

# Nepal Inflation Outlook Worsens as Food Prices Inch Further Up

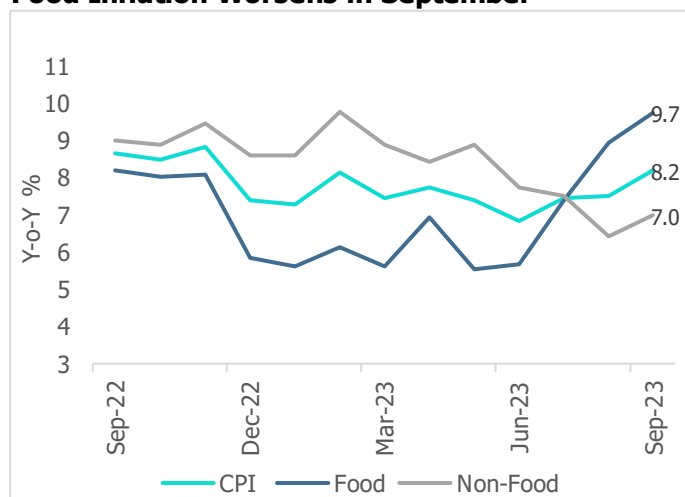
October 30, 2023 | Economics

## Retail Inflation Climbs to Near 1-Year High

After coming off its peak seen in September last year, headline inflation has once again started inching higher over the last three months. Retail inflation picked pace for the third straight month, rising 8.2% y-o-y in September, its highest level since October 2022, driven by food inflation. Food inflation rose 9.7% y-o-y, the largest increase since February 2020, on the back of inflation in items such as vegetables, fruits, milk & milk products, and sugar. Meanwhile, the non-food and services component inched higher in September. Non-food and services inflation rose to 7% y-o-y last month from 6.4% y-o-y in August. Firming of inflation pressures was witnessed in all components within non-food & services, barring 'furnishing & household equipment'. Meanwhile, wholesale price index (WPI)-based inflation rose over 40 bps to 4.8% y-o-y in September. While inflation in the primary goods and fuel & power components cooled, that of manufactured commodities inched up marginally.

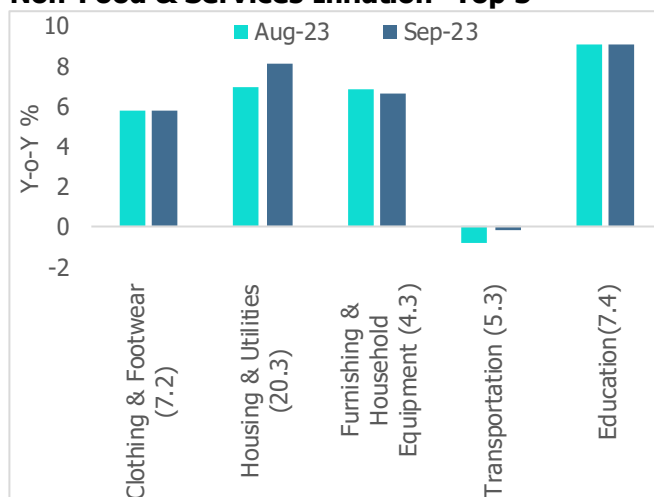
Going ahead, inflationary pressures are likely to worsen given the elevated crude oil prices. This could challenge the central bank's target of bringing average inflation around 6.5% in FY24.

### Food Inflation Worsens in September



Source: Nepal Rastra Bank

### Non-Food & Services Inflation- Top 5



Source: Nepal Rastra Bank (Figures in bracket represent share in overall CPI basket.)

### Trade Deficit Narrows in September

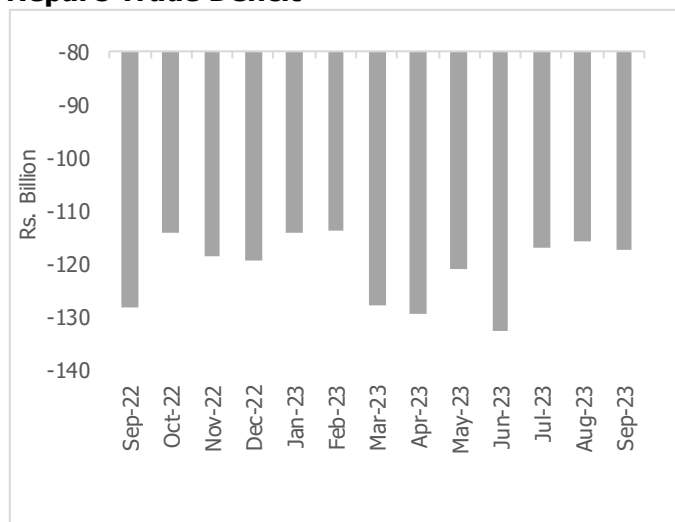
In September, Nepal's trade deficit narrowed to Rs 117.5 billion, from a deficit of Rs 128.4 billion in the same period a year ago. The narrowing of the deficit was on account of a higher contraction in imports (-8.3% y-o-y) compared to a 6.8% y-o-y fall in exports. In the first two months of the fiscal year that began in mid-July, the trade deficit stood at Rs 233 billion compared to Rs 245 billion in the same period a year ago. Although the trade deficit has been narrowing in the past 12 months, the pace has moderated significantly as global crude oil prices continued to remain elevated. In September, global Brent crude oil prices have risen 7% (y-o-y), offsetting the impact of a lower import bill seen in the past few months. In the fiscal year so far, export of polyester yarn & thread (accounting for ~8% of exports) saw an 85% jump from the year-ago period. Destination-wise, imports from India and other countries decreased 5.2% and 21.5%, respectively, while imports from China increased 25.4%. Improvement in the trade

position helped Nepal’s current account balance move to a surplus of Rs 23.5 billion in the first 2 months of the fiscal year, compared to a deficit of Rs 36.8 billion a year ago.

Worker’s remittances, which account for nearly 25% of GDP, continued to record healthy growth in the first two months of FY24. Remittances stood at Rs 228 billion, up 22% from the corresponding period last year. Going ahead however, Nepal Rastra Bank expects the growth rate of remittance inflows in 2023-24 to moderate given the higher base of remittance inflows in 2022-23.

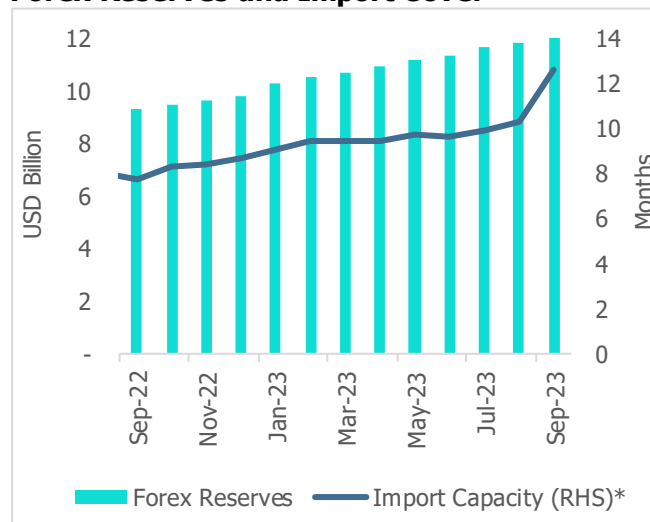
With the rise in remittances income, Nepal's foreign exchange reserves increased 28% (y-o-y) to USD 12 billion in September, the highest level since March 2021. The current level of forex reserve is sufficient to cover imports of goods and services for 12.6 months, up from 7.7 months a year ago. As per NRB’s FY24 monetary policy, the central bank aims to keep foreign exchange reserves at levels sufficient to cover at least 7 months’ imports of goods and services. However, foreign direct investment (FDI) flows continue to remain a pain point for the economy. FDI inflows declined 72% over last year to USD 23 million in the first two months of the fiscal year. That said, the overall balance of payment remained at a surplus of Rs 532.6 billion in September, as against a deficit of Rs 21 billion in the year-ago period.

### Nepal’s Trade Deficit



Source: Nepal Rastra Bank

### Forex Reserves and Import Cover



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

### Way Forward

The outlook for Nepal’s economy remains highly uncertain. While tourist arrivals, healthy remittances flows and forex reserves provide comfort, several headwinds could offset the positive impact. Heavy reliance on imports, dismal foreign direct investment flows, and a rise in global oil prices pose a threat to the economic outlook. Moreover, resurfacing concerns over inflationary pressures have further dampened prospects of a revival, posing a challenge to the central bank, which has announced a ‘cautiously accommodative’ stance for FY24.

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

### Monthly Data of Key Economic Variables

Indicators (Mid-Month)	May 2023	June 2023	July 2023	August 2023	September 2023
Consumer price inflation (y-o-y%)	7.4	6.8	7.4	7.5	8.2
Wholesale price inflation (y-o-y%)	3.3	3.1	4.9	4.3	4.8
Export growth (y-o-y%)	-1.2	1.58	-4.5	-8.7	-6.9
Import growth (y-o-y%)	-3	-8	-17	-1.6	-8.3
Trade deficit (Rs billion)	121.1	132.9	117.2	115.7	117.5
Worker's remittances (Rs billion)	1,005	1,112	1,220	116.0	228.4
Foreign exchange reserves (\$ billion)	11.2	11.2	11.7	11.8	12.0
Domestic credit (y-o-y%)	8.4	8.8	8.7	7.3	7.6
Deposits (y-o-y%)	11.4	12.2	12.3	11.9	13.2
Bank rate (%)	7.5	7.5	7.5	7.5	7.5
Weighted average deposit rate (%)	8.1	8.0	7.8	8.0	8.1
Weighted average lending rates (%)	12.7	12.5	12.3	12.2	12.2

Source: Nepal Rastra Bank

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