access to Electricity**




Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ Sri Lanka, Vietnam, Bangladesh (2016); Pakistan, China (2015); Lao P.D.R. (2012); India (2011); Nepal (2010); Papua New Guinea (2009).
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.




Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.

**2. Nepal has seen a significant reduction in poverty, but vulnerabilities remain.** The estimated poverty headcount ratio (at the US$1.90 per person per day international poverty line) fell from 15 percent in 2008 to 9.3 percent in 2018 (Text Figure 1). Notwithstanding the declining poverty trend, vulnerability remains high, with 41 percent of the population living on incomes below US$3.20 a day and several development areas still lagging peers (Figure 6). Vulnerabilities are further exacerbated by climate related shocks, such as floods and landslides, as well as other natural disasters such as earthquakes.

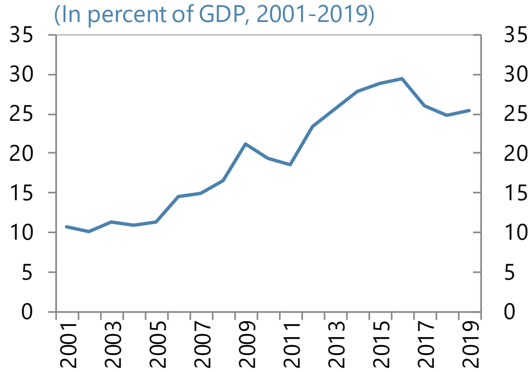
**3. The government's vision is to achieve middle-income country status by 2030.** Under its development plan 'Prosperous Nepal, Happy Nepalis' the authorities are looking to shift the engine of growth from consumption to investment, with plans focused on investments in physical and social infrastructure.

[1] The National Reconstruction Agency estimates the total cost of reconstruction at NPR$630 billion.

**4. Nepal's growth model relies heavily on employment overseas.** Remittance inflows—mainly from Gulf Cooperation Council (GCC) countries, India, and Malaysia—represented 25 percent of GDP in FY2018/19 (Text Figure 2). Remittances have alleviated poverty and unemployment. Household data shows that remittances have boosted consumption of productive goods (such as durable goods, education and health), without discouraging labor supply of remittance-receiving family members (see Selected Issues, Chapter 1). Nevertheless, remittances have also led to real exchange rate appreciation, which can affect competitiveness. Private investment has been insufficient to support adequate job creation and promote productivity growth, weighing down potential growth.

**Text Figure 2. Nepal: Remittances**

**Remittances**
(In percent of GDP, 2001-2019)




Sources: Nepali authorities; and IMF staff estimates.

**Foreign Remittances to Nepal (2016)**

| | Foreign migration share (Percent) | Amount remitted per migrant, annual average (USD) |
|---|---|---|
| India | 30.4 | 609 |
| Malaysia 1/ | 22.3 | 1,889 |
| GCC countries | 41.5 | 1,819 |
| others | 5.8 | 4,534 |

Sources: Nepal Household Risk and Vulnerability Survey - 2016 (World Bank).

1/ Worker migration to Malaysia fell significantly in 2019 but has been recovering after a bilateral agreement in late 2019.

**5. The transition to fiscal federalism is proceeding as mandated by the 2015 constitution, but challenges are monumental.** The shift to federalism was a result of the peace agreement after the decade-long armed conflict. Responsibility for the provision of many public services is being devolved to 7 provincial and 753 local governments. Federalism can improve service delivery and strengthen accountability. However, challenges include spending pressures and weak capacity of subnational governments (SNGs).

# RECENT DEVELOPMENTS, OUTLOOK, AND RISKS

**6. Growth performed well in FY2018/19.** GDP growth increased to 7.1 percent in FY2018/19 (mid-July 2018 to mid-July 2019) from 6.7 percent in FY2017/18, reflecting a rebound in agriculture, earthquake reconstruction, and buoyant tourism. Higher food prices prompted a rise in headline inflation to 6.5 percent in December 2019, compared to 3.7 percent a year earlier.

**7. The current account deficit has been narrowing in recent months, due in part to greater domestic production of electricity and cement.** The current account deficit was 7.7 percent of GDP in FY2018/19, with remittances helping to finance the large trade deficit. During the first months of FY2019/20, the current account deficit narrowed considerably to an estimated 4.3 of GDP, thanks to lower imports of fuel and construction material, reflecting both slowing reconstruction activities and greater domestic electricity and cement production. Exports and FDI inflows remain weak as a share of GDP. Remittances have recently been sluggish because of weak economic performances in major remittance-sending economies. Gross official reserves were at US$8.7 billion in December 2019, remaining adequate at 6.9 months of prospective imports. Nepal's external position in FY2018/19 is assessed as weaker than the level consistent with fundamentals and desirable policy settings (Annex I).[2]

**8. Credit growth to the private sector has moderated but remains elevated as a share of GDP, raising concerns about risks to financial sector asset quality.** Credit growth eased to 14.8 percent (y/y) in December 2019 compared to 25.4 percent (y/y) a year earlier, reflecting regulatory tightening and slowing deposit growth due to sluggish remittances. Nevertheless, credit rose rapidly in recent years to 84 percent of GDP in July 2019, among the highest in its peer group. Official data show that the non-performing loans ratio is at 1.4 percent and all banks are exceeding the regulatory capital adequacy ratio of 11 percent. However, there are risks to asset quality arising from evergreening practices and difficulty in evaluating consolidated exposure to borrowers.[3]

**9. Fiscal policy has been less expansionary than implied by recent budgets due to under-execution of spending.** For the past three fiscal years, budgets featured overall deficit projections of around 8 percent of GDP, incorporating reconstruction spending and higher transfers and revenue sharing with subnational governments. Nevertheless, capacity constraints at the federal and subnational levels led to considerable under-execution and backloading of spending, especially for capital projects, and therefore lower deficits (Text Figure 4). Data for the first months of this FY also show a similar trend of underspending. In FY2018/19, the central government deficit narrowed to 4.6 percent of GDP (from 6.7 percent of GDP in FY2017/18), resulting in a negative fiscal impulse. Public debt is around 30 percent of GDP, implying a low risk of debt distress.

**10. Revenue collection in FY2018/19 was enhanced by upgrades to the tax system.** Several recently enacted measures to improve tax administration and strengthen compliance helped support an increase in revenue collection to 24.8 percent of GDP, from 24.0 percent in FY2017/19.[4] This gain was driven mainly by revenues relating to domestic activity, as import-related revenues remained flat as a share of GDP. Of note, the tax administration expanded its use of digitalization for payments and monitoring, and introduced a Permanent Account Number (PAN) system for tax

[2] The authorities informed staff about restrictions on exchange facilities for non-life insurance payments to India. Staff is seeking further information to conclude an assessment of these from an Article VIII perspective.

[3] Evergreening was highlighted as a major issue in Nepal Rastra Bank (2019), Bank Supervision Report 2018, April 2019.

[4] Recent major reforms to tax administration are outlined in Annex IV.

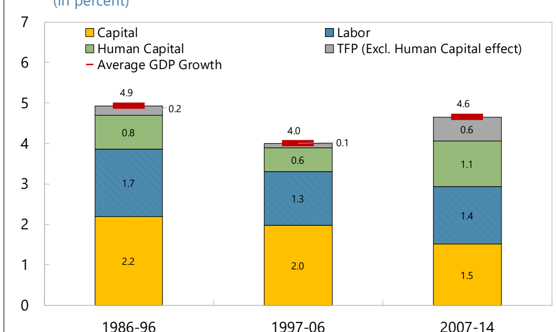
filings. In addition, reforms to customs valuation and adoption of risk-based clearance and an e-payment system will help control revenue leakages. These administrative measures also reduce the opportunities for corruption.

**11. Importantly, the new Integrated Tax System (ITS) will facilitate more prudent risk assessment by banks and strengthen tax compliance.** The ITS is a recently launched on-line portal that contains the financial information provided by corporations in their tax returns. Banks have been mandated by the central bank to cross-check borrower financial statements against the ITS when originating and renewing business loans.[5] Anecdotally, discrepancies between financial information submitted for loan applications and tax purposes have not been uncommon.

**12. In FY2019/20, external headwinds and domestic shocks will contribute to a moderation of growth to 6 percent, and a narrower current account deficit.** The Nepali economy will be negatively affected by the slowdown in India through its extensive exposures in terms of trade and investment, as well as business sentiment. Sluggish remittances growth is also expected to negatively affect the economy. In addition, agricultural sector performance is projected to be weaker this year. Inflation is expected to average around 6 percent, driven by food prices. The current account deficit is forecast to narrow to 5.2 percent of GDP, with foreign exchange reserves stabilizing at US$8.5 billion (6.6 months of prospective imports).

**13. Over the medium-term, growth is expected to ease to 5.3 percent.** Factors supporting above-average growth in recent years—including earthquake reconstruction, building of administrative infrastructure for subnational governments, and worker remittances from GCC countries linked to major infrastructure projects—are expected to wane. Growth prospects are supported by the expected expansion of hydropower and tourism—that would also support exports—and improved government service delivery in the context of fiscal federalism. Nonetheless, production capacity remains constrained by infrastructure gaps and inadequate levels of private investment, and thus a modest contribution of the capital stock to growth (chart). Staff analysis suggests that timely action to improve infrastructure level and quality would boost medium- to long-term growth (see Selected Issues, Chapter 2).[6]

**Contribution to Real GDP Growth**
(In percent)




Sources: Penn World Tables, National data, and IMF staff calculations.

**14. Risks to the outlook are mainly on the downside** (Annex II)**.** A sharp increase in credit growth would renew pressure on the balance of payments and exacerbate financial sector risks. An abrupt slowdown in deposit growth, emanating from disruptions in remittances, could affect

[5] Banks have also been mandated to require that borrowers provide a tax clearance certificate when applying for personal loans.

[6] Annex VI takes stock of staff policy advice from 2017 and 2018.

liquidity and expose loan portfolio weaknesses. Greater government underspending than expected in the baseline poses a downside risk to growth. External risks pertain to a further economic slowdown in India or GCC countries, and higher international oil prices could increase the import bill. Nepal faces a substantial risk from natural disasters, and over the medium-term those relating to climate change (e.g. flooding and landslides) are expected to become more frequent and severe. On the upside, growth could be boosted if tourism activity accelerates, hydropower projects come on stream earlier, or government infrastructure projects are implemented more expeditiously.

***Authorities' Views***

**15. Authorities have a more optimistic medium-term growth outlook than staff, emphasizing favorable export prospects and the role of fiscal federalism.** The authorities underscored that strong growth is critical to their ambition of achieving middle-income-country status by 2030. They recognized external headwinds facing the economy this year. However, they expect growth rates above 8 percent over the medium-term, supported by an expansion of tourism—as international airports in Lumbini and Pokhara are completed and by attracting tourists from different countries—and greater hydropower that will allow for exports to India and Bangladesh. The strategy of bolstering exports would help Nepal maintain strong growth without exerting pressure on the balance of payments. The authorities also anticipate that full implementation of fiscal federalism will stimulate economic activity through better distribution of resources and more efficient delivery of services. supporting more balanced regional development.

# POLICY DISCUSSIONS

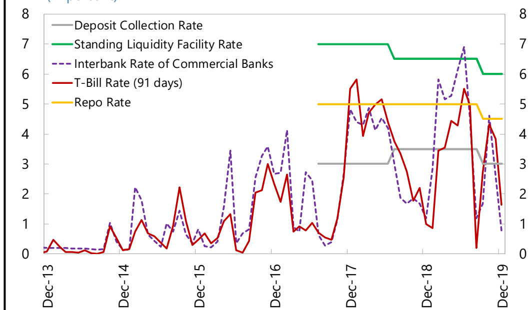
*While the economy has been growing above its long-term average in the last few years, there are signs of moderation, underscored by a welcome narrowing of the current account deficit, stabilization of foreign reserves, and slower credit growth. The policy mix should be geared at containing external pressures and protecting financial stability, while preserving fiscal sustainability. This would be supported by a neutral fiscal stance, and careful management of the transition to fiscal federalism. Credit growth should be kept in check by maintaining macroprudential measures, while actions are taken to build the monetary policy framework and strengthen financial sector supervision. The authorities should nevertheless stand ready to tighten fiscal and macroprudential policies if balance of payments pressures reemerge or if credit growth increases sharply. Expanding Nepal's productive capacity calls for more private investment, including by promoting an enabling implementation environment that allows quality investment projects to move forward in a clear and timely manner.*

## A. Monetary and Exchange Rate Policy

**16. Notwithstanding the exchange rate peg, capital controls imply that there is some limited scope for monetary policy to influence price stability.** Nepal's exchange rate peg to the Indian rupee (1.6 Nepalese rupees per Indian rupee since 1994) provides a credible nominal anchor. At the same time, capital controls provide some limited room for monetary policy to influence domestic prices. Indeed, staff analysis showed that domestic factors play an important role in driving non-food inflation.[7] However, in the context of less developed financial markets and very weak pass-through from the policy rate to markets rates, macroprudential policies have proven to be more effective than the interest rate as a policy tool, by directly affecting the supply of credit.

**17. The interest rate corridor (IRC) has not been effective in stabilizing short-term interest rates.** Deficiencies in the IRC framework—including lack of a standing deposit facility—have resulted in highly volatile short-term rates that often fall below the IRC floor (Annex III).[8] This has undermined the credibility of the IRC and there is no transmission of short-term rates to deposit and lending rates.

**Short-term Interest Rates**
(In percent)




Source: NRB.

**18. There are shortcomings in the autonomy and accountability of the Nepal Rastra Bank (NRB).** Only three out of seven members of the Board are independent. The NRB Act obliges the NRB to follow government directives, and a proposed amendment would allow for dismissal of NRB senior officials if directives are not followed, further weakening the NRB's operational autonomy. Frequent rotation of management and staff undermines capacity building, disincentivizes ownership of key institution-building initiatives, and hampers the implementation of sound internal controls. In addition, the quality of the external audit falls short of international standards and progress on other priority recommendations from the 2018 safeguards monitoring visit has been slow (see Informational Annex).

***Policy Recommendations***

**19. To strengthen the implementation of monetary policy, the NRB needs a well-functioning interest rate framework that reduces volatility in short-term interest rates.** This would allow the NRB to improve financial market development as well as policy signaling and transmission. As a necessary first step, the NRB should introduce a standing deposit facility as a solid floor of the IRC, which would imply a tightening. It can then aim to anchor short-term market rates near the policy rate through regular open market operations. Once the IRC track-record has been firmly established, the NRB can adjust the rates as needed to support the peg and macroeconomic stability objectives. In the meantime, macroprudential policies should continue to be used as necessary, as discussed below, and it is crucial to continue to maintain an adequate level of reserves to preserve the credibility of the peg (Annex I).

**20. Achieving the central bank's mandated price and financial stability objectives requires that operational autonomy go hand in hand with enhanced accountability.** Modernizing the

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[7] See 2019 Selected Issues Paper.

[8] Under the existing framework, liquidity is provided at the request of financial institutions under the standing liquidity facility. However, liquidity absorption through the deposit collection facility and open market operations are at the discretion of the NRB.

NRB governance framework calls for legal amendments to the NRB Act to strengthen independent oversight and safeguard institutional and personal autonomy. Internal controls and the quality of external audit should be enhanced.[9] A prerequisite for success is supportive human resource management. The NRB would benefit from reducing the frequency of rotation of staff—particularly between unrelated business areas that require different skillsets and qualifications— to allow sufficient time for on-the-job training and building expertise, as well as ensuring that training better matches staff responsibilities.

***Authorities' Views***

**21. The authorities agreed that there is scope to improve the functioning of the monetary policy operational framework.** The authorities noted that the IRC framework has been developing gradually as the NRB gains more experience and financial institutions gain familiarity. The NRB is in the process of making the IRC more effective through more active open market operations. The authorities anticipate that the new human resource development plan, which is being finalized, will better support skills building and specialization.

## B. Financial Sector Policies

**22. The NRB has appropriately implemented macroprudential measures to limit the buildup of systemic risk in the financial sector.** Alternative measures suggest that credit growth in 2018 exceeded prudent levels (Text table). However, since late 2018, credit has moderated, as the credit-to-core capital and deposit (CCD) ratio became binding for most banks and the limit on personal overdraft loans was reduced.[10] The recent requirement to cross-check borrowers' financial information against the ITS has also contributed to the moderation of credit growth. Furthermore, a 2 percent countercyclical capital buffer by July 2020 has been mandated and a debt service to income ratio for non-business loans was introduced.

**Nepal: Credit Boom Identification**

| 2018 | Credit Boom |
|---|---|
| Nominal credit and GDP growth | Yes |
| Credit to GDP ratio increase more than 3 percent (GFSR, 2011) | Yes |
| BIS credit gap 1/ | Yes |
| Gourinchas et al (2001) | No |
| Mendoza and Terrones (2008) | Yes |
| Dell'Ariccia et al (2012) | Yes |

Source: Jahan and Sodsriwiboon (Forthcoming).

1/ Red color presents positive credit gap from BIS credit gap approach, as the BIS credit gap does not have a specific criteria for credit boom.

**23.** While official numbers suggest that the non-performing loan ratio is low, there are potentially significant risks to asset quality. A large share of the loan portfolio is revolving in nature, with about 40 percent consisting of overdraft and working capital loans. During on-site inspections, supervisors have uncovered evergreening where firms use revolving loans to make interest

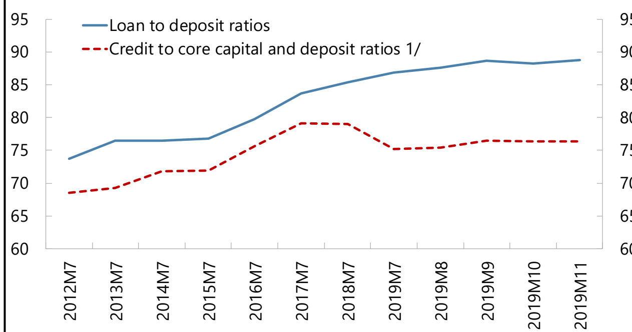
[9] These recommendations are in line with the IMF safeguards assessment (2011, 2016, 2018).

[10] Under the CCD ratio ceiling, banks can provide loans only up to 80 percent of the sum of core capital and deposits. The NRB recently removed interbank borrowing from the CCD calculation, in line with Fund advice, effectively tightening the measure. In August 2018, NRB reduced the limit on personal overdraft loans to Rs.5 million from 7.5 million.

payments. In addition, lack of harmonized group codes across banks constrains their ability to accurately measure the repayment capacity and collateral adequacy of business groups on a consolidated basis. The lack of group codes also hinders the NRB's ability to monitor concentration risk in the financial system. Finally, banks have significant real estate exposures, including through commercial loans collateralized by real estate properties (Text Figure 3). These different risks raise concerns that non-performing loans are understated, provisioning for loan losses is inadequate, and capital adequacy is overstated.

**Bank and Financial Institutions: Loans and Advances**

(Percent of deposits; percent of the sum of core capital and deposits)



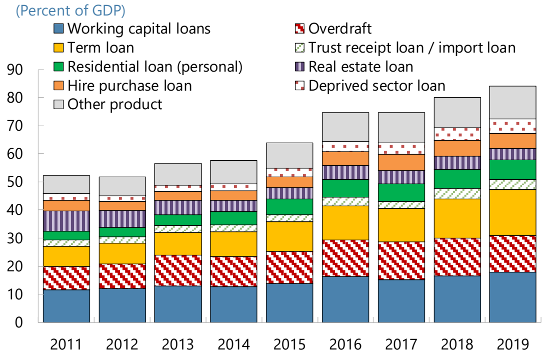

Sources: NRB

Note: 1/ Based on the NRB's defintion in respective year, including the exemptions for the calculations.

**Text Figure 3. Nepal: Bank Loans by Product and Collateral Types**

**Loans and Advances by Product Type**

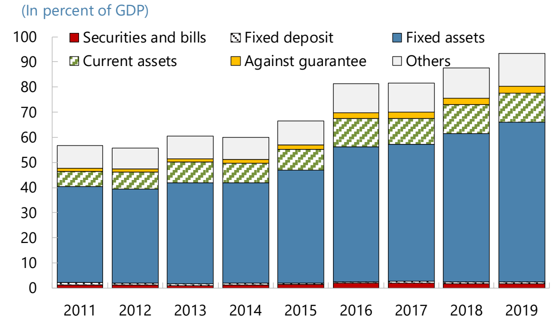
(Percent of GDP)




Sources: NRB (Bank and Financial Institutions Monthly Statistics)

**Loans and Advances by Collateral Type**

(In percent of GDP)




Sources: NRB (Bank and Financial Institutions Monthly Statistics)

Note: Fixed assets include assets that can not be converted into cash easily such as property, plant, and equipment. Others include gold & silver, securities, and credit cards.

**24. The authorities have made progress in strengthening regulation and supervision.** Several elements of the Basel III capital adequacy framework 2015 have been implemented for commercial banks.[11] The NRB has improved its risk-based on-site supervision, with Fund support. The Supervisory Information System (SIS) was launched in its pilot phase in January 2020, which should facilitate timely and reliable collection and analysis of supervisory data. Nonetheless, off-site supervision remains compliance rather than risk-based and frequent rotation of staff hinders capacity development.[12]

**25. Financial inclusion is improving, including through fintech, though challenges remain.** The NRB is actively promoting financial inclusion by mandating an expansion of bank branches to all

[11] These include the Capital Conservation Buffer, Common Equity Capital, and Leverage Ratio.

[12] Annex V takes stock of 2014 FSAP recommendations.

753 localities. Improvements in infrastructure—such as access to more reliable electricity, mobile, and internet networks—have been conducive to fintech payments and greater usage of financial services by individuals (see Selected Issues, Chapter 3). The authorities have also taken measures to promote payments service providers. However, business informality continues to affect access to financing and use of digital services.

***Policy Recommendations***

**26. Macroprudential measures should continue to be strictly enforced to prevent excessive credit growth.** The NRB should resist any relaxation of the CCD ratio and stand ready to tighten it if sharp credit growth resumes. Staff supports the requirement for banks to cross-check corporate borrowers' financial information against the ITS in assessing credit limits, which is expected to foster reliable reporting of financials. The activation of the counter cyclical buffer and introduction of debt-service-to-gross-income limits are welcome.

**27. Asset quality of banks should be closely monitored and evergreening practices curtailed.** To address risks related to revolving loans, the NRB should enforce the requirement that banks regularly review companies' financial statements and adjust credit limits accordingly. Access to financial information in the ITS should help. To better monitor risks related to real estate exposures, the housing price index being developed by the NRB should be finalized promptly.

**28. Measures are needed to enhance monitoring of concentration risk within the financial sector.** NRB should urge the bankers' association to develop a task force, possibly in cooperation with Credit Information Bureau, to harmonize the group codes used to identify the largest 50 business groups. Harmonized group codes should then be included in reporting through the SIS, to facilitate the NRB's analysis of top borrowers.

**29. Further strengthening of risk-based off-site supervision is needed, supported by effective use of the new information system.** This includes improved risk analysis by off-site supervisors of individual banks and the sector, facilitated by the SIS. The NRB should advance in the development of new processes and a new manual of off-site supervision.

**30. Financial inclusion, particularly through fintech, can be further enhanced**. Fintech payments should be encouraged for areas with geographical barriers where bank branches are not economically justified. Actions to enhance digital financial inclusion of businesses include reducing compliance burdens, increasing benefits of using formal services, and raising financial literacy. Policies and regulations should be tailored to support healthy development of the fintech sector.

***Authorities' Views***

**31. The authorities broadly agreed with the need to maintain macroprudential measures and continue to closely monitor the quality of assets in the financial system.** They underscored that the financial sector is sound and credit growth is healthy. The NRB intends to maintain recent regulatory measures, while closely monitoring their impact on credit developments. The authorities will continue to strengthen financial sector oversight, supported by the SIS. The expanded coverage of the Credit Information Bureau and inclusion of the Permanent Account Number in SIS reporting is expected to facilitate monitoring of credit exposure. Payment and settlement systems have also been upgraded with the launch of Real Time Gross Settlement System in November 2019, addressing systemic settlement risks. On financial inclusion, the authorities plan to expand digital banking in remote areas, supplementing the expansion of bank branches to almost all localities.

## C. Fiscal Policy

**32. The FY2019/20 budget again targets an ambitious increase in both revenue and spending, but the effective stance will depend on implementation.** As in prior years, the budgeted tax revenue increase appears overly optimistic compared to the measures described in the budget. Instead, staff projects that tax revenues will remain broadly flat as a share of GDP, as weaker-import related revenues would be offset with revenues derived from domestic activity, in line with outturns so far this FY. Government expenditure is budgeted to be 8 percentage points of GDP higher than last year's outcome. Full implementation of the budget would result in a central government deficit of 8.3 percent of GDP. Nevertheless, reflecting expenditure-implementation-related capacity constraints and a more modest view of revenue mobilization, staff projects a central government deficit of 4.5 percent of GDP (Text Figure 4).

**33. Subnational governments face significant capacity constraints.** SNG budget execution rates averaged only about 60 percent in FY2018/19 (Text Figure 4). Spending is likely to increase in FY2019/20, including because the legal framework for staff hiring is now in place. There is insufficient data on SNG operations, with the financial reporting system yet to be implemented.

***Policy Recommendations***

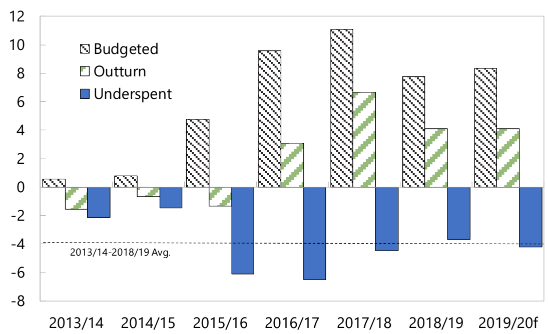
**34. A neutral fiscal stance would help contain external and domestic pressures.** The transition to a federal system reflects a national political compromise and entails a permanent shift up of expenditure to GDP. Nonetheless, total costs are uncertain. In this context, it is important for Nepal to limit overall deficits to levels that keep debt on a sustainable path. Moreover, for the near-term, keeping a neutral fiscal stance will avoid stoking domestic demand and balance of payments pressures. Staff's baseline forecast is consistent with this recommendation. Full execution of budgeted expenditure is unlikely due to capacity constraints and the government's intention to offset revenue shortfalls by curtailing expenditures vis-à-vis the budget.

**35. Budget formulation—at both central and sub-national government levels—should be anchored in a medium-term fiscal framework (MTFF) that is not overly ambitious.** At all levels of government, a top-down budget process and MTFF based on revenue and expenditure assumptions that are not overly optimistic would instill greater prioritization of expenditure plans, prevent dilution of implementation capacity, and avoid creating an unrealistic resource expectations among SNGs (via transfers and revenue sharing). More conservative budgets would also enhance accountability and better support broader macroeconomic management, while helping to shed light on risks and vulnerabilities. In this regard, the central government could consider creating and empowering a macro-fiscal unit to support formulation of the MTFF and budget through macroeconomic and fiscal forecasting, including sensitivity analysis to alternative assumptions and policy scenarios.

**36. Further actions are needed to strengthen the fiscal federalism framework.** Ongoing technical work, with support from the World Bank, to assess the cost of responsibilities devolved to SNGs along with staffing needs is an important step in this regard. Nonetheless, to protect fiscal

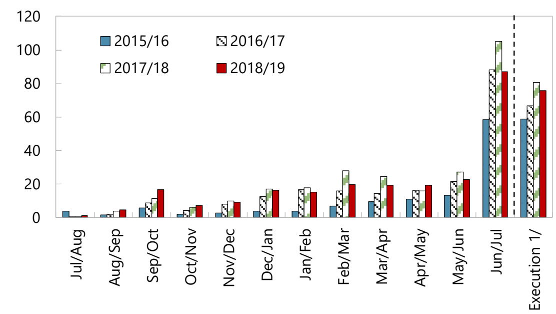
## Text Figure 4. Nepal: Implementation of Government Budget

**Nepal: Central Government Fiscal Deficits**
(Percent of GDP)



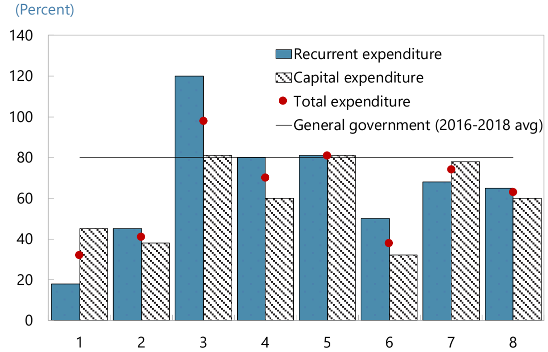

Sources: National authorities, and IMF staff calculations.

**Nepal: Execution of Capital Expenditure, Central Government**
(NPR Billion, or otherwise as indicated)



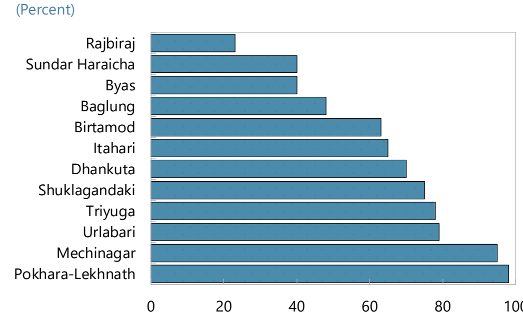

Sources: National authorities, and IMF staff calculations.
1/ Annual execution rate of capital expenditure in percent.

**Nepal: Estimated Budget Execution Rates of Provinces**
(Percent)




Sources: World Bank, *South Asia Economic Focus Fall 2019.*

**Nepal: Execution of Capital Expenditure of Selected Local Governments**
(Percent)




Source: World Bank, *South Asia Economic Focus Fall 2019.*

sustainability, the overall SNG expenditure envelope should be aligned with available funding and tight limits should be set on any subnational borrowing. A robust reporting and monitoring system for SNGs is urgently needed. There also needs to be a clear delineation of roles and responsibilities across levels of government in terms of service delivery and investment-project management to ensure adequate implementation while avoiding duplication.

**37. There remains a need to improve public financial management (PFM) and budget implementation across levels of government.** Adequate government-service provision and sufficient levels of capital spending can only be achieved with a proper PFM architecture in place. In this regard, the recent enactment of the Financial Procedure and Fiscal Responsibility Act to strengthen internal audit practices, alongside recent PFM administration efforts by the Financial Comptroller General's Office, are important steps forward (Annex IV). However, further efforts are needed, including to strengthen the procurement process as discussed below. There is an ongoing need to train staff at the SNG level and ensure that adequate controls and accountability are in place.

***Authorities' Views***

**38. The authorities noted that the budget is used to articulate an ambitious policy agenda, while underscoring the importance of maintaining fiscal discipline.** They view a central government deficit outcome of around 5 percent of GDP as prudent. The authorities acknowledged that import growth this fiscal year has been lower than expected, implying a likely underperformance of associated revenues, and indicated that expenditure will be closely managed to keep the deficit in check. Important progress has been made in establishing the legal framework for fiscal federalism and efforts are underway to examine any duplication of responsibilities and spending across levels of government. In addition, measures were implemented to strengthen capital-spending execution rates and smooth its annual profile, in particular the adoption of a project bank overseen by the National Planning Commission and an action room in the Prime Minister's office for monitoring progress on major projects.

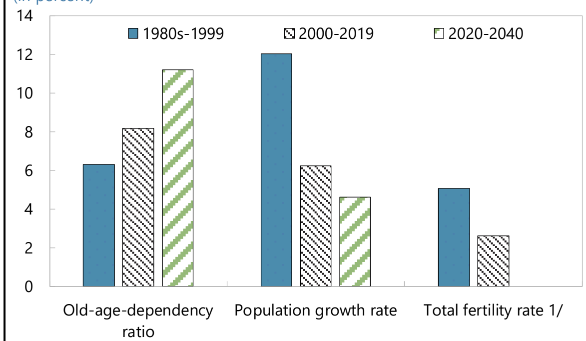
## D. Structural Reforms

**39. Reform efforts in recent years have helped improve the investment climate.** Greater political stability and electricity supply are key structural changes. In the 2020 World Bank Doing Business Report, Nepal's performance improved, though over a longer horizon the improvement has been more modest (see 2018 Article IV).[13]The report highlighted improvements in the Integrated Check Post at the Nepal-India border that reduced the time and cost for cross-border trading and expanded coverage of the Credit Information Bureau that supports greater access to credit.

[13] The Doing Business Report includes scores regarding numerous areas relating to conducting business in a country. Nepal's performance is particularly strong in the areas of obtaining credit and trading across borders, but is weak in the areas of contract enforcement, getting electricity, and ease of obtaining construction permits. Use of these indicators should be considered carefully, as they are derived from perceptions-based data.

**40. Nonetheless, growth is constrained by insufficient infrastructure investment and anemic foreign direct investment (FDI).** Nepal is in the midst of a demographic dividend, with its working-age population expected to continue growing strongly through about 2025 (chart). To better harness the demographic dividend, the private sector must play a larger role in driving economic activity and creating quality jobs. However, noteworthy impediments remain. There are important gaps in the size and quality of the infrastructure network (Text Figure 5, Selected Issues Chapter 2). The process for obtaining all necessary investment-project permits remains cumbersome, often spanning several ministries and involving long approval times, and in some cases a lack of clarity regarding jurisdiction (including between levels of government). In addition, perceptions-based indicators suggest corruption is a significant problem, and that weaknesses in the public procurement process contribute to project under-execution (see 2018 Article IV).

**Nepal: Demographic Trends**
(In percent)

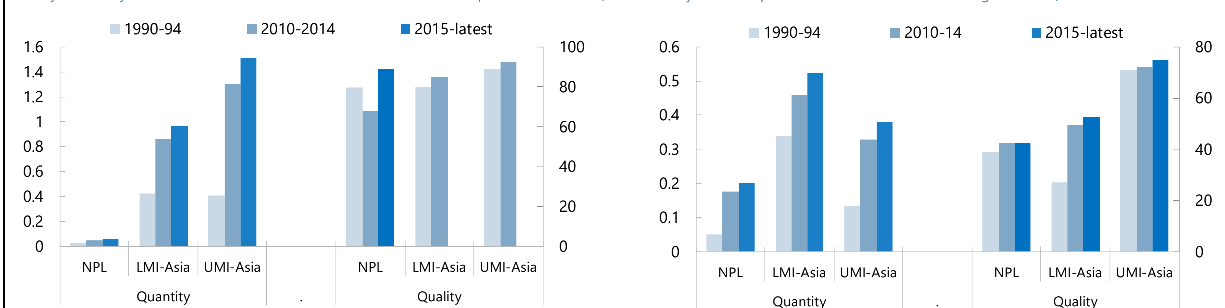



Source: United Nations.
1/ Total fertility rate for 2020-2024 is not available.

### Text Figure 5. Quantity and Quality of Infrastructure

**Utilities Infrastructure**
(Quantity: electricity generating capacity in MW per 1000 workers on LHS
Quality: electricity transmitted & distributed to consumers in % of total production on RHS)

**Transportation Infrastructure**
(Quantity: length of total road network in Km per square Km of land area on LHS
Quality: Share of paved roads in % of total road length on RHS)




Sources: UN Energy Statistics, Nepal Electricity Authority, and IMF staff calculations.

Sources: International Road Federation and staff calculation

Note: LMI- and UMI-Asia refer to simple averages across countries within the group across the relevant period; LMI refers to lower-middle income and UMI refers to upper-middle income.

**41. Efforts to increase compliance with global AML/CFT standards are ongoing, ahead of the 2020/21 review to assess compliance with the global AML/CFT standards, though a mutual evaluation (peer review) program by the Asia Pacific Group.** Nepal's AML/CFT National Strategy and Action Plan was launched in August 2019, with numerous committees tasked with identifying gaps vis-à-vis the Financial Action Task Force prescribed standards. There has been some recent progress towards addressing the highest priority deficiencies, including regarding legislation to clarify penalties for financing of terrorism, though changes have not yet been passed into law.

**42. Although Nepal's contribution to global carbon emissions is miniscule, it is highly vulnerable to climate change.**[14] Owing in part to its heavy dependence on hydropower, Nepal contributed only 0.09 percent of global greenhouse gas emissions (2012). However, rising temperatures, changing weather patterns, and the higher frequency of severe storms brought on by climate change will increase flooding, landslides, and produce greater variation in meltwater flow which feeds hydropower dams. These effects will jeopardize the lives of those living in landslide- and flood-prone areas, as well as the livelihoods of those who are rely on agriculture, which is heavily dependent on steady rainfall for irrigation.

***Policy Recommendations***

**43. There has been some progress on legislative reforms to bolster foreign and private sector investment, but further actions are needed.** Several provisions in the revised Foreign Investment and Technology Transfer Act (FITTA) and the new Public Private Partnership and Investment Act (PPPIA) go in the right direction. These include the establishment of a one-stop service center and a shortening of the approval timeline for projects. However, a very high investment threshold for foreign investors (500,000 USD) undermines efforts to attract FDI to promising small and medium-sized enterprises and should be reduced. A more streamlined approvals process as well as a clearer demarcation of responsibilities between levels of government under fiscal federalism is needed.

**44. To boost foreign investment, new legislation and regulations need to be supported by an enabling implementation environment.** Despite some progress on legislation, the investment situation on the ground appears to be little changed. Responsible ministries have not been equipped to adequately move projects forward, contributing to substantial uncertainty for potential private-sector and foreign investors. Improving implementation capacity requires adequate staffing, better skills matching, and aligning incentives across and within Ministries to ensure high-quality projects move forward in a clear and timely manner.

**45. Further efforts to improve the public procurement process will also strengthen governance.** Recent reforms to public procurement regulations—including a reduction in the up-front project mobilization grant size, more stringent scrutiny of bidding contractors' capacity to deliver, and the introduction of a project pipeline—go in the right direction. However, the ultimate enforcement of these regulations, and project monitoring more generally, lies with the Public Procurement Monitoring Office (PPMO), which is understaffed. More resources should be devoted to the PPMO for hiring staff with expertise in procurement and contract monitoring. Ministries responsible for public construction contracts also need to be more active in tracking project execution, including by maintaining data on projects underway and past performance of contractors.

[14] According to the Global Climate Risk Index—a widely used source for assessing climate risk—Nepal consistently ranks in the top 20 most vulnerable countries globally. The index ranks the climate risk indices of 181 countries every year, taking into account the number of deaths per 100,000 inhabitants attributable to climate-related shocks and the sum of (USD, PPP) property losses.

**46. When formulating its medium-term economic framework, Nepal should factor in policies which support climate-change mitigation and adaptation.** Nepal desires to be on a low-carbon development path. Its emphasis on hydropower as well as the e-mobility guidance—which incentivizes the purchase of electric vehicles through tax exemptions—are welcome steps regarding reducing its carbon footprint. As in most countries, there is a need to build fiscal space and reserve buffers to respond to consequences of extreme weather events, including those attributable to climate change. Adhering to disaster-proof building codes is also critical. Given the substantial resource needs associated with building fiscal buffers in a developing-country context, foreign-grant support must play a key role.

***Authorities' Views***

**47. The authorities underscored their commitment to improving the investment climate in Nepal.** Authorities underscored that efforts to attract FDI and boost private sector investment are being supported by amendments to FITTA and the new PPPI Act. In this regard, last year's Nepal Investment Summit generated many prospective project agreements and concrete spending commitments. Several transportation infrastructure (road, rail) projects are expected to get underway by the end of FY2019/20. In addition, ongoing efforts to improve tax administration and public financial management enhance transparency and governance.

## E. Strengthening Statistics and Building Capacity

**48. Statistics are generally adequate for surveillance, but there is room for improvement.** The ongoing rebasing of national accounts to the new 2010/11 base year (from 2000/01) is a necessary step for SNA2008 compliance. The exercise is expected to result in changes in the composition of GDP, and less so in the GDP level given the scarcity of new information sources. Another GDP rebasing is advisable once new census and survey information is available. The forthcoming dissemination of BOP data according to the BPM6 framework and other improvements to data quality are expected to help reduce large errors and omissions.

**49. Fund capacity development and surveillance have been closely integrated in Nepal, although efforts have had varying degrees of success.** The Fund provides technical assistance and training from HQ, SARTTAC, and the Singapore Training Institute, as well as a MCM long-term financial sector expert based in Kathmandu. In support of the policy priorities in Nepal, capacity development priorities to be covered by the Fund continue to be: (i) financial sector supervision and regulation; (ii) monetary policy framework; (iii) fiscal federalism; (iv) public financial management; and (v) statistics issues on national accounts, government finance statistics, and the external sector. To improve capacity building, less frequent rotation of NRB staff is warranted and officials nominated for training should have job responsibilities aligned with the proposed course.

# STAFF APPRAISAL

**50. Growth is expected to moderate, helping to contain macroeconomic stability risks.** Nepal's recent strong growth performance has been supported by a stable political environment, a more reliable electricity supply, and post-earthquake reconstruction spending. For FY2019/20, growth is expected to ease to 6 percent including because of slower growth in India, sluggish remittance inflows, and weaker agricultural production. Inflation is expected at 6 percent due to high food inflation. In the context of moderating growth, there has been a welcome narrowing of the current account deficit and stabilization of gross official reserves. Credit growth has moderated from very high levels, though credit as a share of GDP remains elevated relative to peers. Nonetheless, downside risks remain, including renewed balance of payments pressures and increase in financial-sector risks if credit growth were to increase sharply or remittances slowdown abruptly. Nepal's external position in FY2018/19 is assessed as weaker than the level consistent with fundamentals and desirable policy settings.

**51. Efforts to prevent excessive credit growth and contain financial-sector risks should continue.** The NRB has appropriately implemented macroprudential measures to limit the buildup of systemic risk in the financial sector. It has also taken actions to further strengthen bank supervision and regulation, including the introduction of a supervisory information system and implementation of selected elements of the Basel III capital framework. The recent regulatory requirement for banks to cross-check corporate borrowers' financial information against the ITS is expected to facilitate more prudent risk assessment by banks. Activation of the countercyclical capital buffer that will require banks to increase their level of capital by July 2020 is appropriate. The NRB should continue to closely monitor asset quality of banks and improve monitoring of concentration risk.

**52. Fiscal policy should be geared towards containing external pressures and protecting fiscal sustainability.** In this regard, a fiscal deficit of 4.5 percent of GDP, similar to the outcome in FY2018/19, would be prudent. Recent upgrades to tax administration are commendable. Staff underscores that a top-down budget process and MTFF based on conservative revenue and expenditure assumptions would instill greater prioritization and would avoid creating unrealistic revenue expectations among SNGs. While important steps have been taken to improve public financial management, further efforts are needed to ensure that spending is of high quality and executed in a timely manner.

**53. The transition to fiscal federalism is a monumental challenge and needs to be carefully managed.** To protect fiscal sustainability, the overall expenditure envelope of SNGs needs to be aligned with available funding, with tight limits on any subnational borrowing. A robust reporting and monitoring system for SNGs is urgently needed. There also needs to be a clear delineation of roles and responsibilities across levels of government to ensure adequate delivery of services and investments.

**54. Strengthening the implementation of monetary policy requires a well-functioning interest rate framework that reduces volatility in short-term interest rates.** Less short-term interest rate volatility would support financial market development and improve policy signaling and transmission. Staff emphasizes the need to introduce a standing deposit facility as a first step towards establishing a reliable implementation track record for the interest rate corridor.

**55. Achieving the central bank's mandated price and financial stability objectives calls for modernizing the NRB governance framework to improve its autonomy and accountability**, Reforms are needed to strengthen independent oversight, safeguard institutional and personal autonomy, and enhance internal controls and quality of external audit, all underpinned by supportive human resource management.

**56. To boost growth prospects, structural reforms that encourage high-quality investment projects, in particular FDI, are critical.** As post-earthquake reconstruction spending draws to a close in coming years, maintaining the recent growth momentum will require an enabling implementation environment for infrastructure projects and FDI. To ensure that high-quality projects move forward in a clear and timely manner, staff encourages authorities to focus on adequate staffing, better skills matching, and aligning incentives across and within government ministries responsible for project approvals, implementation, and subsequent monitoring.

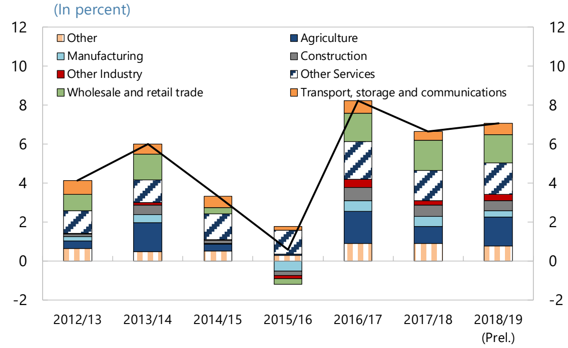
**57. It is proposed that the next Article IV consultation takes place on the standard 12- month cycle.**

## Figure 1: Nepal Recent Macro-Economic Developments

*Growth remained strong in FY2018/19 supported by the pick-up in the agriculture sector, while the service sector remains a key driver for growth.*

### Contribution to Real GDP Growth by Sector

(In percent)

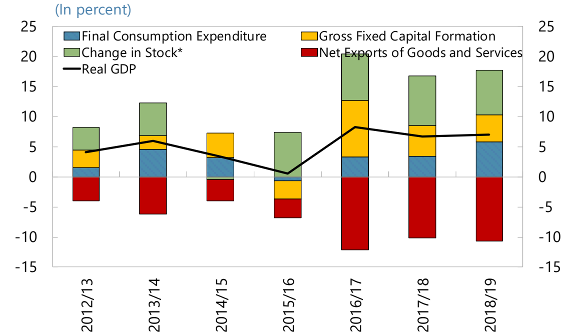



Sources: Nepal Central Bureau of Statistics, and IMF staff calculations.

*On the expenditure side, growth was supported by stronger consumption expenditure.*

### Contribution to Real GDP Growth by Expenditure

(In percent)

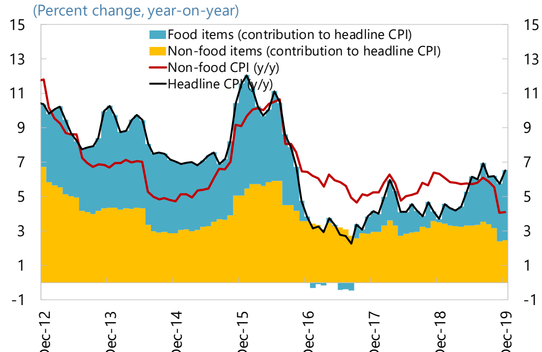



Sources: Nepali Authorities, and IMF staff calculations.
*Includes Statistical discrepancy

*Headline inflation was to 6.5 percent (y/y) in December.*

### Consumer Price Index

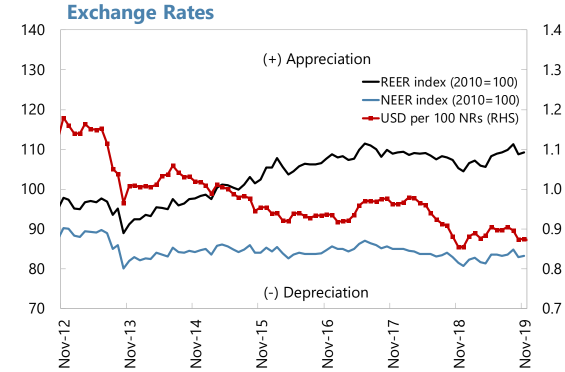
(Percent change, year-on-year)




Sources: Nepali authorities; and IMF staff estimates.

*The REER appreciated by 3.3 percent in Nov. 2019 (y/y).*

### Exchange Rates

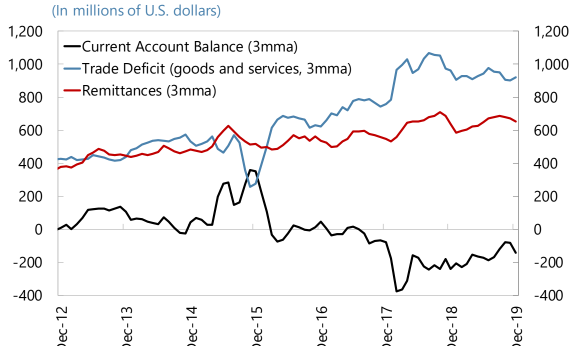



Sources: Nepali authorities; and IMF staff estimates.

*The current account deficit has narrowed in recent months, due in part to lower imports of fuel and construction material.*

### Current Account Balance

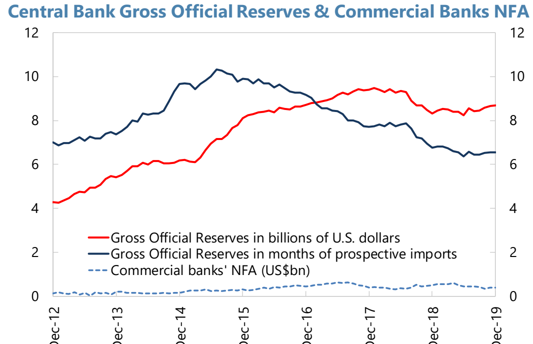
(In millions of U.S. dollars)




Source: Nepali authorities.

*Gross official reserves have stabilized at around US$8.7 billion, covering about 6.9 months of prospective imports of goods and services.*

### Central Bank Gross Official Reserves & Commercial Banks NFA

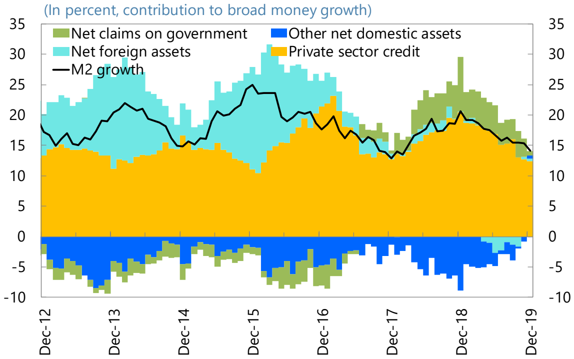



Sources: Nepali authorities; and IMF staff estimates.

## Figure 2. Nepal: Monetary Sector Developments

*Broad money expanded by 14.1 percent (y/y) in December, driven mostly by private sector credit growth.*

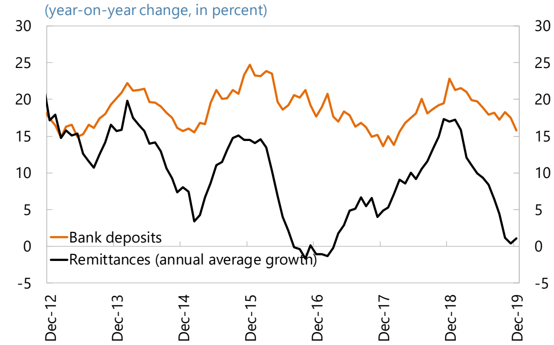
### Broad Money Growth
(In percent, contribution to broad money growth)




Sources: Nepali authorities; and IMF staff estimates.

*Deposit growth was15.7 percent (y/y) in December.*

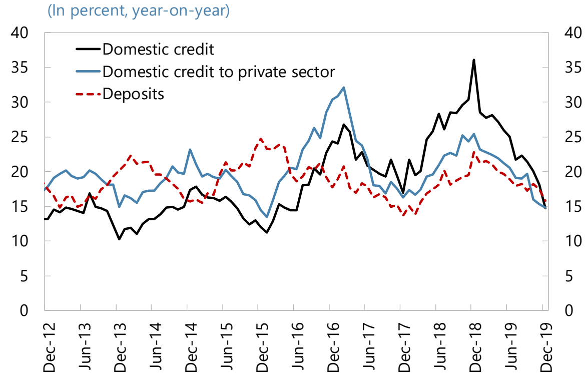
### Bank Deposits and Remittances
(year-on-year change, in percent)




Sources: Nepali Authorities, IMF staff calculations.

*Private sector credit growth slowed to 14.8 percent in December (y/y).*

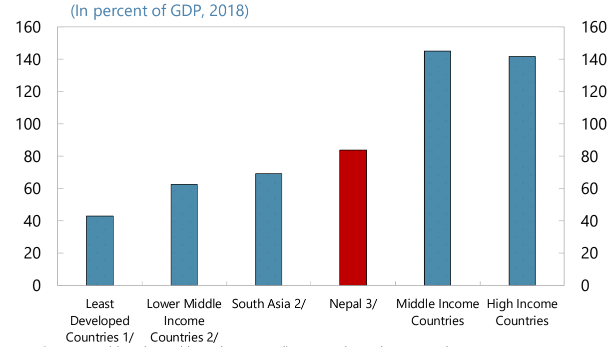
### Deposits and Credit Growth
(In percent, year-on-year)




Sources: NRB and IMF staff calculations.

*The credit-to-GDP ratio in Nepal is among the highest in its peer group.*

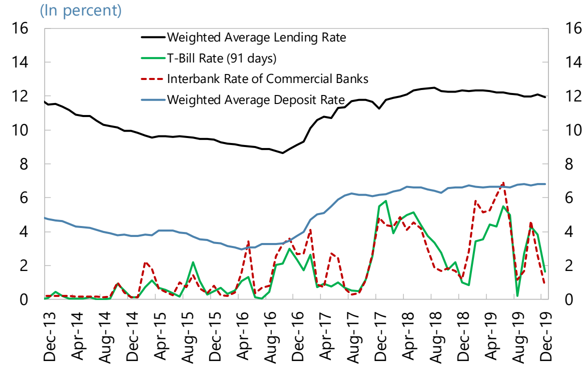
### Domestic Credit Provided by Financial Sector
(In percent of GDP, 2018)




Source: World Bank, *World Development Indicators*, and Nepal Rastra Bank (NRB).
1/ UN Classification.
2/ As of 2017
3/ Nepal data as of July-2019, from the NRB.

*Short-term interest rates showed large volatility in FY2018/19, while deposit and lending rates remained stable.*

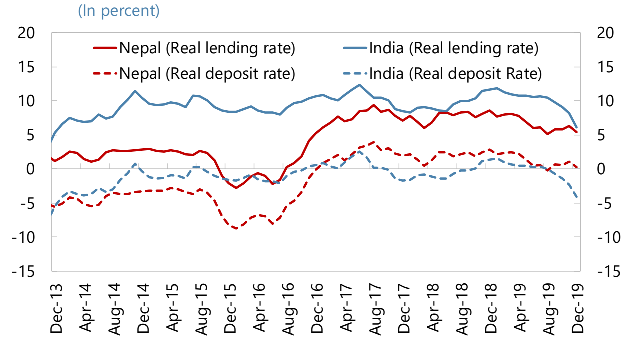
### Interest Rates
(In percent)




Source: NRB.

*The deposit interest rate is near zero in real terms.*

### Real Interest Rates 1/
(In percent)

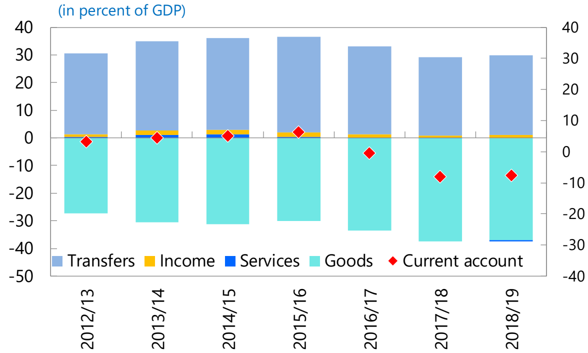



Sources: NRB, CEIC, Haver Analytics, and IMF staff calculations.
1/ Real rates are calculated by subtracting contemporaneous inflation from the nominal rates.

## Figure 3. Nepal: External Sector Developments

*The current account deficit was about 8 percent of GDP for the last two consecutive years…*

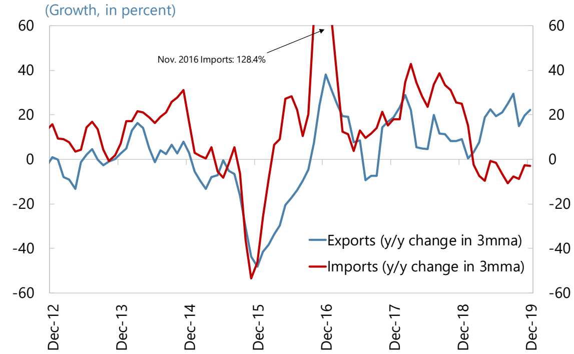
**Current Account**
(in percent of GDP)




Sources: Nepali authorities, and IMF staff estimates.

*…but the trade balance has been improving recently as import growth has declined.*

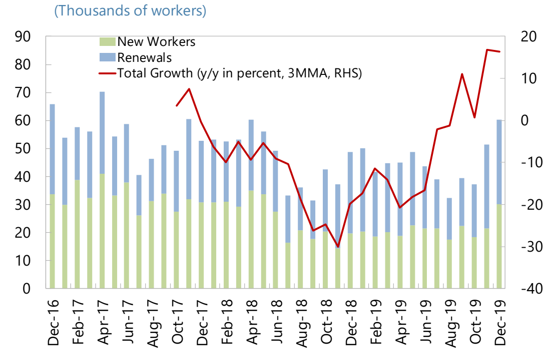
**Exports and Imports**
(Growth, in percent)




Sources: Nepali authorities; and IMF staff estimates.

*The total number of foreign workers (new and renewals) grew by 16.4 percent in December (y/y, 3mma)…*

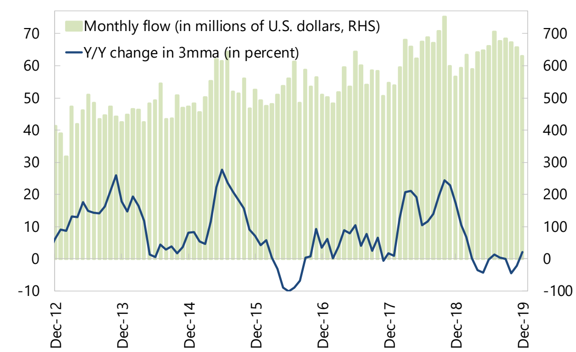
**Total Foreign Employment**
(Thousands of workers)




Sources: Nepali authorities; and IMF staff estimates.

*… while the growth of remittances has slowed in recent months..*

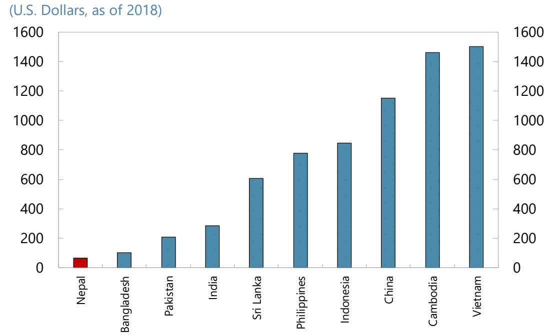
**Remittances**




Sources: Nepali authorities; and IMF staff estimates.

*Attracting FDI flows has been a struggle.*

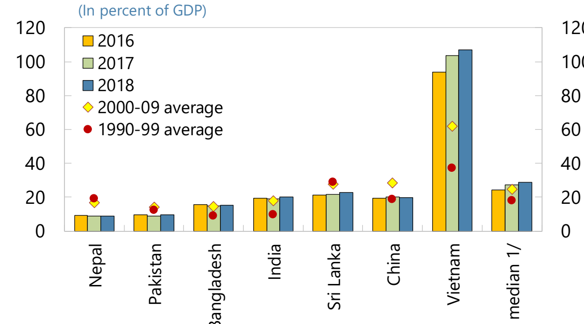
**FDI Stocks Per Capita**
(U.S. Dollars, as of 2018)




Source: UNCTAD.

*Exports contribute little to GDP, and their role has been decreasing over time.*

**Exports of Goods and Services**
(In percent of GDP)

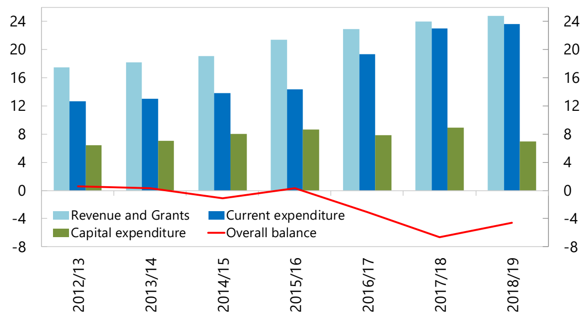



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

## Figure 4. Nepal: Recent Fiscal Developments

*In FY2018/19, the fiscal deficit was 4.6 percent of GDP compared to 6.7 percent of GDP in FY2017/18.*

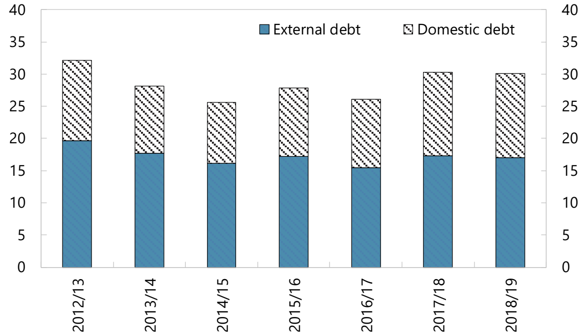
### Central Government Fiscal Performance
(In percent of GDP)




Sources: Nepali authorities; and IMF staff estimates.
Note: Overall balance calculated as total revenue and grants minus expenditure.

*Public debt remained flat at 30 percent of GDP in 2018/19.*

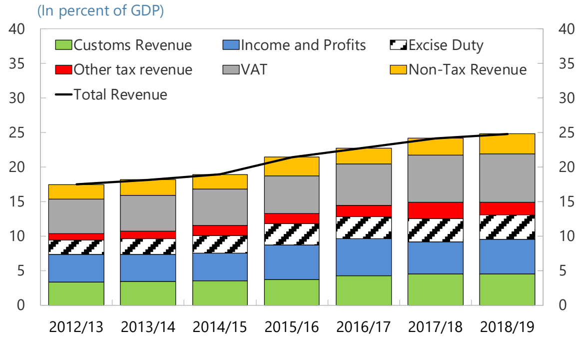
### Public Debt
(In percent of GDP)




Sources: Nepali authorities, and IMF staff estimates.

*In FY2018/19, the chief source of revenue was VAT (7.0 percent of GDP), followed by income tax revenue and customs.*

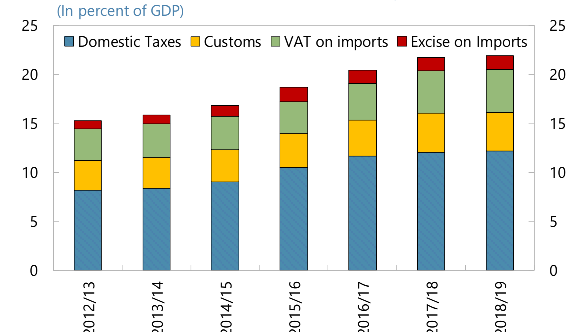
### Central Government Fiscal Revenues (Excl. Grants)
(In percent of GDP)




Sources: Nepali Authorities, and IMF staff estimates.

*Tax collections relating to imports comprise nearly half of total tax revenues.*

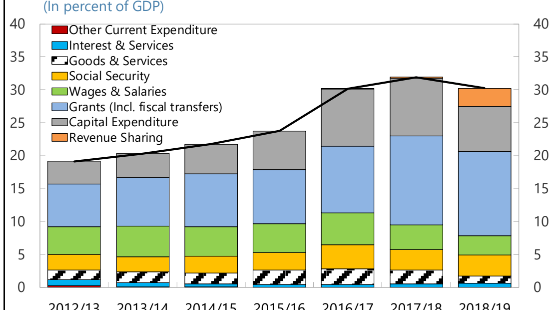
### Central Government Tax Revenue by Source
(In percent of GDP)




Sources: Nepali authorities, and IMF staff calculations.
Note: Domestic taxes are calculated as the residual by subtracting customs, VAT on imports and excise on imports from total tax revenue.

*Expenditure grants were the biggest component of spending in FY2018/19, followed by capital expenditure.*

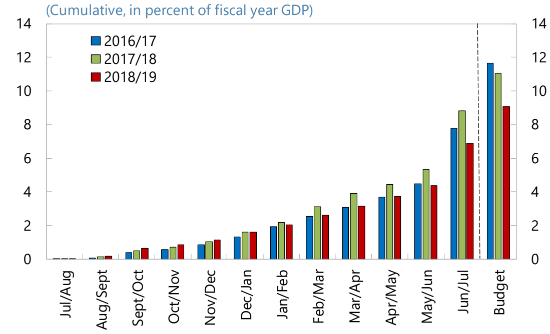
### Central Government Fiscal Expenditure
(In percent of GDP)




Sources: Nepali Authorities, and IMF staff estimates.

*Capital expenditure was 7 percent of GDP in 2018/19*

### Central Government Capital Expenditure
(Cumulative, in percent of fiscal year GDP)

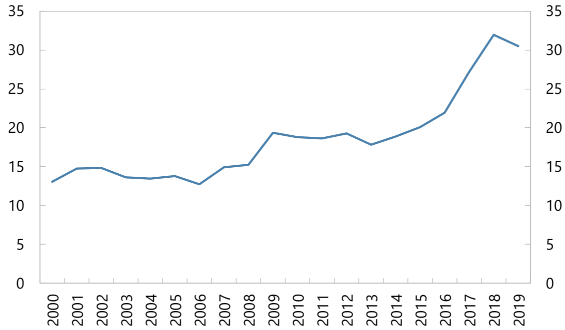



Sources: Nepali Authorities and IMF staff calculations

## Figure 5. Nepal: Cross Country Fiscal Performance

*Government expenditure has risen, in the context of the transition to fiscal federalism.*

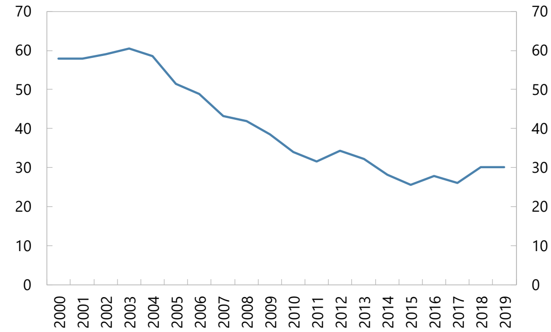
### Nepal: General Government Total Expenditure
(In percent of GDP)




Source: IMF, *World Economic Outlook*.

*Nepal's stock of public debt remains modest, at 30 percent of GDP.*

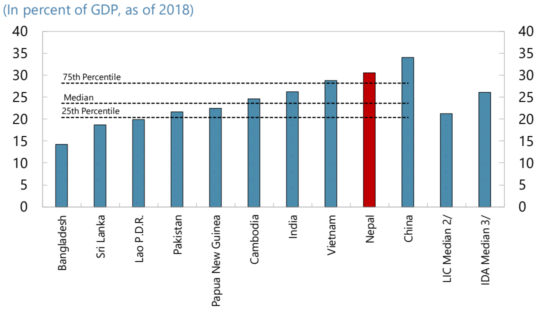
### Nepal: General Government Gross Debt
(In percent of GDP)




Source: IMF, *World Economic Outlook*.

*Relative to peer countries, Nepal's public expenditure is high.*

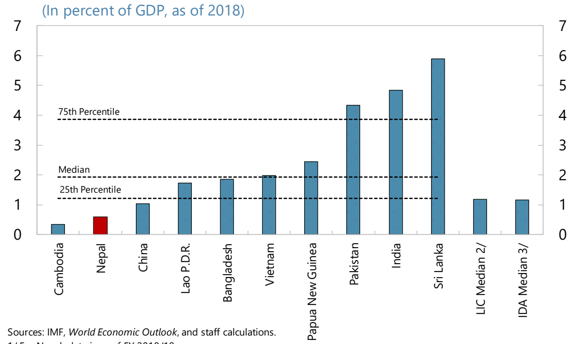
### General Government Total Expenditure 1/
(In percent of GDP, as of 2018)




Sources: IMF, *World Economic Outlook*, and staff calculations.
1/ For Nepal, data is as of FY 2018/19.
2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
3/ IDA: 76 low income countries that are eligible to borrow from the International Development Association (IDA).

*Thanks to its low stock of debt and relatively low interest rates, Nepal's interest expense is modest.*

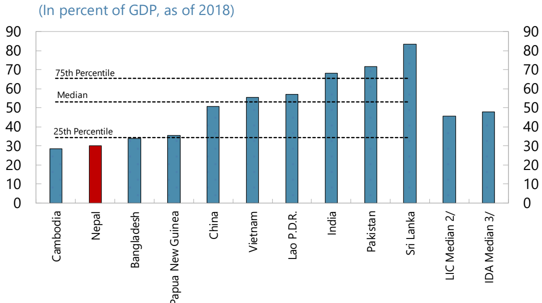
### General Government Interest Expense 1/
(In percent of GDP, as of 2018)




Sources: IMF, *World Economic Outlook*, and staff calculations.
1/ For Nepal, data is as of FY 2018/19.
2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
3/ IDA: 76 low income countries that are eligible to borrow from the International Development Association (IDA).

*Gross debt is considerably lower than in peer countries, and Nepal remains at low risk of debt distress (see also Debt Sustainability Analysis).*

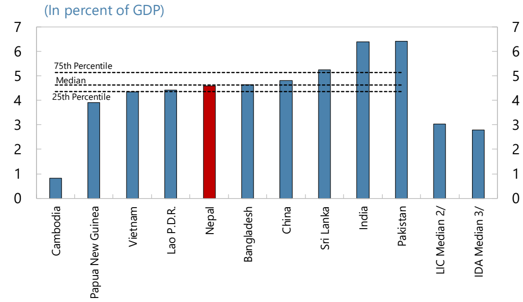
### General Government Gross Debt 1/
(In percent of GDP, as of 2018)




Sources: IMF, *World Economic Outlook*, and staff calculations.
1/ For Nepal, data is as of FY 2018/19.
2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
3/ IDA: 76 low income countries that are eligible to borrow from the International Development Association (IDA).

*Nepal's fiscal deficit is comparable to that in peer countries.*

### General Government Fiscal Deficit 1/
(In percent of GDP)



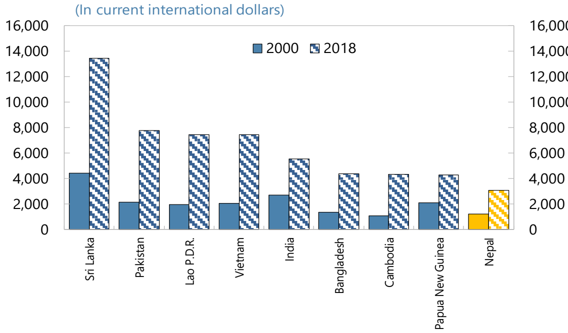

Sources: IMF, *World Economic Outlook*, and staff calculations.
1/ For Nepal, data is as of FY 2018/19.
2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
3/ IDA: 76 low income countries that are eligible to borrow from the International Development Association (IDA).

## Figure 6. Nepal: Socio-Economic Indicators

*Nepal is among the lowest income countries in South Asia.*

### Per Capita GDP (PPP)

(In current international dollars)

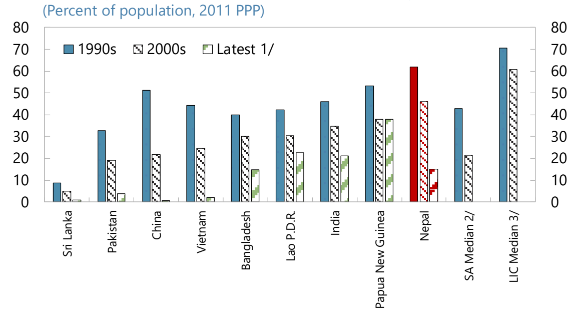



Source: World Bank, *World Development Indicators*.

*Poverty has fallen significantly in the last decade.*

### Poverty Headcount Ratio at $1.90 a day

(Percent of population, 2011 PPP)

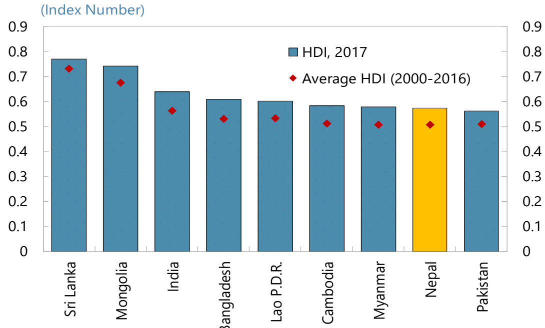



Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ Sri Lanka, Vietnam, Bangladesh (2016); Pakistan, China (2015); Lao P.D.R. (2012); India (2011); Nepal (2010); Papua New Guinea (2009).
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

*The decline in poverty is reflected in an improvement in Nepal's UNDP Human Development Index.*

### Human Development Index (HDI)

(Index Number)

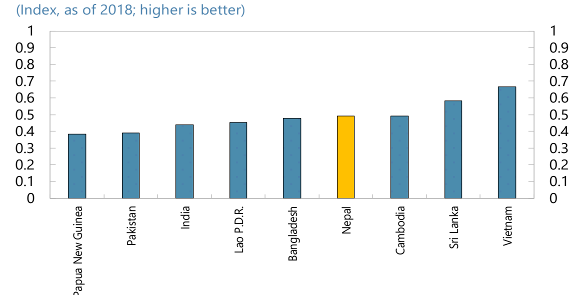



Sources: UNDP, and IMF staff calculations.

*Expected human capital development is somewhat hampered by incomplete education and health factors.*

### Human Capital Index 1/

(Index, as of 2018; higher is better)

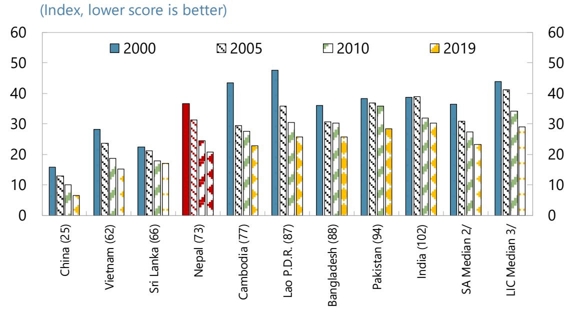



Source: The World Bank, *Human Capital Project*.
1/ Measures the human capital that a child born today can expect to attain by her 18th birthday, given the risks of poor health and poor education in the country where she lives. Units represent productivity relative to a benchmark of complete education and full health, on a scale of 0 to 1.

*There is substantial scope and need to improve poverty metrics, including relating to hunger*

### Global Hunger Index 1/

(Index, lower score is better)

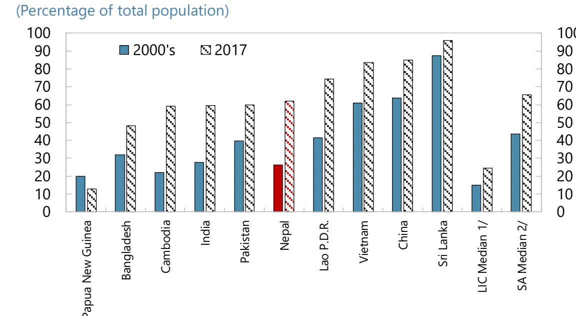



Sources: Global Hunger Index, and IMF staff calculations.
1/ The Global Hunger Index is a multidimensional indicator that captures undernourishment, child wasting, child stunting, and child mortality. Number in parenthesis represents the country's 2019 rank out of 117 countries.
2/ South Asia (SA) includes only India, Nepal, Bangladesh and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

*Substantial gains have been made in sanitation, thought there is scope for further improvement*

### People using at least basic sanitation services

(Percentage of total population)




Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.

## Table 1. Nepal: Selected Social and Economic Indicators, 2016/17–2024/25[1]

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Est. | | | Projections | | | |
| **Output and prices** (annual percent change) | | | | | | | | | |
| Real GDP | 8.2 | 6.7 | 7.1 | 6.0 | 5.7 | 5.5 | 5.4 | 5.3 | 5.3 |
| Headline CPI (period average) | 4.5 | 4.1 | 4.6 | 6.0 | 5.9 | 5.8 | 5.6 | 5.3 | 5.3 |
| Headline CPI (end of period) | 2.7 | 4.6 | 6.0 | 5.9 | 5.8 | 5.7 | 5.5 | 5.3 | 5.3 |
| **Fiscal Indicators: Central Government** (in percent of GDP) | | | | | | | | | |
| Total revenue and grants | 24.1 | 25.3 | 26.0 | 25.8 | 26.0 | 25.8 | 25.5 | 25.6 | 25.5 |
| of which: Tax revenue | 20.7 | 21.1 | 21.9 | 21.9 | 21.8 | 21.6 | 21.4 | 21.3 | 21.4 |
| Expenditure | 27.2 | 31.9 | 30.6 | 30.4 | 30.4 | 30.0 | 29.7 | 29.4 | 29.3 |
| Expenses | 19.4 | 23.0 | 23.6 | 23.1 | 23.1 | 22.9 | 22.7 | 22.7 | 22.8 |
| Net acquisition of nonfinancial assets | 7.8 | 8.9 | 7.0 | 7.3 | 7.3 | 7.1 | 7.0 | 6.7 | 6.5 |
| Operating balance | 4.7 | 2.3 | 2.4 | 2.8 | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 |
| Net lending/borrowing | -3.1 | -6.7 | -4.6 | -4.5 | -4.4 | -4.2 | -4.1 | -3.9 | -3.7 |
| Statistical discrepancy | -1.3 | -3.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net financial transactions | 1.8 | 3.6 | 4.6 | 4.5 | 4.4 | 4.2 | 4.1 | 3.9 | 3.7 |
| Net acquisition of financial assets | 1.4 | -0.7 | 1.7 | 1.6 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Net incurrence of liabilities | 3.2 | 2.9 | 6.3 | 6.1 | 5.3 | 5.0 | 5.0 | 4.8 | 4.6 |
| Foreign | 1.3 | 2.4 | 2.1 | 2.4 | 1.9 | 1.6 | 1.6 | 1.5 | 1.3 |
| Domestic | 1.9 | 0.4 | 4.2 | 3.7 | 3.4 | 3.4 | 3.4 | 3.3 | 3.3 |
| **Money and credit** (annual percent change) | | | | | | | | | |
| Broad money | 15.5 | 19.4 | 15.8 | 13.2 | 11.9 | 11.6 | 11.1 | 10.9 | 10.7 |
| Domestic credit | 20.2 | 26.1 | 21.7 | 17.6 | 15.7 | 14.3 | 13.8 | 13.3 | 13.1 |
| Private sector credit | 18.0 | 22.3 | 19.1 | 15.0 | 13.8 | 12.5 | 12.2 | 12.0 | 12.0 |
| **Saving and Investment** (in percent of nominal GDP) | | | | | | | | | |
| Gross investment | 45.2 | 55.2 | 62.3 | 54.6 | 53.4 | 52.4 | 51.5 | 50.6 | 49.8 |
| Private | 23.6 | 25.8 | 30.0 | 25.1 | 24.4 | 24.0 | 23.5 | 23.3 | 23.0 |
| Central government | 7.8 | 8.9 | 7.0 | 7.3 | 7.3 | 7.1 | 7.0 | 6.7 | 6.5 |
| Change in Stock | 13.8 | 20.5 | 25.3 | 22.2 | 21.7 | 21.3 | 21.0 | 20.6 | 20.2 |
| Gross national saving | 44.8 | 47.1 | 54.6 | 49.4 | 48.5 | 47.6 | 46.8 | 46.0 | 45.3 |
| Private | 41.3 | 46.1 | 53.3 | 47.8 | 47.0 | 46.1 | 45.3 | 44.6 | 44.0 |
| Central government | 3.5 | 1.0 | 1.2 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 |
| **Balance of Payments** | | | | | | | | | |
| Current account (in millions of U.S. dollars) | -93 | -2,350 | -2,369 | -1,760 | -1,832 | -1,963 | -2,104 | -2,215 | -2,323 |
| In percent of GDP | -0.4 | -8.1 | -7.7 | -5.2 | -4.9 | -4.8 | -4.7 | -4.6 | -4.4 |
| Trade balance (in millions of U.S. dollars) | -8,446 | -10,849 | -11,373 | -11,658 | -12,379 | -13,140 | -13,956 | -14,770 | -15,643 |
| In percent of GDP | -33.5 | -37.4 | -37.1 | -34.2 | -33.1 | -32.2 | -31.4 | -30.5 | -29.6 |
| Exports of goods (y/y percent change) | 9.9 | 15.5 | 12.1 | 1.4 | 9.9 | 9.9 | 9.9 | 9.9 | 9.9 |
| Imports of goods (y/y percent change) | 30.0 | 27.4 | 5.4 | 2.4 | 6.5 | 6.5 | 6.5 | 6.2 | 6.3 |
| Workers' remittances (in millions of U.S. dollars) | 6,556 | 7,224 | 7,769 | 8,402 | 8,825 | 9,270 | 9,737 | 10,227 | 10,742 |
| In percent of GDP | 26.0 | 24.9 | 25.3 | 24.7 | 23.6 | 22.7 | 21.9 | 21.1 | 20.3 |
| Gross official reserves (in millions of U.S. dollars) | 9,264 | 9,304 | 8,545 | 8,536 | 8,419 | 8,233 | 8,045 | 7,850 | 7,673 |
| In months of prospective imports | 8.3 | 7.9 | 7.0 | 6.6 | 6.1 | 5.5 | 5.1 | 4.7 | 4.3 |
| **Memorandum items** | | | | | | | | | |
| Public debt (in percent of GDP) | 26.1 | 30.2 | 30.1 | 33.7 | 35.7 | 37.4 | 39.0 | 40.3 | 41.1 |
| Nominal GDP (in billions of U.S. dollars) | 25.2 | 29.0 | 30.7 | 34.1 | 37.4 | 40.8 | 44.5 | 48.4 | 52.9 |
| Nominal GDP (in billions of Nepalese Rupees) | 2,674 | 3,031 | 3,464 | 3,892 | 4,354 | 4,860 | 5,406 | 5,997 | 6,687 |
| Private Sector Credit (in percent of GDP) | 74.7 | 80.6 | 84.0 | 86.0 | 87.5 | 88.2 | 88.9 | 89.8 | 90.2 |
| Exchange rate (NPR/US$; period average) | 106.2 | 104.4 | 112.9 | … | … | … | … | … | … |
| Real effective exchange rate (average, y/y percent change) | 3.6 | 0.2 | -1.4 | … | … | … | … | … | … |

Sources: Nepalese authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

## Table 2. Nepal: Balance of Payments, 2016/17–2024/25[1]

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Est. | | | Projections | | | |
| | | | | (in millions of US dollars) | | | | | |
| **Current account** | -93 | -2,350 | -2,369 | -1,760 | -1,832 | -1,963 | -2,104 | -2,215 | -2,323 |
| Current account (excluding official transfers) | -935 | -2,633 | -2,667 | -2,119 | -2,281 | -2,453 | -2,638 | -2,795 | -2,957 |
| Trade balance | -8,446 | -10,849 | -11,373 | -11,658 | -12,379 | -13,140 | -13,956 | -14,770 | -15,643 |
| Exports, f.o.b. | 774 | 894 | 1,002 | 1,016 | 1,117 | 1,228 | 1,350 | 1,484 | 1,632 |
| Imports, f.o.b. | -9,219 | -11,743 | -12,375 | -12,675 | -13,496 | -14,368 | -15,306 | -16,254 | -17,274 |
| Services (net) | 26 | 18 | -147 | -118 | -104 | -88 | -59 | -35 | -5 |
| Receipts | 1,492 | 1,697 | 1,654 | 1,844 | 2,034 | 2,234 | 2,459 | 2,688 | 2,954 |
| *Of which* : tourism | 552 | 643 | 651 | 729 | 811 | 899 | 992 | 1,093 | 1,211 |
| Payments | -1,466 | -1,680 | -1,801 | -1,962 | -2,138 | -2,322 | -2,518 | -2,723 | -2,959 |
| Income | 294 | 210 | 358 | 398 | 436 | 476 | 519 | 564 | 617 |
| Credit | 490 | 660 | 708 | 786 | 862 | 942 | 1,026 | 1,116 | 1,219 |
| Debit | -196 | -450 | -350 | -389 | -426 | -466 | -507 | -552 | -603 |
| Current transfers | 8,032 | 8,271 | 8,793 | 9,619 | 10,215 | 10,789 | 11,392 | 12,026 | 12,709 |
| Credit, of which: | 8,069 | 8,327 | 8,889 | 9,669 | 10,270 | 10,849 | 11,457 | 12,097 | 12,786 |
| General government | 841 | 283 | 298 | 359 | 449 | 490 | 534 | 580 | 634 |
| Workers' remittances | 6,556 | 7,224 | 7,769 | 8,402 | 8,825 | 9,270 | 9,737 | 10,227 | 10,742 |
| Debit | -37 | -56 | -96 | -50 | -55 | -60 | -65 | -71 | -78 |
| **Financial account** | 255 | 1,344 | 689 | 1,584 | 1,533 | 1,580 | 1,705 | 1,791 | 1,899 |
| Direct investment | 127 | 169 | 115 | 163 | 179 | 195 | 213 | 255 | 306 |
| Portfolio investment | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Other investment (net) | 128 | 1,175 | 573 | 1,421 | 1,354 | 1,385 | 1,492 | 1,536 | 1,594 |
| Of which: Trade credit | 144 | 556 | 427 | 445 | 478 | 514 | 553 | 593 | 637 |
| Official loans | 426 | 764 | 546 | 802 | 684 | 662 | 711 | 695 | 686 |
| **Errors and omissions** | 316 | 1,086 | 839 | 0 | 0 | 0 | 0 | 0 | 0 |
| **Overall balance** | 603 | 249 | -704 | -5 | -107 | -176 | -177 | -186 | -166 |
| | | | | (in percent of GDP) | | | | | |
| **Current account** | -0.4 | -8.1 | -7.7 | -5.2 | -4.9 | -4.8 | -4.7 | -4.6 | -4.4 |
| Current account (excluding official transfers) | -3.7 | -9.1 | -8.7 | -6.2 | -6.1 | -6.0 | -5.9 | -5.8 | -5.6 |
| Trade balance | -33.5 | -37.4 | -37.1 | -34.2 | -33.1 | -32.2 | -31.4 | -30.5 | -29.6 |
| Exports, f.o.b. | 3.1 | 3.1 | 3.3 | 3.0 | 3.0 | 3.0 | 3.0 | 3.1 | 3.1 |
| Imports, f.o.b. | -36.6 | -40.4 | -40.3 | -37.2 | -36.1 | -35.2 | -34.4 | -33.6 | -32.7 |
| Services (net) | 0.1 | 0.1 | -0.5 | -0.3 | -0.3 | -0.2 | -0.1 | -0.1 | 0.0 |
| Receipts | 5.9 | 5.8 | 5.4 | 5.4 | 5.4 | 5.5 | 5.5 | 5.6 | 5.6 |
| Of which: tourism | 2.2 | 2.2 | 2.1 | 2.1 | 2.2 | 2.2 | 2.2 | 2.3 | 2.3 |
| Payments | -5.8 | -5.8 | -5.9 | -5.8 | -5.7 | -5.7 | -5.7 | -5.6 | -5.6 |
| Income | 1.2 | 0.7 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 |
| Credit | 1.9 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 | 2.3 |
| Debit | -0.8 | -1.5 | -1.1 | -1.1 | -1.1 | -1.1 | -1.1 | -1.1 | -1.1 |
| Current transfers | | | | | | | | | |
| Credit, of which: | 32.0 | 28.7 | 29.0 | 28.4 | 27.5 | 26.6 | 25.7 | 25.0 | 24.2 |
| General government | 3.3 | 1.0 | 1.0 | 1.1 | 1.2 | 1.2 | 1.2 | 1.2 | 1.2 |
| Workers' remittances | 26.0 | 24.9 | 25.3 | 24.7 | 23.6 | 22.7 | 21.9 | 21.1 | 20.3 |
| Debit | -0.1 | -0.2 | -0.3 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 | -0.1 |
| **Financial account** | 1.0 | 4.6 | 2.2 | 4.6 | 4.1 | 3.9 | 3.8 | 3.7 | 3.6 |
| Direct investment | 0.5 | 0.6 | 0.4 | 0.5 | 0.5 | 0.5 | 0.5 | 0.5 | 0.6 |
| Portfolio investment | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Other investment (net) | 0.5 | 4.0 | 1.9 | 4.2 | 3.6 | 3.4 | 3.4 | 3.2 | 3.0 |
| Of which: Trade credit | 0.6 | 1.9 | 1.4 | 1.3 | 1.3 | 1.3 | 1.2 | 1.2 | 1.2 |
| Official loans | 1.7 | 2.6 | 1.8 | 2.4 | 1.8 | 1.6 | 1.6 | 1.4 | 1.3 |
| **Errors and omissions** | 1.3 | 3.7 | 2.7 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| **Overall balance** | 2.4 | 0.9 | -2.3 | 0.0 | -0.3 | -0.4 | -0.4 | -0.4 | -0.3 |
| **Memorandum items** | | | | | | | | | |
| Imports (y/y percent change) | 30.0 | 27.4 | 5.4 | 2.4 | 6.5 | 6.5 | 6.5 | 6.2 | 6.3 |
| of which Oil imports (y/y percent change) | 9.0 | 8.9 | 8.7 | 8.4 | 8.4 | 8.5 | 8.6 | 8.6 | 8.7 |
| Exports of G&S (in percent of GDP) | 42.4 | 46.2 | 46.2 | 42.9 | 41.8 | 40.9 | 40.1 | 39.2 | 38.3 |
| Imports of G&S (in percent of GDP) | | | | | | | | | |
| Remittances (y/y percent change) | 4.8 | 10.2 | 7.6 | 8.1 | 5.0 | 5.0 | 5.0 | 5.0 | 5.0 |
| Total external debt (in percent of GDP) | 15.5 | 17.3 | 17.0 | 18.3 | 18.6 | 18.7 | 18.7 | 18.7 | 18.4 |
| Gross official reserves (in mil U.S. dollars) | 9,264 | 9,304 | 8,545 | 8,536 | 8,419 | 8,233 | 8,045 | 7,850 | 7,673 |
| In months of prospective imports | 8.3 | 7.9 | 7.0 | 6.6 | 6.1 | 5.5 | 5.1 | 4.7 | 4.3 |
| As a share of broad money (in percent) | 36.9 | 33.0 | 26.2 | ... | ... | ... | ... | ... | ... |
| Gross foreign exchange reserves (in mil U.S. dollars) 2/ | 10,465 | 10,056 | 9,474 | ... | ... | ... | ... | ... | ... |
| In months of prospective imports | 9.4 | 8.5 | 7.8 | ... | ... | ... | ... | ... | ... |
| In months of current imports | 11.8 | 9.0 | 8.0 | ... | ... | ... | ... | ... | ... |
| Nominal GDP (in mil U.S. dollars) | 25,181 | 29,040 | 30,690 | 34,081 | 37,382 | 40,847 | 44,498 | 48,374 | 52,868 |

Sources: Nepalese authorities; and IMF staff estimates and projections.

1/ Fiscal year ends in mid-July.

2/ The authorities define gross foreign exchange reserves as follows: Gross official reserves -Gold/SDR/IMF reserve position + Bank/financial institutions' reserves

## Table 3. Nepal: Reserve Money and Monetary Survey, 2016/17–2024/25[1]

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|
| | | | | Projections | | | | | |
| | (In billions of Nepalese rupees, end-period) | | | | | | | | |
| **Nepal Rastra Bank** | | | | | | | | | |
| Reserve money | 657 | 710 | 699 | 703 | 710 | 709 | 714 | 717 | 722 |
| Net domestic assets | -296 | -308 | -237 | -284 | -284 | -283 | -276 | -268 | -261 |
| Claims on public sector | -82 | -49 | -29 | -25 | -24 | -24 | -24 | -24 | -24 |
| Claims on private sector | 4 | 5 | 4 | 6 | 7 | 7 | 8 | 8 | 9 |
| Claims on banks & financial institutions | 7 | 12 | 23 | 26 | 27 | 27 | 27 | 27 | 27 |
| Other items (net) | -225 | -277 | -234 | -290 | -293 | -293 | -287 | -280 | -273 |
| Net foreign assets | 953 | 1,018 | 936 | 987 | 994 | 992 | 990 | 986 | 983 |
| **Monetary Survey** | | | | | | | | | |
| Broad money | 2,592 | 3,094 | 3,582 | 4,054 | 4,536 | 5,062 | 5,626 | 6,240 | 6,908 |
| Narrow money | 569 | 669 | 727 | 807 | 903 | 1,008 | 1,120 | 1,248 | 1,382 |
| Quasi-money | 2,022 | 2,425 | 2,855 | 3,247 | 3,633 | 4,054 | 4,506 | 4,992 | 5,527 |
| Net domestic assets | 1,577 | 2,040 | 2,597 | 3,022 | 3,497 | 4,024 | 4,590 | 5,209 | 5,881 |
| Domestic credit | 2,156 | 2,719 | 3,309 | 3,891 | 4,504 | 5,148 | 5,856 | 6,632 | 7,504 |
| Credit to public sector | 159 | 276 | 399 | 545 | 695 | 862 | 1,048 | 1,248 | 1,471 |
| *of which* : Credit to central government | 128 | 236 | 346 | 484 | 624 | 781 | 956 | 1,144 | 1,353 |
| Credit to private sector | 1,997 | 2,443 | 2,910 | 3,346 | 3,809 | 4,286 | 4,808 | 5,384 | 6,033 |
| Other items(net) | -579 | -679 | -712 | -870 | -1,007 | -1,124 | -1,266 | -1,423 | -1,623 |
| Net foreign assets | 1,015 | 1,054 | 985 | 1,032 | 1,039 | 1,038 | 1,035 | 1,031 | 1,028 |
| | (Twelve-month percent change) | | | | | | | | |
| Reserve money | 20.1 | 8.1 | -1.5 | 0.6 | 0.9 | -0.1 | 0.7 | 0.5 | 0.6 |
| Broad money | 15.5 | 19.4 | 15.8 | 13.2 | 11.9 | 11.6 | 11.1 | 10.9 | 10.7 |
| Net domestic assets | 22.4 | 29.4 | 27.3 | 16.3 | 15.7 | 15.1 | 14.1 | 13.5 | 12.9 |
| Domestic credit | 20.2 | 26.1 | 21.7 | 17.6 | 15.7 | 14.3 | 13.8 | 13.3 | 13.1 |
| Credit to public sector | 57.5 | 73.7 | 44.2 | 36.7 | 27.5 | 24.1 | 21.6 | 19.1 | 17.9 |
| Credit to private sector | 18.0 | 22.3 | 19.1 | 15.0 | 13.8 | 12.5 | 12.2 | 12.0 | 12.0 |
| Net foreign assets | 6.1 | 3.9 | -6.6 | 4.8 | 0.7 | -0.1 | -0.2 | -0.5 | -0.3 |
| **Memorandum items** | | | | | | | | | |
| Private credit (in percent of GDP) | 74.7 | 80.6 | 84.0 | 86.0 | 87.5 | 88.2 | 88.9 | 89.8 | 90.2 |
| Net Foreign Assets, NRB (in percent of GDP) | 35.6 | 33.6 | 27.0 | 24.6 | 21.4 | 18.6 | 16.3 | 14.2 | 12.6 |
| Nominal GDP (in billions of Nepalese Rupees) | 2,674 | 3,031 | 3,464 | 3,892 | 4,354 | 4,860 | 5,406 | 5,997 | 6,687 |

Sources: Nepalese authorities; and IMF staff estimates and projections.
1/ Fiscal year ends in mid-July.

## Table 4. Nepal: Central Government Operations, 2016/17–2024/25[1]

| | 2016/17 | 2017/18 | 2018/19 | | | 2019/20 | | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | | | Budget | Rev. Budget | Proj. | Budget | Proj. | Projections | | | | |
| | (In billions of Nepalese rupees) | | | | | | | | | | | |
| **Total revenue and grants** | 645 | 766 | 1,004 | 907 | 901 | 1,170 | 1,006 | 1,132 | 1,254 | 1,381 | 1,533 | 1,707 |
| Total revenue | 613 | 727 | 946 | 860 | 860 | 1,112 | 959 | 1,068 | 1,183 | 1,304 | 1,449 | 1,614 |
| Tax revenue | 554 | 640 | 838 | 777 | 759 | 1,009 | 851 | 951 | 1,052 | 1,157 | 1,280 | 1,432 |
| Non-tax revenue | 59 | 87 | 107 | 83 | 101 | 103 | 108 | 118 | 132 | 147 | 169 | 182 |
| Grants | 32 | 39 | 59 | 47 | 42 | 58 | 47 | 64 | 70 | 77 | 84 | 93 |
| **Expenditure** | 727 | 968 | 1,274 | 1,158 | 1,059 | 1,496 | 1,182 | 1,322 | 1,456 | 1,604 | 1,765 | 1,956 |
| Recurrent expenditure | 519 | 697 | 960 | 885 | 818 | 1,088 | 898 | 1,004 | 1,111 | 1,226 | 1,363 | 1,522 |
| *Of which*: Interest payments | 10 | 16 | 26 | 26 | 21 | 27 | 23 | 30 | 36 | 44 | 53 | 62 |
| Salaries and allowances | 119 | 112 | 117 | 117 | 100 | 145 | 116 | 130 | 145 | 156 | 173 | 193 |
| Grants & subsidies | 244 | 198 | 171 | 168 | 121 | 178 | 132 | 144 | 148 | 160 | 177 | 197 |
| Fiscal transfer | … | 212 | 328 | 270 | 322 | 334 | 327 | 366 | 408 | 454 | 504 | 562 |
| Revenue sharing 2/ | … | … | 114 | 102 | 97 | 131 | 124 | 139 | 154 | 169 | 187 | 207 |
| Capital expenditure | 209 | 271 | 314 | 273 | 242 | 408 | 284 | 318 | 345 | 378 | 402 | 435 |
| Operating balance | 126 | 69 | 45 | 21 | 84 | 82 | 108 | 128 | 143 | 155 | 170 | 185 |
| Net lending/borrowing | -83 | -202 | -269 | -251 | -158 | -326 | -176 | -190 | -202 | -223 | -232 | -249 |
| Statistical discrepancy | -35 | -92 | 0 | -22 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net financial transactions | 48 | 109 | 269 | 230 | 158 | 326 | 176 | 190 | 202 | 223 | 232 | 249 |
| Net acquisition of financial assets | 37 | -22 | 97 | 94 | 59 | 99 | 62 | 39 | 43 | 48 | 53 | 59 |
| Foreign | 3 | 4 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Domestic (net) | 34 | -26 | 97 | 94 | 58 | 99 | 62 | 39 | 43 | 48 | 53 | 59 |
| Sale of equity | 17 | 45 | 58 | 56 | 42 | 63 | 43 | 26 | 29 | 32 | 36 | 40 |
| Lending minus repayment | 26 | 19 | 39 | 37 | 17 | 36 | 19 | 12 | 14 | 15 | 17 | 19 |
| Change in cash/deposit | -9 | -89 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net incurrence of liabilities | 85 | 87 | 366 | 324 | 217 | 425 | 238 | 229 | 245 | 271 | 285 | 309 |
| Foreign | 35 | 74 | 229 | 187 | 71 | 271 | 93 | 81 | 80 | 88 | 87 | 88 |
| Domestic | 50 | 13 | 137 | 137 | 146 | 155 | 145 | 148 | 165 | 184 | 198 | 221 |
| | (In percent of GDP, unless otherwise indicated) | | | | | | | | | | | |
| **Total revenue and grants** | 24.1 | 25.3 | 29.0 | 26.2 | 26.0 | 30.1 | 25.8 | 26.0 | 25.8 | 25.5 | 25.6 | 25.5 |
| Total revenue | 22.9 | 24.0 | 27.3 | 24.8 | 24.8 | 28.6 | 24.6 | 24.5 | 24.4 | 24.1 | 24.2 | 24.1 |
| Tax revenue | 20.7 | 21.1 | 24.2 | 22.4 | 21.9 | 25.9 | 21.9 | 21.8 | 21.6 | 21.4 | 21.3 | 21.4 |
| Non-tax revenue | 2.2 | 2.9 | 3.1 | 2.4 | 2.9 | 2.6 | 2.8 | 2.7 | 2.7 | 2.7 | 2.8 | 2.7 |
| Grants | 1.2 | 1.3 | 1.7 | 1.3 | 1.2 | 1.5 | 1.2 | 1.5 | 1.4 | 1.4 | 1.4 | 1.4 |
| **Expenditure** | 27.2 | 31.9 | 36.8 | 33.4 | 30.6 | 38.4 | 30.4 | 30.4 | 30.0 | 29.7 | 29.4 | 29.3 |
| Recurrent expenditure | 19.4 | 23.0 | 27.7 | 25.6 | 23.6 | 28.0 | 23.1 | 23.1 | 22.9 | 22.7 | 22.7 | 22.8 |
| *Of which*: Interest payments | 0.4 | 0.5 | 0.8 | 0.8 | 0.6 | 0.7 | 0.6 | 0.7 | 0.7 | 0.8 | 0.9 | 0.9 |
| Salaries and allowances | 4.4 | 3.7 | 3.4 | 3.4 | 2.9 | 3.7 | 3.0 | 3.0 | 3.0 | 2.9 | 2.9 | 2.9 |
| Grants & subsidies | 9.1 | 6.5 | 4.9 | 4.8 | 3.5 | 4.6 | 3.4 | 3.3 | 3.1 | 3.0 | 3.0 | 3.0 |
| Fiscal transfer | … | 7.0 | 9.5 | 7.8 | 9.3 | 8.6 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 | 8.4 |
| Revenue sharing | … | … | 3.3 | 3.0 | 2.8 | 3.4 | 3.2 | 3.2 | 3.2 | 3.1 | 3.1 | 3.1 |
| Capital expenditure | 7.8 | 8.9 | 9.1 | 7.9 | 7.0 | 10.5 | 7.3 | 7.3 | 7.1 | 7.0 | 6.7 | 6.5 |
| Operating balance | 4.7 | 2.3 | 1.3 | 0.6 | 2.4 | 2.1 | 2.8 | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 |
| Net lending/borrowing | -3.1 | -6.7 | -7.8 | -7.3 | -4.6 | -8.4 | -4.5 | -4.4 | -4.2 | -4.1 | -3.9 | -3.7 |
| Statistical discrepancy | -1.3 | -3.0 | 0.0 | -0.6 | 0 | 0 | 0 | 0 | 0 | 0 | 0 | 0 |
| Net financial transactions | 1.8 | 3.6 | 7.8 | 6.6 | 4.6 | 8.4 | 4.5 | 4.4 | 4.2 | 4.1 | 3.9 | 3.7 |
| Net acquisition of financial assets | 1.4 | -0.7 | 2.8 | 2.7 | 1.7 | 2.6 | 1.6 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Foreign | 0.1 | 0.1 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Domestic (net) | 1.3 | -0.8 | 2.8 | 2.7 | 1.7 | 2.5 | 1.6 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Sale of equity | 0.6 | 1.5 | 1.7 | 1.6 | 1.2 | 1.6 | 1.1 | 0.6 | 0.6 | 0.6 | 0.6 | 0.6 |
| Lending minus repayment | 1.0 | 0.6 | 1.1 | 1.1 | 0.5 | 0.9 | 0.5 | 0.3 | 0.3 | 0.3 | 0.3 | 0.3 |
| Change in cash/deposit | -0.3 | -3.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net incurrence of liabilities | 3.2 | 2.9 | 10.6 | 9.3 | 6.3 | 10.9 | 6.1 | 5.3 | 5.0 | 5.0 | 4.8 | 4.6 |
| Foreign | 1.3 | 2.4 | 6.6 | 5.4 | 2.1 | 7.0 | 2.4 | 1.9 | 1.6 | 1.6 | 1.5 | 1.3 |
| Domestic | 1.9 | 0.4 | 4.0 | 4.0 | 4.2 | 4.0 | 3.7 | 3.4 | 3.4 | 3.4 | 3.3 | 3.3 |
| **Memorandum items** | | | | | | | | | | | | |
| Primary balance | -2.7 | -6.1 | -7.0 | -6.5 | -4.0 | -7.7 | -3.9 | -3.7 | -3.4 | -3.3 | -3.0 | -2.8 |
| Public debt | 26.1 | 30.2 | … | … | 30.1 | … | 33.7 | 35.7 | 37.4 | 39.0 | 40.3 | 41.1 |
| External | 15.5 | 17.3 | … | … | 17.0 | … | 18.3 | 18.6 | 18.7 | 18.7 | 18.7 | 18.4 |
| Domestic | 10.6 | 12.9 | … | … | 13.1 | … | 15.4 | 17.1 | 18.8 | 20.3 | 21.6 | 22.6 |
| Resources for sub-national governments (billions of Nepalese Rupees) | … | … | 442 | 372 | 420 | 465 | 451 | 505 | 562 | 623 | 691 | 768 |
| (in percent of GDP) | … | … | 12.8 | 10.7 | 12.1 | 11.9 | 11.6 | 11.6 | 11.6 | 11.5 | 11.5 | 11.5 |
| Nominal GDP (billions of Nepalese Rupees) | 2,674 | 3,031 | 3,464 | 3,464 | 3,464 | 3,892 | 3,892 | 4,354 | 4,860 | 5,406 | 5,997 | 6,687 |

Sources: Nepalese authorities; and IMF staff estimates and projections.

1/ Fiscal year ends in mid-July.

2/ 30 percent of VAT and domestic excise revenues are shared with sub-national governments.

**Table 5. Nepal: Financial Soundness Indicators, 2013/14–2018/19[1]**

| | 2013/14 | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 |
|---|---|---|---|---|---|---|
| | | | (in percent) | | | |
| **Capital adequacy** | | | | | | |
| Capital to risk weighted assets | 13.4 | 12.6 | 12.2 | 12.9 | 14.7 | 14.1 |
| Tier 1 capital to risk weighted assets | 11.8 | 11.0 | 10.4 | 11.4 | 13.4 | 12.8 |
| **Asset quality** | | | | | | |
| NPLs to total loans | 1.9 | 2.5 | 2.1 | 1.5 | 1.4 | 1.3 |
| Loan loss provision to total loans | 2.4 | 2.9 | 2.7 | 2.2 | 2.1 | 1.9 |
| **Earnings and profitability** | | | | | | |
| Return on equity (ROE) | 28.2 | 26.9 | 28.0 | 17.8 | 18.8 | 15.0 |
| Return on assets (ROA) | 1.7 | 1.5 | 1.5 | 1.8 | 1.8 | 1.6 |
| Interest income to gross income | 83.4 | 82.6 | 78.9 | 78.7 | 79.7 | 84.5 |
| Non-interest expenditures to gross income | 18.3 | 18.9 | 21.1 | 19.4 | 17.9 | 15.2 |
| Employees expenses to non-interest expenditures | 43.1 | 44.6 | 45.0 | 46.4 | 48.4 | 50.8 |
| **Liquidity** | | | | | | |
| Liquid assets to total assets | 25.3 | 24.4 | 24.7 | 23.0 | 19.3 | 18.4 |
| Liquid assets to total deposits | 30.4 | 29.2 | 29.4 | 26.9 | 23.5 | 22.8 |
| **Exposure to real estate** | | | | | | |
| Share of real estate and housing loans | 16.1 | 15.1 | 14.9 | 14.9 | 14.2 | 13.4 |
| Share of loans collateralized by land and buildings | 50.9 | 51.7 | 52.5 | 59.9 | 59.1 | 59.7 |

Source: Nepalese authorities.

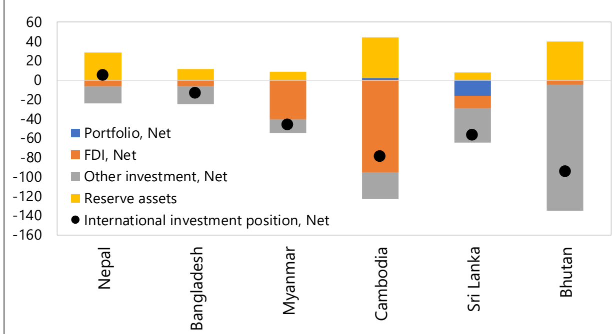
1/ Data for "A" class commercial banks, excluding state owned banks. Data presented as at the end of the fiscal year (i.e. in mid-July for the year indicated).

# Annex I. External Sector Assessment

*Nepal's external position in 2018/19 is assessed to be weaker than the level consistent with medium-term fundamentals and desirable policy settings. Nepal's large current account deficit reflects high imports due to earthquake reconstruction and strong domestic demand. Nonetheless, the current level of foreign reserves is assessed to be adequate and the net international investment position is stronger than in regional peers, supporting the peg to the Indian rupee. Prudent macroeconomic policies are advised to safeguard medium-term external sustainability.*

**1. Nepal's international investment position (IIP) is stronger than regional peers.** Nepal's net IIP stood at US$1.4 billion (4.8 percent of GDP) as at mid-July 2019. Central bank reserve assets exceed public external debt. External liabilities related to foreign direct investment (FDI) are rather small owing to Nepal's weak business climate which has held back private investment. However, there has been a sharp decline in Nepal's IIP over the last two fiscal years (a 65 percent decrease). A continuation of this trend, combined with higher FDI as the business climate improves, could bring Nepal's net IIP to negative territory. Nonetheless, Nepal is at present a net creditor, therefore there are no immediate sustainability concerns.

**Regional Peers: International Investment Position 1/**
(In percent of GDP)




Sources: Nepali authorities and IMF staff calculations.
1/ July-2019 for Nepal, end-2018 for the other countries.

**2. Nepal's external position is assessed to be weaker than the level consistent with medium-term fundamentals and desirable policy settings:**

- The EBA-lite current account model[1] [2] indicates that Nepal's current account is weaker than the current account norm. The current account deficit continued at 7.7 percent of GDP in FY2018/19, reflecting high imports due to earthquake reconstruction and strong domestic demand. Remittances—a quarter of GDP—helped to finance the large trade deficit. This compares with a current account norm of a deficit of 3.8 percent of GDP in FY2018/19. The model indicates a CA-gap of between -2.8 to -4.8 percent of GDP. Assuming an elasticity of the trade balance with respect to changes in the REER of -0.18, this indicates that the REER would need to depreciate between 15 to 27 percent to close the current account gap.

[1] https://www.imf.org/en/Publications/WP/Issues/2019/03/19/The-External-Balance-Assessment-Methodology-2018-Update-46643

[2] These models were applied using mid-2019 data for Nepal and end-2018 data for other countries.

- The EBA-lite IREER model indicates that Nepal's real effective exchange rate (REER) is overvalued compared to the equilibrium REER: By mid-July 2019, Nepal's REER is estimated to be 21 percent more appreciated than the equilibrium REER derived from a panel regression for 126 countries.

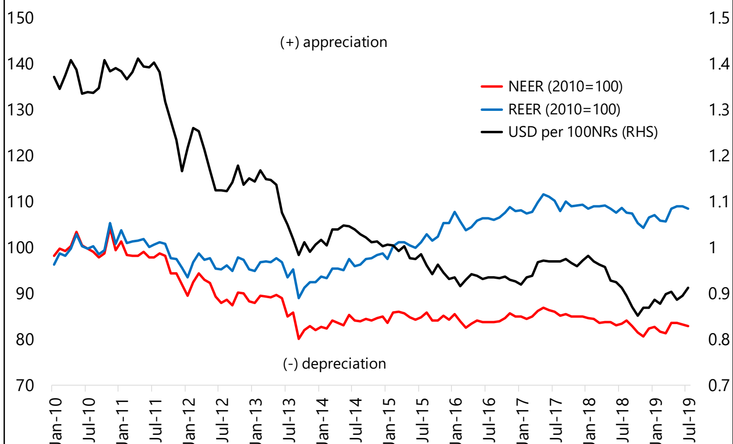
- However, large positive net errors and omissions suggest that the current account deficit and the REER gaps are likely overestimated. Positive net errors and omissions in the balance of payments have been persistent and amounted to 2.7 percent of GDP in FY 2018/19.

**The results of EBA-lite models**

| | |
|---|---|
| **EBA-lite-CA** | |
| CA actual | -7.7% |
| CA norm 1/ | -3.8% |
| CA gap | -3.8% |
| of which Policy ga | -2.6% |
| REER gap | 21.8% |
| | |
| **EBA-lite-IREER** | |
| In(REER) actual | 4.67 |
| Ln(REER) norm | 4.46 |
| REER gap | 20.9% |
| of which Policy ga | 3.8% |

Source: IMF staff estimates.
1/ Multilaterally consistent cyclically adjusted CA norm.

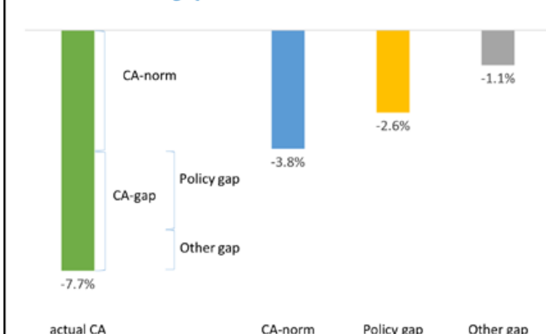
**Exchange rate, NEER and REER**




Sources: Nepali authorities and IMF staff calculations.

3. **The EBA-lite models illustrate that Nepal's weak external position is closely associated with expansionary monetary/financial policies.** The current account gap (-3.8 percent of GDP) can be attributed to (1) an estimated policy gap (-2.6 percent of GDP, 70 percent of CA-gap) and (2) other gap (residual, -1.1 percent of GDP, 30 percent of CA-gap). This suggests that prudent monetary and financial policies would help safeguard Nepal's medium-term external sustainability.

**Actual CA vs. CA gap**




Sources: IMF staff estimates.

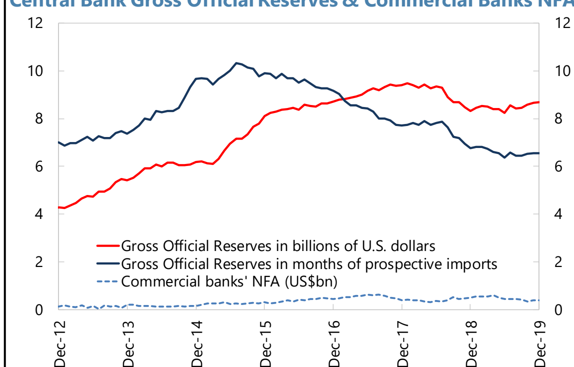
4. **Nepal's competitiveness is affected by structural impediments, in addition to real exchange rate appreciation.** Nepal is landlocked country and relies heavily on India for ground transportation with the rest of the world. Two-thirds of trade is with India and all oil imports are from India. According to the trade treaty with India, Nepal can settle trade with India in Indian rupees and foreign direct investment from India can be made in Indian rupees. In this context, the peg to the Indian rupee reduces exchange rate uncertainty for trade and investment with its major trading partner. Nevertheless, the real appreciation of Nepali rupee against the Indian rupee can

impact Nepal's competitiveness. Moreover, private investment and exports are held back by the infrastructure gap, red tape, and product and labor market frictions.

5. **Capital flows consist mostly of concessional loans and trade credit.** FDI comprised only 0.4 percent of GDP in FY2018/19, as a result of restrictions and complexity of the current approval system. Nepal's capital account remains mostly closed, therefore portfolio flows are negligible. In FY2018/19, official loans declined reflecting delays in project implementation. Trade credits fell slightly.

6. **Despite their decline, the level of gross official reserves remains adequate.** Nepal's central bank reserves fell to US$8.5 billion at mid-July 2019 from a peak of US$9.5 billion in mid-January 2018. The IMF's tool for assessing reserve adequacy in credit-constrained economies (ARA-CC)[3] suggests that the current level of Nepal's foreign exchange reserves—equivalent to about 7 months of prospective imports of goods and services and 28 percent of broad money—is adequate.[4] Reserves have been stabilizing in recent months, thanks in part to greater domestic electricity and cement production. Although current account deficits would narrow somewhat over the medium term, gross official reserve coverage is expected to decline to 4.3 months of prospective imports by FY2024/25.

**Central Bank Gross Official Reserves & Commercial Banks NFA**




Sources: Nepali authorities; and IMF staff estimates.

**Regional comparison of Reserve indicators, 2018**

| | Months of imports of G&S 1/ | Percent of Exports of G&S | Percent of M2 | Percent of GDP |
|---|---|---|---|---|
| Indonesia | 7 | 58 | 30 | 12 |
| Malaysia | 6 | 41 | 23 | 28 |
| Philippines | 7 | 86 | 31 | 24 |
| Singapore | 6 | 46 | 43 | 78 |
| Thailand | 9 | 62 | 33 | 41 |
| Sri Lanka | 3 | 35 | 16 | 8 |
| Myanmar | 3 | 34 | 13 | 8 |
| Mongolia | 5 | 43 | 44 | 27 |
| Lao P.D.R. | 1 | 12 | 8 | 4 |
| Cambodia | 5 | 48 | 46 | 41 |
| Vietnam | 2 | 19 | 14 | 23 |
| Median | 5 | 43 | 30 | 24 |
| **Nepal (Sep 2019)** | 6.4 | 281 | 27 | 25 |

Sources: IMF, WEO: and staff estimates.
1/ In months of prospective imports of goods and services.

[3] See "Guidance Note: Assessing Reserve Adequacy in Credit-Constrained Economies" November 2015

[4] Nepal is assessed to be "credit constrained" for the purpose of this exercise given that it does not regularly borrow from international capital markets and is not rated to be "investment grade." According to this methodology, Nepal's economic classification is non-resource rich, and the exchange rate regime is fixed. This methodology calculates the benefits of reserves and balances them against the assumed cost of holding reserves (6.2 percent), which provides an estimate of the adequate level of reserves of 3.6 months of prospective imports of goods and services. In this calculation, most recent ones or 5-year projections were used for Nepal's economic indicators including potential real GDP growth rate of 5 percent. Modifying the ARA metric to include a buffer given Nepal's high vulnerability to natural disasters (lowering the growth rate by 2 percentage points to 3 percent, based on estimates in Nepal's 2015 Staff Report on the request for disbursement under the Rapid Credit Facility), increases the adequate level of reserves to 4.2 months of prospective imports of goods and services.

## Annex II. Risk Assessment Matrix[1/]

| Source of Risk | Location of Source | Relative Likelihood | Time Horizon | Expected Impact | ***Main Impacts*** **→ Recommended Policy Actions** |
|---|---|---|---|---|---|
| Large swings in energy prices | External | H | ST, MT | M | *Mixed effects: higher international oil prices could put pressure on the current account through higher oil import bills and rising inflation, but may improve external employment prospects for Nepali migrants, strengthening remittance inflows*<br>→ Continue developing hydroelectric capacity to lessen dependence on oil imports; tighten stance of fiscal policy |
| Rising protectionism and retreat from multilateralism | External | H | ST, MT | L | *While a slowdown of global economic activity and more volatile global financial conditions may affect Nepal's major trading partners and Nepal's oversea employment host countries, Nepal's low export base and closed capital account will likely limit the spillovers.*<br>→Maintain sound policy frameworks, including improving the investment climate to reduce dependence on remittance inflows. |
| Cyber-attacks | External | L | ST, MT | M – H | *Safeguards monitoring report (2018) identified significant vulnerability to cyber risks at the NRB, due to weak IT infrastructure and practices. This risk also exists within commercial banks.*<br>→In the broader context of overall strengthening of NRB capacity, such as efforts to improve governance and organizational setup, focus also on enhancing capacity in the NRB's IT department. |
| Excessively expansionary monetary policy | Domestic | M | ST, MT | H | *A sharp increase in credit growth would add to demand growth and BOP pressures and increase the buildup of financial sector risks.*<br>→Tighten macroprudential policies to contain credit growth. |
| Financial sector vulnerabilities, exposed by waning remittances | Domestic | M | ST, MT | H | *A slowdown in deposit growth, emanating from waning remittance inflows and associated softening of real estate prices, could affect liquidity and expose existing loan-portfolio weaknesses.*<br>→Exercise supervisory, corrective, and sanctioning powers more forcefully, including through more pro-active risk-based supervision. |
| Weaker-than-expected growth in India and GCC countries | External | H | ST, MT | H | Slower growth in India and GCC countries could reduce remittances, FDI and exports.<br>→Accelerate structural reforms to improve the investment climate and boost public investment. |
| Higher frequency and severity of natural disaster and climate change | Domestic | L - M | ST, MT | H | *Nepal is highly vulnerable to natural disasters, such as earthquakes and floods.*<br>→Adhere to disaster-proof building codes; build fiscal space and reserve buffers; enhance financial safety nets. |

1/ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). The RAM reflects staff views on the source of risks and level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

2/ Risks to prices are broadly balanced, reflecting offsetting—but large and uncertain—supply and demand shocks.

# Annex III. Improving the Effectiveness of the Interest Rate Corridor

**1. A well-functioning interest rate corridor (IRC) would allow the NRB to move toward an interest rate framework that improves financial market development as well as policy signaling and transmission.[1]** In particular, it would[2]:

- Enhance the signaling of the monetary policy stance, hence facilitating achievement of the NRB's price stability mandate;
- Help stabilize the short-end of the yield curve, in turn supporting financial market development, notably the government securities market;
- Facilitate commercial banks' liquidity management, dampening the liquidity risk premium;
- For the longer term, provide the Nepalese authorities a greater degree of freedom on the choice of an alternative nominal anchor.

**2. The IRC is not yet functioning as an effective policy tool.[3]** Short-term rates are highly volatile and often fall below the corridor (Figure 1). Under the existing framework, liquidity is provided at the request of financial institutions under the standing liquidity facility. However, liquidity absorption through the deposit collection facility and open market operations are at the discretion of the NRB. So far, the NRB has been intervening asymmetrically (Figure 2). When liquidity[4] falls low in the system, the NRB has been able to broadly anchor the interbank market rate within the corridor by providing liquidity (under the standing facility and also through repos, both with collateral requirements). However, when liquidity increases, liquidity absorption has been insufficient, and the interbank market rate has plummeted. The current asymmetric approach and high volatility of short-term interest rates undermine the credibility of the IRC among financial market agents and does not enable the transmission of short-term rates to deposit and lending rates.

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[1] See IMF (2015), "Evolving Monetary Policy Frameworks in Low-Income and Other Developing Countries", October 2015.

[2]The IRC cannot be expected to lift all the obstacles (often of a structural nature) that may exist in the monetary policy transmission mechanism (i.e., transmission of short-term interbank market rates to the yield curve, to banks' lending and deposits rates, and the economy at large).

[3]In the context of less developed financial markets and very weak pass-through from the policy rate to market rates, macroprudential policies have proven more effective than the interest rate as a policy tool, by directly affecting the supply of credit. Until a full-fledged interest rate-based framework is in place, keeping the CCD ratio in place will be necessary.

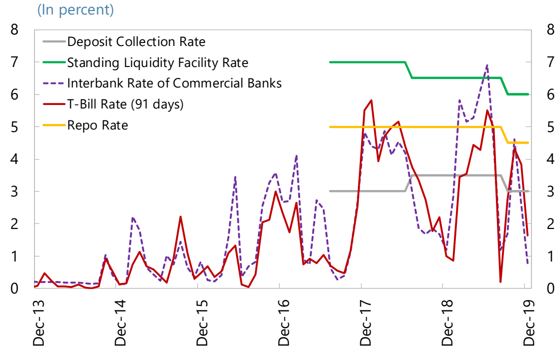
[4] Excess liquidity in this context refers to bank and financial institutions' deposits at the NRB in excess of the required amount under the Cash Reserve Ration regulation.

**3. Credibility of the IRC hinges on a sustained track-record of keeping the interbank rate within the corridor.** This could be achieved by introducing a standing deposit facility (SDF) as a solid floor of the IRC. The SDF would enable banks to park excess liquidity with the NRB at their discretion, without the NRB providing collateral to banks. Once the IRC track-record has been firmly established, the NRB can refine the width of the corridor if needed to further lower interest rate volatility without discouraging interbank trading and adjust the rates as needed to support the peg and macroeconomic stability objectives. Further, when short-term interest rates are stable within the corridor, discrete changes in the policy rate will have greater impact on banks' behavior including the setting of deposit and lending rates.

## Figure 1. Nepal: Interest Rate Corridor

*Short-term rates are volatile, often below the IRC.*

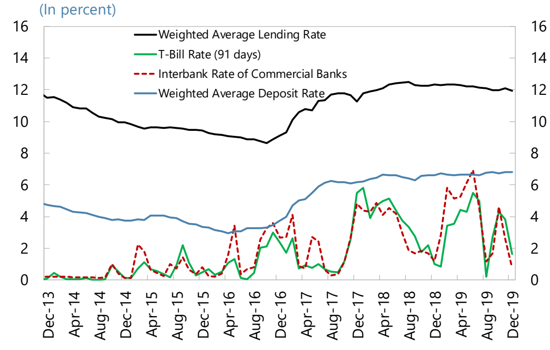
**Short-term Interest Rates**
(In percent)




Source: NRB.

*Transmission is weak.*

**Interest Rates**
(In percent)

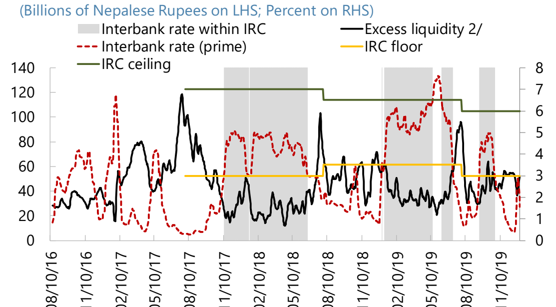



Source: NRB.

## Figure 2. Nepal: NRB, Liquidity Management

*Interventions have been asymmetric....*

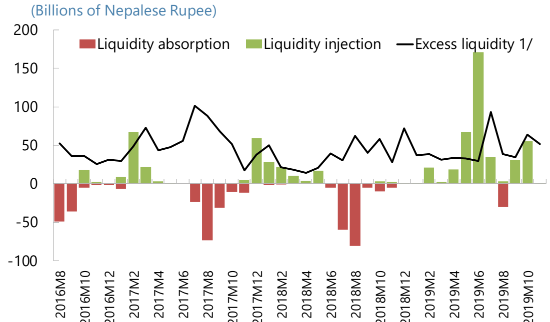
**Excess Liquidity and Interbank Rate 1/**
(Billions of Nepalese Rupees on LHS; Percent on RHS)




Sources: NRB and IMF staff calcuations.
1/ The chart shows 6 day moving average.
2/ Excess liquidity is measured as bank and financial institutions' deposits at the NRB in excess of their cash reserve ratio requirement.

*...and recently mostly to inject liquidity.*

**NRB, Short-Term Liquidity Management**
(Billions of Nepalese Rupee)




Source: NRB.
Note: 1/ Bank and financial institution's deposits at the NRB in excess of the cash reserve requirements.

# Annex IV. Tax Administration and Public Financial Management Reforms (2019)

*Building on past reforms to the tax structure and tax base, as well as efforts to improve tax administration and enforcement (see Annex III of the 2018 Article Consultation staff report), several new measures have been introduced over the last year which are expected to improve tax-revenue collection and public financial administration.*

## 1. Reforms to Tax Administration

- Key steps to reduce under-invoicing of imports, and thereby raise customs revenues include reforms to the custom valuation process such as greater automation, the adoption of risk-based customs clearance, and an e-payment system.
- A Permanent Account Number (PAN) system has been introduced for tax filings and claiming tax allowances and expenses. The system applies to individuals and businesses, and is expected to reduce revenue leakages and increase formal sector activity. The system will be supported by a biometric registration system, which is under development.
- A new provision of the VAT tax code will provide final consumers with a rebate of 10 percent of the tax paid if they make payments through an electronic channel. The objective is to increase formalization by bringing more transactions into the tax net.
- The Integrated Tax System (ITS) was created, which facilitates the cross-checking of financial information.

## 2. Reforms to Public Financial Management Systems and Processes

- The passage of the Financial Procedure and Fiscal Responsibility Act (2019) serves as a framework to guide the process of reforming PFM systems and practices. One key facet is that it clearly separates accounting personnel from internal auditors to ensure independence of the internal audit practice.
- At the federal level, the integration of the Line Ministry Budget Information System (LMBIS), Treasure Single Account (TSA), and Computer-based Government Accounting System (CGAS) will improve information sharing across ministries.
- At the sub-national level, the Provincial LMBIS system (PLMBIS) has been rolled out, and at the local government level the Sub-national Treasury Regulatory Application (SuTRA) has been implemented to capture all facets of budget planning. Substantial training efforts on the operation of both systems for subnational government staff have been conducted by the Financial Comptroller General's Office and will continue.
- The monitoring of major capital projects has been enhanced by the installation of an action room within the office of the Prime Minister, which tracks progress in major projects, identifies problems, and is positioned to respond rapidly to remove obstacles.

# Annex V. Progress in Implementing High-Priority Recommendations in the 2014 FSAP

| Recommendations | Responsible Authority | Time Line* | Progress to date |
|---|---|---|---|
| ***Financial Stability*** | | | |
| Refocus monetary policy operations on domestic liquidity management to reduce excess reserves, and especially their volatility, with appropriate burden sharing of costs between the financial system and the budget. Introduce Treasury sterilization bonds. | NRB | Short term (ST) | **Not done**<br>The interest rate corridor (IRC) is not serving as an effective policy tool. Deficiencies in the IRC framework—including lack of a standing deposit collection facility—have resulted in highly volatile short-term rates that often fall below the IRC floor. |
| Undertake a thorough Asset Quality Review (AQR) to identify the extent of problem loans in banks' balance sheets (with TA support). | NRB | ST | **Fully Implemented** |
| Conduct an in-depth review and financial analysis of loan portfolios during bank examinations. | NRB | ST/Medium term (MT) | **In process**<br>Loan portfolio reviews are performed on a regular basis during on-site inspections by the Supervision department of the NRB. The quality of reviews should be enhanced by the launching of Supervisory Information System (SIS) |
| Reinforce efforts to address financial infrastructure shortcomings in the Payments System, clearing, credit information, collateral registry, and debt recovery areas. | NRB/MOF | ST/MT | **In process**<br>• A Payment and Settlement System Department was established in 2015. Directives for Payment Institutions and Licensing Policy for Payment-Related Institutions were issued in 2016. Nepal Payment System Development Strategy was issued, and Payment System Oversight Framework of 2018 was published. A real-time gross settlement system (RTGS) is in full operation since November 22, 2019 in commercial banks.<br>• The Payment and Settlement Act is before parliament. Payment System Oversight Bylaws are under discussion.<br>• Nepal Financial Reporting Standards (NFRS) were adopted by Class A banks in FY2016/17.<br>• The Credit Information Bureau has expanded its coverage.<br>• Limited progress has been made regarding the strengthening of the collateral registry and debt recovery areas. |
| ***Financial Sector Oversight*** | | | |
| ***A. Banking Sector*** | | | |
| Redefine supervisory approach by:<br>integrating risk-based off-site and on-site supervision;<br>• increasing analytical capacity through training;<br>• introducing supervisory management information systems (MIS);<br>• developing a dedicated human resources (HR) rotation policy; and<br>• streamlining the NRB board participation in operational decisions. | NRB | ST/MT | **In process**<br>Risk-based on-site supervision is being implemented for Class A banks. SARTTAC TA has been received to help extend it to off-site supervision. The pilot Supervisory Information System (SIS) was launched on January 8, 2020. Regular training is being provided for on-site and off-site supervisors, and unit-wise rotation policy is being implemented. No action taken on streamlining the NRB Board's participation in operational decisions. |
| Ensure effective compliance with supervisory directives and guidelines by: | NRB | MT | **In process**<br>The onsite inspection and enforcement unit in the Banking Supervision Department continue to follow up on the |

| Recommendations | Responsible Authority | Time Line* | Progress to date |
|---|---|---|---|
| • performing a thorough follow up of the implementation of supervisory recommendations;<br>• proactive, earlier, and stronger corrective actions. | | | implementation of supervisory recommendations. Risk Management Directive was issued in November 2017, in order to strengthen the effective enforcement of major components of Risk Management Guidelines. |
| Review licensing regulations and policy to strengthen the licensing process and support a consolidation of the sector. Once completed, re-license all Classes A, B, and C banks that meet the new reinforced requirements, with an appropriate phase-in period, into a single-license category. | NRB | MT | **Not done** |
| Granting the NRB explicit consolidated supervision powers, amending the legal framework to incorporate a comprehensive definition of related parties and controlling interests. | NRB | MT | **In progress**<br>The Bank and Financial Institutions Act (BAFIA), 2016 has defined the term "Related Party" and "Controlling Interest". However, neither the BAFIA nor the NRB Act has assigned explicit powers to NRB for consolidated supervision of bank and financial institutions including their related parties and entities with controlling interest. |
| ***B. Non-banking Sector*** | | | |
| Divide the CIT into two separate legal entities, segregating the capital market business, to be placed under the supervision of the Securities Board of Nepal (SEBON), from the pension fund business. | MOF/SEBON | ST | **Not done** |
| Place the EPF and CIT pension fund business under the joint supervision of the Insurance Board (IB) and NRB. | IB/NRB/MOF | MT | **Not done** |
| Strengthen the operational independence of the IB and SEBON. | SEBON/IB/MOF | ST | **Not done** |
| ***Crisis Management*** | | | |
| Revise Prompt Corrective Action (PCA) policy to require stronger supervisory action, including designation of problematic status at an earlier stage of capital depletion. | NRB | ST | **Fully implemented** |
| Develop and implement a banking financial institution (BFI) Supervision Enforcement policy that presumes certain enforcement action based on CAMELS ratings. | NRB | MT | **In process**<br>The supervisory adjustments in risk weighted assets are currently tied up with CAMELS ratings. |
| Revise NRB Act to clarify emergency liquidity assistance (ELA) provisions. | NRB/MOF | ST | **Done**<br>NRB Act has been amended with the revision in provision related to refinancing and lender of last resort in section 49. Previously, refinancing and lender of last resort facilities had been available for 6 months and could be renewed for another 6 months only, however, with the amendment, the tenure has been extended to 1 year for both the facilities. |
| Revise NRB Act to grant it special resolution regime powers. | NRB/MOF | ST | **Fully implemented** |
| Establish a national financial crisis coordinating committee comprised of all financial sector, regulatory, and supervisory agencies. Develop each individual agency's crisis contingency plans and roll up individual agency plans into a national crisis contingency plan. | MOF/NRB/IB/SEBON | ST/MT | **Done**<br>Crisis Management Co-ordination Committee has been formed with the conveyorship of the Deputy Governor, including representative from the Ministry of Finance, the Securities Exchange Board of Nepal, and the Insurance Board. |
| Crisis simulations should be conducted periodically. | MOF/NRB/IB/SEBON | MT | **Not done** |

# Annex VI. Staff Policy Advice from the 2017 and 2018 Article IV

| Staff Advice | Policy Actions |
|---|---|
| **Fiscal Policy** | |
| Care should be taken not to exceed the economy's aggregate absorptive capacity and to safeguard expenditure quality (2017). Accordingly, staff recommended more front-loaded fiscal consolidation and an improved composition of expenditure in the medium-term (2018). | In FY2018/19, the central government deficit is estimated to have narrowed to 4.5 percent of GDP (from 6.7 percent of GDP in FY2017/18). |
| Continued improvements in revenue performance will be important, including efforts to strengthen customs administration (2017/18). | Authorities have undertaken substantial measures to strengthen customs administration, including reforms to customs valuation and adoption of risk-based customs clearance and an e-payment system. The Department of Customs is implementing ASYCUDA World and risk-based custom clearance to incentivize traders with good track record with faster compliance. |
| Budget preparation and implementation capacity should be strengthened further, with a more realistic initial assessment and capital spending spread more evenly throughout the fiscal year (2017/18). | Budget remains ambitious, and capital spending is typically backloaded in the fiscal year. Authorities are working on measures aimed at strengthening capital-spending execution rates, and smoothing its annual profile—most noteworthy are the adoption of a project pipeline, overseen by the National Planning Commission, and an action room in the Prime Minister's office for monitoring progress on major projects. |
| Expansion of government spending should be anchored in a medium-term expenditure framework (2017). A comprehensive assessment of the resources needed by subnational governments to deliver on their expenditure mandates set out in the Constitution should be conducted expediently (2018). | There has been progress assessing the spending needs of sub-national governments, with a workstream led by the World Bank. The Federalism Capacity Needs Assessment provides a broad framework for the devolution of resources and responsibilities under fiscal federalism. Work is ongoing to assess the fiscal gap between expenditure needs and revenue capacity at the SNG level. Authorities are also embarking on an assessment of the duplication of responsibilities and spending across different levels of government. |
| **Monetary, Exchange Rate, and Financial Policies** | |
| The interest rate corridor should be complemented by a binding interest rate floor, which could be set at a level close to current market conditions. Moreover, the NRB would periodically review the level of the floor to keep short-term interest rates in line with fundamentals, and could gradually narrow the width of the corridor to contain interbank rate volatility (2017). The NRB should resume using its IRC, by actively mopping up excess liquidity when needed, bringing interbank rates back towards the mid-point of the target range. The corridor itself should also be adjusted to better align short-term nominal interest rates in Nepal with those in India (2018). | The NRB narrowed the width of the corridor by 1 percentage point in July 2018. However, it continues to lack a binding floor and liquidity absorption remains fully at the NRB's discretion. |
| Consideration should be given to phase out NRB requirements for directed lending by commercial banks (2017). | The provision for banks to extend at least 25 percent of their total lending to priority sectors remains in effect, with the intention to ensure channeling of resources into priority sectors (e.g., agriculture, energy, tourism and small and medium enterprises) to support the economic growth target. |
| Regulatory and macro-prudential measures should be maintained to contain the buildup of financial sector risks, and the relief to banks with regard to the 80 percent loan-to-deposit ratio ceiling should be withdrawn (2017). | The NRB maintains a range of macroprudential measures such as the credit-to-core capital and deposit ratio, loan-to-value ratio, and sectoral limits on banks' exposure. The NRB has also recently introduced debt service-to-income ratio as well as a countercyclical capital buffer (2 percent) to be met by July 2020. In August 2019, the NRB removed interbank borrowing from the CCD ratio calculation. |
| The monetary policy stance needs to be tightened to rein in imbalances and support the exchange rate peg. The NRB should adopt a medium-term inflation objective consistent with eliminating the inflation wedge with India (2017). | In the context of less developed financial markets and very weak pass-through from the policy rate to markets rates, macroprudential policies have proven to be more effective than the interest rate as a policy tool, by directly affecting the supply of credit. Macroprudential measures have been playing a critical role in containing credit growth. |

| Staff Advice | Policy Actions |
|---|---|
| Communication regarding the quarterly reviews conducted by the NRB—which are now in their third year—should be enhanced and used to assess and explain the appropriateness of the policy stance (2018). | Monetary policy statements continue to be a channel for the NRB to announce policy changes including its monetary policy operating targets. However, they lack a clear evaluation of the appropriateness of the announced policy stance that is grounded by a sound assessment of current macroeconomic and market developments. |
| In the context of the recently initiated review of the NRB Act, staff recommends amendments to strengthen the central bank's operational autonomy (2018). | A recently proposed amendment, currently tabled in the Parliament, maintains the provision that allows the government to issue directives to the central bank related to currency, banking and finance, and allow dismissal of the governor, deputy governor, and the board of directors if instructions are not followed. Further, it introduced an additional ground for dismissal: causing unnecessary delay in work performance of the Bank. |
| To ensure that credit growth slows to a sustainable pace, macro-prudential measures should be tightened (2017/18). | Since late 2018, the credit-to-core capital and deposit (CCD) ratio became binding for most banks and the NRB reduced the limit on personal overdraft loans. In recent months, the NRB removed interbank borrowing from the CCD calculation and introduced the requirement to cross-check borrower financial information against the Integrated Tax System. The NRB is also requiring a 2 percent countercyclical capital buffer by July 2020 and introduced a debt service to income ratio for non-business loans. |
| Given data and supervisory weaknesses, as well as the cyclical position of the economy, banks should build additional capital and provisioning buffers against potential losses (2018). | SIS has been launched and is expected to enhance NRB's off-site supervision. Banks have not built additional buffers against losses. There are lingering gaps in measuring asset quality. |
| Staff recommends introduction of a directive to govern practices related to revolving lending, including working capital loans. The requirement for a clean-up period for revolving loans needs to be introduced to help curb ever-greening practices (2018). | A new circular by the NRB requires banks to cross-check reported net tradable assets with tax reports with the likely outcome of controlling the size of working capital loans. The authorities do not have an intention to introduce a clean-up period for working capital loans. |
| On the regulatory front, the central bank's lender of last resort policy, last updated in 2011, needs to be further clarified and aligned with standard central bank practices with respect to emergency liquidity assistance (2018). | A consultant has been hired to draft LOLR policy and the draft is in the progress of being finalized. |
| Staff welcomes the plan to establish a supervisory mechanism for financial cooperatives given the vast number of cooperatives and their linkages to banks as well as the importance of cooperatives to provide financial services particularly in remote areas and to underserved groups. | Depending on the territory of cooperatives' activity, corresponding government authority—municipal, province and federal—monitors and supervises the cooperatives. Authorities are encouraging merging of cooperatives to facilitate more effective supervision of cooperatives. |
| **Structural Policies** | |
| Nepal needs to improve its business environment and address structural bottlenecks to stimulate private sector activity, encourage foreign direct investment, and boost job creation. A single window should be offered to all investors, the investment board of Nepal Act should be strengthened, and public-private partnership policy should be amended. Amendments to the Labor Bill and Foreign Investment and Technology Transfer Act (FITTA) are needed which enhance labor and product-market flexibility (2017/18). | The new FITTA (2019), which supersedes the Investment Board of Nepal Act, includes several improvements vis-à-vis the previous act, including: a broader definition of what constitutes foreign investment, and a foreign investor; Investment Board of Nepal to approve projects above 6 billion rupees; a shortened approval timeline (from 30 to 7 days); a one-stop service center to facilitate foreign investors obtaining necessary visas and some other documentation; and scope for some assistance with land procurement. The Public-Private-Partnership Act is in the process of being revised, but legislation has not yet been passed into law. |
| Efforts are needed to strengthen institutions and reduce corruption. The public procurement act should be strengthened, extending the scope of misconduct which can be pursued as corruption by the Commission for the Investigation of the Abuse of Authority (CIAA). (2018) | Several public-procurement regulations have been issued, including a reduction in the 'mobilization' payment paid to contractors (from 20 to 10 percent), and improvements to the evaluation of bidding contractors' capacity to deliver. Changes to the Public Procurement Act are in progress, but have not yet been passed into legislation by parliament. The CIAA has played an active role in bringing cases against parties accused of misconduct. |

INTERNATIONAL MONETARY FUND

COMMUNICATIONS DEPARTMENT

Press Release No. 20/x
FOR IMMEDIATE RELEASE
[March 16], 2019

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

# Appendix I. Draft Press Release

**IMF Executive Board Concludes 2020 Article IV Consultation with Nepal**

On March 16, 2019, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1]with Nepal.

Recent strong growth in Nepal has been supported by a stable political environment, a more reliable electricity supply, and reconstruction activity following the devastating earthquakes in 2015. Nepal has seen significant poverty reduction, though vulnerabilities remain, exacerbated by climate related shocks.

Growth performed well in FY2018/19. Growth increased to 7.1 percent, reflecting a rebound in agriculture, earthquake reconstruction, and buoyant tourism. Higher food prices prompted a rise in headline inflation to 6.5 percent in December 2019. The current account deficit was 7.7 percent of GDP in FY2018/19, with remittances helping to finance the large trade deficit. The central government deficit narrowed to 4.6 percent of GDP, due to improvements in revenue collection and underspending with respect to the budget. Provinces and local governments also saw spending under-execution.

There are signs of moderation in economic activity in FY2019/20, helping to contain macroeconomic stability risks. Growth is expected to ease to 6 percent including because of slower growth in India (a main trading partner), sluggish remittance inflows, and weaker agricultural production. Inflation is expected at 6 percent due to high food inflation. In the context of moderating growth, there has been a welcome narrowing of the current account deficit—due in part to greater domestic production of electricity and cement—and is expected at 5.2 percent of GDP. Foreign exchange reserves are expected to stabilize at US$8.5 billion (6.6 months of prospective imports). Credit growth tapered to 14.8 percent (y/y) in December 2019 compared to 25.4 percent a year earlier, reflecting in part regulatory tightening. However, credit as a share of GDP is expected to remain elevated at 86 percent. Risks to the outlook are tilted to the downside, related to a further slowdown in remittances and the financial sector.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

## Executive Board Assessment[2]

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[2]At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

## Table 1. Nepal: Selected Social and Economic Indicators, 2016/17–2024/25 1/

| | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 |
|---|---|---|---|---|---|---|---|---|---|
| | | | Est. | Projections | | | | | |
| **Output and prices** (annual percent change) | | | | | | | | | |
| Real GDP | 8.2 | 6.7 | 7.1 | 6.0 | 5.7 | 5.5 | 5.4 | 5.3 | 5.3 |
| Headline CPI (period average) | 4.5 | 4.1 | 4.6 | 6.0 | 5.9 | 5.8 | 5.6 | 5.3 | 5.3 |
| Headline CPI (end of period) | 2.7 | 4.6 | 6.0 | 5.9 | 5.8 | 5.7 | 5.5 | 5.3 | 5.3 |
| **Fiscal Indicators: Central Government** (in percent of GDP) | | | | | | | | | |
| Total revenue and grants | 24.1 | 25.3 | 26.0 | 25.8 | 26.0 | 25.8 | 25.5 | 25.6 | 25.5 |
| of which: Tax revenue | 20.7 | 21.1 | 21.9 | 21.9 | 21.8 | 21.6 | 21.4 | 21.3 | 21.4 |
| Expenditure | 27.2 | 31.9 | 30.6 | 30.4 | 30.4 | 30.0 | 29.7 | 29.4 | 29.3 |
| Expenses | 19.4 | 23.0 | 23.6 | 23.1 | 23.1 | 22.9 | 22.7 | 22.7 | 22.8 |
| Net acquisition of nonfinancial assets | 7.8 | 8.9 | 7.0 | 7.3 | 7.3 | 7.1 | 7.0 | 6.7 | 6.5 |
| Operating balance | 4.7 | 2.3 | 2.4 | 2.8 | 2.9 | 2.9 | 2.9 | 2.8 | 2.8 |
| Net lending/borrowing | -3.1 | -6.7 | -4.6 | -4.5 | -4.4 | -4.2 | -4.1 | -3.9 | -3.7 |
| Statistical discrepancy | -1.3 | -3.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 | 0.0 |
| Net financial transactions | 1.8 | 3.6 | 4.6 | 4.5 | 4.4 | 4.2 | 4.1 | 3.9 | 3.7 |
| Net acquisition of financial assets | 1.4 | -0.7 | 1.7 | 1.6 | 0.9 | 0.9 | 0.9 | 0.9 | 0.9 |
| Net incurrence of liabilities | 3.2 | 2.9 | 6.3 | 6.1 | 5.3 | 5.0 | 5.0 | 4.8 | 4.6 |
| Foreign | 1.3 | 2.4 | 2.1 | 2.4 | 1.9 | 1.6 | 1.6 | 1.5 | 1.3 |
| Domestic | 1.9 | 0.4 | 4.2 | 3.7 | 3.4 | 3.4 | 3.4 | 3.3 | 3.3 |
| **Money and credit** (annual percent change) | | | | | | | | | |
| Broad money | 15.5 | 19.4 | 15.8 | 13.2 | 11.9 | 11.6 | 11.1 | 10.9 | 10.7 |
| Domestic credit | 20.2 | 26.1 | 21.7 | 17.6 | 15.7 | 14.3 | 13.8 | 13.3 | 13.1 |
| Private sector credit | 18.0 | 22.3 | 19.1 | 15.0 | 13.8 | 12.5 | 12.2 | 12.0 | 12.0 |
| **Saving and Investment** (in percent of nominal GDP) | | | | | | | | | |
| Gross investment | 45.2 | 55.2 | 62.3 | 54.6 | 53.4 | 52.4 | 51.5 | 50.6 | 49.8 |
| Private | 23.6 | 25.8 | 30.0 | 25.1 | 24.4 | 24.0 | 23.5 | 23.3 | 23.0 |
| Central government | 7.8 | 8.9 | 7.0 | 7.3 | 7.3 | 7.1 | 7.0 | 6.7 | 6.5 |
| Change in Stock | 13.8 | 20.5 | 25.3 | 22.2 | 21.7 | 21.3 | 21.0 | 20.6 | 20.2 |
| Gross national saving | 44.8 | 47.1 | 54.6 | 49.4 | 48.5 | 47.6 | 46.8 | 46.0 | 45.3 |
| Private | 41.3 | 46.1 | 53.3 | 47.8 | 47.0 | 46.1 | 45.3 | 44.6 | 44.0 |
| Central government | 3.5 | 1.0 | 1.2 | 1.6 | 1.5 | 1.5 | 1.4 | 1.4 | 1.4 |
| **Balance of Payments** | | | | | | | | | |
| Current account (in millions of U.S. dollars) | -93 | -2,350 | -2,369 | -1,760 | -1,832 | -1,963 | -2,104 | -2,215 | -2,323 |
| In percent of GDP | -0.4 | -8.1 | -7.7 | -5.2 | -4.9 | -4.8 | -4.7 | -4.6 | -4.4 |
| Trade balance (in millions of U.S. dollars) | -8,446 | -10,849 | -11,373 | -11,658 | -12,379 | -13,140 | -13,956 | -14,770 | -15,643 |
| In percent of GDP | -33.5 | -37.4 | -37.1 | -34.2 | -33.1 | -32.2 | -31.4 | -30.5 | -29.6 |
| Exports of goods (y/y percent change) | 9.9 | 15.5 | 12.1 | 1.4 | 9.9 | 9.9 | 9.9 | 9.9 | 9.9 |
| Imports of goods (y/y percent change) | 30.0 | 27.4 | 5.4 | 2.4 | 6.5 | 6.5 | 6.5 | 6.2 | 6.3 |
| Workers' remittances (in millions of U.S. dollars) | 6,556 | 7,224 | 7,769 | 8,402 | 8,825 | 9,270 | 9,737 | 10,227 | 10,742 |
| In percent of GDP | 26.0 | 24.9 | 25.3 | 24.7 | 23.6 | 22.7 | 21.9 | 21.1 | 20.3 |
| Gross official reserves (in millions of U.S. dollars) | 9,264 | 9,304 | 8,545 | 8,536 | 8,419 | 8,233 | 8,045 | 7,850 | 7,673 |
| In months of prospective imports | 8.3 | 7.9 | 7.0 | 6.6 | 6.1 | 5.5 | 5.1 | 4.7 | 4.3 |
| **Memorandum items** | | | | | | | | | |
| Public debt (in percent of GDP) | 26.1 | 30.2 | 30.1 | 33.7 | 35.7 | 37.4 | 39.0 | 40.3 | 41.1 |
| Nominal GDP (in billions of U.S. dollars) | 25.2 | 29.0 | 30.7 | 34.1 | 37.4 | 40.8 | 44.5 | 48.4 | 52.9 |
| Nominal GDP (in billions of Nepalese Rupees) | 2,674 | 3,031 | 3,464 | 3,892 | 4,354 | 4,860 | 5,406 | 5,997 | 6,687 |
| Private Sector Credit (in percent of GDP) | 74.7 | 80.6 | 84.0 | 86.0 | 87.5 | 88.2 | 88.9 | 89.8 | 90.2 |
| Exchange rate (NPR/US$; period average) | 106.2 | 104.4 | 112.9 | … | … | … | … | … | … |
| Real effective exchange rate (average, y/y percent change) | 3.6 | 0.2 | -1.4 | … | … | … | … | … | … |

Sources: Nepalese authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.