INTERNATIONAL MONETARY FUND

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NEPAL

July 2024

FOURTH 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—Fourth 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 July 9, 2024, following discussions that ended on June 5, 2024, 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 June 21, 2024.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by IMF staff Representative** on Nepal
- 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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PRESS RELEASE

PR24/266

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

FOR IMMEDIATE RELEASE

- *The IMF Executive Board completed the fourth review under the Extended Credit Facility (ECF) Arrangement for Nepal, providing the country with access to SDR 31.4 million (about US$ 41.3 million).*
- *Nepal has made good progress with implementation of the program, despite a challenging political environment.*
- *Following a slowdown last year, economic activity has started to pick up and the recovery is expected to gather steam, supported by cautiously accommodative monetary policy stance, planned increase in capital expenditure in the FY2024/25 budget, additional hydropower generation, and continued increase in tourist arrivals.*

Washington, DC – July 10, 2024: On July 9, 2024, the Executive Board of the International Monetary Fund (IMF) completed the fourth review under the four-year Extended Credit Facility (ECF) for Nepal, allowing the authorities to withdraw the equivalent of SDR 31.4 million (about US$ 41.3 million). This brings total disbursements under the ECF for budget support thus far to SDR 188.3 million (about US$ 247.7 million).

The ECF arrangement for Nepal was approved by the Executive Board on January 12, 2022 (see Press Release No. 22/6) for SDR 282.42 million (180 percent of quota or about US$ 371.6 million). Nepal has made good progress with 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.

The economy continues to face challenges as growth, projected around 3 percent in FY2023/24, remains below potential in the context of subdued domestic demand and post-pandemic balance sheet repairs. Economic activity is expected to pick up with growth reaching 4.9 percent in FY2024/25, supported by stronger domestic demand. The cautiously accommodative monetary policy stance, planned increase in capital expenditure in the FY2024/25 budget, additional hydropower generation, and a continued increase in tourist arrivals are expected to boost domestic demand and growth. Inflation is expected to remain within the Nepal Rastra Bank's (NRB) target ceiling of 5.5 percent.

Domestic risks dominate the outlook. Failure to raise the execution rate of capital projects would deprive the economy of much-needed stimulus and weigh on growth. Fragile political stability could disrupt policy continuity and reform implementation. Intensification of financial sector vulnerabilities such as a further rise in NPLs or more failures of cooperative lenders

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could endanger banking system soundness. Externally, high commodity prices could slow the recovery in energy-intensive sectors. Nepal remains vulnerable to natural disasters.

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 and so far in FY2023-24, despite revenue shortfalls. 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, executing the planned increase in capital spending, as envisaged in the FY24/25 budget, while maintaining fiscal discipline through domestic revenue mobilization and rationalization of current spending remains critical to boost growth and preserve medium-term fiscal sustainability. Strengthening public investment management will support the needed boost to capital spending. Enhancing fiscal transparency will help contain fiscal risks and further strengthen medium-term fiscal sustainability.

“As monetary policy transmission is still weak in a context of balance sheet repair, a cautious and data dependent monetary policy remains appropriate to preserve price and external stability. Continuing to strengthen Nepal’s financial system remains a top priority. Financial policy should remain vigilant and focused on building regulatory frameworks that promote sustainable credit growth while proactively addressing emerging vulnerabilities in the savings and credit cooperatives sector. Maintaining recent reforms regarding lending practices and asset classification is important as preparations for the loan portfolio review of the ten largest banks continue.

“Nepal’s commitment to strengthen its AML/CFT framework is welcome. Amendments to a set of fifteen laws, including on money laundering, have been recently enacted—and secondary legislation is under preparation—to bring Nepal’s AML/CFT legal framework in line with international standards. It remains critical to ensure the effectiveness of the new legal framework. 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 remains 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 aiming for full execution of the child grant budget, followed by an expansion of the program to all districts in Nepal.”

Nepal: Selected Economic Indicators 2020/21-2028/29 1/

	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29
							Projections		
Output and Prices (annual percent change)									
Real GDP	4.8	5.6	2.0	3.1	4.9	4.9	5.0	5.0	5.0
Headline CPI (period average)	3.6	6.3	7.8	5.6	5.2	5.4	5.4	5.4	5.4
Headline CPI (end of period)	4.2	8.1	7.4	5.0	5.4	5.4	5.4	5.4	5.4
Fiscal Indicators: Central Government (in percent of GDP)									
Total revenue and grants	23.3	22.9	19.3	19.3	20.2	21.4	22.1	22.7	23.2
of which: Tax revenue	20.0	19.8	16.2	16.4	17.4	18.3	19.0	19.7	20.2
Expenditure	27.2	26.1	25.2	24.0	24.4	25.0	25.3	25.7	25.9
Expenses	22.0	21.7	20.8	20.3	19.4	19.4	19.5	19.7	19.8
Net acquisition of nonfinancial assets	5.3	4.3	4.4	3.7	5.0	5.6	5.8	6.0	6.1
Operating balance	1.3	1.2	-1.4	-1.0	0.9	2.0	2.6	3.0	3.4
Net lending/borrowing	-4.0	-3.1	-5.8	-4.7	-4.1	-3.6	-3.2	-2.9	-2.7
Statistical discrepancy	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	3.9	3.1	5.8	4.7	4.1	3.6	3.2	2.9	2.7
Net acquisition of financial assets	3.8	2.6	-0.9	1.3	1.3	1.3	1.3	1.3	1.3
Net incurrence of liabilities	7.7	5.8	4.9	6.0	5.4	4.9	4.5	4.2	4.0
Foreign	3.4	2.0	1.7	1.6	1.6	1.5	1.2	1.2	1.2
Domestic	4.3	3.7	3.3	4.4	3.8	3.4	3.3	3.1	2.8
Money and Credit (annual percent change)									
Broad money	21.8	6.8	11.4	12.5	10.8	10.5	10.6	10.7	10.7
Domestic credit	26.8	17.9	8.8	8.8	9.3	9.4	10.1	10.5	10.7
Private sector credit	26.3	13.3	4.6	5.5	7.8	8.2	9.5	10.3	10.6
Saving and Investment (in percent of nominal GDP)									
Gross investment	35.2	37.6	31.7	33.2	37.6	39.0	37.8	36.3	35.1
Gross fixed investment	29.3	29.0	25.1	26.3	29.8	30.9	29.9	28.8	27.8
Private	24.1	23.6	21.7	22.6	24.8	25.3	24.1	22.8	21.7
Central government	5.3	5.3	3.4	3.7	5.0	5.6	5.8	6.0	6.1
Change in Stock	5.8	8.7	6.6	6.9	7.8	8.1	7.9	7.6	7.3
Gross national saving	27.5	25.1	30.3	36.4	36.0	35.0	33.8	32.6	31.5
Private	27.0	24.4	32.2	38.0	35.7	33.8	32.1	30.4	29.0
Central government	0.4	0.7	-1.9	-1.6	0.3	1.1	1.7	2.2	2.6
Balance of Payments									
Current account (in millions of U.S. dollars)	-2,844	-5,174	-557	1,409	-775	-2,100	-2,312	-2,419	-2,523
In percent of GDP	-7.7	-12.6	-1.4	3.2	-1.6	-4.0	-4.0	-3.8	-3.6
Trade balance (in millions of U.S. dollars)	-11,510	-13,759	-10,699	-10,492	-13,037	-15,067	-15,904	-16,711	-17,580
In percent of GDP	-31.2	-33.4	-26.2	-24.0	-27.3	-28.6	-27.4	-26.1	-25.0
Exports of goods (y/y percent change)	30.0	43.9	-19.9	-0.7	14.0	9.5	9.3	10.0	9.4
Imports of goods (y/y percent change)	25.7	21.9	-22.0	-1.8	23.1	14.9	5.9	5.6	5.7
Workers' remittances (in millions of U.S. dollars)	8,150	8,326	9,330	10,679	11,141	11,623	12,126	12,651	13,199
In percent of GDP	22.1	20.2	22.8	24.5	23.3	22.1	20.9	19.8	18.7
Gross official reserves (in millions of U.S. dollars)	10,884	8,973	10,974	13,564	14,582	14,565	14,399	14,398	14,578
In months of prospective imports	7.5	7.6	9.2	9.4	8.8	8.3	7.8	7.3	7.0
Memorandum Items									
Public debt (in percent of GDP)	43.3	42.7	47.1	49.7	50.4	50.4	50.0	49.3	48.4
Nominal GDP (in billions of U.S. dollars)	36.9	41.2	40.9	43.7	47.8	52.6	58.0	63.9	70.4
Nominal GDP (in billions of Nepalese Rupees)	4,353	4,977	5,349	5,793	6,393	7,071	7,823	8,657	9,582
Net International Reserves (in millions of U.S. dollars)	10,620	8,821	10,528	13,081	14,024	14,012	13,899	13,962	14,222
Primary Deficit (in billions of Nepali Rupees)	138	110	239	173	158	141	125	114	104
Primary Deficit (in percent of GDP)	3.2	2.2	4.5	3.0	2.5	2.0	1.6	1.3	1.1
Tax Revenue (in billions of Nepalese Rupees)	870	984	866	950	1,115	1,292	1,489	1,705	1,932
Tax Revenue (In percent of GDP)	20.0	19.8	16.2	16.4	17.4	18.3	19.0	19.7	20.2
Health Expenditure (in percent of GDP)	1.1	2.3	1.7	1.2	1.2	1.2	1.2	1.2	1.2
Social Protection/Assistance (in percent of GDP)	1.7	3.7	2.8	2.8	2.8	2.8	2.8	2.8	2.8
CCRT debt relief (in millions of SDR) 2/	7.1	3.6	...	...	...	...	...	...	...
Private sector credit (in percent of GDP)	95.1	94.2	91.7	89.3	87.2	85.3	84.4	84.1	84.1
Exchange rate (NPR/US$; period average)	117.9	120.8	130.8	...	...	...	...	...	...
Real effective exchange rate (average, y/y percent change)	-2.9	1.6	1.2	...	...	...	...	...	...

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 April 2024 growth was revised up for FY2022/23 from 1.9 percent to 2 percent in light of new data.

Note: Current baseline forecast is as of June 10, 2024.

INTERNATIONAL MONETARY FUND

NEPAL

June 21, 2024

FOURTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT

EXECUTIVE SUMMARY

Context. Subdued economic activity has helped strengthen the external position and ease inflation. Growth is expected to rebound to 4.9 percent in FY2024/25, supported by further expansion in hydropower generation and a higher execution rate of public capital expenditure. Inflation is expected to remain within the authorities' target ceiling of 5.5 percent. Non-performing loans have risen, bank profitability has weakened, and the financial health of savings and credit cooperatives (SACCOs) has deteriorated.

Program developments. Despite the uncertain political environment, program performance was broadly on track with all but one quantitative metrics met. The performance criteria (PCs) on net international reserves and primary fiscal deficit were met. The indicative target (IT) on child spending was missed due to technical difficulties in transitioning to a new electronic payment system. All of the continuous PCs were met. Progress was adequate on reform implementation, with three out of five structural benchmarks completed (two met), and some progress made on the remaining two that are proposed to be reset. The challenging political situation remains a risk for policy continuity and reform implementation.

Policy recommendations.

- **Fiscal policy**. Executing the planned increase in capital spending, as envisaged in the FY2024/25 budget, while maintaining fiscal discipline through domestic revenue mobilization and rationalization of current spending, is critical to boost growth and preserve medium-term fiscal sustainability. Strengthening public investment management to enhance the efficiency of capital spending and advancing fiscal transparency will bolster medium-term fiscal sustainability. Policies should also support the most vulnerable, notably through a full execution of the child grant budget, and a future expansion of the program to all districts.

- **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 equilibrium. Reforms regarding lending practices and asset classification

need to be maintained and bank capitalization levels strengthened as the loan portfolio review of the ten largest banks advances. The authorities should swiftly implement plans to address increasing vulnerabilities in SACCOs, including to reform the supervisory framework and architecture.

- **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. Recent law amendments are an important step forward and should be accompanied by needed secondary legislations and effective implementation. Reforms to implement the 2021 IMF Safeguards Assessment recommendations regarding the NRB Act and the NRB external audit remain a priority.

Approved By
Rupa Duttagupta (APD) and Fabian Valencia (SPR)

Discussions took place in Kathmandu during May 22-June 5, 2024. The staff team comprised T. Kinda (Head), R. Green, Y. Hul (all APD), Y. Cao (FAD), M. Gort (MCM), M. Ivanyna (SPR), T. Daban (Resident Representative for Nepal), R. Ghimire and S. Sharma (local office). S. Bhatta (OED) also participated in some meetings. S. Lee, R. Paewai, A. Sinjar (APD) supported the preparation of the report. The team met with Finance Minister B. M. Pun, 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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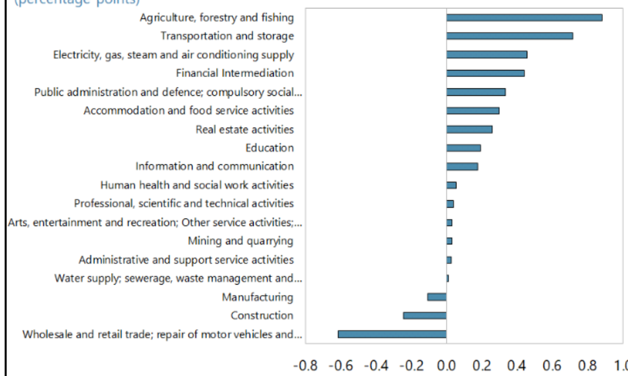
RECENT DEVELOPMENTS

1. **Economic activity remains subdued, supporting a strengthened external position and easing inflation**. Real GDP growth is expected to recover modestly to 3.1 percent in FY2023/24 from a weak 2.0 percent growth in FY2022/23, mainly due to strong performance of export-oriented sectors and supported by increased agricultural production.[1] Capital spending is still weak, however, and imports are recovering only gradually, with year-on-year growth still negative. Political uncertainty continues to act as a headwind to growth. The economic slowdown and lower commodity prices contributed to easing inflationary pressures. Headline inflation declined from a recent peak of 8.2 percent in September 2023 to 4.4 percent in May 2024. Weak import demand and lower commodity prices, coupled with buoyant remittances and a rebound in tourism, underpinned a reversal in the current account balance, which is projected to turn positive in FY2023/24 (already at 3.1 percent of GDP in first 9 months of the fiscal year). Gross international reserves increased to USD13.2 billion as of March 2024 (9.1 months of prospective imports). The external position is assessed to be stronger than implied by medium-term fundamentals and desired policies, reflecting the need to boost domestic investment (Annex II).

Sectoral Contributions to Real GDP Growth, FY2023/24
(percentage points)



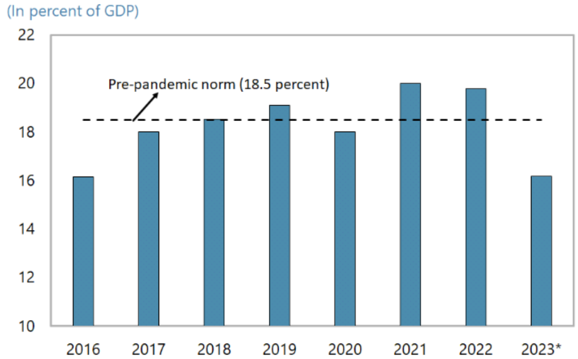
Sources: Nepali authorities; and IMF staff estimates.

2. **Credit growth remains well below nominal GDP growth and non-performing loans (NPLs) have risen**. Credit growth remains subdued at 5.6 percent (year-on-year through May 2024), while NPLs continue to increase, reflecting several factors: (i) weak GDP growth, low business sentiment and political uncertainty, (ii) ongoing deleveraging and balance sheet repair following the recent credit boom (Annex I), (iii) tighter regulation of working capital loans and asset classification, and (iv) capital adequacy requirements of a few banks approaching regulatory limits. NPLs for commercial banks have increased from 1.3 percent in June 2022 to 4.0 percent as of April 2024, also reflecting the unwinding of forbearance measures and long-standing evergreening practices.

[1] The fiscal year in Nepal begins on July 16.

3. **Revenue growth in FY2023/24 has remained subdued despite tax measures, leading the government to reduce expenditure to address near-term fiscal pressures**. While the government announced several tax measures in the FY2023/24 budget, tax revenue only grew by 9.1 percent year-on-year by mid-May broadly in line with the nominal GDP growth projection.[2]

Tax Revenue
(In percent of GDP)



Sources: Nepali authorities; and IMF staff calculations.
Note: Tax revenue in 2023 is a projection.

The tax revenue-to-GDP ratio declined from the pre-pandemic average of 18.5 percent to 16.2 percent in FY2022/23—across both domestic and import-related taxes.[4] The lower tax-to-GDP ratio (by 2.3 percent of GDP) reflects a combination of factors, including weaker imports (about 0.8 percent of GDP), a transition to electric vehicles with lower import duties (0.4 percent of GDP), increased tax administration challenges from intensified informal trade, and restrictions India imposed on its own exports.[5,6] Tax collection so far during the current fiscal year shows little sign of recovery. However, spending restraint in the January 2024 mid-term budget review is expected to more than offset lower-than-expected revenue collection, leading to a larger-than-anticipated improvement in the primary balance (+0.7 percent of GDP) in FY2023/24.

Text Table 1. Nepal: Fiscal Outcome 1/

	2022/23	2023/24		
	Preliminary	3rd review	4th review	Difference
(In percent of GDP, unless otherwise indicated)				
Total revenue and grants	19.3	19.8	19.3	-0.5
Total revenue	18.9	18.9	18.7	-0.2
Tax revenue	16.2	16.5	16.4	-0.1
Of which : Income and profits tax	4.5	4.2	4.6	0.4
Customs	2.8	3.1	3.0	-0.1
Excise duty	2.7	3.0	3.0	0.0
VAT	5.4	5.3	5.1	-0.2
By source : Domestic taxes	9.8	9.7	10.0	0.2
Import-related taxes	6.4	6.8	6.4	-0.4
Non-tax revenue & other receipts	2.7	2.3	2.3	0.0
Grants	0.4	0.9	0.6	-0.3
Expenditure	25.2	25.1	24.0	-1.1
Recurrent expenditure	20.8	20.6	20.3	-0.3
Of which : Interest payments	1.4	1.6	1.7	0.1
Capital expenditure	4.4	4.5	3.7	-0.8
Memorandum items				
Overall balance	-5.8	-5.3	-4.7	0.6
Prmary balance	-4.5	-3.7	-3.0	0.7
GDP (in NPR billions)	5,348.5	5,957.0	5,792.8	-2.8%

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

[2] Some of the rise in FY2023/24 fiscal revenue reflects a one-off collection from retroactively taxing the gains made through follow-on public offers, mergers and acquisitions and sale of auction shares (0.2 percent of GDP).

[4] Pandemic mobility restrictions limited informal activities and pushed imports to official channels, temporarily raising tax revenue to GDP in 2020-21.

[5] The share of EVs in the import value of vehicles increased from 3 percent in FY2017/18 to 59 percent in FY2022/23, in line with Nepal's ambitious climate goal of reaching net zero emissions by 2045, with a significantly lower effective tax rate at 40 percent, versus 139 percent for combustion engines.

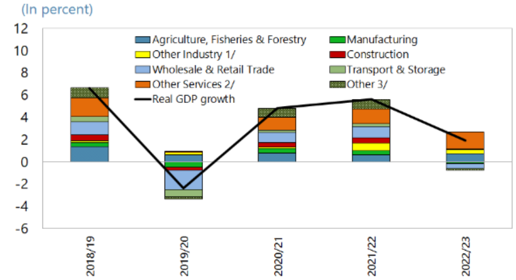
[6] Nepal introduced restrictions to curb imports during the second half of FY2021/22, but these were subsequently lifted in end-December 2022. The imposition of import restrictions may have contributed to an intensification of informal trade, creating more challenges for tax administration. For example, although sugar imports in FY2022/23 were 80 percent below FY2020/21 level, they were 18 percent higher than average sugar imports in FY2019/20 and FY2018/19.

Figure 1. Recent Developments

Contraction in retail, manufacturing, and construction sectors underpinned a slowdown in FY2022/23 growth.

Contribution to GDP Growth by Sector

(In percent)

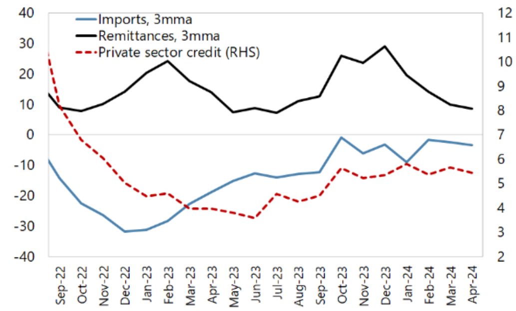


Sources: Nepal Central Bureau of Statistics; and IMF staff calculations.
1/Mining & quarrying; Electricity, gas, steam & air conditioning supply; Water supply, sewage, waste management & remediation activities. 2/Accommodation & food service activities; Information & communication; Financial & Insurance Activities; Real Estate activities; Professional, scientific & technical activities; Administrative & support service activities; Public administration & defence, compulsory social security; Education; Human health & Social work activities; Arts, entertainment and recreation; Other service activities. 3/ Includes taxes, subsidies and statistical discrepancy.

Aggregate demand remains subdued so far in FY2023/24, with credit growth still anemic and contracting imports.

High Frequency Indicators

(In percent, year-on-year change)

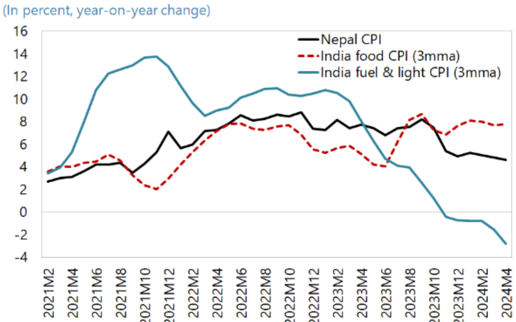


Sources: Nepal authorities; and IMF staff calculations.

Inflation is easing on the back of subdued domestic demand, helped by lower commodity prices.

Consumer Price Index Trends

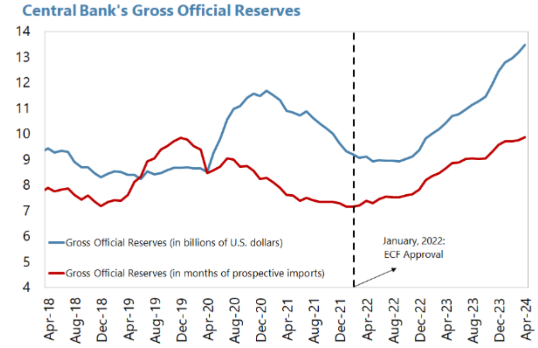
(In percent, year-on-year change)



Sources: Nepali authorities; Haver Analytics; and IMF staff calculations.

External sustainability continues to improve with higher reserves in a context of weak domestic demand.

Central Bank's Gross Official Reserves

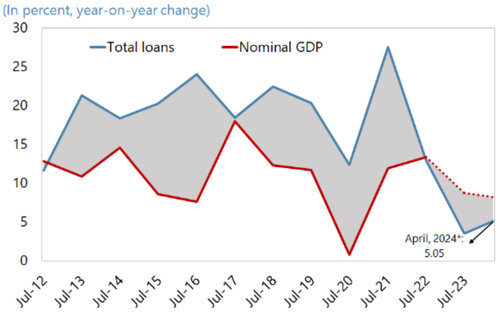


Sources: Nepali authorities; and IMF staff estimates.

Credit growth has fallen well below nominal GDP growth.

Total Loans and Nominal GDP Growth

(In percent, year-on-year change)

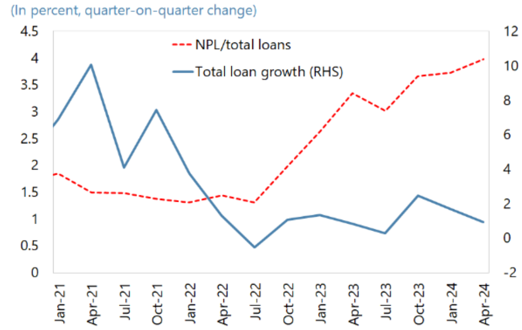


Sources: NRB; Nepal Central Bureau of Statistics; and IMF staff estimates.
Note: GDP growth is projected for FY2023/24.
Note: April 2024 loan growth compared to July 2023 instead of year-on-year.

NPLs have risen amid slow economic growth and regulatory tightening.

Total Loans and NPLs

(In percent, quarter-on-quarter change)



Sources: NRB; and IMF staff calculations.

OUTLOOK AND RISKS

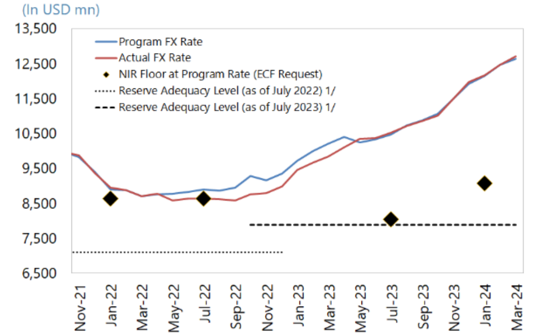
4. **A growth pickup is projected in FY2024/25, and the medium-term outlook remains broadly favorable**. Real GDP growth is projected to rebound to 4.9 percent in FY2024/25, which is close to potential, driven by a pickup in public investment and recovery in domestic demand. With an increase in economic activity, inflation will recover from the recent lows and is projected to remain within the NRB's target ceiling of 5.5 percent for FY2024/25 and beyond. Imports are expected to revive over time, driven by catch-up from pent-up import demand, as well as higher execution of public and private capital expenditure—especially in the energy sector.[7] Slower remittance growth and a pickup in imports are expected to result in a further normalization in the level of reserves and align the external position with fundamentals over the medium term.

5. **Domestic risks dominate the outlook with elevated—and interlinked—risk of political volatility and weak policy execution** (Annex III). Failure to raise the execution rate of capital projects would deprive the economy of much-needed stimulus and weigh on medium-term growth.[8] Fragile political or social stability could further disrupt policy continuity and reform implementation. Intensification of financial sector vulnerabilities such as a further rise in NPLs and weak capitalization or more failures of cooperative lenders could endanger banking system soundness.[9] Continued large emigration for work and education would further reduce the labor force and dampen demand, weighing on medium-term growth prospects. Externally, high commodity prices and trade restrictions in partner economies could slow the recovery in energy-intensive sectors, aggravate food insecurity, and impose fiscal costs. Moreover, Nepal remains vulnerable to natural disasters and climate shocks.

PROGRAM PERFORMANCE

6. **The program is broadly on track**. The January 2024 performance criterion (PC) on net international reserves (floor) was met comfortably. The PC on the primary deficit (ceiling) was met due primarily to spending restraint (Text Table 1). However, the indicative target (IT) on the child allowance spending (floor) was missed due to technical difficulties in implementing a new electronic direct benefit transfer mechanism. The authorities committed to closely monitor the new transfer mechanism,

Net International Reserves
(In USD mn)



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

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[7] Based on the latest power purchase agreements data, Nepal's hydropower generation capacity (3000 MW at present) is projected to double within next four years and triple in the medium term.

[8] More broadly, the budget's low credibility reduces its influence on actual execution, raising uncertainty about fiscal outcomes.

[9] NPLs are expected to further increase once loan portfolio review results are incorporated.

with the goal to achieve full execution of the child grant budget by end-FY2023/24 (MEFP ¶14). All continuous PCs were met (Table 8).

7. Progress continued on reforms implementation (Table 11). Out of five SBs for the 4th review, two were met, one completed with a small delay, and two were missed. The on-site module of the Supervisory Information System (SIS) for class A banks has been implemented. The National Planning Commission approved the Public Investment Management Assessment (PIMA) action plan. The Domestic Revenue Mobilization Strategy was approved by the Finance Ministry in early June. The procurement of international advisors for the Loan Portfolio Review (LPR) started late but is now in full swing. However, the time needed to complete procurement would lead to a launch of the LPR only in end-August 2024 (new proposed date for the SB). Staff and the authorities have pursued discussions on amendments to the NRB Act to reflect the recommendations of the 2021 Safeguards Assessment (SGA), with the aim to strengthen the NRB's autonomy (institutional, functional, personal, financial), governance and accountability framework. It is therefore proposed to reset the SB to end-September 2024 to allow more time for technical discussions before Parliament submission. Progress on reform implementation is also notable for SBs of the 5th review.[10]

POLICY DISCUSSION

With growth below potential, executing the planned increase in capital spending, as envisaged in the FY2024/25 budget, while maintaining fiscal discipline through domestic revenue mobilization and rationalization of current spending, remains critical to boost growth and preserve medium-term fiscal sustainability. As monetary policy transmission is still weak in the context of balance sheet repair, a cautious and data dependent monetary policy is appropriate. Financial policy should remain vigilant and focused on building regulatory frameworks that promote sustainable credit growth while proactively addressing increasing vulnerabilities among savings and credit cooperative organizations (SACCOs).

A. Safeguarding Fiscal Resilience

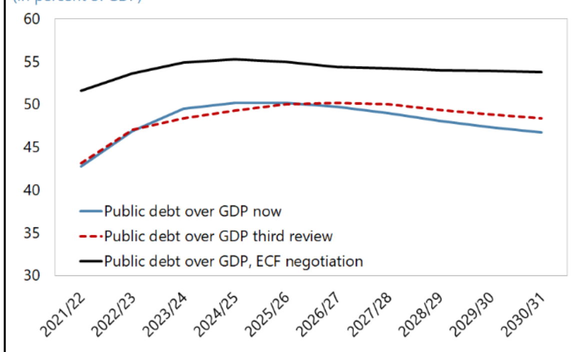
8. The government remains committed to a gradual, growth-friendly fiscal consolidation through tax reforms and expenditure measures in the FY2024/25 budget. The authorities included tax measures, such as introducing a green tax on petroleum products, adjusting tax structures to raise rates on electric and conventional vehicles, increasing excise duties on alcohol, beer, and tobacco, and improving tax compliance, in line with the recently approved Domestic Revenue Mobilization Strategy (DRMS). Revenue gains from these measures will be partially offset by the planned reduction or elimination of duties on some raw materials and intermediate goods to boost domestic production, as well as reinstating VAT exemptions on potatoes, onions, and a few other agricultural products. Revenue projections in the new FY2024/25 budget are more realistic

[10] Audits of the financial statements for three of the four priority nonfinancial PEs have been published (end-August 2024 SB). The government passed amendments to AML/CFT laws, and staff will assess whether they align sufficiently with FATF standards (end-July 2024 SB).

than the current budget but remain sanguine. Staff projects an increase in the revenue-to-GDP ratio of about 1.0 pp of GDP in FY2024/25 (relative to 3.7 percent in the new budget), reflecting import recovery, and gains from ongoing tax reforms.[11] The new budget also projects higher capital expenditure with more contained recurrent expenditure—through rationalization of spending duplication with subnational governments and administrative costs—which bodes well for advancing the growth-friendly fiscal consolidation envisaged under the program. While the child grant allocation was not expanded, the new budget broadens a scholarship program to include students from grades 6 to 12 from marginalized and underprivileged communities to promote equality in human capital development. The fiscal deficit is projected to decline to 4.1 percent of GDP in FY2024/25 (compared to 4.6 in the 3rd review).

9. **The deficit level in the FY2024/25 budget is consistent with program objectives of gradual fiscal consolidation to stabilize public debt at a low risk of distress**. A gradual fiscal consolidation amounting to a reduction of the primary deficit from 3.0 percent of GDP FY2023/24 to 2.5 percent in FY2024/25 and further to 1.1 percent in FY2028/29 is expected to help stabilize public debt at a low risk of debt distress. Both public and external debts are assessed at low risk of debt distress (Debt Sustainability Analysis). Owing to the larger-than-anticipated fiscal consolidation in FY2023/24, public debt is on track to stabilize at 50 percent of GDP by FY2026/27, a year earlier than projected in the 3rd review. The share of external financing is projected to remain below pre-pandemic levels.

Public Debt
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

10. **Continued efforts to enhance domestic revenue mobilization, boost public investment, and support the most vulnerable will undergird medium-term fiscal sustainability**. Implementing the domestic revenue mobilization strategy (DRMS) (end-April 2024 SB, not met, approved June 2024) will help boost tax revenue through enhancements in tax administration and base broadening measures.[12] The DMRS includes plans to reduce the number of VAT-exempt items,

[11] The forecasted 1.0 percentage points of GDP rise in tax revenue for FY2024/25 mainly results from a rebound in imports (0.7 percentage points), new tax measures (0.2 percentage points), and tax administration improvements (0.1 percentage points).

[12] 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) *personal 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

(continued)

impose green tax on petroleum products, plastic items, coal with specific rates indexed to inflation, and rationalize income tax incentives. Considering the large informal economy and significant cross-border informal trade, the DRMS includes commendable tax administration measures such as initiatives to improve ICT use, HR management, and risk-based compliance that could have considerable revenue impact.[13] To boost growth, the authorities aim to ensure a sustained increase of public capital spending, also leveraging external concessional financing, particularly project loans. Based on the approved PIMA action plan (end-April 2024 SB, met), they intend to revise the National Project Bank Operational Procedures and revise the Unified Directives related to project development to enable more robust design, prioritization, and selection of projects based on systematic appraisal (end-March 2025 SB).[14] The authorities should ensure full execution of child grant budgets in the near-term and endeavor to extend the coverage of the program from 25 districts to all 77 districts. Considering risks of natural disasters, including earthquakes, contingency planning to quickly respond to shocks remains essential.

11. Enhancing fiscal transparency will help contain fiscal risks and further strengthen medium-term fiscal sustainability. The authorities are enhancing initial estimates of customs duty exemptions to be included in the comprehensive report on tax expenditure (previous SB) and non-customs-related tax exemptions (VAT, CIT, and PIT; previous SB). To publish a comprehensive report on tax expenditures (end-January 2025 SB), the authorities will leverage the IMF TA, including to cover customs tax expenditures. Covering tax allowances, credits, deferrals, and reliefs in addition to tax exemptions in the report would help guide future tax reforms. The authorities have published a fiscal risk section in the Fiscal Policy Statement of the FY2024/25 budget, building on the fiscal risk registry. The Finance Ministry plans to prepare and publish a comprehensive fiscal risk statement with the FY2025/26 budget (end-August 2025 SB). The authorities are preparing to publish the FY2022/23 annual financial statements of all majority- and wholly-owned public enterprises (PEs) by August 2024 (end-August 2024 SB). Audits of three of the four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation and Nepal Telecom) have been published and the authorities are committed to complete the audit of Nepal Airlines by end-August 2024 (end-August 2024 SB). Building on the new cash flow forecasting framework (previous SB) and with support from IMF TA, the authorities intend to improve budget realism—including revenue forecasts—and reduce

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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.

[13] The DRMS includes plans to review (i) the tax-free allowance and top income bracket for personal income taxation, (ii) the turnover tax and presumptive tax regime, and (iii) investment income tax, all of which should be expedited to lead to specific reform measures that would support revenue collection. Important tax administration measures in the DRMS that need to be swiftly implemented comprise developing a fully automated audit selection module, including risk-based indicators; designing a new automated risk-based selectivity module to identify high risk import declaration; undertaking tax audit (including full audit, investigative audit, concurrent audit, and verification audit) of duly selected taxpayers; reforming staff transfer norms to retain and develop capable staff; and collaborating with local governments to improve the collection of property taxes, including by sharing relevant data.

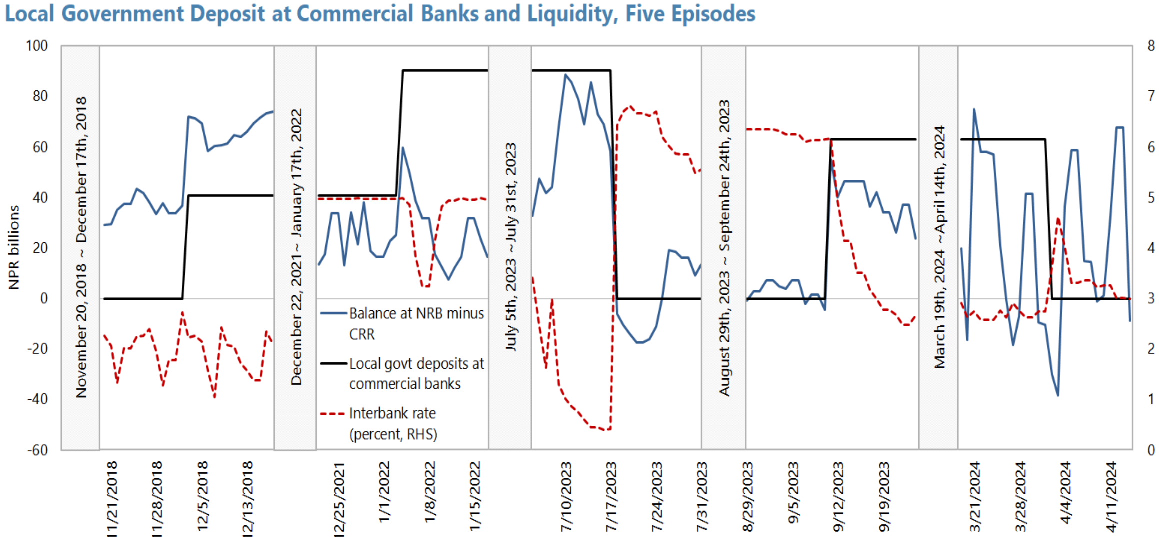
[14] The authorities also aim to update and link the National Project Bank Management Information System (NPBMIS) with the Line Ministries Budget Information System (LMBIS) and the Provincial Project Bank Management Information System with the NPBMIS, and include all multi-year projects in the project bank for monitoring and budgeting.

negative Treasury Single Account (TSA) balances. The authorities have included 88 extrabudgetary units (EBUs) at the Federation level and 5 EBUs at the provincial level in the FY2022/23 FCGO annual financial statements. They are making progress with the intention to include all EBUs in the FY2023/24 financial statements.[15]

B. Preserving Macroeconomic and Financial Stability

12. The monetary policy has *de facto* shifted to a looser stance, but credit market obstacles limit transmission. The monetary target effectively shifted from the midpoint of the interest rate corridor (IRC) to the bottom. With the reduction in December 2023 of the bottom of the corridor by 150 basis points, the *de facto* target rate has fallen by about 400 basis points since July 2023. Credit market disruption and interest rate-setting regulations have so far delayed these from transmitting into credit growth, though lending rates have come down approximately 200 basis points as of May 2024. Moderation of credit growth is an important part of reversing the post-pandemic credit boom and safeguarding financial stability (Annex I). In April 2024, the Finance Ministry ended the policy of counting local government bank deposits in the calculation of deposits. This is welcome although it caused a large shift of money supply (a fall of about 10 percent of money supply).

Local Government Deposit at Commercial Banks and Liquidity, Five Episodes



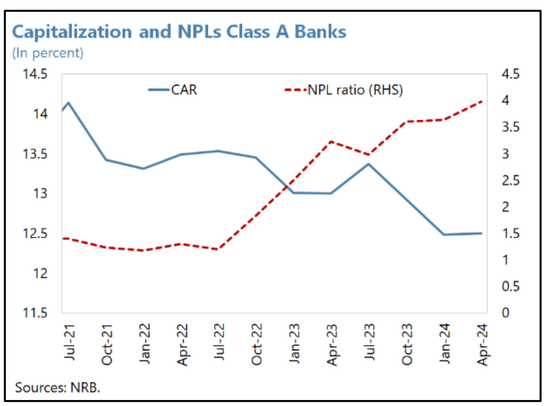
Sources: Nepali authorities; and IMF staff calculations.

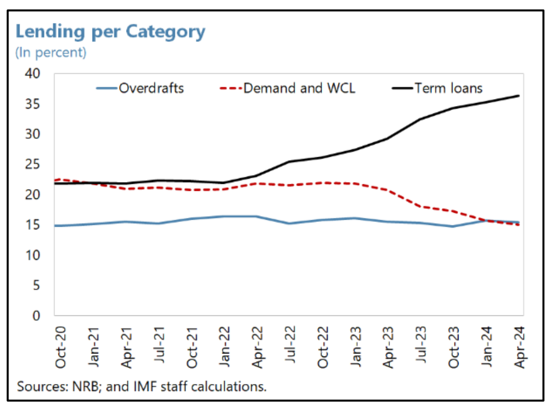
13. Implementing the monetary policy IRC framework would improve market function, regardless of the monetary policy stance. More active intervention to target keeping the interbank rate at the midpoint will support the clarity and credibility of monetary policy. With ample liquidity at present, that means the *de facto* target rate may need to rise if inflationary pressures return and—in conjunction with macroprudential measures—to avoid excessive credit expansion.

[15] The FCGO will include all non-budgetary entities of the government whose annual income or expenditure is more than NPR 50 million, those of provincial governments whose annual income or expenditure is more than NPR 20 million, and those of local levels whose annual income or expenditure is more than NPR 5 million.

Introduction of the Deposit Collection Facility in February 2024 to absorb liquidity at the bottom of the IRC significantly reduced the size of dips of the interbank rate below the IRC. Improved cash flow forecasting by the Finance Ministry—with assistance from upcoming IMF TA—will allow greater coordination on its use of the TSA, helping the NRB calibrate the timing and magnitude of monetary operations.

14. Financial sector vulnerabilities are increasing as banks face mounting capital pressure. Following the post-pandemic credit boom, banks have started to adjust lending practices, reclassifying loans and absorbing losses amid a challenging economic environment. Improvements in the working capital loan guidelines in 2022 and asset classification regulation in 2023 (previous SB) to tackle forbearance and evergreening practices have caused a healthy shift to term lending but also a reassessment of client relationships and an increase in gross NPLs. The NRB phased-out forbearance on restructuring and rescheduling loans in mid-April. The banking system on aggregate remains adequately provisioned with a coverage ratio of 70 percent, but potential differentiation among individual institutions warrants close monitoring. A downturn in the real estate market has hit loan performance and complicated efforts of banks to sell seized collateral, with higher NPLs and ad hoc retroactive taxation (¶3) hurting bank profitability. The aggregate Tier-1 capital ratio of commercial banks has decreased from 10.2 in April 2023 to 9.7 percent in April 2024 relative to the current regulatory minimum of 8.5 percent.[16] Although capital-raising options are currently limited by the NRB, it is considering policies to facilitate issuance of capital instruments. In giving banks more options to raise capital, it would be important for the NRB to align the policy with international standards to avoid that banks finance the acquisition of their own capital instruments as has happened in the past. A likely decrease of the counter-cyclical buffer on the back of a period of weak credit growth in FY2024/25, will provide some relief. This potential reduction is an outcome of the NRB's data-driven approach when setting the level for the counter-cyclical buffer and is appropriate in view of the current credit dynamics.





15. The NRB is preparing a loan portfolio review (LPR) of the ten largest banks. This exercise will help the NRB get a better overview of loan portfolio performance and devise a strategy to address any capital shortfalls or other shortcomings. The NRB agreed to a Terms of Reference for

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[16] This includes the minimum capital requirement of 8 percent and a counter-cyclical buffer of 0.5 percent. Two small commercial banks do not meet the capital requirement by a small margin and are undertaking remedial actions.

the LPR with staff in February 2024. Procurement of an international independent consultant to assist the NRB with the LPR—the main step to enable its launch—started late but is now ongoing. The NRB has committed to—and made progress on—a realistic, detailed, and expedited procurement timeline. The time needed to conclude the procurement, including assessment of bids and onboarding of the consultant, would allow the launch of the LPR in end-August 2024. It is proposed to reset this SB (end-April 2024 SB, not met, reset to end-August 2024). The delay in launching the LPR impacts the SBs on completion as the consultants should be given sufficient time to ensure a quality review, so it is proposed to reset the completion SB (end-December 2024 SB, reset to end-February 2025). This will coincide with the finalization of the roadmap outlining the NRB's approach to the outcome of the LPR (end-February 2025 SB). In anticipation of the roadmap, the NRB will identify reforms related to the bank resolution framework, consistent with the 2023 Financial Sector Stability Report (FSSR) recommendations.

16. The NRB is furthering reforms to enhance the bank supervision framework with the help of IMF TA. With the implementation of the on-site module of the Supervisory Information System (end-April SB, met), the NRB has completed reforms to improve its supervisory data capabilities (including the previous SB). The reintroduction of the counter-cyclical buffer following a two-year suspension enhances the NRB's capacity to manage the credit cycle and support sustainable credit growth. The NRB is also progressing with plans to introduce NFRS 9 and will implement expected credit loss modeling for the banks in the next fiscal year.[17] The LPR is expected to contribute to this initiative as it will be partially based on IFRS 9 (subject to data availability). The NRB is furthermore finalizing the policy framework for the introduction of the Basel III liquidity coverage ratio (LCR) to help strengthen banks' liquidity risk management with a view of implementation in FY2024/25. Finally, the NRB has developed a workplan with staff to implement the recommendations of the 2023 FSSR focusing on the development of off-site analytical tools, improving credit risk supervisory practices and consolidated supervision.

17. Problems in the savings and cooperative sector are expanding. In the last six months several SACCOs have collapsed, causing a loss or freeze of client savings and creating small-scale social unrest. The main cause of the failure is investment in illiquid and underperforming assets—impacting repayment capacity—combined with some cases of fraud. With over 14,000 SACCOs holding an estimated NPR 478 billion of savings deposits—1/12th the size of banking sector deposits in June 2023—there is an increasing risk of negative spillovers to other SACCOs and the smallest regulated banks. The authorities have started to take action by suspending the registration of new SACCOs and are considering reforms to deal with the issues in the sector. A strategy that facilitates a cleanup of the problematic SACCOs, ensures central coordination of the 761 district and provincial SACCO regulators to implement the strategy, and reforms the supervisory and regulatory architecture is needed. In view of likely limited resources, this strategy needs to ensure that the largest financially sound SACCOs remain stable and are appropriately regulated while dealing with the problematic SACCOs. As regards the latter, the strategy should prioritize the remedying of large data gaps, triaging the problematic institutions and implementing strategies to deal with them.

[17] International Financial Reporting Standard (IFRS) 9 applied to Nepal.

Expediting reforms to the regulatory framework and supervisory architecture—including the planned establishment of a specialized regulatory authority to collect data, regulate and supervise financial cooperatives and re-license the SACCOs (see Annex IV)—is essential.

C. Enhancing Governance and Other Structural Reforms to Boost Growth

18. The NRB is making progress implementing the 2021 Safeguards Assessment (SGA) recommendations. Of the 16 recommendations, eight have been fully implemented and the NRB is making progress on the remaining recommendations, albeit slowly. Progress on most SGA recommendations related to legal structure and internal controls in key operations has been limited. Among the remaining recommendations, staff have worked most closely with the authorities to make the draft amendments to the NRB Act consistent with the recommendations in the SGA but further progress remains needed (end-April 2024 SB, not met, reset to September 2024). For the audit of the FY2023/24 financial statement of the NRB, the authorities agreed to involve the service of experts with international experience in central bank auditing (end-July 2024 SB, modified).

19. The government passed amendments to AML/CFT laws and is producing a national strategy to address deficiencies. Staff will assess whether the AML/CFT law amendments align sufficiently with Financial Action Task Force (FATF) standards (end-July 2024 SB). The International Co-operation Review Group (ICRG) observation period to implement reforms necessary to address the findings of the Asia/Pacific Group on Money Laundering's (APG) 2023 assessment ends in October 2024, followed by possible public identification ("grey listing") and formal review by the FATF. The deficiencies in the report, coupled with its publication, could lead to reputational risks and impact access to the financial system.

20. Strengthening economic governance and anticorruption institutions, and accelerating market de-regulation and digitalization efforts would help enhance the business climate and increase investment. Addressing the high cost of doing business remains a priority to unlock the country's potential. Growth and competition could be enhanced through full implementation and enforcement of the Competition Act, enhancing contract and property rights enforcement, improving efficiency and execution of public investment by implementing the PIMA Action Plan (¶10), and modernizing the regulatory framework, including measures to strengthen fiscal federalism (¶11) and facilitate trade diversification. In addition, efforts to enhance governance and combat corruption, such as strengthening anticorruption institutions, are essential for restoring sound business climate and attracting investment. Progressive digitalization of government and judicial administration and services will help promote transparency and reduce corruption. Foreign direct investment (FDI) would benefit from deregulation.[18] The recently approved 16th Development Plan prioritizes efforts to improve agricultural and food security, invest in climate adaptation, and expand social safety nets, with an emphasis on enhancing productivity and supporting job creation in the agricultural sector and improving targeted social protection schemes (MEFP ¶15, ¶27).

[18] This includes removal of burdensome regulatory approval procedures and restrictions on foreign investment in consultancy services, agriculture, and tourism sectors.

PROGRAM MODALITIES

21. Capacity to repay remains adequate. IMF credit outstanding is projected to peak at 14.8 percent of exports and 1.1 percent of GDP in FY2024/25 (Table 9). Nepal's outstanding credit to the IMF relative to key macroeconomic metrics remains low compared to other UCT arrangements of PRGT-eligible countries, while debt service indicators fall within the interquartile range of the comparator group (Figure 8). The authorities' track record of servicing IMF debt is strong.

22. The program is fully financed, with firm commitments in place for the next 12 months. There are good prospects for the remainder of the program. Even though budget support financing in FY2022/23 was lower than projected, pledges for FY2023/24 through FY2024/25 are above the level recorded during the third review (Text Table 2 and Table 5).[19,20] Near-term external financing needs are projected to be lower than during the 3rd review because of smaller-than-expected current account deficits. Prospective financing needs remain, as the current account deficit is projected to widen in the medium term. The authorities intend to use the ECF arrangement for budget support.

Text Table 2. Nepal: Projected Financing Gap
(In percent of GDP)

External financing need			Fiscal financing need		
	FY2023/24	FY2024/25		FY2023/24	FY2024/25
External financing requirement	**-2.7**	**1.5**	Total revenue and grants	19.3	20.2
of which:			Expenditure	24.0	24.4
Current account deficit 1/	-2.6	2.2	**Fiscal deficit**	**4.7**	**4.1**
Financing sources	**-3.5**	**0.6**	**Total financing**	**3.8**	**3.3**
Foreign borrowing	1.4	1.4	Net acquisition of financial assets	1.3	1.3
Current and capital grants	0.9	0.9	Net incurrence of liabilities	5.1	4.6
FDI, net	0.2	0.3	Foreign borrowing	0.7	0.7
Change in reserves (+ decrease)	-6.1	-2.1	Domestic borrowing	4.4	3.8
External financing gap	**0.8**	**0.9**	**Fiscal financing gap**	**0.8**	**0.9**
Financing commitments so far:	0.8	0.9	Financing commitments so far:	**0.8**	**0.9**
IMF: ECF	0.2	0.2	IMF: ECF	0.2	0.2
Asian Development Bank	0.3	0.3	Asian Development Bank	0.3	0.3
World Bank	0.3	0.4	World Bank	0.3	0.4

Sources: Nepali authorities; and IMF staff estimates.
1/ Current account excludes official transfers.
Note: Current baseline forecast is as of June 10, 2024.

[19] The lack of implementation of the reforms underpinning their budget operations caused delay and uncertainty in disbursement from development partners.

[20] The increase in projected budget support by development partners over the next few years is mainly due to an increase in climate-related financing by the World Bank and the Asian Development Bank within the Nepal Green, Resilient, and Inclusive Development action plan, adopted in November 2023 by the government of Nepal and 16 development partners.

23. The program continues to face important risks, but reserve growth has provided a backstop. Political stability and commitment to reforms is key for policy continuity and the implementation of the program. Reform implementation should help improve fiscal performance, especially much-needed capital expenditure. A large adverse commodity price shock would likely require monetary policy tightening, given weakly-anchored inflation expectations, as well as fiscal restraint, following the guardrails provided by the program. Likewise, a significant reduction in remittances could lead to a decline in growth, reserves, and revenues. Spending restraint in response to potential revenue underperformance should protect public investment and social spending. The program includes some flexibility through adjustors on program fiscal 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 strengthened reserve position also provides an increasingly potent backstop to external shocks, necessary for an oil import dependent country in the context of heightened geopolitical risks and uncertainty. The NRB has been maintaining tight regulatory measures and developing liquidity facilities to stave off potential banking problems. The NRB stands ready to provide liquidity support to prevent wider systemic concerns. The NRB plans to enable banks to raise more capital could help stave off any public anxiety about banking sector capitalization and soundness. A systemic event may require government intervention with significant fiscal implications, but intervention should ensure that investors bear the burden of costs, especially since any unanticipated fiscal space should be prioritized to public investment.

24. 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 development of the DRMS and PIMA action plan, implementation of the 2021 SGA recommendations, improvements in revenue administration and, for the next review, preparation of a tax expenditure report. Fund and SARTTAC CD is also underway to improve statistics—mostly on the area of national accounts; strengthening the monetary policy implementation framework; and ensuring sustainability of reforms implemented under previous reviews, such as on cashflow forecasting (previous SB). Prospective CD will continue, focusing on program and SGA implementation as needed, and on strengthening the financial sector, including the development of a road map of reforms for the implementation of the FSSR recommendations. Fund TA is helping to enhance the AML/CFT framework along with other development partners and continues to promote compliance with international standards and address gaps in the effectiveness of the AML/CFT regime.

STAFF APPRAISAL

25. Despite the ongoing deleveraging and necessary balance sheet repair after the post-pandemic credit boom, economic growth is expected to pick up. Real GDP growth is projected to rebound to 4.9 percent in FY2024/25—close to potential—driven by a pickup in public investment and recovery in domestic demand. Both borrowers and banks continue to face balance sheet constraints—hindering lending activity—with public sector capital expenditure execution expected to provide a much-needed boost. Although the external position was stronger than the level implied by medium-term fundamentals and desired policies in FY2023/24, it is projected to weaken as imports revive and remittances slow.

26. Program performance was broadly on track with all PCs met, and a majority of structural benchmarks completed. The PCs on net international reserves and the primary fiscal deficit were met, together with all standard continuous PCs. Only the IT on child allowance spending was missed. Three of five SBs completed (two met) represents a critical mass of measures, with a commitment and clear process to finish the remaining two.

27. The authorities should ensure medium-term fiscal sustainability by swiftly implementing the recently approved DRMS while pursuing rationalization of current spending, enhancing capital outlays and protecting the most vulnerable. To boost revenue collection, the authorities should expedite the implementation of tax policy and administration measures laid out in the recently approved DRMS while accelerating planned reviews to identify additional specific reform measures. Spending priorities include curtailing spending duplication with subnational governments, rationalizing unnecessary administrative costs, and prioritizing social spending, especially child grants. To support growth, the authorities should execute the planned increase in capital expenditure in the FY2024/25 budget, leveraging external concessional financing. The authorities should continue efforts to improve public investment efficiency by implementing the approved PIMA action plan. Additional efforts on structural reforms, including closely monitoring fiscal risks and enhancing fiscal transparency, are needed to further support medium-term fiscal sustainability.

28. Monetary policy should focus on preserving price and external stability, allowing prudential policies to address credit market disruptions. Monetary policy should maintain the current, appropriately cautious and data-driven approach. This should be aided by continued improvement of the toolkit to implement the IRC and more active use of discretionary intervention, which also rests on clear authority and commitment to use the tools.

29. A vigilant and a proactive approach is critical to curb increasing vulnerabilities in the financial sector. Banks are sacco following regulatory adjustments. Aligning regulations on asset classification and lending practices with international standards will support balance sheet repairs and the emergence of more sustainable and pro-growth credit creation. With weak demand, increasing NPLs, and reduced profitability, the NRB needs to continue its close monitoring of banks while developing policies to facilitate their capitalization. In this context, the LPR will contribute to improving 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 will help further enhance financial sector stability. As vulnerabilities in the SACCO sector deepen, it is important that the authorities expedite a cohesive strategy that prioritizes resolving problematic SACCOs in the near term and safeguards sound, large SACCOs while reforming the regulatory framework and supervisory architecture.

30. Aligning the NRB operating framework with international standards is essential to conduct effective monetary policy and undergird financial stability. Implementation of the 2021 SGA 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 submitting to Parliament amendments to the NRB Act to safeguard operational and financial independence.

31. 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 is critical to avoid potentially severe impacts on Nepal's correspondent banking relationships and cost of financial transactions.

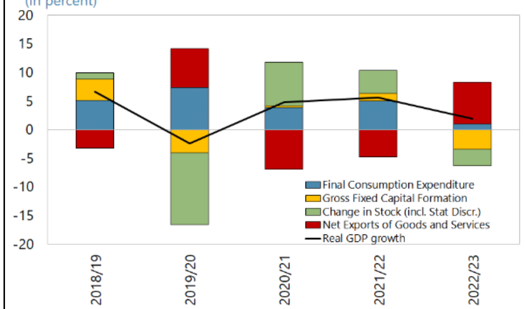
32. Further reforms to address barriers to growth, improve the investment climate, social safety nets, and anticorruption institutions are needed to support growth. Reforms to improve the business environment, reduce the cost of doing business, strengthen governance and anticorruption institutions, develop climate change-resilient systems, build human capital, and strengthen social protection frameworks—remain essential to fostering investment and promoting more inclusive and green growth. Coverage of the child grant program should continue to improve, including by extending it to all districts.

33. Staff supports the completion of the fourth review of the ECF-supported program and the disbursement of fifth tranche in the amount of SDR 31.4 million.

Figure 2. Nepal: Recent Macroeconomic Developments

The slowdown in FY2022/23 was driven by lower domestic demand and investment.

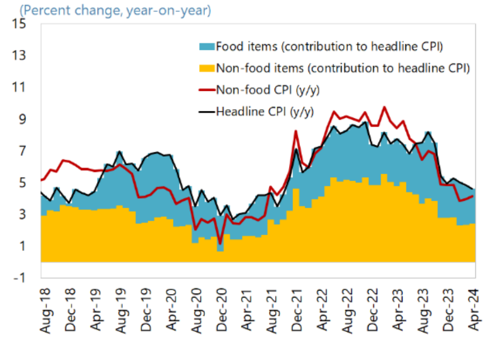
Contribution to Real GDP Growth by Expenditure
(In percent)



Sources: Nepali authorities; and IMF staff calculations.
Note: IMF staff estimates. There is a large statistical discrepancy between the GDP from expenditure approa and the headline GDP from the industry approach.

Inflation has declined from its peak in September 2023, on the back of low demand and favorable commodity prices.

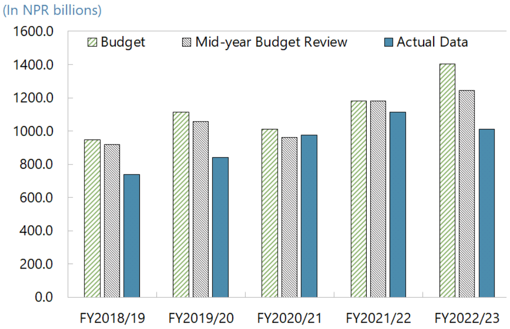
Consumer Price Index
(Percent change, year-on-year)



Sources: Nepali authorities; and IMF staff estimates.

Revenue collection dropped markedly in FY 2022/23

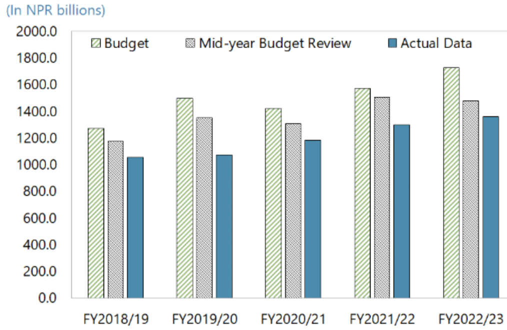
Budget Execution: Revenue
(In NPR billions)



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

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

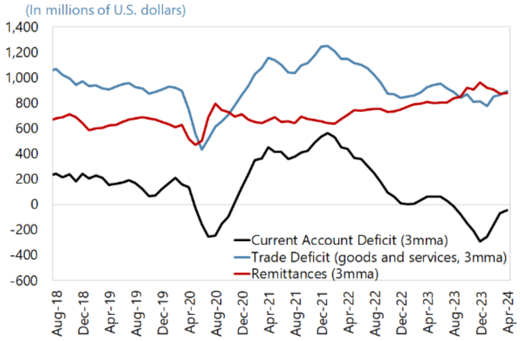
Budget Execution: Expenditure
(In NPR billions)



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

The trade deficit shrank in FY2022/23, driven by lower imports, while remittances remain buoyant.

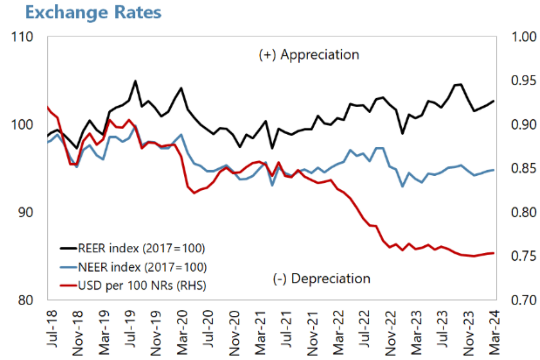
Current Account Deficit
(In millions of U.S. dollars)



Source: Nepali authorities.

The Nepalese Rupee exchange rate to the US dollar, NEER and REER have been stable since 2023.

Exchange Rates

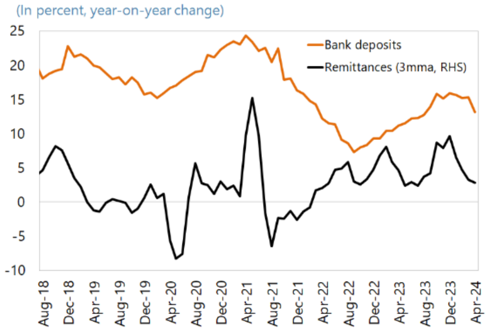


Sources: Nepali authorities; and IMF staff estimates.

Figure 3. Nepal: Recent Monetary Sector Developments

Remittances and deposit growth have eased to 8.6 and 13.2 percent y-o-y, respectively, in April 2024…

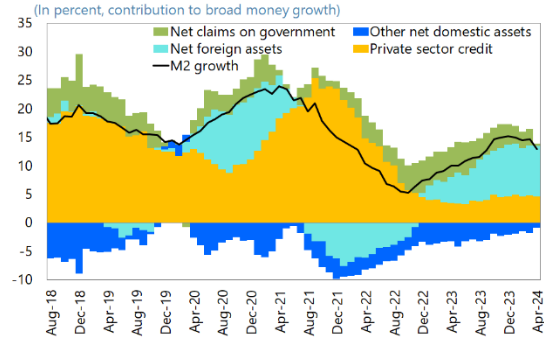
Bank Deposits and Remittances
(In percent, year-on-year change)



Sources: Nepali authorities; and IMF staff calculations.

…bringing broad money growth to 12.9 percent (y-o-y) in April 2024, largely due to net foreign asset accumulation.

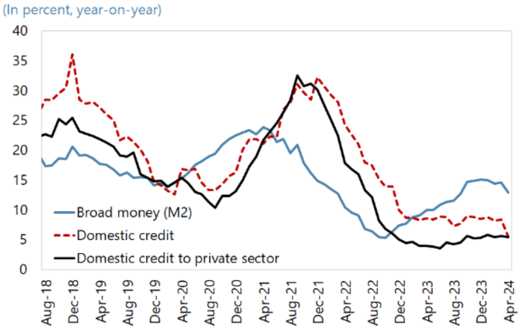
Broad Money Growth
(In percent, contribution to broad money growth)



Sources: Nepali authorities; and IMF staff estimates.

Private sector credit growth remains in single digits, essentially only keeping up with inflation…

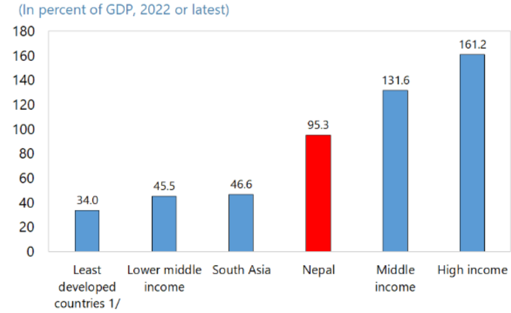
Credit and Money Growth
(In percent, year-on-year)



Sources: NRB; and IMF staff calculations.

…Nonetheless, the private sector credit-to-GDP ratio remains among the highest in its peer group.

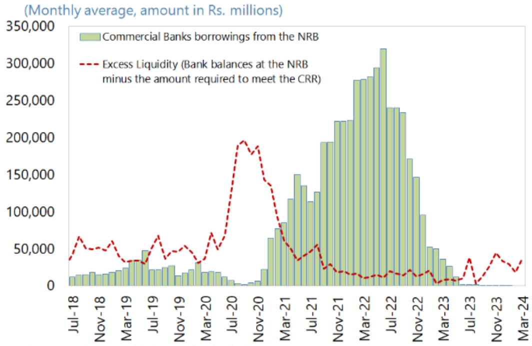
Domestic Credit to Private Sector
(In percent of GDP, 2022 or latest)



Source: World Bank, *World Development Indicators.*
1/ UN Classification.

High deposit and low credit growth led to excess liquidity, although not very high by recent historical standards…

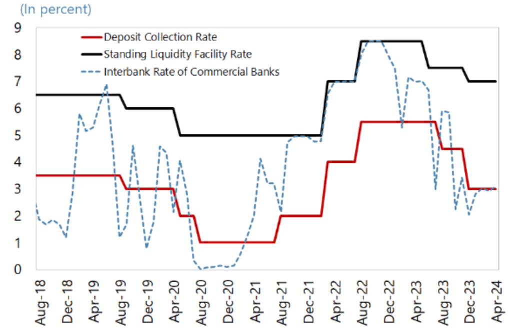
Liquidity Conditions
(Monthly average, amount in Rs. millions)



Sources: NRB; and IMF staff calculations.

…keeping interbank rates at the bottom of the interest rate corridor in a context of weak liquidity absorption.

Short-term Interest Rates
(In percent)



Source: NRB.

Figure 4. Nepal: External Sector Developments

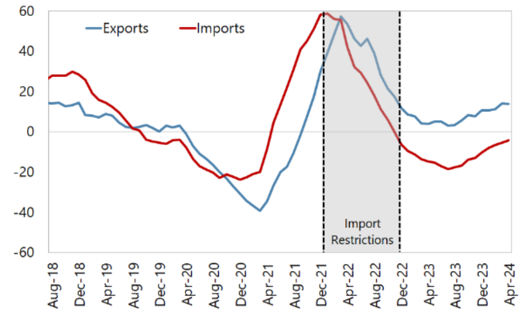
The FY2022/23 current account deficit shrank on the back of import contraction and strong remittances.

Current Account
(In percent of GDP)

Sources: Nepali authorities; and IMF staff estimates.

Imports have continued to contract in FY2023/24 on a year-on-year basis, albeit at a decreasing rate.

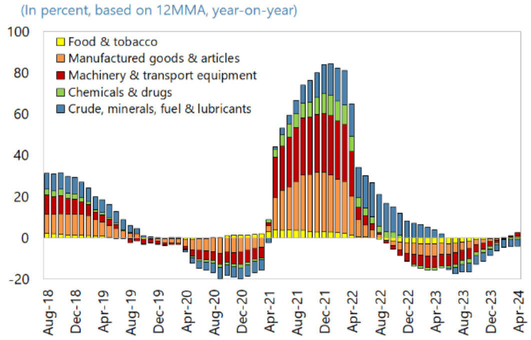
Exports and Imports
(In percent, year-on-year change, 12MMA)



Sources: NRB; and IMF staff calculations.

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

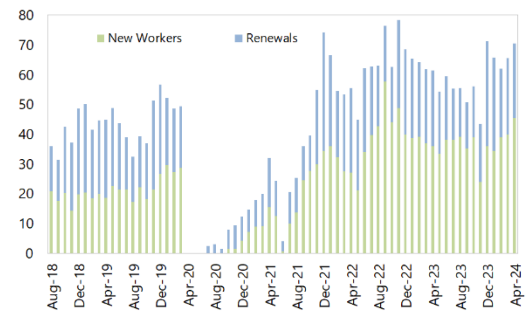
Contribution to Import Growth
(In percent, based on 12MMA, year-on-year)



Sources: Nepali authorities; and IMF staff calculations.

Foreign employment of Nepalis remains resilient, driving robust growth in remittances.

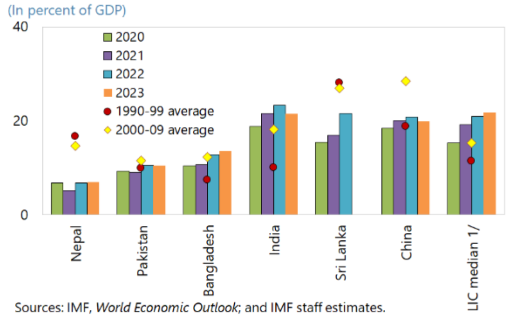
Total Foreign Employment
(Thousands of workers)



Sources: Nepali authorities; and IMF staff estimates.

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

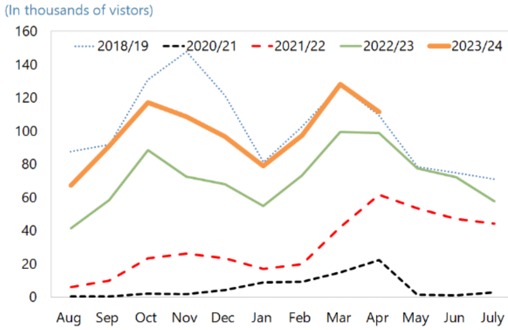
Exports of Goods and Services
(In percent of GDP)



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 $1,135 or less in 2022.

Tourism is rebounding, approaching pre-pandemic levels.

International Visitor Arrivals
(In thousands of vistors)

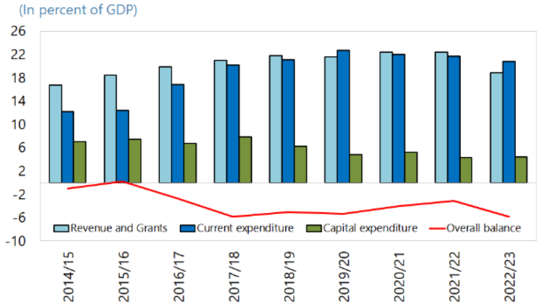


Source: Nepali authorities.

Figure 5. Nepal: Recent Fiscal Developments

The FY2022/23 fiscal deficit has widened to 5.8 percent of GDP driven by a sizable drop in revenue collection.

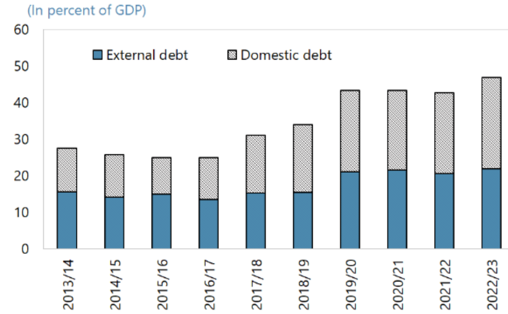
Central Government Fiscal Performance
(In percent of GDP)



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

Total public debt increased to 46.9 percent of GDP in FY2022/23.

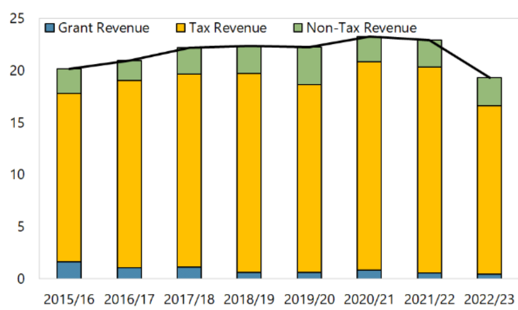
Public Debt
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

Lower tax collection drove the sharp fall in total fiscal revenue in FY2022/23.

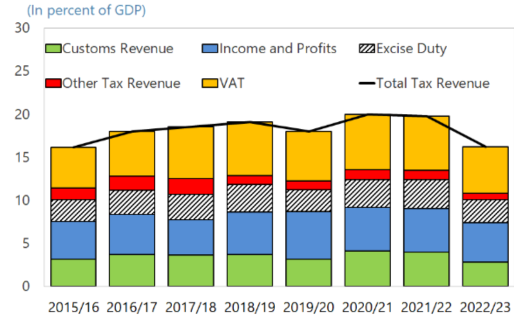
Central Government Fiscal Revenues (Incl. Grants)
(In percent of GDP)



Sources: Nepali authorities; and IMF staff estimates.

Taxes from several sources declined, with the largest decline in VAT, customs, and excise duty.

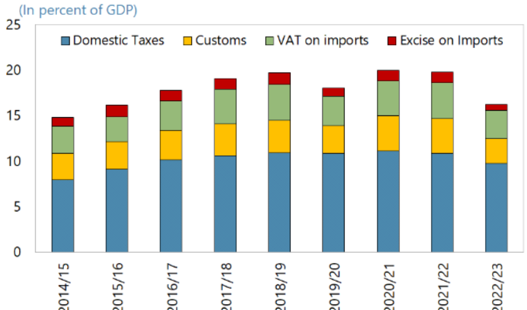
Central Government Tax Revenues
(In percent of GDP)



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.

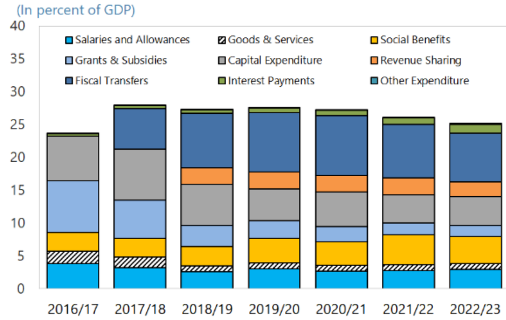
Tax Revenue by Source
(In percent of GDP)



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 FY2022/23.

Central Government Fiscal Expenditure
(In percent of GDP)

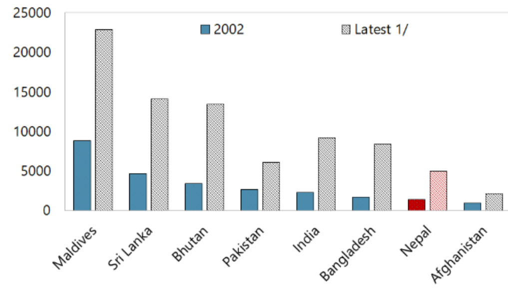


Sources: Nepali authorities; and IMF staff estimates.

Figure 6. Nepal: Socio-Economic Indicators

Nepal is one of the lowest income countries in Asia and South Asia…

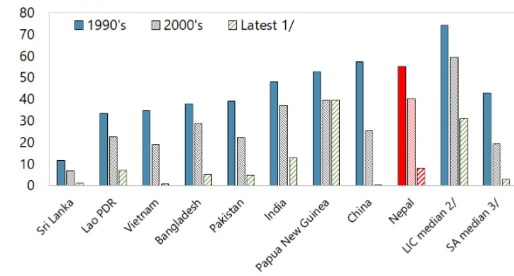
Per Capita GDP (PPP)
(In current international dollars)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.
1/ Maldives (2022); Sri Lanka (2022); Bhutan (2021); Pakistan (2022); India (2022); Bangladesh (2022); Nepal (2022); Afghanistan (2021)

…yet poverty has fallen significantly in the last decade.

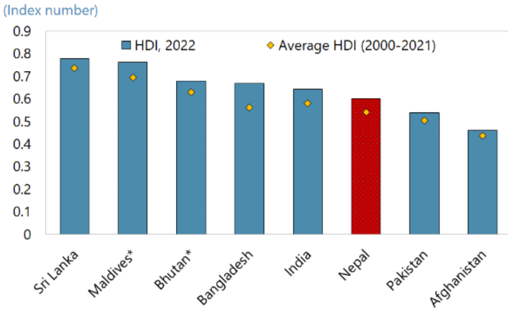
Poverty Headcount Ratio at USD 1.90 per Day
(Percent of population, 2011 PPP)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.
1/ Sri Lanka (2019), Vietnam (2020), Bangladesh (2022); Pakistan (2018), China (2020); Lao P.D.R. (2018); India (2021); Nepal (2010); Papua New Guinea (2009).
2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,135 or less in 2022.
3/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.

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

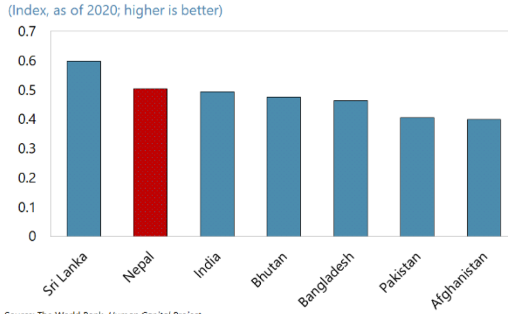
Human Development Index
(Index number)



Sources: UNDP; and IMF staff calculations.
Note: Historical HDI averaged using partial data for Maldives and Bhutan.

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

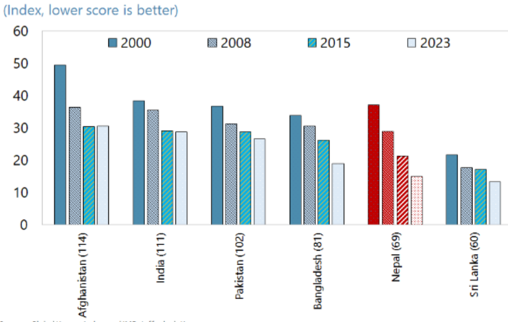
Human Capital Index 1/
(Index, as of 2020; higher is better)



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.

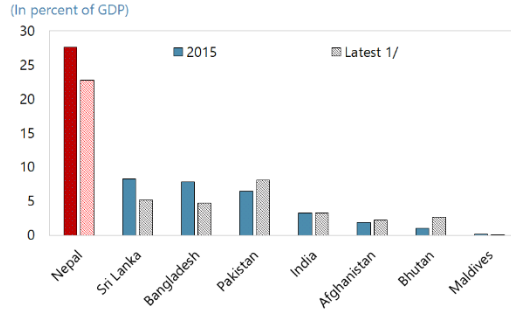
Global Hunger Index 1/
(Index, lower score is better)



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.

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

Remittances Received
(In percent of GDP)

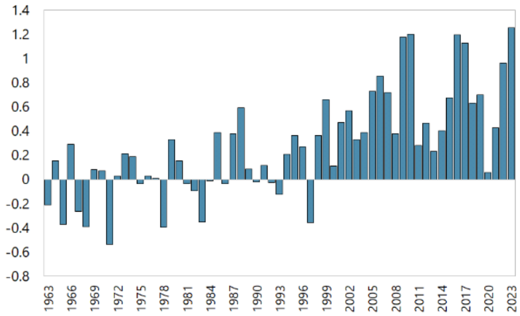


Sources: World Bank, *World Development Indicators*
1/ Nepal (2022), Sri Lanka (2022), Bangladesh (2022), Pakistan (2022), India (2022), Afghanistan (2021), Bhutan (2021), Maldives (2022)

Figure 7. Nepal: Climate Change and Pollution

Average temperatures have risen in Nepal.

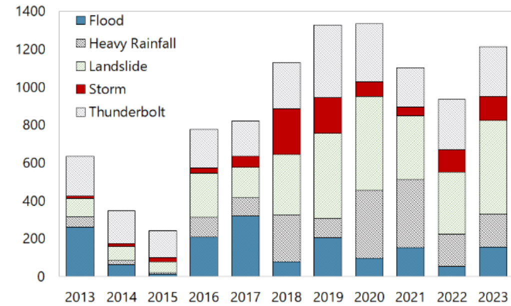
Mean Temperature Change of Meteorological Year
(Change centigrade from 1951-1980 baseline)



Sources: FAO; and IMF Climate Dashboard.

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

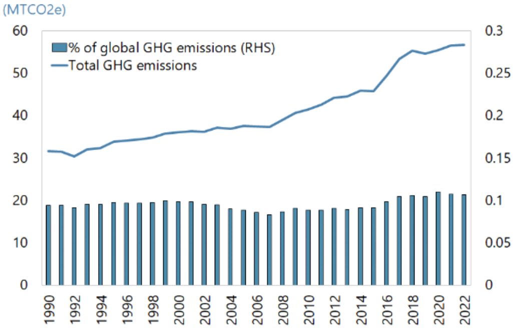
Number of Climate Related Incidents
(Count)



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

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

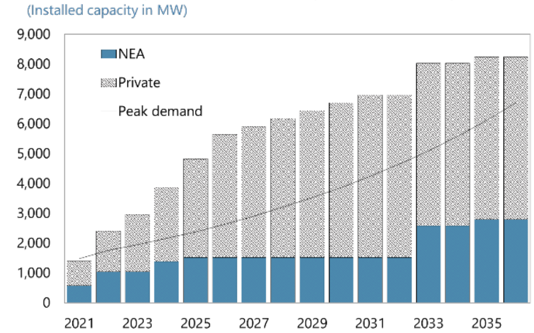
Total GHG Emissions
(MTCO2e)



Source: IMF Climate Dashboard

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

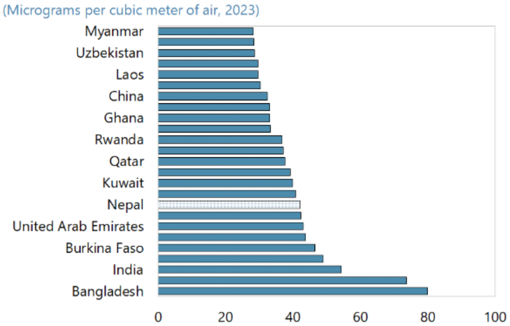
Forecast of Hydropower and Projected Electricity Demand
(Installed capacity in MW)



Source: World Bank CCDR 2022.

Pollution is trapped by Nepal's mountainous geography making it the 9th most polluted country…

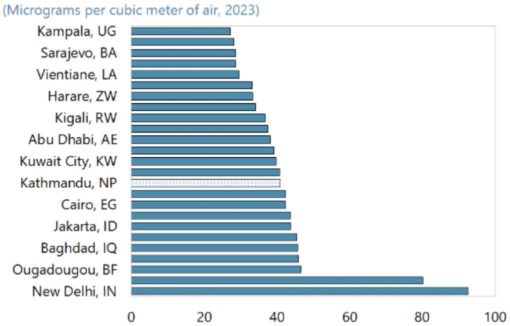
PM2.5 Concentration of the Most Polluted Countries
(Micrograms per cubic meter of air, 2023)



Source: 2023 World Air Quality Report.

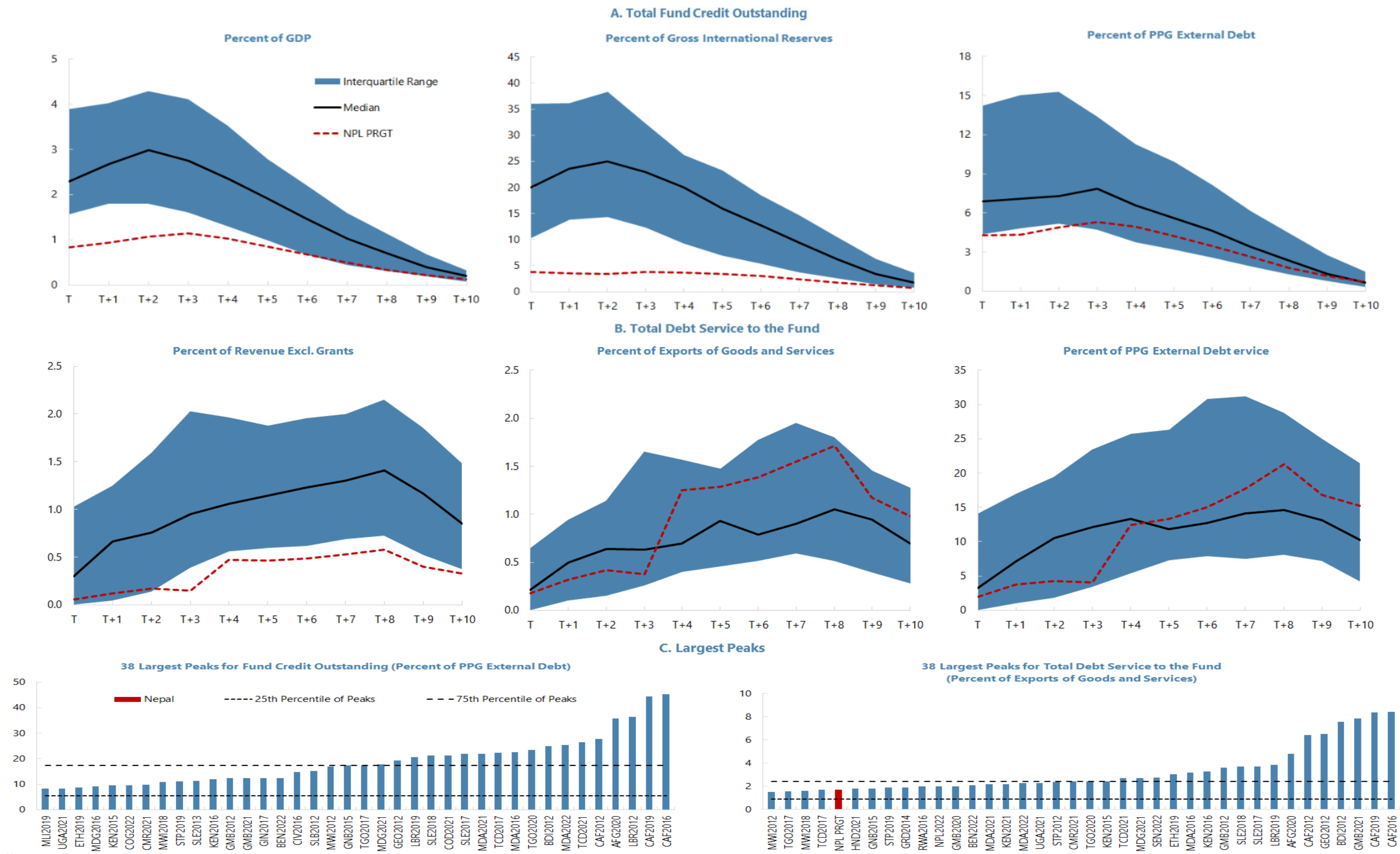
… and Kathmandu is the 11th most polluted capital city.

PM2.5 Concentration of the Most Polluted Capitals
(Micrograms per cubic meter of air, 2023)



Source: 2023 World Air Quality Report.

Figure 8. Nepal: Capacity to Repay



Notes:

1) T = date of arrangement approval. PPG = public and publicly guaranteed.
2) Red lines/bars indicate the CtR indicator for the arrangement of interest.
3) The median, interquartile range, and comparator bars reflect all UCT arrangements (including blends) approved for PRGT countries between 2012 and 2022.
4) PRGT countries in the control group with multiple arrangements are entered as separate events in the database.
5) Comparator series is for PRGT arrangements only and runs up to T+10.
6) Debt service obligations to the Fund reflect prospective payments, including for the current year.
7) In the case of blenders, the red lines/ bars refer to PRGT+GRA. In the case of RST, the red lines/ bars refer to PRGT+GRA+RST.

Table 1. Nepal: Selected Economic Indicators, 2020/21-2028/29 1/

	2020/21	2021/22	2022/23	2023/24		2024/25		2025/26	2026/27	2027/28	2028/29
				Proj.	3rd Rev.	Proj.	3rd Rev.	Projections			
Output and Prices (annual percent change)											
Real GDP	4.8	5.6	2.0	3.1	3.5	4.9	5.2	4.9	5.0	5.0	5.0
Headline CPI (period average)	3.6	6.3	7.8	5.6	7.3	5.2	6.2	5.4	5.4	5.4	5.4
Headline CPI (end of period)	4.2	8.1	7.4	5.0	6.8	5.4	5.5	5.4	5.4	5.4	5.4
Fiscal Indicators: Central Government (in percent of GDP)											
Total revenue and grants	23.3	22.9	19.3	19.3	19.8	20.2	20.8	21.4	22.1	22.7	23.2
of which: Tax revenue	20.0	19.8	16.2	16.4	16.5	17.4	17.6	18.3	19.0	19.7	20.2
Expenditure	27.2	26.1	25.2	24.0	25.1	24.4	25.4	25.0	25.3	25.7	25.9
Expenses	22.0	21.7	20.8	20.3	20.6	19.4	20.7	19.4	19.5	19.7	19.8
Net acquisition of nonfinancial assets	5.3	4.3	4.4	3.7	4.5	5.0	4.7	5.6	5.8	6.0	6.1
Operating balance	1.3	1.2	-1.4	-1.0	-0.8	0.9	0.1	2.0	2.6	3.0	3.4
Net lending/borrowing	-4.0	-3.1	-5.8	-4.7	-5.3	-4.1	-4.6	-3.6	-3.2	-2.9	-2.7
Statistical discrepancy	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	3.9	3.1	5.8	4.7	5.3	4.1	4.6	3.6	3.2	2.9	2.7
Net acquisition of financial assets	3.8	2.6	-0.9	1.3	1.7	1.3	1.7	1.3	1.3	1.3	1.3
Net incurrence of liabilities	7.7	5.8	4.9	6.0	7.0	5.4	6.4	4.9	4.5	4.2	4.0
Foreign	3.4	2.0	1.7	1.6	1.8	1.6	1.4	1.5	1.2	1.2	1.2
Domestic	4.3	3.7	3.3	4.4	5.2	3.8	5.0	3.4	3.3	3.1	2.8
Money and Credit (annual percent change)											
Broad money	21.8	6.8	11.4	12.5	10.4	10.8	11.7	10.5	10.6	10.7	10.7
Domestic credit	26.8	17.9	8.8	8.8	11.3	9.3	11.2	9.4	10.1	10.5	10.7
Private sector credit	26.3	13.3	4.6	5.5	8.6	7.8	8.8	8.2	9.5	10.3	10.6
Saving and Investment (in percent of nominal GDP)											
Gross investment	35.2	37.6	31.7	33.2	35.1	37.6	37.1	39.0	37.8	36.3	35.1
Gross fixed investment	29.3	29.0	25.1	26.3	26.7	29.8	28.2	30.9	29.9	28.8	27.8
Private	24.1	23.6	21.7	22.6	22.2	24.8	23.5	25.3	24.1	22.8	21.7
Central government	5.3	5.3	3.4	3.7	4.5	5.0	4.7	5.6	5.8	6.0	6.1
Change in Stock	5.8	8.7	6.6	6.9	8.4	7.8	8.9	8.1	7.9	7.6	7.3
Gross national saving	27.5	25.1	30.3	36.4	33.5	36.0	33.1	35.0	33.8	32.6	31.5
Private	27.0	24.4	32.2	38.0	35.2	35.7	34.0	33.8	32.1	30.4	29.0
Central government	0.4	0.7	-1.9	-1.6	-1.7	0.3	-0.8	1.1	1.7	2.2	2.6
Balance of Payments											
Current account (in millions of U.S. dollars)	-2,844	-5,174	-557	1,409	-721	-775	-2,015	-2,100	-2,312	-2,419	-2,523
In percent of GDP	-7.7	-12.6	-1.4	3.2	-1.6	-1.6	-4.0	-4.0	-4.0	-3.8	-3.6
Trade balance (in millions of U.S. dollars)	-11,510	-13,759	-10,699	-10,492	-11,813	-13,037	-13,735	-15,067	-15,904	-16,711	-17,580
In percent of GDP	-31.2	-33.4	-26.2	-24.0	-25.7	-27.3	-27.0	-28.6	-27.4	-26.1	-25.0
Exports of goods (y/y percent change)	30.0	43.9	-19.9	-0.7	5.4	14.0	9.3	9.5	9.3	10.0	9.4
Imports of goods (y/y percent change)	25.7	21.9	-22.0	-1.8	9.6	23.1	15.5	14.9	5.9	5.6	5.7
Workers' remittances (in millions of U.S. dollars)	8,150	8,326	9,330	10,679	9,967	11,141	10,356	11,623	12,126	12,651	13,199
In percent of GDP	22.1	20.2	22.8	24.5	21.7	23.3	20.3	22.1	20.9	19.8	18.7
Gross official reserves (in millions of U.S. dollars)	10,884	8,973	10,974	13,564	12,674	14,582	13,225	14,565	14,399	14,398	14,578
In months of prospective imports	7.5	7.6	9.2	9.4	8.4	8.8	8.3	8.3	7.8	7.3	7.0
Memorandum Items											
Public debt (in percent of GDP)	43.3	42.7	47.1	49.7	48.4	50.4	49.3	50.4	50.0	49.3	48.4
Nominal GDP (in billions of U.S. dollars)	36.9	41.2	40.9	43.7	45.9	47.8	50.9	52.6	58.0	63.9	70.4
Nominal GDP (in billions of Nepalese Rupees)	4,353	4,977	5,349	5,793	5,957	6,393	6,653	7,071	7,823	8,657	9,582
Net International Reserves (in millions of U.S. dollars)	10,620	8,821	10,528	13,081	12,146	14,024	12,623	14,012	13,899	13,962	14,222
Primary Deficit (in billions of Nepali Rupees)	138	110	239	173	217	158	194	141	125	114	104
Primary Deficit (in percent of GDP)	3.2	2.2	4.5	3.0	3.6	2.5	2.9	2.0	1.6	1.3	1.1
Tax Revenue (in billions of Nepalese Rupees)	870	984	866	950	986	1,115	1,173	1,292	1,489	1,705	1,932
Tax Revenue (In percent of GDP)	20.0	19.8	16.2	16.4	16.5	17.4	17.6	18.3	19.0	19.7	20.2
Health Expenditure (in percent of GDP)	1.1	2.3	1.7	1.2	1.1	1.2	1.1	1.2	1.2	1.2	1.2
Social Protection/Assistance (in percent of GDP)	1.7	3.7	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8	2.8
CCRT debt relief (in millions of SDR) 2/	7.1	3.6	…	…	…	…	…	…	…	…	…
Private sector credit (in percent of GDP)	95.1	94.2	91.7	89.3	89.4	87.2	87.1	85.3	84.4	84.1	84.1
Exchange rate (NPR/US$; period average)	117.9	120.8	130.8	…	…	…	…	…	…	…	…
Real effective exchange rate (average, y/y percent change)	-2.9	1.6	1.2	…	…	…	…	…	…	…	…

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 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 FY2020/21 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 June 10, 2024.

Table 2a. Nepal: Summary of Central Government Operations, 2020/21-2028/29 1/

(In billions of rupees)

	2020/21	2021/22	2022/23	2023/24	2024/25		2025/26	2026/27	2027/28	2028/29
		Current Baseline Proj.	Current Baseline Proj.	Current Baseline Proj.	Budget	Current Baseline Proj.	Projections			
					(In billions of Nepalese rupees)					
Total Revenue and Grants	1,013	1,141	1,034	1,119	1,472	1,294	1,511	1,730	1,966	2,220
Total revenue	976	1,114	1,011	1,084	1,419	1,256	1,449	1,662	1,897	2,144
Tax revenue	870	984	866	950	1,284	1,115	1,292	1,489	1,705	1,932
of which: Income and profits tax	222	252	243	268	380	306	360	421	483	554
Customs	179	199	151	171	260	210	232	257	285	315
Excise duty	137	167	143	171	195	202	240	278	322	372
VAT	282	314	287	294	387	347	405	471	547	616
Other	50	52	42	45	62	50	55	61	68	75
By source: Domestic taxes	484	541	522	577	761	656	782	928	1,088	1,252
Import-related taxes	386	443	344	373	524	458	510	561	618	680
Non-tax revenue & Other Receipts	106	130	145	134	135	141	156	173	191	212
Of which: Non Tax Revenue	66	81	92	99	135	110	121	134	148	164
Other Receipts	40	49	53	35	0	32	35	39	43	48
Grants 2/	36	27	23	35	52	38	63	68	69	76
Expenditure	1,186	1,297	1,346	1,390	1,652	1,559	1,765	1,982	2,221	2,481
Recurrent expenditure	957	1,081	1,111	1,175	1,300	1,239	1,369	1,529	1,706	1,897
Of which : Interest payments	35	45	73	99	103	106	113	127	141	157
Salaries and allowances	118	136	156	157	160	160	177	196	217	240
Grants & subsidies	101	87	90	101	130	112	117	129	143	158
Social benefits	156	225	219	251	259	253	280	310	343	379
Goods & services	37	48	50	55	55	60	67	74	82	90
Fiscal transfers	395	406	397	382	409	396	438	485	536	594
Revenue sharing 3/	111	128	120	125	159	147	173	203	237	271
Other current expenditure	5	5	6	5	24	5	5	6	7	7
Capital expenditure	229	216	235	215	352	320	396	454	515	584
Operating balance	56	61	-77	-56	172	55	142	202	260	323
Net lending/borrowing	-173	-155	-312	-271	-180	-265	-254	-252	-255	-261
Statistical discrepancy	-2	0	0	0	0	0	0	0	0	0
Net financial transactions	171	155	312	271	180	265	254	252	255	261
Net acquisition of financial assets	166	132	-49	75	68	83	92	102	113	125
Foreign	0	0	0	0	0	0	0	0	0	0
Domestic (net)	166	131	-50	75	67	83	92	101	112	124
Sale of equity	27	36	37	14	11	16	17	19	21	24
Lending minus repayment	34	37	41	61	56	67	74	82	91	101
Change in cash/deposit	104	58	-127	0	0	0	0	0	0	0
Net incurrence of liabilities	337	287	263	347	248	348	346	354	368	386
Foreign	150	101	88	91	108	102	107	93	100	116
Domestic	187	186	174	256	139	246	239	261	268	270
Memorandum Items										
Primary balance (billions of Nepali Rupees)	-138	-110	-239	-173	-77	-158	-141	-125	-114	-104
Primary balance (in percent of GDP)	-3.2	-2.2	-4.5	-3.0	-1.2	-2.5	-2.0	-1.6	-1.3	-1.1
Public debt (in percent of GDP)	43.3	42.7	47.1	49.7	50.4	50.4	50.4	50.0	49.3	48.4
External (in percent of GDP)	21.5	20.6	21.8	22.2	21.5	21.5	21.0	20.2	19.4	18.9
Domestic (in percent of GDP)	21.8	22.2	25.3	27.6	28.8	28.8	29.5	29.8	29.9	29.6
Resources for sub-national governments (billions of Nepalese Rupees)	505	534	518	507	568	543	611	688	774	865
(in percent of GDP)	11.6	10.7	9.7	8.8	8.9	8.5	8.6	8.8	8.9	9.0
Nominal GDP (billions of Nepalese Rupees)	4,353	4,977	5,349	5,793	6,393	6,393	7,071	7,823	8,657	9,582

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

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

Note: Current baseline forecast is as of June 10, 2024.

Table 2b. Nepal: Summary of Central Government Operations, 2020/21-2028/29 1/

(In percent of GDP)

	2020/21	2021/22	2022/23	2023/24	2024/25		2025/26	2026/27	2027/28	2028/29
		Current Baseline Proj.	Current Baseline Proj.	Current Baseline Proj.	Budget	Current Baseline Proj.	Projections			
					(In percent of GDP, unless otherwise indicated)					
Total Revenue and Grants	23.3	22.9	19.3	19.3	23.0	20.2	21.4	22.1	22.7	23.2
Total revenue	22.4	22.4	18.9	18.7	22.2	19.6	20.5	21.3	21.9	22.4
Tax revenue	20.0	19.8	16.2	16.4	20.1	17.4	18.3	19.0	19.7	20.2
of which: Income and profits tax	5.1	5.1	4.5	4.6	5.9	4.8	5.1	5.4	5.6	5.8
Customs	4.1	4.0	2.8	3.0	4.1	3.3	3.3	3.3	3.3	3.3
Excise duty	3.2	3.4	2.7	3.0	3.0	3.2	3.4	3.6	3.7	3.9
VAT	6.5	6.3	5.4	5.1	6.1	5.4	5.7	6.0	6.3	6.4
Other	1.2	1.1	0.8	0.8	1.0	0.8	0.8	0.8	0.8	0.8
By source: Domestic taxes	11.1	10.9	9.8	10.0	11.9	10.3	11.1	11.9	12.6	13.1
Import-related taxes	8.9	8.9	6.4	6.4	8.2	7.2	7.2	7.2	7.1	7.1
Non-tax revenue & Other Receipts	2.4	2.6	2.7	2.3	2.1	2.2	2.2	2.2	2.2	2.2
Of which: Non Tax Revenue	1.5	1.6	1.7	1.7	2.1	1.7	1.7	1.7	1.7	1.7
Other Receipts	0.9	1.0	1.0	0.6	0.0	0.5	0.5	0.5	0.5	0.5
Grants 2/	0.8	0.6	0.4	0.6	0.8	0.6	0.9	0.9	0.8	0.8
Expenditure	27.2	26.1	25.2	24.0	25.8	24.4	25.0	25.3	25.7	25.9
Recurrent expenditure	22.0	21.7	20.8	20.3	20.3	19.4	19.4	19.5	19.7	19.8
Of which : Interest payments	0.8	0.9	1.4	1.7	1.6	1.7	1.6	1.6	1.6	1.6
Salaries and allowances	2.7	2.7	2.9	2.7	2.5	2.5	2.5	2.5	2.5	2.5
Grants & subsidies	2.3	1.8	1.7	1.8	2.0	1.7	1.7	1.6	1.7	1.7
Social benefits	3.6	4.5	4.1	4.3	4.1	4.0	4.0	4.0	4.0	4.0
Goods & services	0.8	1.0	0.9	0.9	0.9	0.9	0.9	0.9	0.9	0.9
Fiscal transfers	9.1	8.2	7.4	6.6	6.4	6.2	6.2	6.2	6.2	6.2
Revenue sharing 3/	2.5	2.6	2.2	2.2	2.5	2.3	2.4	2.6	2.7	2.8
Other current expenditure	0.1	0.1	0.1	0.1	0.4	0.1	0.1	0.1	0.1	0.1
Capital expenditure	5.3	4.3	4.4	3.7	5.5	5.0	5.6	5.8	6.0	6.1
Operating balance	1.3	1.2	-1.4	-1.0	2.7	0.9	2.0	2.6	3.0	3.4
Net lending/borrowing	-4.0	-3.1	-5.8	-4.7	-2.8	-4.1	-3.6	-3.2	-2.9	-2.7
Statistical discrepancy	-0.1	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	3.9	3.1	5.8	4.7	2.8	4.1	3.6	3.2	2.9	2.7
Net acquisition of financial assets	3.8	2.6	-0.9	1.3	1.1	1.3	1.3	1.3	1.3	1.3
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	3.8	2.6	-0.9	1.3	1.1	1.3	1.3	1.3	1.3	1.3
Sale of equity	0.6	0.7	0.7	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Lending minus repayment	0.8	0.8	0.8	1.1	0.9	1.1	1.1	1.1	1.1	1.1
Change in cash/deposit	2.4	1.2	-2.4	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	7.7	5.8	4.9	6.0	3.9	5.4	4.9	4.5	4.2	4.0
Foreign	3.4	2.0	1.7	1.6	1.7	1.6	1.5	1.2	1.2	1.2
Domestic	4.3	3.7	3.3	4.4	2.2	3.8	3.4	3.3	3.1	2.8
Memorandum Items										
Primary balance (billions of Nepali Rupees)	-138	-110	-239	-173	-77	-158	-141	-125	-114	-104
Primary balance (in percent of GDP)	-3.2	-2.2	-4.5	-3.0	-1.2	-2.5	-2.0	-1.6	-1.3	-1.1
Public debt (in percent of GDP)	43.3	42.7	47.1	49.7	50.4	50.4	50.4	50.0	49.3	48.4
External (in percent of GDP)	21.5	20.6	21.8	22.2	21.5	21.5	21.0	20.2	19.4	18.9
Domestic (in percent of GDP)	21.8	22.2	25.3	27.6	28.8	28.8	29.5	29.8	29.9	29.6
Resources for sub-national governments (billions of Nepalese Rupees)	505	534	518	507	568	543	611	688	774	865
(in percent of GDP)	11.6	10.7	9.7	8.8	8.9	8.5	8.6	8.8	8.9	9.0
Nominal GDP (billions of Nepalese Rupees)	4,353	4,977	5,349	5,793	6,393	6,393	7,071	7,823	8,657	9,582

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 million.

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

Note: Current baseline forecast is as of June 10, 2024.

Table 3. Nepal: Balance of Payments, 2020/21-2028/29 1/

	2020/21	2021/22	2022/23	2023/24		2024/25		2025/26	2026/27	2027/28	2028/29
				Proj.	3rd Rev.	Proj.	3rd Rev.	Projections			
					(in millions of US dollars)						
Current Account	-2,844	-5,174	-557	1,409	-721	-775	-2,015	-2,100	-2,312	-2,419	-2,523
Current account (excluding official transfers)	-3,052	-5,312	-657	1,147	-1,142	-1,062	-2,470	-2,566	-2,814	-2,929	-3,086
Trade balance	-11,510	-13,759	-10,699	-10,492	-11,813	-13,037	-13,735	-15,067	-15,904	-16,711	-17,580
Exports, f.o.b.	1,219	1,754	1,406	1,396	1,481	1,591	1,619	1,743	1,905	2,095	2,292
Imports, f.o.b.	-12,729	-15,513	-12,104	-11,888	-13,295	-14,628	-15,353	-16,810	-17,809	-18,806	-19,872
Services (net)	-618	-893	-642	-557	-664	-600	-530	-646	-667	-640	-673
Receipts	671	1,008	1,439	1,888	1,803	2,116	2,204	2,343	2,524	2,782	3,067
Of which : tourism	62	268	470	655	689	909	968	1,052	1,159	1,278	1,409
Payments	-1,290	-1,901	-2,081	-2,445	-2,466	-2,716	-2,734	-2,990	-3,190	-3,422	-3,739
Income	198	238	476	707	425	488	392	484	475	524	578
Credit	517	474	733	983	713	837	763	868	898	991	1,092
Debit	-318	-237	-258	-275	-289	-349	-371	-384	-423	-467	-514
Current transfers	9,086	9,241	10,308	11,750	11,332	12,375	11,857	13,129	13,784	14,407	15,152
Credit, of which:	9,137	9,305	10,368	11,806	11,390	12,436	11,923	13,196	13,858	14,489	15,242
General government	208	138	100	262	421	287	455	465	503	510	562
Workers' remittances	8,150	8,326	9,330	10,679	9,967	11,141	10,356	11,623	12,126	12,651	13,199
Debit	-51	-64	-59	-56	-59	-61	-65	-67	-74	-82	-90
Capital Account 2/	130	116	98	149	240	149	237	233	251	255	281
Financial Account	2,139	2,546	1,551	1,087	2,222	1,638	2,352	1,868	1,909	2,178	2,437
Direct investment	166	155	45	66	188	167	311	237	261	288	317
Portfolio investment	0	0	0	0	0	0	0	0	0	0	0
Other investment (net)	1,974	2,391	1,506	1,022	2,034	1,471	2,041	1,631	1,648	1,890	2,120
Of which: Trade credit	856	858	911	367	812	494	929	572	622	692	772
Official loans 3/	881	760	516	685	822	763	694	794	688	738	852
Errors and Omissions	721	980	1,045	0	0	0	0	0	0	0	0
Overall Balance	146	-1,533	2,137	2,646	1,741	1,013	573	0	-151	14	195
					(in percent of GDP)						
Current Account	-7.7	-12.6	-1.4	3.2	-1.6	-1.6	-4.0	-4.0	-4.0	-3.8	-3.6
Current account (excluding official transfers)	-8.3	-12.9	-1.6	2.6	-2.5	-2.2	-4.8	-4.9	-4.9	-4.6	-4.4
Trade balance	-31.2	-33.4	-26.2	-24.0	-25.7	-27.3	-27.0	-28.6	-27.4	-26.1	-25.0
Exports, f.o.b.	3.3	4.3	3.4	3.2	3.2	3.3	3.2	3.3	3.3	3.3	3.3
Imports, f.o.b.	-34.5	-37.7	-29.6	-27.2	-29.0	-30.6	-30.1	-31.9	-30.7	-29.4	-28.2
Services (net)	-1.7	-2.2	-1.6	-1.3	-1.4	-1.3	-1.0	-1.2	-1.2	-1.0	-1.0
Receipts	1.8	2.4	3.5	4.3	3.9	4.4	4.3	4.5	4.4	4.4	4.4
Of which: tourism	0.2	0.7	1.1	1.5	1.5	1.9	1.9	2.0	2.0	2.0	2.0
Payments	-3.5	-4.6	-5.1	-5.6	-5.4	-5.7	-5.4	-5.7	-5.5	-5.4	-5.3
Income	0.5	0.6	1.2	1.6	0.9	1.0	0.8	0.9	0.8	0.8	0.8
Credit	1.4	1.2	1.8	2.3	1.6	1.8	1.5	1.7	1.6	1.6	1.5
Debit	-0.9	-0.6	-0.6	-0.6	-0.6	-0.7	-0.7	-0.7	-0.7	-0.7	-0.7
Current transfers											
Credit, of which:	24.7	22.6	25.3	27.0	24.8	26.0	23.4	25.1	23.9	22.7	21.6
General government	0.6	0.3	0.2	0.6	0.9	0.6	0.9	0.9	0.9	0.8	0.8
Workers' remittances	22.1	20.2	22.8	24.5	21.7	23.3	20.3	22.1	20.9	19.8	18.7
Debit	-0.1	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital Account 2/	0.4	0.3	0.2	0.3	0.5	0.3	0.5	0.4	0.4	0.4	0.4
Financial Account	5.8	6.2	3.8	2.5	4.8	3.4	4.6	3.6	3.3	3.4	3.5
Direct investment	0.4	0.4	0.1	0.2	0.4	0.3	0.6	0.5	0.5	0.5	0.5
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.3	5.8	3.7	2.3	4.4	3.1	4.0	3.1	2.8	3.0	3.0
Of which: Trade credit	2.3	2.1	2.2	0.8	1.8	1.0	1.8	1.1	1.1	1.1	1.1
Official loans	2.4	1.8	1.3	1.6	1.8	1.6	1.4	1.5	1.2	1.2	1.2
Errors and Omissions	2.0	2.4	2.6	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	0.4	-3.7	5.2	6.1	3.8	2.1	1.1	0.0	-0.3	0.0	0.3
Memorandum Items											
Imports (y/y percent change)	25.7	21.9	-22.0	-1.8	9.6	23.1	15.5	14.9	5.9	5.6	5.7
Exports of G&S (in percent of GDP)	5.1	6.7	7.0	7.5	7.2	7.8	7.5	7.8	7.6	7.6	7.6
Imports of G&S (in percent of GDP)	38.0	42.3	34.7	32.8	34.3	36.3	35.5	37.6	36.2	34.8	33.5
Remittances (y/y percent change)	8.2	2.2	12.1	14.5	6.8	4.3	3.9	4.3	4.3	4.3	4.3
Total external debt (in percent of GDP)	25.5	24.9	26.4	25.7	26.1	25.4	25.6	25.0	24.3	23.8	23.4
Gross official reserves (in mil U.S. dollars)	10,884	8,973	10,974	13,564	12,674	14,582	13,225	14,565	14,399	14,398	14,578
In months of prospective imports	7.5	7.6	9.2	9.4	8.4	8.8	8.3	8.3	7.8	7.3	7.0
As a share of broad money (in percent)	25.2	20.8	23.5	26.4	24.5	25.6	23.0	23.2	20.9	18.9	17.4
Net international reserves (in mil. U.S. dollars) 3/	10,620	8,821	10,528	13,081	12,146	14,024	12,623	14,012	13,899	13,962	14,222
Nominal GDP (in mil U.S. dollars)	36,927	41,183	40,907	43,673	45,911	47,826	50,950	52,622	57,968	63,907	70,443

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 June 10, 2024.

Table 4. Nepal: Monetary Indicators, 2020/21-2024/25 1/

	2020/21	2021/22	2022/23	2023/24		2024/25	
				Proj.	3rd Rev.	Proj.	3rd Rev.
Nepal Rastra Bank	(In billions of Nepalese rupees, end-period)						
Reserve money	932	826	912	976	1,021	1,040	1,107
Net domestic assets	-367	-319	-528	-844	-635	-914	-633
Claims on public sector	-137	-175	3	-15	-28	-7	-25
Claims on private sector	3	7	7	5	5	5	5
Claims on banks & financial institutions	123	270	1	4	55	5	54
Other items (net)	-356	-420	-539	-839	-668	-917	-667
Net foreign assets	1,299	1,145	1,440	1,821	1,656	1,954	1,740
Monetary Survey							
Broad money	5,155	5,505	6,130	6,896	6,769	7,638	7,563
Narrow money	1,049	948	947	1,362	1,337	1,508	1,493
Quasi-money	4,105	4,557	5,184	5,535	5,433	6,130	6,069
Net domestic assets	3,804	4,281	4,577	4,989	5,040	5,584	5,746
Domestic credit	4,811	5,672	6,169	6,713	6,868	7,340	7,636
Credit to public sector	671	983	1,266	1,540	1,541	1,763	1,843
of which : Credit to central government	593	744	1,005	1,248	1,300	1,482	1,616
Credit to private sector	4,140	4,689	4,903	5,173	5,326	5,577	5,794
Other items(net)	-1,007	-1,391	-1,591	-1,724	-1,828	-1,757	-1,891
Net foreign assets	1,351	1,225	1,553	1,907	1,729	2,054	1,817
	(Twelve-month percent change)						
Reserve money	5.2	-11.4	10.4	7.1	12.0	6.5	8.4
Broad money	21.8	6.8	11.4	12.5	10.4	10.8	11.7
Net domestic assets	31.1	12.5	6.9	9.0	10.3	11.9	14.0
Domestic credit	26.8	17.9	8.8	8.8	11.3	9.3	11.2
Credit to public sector	30.1	46.4	28.8	21.7	21.8	14.5	19.6
Credit to private sector	26.3	13.3	4.6	5.5	8.6	7.8	8.8
Net foreign assets	1.7	-9.3	26.8	22.8	10.6	7.7	5.1
Memorandum Items							
Private credit (in percent of GDP)	95.1	94.2	91.7	89.3	89.4	87.2	87.1
Net international reserves (in mil. U.S. dollars) 2/	10,620	8,821	10,528	13,081	12,146	14,024	12,623
Net Foreign Assets, NRB (in percent of GDP)	29.8	23.0	26.9	31.4	27.8	30.6	26.1
Nominal GDP (in billions of Nepalese Rupees)	4,353	4,977	5,349	5,793	5,957	6,393	6,653

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 June 10, 2024.

Table 5. Nepal: External Financing Requirements and Sources, FY2022/23-2025/26 1/

(In millions of U.S. dollars)

	2022/23	2023/24	2023/24	2024/25	2024/25	2025/26
		Proj.	3rd Rev.	Proj.	3rd Rev.	Proj.
Gross external financing requirements	**-1,114**	**-1,168**	**173**	**697**	**1,380**	**2,138**
Current account excluding official transfers (+ = deficit)	657	-1,147	1,142	1,062	2,470	2,566
Amortization of medium- and long-term debt	264	316	243	343	256	409
Other net capital flows (- = outflow) 2/	2,035	337	1,212	709	1,347	837
Available financing	**-1,337**	**-1,537**	**-246**	**283**	**1,146**	**1,696**
Current and capital grants	198	411	661	436	691	698
Medium- and long-term borrowing excluding exceptional financing	557	632	646	692	717	762
FDI, net	45	66	188	167	311	237
Portfolio investment, net	0	0	0	0	0	0
Change in reserves (+ = decrease) 3/	-2,137	-2,646	-1,741	-1,013	-573	0
Financing Gap	**223**	**369**	**419**	**414**	**234**	**442**
Exceptional/additional financing 4/	**223**	**369**	**419**	**414**	**234**	**442**
IMF: ECF arrangement	52.3	94.1	94.1	83.7	83.7	41.8
Asian Development Bank	75	150	125	150	50	200
World Bank	96	125	200	180	100	200
Memorandum items						
Gross official reserves (in millions of U.S. dollars)	10,974	13,564	12,674	14,582	13,225	14,565
In months of prospective imports	9.2	9.4	8.4	8.8	8.3	8.3

1/ Fiscal year ends mid-July.

2/ Other includes currency and deposits, trade credits and other financial flows, as well as net errors and omissions

3/ Net of valuation changes.

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

Note: Current baseline forecast as of June 10, 2024

Table 6. Nepal: Financial Soundness Indicators, FY2019/20-2023/24 Q3

	2019/20	2020/21	2021/22	2022/23	2023/24 Q3
Capital Adequacy					
Regulatory capital to risk weighted assets	14.16	14.19	13.58	13.42	12.59
Tier 1 capital to risk weighted assets	12.01	11.12	10.81	10.59	9.78
Asset Quality					
NPLs to total gross loans	1.89	1.48	1.31	3.02	3.98
Loan loss provisions to NPLs	65.90	70.24	68.25	62.17	69.93
Deposits and Credits					
Credit to deposit ratio 1/	...	...	86.22	81.63	80.88
Credit to core captial cum deposit 1/	69.58	76.32	...	...	...
Liquidity					
Cash & bank balance to total deposits	12.21	9.51	8.03	8.05	8.14
Total liquid assets to total deposits	27.90	26.18	27.52	27.10	27.87
Exposure to Real Estate					
Share of real estate and housing loans	12.71	11.54	12.01	12.27	12.46
Share of loans collateralized by fixed assets	76.04	74.71	75.06	76.87	76.96
Revolving Loans					
Overdraft 2/	14.93	15.19	15.25	15.32	15.38
Demand & working capital loans	21.45	21.09	21.51	18.04	15.05

Sources: NRB; and IMF 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 relevant year unless indicated otherwise.

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 separately 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	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)

	FY2022/23				FY2023/24				FY2023/24	FY2024/25	
	16-Jul-23				14-Jan-24				15-Jul-24	13-Jan-25	15-Jul-25
	Program target	Adjusted target	**Outturn**	Status	Program target	Adjusted target	**Outturn**	Status	Program target	Program target	Program target
Quantitative performance criteria under the ECF-supported program:											
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7,12/					435,959	440,278	**178,827**	met	315,628	233,270	256,943
Stock of NRB's net international reserves (floor; in U.S. dollars million) 1,8,9/	8,038	6,998	**10,473**	met	9,076	9,014	**12,144**	met	9,076	9,649	9,845
Accumulation of external payments arrears (ceiling) 2/	0	0	**0**	met	0	0	**0**	met	0	0	0
Indicative targets under the ECF-supported program:											
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7,12/	256,523	355,213	**315,070**	met							
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	6,987	6,987	**6,763**	not met	3,092	3,092	**1,674**	not met	6,987	3,092	6,987
Indicative target: floor on tax revenue of the federal government 10,13/									845,938	392,743	902,288
Memorandum items:											
Budget support from development partners (in U.S. dollars million) 1,11/	330		171		162		**100**		325	334	493
Revenues of the budgetary central government under the program (in NPR million) 1,3/	968,166		838,029		341,044		438,939		..	..	..
Revenue targets of the budgetary central government (in NPR million) 1,3/	1,066,000		..		563,983				1,248,620	..	1,125,209
Primary deficit adjustor for revenue (in NPR million) 6/	..		109,170		..		0		..	..	..
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 6/	109,170		..		61,009				..	..	..
Foreign-financed project loan disbursements (in NPR million) 1,3/	104,207		93,727		13,977		18,295		83,832	12,501	92,620
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 1,3/	..		-10,480		..		4,319		..	..	..

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 the level of revenue collection (same ceiling as for the target for primary deficit). Any downward adjustment to the NIR floor will be capped at USD 612 million for the next 12 months to maintain reserve adequacy. The revenue adjustor will be phased out starting at the July 15, 2024 test date.

9/ NIR floor target for July 15 2024 testing date is set about 0.8 months of imports above the adequacy level to provide margin in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy. The margin is being gradually reduced to 0.6 months of imports for subsequent targets.

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 July 14 2024, January 13 2025, and Juy 15 2025 testing dates the figures are cumulative of the period from January 15 2024 to July 14 2024, January 15 2024 and January 13 2025, and January 15 2024 to July 15 2025 respectively.

12/ Revenue sharing for province and local levels and other receipts are also excluded.

13/ Revenue sharing for province and local levels, nontax revenue and other receipts are also excluded.

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) 2/														
Principal	7.1	7.1	34.9	39.2	47.1	58.8	62.8	31.4	23.5	15.7	3.9	0.0	0.0	0.0
Charges and interest	3.2	3.4	3.4	3.4	3.5	3.4	3.4	3.4	3.5	3.4	3.4	3.4	3.5	3.4
Fund obligations based on existing and prospective credit (millions of SDR)														
Principal	7.1	7.1	34.9	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	3.2	3.4	3.4	3.4	3.5	3.4	3.4	3.4	3.5	3.4	3.4	3.4	3.5	3.4
Total obligations based on existing and prospective credit														
Millions of SDR	10.3	10.6	38.4	42.7	50.5	62.3	75.6	56.8	52.1	44.2	32.5	19.1	6.6	3.4
Billions of Nepali Rupees	1.8	1.9	6.9	7.7	9.1	11.3	13.8	10.3	9.5	8.0	5.9	3.5	1.2	0.6
Percent of exports of goods and services	0.4	0.4	1.3	1.3	1.4	1.6	1.7	1.2	1.0	0.8	0.5	0.3	0.1	0.0
Percent of debt service	0.7	0.6	2.1	2.1	2.3	2.6	2.9	2.0	1.7	1.3	0.9	0.5	0.2	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	0.2	0.1	0.5	0.5	0.5	0.5	0.6	0.4	0.3	0.3	0.2	0.1	0.0	0.0
Percent of quota	6.6	6.7	24.5	27.2	32.2	39.7	48.2	36.2	33.2	28.2	20.7	12.2	4.2	2.2
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	62.4	72.8	72.9	66.3	58.2	47.8	34.7	25.0	16.1	8.7	3.4	0.6	0.0	0.0
Percent of exports of goods and services	14.4	14.8	13.3	11.1	8.8	6.6	4.3	2.8	1.7	0.8	0.3	0.0	0.0	0.0
Percent of debt service	24.2	25.1	22.3	18.2	14.4	10.8	7.2	4.8	2.9	1.4	0.5	0.1	0.0	0.0
Percent of GDP	1.1	1.1	1.0	0.8	0.7	0.5	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.0
Percent of government revenue	5.8	5.8	5.0	4.0	3.1	2.2	1.5	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	70.6	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	7.1	7.1	34.9	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)	2,468	2,790	3,069	3,320	3,649	4,001	4,396	4,830	5,307	5,830	6,406	7,038	7,733	8,496
Debt service (billions of NPR)	257.6	290.0	326.5	363.9	402.7	442.7	481.4	517.7	564.1	613.0	668.4	729.0	797.0	871.1
Nominal GDP (at market prices, billions of NPR)	5,793	6,393	7,071	7,823	8,657	9,581	10,603	11,735	12,987	14,372	15,906	17,603	19,481	21,560
Government revenue (billions of NPR)	1,084	1,257	1,450	1,664	1,898	2,145	2,370	2,619	2,895	3,201	3,538	3,912	4,326	4,783
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.

2/ Nepal received debt relief of SDR 3.6 million in FY2020/21 covered by grants from the CCRT. 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.

Table 10. Nepal: Structural Benchmark Status and Modifications
April 2022-August 2025

Measure	Original Target Date	Status	Proposal
Cross-Cutting Institutional Reforms to Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption			
Implementing agency publishes on a government website large public procurement documentation, ex-post validation of delivery, name of awarded companies, and name of beneficial owner(s) for all new, large, COVID-19 related procurement contracts consistent with the December 2021 public information notice (as of December 9, 2021).	Prior Action	**Met**	
The MOF publishes the 4th COVID-19 Active Response and Expenditure Support Program (CARES) report which includes federal government budget expenditures related to COVID-19 on a government website.	End-April 2022	**Met**	
The FCGO reports the consolidated financial information of all operational funds in annual financial statements, starting with FY2021/22 1/	End-January 2025		
The MOF submits to Parliament amendments to modernize the NRB Law, addressing key recommendations of the 2021 Safeguards Assessments Report 2/	End-April 2024	**Not Met**	Reset to end-September 2024
An external audit of the NRB financial statements for FY2021/22 is commissioned, consistent with the recommendation in the 2021 Safeguards Assessment	End-April 2022	**Not Met, Implemented September 2022**	
An audit of the FY2023/24 financial statement of the NRB is conducted involving the service of experts with international experience in auditing and central bank auditing.	End-July 2024	**Modified**	
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	End-July 2024		
Revenue Mobilization			
The MOF publishes a report on tax exemptions for all other non-customs related taxes	End-August 2023	**Not Met, Implemented September 2023**	
MOF approval of a revenue mobilization strategy covering tax policy, law, and revenue administration reforms	End-April 2024	**Not Met, Implemented June 2024**	
The MOF publishes a comprehensive report on tax expenditures 3/	End-January 2025		
Fiscal Sustainability and Fiscal Risk Management			
The MOF implements a fiscal risk register to capture various dimensions of major fiscal risks	End-August 2023	**Met**	
A comprehensive fiscal risk statement is published by the MOF with the FY2025/26 Budget	End-August 2025		

1/ This SB was originally set for end-May 2022, was not met, was reset at the combined First and Second Review to end-August 2023, was not met, and was reset at the Third Review to end-January 2025.
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 20232023, was not met, and was reset at the Third Review to end-April 2024.
3/ This SB was originally set for End-April 2024 and was reset at the Third Review to end-April 2025.

Table 10. Nepal: Structural Benchmark Status and Modifications April 2022-August 2025 (continued)

Measure	Original Target Date	Status	Proposal
Fiscal Sustainability and Fiscal Risk Management (concluded)			
The MOF develops cash flow forecasting to be shared with the PDMO and the NRB on a regular basis	End-September 2023	**Met**	
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements	End-August 2024		
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Telecom) will have their FY2022/23 financial statements audited 1/	End-August 2024		
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)	End-April 2024	**Met**	
NPC approval of the revised National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection	End-March 2025	**New**	
Advance fiscal federalism in a fiscally prudent manner, for better delivery of public services			
The National Planning Commission (NPC) issues a Poverty Reduction and Growth Strategy Paper	End-October 2022	**Not Met, Implemented March 2023**	
Financial Sector Regulation & Supervision			
The NRB enhances and customizes its current bank reporting template to enhance the timely monitoring of the impact of COVID-19 impact on the financial sector	End-April 2022	**Met**	
The NRB drafts amendments to the regulations to (1) strengthen the identification criteria of non-performing loans (e.g. unlikeliness to repay in full, debt servicing with another loan); (2) clarify the rules of asset classification and reclassification, including for revolving loans; and (3) provide a clear guidance on restructuring and rescheduling	End-April 2022	**Not Met, implemented May 2022**	
The NRB issues the updated regulation on asset classification	End-August 2023	**Met**	
The NRB Board approves an action plan for full implementation of the Supervisory Information System (SIS) for class A banks	End-April 2022	**Not Met, Implemented December 2022**	
The NRB completes the full implementation of the SIS among class A, B and C banks, excluding the onsite module	End-August 2023	**Met**	
The NRB completes implementation of the onsite module of the SIS among class A banks 2/	End-April 2024	**Met**	
Launch for 10 largest Banks in-depth onsite inspections assisted by independent international third-party auditors	End-April 2024	**Not Met**	Reset to end-August 2024

1/ This SB was originally set for End-April 2024 and was reset at the Third Review to end-August 2024.
2/ 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 10. Nepal: Structural Benchmark Status and Modifications
April 2022-August 2025 (concluded)

Measure	Original Target Date	Status	Proposal
Financial Sector Regulation & Supervision (concluded)			
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors	End-December 2024		Reset to end-February 2025
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections	End-February 2025		

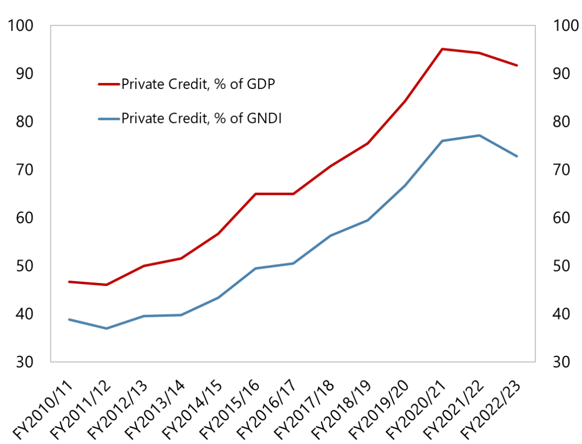
Annex I. Private Sector Credit in Nepal: Transitioning to a Sustainable Growth Path

The nature of credit growth in Nepal changed after the pandemic. Despite the widely adopted view that Nepal's recent economic history has seen multiple distortive boom-bust credit cycles, under closer examination the cycles preceding the pandemic do not appear excessive. Credit growth before the pandemic was mostly demand-driven and directed broadly towards investment activities, contributing to robust non-inflationary economic growth. In contrast, the latest post-pandemic credit boom was largely supply-driven, facilitated by an unprecedented broad-based relaxation of financial regulations. The resulting credit expansion was disproportionately channeled towards households and non-tradable sector firms. The excessive accumulation of credit led to a subsequent correction, characterized by the ongoing deleveraging and economic slowdown. The recent regulatory adjustments pursued by the NRB, if sustained, can support a transition to more sustainable and pro-growth credit allocation and help prevent disruptive boom-bust cycles in the future.

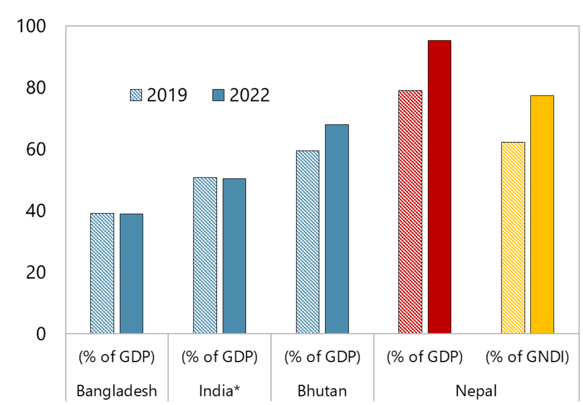
Background

1. **Nepal's private sector credit has expanded significantly in recent years, appearing excessive and recently undergoing a correction**. A decade of rapid credit growth, on the back of large inflows of remittances, accommodative monetary policy, and lax supervision, further fueled by pandemic-related stimulus, led to a build-up of financial vulnerabilities and underlying risks in the banking system. With a credit-to-GDP ratio close to 100 percent, financial deepening levels appear to be excessive for Nepal's level of economic development. When examining credit relative to Gross National Disposable Income (GNDI)—which importantly factors in Nepal's large remittances inflows—pre-pandemic credit levels appear more in line with those observed for the regional peers (see Annex I. Figure 1). Nonetheless, the recent correction appears to follow ten years of fast credit growth.

Annex I. Figure 1. Private Sector Credit
(in percent of GDP and GNDI)



Sources: Haver Analytics; and IMF staff calculations.



Sources: World Bank, *World Development Indicators*; Haver Analytics; and IMF staff calculations.
Note: India (2021)

2. In this context, understanding past credit fluctuations is essential to avoid future credit boom-bust cycles and establishing a more stable, pro-growth financial sector equilibrium. This annex analyzes past credit cycles in Nepal to understand credit growth patterns and help identify policy measures to achieve sustainable credit growth. We first describe the measurement of the credit cycles and assess their historical drivers, then examine the sectoral composition of credit growth, and finally provide some policy-relevant insights.

Measuring the Credit Cycle

3. Properly measuring the credit cycle is key for understanding the dynamics of credit expansion and contraction within the economy, as well as assessing associated risks and vulnerabilities. The credit cycle serves as a useful leading indicator of potential financial imbalances and systemic risks.[1] By detecting these imbalances early, authorities can take preemptive measures to mitigate risks and safeguard financial stability.

4. The deviation of the credit-to-GDP ratio from its long-term trend is widely utilized as a measure of the credit cycle despite some challenges.[2] Empirical research has demonstrated good predictive power of the credit-to-GDP gap in signaling vulnerabilities in the banking system and forecasting financial crises.[3] Studies have shown that widening credit-to-GDP gaps are associated with increased probabilities of banking crises and economic downturns.[4] At the same time, the credit-to-GDP gap has been subject to a number of reservations, including the choice of a denominator in the credit ratio and reliance on the Hodrick-Prescott (HP) filter to estimate the long-term trend in the credit ratio.[5]

5. For Nepal, trend nominal GDP is used as a denominator for the credit ratio and the HP filter adjusted for shorter credit cycles.[6] By using 'trend GDP' as a reference point, the credit-to-trend-GDP gap (henceforth, 'credit gap') adjusts for business cycle fluctuations, focusing

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[1] See, for example, Borio & Lowe (2002), Borio & Drehmann (2009), and Aldaroso et al. (2018).

[2] In the subsequent analysis, we use credit-to-GDP as a benchmark measure instead of credit-to-GNDI, given that the dynamics in the two indicators is very similar (despite notably different levels, see Figure A1), resulting in largely similar estimates for credit gaps.

[3] The Basel Committee on Banking Supervision (BCBS) recommends the use of the credit-to-GDP gap as one of the key indicators to assess systemic risk buildup in the banking sector and formalized it in the Basel III framework to guide the setting of countercyclical capital buffers and macroprudential policy interventions.

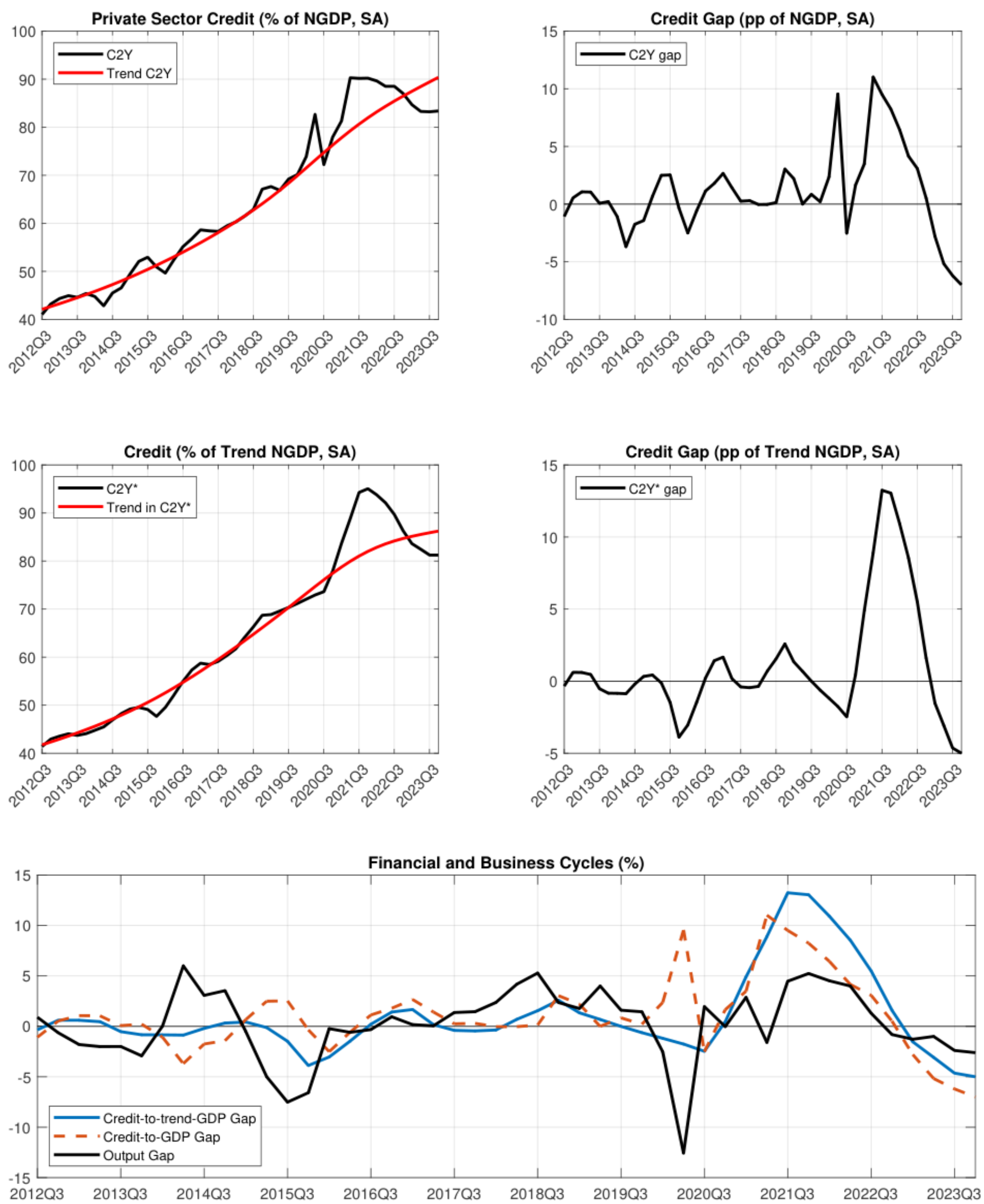
[4] See, for instance, Drehmann (2014), Drehmann & Tsatsaronis (2014), and Detken et al. (2014) and further references therein.

[5] Critics argue that using GDP as a denominator can be misleading, as it does not account for variations in the relationship between credit growth and economic growth across different contexts and time periods. Some studies propose scaling credit with a more stable denominator, such as population, to mitigate this issue (Jorda et al. 2017; Richter et al. 2017). Additionally, the choice of smoothing parameter (lambda) in the HP filter method for estimating credit cycles has been debated (Baba et al. 2020; Jorda et al. 2017). For broader discussion of shortcomings of the credit-to-GDP gap, see for example Drehmann & Yetman (2021).

[6] Trend nominal GDP is calculated by combining the actual GDP deflator and the estimated potential real GDP. The latter is estimated using an adjusted HP filter, which incorporates the Nepal team's assessment about the size of real output gap and judgment about the dynamics of trend real GDP during the pandemic.

instead on the underlying tendencies in credit expansion relative to the economy's long-term capacity. Similarly, by using HP filter parameters for business cycle frequencies rather than longer frequencies, we account for both a relatively short duration of Nepal's credit cycles economy and a short span of available credit data.[7]

Annex I. Figure 2. Comparison of Credit-to-GDP and Credit-to-trend-GDP Ratios



Sources: Nepali authorities and IMF staff estimates

[7] The average duration of a credit cycle in Nepal after 2011 is estimated to be only 8 quarters (NRB 2022).

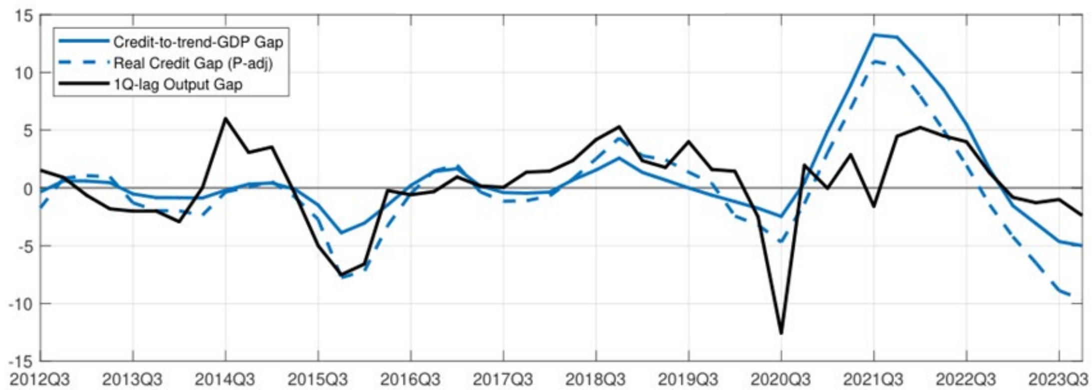
6. Examining the resulting credit gap suggests that the latest credit cycle is an outlier and different from a historical perspective. Despite the commonly held view that Nepal's recent economic history has seen multiple distortive boom-bust credit cycles, a closer examination suggests that the cycles preceding the pandemic were not particularly remarkable or excessive. During these pre-pandemic cycles, the credit gap averaged about 1 percentage point (pp) during boom years and -1 pp during deleveraging episodes, with the maximum peak of around 2.5 pp in FY2018/19, and the minimum trough of close to -4 pp in the aftermath of the 2015 earthquake (blue line in Annex I. Figure 2). However, the latest credit cycle, which unfolded in the wake of the pandemic, stands out as a notable outlier. At its peak, the credit gap expanded to above 10 pp, signaling an unprecedented surge in credit relative to the underlying economic capacity. Recently, the credit gap has contracted to approximately -5 pp, reflecting a sharp reversal from the peak levels observed earlier. This abrupt turnaround raises questions about the underlying drivers and implications of the unprecedented post-pandemic credit cycle.

Assessing Drivers of Historical Credit Cycles

7. To gain a thorough understanding of the credit growth drivers in Nepal, this annex analyzes credit dynamics from three angles—macroeconomic, policy, and market. First, analyzing how Nepal's credit and economic business cycles are related helps identify how broader macroeconomic conditions interact with credit dynamics. Second, examining changes in the NRB's financial policies and regulations over time allows to better assess the supply factors behind historical credit cycles. Finally, from a market perspective, by understanding which sectors of the economy were attracting relatively more credit during historical macro-financial cycles allows to gain insights into determinants of credit demand, sectoral credit productivity, and effectiveness of credit management policies.

8. On the macroeconomic angle, business cycles generally led financial cycles in Nepal in the past, but this tendency has likely reversed since the pandemic (Annex I. Figure 3). Whereas in the decade before pandemic the output gap tended to lead the credit gap by one quarter, since FY2020/21 they became more contemporaneous (see Annex I. Table 1.a). Furthermore, statistical evidence—correlations and Granger causality tests—suggests that before the pandemic past values of the output gap were helping to predict future values of the credit gap, while the reverse has been true since FY2020/21 (Annex I. Table 1.b). In other words, whereas in the past the changes in aggregate demand (approximated by output gap) appear to have been stimulating credit growth in Nepal, after the pandemic the situation likely reversed, with credit expansion instead driving the revival in domestic demand.

Annex I. Figure 3. Measurements of Credit Cycle vs. Lagged Business Cycle
(in percent)



Sources: Nepali authorities and IMF staff estimates

Annex I. Table 1. Nepal: Cross Correlation and Granger Causality between Credit and Output Gaps

a. Cross Correlations

j	Credit gap, Output gap (-j)	Credit gap, Output gap (+j)
	Before pandemic (2012Q3-2020Q3)	
0	0.46	0.46
1	**0.73**	0.18
2	0.53	0.03
	** Here, correlation is the strongest between the current-period credit gap and the output gap lagged by one quarter.*	
	After pandemic (2020Q4-2023Q4)	
0	**0.86**	**0.86**
1	0.61	0.75
2	0.35	0.58
	** Here, correlation is the strongest between the contemporaneous credit and output gaps.*	

b. Pairwise Granger Causality Tests (Lags: 2)

Before pandemic (2012Q3-2020Q3)

Null Hypothesis:	F-Stat	Prob.
Output gap does not Granger Cause Credit gap	8.2957	**0.0015**
Credit gap does not Granger Cause Output gap	0.0691	0.9334

** Here, we reject the null hypothesis that output gap does not Granger cause credit gap. In other words, there is statistical evidence that past values of the output gap help predict future values of the credit gap*

After pandemic (2020Q4-2023Q4)

Null Hypothesis:	F-Stat	Prob.
Output gap does not Granger Cause Credit gap	0.1112	0.8961
Credit gap does not Granger Cause Output gap	5.3062	**0.0341**

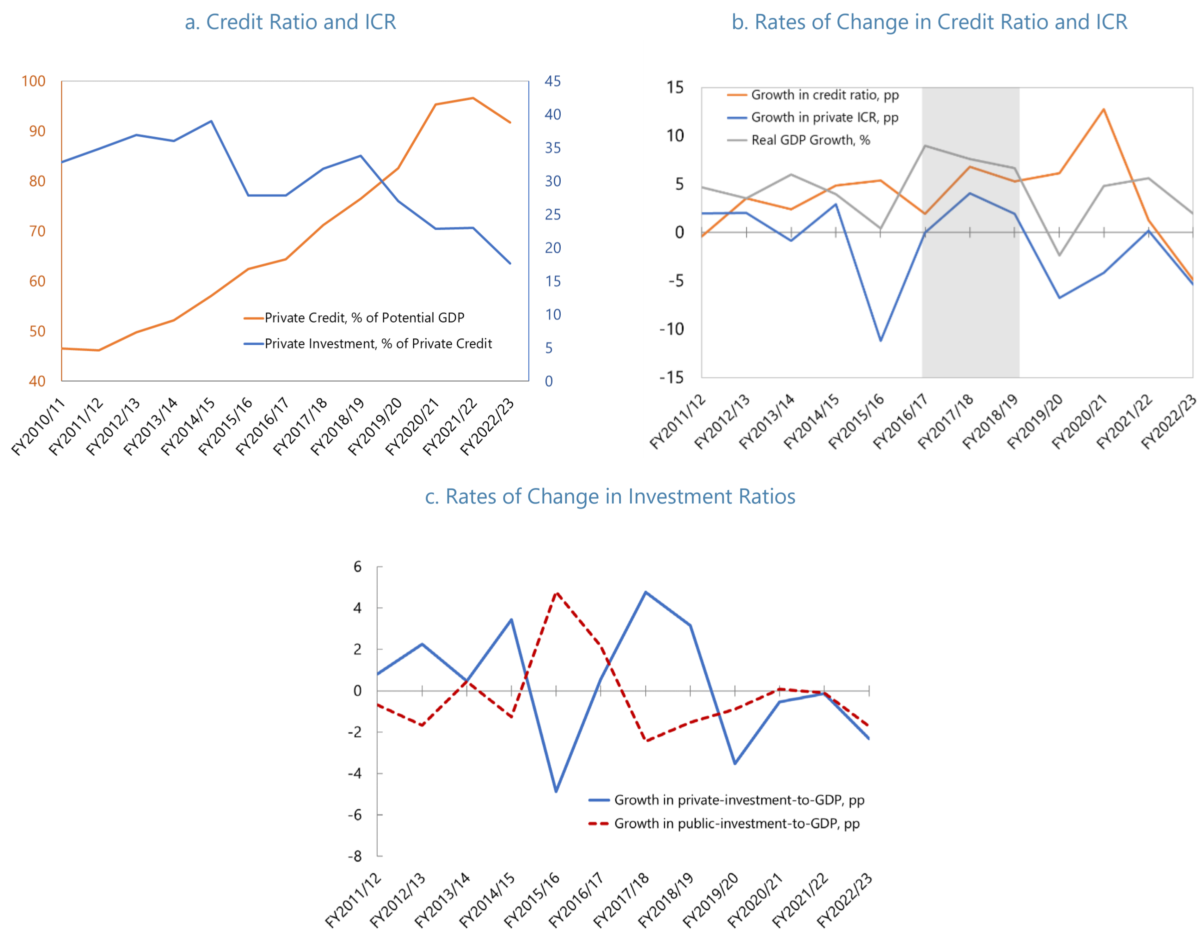
** Here, we reject the hypothesis that credit gap does not Granger cause output gap. In other words, there is statistical evidence that past values of the credit gap help predict future values of the output gap*

Sources: Nepali authorities and IMF staff estimates

9. **The private investment-to-credit ratio (ICR) can further illustrate the shift in the nature of credit cycles**. A credit expansion accompanied by rising ICR and non-inflationary economic growth suggests that credit financing is generally being allocated towards investment activities that

contribute to long-term economic potential, such as capital expenditures, infrastructure projects, and small and medium business expansions rather than activities that would create inflation (Mian et al. 2019). Conversely, a declining ICR during an inflationary credit boom could signal deteriorating credit quality, allocation of capital to less productive uses, or poorly-targeted policies, impeding long-term GDP growth (World Bank 2017, 2023). In the case of Nepal, ICR was increasing before the 2015 earthquake and in the years following the earthquake, up until the pandemic (see Annex I. Figure 4). The ICR saw a big one-off drop in FY2015/16, in the immediate aftermath of the 2015 earthquake, when private investment was constrained by severe economic disruptions, but it quickly recovered after that, consistent with major reconstruction efforts and increasing aggregate demand. The period during FY2016/17-FY2018/19 saw a sustained increase in ICR in tandem with the credit ratio, and strong non-inflationary economic growth (Annex I. Figure 4.b). In contrast, after a similar contraction in FY2019/20 as in FY2015/16, the ICR did not recover, declining after the pandemic despite booming credit growth in FY2020/21-FY2021/22.[8]

Annex I. Figure 4. Private Sector Credit and Investment

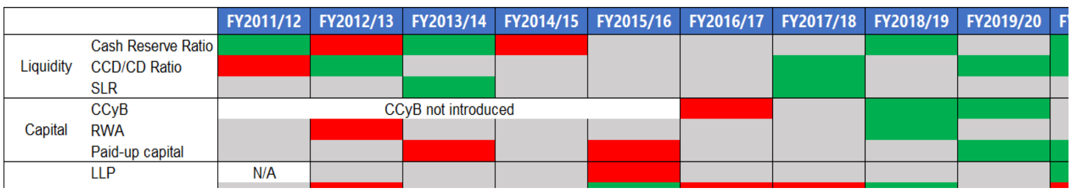


Sources: Nepali authorities and IMF staff estimates

[8] While in the past, higher public investment offset some of the decline in private investment, this has not been the case post-pandemic, as both private and public investment-to-GDP ratios have been declining (Figure A4.c).

10. From the policy angle, the post-pandemic credit boom appears to have been preceded by broad-based regulatory easing, unlike the pre-pandemic credit cycles. A heatmap shows regulatory interventions within three broad categories—liquidity measures, capital requirements, and asset quality requirements—to examine changes in the NRB's financial policies and assess whether the policy stance could be a factor impacting credit cycles (Annex I. Table 2). By this measure, lending standards were relaxed across all regulatory categories just prior to and through the pandemic period. This stands in contrast to any of the pre-pandemic credit cycles, where regulatory relaxations, when they happened, were typically limited to only one or two specific categories.

Annex I. Table 2. Nepal: Changes in Regulatory Measures by the NRB /1



1/ The colors indicate changes in regulatory measures within each category compared to previous period

- tightening - loosening

Sources: Nepali authorities and IMF staff estimates

11. The above observations are consistent with pre-pandemic credit cycles being largely demand-driven, while the latest one is primarily supply-driven. A demand-driven credit cycle occurs when increased investment opportunities and economic expansion lead to higher demand for loans by businesses and households, driving borrowing activity. A good example of a demand-driven credit cycle occurred during FY2016/17-FY2018/19, when private investment surged in tandem with credit growth, amid strong non-inflationary GDP growth (see Annex I. Figure 4.b). Conversely, the recent post-pandemic credit boom has been characterized by declining ICR, high inflation, and easing lending standards, indicating a shift towards a supply-driven credit cycle. Supply-driven credit booms typically result in less efficient and less productive credit allocation compared to demand-driven credit booms, leading to more disruptive credit busts and slower medium-term growth (World Bank 2017, Manaresi & Pierri 2019, Muller & Verner 2023). We next test this notion for Nepal by analyzing how sectoral composition of credit evolved and which sectors drove the historical credit expansion.

Sectoral Credit Performance

12. The allocation of credit across various sectors of the economy has been markedly different during the recent cycle compared to historical ones. Table A3 compares median growth rates of sectoral credit ratios during past credit cycles.[9] All sector-groups experienced

[9] The median growth rate of sectoral credit ratios is calculated separately for credit expansion and deleveraging episodes, where an "expansion" period is defined as the duration of a buildup in the credit gap from trough to peak, and "deleveraging" is the duration of a decline in the credit gap from peak to trough. An increasing credit ratio (i.e., positive growth rate in Table A3) indicates that credit had been on average growing faster than trend nominal GDP.

abnormal credit ratio growth by pre-pandemic standards during the expansion of the latest credit cycle and almost all of them contracted in the deleveraging, unlike the pre-pandemic cycles.[10] The sector-group that stands out in this regard is "G3. Energy, Transportation, Communications, & Public Services". It is the only sector-group that did not contract in the latest deleveraging episode (growth rate of 0.04 pp) and also grew the strongest on average during pre-pandemic deleveraging episodes (0.30 pp).

Annex I. Table 3. Nepal: Median Growth Rates of Sectoral Credit Ratios During Credit Expansion and Deleveraging Periods

(in percentage points)

Sector-groups \1	Expansion (pre-pandemic)	Deleveraging (pre-pandemic)	Expansion (latest)	Deleveraging (latest)
G1. Agriculture	0.71	0.28	3.17	-0.48
G7. Finance	0.24	0.16	1.36	-0.37
G8. Household Consumption	1.41	0.14	6.70	-2.12
G2. Non-food Production	0.94	0.06	2.60	-1.06
G3. Energy, Transp, Comm., & Pub. Serv.	0.70	0.30	1.63	0.04
G4. Private Services	0.38	0.19	1.09	-0.66
G5. Real Estate	-0.10	-0.10	0.45	-0.21
G6. Wholesale & Retail Trade	1.33	0.15	4.07	-1.36
Total credit	5.75	2.07	21.24	-5.87

1/ Sector-groups are defined by clustering individual sectors (as reported by the NRB), so as to minimize re-classification of individual sectors (done by authorities with some periodicity) within each sector-group

Sources: Nepali authorities and IMF staff estimates

13. **Export-oriented sectors drove the credit expansion of FY2016/17-FY2018/19, unlike the most recent post-pandemic cycle led by consumer credit**. Annex I Table 4 explores changes in sectoral credit weights during different periods. A rise (fall) in the proportion of credit to a specific sector means that credit growth to this sector exceeded (lagged) overall credit growth during the given period. In other words, rising sectors were disproportionate contributors to the overall expansion of credit during this time. Two of the sector-groups that contributed the most to the credit expansion of FY2016/17-FY2018/19 were "G4. Private Services" and "G3. Energy, Transportation, Communications, & Public Services." Their weights in overall credit during that period increased by 0.8 percentage points each. However, the same credit-groups saw relatively less credit allocation during the credit boom of FY2020/21-FY2021/22, with their weights declining by 0.5 and 0.6 percentage points respectively. Conversely, one sector-group that drove the credit boom of FY2020/21-FY2021/22—"G8. Household Consumption"—saw the least credit allocation during FY2016/17-FY2018/19.

[10] A "sector-group" is defined as a cluster of related individual sectors. For example, sector-group called "G1. Agriculture" contains the following categories of credit (as defined by the NRB): Agriculture, Food Production, Agriculture and Forest Production, Beverages Production, Tobacco Production, and Agricultural Machinery.

Annex I. Table 4. Nepal: Change in Sectoral Weights
(in percentage points of total credit)

Groups	Name: / Range:	Investment Expansion FY17—FY19	Post-pandemic Expansion FY21—FY22	Post-pandemic Deleveraging FY22—FY24	Major contributors to FY17-FY19 expansion
G4. Private Services		0.8	-0.5	-0.2	***(+):*** *Hotels;* ***(-):*** *Non-resid. Constr.*
G3. Energy, Transp., Comm. & Pub. Serv.		0.8	-0.6	1.6	***(+):*** *Electr., Heavy Constr.;* ***(-):*** *Hospitals, Educ.*
G7. Finance		0.6	0.7	-0.4	***(+):*** *MFIs;* ***(-):*** *Cooperatives*
G1. Agriculture		-0.1	0.9	0.8	***(+):*** *Agriculture;* ***(-):*** *Food Prod.*
G6. Wholesale Retail Trade		-0.2	-0.2	0.0	***(-):*** *Wholesale & Retail*
G2. Non-food Production		-0.2	-0.9	-0.2	***(+):*** *Cement, Iron;* ***(-):*** *Textile*
G5. Real Estate		-0.5	-0.3	-0.2	***(-):*** *Real Estate*
G8. Household Consumption		-1.3	0.9	-1.4	***(-):*** *Consumable Loan, Resid. Constr.*

Sources: Nepali authorities and IMF staff estimates

14. While non-performing loan (NPL) ratios increased in almost all sectors in the aftermath of the latest credit boom, domestically-oriented sectors saw the largest rises. The overall gross NPL ratio for Class A banks increased by about 2.7 percentage points between October 2021 and April 2024 (from 1.2 to 3.9 percent).[11] Although NPL ratios rose in most of the sectors during that period, there is a divergence between the degree of increase across sectors (Annex I. Table 5). The sector that saw by far the biggest rise in NPL ratios, and also accounts for about a third of all NPLs, is "Wholesale and Retail". It is followed by other domestically-oriented sectors, including "Agriculture" and "Agriculture-related production" (15 percent of all NPLs), "Construction" (10 percent), "Consumable loans" (10 percent), and "Non-food production" (8 percent). Other sectors fared relatively much better, with "Electricity, Gas and Water"—including the energy-exporting hydroelectric sector—even seeing a mild reduction in the NPL ratio.

Annex I. Table 5. Nepal: Rate of Change in NPL Ratios by Sector
(in percentage points, quarter-on-quarter)

	2022				2023				2024	
	January	April	July	October	January	April	July	October	January	Cumulative change
Electricity,Gas and Water	-0.010	-0.008	0.022	-0.009	-0.019	-0.005	0.014	-0.004	-0.001	-0.02
Local Government	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.000	0.00
Mining	0.000	0.000	0.000	0.000	0.001	0.005	-0.004	0.001	0.000	0.00
Fishery	0.000	0.000	-0.002	0.003	0.003	0.003	0.001	0.002	0.004	0.02
Others	0.012	0.022	0.001	-0.004	0.040	0.015	-0.032	0.045	-0.049	0.05
Transportation, Communications and Public Services	-0.010	-0.009	-0.003	0.013	0.045	0.038	-0.053	0.002	0.065	0.09
Finance, Insurance and Fixed Assets	-0.023	0.018	-0.011	0.027	0.050	-0.010	-0.004	0.050	-0.006	0.09
Hotel or Restaurant	-0.034	0.019	0.002	0.075	-0.004	0.094	-0.048	-0.001	-0.005	0.10
Metal Production, Machinary and Electrical Tools	-0.001	0.007	-0.010	0.006	0.014	0.046	0.064	0.000	-0.010	0.12
Other Service Industries	0.001	0.019	0.023	0.027	0.005	0.003	0.015	0.047	0.007	0.15
Non-food Production Related	-0.012	0.018	-0.030	0.067	0.072	0.084	0.015	0.002	-0.002	0.21
Consumable Loan	-0.012	-0.014	-0.058	0.106	0.091	0.054	-0.031	0.057	0.027	0.22
Construction	-0.040	-0.002	-0.059	0.048	0.132	0.058	-0.026	0.052	0.088	0.25
Agriculture, Forestry & Bevarage Production Related	-0.027	0.004	0.001	0.041	0.089	0.053	0.004	0.096	0.006	0.27
Agriculture	0.031	-0.009	0.019	0.060	0.079	0.085	-0.038	0.049	0.035	0.31
Wholesaler and Retailer	0.024	0.037	-0.098	0.137	0.235	0.284	0.027	0.167	0.007	0.82
Total	**-0.10**	**0.10**	**-0.20**	**0.60**	**0.83**	**0.81**	**-0.10**	**0.57**	**0.17**	**2.68**

Sources: Nepali authorities and IMF staff estimates

[11] The annex uses quarterly data for the10 largest Class A banks (representing about 60 percent of the Class A banking system by assets) for the period between October 2021 and January 2024, which encompasses the latest credit cycle. Given the well-dispersed and competitive banking sector in Nepal, and largely similar sectoral credit exposure among Class A banks, due in part to the NRB's directed lending requirements, the dynamics of NPL ratios for these 10 banks is broadly representative of the NPL dynamics across all Class A banks.

Summary

15. The analytical findings suggest that the nature of credit growth in Nepal changed during the pandemic. The findings suggest that pre-pandemic credit growth was mostly demand-driven and directed broadly towards investment. In contrast, the latest credit boom was largely supply-driven, with 'easy' credit flowing disproportionately towards household consumption and less productive economic activities, so that the ratio of private investment to credit has been steadily declining. Credit directed towards investment activity tends to raise potential growth and support non-inflationary potential growth. The latest credit boom was not as investment-oriented, instead characterized by unsustainable credit growth that contributed to overheating of the economy, with a subsequent deleveraging and economic slowdown. In addition, the pandemic-era credit boom was preceded by a significant and broad-based relaxation of financial regulation, unlike the pre-pandemic credit cycles. Thus, while superficially there appears to have been more than a decade of too-fast credit growth in Nepal, a closer analysis suggests that only the recent post-pandemic credit cycle was truly excessive.

16. The results of the sectoral credit analysis are broadly consistent with the findings in the literature, which suggests that supply-driven credit booms are disproportionately allocated to non-tradable sectors and are typically more fragile. In the latest credit boom in Nepal, the primary beneficiaries of 'easy' credit conditions were mainly the non-tradable sectors. The share of credit allocated to these sectors was gradually declining before the pandemic—a period which was generally characterized by increasing investment-to-credit ratio and robust non-inflationary economic growth. This suggests that pre-pandemic credit to non-tradable sectors was less influential in boosting potential growth. Those sectors have also recently witnessed a greater increase in NPLs. When considered alongside the persistent decline in the investment ratio after the pandemic and the recent economic slowdown, these observations reinforce the empirical literature's view that rapid credit expansions to non-tradable sectors often result in slower GDP growth and a higher likelihood of financial distress.[12]

17. Recent regulatory adjustments pursued by the NRB, as well as the government's reform agenda supported by the ECF program, can support the transition to more sustainable and pro-growth credit allocation and should continue. Recent policy adjustments in credit management and prudential regulations, including the tightening of asset classification and lending practices (SR ¶14), are timely and crucial measures. The efforts to restore the health of bank balance sheets and enhance the quality of bank lending (including the upcoming loan portfolio review), although involving some necessary adjustments, are essential. These efforts can help steer lending towards more productive sectors and help avoid damaging credit boom-bust cycles in the future. Furthermore, the government's focus on increasing investment, particularly in infrastructure and hydropower, supported by larger and more efficient capital expenditure, will help bolster long-term economic growth. These initiatives, together with continued structural reforms aimed at enhancing overall productivity, while supporting the most vulnerable, are well-aligned with the goals of the ECF program.

[12] See Muller & Verner (2023) and references therein for details.

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Annex II. External Sector Assessment

Overall Assessment*: The external position in FY2022/23 was stronger than the level implied by medium-term fundamentals and desirable policies. Driven by slower domestic demand and strong remittance and tourism growth, the current account deficit shrank from 12.7 percent of GDP in FY2021/22 to 1.4 percent in FY2022/23, and is projected to reverse into a surplus in FY2023/24. Foreign reserves are on a growing trend and are assessed to be adequate, supporting the peg to the Indian rupee. The current account gap is projected to inch closer to zero over the medium term as the economy recovers and the post-COVID rebound in remittances normalizes.*

Potential Policy Responses*: The policies to align the external position with the level implied by fundamentals should aim at boosting investment. These include fiscal consolidation while increasing capital spending and protecting the vulnerable, as well as prompt resolution of financial sector vulnerabilities, including through enhancing the bank supervision framework.. Structural reforms—for example, through investing in resilient and sustainable infrastructure, reducing product, financial, and labor market frictions, and promoting trade and foreign investment— are key to address Nepal's medium- and long-term external vulnerabilities and stimulate economic development and private investment.*

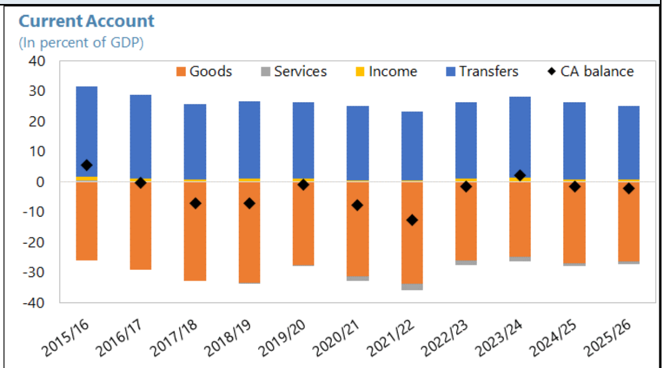
Foreign Assets and Liabilities: Position and Trajectory

Background. The net IIP was estimated at -USD 570 million (-1.4 percent of GDP) at the end of FY2022/23 (mid-July 2023). As in many developing economies, the majority of Nepal's external assets (more than 85 percent) were in the form of reserve assets held by the Nepal Rastra Bank (NRB). External liabilities were mostly concessional loans from multilateral and bilateral sources at around 68 percent, and the share of foreign direct investment (FDI) was still relatively small at 16 percent owing to a weak business climate and barriers to invest across borders. The net IIP increased from -USD 2,123 million (-5.5 percent of GDP) in FY2021/22 amid a sharp drop in the current account deficit and large positive net errors and omissions. The increase is a reversal of a multi-year trend as the net IIP declined from 17 percent of GDP in FY2015/16 into a negative territory in FY2021/22 driven by large current account deficits.

Assessment. Nepal's net IIP is likely to increase further in FY2023/24 as the current account turns positive, but gradually decline in the medium term. At present, the absolute net IIP is small, and there are no immediate sustainability concerns.

FY2022/23 (% GDP)	NIIP: -1.4	Gross Assets: 30.1	Debt Assets: 0.0	Gross Liab.: 32.2	Debt Liab.: 25.1

Current Account



Sources: Nepali authorities and IMF staff calculations.

Background. The CA deficit widened from 1.0 percent in FY2019/20 during the first wave of the pandemic to 12.7 percent of GDP in FY2021/22 amid accommodative monetary policy and a strong credit boom, compounded by elevated commodity prices. The authorities tightened monetary policy and began unwinding pandemic support measures in the financial sector, gradually increased domestic energy prices to align them with global developments and introduced a number of administrative measures to restrict imports. The credit boom came to a halt, especially in import-related sectors, resulting in a sharp drop in imports, exacerbated by weak social protection and low execution of public capital spending. Meanwhile, remittances and tourism rebounded after the pandemic, and as a result the current account deficit shrank to 1.4 percent of GDP in FY2022/23 and is projected to continue to strengthen into a surplus in FY2023/24.

Assessment. Reflecting a sharp drop in the CA deficit in FY2022/23, the EBA-lite CA model indicates a CA gap of 3.6 percent of GDP, with an adjusted CA deficit of -1.3 percent of GDP and CA norm of 5 percent of GDP. The CA gap estimate is subject to elevated uncertainty in the aftermath of COVID-19 and Russia's war in Ukraine. However, the cyclical CA adjustment is small in FY2022/23 as the negative output gap offsets positive terms-of-trade gap due to food and energy prices, which are still elevated compared to the long-run average, though to a lesser extent than in FY2021/22. Likewise, remittances and tourism have largely recovered from the pandemic, with COVID-19 adjustors set at zero. The gap is likely to increase further in FY2023/24 amid continued stress in the financial sector, and because of a natural disaster adjustment due to the November 2023 earthquake.

	CA model 1/	**REER model**
	(in percent of GDP)	
CA-Actual	**-1.36**	
Cyclical contributions (from model) (-)	0.00	
Natural disasters and conflicts (-)	-0.01	
Adjusted CA	**-1.34**	
CA Norm (from model) 2/	**-4.95**	
CA Gap	**3.61**	**-3.01**
o/w Relative policy gap	4.81	
Elasticity	-0.13	
REER Gap (in percent)	**-28.31**	**23.62**

1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. After a period of continued appreciation (2014-2017), the real effective exchange rate (REER) had been broadly stable prior to and during the COVID-19 pandemic (2018-2021), before appreciating again in FY2021/22. The REER appreciated further in FY2022/23 by about 1.1 percent as a small nominal depreciation of the Nepali rupee against the US dollar was outweighed by an appreciation against currencies in other trading partners (e.g. China) as well as by higher inflation than in trading partners.

Assessment. The appreciation of Nepal's REER in FY2022/23 is consistent with the results of the EBA-lite CA model, which finds a large positive CA gap. However, the EBA-lite IREER model indicates a REER overvaluation of 23.6 percent over the equilibrium level and implies a negative CA gap. The inconsistency is because the CA deficit in FY2022/23 shrank largely due to non-price factors: import restrictions, slowdown in credit amid a stress in the financial sector, low level of public investment, as well as post-COVID recovery in remittances and tourism. Because of the large role of non-price factors, the CA model serves as a primary anchor for the external position assessment in FY2022/23. Assuming the standard elasticity of the trade balance with respect to the REER of -0.14, the model implies that the REER would need to appreciate by about 28 percent to close the CA gap, indicating an external position that is stronger than implied by fundamentals and desirable policies.

Capital and Financial Accounts: Flows and Policy Measures

Background. The financial account remains mostly closed, and portfolio flows are negligible. Net capital and financial account inflows increased considerably though, from 0.3 percent of GDP in FY2015/16 to 6.5 percent of GDP in FY2021/22, driven mostly by higher official loans and trade credits (1.9 and 2.2 percent of GDP respectively). The inflows decreased in FY2022/23 largely due to a lower absorption of external concessional financing (official loans). Official loans are expected to remain strong in the coming years, as support from multilateral and bilateral sources helps Nepal advance socio-economic development, but their role is now assumed lower than projected the year before. External borrowing by banks and other sectors and non-resident deposits are small but picked up in the last quarter of FY2021/22 and in FY2022/23-FY2023/24, possibly due to the monetary tightening by the Nepalese authorities. FDI remained small at only 0.1 percent of GDP in FY2022/23, with no sign of improvement in FY2023/24.

Assessment. As Nepal's financial account remains mostly closed and financial inflows consist mostly of long-term concessional loans from multilateral and bilateral development partners, vulnerabilities related to capital flows are limited.

FX Intervention and Reserves Level

Background. Nepal is a landlocked country and relies heavily on India for trade with the rest of the world. According to the trade treaty with India, Nepal can settle trade with India in Indian rupees and foreign direct investment from India can be made in Indian rupees. About a quarter of Nepal's gross official reserves are held in Indian rupees. The reserves dropped from USD11.7 billion (11.5 months of prospective imports of goods and services) in mid-January 2021 to USD$8.9 billion in mid-May 2022—driven by a post-COVID surge in imports amid accommodative monetary policy, strong credit growth, and elevated commodity prices. As a result of the monetary policy tightening and other policy measures, the reserves have then stabilized and embarked on a growing trend, standing at USD12.7 billion in mid-January 2024 (9.6 months of prospective imports).

Assessment. For the purpose of Assessing Reserve Adequacy (ARA), and given that it rarely borrows from international capital markets, Nepal is classified as a "credit constrained" non-resource rich economy with a fixed exchange rate regime. The ARA methodology balances the benefits of holding reserves, e.g. reducing the probability of an external stress event and smoothing its impact, against the opportunity cost, assuming sovereign borrowing at 6.2 percent—an average estimate for low income countries. The model mechanically

puts the optimal level of reserves in Nepal at 5 months of prospective imports of goods and services. Given Nepal's high vulnerability to natural disasters and exposure to remittances, a modification to the ARA methodology raises the optimal level of reserves to 5.7 months by assuming an additional absorption loss of 2 percentage points of GDP—about equivalent to 90th percentile damage from natural disasters and drops in remittances in the last ten years. This is up from 5.2 months in the last ESA, largely driven by a lower imports/GDP ratio in FY2022/23.[1]
[1] Both the impact of external stress event and the opportunity cost of holding reserves are measured relative to GDP, so if imports/GDP ratio decreases a reserve measure in terms of months of imports would automatically increase.

Annex III. Risk Assessment Matrix[1]

Source of Risks	Likelihood / Time Horizon	Expected Impact on Economy	Policy Response
Potential Domestic Shocks			
Financial sector vulnerabilities intensify	**High** **Short to Medium Term**	**High**. Financial sector risks are likely to have accumulated during the credit boom, on the back of pandemic-related relaxation and an extended period of accommodative monetary policy. The impact of unwinding of pandemic-related support measures and deterioration in repayment capacity of borrowers or other catalytic domestic and external events, risk triggering financial sector stability concerns.	• Accelerate implementation of risk-based supervision and other financial sector reforms to contain financial sector risks. • Accelerate implementation of the amended regulatory framework, to ensure (i) appropriate use of working capital loans, (ii) relevant asset classification for loans, and (iii) sufficient provisioning. • Take structural actions to address increasing stress in the savings and credit cooperative sector, to prevent negative spillovers to the banking sector. • If downside risks amplify, use available fiscal policy space appropriately to reduce risks to financial stability.
Frequent and/or severe natural disasters	**Medium** **Medium to long term**	**High**. Earthquakes, flooding, climate and other disasters cause severe damage and economic disruption. Fiscal deficits and debt ratios increase in response.	• Further improve risk management and resilience in public investment and building codes. • Rebuild and maintain fiscal and reserve buffers. • Strengthen social safety nets. • Accelerate implementing recommendations from the climate module of the PIMA
Political instability and social unrest	**High** **Short to Medium Term**	**Medium**. The political cycle generates governance and/or social instabilities, restricting policy making and delivery. Economic activity is disrupted.	• Secure policy continuity, including on reform implementation under the program. • Continue to ensure transparency, accountability, and inclusion in policy implementation. • Restore and preserve public confidence in policymaking and communicate clearly on the benefits of structural reforms, while protecting the most vulnerable from possible adverse impacts.
Low revenue collection, low public expenditure execution for growth-	**High**	**Medium**. This would lead to lower growth and investment.	• Remain committed to fiscal targets and reforms under the program.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

Source of Risks	Likelihood / Time Horizon	Expected Impact on Economy	Policy Response
enhancing capital projects, and unpredictable fiscal impulses.	**Short to Medium Term**		• Further prioritize improvement of public investment management, including implementation of PIMA recommendations to enhance capital spending execution. • Further strengthen domestic revenue mobilization through tax policy reforms and improvements in revenue administration to create fiscal space for higher public investment. • Continue to improve the budgeting process to underpin budgets with realistic analysis.
Potential External Shocks			
Commodity price volatility, including related to trade tensions	**High** **Short to Medium Term**	**Medium**. Balance of payment pressures and drag on energy-intensive sectors (agriculture, tourism, transportation, infrastructure development) increase. Disruption of food and/or fuel supply could increase import prices and reduce food availability. High food inflation and food insecurity further impacts vulnerable populations. Fiscal pressure to mitigate higher energy prices for NOC.	• Continue to develop hydropower to diversify energy sources. • Accelerate structural reforms to diversify import sources and improve agricultural and food security. • Maintain adequate reserve levels and fiscal policy space as a buffer. • Ensure convergence between domestic and global commodity prices, while protecting the vulnerable. • Stand ready to tighten monetary policy in case of second-round effects.
Abrupt global slowdown or recession in major trading partners, particularly India and GCC	**Medium** **Short to Medium Term**	**High**. Lower growth abroad could adversely affect exports (including tourism) and remittances, with significant effects on GDP growth and external accounts.	• Maintain adequate reserve levels and fiscal policy space as buffers. • Provide targeted policy support to the vulnerable within the available fiscal space. • Accelerate structural reforms to diversify and expand exports and increase FDI.

Annex IV. Addressing Difficulties in SACCOs

Vulnerabilities in the large Nepali savings and credit cooperatives sector have been mounting, with an increasing number of institutions closing or being deemed problematic by authorities. There are over 14,000 savings and credit cooperatives and a large number of federal and sub-national regulators involved. Authorities have started to take action by suspending registration of new cooperatives and envisage reforms to the regulatory regime and establishment of a supervisory regulatory agency. This Annex sets out steps and principles that could be of use in this reform effort, focusing on addressing data gaps, developing a strategy to deal with problematic institutions and regulatory reforms.

Background

1. **Nepal has a large and vibrant cooperative sector regulated by a high number of agencies.** There are around 32,000 cooperatives registered. In addition to savings and credit cooperatives (SACCOs), which focus on providing savings and loans services, there are cooperatives active in areas such as agriculture, consumers and multiple purposes (e.g. combination of agriculture and consumer services). These non-financial cooperatives are allowed to provide savings and loans services for up to 30 percent of their activities. There are more than 14,000 SACCOs and around 10,000 non-financial cooperatives that also provide financial services. As of June 2023, SACCOs hold NPR 478 billion of savings deposits and NPR 426 billion in assets. SACCOs are regulated based on their geographical scope, i.e. at a federal, provincial or local level. As a result, the number of regulators amount to maximum 761 different agencies. In case a SACCO is declared problematic, it falls upon the relevant regulator to appoint a Problematic Cooperative Asset Management Committee (PCAMC).

2. **Since the middle of 2023, pressures in the Nepali SACCOs have been mounting.** A combination of large data gaps, weak governance, unsound credit and liquidity risk management and a lack of licensing, effective regulation, monitoring and supervision caused the failure and closure of multiple SACCOs. In addition, an increasing number of SACCOs is reportedly being declared problematic by the Department of Land Management, Cooperatives and Poverty Alleviation (LMCP) and sub-national authorities, implying the need for decisive intervention to prevent further contagion.

3. **Authorities have started to take action.** They have suspended the registration of SACCOs and in the FY2024/25 budget announced reforms to the regulatory framework, including plans to establish a new supervisory regulatory agency and repayment of depositors of failed SACCOs. In view of the large number of regulators involved, any solution requires a national approach, close coordination and information sharing between all relevant regulators. In view of the widespread issues and the plans of authorities to centrally regulate SACCOs by a second-tier regulatory institution, it is important that existing interagency coordination is strengthened to ensure a consistent implementation of the national plan to address problems at the SACCOs.

4. **Authorities need a comprehensive strategy to deal with the issues in SACCOs.** The steps suggested below have been categorized based on an appropriate timeframe for their

implementation given the information currently available. In view of the large uncertainties regarding the SACCO sector, authorities may need to adjust their approach as appropriate.

5. Immediate steps (e.g. within 6 months)

- Suspend registering new SACCOs
  - The current registering of new SACCOs does not provide the same scrutiny as licensing, and adequate supervision is currently not guaranteed. A temporary stop of registering new SACCOs at federal, provincial, and local levels until the issues have been addressed and the licensing and supervisory process and capacity have been improved would be appropriate. The authorities have already taken this step.
- Address data gaps
  - Considering the high number of entities and expected low capacity of both regulators and SACCOs, it can be difficult to collect reliable data directly from the institutions. The operationalization of data collection (including on the side of authorities) can be quite resource demanding. Ways of addressing the data gaps include:

    (i) Exploring contagion channels to systematically important institutions and sectors using the data (including data about exposures) already reported by the Class A-D institutions.

    (ii) Using other data sources about cooperatives, including data in the credit bureau and umbrella organizations (e.g. NEFSCUN) to get a view on the size and magnitude of the problem.

    (iii) Ad hoc reporting of core supervisory data could be considered. Although more labor intensive, a targeted data request could also help to identify and triage problematic SACCOs (see step 3).
- Design a strategy to clean-up SACCOs
  - The strategy, which could be designed while step 2 is being implemented, should first determine the approach(es) to problematic institutions in the short-term based on their size and the nature of the problems.
  - Resolution options in the strategy should follow the existing legal framework and could focus on liquidation combined with repayment of savings of failed SACCOs, possibly the transfer of assets and liabilities of a failed SACCO to a healthy SACCO or continuation after restructuring. Once the data under step 2 has been collected, problematic SACCOs can be triaged accordingly.

  - Authorities need a pragmatic and workable institutional structure to coordinate implementation of the strategy to deal with problematic SACCOs. Policy development should take place at the federal level, while implementation could take place at the sub-national level coordinated by the federal level through existing (strengthened) coordination mechanisms. It is important that all authorities involved in the SACCO resolution process are adequately resourced, exchange information and coordinate actions.

  - To support implementation of the strategy, authorities should urgently operationalize the SACCO resolution regime in the Cooperatives Act[1] (i.e. extend its application to all SACCOs if necessary) and support sub-national authorities to establish and strengthen PCAMCs (currently 1 federal and 1 provincial committee are in place).

- Triage and resolve problematic SACCOs

  - Following the collection of information under step 2, SACCOs need to be triaged based on their condition in accordance with the strategy designed under step 3.

  - Triaging requires information that allows authorities to identify problematic SACCOs and gives them a view of their (financial) situation.

6. Near-term steps (e.g. within 1 year)

- Tighten and enforce *existing* regulatory requirements

  - The recent crisis reveals flaws in the application of the legislative/regulatory framework. The bar for SACCOs must be raised while customizing the requirements to the size and nature of the businesses and to the realistic capacity of supervision.

  - Authorities could tighten *existing* regulatory requirements in the areas of capitalization, liquidity, loan concentration and/or governance. SACCOs should be required to report on a regular basis. SACCOs could be given a certain period to meet the requirements, compliance with which needs to be closely monitored. SACCOs that do not meet the tightened requirements may opt to consolidate or will cease operating and wind-down their operations.

- Implement new regulatory framework for SACCOs, including a second-tier institution

[1] The Act includes: powers to take control of a problematic SACCO by a Management Committee (MC), the management, sale and realization of assets and repayment of savings by the MC, depositor preference and the option for the government to contribute if realization of SACCO assets is insufficient to repay liabilities.

- While SACCOs are being asked to implement step 5, authorities could improve the regulatory framework and start building an adequate regulatory and supervisory, reporting and enforcement structure with sufficient supervisory capacity.

- The improved regulatory mandate needs to be proportional to cater for the size and complexity of SACCOs[2]. The mandate could cover licensing, capital, liquidity, governance, human resources and systems, complemented by the requirement to submit to external audits and similar safeguards. It also needs to ensure regular reporting by the SACCOs, with the regulator in the medium-term adjusting requirements to improve data quality to strengthen prudential and conduct supervision.

- An adequate level of supervision of a very high number of entities, or even oversight of very essential requirements (e.g., fit & proper requirements on their Boards) can be very hard to achieve. Striking a good balance between the market structure and the supervisory architecture/model of supervision will be critical. Typically, the supervisory architecture for SACCOs relies on several layers or tiers of supervision. However, for this multi-tier model of supervision to prevent some major failures and to ensure consistency in regulatory standards and supervisory approach, a central supervisory authority (such as a second-tier regulatory agency) needs to ensure stability at the system level. This would require the central supervisory authority potentially to conduct direct supervision of the largest institutions or – depending on the market structure and supervisory architecture – umbrella institutions and for it to be entrusted with sufficient enforcement powers.

- Once a decision has been made on the supervisory architecture, it needs to be implemented and the necessary institution(s) established with a clear legal mandate, sufficient staffing and funding. In addition to closely supervising the SACCOs, the new architecture will be responsible for the licensing process of the SACCOs (see step 7).

7. Medium-term steps (e.g. 1-2 years)

- Start licensing of SACCOs

  - As a proper authorization/licensing process hasn't been established in the current regime, licensing of SACCOs is needed for both existing SACCOs and new entities.

  - The mentioned licensing would have to reflect the new regulatory requirements and would prepare both credit cooperatives and supervisors for the new supervisory

[2] See Section 5 of FSI Insights No. 15 – Regulation and supervision of financial cooperatives available at https://www.bis.org/fsi/publ/insights15.htm and Annex D of the BCBS guidance on financial inclusion available at https://www.bis.org/bcbs/publ/d383.htm.

regime. The licensing regime should include a mechanism that allows the regulator to verify compliance and a process to treat cases of major non-compliance (which could result in withdrawal/suspension of the license).

- Expand SACCO institutional architecture

    - Once the SACCOs sector has been cleaned-up and the remaining SACCOs licensed, authorities can start expanding the SACCO institutional architecture. The Cooperatives Act includes the creation of a debt information center, credit tribunal and a savings and guarantee fund for SACCOs. These institutions could be aligned with existing structures. For example, the debt information center could be set up within the Credit Information Bureau as this would allow all financial institutions to have access to information on debtors. The savings and guarantee fund could be modelled on the Nepali Deposit Insurance System (DCGF).

Appendix I. Letter of Intent

Kathmandu, Nepal
July 19, 2024

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 November 9, 2023, at the time of the completion of the third review under the Extended Credit Facility (ECF), we confirm the commitment of Nepal to the policies and objectives of the economic program supported by the 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, buoyant remittances, and subdued imports. On the domestic front, the economy continues to face challenges as growth remains below potential, driven by subdued demand. Weak demand reflects large post-pandemic outflows of students and workers, limited capital spending, and low lending activity as the credit boom corrects and financial vulnerabilities emerge. Despite some recovery, tax collection remains below pre-pandemic levels, limiting fiscal space for development spending. The spending discipline instilled through our mid-term budget review in February 2024 helped maintain fiscal sustainability. The banking sector's non-performing loans (NPLs) doubled since August 2022 to 4.0 percent in April 2024, bank profitability declined, and the financial health of the savings and credit cooperatives (SACCO) sector has weakened. Reflecting timely policy actions, subdued domestic demand, and favorable commodity prices, inflation has significantly decreased from a multi-year peak of 8.6 percent in September 2022 to 4.4 percent in May 2024.

3. Against this backdrop, the implementation of policies and reforms envisaged under the ECF-supported program will support our commitment to preserve macroeconomic stability and improve financial well-being. The moderate spending growth and improved revenue projections envisaged in the FY2024/25 budget bode well for achieving a growth-friendly fiscal consolidation that accommodates steadfast capital spending. The budget includes actions to curtail spending duplication with subnational governments, expand targeted social spending, and prioritize capital spending while improving its execution, in line with the recently developed Public Investment Management Assessment (PIMA) Action Plan. The budget also includes tax

reforms such as introducing a green tax on petroleum products, raising taxes on vehicles, increasing excise duties on alcohol, beer, and tobacco, and improving tax compliance, in line with the recently approved Domestic Revenue Mobilization Strategy (DRMS). We remain committed to enhancing the use of the cash-flow forecasting framework that was adopted last year, with IMF technical assistance. Improved cash-flow forecasting will help ensure the availability of funds for infrastructure and priority projects and reduce negative Treasury balances, thereby improving the predictability of government operations.

4. On the monetary front, we will continue our cautiously data-driven approach to monetary policy to maintain price and external sector stability, while supporting growth. We will endeavor to improve monetary policy implementation, including through proactive liquidity management aligned with the interest rate corridor. The envisaged mix of a prudent monetary policy stance and fiscal discipline will help keep inflation in check and maintain reserve coverage at adequate levels, while maintaining a low risk of public debt distress. In addition, it will provide space for a revival in productive credit activity as the economy transitions to a sustainable level of credit growth. With domestic demand showing early signs of recovery, helped by lower lending rates, and continued strong remittance inflows, the ongoing efforts to improve capex execution would help provide a further demand boost. This, along with good harvest prospects, strong recovery in tourism, and generation of additional hydropower will support a pick-up in growth in FY2024/25.

5. Reforms to strengthen Nepal's financial sector remain our top priority, as envisaged under the ECF-supported program. First, in the process of improving bank asset quality, we continue to take measures to strengthen asset classification and provisioning and support NPL workouts. We are continuing our efforts to further align bank regulation and supervisory practices with international standards. To that end, we have completed the full implementation of the Supervisory Information System. We are in the process of introducing the liquidity coverage ratio for the banks and plan to implement the Financial Sector Stability Report (FSSR) recommendations. Although with some delay compared to original plans, we have initiated and are finalizing the procurement of an independent international consultant to assist us with the loan portfolio review. We are scheduled to launch the review by August 2024 to verify loan classification, provisioning and compliance with the regulatory framework and will develop a plan to deal with the outcomes. Recognizing the growing size and interconnectedness of savings and credit cooperatives, we are devising a strategy to deal with problematic SACCOs and intend to improve the regulatory oversight and supervisory architecture of these institutions, including through creation of a regulatory and supervisory agency.

6. We remain committed to diligently implementing recommendations from the AML/CFT Mutual Evaluation conducted by the Asia Pacific Group on Money Laundering. In that connection, we have enacted legal amendments to a set of fifteen laws, including on money laundering, to bring Nepal's AML/CFT legal framework in line with international standards. We are confident this will improve Nepal's technical compliance with FATF standards by the end of the observation period in October 2024. We are determined to ensure the effectiveness of the new legal framework,

including issuance of secondary regulations. We welcome technical support from the IMF and other donors on these matters.

7. We have progressed with the implementation of the recommendations in the 2021 Safeguards Assessment (SGA). We have requested the Auditor General, when conducting the audits of the NRB annual financial statements as per the prevailing laws of Nepal, to conduct the FY2023/24 audit with the service of experts with international experience in auditing and central bank auditing. We are preparing amendments to the NRB Act in consultation with stakeholders to address key recommendations of the SGA. To give time to submit these proposed amendments to Parliament, we propose to reset by four months the deadline of the related structural benchmark to September 2024. We will also accelerate progress on the remaining recommendations in the 2021 Safeguards Assessment.

8. We remain committed to the implementation of 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) preparing a comprehensive report on tax expenditures; (ii) publishing the FY2022/23 annual financial statements of all majority- and wholly-owned Public Enterprises (Pes); (iii) auditing the FY2022/23 financial statements of Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Telecom, (iv) FCGO reporting the consolidated financial information of operational funds in annual financial statements, and (v) revising and approving the National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection. We expect progress on involving the services of consultants with international experience in auditing and central bank auditing in an audit of the FY2023/24 financial statements of the NRB before the next review in compliance with the prevailing laws of Nepal. Other important reforms require more time to advance, including launching the loan portfolio review and preparing amendments to the NRB Act consistent with key recommendations of the 2021 Safeguards Assessments Report. In light of institutional challenges, we propose to reset these last two reforms to later dates.

9. We believe that the commitments outlined in the MEFP are adequate to make progress with 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 the implementation of policies under the ECF-supported program.

10. With this progress and commitment, we request SDR 31.4 million to be made available for the fourth 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/
Mr. Maha Prasad Adhikari Governor, Nepal Rastra Bank	Hon. Barsha Man Pun Finance Minister

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 reiterates our commitment to the program and 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. **Recent credit market developments call for targeted policy adjustments to tackle emerging vulnerabilities and support sustainable, robust economic growth**. Liquidity, credit and macroprudential policies eased financing conditions during the pandemic, which helped to absorb the worst economic impact of the shock and expedite a recovery. However, these warranted accommodative measures also contributed to a build-up of imbalances in the economy. To rein in the resulting credit surge and high inflation and help restore external stability, we employed a range of policy measures, consistent with the ECF program, including tightening of monetary and prudential policies and implementing fiscal initiatives aimed at preserving debt sustainability. The subsequent economic slowdown and stress in the financial sector, particularly emanating from the non-banking sector required targeted policy interventions to help establish robust and resilient growth, while ensuring long-term financial and fiscal sustainability.

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. The fourth review quantitative performance criteria and continuous performance criteria were met. External sector strength has allowed rebuilding ample international reserve buffers, while the primary balance target was met. The primary balance was contained *inter alia* due to prudent spending in a context of revenue weakness and low absorption of external project financing. Child grant spending did not attain the January 2024 indicative target, largely due to transitional issues introducing an electronic direct benefit transfer mechanism. Out of five structural benchmarks (SBs), three were completed, including one with delay. 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. **Following a marked slowdown, growth picked up in FY2023/24, supported by a good harvest, strong recovery in tourism, and generation of additional hydroelectricity**. Real GDP growth slowed to 2.0 percent in FY2022/23 due to contractions in construction, manufacturing and

wholesale and retail trade sectors, further compounded by adverse shocks to the agriculture and livestock sectors and high post-pandemic outflows of students and workers. Low execution of capital spending has continued to weigh on growth. A good harvest, continued recovery in tourism, and expansion of hydroelectric generation will support a rebound in growth to 3-4 percent in FY2023/24, which remains below potential. Inflation has gradually declined to 4.4 percent in mid-May 2024, comfortably within our estimated ceiling of 6.5 percent for FY2023/24, underpinned by timely policy actions, still subdued demand, and recently favorable core and fuel price dynamics in India. After a sharp drop in FY2022/23, imports remained stagnant for most of the FY2023/24, but began a gradual recovery by the end of the year as domestic demand showed signs of improvement. Meanwhile, remittances and tourism continued the post-pandemic rebound. As a result, the current account is set to reach a surplus of 3.2 percent of GDP in FY2023/24, and reserves—remaining on an increasing trend—are comfortably above adequacy levels.

4. The growth recovery is expected to continue in FY2024/25, supported by stronger domestic demand, and inflation should remain in check. Domestic demand will continue recovering in FY2024/25, aided by the cautiously accommodative monetary policy stance and expected increased execution of capital expenditure. This, along with continued increase in tourist arrivals, recovery in imports, and additional hydropower capacity will contribute to stronger growth in FY2024/25. As domestic demand picks up, monetary policy will adjust as needed to keep inflation within the policy target ceiling of 5.5 percent. With a rebound in imports, the current account is expected to fall moderately in FY2024/25, while international reserves remain at an adequate level, supported by robust remittance inflows. 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. We recognize that improving public expenditure execution for growth-enhancing capital projects is critical to the economic recovery. Additionally, improving the business and investment climate is essential to sustainable medium-term growth, and creation of jobs that can compete with work opportunities overseas. The financial sector requires policy attention to identify and address a further rise in bank NPLs and more failures among cooperatives. Limited progress to enhance the AML/CFT framework and address deficiencies before formal review by the Financial Action Task Force (FATF) could pose a challenge to access to the global financial system. Continued budget under-execution risks disrupting fiscal dynamics. Other important risks include a sharp growth slowdown in Nepal's major trade- and remittance-partner economies or volatile and higher global commodity prices—especially for fuel and food. These external shocks would have a pronounced impact on inflation, food security and economic activity, and a disproportionate impact on the poor and vulnerable. Despite its minimal contribution to global carbon emissions, 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 approaches 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**. Despite the tax measures in the FY2023/24 budget, the tax revenue-to-GDP ratio did not rebound to pre-pandemic range of 18-19 percent of GDP. The subdued revenue collection necessitated spending discipline in the mid-term budget review in addition to the under-execution of capital spending. Therefore, the overall fiscal deficit excluding revenue sharing with local governments is expected to decline to 2.8 percent of GDP. Due to tight fiscal conditions and domestic borrowing limit set in the budget, the negative federal government cash balance is expected to remain high relative to the historical trend at the end of the fiscal year 2023/24.

7. **We remain committed to a gradual growth-friendly fiscal consolidation to stabilize public debt consistent with the program framework**. Our FY2024/25 budget is broadly consistent with the target set out in the program to stabilize public debt at a moderate level. The budget includes measures such as introducing a green tax on petroleum products, raising taxes on vehicles, increasing excise duties on alcohol, beer, and tobacco, and improving tax compliance, in line with the recently approved Domestic Revenue Mobilization Strategy (DRMS). Revenue gains from these measures will be partially offset by the planned reduction or elimination of duties on some raw materials and intermediate goods. The budget also includes actions to curtail spending duplication with subnational governments, expand targeted social spending, and reverse the continued low execution of capital expenditure. In addition, we aim to support growth while maintaining debt stability by increasing the absorption of external concessional financing, in particular project loans.

Revenue Mobilization

8. **We are committed to enhancing revenue collection, focusing on domestic sources for revenue collection for sustainable development**. Drawing on IMF TA recommendations and the recommendations of our high-level committee for tax reform, we developed and approved 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 IMF Technical Assistance (TA) report on simplifying tax policy while broadening the tax base to enhance revenue and efficiency. We will enhance tax compliance by harmonizing procedures across taxes and accelerate digitalization efforts, including by building a suite of integrated IT systems to perform core Inland Revenue Division responsibilities (registration, processing, payment, etc.) and reduce integrity risks.

9. **We enhanced taxation transparency by disclosing tax exemption information, which can also support more effective policy making**. We conducted detailed assessment of the costs of non-customs-related tax (VAT, CIT, and PIT) exemptions beyond what has been published in September 2023. We will continue estimating the cost of tax exemptions at the Department of Customs and publishing a list of the exemptions and their costs as inputs to the publication of a comprehensive report on tax expenditures (end-January 2025 SB) covering tax allowances, credits,

deferrals, and reliefs in addition to tax exemptions. We are preparing to engage with the IMF technical assistance (TA) team scheduled to visit Nepal in September 2024 to support this reform and build stronger internal capacity. We will share a draft of the tax expenditure report with the IMF by end-November 2024 to get feedback from the IMF and address them. These reforms would help enhance transparency and the design of revenue collection measures in the future.

Expenditure Reforms

10. We will enhance the efficiency of capital spending to support our commitment to boost public investment. The FY2024/25 budget affirms our commitment to increase the share of public resources allocated to public investment. To support this commitment, the National Planning Commission (NPC) approved 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) (end-April 2024 SB). The Cabinet approved the 16th National Development Plan, which appropriately reflects findings from the PIMA Action Plan. The NPC will approve the reformulated National Project Bank Operational Procedures and revised the Unified Directives related to project development to enable more robust design, prioritization, and selection of projects based on systematic appraisal (new, end-March 2025 SB). We will request IMF TA to support this reform. We will share a draft of the procedures and directives with the IMF by end-December 2024 for comments and approve them by end-March 2025. Based on the approved procedures and directives, we aim to update and link the National Project Bank Management Information System (NPBMIS) with the Line Ministries Budget Information System (LMBIS) to allow a consistent and complementary approach to project development, selection, and prioritization across government levels by end-July 2025. We plan to subsequently link the Provincial Project Bank Management Information System with the NPBMIS. We will only include in the budget major public investment projects selected from the Project Bank that have been first appraised using the revised procedures and will guarantee all multi-year future financing commitments starting FY2025/26.

11. We will continue strengthening cash flow management and improve its implementation, with the support of IMF TA envisaged for June 2024. In addition, we will continue seeking Cabinet approval of the Guidelines on Cash Flow Management that were issued by the Ministry of Finance last year. This will help enhance short-term management of government funds, avoid negative balances of the treasury single account, improve debt management and budget formulation, and inform liquidity forecasting by the Nepal Rastra Bank (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).

12. We are making progress in enhancing fiscal risk management. We prepared and are currently implementing a fiscal risk registry (end-August 2023 SB, met), drawing on TA provided by the IMF in October 2022. We will gradually expand the coverage of the registry by including subnational governments and PPPs. We will publish a fiscal risk section in the Fiscal Policy Statement of the FY2024/25 budget, 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 (end-August 2025 SB). Supported by IMF TA, we intend to help government review subnational entities to identify the largest fiscal risks.

13. We will also endeavor to limit fiscal risks by strengthening the financial oversight of PEs, extra-budgetary funds and subnational governments. 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-August 2024 SB).[1] We sent a letter to PEs requiring them to publish their financial statements by end-June. In this context, the four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation (NAC) and Nepal Telecom) will have their FY2022/23 financial statements audited by August 2024 (end-August 2024 SB). Three of them have completed the audit. We will engage with NAC and the Ministry of Culture, Tourism and Civil Aviation and leverage the Ministry of Finance position on the NAC Board of Directors to ensure that NAC provides its financial statements to the OAG by end-June 2024. We will then prioritize completion of audits of the FY2023/24 financial statements of all other PEs by mid-FY2024/25. The FCGO included 88 extra budgetary units at the Federation level and 5 EBUs at the provincial level in the FY2022/23 annual financial statements. We continue to make progress with the intention to include all EBUs in the Nepal Public Sector Accounting Standard (NPSAS)-based financial statements for FY2023/24 (end-January 2025 SB).[2] FCGO will document commitments from the line ministries based on contract information, which could help monitor arrears, and we will endeavor to address any potential arrears.

Social Spending

14. 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. We commit to fully execute the allocated budget for child grants in FY2023/24 (Indicative Target), despite transitional issues that hampered disbursement in the middle of the fiscal year. Considering that it is a well-targeted social protection program, we plan to expand coverage of child grants to all 77 districts as resources become available. We have expanded our scholarship program to include students from grades 6 to 12 from marginalized and underprivileged communities to further promote equality in human capital development. 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.

15. We are committed to further enhancing our social safety net to support our poverty alleviation efforts. The Cabinet has approved the 16th National Development Plan, which will guide our medium-term strategy to enhance governance, social justice, and prosperity. Despite recent

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

[2] We will include all the non-budgetary entities of the Nepal government, whose annual income or expenditure is more than Rs. 5 crore, and the non-budgetary entity of the provincial government, whose annual income or expenditure is more than Rs. 2 crore, and the non-budgetary bodies of the local level whose annual income or expenditure is more than 5 million.

setbacks, we plan to continue the development of the National Social Registry (NSR), including a system of national identification cards. The NSR will facilitate the identification of vulnerable households and allow for more efficient targeting of social transfers.

Monetary and Exchange Rate Policy

16. **Our monetary policy stance remains cautiously accommodative**. In an environment of ample liquidity, we have maintained the interbank rate around the bottom of the interest rate corridor (IRC) this fiscal year, effectively a loosening of about 400 basis points since July 2023. Lending rates have come down by almost 200 basis points since July 2023. This has not yielded much credit growth in the context of ongoing deleveraging following the post-pandemic credit boom. We will continue to maintain a cautious, data-dependent monetary policy stance to achieve our primary target of price stability, while also maintaining banking and financial sector stability and external sector stability.

17. **We commit to implementing the interest rate corridor (IRC) as designed, with the midpoint as the target rate**. Development of the interbank market—a lynchpin of further financial market development—depends on predictable, well-communicated monetary policy. Moreover, maintaining the interbank rate at the midpoint of the corridor is essential for clarity and credibility of monetary policy. Recognizing that the interbank rate has remained at or below the bottom of the corridor for most of this fiscal year, and in line with Fund TA recommendations, we will endeavor to move the IRC or intervene as necessary to secure the interbank rate at the mid-point. Monetary policy will also remain nimble, including to appropriately raise the target rate should inflation pressures reappear. To aid the functioning of the IRC by absorbing liquidity at the bottom of the IRC, the NRB introduced the Deposit Collection Facility in February 2024. By providing an automatic defense of the band, it has significantly reduced the size of deviations of the interbank rate below the IRC. We will continue to develop and refine the monetary policy toolkit to improve the functioning of the IRC in line with IMF TA recommendations. Except for improving financial inclusion in remote areas, we no longer count balances of local governments in the banking system as deposits.

Financial Sector Policies

18. **Pressures on the banking sector continued to increase**. Following the credit surge and reforms to the asset classification and working capital loan framework, banks have started to adjust lending practices and reclassify loans. Aggregate gross NPL levels of the banking sector rose to approximately 4.0 percent in April 2024, a 0.6 percentage point increase over the previous year. Aggregated bank capital ratios have decreased by 0.5 percent since January 2023 to 9.6 percent although there are signs these ratios are stabilizing. Loan loss provisioning coverage for the sector is adequate at 70 percent in April 2024. Bank profitability has fallen in the context of weak economic growth and declining bank income. Banks are facing increasing difficulties in NPL management, resulting in increases in non-bank assets and accrued interest. As forbearance on loan restructuring and rescheduling has been phased out, we will continue to prudently monitor the banking sector to ensure appropriate loan classification and restructuring, provisioning and capitalization.

19. Banks need to pursue structural solutions to the restructuring of problem loans to viable borrowers. Banks are implementing the asset classification regulation and the Working Capital Loan guidelines. The asset classification regulation in particular improved transparency and clarified definitions on loan performance, restructuring, rescheduling and reclassification together with the associated provisioning requirements. We phased out the provisions regarding forbearance. We will further align the asset classification regulation with international standards. We remain committed to avoid any conflict between the amended asset classification regulation and the WCL guidelines. We will continue to enhance the guidelines in a sustained manner to gradually reduce misuse of WCLs, ensuring that any adjustments are targeted and time bound and do not impact the core purpose of the guidelines.

20. We will conduct a loan portfolio review of the 10 largest banks. The aim of the loan portfolio review is to ensure that loans are classified and provisioned for in line with the new regulatory framework, paying special attention to evergreening, group borrowing, and concentration risks. In preparation of this exercise, we finalized the Terms of Reference in January and issued the Request for Proposal (RFP) to five short-listed parties in May 2024. A delay in the procurement process of the consultant has prevented us from launching this exercise by end-April 2024. To allow us to onboard the consultant, we propose to reset this benchmark to end-August (end-April 2024 SB, reset to end-August 2024). To expedite the launch, we will start laying some groundwork by preparing a document that provides more context on the priorities and information resources for the selected consultant. We will complete the exercise by end-February 2025 (end-December 2024 SB, reset to end-February 2025). In parallel, we will develop a plan to deal with the review's findings by end-February 2025 (end-February 2025 SB), and any bank with capital shortfalls will be required to submit time bound capital management plans setting out how they will return to full compliance with regulatory requirements.

21. We have taken further steps to strengthen bank regulation and supervision. We are improving risk-based supervision with Fund support, taking into account the recommendations in the 2023 Financial Sector Stability Report (FSSR). We have finalized the Supervisory Information System—including the on-site module for all the banks (end-April 2024 SB, met)—implemented a manual for onsite and offsite supervision and introduced the countercyclical capital buffer at 0.5 percentage points for this fiscal year. We are developing and enhancing our credit risk modelling and assessment capabilities with technical assistance from the Fund in anticipation of banks implementing IFRS-9 in FY2024/25. We aim to finalize the policies for the implementation of the Liquidity Coverage Ratio and will start an implementation pilot in FY2024/25, while consulting with banks. We stand ready to use other macro-prudential tools to mitigate the buildup of financial vulnerabilities.[3] Going forward, we intend to prioritize efforts to improve the bank resolution framework in line with the 2023 FSSR.

[3] 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 to 70 percent), (4) a debt-to-equity ratio (4:1), (5) loan to value ratios (between 50 and 70 percent), and (6) a sectoral limit (40 percent of total outstanding loans).

22. We remain committed to policy actions that ensure a stable and well-capitalized banking system. We will assess the uses of directed lending by closely monitoring the quality of these loans and review the provision of directed lending as needed.[4] We will streamline our prompt corrective action framework with a clear escalation process across various states of distress. For banks that are facing capital issues, NRB has taken remedial action including suspension of dividend payments. Further, as announced in the recent Monetary Policy Review, we will issue new policy measures to allow banks to raise additional capital. NRB will remain vigilant and use the relevant early intervention measures where necessary.

23. We are working to tackle the problems in the SACCOs to avoid contagion and spillovers to the banking sector. While we are addressing the issues, the registration of new SACCOs has been suspended. The FY2024/25 budget includes measures to improve the regulatory framework, establish a regulatory and supervisory agency, facilitate consolidation of SACCOs and arrangements to safeguard SACCO assets, operators and depositors using available collateral. We acknowledge that coordination and information exchange between all SACCO regulators needs to be reinforced to ensure consistent application of these policies. We also recognize that subnational level regulators may need assistance in setting up Problematic Cooperatives Management Committees. We are furthermore incorporating the SACCO sector reforms in the 2nd Financial Sector Development strategy. We are devising a strategy to deal with problematic SACCOs and intend to improve the regulatory oversight and supervisory architecture of these institutions, including through creation of a regulatory and supervisory agency.

Governance and Other Structural Reforms to Boost Growth

24. We are committed to further enhancing the autonomy and accountability framework of the NRB. The OAG conducted the audit of the NRB's FY2021/22 financial statements assisted by auditors with recognized international experience in auditing central banks. Building on this progress, we have requested the Auditor General, when conducting the audits of the NRB annual financial statements as per the prevailing laws of Nepal, to conduct the FY2023/24 audit with the service of experts with international experience in auditing and central bank auditing (end-July 2024 SB). We are drafting amendments to the NRB Act, with a view of implementing the recommendations of the 2021 Safeguards Assessment (SGA) to strengthen the NRB's autonomy and governance practices. This is an important reform that requires building strong consensus and substantive technical and legal discussions, requiring to reset the SB. The NRB will share a revised version of the amendments with the Ministry of Finance by end-June. The Ministry of Finance will complete a draft by mid-July and submit the NRB Act amendments to the Cabinet by end-July and to the Parliament by end-September 2024 (end-April 2024 SB, not met and proposed to be reset to end-September 2024).

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[4] 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.

25. We will accelerate progress on the remaining recommendations in the 2021 SGA.[5] We have made good progress since the last review, completing seven additional sub-recommendations since February 2024, bringing the total to about 2/3 of sub-recommendations completed. We will complete the implementation of the following SGA recommendations by mid-August 2024: 1) reporting to the Audit Committee based on the reporting templates proposed by the Fund TA in 2018 and 2019; 2) adopting a medium-term plan to strengthen staff capacity, particularly in internal audit, financial reporting, and foreign reserves management; and 3) completing the certification of the Chief Information Security Officer (CISO) or otherwise appointing a qualified CISO in the Information Security Unit. 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.

26. We are urgently strengthening our AML/CFT framework.[6] The International Co-operation Review Group observation period related to the Asia/Pacific Group on Money Laundering (APG) mutual evaluation of Nepal's compliance with global AML/CFT standards ends soon. We recognize the importance of Nepal not being listed by the FATF as a jurisdiction with strategic AML/CFT deficiencies. In this context, we have enacted the "Amendments to Some Laws relating to AML and Business Promotion Act" to bring Nepal's AML/CFT legal framework in line with international standards (end-July 2024 SB). We are confident the amendments—including secondary regulations—will improve Nepal's technical compliance with FATF standards by the end of the observation period in October 2024. We further commit to implement the remaining reforms in the APG action plan through implementation of the new AML/CFT National strategic plan, assisted by technical assistance from the Fund and other development partners. These include changing relevant regulations, improving capacity, understanding money laundering/terrorist financing risks, and strengthening supervision and enforcement.

27. We will continue our efforts to address structural barriers to growth. Improving the business and investment climate is essential to sustainable medium-term growth. We commit to pursue different avenues to reduce the cost of doing business, including by simplifying regulatory provisions and gradually improving the foreign investment climate, strengthening governance and anticorruption institutions, continue digitalizing government services, improving the inter-relationship between tiers of government in the context of advancing fiscal federalism, and enhancing the transparency, accountability, and effectiveness of public administration. To mitigate climate change and disaster-related risks and vulnerabilities, we will continue investing in resilient and sustainable infrastructure, improving agricultural and food security, enhancing financial resilience, and promoting green and inclusive growth. In this effort we will be guided by our Nationally Determined Contribution (NDC) and National Adaptation Plan (NAP), which include among the key priorities advancing climate smart agriculture (CSA) practices, enhancing sustainable forest management (SFM), strengthening social protection systems, and implementing disaster risk financing (DRF) mechanisms and instruments. Furthermore, in line with our 16th Development Plan,

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

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

we will focus on (i) increasing productivity in agriculture, industry and trade-related services (IT, tourism, and hydropower); (ii) supporting job creation; and (iii) strengthening social inclusion and integration programs—to reduce inequality and support labor mobility.

D. Risks and Contingencies

28. Downside risks and global uncertainty remain, but we stand ready to adjust policies as needed to respond. The effectiveness of monetary policy is constrained by credit market disruptions. On the other hand, prudent fiscal management in FY2023/24 would allow more fiscal space—should growth fail to rebound and revenues decline—while remaining within the guardrails of the ECF program. Any expenditure compression should prioritize protecting critical capital and social spending. Another major commodity price shock could require monetary policy tightening to maintain external stability and keep inflation in check. Foreign exchange reserve buffers are currently adequate to cushion against temporary shocks. 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. The NRB has been improving its tools and remains vigilant to prevent potential problems in the banking system. In the event of bank stress, the NRB stands ready to provide systemic liquidity support while triaging deeper solvency problems.[7] Finally, we will adopt policies to prevent spillovers from the difficulties in SACCOs.

E. Financing and Program Monitoring

29. 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, including 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.

30. 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 31.4 million is made available for the fourth review. The fifth, sixth and seventh reviews are respectively scheduled to be completed on or after November 1, 2024, May 1, 2025 and November 1, 2025; these reviews will be based on July 15, 2024, January 13,

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

2025 and July 15, 2025 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.

Table 1. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks: January 2024-July 2025

Measure	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-January 2025		
The MOF submits to Parliament amendments to modernize the NRB Law, addressing key recommendations of the 2021 Safeguards Assessments Report 2/	End-April 2024	**Not Met**	Reset to end-September 2024
An audit of the FY2023/24 financial statement of the NRB is conducted involving the service of experts with international experience in auditing and central bank auditing.	End-July 2024	**Modified**	
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	End-July 2024		
Revenue Mobilization			
MOF approval of a revenue mobilization strategy covering tax policy, law, and revenue administration reforms	End-April 2024	**Not Met, Implemented June 2024**	
The MOF publishes a comprehensive report on tax expenditures 3/	End-January 2025		
Fiscal Sustainability and Fiscal Risk Management			
A comprehensive fiscal risk statement is published by the MOF with the FY2025/26 Budget	End-August 2025		
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements	End-August 2024		
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Telecom) will have their FY2022/23 financial statements audited 3/	End-August 2024		
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)	End-April 2024	**Met**	
NPC approval of the revised National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection	End-March 2025	**New**	

1/ This SB was originally set for End-May 2022, was not met, was reset at the combined First and Second Review to end August 2023, was not met, and was reset at the Third Review to end-January 2025.
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, was not met, and was reset at the Third Review to end-April 2024.
3/ This SB was originally set for End-April 2024 and was reset at the Third Review to end-August 2024.

Table 1. Nepal: Structural Benchmark Status, Modifications and New Structural Benchmarks: January 2024-July 2025 (concluded)

Measure	Original Target Date	Status	Proposal
Financial Sector Regulation & Supervision			
The NRB completes implementation of the onsite module of the SIS among class A banks 1/	End-April 2024	**Met**	
Launch for 10 largest Banks in-depth on-site inspections assisted by independent international third-party auditors	End-April 2024	**Not Met**	Reset to end-August 2024
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors	End-December 2024		Reset to end-February 2025
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections	End-February 2025		

1/ 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)

	FY2022/23				FY2023/24				FY2023/24	FY2024/25	
	16-Jul-23				14-Jan-24				15-Jul-24	13-Jan-25	15-Jul-25
	Program target	Adjusted target	**Outturn**	Status	Program target	Adjusted target	**Outturn**	Status	Program target	Program target	Program target
Quantitative performance criteria under the ECF-supported program:											
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7,12/					435,959	440,278	**178,827**	met	315,628	233,270	256,943
Stock of NRB's net international reserves (floor; in U.S. dollars million) 1,8,9/	8,038	6,998	**10,473**	met	9,076	9,014	**12,144**	met	9,076	9,649	9,845
Accumulation of external payments arrears (ceiling) 2/	0	0	**0**	met	0	0	**0**	met	0	0	0
Indicative targets under the ECF-supported program:											
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7,12/	256,523	355,213	**315,070**	met							
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	6,987	6,987	**6,763**	not met	3,092	3,092	**1,674**	not met	6,987	3,092	6,987
Indicative target: floor on tax revenue of the federal government 10,13/									845,938	392,743	902,288
Memorandum items:											
Budget support from development partners (in U.S. dollars million) 1,11/	330		171		162		**100**		325	334	493
Revenues of the budgetary central government under the program (in NPR million) 1,3/	968,166		838,029		341,044		438,939		..	..	..
Revenue targets of the budgetary central government (in NPR million) 1,3/	1,066,000		..		563,983				1,248,620	..	1,125,209
Primary deficit adjustor for revenue (in NPR million) 6/	..		109,170		..		0		..	..	..
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 6/	109,170		..		61,009				..	..	..
Foreign-financed project loan disbursements (in NPR million) 1,3/	104,207		93,727		13,977		18,295		83,832	12,501	92,620
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 1,3/	..		-10,480		..		4,319		..	..	..

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 the level of revenue collection (same ceiling as for the target for primary deficit). Any downward adjustment to the NIR floor will be capped at USD 612 million for the next 12 months to maintain reserve adequacy. The revenue adjustor will be phased out starting at the July 15, 2024 test date.

9/ NIR floor target for July 15 2024 testing date is set about 0.8 months of imports above the adequacy level to provide margin in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy. The margin is being gradually reduced to 0.6 months of imports for subsequent targets.

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 July 14 2024, January 13 2025, and Juy 15 2025 testing dates the figures are cumulative of the period from January 15 2024 to July 14 2024, January 15 2024 and January 13 2025, and January 15 2024 to July 15 2025 respectively.

12/ Revenue sharing for province and local levels and other receipts are also excluded.

13/ Revenue sharing for province and local levels, nontax revenue and other receipts are also excluded.

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 133.3 per one USD, which corresponds to the exchange rate on May 20, 2024. Gold holdings will be valued at USD 2333.6 per troy ounce, the price in April 2024 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 May 20, 2024 exchange rates reported in the Table 1:

Table 1. Nepal: Program Exchange Rates [1/]

Currency	Program Exchange Rate
U.S. dollars / Nepali rupee	0.007
U.S. dollars / U.K. pound	1.270
U.S. dollars / Indian rupee	0.012
U.S. dollars / Chinese yuan	0.138
U.S. dollars / Euro	1.086
U.S. dollars / Japanese yen	0.006
U.S. dollars / Brunei dollar	0.743
U.S. dollars / Korean won	0.001
U.S. dollars / Kuwaiti dinar	3.261
U.S. dollars / Malaysian ringgit	0.213
U.S. dollars / Australian dollar	0.668
U.S. dollars / Bahrain dinar	2.659
U.S. dollars / Canadian dollar	0.734
U.S. dollars / Danish krone	0.146
U.S. dollars / Hong Kong dollar	0.128
U.S. dollars / Swedish krona	0.094
U.S. dollars / Swiss franc	1.099
U.S. dollars / Omani rial	2.601
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	0.028
U.S. dollars / U.A.E. dirham	0.272
U.S. dollars / Singapore dollar	0.742
U.S. dollars / SDR	1.325

1/ The reference date for Nepali rupee is May 20, 2024.

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 an adjustor for 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.

- A downward adjustment to the NIR floor for the condition described above will be capped at USD 556 million.[1]

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

Date	Cumulative over the period from January 15, 2024 to July 15, 2025 (USD million)
January 13, 2025	334
July 15, 2025	493

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).

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.

[1] 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)

10. 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.

11. 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.

12. 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.

13. 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 4.

Table 4. Nepal: Foreign -Financed Project Loan Disbursements Projected under the Program

Date	Cumulative over the respective fiscal year (Million NPR)
July 15, 2024	83,832
January 13, 2025	12,501
July 15, 2025	92,620

Indicative Target on Social Spending of the Budgetary Central Government

14. 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)

15. 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.

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

Continuous Performance Criteria

17. 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.

18. 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.

19. 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

20. 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 5 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.

21. 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 5. 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 5. 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 5. 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.).	M	75 calendar days
Other depository corporations survey data in NPR.	M	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.

NEPAL

June, 21 2024

FOURTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT—DEBT SUSTAINABILITY ANALYSIS

Approved By
Rupa Duttagupta and Fabian Valencia (IMF) and Manuela Francisco and Mathew Verghis (IDA)

Prepared by the staffs of the International Monetary Fund and the International Development Association.

Joint Bank-Fund Debt Sustainability Analysis	
Risk of External Debt Distress	Low
Overall Risk of debt Distress	Low
Granularity in the Risk Rating	No Applicable
Application of Judgment	Yes

Both external and overall public debts in Nepal are assessed at low risk of debt distress, unchanged from the last year's Debt Sustainability Analysis (DSA).[1] *Present value (PV) of external debt-to-exports ratio and external debt service-to-exports ratio breach the indicative thresholds under an export shock scenario, suggesting a mechanical rating of moderate risk of debt distress. Still, similar to last year's DSA, staff has applied judgement to override the mechanical signal due to Nepal's exceptionally high level of remittances, making the high debt-to-exports ratio a less relevant signal of debt distress in Nepal compared to most other countries. At over three times the exports, remittances are the major source of foreign exchange earnings in Nepal, which along with concessional external financing, help the country maintain an adequate level of reserves and meet its debt obligations despite a sizeable trade deficit. All other external and public debt risk indicators are below their respective indicative thresholds in all stress-tests. Public debt stood at 47 percent of GDP in FY2022/23: in line with the projection in last year's DSA despite much slower GDP growth*

[1] Nepal's debt carrying capacity remains strong, based on Nepal's composite indicator (CI) score. The CI is calculated at 3.14, based on the October 2023 World Economic Outlook (WEO) and the 2022 World Bank Country Policy and Institutional Assessment (CPIA) index.

and a sharp drop in revenue. The better-than-expected result is due to a favorable valuation effect in external debt, lower net acquisition of financial assets, as well as fiscal consolidation efforts by the authorities. Despite continuing macroeconomic headwinds, debt is projected to peak at 50 percent of GDP in FY2025/26 and to gradually subside afterwards. The assessment, however, is contingent upon continued fiscal consolidation effort by the authorities (as envisaged in the ECF-supported program as well as in the FY2023/24 mid-year budget review)—including tax revenue and spending reforms—and continued utilization of external borrowing at concessional terms. Nepal also needs structural reforms to diversify exports, improve productivity and competitiveness, and enhance resilience to shocks, in particular natural disasters.

PUBLIC DEBT COVERAGE

1. **Public debt in this DSA comprises debt from the general government, central bank (borrowing on behalf of the government) and government guarantees** (Text Table 1). Nepal's provincial and local governments have no debt. Their borrowing is permitted by the Public Debt Management Act of 2022 but has not yet commenced, apart from on-lending by the central government. The social security fund and other extra budgetary funds currently are not allowed to borrow, and thus do not have debt either. IMF disbursements in 2020-2023 were used for direct budget support, and bond issuances by the central bank were only for the purpose of monetary policy operations. The government has provided guarantees for the debts of State-Owned-Enterprises (SOEs), and the current stock of guarantees—totaling NPR 46 billion (0.9 percent of GDP)—is included in the debt stock.[2] The majority of the medium- and long-term SOE loans are from the central government, and thus are already covered under central government debt. SOE liabilities not covered by public debt are part of the contingent liability stress test.

2. **Public debt is defined in the LIC DSF to include the negative balance of the Treasury Single Account (TSA)**.[3] According to the Government Finance Statistics Manual and Public Sector Debt Statistics Guide, the negative cash balance of the TSA should be considered as government gross debt. The TSA receives central government revenue inflows and pays expenditure outflows. However, extra-budgetary funds, provincial, and local governments are not integrated into the TSA system, thus complicating cash management and reducing transparency. The net balance across all government accounts is positive—standing at about 5 percent of GDP in Q3 of FY2023/24. But other cash balances cannot be used to offset the negative cash balance of the TSA for the purposes of measuring gross debt in the LIC DSF, in part because it is not always clear how liquid these financial assets are and whether they can be used for servicing debt.[4] The negative TSA balance stood at 3.4 percent of GDP in FY2022/23, sharply up from 1.2 percent of GDP in FY2021/22, reflecting the authorities' efforts to reduce borrowing in the domestic bond market amid high interest rates and binding domestic borrowing limit. The increase in the negative TSA balance indicates elevated debt pressures in FY2022/23, which would have been harder to identify had the TSA balance not been included in the LIC DSF public debt definition.[5]

[2] The stock of guarantees increased by NPR 12 billion since the last DSA, as the interest due to be paid on the loan was amortized.

[3] Negative TSA balance is not part of the public debt as reported by the authorities.

[4] These cash balances can only be counted to reduce net debt.

[5] The negative balance of government accounts at the NRB cannot exceed 5 percent of the previous year's government revenue. However, there is legal uncertainty as to whether the limit applies to the consolidated balance across all accounts or to the TSA only.

Text Table 1. Nepal: Public Debt Coverage

	Subsectors of the public sector	Check box
1	Central government	X
2	State and local government	X
3	Other elements in the general government	X
4	o/w: Social security fund	X
5	o/w: Extra budgetary funds (EBFs)	X
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	X
8	Non-guaranteed SOE debt	

1	The country's coverage of public debt	The general government, central bank, government-guaranteed debt	
		Default	Used for the analysis
2	Other elements of the general government not captured in 1.	0 percent of GDP	0
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	2
4	PPP	35 percent of PPP stock	2.11
5	Financial market (the default value of 5 percent of GDP is the minimum value)	5 percent of GDP	5
	Total (2+3+4+5) (in percent of GDP)		9.1

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

3. **The contingent liability stress test is based on the default setting and includes contingent liabilities stemming from SOE debt (2 percent of GDP), PPP projects (2.1 percent of GDP) and financial market (5 percent of GDP)**. PPP projects have not been formally compiled by the government. According to the PPI database of the World Bank, Nepal's PPP contracts are estimated to account for 6 percent of GDP as of 2022. Already incorporated in the baseline debt figures is the Net Acquisition of Financial Assets (NAFA), which represents mostly loans and capital injections to SOEs from the government. The NAFA has averaged 1.4 percent of GDP annually since 2009, but dropped sharply to -0.9 percent of GDP in FY2022/23 as part of government consolidation efforts. The program baseline assumes NAFA to pick up and remain close to its long-term average in the foreseeable future. The stress test on contingent liabilities from SOE debt is thus in addition to the NAFA assumed in the baseline. The standard default risk of 2 percent of GDP is appropriate at this stage, as it covers about a fifth of total financial liabilities in all non-financial SOEs and all of the financial liabilities in Nepal Airlines Corporation, which is the highest risk at present, still running losses despite the post-pandemic tourism rebound.[6] Nevertheless, SOE risks remain high and need to be carefully monitored. This should be aided in part by timely publication and audit of SOE financial statements, as envisaged in the ECF program (end-August 2024 SB) and expanding the fiscal risk registry to include subnational governments and PPPs and publication of a comprehensive fiscal risk statement with the FY2025/26 budget (end-August 2025 SB). Likewise, given that Nepal's banks are adequately capitalized at the moment, the standard financial market default risk of 5 percent of GDP remains appropriate. However, Nepal's financial sector, including savings and cooperative organizations (SACCOs), is showing signs of stress—as manifested by the growing share of non-performing loans, lower capitalization, and stagnant private sector credit growth—and should be monitored (SR ¶12). The upcoming

[6] Other major SOEs, including Nepal Oil Corporation, were profitable in FY2022/23. For more details on SOE risks in Nepal, see the 2023 Selected Issues Paper on "Public Enterprises and Fiscal Risks".

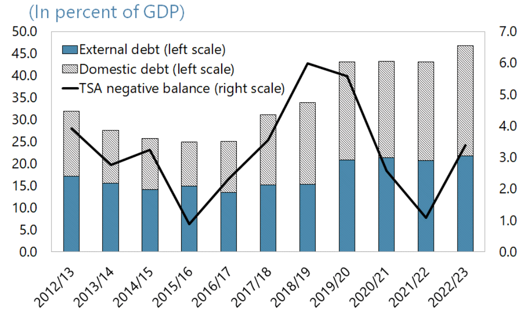
loan portfolio review (LPR) in the ten largest banks by the NRB is an important step in the right direction (SR ¶15). Once ready, its results will be used to calibrate the financial market default risk value.[7]

4. **Public debt management practices are steadily improving, but space for progress remains**. The Public Debt Management Act (PDMA), enacted in October 2022, consolidates debt management functions in the Public Debt Management Office (PDMO). The act also sets the limit on external public debt at one third of past fiscal year's GDP. As per the act, the PDMO took over the domestic debt issuance functions from the Nepal Rastra Bank (NRB) in April 2024, and made significant progress towards dematerializing debt securities. The transition process so far has been smooth and efficient. The Debt Management Committee, which decides on the debt issuance calendar and other matters, is now chaired by the Revenue Secretary, thereby seeking to separate domestic debt management—previously conducted within the NRB—from monetary policy operations. The Medium-Term Debt Strategy (MTDS) has now been published at the PDMO's website, with the intention to update it annually and use it as an input in the budget process. In August 2023, the Ministry of Finance implemented a fiscal risk register to identify, disclose, and manage fiscal risks, including those emanating from SOEs and guarantees. Despite the good progress, further strengthening fiscal risk and public debt management remains critical. Resource constraints and frequent rotation of the staff at the PDMO slow down the implementation of the PDMA. The middle- and back-office functions could be improved too, including though mainstreaming cash flow forecasting, integrating it with debt management and anchoring annual borrowing and issuance plans on the MTDS and market considerations.

BACKGROUND ON DEBT

5. **Nepal's total public debt has been on an increasing trajectory** (Text Figure 1). Public debt began to rise in 2016 amid the country's transition to fiscal federalism and the need to rebuild after the earthquake of 2015. It jumped up further in FY2019/20 during the pandemic and continued to climb up as the post-pandemic recovery in credit and imports turned into a bust, slowing GDP growth and denting tax revenue. As a result, debt has almost doubled from 25 percent of GDP in FY2015/16 to 47 percent in FY2022/23.

Text Figure 1. Evolution of Public Debt
(In percent of GDP)



Sources: Nepal authorities; and IMF staff estimates.

6. **External public debt is highly concessional, but has not increased much since the pandemic**. Multilateral creditors, such as the World Bank's International Development Association (IDA) and the Asian Development Bank (ADB) represent most of Nepal's external debt (87 percent of the total external debt)

[7] The LPR may also shed some light on the spillovers to the banking sector from the SACCOs, where vulnerabilities are rising (SR ¶16). The focus of the LPR however is not on SACCO exposure, and banks have little information on whether they have provided loans to clients that also are exposed to SACCOs as the latter don't do any credit information reporting.

(Text Table 2). Their loans have low interest rates (1 percent on average) and long maturities (around 36 years on average). The present value (PV) of external debt is estimated at 14.5 percent of GDP in FY2022/23, reflecting a high degree of concessionality. Bilateral loans—with the largest creditors being Japan, India, China, and Korea—have been concessional too. Nevertheless, external debt-to-GDP ratio has been nearly constant since the pandemic, largely reflecting political and capacity constraints in the government to implement externally financed capital projects.

Text Table 2. Nepal: Decomposition of Public Debt and Debt Service by Creditor, 2023-25

	Debt Stock (end of period) 2023			Debt Service					
				2023	2024	2025	2023	2024	2025
	(In million US$)	*(Percent total debt)*	*(Percent GDP)*	*(In million US$)*			*(Percent GDP)*		
Total[1]	19,171	100	47.1	4,720	1,708	1,408	11.6	4.2	3.5
External	8,881	46.3	21.8	396	420	481	1.0	1.0	1.2
Multilateral creditors[2]	7,815	40.8	19.2	319	339	398	0.8	0.8	1.0
IMF	395	2.1	1.0						
World Bank	4,404	23.0	10.8						
ADB	2,808	14.6	6.9						
Other Multilaterals	207	1.1	0.5						
Bilateral Creditors	1,066	5.6	2.6	77	81	84	0.2	0.2	0.2
Paris Club	467	2.4	1.1	19	18	22	0.0	0.0	0.1
o/w: JICA	409	2.1	1.0						
EXIM Bank of Korea	44	0.2	0.1						
Non-Paris Club	599	3.1	1.5	58	63	62	0.1	0.2	0.2
o/w: EXIM Bank of China	262	1.4	0.6						
EXIM Bank of India	300	1.6	0.7						
Bonds	0	0.0	0.0	0	0	0	0.0	0.0	0.0
Commercial creditors	0	0.0	0.0	0	0	0	0.0	0.0	0.0
Other international creditors	0	0.0	0.0	0	0	0	0.0	0.0	0.0
Domestic	10,290	53.7	25.3	4,324	1,288	927	10.6	3.2	2.3
Held by residents, total	10,290	53.7	25.3	4,324	1,288	927	10.6	3.2	2.3
Held by non-residents, total	0	0.0	0.0	0	0	0	0.0	0.0	0.0
T-Bills	3,482	18.2	8.6	3,553	144	0	8.7	0.4	0.0
Bonds	5,076	26.5	12.5	771	1,145	927	1.9	2.8	2.3
Loans[3]	1,732	9.0	4.3	0	0	0	0.0	0.0	0.0
Memo items:			0.0						
Collateralized debt[4]	0	0.0	0.0						
o/w: Related	0	0.0	0.0						
o/w: Unrelated	0	0.0	0.0						
Contingent liabilities	353	1.8	0.9						
o/w: Public guarantees	353	1.8	0.9						
o/w: Other explicit contingent liabilities[5]	0	0.0	0.0						
Nominal GDP	40,682								

1/ As reported by country authorities according to their classification of creditors, including by official and commercial. Debt coverage is the same as the DSA. Debt levels in this table may differ from those in other tables as the calculations here are based on US$. A year indicates the end of the corresponding fiscal year, e.g. 2023 stands for FY2022/23

2/ Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policies (e.g. Lending Into Arrears)

3/ Loans here refer to the negative Treasury Single Account (TSA) balance and SOE debt guarantees

4/ Debt is collateralized when the creditor has rights over an asset or revenue stream that would allow it, if the borrower defaults on its payment obligations, to rely on the asset or revenue stream to secure repayment of the debt. Collateralization entails a borrower granting liens over specific existing assets or future receivables to a lender as security against repayment of the loan. Collateral is "unrelated" when it has no relationship to a project financed by the loan. An example would be borrowing to finance the budget deficit, collateralized by oil revenue receipts. See the joint IMF-World Bank note for the G20 "Collateralized Transactions: Key Considerations for Public Lenders and Borrowers" for a discussion of issues raised by collateral.

5/ Includes other one-off guarantees not included in publicly guaranteed debt (e.g. credit lines) and other explicit contingent liabilities not elsewhere classified (e.g. potential legal claims, payments resulting from PPP arrangements).

7. Domestic public debt has been increasing faster than external debt in recent years. Domestic public debt rose from 10.1 percent of GDP in FY2015/16 to 25 percent in FY2022/23—much faster than external debt. About one-third of domestic debt is in short-term treasury bills with a maturity of up to 1 year, and close to sixty percent of domestic debt is in medium- to long-term development bonds with maturities of 3-7 years (Text Table 2). The debt is held mainly by domestic financial institutions. As all domestic public debt is held by residents, it is unlikely that there would be a material difference between currency- and residency-based measures of external debt. The interest rates on domestic borrowing are subject to significant volatility. Reflecting an uptick in inflation and consequent monetary policy tightening, the rates increased by over 6 percentage points in FY2021/22. Over 85 percent of total government interest spending in FY2022/23 (1.3 percent of GDP) was to pay interest on domestic debt. Interest rates have since gone down to 3-4 percent (depending on the debt instrument)—in line with the interbank rate and much lower than policy rates.

8. The stock of private external debt in Nepal is relatively low, but has been on the rise lately. While the government and the NRB are encouraging commercial banks to access external loans, bank external borrowing has been constrained by limited access, high relative cost, and regulations by authorities, such as a maximum spread limit on banks' foreign loans and limits on the set of potential lenders. Apart from trade credit, the external debt by banks and other sectors in FY2019/20 was relatively low at about 0.5 percent of GDP, but the external borrowing picked up in 2021-23, with the debt reaching estimated 2.2 percent of GDP in FY2022/23, driven by the NRB's monetary policy tightening and increased cost of funding in Nepal versus the rest of the world. Reflecting this recent trend, private medium-and long-term external debt is assumed to increase to 3 percent of GDP in the long term, with the total private external debt (including trade credit) reaching 4.5 percent of GDP. Most of the private external borrowing so far has been by banks and hydropower projects, which is likely well-covered in the standard contingent liabilities stress test for financial market and PPPs. The dynamics of the private external debt may change and has to be monitored, as the authorities have been signaling their increasing openness to foreign capital inflows, in part by engaging with international credit agencies to issue the country's first sovereign credit risk rating.

BACKGROUND ON MACRO FORECASTS

9. Nepal's post-pandemic rebound came to a halt in FY2022/23, and the country is facing significant structural challenges. Both real GDP growth, credit growth, and imports declined considerably in FY2022/23 after a post-pandemic credit boom, on the back of import restrictions, and monetary and financial sector tightening, which the government introduced to stem inflation, contain financial sector risks, and halt falling international reserves.[8] Growth was also hit by a post-pandemic rebound in emigration and under-execution of capital spending. External pressure subsided and reversed as a result of falling imports and buoyant remittances. The recovery will likely be subdued in FY2023/24, as credit growth remains low, capital spending is weaker-than-planned, and imports continue to contract, albeit at a slower pace. Going forward, the economy is helped by buoyant tourism and energy sectors, but at the same time

[8] Nepal introduced restrictions to curb imports during the second half of FY2021/22, but these were subsequently lifted in end-December 2022.

the present macroeconomic challenges are being compounded by Nepal's structural constraints, such as low domestic job creation, vulnerability to natural disasters—including those caused by climate change and environmental degradation—and large infrastructure gaps.

10. Growth and inflation. The latest estimates suggest that the economy grew considerably slower in FY2022/23 than anticipated a year ago—at 2.0 percent versus 4.4 percent as was projected in the last DSA (Text Table 3). Inflation increased to 7.8 percent in FY2022/23 in the aftermath of FY2021/22's booming domestic demand combined with the global surge in commodity prices. It is projected to subside to 5.6 percent in FY2023/24 and then converge to around 5.4 percent in the medium and long term—largely in line with the last DSA's projections—helped by cautious data-driven monetary policy by the NRB and favorable price developments abroad, particularly in India. Real GDP growth is projected to pick up in FY2023/24 but remain subdued at 3.1 percent amid weak credit growth, low capital spending, and fragile import recovery.[9]

11. Medium and long-term growth drivers. Growth is projected to gradually revert to around 5 percent over the medium to long-term. The growth forecast is contingent upon Nepal's steady progress on structural reforms, including those envisaged by the ECF, as well as adequate take-up of concessional external financing to boost the level of high quality social and capital spending. Growth will be driven by tourism-related service activities with the ongoing construction of over 20 new five-star hotels, adding to the existing 16. The NRB's increase in the loan-to-value ratio for real estate loans and a higher lending ceiling (NPR 20 million) for first-time homebuyers may provide some support to real estate prices. The industrial sector is also expected to contribute to growth in the medium term, fueled by a significant expansion of hydropower production and exports. This increased and more reliable power supply will create a more favorable environment, as businesses will have better access to electricity to operate, expand, and increase productivity. In addition, the National Project Bank's integrated guidelines, issued in March 2023, as well as Public Investment Management Assessment action plan issued by the National Planning Commission in June 2024, are expected to streamline project development, selection, and prioritization, leading to better capital spending over the medium term. At the same time, with increased evidence of more severe climate change impacts, Nepal's medium and long-term growth forecast is revised slightly downwards compared to the last year's DSA. The forecast is contingent upon comprehensive and scaled-up climate action, building on policy successes such as community forestry and hydropower investments, as well as managing climate-smart urbanization, strengthening low-carbon, resilient connectivity, improving disaster risk management, and prioritizing and utilizing climate finance, including through Green, Resilient, and Inclusive Development (GRID) approach and action plan, adopted by the government of Nepal and 16 development partners in November 2023.[10]

[9] The projection is more conservative but broadly in line with the estimate by National Statistics Office of 3.9 percent real GDP growth in FY2023/24.

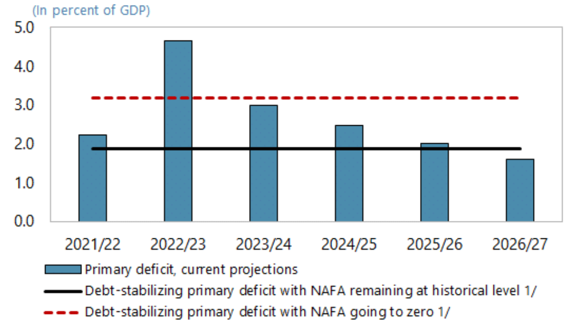
[10] More details on Nepal's climate policies and vulnerabilities in the World Bank's Country Climate and Development Report on Nepal (August 2022).

Text Table 3. Nepal: Selected Macroeconomic Assumptions 1/

	Previous DSA 2/				Current DSA				Current vs. Previous	
	22/23	**23/24**	**MT**	**LT**	**22/23**	**23/24**	**MT**	**LT**	**MT**	**LT**
Real growth (%)	4.4	5.1	5.2	5.2	2.0	3.1	5.0	5.0	-0.2	-0.2
CPI (period average, %)	7.8	6.3	5.6	5.4	7.8	5.6	5.4	5.5	-0.3	0.1
Revenues and grants (% GDP)	21.6	22.9	24.5	25.3	19.3	19.3	21.9	23.2	-2.5	-2.2
Primary expenditure (% GDP)	24.9	25.6	26.3	26.8	23.8	22.3	23.6	24.3	-2.7	-2.6
Net acquisition of non-financial assets (% GDP)	5.0	5.9	5.9	5.9	4.4	3.7	5.7	6.1	-0.2	0.2
Primary balance (% GDP)	-3.2	-2.7	-1.8	-1.5	-4.5	-3.0	-1.7	-1.1	0.2	0.4
Net acquisition of financial assets (% GDP)	1.4	1.4	1.4	1.4	-0.9	1.3	1.3	1.3	-0.1	-0.1
Net incurrence of liabilities (% GDP)	5.9	5.4	4.4	3.8	4.9	6.0	4.6	3.9	0.2	0.1
Net domestic financing (% GDP)	3.7	3.0	2.3	1.8	3.3	4.4	3.3	2.5	1.1	0.6
Exports of G&S (% GDP)	6.8	7.4	7.7	7.7	7.0	7.5	7.7	7.4	0.0	-0.3
Imports of G&S (% GDP)	36.6	36.3	34.5	27.2	34.7	32.9	36.0	28.4	1.4	1.2
Remittances (% GDP)	21.2	20.3	18.9	13.5	22.8	24.5	21.0	13.1	2.1	-0.4
Current account balance (% GDP)	-5.2	-5.0	-4.5	-2.7	-1.4	3.2	-3.6	-3.1	0.9	-0.4

Note: MT (medium term) is the average over the next 5 years, and LT (long term) is the average over the following 6-19 years.
Sources: Nepalese authorities; and IMF staff estimates
1/ Nepal's fiscal year starts in mid-July. For example, FY2022/23 runs from mid-July 2022 to mid-July 2023.
2/ Previous DSA refers to ECF Combined 1st and 2nd Review IMF CR 2023/158.

Text Figure 2. Debt-Stabilizing Primary Deficits
(In percent of GDP)



Source: IMF staff estimates.
1/ As of FY2025/26.

12. Fiscal: The primary deficit in FY2022/23 came in at 4.5 percent of GDP, sharply up from 2.2 percent in FY2021/22 and larger than projected in the last DSA. Slower growth and a sharp drop in imports deflated government revenue, resulting in a wider-than-expected deficit despite government efforts to consolidate spending. Despite the continued stagnation in revenue, the primary deficit is projected to shrink to 3 percent in FY2023/24—not far above the last DSA's projection—amid sizeable spending cuts of about 3.5 percent of GDP announced by the government during the January 2024 mid-term budget review. Part of the cuts are to capital spending, weighing on the private sector and undermining economic recovery. The other part is mainly related to administrative spending, such as abolishing incentive allowances, additional time allowances, purchasing new vehicles and furniture, as well as restructuring and reducing vacancies in government agencies. Such consolidation efforts are likely to have minimal spillovers to the private sector in the short-term, and a negligeable, if not positive, effect on growth in the medium-term.

13. Fiscal developments over the medium-term: The deficit is projected to subside further over the medium term to 1.4 percent of GDP, consistent with the consolidation path set out in the ECF program framework (Text Figure 2). The improvements in fiscal balances are contingent upon continued revenue mobilization efforts by the government—guided by the Domestic Revenue Mobilization Strategy adopted by the authorities in June 2024—and less duplication of spending responsibilities across levels of government. Capital spending is projected to pick up over the medium term, in part helped by the public investment management action plan, prepared by the authorities in April 2024 in the context of the ECF program. The FY2024/25 budget, announced in May 2024, is broadly consistent with the projected consolidation path. It includes additional revenue measures such as green tax on petroleum products, higher taxes on vehicles, increased excise duties on alcohol and tobacco, and measures to improve tax compliance. More capital spending has been budgeted, but current spending will be contained, resulting in a projected further reduction of the primary deficit by about 0.5 percent of GDP from the FY2023/24 level.

14. Net acquisition of financial assets: The dynamics of the existing debt stock and the fiscal path suggest a debt-stabilizing primary deficit of around 3.2 percent of GDP, but the continuation of the sizeable NAFA implies a much lower level of about 1.9 percent. The authorities sharply reduced NAFA in FY2022/23 to reduce fiscal pressure, but the proposed fiscal path is expected to stabilize public debt assuming the NAFA remains broadly at historical average—consistent with the levels observed in the last few years (net of the changes in the TSA balance).

15. External sector: The current account (CA) deficit shrank from 12.7 percent in FY2021/22 to just 1.4 percent in FY2022/23 and is projected to reverse into a surplus in FY2023/24—reflecting a sharp drop in imports amid slowing economy coupled with continued post-pandemic recovery in remittances and tourism services. The CA is projected to revert back to a deficit of about 3.6 percent of GDP in the medium term as the economy recovers and pent-up demand for imports catches up. Exports as a share of GDP have performed better-than-projected in the previous DSA in FY2022/23 and (projected) in FY2023/24, despite an abrupt slowdown of palm and soybean oil re-export to India. The growth is mainly due to a stronger-than-expected recovery in tourism, which comprises over forty percent of total exports, and a healthy growth in exports of agricultural and industrial items, including cement and clinker and, notably, hydropower. Exports are expected to gradually reach around 7.7 percent of GDP in the medium-term, supported by further growth of the hydropower sector.[11] Remittances are expected to decline as a percent of GDP—including because of growth underperformance in migrant-hosting countries, return migration, and fewer new workers traveling abroad— but will remain sizeable at about 21 percent of GDP over the medium term. International reserves are projected to reach 9.4 months of prospective imports in FY2023/24, and remain high in the medium term at 7-8 months of prospective imports.

16. Financing: External government financing decreased in 2021-23 both in nominal terms and as a share of GDP as the authorities increasingly relied on domestic borrowing and tapped the TSA. Nonetheless, concessional loans from development partners, mainly multilateral development banks, are expected to remain a key source of funding to cover the BOP and fiscal financing needs next year and in

[11] The projection of hydropower export is fairly conservative—assuming a quadrupling over the next 10 year from a relatively low base in FY2022/23. Exports of hydropower are projected to grow by 50 percent already in FY2023/24. Efforts are also ongoing for boosting the hydropower export further, with the recently signed agreement for exporting 10,000 MW to India in 10 years—about a ten-fold increase from the current levels. Should this ambition be realized, it would present a significant upside to the current DSA projections.

the medium term (Text Table 4). At the same time, reflecting upon the dynamics of the last few years, the size of external financing is now projected at about 1.4 percent of GDP in the medium term—lower than 1.9 percent of GDP as was projected in the last DSA. Domestic borrowing is now projected to cover about two thirds of fiscal financing needs over the medium and long term, while remaining a costlier and generally riskier alternative to external concessional funding. The interest rates on domestic borrowing are projected to pick up from presently low levels to reach about 5-6 percent over the medium-term—in line with the projected inflation and an assumption of less financial repression. The interest rate on newly issued external debt, as well as other elements of concessional financing such as maturity and grace periods, are projected to remain broadly unchanged. External borrowing is subject to exchange rate risk (low so far), but the borrowing terms are extremely favorable for Nepal especially compared to Frontier and Emerging Market economies attempting to access international bond markets. About a third of the newly-issued domestic debt is assumed to be short-term—in line with the recent trend and current government practices, and subject to a significant refinancing risk.

Text Table 4. Nepal: External Borrowing Program, FY2023/24

PPG external debt contracted or guaranteed	Volume of new debt, US$ million 1/	Present value of new debt, US$ million 1/
Sources of debt financing	1,001	521
Concessional debt, of which 2/	920	465
Multilateral debt	757	385
Bilateral debt	164	80
Non-concessional debt, of which	81	56
Semi-concessional debt 3/	81	56
Commerical terms 4/	0	0
Uses of debt financing	1,001	521
Project financing	726	
Budget financing	275	
Memorandum items		
Indicative projection FY2024/25	1,068	601
Indicative projection FY2025/26	1,184	682

Sources: Nepalese authorities; and IMF staff estimates.

1/ Contracting and guaranteeing of new debt. The present value of debt is estimated using the terms of recent individual loans and applying the 5 percent program discount rate.

2/ Debt with a grant element that exceeds 35 percent.

3/ Debt with a positive grant element which is lower than the minimum grant element of 35 percent.

4/ Debt without a positive grant element.

17. Realism of the baseline is broadly corroborated by the realism checks and debt dynamics tools.

- Unexpected changes in both public and external debt over the last five years are well within the 25-75 percent interquartile range of the distribution across all LICs.

- The public debt-creating flows over the next five years are similar to the 5-year historical average. The contribution of future GDP growth is somewhat lower considering that the 5-year historical average includes the pandemic. The contribution of primary deficit is lower too, reflecting the authorities' commitment to stabilize debt over the medium-term, already demonstrated during the FY2023/24 mid-year budget review. The external debt-creating flows over the next five years show a much smaller contribution of the current account partly offset by the accumulation of reserves—in line with the dynamics of the last two years (Figure 3).

- The projected 3-year fiscal adjustment is marginally above the 75th percentile across all LICs with Fund-supported programs since 1990. However, close to half of the adjustment is already visible 10 months into the fiscal year, and likely to materialize in FY2023/24.

- The impact of the adjustment on economic growth is projected to be lower than implied by conventional assumptions about fiscal multipliers. Part of the projected fiscal adjustment reflects a reverse causality as economic recovery and a rebound in imports contribute to higher government revenue. Nevertheless, it is important to make sure that the projected fiscal consolidation is gradual and growth-friendly: focused on increasing revenue while protecting the most vulnerable and boosting public investment.

- The implied projected impact of public investment on economic growth is more conservative than what has been likely the case historically (Figure 4). Should the capital spending turn out more targeted and efficient, as is the authorities' ambition, it would present an upside to the current DSA projections and reduce potential negative spillovers from fiscal consolidation to economic growth.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

18. Nepal's debt carrying capacity is strong. A composite indicator (CI) is used to capture the different factors affecting a country's debt carrying capacity. The CI is a weighted average of the World Bank's Country Policy and Institutional Assessment (CPIA) score, the country's real GDP growth, remittances, foreign exchange reserves, and global growth. The calculation of the CI is based on 10-year averages of the variables, across 5 years of historical data and 5 years of projections. Nepal's CI score is calculated at 3.14, based on the October 2023 World Economic Outlook and the 2022 World Bank CPIA index, which lies in a range of a *strong* rating (Text Table 5).

19. Tailored stress tests: The LIC-DSF includes stress tests to assess the sensitivity of projected debt burden indicators to adverse changes in the baseline projections as well as to materialization of contingent liabilities. All stress tests were kept at their default settings. In addition, to reflect Nepal's vulnerability to natural disasters, such as the 2015 earthquake, a natural disaster shock was applied as one of the stress tests. A one-off shock of 10 percentage points of GDP to the debt-to-GDP ratio in the second year of the projection period (FY2024/25) is assumed, and real GDP growth and exports were lowered by 1.5 and 3.5 percentage points, respectively, in the year of the shock for the stress test.

Text Table 5. Nepal: Debt Carrying Capacity and Thresholds

Debt Carrying Capacity and Thresholds

Country	Nepal
Country Code	558

Debt Carrying Capacity	Strong

Final	Classification based on current vintage	Classification based on the previous vintage	Classification based on the two previous vintage
Strong	Strong 3.14	Strong 3.16	Strong 3.17

-

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.39	3.42	1.31	42%
Real growth rate (in percent)	2.72	4.11	0.11	4%
Import coverage of reserves (in percent)	4.05	57.32	2.32	74%
Import coverage of reserves^2 (in percent)	-3.99	32.85	-1.31	-42%
Remittances (in percent)	2.02	15.49	0.31	10%
World economic growth (in percent)	13.52	2.89	0.39	12%
CI Score			3.14	100%
CI rating			Strong	

Applicable thresholds

APPLICABLE	
EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	240
GDP	55
Debt service in % of	
Exports	21
Revenue	23

APPLICABLE	
TOTAL public debt benchmar	
PV of total public debt in percent of GDP	70

New framework			
	Cut-off values		
Weak	CI <	2.69	
Medium	2.69	≤ CI ≤	3.05
Strong	CI >	3.05	

EXTERNAL DEBT SUSTAINABILITY

20. **All external debt indicators remain below their indicative thresholds under the baseline** (Figure 1, Table 1, Table 3). External debt in FY2022/23 was significantly lower than projected in the last DSA despite worse-than-expected automatic dynamics (e.g. lower GDP growth). This can be attributed to two reasons. Firstly, a stronger US dollar in 2022, in particular vis-à-vis the SDR, played in Nepal's favor, as over three quarters of Nepal's external debt is nominated in SDR, and another ten percent is denominated in currencies other than US dollar or SDR. Secondly, external financing in FY2022/23 was lower-than projected. Lower reliance on external borrowing is projected to continue into the medium and long-term, and as a result PPG external debt is projected to decline gradually to about 18 percent of GDP by FY2033/34. Correspondingly, the PV of PPG external debt-to-GDP ratio—hovering at about 12-14 percent in the medium term—is well below its respective threshold of 55. The PV of PPG external debt-to-exports ratio is below the threshold too, though it is relatively high due to Nepal's very low exports-to-GDP ratio. Other indicators (debt service-to-exports ratio, and debt service-to-revenue ratio) are all below their respective thresholds.

21. **External debt is most vulnerable to export shocks**. The PV of PPG external debt-to-exports ratio and external debt service-to-export ratio breach the thresholds in an export shock stress test scenario.[12] In the case of the external debt service-to-export ratio, the breach is marginal (close to 5 percent) and temporary, though not one-off (lasting 2 years, FY2025/26 and FY2026/27). The shock to exports is particularly large for Nepal as it is calibrated based on export volatility in the last ten years, a period that includes the earthquake in 2015 and the pandemic in 2020, both having had a devastating effect on the country's tourism sector. The calibration period also includes a one-off 46 percent spike in exports in FY2021/22 due to a massive increase in the palm oil re-export driven by a now-removed loophole in custom tariffs between Nepal, India, and Indonesia.[13] In the case of the external debt service-to-exports ratio, the breach is a new adverse development compared to the last year's DSA. Because of a small denominator (exports), the indicator is highly sensitive to macroeconomic assumptions. It breaches the threshold primarily because of a larger implied volatility of exports in the export shock stress test compared to the last year's DSA, as well as because of the SDR's appreciation against the US dollar and hence larger-than-projected repayments on SDR-denominated debt compared to the last year's projection. Even though the breach is marginal, it needs to be monitored going forward. The other indicators are all below the respective thresholds even in their most extreme stress tests.

OVERALL RISK OF PUBLIC DEBT DISTRESS

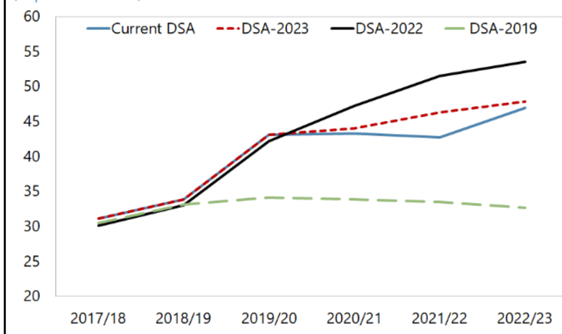
22. **Under the baseline scenario, the PV of public debt-to-GDP ratio remains firmly below the 70 percent benchmark during the projection period** (Figure 2, Table 2, Table 4). Public debt in

[12] The PV of PPG external debt-to-GDP ratio also breaches the threshold in the combined shocks scenario, where the culprit is again the shock to exports.

[13] The calibrated volatility of exports would decrease by one third if FY2021/22 is excluded from the calculation. The PPG external debt-to-exports ratio would still breach the indicative threshold, but the breach would be marginal and temporary (4 years).

FY2022/23 turned out lower than projected in the last DSA, despite slower GDP growth, a sharp drop in imports, and a reduced reliance on concessional external financing. Besides fiscal consolidation effort by the authorities, one factor which helped is the valuation effect due to a strong US dollar, which reduced the external debt-to-GDP ratio. Another factor is a sharp drop in NAFA as the authorities sought to reduce domestic borrowing amid high interest rates. Overall, the public debt has so far been lower-than-projected during the ECF program request in January 2022, but above the pre-pandemic projections and still rising (Text Figure 3). Gradual fiscal consolidation coupled with economic recovery is projected to stabilize public debt dynamics in the medium-term: the debt is projected to peak at around 50 percent of GDP in FY2025/26, and gradually subside after. The PV of the debt-to-GDP ratio is expected to increase from 40 to a peak of 43 percent of GDP—well below the 70 percent benchmark. At the same time, Nepal's debt service-to-revenue ratio is relatively high at over 50 percent because close to a third of domestic debt is short-term and the revenue-to-GDP ratio has recently fallen.

Text Figure 3. Public Debt: Projections vs Actual
(In percent of GDP)



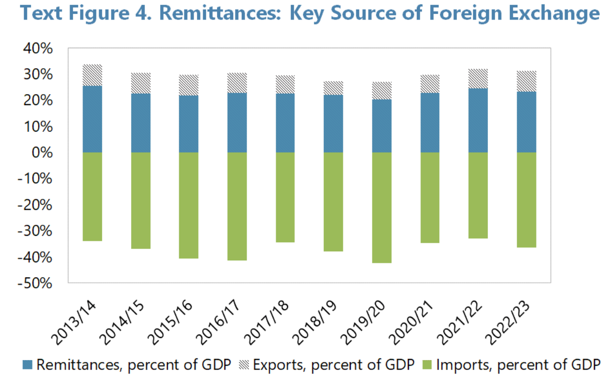
Sources: Nepali authorities; and IMF staff estimates.

23. **Public debt is most vulnerable to a growth shock**. The growth shock is defined as a temporary shock to real GDP growth in the second and third year of the projection period and is set to either the 10-year historical average growth minus one standard deviation or projected growth minus one standard deviation, whichever is lower. The shock would raise the PV of debt-to-GDP ratio close to the threshold of 70 percent in the last year of the projection period, 2034. The PV of debt-to-revenue ratio and the debt service-to-revenue ratio also rise significantly under such a shock. However, none of the thresholds are breached. Like with exports, the shock to growth is calibrated to be particularly large for Nepal as the calibration period includes both the earthquake of 2015 and the pandemic. Under all other shock scenarios, the PV of debt-to-GDP ratio remains well below the indicative threshold.

OTHER FACTORS TO ACCOUNT FOR

24. **Judgment is applied in interpreting the risk signal from stress tests on the PV of debt-to-exports and debt service-to-exports in light of the exceptionally high level of remittances and the resilience to shocks of all other debt burden metrics**. Remittances are the major source of foreign exchange in the country (Text Figure 4). Nepal's remittance-to-GDP ratio (averaging 24 percent of GDP in 2018-2023) is the fourth largest in the world, and its

Text Figure 4. Remittances: Key Source of Foreign Exchange



Sources: Nepal authorities; and IMF staff estimates.

remittance-to-exports ratio is by far the largest in the world (2018-22 averages), indicating an exceptionally high role of remittances in the economy. Remittances have also been less volatile than exports—with standard deviation of remittance growth being 7.4 percent versus 19.3 percent for export growth in the last 10 years—providing an important cushion in times of economic adversity.[14] The high level of remittances is also a major contributor to Nepal's Composite Indicator and the country's strong rating of debt carrying capacity. However, the current level of remittances is well above 7 percent of GDP—the minimum that is needed, everything else equal, to maintain the strong rating. The exceptional role of remittances, combined with the fact that all other debt burden metrics remain below their sustainability thresholds, mitigates the risk signal from stress tests on the PV of debt-to-exports and debt service-to-exports. Nepal's low level of exports and their volatility is, however, a major vulnerability requiring committed policy attention. Boosting exports and reducing structural trade imbalances will become increasingly important over the medium and long-term as the role of remittances in the economy is projected to diminish.

RISK RATINGS AND VULNERABILITIES

25. The risk of both public external debt distress and overall debt distress are assessed as low. All debt indicators remain below the relevant indicative thresholds under the baseline. The PV of public debt remains below the threshold under all stress tests. The PV of PPG external debt-to-exports ratio and external debt service-to-exports ratio breach the indicative thresholds under an export shock scenario, suggesting a mechanical rating of medium risk of debt distress. However, staff applied judgment to assess both external and public debt to be at low risk of debt distress given the exceptionally high level of remittances, the major source of foreign exchange, to balance the current account and service external debt. The fact that the PV of PPG external debt is 14.5 percent of GDP in FY2022/23, well below the indicative threshold of 55, is reassuring. In case of external debt service-to-exports ratio, the threshold breach is marginal and temporary. External debt is also below thresholds in baseline and shock scenarios across other metrics (PV of debt-to-GDP and external debt service-to-revenues), reflecting to a large extent the high level of concessionality of external borrowing and the low cost of debt servicing.[15] Nepal's high and increasing international reserves, projected to remain well above the adequacy level in the medium and long term, also supports the assessment. Besides, the authorities have achieved a considerable fiscal consolidation despite challenging macroeconomic environment in FY2022/23 and (projected) FY2023/24, and kept the public debt broadly in line with the previous DSA's projection, thus demonstrating their commitment to fiscal prudence. At the same time, exports of goods and services in FY2022/23 and (projected) FY2023/24 grew faster than projected in the previous DSA, and there are good prospects for an upside going forward, especially in the hydropower sector. Nevertheless, uncertainty around the baseline

[14] Besides, Nepal's net errors and omissions have been consistently positive in the last decade and large (averaging over 2 percent of GDP in the last 5 years), indicating large unaccounted foreign exchange inflows into Nepalese economy, and thus contributing to large residuals in the external debt dynamics (Table 1). The positive errors and omissions could be due to informal exports, especially in the tourism sector, or due to informal (and possibly in-kind) remittances. The authorities are in the process of transitioning the BoP accounts to the BPM6 standard, helped by an IMF TA mission in June 2024. The new accounting rules should improve the official estimates and, everything else equal, reduce net errors and omissions, and possibly increase exports and/or remittances.

[15] In reference to the LIC DSF guidance note, the use of staff judgement is based on the general provision to take into account country-specific factors that are not fully accounted for in the model.

projections, the calibration of the shocks, and the debt risk assessments is exceptionally high in light of the major global shocks that hit Nepal in the last couple of years, and in light of climate-related shocks that are bound to increase in size in the future at the same time as the role of remittances in the economy is projected to diminish.

26. While debt remains sustainable in the medium term, a number of steps could be taken to mitigate any potential risks. To build resilience to shocks and boost exports, the authorities should continue to make efforts to improve productivity and competitiveness through stepping up investment in resilient and sustainable infrastructure, as well as streamlining regulations and administrative processes, accompanied also by sustained stronger domestic revenue mobilization. It is also important to pursue rigorous analysis of the risks related to contingent liabilities, for example, related to non-guaranteed commercial SOE debt or unfunded pension liabilities, PPP projects, and budget support for the financial sector, including SACCOs. Improvements are needed in subnational governments' public financial management and reporting. The authorities will also need to make significant progress in mainstreaming the medium-term debt strategy (MTDS) and cash flow forecasting—developing the government bond market further to facilitate domestic borrowing and moving towards longer maturity debt replacing short-term bills. At the same time, the authorities need to boost their effort to utilize external borrowing at concessional terms, which is readily available and much-needed to close infrastructure gaps. Finally, the findings in this assessment are contingent upon prudent execution of medium-term fiscal consolidation strategy, including the tax revenue and spending reforms envisaged in the ECF arrangement.

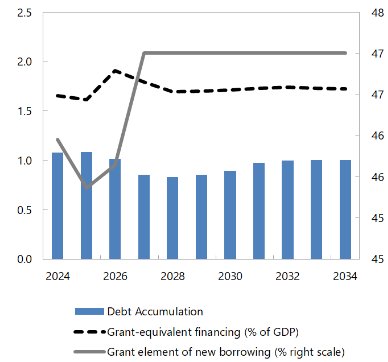
AUTHORITIES' VIEWS

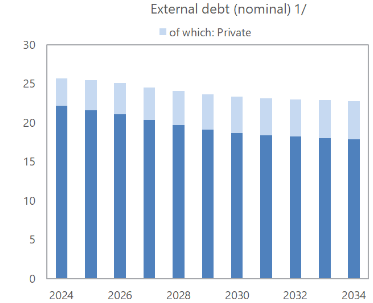
27. The authorities broadly agreed with the assessment. They reiterated their commitment to stabilizing debt over the medium term and pointed to the legislative limit on external debt set by the Public Debt Management Act (at 33 percent of the previous year's GDP), as well as to the annual limits on domestic borrowing set by the Natural Resource Commission as key anchors. They also pointed to Nepal's strong external position, which serves as a mitigating factor and strengthens the country's ability to serve its debt, but fully agreed with the need for policies to boost exports and reduce trade deficits. The authorities acknowledged the importance of utilizing concessional external borrowing, while noting the risk that its availability and conditions will worsen as Nepal graduates from Least Developed Country status, scheduled for 2026.

Table 1. Nepal: External Debt Sustainability Framework, Baseline Scenario, 2021-2044

	Actual			Projections								Average 8/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2044	Historical	Projections
External debt (nominal) 1/	25.4	24.6	26.4	25.7	25.4	25.1	24.5	24.0	23.6	22.8	21.4	19.7	24.0
of which: public and publicly guaranteed (PPG)	21.4	20.6	21.8	22.2	21.6	21.1	20.4	19.7	19.1	17.8	16.4	17.3	19.6
Change in external debt	2.1	-0.8	1.7	-0.7	-0.3	-0.3	-0.6	-0.5	-0.4	-0.1	-0.1		
Identified net debt-creating flows	5.0	9.6	1.4	-4.2	0.1	2.4	2.4	2.2	2.0	1.6	1.1	0.9	1.2
Non-interest current account deficit	7.5	12.4	1.1	-3.5	1.4	3.7	3.7	3.5	3.3	2.8	2.4	2.1	2.4
Deficit in balance of goods and services	32.8	35.6	27.7	25.3	28.5	29.9	28.6	27.1	25.9	21.3	15.6	29.7	25.4
Exports	5.1	6.7	7.0	7.5	7.8	7.8	7.6	7.6	7.6	7.5	7.2		
Imports	38.0	42.3	34.7	32.8	36.3	37.6	36.2	34.8	33.5	28.7	22.8		
Net current transfers (negative = inflow)	-24.6	-22.4	-25.2	-26.9	-25.9	-25.0	-23.8	-22.5	-21.5	-17.4	-12.2	-26.3	-21.8
of which: official	-0.6	-0.3	-0.2	-0.6	-0.6	-0.9	-0.9	-0.8	-0.8	-0.8	-0.8		
Other current account flows (negative = net inflow)	-0.7	-0.8	-1.4	-1.9	-1.3	-1.2	-1.1	-1.1	-1.1	-1.1	-1.0	-1.2	-1.2
Net FDI (negative = inflow)	-0.4	-0.4	-0.1	-0.2	-0.3	-0.5	-0.5	-0.5	-0.5	-0.5	-0.5	-0.3	-0.4
Endogenous debt dynamics 2/	-2.0	-2.4	0.4	-0.5	-0.9	-0.9	-0.9	-0.9	-0.8	-0.8	-0.8		
Contribution from nominal interest rate	0.2	0.2	0.3	0.3	0.2	0.3	0.3	0.2	0.2	0.3	0.2		
Contribution from real GDP growth	-1.0	-1.3	-0.5	-0.8	-1.1	-1.1	-1.1	-1.1	-1.1	-1.0	-1.0		
Contribution from price and exchange rate changes	-1.2	-1.3	0.7	...	...	...	...	...	...	...	...		
Residual 3/	-3.0	-10.4	0.3	3.5	-0.4	-2.7	-3.0	-2.7	-2.4	-1.7	-1.2	-0.1	-1.6
of which: exceptional financing	-0.5	-0.6	-0.5	-0.8	-0.8	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	14.6	14.6	14.4	14.0	13.5	13.0	12.5	11.4	10.3		
PV of PPG external debt-to-exports ratio	...	...	209.3	194.7	185.3	180.0	176.2	169.9	164.9	152.4	142.7		
PPG debt service-to-exports ratio	12.8	9.6	10.4	12.1	11.6	12.2	11.9	11.3	10.9	8.8	7.7		
PPG debt service-to-revenue ratio	2.9	2.9	3.8	4.8	4.6	4.6	4.3	3.9	3.7	3.0	2.4		
Gross external financing need (Million of U.S. dollars)	3577.4	6241.9	1736.6	-189.2	1507.6	2981.0	3286.6	3457.8	3650.5	4955.1	7481.1		
Key macroeconomic assumptions													
Real GDP growth (in percent)	4.8	5.6	2.0	3.1	4.9	4.9	5.0	5.0	5.0	5.0	5.0	4.4	4.8
GDP deflator in US dollar terms (change in percent)	5.4	5.6	-2.6	3.5	4.4	4.8	4.9	5.0	5.0	5.0	5.0	2.0	4.8
Effective interest rate (percent) 4/	0.8	0.9	1.1	1.3	1.1	1.1	1.1	1.1	1.1	1.2	0.8	1.0	1.2
Growth of exports of G&S (US dollar terms, in percent)	-17.5	46.1	3.0	15.5	12.9	10.2	8.4	10.1	9.9	9.8	9.9	4.8	10.6
Growth of imports of G&S (US dollar terms, in percent)	22.0	24.2	-18.5	1.0	21.0	14.2	6.1	5.8	6.2	7.4	7.9	8.4	8.1
Grant element of new public sector borrowing (in percent)	...	...	...	46.0	45.4	45.6	47.0	47.0	47.0	47.0	47.0	...	46.6
Government revenues (excluding grants, in percent of GDP)	22.4	22.4	18.9	18.7	19.6	20.5	21.3	21.9	22.4	22.2	23.0	19.9	21.4
Aid flows (in Million of US dollars) 5/	309.5	227.5	178.8	759.8	745.5	995.3	1119.3	1165.7	1293.1	2128.3	5334.5		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	1.7	1.6	1.9	1.8	1.7	1.7	1.7	1.6	...	1.7
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	57.2	56.9	61.0	63.2	62.7	62.5	62.3	63.4	...	61.3
Nominal GDP (Million of US dollars)	36,927	41,183	40,907	43,673	47,826	52,622	57,968	63,907	70,443	114,536	302,823		
Nominal dollar GDP growth	10.4	11.5	-0.7	6.8	9.5	10.0	10.2	10.2	10.2	10.2	10.2	6.5	9.8
Memorandum items:													
PV of external debt 7/	...	...	19.1	18.2	18.2	18.0	17.6	17.3	17.1	16.3	15.4		
In percent of exports	...	...	274.4	241.6	235.0	231.8	230.6	226.8	224.2	218.3	212.2		
Total external debt service-to-exports ratio	51.0	47.2	46.9	43.4	27.5	30.6	31.2	30.4	30.2	26.5	7.7		
PV of PPG external debt (in Million of US dollars)			5952.0	6394.5	6868.7	7355.6	7804.7	8288.0	8835.1	13061.6	31303.7		
(PVt-PVt-1)/GDPt-1 (in percent)				1.1	1.1	1.0	0.9	0.8	0.9	1.0	1.0		
Non-interest current account deficit that stabilizes debt ratio	5.5	13.2	-0.6	-2.9	1.6	4.1	4.3	4.0	3.7	2.9	2.5		

Definition of external/domestic debt	Residency-based
Is there a material difference between the two criteria?	No





Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponding fiscal year, e.g. 2023 stands for FY2022/23

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - \rho(1+g) + \varepsilon\alpha(1+r)]/(1+g+\rho+g\rho)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, ρ = growth rate of GDP deflator in U.S. dollar terms, ε=nominal appreciation of the local currency, and α= share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes. Large residuals in FY2020/21, FY2021/22, and FY2023/24 are mostly due to changes in reserves as well as large net errors and omissions.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

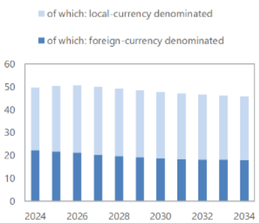
Table 2. Nepal: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021-2044

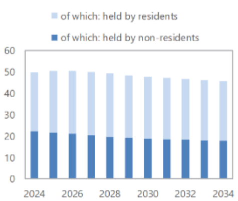
(In percent of GDP, unless otherwise indicated)

	Actual			Projections												Average 6/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2044	Historical	Projections
Public sector debt 1/	**43.2**	**42.7**	**47.1**	**49.7**	**50.4**	**50.4**	**50.0**	**49.3**	**48.4**	**47.6**	**47.1**	**46.6**	**46.2**	**45.9**	**42.4**	**34.4**	**48.3**
of which: external debt	**21.4**	**20.6**	**21.8**	**22.2**	**21.6**	**21.1**	**20.4**	**19.7**	**19.1**	**18.7**	**18.4**	**18.2**	**18.0**	**17.8**	**16.4**	**17.3**	**19.6**
Change in public sector debt	0.1	-0.5	4.4	2.6	0.6	0.1	-0.5	-0.7	-0.9	-0.7	-0.6	-0.5	-0.4	-0.3	-0.8		
Identified debt-creating flows	**2.7**	**1.4**	**2.0**	**1.7**	**0.7**	**0.5**	**0.2**	**-0.1**	**-0.2**	**-0.1**	**0.0**	**0.1**	**0.2**	**0.2**	**-0.3**	**1.6**	**0.3**
Primary deficit	**3.2**	**2.2**	**4.5**	**3.0**	**2.5**	**2.0**	**1.6**	**1.3**	**1.1**	**1.1**	**1.2**	**1.2**	**1.2**	**1.2**	**0.5**	**2.2**	**1.6**
Revenue and grants	23.3	22.9	19.3	19.3	20.2	21.4	22.1	22.7	23.2	23.1	23.1	23.1	23.1	23.0	23.8	**21.0**	**22.2**
of which: grants	0.8	0.6	0.4	0.6	0.6	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8	0.8	0.8		
Primary (noninterest) expenditure	26.5	25.1	23.8	22.3	22.7	23.4	23.7	24.0	24.3	24.3	24.3	24.3	24.3	24.3	24.3	**23.2**	**23.8**
Automatic debt dynamics	**-4.3**	**-3.5**	**-1.6**	**-2.6**	**-3.1**	**-2.8**	**-2.7**	**-2.7**	**-2.6**	**-2.5**	**-2.5**	**-2.4**	**-2.4**	**-2.3**	**-2.1**		
Contribution from interest rate/growth differential	-3.1	-3.5	-2.0	-2.6	-3.1	-2.8	-2.7	-2.7	-2.6	-2.5	-2.5	-2.4	-2.4	-2.3	-2.1		
of which: contribution from average real interest rate	-1.2	-1.2	-1.2	-1.2	-0.8	-0.4	-0.3	-0.3	-0.3	-0.2	-0.2	-0.1	-0.1	-0.1	-0.1		
of which: contribution from real GDP growth	-2.0	-2.3	-0.8	-1.4	-2.3	-2.4	-2.4	-2.4	-2.4	-2.3	-2.3	-2.2	-2.2	-2.2	-2.1		
Contribution from real exchange rate depreciation	-1.1	0.0	0.4	...	...	...	...	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**3.8**	**2.6**	**-0.9**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.5**	**1.3**
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Debt relief (HIPC and other)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Other debt creating or reducing flow (please specify)	3.8	2.6	-0.9	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3		
Residual	**-2.6**	**-1.9**	**2.4**	**0.9**	**-0.1**	**-0.4**	**-0.7**	**-0.7**	**-0.6**	**-0.6**	**-0.6**	**-0.6**	**-0.5**	**-0.5**	**-0.4**	**-0.1**	**-0.4**
Sustainability indicators																	
PV of public debt-to-GDP ratio 2/	**...**	**...**	**39.9**	**42.4**	**43.2**	**43.4**	**43.1**	**42.6**	**41.8**	**41.2**	**40.6**	**40.2**	**39.8**	**39.4**	**36.4**		
PV of public debt-to-revenue and grants ratio	**...**	**...**	**206.5**	**219.5**	**213.3**	**203.0**	**194.9**	**187.4**	**180.5**	**177.9**	**175.8**	**174.0**	**172.5**	**171.3**	**153.1**		
Debt service-to-revenue and grants ratio 3/	**19.1**	**24.1**	**41.7**	**55.5**	**38.9**	**29.4**	**27.6**	**33.2**	**38.2**	**34.3**	**35.7**	**34.5**	**34.6**	**33.6**	**30.3**		
Gross financing need 4/	11.4	10.4	11.6	15.0	11.6	9.6	9.0	10.1	11.2	10.4	10.7	10.5	10.5	10.3	9.0		
Key macroeconomic and fiscal assumptions																	
Real GDP growth (in percent)	4.8	5.6	2.0	3.1	4.9	4.9	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	5.0	**4.4**	**4.8**
Average nominal interest rate on external debt (in percent)	0.4	0.3	0.6	0.9	0.9	0.9	0.9	0.9	0.9	1.1	1.0	1.1	1.1	1.1	1.0	**0.8**	**1.0**
Average real interest rate on domestic debt (in percent)	-4.1	-4.9	-1.9	0.2	-0.4	-0.5	-0.4	-0.4	-0.3	-0.2	-0.1	0.0	0.0	0.0	0.3	**-3.5**	**-0.2**
Real exchange rate depreciation (in percent, + indicates depreciation)	-5.7	0.2	2.0	...	...	...	...	...	...	...	...	...	...	...	...	**-0.6**	**...**
Inflation rate (GDP deflator, in percent)	6.8	8.2	5.4	5.0	5.2	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	5.4	**6.1**	**5.3**
Growth of real primary spending (deflated by GDP deflator, in percent)	2.9	0.4	-3.5	-3.4	6.9	7.9	6.5	6.3	6.1	5.0	5.0	5.0	5.0	5.0	5.0	**10.1**	**5.0**
Primary deficit that stabilizes the debt-to-GDP ratio 5/	3.0	2.7	0.1	0.4	1.9	1.9	2.1	2.0	2.0	1.9	1.7	1.7	1.6	1.6	1.3	**1.9**	**1.7**
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Residency-based**
Is there a material difference between the two criteria?	**No**

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

1/ Coverage of debt: The general government, central bank, government-guaranteed debt . Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

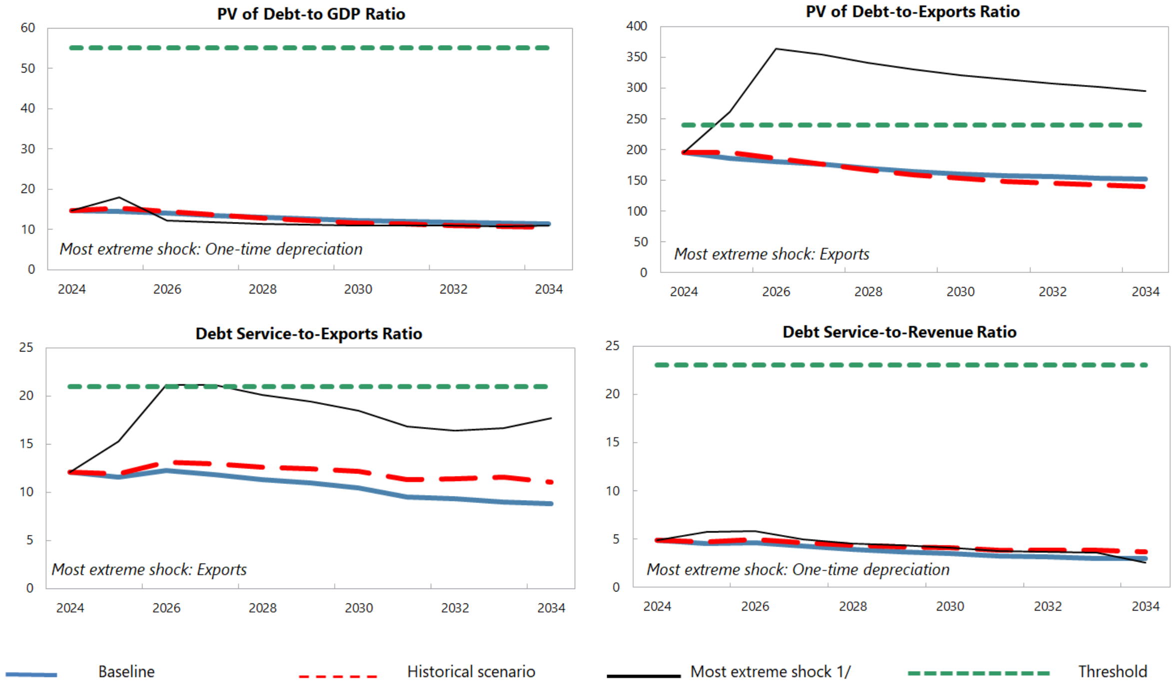
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilize the debt ratio only in the year in question.

6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Nepal: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2024-2034



Customization of default settings		
	Size	Interactions
Tailored Stress		
Combined CL	No	
Natural disaster	No	No
Commodity price	n.a.	n.a.
Market financing	n.a.	n.a.

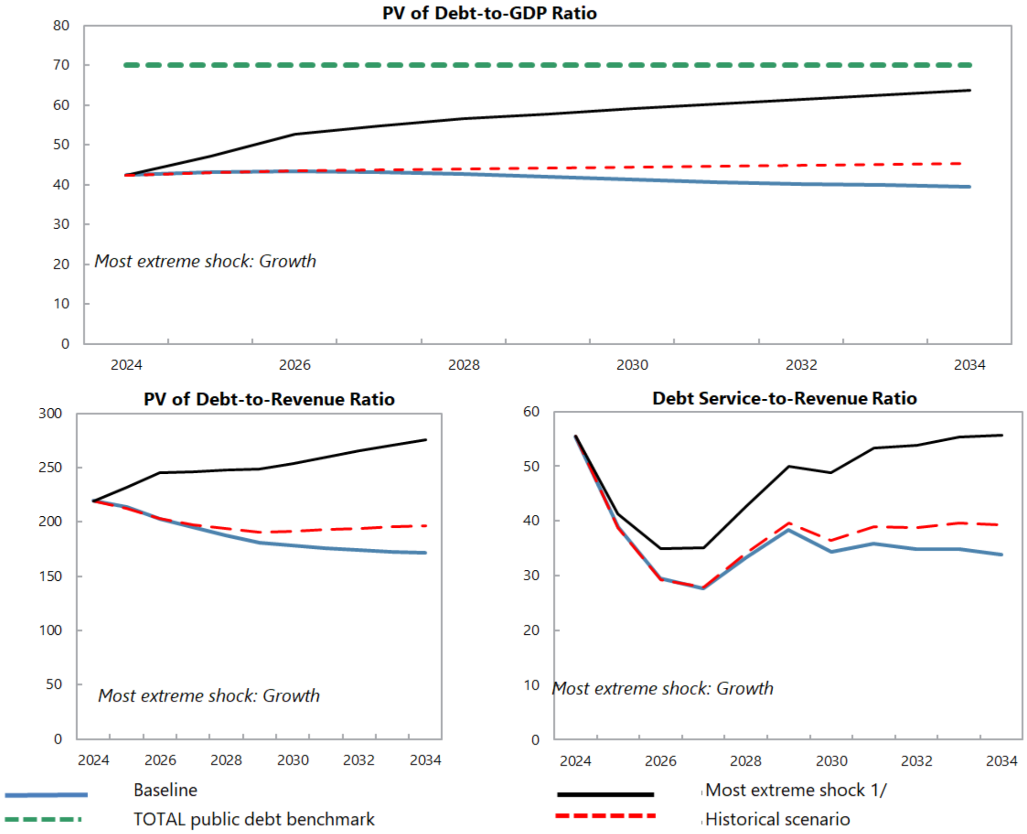
Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	0.9%	0.9%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	30	30
Avg. grace period	7	7

* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23
1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 2. Nepal: Indicators of Public Debt Under Alternatives Scenarios, 2024-2034



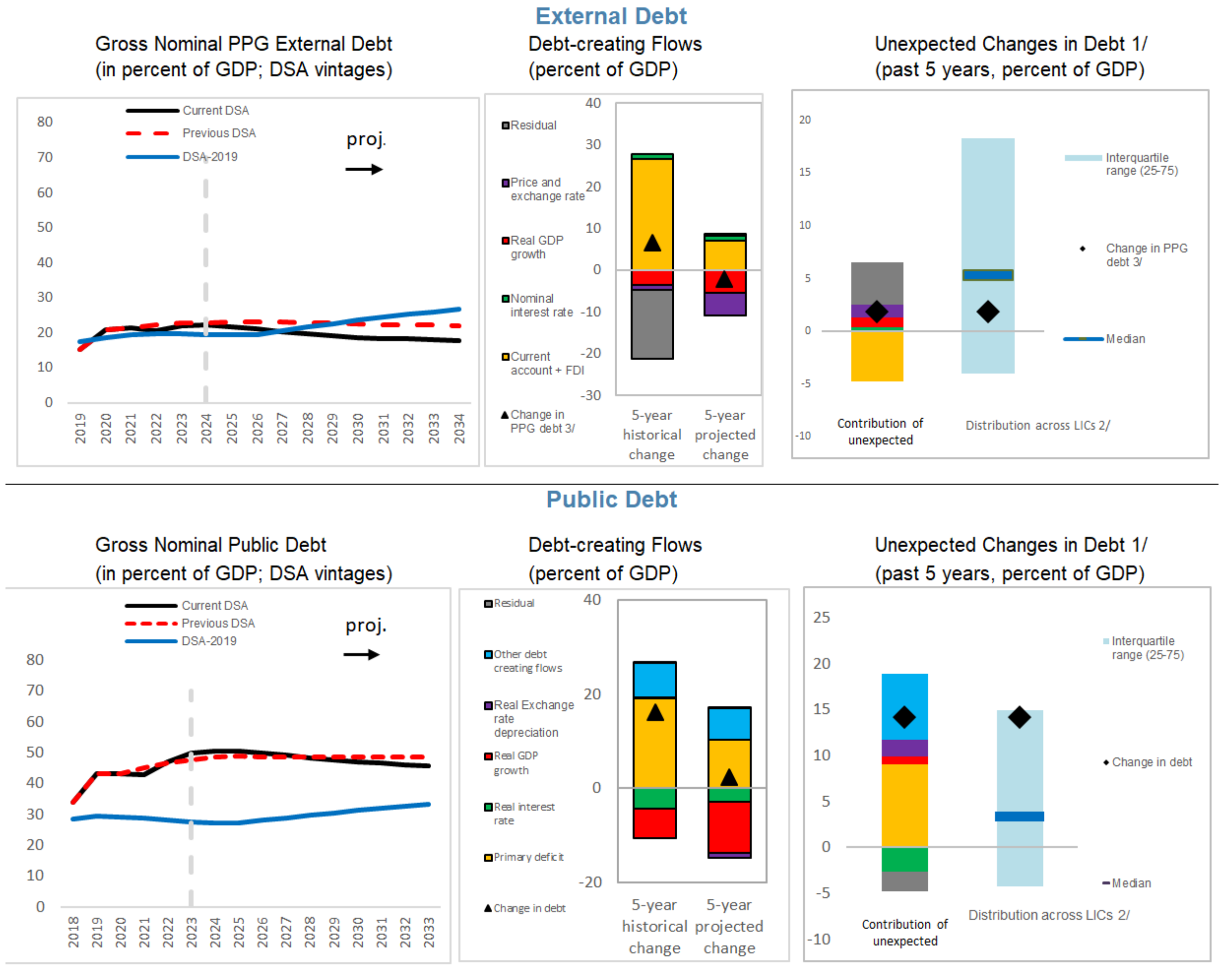
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	19%	19%
Domestic medium and long-term	55%	55%
Domestic short-term	26%	26%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.9%	0.9%
Avg. maturity (incl. grace period)	30	30
Avg. grace period	7	7
Domestic MLT debt		
Avg. real interest rate on new borrowing	0.3%	0.3%
Avg. maturity (incl. grace period)	5	5
Avg. grace period	3	3
Domestic short-term debt		
Avg. real interest rate	-0.3%	-0.3%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Figure 3. Nepal: Drivers of Debt Dynamics-Baseline Scenario



A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

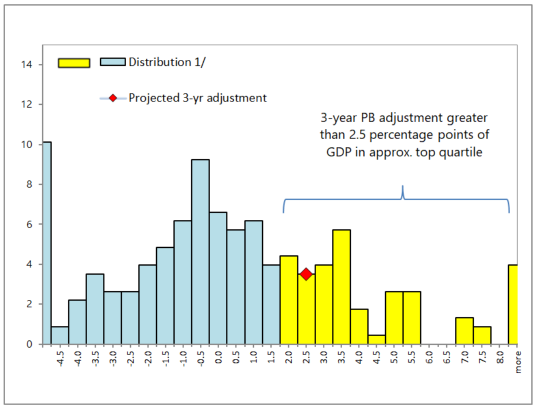
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

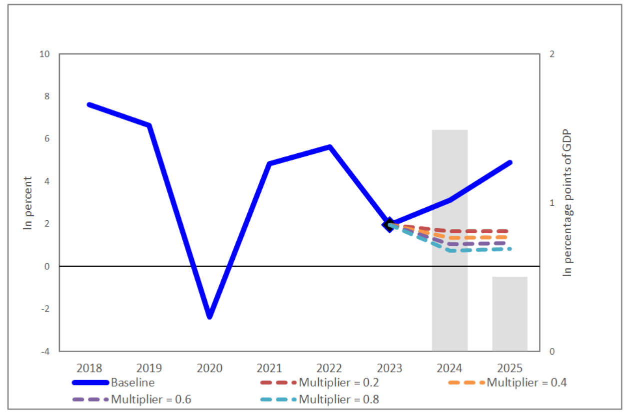
Figure 4. Nepal: Realism Tools

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



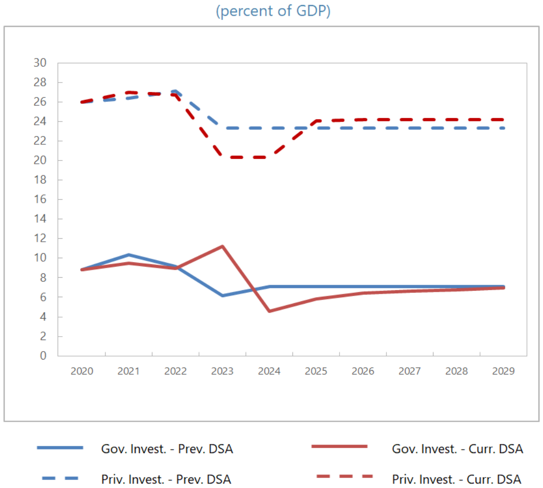
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/

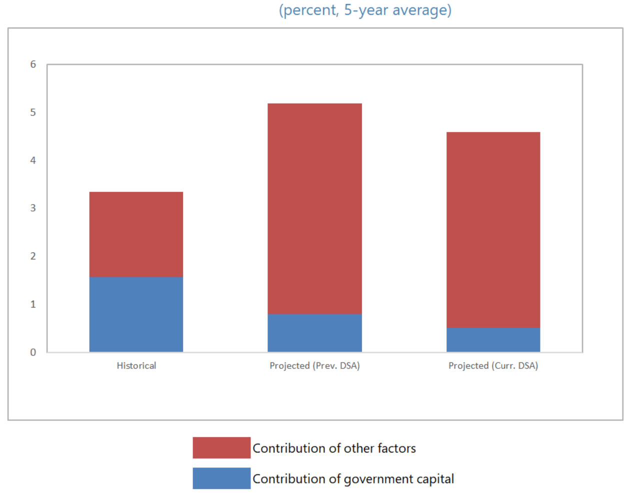


1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)



Contribution to Real GDP growth
(percent, 5-year average)



A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

Table 3. Nepal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2024-2034

(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of Debt-to GDP Ratio											
Baseline	14.6	14	14	13	13	13	12	12	12	12	11
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	15	15	14	14	13	12	12	11	11	11	11
B. Bound Tests											
B1. Real GDP growth	15	15	16	15	15	14	14	14	13	13	13
B2. Primary balance	15	15	15	14	14	13	13	13	13	12	12
B3. Exports	15	15	17	16	16	15	14	14	14	13	13
B4. Other flows 3/	15	16	17	16	15	15	14	14	14	13	13
B5. Depreciation	15	18	12	12	11	11	11	11	11	11	11
B6. Combination of B1-B5	15	18	18	17	16	16	15	15	15	14	14
C. Tailored Tests											
C1. Combined contingent liabilities	15	15	15	15	14	14	14	13	13	13	13
C2. Natural disaster	15	16	15	15	15	14	14	14	14	14	14
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	55	55	55	55	55	55	55	55	55	55	55
PV of Debt-to-Exports Ratio											
Baseline	195	185	180	176	170	165	161	158	156	154	152
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	195	196	186	177	167	159	153	149	146	143	141
B. Bound Tests											
B1. Real GDP growth	195	185	180	176	170	165	161	158	156	154	152
B2. Primary balance	195	189	188	185	179	174	172	170	168	166	164
B3. Exports	195	**261**	**364**	**355**	**341**	**330**	**320**	**313**	**308**	**301**	**294**
B4. Other flows 3/	195	202	214	209	201	194	188	184	181	177	173
B5. Depreciation	195	185	124	123	119	117	115	115	115	115	118
B6. Combination of B1-B5	195	**255**	203	**273**	**263**	**254**	**247**	**242**	238	233	228
C. Tailored Tests											
C1. Combined contingent liabilities	195	197	194	191	185	181	180	178	176	174	173
C2. Natural disaster	195	205	202	200	194	191	190	189	188	187	186
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	240	240	240	240	240	240	240	240	240	240	240
Debt Service-to-Exports Ratio											
Baseline	12.1	12	12	12	11	11	10	10	9	9	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	12	12	13	13	13	12	12	11	11	12	11
B. Bound Tests											
B1. Real GDP growth	12	12	12	12	11	11	10	10	9	9	9
B2. Primary balance	12	12	12	12	11	11	11	10	9	9	9
B3. Exports	12	15	**21.2**	**21.1**	20	19	18	17	16	17	18
B4. Other flows 3/	12	12	13	12	12	11	11	10	10	10	10
B5. Depreciation	12	12	12	11	10	10	10	9	9	8	6
B6. Combination of B1-B5	12	14	17	17	16	15	15	13	13	14	14
C. Tailored Tests											
C1. Combined contingent liabilities	12	12	12	12	12	11	11	10	10	9	9
C2. Natural disaster	12	12	13	13	12	12	11	10	10	10	9
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	21	21	21	21	21	21	21	21	21	21	21
Debt Service-to-Revenue Ratio											
Baseline	5	5	5	4	4	4	4	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	5	5	5	5	4	4	4	4	4	4	4
B. Bound Tests											
B1. Real GDP growth	5	5	5	5	4	4	4	4	4	3	3
B2. Primary balance	5	5	5	4	4	4	4	3	3	3	3
B3. Exports	5	5	5	5	4	4	4	3	3	3	4
B4. Other flows 3/	5	5	5	4	4	4	4	3	3	3	3
B5. Depreciation	5	6	6	5	5	4	4	4	4	4	3
B6. Combination of B1-B5	5	5	5	5	5	4	4	4	4	4	4
C. Tailored Tests											
C1. Combined contingent liabilities	5	5	5	4	4	4	4	3	3	3	3
C2. Natural disaster	5	5	5	4	4	4	4	3	3	3	3
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Threshold	23	23	23	23	23	23	23	23	23	23	23

Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

Table 4. Nepal: Sensitivity Analysis for key Indicators of Public Debt, 2024-2034

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of Debt-to-GDP Ratio											
Baseline	42.3	43.2	43.4	43.2	42.7	41.9	41.3	40.7	40.2	39.8	39.5
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	42.35	42.97	43.39	43.72	43.97	44.19	44.39	44.62	44.83	45.06	45.29
B. Bound Tests											
B1. Real GDP growth	42.35	47.11	52.76	54.81	56.51	57.84	59.09	60.32	61.50	62.66	63.80
B2. Primary balance	42.35	45.71	48.24	47.72	46.99	45.98	45.01	44.18	43.47	42.88	42.35
B3. Exports	42.35	44.20	46.04	45.66	45.03	44.15	43.37	42.71	42.11	41.58	41.06
B4. Other flows 3/	42.35	44.54	46.05	45.67	45.04	44.16	43.37	42.71	42.12	41.57	41.06
B5. Depreciation	42.35	44.35	42.49	41.32	39.75	37.99	36.53	35.22	33.87	32.68	31.62
B6. Combination of B1-B5	42.35	43.77	44.87	44.37	43.80	43.01	42.32	41.71	41.14	40.69	40.34
C. Tailored Tests											
C1. Combined contingent liabilities	42.35	51.50	51.09	50.42	49.55	48.29	47.09	46.14	45.33	44.62	43.97
C2. Natural disaster	42.35	53.20	52.98	52.52	51.84	50.76	49.71	48.91	48.24	47.67	47.13
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
TOTAL public debt benchmark	70	70	70	70	70	70	70	70	70	70	70
PV of Debt-to-Revenue Ratio											
Baseline	219	213	203	195	188	181	178	176	174	173	172
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	219	212	203	198	194	191	192	193	194	195	197
B. Bound Tests											
B1. Real GDP growth	219	232	245	246	248	248	254	260	265	270	276
B2. Primary balance	219	226	225	216	207	198	194	191	188	186	184
B3. Exports	219	218	215	206	198	190	187	185	182	180	178
B4. Other flows 3/	219	220	215	206	198	190	187	185	182	180	178
B5. Depreciation	219	219	199	187	175	164	158	153	147	142	138
B6. Combination of B1-B5	219	216	210	200	193	185	183	180	178	176	175
C. Tailored Tests											
C1. Combined contingent liabilities	219	254	239	228	218	208	203	200	196	193	191
C2. Natural disaster	219	262	248	237	228	219	215	211	209	207	204
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Debt Service-to-Revenue Ratio											
Baseline	55	39	29	28	33	38	34	36	35	35	34
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	55	39	29	28	34	40	36	39	39	40	39
B. Bound Tests											
B1. Real GDP growth	55	41	35	35	43	50	49	53	54	55	56
B2. Primary balance	55	39	33	33	35	42	41	42	38	37	37
B3. Exports	55	39	30	28	34	39	35	36	35	35	34
B4. Other flows 3/	55	39	30	28	34	39	35	36	35	35	34
B5. Depreciation	55	37	29	25	32	36	32	33	33	33	32
B6. Combination of B1-B5	55	38	29	29	34	39	36	38	36	36	35
C. Tailored Tests											
C1. Combined contingent liabilities	55	39	41	32	36	47	46	42	38	39	39
C2. Natural disaster	55	39	43	33	37	50	49	45	41	41	42
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: Country authorities; and staff estimates and projections. A year indicates the end of the corresponsing fiscal year, e.g. 2023 stands for FY2022/23

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

Statement by the IMF Staff Representative on Nepal
July 9, 2024

This statement provides information that has become available since the staff report was issued to the Executive Board. This information does not alter the thrust of the staff appraisal.

1. On July 3, the Unified Marxist-Leninist (UML) Party withdrew support for the government of Prime Minister Pushpa Kamal Dahal, who belongs to the Maoist-Centre (CPN) Party. At the same time, UML made public the intention to form a new coalition with the largest opposition party, the Nepal Congress Party (NC). On July 5, Prime Minister Dahal reportedly requested Parliament to arrange a confidence vote for July 12. If the agreement between UML and NC stands until the vote, Prime Minister Dahal is likely to lose the vote as UML and NC account for above sixty percent of Parliament's seats.

2. If it materializes, a new UML-NC coalition will be the fifth government since the approval of the Extended Credit Facility (ECF) in January 2022. All governments since the beginning of the ECF arrangement, including the current one, have been a coalition between one of the two largest parties—either UML or NC—and CPN. At the same time, all three political parties (UML, NC, and CPN) have always supported the objectives and policy commitments under the ECF arrangement, and there has been sustained commitment with program reforms at the parliament level, which is represented by all political parties.

Statement by Yati Kurniati, Executive Director for Nepal
And Raja Anwar, Alternate Executive Director
And Siddha Raj Bhatta, Advisor to the Executive Director
July 09, 2024

On behalf of the Nepali authorities, we would like to express our appreciation to the IMF team led by Mr. Kinda for the close and constructive engagement during the fourth review of the Extended Credit Facility (ECF). The authorities appreciate the support provided through the ECF program and are grateful to the IMF Board, Management, and Staff. They broadly concur with the staff analysis and are committed to implementing the reforms agreed under the ECF program arrangements to safeguard macroeconomic stability and support sustained growth.

The Nepali economy is rebounding, as reflected in the recovery in economic activity, contained inflation and strong external sector performance. The economy will grow at a faster pace in FY2024/25 and strengthen further in FY2025/26. Consumer inflation declined to 4.4 percent in May 2024, a 31-month low, after reaching 8.6 percent in September 2022. The current account registered a surplus and the international reserve position has substantially improved, providing a cushion to imports for 12.6 months as of May 2024. Financial sector consolidation is progressing in line with program objectives. The authorities broadly concur with the Staff's assessment of the economic outlook and remain committed to mitigate potential risks.

ECF program implementation remains satisfactory despite the challenging environment. The authorities have comfortably met the performance criterion (PC) on net international reserves and primary fiscal deficit. The indicative target (IT) on child grant spending has been missed due to a transition to an electronic payment mechanism. The authorities reaffirm their best efforts to meet the IT before the end of the current fiscal year. All continuous PCs have been met. Out of the five structural benchmarks, three have been met albeit one was completed with delay. The remaining two SBs have been proposed to be reset. The authorities **reiterate their strong commitment to meeting the remaining SBs.**

Monetary Policy

The Nepal Rastra Bank (NRB) will continue its cautious and data-driven monetary policy approach to achieve its mandate of price and external sector stability. On the back of easing inflation pressures, the NRB cautiously loosened its monetary policy stance in December 2023, which is expected to support credit growth that currently remains subdued. Implementation of the standing deposit facility has helped stabilize the interbank rate in line with the Interest Rate Corridor (IRC) framework. The NRB is fully committed to further strengthening implementation of the monetary policy framework to enhance the clarity and credibility of monetary policy.

Fiscal Policy

Fiscal reforms have always been a priority for the authorities to strengthen fiscal sustainability and rebuild buffers to enhance economic resilience. In line with the program objectives, the authorities are implementing a series of consolidation efforts to strengthen fiscal sustainability. A Domestic Revenue Mobilization Strategy (DRMS) was recently approved, and the authorities are fully committed to implementing the measures specified in the DRMS to broaden the tax base and enhance tax administration. Several tax reforms were introduced in the 2024/25 budget, including a green tax on petroleum products, increase in excise duties on alcohol, beer and tobacco, and initiatives for improving tax compliance. On the spending side, the budget focuses on containing recurrent expenditure through rationalization of spending duplication with the sub-national governments and administrative costs. The authorities, however, recognize the importance of social spending and will continue to support food security and poverty reduction.

Public debt is expected to stabilize at around 50 percent of GDP by FY 2026/27, a year earlier than projected in the third review. Focus on revenue mobilization and improving the efficiency of public spending will support the stabilization of public debt. External debt stood at 21.9 percent of GDP at the end of FY 2022/23, almost the same level during the last four years. Both public and external debt are assessed to be at low risk of debt distress. The authorities are aware of the need to continue to gradually reduce the fiscal deficit and stabilize debt to strengthen fiscal sustainability.

The authorities reiterate their strong commitment to pursuing public financial management reforms. They are planning to formulate a Public Financial Management Improvement Strategy based on the third Public Expenditure and Financial Accountability (PEFA) assessment report. Based on the recently approved Public Investment Management Assessment (PIMA) action plan, they are planning to revise the National Project Bank Operational Procedures for supporting more robust project design, prioritization, and selection. The fiscal risk registry and cash flow forecasting framework have been proven helpful, and the authorities plan to further strengthen the tools for better budget forecasting and comprehensive fiscal risk assessment. Audits of three of the four priority nonfinancial public enterprises (PEs) have been completed and the authorities are committed to completing the remaining audit by August 2024. The authorities are also preparing to publish the FY2022/23 annual financial statements of all majority and wholly-owned PEs by August 2024.

Financial Sector

The authorities have continued their efforts to further align the bank regulation and supervisory practices with international standards. The financial sector has remained broadly sound and resilient, amid the subdued credit demand and increase in vulnerabilities especially arising from the cooperative sector. While the non-performing loan ratio has increased due to the slowdown in economic activities, issues with the savings and credit cooperatives (SACCOs), new asset classification regulations by the NRB and phase-out of the regulatory forbearances provided by the NRB during COVID-19, it remains below 5 percent and lower than many peer economies. Capital adequacy ratios and the liquidity ratios are above the regulatory minimum. To address the capital pressure faced by some banks, the NRB has recently allowed them to raise additional capital through perpetual non-cumulative preference shares. The Asset Classification Guidelines and Working Capital Loan Guidelines, and the reintroduction of counter cyclical buffer have helped address the vulnerabilities in the financial system and support more sustainable credit growth. Implementation of the Supervisory Information System (SIS) is expected to support the prudent and effective supervision of the financial institution. The authorities are planning to strengthen the liquidity risk management framework of banks by introducing the Basel III liquidity coverage ratio.

The authorities remain committed to the loan portfolio review of the ten largest banks and intend to complete it within the time limit agreed under the ECF program. To mitigate the financial stability risks from the SACCOs, the authorities plan to establish and operationalize a specialized regulatory authority to regulate and supervise the SACCOs with a new regulatory framework and supervisory architecture. They are committed to implementing the recommendations of the Financial Sector Stability Review (FSSR) and would welcome technical assistance in needed areas.

Governance, Transparency and Structural Reforms

The authorities have prioritized economic reforms to address structural bottlenecks and support growth. The recently approved 16th Development plan adopts a strategy of enhancing output, productivity, and competition by addressing structural impediments. The government budget for FY2024/25 has declared the year as 'Economic Reform Year' and considers 'economic reforms and private sector promotion' as the top priority. The budget lays five strategies for economic reforms, including structural reforms, improving the business environment, reforms in the public financial system, financial sector reforms and public administration reforms.

Governance reforms and transparency have been a key priority. The authorities have introduced several measures to improve governance and transparency and are committed to implementing the feasible recommendations of the 2021 Safeguards Assessment to strengthen the autonomy and governance processes of the central bank. The government has passed amendments to AML/CFT laws and is working to develop a national strategy to address the deficiencies. They are fully committed to implementing further reforms to address the findings of the Asia-Pacific Group on money laundering's 2023 assessment. They are planning to introduce a risk-based evaluation system for controlling financial crimes and are working to implement intensive supervision for the sectors with high risk, including casinos, precious metals, cooperatives, real estate, remittance, and banking.

Conclusion

The Nepali authorities view that the ECF program has helped in maintaining macroeconomic stability and in implementing governance and structural reforms. They reiterate their strong commitment to program objectives and request for completion of the Fourth Review. The authorities fully agree that the accompanying structural reforms are well-aligned with domestic policy priorities. The authorities would like to thank the IMF Executive Board, Management and Staff, and international partners for their continued support.