

Nepal Rasta Bank's FY24 Monetary Policy to Support Recovery

July 27, 2023 | Economics

For the fiscal year starting mid-July 2023, the Nepalese government has adopted a prudent fiscal policy focusing on the rationalization of expenditure and increasing domestic revenue mobilization. The government announced an annual expenditure plan worth NPR 1.75 trillion for FY24. The expenditure estimated is 2.4% lower than the allocation for FY23, and over 16% higher than the revised estimate of NPR 1.5 trillion. Of the total allocation, NPR 1.14 trillion (65%) is assigned to current expenditure, NPR 302 billion (17%) to capital expenditure, and NPR 308 billion (18%) to financing. Meanwhile, the government expects its initiatives to increase the use of digital technology in revenue administration, control revenue leakages, broaden tax base and update tax rates for certain goods, to help achieve targeted revenue of NPR 1.3 trillion in FY24. This compares to the revenue target of NPR 1.1 trillion in FY23. Consequently, the fiscal deficit is projected to decline in FY24 resulting from the estimation of improved performance in revenue mobilization and various policy measures adopted in the budget for rationalization of recurrent expenses. On the borrowing front, gross domestic borrowing is targeted at NPR 240 billion in FY24, lower than the estimated target of NPR 256 billion in FY23. Overall, the government expects fiscal policy to help achieve GDP growth of 6% in FY24, from an estimated 2.2% in FY23.

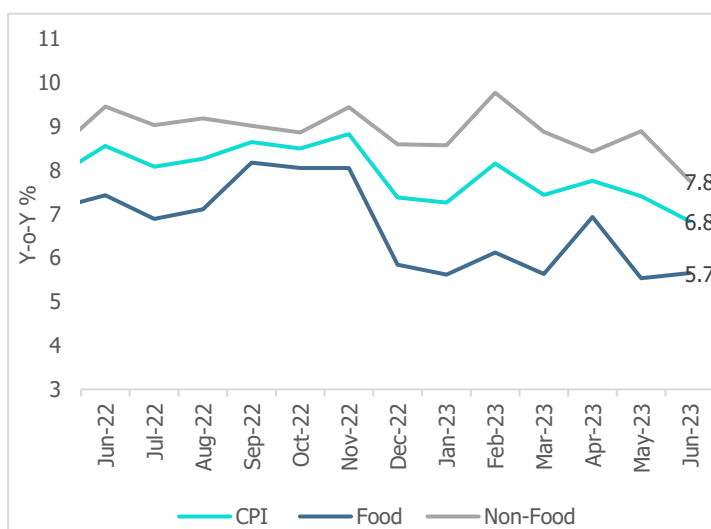
FY24 Monetary Policy Supportive of Recovery; NRB Slashes Policy Rate

Nepal Rastra Bank (NRB) unveiled the country's monetary policy for the fiscal year 2023-24 which has zeroed in on supporting economic recovery, controlling inflation, stabilising interest rates, and ensuring credit demand. NRB reduced the policy rate, the rate at which it lends to banks, by 50 basis points to 6.5%, supporting growth amid an economic slowdown. Meanwhile, NRB kept the bank rate unchanged at 7.5% and lowered the deposit collection rate from 5.5% to 4.5%.

Retail Inflation Eases Below 7%

Retail inflation eased 60 bps for the first time in 16 months to 6.8% y-o-y in June, on the back of moderation in the non-food and services segment. Amongst this segment, inflation in categories such as housing and utilities (8.4% y-o-y in June vs 9.7% in May), transportation (2% y-o-y in June vs 7% in May) and furnishing & household equipment (7.8% y-o-y in June vs 8.3% in May) eased significantly. Food inflation however firmed slightly to 5.7% y-o-y, from 5.5% a month prior. Vegetable inflation picked pace in June (0.3% y-o-y), after contracting 2% in the previous month, while protein-items and spices registered a notable uptick. For the 11 months of the current fiscal year, headline inflation has averaged 7.8%, 80 bps higher than the central bank's target of 7%.

Retail Inflation Moderates in June



Source: Nepal Rastra Bank

Trade Deficit Narrows as Imports Contract; Remittances Remain Supportive

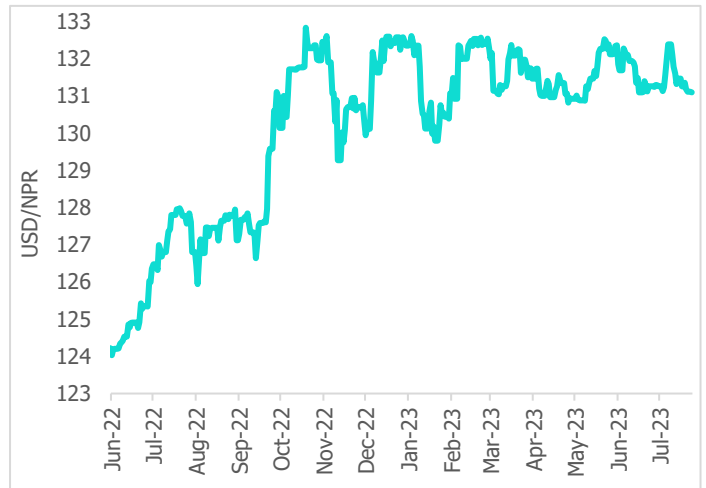
Nepal’s merchandise exports rose 2% y-o-y to Rs 12.7 billion, while imports contracted 8% y-o-y to Rs 145 billion in June. Consequently, the trade deficit narrowed to an 11-month low of Rs 132 billion in June from Rs 143 billion in the corresponding period a year ago. Meanwhile, in the 11 months of the current fiscal year, the trade deficit narrowed by 15% y-o-y to Rs 1.3 trillion. A 40% (y-o-y) decline in crude oil prices in the international market in June has likely supported the trade balance position. Remittances continued to record healthy growth as foreign employment permits increased by 47% in FY23. Remittances stood 23% higher at Rs 1,112 billion in the first eleven months of FY23. With the rise in remittances income, Nepal's foreign exchange reserves increased 1% (y-o-y) to USD 11.3 billion in June. The current level of forex reserve is sufficient to cover imports of goods and services for 9.6 months, up from 6.7 months a year ago. Meanwhile, foreign direct investment (FDI) flows continue to be a pain point for the economy. FDI flows stood at USD 49 million in the eleven months ending mid-June, nearly 70% less in the current fiscal year compared to the same period last year. That said, Nepal’s balance of payments remained at a surplus of Rs 229 billion in the fiscal year so far, compared to a deficit of Rs 270 billion in the same period of the previous year.

Nepalese Rupee Appreciates in July

After weakening over 1% to 132.03 in June, the Nepali rupee (NPR) gained ground against the US dollar over the last month amidst a repricing of US Federal Reserve rate hike expectations. Since the Nepali currency is pegged to the Indian currency, the appreciation of the Indian currency against the dollar has also led to the strengthening of the Nepali currency in the last month. Moderating inflation and a cooling labour market in the US raised bets that a 25 bps rate hike at the July FOMC meeting would be the final one in the current tightening cycle, which saw the dollar index weaken over 2% in the last month.

For the Nepalese economy, the performance of the domestic currency has a significant bearing on the economic outlook, with depreciation of the NPR adding pressures on inflation, foreign debt and import bills.

USD/NPR Daily Currency Performance

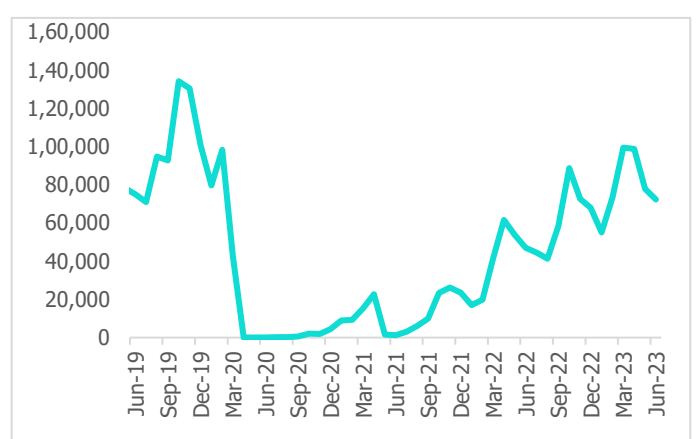


Source: Refinitiv

Tourism Industry Remains Supportive

Tourist arrivals in June 2023 stood at 72,250, lower than 77,703 in the previous month. For FY23 however, the footfall stood at 8,05,266. This compares to 3,29,926 arrivals seen in the corresponding period a year ago. Going ahead, tourist arrivals are expected to dip in the off-season period of July-September. Over the near term, however, the contribution of the tourism industry in the growth of the contact-intensive sub-services sector such as accommodation and transportation is expected to remain positive.

Tourist Arrivals Dip as Peak Season Ends



Source: Nepal Rastra Bank

Way Forward

While the latest inflation reading and a supportive monetary policy come as a relief, the Nepalese economy is likely to remain surrounded by economic challenges in the near term. Continued weakness in government finances led by unproductive expenditure and an unexpected increase in borrowing could pose as a headwind to the government's GDP growth target of 6% in FY24. The performance of revenue collection has also remained weak, primarily due to the import restriction policy, and meeting its target for FY24 will depend largely on the effective implementation of reforms and measures. Moreover, slowing exports (-23% y-o-y in FY23 so far) on the back of waning external demand could continue to weigh on growth prospects. Inflation and the trade position could also worsen if crude oil prices pick pace going ahead. Brent crude oil has risen nearly 9% in the last one month. In the medium to long run however, support from international agencies like Asian Development Bank (ADB) and International Monetary Fund (IMF) could help steer the country towards sustainable economic growth. Recently, ADB approved a USD 50 million loan to support the implementation of policy reforms by the government of Nepal to help improve its domestic and international trade.

(Note: Data for June is for the month-ending mid-June)

Monthly Data of Key Economic Variables

Indicators (Mid-Month)	February 2023	March 2023	April 2023	May 2023	June 2023
Consumer price inflation (y-o-y%)	7.9	7.4	7.8	7.4	6.8
Wholesale price inflation (y-o-y%)	9.7	7.1	5.6	3.3	3.1
Export growth (y-o-y%)	-29	-29	5	-1.2	1.58
Import growth (y-o-y%)	-20	-19	-9	-3	-8
Trade deficit (Rs billion)	113.8	127.8	129.6	121.1	132.9
Worker's remittances (Rs billion)	689.9	794.3	903.3	1,005	1,112
Foreign exchange reserves (\$ billion)	10.5	10.7	10.9	11.2	11.2
Domestic credit (y-o-y%)	8.6	8.1	8.6	8.4	8.8
Deposits (y-o-y%)	10.5	10.5	11.0	11.4	12.2
Bank rate (%)	8.5	8.5	8.5	7.5	7.5
Weighted average deposit rate (%)	8.4	8.4	8.3	8.1	8.0
Weighted average lending rates (%)	13.0	13.0	12.8	12.7	12.5

Source: Nepal Rastra Bank

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