

MACROECONOMIC ANALYSIS OF NEPAL

Bhadra 2080 (Based on Two months' data published by NRB)



Machhapuchpuchhre Capital
Research, Strategy & Product Development





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1. MONTHLY MACROECONOMIC OVERVIEW

As per South Asian Development Update and Nepal Development Update 2023, Nepal's economic growth is estimated to rebound to 3.9% in the year 2024, and projects Nepal's economy to grow by 5% in 2025. However, Nepal's gross domestic growth rate will remain at 1.9% this year. The economy is expected to rebound due to the lagged impact of the lifting of import restrictions, the rebound in the tourism sector, and the gradual loosening of monetary policy.

The macroeconomic situation in the second month of the fiscal year 2080/81 (Bhadra 2080) presents a modestly improving economic outlook overall. The balance of payments (BOP) surplus in Bhadra 2080 is 53.61 Billion. The BOP surplus in the first month of the fiscal year was 32.90 Billion so the surplus figure in the first month of the fiscal year provides an optimistic view that the BOP Surplus will continue in the present fiscal year as well. The BOP Surplus can be attributed majorly to the rising inflow of remittance into the country and declining imports. The inflation rate of Nepal stands at 8.19% as of Bhadra 2080 which is above the targeted limit of 6.5% set by NRB.

The price of crude oil has increased by 6.80% on a Y-o-Y basis from USD 89.43 per barrel to USD 95.55 per barrel. The increase in price per barrel also leads to a significant increase in the import figure of the country as petroleum products fall into the topmost import of the country (Market share =15.1%). The GoN's policy to promote electric vehicles within the country is expected to lead to a gradual decrease in the import of petroleum products. On the one hand, the reduced reliance on imported petroleum products will result in reduced expenditure on

imports. On the other hand, the increased usage of domestically produced electricity for powering electric vehicles can contribute to the economic development of Nepal.

The export figure is still in a decreasing trend nonetheless, a positive development is the rising electricity exports, which can be viewed as a silver lining in the present difficult circumstances. As per the fifth meeting of the Joint Steering Committee held in Bangladesh, Bangladesh has agreed to purchase 40 MW of electricity from Nepal through India's transmission lines. However, according to the recent update, the political factors in Bangladesh have been obstructing the two countries from reaching a final agreement which makes electricity export to Bangladesh unlikely in the current fiscal year. Additionally, Nepal has signed a long-term power purchase agreement with India for the export of 10,000 MW within 10 years. According to the latest reports, Nepal has been exporting 11 million units of electricity to India daily. If Nepal succeeds in selling electricity to Bangladesh and India, it will contribute to an increase in exports, leading to a decrease in the trade deficit to a certain extent.

In the previous fiscal year, NRB's attempt to preserve gross foreign reserves through the implementation of import controls led to the loss of government revenue in the form of import and excise duties. This measure led to a budget deficit of 397.87 Billion in the FY 2079/80. To manage the budget deficit, the government has resorted to raising funds from internal borrowing. The government has set a target of acquiring internal loans worth Rs 240 billion in the current fiscal year 2080/81, while a total of Rs 55 billion will be



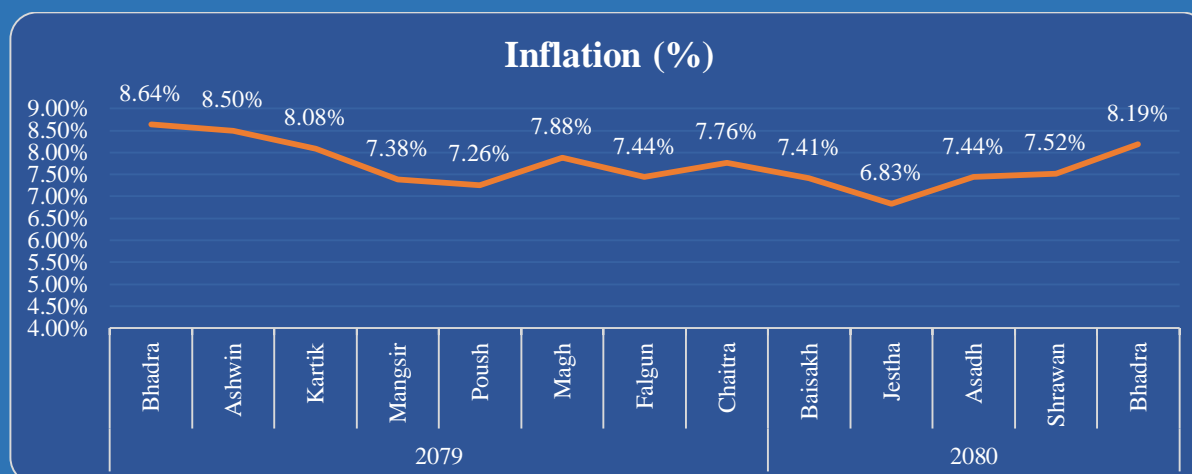
collected by the first quarter end in mid-October.

As for the situation of liquidity in the economy, the efforts to maintain liquidity have proved to be successful with various efforts including extending the inclusion of 80% of government funds in the deposits of BFIs and the recurring issue of Repo. As the liquidity situation of the country

recovered greatly, the allowance of including 80% of government funds in deposits had been discontinued as of the end of FY 2079/80. However, at the end of Bhadra 2080, the government has once again permitted the BFIs to count 60% of government funds as deposits to aid liquidity in the hopes of the interest rate decrease.

2. MACROECONOMIC INDICATORS

2.1 Inflation

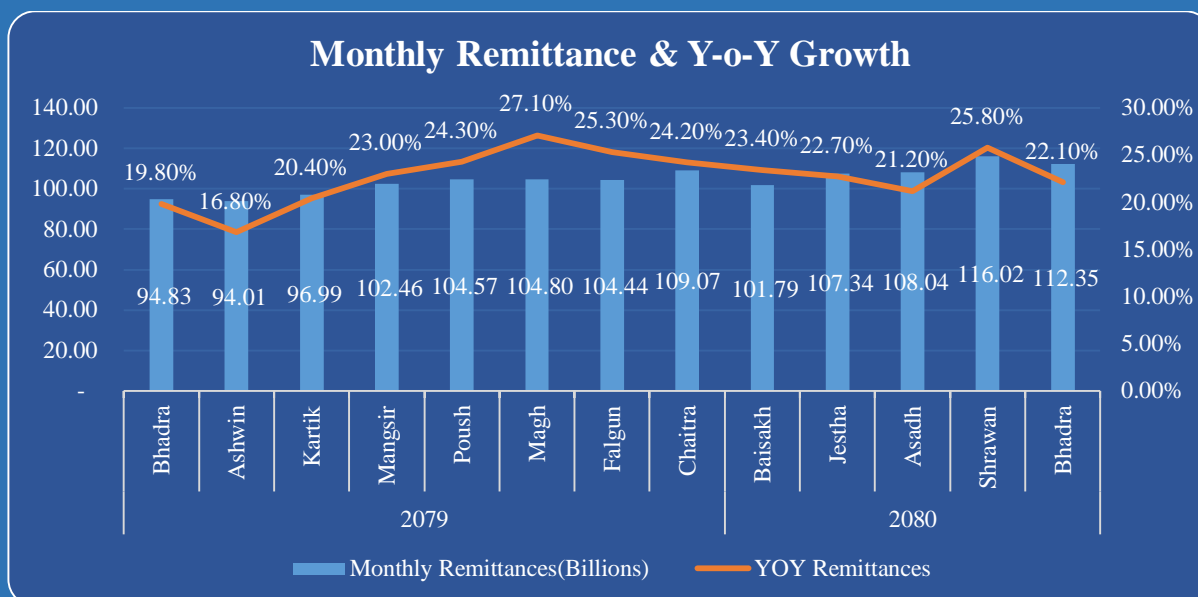


The inflation as of Bhadra 2080 has increased as compared to the previous month and is nearing the same inflation level of the same period of the previous fiscal year. The increase in inflation from the previous month can be associated with the increase in oil prices from the previous month by 12.095%. Food and Beverage inflation stood at 9.74% whereas non-food and service inflation stood at 6.99%. The inflation rate is above the targeted rate of 6.5% limit set by the central bank in the monetary policy for FY 2080-81.

Meanwhile, India's CPI inflation which surged to a 15-month high of 7.44% in July 2023 has slightly come down to 5.02% in September 2023. Changes in India's CPI inflation hold direct implications for Nepal's economy, given the close economic ties between the two nations. India has also lifted the ban on the export of non-basmati rice which would slightly ease the consumer prices in Nepal as well. However, the export ban on sugar still exists and the minimum export price of onion has been increased by India, which will most likely affect Nepal's inflation in the upcoming months.



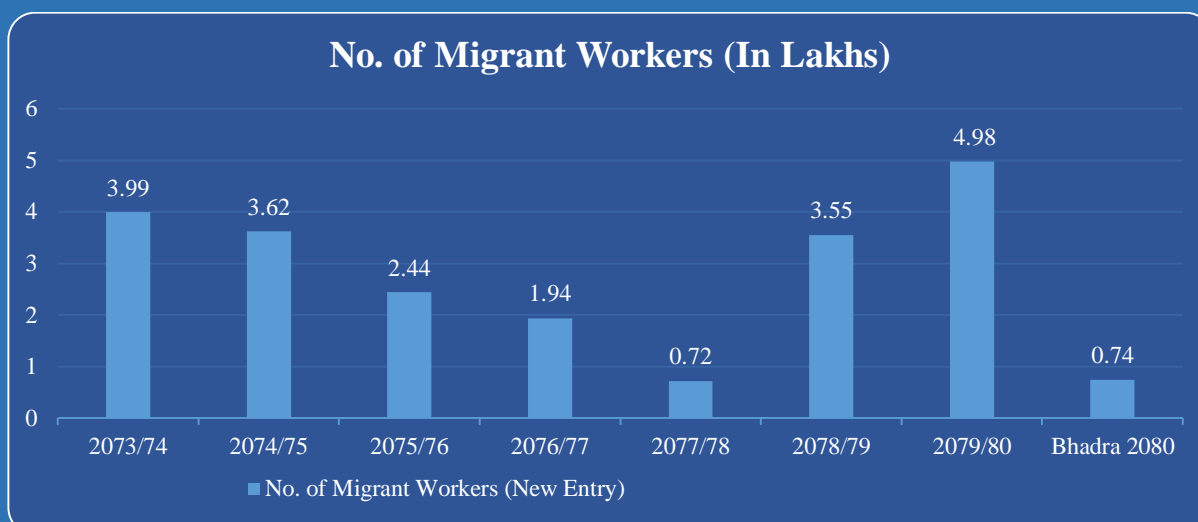
2.2 Remittance



Nepal's economy is highly dependent on remittance so the growth of remittance can be considered positive for the economy. The remittance increased by 22.10% on a Y-o-Y basis as of Bhadra 2080.

The remittance has been more than Rs 100 billion for the ten consecutive months now. As of Bhadra 2080, the remittance to GDP ratio has increased to 2.09% from 1.95% during the corresponding period last year. Nepal has the largest remittance inflow as a share of GDP in the South Asian region. According to the World Bank's 2021 data, the Remittance to GDP ratio of Nepal is 22.7% whereas other South Asian Nations' figures are below 10%.

2.3 No. of Migrant Workers



The above chart presents the yearly data of no. of migrant workers from the FY 2073/74 to the recent FY 2079/80. As of Bhadra 2080, the number of migrant workers (new entry) has reached 74,455 in the two months of FY 2080/81 which is a 28.3% decrease from the same period of the previous year. The number of migrant workers (renewed entry) decreased by 18.3% as of



Bhadra 2080 on a Y-o-Y basis. Currently, UAE is the number one destination nation for Nepali migrant workers with a share of 22.4% followed by Malaysia, Saudi Arabia, and Qatar.

2.4 No. of Tourist Arrival

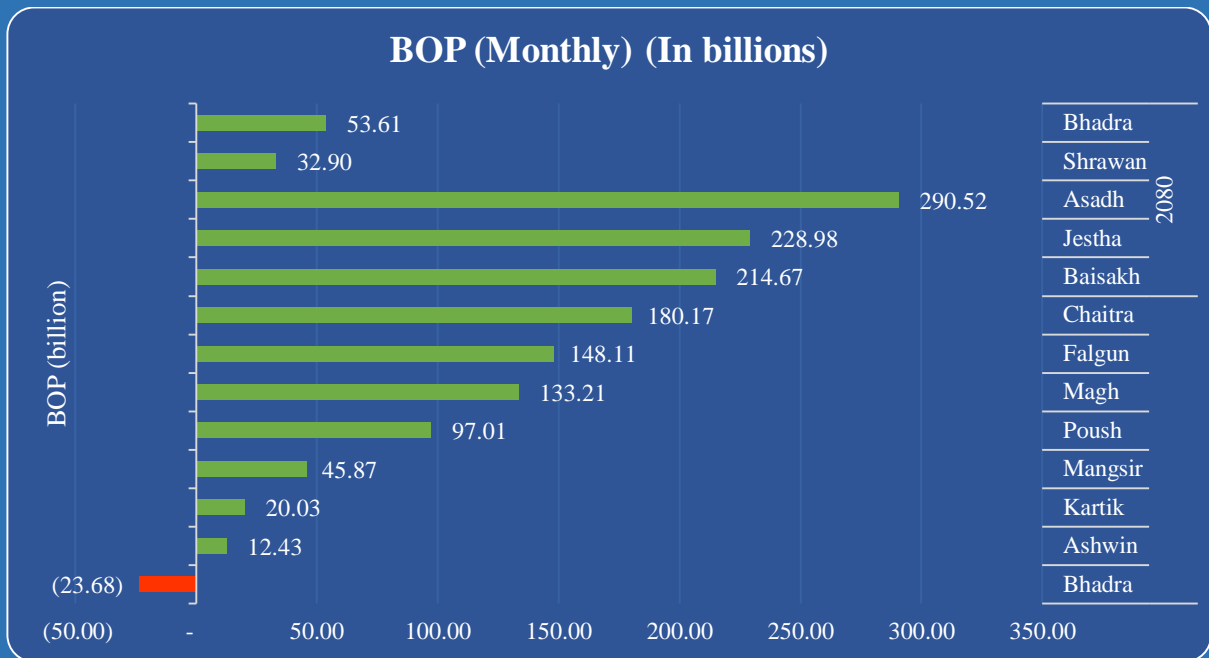


The number of tourist arrivals, which had significantly decreased in the year 2020 due to the pandemic, is slowly increasing. The number of tourist arrivals increased from 1.5 lakh to 6.14 lakhs in the year 2022. As of September 2023 (As of 9 Months), the number of tourist arrivals stood at 6.92 lakhs which was around 3.84 lakhs only in the same period of the previous year. Even till September 2023 (9 months), the no of tourist arrivals increased significantly as compared to the total no of tourist arrivals in recent years. The gradual increased number of tourists coming to the nation is expected to have a positive impact on the hospitality sector of the nation.

The government of Nepal has decided to mark the period from 2023 to 2033 as the Visit Nepal Decade (VND) to revitalize the nation's tourism sector, which suffered significant setbacks due to the Covid-19 pandemic over the past two years and with the longer-term goal of establishing Nepal as a leading destination in the global tourism market. The Ministry of Culture, Tourism, and Civil Aviation has already prepared a Strategic Action Plan to make the VND 2023-32 successful. It plans to increase the number of tourist arrivals to 3.5 million (excluding Indian nationals) and to generate 1 million additional jobs in the tourism industry. Likewise, the government aims to increase per tourist per day spending from the present 48 US dollars to 125 US dollars. This is expected to boost tourism's contribution to the country's gross domestic product.

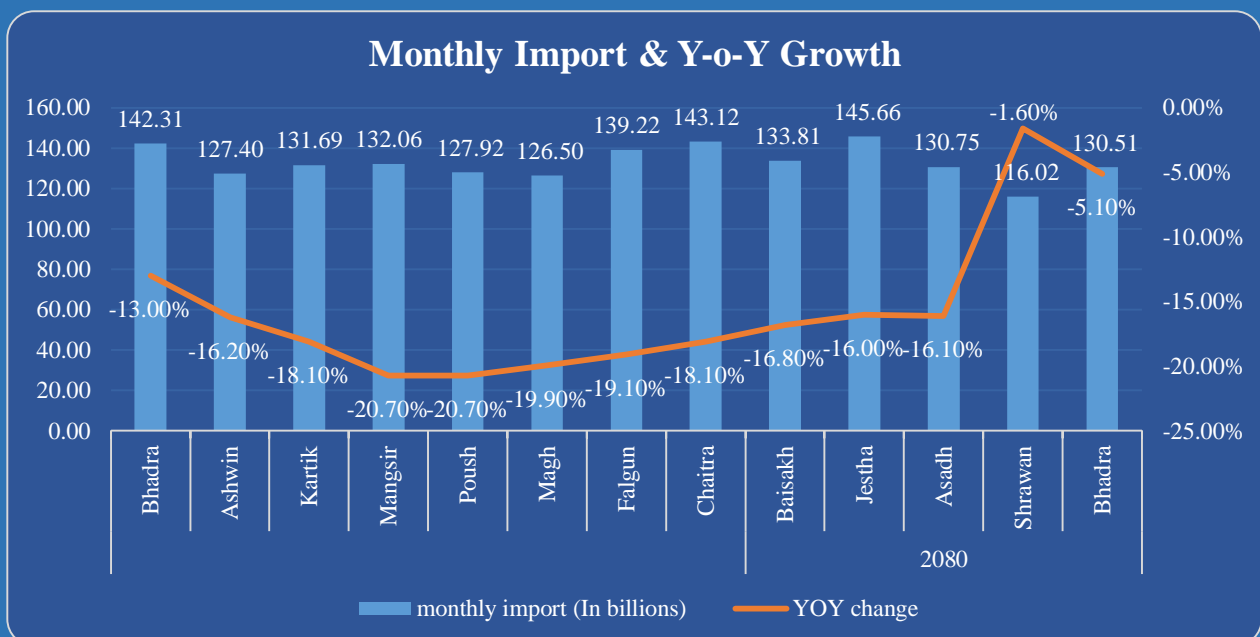


2.5 Balance of Payment (BOP)



As of Bhadra 2080, the BOP remained at a surplus of Rs.53.61 billion. In the same period last year, it was at a deficit of 23.68 billion. The reduced imports caused by the economic slowdown and increase in remittance have reduced the pressure on BOP and the trade deficit which has significantly contributed to BOP Surplus. It is crucial to closely monitor import figures to keep a close eye on the liquidity position of the economy as the import restrictions have been completely lifted.

2.6 Imports





Macroeconomic Situation of Nepal as of Bhadra 2080/81

The import has decreased by 5.10% as of Bhadta 2080 to 130.51 billion on a Y-o-Y basis. In the same period of the previous year, the import figure stood at 142.31 billion.

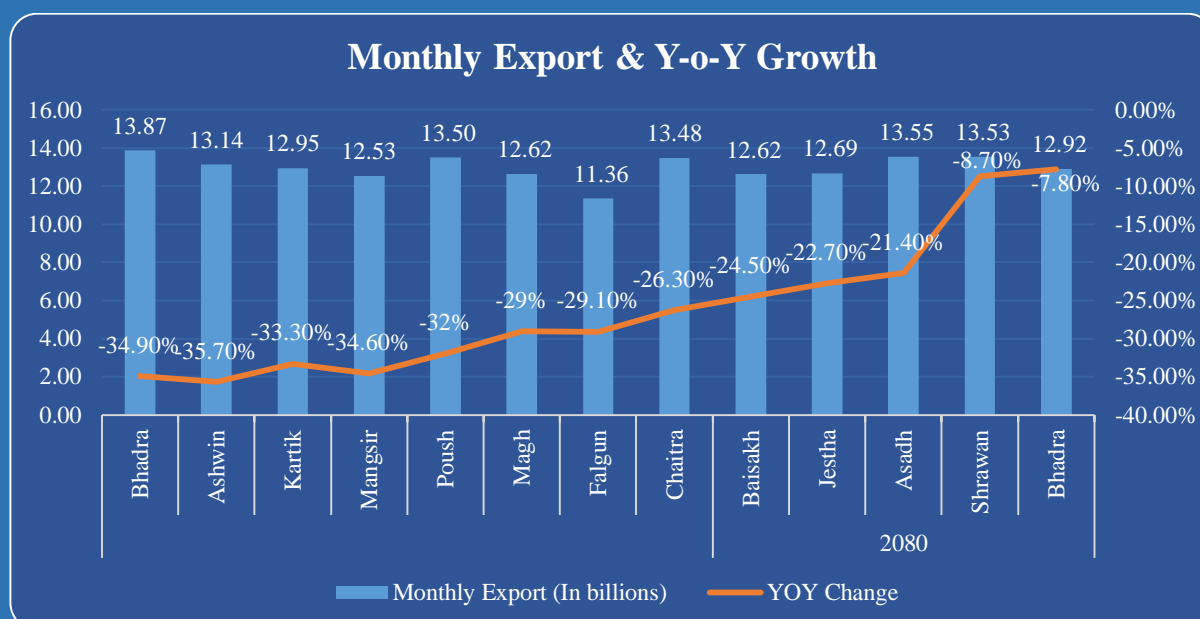
The monthly imports have increased to 130.51 billion in Bhadra 2080 from 116.02 billion in the previous month. Destination-wise, imports from India have decreased by 5.2% percent, and imports from China have increased by 25.4 % percent respectively, and it has decreased by 21.5% for other countries. The reduction in imports in the current month can be attributed to the decline in the import of Petroleum products with a share of 15.1% in total imports by 14.5% and the import of Transport Equipment, Vehicle, and Other Vehicle Spare parts having a share of 4.4% in total imports by 15.4%.

2.6.1 Top Five Imports

| S.N | Top 5 Imports | Two Months (Mid-Sept 2023) (In Mn.) | Share in Total imports (%) | Percentage Change |
|-----|---|-------------------------------------|----------------------------|-------------------|
| 1 | Petroleum Products | 39,151.18 | 15.1 | -14.5 |
| 2 | Other Machinery and Parts | 12,209.69 | 4.7 | 2.8 |
| 3 | Transport Equip, Vehicle, and other Vehicle Spare Parts | 11,437.35 | 4.4 | -15.4 |
| 4 | Chemical Fertilizer | 7,788.71 | 3.0 | -3.3 |
| 5 | Medicine | 7,139.98 | 2.7 | -32.9 |

The Top 5 Imports in the month of Bhadra 2080 have been presented in the above table. The data shows that the import of petroleum products has decreased by 14.5% as compared to the same period of the previous year while the import of transport equipment, vehicles, and other vehicle spare parts decreased by around 15.4%. The import of other machinery and parts has slightly increased by 2.8% as compared to the same period of the previous year.

2.7 Exports





The exports have decreased by 7.8% to 12.92 billion as of Bhadra 2080 on a Y-o-Y basis. In the same period of the previous year, the exports stood at 13.87 billion.

Destination-wise, exports to India decreased by 15.6 percent while exports to China increased massively by 338.5 percent and 5.1 percent to other countries (Y-o-Y Change). A reduction in the exports could be due to a substantial decline in the export of textiles by 36.6%. Whereas the export of Polyester Yarn and thread, Cardamom, woolen carpets, and readymade garments has significantly increased. These exports have emerged as the top exports of Nepal. Similarly, Nepal has exported electricity worth 4.54 billion in the two months of the current fiscal year 2080/81 which has increased from 4.14 billion in the same period of the previous year.

The total trade deficit has decreased by 4.7 percent to Rs.233.30 billion during the two months of the current fiscal year. Such a deficit had decreased by 9.4 percent in the corresponding period of the previous year. The export-import ratio decreased to 10.2 percent in the review period from 10.5 percent in the corresponding period of the previous year.

2.7.1 Top Five Exports

| S.N | Top 5 Exports | Two Months (Mid-Sept 2023) (In Mn.) | Share in Total Exports (%) | Percentage Change |
|-----|-------------------------|-------------------------------------|----------------------------|-------------------|
| 1 | Polyester Yarn & Thread | 2,039.15 | 7.7 | 85.1 |
| 2 | Cardamom | 1,936.19 | 7.3 | 17.1 |
| 3 | Zinc sheet | 1,896.43 | 7.2 | -11.2 |
| 4 | Woolen Carpet | 1,500.59 | 5.7 | 120.4 |
| 5 | Readymade Garments | 1,390.41 | 5.3 | 12.6 |

The top five exports from our country have been presented in the above table. While the overall export figure has decreased as a result of a decrease in the export of palm oil and soybean oil following the increase in import duty of oils imported from Nepal by India, it has also encouraged the export of domestically produced/available goods. The exports of Polyester Yarn, thread, cardamom, zinc sheet, woolen carpet, and readymade garments have impressively increased in FY 2080/81 compared to the previous year. Nepal is considered to be the world's largest cardamom producer. Hence, Nepal has prospects in diversifying its cardamom exports in the global market apart from India.

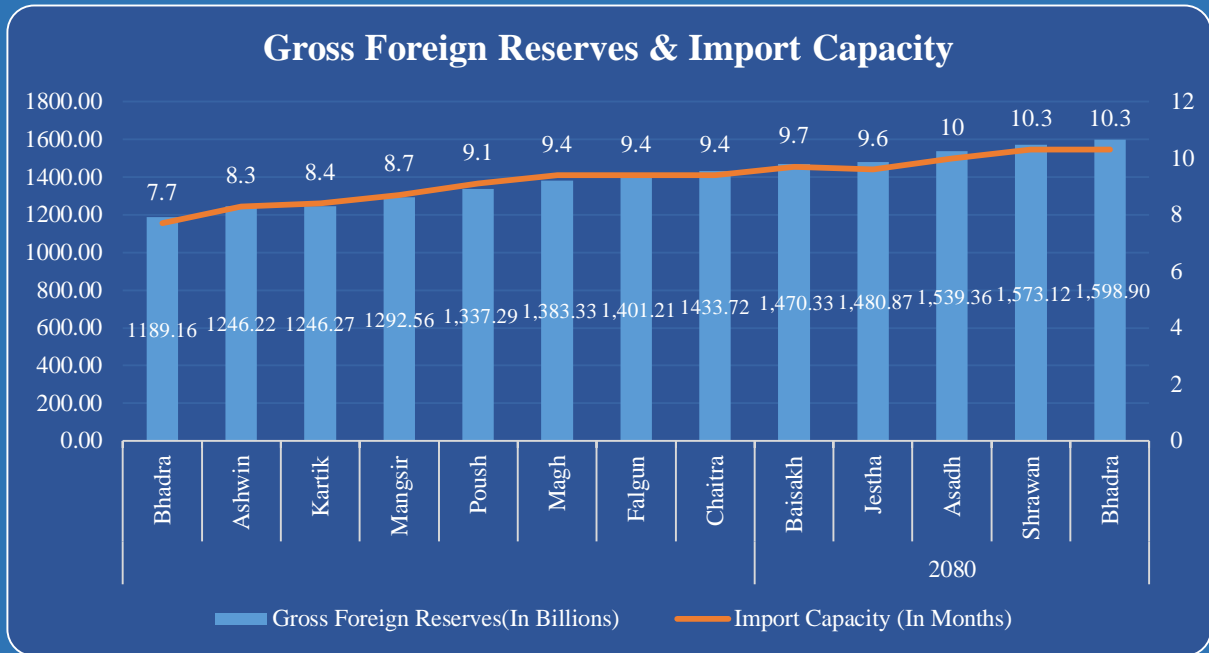
| Electricity Exports | | | | |
|---------------------|-------------|---------------------|---------------------|----------|
| S.N. | Export | 2022/23 | 2023/24 | % Change |
| | | Two months (In Mn.) | Two months (In Mn.) | |
| 1 | Electricity | 4,146.97 | 4,544.73 | 9.59% |

Looking into the exports of electricity from Nepal, the data shows that the exports of electricity have increased on a Y-o-Y basis in the current fiscal year 2080/81. Thus, there is the prospect of electricity exports due to various reasons. The "Upper Tamakoshi Hydropower Project" has increased the production capacity to 2,190 MW. Further, with the announcement of a restructuring of NEA and HIDCL in the financial budget of 2080/81, electricity production shall increase creating further prospects for electricity exports. Additionally, Nepal and Bangladesh have agreed to the power trading of around 40-50MW of electricity from Nepal. If



Nepal succeeds in selling electricity to Bangladesh, it will become the country's first power export outside India. It can become a catalyst for increasing exports in the upcoming months.

2.8 Gross Foreign Reserves & Import Capacity

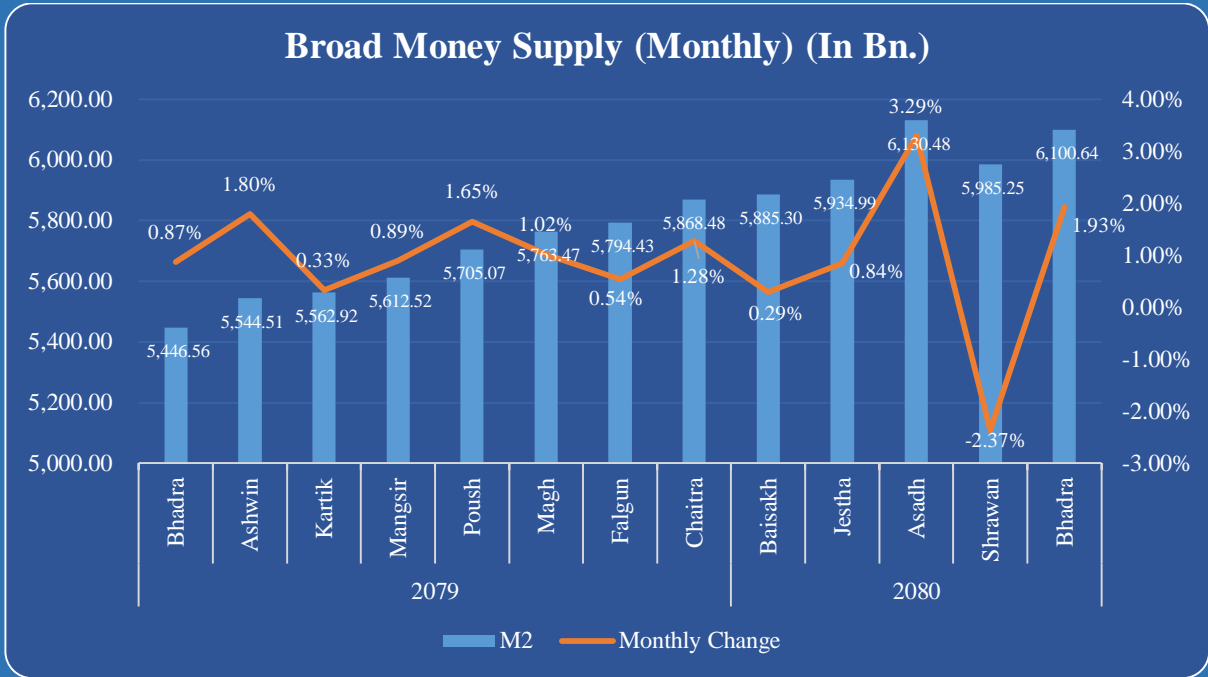


The Gross Foreign Reserves and import capacity is on an increasing trend in FY 2080/81 as well. As of Bhadra 2080, gross foreign reserves stood at 1598.90 billion which was 1189.16 billion in the same period of the previous year. The gross foreign reserves increased to 1573.12 billion from 1573.12 billion in Shrawan 2080. Likewise, the import capacity for merchandise and service imports remained constant at 10.3 months as of Bhadra 2080.

Currently, Nepal's import capacity and gross foreign exchange reserves are in a favorable position, alleviating concerns of the nation experiencing a situation similar to Sri Lanka, which underwent an economic crisis due to a shortage of gross foreign exchange.



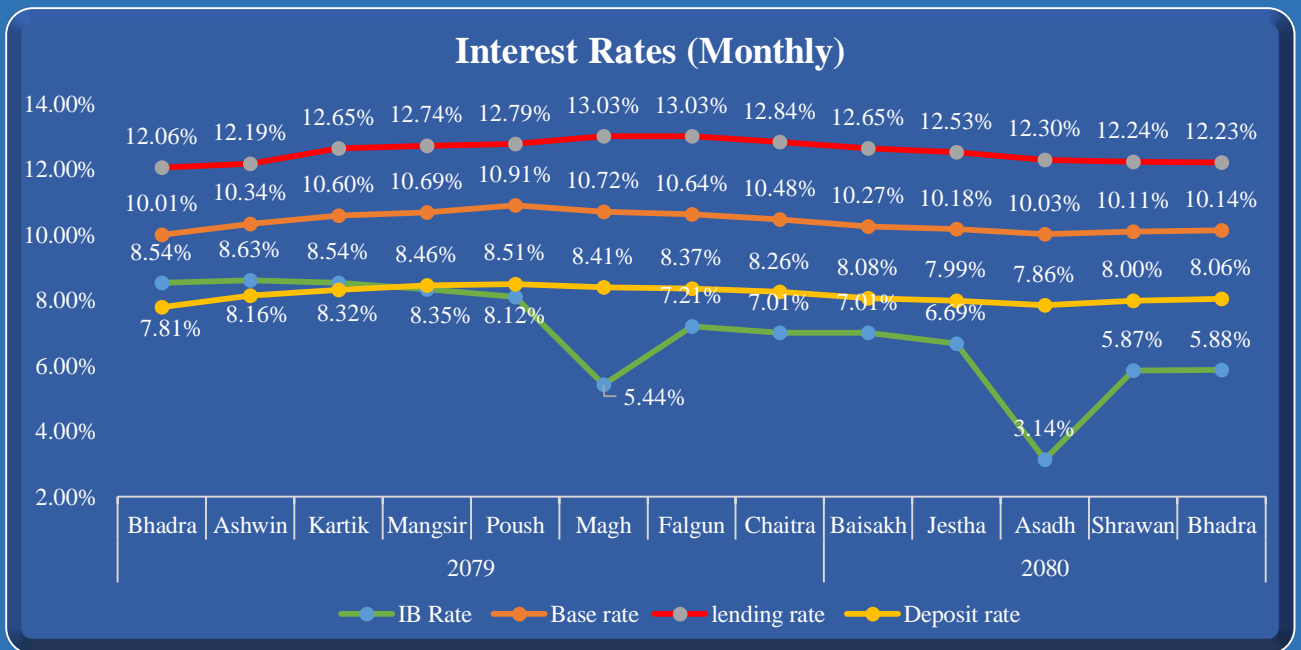
2.9 Broad Money Supply



Broad money supply is a measure of the total amount of money in an economy that is readily available for spending. It includes all physical currency, such as banknotes and coins, as well as money held in various types of accounts, such as demand deposits, time deposits, and savings deposits. The broad money supply figure had been in an increasing trend in the previous fiscal year and has slightly increased by 1.93% in the second month of the new fiscal year.

2.10 Interest Rates

Weighted Average Monthly Interest Rates (Line Chart)





To control rising inflation and excessive lending in unproductive sectors, NRB implemented several measures to reduce market liquidity, resulting in a rise in the market interest rate. Likewise, the interest rate increased in the beginning months of the previous fiscal year. But, with the gradual liquidity ease, the interbank rate had decreased from 8.35% in Mangsir to 5.44% in Magh 2079. The interest rates again increased around Chaitra 2080 signifying a reemergence of liquidity tightening during the period. However, the liquidity persevered in the ending month of the previous fiscal year with the interbank rate coming down to as low as 3.14%. The interbank rate as of Bhadra 2080/81 has increased to 5.88%.

As per the latest interest rates published by commercial banks for the month of Kartik 2080, 14 commercial banks have decreased their deposit interest rates, 4 banks have increased their interest rates and 4 have kept them constant following the previous month's interest rate.

At the end of Bhadra 2080, the government has permitted the BFIs to count 60% of government funds as deposits to aid liquidity in the hopes of the interest rate decrease.

2.11 Government Revenue and Expenditure

| Date | Government Revenue | | Government Expenditure | |
|-------------|--------------------|--------------------|------------------------|--------------------|
| | Amt. in billions | % of Target Budget | Amt. in billions | % of Target Budget |
| Bhadra 2079 | 163.02 | 11.61% | 134.34 | 7.49% |
| Bhadra 2080 | 154.24 | 10.84% | 131.14 | 7.48% |

The government revenue and expenditure as of Bhadra 2080 are 154.24 billion and 131.14 billion respectively. The government revenue and expenditure have reached 10.84% and 7.48% of the target budget respectively as of the beginning of the fiscal year 2080/81. The government revenue is slightly less in the current year compared to the same period of the previous year.

However, the government expenditure disbursed is slightly lower than that of the previous year. The money in circulation also depends on the disbursement of government expenditure. Higher government expenditure aids in easing the liquidity situation in the economy.

| Date | Capital Expenditure | Budget Deficit/Surplus (In Bn.) |
|-------------|---------------------|---------------------------------|
| Bhadra 2079 | 1.51% | 28.68 |
| Bhadra 2080 | 2.56% | 23.10 |

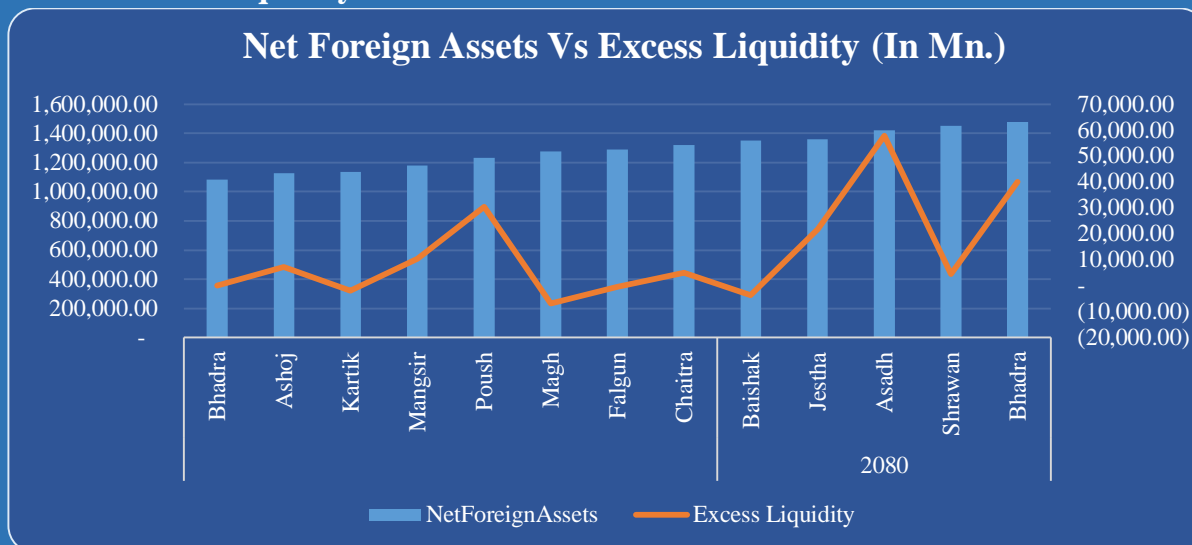
Source: FCGO

Capital expenditure is the most important component of government expenditure as it helps to accelerate the economy through development projects. The capital expenditure utilized by the government as of Bhadra's end stood at 2.56%. While it is at a slightly higher rate than the capital expenditure utilized the year before, it is still a very minimal percentage of capital expenditure being utilized.

As of Bhadra 2080, there is a budget surplus of 23.10 billion which is lower compared to the budget surplus amount of the previous year.

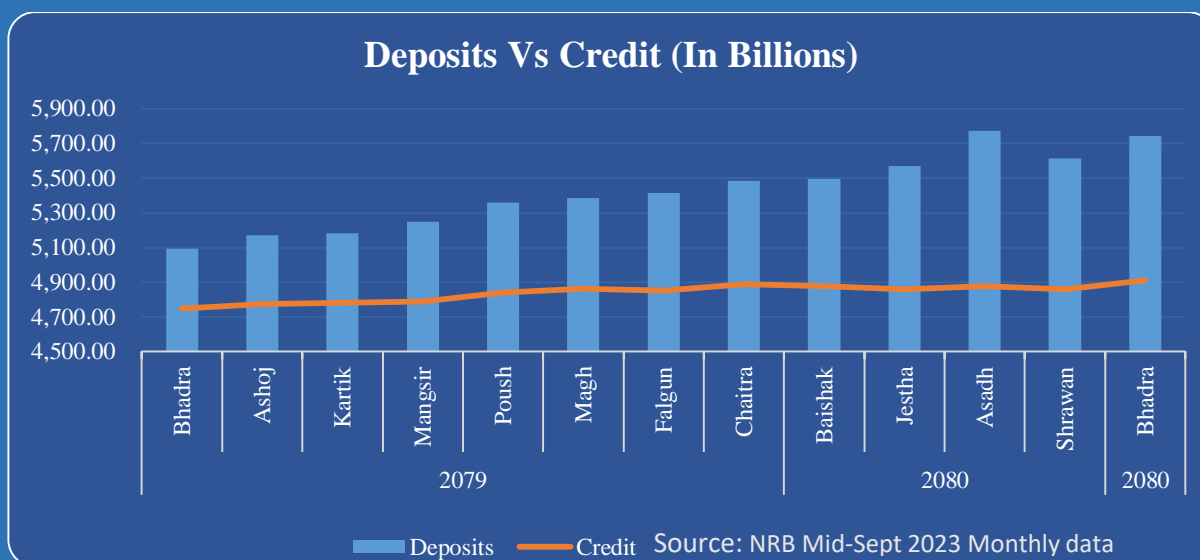


2.12 Market Liquidity



The position of excess liquidity stood at around 40.07 Billion (As of Bhadra 2080). The excess liquidity has improved significantly compared to the previous month which stood at 4.52 Billion. The position of excess liquidity had been in an extremely vulnerable state after the persisting credit crisis in the Nepalese economy which arose as a result of excessive lending during the post-COVID period and the rising import figure. The liquidity situation had improved greatly at the end of the previous fiscal year which may be attributed to the import restrictions placed, the discouragement of loans flowing into unproductive sectors, and the allowance to count 80% of local funds as deposits. The liquidity figure may have shown a drastic fall due to the removal of 80% of local funds as deposit facilities. At the end of Bhadra 2080, the decision was made on the allowance of counting 60% of local funds as deposits, which has contributed to increased liquidity in Bhadra 2080. The decreased import figure and increased remittance have positively affected the net foreign assets of the country with a growth of 2.08% in the current month.

2.6 Total Deposits and Credit





The total deposits have increased by 2.36% and the lending has increased by 1.04% as of Bhadra 2080 compared to the previous month. The total deposits stand at 5743.75 billion and the total credit stands at 4911.54 billion as of Bhadra 2080.

3 Conclusion

In conclusion, the current economic outlook in Nepal appears positive and improving outlook supported by reduced imports, growth in remittances, and a surplus in the balance of payments. However, it's important to note that the reduction in imports, initially due to restrictive policies and more recently because of economic slowdown, may not be a sustainable, long-term solution, especially without corresponding growth in domestic production. While the increase in remittances is a boost to the economy, it also signals a significant outflow of active manpower from the nation, which can pose challenges to the country's long-term economic growth prospects. Despite a comfortable liquidity position compared to the previous year, interest rates have not decreased as expected, resulting in limited credit expansion and subdued market demand. Moreover, the inflation rate remains higher than the targeted rate set by the central bank. The inflation might potentially stay at a higher level due to the Israel-Palestine war conflict. The government's ineffectiveness in allocating and spending funds for capital expenditure presents challenges in sustaining a favorable liquidity position in the economy throughout the year.

Nevertheless, the possibility of making positive contributions to the economy through the opportunity to export electricity exists. With the Credit to Deposit Ratio staying within the 82% range, there is an excess of loanable funds exceeding 250 billion within the banking industry. If the government and central bank implement appropriate policies and strategies, improving liquidity could be utilized for credit expansion at a lower interest rate. This, in turn, would stimulate demand in the market, boosting economic activity in the country. The reduction in market interest rates, coupled with increased liquidity, could catalyze enhancing economic activities and mitigating the impact of the economic slowdown.

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