# NEPAL

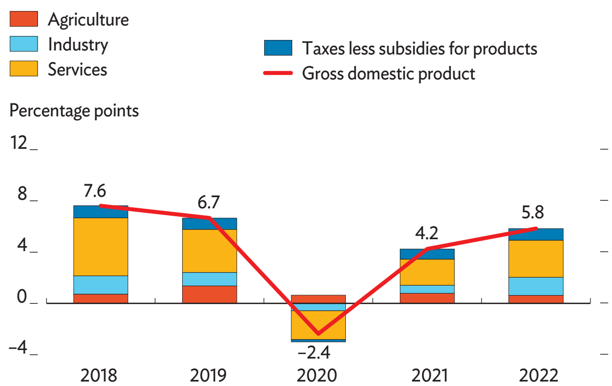
Growth accelerated in fiscal 2022 on continued fiscal and monetary stimulus. Inflation increased as prices for oil and other commodities rose, and the current account deficit substantially widened as imports surged. Growth will decelerate this year under tight monetary policy, the unwinding of pandemic stimulus, and persistent global headwinds, then pick up again in fiscal 2024. Inflation will rise again on elevated import prices, but the current account deficit will narrow with a reduced trade deficit and buoyant remittance inflow.

## Economic Performance

**The economy grew strongly, underpinned by the authorities' expansionary macroeconomic policies.** Preliminary official estimates show GDP expanding by 5.8% in fiscal year 2022 (FY2022, ended mid-July 2022) after rising by 4.2% in FY2021 (Figure 2.19.1). Higher growth was supported by increased generation of hydroelectricity, improved manufacturing output, expanded construction, and a gradual revival of tourism.

**Figure 2.19.1 Supply-side Contributions to GDP Growth**

*Growth surged on favorable macroeconomic policies in 2022.*




Note: Years are fiscal years ending in mid-July of that year.

Sources: Central Bureau of Statistics. 2022. National Accounts of Nepal 2021/22; Asian Development Bank estimates.

**Supply conditions were buoyant except in agriculture.** Growth in agriculture slipped from 2.8% in FY2021 to 2.3% in FY2022 after excessive rain and consequent flooding in mid-October damaged crops just as they were ready to harvest. Industry growth more than doubled to 10.2% on strong domestic demand and a surge in exports. Gains in construction, electricity, and manufacturing were notable. Growth in services accelerated from 4.2% in FY2021 to 5.9% as wholesale and retail trade, transport, and financial services picked up significantly with the lifting of COVID-19 mobility restrictions. Tourism and related activities gathered pace, but income from them was far below pre-pandemic levels.

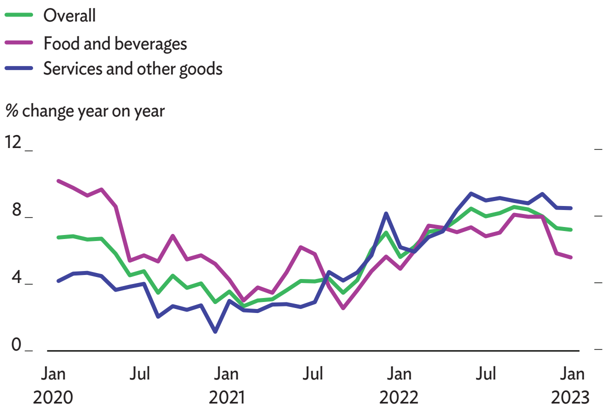
**On the demand side, a 10.5% increase in gross capital formation underpinned accelerated growth.** Private investment advanced by 8.8%, raising its share to 27.1% of GDP. There was a double-digit inventory growth , but public investment declined by 6.0% due to delays in implementation of budgeted initiatives. Growth in private consumption rose from 4.3% in FY2021 to 5.4%. Imports grew rapidly, particularly in the first half of FY2022, as economic activity intensified with the lifting of COVID-19 restrictions. This generated a large trade deficit, however, that dragged down growth.

**Inflation increased largely owing to high global prices following the Russian invasion of Ukraine.** Average annual inflation increased from 3.6% in FY2021 to 6.3%

This chapter was written by Manbar Singh Khadka and Neelina Nakarmi of the Nepal Resident Mission, ADB, Kathmandu. The policy challenge draws from 'The COVID-19 Food Relief Program in Nepal' under the ADB Covid-19 Active Response and Expenditure Support Technical Assistance.

**Figure 2.19.2** Monthly Inflation

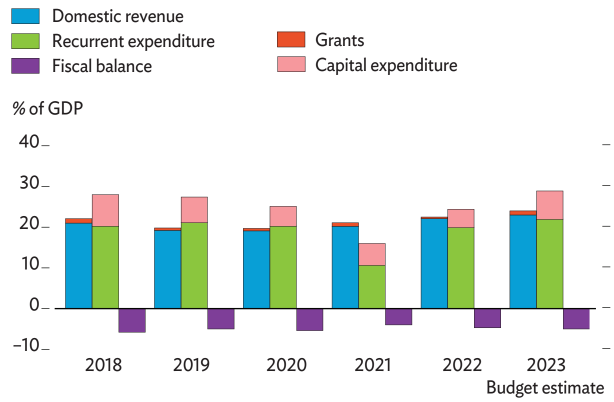
*Inflation is likely to remain elevated as global headwinds persist.*




Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

**Figure 2.19.3** Fiscal Indicators

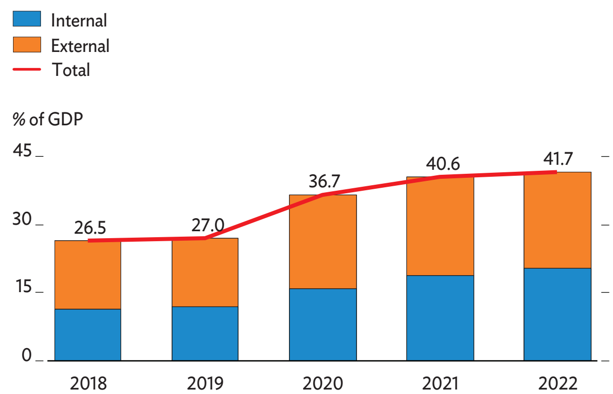
*The fiscal deficit widened on increased recurrent expenditure.*




GDP = gross domestic product.
Note: Years are fiscal years ending in mid-July of that year.
Source: Ministry of Finance. Budget Speech 2023 .

**Figure 2.19.4** Public Debt

*Growth in public debt moderated as external borrowing declined with the waning of COVID-19 influence.*




Note: Years are fiscal years ending in mid-July of that year.
Source: Central Bureau of Statistics; Financial Comptroller General Office; Public Debt Management Office.

in FY2022 as food and fuel prices rose (Figure 2.19.2). Other factors driving up inflation were dampened domestic agriculture production and recovery in domestic demand. Food inflation accelerated from 5.8% to 6.9%, while nonfood inflation rose from 2.9% to 9.0%. About 6% depreciation of Nepali rupee vis-à-vis US dollar in FY2022 also raised market prices of goods.

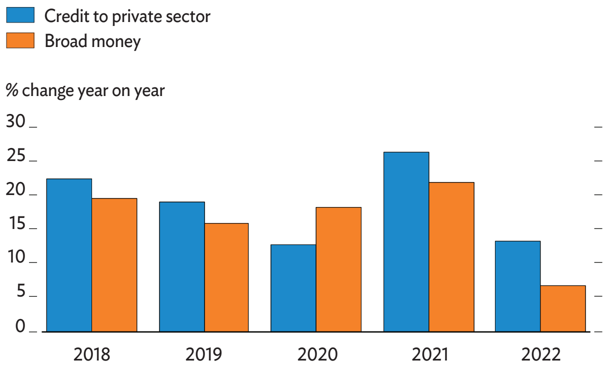
**The budget deficit widened on higher recurrent expenditure.** It deepened from the equivalent of 4.0% of GDP in FY2021 to 4.7% in FY2022 (Figure 2.19.3). Expenditure increased by 18.3% to equal 26.2% of GDP in FY2022 despite sluggish growth in capital expenditure. A 27.9% increase in recurrent expenditure—mainly for vaccine procurement, strengthening the health-care system, and economic relief measures—raised overall expenditure. Revenue (including grants), at 21.5% of GDP, increased by 17.7% in FY2022 on buoyant income tax and excise duty receipts.

**Since FY2019, government debt has mounted rapidly with higher domestic and foreign borrowing.** Debt increased from the equivalent of 27.0% of GDP in FY2019 to 36.7% in FY2020 and 40.6% in FY2021 as the government borrowed to finance COVID-19 expenditure and to support the economy (Figure 2.19.4). With economic activity gaining fuller traction in FY2022, growth in debt moderated but still rose to equal 41.7% of GDP, with domestic debt at 20.4% of GDP and external debt, most of it concessional, at 21.3%. Despite the rise, Nepal's risk of debt distress is low in light of low ratios of external debt to GDP and of external debt servicing to exports.

**Monetary policy remained accommodative in the first half of FY2022.** A surge in credit in FY2021 and the first half of FY2022 spurred rapid growth in imports and consequent loss of foreign exchange reserves. To restrain growth in private sector credit, Nepal Rastra Bank, the central bank, intervened through its midyear monetary policy review to hike the policy rate by 250 basis points to 5.5% in February 2022. The cost of using the refinancing facility was similarly raised by 200 basis points to 7.0%. Private sector credit growth consequently moderated from a peak of 32% year on year in September 2021 to 13.3%

**Figure 2.19.5 Credit to the Private Sector and Broad Money Growth**

*Growth in credit to the private sector moderated after a hike in interest rates.*




Note: Years are fiscal years ending in mid-July of that year.
Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

in mid-July 2022 (Figure 2.19.5). Broad money growth moderated from 21.8% in FY2021 to 6.8% in FY2022 as net foreign assets declined.

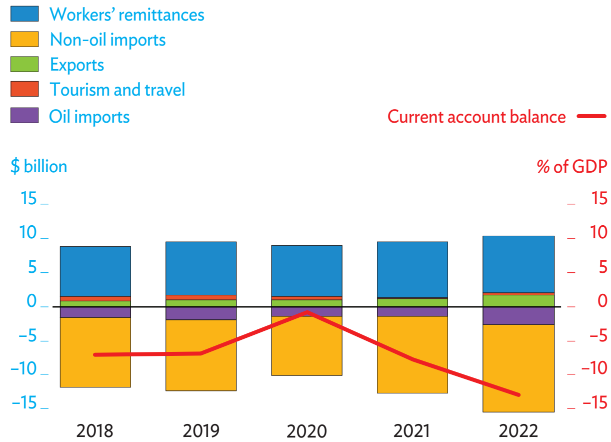
**The current account deficit widened along with the trade deficit** (Figure 2.19.6). Measures to restrict credit and hike interest rates moderated import growth from 26.5% in FY2021 to 21.9% in FY2022. Exports increased but had a minimal impact on the trade deficit as they were worth only about 10% of imports. Workers' remittances increased by 2.2% but fell far short of countering the deepening trade deficit. The current account deficit widened in FY2022 by 82.2% to $5.2 billion, equal to 12.9% of GDP. Financial inflow was insufficient to offset the deteriorating current account, requiring a drawdown of foreign exchange reserves. Reserves fell from $11.8 billion in mid-July 2021, or cover for 10.2 months of imports of goods and services, to $9.5 billion a year later, or cover for only 6.9 months, but a substantial part of the reduction took place in the first half of FY2022 (Figure 2.19.7).

## Economic Prospects

**Growth is expected to decelerate to 4.1% in FY2023 and then pick up to 5.0% in FY2024** (Table 2.19.1). The downturn in FY2023 reflects tighter monetary policy, slackened domestic demand, the unwinding of COVID-19 stimulus, and persistent global headwinds. GDP growth was officially estimated at 0.8% in the first quarter of FY2023, significantly down from 3.0% a year

**Figure 2.19.6 Current Account Indicators**

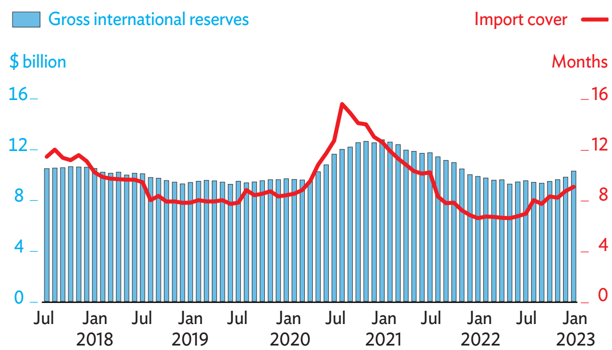
*The current account deficit widened along with a large trade deficit.*




GDP= gross domestic product.
Note: Years are fiscal years ending in mid-July of that year.
Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

**Figure 2.19.7 Gross International Reserves and Foreign Exchange Adequacy**

*After declining, foreign exchange reserves have improved due to tighter monetary policy.*




Source: Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

earlier. Key areas of the economy have contracted, notably construction and manufacturing. Monetary policy in FY2023 continues to aim to curb high credit growth to contain domestic demand, escalating prices, and rising imports. The central bank hiked the bank rate by 150 basis points to 8.5% and the policy rate by the same amount to 7.0%, effective in August 2022. This exerted further upward pressure on market interest rates. The aim is to restrict private sector credit growth to 12.6% in FY2023. GDP growth is expected to pick up to 5.0% in FY2024, however, with the dissipation of inflation, increased infrastructure spending, and further

**Table 2.19.1 Selected Economic Indicators, %**

*Growth decelerates on tighter monetary policy, but picks up with the dissipation of inflation.*

| | 2021 | 2022 | 2023 | 2024 |
|---|---|---|---|---|
| GDP growth | 4.2 | 5.8 | 4.1 | 5.0 |
| Inflation | 3.6 | 6.3 | 7.4 | 6.2 |

GDP = gross domestic product.
Note: Years are fiscal years ending in mid-July of that year.
Sources: Asian Development Bank estimates.

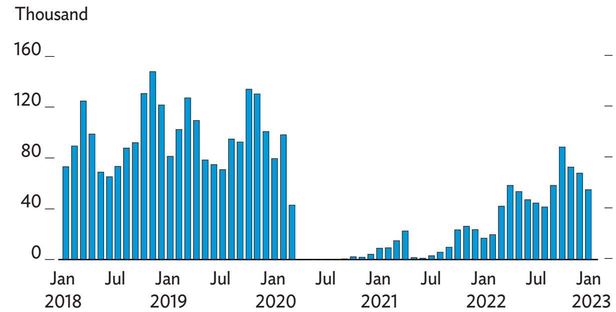
recovery in tourism and related services. The successful conclusion of the International Monetary Fund's Extended Credit Facility review on 28 February 2023 showed Nepal's economy on a sustainable path, with fiscal risks mitigated, external risks largely contained, and sustainable debt management ensured.

**Growth in all production sectors is forecast to moderate in FY2023.** Agriculture growth will likely ease from 2.3% in FY2022 to 2.0% in FY2023. Preliminary estimates show that rice output increased by about 7.0% thanks to a normal monsoon, but winter rainfall has been scanty, likely affecting winter crop yield and overall agriculture output. Despite a boost to industry expected with 700 megawatts of hydroelectricity added to the national grid, sector growth will likely decelerate by half from 10.2% to 5.1% as manufacturing and construction are hit by higher interest rates, import restrictions, a slowdown in domestic consumption, and dampened external demand. Growth in services will moderate from 5.9% to 4.4% after credit controls and a hike in interest rates slow real estate, wholesale, and retail trade. While tourism growth has been strong, international tourist arrivals are still only half of their pre-pandemic numbers (Figure 2.19.8).

**Growth in private consumption expenditure will slow, and public investment may grow marginally in FY2023.** After rising by 5.4% in FY2022, growth in private consumption expenditure will decelerate to 3.7% in FY2023, dampened by higher prices and credit controls. Public sector consumption is anticipated to expand by 3.6% in FY2023, largely on election spending by provinces and the federal government. Growth in private investment expenditure will slow from 8.8% in FY2022 to 4.0%, tamped down by import restrictions (lifted in mid-December 2022), higher policy rates, and a cash margin requirement for imports (lifted on 19

**Figure 2.19.8 Monthly Tourist Arrivals**

*Tourism has picked up but has yet to reach pre-pandemic levels.*




Nepal Rastra Bank. 2022. Recent Macroeconomic Situation.

January 2023). Public investment, having contracted by 6.0% in FY2022, is expected to expand only marginally by 1.3% in FY2023.

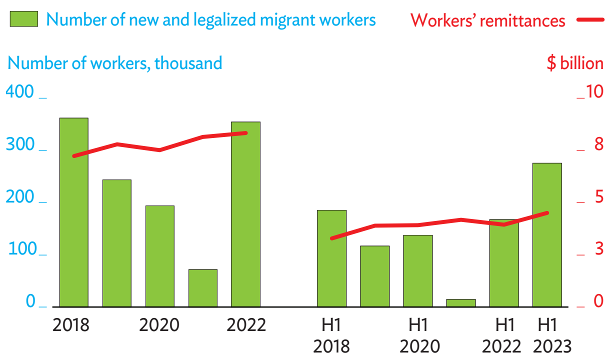
**Fiscal policy in FY2023 continues to prioritize agriculture, infrastructure, and social protection.** While the original FY2023 budget was expansionary, the government downsized budget expenditure by about 14.0% during its midyear review, largely to cover revenue shortfalls in the first half of FY2023. The revised estimate sets recurrent expenditure equal to 12.5% of GDP and capital expenditure at 5.8%. The budget deficit is expected to narrow from 4.7% of GDP in FY2022 to 3.6%.

**Inflation is forecast to edge up in FY2023 before moderating in FY2024.** Average inflation accelerated to 8.0% in the first 6 months of FY2023. Food inflation edged up to 5.6% and nonfood inflation climbed to 8.6% as prices rose for housing, utilities, and transportation. Inflation is expected to moderate to an average of 7.4% in FY2023 as tighter monetary and fiscal policies take further hold in the second half of the fiscal year. Inflation is expected to decelerate to 6.2% in FY2024, assuming a normal harvest, subdued oil prices, and a decline in Indian inflation.

**The current account deficit is projected to narrow in FY2023 and further in FY2024.** Moderation in the deficit reflects both an easing trade deficit and buoyant remittance inflows. Having deepened by 44.2% in the first 6 months of FY2022, the merchandise trade deficit narrowed by 27.2% a year later, largely because of tight monetary policy and import restrictions. Workers' remittances, meanwhile, reversed 5.7% contraction to expand by 13.9% thanks to increased migration for employment overseas (Figure 2.19.9). The current account deficit narrowed sharply by 92.1% to $233.3 million and, coupled with broadly stable financial inflow, increased reserves by $765.3 million in the first 6 months of FY2023, bringing them to $10.3 billion providing import cover for 9.1 months. Considering developments so far, this fiscal year, the current account deficit is expected to narrow substantially from the equivalent of 12.9% of GDP in FY2022 to 4.0%. It will likely moderate slightly in FY2024 to 3.9% of GDP, even as growth increases to 5.0%, as global commodity prices normalize, and fuel imports are partially replaced by domestic hydroelectricity.

**Figure 2.19.9** Migrant Workers and Remittances

*Remittances have been resilient as migration for employment overseas increased.*




Note: Years are fiscal years ending in mid-July of that year.
Source: Nepal Rastra Bank. 2023. Recent Macroeconomic Situation.

**The main downside risk to the outlook is a global downturn hitting Nepal's tourism and remittance receipts.** A drastic tightening of global financial conditions to tame rising inflation would require tighter domestic monetary policy, which would erode investment and domestic consumption, dragging down growth. Intensified geopolitical turmoil and any natural hazards such as landslides or floods would further dampen growth prospects.

## Policy Challenge—Effectively Implementing Relief Programs

**Fearing food insecurity, the government announced a food relief program for vulnerable groups and those who lost livelihoods in the pandemic.** When the pandemic struck Nepal, food security and food systems were already stressed by powerful earthquakes in 2015 and trade supply disruption in 2016. Local governments distributed food to poor and vulnerable households from 24 March to 21 July 2020. The Ministry of Federal Affairs and General Administration facilitated and coordinated the food relief. While the program was considered successful, it faced several challenges: beneficiary identification, food procurement, monitoring, auditing, transparency, and food expenditure accountability.

**Despite formulation of a systematic approach to provide food relief to the poor and vulnerable, it was not effectively carried out.** Beneficiary selection in some local levels was flawed, and there was no mechanism by which a third party would monitor food distribution. Local governments conducted no serious public audits of food relief expenditure. Data from a crisis management information system were found useful for monitoring the crisis and food relief program, but local governments failed to establish an enabling environment for information management through dedicated information technology sections. Further, system data were not fully integrated for policy formulation, planning, or monitoring.

**The authorities could better plan and execute future relief programs by heeding the following policy recommendations.** Maintain a good database of poor and vulnerable households and update it periodically to better target relief. Intersectoral coordination among stakeholders is instrumental for efficiently delivering relief programs, harmonizing relief implementation procedures, and avoiding duplication. Local governments' institutional, technical, and managerial capacity should be strengthened to enable them to respond better to crises, provided that they have adequate resources and can generate additional resources from civil society. To avoid any fiduciary risks, a committee that selects beneficiaries should be as inclusive as possible. It should use digital modes of communication and strong procurement capacity and quality control mechanisms. To address grievances, a judicial committee should be formed by mobilizing trained staff and recruiting experts on gender-based violence. Finally, disaster management sections should be established in all local levels and be fully equipped with requisite human and technical resources.