

Nepal Economy: Growth Outlook Remains Grim

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FY23 Growth Outlook Revised Lower; NRB Slashes Policy Rate

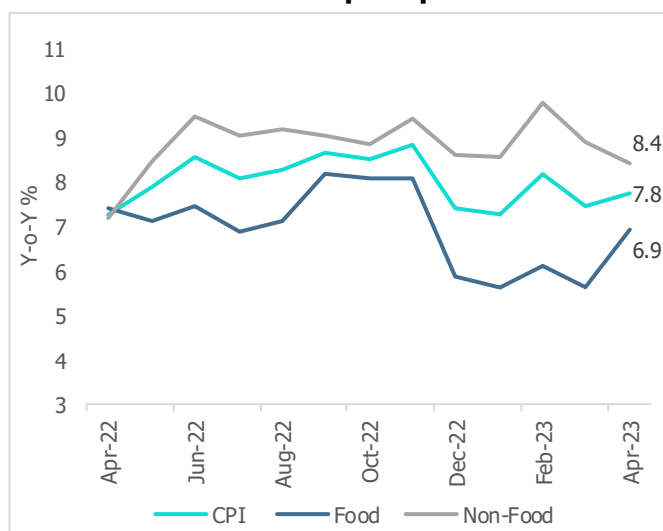
The National Statistics Office (NSO) projected Nepal’s GDP growth rate at 2% for FY23, four times lower than the government’s initial target announced at the start of the fiscal year. The forecast falls well below the estimates of multilateral funding agencies like the Asian Development Bank and World Bank, that estimate GDP growth of around 4%. According to NSO, the growth of the manufacturing sector is likely to decelerate further due to higher interest rates, import restriction measures, and the slowdown in domestic consumption. Moreover, to address the economic crisis, Nepal Rastra Bank (NRB) lowered the bank rate from 8.5% to 7.5% in its third-quarter monetary policy review.

Retail Inflation Rises on Account of Higher Food Prices

Retail inflation rose 40 bps to 7.8% y-o-y in April, on the back of a rise in food inflation. Food inflation inched up to 7% in April, the fastest pace since November 2022, as costs of vegetables and milk products & eggs witnessed a sharp increase. Vegetable prices snapped a 5-month contractionary streak rising 1% y-o-y, while inflation in the milk products & eggs category jumped to an eight-month high of 10.4% y-o-y in April. In contrast, non-food and services inflation cooled in April. Non-food and service inflation eased for the second straight month from 8.9% to 8.4% y-o-y in April. The moderation was led by the transportation segment, which saw inflation move back into single-digit growth for the first time since June 2021. Other categories such as housing and furnishing & household equipment also reported witnessed marginal softening. Although the headline inflation print has come off the record high of 8.6% seen in September 2022, the FY23 average remains over 90 bps higher than the target of 7%.

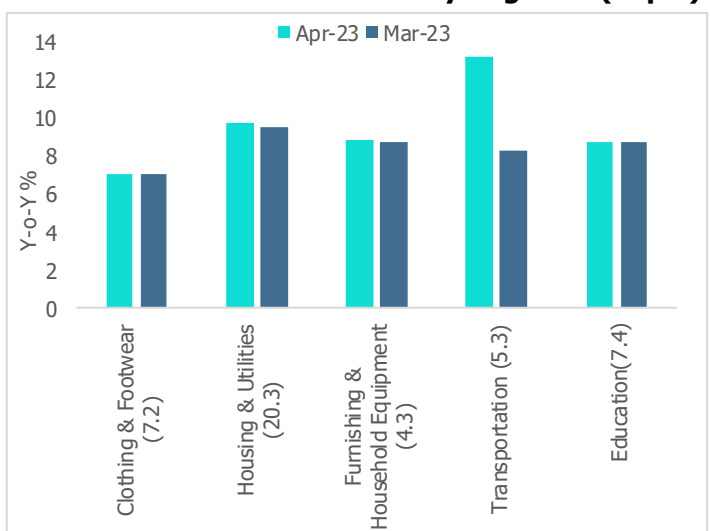
Meanwhile, wholesale inflation softened to a 17-month low of 5.6% y-o-y in April (from 7.1% in March). The moderation was driven by waning price pressures in the fuel and power component (15% y-o-y in April vs 25.8% prior) and manufactured products (6.2% y-o-y in April vs 7.3% prior). Inflation in the primary goods category witnessed a marginal increase from 1.8% to 2% y-o-y in April.

Retail Inflation Inches Up in April



Source: Nepal Rastra Bank

Non-food & Services Inflation by Segment (Top 5)



Source: Nepal Rastra Bank; Figures in brackets are share in overall index

Trade Deficit Widens in April; Remittances Remain Healthy

Nepal’s merchandise exports rose 5% y-o-y to Rs 13.5 billion, while imports decreased 9% y-o-y to Rs 143 billion in the month ending mid-March. The trade deficit worsened to a nine-month high of Rs 130 billion in the month to mid-April. The worsening of the trade position can be attributed to the sequential rise in imports for two consecutive months, reflective of the removal of the eight-month-long ban on the import of luxurious goods. However, for FY23 (August-April), the trade deficit was lower at Rs 1.1 trillion from Rs 1.3 trillion in the same period a year ago. Given that petroleum products account for nearly 20% of the import basket, a rise in crude oil prices in the international markets could worsen Nepal’s trade position going ahead.

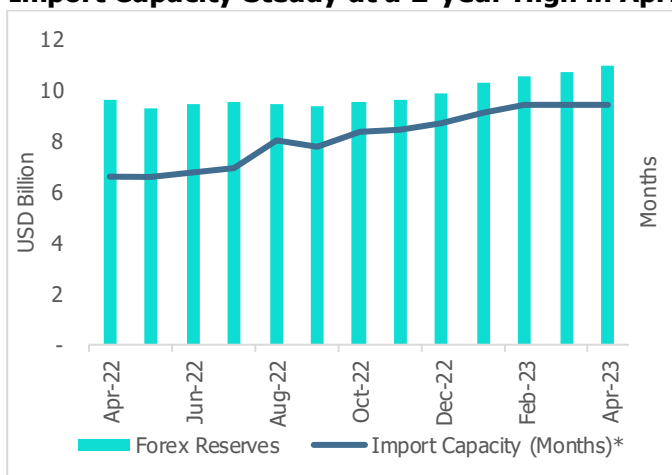
Meanwhile, remittances continued to record healthy growth as foreign employment permits increased by 52% in FY23 (August-April). Remittances stood 24% higher at Rs 903 billion in the first nine months of FY23. With the rise in remittances income, Nepal’s foreign exchange reserves increased 14% (y-o-y) to USD 10.9 billion in the month ended mid-April. The current level of forex reserve is sufficient to cover imports of goods and services for 9.4 months, higher than the import cover of 6.6 months a year ago.

Foreign direct investment continues to remain discouraging despite Nepal’s efforts over the years to attract overseas investment. FDI flows stood at USD 34 million in the nine months ending mid-April, 76% less in the current fiscal year (August-April) compared to the same period last year. That said, Nepal’s balance of payments remained at a surplus of Rs 180 billion in the fiscal year so far, compared to a deficit of Rs 268 billion in the same period of the previous year.

Tourism Industry Remains Supportive

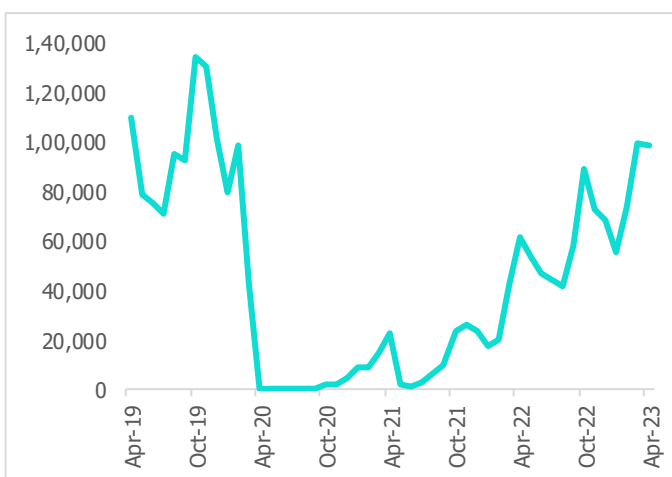
The tourism sector in Nepal, which had experienced a significant decline due to the Covid-19 crisis, is slowly bouncing back. Tourist arrivals in April 2023 stood at 98,773, its highest since the pandemic, taking the FY23 (year so far) footfall to 655,313. This compares to 229,120 arrivals seen in the corresponding period a year ago. Nepal has designated 2025 as a ‘special year for tourism’, announcing efforts to support the recovery of the tourism industry. The government plans to revise tourism-related laws, develop infrastructure to promote destinations amongst the international community, identify and develop new tourist destinations, mitigate safety-related issues, promote film tourism, and create opportunities for adventure tourism.

Import Capacity Steady at a 2-year High in April



Source: Nepal Rastra Bank (*Import Capacity for Goods & Services)

Tourist Arrivals at Pre-Pandemic Levels in April



Source: Nepal Rastra Bank

Going forward, the Nepalese economy will remain exposed to several headwinds. Continued import dependence, shrinking government revenue and high inflation could contribute to waning economic momentum. Additionally, the outlook for the agriculture sector has turned grim with the South Asian Climate Outlook Forum (SASCOF) forecasting below-normal monsoon or even drought-like conditions in Nepal this year. As a result, we could expect inflationary pressures to worsen, while the need to ramp up the import of essential items could further deteriorate the trade position. Overall, mounting challenges could play spoilsport in Nepal's plans to graduate from its status of Least Developed Country (LDC) by 2026.

Monthly Data of Key Economic Variables

| Indicators (Mid-Month) | December 2022 | January 2023 | February 2023 | March 2023 | April 2023 |
|--|---------------|--------------|---------------|------------|------------|
| Consumer price inflation (y-o-y%) | 7.4 | 7.3 | 7.9 | 7.4 | 7.8 |
| Wholesale price inflation (y-o-y%) | 9.1 | 9.8 | 9.7 | 7.1 | 5.6 |
| Export growth (y-o-y%) | -39.7 | -32 | -29 | -29 | 5 |
| Import growth (y-o-y%) | -29.8 | -20.7 | -20 | -19 | -9 |
| Trade deficit (Rs billion) | 119.5 | 114.4 | 113.8 | 127.8 | 129.6 |
| Worker's remittances (Rs billion) | 480.5 | 585.1 | 689.9 | 794.3 | 903.3 |
| Foreign exchange reserves (\$ billion) | 9.8 | 10.3 | 10.5 | 10.7 | 10.9 |
| Domestic credit (y-o-y%) | 10.1 | 8.7 | 8.6 | 8.1 | 8.6 |
| Deposits (y-o-y%) | 9.5 | 9.4 | 10.5 | 10.5 | 11.0 |
| Bank rate (%) | 8.5 | 8.5 | 8.5 | 8.5 | 8.5 |
| Weighted average deposit rate (%) | 8.46 | 8.51 | 8.41 | 8.37 | 8.26 |
| Weighted average lending rates (%) | 12.74 | 12.79 | 13.03 | 13.03 | 12.84 |

Source: Nepal Rastra Bank

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