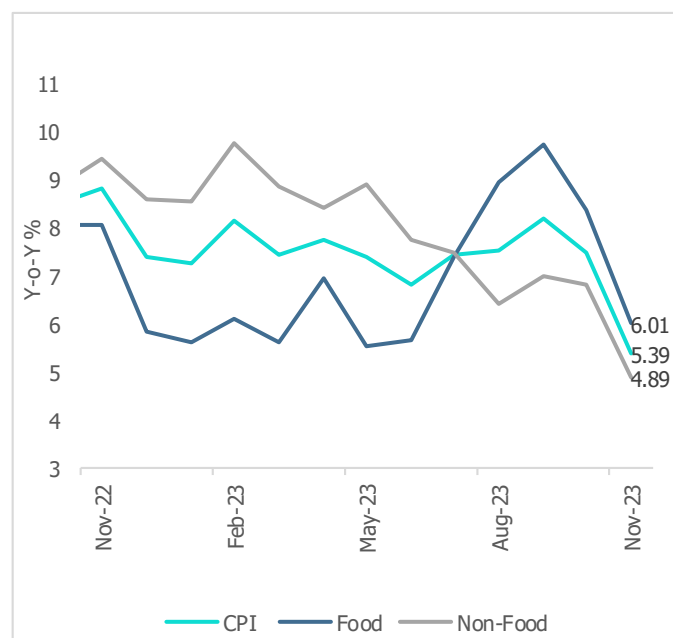


Nepal's economy is currently showing a reduction in inflation and a rise in foreign exchange reserves. While fall in global commodity prices has helped in bringing inflation down, a subdued domestic demand, contrary to the expectations during Nepal's festive season, could also have weighed on the inflation numbers. Notably, the surge in foreign exchange reserves is primarily driven by a reduction in imports, indicating subdued domestic demand and easing commodity prices. Given Nepal's status as a consumption-based economy, this trend raises concerns about potential risks associated with low economic growth in the future.

Inflation

Consumer price inflation (year-on-year) eased to 5.4% in mid-November 2023, a 22-month low from 8.8% in mid-November 2022. In the food and beverage category, inflation was recorded at 6%, while non-food and service category inflation stood at 4.8% for the same period. Even though inflation has moderated within the central bank's target of 4-6%, the decrease is during Nepal's significant festival season, a period traditionally marked by rising prices, increased hoardings and black marketing.

Inflation trend



Source: Nepal Rastra Bank

Several factors may have contributed to the observed trend in inflation. Firstly, consumer spending has reduced, a consequence of slow economic growth that has resulted in widespread job losses and company layoffs. Despite the absence of disruptions in the supply chain, there has been a sudden and notable decline in overall demand. Additionally, base effect has played a role, as mid-November 2022 had a notably high inflation rate, making any decrease in mid-November 2023 appear proportionally larger. Furthermore, some global commodity prices, especially fuel prices, have exhibited signs of stabilisation, potentially moderating Nepal's import costs and contributing to the inflation slowdown. However, it is crucial to acknowledge that despite the apparent decrease, underlying pressures, such as global food and energy costs and supply chain inefficiencies, persist and haven't entirely dissipated.

Meanwhile, year-on-year wholesale price inflation was at 2.1% in mid-November 2023, a notable decrease from the 10% reported in mid-November 2022. The WPI inflation for consumption goods, intermediate goods, and capital goods saw increases of 2.6%, 1.7%, and 2.7%, respectively. Conversely, the WPI inflation of construction materials decreased to 1.1% in mid-November.

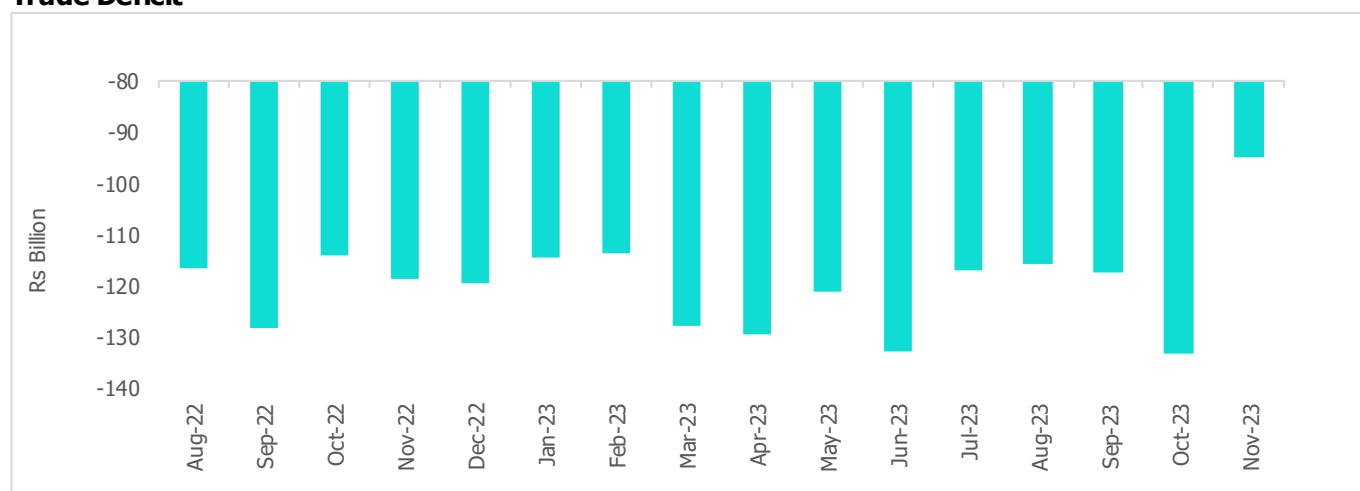
First quarterly review of the monetary policy - December 2023

The Nepal Rastra Bank (NRB), in its analysis of factors influencing current inflation, has opted to reduce bank rates from 7.5% to 7%. Concurrently, repo rate has been reduced to 5.5%, in contrast to the previous 6.5%. Amid the prevailing economic slowdown, the private sector has consistently urged the central bank to ease monetary policy. There have been no changes to the provisions concerning mandatory cash reserve ratios and statutory liquidity ratios.

External sector

During mid-November 2023 the value of merchandise exports showed a 25.2% decline to Rs 9.69 billion, from Rs 12.95 billion in mid-November 2022. Specific items such as zinc sheet, particle board, juice, readymade garments, polyester yarn & thread, and others recorded growth. In contrast, exports of palm oil, soyabean oil, tea, woollen carpet, rosin, and others decreased. In mid-November 2023, merchandise imports contracted by 20.5% to Rs 104.74 billion, compared to Rs 131.69 billion in mid-November 2022. Notable increases were observed in the imports of readymade garments, M.S. wire rods, bars, and coils, electrical equipment, textiles, aircraft spare parts, and others. In contrast, imports of crude soyabean oil, gold, petroleum products, crude palm oil, M.S. billet, and others decreased. Nepal being a consumption-based economy, the decrease in imports hints towards low domestic demand and potential risk of low economic growth in the future. The total trade deficit saw a reduction to Rs 95.05 billion, indicating an improvement from Rs 118.73 billion in mid-November 2022.

Trade Deficit



Source: Nepal Rastra Bank

The current account showed a surplus of USD 0.73 billion for the first four months of the current fiscal year, contrasting with the deficit of USD 0.30 billion in the same period last year, owing to narrowing of trade deficit and an influx of remittances. The Balance of Payments (BOP) also remained in surplus at USD 1.11 billion for the first four months of the current fiscal year, in contrast to the surplus of USD 0.15 billion in the same period of the previous year.

Forex Reserves and Import Cover



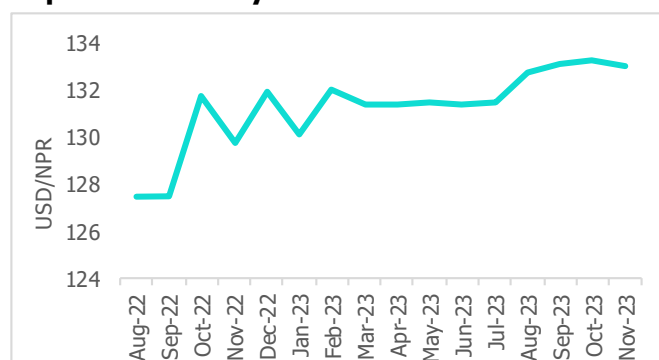
Source: Nepal Rastra Bank (*Import capacity includes cover for merchandise & services)

The gross foreign exchange reserves saw an 8.9% increase from mid-July 2023, reaching USD 12.7 billion in mid-November 2023. This was due to a notable decrease in imports and increase in remittance inflows. Remittance inflows grew by 23.1% to USD 3.60 billion, compared to a 10.8% increase in the same period of the previous year.

The foreign exchange reserves are adequate to cover prospective merchandise and services imports for 11.3 months. The ratios of reserves-to-GDP and reserves-to-imports, stood at 31.5% and 94.3%, respectively, in mid-November 2023. These ratios were 28.6% and 83.0%, respectively, in mid-July 2023.

Currency movements

Nepalese Currency Performance



Source: Nepal Rastra Bank

The Nepalese currency, in relation to the US dollar, experienced a depreciation of 1.19% in mid-November 2023 compared to mid-July 2023. The exchange rate per US dollar was recorded at Rs 133.04 in mid-November 2023, compared to Rs 131.47 in mid-July 2023.

Monthly Data of Key Economic Variables

Indicators (Mid-Month)	July 2023	August 2023	September 2023	October 2023	November 2023
Consumer price inflation (y-o-y%)	7.4	7.5	8.2	7.5	5.4
Wholesale price inflation (y-o-y%)	4.9	4.3	4.8	2.8	2.1
Export growth (y-o-y%)	-4.5	-8.7	-6.9	9.8	-25.2
Import growth (y-o-y%)	-17	-1.6	-8.3	16.1	-20.5
Trade deficit (Rs billion)	117.2	115.7	117.5	133.6	95.1
Worker's remittances (Rs billion)	1,220	116.0	228.4	365.3	477.9
Foreign exchange reserves (\$ billion)	11.7	11.8	12.0	12.3	12.8
Domestic credit (y-o-y%)	8.7	7.3	7.6	9.0	8.8
Deposits (y-o-y%)	12.3	11.9	13.2	14.9	14.3
Repo rate (%)	7	6.5	6.5	6.5	6.5*
Bank rate (%)	7.5	7.5	7.5	7.5	7.5*
Weighted average deposit rate (%)	7.8	8.0	8.1	7.9	7.8
Weighted average lending rates (%)	12.3	12.2	12.2	12.1	12.0

Source: Nepal Rastra Bank (*Policy rate cut in December)

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