

**EXECUTIVE
BOARD
MEETING**

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February 28, 2020

To: Members of the Executive Board

From: The Secretary

Subject: **Nepal—Staff Report for the 2020 Article IV Consultation—Informational Annex**

Board Action:	Executive Directors' consideration (Formal)
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***Unless an objection from the authorities is received prior to the conclusion of the Board's consideration, the document will be published.**



NEPAL

STAFF REPORT FOR THE 2020 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

February 27, 2020

Prepared By

Asia and Pacific Department

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FUND RELATIONS

(As of December 31, 2019)

Membership Status: Joined September 6, 1961; accepted Article VIII, Sections 2, 3, and 4 on May 30, 1994.

General Resources Account:

	SDR Million	Percent Quota
Quota	156.90	100.00
Fund holdings of currency	140.92	89.82
Reserve position in Fund	15.98	10.19

SDR Department:

	SDR Million	Percent Allocation
Net cumulative allocation	68.10	100.00
Holdings	1.36	2.00

Outstanding Purchases and Loans:

	SDR Million	Percent Quota
RCF Loans	38.50	24.54

Financial Arrangements: (In SDR Million)

Type	Approval Date	Expiration Date	Amount Approved	Amount Drawn
ECF	11/19/03	11/18/07	49.90	49.90
ECF	10/05/92	10/04/95	33.57	16.79
SAF	10/14/87	10/13/90	26.11	26.11

Projected Obligations to Fund:

(in millions of SDRs; based on existing use of resources and present holdings of SDRs):

		Forthcoming			
	2020	2021	2022	2023	2024
Principal	2.85	7.13	7.13	7.13	7.13
Charges/interest	0.50	0.49	0.49	0.49	0.50
Total	3.35	7.62	7.62	7.62	7.63

Exchange Rate Arrangement

The exchange rate arrangement of Nepal is a conventional peg to a single currency unit. The Nepalese rupee is pegged to the Indian rupee at a rate of NRs 1.6 per Indian rupee. As of January 30, 2020, the exchange rate of the Nepalese rupee (Nr) was US\$1=Nrs. 114.2

The Industrial Enterprises Act places a 75 percent limit on the conversion and transfer to foreign currency of salaries of non-residents from countries where convertible currency is in circulation. Since the limit applies to amounts that may be less than net salaries, it gives rise to an exchange restriction under Article VIII.¹

Safeguards Assessments

An update safeguards assessment of the Nepal Rastra Bank (NRB) was completed in February 2016 with respect to the Rapid Credit Facility approved on July 31, 2015. The assessment found that the NRB had made limited progress in improving its safeguards framework and addressing recommendations from the previous assessment (2011). In particular, the quality of the external audit continued to fall short of international standards and priority should be given to engaging an auditor with requisite experience. The legal framework should also be enhanced to strengthen the central bank's autonomy and governance arrangements. The assessment concluded that strong commitment from the NRB Board and management is essential to improve the internal audit function and reinforce controls in key areas, including foreign reserves management and currency operations.

A safeguards monitoring mission in May 2018 found implementation of safeguards recommendations from the 2016 assessment to be limited. Similarly, progress on implementing recommendations from the 2018 monitoring visit continues to be slow, as several priority recommendations remain outstanding. Key areas that need to be strengthened include the NRB's autonomy and governance by way of amending the central bank legal framework, external audit, and internal controls. Staff is providing technical assistance to strengthen the internal audit function, and the NRB is in the process of establishing an information security unit and updating its lender of last resort regulation. Greater progress in strengthening safeguards continues to be hampered by human resources policy, which the NRB is currently reviewing.

2018 Article IV Consultation

Consultations with Nepal are held on the standard 12-month Article IV consultation cycle. The 2018 Article IV Consultation discussions were held during December 2-13, 2018 in Kathmandu and the Executive Board concluded the consultation on February 8, 2019 (IMF Country Report No. 19/60).

¹ 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.

Technical Assistance (since 2018 Article IV Consultation)

	Purpose	Year
MCM	Strengthening Internal Audit	2018
	Cyber Security	2018
SARTTAC	Financial Supervision and Regulation	2018/2019
	Strengthening Fiscal Reporting	2018
	Government Finance Statistics and Public Sector Debt Statistics Training	2018/2019
	Price Statistics Training	2018
	National Accounts Training	2019
	Liquidity Monitoring and Forecast Tool	2019
	External Sector Statistics	2019
STA	Fiscal federalism workshop	2020
	Monetary and Financial Statistics	2019
	External Sector Statistics	2019

Resident Representative

Mr. Luis Breuer has been the Senior Resident Representative since July 26, 2019. He is based in New Delhi.

INFORMATION ON THE ACTIVITIES OF OTHER IFIS

Information on the activities of other IFIs in Nepal can be found at:

- World Bank: <http://www.worldbank.org/en/country/nepal/overview>
- Asian Development Bank: <https://www.adb.org/countries/nepal/strategy>

STATISTICAL ISSUES

As of January 2020

I. Assessment of Data Adequacy for Surveillance
<p>General: Economic and financial data are broadly adequate for surveillance, with scope for improvement especially in updating the base year of the national account, more detailed price statistics, and the timeliness and quality of balance of payments data.</p>
<p>National Accounts: The Central Bureau of Statistics (CBS) compiles national accounts using the 1993 SNA standard. Key estimates include annual GDP by production and by expenditure categories (in current and constant prices), and gross national income and savings. Some expenditure categories continue to be affected by limited source data, particularly for household final consumption and the current and constant price discrepancies with GDP by production have become very large in recent years. During 2020, the CBS has plans to release a major revision of the national accounts that are SNA2008 compliant and will update the base year for the constant price measures from 2000/01 to 2010/11. The compilation of the new benchmark year for the national accounts and its rebasing, based on the supply and use table framework, is being supported by the World Bank. Quarterly GDP estimates are compiled and are to be updated with the revised base year.</p>
<p>Price Statistics: The Nepal Rastra Bank (NRB) compiles the consumer price index (CPI). A new CPI series with 2014/15 as base year (from previous base year of 2005/06) has been released in October 2015 based on a new household expenditure survey. Initial plans had been made to transfer the responsibility of compiling the CPI from the NRB to the Central Bureau of Statistics (CBS). A core inflation series is not published, although underlying data necessary to calculate such a series appear to be available. NRB also publishes a wholesale price index (WPI), with weights based on 1999/2000 data. Broadly, the index covers agricultural commodities (49.6 percent), domestic manufactured goods (20.4 percent), and imported goods (30 percent). The CBS has received TA to update and expand the producer price index (PPI) to include other economic sectors. Current PPI coverage is restricted to manufacturing. As well, an index of wages and salaries is compiled and published, with base year 2004/05.</p>
<p>Government Finance Statistics: The authorities began to compile fiscal data for the budgetary central government in accordance with IMF's Government Finance Statistics Manual 2001 (GFSM 2001) in 2011 and is now – with the support of SARTTAC – adopting GFSM 2014. Annual data on government operations are reported to STA. However, further improvement is needed in a number of areas in order for the evolving time series to support surveillance. For example, financing transactions should be excluded from the functional classification of expenditure; a clearer distinction needs to be made in the COA between revenue and expense transactions and transactions in nonfinancial assets; clarifications are needed as to whether transfers are correctly classified: as social benefits, as subsidies, or as capital payments to enterprises. There may also be cases where the latter represent acquisitions of financial assets (equity stakes). Compilation of below-the-line financing transactions needs improvement and the government's financial balance sheet needs further development. Efforts are underway that will allow for more timely and</p>

accurate reporting and monitoring of consolidated general government operations (operations of extra- budgetary entities and local governments)

Monetary and Financial Statistics: The Nepal Rastra Bank (NRB) reports the Standardized Report Forms (SRFs) 1SR for central bank, 2SR for other depository corporations (ODCs), and 5SR for monetary aggregates for publication in the IMF's *International Financial Statistics* on a monthly basis with a lag of about one month. The coverage of monthly monetary statistics has been expanded to include development banks and finance companies, and the NRB now compiles and publishes an expanded broad money survey, which is a significant step forward. However, there are some inconsistencies in the reporting of positions between the NRB and the ODCs. Minimizing these will further improve data quality. A monetary and financial statistics mission took place in November 2019 to assist the NRB in improving the compilation of SRFs 1SR and 2SR and advancing work to expand the SRF 2SR coverage to include microfinance institutions and savings and credit cooperatives.

The NRB reports some data and indicators to the Financial Access Survey (FAS), including the two indicators (commercial bank branches per 100,000 adults and ATMs per 100,000 adults) adopted by the UN to monitor Target 8.10 of the Sustainable Development Goals (SDGs).

Financial Soundness Indicators: the NRB reports the 12 core financial soundness indicators (FSIs) and 8 of the 13 encouraged FSIs for deposit takers, 2 FSIs for the other financial corporations (OFCs), one FSI for households, and 2 FSIs for real estate markets—on a quarterly basis—on posting on the IMF's FSI website. FSIs are reported with a lag of about one quarter.

External Sector Statistics: The NRB compiles and disseminates balance of payments (BOP) statistics in conformity with the fifth edition of the *Balance of Payments Manual (BPM5)*. In February 2015, the NRB started reporting international investment position (IIP) data following the sixth edition of the *Balance of Payments and International Investment Position Manual (BPM6)*. Key shortcomings in external sector statistics (ESS) are: (i) overestimation of imports of goods; (ii) underestimation of exports of travel services (iii) inclusion of commercial banks' assets in reserve assets; (iv) incompleteness of data on foreign grants, making it difficult to classify current vs. capital, and official vs. private grants; and (v) potential under-coverage of external debt statistics (EDS).

Since 2012, NRB has been receiving technical assistance (TA) in the ESS that include the areas of BOP, IIP and EDS. The 2019 STA mission reviewed NRB's preliminary BOP data according to the BPM6 framework, and assisted the authorities in improving the measurement of trade in goods and services, remittances, direct investment, trade credit, external debt statistics, and reserve assets.

Overall the quality of BOP data has improved with the support of IMF STA TA and training of the NRB staff through ESS IMF HQ and regional courses.

II. Data Standards and Quality	
Nepal has implemented the recommendations of enhanced General Data Dissemination System (e-GDDS). Its National Summary Data Page was launched in June 2017 and is available at https://www.nrb.org.np/red/nsdp/ .	Data ROSC on fiscal transparency was published in October 2007.

Nepal—Table of Common Indicators Required for Surveillance

(As of January 31, 2020)

	Date of latest observation	Date received	Frequency of Data ⁷	Frequency of Reporting ⁷	Frequency of Publication ⁷
Exchange Rates	12/19	01/20	D and M	W and M	W and M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	12/19	01/20	M	M	M
Reserve/Base Money	12/19	01/20	M	M	M
Broad Money	12/19	01/20	M	M	M
Central Bank Balance Sheet	12/19	01/20	M	M	M
Consolidated Balance Sheet of the Banking System	12/19	01/20	M	M	M
Interest Rates ²	12/19	01/20	D and M	W and M	W and M
Consumer Price Index	12/19	01/20	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – General Government ⁴	12/19	01/20	M	M	M
Revenue, Expenditure, Balance and Composition of Financing ³ – Central Government	12/19	01/20	M	M	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	12/19	01/20	M/A	M/A	M/A
External Current Account Balance	12/19	01/20	M	M	M
Exports and Imports of Goods and Services	12/19	01/20	M	M	M
GDP/GNP	2018/19	08/19	A	A	A
Gross External Debt	2018/19	08/19	A	A	A
International Investment Position ⁶	Q2/19	08/19	Q	Q	Q

¹ Any reserve assets that are pledged or otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency but settled by other means.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).