Road to Recovery: Post Lockdown

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The Covid-19 led national shutdown since 24 March 2020 and the resultant halt to commercial activity has severely dented the prospects of the Nepalese economy. All sectors of the economy have been impacted, with varying degree of severity. A large number of sectors across regions have not witnessed any activity for over 2 months as provinces across the country have been in various stages of lockdown since March 2020.

As per World Bank, economic growth of Nepal is expected to fall to a range between 1.5 and 2.8 percent in FY20 reflecting lower remittances, trade and tourism and disruptions caused by the Covid-19 outbreak. Weak agricultural activity during the first half of FY20 is expected to have lowered economic growth of the country during the period. Also, growth in services, particularly hotels and restaurants is also likely to have moderated with lower tourist arrivals in the first half of FY20. Further trade deficit contracted during the first half of FY20 because of lower imports. In the event Covid-19 outbreak gets prolonged, then it might significantly affect the growth with a further disruption/ decline in services and industrial production. On account of the lingering effect of the corona pandemic, economic growth is more likely to remain subdued in FY21.

There has been some easing in restrictions on conduct of commercial activity for few industries in recent days based on the containment of the spread of the virus and the subjective view of the high-level committee for prevention and control of Covid-19. However, the resumption of activity there has been limited and prone to uncertainties and will take time to move towards normal.

We have attempted to chart the likely road to recovery for the Nepalese economy after the lockdown. This includes making estimates for overall economic growth for coming ten months, the fiscal implications for the government and the likely liquidity scenario. We have also put down the expected recovery path for certain key industries based on the evolving conditions.

Economic recovery is expected to be slow and prolonged and vary significantly across sectors. Sectoral improvements are expected from Q2 FY21 onwards though reaching the pre-lockdown normal would probably get extended into FY22.

Downward revision in GDP growth estimates

The Budget for FY19-20 had targeted a GDP growth rate of 8.50% with growth rate of 6.99% achieved for FY18-19. The GDP growth rate stood at around 6-6.75% before ongoing impact of Covid-19 started to be seen on Nepalese economy. However, with lockdown imposed throughout the country with direct effect on the economy, GDP growth is expected to remain at 2.28% for FY19-20. Based on the evolving approach to the pandemic with there being multiple extensions of the lockdown, uncertainty surrounding the post lockdown scenario is palpable. There are some signs of opening up in some regions which do offer hope of the nation being prepared to live with the virus and gradually ease curbs on economic activity. Further extensions of the lockdown cannot be ruled out.

Several recent high frequency economic indicators point to a severe contraction in the overall economy since the imposition of the lockdown. Even though the central government along with central bank of Nepal have announced few relief packages for the borrowers, the measures here have not properly addressed immediate relief for sectors affected by the pandemic nor does it provide for a demand boost in the near term.

Table 1: FY20 GDP growth: Revised estimates

Sector	FY20	
	Earlier Estimate	Revised Estimate
1. Agriculture and forestry	5.05	2.48
2. Fishing	5.60	7.17
3. Mining & quarrying	8.91	-0.69
4. Manufacturing	6.82	-2.27
5. Electricity, gas and water supply	9.15	28.75
6. Construction	8.05	-0.31
7. Wholesale and retail trade	11.06	2.11
6. Hotels and Restaurant	7.33	-16.30
7. Transport, storage and communications	5.90	-2.45
8. Financial intermediation	6.18	5.15
9. Real Estate, renting and business activities	6.12	3.25
10. Public Administration and defence	5.54	6.91
11. Education	5.11	4.88
12. Health and social work	6.75	7.07
13. Other community, social and personal service activities	5.73	4.70
GDP at basic prices	6.75	2.27
GDP	6.99	2.28

Source: Central Bureau of Statistics

Sector-wise GDP forecasts:

Agriculture, power and government sectors will statistically provide an upward thrust in FY21 while other sectors could be pressurized.

- Agriculture sector growth has been expected at 2.48%. Essential items like food grains were out of the purview of lockdown restrictions. Further, the prediction of a normal monsoon is expected to bode well for Kharif crop output. However, this has been impacted by decline in paddy production followed by impact of latest Covid-19 on meat and milk products.
- Fishery sector is expected to have positive growth to 7.17%. With implementation of latest policies from both government and non-government sectors, this sector is expected to grow.
- The mining and quarrying sector will be under pressure and the growth is expected to be negative. Labour shortages are also expected to weigh on the production in this sector.

- The manufacturing sector is expected to contract to 2.27% de-growth due to the extension of the lockdowns in most regions and the limited easing for few sectors. The shortage of labour and raw materials would further exacerbate their condition. The expected special boost to capex by the government has not yet been announced which will come in the way of growth of related industries.
- The electricity, gas and water supply is expected to see highest growth in FY20 of 28.75%. Increase in power production contributing cut to schedule power cuts and increasing domestic demand is expected to remain positive for the sector. However, this is to be hit by shutdown of commercial and industrial sectors.
- Construction sector is expected to witness decline of 0.31%. A major challenge will be getting labour back on board and completing ongoing projects and availability of required machineries and construction materials.
- Wholesale and retail sector growth has been expected at 2.11%. With lockdown imposed, disruption in supply chain has been a major challenge.
- Hotel and Restaurant sector is the highest hit sector, expected to contract to 16.30%. Smooth arrival of tourists is unexpected long even after the pandemic ends.
- The transportation sector is expected to contract to 2.45% de-growth due to the extension of the lockdowns and low possibility of resuming the business even after easement of lockdown.
- Financial services would grow at a positive rate though demand side issues would hold back growth. The tourism and manufacturing sector which has higher weightage in this component and would witness a decline in growth this year. Stock trading activities remained closed since imposition of lockdown has negative implications.
- Government expenditure could be the driving sector as there has been expenditure at different levels towards public administration and defence with new three-layer government. Thus, the growth for the sector has been expected at 6.91% for FY20.
- With increase in government expenditure towards medical facilities and equipment followed by upliftment of awareness among people towards health issues, Health and social work sector is expected to evidence growth of 7.07% for FY20.

On the expenditure side, the demand will be low with employment being a challenge. The investment will be subdued as there is a surplus capacity and government attention will be more on relief than CAPEX. The private sector will focus more on completing projects than going in for new ones. Foreign trade will be depressed given recessionary conditions in most countries. These estimates would be in for a review during the course of the year depending on the way the shutdown ends and whether or not there are any further policies announced by the government.

Table 2: Province-wise GDP forecasts:

Province	GDP Growth Rate		Provincial Share in GDP	
	FY19	FY20	FY19	FY20
Province 1	7.40	3.40	15.70	15.80
Province 2	8.10	2.30	13.60	13.80
Bagmati	6.40	1.20	36.40	35.80
Gandaki	6.70	2.70	8.90	8.90
Province 5	6.80	2.00	14.20	14.20
Karnali	8.10	3.60	4.20	4.30
Sudurpaschim	6.90	4.10	7.00	7.20

Source: Central Bureau of Statistics

Fiscal Position

The central government finances are expected to be pressured in FY21 on account of revenue shortfalls owing to the restriction on economic activity and an increase in government spending towards relief measures. The constrained financial position of the government has prompted an increase in the government's market borrowing program for FY21. Even though the details of the government's financing of additional expenditure has not been released, by factoring the likely revenue shortfalls and increased expenditure in FY21, we estimated the *central government's fiscal deficit to widen*. Here it is also reckoned that the denominator of GDP in nominal terms will be lower.

Fiscal position for 9MFY20

- The government balance (difference between total revenue and expenditure) recorded a deficit of Rs.56.3 Bn during the first 9 months of the fiscal as against a surplus of Rs 17.3 Bn during the corresponding period a year ago. Total revenues contracted by 5.2% for the 9 months under review while total expenditure grew by 7% which cumulatively pressured government finances.
- The negative growth in revenues was seen in case of customs (-5.5%) and excise (-4.5%), both of which account for 30% of total revenues of the government. However, the revenues under income tax grew by15% during the 9 months compared with corresponding period a year ago.
- The government has mobilized Rs. 55 Bn internal loan and Rs. 45.78 Bn external loan with balance of cash at various accounts maintained by NRB remaining at Rs. 162.31 Bn (includes Rs. 62.86 Bn in respect of Local Authorities Account) as on mid-April, 2020.

Table 3: Monthly Situation of Major Economic Indicators

Particulars	2019	2020	
	Mid-Apr	Mid-Mar	Mid-Apr
Consumer Inflation (y-o-y)	4.44	6.70	6.74
Consumer Inflation	0.58	-0.27	0.62
Food and Beverage	1.35	-0.66	1.68
Non-Food and Service	-0.02	0.04	-0.21
Total Export	8.6	9.9	3.9
Total Import	112.5	120.6	58.3
Travel Credit	7.1	5.1	1.6
Travel Debit	6.4	5.4	1.2
Remittance Inflow	71.0	79.2	34.5
Total Government Expenditure	-	124.1	64.6
Recurrent Expenditure	-	85.1	44.6
Capital Expenditure	-	19.6	8.7
Total Revenue	-	54.4	43.9
Total Deposit	24.9	51.0	53.4
Private Sector Credit	46.5	35.6	40.0
Weighted Average Interest Rate on Deposit	6.7	6.8	6.7
Weighted Average Interest Rate on Credit	12.3	11.8	11.8

Banking Sector

Banking and finance sector is one of the crucial sector in any economy. The financial sector contributed about 6.3% to the country's GDP. But with the outbreak of Covid-19 pandemic, the banking sector of the country has been severely hit. It is expected to have negative impact over the short term revenue profile and expense of the banking sector resulting in significant decline of profits. Presently, there are 73 players in the banking sector of Nepal comprising of Class A- Commercial Banks (includes 27 banks), Class B- Development Banks and Class C- Finance Companies.

The relief measure introduced by the NRB provided temporary relief to the bank borrowers. However, there is an added burden to bank borrowers who now may have to pay huge instalment of up to six months in mid-July 2020. If the current crisis prolongs, then the businesses might face stressed revenue profile and cash crunch issues which might translate into generation of non- performing loans especially in the key sectors such as tourism, transportation, manufacturing, retail and agriculture sector on account of their reduced repayment capacity raising concerns over asset quality.

Further, it is expected that the Covid-19 pandemic will have negative impact over inward remittance followed by negative current account position of Nepal depleting forex reserve of the country and putting stress in the liquidity position of the financial system. With expected decrease in remittances and government revenue in the meantime, both deposit collection and credit disbursement will get affected further worsening the situation. In the first 7-month period of FY20, remittance inflow decreased by 0.5% as compared to increment of 28.5% in the same period of the previous year. In previous fiscal year, Nepal received Rs. 879 Bn in remittance that is 25.4% of the GDP of Nepal. Also, the interest rates of banking sector are being controlled in order to promote credit growth and to prevent economic slowdown aftermath of the Covid-19 crisis. It is crucial for the central bank to expedite the process of obtaining credit facility from external sources such as International Monetary Fund and promote government spending to provide cushion in the liquidity position of the banking sector.

In the event of tight liquidity position and decrease in availability of loanable funds, it will be challenging for new and existing businesses to avail additional funds especially for Small and Medium Enterprises (SME). Out of the ~275,000 registered SMEs, 50% avail credit from banks and financial institutions. Thus, it is imperative to ensure effective and smooth flow of funds to these businesses in flexible terms considering present scenario. Currently, the central bank has increased refinancing limit to Rs. 100 Bn which increased from Rs. 50 Bn in FY19 that could stimulate bank credit off-take and provide some financial comfort the businesses. There could be an increase in bank credit off-take in the coming quarters. Businesses as well as the retail segment who have been faced with cash flow issues due to the shutdown are expected to seek bank funding. Further, banks have been told to increase the working capital limits of borrowers by 10% which will help the SMEs in particular.

There may however not be a sizeable increase in bank credit growth given the underlying risk aversion of banks to lend on fears of the lending turning bad in the future. Businesses too would not want to add to their liabilities given the bleak and uncertain economic prospects. Bank deposits on the other hand are expected to see a growth in FY21 given the Covid19 led turmoil in the financial market that has increased the preference for bank deposits. Bank deposit growth would continue to surpass bank credit growth in FY21. Additionally, to ease the financing conditions of the sectors most affected by the pandemic, the central bank could announce stimulus/ relief package soon.

Sector-wise scenario and recovery path

The prevailing sector-wise scenario and the likely recovery path has been highlighted in table 4 and 5 below. Most sectors are faced with issues of labour, liquidity, logistics, low demand and capacity utilization and could see a gradual recovery from Q2 FY21.

Table 4: Sector-wise scenario

The table below looks at how various industries are positioned today against certain challenges which are related to labour, liquidity, logistics, capacity utilization and inventories. These are the broad headings which indicate whether a sector is well positioned right now. A tick mark indicates that the variable mentioned is a challenge for the sector while a cross show that there are no problems vis-à-vis this parameter. Hence the pharmaceuticals industry does not have any of these challenges and is in a relatively better position than the others.

	Labour	Liquidity	Logistics	Lack of demand	Capacity Utilisation	Inventory
Auto	✓	✓	✓	✓	NA	✓
Aviation	✗	✓	NA	✓	✓	NA
Cement	✓	✗	✓	✓	✓	✓
Consumer Durables	✓	✓	✓	✗	NA	✓
Drugs & pharma	✗	✗	✗	✗	✗	NA
Retail - essential goods	✗	✓	✗	✗	NA	✗
Gems & Jewellery	✓	✓	✓	✓	NA	✓
Hospitality & Tourism	✓	✓	✓	✓	NA	✓
Hospitals	✗	✓	✗	✓	✓	NA
Media & Entertainment	✓	✓	✓	✗	NA	NA
Retail - non-essential goods	✓	✓	✓	✗	NA	✓
Power	✓	✓	✓	✓	✓	NA
Ports	✓	✗	NA	✗	✓	NA
Real Estate	✓	✓	NA	✓	✓	✓
Construction	✓	✓	✓	✗	✗	NA
Steel	✓	✓	✓	✓	✓	✓
Textiles	✓	✓	✗	✓	✓	NA

✓ Mark in the table suggest the particular problem prevails for the sector, ✗ is the absence of the problem and NA is not applicable

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Table 5: Sector-wise recovery path

	Jun-20	Jul-20	Aug-20	Sep-20	Oct-20	Nov-20	Dec-20	Jan-21	Feb-21	Mar-21
Retail – Essential goods										
Power										
Drugs & Pharma										
Aluminium										
Hospitals										
Real Estate										
Media & Entertainment										
Consumer Durables										
Cement										
Construction										
Textiles										
Steel										
Retail-Non Essential Goods										
Auto										
Gems & Jewellery										
Hospitality & Tourism										
Aviation										

Towards Recovery	Partial Recovery	Stressed

The chart above provides a view on when we could expect a recovery in these sectors. The colours are self-explanatory and the prolonged shade of red does not augur well for the sector. The yellow shade talks of a less than normal tough stable path while green may be viewed as being closest to normal. The view on power should be viewed with caution as the green shade representing the sector is more due to the household demand which is unchanged if not increasing as work from home had been the order. However, commercial and industrial demand which actually provides more revenue as they subsidize household consumption is down presently.

1. Auto

Auto demand is expected to have weakened due to the Covid-19 Pandemic. Auto industry is expected to witness marginal recovery on a m-o-m basis starting from September 2020 and continue in Q2 FY21 (some respite led by festival demand). The sector is expected to experience further recovery but remain under pressure in Q3 FY21. Automobile industry continues to face concerns in terms of logistics, liquidity as well as inventory. Also, the trading and import activities of the automobiles is halted for the time being due to nationwide lockdown. As the lockdown gets lifted in a phased manner, public transport is expected to be one of the last ones to be opened up. More than these restrictions, change in consumer behaviour towards owning his/her vehicle migrating away from public transport could likely generate some demand for two wheelers as well as small passenger cars in the country. Having faced with disruption, small scale manufacturers and traders may have their own challenges to reverse gear immediately. Nepal Rastra Bank has enforced stringent measures with regard to personal and hire purchase credit that has resulted in lower auto sales as evidenced by 0.6% y-o-y decrease in hire purchase credit in mid-February 2020 after rising by 13.6% in the year earlier period. Arguably, the sector is caught in a slow lane and will take time to get things in order.

2. Aviation

The aviation sector not expected to fully recover in the current fiscal year and it is expected to be in the red till December 2020. The GoN has suspended all international and domestic flights till June 14, 2020. Even post lifting of suspension, passenger growth will face a sharp contraction considering the inhibitions of travelling anywhere till the pandemic scare has been settled fully in the domestic regions and internationally especially on certain routes. Countries including Nepal will not be issuing visas anytime soon fearing the rise of any exigency with the entry of foreign nationals. Further, construction of Pokhara International Airport in Pokhara and Gautam Buddha International Airport in Bhairahawa has largely been affected.

Recommendations

The GoN has not announced any major package for relief of various sectors yet. Hence, Nepalese airlines are still seeking a comprehensive bailout package which will aid the beleaguered industry considering the entire fleet is grounded and unable to operate which is resulting in the airlines incurring heavy losses.

The government will need to intervene in order to provide aid maybe in the form of

- Grant 100% waiver on existing Airport Navigation Services (ANS) charges for the duration of Covid-19.
- To grant aircrafts waiver on parking and housing charges and landing charges post the lifting of the lockdown for few months' period.
- Defer repayment of loans and interest for few months.

3. Cement

The cement industry is facing decline in end user demand due to the lack of activity in the housing and infrastructure sector. Further, with whole industry being shut down, impact can be seen on easy availability of raw materials for smooth operation. With this, the cement industry is expected to remain in the red zone till October 2020 at least, till the end of the monsoon season. Partial recovery is expected November 2020 onwards and normalisation of operations post January 2021 onwards.

4. Drugs & Pharmaceuticals

The operations of pharmaceuticals industry being considered necessary, came under the ambit of essential manufacturing. This has kept production activities at many pharma companies less affected. Production has been affected due to shortage of raw materials. Further, import of pharma products have been impacted due to lower supply by foreign countries. However, various relaxations given during lockdown is believed to have supported the operations of pharma companies. Thus, these factors will continue to keep the pharma industry in neutral zone for the month of June 2020.

Following this, the industry is expected to enter in green zone July 2020 onwards as easing of restrictions will pick up pace in Nepal thus allowing movement of goods and people which will aid the flow of pharma products. Also, the industry will see pent up demand for treatments that were postponed which will further support the demand for drugs. Moreover, the demand for medicines will increase during the monsoon season as the distributors and retailers normally stock drugs for the season. These parameters will augur well for pharma industry.

The manufacturing activities of pharma industry being considered essential continued even during the lockdown though some pharma players were operating at suboptimal capacity in the initial days of lockdown. This was primarily due to shut down that affected the movement of labour and disrupted logistics activities during the first few weeks of the announcement. However, with the pharma industry being considered essential and subsequent easing of restrictions for the industry prevented the pharma companies from labour shortage and logistics issues to an extent. Also, ongoing operations in the industry have restricted any major liquidity problems for the industry. The demand for drugs and pharma remains steady to a large extent and the level of operations continues to pick up pace.

5. Gems & Jewellery

In the Covid-19 scenario, most units of the gem and jewellery industry were brought to a halt with nil or limited operations, as workers faced restrictions on traveling to work stations. With a nation-wide lockdown, jewellery retailers had temporarily shut shops, which impacted domestic demand and thereby sales. Also, the gems and jewellery industry is facing hurdles with virtually no footfalls in their jewellery stores. High gold prices also added to the woes. The gems and jewellery industry continues to face hurdles in the form of high custom duty. However, NRB has allowed commercial banks to accept gold as interest bearing deposit that is expected to infuse more cash into the market and help banks in maintaining its obligation for liquid assets. The situation remains grim at least till Q1FY21. We could expect recovery Q2FY21 onwards, owing to limited or nil lockdown in the country and globally. Q2FY21 also marks the start of auspicious festivals and wedding season which will uplift domestic jewellery demand. However, full recovery of the gems and jewellery is still distant and not in visible until FY22. During 9MFY20, the import of Gold is down by 48% in comparison to the import of Gold during 9MFY19.

6. Hospitality & Tourism

Travel and tourism was one of the worst hit sector due to Covid-19 pandemic. Visit Nepal Year 2020, an initiation by the Government of Nepal (GoN) with a target to bring 2 million foreign tourists in the county, resulting in infrastructure development and huge public as well as private investments in the tourism and hotel sectors has been cancelled by the GoN in light of the Covid-19. This is expected to have negative financial and operational implication on all the players in the tourism and hospitality sector in the meantime. There has been 13.82% decline in the international tourist arrival in the country during 9 month's period in FY20 as compared to the same period in previous year. India and China which are severely affected by the corona crisis cumulatively account for more than 35% of the inbound tourists in Nepal. With the continued lockdown and travel restrictions in the country along with a halt on hospitality services, demand, logistics, labour and liquidity is expected to continue to be under pressure. Also, even after lockdown is lifted, leisure travel is expected to be marginal over health concerns leading to distressed domestic travel while foreign travel is estimated to be minimal or negligible for the year impacting the occupancy rates and the average room rates significantly for the industry.

Industry recommendations – Affected adversely by the Covid-19 pandemic, the country's travel and hospitality industry is in jeopardy. Further, international tourists' arrival is expected to decline by 20-30% in FY20 resulting in loss of USD 300-450 Bn globally in international tourist receipts according to the UNWTO. The nationwide lockdown has shuttered hotel and travel sectors, clogging their earnings. The situation is likely to worsen in the event of wide and prolonged outbreak of the Covid-19. Therefore, it is crucial for the GoN to address this sector via wide recovery plans, policies and relief packages.

7. Hospitals

The nation-wide lockdown announced by the government has been affecting footfalls in hospitals. With the announcement of first lockdown, the government encouraged suspension of routine services and non-emergency services by hospitals so as to prioritize the treatment of Covid-19 patients and to ensure social distancing norms to prevent infection of the virus. Also, some hospitals suspended outpatient departments (OPD) to ensure safety of its healthcare workers and to avoid the spread of infection in healthcare premises.

Even with relaxations in recent lockdowns, patients will be hesitant to visit hospitals to avoid infection and will continue to postpone their non-essential treatments. This condition will continue to keep hospitals in red zone in the month of June 2020. Also, patients that need to visit to other cities for their treatment may opt for treatments when travelling is smooth and is functioning efficiently to avoid unnecessary problems. With government advancing relaxations in subsequent lockdown and adhering strict norms, it is expected that patients will start visiting hospitals without much reluctance from July 2020 onwards. Also, hospitals will find better solutions to provide treatments to non-Covid19 patients. This, in turn, will aid hospitals to move to a neutral zone.

The hospitals are expected to return to green zone or to normalcy level November 2020 onwards as hospitals and patients will try to adapt themselves to the Covid-19 environment and social distancing norms.

The hospital services being considered as essential services has not resulted in significant problem for movement of healthcare workers and emergency instruments for hospitals. Also, guidelines issued during lockdown mentioned that movement of all medical personnel, nurses, para-medical staff, other hospital services including ambulances will not be restricted. Also, supply chain serving hospitals were to remain functional. Fearing the infection of Covid-19, many patients are delaying their non-essential treatments which indicate weak demand from this segment of patients that is affecting the operation level of hospitals. Along with this, the operation rate also stands impacted with preference to be given to the treatment of Covid-19 patients. Liquidity also remains a problem for hospitals as non-essential treatments and routine services provided by them stands disrupted which is affecting their cash flows as they continue to bear fixed costs like remuneration to doctors, nurses among others.

8. Media and entertainment industry

The media and entertainment sector is facing the ripple effects of Covid-19. Industries such as print, film exhibition, TV production, radio, live events, stage shows, music and out of home media are negatively impacted, while digital media and OTT platforms have gained.

Media and entertainment is a labour intensive sector and with restrictions on movement of people, production of new movies and fresh content for TV viewers has come to a halt. Film producers are facing liquidity issues as they are unable to release movies on the scheduled dates. Print industry is grappling with logistics challenge of circulating newspapers, which hits their subscription revenue. Most segments of the media and entertainment sector are heavily dependent on advertising income. However smaller segments such as radio, live events, out of home media have advertising as their only or largest source of revenue and in the present Covid-19 scenario most corporates have reduced their advertisement spends, it being a discretionary expense.

Timing of recovery of the media and entertainment sector is directly dependent on how soon the lockdown in the country concludes. As the sector is labour intensive, it is quintessential for restrictions on movement of people to end. If the lockdown is assumed to end in June 2020, segments such as TV production, film exhibition, out of home, live events, print can start functioning. However, certain segments will still not be functioning normally as general public will have increasing anxiety to go to a film theatre or attend a live event which has mass public gathering. Also, at least till the next 6-7 months, advertising income will not grow as robustly as in the pre-covid era as most corporates shall restrain their discretionary spending. Therefore, full recovery of the media and entertainment sector is not expected until Q3FY21.

9. Power Sector

Nepal's power sector has come a long way from decade long load shedding having more than 20 hours of scheduled power cuts to no scheduled power cuts currently. Nepal Electricity Authority (NEA) and Independent Power Producers (IPPs) have significantly increased the installed capacity of power projects in last 4 years. However, recent Corona Virus (Covid-19) pandemic which has impacted entire Nepalese economy has affected power sector as well. The emerging disruption caused by the Covid-19 pandemic will add weakness to the sector which otherwise had been progressing well for last few years.

Power supply has been uninterrupted during the lockdown given its status of being an essential service. Owing to countrywide lockdown declared by Government of Nepal (GoN) to contain the pandemic, industries across Nepal has been shut down for more than a month. Though GoN has eased the lockdown and has allowed certain industries to start its operation, due to unavailability of labour and logistical issues few industries have started partial operations. This has resulted in decrease in demand of electricity. Considering 40% of NEA's revenue generated from industries during FY19, NEA's revenue is likely to be declined substantially during this period. However, in case of domestic consumers, NEA's revenue might not get impacted. However, due to lockdown, NEA has been unable to do meter reading for all the consumers and is unable to receive the payments for the due amounts from the consumers. Due to this reason, NEA is likely to have a stress in its cashflow position.

The recent government has decided to provide a relief package to tackle the effects of Covid-19 pandemic where NEA provided 25% discount on monthly tariff for limited period of two months which can be seen as an effort to boost the demand and to promote electric cooking to tackle the shortage of Liquid Petroleum Gas (LPG) cooking gas in the country.

Power sector has been categorized as a priority sector and apart from various incentives provided by GoN, Nepal Rastra Bank (NRB) through the Monetary policy has mandated Commercial Banks to disburse a minimum of 15% of their total credit to energy and tourism sector to boost the sector with required liquidity. BFIs would be least impacted from the under-construction projects as repayment of instalments would not be due and interest during construction are being capitalized by Banking and Finance Institutions (BFIs) for such projects. As operational projects are least likely to be impacted by the current situation, such projects might not put pressure in BFIs asset quality. However, if the current situation prolongs, operational projects could be also get impacted due to stress in cashflow of NEA.

Recommendation:

Nepal's Power sector is expected to see a decline in coming months, due to the likely prolonged disruptions caused by the Covid-19 pandemic. As the pandemic has impacted other countries like India, China and European countries with whom the sector relies heavily for materials supply and technical support, power sector will take substantial time and effort to come on track. Electricity demand is expected to contract during the year, largely driven by slippages in commercial and industrial demand. With the industrial and commercial sector together accounting for nearly 46% of the country's electricity consumption, a decline in their consumption would no doubt weigh down overall demand. With the pandemic bringing activity in these sectors to a standstill, electricity demand by these segments is to see a significant decline this year. Additionally, with NEA being a sole customer to off take the electricity generated by IPPs, stress in its financial health could impact overall power sector. The increase in power demand would be contingent on the resumption of commercial and industrial activity. The reduction in intensity of pandemic would be a key monitorable for the recovery in the sector. The government may consider providing additional relief or stimulus to the sector. There could also be relaxation and flexibility in compliances, reduction in interest rates, increase in the moratorium period for repayment of loan obligations etc.

10. Real Estate

The Real Estate sector is to partially start recovering July 2020 onwards on this basis ongoing construction should ideally begin and by November 2020, festive demand and improvement in the macros should ideally normalise the operations of the sector. While commercial & new residential launches, sales and new leasing will not be able to fully recover in the aforementioned timelines, focus on project completing and clearing of existing inventory will be the focus area of realtors during this time.

11. Wholesale and Retail

The wholesale and retail industry contributes 14.37% to the nation's economy and is the second contributor to the economy after agriculture and employed more than 1.24 Mn workers directly in FY18. This sector is severely affected by significant downfall of imports from Indian and China, largest trading partner of Nepal, aftermath the Covid-19 outbreak. While retail industry for essential goods and services continues to function without restrictions, logistics, labour and liquidity remains an issue for non-essential goods and is expected to normalise only by Q2 FY21 and continue to improve further in Q3 FY21. Demand for non-essentials might also take longer to recover; even if the malls open; the footfalls will be very low as consumers will be extra cautious. The supply of raw materials would be difficult on account of disrupted supply chains. Wholesale and retail trade accounts for 20.4% of the total credit of the banking sector in Nepal at the end of first 9 months of FY20. Retail inflation was at 6.74% in April 2020 higher than 4.4% witnessed during the corresponding month a year ago which has been largely driven by elevated food price inflation. Also, wholesale inflation rose to 3-months high of 7.8% in April 2020 compared with 6.6% in March 2020 and 4.4% in April 2019 mainly due to significant increase in the food prices which was partially offset by deflation in fuel and power component.

12. Consumer durables

Consumer durables – mixed bag, demand for some products such as smartphones, premium TV sets, ACs, etc witnessed an uptick, but logistics remain an issue, festival demand likely to pick up in Q2 FY21 and continue momentum going forward. However, discretionary spending is expected to be curtailed by consumers during the year impacting demand for consumer goods considerably. AC and refrigerators sales are likely to be significantly impacted as large part of summer season (April – June) has been under lockdown.

13. Construction

Since Nepal is a developing country so infrastructure development is the back bone for prosperity of the nation. This sector's contribution to the GDP of Nepal is 7.23% and employment is 13.8%. After decades of unstable government, currently the political situation is stable and are more focused on development of infrastructure including hydropower projects, tourism, railways, roads, bridges etc. which has increased the scope of construction business in the economy. Also, many infrastructures were destroyed in most parts of the country due to earthquakes and its aftershocks, so there is good business for construction and reconstruction of infrastructures.

However, in the wake of Covid-19 pandemic resulting in nationwide lockdown and closure of many industries, the construction sector is severely affected. It is expected that the construction sector will contribute Rs. 488 Mn in FY20 which is a decline of 0.31% as compared to previous year. Any decline in this sector gets translated into decline in demand for other sector as well such as manufacturing, transportation, trade and services. Further, the construction and manufacturing activities of several sectors such as cement, hydropower, steel and other various projects etc. has been halted. Also, there has been shortage of labours on account of fear of working in epidemic and many projects operated by foreign contractors and migrant labours followed by job loss for many workers in the industry due to the Covid-19 pandemic. The supply chain network has been disrupted due to closure of border and suspension of import- export activities with the exception of essentials. It is expected that 75% of the currently ongoing construction projects are more likely to be closed for the remainder of the current financial year due to nationwide lockdown. Additionally, the lockdown started in the midst of the busiest time for the construction industry i.e. usually after November and before the monsoon begins in June and thus is expected to have negative impact over revenue generation, profitability margins, debt coverage indicators and cash flows of many businesses. It is expected with construction activities being halted due to lockdown, all construction contracts will undergo time extension negotiation resulting in cost escalation effect which needs to be addressed by the government in an effective manner being one of the biggest client for the construction sector.

In the meantime, it is important for the government to introduce effective fiscal stimulus/ relief packages to revive the sector as this sector is one of the main employment generator in the country and growth in this sector will more likely augment growth of manufacturing sector as well. Nonetheless, there is huge opportunity for construction companies since Nepal is a developing country and government is prioritizing infrastructure development.

14. Steel

We expect steel industry largely to be impacted during FY21 as compared to FY20 due to increased number of players in the industry. Further, Covid-19 has impacted demand due to the lack of activity in the housing and infrastructure sector followed by shipment of raw materials which are majorly imported from India. Most steel plants are running at lower capacity utilisation levels. The capacity utilisation for TMT Bars and other allied products is expected to be reduced significantly during FY20. Most of the peak season demand for steel has been lost and the weak June and September quarters will pull down steel demand for FY21.

Steel demand may not return to pre-covid levels in FY21 but will see gradual recovery from the Q2 with Q3 and Q4 to be further better. This will be driven by resumption in demand with increase in development and construction works.

Recommendations:

Stimulus package from government is required to create demand for steel. Timely Implementation of infrastructure and development projects as announced by government.

15. Textiles

The Covid-19 pandemic has disturbed the demand-supply situation of the Nepalsese textiles industry. The demand for textiles has been facing headwinds in both the markets, domestic and international. The closure of retail stores and malls on account of lockdown situation across the nation has been affecting industry's sales. Also, consumers are expected to restrict their movements to buy essential goods and services so as to avoid any chance of infection. Even when restrictions and lockdown are lifted completely, demand for textiles will take time to pick up. This is because footfalls will be low in malls and retail stores as people will avoid visiting crowded markets and will be skeptical of touching garments. Moreover, export demand for textiles will also remain under pressure as demand for not so essential goods will take time to pick up. Weak demand will continue to impact cash flows and the shortage of labour at many textile firms will together affect textiles industry production. All these factors are expected to continue to keep the textiles industry in red zone for the period June-September 2020.

The impact of Covid-19 on textiles industry is likely to moderate in the third quarter of FY21 as the industry is expected to witness pent up demand for apparels and garments with festivals like Dussehra, Diwali and Christmas falling during this period. Also, advancing of relaxations by the government may open up shopping malls. Moreover, to ensure safety of customers the retail outlets and shopping zones are also expected to follow strict guidelines which to an extent will alleviate the fear of infection among consumers. Also, export demand for textiles is likely to increase as the international markets will continue with their efforts to contain virus and to resume with normal activities which may bring normalcy in these markets. A likely growth in demand will push up production and also expected returning of migrant labour to work will support the textiles industry output.

In the last quarter of FY21, the industry is likely to enter in green zone with demand from domestic and exports markets expected to return to normal levels as nations across the globe contemplate to find better ways to fight the Covid-19 pandemic.

The unsold stock with the industry players may soon be out of fashion for the next season to come which will add to their burden. The unfavourable demand scenario in domestic and export markets have been leading to pile-up of inventories which is creating liquidity issues for textile companies. The lockdown situation in initial phases had restricted the operation capacities of textiles industry. Nevertheless, the lockdown guidelines now have been eased for various manufacturing units thus improving their logistics problems to an extent which is aiding them to improve their operation capacities. Also it is to be noted that not so favourable demand scenario is restricting textile firms to utilize their full capacities and is bounding them to undertake production cuts. Labour disruption (many labour have migrated to their hometowns) however continues to limit operation capacities of the industry.

What more can be done?

Although, the measures introduced by the NRB provided temporary relief to the bank borrowers, If we were to draw up a further wish list on what should be on the agenda of the government to bring about some momentum in demand, the following can be considered.

1. Tax breaks for individuals to give push to demand.
2. Lowering of VAT rates especially on consumer goods to provide an incentive which can be for a fixed period of time of 6 months to cover the festival cum harvest season.
3. Deferment of corporate tax payments for the year if not a tax holiday.
4. Higher government expenditure on capex on roads, rural construction, urban infrastructure etc. that will generate jobs for everyone. In fact, the migrant labour that has gone back to their hometowns can be engaged in such activity.
5. Specific temporary funding for sectors such as hotels, aviation, auto, real estate, gems and jewellery, etc. To address the concerns of banks on risk, a guarantee can be extended for a limited period by the government. This will enable to flow of funds to these sectors which will require funding on a large scale to meet costs such as salaries and wages and operations once functional.

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