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December 2023

THIRD REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NEPAL

In the context of the Nepal—Third Review Under the ECF Arrangement, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 29, 2023, following discussions that ended on October 5, 2023, with the officials of Nepal on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on November 10, 2023.
- A **Statement by the Executive Director** for Nepal.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Completes the Third Review of the Nepal Extended Credit Facility

FOR IMMEDIATE RELEASE

- *The IMF Executive Board completed the third review under the Extended Credit Facility (ECF) Arrangement for Nepal, providing the country with access to SDR 39.2 million (about US$ 52.25 million).*
- *Nepal has made good progress with the implementation of the program, which has helped mitigate the impact of the pandemic and global shocks on economic activity, protect vulnerable groups, and preserve macroeconomic and financial stability.*
- *Policy priorities for sustained growth include enhancing capital expenditure while maintaining overall fiscal discipline and advancing reforms in areas such as banking regulation, governance, and business climate.*

Washington, DC – November 30, 2023: On November 29, the Executive Board of the International Monetary Fund (IMF) completed the third review under the four-year Extended Credit Facility (ECF) for Nepal, allowing the authorities to withdraw the equivalent of SDR 39.20 million (about US$ 52.25 million). This brings total disbursements under the ECF for budget support thus far to SDR 166.90 million (about US$ 222.5 million).

The ECF arrangement for Nepal was approved by the Executive Board on January 12, 2022 (see Press Release No. 22/6) in an amount equivalent to SDR 282.42 million (180 percent of quota or about US$ 376.5 million). Nepal has made good progress with the implementation of the program, which has helped mitigate the impact of the pandemic and global shocks on economic activity, protect vulnerable groups, and preserve macroeconomic and financial stability. The program is also helping to catalyze additional financing from Nepal's development partners.

Nepal's post-pandemic rebound, fueled by a credit boom, ended last year as growth slowed markedly. Low domestic demand helped resolve external pressures but also deflated government revenue and led to a widening of the fiscal deficit despite expenditure control. Inflation is declining but remains high at 8.2 percent in September. Growth is expected to recover to 3.5 percent in FY2023/24, which is below potential, led by increased domestic demand, new hydroelectric capacity, and a continued recovery in tourism.

Risks are skewed to the downside. External sector risks dominate Nepal's outlook given its high remittance income and dependence on imported goods. Domestically, further deterioration in bank balance sheets or lack of progress in addressing the deficiencies identified by the Asia Pacific Group of the Financial Action Task Force (FATF) could create financial system stress.

Following the Executive Board discussion, Mr. Bo Li, Deputy Managing Director and Acting Chair, made the following statement:

“Nepal has made important strides on its economic reform agenda. Decisive actions in monetary policy, bank regulation and rolling off COVID support policies played a major role in overcoming urgent balance of payments pressure in FY2021-22. Reserves continue to rise without the need to use distortive import restrictions. Fiscal discipline was maintained in FY2022-23 despite a large revenue shortfall. Bank supervision and regulation have improved with the rolling out of new supervisory information systems, the Working Capital Loan Guidelines and Asset Classification Regulations. Nepal’s medium-term outlook remains favorable as strategic investments in infrastructure, especially in the energy sector, are expected to support potential growth.

“With growth below potential, boosting the execution of capital spending while maintaining fiscal discipline —growth friendly consolidation—is critical to provide much-needed stimulus to near-term economic growth and achieve investments that will underpin medium-term growth. Maintaining momentum on governance reforms is critical to cementing recent gains in fiscal transparency. Further structural reforms, including to mobilize domestic revenue, strengthen public investment management and address fiscal risks, are needed to bolster medium term fiscal sustainability.

“As monetary policy transmission appears weak in a context of balance sheet repair and inflation is elevated —though declining—maintaining the current cautious and data dependent monetary policy is appropriate to preserving price and external stability. Financial policy should remain vigilant and focused on building regulatory frameworks to avoid further boom bust cycles and establish a more stable, pro-growth financial sector equilibrium. Reforms regarding lending practices and asset classification are encouraging and need to be continued as preparations for the loan portfolio review of the ten largest banks gather steam. Implementation of the financial sector reform agenda should continue with a view to align the local framework more closely to international standards.

“Improving the anti-money laundering/combatting the financing of terrorism (AML/CFT) framework and its effectiveness in line with international standards and peer evaluations is urgently needed to maintain smooth access to the global financial system. Reforms to implement the 2021 IMF Safeguards Assessment recommendations regarding the Nepal Rastra Bank (NRB) Act and NRB audit are a priority.

“Continued progress on the structural front is also needed to foster investment and more inclusive growth. These include improving the business climate, building human capital, and continuing to improve social safety nets, in particular the coverage of the child grant program.”

Nepal: Selected Economic Indicators 2019/20-2027/28 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Est.			Projections		
Output and Prices (annual percent change)									
Real GDP	-2.4	4.8	5.6	0.8	3.5	5.2	5.2	5.2	5.2
Headline CPI (period average)	6.1	3.6	6.3	7.8	7.3	6.2	5.5	5.4	5.4
Headline CPI (end of period)	4.8	4.2	8.1	7.4	6.8	5.5	5.4	5.4	5.4
Fiscal Indicators: Central Government (in percent of GDP)									
Total revenue and grants	22.2	23.3	23.1	19.3	19.8	20.8	21.5	22.1	22.8
of which: Tax revenue	18.0	20.0	20.0	16.1	16.5	17.6	18.4	19.1	19.7
Expenditure	27.6	27.2	26.3	25.1	25.1	25.4	25.5	25.7	25.8
Expenses	22.7	22.0	21.9	20.7	20.6	20.7	20.8	21.0	21.1
Net acquisition of nonfinancial assets	4.9	5.3	4.4	4.4	4.5	4.7	4.7	4.7	4.7
Operating balance	-0.5	1.3	1.2	-1.4	-0.8	0.1	0.7	1.2	1.7
Net lending/borrowing	-5.4	-4.0	-3.2	-5.8	-5.3	-4.6	-4.0	-3.6	-3.1
Statistical discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	4.6	3.9	3.2	5.8	5.3	4.6	4.0	3.6	3.1
Net acquisition of financial assets	1.9	3.8	2.7	-0.8	1.7	1.7	1.7	1.7	1.7
Net incurrence of liabilities	6.5	7.7	5.8	5.0	7.0	6.4	5.8	5.3	4.8
Foreign	2.4	3.4	2.1	1.7	1.8	1.4	1.4	1.2	1.2
Domestic	4.1	4.3	3.8	3.3	5.2	5.0	4.3	4.1	3.6
Money and Credit (annual percent change)									
Broad money	18.1	21.8	6.8	11.4	10.4	11.7	11.0	10.9	10.6
Domestic credit	14.6	26.8	17.9	8.8	11.3	11.2	11.1	10.9	10.9
Private sector credit	12.6	26.3	13.3	4.6	8.6	8.8	9.5	10.2	10.9
Saving and Investment (in percent of nominal GDP)									
Gross investment	30.4	35.2	37.4	33.6	35.1	37.1	35.5	34.6	33.5
Gross fixed investment	30.5	29.3	28.5	25.6	26.7	28.2	27.0	26.3	25.5
Private	25.6	24.1	23.1	22.2	22.2	23.5	22.2	21.6	20.8
Central government	4.9	5.3	5.4	3.4	4.5	4.7	4.7	4.7	4.7
Change in Stock	0.0	5.8	9.0	8.1	8.4	8.9	8.5	8.3	8.0
Gross national saving	29.4	27.5	24.7	32.2	33.5	33.1	32.1	31.3	30.4
Private	30.5	27.0	24.1	34.1	35.2	34.0	32.3	31.0	29.5
Central government	-1.1	0.4	0.7	-1.9	-1.7	-0.8	-0.2	0.3	0.9
Balance of Payments									
Current account (in millions of U.S. dollars)	-339	-2,844	-5,174	-586	-721	-2,015	-1,903	-2,032	-2,132
In percent of GDP	-1.0	-7.7	-12.7	-1.4	-1.6	-4.0	-3.4	-3.3	-3.1
Trade balance (in millions of U.S. dollars)	-9,186	-11,510	-13,759	-10,728	-11,813	-13,735	-14,337	-15,230	-16,113
In percent of GDP	-27.5	-31.2	-33.7	-26.2	-25.7	-27.0	-25.6	-24.7	-23.8
Exports of goods (y/y percent change)	-6.4	30.0	43.9	-19.9	5.4	9.3	9.3	8.8	8.5
Imports of goods (y/y percent change)	-18.2	25.7	21.9	-21.8	9.6	15.5	4.9	6.5	6.1
Workers' remittances (in millions of U.S. dollars)	7,533	8,150	8,326	9,330	9,967	10,356	10,811	11,341	11,891
In percent of GDP	22.5	22.1	20.4	22.7	21.7	20.3	19.3	18.4	17.5
Gross official reserves (in millions of U.S. dollars)	10,559	10,884	8,953	10,916	12,674	13,225	14,186	15,134	16,125
In months of prospective imports	9.0	7.5	7.6	8.3	8.4	8.3	8.4	8.4	8.4
Memorandum Items									
Public debt (in percent of GDP)	43.3	43.3	43.1	47.0	48.4	49.3	50.0	50.2	50.0
Nominal GDP (in billions of U.S. dollars)	33.4	36.9	40.8	41.0	45.9	50.9	56.1	61.7	67.8
Nominal GDP (in billions of Nepalese Rupees)	3,889	4,353	4,934	5,364	5,957	6,653	7,381	8,186	9,078
Net International Reserves (in millions of U.S. dollars)	10,291	10,620	8,821	10,473	12,146	12,623	13,589	14,590	15,644
Primary Deficit (in billions of Nepali Rupees)	183	138	110	238	217	194	167	144	118
Primary Deficit (in percent of GDP)	4.7	3.2	2.2	4.4	3.6	2.9	2.3	1.8	1.3
Tax Revenue (in billions of Nepalese Rupees)	700	870	984	866	986	1,173	1,357	1,560	1,790
Tax Revenue (In percent of GDP)	18.0	20.0	20.0	16.1	16.5	17.6	18.4	19.1	19.7
Health Expenditure (in percent of GDP)	1.0	1.1	2.3	1.7	1.1	1.1	1.1	1.1	1.1
Social Protection/Assistance (in percent of GDP)	1.7	1.7	3.7	2.8	2.8	2.8	2.8	2.8	2.8
CCRT debt relief (in millions of SDR) 2/	2.9	7.1	3.6	…	…	…	…	…	…
Private sector credit (in percent of GDP)	84.3	95.1	95.0	91.4	89.4	87.1	86.0	85.4	85.4
Exchange rate (NPR/US$; period average)	116.3	117.9	120.8	130.8	…	…	…	…	…
Real effective exchange rate (average, y/y percent change)	1.9	-2.9	1.6	1.4	…	…	…	…	…

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends in mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for SDR 3.6 million.

Note: The NSO adopts a 3 year cycle in its national accounts producing preliminary, revised and final estimates for real GDP growth. In May 2023 growth was revised up in FY2021/22 from 4.2 percent to 4.8 percent and from 5.3 percent to 5.6 percent in FY2021/22 in light of new data.

Note: Current baseline forecast is as of September 28, 2023.

INTERNATIONAL MONETARY FUND

NEPAL

November 10, 2023

THIRD REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT

EXECUTIVE SUMMARY

Context. Nepal's post-pandemic rebound, fueled by a credit boom, came to an end last year as growth slowed markedly. Low domestic demand helped resolve external pressures but also deflated government revenue and led to a widening of the fiscal deficit despite spending discipline. Despite the November 2023 earthquake, growth is expected to recover to 3.5 percent in FY2023/24, which is below potential. Inflation is declining but remains high. While the financial sector appears to be weathering the credit contraction, regulatory and supervisory practices need to continue to be strengthened to facilitate the needed transition to more sustainable and pro-growth credit growth.

Program developments. Despite the difficult economic context, program performance was good with all but one quantitative metrics met. The performance criteria (PCs) on net international reserves and external arrears were met, the indicative target (IT) on the primary deficit was met, but the IT on child spending was missed by a slim margin. All of the standard continuous PCs were met. Progress was good on reform implementation, with five out of seven structural benchmarks completed (four met), and two reset.

Policy Recommendations.

- **Fiscal policy**. Policies should focus on a gradual, growth-friendly fiscal consolidation, while enhancing capital spending and supporting the most vulnerable, to ensure medium-term fiscal sustainability. Maintaining momentum on governance reforms is critical to cementing recent gains in fiscal transparency. Further structural reforms, including to mobilize domestic revenue, strengthen public investment management and address fiscal risks, are needed to bolster medium-term fiscal sustainability.

- **Monetary and financial sector policies**. Monetary policy should maintain the current cautious, data-driven approach to preserving price and external stability. Avoiding further boom-bust credit cycles is critical to establish a more stable, pro-growth financial sector equilibrium. Reforms regarding lending practices and asset classification represent important steps and need to be continued as the loan portfolio review of the ten largest banks advances. Implementation of the financial

sector reform agenda should continue with a view to more closely align the local framework to international standards.

- **Governance and structural reforms**. Improving the anti-money laundering/ combatting the financing of terrorism (AML/CFT) framework and its effectiveness in line with international standards and peer evaluations is urgently needed to maintain smooth access to the global financial system. Reforms to implement the 2021 IMF Safeguards Assessment recommendations regarding the NRB Act and NRB audit are a priority.

Approved By
Anne-Marie Gulde-Wolf (APD) and Fabian Valencia (SPR)

Discussions took place in Kathmandu during September 21-October 5, 2023. The staff team comprised T. Kinda (Head), R. Green, J. Spray (all APD), Y. Cao (FAD), M. Gort (MCM), M. Ivanyna (SPR), T. Daban (Resident Representative for Nepal), S. Dulal and S. Sharma (local office). T. Khatiwada (OED) also participated in some meetings. M. Conde Panesso, S. Lee (APD) supported the preparation of the report. The team met with Finance Minister P. Mahat, Nepal Rastra Bank Governor M. Adhikari, National Planning Commission Vice-Chairman M, Shrestha, other senior government and central bank officials, development partners and representatives of the business community.

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APPENDICES

RECENT DEVELOPMENTS

1. **The external sector strengthened by end-FY2022/23, as the economy downshifted to slower growth, while inflation has been on an uneven downwards trend**. Real GDP growth decelerated to 0.8 percent in FY2022/23 on the back of a sharp decline in lending, import restrictions and substantial post-pandemic emigration.[1,2] The economic slowdown and lower commodity prices contributed to a sharp decline of imports. This together with buoyant remittances underpinned a reduction of the current account deficit and a reversal of external pressures, with international reserves rising to 8.3 months of prospective imports. Inflation peaked at 8.6 percent in September 2022 before easing to 6.8 percent in June 2023. Higher regional food prices have caused inflation to rise to 8.2 percent in September 2023, though non-food inflation continues to fall.

2. **Credit growth dropped to low single digits in FY2022/23—after exceeding 30 percent in FY2021/22 spurred by COVID stimulus—and non-performing loans (NPLs) have risen**. The sharp drop in credit growth reflects several factors, including (i) weak demand, (ii) credit overhang, (iii) weak real estate markets, (iv) tighter regulation of working capital loans, and (v) capital adequacy requirements of a few banks approaching regulatory limits. NPLs for commercial banks have increased from 1.3 percent in June 2022 to 3.0 percent as of August 2023, reflecting higher lending rates and unwinding of forbearance measures and long-standing evergreening practices.

3. **The FY2022/23 fiscal deficit widened to 5.8 percent of GDP due to a sizable drop in revenue collection**. Although both current and capital expenditures were contained within program projections, the economic slowdown and lower imports led to a sharp decline in revenue and an associated larger than expected fiscal deficit.

Nepal: Fiscal Outcome, 2022/23[1/]

	2022/23		
	1st and 2nd Review	Preliminary Data	Difference
(In percent of GDP, unless otherwise indicated)			
Total revenue and grants	21.6	19.3	-2.4
Total revenue	21.0	18.8	-2.1
Tax revenue	18.4	16.1	-2.2
Of which: Income and profits tax	4.9	4.1	-0.8
Customs	3.4	3.0	-0.4
Excise duty	3.2	2.7	-0.6
VAT	5.8	5.3	-0.5
By source: Domestic taxes	10.8	9.7	-1.0
Import-related taxes	7.6	6.4	-1.2
Non-tax revenue & other receipts	2.6	2.7	0.1
Grants	0.7	0.4	-0.2
Expenditure	26.1	25.1	-1.1
Recurrent expenditure	21.1	20.7	-0.4
Of which: Interest payments	1.3	1.4	0.1
Capital expenditure	5.0	4.4	-0.6
Memorandum items			
Overall balance	-4.5	-5.8	-1.3
Prmary balance	-3.2	-4.4	-1.2
GDP (in NPR billions)	5,459.0	5,364.0	-1.7%

Sources: Nepali authorities; and IMF staff estimates and projections.
1/ Fiscal year ends mid-July.

[1] Nepal introduced restrictions to curb imports during the first half of the fiscal year FY2022/23, which were lifted in end-December 2022.

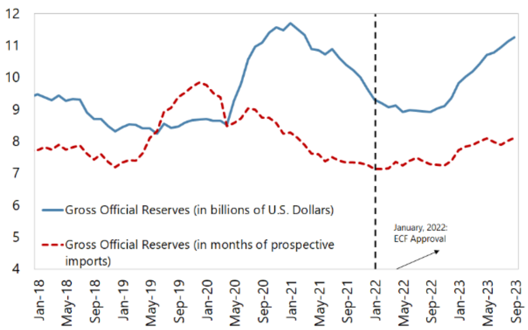
[2] After averaging roughly 5,000 per month pre-pandemic, net departures per month jumped to nearly 40,000 per month between early 2022 and mid 2023 according to official immigration statistics.

Figure 1. Nepal: Recent Developments

The ECF arrangement has started to yield structural gains, including by improving external sustainability through higher reserves

...and by supporting transition to a more sustainable credit growth, closer to GDP growth, following the credit boom fueled by COVID-related stimulus

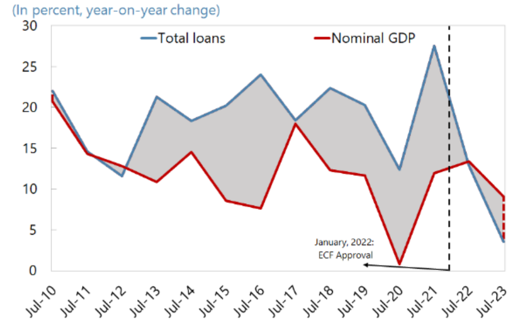
Central Bank's Gross Official Reserves



Sources: Nepali authorities; and IMF staff calculations.

Total Loans and Nominal GDP Growth

(In percent, year-on-year change)



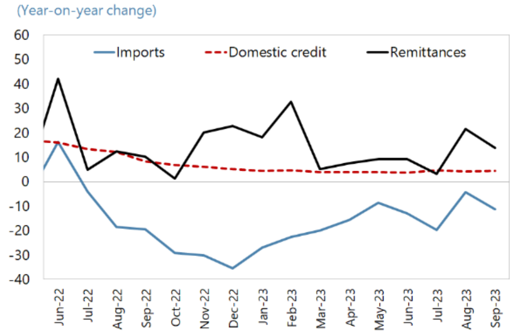
Sources: NRB, Nepal Central Bureau of Statistics

Meanwhile, growth and demand slowed markedly in FY2022/23, particularly during the first half of the year

With construction, retail, and manufacturing sectors contracting while tourism and electricity sectors expanded

High Frequency Indicators

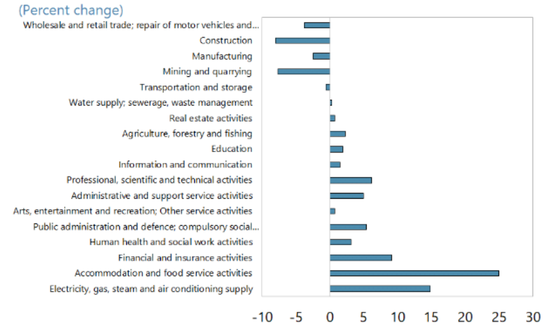
(Year-on-year change)



Sources: Nepal authorities; and IMF staff calculations.

Sectoral Real GDP Growth, 2022/23

(Percent change)



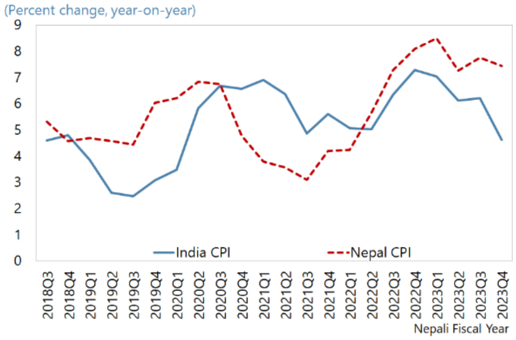
Sources: Nepali authorities; and IMF staff estimates.

Disinflation in India had helped ease Nepal's inflation before a recent uptick driven by food prices

NPLs have risen in the context of regulatory tightening to unwind long-standing evergreening practices

Comsumer Price Index Trends

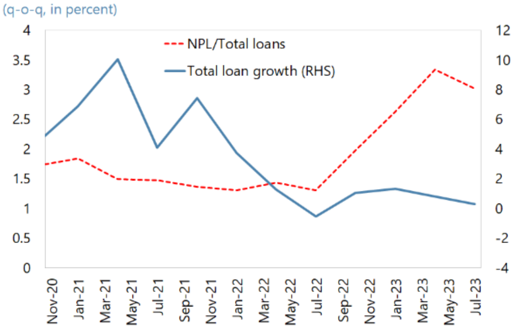
(Percent change, year-on-year)



Sources: Nepali authorities; and IMF staff calculations.

Total Loans and NPLs

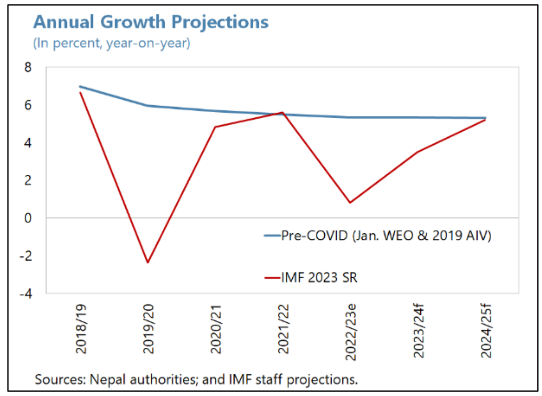
(q-o-q, in percent)



Sources: NRB

OUTLOOK AND RISKS

4. **A modest growth pickup is projected in FY2023/24, and the medium-term outlook remains favorable**. Growth is expected to recover to 3.5 percent in FY2023/24—despite the November 2023 earthquake in western Nepal—led by increased domestic demand, new hydroelectric capacity, and a continued recovery in tourism (Annex I), but to remain below potential.[3] The recent uptick in food prices is expected to abate with the upcoming regional harvest. External factors, including disinflation in India, would help bring down Nepal's inflation towards the NRB's target of 6.5 percent by the end of FY2023/24. With imports gradually normalizing after the sharp contraction in FY2022/23, and remittance and travel service growth moderating, the current account (CA) deficit excluding grants is expected to widen to 2.5 percent of GDP in FY2023/24.[4] A gradual increase in FDI and other investment is expected to finance the CA deficit, whereas reserve coverage is projected to remain stable and above estimated adequacy levels through the medium term. Strategic investments in infrastructure, especially in the energy sector, and a higher execution rate of capital expenditure are expected to support growth over the medium-term. Imports are projected to rebound strongly in FY2024/25 in line with growing capital expenditure and a rebound in GDP growth.



5. **The outlook is subject to downside risks**. Externally, higher commodity prices would slow the recovery in energy-intensive sectors, aggravate food insecurity, and impose fiscal costs. A growth slowdown in partner economies would weigh on incomes of Nepalese workers abroad, stall the recovery in tourism, and slow exports. Domestically, continued lower execution of capital projects, more subdued demand for credit or more extensive balance sheet repair would further depress domestic demand and weigh on economic activity. Moreover, the budget's low credibility reduces its influence on actual execution, raising uncertainty about fiscal outcomes. Lack of progress in addressing the deficiencies identified by the Asia Pacific Group of the Financial Action Task Force (FATF) could lead to severe reputational cost, be perceived as an indicator of negative business environment, hinder the country's access to the global financial system together with higher financial transaction costs and increase risks to financial stability. A further rise in NPLs could raise concerns about bank capital adequacy ratios.[5] Fragile social or political stability could create

[3] Despite several revenue measures in the current budget, revenue collection has been weak (-1.6 percent year-on-year) in the first two months of the current fiscal year, suggesting—along with falling imports—that growth is off to a slow start.

[4] Including grants, the current account deficit is projected at almost the same level as in FY2022/23 (1.6 percent of GDP), helped by a grant from the Millennium Challenge Corporation.

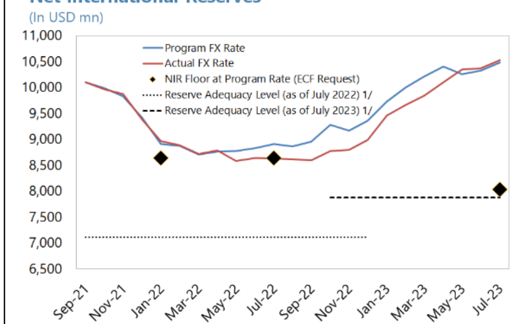
[5] Reported NPLs are expected to further increase once loan portfolio review results are incorporated, but they could also rise if bank portfolio quality deteriorates.

disruptions that dampen policy continuity and the implementation of reforms. Finally, Nepal remains vulnerable to natural disasters such as earthquakes and to climate shocks.[6]

PROGRAM PERFORMANCE

6. **Program performance was good, with renewed momentum**. The performance criterion (PC) on net international reserves (floor) was met comfortably, due *inter alia* to slow growth and prudent monetary policy, as was the external arrears PC. The indicative target (IT) on the primary fiscal deficit (ceiling) was met thanks to the spending discipline of the midterm budget review and the revenue adjustor in the context of a large revenue shortfall. Despite achieving an execution rate of over 95 percent last year, the IT on child grant spending (floor) was marginally missed (by 3 percent of the target or 0.004 percent of GDP). All standard continuous PCs were met. (Table 8)

Net International Reserves



Sources: NRB; and IMF staff calculations.
1/ Based on a conservative estimate of 6 month of prospective imports.

7. **The authorities made good progress on reform implementation**. (Table 11) Out of seven structural benchmarks (SBs), four (the fiscal risk registry, cash-flow forecasting, issuance of amendments to the asset classification regulation and the supervisory information system) were met, and one (publication of non-customs tax exemptions) was completed with delay. Two SBs (reporting consolidated financial statements and submission of NRB Act amendments to Parliament) were missed and are proposed to be reset.

POLICY DISCUSSION

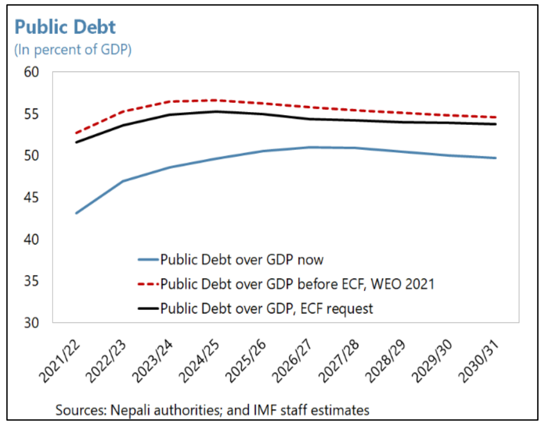
With growth below potential, boosting the execution of capital spending while maintaining fiscal discipline through domestic revenue mobilization and rationalization of current spending—growth-friendly consolidation—is critical to provide much-needed stimulus to near-term economic growth and achieve investments that will underpin medium-term growth. As monetary policy transmission appears weak in a context of balance sheet repair and inflation is elevated —though declining—cautious and data dependent monetary policy is appropriate. Financial policy should remain vigilant and focused on continuing to build regulatory frameworks that promote sustainable credit growth. The structural reform agenda has been re-prioritized to account for the authorities' implementation capacity constraints and emerging short-term risks, in particular related to AML/CFT, that need to be urgently addressed. This resulted in the introduction of new SBs, for instance on AML/CFT, while other SBs (reporting operational funds financial statements, publishing a tax

[6] As an example, a 6.4 magnitude earthquake struck western Nepal on November 3, 2023, estimated to have caused more than 150 deaths and 300 injuries.

expenditure report, auditing four key public enterprises (PEs), and publishing PEs financial statements) were postponed to later dates.

A. Safeguarding Fiscal Resilience

8. The government is addressing near-term fiscal pressures through tax reforms and expenditure measures in the FY2023/24 budget. The authorities introduced several measures to boost tax collection, curtail spending duplication with subnational governments, and enhance the efficiency of capital expenditure. [7,8] Tax measures include establishing a 39 percent top income tax rate for income above NPR 5 million, increasing the tax rate for interest paid to bank depositors, removing VAT exemptions for 170 items, and other excise duty measures, which the authorities expect could yield at least 0.4 percent of GDP in additional revenue. Despite the expected modest growth and y-o-y decline in domestic revenue in the first two months of the fiscal year, the fiscal deficit is projected to decline to 5.3 percent of GDP in FY2023/24.[9]



9. The deficit level is consistent with program objectives of gradual fiscal consolidation to stabilize public debt at a low risk of distress.[10] This holds despite the debt-to-GDP ratio rising slightly through FY2026/27. Reflecting the FY2022/23 outcome, the medium-term public debt projections assume a reduced share of external financing, leading to lower exchange rate risk but a higher cost of debt servicing (the debt-service-to-revenue ratio would reach 40 percent in 2023/24 relative to about 25 percent in the May 2023 Debt Sustainability Analysis (DSA) before declining to 25 percent in the medium term); higher gross financing requirements, including due to lower maturity instruments; and crowding out of credit to the private sector. The May 2023 DSA for the combined 1st and 2nd reviews shows that both external and overall debt are at low risk of debt

[7] The FY2023/24 budget indicates that institutions with overlapping jurisdiction with the permanent structure of the government, those that have lost their relevance, and 20 entities deemed unnecessary in the changed context would be dissolved. All allowances, including the incentive allowance and extra hour allowance, will be abolished due to treasury pressure.

[8] Measures to prioritize infrastructure projects and enhance project monitoring are broadly in line with recommendations from the Public Investment Management Assessment (PIMA) and include prioritizing strategically significant projects, streamlining public procurement, and enhancing the accountability of departmental and project heads for project implementation.

[9] The difference in the fiscal deficit between staff projections and the FY2023/24 budget (2.4 percent of GDP) is mostly due to the authorities' overly optimistic revenue targets, beyond the impact of the tax reforms and the projected economic recovery that is expected to support revenue collection.

[10] A gradual fiscal consolidation amounting to a cumulative reduction of the primary deficit by 3.1 percent of GDP between FY2022/23 and FY2027/28 (2.7 percent of GDP reduction of the overall deficit) is expected to help stabilize public debt at a low risk of debt distress. The downward shift in the public debt-to-GDP ratio in FY2021/22 in the text chart is primarily due to (1) better performance of GDP and the fiscal balance in FY2020/21 and FY2021/22 than projected at the ECF request, and (2) valuation effects due to SDR depreciation.

distress. With the aforementioned changes, debt burden ratios remain below the LIC DSA thresholds over the forecast horizon.

10. Policies should focus on achieving gradual, growth-friendly fiscal consolidation while supporting the most vulnerable to ensure medium-term fiscal sustainability. The authorities should further mobilize domestic revenue by pursuing improvement of the value added tax, personal and corporate income taxes, excises, and the property tax.[11] These reforms should be guided by a comprehensive domestic revenue mobilization strategy with an appropriate balance of tax policy, law, and revenue administration reforms (end-April 2024 SB). The authorities should continue enhancing the initial estimates of custom duty exemptions (previous SB) and non-customs-related tax (VAT, CIT, and PIT) exemptions (end-August 2023 SB, not met, implemented with delay). Building on these initial customs and non-customs related estimates, the authorities should prepare and publish a comprehensive report on tax expenditures (end-April 2024 SB, reset for end-January 2025) covering tax allowances, credits, deferrals, and reliefs in addition to tax exemptions to further guide tax reforms. The authorities should continue to rationalize spending duplication with subnational governments. They should also undertake measures to maintain the level of spending on the child grant in FY2023/24 and endeavor to extend the coverage of the child grant program from 25 districts to all 77 districts. Considering risks of natural disasters, including earthquakes, contingency planning to quickly respond to these shocks remain essential.

11. Further actions are needed to continue progress on the structural fiscal reform agenda, particularly to boost capital spending. The 2021 Public Investment Management Assessment (PIMA) revealed that Nepal's perceived quality of infrastructure is low compared to its peers. Estimates indicate that by improving investment efficiency, infrastructure outcomes could be significantly improved, providing further support to growth. Building on measures announced in the FY2023/24 budget to improve capital expenditure efficiency, a more comprehensive reform action plan should be developed to address underlying weaknesses (end-April 2024 SB).[12] Notably, the Climate-PIMA component can inform the action plan to integrate climate considerations into public investment to improve climate resilience. Maintaining momentum on governance reforms is critical to cementing recent gains in fiscal transparency. The fiscal risk registry (end-August 2023 SB, met)

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[11] Based on Fund TA, estimates suggest that full implementation of the revenue mobilization effort could raise 3.7-4.1 percentage points of GDP of additional revenue over five years. Major components of such effort could include reforming (i) the *value added tax* by broadening tax base; adopting a single, high compulsory registration threshold; and removing the exemption on capital inputs, while keeping a single positive rate; (ii) *excise tax* by simplifying the excise regime to limit excise to tobacco, alcohol, sugar, and single use plastics while introducing excises on fuels, vehicles, coal, and cement that approximate their external costs; (iii) p*ersonal income tax* by broadening the tax base and enhancing income tax progressivity; (iv) *corporate income tax* by removing tax holidays; curtailing tax incentives; introducing a minimum alternative tax to place a floor under CIT; reducing tax rates; and allowing full expensing for capital expenditure and indefinite carry forward of losses; and (v) *property tax* by increasing property tax rates and periodically revising threshold exemptions. Reforming trade tax, by reducing the highest tariff rates and removing those excises that are *de facto* tariffs could also be part of the reform package with the associated revenue loss more than compensated by gains from other reforms.

[12] The approval of the PIMA action plan is proposed to be done by the National Planning Commission—which coordinates inter-Ministerial planning—rather than Cabinet. The action plan will be reflected in the 16th National Development Plan that the Cabinet will approve.

should be expanded to include subnational governments and PPPs, and a comprehensive fiscal risk statement should be prepared and published with the FY2025/26 budget (new end-August 2025 SB). All majority- and wholly-owned public enterprises (PEs) should publish their FY2022/23 annual financial statements (end-April 2024 SB, modified and reset to end-August 2024).[13] The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Doorsanchar Company (Nepal Telecom)) should have their FY2022/23 financial statements audited (end-April 2024 SB, reset to end-August 2024). The reporting of extra-budgetary operational funds in the annual financial statements is proposed to be reset to allow more time for the Financial Comptroller General Office (FCGO) to map the accrual accounts of extra-budgetary units into the consolidated cash-based accounts of the central government (end-August 2023 SB, reset to end-January 2025). Building on the new cash flow forecasting framework (end-September 2023 SB, met), the authorities should continue to improve the realism of the initial budget, including revenue forecasts.

B. Preserving Macroeconomic and Financial Stability

12. The NRB has appropriately focused monetary policy on maintaining price and external stability. Considering the moderate decline in inflationary pressures, the NRB eased monetary policy on July 23, 2023, through a 50-basis point cut in the context of rising reserves. Credit growth has not yet responded despite the interbank rate falling below 2 percent (Annex II), suggesting limited scope for monetary policy to boost growth. The NRB should remain focused on its price and external stability mandate through cautious and data dependent monetary policy. Avoiding further boom-bust cycles is critical to establish a more stable, pro-growth financial sector equilibrium. Prudent monetary policy, alongside the ECF arrangement and budget support from development partners, should continue to help build reserves going forward without the need to resort to distortionary trade restrictions.

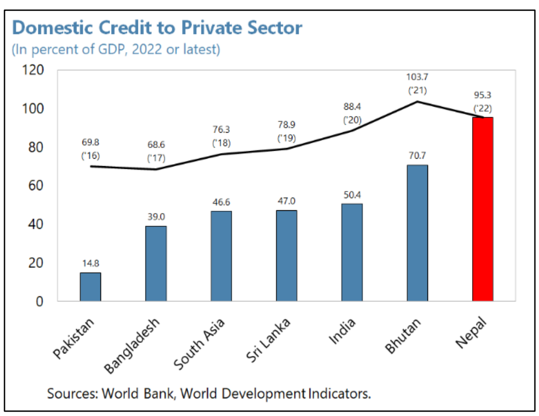
13. Recent shocks to money supply highlight the need to expand the NRB's monetary policy implementation capacity. The Finance Ministry changed the amount of funds local governments can place as commercial bank deposits, shifting base money by roughly 7-9 percent.[14] Such drastic shifts disrupt monetary policy. Changes in local government deposit policy should take place only for non-monetary policy purposes and should be done gradually, announced well in advance and coordinated with the NRB to minimize the impact on the monetary policy stance. The NRB should neutralize the resulting excess liquidity because large deviations from the policy rate (over 400 basis points in mid-October 2023) undermines the credibility of the monetary policy framework. Even without those shocks, further refinement of the monetary policy toolkit is required to keep rates inside the interest rate corridor, and plans for a new facility to absorb liquidity at the bottom of the corridor are welcome (Annex II). Improved cash flow forecasting by the Finance

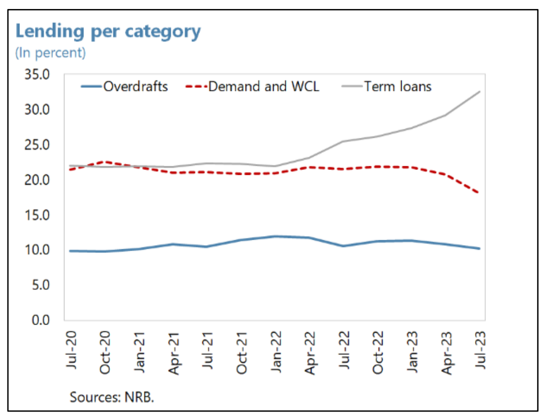
[13] The government has a minority stake in 19 of the 59 enterprises considered to be PEs. These were excluded from the SB for greater tractability and improved focus on fiscal risks.

[14] In July 2023 the allowance to place 80 percent of funds with commercial banks (otherwise deposited at the NRB) was allowed to expire, then in September it was raised back to 60 percent.

Ministry (end-September 2023 SB, met) would allow greater coordination on its use of the Treasury Single Account, helping the NRB calibrate the timing and magnitude of monetary operations.

14. Regulatory changes to improve lending practices and asset classification will support the needed transition to more sustainable credit growth. From a high base, Nepal's credit to GDP ratio has almost doubled in recent years to about 100 percent of GDP, far above the level in peer South Asian countries. After the post-pandemic credit boom, vulnerabilities in the banking sector have slowly started to become more apparent. NPLs across all types of banks almost doubled compared to the level in July 2022. Over the same timeframe the banking system's core capital position has slowly eroded from 10.8 to 10.6. In this context, the NRB drafted amendments to the asset classification regulations to tackle forbearance. These were published in February and August 2023 (end-August 2023 SB, met). In addition, the NRB issued guidelines to tighten the use of Working Capital Loans (WCL) to reinforce proper use of this loan product and limit evergreening practices. These guidelines have been effective since October 2022 but have recently been relaxed in view of the slow growth momentum and to address implementation issues.[15] Both regulations should lead to better alignment of asset classifications and provisioning with international standards, support a more sustainable level of credit growth, and help the NRB get a better overview of the health of loan portfolios prior to launching the loan portfolio review (LPR, ¶16). The transition to the new framework will improve bank lending practices but will require some adjustment by banks and borrowers as the framework is phased in. The NRB plans to pursue further improvements of the asset classification regulation assisted by the Fund and seek full convergence with international standards.





15. The NRB is furthering reforms to enhance the bank supervision framework. The NRB implemented the Supervisory Information System (excluding on-site module) for all banks (end-August 2023 SB, met). Implementation of the on-site module for Class A Banks will be completed next (end-April 2024 SB). In addition, the NRB introduced the counter-cyclical capital buffer in July 2023, initially setting the buffer at 0, and will discontinue the option for banks to classify debentures as both deposits and capital by mid-January 2024. The NRB plans to introduce the Basel III liquidity coverage ratio and net stable funding ratio to help strengthen banks' liquidity risk management and is planning to transition banks to the expected credit loss provisioning

[15] The NRB amended the guidelines in January and August 2023.

approach in 2024. Further reforms to implement the recommendations of the 2023 Financial Sector Stability Review (FSSR) are being considered.

16. The authorities need to continue enhancing policies to ensure a stable and well-capitalized banking system. Assessing the impact of directed lending on the business models of banks and on financial stability, closely monitoring the quality of these loans, and reviewing their amount as needed could help unlock further credit to the most bankable projects across sectors.[16] In addition, monitoring the impact of interest rate regulations on monetary policy transmission and bank viability and gradually moving to more market-based determination of interest rates to improve transmission could further support the banking system's stability.

17. The NRB has started preparations for the portfolio review of the ten largest banks.[17] It has established a project team and finalized a Concept Note outlining the main elements of the LPR. The NRB will launch the exercise early next year (end-April 2024 SB). It is expected to be phased in such a way to allow for the use of end-year data (mid-July 2024). In preparation of the launch of the LPR, the NRB will finalize the Terms of Reference for the exercise by end-December 2023. In addition, two new SBs on completion of the LPR by end-December 2024 and finalizing a roadmap outlining the NRB's approach to the outcome of the exercise by end-February 2025 were agreed (new end-December 2024 and end-February 2025 SBs, respectively).

18. The growing importance of financial cooperatives and their interconnectedness with the banking sector requires more effective oversight. Currently, there are over 14,000 saving and credit cooperatives which represent around 7 percent of total lending with some exceeding the size of Class B and C banks. These cooperatives are regulated by the Department of Cooperatives or local authorities without the necessary data to assess the risks of these institutions. The "Amendments to Some Laws relating to AML and Business Promotion Bill" (¶20), will expand oversight and data collection in this area. The authorities intend to establish and operationalize a specialized regulatory authority to regulate and supervise financial cooperatives, with technical assistance from the NRB and incorporating FSSR recommendations. In addition, the NRB will closely collaborate on the supervision of systemically important financial cooperatives.

C. Enhancing Governance and Other Structural Reforms to Boost Growth

19. While some progress has been made, most of the 2021 safeguards assessment (SGA) recommendations remain outstanding. Progress on most SGA recommendations related to governance, internal audit and controls in key operations has been limited.[18] Importantly, the audit

[16] The NRB requires banks to extend a certain percentage of their total loans to agricultural and energy sectors and MSMEs. These loans correspond to 29 percent of Class A banks' total loan portfolio as of January 2023.

[17] Bank diagnostics are a common feature in effective risk management of banking systems, including in countries that are in an IMF program. These diagnostics can help address potential vulnerabilities in the banking system to ensure that banks can play their critical role in channeling credit and supporting the economy (see also the documentation on the ECF request).

[18] 5 out of 16 recommendations have been implemented, the other recommendations are in progress.

of the NRB's FY2022/23 financial statements is underway without the participation of auditors with international experience in auditing central banks.[19] The FY2023/24 audit, however, will involve auditors with such experience (new end-July 2024 SB). Fund staff provided advice to modernize the NRB Act to strengthen its mandate, autonomy, and governance in line with international best practices. While the draft amendments address some of the key vulnerabilities identified in the SGA, large parts of these amendments still materially deviate from the recommendations in the SGA. The authorities should continue engaging with Fund staff to further align the amendment bill with the SGA recommendations before submitting it to Parliament (end-August 2023 SB, reset to end-April 2024).

20. In view of the results of the Asia/Pacific Group on Money Laundering's (APG) recent assessment of Nepal, improving the AML/CFT framework is an urgent priority (Annex III). The APG has determined that, reflecting deficiencies in numerous areas, Nepal will enter the International Co-operation Review Group (ICRG) observation period and will need to implement necessary reforms in the action plan within one year before possible public identification and formal review by the Financial Action Task Force (FATF). The deficiencies in the report, coupled with its publication, could lead to severe reputational and financial stability risks, and negatively impact Nepal's correspondent banking relationships and access to the global financial network together with higher financial transaction costs. The authorities will enact the "Amendments to Some Laws relating to AML and Business Promotion" Bill to improve compliance with international standards and address gaps in the effectiveness of the AML/CFT regime with TA support from the Fund and other development partners (new end-July 2024 SB).

21. Structural barriers, including in market regulation, hamper Nepal's growth potential and social safety nets can be improved. Barriers to growth include a high cost of doing business, weak governance and anti-corruption institutions, low human capital and productivity, regulatory restrictions to foreign investments and associated low FDI flows compared to peers. Capital expenditure on growth-enhancing infrastructure consistently underperforms budgeted amounts. The government plans to release the 16th Development Plan in February 2024, which will guide the policy agenda on investment, climate adaptation, social justice, and employment from FY2024/25 to FY2028/29. On the social justice front, social safety net spending is highly skewed towards pensions. The child grant remains well targeted as it covers children 0-5 years old in 25 of the poorest districts and Dalit children nationwide. However, the size of the grant is small (NPR 532 per month per child) and does not adjust with inflation.

PROGRAM MODALITIES

22. Conditionality is proposed to evolve to promote the achievement of program objectives. The primary deficit target, currently an IT, will become a quantitative PC at the January 14, 2024 test date, and the cap on the upward adjustment of the foreign-financed project loan

[19] The audit of the NRB's FY2021/22 financial statement was completed in November 2022 and did involve international auditors with international experience in the auditing of central banks.

adjustor on the primary deficit will be removed.[20] Reflecting lower volatility, the revenue adjustor to the primary deficit is proposed to be removed from the July 15, 2024 test date onwards.[21] As envisioned at program approval, an IT floor on tax revenue is proposed to begin at the 5th review. To help improve performance on future SBs, commitments to intermediate steps have been added in addition to the re-prioritization of SBs to account for implementation capacity constraints and emerging short-term risks. Similarly, commitments to accelerate progress on meeting some non-SB safeguard assessment recommendations have been added.

23. **Capacity to repay remains adequate**. IMF credit outstanding is projected to peak at 262.3 percent of quota in FY2024/25 (SDR 411.6 million), within the cumulative normal access limit. This amount corresponds to 17.3 percent of exports and 1.2 percent of GDP (Table 9). The authorities' track record of servicing IMF debt is strong.

Nepal: Projected Financing Gap

(In percent of GDP)

External financing need	FY2023/24	FY2024/25	Fiscal financing need	FY2023/24	FY2024/25
External financing requirement	**0.4**	**2.7**	Total revenue and grants	19.8	20.8
of which:			Expenditure	25.1	25.4
Current account deficit[1/]	2.5	4.8	**Fiscal deficit**	**5.3**	**4.6**
Financing sources	**-0.5**	**2.2**	**Total financing**	**4.4**	**4.2**
Foreign borrowing	1.4	1.4	Net acquisition of financial assets	1.7	1.7
Current and capital grants	1.4	1.4	Net incurrence of liabilities	6.1	5.9
FDI, net	0.4	0.6	Foreign borrowing	0.9	0.9
Change in reserves (+ decrease)	-3.8	-1.1	Domestic borrowing	5.2	5.0
External financing gap	**0.9**	**0.5**	**Fiscal financing gap**	**0.9**	**0.5**
Financing commitments so far:	**0.9**	**0.5**	Financing commitments so far:	**0.9**	**0.5**
IMF: ECF	0.2	0.2	IMF: ECF	0.2	0.2
Asian Development Bank	0.3	0.1	Asian Development Bank	0.3	0.1
World Bank	0.4	0.2	World Bank	0.4	0.2

Sources: Nepali authorities; and IMF staff estimates.
1/ Current account excludes official transfers.
Note: Current baseline forecast is as of September 28, 2023.

24. **The program is fully financed, with firm commitments in place for the next 12 months, and there are good prospects for the remainder of the program**. The lack of reform implementation underpinning Nepal's budget operations delayed disbursements from development partners, and hence lowered budget support financing below projections in FY2022/23. However, pledges for FY2023/24 through FY2024/25 are broadly in line with the level recorded during the first

[20] These two changes were proposed and approved under the first and second review.

[21] At the last review the revenue adjustor on the primary deficit was narrowed for the January 14, 2024 test date and the revenue adjustor on NIR was removed.

and second review, narrowing the near-term balance of payments need (Text table and Table 5).[22] The authorities intend to use the ECF arrangement for budget support.

25. The program continues to face important risks. Political stability is key for policy continuity and the implementation of the program. A large commodity price shock would require monetary policy tightening if the shock were not expected to be short-lived. Fiscal restraint, following the guardrails provided by the program, would help preserve macro stability. Should external concessional financing fall short of expectation, further reduction of low priority expenditures would be needed. Likewise, a significant reduction in remittances could lead to a decline in growth, reserves, and revenues. The program includes some flexibility through adjustors on program targets. Nonetheless, a large decline in remittances and/or a large natural disaster would require greater external support from development partners to help replace lost income among vulnerable populations without risking unsustainable fiscal outcomes. The NRB has been maintaining tight regulatory measures and developing liquidity facilities to stave off potential problems, but an episode of elevated bank stress due to rising NPLs could raise solvency problems. The NRB stands ready to provide liquidity support to prevent wider systemic concerns. Such a scenario may require government intervention with significant fiscal implications, but intervention should be designed so that investors bear the burden of costs appropriately.

26. Capacity development (CD) remains well-aligned with program objectives, and staff will continue to mobilize CD to support program implementation. Recent CD prioritized reform implementation under the program, including the establishment of a fiscal risk register and the implementation of a cash flow forecast framework. Prospective CD also focuses on program implementation, including the formulation of a domestic revenue mobilization strategy, the preparation of a tax expenditure report, and improvements in tax administration.

STAFF APPRAISAL

27. The economy is undergoing necessary balance sheet repair after a post-pandemic boom-bust cycle, impeding growth. Following a slowdown last year, growth is projected to recover modestly in FY2023/24 to 3.5 percent, which is below potential. Both borrowers and banks face balance sheet constraints on expansion—limiting the scope for monetary stimulus—and public sector capital execution has not yet picked up to provide a much-needed boost. Subdued domestic demand has helped relieve external pressures but has also provided insufficient support for government revenue. Inflation has been on an uneven downward trend but remains elevated.

28. Program performance has renewed momentum and was good with all but one quantitative metrics met, and a critical mass of structural benchmarks completed. The PC on net international reserves and the IT on the primary fiscal deficit were met, together with all standard continuous PCs. Only the IT on child allowance spending was missed by a slim margin. Five

[22] Additional concessional financing would reduce the need for domestic financing—which may be particularly constrained by higher domestic interest rates—and help authorities build reserves.

of seven SBs completed (four met) represents good progress considering the high number of SBs set for this review.

29. The authorities should continue to address fiscal pressures to ensure medium-term fiscal sustainability, while enhancing capital spending and protecting the most vulnerable. The FY2023/24 budget includes measures to boost tax collection, curtail spending duplication with subnational governments, and enhance the efficiency of capital expenditure, which are essential and should continue to be implemented swiftly. Going forward, fiscal policies should focus on achieving gradual, growth-friendly fiscal consolidation to ensure medium-term fiscal sustainability, while also supporting the most vulnerable and enhancing public investment efficiency. Additional efforts on structural reforms, including further mobilizing domestic revenue, strengthening public investment management, and addressing fiscal risks, are needed to support fiscal sustainability. Maintaining momentum on governance reforms is critical to solidify recent gains in fiscal transparency.

30. Monetary policy settings should focus on preserving price and external stability. Monetary policy should maintain the current appropriately cautious and data-driven approach. However, refinements to the toolkit to address surplus liquidity will help monetary operations, which also rest on clear authority and commitment to use the tools. Large shifts in local government deposit policy disrupt monetary policy. These shifts should take place only for non-monetary policy purposes, be done gradually, announced well in advance, and coordinated with the NRB to minimize the impact on the monetary policy stance.

31. Regulatory adjustments pursued by the NRB are an important step for the needed transition to more sustainable credit growth. The introduction of tighter regulation on asset classification and lending practices will support balance sheet repairs and the emergence of more sustainable and pro-growth credit creation. Avoiding further boom-bust cycles is critical to establish a more stable, pro-growth financial sector equilibrium. The planned loan portfolio review is important and will improve the NRB's visibility on potential asset quality issues and test the comprehensiveness and efficiency of the Supervisory Information System. Other scheduled financial sector reforms aimed at implementing international standards on capital and liquidity requirements will help further enhance financial sector stability. More effective regulation of the saving and credit cooperatives is necessary to enable the authorities to assess and regulate risks.

32. Aligning the NRB operating framework with international standards is essential to conduct effective monetary policy and undergird financial stability. Implementation of the 2021 Safeguards Assessment recommendations will help achieve this goal. This includes conducting the audit of the NRB assisted by experts with international experience in auditing central banks and amendments to the NRB Act to safeguard operational and financial independence.

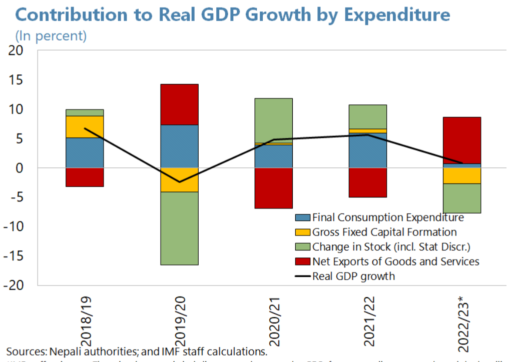
33. Strengthening the AML/CFT framework is a top and urgent priority. Implementing the needed reforms identified by the APG in its mutual evaluation report of the AML/CFT framework, starting with the enactment of the AML/CFT legislation, is critical to avoid potentially severe impacts on Nepal's correspondent banking relationships, access to the global financial network, the cost of financial transactions, and the business environment.

34. Further reforms to market regulation, social safety nets, and anticorruption institutions are needed to support growth. Reforms to improve the business climate, improve governance, strengthen anticorruption institutions, and build human capital remain essential to fostering investment and more inclusive growth. Coverage of the child grant program should continue to improve, including by extending it to all districts in Nepal.

35. Staff supports the completion of the third review of the ECF-supported program and the disbursement of fourth tranche in the amount of SDR 39.2 million.

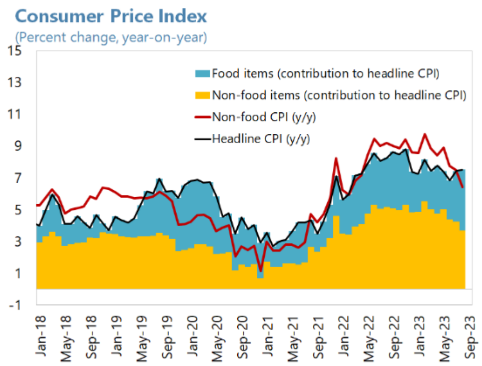
Figure 2. Nepal: Recent Macro-Economic Developments

The slow-down in FY2022/23 was driven by lower fixed capital formation and domestic demand.



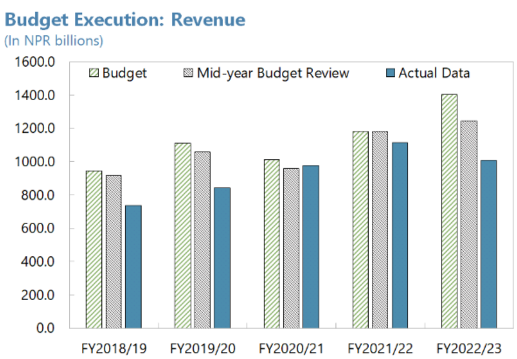
Sources: Nepali authorities; and IMF staff calculations.
*IMF staff estimates. There is a large statistical discrepancy between the GDP from expendiure approach, and the headlin GDP from the industry approach.

Non-food inflation has been declining steadily, but food inflation has made the decline in overall inflation less consistent.



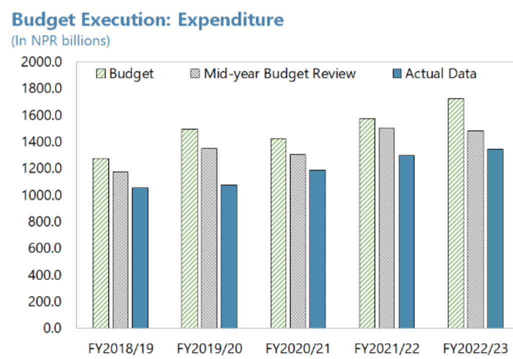
Sources: Nepali authorities; and IMF staff estimates.

Revenue collection in FY2022/23 fell short of initial projections…



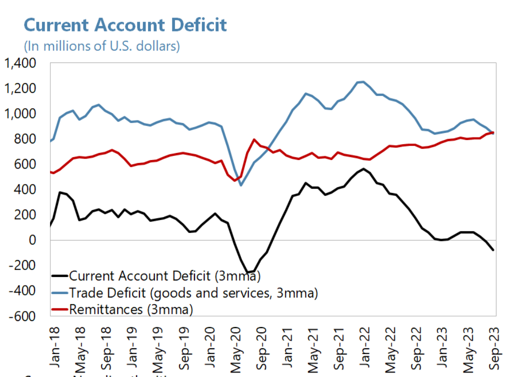
Sources: FCGO and MOF. Note: Fiscal year begins mid-July.

…constraining spending and reinforcing the usual pattern of under-execution of expenditures.



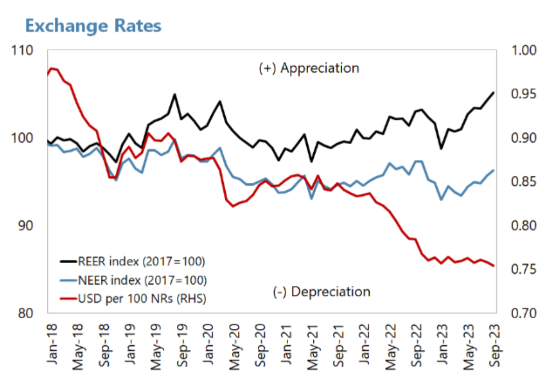
Sources: FCGO and MOF. Note: Fiscal year begins mid-July.

The current account deficit has disappeared, driven by lower imports, while remittances remain buoyant.



Source: Nepali authorities.

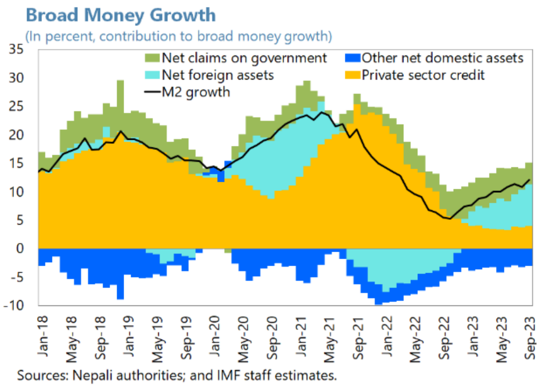
The REER has appreciated 6.4 percent in 2023 through September, largely on Renminbi weakness and elevated inflation in Nepal.



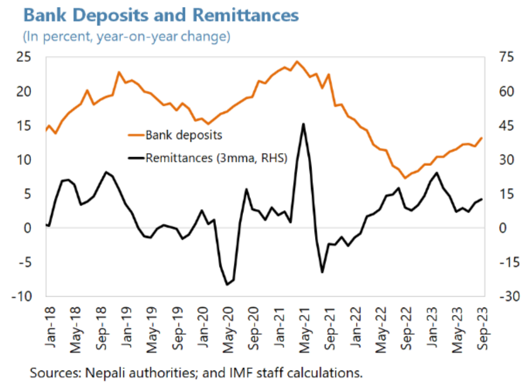
Sources: Nepali authorities; and IMF staff estimates.

Figure 3. Nepal: Recent Monetary Sector Developments

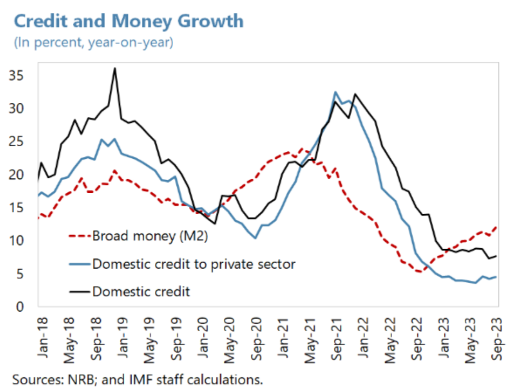
Net foreign asset accumulation has driven growth in broad money as private sector credit remains subdued.



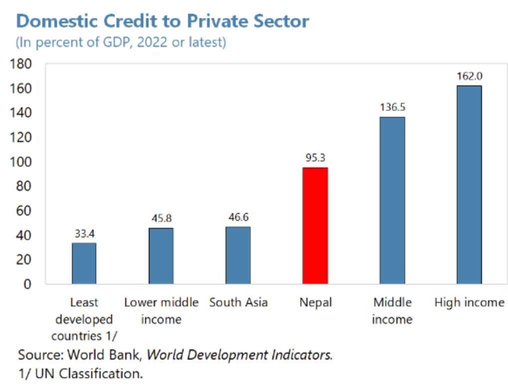
Deposit growth continued to rise at 13.2 percent as remittance growth averaged 12.9 percent since May 2022.



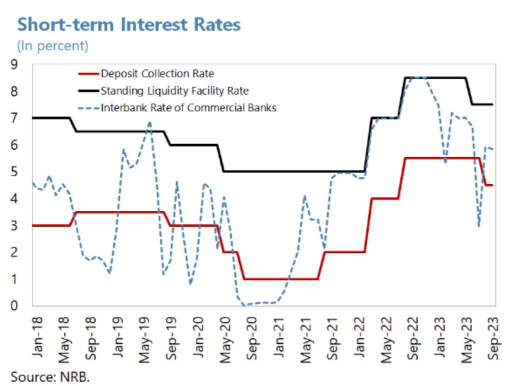
Private sector credit growth has fallen to single digits from a recent peak of 32.5 percent (y-o-y) in Sept 2021.



Private sector credit-to-GDP ratio remains among the highest in its peer group.



The interbank rate has hit the middle of the interest rate corridor in 2023 when liquidity was in deficit.



Excess liquidity was low through August 2023, so banks stopped borrowing from the Standing Liquidity Facility.

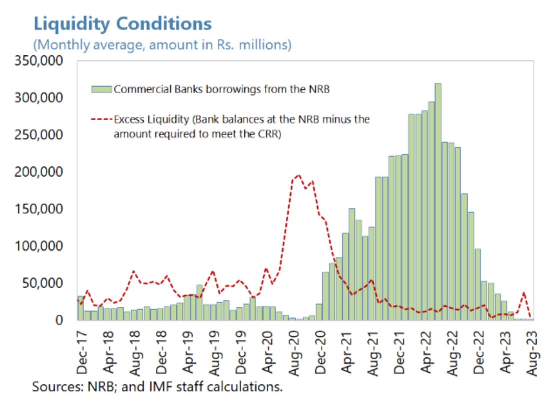


Figure 4. Nepal: External Sector Developments

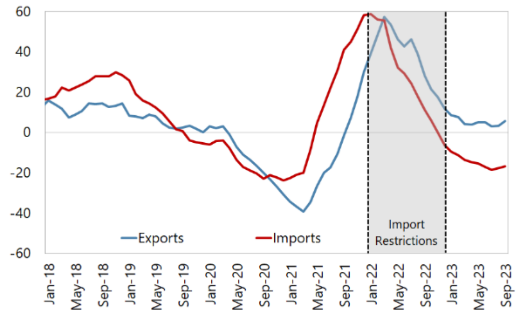
The FY2022/23 current account deficit shrunk on the back of a large drop in imports and strong remittances.

Current Account
(In percent of GDP)

Sources: Nepali authorities; and IMF staff estimates.

Imports and exports slowed considerably in FY2022/23 and imports continue to fall after lifting import restrictions.

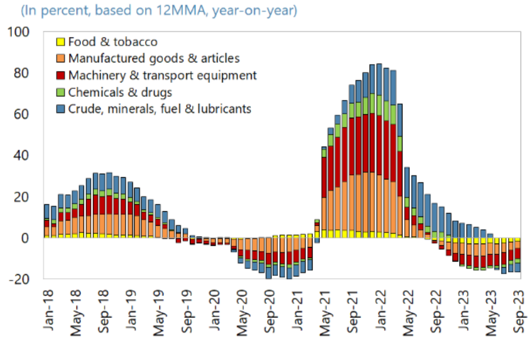
Exports and Imports
(In percent, year-on-year change, 12MMA)



Sources: NRB; and IMF staff calculations.

The decrease in imports is driven mainly by manufactured goods and equipment.

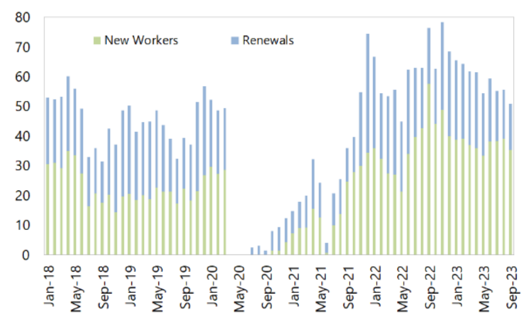
Contribution to Import Growth
(In percent, based on 12MMA, year-on-year)



Sources: Nepali authorities; and IMF staff calculations.

A strong post-pandemic recovery in foreign employment has driven remittance growth.

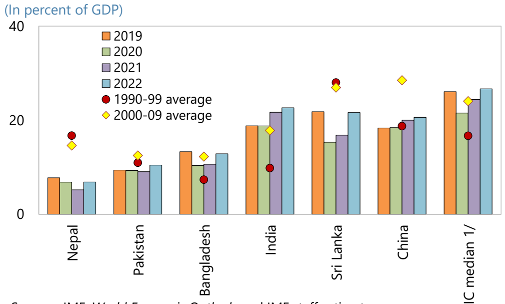
Total Foreign Employment
(Thousands of workers)



Sources: Nepali authorities; and IMF staff estimates.

Exports have rebounded since 2020, but remain well below the 1990-2009 levels, and below peers.

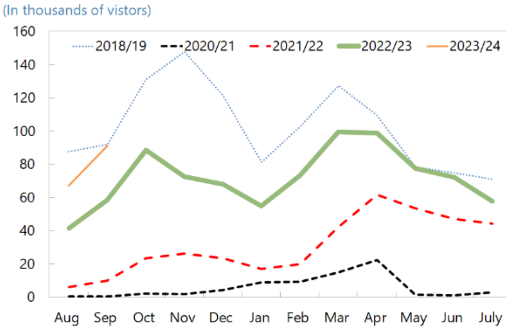
Exports of Goods and Services
(In percent of GDP)



Sources: IMF, *World Economic Outlook*; and IMF staff estimates.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

Tourism is rebounding, approaching pre-pandemic levels.

International Visitor Arrivals
(In thousands of vistors)

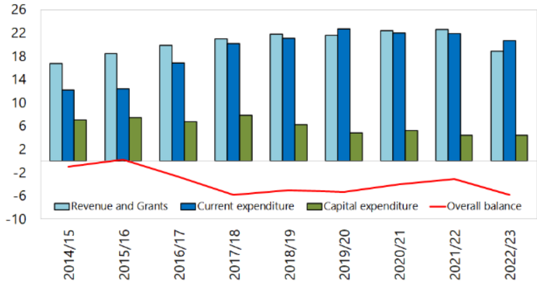


Source: Nepali authorities.

Figure 5. Nepal: Recent Fiscal Developments

The FY2022/23 fiscal deficit has widened to 5.9 percent of GDP driven by a sizable drop in revenue collection.

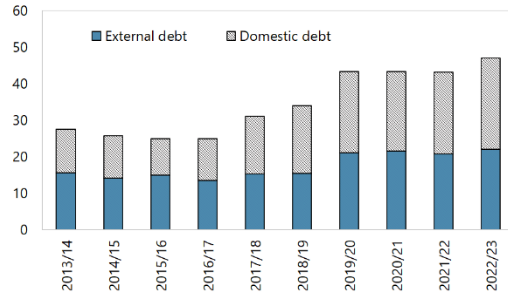
Central Government Fiscal Performance
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.
Note: Overall balance calculated as total revenue and grants minus expenditure.

Total public debt increased to 46.7 percent of GDP in FY2022/23.

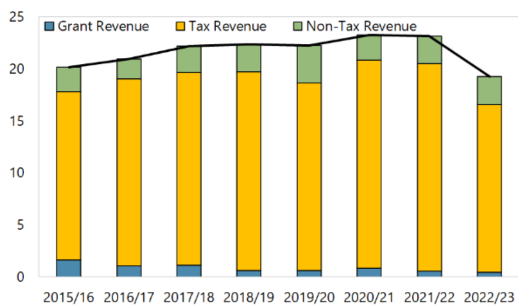
Public Debt
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

Total revenue fell sharply as the tax collection was significantly lower than last year.

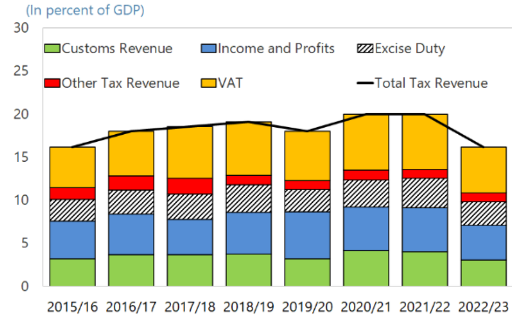
Central Government Fiscal Revenues (Incl. Grants)
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

Revenue from several sources declined, with a large decline in VAT, customs, and excise duty.

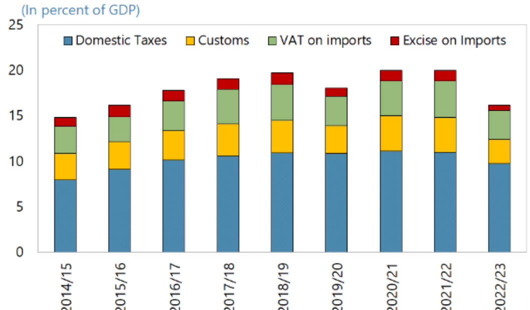
Central Government Tax Revenues
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

The tax revenue decline in FY2022/23 was mostly driven by a sharp drop in import-related tax revenues.

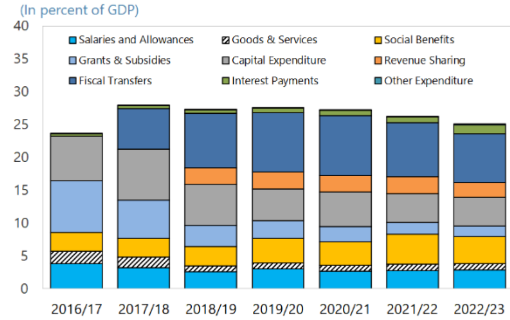
Tax Revenue by Source
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.
Note: Domestic taxes are calculated as the residual by subtracting customs, VAT on imports and excise on imports from total tax revenue.

Current and capital expenditure were contained in the context of low revenue collection in FY 2022/23.

Central Government Fiscal Expenditure
(In percent of GDP)

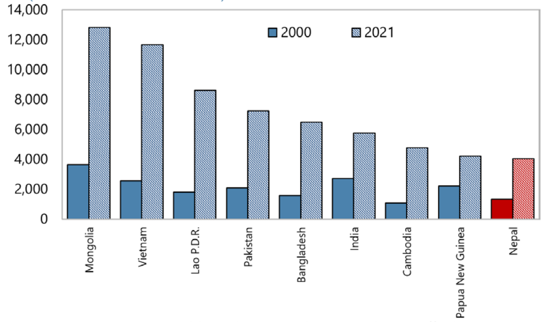


Sources: Nepali authorities; and IMF staff estimates.

Figure 6. Nepal: Socio-Economic Indicators

Nepal is among the lowest income countries in South Asia.

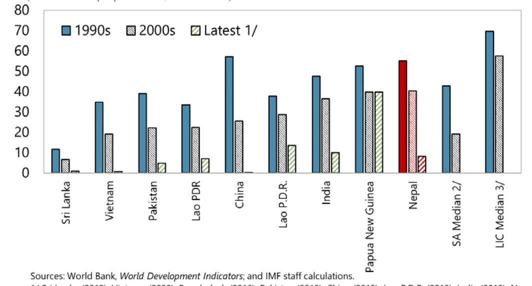
Per Capita GDP (PPP)
(In current international dollars)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.

Poverty has fallen significantly in the last decade.

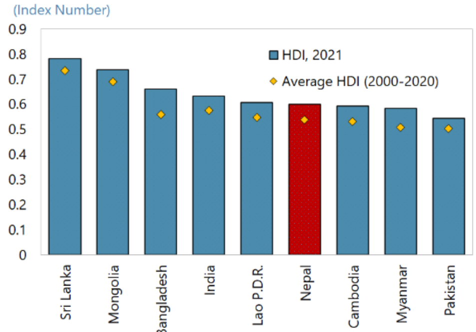
Poverty Headcount Ratio at $2.15 a day
(Percent of population, 2017 PPP)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.
1/ Sri Lanka (2019), Vietnam (2020), Bangladesh (2016); Pakistan (2018), China (2019); Lao P.D.R. (2018); India (2019); Nepal (2010); Papua New Guinea (2009).
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

The decline in poverty is reflected in an improvement in Nepal's UNDP Human Development Index.

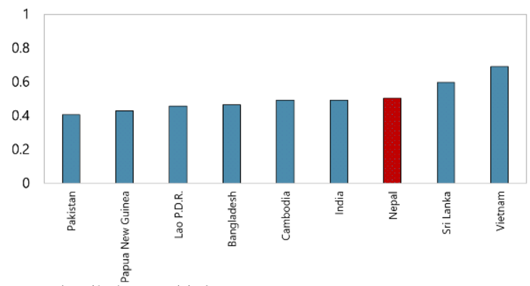
Human Development Index (HDI)
(Index Number)



Sources: UNDP; and IMF staff calculations.

Although human capital levels are similar to comparators, there is scope for improvement.

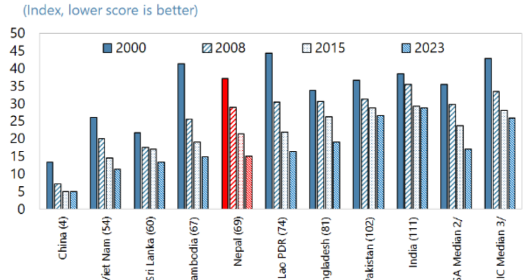
Human Capital Index 1/
(Index, as of 2020; higher is better)



Source: The World Bank, *Human Capital Project*.
1/ Measures the human capital that a child born today can expect to attain by her 18th birthday, given the risks of poor health and poor education in the country where she lives. Units represent productivity relative to a benchmark of complete education and full health, on a scale of 0 to 1.

There is substantial scope and need to improve living standards, including relating to hunger.

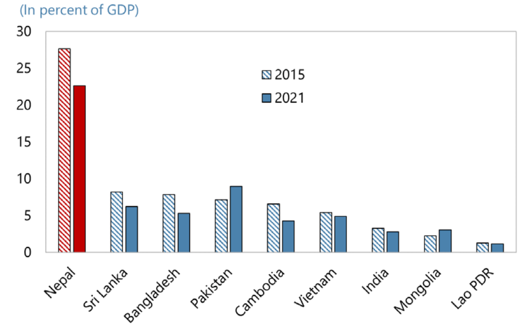
Global Hunger Index 1/
(Index, lower score is better)



Sources: Global Hunger Index; and IMF staff calculations.
1/ The Global Hunger Index is a multidimensional indicator that captures undernourishment, child wasting, child stunting, and child mortality. Number in parenthesis represents the country's 2023 rank out of 125 countries.
2/ South Asia (SA) includes only India, Nepal, Bangladesh and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

One of Nepal's most important safety nets comes from remittances.

Remittances Received
(In percent of GDP)

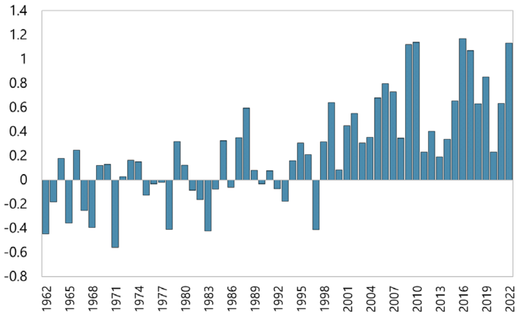


Source: World Bank, *World Development Indicators*.

Figure 7. Climate Change and Pollution in Nepal

Average temperatures have risen in Nepal.

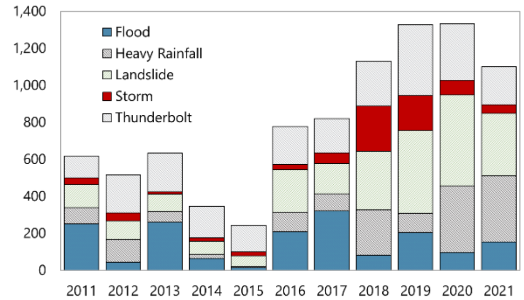
Mean Temperature Change of Meteorological Year
(Change centigrade from 1951-1980 baseline)



Sources: FAO; and IMF Climate Dashboard.

The country is subject to significant and growing climate related shocks including landslides, floods, and storms.

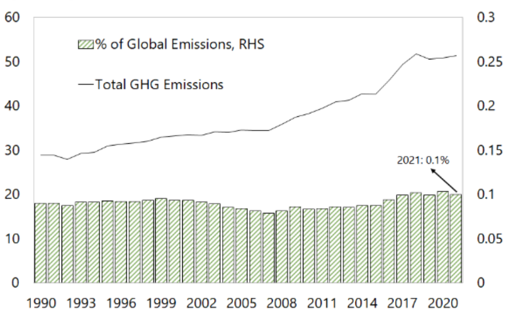
Number of Climate Related Incidents
(Count)



Sources: BIPAD Government of Nepal; and IMF staff calculations.

Total greenhouse gas emissions are growing but represent a small percentage of global emissions.

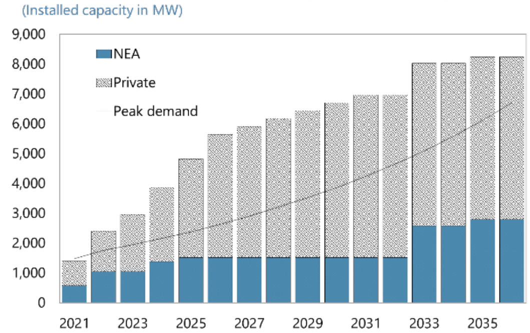
Total GHG Emissions
(MTCO2e)



Source: IMF Climate Dashboard.

Hydropower accounts for 90 percent of current electricity production and is set to become a major export.

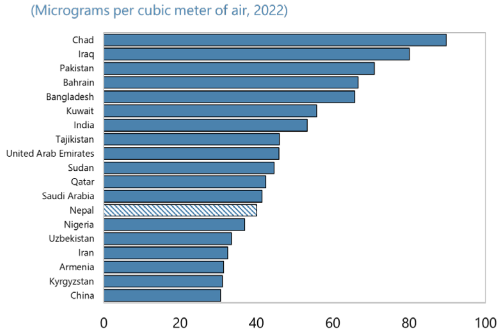
Forecast of Hydropower and Projected Electricity Demand
(Installed capacity in MW)



Source: World Bank CCDR 2022.

Pollution is trapped by Nepal's mountainous geography making is the 13th most polluted country.

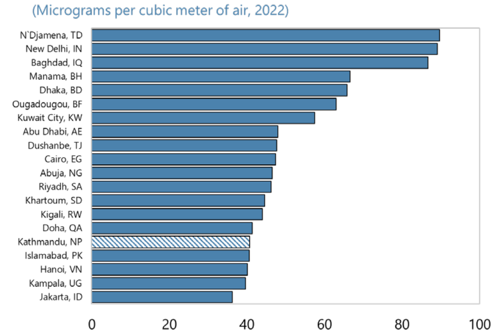
PM2.5 Concentration of the Most Polluted Countries
(Micrograms per cubic meter of air, 2022)



Source: 2022 World Air Quality Report.

Kathmandu is the 16th most polluted capital cities.

PM2.5 Concentration of the Most Polluted Capitals
(Micrograms per cubic meter of air, 2022)



Source: 2022 World Air Quality Report.

Table 1. Nepal: Selected Economic Indicators, 2019/20-2027/28 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Est.	Projections				
Output and Prices (annual percent change)									
Real GDP	-2.4	4.8	5.6	0.8	3.5	5.2	5.2	5.2	5.2
Headline CPI (period average)	6.1	3.6	6.3	7.8	7.3	6.2	5.5	5.4	5.4
Headline CPI (end of period)	4.8	4.2	8.1	7.4	6.8	5.5	5.4	5.4	5.4
Fiscal Indicators: Central Government (in percent of GDP)									
Total revenue and grants	22.2	23.3	23.1	19.3	19.8	20.8	21.5	22.1	22.8
of which: Tax revenue	18.0	20.0	20.0	16.1	16.5	17.6	18.4	19.1	19.7
Expenditure	27.6	27.2	26.3	25.1	25.1	25.4	25.5	25.7	25.8
Expenses	22.7	22.0	21.9	20.7	20.6	20.7	20.8	21.0	21.1
Net acquisition of nonfinancial assets	4.9	5.3	4.4	4.4	4.5	4.7	4.7	4.7	4.7
Operating balance	-0.5	1.3	1.2	-1.4	-0.8	0.1	0.7	1.2	1.7
Net lending/borrowing	-5.4	-4.0	-3.2	-5.8	-5.3	-4.6	-4.0	-3.6	-3.1
Statistical discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	4.6	3.9	3.2	5.8	5.3	4.6	4.0	3.6	3.1
Net acquisition of financial assets	1.9	3.8	2.7	-0.8	1.7	1.7	1.7	1.7	1.7
Net incurrence of liabilities	6.5	7.7	5.8	5.0	7.0	6.4	5.8	5.3	4.8
Foreign	2.4	3.4	2.1	1.7	1.8	1.4	1.4	1.2	1.2
Domestic	4.1	4.3	3.8	3.3	5.2	5.0	4.3	4.1	3.6
Money and Credit (annual percent change)									
Broad money	18.1	21.8	6.8	11.4	10.4	11.7	11.0	10.9	10.6
Domestic credit	14.6	26.8	17.9	8.8	11.3	11.2	11.1	10.9	10.9
Private sector credit	12.6	26.3	13.3	4.6	8.6	8.8	9.5	10.2	10.9
Saving and Investment (in percent of nominal GDP)									
Gross investment	30.4	35.2	37.4	33.6	35.1	37.1	35.5	34.6	33.5
Gross fixed investment	30.5	29.3	28.5	25.6	26.7	28.2	27.0	26.3	25.5
Private	25.6	24.1	23.1	22.2	22.2	23.5	22.2	21.6	20.8
Central government	4.9	5.3	5.4	3.4	4.5	4.7	4.7	4.7	4.7
Change in Stock	0.0	5.8	9.0	8.1	8.4	8.9	8.5	8.3	8.0
Gross national saving	29.4	27.5	24.7	32.2	33.5	33.1	32.1	31.3	30.4
Private	30.5	27.0	24.1	34.1	35.2	34.0	32.3	31.0	29.5
Central government	-1.1	0.4	0.7	-1.9	-1.7	-0.8	-0.2	0.3	0.9
Balance of Payments									
Current account (in millions of U.S. dollars)	-339	-2,844	-5,174	-586	-721	-2,015	-1,903	-2,032	-2,132
In percent of GDP	-1.0	-7.7	-12.7	-1.4	-1.6	-4.0	-3.4	-3.3	-3.1
Trade balance (in millions of U.S. dollars)	-9,186	-11,510	-13,759	-10,728	-11,813	-13,735	-14,337	-15,230	-16,113
In percent of GDP	-27.5	-31.2	-33.7	-26.2	-25.7	-27.0	-25.6	-24.7	-23.8
Exports of goods (y/y percent change)	-6.4	30.0	43.9	-19.9	5.4	9.3	9.3	8.8	8.5
Imports of goods (y/y percent change)	-18.2	25.7	21.9	-21.8	9.6	15.5	4.9	6.5	6.1
Workers' remittances (in millions of U.S. dollars)	7,533	8,150	8,326	9,330	9,967	10,356	10,811	11,341	11,891
In percent of GDP	22.5	22.1	20.4	22.7	21.7	20.3	19.3	18.4	17.5
Gross official reserves (in millions of U.S. dollars)	10,559	10,884	8,953	10,916	12,674	13,225	14,186	15,134	16,125
In months of prospective imports	9.0	7.5	7.6	8.3	8.4	8.3	8.4	8.4	8.4
Memorandum Items									
Public debt (in percent of GDP)	43.3	43.3	43.1	47.0	48.4	49.3	50.0	50.2	50.0
Nominal GDP (in billions of U.S. dollars)	33.4	36.9	40.8	41.0	45.9	50.9	56.1	61.7	67.8
Nominal GDP (in billions of Nepalese Rupees)	3,889	4,353	4,934	5,364	5,957	6,653	7,381	8,186	9,078
Net International Reserves (in millions of U.S. dollars)	10,291	10,620	8,821	10,473	12,146	12,623	13,589	14,590	15,644
Primary Deficit (in billions of Nepali Rupees)	183	138	110	238	217	194	167	144	118
Primary Deficit (in percent of GDP)	4.7	3.2	2.2	4.4	3.6	2.9	2.3	1.8	1.3
Tax Revenue (in billions of Nepalese Rupees)	700	870	984	866	986	1,173	1,357	1,560	1,790
Tax Revenue (In percent of GDP)	18.0	20.0	20.0	16.1	16.5	17.6	18.4	19.1	19.7
Health Expenditure (in percent of GDP)	1.0	1.1	2.3	1.7	1.1	1.1	1.1	1.1	1.1
Social Protection/Assistance (in percent of GDP)	1.7	1.7	3.7	2.8	2.8	2.8	2.8	2.8	2.8
CCRT debt relief (in millions of SDR) 2/	2.9	7.1	3.6	…	…	…	…	…	…
Private sector credit (in percent of GDP)	84.3	95.1	95.0	91.4	89.4	87.1	86.0	85.4	85.4
Exchange rate (NPR/US$; period average)	116.3	117.9	120.8	130.8	…	…	…	…	…
Real effective exchange rate (average, y/y percent change)	1.9	-2.9	1.6	1.4	…	…	…	…	…

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for SDR 3.6

Note: The NSO adopts a 3 year cycle in its national accounts producing preliminary, revised and final estimates for real GDP growth. In May 2023 growth was revised up in FY2021/22 from 4.2 percent to 4.8 percent and from 5.3 percent to 5.6 percent in FY2021/22 in light of new data.

Note: Current baseline forecast is as of September 28, 2023.

Table 2a. Nepal: Summary of Central Government Operations, 2019/20-2027/28 1/

(In billions of rupees)

	2019/20	2020/21	2021/22	2022/23		2023/24		2024/25	2025/26	2026/27	2027/28
			Current Baseline Proj.	Budget	Current Baseline Proj.	Budget	Current Baseline Proj.	Projections			
					(In billions of Nepalese rupees)						
Total Revenue and Grants	865	1,013	1,141	1,459	1,034	1,472	1,179	1,381	1,586	1,813	2,065
Total revenue	841	976	1,114	1,403	1,010	1,423	1,125	1,321	1,522	1,743	1,993
Tax revenue	700	870	984	1,295	866	1,305	986	1,173	1,357	1,560	1,790
of which: Income and profits tax	213	222	252	339	219	350	250	300	347	401	463
Customs	124	179	199	274	162	260	186	216	239	266	295
Excise duty	101	137	167	217	143	207	179	209	243	284	330
VAT	224	282	314	398	286	426	313	385	456	531	616
Other	38	50	52	67	56	62	57	64	71	79	87
By source: Domestic taxes	421	484	541	701	522	740	578	699	834	982	1,153
Import-related taxes	279	386	443	595	344	565	408	474	523	577	638
Non-tax revenue & Other Receipts	141	106	130	108	145	117	139	149	165	183	203
Of which: Non Tax Revenue	94	66	81	108	92	117	104	116	129	143	158
Other Receipts	48	40	49	0	53	0	35	33	36	40	45
Grants 2/	24	36	27	55	23	50	55	59	65	70	72
Expenditure	1,074	1,186	1,297	1,727	1,345	1,618	1,494	1,690	1,884	2,104	2,342
Recurrent expenditure	884	957	1,081	1,346	1,111	1,316	1,227	1,375	1,536	1,717	1,913
Of which : Interest payments	26	35	45	54	73	105	98	115	131	147	159
Salaries and allowances	117	118	136	189	156	172	173	186	207	229	254
Grants & subsidies	104	101	87	144	90	118	113	113	118	131	145
Social benefits	147	156	225	253	219	259	259	292	324	360	399
Goods & services	35	37	48	58	50	55	46	51	57	63	70
Fiscal transfers	350	395	406	430	398	400	402	453	502	557	618
Revenue sharing 3/	100	111	128	163	119	174	132	160	190	223	261
Other current expenditure	5	5	5	55	6	33	5	5	6	6	7
Capital expenditure	189	229	216	380	235	302	267	314	349	387	429
Operating balance	-19	56	61	112	-77	157	-48	5	51	96	152
Net lending/borrowing	-209	-173	-155	-268	-312	-145	-315	-309	-298	-291	-277
Statistical discrepancy	-29	-2	0	0	0	0	0	0	0	0	0
Net financial transactions	179	171	155	268	312	145	315	309	298	291	277
Net acquisition of financial assets	75	166	132	97	-44	82	102	114	127	141	156
Foreign	0	0	0	0	0	0	0	0	0	0	0
Domestic (net)	74	166	131	97	-45	82	102	114	127	140	156
Sale of equity	12	27	36	22	37	14	41	46	51	57	63
Lending minus repayment	48	34	37	74	41	68	61	68	75	84	93
Change in cash/deposit	14	104	58	0	-122	0	0	0	0	0	0
Net incurrence of liabilities	254	337	287	365	267	228	417	423	425	432	433
Foreign	93	150	101	200	91	170	107	91	106	99	104
Domestic	161	187	186	165	176	57	310	333	319	333	328
Memorandum Items											
Primary balance (billions of Nepali Rupees)	-183	-138	-110	-214	-238	-40	-217	-194	-167	-144	-118
Primary balance (in percent of GDP)	-4.7	-3.2	-2.2	-4.0	-4.4	-0.7	-3.6	-2.9	-2.3	-1.8	-1.3
Public debt (in percent of GDP)	43.3	43.3	43.1	47.0	47.0	48.4	48.4	49.3	50.0	50.2	50.0
External (in percent of GDP)	21.1	21.5	20.7	22.1	22.1	21.6	21.6	21.1	20.8	20.1	19.3
Domestic (in percent of GDP)	22.2	21.8	22.4	24.9	24.9	26.7	26.7	28.1	29.2	30.2	30.7
Resources for sub-national governments (billions of Nepalese Rupees)	451	505	534	593	517	574	534	612	693	781	879
(in percent of GDP)	11.6	11.6	10.8	11.1	9.6	9.6	9.0	9.2	9.4	9.5	9.7
Nominal GDP (billions of Nepalese Rupees)	3,889	4,353	4,934	5,364	5,364	5,957	5,957	6,653	7,381	8,186	9,078

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively

3/ 30 percent of VAT and domestic excise revenues are shared with sub-national governments.

Note: Current baseline forecast is as of September 28, 2023.

Table 2b. Nepal: Summary of Central Government Operations, 2019/20-2027/28 1/

(In percent of GDP)

	2019/20	2020/21	2021/22	2022/23		2023/24		2024/25	2025/26	2026/27	2027/28
			Current Baseline Proj.	Budget	Current Baseline Proj.	Budget	Current Baseline Proj.	Projections			
	(In percent of GDP, unless otherwise indicated)										
Total Revenue and Grants	22.2	23.3	23.1	27.2	19.3	24.7	19.8	20.8	21.5	22.1	22.8
Total revenue	21.6	22.4	22.6	26.2	18.8	23.9	18.9	19.9	20.6	21.3	22.0
Tax revenue	18.0	20.0	20.0	24.1	16.1	21.9	16.5	17.6	18.4	19.1	19.7
of which: Income and profits tax	5.5	5.1	5.1	6.3	4.1	5.9	4.2	4.5	4.7	4.9	5.1
Customs	3.2	4.1	4.0	5.1	3.0	4.4	3.1	3.2	3.2	3.2	3.2
Excise duty	2.6	3.2	3.4	4.1	2.7	3.5	3.0	3.1	3.3	3.5	3.6
VAT	5.8	6.5	6.4	7.4	5.3	7.1	5.3	5.8	6.2	6.5	6.8
Other	1.0	1.2	1.1	1.2	1.0	1.0	1.0	1.0	1.0	1.0	1.0
By source: Domestic taxes	10.8	11.1	11.0	13.1	9.7	12.4	9.7	10.5	11.3	12.0	12.7
Import-related taxes	7.2	8.9	9.0	11.1	6.4	9.5	6.8	7.1	7.1	7.1	7.0
Non-tax revenue & Other Receipts	3.6	2.4	2.6	2.0	2.7	2.0	2.3	2.2	2.2	2.2	2.2
Of which: Non Tax Revenue	2.4	1.5	1.6	2.0	1.7	2.0	1.7	1.7	1.7	1.7	1.7
Other Receipts	1.2	0.9	1.0	0.0	1.0	0.0	0.6	0.5	0.5	0.5	0.5
Grants 2/	0.6	0.8	0.6	1.0	0.4	0.8	0.9	0.9	0.9	0.9	0.8
Expenditure	27.6	27.2	26.3	32.2	25.1	27.2	25.1	25.4	25.5	25.7	25.8
Recurrent expenditure	22.7	22.0	21.9	25.1	20.7	22.1	20.6	20.7	20.8	21.0	21.1
Of which : Interest payments	0.7	0.8	0.9	1.0	1.4	1.8	1.6	1.7	1.8	1.8	1.7
Salaries and allowances	3.0	2.7	2.8	3.5	2.9	2.9	2.9	2.8	2.8	2.8	2.8
Grants & subsidies	2.7	2.3	1.8	2.7	1.7	2.0	1.9	1.7	1.6	1.6	1.6
Social benefits	3.8	3.6	4.6	4.7	4.1	4.3	4.3	4.4	4.4	4.4	4.4
Goods & services	0.9	0.8	1.0	1.1	0.9	0.9	0.8	0.8	0.8	0.8	0.8
Fiscal transfers	9.0	9.1	8.2	8.0	7.4	6.7	6.8	6.8	6.8	6.8	6.8
Revenue sharing 3/	2.6	2.5	2.6	3.0	2.2	2.9	2.2	2.4	2.6	2.7	2.9
Other current expenditure	0.1	0.1	0.1	1.0	0.1	0.5	0.1	0.1	0.1	0.1	0.1
Capital expenditure	4.9	5.3	4.4	7.1	4.4	5.1	4.5	4.7	4.7	4.7	4.7
Operating balance	-0.5	1.3	1.2	2.1	-1.4	2.6	-0.8	0.1	0.7	1.2	1.7
Net lending/borrowing	-5.4	-4.0	-3.2	-5.0	-5.8	-2.4	-5.3	-4.6	-4.0	-3.6	-3.1
Statistical discrepancy	-0.8	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	4.6	3.9	3.2	5.0	5.8	2.4	5.3	4.6	4.0	3.6	3.1
Net acquisition of financial assets	1.9	3.8	2.7	1.8	-0.8	1.4	1.7	1.7	1.7	1.7	1.7
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	1.9	3.8	2.7	1.8	-0.8	1.4	1.7	1.7	1.7	1.7	1.7
Sale of equity	0.3	0.6	0.7	0.4	0.7	0.2	0.7	0.7	0.7	0.7	0.7
Lending minus repayment	1.2	0.8	0.8	1.4	0.8	1.1	1.0	1.0	1.0	1.0	1.0
Change in cash/deposit	0.4	2.4	1.2	0.0	-2.3	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	6.5	7.7	5.8	6.8	5.0	3.8	7.0	6.4	5.8	5.3	4.8
Foreign	2.4	3.4	2.1	3.7	1.7	2.9	1.8	1.4	1.4	1.2	1.2
Domestic	4.1	4.3	3.8	3.1	3.3	1.0	5.2	5.0	4.3	4.1	3.6
Memorandum Items											
Primary balance (billions of Nepali Rupees)	-183	-138	-110	-214	-238	-40	-217	-194	-167	-144	-118
Primary balance (in percent of GDP)	-4.7	-3.2	-2.2	-4.0	-4.4	-0.7	-3.6	-2.9	-2.3	-1.8	-1.3
Public debt (in percent of GDP)	43.3	43.3	43.1	47.0	47.0	48.4	48.4	49.3	50.0	50.2	50.0
External (in percent of GDP)	21.1	21.5	20.7	22.1	22.1	21.6	21.6	21.1	20.8	20.1	19.3
Domestic (in percent of GDP)	22.2	21.8	22.4	24.9	24.9	26.7	26.7	28.1	29.2	30.2	30.7
Resources for sub-national governments (billions of Nepalese Rupees)	451	505	534	593	517	574	534	612	693	781	879
(in percent of GDP)	11.6	11.6	10.8	11.1	9.6	9.6	9.0	9.2	9.4	9.5	9.7
Nominal GDP (billions of Nepalese Rupees)	3,889	4,353	4,934	5,364	5,364	5,957	5,957	6,653	7,381	8,186	9,078

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for

3/ 30 percent of VAT and domestic excise revenues are shared with sub-national governments.

Note: Current baseline forecast is as of September 28, 2023.

Table 3. Nepal: Balance of Payments, 2019/20-2027/28 1/

	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28
				Est.	Projections				
				(in millions of US dollars)					
Current Account	-339	-2,844	-5,174	-586	-721	-2,015	-1,903	-2,032	-2,132
Current account (excluding official transfers)	-552	-3,052	-5,312	-686	-1,142	-2,470	-2,394	-2,561	-2,670
Trade balance	-9,186	-11,510	-13,759	-10,728	-11,813	-13,735	-14,337	-15,230	-16,113
Exports, f.o.b.	938	1,219	1,754	1,406	1,481	1,619	1,770	1,925	2,088
Imports, f.o.b.	-10,124	-12,729	-15,513	-12,133	-13,295	-15,353	-16,107	-17,155	-18,201
Services (net)	-10	-618	-893	-642	-664	-530	-452	-415	-363
Receipts	1,354	671	1,008	1,439	1,803	2,204	2,501	2,750	3,022
Of which : tourism	530	62	268	470	689	968	1,122	1,234	1,356
Payments	-1,364	-1,290	-1,901	-2,081	-2,466	-2,734	-2,953	-3,164	-3,385
Income	399	198	238	476	425	392	431	475	521
Credit	588	517	474	733	713	763	840	924	1,015
Debit	-189	-318	-237	-258	-289	-371	-409	-449	-494
Current transfers	8,459	9,086	9,241	10,308	11,332	11,857	12,455	13,139	13,823
Credit, of which:	8,506	9,137	9,305	10,368	11,390	11,923	12,527	13,217	13,909
General government	213	208	138	100	421	455	491	530	538
Workers' remittances	7,533	8,150	8,326	9,330	9,967	10,356	10,811	11,341	11,891
Debit	-47	-51	-64	-59	-59	-65	-72	-79	-87
Capital Account 2/	123	130	116	98	240	237	245	265	269
Financial Account	1,963	2,139	2,546	1,733	2,222	2,352	2,645	2,746	2,888
Direct investment	169	166	155	45	188	311	398	438	482
Portfolio investment	0	0	0	0	0	0	0	0	0
Other investment (net)	1,794	1,974	2,391	1,688	2,034	2,041	2,246	2,307	2,406
Of which: Trade credit	635	856	858	911	812	929	965	1,021	1,077
Official loans 3/	1,176	881	760	698	822	694	804	748	780
Errors and Omissions	561	553	966	980	0	0	0	0	0
Overall Balance	2,309	-22	-1,547	2,225	1,741	573	987	979	1,025
				(in percent of GDP)					
Current Account	-1.0	-7.7	-12.7	-1.4	-1.6	-4.0	-3.4	-3.3	-3.1
Current account (excluding official transfers)	-1.7	-8.3	-13.0	-1.7	-2.5	-4.8	-4.3	-4.2	-3.9
Trade balance	-27.5	-31.2	-33.7	-26.2	-25.7	-27.0	-25.6	-24.7	-23.8
Exports, f.o.b.	2.8	3.3	4.3	3.4	3.2	3.2	3.2	3.1	3.1
Imports, f.o.b.	-30.3	-34.5	-38.0	-29.6	-29.0	-30.1	-28.7	-27.8	-26.8
Services (net)	0.0	-1.7	-2.2	-1.6	-1.4	-1.0	-0.8	-0.7	-0.5
Receipts	4.0	1.8	2.5	3.5	3.9	4.3	4.5	4.5	4.5
Of which: tourism	1.6	0.2	0.7	1.1	1.5	1.9	2.0	2.0	2.0
Payments	-4.1	-3.5	-4.7	-5.1	-5.4	-5.4	-5.3	-5.1	-5.0
Income	1.2	0.5	0.6	1.2	0.9	0.8	0.8	0.8	0.8
Credit	1.8	1.4	1.2	1.8	1.6	1.5	1.5	1.5	1.5
Debit	-0.6	-0.9	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7
Current transfers									
Credit, of which:	25.4	24.7	22.8	25.3	24.8	23.4	22.3	21.4	20.5
General government	0.6	0.6	0.3	0.2	0.9	0.9	0.9	0.9	0.8
Workers' remittances	22.5	22.1	20.4	22.7	21.7	20.3	19.3	18.4	17.5
Debit	-0.1	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital Account 2/	0.4	0.4	0.3	0.2	0.5	0.5	0.4	0.4	0.4
Financial Account	5.9	5.8	6.2	4.2	4.8	4.6	4.7	4.4	4.3
Direct investment	0.5	0.4	0.4	0.1	0.4	0.6	0.7	0.7	0.7
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.4	5.3	5.9	4.1	4.4	4.0	4.0	3.7	3.5
Of which: Trade credit	1.9	2.3	2.1	2.2	1.8	1.8	1.7	1.7	1.6
Official loans	3.5	2.4	1.9	1.7	1.8	1.4	1.4	1.2	1.2
Errors and Omissions	1.7	1.5	2.4	2.4	0.0	0.0	0.0	0.0	0.0
Overall Balance	6.9	-0.1	-3.8	5.4	3.8	1.1	1.8	1.6	1.5
Memorandum Items									
Imports (y/y percent change)	-18.2	25.7	21.9	-21.8	9.6	15.5	4.9	6.5	6.1
Exports of G&S (in percent of GDP)	6.9	5.1	6.8	6.9	7.2	7.5	7.6	7.6	7.5
Imports of G&S (in percent of GDP)	34.4	38.0	42.7	34.7	34.3	35.5	34.0	32.9	31.8
Remittances (y/y percent change)	-3.0	8.2	2.2	12.1	6.8	3.9	4.4	4.9	4.8
Total external debt (in percent of GDP)	23.5	25.5	25.1	26.6	26.1	25.6	25.3	24.8	24.3
Gross official reserves (in mil U.S. dollars)	10,559	10,884	8,953	10,916	12,674	13,225	14,186	15,134	16,125
In months of prospective imports	9.0	7.5	7.6	8.3	8.4	8.3	8.4	8.4	8.4
As a share of broad money (in percent)	30.1	25.2	20.8	23.4	24.5	23.0	22.4	21.8	21.1
Net international reserves (in mil. U.S. dollars) 3/	10,291	10,620	8,821	10,473	12,146	12,623	13,589	14,590	15,644
Nominal GDP (in mil U.S. dollars)	33,434	36,927	40,828	41,018	45,911	50,950	56,107	61,700	67,802

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for SDR 3.6 million.

3/ Net international reserves program definition, see Technical Memorandum of Understanding.

Note: Current baseline forecast is as of September 28, 2023.

Table 4. Nepal: Monetary Indicators, 2019/20-2023/24 1/

	2019/20	2020/21	2021/22	2022/23	2023/24
				Est.	Projections
Nepal Rastra Bank	(In billions of Nepalese rupees, end-period)				
Reserve money	886	932	826	912	1,021
Net domestic assets	-388	-367	-319	-528	-635
Claims on public sector	-74	-137	-175	3	-28
Claims on private sector	4	3	7	7	5
Claims on banks & financial institutions	7	123	270	1	55
Other items (net)	-326	-356	-420	-539	-668
Net foreign assets	1,274	1,299	1,145	1,440	1,656
Monetary Survey					
Broad money	4,231	5,155	5,505	6,130	6,769
Narrow money	856	1,049	948	947	1,337
Quasi-money	3,375	4,105	4,557	5,184	5,433
Net domestic assets	2,903	3,804	4,283	4,567	5,040
Domestic credit	3,793	4,811	5,672	6,169	6,868
Credit to public sector	516	671	983	1,266	1,541
of which : Credit to central government	461	593	744	1,005	1,300
Credit to private sector	3,277	4,140	4,689	4,903	5,326
Other items(net)	-890	-1,007	-1,389	-1,602	-1,828
Net foreign assets	1,328	1,351	1,223	1,563	1,729
	(Twelve-month percent change)				
Reserve money	26.7	5.2	-11.4	10.4	12.0
Broad money	18.1	21.8	6.8	11.4	10.4
Net domestic assets	11.8	31.1	12.6	6.6	10.3
Domestic credit	14.6	26.8	17.9	8.8	11.3
Credit to public sector	29.3	30.1	46.4	28.8	21.8
Credit to private sector	12.6	26.3	13.3	4.6	8.6
Net foreign assets	34.9	1.7	-9.5	27.8	10.6
Memorandum Items					
Private credit (in percent of GDP)	84.3	95.1	95.0	91.4	89.4
Net international reserves (in mil. U.S. dollars) 2/	10,291	10,620	8,821	10,473	12,146
Net Foreign Assets, NRB (in percent of GDP)	32.8	29.8	23.2	26.8	27.8
Nominal GDP (in billions of Nepalese Rupees)	3,889	4,353	4,934	5,364	5,957

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ Net international reserves program definition, see Technical Memorandum of Understanding.

Note: Current baseline forecast is as of September 28, 2023.

Table 5. Nepal: External Financing Requirements and Sources, 2023/24-2025/26 1/

(In millions of U.S. dollars)

	2023/24	2024/25	2025/26
	Projections		
Gross External Financing Requirements	**173**	**1380**	**1229**
Current account excluding official transfers (+ = deficit)	1142	2470	2394
Amortization of medium- and long-term debt	243	256	277
Other net capital flows (- = outflow) 2/	1212	1347	1442
Financing Sources	**-246**	**1146**	**937**
Current and capital grants	661	691	736
Medium- and long-term borrowing excluding exceptional financing	646	717	790
FDI, net	188	311	398
Portfolio investment, net	0	0	0
Change in reserves (+ decrease)	-1741	-573	-987
Financing Gap	**419**	**234**	**292**
Exceptional/Additional Financing 3/	**419**	**234**	**292**
IMF: ECF arrangement	94.1	83.7	41.8
Asian Development Bank	125	50	150
World Bank	200	100	100
Memorandum Items			
Gross official reserves (in millions of U.S. dollars)	12674	13225	14186
In months of prospective imports	8.4	8.3	8.4

1/ Fiscal year ends mid-July.

2/ Other includes currency and deposits, trade credits and other financial flows.

3/ Includes exceptional financing with good prospects over the the projection period.

Note: Current baseline forecast as of September 28, 2023.

Table 6. Nepal: Financial Soundness Indicators, 2018/19-2022/23

	2018/19	2019/20	2020/21	2021/22	2022/23
Capital Adequacy					
Regulatory capital to risk weighted assets	13.54	13.71	13.76	13.58	13.42
Tier 1 capital to risk weighted assets	12.19	11.79	11.33	10.81	10.59
Asset Quality					
NPLs to total gross loans	1.56	1.66	1.48	1.31	3.02
Loan loss provisions to NPLs	43.02	54.24	62.98	41.12	44.72
Deposits and Credits					
Credit to deposit ratio 1/	...	...	...	86.22	81.63
Credit to core captial cum deposit 1/	75.20	69.60	76.32	...	...
Liquidity					
Cash & bank balance to total deposits	11.60	12.20	9.51	8.03	8.05
Total liquid assets to total deposits	25.10	27.90	26.18	27.52	27.10
Exposure to Real Estate					
Share of real estate and housing loans	12.09	11.96	10.86	10.95	12.28
Share of loans collateralized by fixed assets	75.80	76.20	74.70	75.13	76.93
Revolving Loans					
Overdraft 2/	15.70	15.00	15.20	15.26	15.33
Demand & working capital loans	21.10	21.50	21.10	21.53	18.06

Sources: Nepali authorities, IMF FSI database and staff calculations.

Note. Data reflects all banks and financial institutions and is presented at the end of the fiscal year (i.e. mid-July) for the year indicated.

1/ Credit to core capital cum deposit was replaced by the Credit to deposit ratio in 2021/2022.

2/ As of April 2023, NRB has started to report separatly on 'overdrafts' and 'cash credit'. For the purposes of compiling the FSIs, these have been added back together.

Table 7. Nepal: Current Access and Phasing Under the Extended Credit Facility 1/

Review	Available from	Conditions	Disbursement SDR Million	Disbursement Percent of Quota
	January 12, 2022	Board approval of the Arrangement	78.50	50%
First Review	June 12, 2022	Observance of performance criteria on Jan 14, 2022, completion of first review	19.60	13%
Second Review	January 12, 2023	Observance of performance criteria on Jul 14, 2022, completion of second review	19.60	13%
Third Review	November 1, 2023	Observance of performance criteria on Jul 16, 2023, completion of third review	39.20	25%
Fourth Review	May 1, 2024	Observance of performance criteria on Jan 14, 2024, completion of fourth review	31.40	20%
Fifth Review	November 1, 2024	Observance of performance criteria on Jul 15, 2024, completion of fifth review	31.40	20%
Sixth Review	May 1, 2025	Observance of performance criteria on Jan 13, 2025, completion of sixth review	31.40	20%
Seventh Review	November 1, 2025	Observance of performance criteria on Jul 15, 2025, completion of seventh review	31.32	20%
Total			**282.42**	**180%**

Source: IMF staff estimates.

1/ Nepal's quota is SDR 156.9 million.

Table 8. Nepal: Quantitative Performance Criteria (PC) and Indicative Targets (IT) 1/

(Cumulative Rs. million unless otherwise indicated)

	FY2021/22				FY2022/23				FY2023/24	
	16-Jul-22				16-Jul-23				14-Jan-24	15-Jul-24
	Program target	Adjusted target	Outturn	Status	Program target	Adjusted target	Outturn	Status	Program target	Program target
Quantitative performance criteria under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/									435,959	315,628
Stock of NRB's net international reserves (floor; in U.S. dollars million) 1,8,9/	8,640	8,344	8,821	met	8,038	6,998	10,473	met	9,076	9,076
Accumulation of external payments arrears (ceiling) 2/	0	0	0	met	0	0	0	met	0	0
Indicative targets under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	333,591	296,329	163,470	met	256,523	355,213	315,070	met	..	..
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	5,300	5,300	6,987	met	6,987	6,987	6,763	not met	3,092	6,987
Indicative target: floor on tax revenue of the federal government 10/										845,938
Memorandum items:										
Budget support from development partners (in U.S. dollars million) 1,11/	641		345		330		171		162	325
Revenues of the budgetary central government under the program (in NPR million) 1,3/	926,767		938,280		968,166		838,029		341,044	..
Revenue targets of the budgetary central government (in NPR million) 1,3/	1,050,821		..		1,066,000		..		563,983	1,248,620
Primary deficit adjustor for revenue (in NPR million) 6/	..		0		..		109,170		..	..
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 6/	124,003		..		109,170		..		61,009	..
Foreign-financed project loan disbursements (in NPR million) 1,3/	129,883		92,621		104,207		93,727		13,977	83,832
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 1,3/	..		-37,262		..		-10,480		..	..

Sources: Nepali authorities; and IMF staff estimates/projections based on the Nepali fiscal year and calendar.

1/ The quantitative targets, indicative targets, program exchange rates and adjustors are defined in the Technical Memorandum of Understanding (TMU). Foreign currency deposits of commercial banks and other financial institutions held at the NRB are considered reserve related liabilities and excluded.

2/ This quantitative target is applied on a continuous basis.

3/ Cumulative from the beginning of the fiscal year.

4/ Excludes interest payments. The program primary deficit definition also excludes grants and other receipts from the revenue side, so figures in this table are higher than those reported in the macroeconomic framework.

5/ The social spending indicative target will initially be a floor on spending on the child protection grant. This indicative target will start in the second review with the test dates beginning in July 2022. The initial floor will be FY2020/21 outturns plus an additional amount to reflect the announced one third increase in budget.

6/ The program targets for the primary deficit include adjustors for the level of revenue collection. The upward adjustment to the ceiling is capped at NPR 61,009 million for the January 14, 2024 test date. The adjustor will be phased out starting at the July 15, 2024 test date.

7/ The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms. Foreign-financed project loan disbursements is the difference between total external financing and budget support from development partners.

8/ The program targets for net international reserves include adjustors for budget support from development partners and for revenue collection. Any downward adjustment to the NIR floor will be capped at USD 710 million for the next 12 months to maintain reserve adequacy.

9/ NIR floor target is set as a mid-point between the baseline projection and the adequacy level to provide space in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy.

10/ This is a program indicative target, not a revised target of the Budget. The Budget target remains NPR 1,248.620 million.

11/ For the January 14 2024 and Juy 15 2024 testing dates the figures are cumulative of the period from July 17, 2023 to January 14 2023 and July 17 2023 to July 15, 2024 respectively.

Table 9. Nepal: Indicators of Capacity to Repay the Fund, FY2023/24-2036/37 1/

	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34	2034/35	2035/36	2036/37
Fund obligations based on existing credit (millions of SDR)														
Principal	3.6	7.1	35.0	39.2	47.1	54.9	54.9	23.5	15.7	7.8	0.0	0.0	0.0	0.0
Charges and interest	2.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Fund obligations based on existing and prospective credit (millions of SDR)														
Principal	3.6	7.1	35.0	39.2	47.1	58.8	72.2	53.4	48.6	40.8	29.0	15.7	3.1	0.0
Charges and interest	2.4	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2	3.2
Total obligations based on existing and prospective credit														
Millions of SDR	5.9	10.3	38.1	42.4	50.3	62.0	75.4	56.5	51.8	44.0	32.2	18.9	6.3	3.2
Billions of Nepali Rupees	1.0	1.9	7.0	8.0	9.6	11.9	14.4	10.8	9.9	8.4	6.2	3.6	1.2	0.6
Percent of exports of goods and services	0.3	0.4	1.4	1.4	1.5	1.7	1.9	1.3	1.1	0.9	0.6	0.3	0.1	0.0
Percent of debt service	0.5	0.7	2.4	2.4	2.5	2.8	3.0	2.0	1.7	1.3	0.8	0.4	0.1	0.1
Percent of GDP	0.0	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0
Percent of government revenue	0.1	0.2	0.5	0.5	0.5	0.6	0.6	0.4	0.4	0.3	0.2	0.1	0.0	0.0
Percent of quota	3.8	6.6	24.3	27.0	32.0	39.5	48.0	36.0	33.0	28.0	20.5	12.0	4.0	2.0
Outstanding IMF credit based on existing and prospective drawings														
Millions of SDR	355.9	411.6	407.9	368.7	321.6	262.8	190.6	137.3	88.6	47.8	18.8	3.1	0.0	0.0
Billions of Nepali Rupees	62.7	74.0	74.9	69.1	61.6	50.4	36.5	26.3	17.0	9.2	3.6	0.6	0.0	0.0
Percent of exports of goods and services	17.0	17.3	14.6	12.1	9.5	7.1	4.7	3.1	1.9	0.9	0.3	0.1	0.0	0.0
Percent of debt service	31.4	29.1	25.8	20.6	16.1	11.7	7.6	4.9	2.9	1.4	0.5	0.1	0.0	0.0
Percent of GDP	1.2	1.2	1.1	0.9	0.7	0.6	0.4	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Percent of government revenue	6.2	6.2	5.5	4.4	3.4	2.5	1.6	1.0	0.6	0.3	0.1	0.0	0.0	0.0
Percent of quota	226.8	262.3	260.0	235.0	205.0	167.5	121.5	87.5	56.5	30.5	12.0	2.0	0.0	0.0
Net use of IMF credit (millions of SDR)	63.5	55.7	-3.6	-39.2	-47.1	-58.8	-72.2	-53.4	-48.6	-40.8	-29.0	-15.7	-3.1	0.0
Disbursements	67.0	62.8	31.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Repayments and repurchases	3.6	7.1	35.0	39.2	47.1	58.8	72.2	53.4	48.6	40.8	29.0	15.7	3.1	0.0
Memorandum items:														
Exports of goods and services (millions of SDR)	2,089	2,386	2,786	3,055	3,389	3,712	4,024	4,362	4,728	5,125	5,556	6,023	6,529	7,078
Debt service (billions of NPR)	199.5	254.3	290.8	335.0	382.7	431.4	481.1	535.7	591.0	659.2	735.9	823.3	919.6	1,031.1
Nominal GDP (at market prices, billions of NPR)	5,362	6,006	6,697	7,421	8,220	9,107	10,098	11,197	12,415	13,766	15,263	16,924	18,766	20,808
Government revenue (billions of NPR)	1,010	1,191	1,363	1,568	1,792	2,047	2,267	2,511	2,781	3,080	3,412	3,779	4,186	4,637
Quota (millions of SDR)	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9

Source: IMF staff estimates and projections.
1/ Reporting Year: August to July.

Table 10. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks, July 2023-January 2025

Measure	Original Target Date	Status	Proposal
Cross-Cutting Institutional Reforms to Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption			
The FCGO reports the consolidated financial information of all operational funds in annual financial statements, starting with FY2021/22 1/	End-August 2023	**Not met**	Reset to end-January 2025
The MOF submits to Parliament amendments to modernize the NRB Act, addressing key recommendations of the 2021 Safeguards Assessments Report 2/	End-August 2023	**Not met**	Reset to end-April 2024
The FY2023/24 external audit of the NRB is conducted by the Auditor General's Office with the service of experts with international experience in auditing and central bank auditing.		**New**	End-July 2024
Report that the *Amendments to Some Laws Relating to AML and Business Promotion* bill has been enacted in line with Financial Action Task Force AML/CFT international standards		**New**	End-July 2024
Revenue mobilization			
The MOF publishes a report on tax exemptions for all other non-customs related taxes 3/	End-August 2023	**Not met, Implemented September 2023**	
MOF approval of a domestic revenue mobilization strategy covering tax policy, law, and revenue administration reforms	End-April 2024		
The MOF publishes a comprehensive report on tax expenditures	End-April 2024	**Reset**	End-January 2025
Fiscal Sustainability and Fiscal Risk Management			
The MOF implements a fiscal risk register to capture various dimensions of major fiscal risks 3/	End-August 2023	**Met**	
A comprehensive fiscal risk statement is published by the MOF with the FY 25/26 Budget		**New**	End-August 2025
The MOF develops cash flow forecasting to be shared with the PDMO and NRB on a regular basis 3/	End-September 2023	**Met**	
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements	End-April 2024	**Modified and reset**	End-August 2024
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Doorsanchar Company (Nepal Telecom)) will have their FY2022/23 financial statements audited	End-April 2024	**Reset**	End- August 2024

1/ This SB was originally set for End May 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
2/ This SB was originally set for End October 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
3/ This SB was originally set for End October 2022, was not met, and was reset at the combined First and Second Review to end September 2023.

Table 10. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks, July 2023-January 2025 (concluded)

Measure	Original Target Date	Status	Proposal
Equitable and Sustainable Growth			
National Planning Commission approves an action plan to improve the efficiency of public investment spending and strengthen climate resilience, drawing on recommendations of a Public Investment Management Assessment (PIMA) 1/	End-April 2024	**Modified**	
Financial Sector Regulation & Supervision			
The NRB issues the updated regulation on asset classification 2/	End-August 2023	**Met**	
The NRB completes the full implementation of the SIS among class A, B and C banks, excluding the onsite module 3/	End-August 2023	**Met**	
The NRB completes implementation of the onsite module of the SIS among class A banks 4/	End-April 2024		
Launch for 10 largest Banks in-depth on-site inspections assisted by independent international third-party auditors	End-April 2024		
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors		**New**	End-December 2024
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections		**New**	End-February 2025

1/ This SB was originally set for end October 2022, was not met, and was reset at the combined First and Second Review to end April 2024.
2/ This SB was originally set for end October 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
3/ This SB was originally set for end-October 2022, was not met, was reset at the combined First and Second Review to end August 2023 and was modified to include Class B and C banks but restricted to exclude the onsite module.
4/ This SB was originally set for end-October 2022, was not met, was reset at the combined First and Second Review to end April 2024 and was modified to only cover the onsite module.

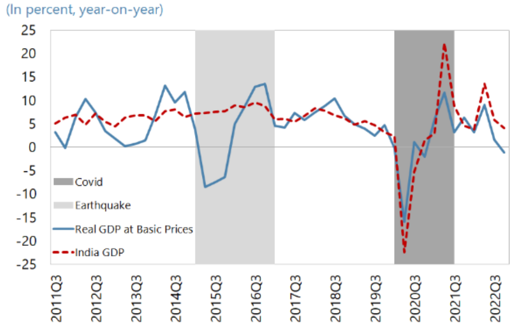
Annex I. The Drivers and Dynamics of Growth in Nepal

Nepal's growth has been historically highly volatile and characterized by periods of large economic shocks making forecasting a challenge. Historical data suggest that the strongest correlates of Nepal's GDP growth are growth in India, domestic credit, and imports. In the preferred model in this annex, a 1pp higher growth in each variable correlates with 0.4pp, 0.08pp and 0.07pp higher growth in Nepal, respectively. Based on the model output, GDP growth in basic prices[1] FY2022/23 is expected to be in the region of 1 percent, while GDP growth in FY2023/24 is expected to range from 5.8-6.0 percent. As economic intuition serves as a necessary complement to the model considering its limitations, growth may underperform the model in FY2023/24.

1. **Historically, GDP growth in Nepal has been characterized by high volatility—making forecasting challenging—and has led to competing theories on Nepal's main drivers of growth**. Figure 1 shows Nepal's quarterly GDP growth next to that of India. Both countries see volatility over time, but Nepal is subject to larger and more frequent shocks. Professional forecasters have proposed many possible, and sometimes conflicting, drivers of growth in Nepal. For example, it has been argued that higher remittances are pro-cyclical as they can fund domestic investment. Conversely, others have argued that remittances are counter-cyclical as migration and remittances increase in response to negative shocks to smooth out consumption. Similarly, higher imports are typically modelled as lowering aggregate demand, but in Nepal, they may instead be correlated with higher domestic demand due to the import-driven economy.

Figure 1. Nepal and India Quarterly GDP Growth

(In percent, year-on-year)



Sources: Nepali authorities; and IMF staff calculations

2. **The approach followed in this annex is to identify which variables are historically correlated with growth to identify the drivers of growth in Nepal and to inform future growth projections**. Data on 46 quarters of real GDP growth at basic prices over the period Q1 2011-Q2 2023 is compiled from the Nepal National Statistics Office (NSO). Additionally, a series of quarterly high-frequency data on domestic and external variables are gathered from the IMF and the NRB. The following model is estimated via Ordinary least squares (OLS):

$$y_t = \alpha + \Phi' I_t + \Gamma' C_t + \Lambda' X_t + \delta_1 y_{t-1} + \delta_2 y_{t-4} + u_t$$

where I_t is a vector of proxies for investment including domestic credit and remittances, C_t is a vector of proxies for input costs including world food and oil prices, X_t is a vector of proxies for the external sector including and imports and exports and Indian GDP growth. Quarterly real GDP growth is denoted y_t. A one- and four-period lag to capture any impacts from growth momentum

[1] The NSO only records quarterly GDP data in basic prices net of taxes and subsidies. To translate this figure into an annual headline GDP growth forecast requires an additional step of forecasting changes in taxes and subsidies.

or base effects over time. The lack of high-frequency data for the agricultural sector or additional sources of domestic demand restricts the inclusion of additional variables in the model.

3. There are three main empirical challenges to overcome.

- **First, given the limited sample size in the data, there is a significant risk of model overfitting**. To overcome this, a general-to-specific modelling approach is adopted to parse the initially large set of possible growth drivers into a more parsimonious model.
- **Second, during the observation period Nepal suffered two very large economic shocks: the 2015 earthquake and the 2020 pandemic**. This is shown in Figure 1. It is possible that during these periods the relationship between model variables maybe unstable and impacted by outliers. We therefore present four different specifications: (1) with the full sample, (2) dropping the periods with economic shocks, (3) including one dummy for each shock, (4) including one dummy for each negative-growth shock period and one dummy for each positive-growth shock period.
- **Third, many of the variables in our specification are endogenous**. For example, a high correlation between growth in India and growth in Nepal could be due to economic linkages between the countries or could be down to the countries being hit by common shocks. While this is a genuine issue for the purpose of identifying causality, it is less of a concern for the purpose of nowcasting or short-run projections, where the correlation may remain predictive. Moreover, the larger availability of high-frequency economic data and projections in India makes it a valuable input in projections for Nepal where data is scarce. Finally, as a robustness test, growth in China and the USA are included as controls.

Model Results

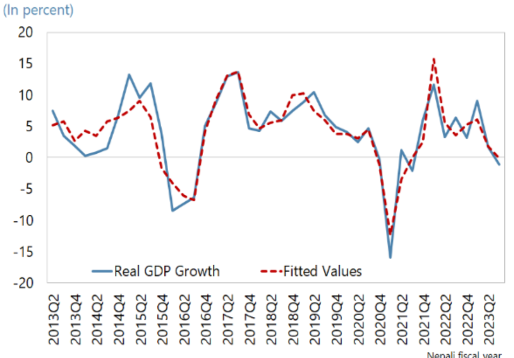
4. Very few of the variables are statistically significant highlighting a lack of statistical power given the small sample. The full model is shown in Table 1. By far the strongest correlate across all specifications is GDP growth in India, indicating the strong relationship between the two economies. Overall, the coefficients are relatively stable across specifications, although specification (2), which drops the periods of large shocks, varies more than others.

5. Motivated by a desire to avoid overfitting, Table 2 presents a parsimonious model including only variables identified as important in the data. Notice, in column 4 that despite having three fewer variables, the R^2 suggests the model explains 81 percent of the variation in the data; no less than the full model. By contrast, the Akaike and Bayesian Information Criteria (AIC and BIC), which punish models with a larger number of variables, have significantly smaller values, indicating the parsimonious model is a preferable model selection.

6. Among the four models in Table 2, model 4 is preferred since it does not discard any of the data but does include the richest set of dummies to account for the two economic shocks. This is shown by the relatively low values for AIC and BIC. In the preferred model, the most significant correlates of growth are India's GDP growth, domestic credit growth, and import growth. In terms of magnitudes, 1 percentage point higher growth in each of these variables is associated with 0.4 percentage point, 0.08 percentage point and 0.07 percentage point higher growth, respectively. Four-quarter lagged GDP also is a strong negative impulse on growth, consistent with base effects being strong drivers of growth. This is likely caused by Nepal's tendency for boom-bust cycles.

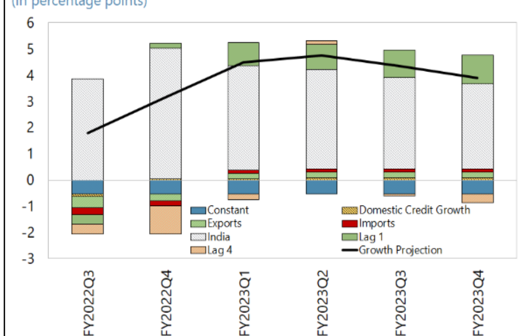
7. **Having fitted the model to the data, it can now be used for nowcasting and short-term projections**. Figure 2 shows quarterly real GDP growth over time alongside the model fit. The model fits the data well, particularly during periods of less extreme shocks. On the right of the vertical line is shown the model's projection for quarterly growth over the remainder of FY2022/23 and FY2023/24.[2] The model expects growth to remain sluggish in FY2022/23 at 0.8 percent before a strong rebound in FY2023/24 above 3 percent. The main drivers of this growth trajectory are shown in Figure 3 which indicates that FY2022/23 growth is low due to a high base from the previous year and poor external sector performance. The expected pick-up in FY2023/24 is driven by the low base effects, India's strong growth, a pickup in credit and stronger external sector performance.

Figure 2. Model Fit and Prediction
(In percent)



Sources: Nepali authorities; and IMF staff calculations

Figure 3. Growth Decomposition
(In percentage points)



Sources: Nepali authorities; and IMF staff calculations

8. **While the model is optimistic on a growth rebound in FY2023/24, there are several reasons to expect that growth may undershoot this forecast**. First, India's growth has historically been a good predictor of Nepal's growth, but this was not the case in 2023 and so may also not be in 2024.[3] Second, the strong rebound effect observed in the historical data can be largely attributed to Nepal's boom-bust business cycles with periods of rapid credit growth often followed by periods of rapid slow down. At present, the authorities have adopted a more prudent policy stance on monetary and fiscal policies, suggesting that a rapid and unstable rebound is less likely. Third, credit growth and imports may not bounce back as rapidly as forecast. Recent and proposed bank

[2] Although FY2022/23 ended in July 2023, the NSO has so far only released an estimate of growth based on 6-9 months of data. Staff continue to forecast growth until the preliminary estimate for FY2022/23 growth is released (expected in December 2023).

[3] The reason Nepal had slower growth than India in 2023 is likely because of Nepal's tight monetary and fiscal policy slowing domestic demand as well as India's strong productivity growth led by its digitalization agenda.

regulatory measures and banks concern about rising non-performing loans may cause financial conditions to remain tight.

Table 1. Nepal: Full Model

	(1) GDP growth	(2) GDP growth \ drop breaks	(3) GDP growth \ dummy for breaks	(4) GDP growth \ two dummies for breaks
Domestic Credit (y/y)	0.0635	0.0504	-0.0463	0.0633
	(0.105)	(0.127)	(0.103)	(0.122)
Remittances (y/y)	-0.0284	0.0842	0.0239	-0.0130
	(0.0944)	(0.0870)	(0.0826)	(0.0838)
World Oil Prices (y/y)	0.0760	0.00627	-0.0563	-0.0129
	(0.0481)	(0.0755)	(0.0626)	(0.0618)
World Food Prices (y/y)	-0.0817	-0.0716	-0.0326	0.00195
	(0.0754)	(0.0777)	(0.0837)	(0.0713)
India GDP (y/y)	0.354*	0.907**	0.418**	0.423**
	(0.177)	(0.393)	(0.185)	(0.167)
Imports (Winsorized 5%, y/y)	0.0559	-0.0280	0.0570	0.0822
	(0.0649)	(0.0674)	(0.0617)	(0.0581)
Exports (Winsorized 5%, y/y)	0.0373	0.0543	0.0277	0.0362
	(0.0351)	(0.0378)	(0.0338)	(0.0347)
L. GDP growth	0.142	0.290	0.147	-0.00319
	(0.144)	(0.190)	(0.147)	(0.144)
L4. GDP growth	-0.231	-0.287	-0.362	-0.282
	(0.230)	(0.215)	(0.215)	(0.184)
Constant	4.836	5.984	11.95	3.680
	(6.564)	(4.933)	(7.958)	(5.340)
N	42	27	42	42
R^2	0.660	0.491	0.716	0.808
Akaike information criterion	244.3	147.1	240.7	228.2
Bayesian information criterion	261.7	160.0	261.6	252.5

Standard errors in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

Table 2. Nepal: Parsimonious Model

	(1) GDP growth	(2) GDP growth \ drop breaks	(3) GDP growth \ dummy for breaks	(4) GDP growth \ two dummies for breaks
Domestic Credit (y/y)	-0.0333	0.0234	0.0348	0.0844
	(0.0715)	(0.0696)	(0.0767)	(0.0851)
Exports (Winsorized 5%, y/y)	0.0603	0.0316	0.0232	0.0381
	(0.0360)	(0.0446)	(0.0352)	(0.0315)
Imports (Winsorized 5%, y/y)	0.0593	0.0138	0.0586	0.0739^{**}
	(0.0433)	(0.0488)	(0.0421)	(0.0352)
India GDP (y/y)	0.364^{**}	0.637^{**}	0.332^{*}	0.421^{***}
	(0.169)	(0.300)	(0.176)	(0.145)
L. GDP growth	0.217	0.322^{**}	0.102	-0.00289
	(0.140)	(0.150)	(0.143)	(0.130)
L4. GDP growth	-0.174	-0.120	-0.320^{*}	-0.284
	(0.174)	(0.195)	(0.168)	(0.172)
Constant	1.393	-0.544	3.175	2.539
	(1.608)	(1.949)	(1.876)	(1.629)
N	42	27	42	42
R^2	0.643	0.408	0.692	0.808
Akaike information criterion	240.3	145.2	238.1	222.4
Bayesian information criterion	252.5	154.3	253.8	241.5

Standard errors in parentheses
* $p < 0.1$, ** $p < 0.05$, *** $p < 0.01$

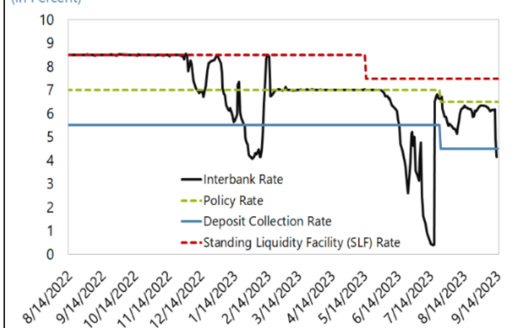
Annex II. The Monetary Policy Toolkit

New liquidity absorbing facilities added to the monetary policy toolkit in the past year were successful at improving the functioning of the interest rate corridor (IRC) under liquidity deficit conditions. However, the NRB did not adequately respond to two recent episodes of liquidity glut, highlighting the need for further refinements of the toolkit.

1. The monetary policy regime aims to maintain the interbank rate within the IRC. The rate is bound by the Standing Liquidity Facility (SLF) Rate above and the Deposit Collection Rate below, and the Policy Rate in the middle is the monetary policy target. The SLF lending facility has provided an effective ceiling to the IRC. At the bottom, NRB policy requires reverse repo auctions when the interbank rate falls below the Deposit Collection Rate, and deposit collection auctions when it falls more than 3 percentage points below the policy rate.

2. New liquidity lending facilities introduced in mid-February 2023 dramatically improved adherence of the interbank rate to the policy rate, as long as liquidity was in deficit. By being set at the Policy Rate and capped at 90 percent of the securities kept as collateral, the Intraday Liquidity Facility (ILF) and Overnight Liquidity Facility (OLF) provided enough liquidity to effectively peg the interbank rate to the Policy Rate from its introduction in mid-February until liquidity began to shift into surplus in mid-June.

Short-term Interest Rates
(In Percent)

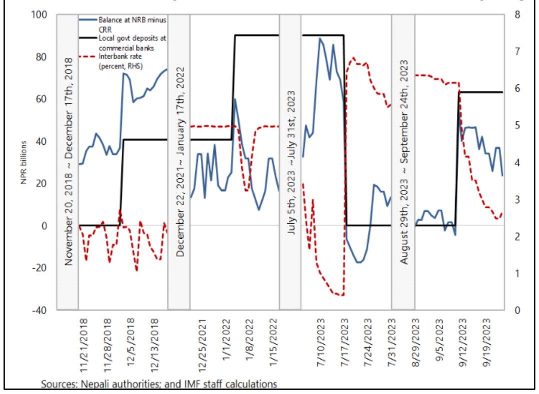


Sources: NRB; and IMF staff calculations

3. Importantly, the new tools enabled the NRB to largely eschew use of regulatory or administrative measures to enhance liquidity. While liquidity was in deficit, no meaningful adjustments were made to interest rate regulations and directed lending measures. The Working Capital Loan Guidelines and amendments to the Asset Classification Regulations have affected credit growth but were not used as monetary policy tools. However, liquidity grew rapidly in the last month of the fiscal year (ending July 16, 2023) as the government cleared year-end payables, and the interbank rate fell outside the IRC. The Finance Ministry subsequently ended its policy of allowing 80 percent of sub-national government deposits to be held by commercial banks, reducing systemic liquidity just enough to put it back into deficit and return the interbank rate to close to the policy rate.

4. The toolkit for managing the interbank rate when liquidity is in surplus remains a work in progress. During the end-of-year liquidity glut, the NRB held reverse repo and deposit collection auctions, but the volumes were too small to pull the interbank rate inside the corridor. In September the Finance Ministry reversed course and allowed 60 percent of sub-national government deposits to be held by commercial banks, once again creating an unaddressed liquidity glut with the interbank rate more than 200 basis points below the bottom of the IRC, only returning inside the IRC at the end of October 2023. The NRB intends to introduce a new unlimited-amount facility in January 2024 to absorb liquidity at the Deposit Collection Rate at the bottom of the corridor, consistent with Fund TA. A dedicated account has been funded to cover interest cost of the facility, further insulating the NRB from political pressure to allow excess liquidity. Combined with the ILF and OLF, the interbank rate should have effective automatic defenses to keep it between the middle and bottom of the IRC under normal circumstances. Nonetheless, a commitment to more pro-active intervention by the NRB, using reverse repos, deposit auctions and outright purchases, will still be needed to steer the interbank rate close to the Policy Rate.

Local Government Deposit Shifts at Commercial Banks and Liquidity



Sources: Nepali authorities; and IMF staff calculations

5. **Achieving stability of the interbank rate inside the IRC will help reduce interest rates by reducing the liquidity premium**. Using the corridor to keep the interbank rate reliably aligned with fundamentals— stabilizing domestic interest rates at positive real levels—would discourage excessive risk taking and lower the potential for asset bubbles or capital outflows.

Annex III. The 2023 Asia Pacific Group on Money Laundering (APG) Mutual Evaluation Report

1. **The Asia Pacific Group on Money Laundering (APG) Mutual Evaluation Report was published in September 2023**. The report provided a comprehensive assessment of Nepal's level of compliance with the Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT) recommendations of the Financial Action Task Force (FATF).

2. **While the report outlined some progress in strengthening the legal and institutional framework, significant deficiencies remain in its effective implementation**. Nepal has taken steps to update and amend some AML/CFT-related laws, but shortcomings remain. For example, Nepal should swiftly pass the "Amendments to Some Laws Relating to AML and Business Promotion" bill. Nepal failed to receive an effectiveness rating of "high" or "significant" for any area and was assessed to have a "low-level of effectiveness" across seven of the FATF's immediate outcomes, with the remaining four receiving a rating of "moderate".[1] This assessment signals that major and fundamental improvements are required.

3. **Competent authorities and the private sector are considered to have a varied and developing understanding of Money Laundering (ML) risks and a limited understanding of Terrorist Financing (TF) risks**. In addition to the limited understanding of risks, there is a need for greater resources (targeting key AML/CFT functions), operational-level prioritization, and cooperation in order for Nepal to move towards effectively combatting ML/TF risks. On the other hand, the Financial Intelligence Unit is considered to have a good resources, strong operational independence, and adequate policies and procedures to properly perform its functions.

4. **Overall, risk-based AML/CFT supervision of financial institutions is at its early stages and supervision of non-financial institutions has not commenced**. While there has been some recent progress via a new supervisory framework for commercial banks, sanctions imposed for AML/CFT related deficiencies in financial institutions have been limited and not dissuasive. Supervisors have not conducted sectoral risk assessments since 2020 and action is required to develop a supervisory framework for non-financial institutions.

5. **Significant efforts are required to enhance entity-level transparency**. Accurate and up to date information on the beneficial owner of legal persons and arrangements is not available. The amendments to the AML and Business Promotion Bill to introduce a beneficial ownership register should be passed and steps should be taken to improve the collection, accuracy, dissemination, and use of this information.

6. **Although Nepal is pursuing some high-level confiscation-related policy objectives, additional resources and further efforts are required to enhance ML investigations, prosecutions, and convictions**. Institutional-level policies and procedures are required for Law Enforcement Agencies, and the value of recovered confiscation orders is considered low. ML

[1] The effectiveness rating scale is High, Substantial, Moderate and Low (with low being the weakest rating).

investigations, prosecutions, and convictions for crimes (with the exception of self-laundering) are also considered low.

7. The deficiencies identified in the report, coupled with its publication, could lead to reputational and financial stability risks, and could impact Nepal's access to the financial system. Nepal will now enter the International Co-operation Review Group review process, which involves a one-year observation period where Nepal will have an opportunity to enhance its AML/CFT framework and address deficiencies before possible public identification and formal review by the FATF.

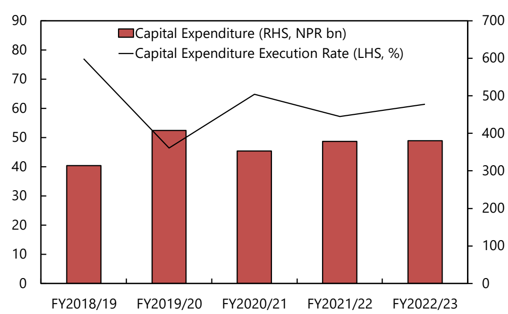
Annex IV. A Structural Reforms Agenda for Investment, Adaptation, and Employment

1. **Nepal is producing a new development plan**. The National Planning Commission of Nepal has issued a concept paper ahead of the 16th Development Plan with 12 identified areas for structural transformation.[1] These headings cover a broad range of areas from enhancing production and productivity to disaster management and environmental protection. The plan has strong overlap with the goals of the IMF Extended Credit Facility (ECF) Program for Nepal. Once the plan is published (expected mid-February 2024), the document will help set the government's policy agenda.

Three of the targeted areas for structural transformation in the 16th Plan particularly match the ECF program agenda.

Efficient Allocation and Capacity Enhancement of Capital Expenditure

2. **Higher and better-allocated capital expenditure could help boost growth by boosting the supply-side potential of the economy**. Despite an ambitious set of priority projects, recent capital execution rates have substantially underperformed the budget targets (Text Figure). Higher capital expenditure execution rates would help the private sector to make informed investments.



Sources: Nepal Authorities and IMF Staff Calculations

3. **A focus on practical projects in priority sectors should increase the fiscal multiplier and help enhance supply-side growth**. Many of the concept note's proposed initiatives mirror policies announced in the recent 2023/24 national budget including making domestic and external debt mobilization focused solely on feasible projects based on a cost-benefit analysis, and budget allocation only to those projects that emphasize project governance, have completed all preparatory works, and are listed in the project bank.

4. **This overlaps with the 2021 Public Investment Management Assessment (PIMA)**. The 2023 Article IV Staff Report and 2021 PIMA recommend to rationalize low priority administrative expenditures while protecting high quality capital expenditures to support growth and build resilience to climate shocks. Approval of the PIMA action plan (SB, April 2024) can help continue the

[1] The full list of 12 reform areas are: Strengthening Macroeconomic Fundamentals, Enhancing Production and Productivity; Creation of Decent, Productive, and Inclusive Employment Opportunities; Human Capital Formation and Effective Human Resource Planning; Qualitative, Equitable, and Life-skills Education; 6) Quality and Easy Affordable/Accessible Health Care System; Quality Infrastructure and Systematic Urbanization; Social Empowerment, Inclusion, and Social Security; Informal Transactions Control; Efficient Allocation and Capex Capacity Enhancement; Protection of Environmental and Biological Diversity, Disaster Management, and Sustainable Development; Promoting Good Governance and Efficient Public Service delivery.

reform effort in this area, in particular to strengthen federal coordination of investment plans through clarification of the legal framework. This would also help improve the central oversight of PPPs through improved legal and regulatory frameworks and enhance transparency through expanded budget documentation.

Climate Change Adaptation and Disaster Management

5. **Nepal is highly vulnerable to climate shocks and climate change**. A recent IMF working paper estimated that on an annual basis, floods, landslides, droughts, and storms combined generated GDP losses of 2.3 percent, welfare losses of 3.3 percent for the average household and increased the rate of undernourishment by 2.8 percent (Baptista, Unsal and Spray, 2023). A severe climate change scenario could cause GDP to be 7 percent lower by 2050 (World Bank, 2022). Shocks have persistent negative effects on poverty and food security and disproportionately harm vulnerable households, including those not able to access finance, living in remote areas, and unable to migrate (Selected Issues Paper: Climate Change, Food Insecurity and Remittances in Nepal, 2023).[2]

6. **In response, the 16th Plan concept note focuses on policies to prevent natural disasters and to enhance financial and economic stability in response to shocks as well as policies to lower emissions**. This builds on the National Adaptation Plan (NAP, 2021) which includes costed priority climate adaptation programs including on (i) agriculture and food security, (ii) industry, transport, and physical infrastructure, and (iii) disaster risk reduction and management.

7. **Implementing the NAP in full is estimated to cost USD 47.4 billion until 2050, but Nepal has limited fiscal resources to finance these policies**. A strong potential reform agenda could be combined with concessional climate finance (including from the RST) and be based on the NAP and several recent analytical documents: (i) the Climate-PIMA (2021) includes recommendations on reforms to incorporate climate risk in investment planning; (ii) The World Bank Climate Change Development Report (2022) includes a comprehensive action plan of mitigation and adaptation reforms; and (iii) the 2023 Article IV Staff Report and Selected Issues Paper included a focus on climate adaptation including piloting a new IMF model on climate change and food security.

Increasing Productivity and Employment Creation

8. **The creation of productive jobs has been hampered by the high cost of doing business**. Impediments include the high cost of land, capital controls, corruption, constraints to repatriating profits, lack of insolvency and bankruptcy laws, poor logistics and high transportation costs. The concept note identifies improved infrastructure, addressing knowledge and skills gaps and ensuring

[2] In addition to its focus on adaptation, Nepal has also committed to Net Zero by 2045. It's current level of greenhouse gas emissions are low by global standards and energy is primarily produced through hydropower.

timely, quality and cost-effective supply systems as key policies to enhance production. Targeted programs are proposed for the empowerment of disadvantaged communities.

9. The 2023 Article IV Staff Report recommended policies to help boost production and generate employment opportunities. Growth and competition could be enhanced through full implementation and enforcement of the Competition Act, public investment, creating a conducive environment for private investment, and strengthening the regulatory framework. Foreign investment would benefit from removal of burdensome regulatory approval procedures and restrictions on foreign investment in sectors including agriculture, tourism and consultancy services. Domestic investment could be channeled from remittances including developing financial instruments tailored to migrant workers, better access to finance, and efforts to improve digital and financial literacy.

Appendix I. Letter of Intent

Kathmandu, Nepal
November 9, 2023

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva,

1. In the attached update to the Memorandum of Economic and Financial Policies (MEFP) that was signed by the authorities of Nepal on April 10, 2023, at the time of the completion of the first and second reviews under the Extended Credit Facility (ECF), we confirm the commitment of Nepal to the policies and objectives of the economic program supported by an IMF arrangement under the ECF. The ECF-supported program is consistent with the priorities and objectives of the Government of Nepal. We describe the progress that has been made so far, the challenges that were overcome, and the further policy steps and reform initiatives we will undertake to meet the ECF-supported program's objectives.

2. Nepal's external position continues to strengthen, supported by decisive policy actions and buoyant remittances and despite headwinds from global commodity price volatility. However, on the domestic front, growth slowed in FY2022/23, reflecting low imports, lower credit growth, large post-COVID emigration flows and supply chain disruptions. The ensuing shortfall in fiscal revenue pushed upward the fiscal deficit, but to a level that remains consistent with a sustainable level of public debt, by implementing budget discipline through the mid-term budget review in January. On the positive side, inflation fell to 7.5 percent in August from last year's peak of 8.6 percent in September. Although regional food prices have recently spiked, moderating inflation in major trading partners and slowing domestic demand are expected to continue to soften Nepal's non-food inflation expectations. NPLs have increased from 1.7 percent in August 2022 to 3.0 percent in August 2023.

3. We remain committed to the goal of preserving macroeconomic stability. The moderate spending growth and sanguine revenue projections envisaged in the FY2023/24 budget bode well for achieving a strong fiscal consolidation this fiscal year while protecting growth and economic development through steadfast capital spending. The budget incorporates measures to curtail spending duplication with subnational governments while improving the execution of capital spending. It also includes tax reforms aimed at broadening the tax base towards non-import-related taxes, such as increasing withholding tax, personal income tax and streamlining exemptions in the value added tax. The recently developed fiscal risk register and cash flow forecasting framework are critical tools to help monitor major risks to public finances and better manage the government's short-term funding needs. On the monetary front, we will continue

our cautiously accommodative and data-driven approach to monetary policy to maintain price and external stability, while supporting growth. In the process of improving bank asset quality, we have stepped up our supervisory efforts and strengthened our vigilance by amending key asset classification regulations. We will continue our reform process to further align the regulation with international best practices. We completed the full implementation of the Supervisory Information System for Class A, B and C banks (excluding the onsite module).

4. The monetary policy stance and the fiscal discipline envisaged in the FY2023/24 budget will help keep inflation in check and maintain reserve coverage at adequate levels, while maintaining a low risk of public debt distress. Growth is projected to pick up in FY2023/24 supported by a continued recovery in tourism, strong growth in trading partners and additional hydropower capacity. Fiscal and monetary policies together have provided space for credit growth and economic expansion as the economy transitions to a sustainable level of credit growth. In this context, accelerating our planned increase in capital spending, including through concessional external financing, is particularly important to boost aggregate demand.

5. We remain committed to the implementation of the policies and reforms envisaged in the ECF and continue to make progress, with the support of Fund technical assistance. As detailed in the attached MEFP, we are making progress on (i) the formulation of a Domestic Revenue Mobilization Strategy; (ii) developing an action plan to improve the efficiency of public investment spending, in line with the recommendations of the Public Investment Management Assessment conducted in 2021; (iii) the preparatory work for launching a loan portfolio review of the banking system and (iv) continuing to strengthen the capability of the Supervisory Information System. Other important reforms require more time to advance, including (i) reporting the consolidated financial information including operational funds; (ii) publication of a comprehensive tax expenditure report; (iii) publication of annual financial statements by all public enterprises; and (iv) auditing the financial statements of the four-priority nonfinancial public enterprises. In light of institutional challenges, we propose to reset these reforms to later dates.

6. We have continued to implement our financial sector reforms. We will continue upgrading and revising our regulatory framework in line with international practices. We are implementing the Supervisory Information System (SIS) onsite module and plan to implement the Financial Sector Stability Report (FSSR) recommendations. We are committed to launching a loan portfolio review to verify compliance and the impact of the new regulatory framework and develop a plan to deal with the outcomes. Recognizing the growing size and interconnectedness of savings and credit cooperatives, we intend to improve regulatory oversight of these institutions through creation of a dedicated specialized regulatory and supervisory agency.

7. We remain committed to diligently implementing recommendations from the AML/CFT Mutual Evaluation conducted by the Asian Pacific Group, and we have a new structural benchmark to enact amendments of AML laws to bring them in line with international standards. In that context, we welcome technical support from the IMF to improve our technical compliance and effectiveness. We have progressed with the implementation of the recommendations in the

2021 Safeguards Assessment. An audit of the NRB 2021/2022 financial statement was conducted by the Auditor General with involvement of auditors with recognized international experience. We will request the Auditor General, when conducting the audits of the NRB annual financial statements as per the prevailing laws of Nepal, to conduct the audits with the service of experts with international experience in auditing and central bank auditing. We have prepared amendments to the NRB Act in consultation with stakeholders including the Fund, that take further steps towards greater transparency. We will continue to finalize the draft with a view to maintain the NRB's autonomy and governance. To give time to complete this work, we propose to reset by four months the related structural benchmark to submit these amendments to Parliament. We will also accelerate progress on the remaining recommendations in the 2021 Safeguards Assessment.

8. We believe that the commitments outlined in the MEFP are adequate to achieve the objectives of the ECF-supported program and promote sustainable and equitable growth in Nepal. The implementation of the program will also help support macroeconomic stability and build the resilience needed to implement our objectives. We will take any additional measures that may become appropriate for this purpose. We will consult with the IMF in advance of any substantive revisions to the policies and reforms contained in the MEFP, in accordance with the Fund's policies. On behalf of the Government of Nepal and the NRB, we would like to communicate our appreciation of the technical assistance and capacity development support provided by the Fund to Nepal, especially since the approval of the ECF. We intend to remain in close consultation with the Fund and provide timely information necessary for implementation of policies under the ECF-supported program.

9. Against this background, we request the completion of the third review under the ECF. We do not intend to introduce measures or policies that could generate balance-of-payments difficulties, or which are inconsistent with Article VIII of the IMF's Articles of Agreement. We do not intend to accumulate external or domestic arrears. In line with our commitment to transparency, we hereby consent to the publication of this letter, the attached MEFP and Technical Memorandum of Understanding (TMU), the staff report and other ECF-related documents, on the IMF's website.

Sincerely yours,

/s/	/s/
Hon. Prakash Sharan Mahat Finance Minister	Mr. Maha Prasad Adhikari Governor, Nepal Rastra Bank

Attachment I. Memorandum of Economic and Financial Policies

We remain fully committed to the economic reform program supported by the arrangement under the Extended Credit Facility (ECF) of the International Monetary Fund approved in January 2022. This memorandum outlines in detail the progress we have made toward meeting the objectives of the economic reform program and our policy plans to advance these objectives. Tables 1 and 2 summarize performance to date and how we plan to update the quantitative targets and structural benchmarks going forward.

A. Background

1. Decisive policy action succeeded in supporting the recovery from the pandemic and global commodity volatility, but the impact of strong measures now requires new adjustment. Nepal stepped up healthcare and social sector support and provided tax relief measures with support from the Rapid Credit Facility and Catastrophe Containment and Relief Trust and other sources. Further spending was needed to cushion the impact of commodity price volatility. Liquidity, credit and macroprudential policies eased financing conditions, but then higher global commodity prices necessitated monetary tightening last year to rein in inflation and a credit boom and help restore external stability. Policies are normalizing as needs abate, but their cost remains to be fully addressed. Fiscal measures and the fiscal path envisioned under the ECF are needed to preserve debt sustainability. The earlier monetary and financial relaxation now requires a more effective and cautious regulatory and supervisory framework for bank asset portfolios—outlined under the program—to avoid future stress.

2. In this context, we remain committed to the ECF to support our efforts to preserve macroeconomic and financial stability and transition towards sustainable and inclusive growth. The macroeconomic framework and reform agenda underpinning the ECF provide a critical path to returning to stable long-term growth. The program also contributes to strengthening our institutional frameworks and helps build capacity while catalyzing additional financing from development partners. Recognizing its importance, we have accelerated progress relative to the first and second reviews in achieving the actions set out in the program. The third review quantitative performance criterion and continuous performance criteria were met. The indicative target on the primary balance was met due to our efforts to contain spending envisaged in the mid-year budget review in a context of a large revenue shortfall and low absorption of external project financing. Despite achieving an execution rate of over 95 percent last year, child grant spending remained slightly below the indicative target. Out of seven structural benchmarks (SBs), five were completed, including one with delay and the remaining two SBs were not completed and are proposed to be reset for future reviews to allow time to advance needed reforms.

B. Recent Macroeconomic Developments and Outlook

3. The economy slowed markedly in FY2022/23 due to low imports, lower credit growth, large post-pandemic emigration, supply chain disruption and agricultural shocks. Real GDP growth slowed and could be in the range of 1-2 percent in FY2022/23 once estimates are finalized. The slowdown is a result of contractions in construction, manufacturing and wholesale and retail trade sectors. This was compounded by negative shocks to the agriculture and livestock sector and high post-pandemic emigration. However, growth was strong in the tourism and electricity sectors, supported by additional hydroelectric capacity and the rebound in tourist arrivals. High commodity prices lifted headline inflation to a peak of 8.6 percent in September 2022, but the slowing economy, tighter monetary policy, and lower core inflation in India have put inflation on an uneven downward path reaching 6.8 percent in June. More recently, a spike in regional food prices has caused inflation to rise to 7.5 percent in August 2023, while non-food inflation continued to decline. Import growth was strongly negative in FY2022/23 amid temporary import controls, a slower economy, and low capital spending. Remittances and tourism continued a post-COVID rebound resulting in the current account deficit falling from 12.7 percent of GDP in FY2021/22 to 1.4 percent of GDP in FY2022/23. Reserves reversed the declining trend of FY2021/22 and stood at 8.3 months of prospective imports as of July 2023.

4. **Momentum is expected to pick up gradually through the fiscal year supported by policy normalization, while inflation should continue on an uneven downwards path**. Last year's economic slowdown has persisted into the start of FY2023/24. However, policy normalization—removal of import restrictions and resolving construction material licensing and land zoning issues—is expected to support a recovery in growth. A gradual recovery in domestic demand, strong growth in tourism, additional capacity in hydropower, cautiously accommodative monetary policy and prudent fiscal policy are also expected to support growth. Although higher regional food prices have recently raised inflation, we anticipate the shock to abate within this fiscal year and not to feed into higher inflation expectations. The spending discipline introduced by our FY2023/24 budget is expected to combine with a normalization of food prices to bring Nepal's inflation down towards the FY2024 target of 6.5 percent by the end of the fiscal year. As domestic demand recovers, the current account deficit is expected to widen to about 1.6 percent of GDP in FY2023/24 while international reserves remain at an adequate level. The medium-term outlook remains positive, supported by our strategic investments into priority infrastructure projects including in hydropower and transmission lines.

5. **The outlook faces important downside risks**. Critical risks to growth include (i) weak public expenditure execution for growth-enhancing capital projects; (ii) stronger headwinds from post-credit boom balance sheet repair by both banks and borrowers; and (iii) a sharp growth slowdown in Nepal's major trade- and remittance-partner economies. Volatile and higher global commodity prices — especially for fuel and food— would have a pronounced impact on inflation, food security and economic activity with a disproportionate impact on the poor and vulnerable. Uncertainty around budget execution of both revenue and expenditure risks disrupting fiscal dynamics. Insufficient progress to enhance the AML/CFT framework and address deficiencies before possible public identification and formal review by the Financial Action Task Force (FATF) could hinder the country's access to the global financial system and increase risks to financial stability. A further rise in NPLs could raise concerns about bank capital adequacy ratios. Nepal is vulnerable to natural disasters and weather variability which can impact food production, poverty reduction and

growth. To help manage these risks, we intend to take forward-looking, data-driven responses to monetary and fiscal policy and stand ready to adjust the policy stance.

C. Economic and Financial Policies

Fiscal Policy

6. **Our fiscal position has been anchored by the program targets**, **despite a challenging environment**. Lower revenue collection last fiscal year (ended July 16, 2023) created fiscal pressures even though the government contained spending within the mid-year budget review. The overall fiscal deficit excluding revenue sharing with local governments expanded to 5.8 percent of GDP. After two years of double-digit growth, tax revenues declined by double digits in FY2022/23. A disproportionately large drop in import-related tax revenues, which represent about 40 percent of total tax revenue, reflected both the impact of import controls during the first half of the fiscal year and lower import demand stemming from the slower economy. The slowing economy also weighed on domestic tax revenues. Despite higher interest payments, current spending was contained within the mid-year budget review and the execution of capital projects remains low. Due to the tight fiscal conditions, the negative federal government cash balance at the end of the fiscal year 2022/23 increased relative to the historical trend.

7. **We remain committed to a gradual growth-friendly fiscal consolidation to stabilize public debt consistent with the program framework**. Our FY 2023/24 budget is broadly consistent with the target set out in the program to stabilize public debt at a moderate level. Revenue collection is expected to recover with economic growth and additional tax measures, including an increase in the personal income tax rate for the top income bracket, a higher tax rate on interest paid to bank depositors, the removal of several VAT exemptions, and other measures related to firms and excise duties. To reverse the trend of low capital expenditure execution, we have announced several measures to improve the effectiveness of capital expenditure in the FY2023/24 budget. In addition, we aim to support growth while maintaining debt stability by increasing the absorption of external concessional financing, in particular project loans. We will continue reducing expenditures that duplicate subnational government spending, including grants and subsidies and spending on goods and services and prioritize social spending, particularly child grants.

Revenue Mobilization

8. **We enhanced taxation transparency by disclosing tax exemption information, which can also support more effective policy making**. We will continue estimating the cost of tax exemptions at the Department of Customs and publishing a list of the exemptions and their costs in a Ministry-wise Progress Details report. We conducted an initial assessment of the costs of non-customs-related tax (VAT, CIT, and PIT) exemptions and published these in September 2023 (end-August 2023 SB, not met, implemented with delay). We will continue improving these estimates and will update the September 2023 publication by end-January 2024. To further enhance transparency, we will publish a comprehensive report on tax expenditures (end-April 2024 SB, proposed to be reset for end-January 2025) covering tax allowances, credits, deferrals, and reliefs in

addition to tax exemptions. We have requested IMF technical assistance (TA) to support this reform and the benchmark has been reset to allow more time for the completion of the upcoming IMF TA missions to build stronger internal capacity. We will share a draft of the tax expenditure report with the IMF by end-May 2024. Drawing on IMF TA recommendations, we will develop and approve a comprehensive domestic revenue mobilization strategy (end-April 2024 SB) covering tax policy, law, and revenue administration reforms. The reform proposals will draw in part on the results of the TADAT diagnostic conducted in late 2022 as well as the results of the TA report on simplifying tax policy to enhance revenue and efficiency. We will share a draft of the revenue mobilization strategy with the IMF by end-January 2024. Such reforms can significantly enhance our revenue collection to finance national development and contribute to fiscal sustainability.

Expenditure Reforms

9. We will improve our expenditure management processes to enhance the efficiency of spending. Our FY2023/24 budget included several measures aimed at improving capital expenditure effectiveness such as: (i) prioritizing strategically significant projects; (ii) streamlining environmental impact assessment; (iii) simplifying and expediting land acquisition by amending the Land Acquisition Act; (iv) streamlining public procurement; (v) unlocking more foreign aid disbursements; (vi) enhancing the accountability of departmental and project heads for project implementation; and (vii) enhancing project monitoring using the monitoring information system. The National Planning Commission, in coordination with our Ministry of Finance and other line ministries, remains committed to developing an action plan to improve the efficiency of public investment spending and strengthen climate resilience, drawing on recommendations from the Public Investment Management Assessment (PIMA) reports. We will share a first draft of the action plan by mid-January 2024 with the IMF. We will also share the final draft, taking into account IMF inputs, by end-March 2024 with the IMF. The National Planning Commission will approve this action plan by end-April 2024 (end-April 2024 SB). We will appropriately incorporate the PIMA action plan into the 16th National Development Plan before submission to the Cabinet.

10. We developed cash flow forecasts, with TA support from the IMF. This will help enhance short-term management of government's funds, avoid negative balances of the treasury single account, improve debt management and budget formulation, and inform liquidity forecasting by the NRB. Cash flow forecasts will be shared among the Financial Comptroller General Office (FCGO), PDMO and NRB on a regular basis (end-September 2023 SB, met). We prepared working procedures (Government Cash Management Guidelines) to support implementation of the cash flow forecast tool and will use this tool to produce new cash flow needs for the mid-year budget in January 2024. We will enhance current cash flow management and explore requesting IMF TA for TSA management.

11. We are making progress in enhancing fiscal risk management. To better understand our fiscal risk exposure, our FY2022/23 budget proposed to develop a fiscal risk registry to capture the major fiscal risks. We prepared and are currently implementing such a registry (end-August 2023 SB, met), drawing on TA provided by IMF in October 2022. Subsequently, we will expand the coverage of the registry by including subnational governments and PPPs. We will prepare and publish with the FY2024/25 budget a fiscal risk section in the Fiscal Policy Statement building on the fiscal risk registry. We will prepare and publish with the FY2025/26 budget a comprehensive fiscal risk statement in the Fiscal Policy Statement to systematically analyze the sensitivity of budget estimates and public debt projections to various fiscal risks (new end-August 2025 SB). We intend to build an inventory of key risks indicators of all subnational entities to help identify the largest potential risks, supported by IMF TA.

12. We will also endeavor to limit fiscal risks by strengthening the financial oversight of PEs and extra-budgetary operational funds and enhance their governance framework. This will help ensure that PEs can operate independently, efficiently, and effectively. We will require all majority- and wholly-owned PEs to publish their FY2022/23 annual financial statements by end-August 2024 (end-April 2024 SB, proposed to be modified and reset to end-August 2024).[1] We will update the IMF on progress on this benchmark by mid-December 2023. In this context, the four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Doorsanchar Company (Nepal Telecom)) will have their FY2022/23 financial statements audited by August 2024 (end-April 2024 SB, proposed to be reset to end-August 2024). We will then prioritize completion of audits of the FY2023/24 financial statements of all other PEs by the end of FY2024/25. The last fiscal/debt risk management measure to note is the inclusion of all extra-budgetary operational funds in the annual financial statements. Although this was not completed, the FCGO has an action plan to incorporate extra-budgetary funds in the Nepal Public Sector Accounting Standard (NPSAS)-based financial statements, starting with FY2021/22(end-August 2023 SB, missed, proposed to be reset to end-January 2025).

Social Spending

13. Social spending has played a key role in helping households navigate shocks. Shocks like unpredictable weather patterns damage crops and cause persistent poverty, while high inflation erodes incomes. One initiative we took to address these needs is the increase in coverage of the child grant to all 25 districts with a low human development index and to all Dalit children. We will ensure that spending on the child grant does not decline in FY2023/24 (Indicative Target) and work towards expanding the program as resources become available. We will continue to support food security and poverty reduction, including through child grants, the mid-day meal program, and the expanded Prime Minister's Employment Program.

14. We are committed to further enhancing our social safety net to support our poverty alleviation efforts. We are in the process of developing the 16th National Development plan, which will guide our medium-term strategy to enhance governance, social justice, and prosperity, expected to be published in early 2024. Despite recent setbacks, we aim to accelerate the development of the National Social Registry (NSR), including a system of national identification cards, supported by the World Bank. We are also rolling out the Poverty Identification Program (PIR) registry. The NSR and

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[1] All PEs covered in the Annual Status Review of Public Enterprises 2022, except those PEs not in operation.

PIR will facilitate the identification of vulnerable households and allow for more efficient targeting of social transfers.

Monetary and Exchange Rate Policy

15. Our monetary policy has begun loosening cautiously, supported by regulatory policies. With reserves rising to a comfortable level and external pressures currently at bay, our Annual Monetary Policy Review set the Policy Rate to decline by 50 basis points in July 2023. However, necessary balance sheet repairs have contributed to slow credit growth in spite of monetary relaxation. (¶15). In this context, accelerating our planned increase in capital spending, including through concessional external financing, is particularly important to boost aggregate demand. In congruence with monetary policy, our regulatory measures have improved—and will continue to improve—lending standards so that the normalization of rates does not lead to another boom-bust credit cycle. Together, the set of policies aims to facilitate a loan portfolio cleanup to establish a more stable, pro-growth financial sector equilibrium while maintaining price and external stability.

16. We have made substantial progress developing tools for implementing monetary policy, but policy-induced shocks have driven rates outside the interest rate corridor (IRC). In line with Fund TA recommendations, our primary instrument for monetary policy is now maintaining the interbank rate in the IRC, ideally close to the Policy Rate at the center of the band, with monetary policy review statements regularly communicating this policy framework. The NRB introduced two facilities to lend at the Policy Rate in February 2023, the Intraday and Overnight Lending Facilities (ILF and OLF), which have successfully maintained the interbank rate very close to the Policy Rate while liquidity is in deficit. However, we need new facilities to anchor the interbank rate more closely to the Policy Rate under surplus liquidity conditions. For instance, the shift of 60 percent of local government funds into commercial banks has pushed rates well below the Bank Deposit Collection Rate at the bottom of the IRC. To more effectively defend the bottom of the IRC, we intend to introduce by January 2024 a Standing Deposit Facility to absorb liquidity at the Deposit Collection Rate.

Financial Sector Policies

17. Bank-reported non-performing loan (NPL) levels have continued to increase while capital adequacy ratios have been eroding. Pandemic-related support measures to the banking sector helped support the economy and dampen NPL levels. As these measures have ended, we introduced regulations on working capital loans and amended the asset qualification regulations to improve the quality of bank loan portfolios, which together with high interest rates and a sharp correction in real estate prices uncovered hidden vulnerabilities, including the limited ability of many borrowers to repay. Consequently, NPLs increased from 1.3 percent in July 2022 to 3 percent as of August 2023. Bank capitalization meets the minimum requirement, but core capital declined from 10.8 to 10.1 percent in June 2023 before improving to 10.5 percent in August 2023. As NPLs may increase further, we will continue to prudently monitor the banking sector to ensure appropriate loan classification and restructuring, provisioning and capitalization for all banks.

18. We have taken further steps to strengthen bank regulation and supervision. We are improving risk-based supervision with Fund support and taking into account of the recommendations in the recently issued Financial Sector Stability Report (FSSR). As part of this effort, we have finalized the Supervisory Information System (excluding the off-site module) for all the banks (end-August 2023 SB, met), implemented a manual for both onsite and offsite supervision purposes, and are developing and enhancing our credit risk modelling and assessment capabilities in anticipation of banks implementing IFRS9 next year. We implemented the countercyclical capital buffer (CCyB) in July 2023 and will gradually phase it in to moderate credit cycles and discourage excessive risk taking. We stand ready to use other macroprudential tools for the oversight of banking system liquidity and loan growth and to mitigate the buildup of financial vulnerabilities.[2] Going forward, we will implement the SIS onsite module for class A banks by April 2024 (end-April 2024 SB). We intend to gradually implement the Basel III Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR) frameworks to help strengthen liquidity risk management and soundness of banks. Further, implementation of FSSR recommendations will enhance the resilience of our banking system.

19. We recognize the growing importance of financial cooperatives and their interconnectedness with the banking sector. As part of the "Amendments to Some Laws relating to AML and Business Promotion Bill", we will expand oversight and data collection in this area. We will establish and operationalize a specialized regulatory authority to regulate and supervise financial cooperatives, with TA from the NRB. In line with FSSR recommendations, we will formalize data sharing arrangements with these cooperatives under a written agreement to ensure a timely flow of information. NRB will pay particular attention and closely collaborate on the supervision of systemically important financial cooperatives.

20. Banks should pursue restructuring of problem loans to borrowers that are viable but have temporary liquidity shortages. To that end, we issued regulations on asset classification (end-August 2023 SB, met) that improved transparency and clarified definitions on loan performance, restructuring, rescheduling and reclassification together with the associated provisioning requirements, while considering the economic situation of subdued credit growth. We recognize that more refinements are needed to align them with international standards and improve their application. We will further align the asset classification regulation with those standards and IFRS9 and ensure its consistent application across banks, in particular as regards provisions allowing a different treatment of national priority projects and those covering forbearance. We are monitoring the implementation of the new regulations and, assisted by Fund TA, will seek to further align them with the wider regulatory framework one year after they have become effective. We issued Working Capital Loan (WCL) guidelines effective October 2022 and, in view of the economic slowdown, and considering the practical aspects of implementation, issued amendments to the guidelines in January and August 2023. We remain committed to avoid any conflict between the amended asset classification regulation and the WCL guidelines, in particular by introducing

[2] The NRB implements several macroprudential measures: (1) single obligor limits (between 25 to 50 percent of capital depending on the sector), (2) a credit to deposit ratio (90 percent), (3) a debt service to income ratio (50 percent), (4) a debt-to-equity ratio (4:1) and (5) loan to value ratios (between 30 and 70 percent).

provisions that would impede conversion of WCLs to term loans or avoid proper classification in accordance with the regulation. We will continue to enhance the guidelines in a sustained manner to gradually reduce the excessive use of WCLs, ensuring that any adjustments are targeted and timebound and do not impact the core purpose of the guidelines.

21. We remain committed to policy actions that ensure a stable and well-capitalized banking system. We will assess the impact of directed lending on the business models of banks and on financial stability, closely monitor the quality of these loans and review the amount of directed lending as needed to unlock further credit to the most bankable projects across sectors.[3] Additionally, we will monitor the impact of interest rate regulations on monetary policy transmission and bank viability and gradually move to more market-based determination of interest rates to improve transmission. To this end, we have allowed banks more space to set deposit rates. We will streamline our prompt corrective action framework with a clear escalation process across various states of distress. If any bank becomes undercapitalized, the NRB will use the relevant early intervention measures, including suspension of dividend payments where necessary.

22. We will prioritize bank asset quality and compliance with prudential requirements. By end--April 2024, we will launch in-depth on-site loan portfolio reviews for the largest 10 banks assisted by independent international third-party auditors (end-April 2024 SB). To optimize the exercise, we will phase the qualitative and quantitative part to allow for the use of end-July 2024 data that also incorporates the implementation of the loan portfolio review. In preparation of this exercise, we will finalize the related Terms of Reference by end-December 2023. The aim of the loan portfolio review is to ensure that loans are classified and managed in line with the new regulatory framework, paying special attention to loan classification and provisioning, evergreening, group borrowing, and concentration risks. We expect to complete the exercise by December 2024 (end-December 2024 new SB). We will develop a plan to deal with the review's findings by end-February 2025 (end-February 2025 new SB), and any bank with capital shortfalls will be required to submit timebound capital management plans setting out how they will return to full compliance with regulatory requirements.

Governance and Other Structural Reforms to Boost Growth

23. We are committed to further enhancing the autonomy and accountability framework of the NRB. We have conducted the audit of the FY2021/22 financial statements of NRB assisted by auditors with recognized international experience in auditing. Within this context, we will request the Auditor General, when conducting the audits of the NRB annual financial statements as per the prevailing laws of Nepal, to conduct the audits with the service of experts with international experience in auditing and central bank auditing (new end-July 2024 SB). We drafted amendments to the NRB Act, with a view to implementing the recommendations of the 2021 Safeguards Assessment (SGA) and strengthening its autonomy and governance practices, and we will continue further work to finalize the draft considering the recommendations in the 2021 SGA. As a result of

[3] The NRB requires banks to gradually extend a certain percentage of their total loans to agricultural and energy sectors and MSMEs. These loans correspond to 29 percent of Class A banks' total loan portfolio as of January 2023.

the need for further work, the reset SB of end-August 2023 was not met. We welcome suggestions during the process of finalizing draft and submitting amendments to the NRB Act to the Parliament by end-April 2024 (end-August 2023 SB, not met and proposed to be reset to end-April 2024).

24. We will accelerate progress on the remaining recommendations in the 2021 SGA.[4] We will complete the implementation of the following SGA recommendations by mid-January 2024: 1) adopt a medium-term plan to strengthen staff capacity, particularly in internal audit, financial reporting, and foreign reserves management; 2) advance the risk management function by adopting a business continuity policy; and 3) ensure accuracy of NRB monetary data through setting out procedures for compiling data, assigning responsibilities for independent review of the data and reconciliation to the financial statements at the test dates that fall on year-ends and having the internal audit department review this. In addition, we will continue to strengthen the management of our foreign exchange reserves through better segregation of responsibilities, stronger accounting, and valuation criteria, drawing on the recent IMF TA.

25. We are urgently strengthening our AML/CFT framework.[5] The Asia/Pacific Group on Money Laundering (APG) has conducted a mutual evaluation to assess Nepal's compliance with global AML/CFT standards and has determined Nepal will enter the International Co-operation Review Group observation period. We recognize the importance of Nepal not being listed by the FATF as a jurisdiction with strategic AML/CFT deficiencies. We are aware of the potential impact that this could have on Nepal's correspondent banking relationships and access to the global financial network. We commit to implementing the necessary reforms in the APG action plan, assisted by technical assistance from the Fund and other development partners. These include making the utmost effort to achieve the enactment of the bill "Amendments to Some Laws relating to AML and Business Promotion Bill", in line with Financial Action Task Force AML/CFT international standards and the 2023 APG Mutual Evaluation Report (new end-July 2024 SB), changing relevant regulations, improving capacity, understanding AML/CFT risks, and strengthening supervision and enforcement.

26. We will continue our efforts to address structural barriers to growth. This includes further exploring avenues to reduce the cost of doing business, including by simplifying regulatory provisions to foreign investment, investing in resilient and sustainable infrastructure and human capital, and promoting trade across sectors.

D. Risks and Contingencies

27. Downside risks and global uncertainty remain, but we stand ready to adjust policy as needed to respond. Should growth fail to rebound, low revenues will pressure the fiscal balance. Government expenditure compression—while protecting critical capital and social spending—could be matched with cautious monetary accommodation. Another major commodity price shock could require further monetary policy tightening to maintain external stability and keep inflation in check.

[4] 5 out of 16 recommendations have been fully implemented and the others are in progress.

[5] Anti-money laundering/combatting the financing of terrorism.

Foreign exchange reserves were an important cushion for the 2022 commodity price shock, and our buffers are once again adequate. In any case, the fiscal path will continue to provide an important anchor for fiscal policy to support macroeconomic stability. In the event of a shock too large to be offset exclusively with our buffers and needed policy adjustment, we will seek assistance from our development partners for increased external support. Our ability to mobilize additional resources from development partners is aided by our low risk of debt distress, strong track record of repayment and anchored by our ECF-supported program commitments. Finally, the NRB has been improving its tools and remains vigilant to prevent potential problems in the banking system. In the event of elevated bank stress, the NRB stands ready to provide systemic liquidity support while triaging deeper solvency problems.[6]

E. Financing and Program Monitoring

28. We will continue to mobilize resources from international development partners to support our reform program. In addition to mobilizing domestic resources, the government estimates that remaining financing needs for the program will be covered by assistance from the IMF, the World Bank, the Asia Development Bank, and other development partners. We will continue to work with our development partners, especially the IMF, the World Bank and the Asian Development Bank, to successfully implement the reforms outlined above. IMF disbursements will be made available to the budget during the program period.

29. The program will be closely monitored through quantitative performance criteria, indicative targets, and structural benchmarks as listed in Tables 1 and 2. The Technical Memorandum of Understanding (TMU) describes the definitions as well as data provision requirements. The ECF program is monitored on a semi-annual basis by the IMF Executive Board. We are requesting that an amount of SDR 39.20 million is made available for the third review. The fourth and fifth reviews are scheduled to be completed on or after May 1, 2024, and November 1, 2024; these reviews will be based on January 14, 2024 and July 15, 2024 test dates respectively, as per Table 2. The government undertakes to adopt, in consultation with IMF staff, any new financial or structural measures, which may be necessary for the success of the program.

[6] Triaging refers to addressing solvency problems through (i) using banks' resources, (ii) restructuring, or (iii) resolution/liquidation.

Table 1. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks, July 2023-January 2025

Measure	Original Target Date	Status	Proposal
Cross-Cutting Institutional Reforms to Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption			
The FCGO reports the consolidated financial information of all operational funds in annual financial statements, starting with FY2021/22 1/	End-August 2023	**Not met**	Reset to end-January 2025
The MOF submits to Parliament amendments to modernize the NRB Act, addressing key recommendations of the 2021 Safeguards Assessment Report 2/	End-August 2023	**Not met**	Reset to end-April 2024
The FY2023/24 external audit of the NRB is conducted by the Auditor General's Office with the service of experts with international experience in auditing and central bank auditing.		**New**	End-July 2024
Report that the *Amendments to Some Laws Relating to AML and Business Promotion* bill has been enacted in line with Financial Action Task Force AML/CFT international standards		**New**	End-July 2024
Revenue mobilization			
The MOF publishes a report on tax exemptions for all other non-customs related taxes 3/	End-August 2023	**Not met, Implemented September 2023**	
MOF approval of a domestic revenue mobilization strategy covering tax policy, law, and revenue administration reforms	End-April 2024		
The MOF publishes a comprehensive report on tax expenditures	End-April 2024	**Reset**	End-January 2025
Fiscal Sustainability and Fiscal Risk Management			
The MOF implements a fiscal risk register to capture various dimensions of major fiscal risks 3/	End-August 2023	**Met**	
A comprehensive fiscal risk statement is published by the MOF with the FY 25/26 Budget		**New**	End-August 2025
The MOF develops cash flow forecasting to be shared with the PDMO and NRB on a regular basis 3/	End-September 2023	**Met**	
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements	End-April 2024	**Modified and reset**	End-August 2024
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Doorsanchar Company (Nepal Telecom)) will have their FY2022/23 financial statements audited	End-April 2024	**Reset**	End-August 2024

1/ This SB was originally set for End May 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
2/ This SB was originally set for End October 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
3/ This SB was originally set for End October 2022, was not met, and was reset at the combined First and Second Review to end September 2023.

Table 1. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks, July 2023-January 2025 (concluded)

Measure	Original Target Date	Status	Proposal
Equitable and Sustainable Growth			
National Planning Commission approves an action plan to improve the efficiency of public investment spending and strengthen climate resilience, drawing on recommendations of a Public Investment Management Assessment (PIMA) 1/	End-April 2024	**Modified**	
Financial Sector Regulation & Supervision			
The NRB issues the updated regulation on asset classification 2/	End-August 2023	**Met**	
The NRB completes the full implementation of the SIS among class A, B and C banks, excluding the onsite module 3/	End-August 2023	**Met**	
The NRB completes implementation of the onsite module of the SIS among class A banks 4/	End-April 2024		
Launch for 10 largest Banks in-depth on-site inspections assisted by independent international third-party auditors	End-April 2024		
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors		**New**	End-December 2024
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections		**New**	End-February 2025

1/ This SB was originally set for end October 2022, was not met, and was reset at the combined First and Second Review to end April 2024.
2/ This SB was originally set for end October 2022, was not met, and was reset at the combined First and Second Review to end August 2023.
3/ This SB was originally set for end-October 2022, was not met, was reset at the combined First and Second Review to end August 2023 and was modified to include Class B and C banks but restricted to exclude the onsite module.
4/ This SB was originally set for end-October 2022, was not met, was reset at the combined First and Second Review to end April 2024 and was modified to only cover the onsite module.

Table 2. Nepal: Indicators Proposed for Quantitative Targets [1/]

(Cumulative Rs. million unless otherwise indicated)

	FY2021/22				FY2022/23				FY2023/24	
	16-Jul-22				16-Jul-23				14-Jan-24	15-Jul-24
	Program target	Adjusted target	Outturn	Status	Program target	Adjusted target	Outturn	Status	Program target	Program target
Quantitative performance criteria under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/									435,959	315,628
Stock of NRB's net international reserves (floor; in U.S. dollars million) 1,8,9/	8,640	8,344	8,821	met	8,038	6,998	10,473	met	9,076	9,076
Accumulation of external payments arrears (ceiling) 2/	0	0	0	met	0	0	0	met	0	0
Indicative targets under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	333,591	296,329	163,470	met	256,523	355,213	315,070	met	..	..
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	5,300	5,300	6,987	met	6,987	6,987	6,763	not met	3,092	6,987
Indicative target: floor on tax revenue of the federal government 10/										845,938
Memorandum items:										
Budget support from development partners (in U.S. dollars million) 1,11/	641		345		330		171		162	325
Revenues of the budgetary central government under the program (in NPR million) 1,3/	926,767		938,280		968,166		838,029		341,044	..
Revenue targets of the budgetary central government (in NPR million) 1,3/	1,050,821		..		1,066,000		..		563,983	1,248,620
Primary deficit adjustor for revenue (in NPR million) 6/	..		0		..		109,170		..	..
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 6/	124,003		..		109,170		..		61,009	..
Foreign-financed project loan disbursements (in NPR million) 1,3/	129,883		92,621		104,207		93,727		13,977	83,832
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 1,3/	..		-37,262		..		-10,480		..	..

Sources: Nepali authorities; and IMF staff estimates/projections based on the Nepali fiscal year and calendar.

1/ The quantitative targets, indicative targets, program exchange rates and adjustors are defined in the Technical Memorandum of Understanding (TMU). Foreign currency deposits of commercial banks and other financial institutions held at the NRB are considered reserve related liabilities and excluded.

2/ This quantitative target is applied on a continuous basis.

3/ Cumulative from the beginning of the fiscal year.

4/ Excludes interest payments. The program primary deficit definition also excludes grants and other receipts from the revenue side, so figures in this table are higher than those reported in the macroeconomic framework.

5/ The social spending indicative target will initially be a floor on spending on the child protection grant. This indicative target will start in the second review with the test dates beginning in July 2022. The initial floor will be FY2020/21 outturns plus an additional amount to reflect the announced one third increase in budget.

6/ The program targets for the primary deficit include adjustors for the level of revenue collection. The upward adjustment to the ceiling is capped at NPR 61,009 million for the January 14, 2024 test date. The adjustor will be phased out starting at the July 15, 2024 test date.

7/ The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms. Foreign-financed project loan disbursements is the difference between total external financing and budget support from development partners.

8/ The program targets for net international reserves include adjustors for budget support from development partners and for revenue collection. Any downward adjustment to the NIR floor will be capped at USD 710 million for the next 12 months to maintain reserve adequacy.

9/ NIR floor target is set as a mid-point between the baseline projection and the adequacy level to provide space in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy.

10/ This is a program indicative target, not a revised target of the Budget. The Budget target remains NPR 1,248.620 million.

11/ For the January 14 2024 and Juy 15 2024 testing dates the figures are cumulative of the period from July 17, 2023 to January 14 2023 and July 17 2023 to July 15, 2024 respectively.

Attachment II. Technical Memorandum of Understanding

This memorandum reflects understandings between the Nepali authorities and the IMF staff in relation to the Extended Credit Facility (ECF). It specifies valuation for monitoring quantitative performance criteria under the program (Section A), performance criteria and indicative targets (Section B), and data reporting (Section C). The authorities will consult with the IMF before modifying measures contained in this TMU or adopting new measures that would deviate from the goals of the program.

A. Program Exchange Rates and Gold Valuation

1. **Program exchange rates are used for formulating and monitoring quantitative performance criteria**. All assets and liabilities denominated in U.S. dollars (USD) will be converted into Nepali Rupees (NPR) at a program exchange rate of NPR 131.3 per one USD, which corresponds to the exchange rate on July 17, 2023. Gold holdings will be valued at USD 1950.3 per troy ounce, the price in July 2023 from the IMF website on primary commodity prices. Assets and liabilities denominated in SDRs and in foreign currencies not in USD will be converted into USD at the July 17, 2023 exchange rates reported in the Table 1:

Table 1. Nepal: Program Exchange Rates 1/

Currency	Program Exchange Rate
U.S. dollars / Nepali rupee	0.008
U.S. dollars / U.K. pound	1.308
U.S. dollars / Indian rupee	0.012
U.S. dollars / Chinese yuan	0.139
U.S. dollars / Euro	1.123
U.S. dollars / Japanese yen	0.007
U.S. dollars / Brunei dollar	0.756
U.S. dollars / Korean won	0.001
U.S. dollars / Kuwaiti dinar	3.262
U.S. dollars / Malaysian ringgit	0.220
U.S. dollars / Australian dollar	0.681
U.S. dollars / Bahrain dinar	2.653
U.S. dollars / Canadian dollar	0.759
U.S. dollars / Danish krone	0.151
U.S. dollars / Hong Kong dollar	0.128
U.S. dollars / Swedish krona	0.097
U.S. dollars / Swiss franc	1.162
U.S. dollars / Omani rial	2.598
U.S. dollars / Qatari riyal	0.275
U.S. dollars / Russian ruble	0.011
U.S. dollars / Saudi Arabian riyal	0.267
U.S. dollars / Thai baht	0.029
U.S. dollars / U.A.E. dirham	0.272
U.S. dollars / Singapore dollar	0.756
U.S. dollars / SDR	1.354

1/ The reference date for Nepali rupee is July 17, 2023.

2. For purposes of this TMU, "external" and "domestic" shall be defined on a residency basis.

B. Performance Criteria and Indicative Targets

3. **The quantitative performance criteria and indicative targets for relevant test dates are specified in Table 2 of the Memorandum of Economic and Financial Policies**.

Quantitative Performance Criteria on Net International Reserves of the Nepal Rastra Bank

4. Net international reserves (NIR) are defined as reserve assets minus reserve related liabilities of Nepal Rastra Bank (NRB) expressed in U.S. dollars.

- Reserve assets of the NRB, as defined in the sixth edition of the Balance of Payments Manual (BPM6), are claims on nonresidents denominated in foreign convertible currencies and Indian rupee controlled by the NRB and are readily and unconditionally available to the NRB for meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include NRB holdings of monetary gold, SDRs, Nepal's reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of NRB), and readily available deposits abroad (including balances on accounts maintained with overseas correspondent banks). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).

- Reserve related liabilities are defined as foreign exchange liabilities of the NRB to nonresidents; Nepal's outstanding credit to the IMF; foreign currency reserves and deposits of commercial banks and other financial institutions held at the NRB; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies.

- To measure the program NIR, all foreign-currency related assets and liabilities will be converted into USD at the exchange rates specified in paragraph 1, Table 1.

5. Targets for the program NIR are set as a floor.

6. The program targets for net international reserves include adjustors for budget support from development partners and for revenue collection.

- *Budget support from development partners.* Should the actual disbursement of budget support from development partners be below the projections under the program, the NIR floor will be adjusted downward by the difference between the actual level and the projected level of disbursements under the program. The projections of budget support from development partners for the next 12 months are presented in Table 2.

- *Revenue collection. The program targets for NIR include adjustors for revenue collection, reflecting* the strong link between the revenue base to remittances and other foreign exchange flows. In case revenue collection is below the level projected under the program, the NIR target will be adjusted by the equivalent USD amount of the revenue adjustor to the primary deficit ceiling described in paragraph 10 below.

- *Cap on downward adjustment.* Any downward adjustment to the NIR floor for the conditions described in the two preceding bullets will be capped at USD 710 million.[1]

Table 2. Nepal: Budget Support from Development Partners Projected under the Program

Date	Cumulative over the period from July 16, 2023 to July 15, 2024 (USD million)
January 14, 2024	162
July 15, 2024	365

Indicative Target and Quantitative Performance Criterion on the Primary Deficit of the Budgetary Central Government

7. The terms described in paragraphs 7-11 apply to both the indicative target on the primary deficit for the third review and quantitative performance criterion on the primary deficit for the fourth review and all subsequent reviews.

8. The budgetary central government, for the purpose of the program, consists of all the entities listed in the Administrative Expenditure Estimate table of the budget (Table 3).

[1] The NIR adjustor cap is the minimum of: (i) the revenue cap converted to USD at program exchange rates; and (ii) the difference between the NIR floor and NIR adequacy levels. The cap ensures that any downward adjustment maintains reserve adequacy levels.

Table 3. Nepal: Institution Coverage of Budgetary Central Government

President
Deputy President
Chief of Provinces
Federal Parliament
Courts
Commission for Investigation of Abuse of Authority
Office of the Auditor General
Public Service Commission
Election Commission
National Human Rights Commission
Council of Justice
National Natural Resources and Fiscal Commission
National Women Commission
National Dalit Commission
National Inclusion Commission
Indigenous Nationalities Commission
Madhesi Commission
Tharu Commission
Muslim Commission
Office of Prime Minister and Council of Ministers
Ministry of Finance
Ministry of Industry, Commerce and Supply
Ministry of Energy, Water Resources and Irrigation
Ministry of Law, Justice and Parliamentary Affairs
Ministry of Agriculture and Livestock Development
Ministry of Water Supply
Ministry of Home Affairs
Ministry of Culture, Tourism and Civil Aviation
Ministry of Foreign Affairs
Ministry of Forest and Environment
Ministry of Land Management, Cooperative and Poverty Alleviation
Ministry of Physical Infrastructure and Transport
Ministry of Women, Children and Senior Citizen
Ministry of Youth and Sports
Ministry of Defense
Ministry of Urban Development
Ministry of Education, Science and Technology
Ministry of Communications and Information Technology
Ministry of Federal Affairs and General Administration
Ministry of Health and Population
Ministry of Labour, Employment and Social Security
National Planning Commission
MOF- Domestic Debt Service
MOF- External Debt Service (Multilateral)
MOF- External Debt Service (Bilateral)
MOF Staff Benefits and Retirement Benefits
MOF Miscellaneous
Province (Equalization, Special and Complementary)
Local Level (Equalization, Special and Complementary)

9. The primary deficit of the budgetary central government is defined as primary expenditures minus revenues.

- Primary expenditures include capital expenditures and recurrent expenditures except interest payments. Financing expenditures (the amortization of domestic and external borrowing, loan and share investment in public enterprises and other enterprises, and foreign share investments) are excluded. Capital expenditures are the same as the capital expenditures defined in the budget. Recurrent expenditures (excluding interest expenditure) include the following items in the budget: compensation of employees, use of goods and services, subsidies, grants, social security, other current expenditure. Revenue sharing for province and local levels is excluded.

- Revenues of the budgetary central government are those revenues to be deposited in the Federal Treasury. They include all taxes and non-tax revenue as defined in the budget. Revenue sharing for province and local levels is excluded. Other receipts are also excluded.

- Revenues and primary expenditures should be recognized on a cash basis.

- The Financial Comptroller General Office monthly reports will be used as the basis for program monitoring.

10. Targets for the primary deficit of the budgetary central government are set as a ceiling. Targets are set for cumulative flows from the end of the previous fiscal year.

11. The program targets for the primary deficit include adjustors for revenue collection, which will be phased out starting with the July 15, 2024, test date.

- *Adjustor for revenue shortfalls*. Should the revenue outturn be below the projected level under the program, the primary deficit ceiling will be adjusted upward (higher deficit) by the difference between the revenue outturn and the level of revenues projected under the program. The upward adjustment to the ceiling is capped at NPR 61,009 million for January 15, 2024. This adjustor would prevent having to unduly tighten fiscal policy under the program if the economy is weaker than projected.

- *Adjustor for revenue windfalls*. Should revenue outturn be above the projected level under the program but below the MOF revenue collection targets, there would be no adjustment to the primary deficit target (implying that expenditure could be higher by the equivalent amount of the revenue overperformance, keeping the overall primary deficit target unchanged). Should the revenue outturn exceed the MOF revenue collection targets, the primary deficit ceiling will be adjusted downward (lower deficit) by the difference between the revenue outturn and the MOF revenue collection target. This adjustor would allow for higher spending if revenues are higher than the program projection, while promoting a buildup of fiscal buffers if revenues overperform by a large amount.

- The level of revenues projected under the program and MOF revenue collection targets for the following test date are presented in Table 4.

Table 4. Nepal: Revenues of the Budgetary Central Government Projected under the Program and Revenue Collection Targets		
Date	**Revenues Projected under the Program, Cumulative over the Respective Fiscal Year (NPR million)**	**MOF Revenue Collection Targets, Cumulative over the Respective Fiscal Year (NPR million)**
January 14, 2024	341,044	563,983

12. The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms.

- *Adjustor for higher than projected foreign-financed project loan disbursements on concessional terms*. Should the actual disbursement of foreign-financed project loans be above the projections under the program, the primary deficit ceiling will be adjusted upward (higher deficit) by the difference between the actual level and the projected level of disbursements under the program. The upward adjustment to the ceiling is capped at the difference between the budget amount and the projected level of disbursement for the indicative target for the 3rd review. This cap does not apply for the quantitative performance criteria for the 4th and all subsequent reviews. This adjustor means that the program does not constrain foreign-financed project loan disbursements on concessional terms.

- *Adjustor for lower than projected foreign-financed project loan disbursements on concessional terms.* Should the actual disbursement of foreign-financed project loans be below the projections under the program, the primary deficit ceiling will be adjusted downward (lower deficit) by the difference between the actual level and the projected level of disbursements under the program. This adjustor would align project spending with the actual disbursement of foreign-financed project loans on concessional terms.

- The projections of foreign-financed project loan disbursements for the following 2 test dates are presented in Table 5.

Table 5. Nepal: Foreign-Financed Project Loan Disbursements Projected under the Program	
Date	**Cumulative over the respective fiscal year (Million NPR)**
January 14, 2024	13,977
July 15, 2024	83,832

Indicative Target on Social Spending of the Budgetary Central Government

13. **The indicative target will focus on the child grant spending**. The child grant reaches vulnerable households, is implemented by the federal government, and is monitorable in a timely way. Health and education spending, while key pillars of social spending, are being devolved to local and provincial governments and implementation is not fully under control of the federal government. Indicative targets on the child grant, including the activity code 7.1.1.10 (dalit children), 7.1.1.41 (areas designated children), and 7.1.1.43 (areas designated children), are set as a floor for: (1) Cumulative flows from the end of the previous fiscal year. Spending should be recognized on a cash basis and flows should be recorded when cash is paid.

Indicative Target on tax revenues of the federal government (starting with the July 15, 2024 test date)

14. **The indicative target will be defined as the tax revenue of the federal government.**

This includes tax revenues of the budgetary central government to be deposited in the Federal Treasury. Non-tax revenue and revenue sharing for provinces and local levels are excluded. Other receipts are also excluded.

- Import-related tax revenue includes import-related customs, VAT, and excise duty.
- The monthly data from MoF will be used as the basis for program monitoring.

15. **Indicative targets are set as a floor. Targets are set for cumulative flows from the end of the previous fiscal year**.

Continuous Performance Criteria

16. **A continuous quantitative performance criterion applies to the non-accumulation of new external payments arrears on external debt contracted or guaranteed by the budgetary central government or NRB**. External payment arrears consist of the total amount of external debt service obligations (principal and interest)—deriving from loans arranged or guaranteed by the central government and the NRB, penalties, and interest charges deriving from these loans not paid at maturity—falling due to nonresidents after approval of this arrangement and that have not been paid when due in accordance with the relevant contractual agreements (including any contractual grace period). Excluded from the prohibition on the accumulation of new arrears are (i) external arrears that are subject to debt rescheduling agreements or negotiations and/or (ii) disputed external debt service obligations.

17. **Debt will be understood to mean**—as specified in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by the Decision No. 16919-(20/103) of the Executive Board of the IMF on October 28, 2020—a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of

assets (including currency) or services, according to a specific schedule; these payments will discharge the obligor of the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets, that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases, i.e., arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property , while the lessor retains the title to the property. For the purpose of this guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments necessary for the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

18. Standard continuous performance criteria include: (1) prohibition on the imposition or intensification of restrictions on making of payments and transfers for current international transactions; (2) prohibition on the introduction or modification of multiple currency practices; (3) prohibition on the conclusion of bilateral payments agreements that is inconsistent with Article VIII; and (4) prohibition on the imposition or intensification of import restrictions for balance of payments reasons.

C. Provision of Information to the IMF

19. Performance under the program will be monitored using data supplied to the IMF by the Ministry of Finance (MOF) and the NRB as specified in Table 6 below, consistent with the program definitions above and within the time frame specified. The authorities will transmit promptly to the IMF staff any data revisions within 14 days after being made. Any data and information indicating the non-observance of the continuous performance criteria will be provided immediately. In addition, the authorities will transmit to IMF staff any information or data not defined in this TMU but pertinent for assessing or monitoring performance relative to the program objectives. All reports and data should be transmitted to the IMF electronically and in English.

20. The authorities will inform IMF staff of the creation of any new extra-budgetary funds or programs immediately. This includes any new funds, or other special budgetary and extra-budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2014.

Table 6. Nepal: Data Reporting Requirements [1/]		
Data	**Frequency**	**Submission Lag[2/]**
Ministry of Finance		
Summary of budgetary central government accounts, including revenues (broken down by economic classification) and grants, expenditures (broken down by economic classification), and net acquisition of financial assets (broken down by loan investment and share investment) on a cash basis, consistent with the presentation in budget. The Financial Comptroller General Office (FCGO) monthly reports will be used as the basis for program monitoring.	M	30 calendar days
Summary of budgetary central government's net incurrence of liabilities (broken down by domestic borrowing disbursement and principal repayment, as well as external borrowing disbursement and principal repayment) consistent with the presentation in budget. Foreign-financed project loan disbursements and budget support disbursements. The Public Debt Management Office (PDMO) monthly reports will be used as the basis for program monitoring.	Q	30 calendar days
Domestic and external public debt stock (broken down by currency, maturities, creditors, and instruments), disbursements, and debt service costs of the budgetary central government, including interest payments and amortization schedules until full loan repayment. The PDMO quarterly reports will be used as the basis for program monitoring.	A	60 calendar days
Debt guarantees issued by budgetary central government and the NRB. The PDMO and NRB quarterly reports will be used as the basis for program monitoring.	Q	45 calendar days
Audited Financial statements of public enterprises.	A	210 calendar days
Social spending data on: (1) the amount budgeted, (2) the amount dispersed, (3) the number of recipients. Data provided separately for each of the following programs: old age pension, widows grant, indigenous allowance, disabled persons allowance and Prime Minister's Employment program (PMEP).	H	30 calendar days
Data on the child grant program: (1) the amount budgeted, (2) the amount dispersed, (3) the number of recipients.	H	30 calendar days
The Annual Budget. The Budget speech (with annex) and MOF budget reports will be used as the basis for program monitoring.	A	30 calendar days[3/]
Mid-year budget review. The MOF Mid-year budget review reports will be used as the basis for program monitoring.	A	30 calendar days[4/]
Annual budget execution report. The FCGO annual reports will be used as the basis for program monitoring.	A	90 calendar days
National accounts data.	A, Q	90 calendar days

Table 6. Nepal: Data Reporting Requirements (continued)		
Data	**Frequency**	**Submission Lag**
Public Debt Management Office		
Stock of outstanding external debt payment arrears of the general government (if any) by creditor.	Q	30 calendar days
Nepal Rastra Bank		
Exchange rate data: (i) Monthly official exchange rates NPR/$ (data to be submitted once a week for the previous week). (ii) Monthly average buy and sell exchange rates NPR/$ as quoted by foreign exchange bureaus and banks.	M	5 working days after the end of the month
Monthly consumer price indexes (CPIs).	M	30 calendar days
Program net international reserves and its components (foreign reserve assets, deposits from banks and financial institutions in foreign currency, and foreign reserve-related liabilities of the NRB) at program and current exchange rates.	M	7 working days
Breakdown of gross foreign assets and liabilities (including foreign currency liabilities to residents) of the NRB by currency at actual and program exchange rates.	M	15 calendar days
Balance of payments consistent with the 6th edition of the Balance of Payments Manual (BPM6).	M	30 calendar days
International investment position and private and public external debt data.	Q	90 calendar days
Data on remittances including remittance flows in USD by country, and total approved Nepali migrant workers permit by new/renewed permits and if possible, by destination country.	M	30 days
Tourist arrivals by nationality and country of residence.	M	30 days
Imports and exports data by commodity at HS-2 classification level.	M	30 days
Central bank balance sheet in NPR (Summary).	M	30 calendar days
Balance of government's accounts/funds at NRB, including treasury accounts, pre-funding accounts, VAT refund, custom fund, federal divisible fund, and other funds outside treasury operation. The FCGO and NRB monthly reports (after reconciliation) will be used as the basis for program monitoring.	M	30 calendar days
Data on monetary operations in NPR.	M	30 calendar days
Interbank rates, Treasury bill rates, and volumes of Treasury bills and treasury bonds issued.	M	30 calendar days
Central bank liquidity data: (1) BFI's balance at the NRB; (2) amount required to meet cash reserve ratios in NPR.	M	30 calendar days
Update on the progress on the implementation of the in-depth on-site loan portfolio review.	M	5 working days after the end of the month
Central bank daily purchases and sales of foreign exchange by counterparts (commercial banks, government).	W	2 working days after the end of the week
Daily interbank turnover in the FX spot market.	W	15 working days

Table 6. Nepal: Data Reporting Requirements (concluded)		
Data	**Frequency**	**Submission Lag**
Commercial bank-by-bank data: i) balance sheet by currency (foreign exchange and Nepali Rupee); ii) income statements; iii) breakdown of loan classification and provisioning levels for borrower types (corporate, commercial, retail, SMEs, etc.), product type (overdrafts, working capital loans, demand loans, etc.), economic sectors, and restructured loans; iv) loan write-offs; v) information on forborne loans (payback, reclassification and provisioning) by type of forbearance (deductions in interests, payment deferrals, restructuring of performing loans, restructuring of non-performing loans); vi) breakdown of deposits and net open positions; vii) FSI indicators (capital, asset quality, liquidity, earnings).	M	75 calendar days
Data on foreign currency loans and deposits. Commercial bank-by-bank data: i) breakdown of foreign currency loans for borrower types (corporate, commercial, retail, SMEs, etc.), product types (overdrafts, working capital loans, demand loans etc.), economic sectors, and restructured loans; ii) share of foreign currency deposits by deposit types (current, call, fixed, savings etc.). Other depository corporations survey data in NPR.	M M	75 calendar days 30 calendar days
Condensed assets and liabilities of commercial banks and all BFIs in NPR.	M	30 calendar days
Data specific to class A and B banks: (i) CAMEL rating for class A and B banks (ii) Ratio of Cash & Bank Balance/Total Deposit (iii) Ratio of Investment in Government Securities/Total Deposit (iv) Total Liquid Assets/Total Deposit ratios	M	30 calendar days
NRB's claims on the government with breakdown by type (debt types, loan type, including the gross amounts of overdrafts).	M	30 calendar days
Banks and financial institutions' claims on the government with breakdown by type (debt types, loan types including the gross amount of overdrafts).	M	30 calendar days

Note: A = Annually; Q = Quarterly; H=Half-yearly; M = Monthly; W = Weekly.
1/ Reports and data are provided in English. Data are provided in excel files.
2/ After the end of respective week, month, quarter, or fiscal year in Nepali calendar, unless otherwise indicated.
3/ 30 calendar days after the delivery of the budget speech.
4/ 30 calendar days after January 15.

Statement by Yati Kurniati, Executive Director for Nepal,
Raja Anwar, Alternate Executive Director
Siddha Raj Bhatta and Justin Lee, Advisors to Executive Director
November 29, 2023

On behalf of the authorities of Nepal, we would like to express our appreciation to the IMF team led by Mr. Kinda for the close and constructive engagement during the third review of the Extended Credit Facility (ECF). The authorities broadly concur with the staff analysis and are committed to implement the reforms suggested under the ECF program arrangements to safeguard macroeconomic stability and support sustained growth.

Introduction

The Nepali economy rebounded strongly from the COVID-19 pandemic supported by robust macroeconomic fundamentals and timely policy responses by the authorities. The external sector was buoyed by remittances and tourist arrivals, with imports subdued. The current account as well as international reserves registered a substantial improvement in FY 2022/23 and is projected to improve further. The current account deficit narrowed significantly from 12.7 percent of GDP in 2021/22 to 1.4 percent in 2022/23 supported by decisive policy actions and increase in remittances and tourism. The deficit is projected to remain below 5 percent in the medium term. However, spillover effects from geopolitical tensions, tighter financial conditions and the slowdown in domestic demand have resulted in reduced revenue mobilization and lower credit growth.

The authorities take the Extended Credit Facility (ECF) program as a critical policy anchor for achieving fiscal sustainability, supporting governance and economic reforms, and maintaining overall macroeconomic stability. They have shown a strong commitment for introducing the necessary reforms and implementing the ECF program within the stipulated timeframe.

Program Performance

The authorities reiterate their strong commitment to the ECF program, improving on the program performance since the First and Second Review despite the difficult environment faced. The authorities achieved five out of the seven Structural Benchmarks (SBs) albeit one was completed with delay. The remaining two SBs have been proposed to be reset. The authorities also comfortably met the performance criterion (PC) on net international reserves alongside all standard continuous PCs. Further, the Indicative Target (IT) on the primary fiscal deficit was met. Only the IT on child grant spending was marginally missed, which the authorities continue to work on.

Recent Macroeconomic Developments and Outlook

Economic growth decelerated in 2022/23 due to lower credit growth, low imports, supply-chain disruptions, agricultural shocks and substantial post-pandemic emigration. In FY

2023/24, economic growth is projected to recover back to potential, supported by a gradual recovery in domestic demand in line with the cautiously accommodative stance of monetary policy and prudent fiscal policy measures. On the supply side, growth has been strong in tourism and the electricity sector on the back of additional capacity in hydropower.

Inflation is moderating gradually. The headline inflation stood at 7.5 percent in mid- October 2023 compared to 8.5 percent in mid-October 2022. Inflation is expected to moderate to the 6.5 percent target by the end of FY 2023/24 supported by the cautious monetary policy stance, low credit growth, and lower imported inflation.

Monetary and Exchange Rate Policy

The NRB remains fully committed to maintaining price and external sector stability as the key mandate of monetary policy and preserving credibility of Nepal's exchange rate peg by keeping an adequate level of reserves. The NRB cautiously eased monetary policy in July 2023 on the backdrop of moderating inflation and significant improvement in the external sector. While this has helped in lowering the weighted average interbank rate, credit demand has yet to increase due to necessary balance sheet repairs. The NRB is taking measures to maintain the stability of the interbank rate and maintaining it within the interest rate corridor. One of such measures is the standing deposit facility rate, which acts as the floor of the interest rate corridor. The NRB is fully committed to ensuring the data-driven monetary policy decisions, in line with the program recommendation.

Fiscal Policy

The authorities are committed to implementing fiscal reforms to ensure fiscal sustainability and build policy buffers to increase resilience. Due to a decline in tax revenues, fiscal deficit increased slightly in FY 2022/23 but remain within the program's projections. The authorities have introduced several tax reforms and expenditure measures in 2023/24 to address the near-term fiscal pressures. The tax measures taken in this regard include a 39 percent maximum income tax rate and removal of VAT exemptions for a number of items, among others. Furthermore, the government of Nepal incorporates measures to address spending duplication with subnational governments while improving capital spending.

Nepal remains at low risk of debt distress, despite public debt remaining elevated at 47 percent of GDP at the end of FY 2022/23 due to spending during the COVID pandemic. The external debt stood at 21.7 percent of GDP at the end of FY 2022/23, almost the same level as FY 2019/20. The Debt Sustainability Analysis done by the Fund in May 2023 shows that Nepal is at low risk of debt distress in terms of both external and overall debt. Despite large trade deficit, high level of remittances and concessional external financing have helped Nepal to maintain an adequate level of international reserves and meet its debt obligations. The authorities are conscious of the need to gradually reduce fiscal deficits and stabilize debt in order to ensure fiscal sustainability. In addition, they are in process to develop a revenue mobilization strategy and advancing an action plan to address the public investment efficiency gap in line with the recommendations of the Public Investment Management Assessment conducted in 2021.

The authorities are committed to initiating significant public financial management reforms. They have maintained a fiscal risk register and are committed to expanding it to subnational governments. The cash flow forecasting system has been operationalized and is expected to improve the budget forecasting process. The authorities agree with the need to audit the financial statements of public enterprises and are committed to implementing the structural benchmarks related to it.

Financial Sector

The financial sector has remained broadly sound and resilient. Capital adequacy ratios and the liquidity ratios are above the regulatory minimum. While the non-performing loan ratio has increased recently due to the slowdown in economic activities, it remains below 5 percent. Moreover, the NRB is adopting sound regulatory and supervisory frameworks to maintain the health of the financial system. The Asset Classification Guidelines and Working Capital Loan Guidelines are expected to help in addressing vulnerabilities and achieving a more sustainable credit growth. Other reforms include the implementation of the Supervisory Information System (SIS) and reintroduction of a counter cyclical buffer. The authorities have started preparations for a loan portfolio review of the ten largest banks and intend to complete it within the time limit agreed under the ECF program. The NRB plans to introduce the on-site module in the Supervisory Information System and the liquidity ratios under BASEL III to strengthen the supervisory framework. The authorities plan to establish and operationalize a specialized regulatory authority to regulate and supervise financial cooperatives. In addition, the authorities are committed to introduce other reforms as per the recommendations of the Financial Sector Stability Review.

Governance and Transparency

The authorities consider governance and transparency a key priority. Nepal has introduced several measures to improve governance and transparency. The authorities are committed to implement the feasible recommendations of the safeguards assessment in view of maintaining the autonomy and strengthening the transparency of the central bank. Also, they fully commit to improve the AML/CFT framework by enacting the necessary legal arrangements.

The authorities have submitted amendments to 19 laws in parliament to strengthen the legal framework. They are committed to act upon any new or emerging AML/CFT risks and will adopt further measures to strengthen governance and combat corruption as necessary. The NRB has established a separate division for AML/CFT supervision of commercial banks. The authorities would welcome technical assistance to strengthen these areas.

Conclusion

Nepali authorities reiterate their commitment to the ongoing program's objectives and request for completion of the Third Review. The ECF program has helped maintain macroeconomic stability, introduce reforms, and improve the governance framework. The authorities fully agree that accompanying structural reforms are well-aligned with the domestic policy priorities. They look forward to further Fund support in terms of capacity development to address the constraints. The authorities would like to take the opportunity to thank the IMF Executive Board and management, as well as international partners for their continued support.