

Nepal: Export Slowdown, Weak Currency Present Challenges

February 28, 2023 | Economics

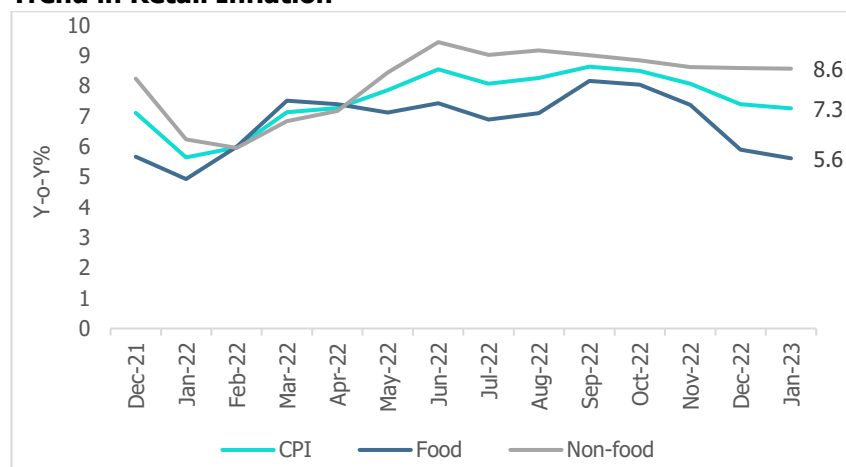
High-frequency indicators of Nepal's economy painted a mixed picture of the country in the month ended mid-January. Indicators like inflation, remittance inflows, and reserves remained supportive of recovery. However, declining foreign direct investment flows, export slowdown, declining tourist arrivals and weak credit offtake remain a challenge.

Inflation Eases for the Fourth Straight Month; Non-Food Inflation Remains a Concern

Retail inflation softened for the fourth straight month to 7.3% in the month ended mid-January compared with 7.4% in the previous month, mainly due to lower food inflation. Food inflation dropped further to 5.6% in January from 5.9% in the previous month, supported by a fall in vegetable prices. Non-food and service inflation remained sticky at 8.6% on account of high inflation in the health, transportation, and housing categories.

In contrast, wholesale inflation increased to 9.8% in the month ended mid-January from 9.2% in the previous month. The rise was driven by a 9% rise in manufactured goods inflation, 5.3% rise in primary products and a 32.4% rise in the fuel and power component of inflation.

Trend in Retail Inflation



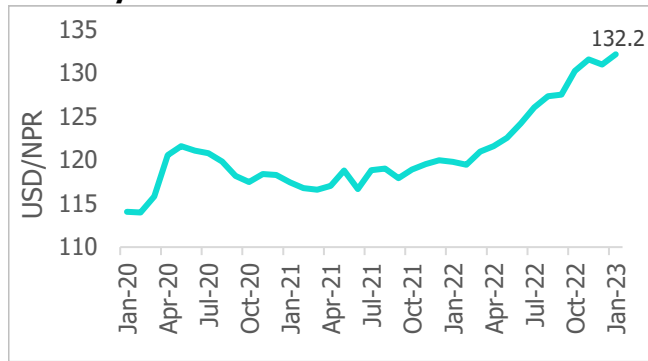
Source: Nepal Rastra Bank

Trade Deficit, Remittances and FDI Flows Remain Supportive of Recovery

Nepal's merchandise exports dropped by 15% (y-o-y) to Rs 13.5 billion in the month ending mid-January, as against an increase of 48% in the same period of the previous year. Even on a sequential basis, exports registered a contraction for the tenth consecutive month. Meanwhile, merchandise imports decreased 21% to Rs 128 billion against an increase of 19% a year ago in the month ending mid-January. With a share of 19% and 5%, petroleum products and machinery parts dominate the import basket. The total trade deficit narrowed to Rs 114 billion in the month to mid-January from Rs 119 billion in the previous month. In the first six months of the current fiscal year that began in August, the trade deficit narrowed to Rs 712 billion from Rs 880 billion in the same period a year ago. While crude oil prices in the international market have witnessed some moderation, they still remain elevated. Looking ahead, higher oil prices and further weakness in the local currency could weigh on Nepal's trade deficit. Remittances, which make up nearly one-fourth of the GDP, continued to record healthy growth and stood 24%

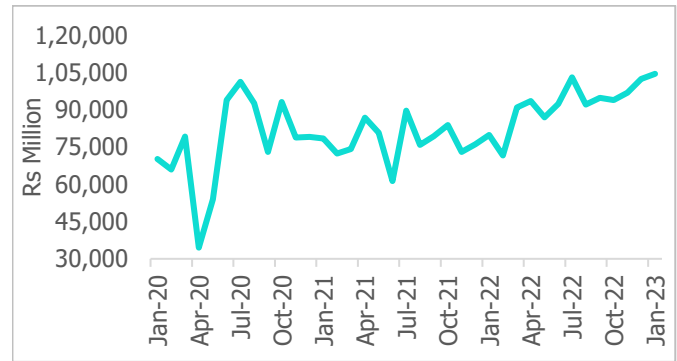
higher at Rs 585 billion in January, compared to a year ago. Nepalese currency however weakened 1% against the US dollar to 132.2 in mid-January 2023. Foreign direct investment continues to remain anaemic, as FDI flows stood at USD 19.7 million in the six months ending mid-January, almost 80% less in the current fiscal year (August-January) compared to the same period last year. The sequential decline in the trade deficit and healthy remittance inflows have nonetheless helped in improving the overall Balance of Payments.

Currency Weakness Continues



Source: Nepal Rastra Bank

Remittances Flows Remain Supportive



With the rise in remittances income, Nepal's foreign exchange reserves increased by 4% (y-o-y) to USD 10.3 billion in the month that ended mid-January. The current level of forex reserve is sufficient to cover imports of goods and services for 9.1 months, higher than the average import cover of 7.1 months in 2021-22.

Credit Offtake Witnesses a Slump

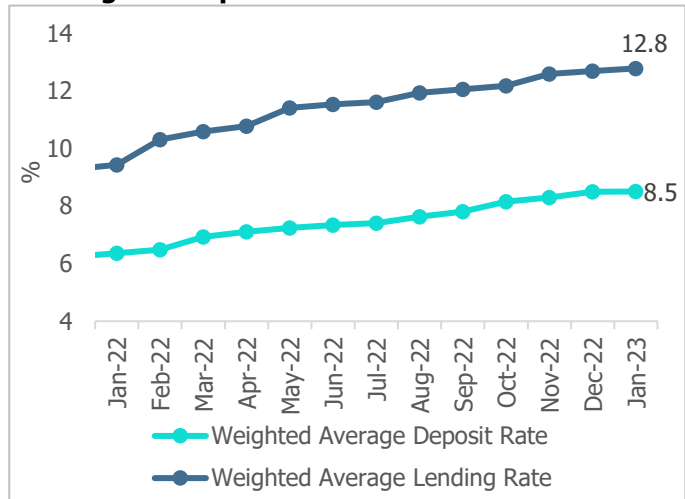
Outstanding credit of banks and financial institutions grew 2.5% in the six months ending mid-January from 11.5% in the same period a year ago. Key sectors such as manufacturing, wholesale and retail businesses, and transportation reported a notable slowdown in credit offtake. A steady rise in weighted average lending rates during this period (from 11.9% in August 2022 to 12.8% in January 2023) could be one of the reasons for the slump in credit growth. Meanwhile, deposits grew 3.9% in the August-Jan period, compared to 3.4% growth in the same period a year ago. While higher deposit rates bode well during a liquidity crunch, higher lending rates could put pressure on credit demand in the economy and dampen investor sentiments.

Sector-wise Credit Offtake (y-o-y %)

Sectors	H1FY22	H1 FY23
Agriculture	13.0	3.7
Mines	0.6	24.6
Productions	11.9	8.4
Construction	-48.8	3.1
Metal Productions, Machinery, and Electrical Tools and fitting	22.1	5.4
Transportation Equipment Production and Fitting	7.3	-1.0
Transportation, Communications and Public Services	8.5	8.2
Wholesaler and Retailers	12.7	3.9
Finance, Insurance, and Fixed Assets	8.1	-2.7
Service Industries	5.1	4.6
Consumable Loan	440.8	1.3
Local Government	-8	0.2
Others	-39.3	-10.6
Total	11.8	2.5

Source: Nepal Rastra Bank

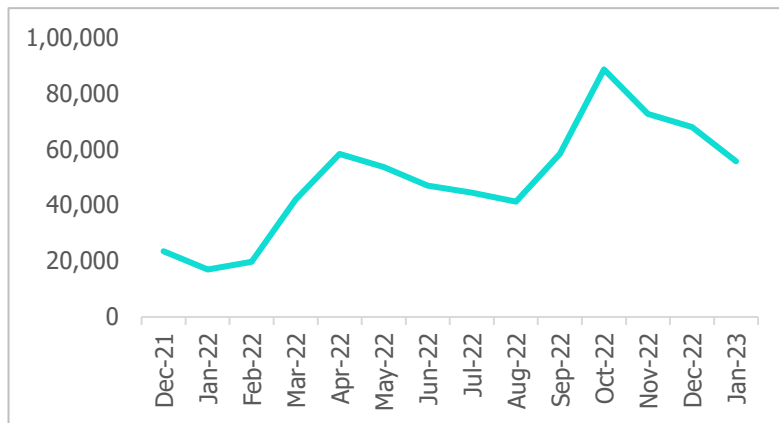
Lending and Deposit Rates On The Rise



Tourist Arrivals Slow Down

Being the fourth largest employer in Nepal, a revival in the tourism sector could provide a boost to the economy. A total of 614,148 tourists visited Nepal in 2022, while there were 230,085 and 149,833 tourists in the pandemic years of 2020 and 2021, respectively. On a sequential basis, however, tourist arrivals declined 18% (y-o-y) in January to 55,704, contracting for the third straight month.

Monthly Tourist Arrivals Decline For Third Straight Month



Source: Nepal Rastra Bank

Going forward, Nepal's exports and tourism industry could take a hit on account of an impending global slowdown. Being an import-dependant country, further weakness in the local currency and worsening of the trade imbalance could have a significant bearing on the inflation trajectory, and limit growth prospects.

Monthly Data of Key Economic Variables

Indicators (Mid-Month)	September 2022	October 2022	November 2022	December 2022	January 2023
Consumer price inflation (y-o-y%)	8.6	8.5	8.1	7.4	7.3
Wholesale price inflation (y-o-y%)	14.0	13.7	10.0	9.1	9.8
Export growth (y-o-y%)	-40.4	-37.5	-24.1	-39.7	-32
Import growth (y-o-y%)	-13.1	-22.3	-23.3	-29.8	-20.7
Trade deficit (Rs billion)	128.4	114.3	118.7	119.5	114.4
Worker's remittances (Rs billion)	187	281.1	378	480.5	585.1
Foreign exchange reserves (\$ billion)	9.3	9.5	9.6	9.8	10.3
Domestic credit (y-o-y%)	11.7	10.5	10.5	10.1	8.7
Deposits (y-o-y%)	7.4	8.2	8.6	9.5	9.4
Bank rate (%)	8.5	8.5	8.5	8.5	8.5
Weighted average deposit rate (%)	7.81	8.16	8.32	8.46	8.51
Weighted average lending rates (%)	12.06	12.19	12.65	12.74	12.79

Source: Nepal Rastra Bank

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