Nepal: Request for an Arrangement Under the Extended Credit Facility-Press Release; Staff Report; Debt Sustainability Analysis; Staff Supplement; Statement by the Executive Director for Nepal

INTERNATIONAL MONETARY FUND

IMF Country Report No. 22/24

NEPAL

January 2022

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—PRESS RELEASE; STAFF REPORT; DEBT SUSTAINABILITY ANALYSIS; STAFF SUPPLEMENT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NEPAL

In the context of the Request for an Arrangement Under the Extended Credit Facility, 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 January 12, 2022, following discussions that ended on December 2, 2021, 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 December 22, 2021.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the International Development Association (IDA).
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Nepal.

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International Monetary Fund
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PRESS RELEASE

PR22/6

IMF Executive Board Approves US$395.9 million ECF Arrangement for Nepal

FOR IMMEDIATE RELEASE

- IMF Board approves SDR 282.42 million (about US$395.9 million) ECF arrangement for Nepal, with SDR 78.5 million (about US$110 million) available for immediate disbursement.
- The 38-month financing package will help mitigate the pandemic's impact on health and economic activity and protect vulnerable groups; preserve macroeconomic and financial stability; and support a reform agenda that leads to sustained growth and poverty reduction.
- Key policy actions under the program include measures to boost revenues and public spending efficiency, strengthen financial sector regulation and supervision and support fiscal transparency, as well as measures to enhance governance and combat corruption.

Washington, DC – January 13, 2022: On January 12, 2022, the Executive Board of the International Monetary Fund (IMF) approved a 38-month arrangement under the Extended Credit Facility (ECF) for Nepal in an amount equivalent to SDR 282.42 million (180 percent of quota or about US$395.9million). The ECF arrangement will assist the authorities' Covid-19 response in mitigating the pandemic's impact on health and economic activity, protect vulnerable groups, preserve macroeconomic and financial stability, and support sustained growth and poverty reduction. The program will help fill financing gaps and will catalyze additional financing from Nepal's development partners.

Approval of the ECF arrangement enables immediate disbursement of SDR78.5 million (50 percent of quota, about US$110 million, usable for budget financing. This follows Fund emergency support to Nepal in May 2020 under the Rapid Credit Facility (100 percent of quota, SDR 156.9 million, equivalent to US$214 million at the time of approval).

The Covid-19 pandemic is taking a heavy toll on Nepal's economy. From April to July 2021, Nepal suffered a devastating second wave of Covid-19, interrupting a gradual recovery in economic activity. GDP contracted by 2.1 percent in FY2019/20, staff estimate a partial recovery of growth at 2.7 percent for FY2020/21 and forecast growth of 4.4 percent in FY2021/22. The collapse of the tourism and service sectors, which are key drivers for growth, will take time to recover. After a sharp drop in 2020, imports have rapidly grown, fueling a large current account deficit (8.3 percent of GDP in FY2020/21). Gross international reserves remain adequate but have begun to decline in recent months. The Covid-19 shock affected both revenues and expenditures with the fiscal deficit expected to widen from 4.2 percent of GDP in FY2020/21 to 6.3 percent of GDP in FY2021/22.

The Fund-supported program under the ECF has three main objectives, aligned with the government's Relief, Restructuring, and Resilience (3R) plan. First, mitigating the Covid-19 impact on health and economic activity, and protecting vulnerable groups, including by making room in the budget for health, social assistance, and job support, while enhancing fiscal

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transparency and governance. Second, preserving macroeconomic and financial stability, including by maintaining a prudent fiscal stance, preserving reserve adequacy, and strengthening financial sector regulation and supervision. Third, supporting a reform agenda that leads to sustained growth and poverty reduction over the medium term, including by implementing cross-cutting institutional reforms that improve governance and reduce corruption vulnerability.

At the conclusion of the Executive Board's discussion, Mr. Bo Li, Deputy Managing Director and Acting Chair, made the following statement:

"The COVID-19 pandemic severely impacted Nepal's economy, including through a decline in tourism and domestic activity and volatile remittances. Households are experiencing an ongoing shock to income and social assistance programs have limited coverage, implying a likely setback to poverty alleviation gains in recent years. Further, important fiscal and external financing needs remain to support the COVID-19 response, facilitate a continued recovery, and maintain a comfortable level of reserves.

"The Extended Credit Facility arrangement will support the government's priorities, to mitigate the pandemic's impact on health and economic activity and protect vulnerable groups; preserve macroeconomic and financial stability; support sustained growth and poverty reduction; and catalyze additional external financing. It will also help anchor and leverage the Fund's capacity development strategy in Nepal.

"Fiscal policy in the early part of the program accommodates priority spending to address health needs, support the economy, and protect the most vulnerable. Fiscal deficits would gradually decline once the health crisis wanes, helping to ensure debt sustainability, while also accommodating the authorities' commitment to further enhance social safety nets. A comprehensive fiscal structural reform agenda underpins the program, with both revenue mobilization and public financial management reforms to address the public investment efficiency gaps, strengthen fiscal risk management, improve public debt and cash management, and help advance fiscal federalism in a fiscally prudent manner. Moving ahead with reforms to further enhance fiscal transparency and reporting will be important.

"The gradual unwinding of accommodative monetary policy and the authorities' commitment to remain vigilant toward emerging risks in the external and financial sectors are welcome.

"Financial sector regulation and supervision needs to be strengthened. Progress is needed on policies that preserve the stability of the financial system while supporting growth through ensuring the availability of adequate and timely supervisory data, updating the regulatory framework to better capture risks including to banks' asset quality, and enhancing the quality of supervision. Measures set out under the program to further improve the autonomy and accountability framework of the central bank would support this agenda.

"Sustained structural reform efforts are necessary to enhance the business environment, strengthen climate resilience, and raise medium-term growth. To this end, the program supports several cross-cutting institutional reforms that address governance, vulnerability to corruption, and efficiency of the public sector."

INTERNATIONAL MONETARY FUND

NEPAL

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY

December 22, 2021

EXECUTIVE SUMMARY

Background. The COVID-19 pandemic severely impacted Nepal's economy. Tourist arrivals collapsed, domestic activity plummeted, and remittances have been volatile. As a result, balance of payments and fiscal financing gaps emerged. After growth was lower than expected in 2019/20, a gradual resumption in economic activity and a corresponding surge in imports and related tax receipts led to higher growth and improved fiscal outturns in 2020/21. However, important fiscal and external financing needs remain to support the COVID-19 response, facilitate a continued recovery, and maintain a comfortable level of reserves.

Program Objectives and Modalities. The authorities have requested an Extended Credit Facility (ECF) arrangement to help mitigate the pandemic's impact on health and economic activity and protect vulnerable groups; preserve macroeconomic and financial stability; implement reforms to support sustained growth and poverty reduction; and catalyze additional external financing. Staff supports a 38-month ECF arrangement with semi-annual reviews and access at 180 percent of quota (SDR282.42 million, about US$398.8 million). The authorities would use the ECF for budget support. Public debt remains at low risk of distress and there is adequate capacity to repay the Fund.

Program Policies. Fiscal policy in the early part of the program would accommodate spending to address health needs, support the economy, and protect the most vulnerable. Fiscal deficits would gradually decline once the health crisis wanes, helping to stabilize public debt, while accommodating the authorities' commitment to further enhance social safety nets. The program also supports a comprehensive fiscal structural reform agenda. Recognizing the importance of preserving the stability of the financial system to help support growth, the program follows a carefully sequenced strategy to further strengthen financial sector regulation and supervision, while also enhancing the autonomy and accountability framework of the Nepal Rastra Bank (NRB).

Staff views. The Letter of Intent and Memorandum of Economic and Financial Policies demonstrate program ownership and appropriate policies to reach the goals of the authorities' program. The main risk to the program is the depth and duration of the pandemic, while continued ownership, capacity development, and sustained support from development partners will remain key for success.

Approved By
Anne-Marie Gulde-Wolf and Maria Gonzalez

The mission team consisted of Mr. Gregory (head), Ms. Sanya and Ms. Laws (APD), Mr. Huang (FAD), Ms. Aydin (MCM), Mr. Shang (SPR), Mr. Breuer (Senior Resident Representative), and was assisted by Ms. Dulal (local economist). Ms. Conde Panesso and Ms. Laluces (APD) contributed to the preparation of this report. Mr. Ong (OED) also participated in the discussions. Hybrid discussions were held in Washington and Kathmandu from October 20-29, November 17-18, and November 30-December 2, 2021. The team met with the Minister of Finance, Mr. Sharma, Finance Secretary, Mr. Marasini; Governor of the Nepal Rastra Bank (NRB), Mr. Adhikari; and other NRB and senior government officials. Staff also had productive discussions with representatives of the private sector, and development partners.

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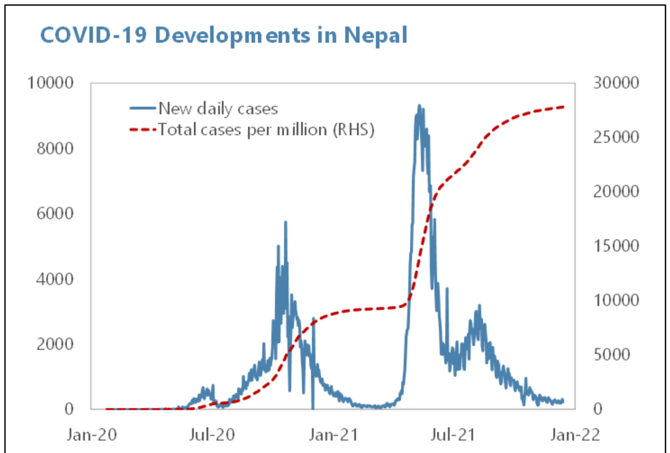
BACKGROUND

1. **Before the COVID-19 shock, strong growth in Nepal had been supported by greater political stability, improved electricity supply, and earthquake reconstruction.** Large remittance inflows (mainly from Gulf Cooperation Council (GCC) countries, India, and Malaysia) were also helping to alleviate poverty and unemployment. Buffers built before the COVID-19 pandemic—including a modest fiscal deficit, relatively low public debt to GDP, and a comfortable level of gross official reserves—provided some policy space to respond.

2. **The COVID-19 pandemic is taking a heavy toll on Nepal's economy.** Faced with immediate healthcare and economic shocks, in FY2019/20, Nepal met financing needs with the Rapid Credit Facility (100 percent of quota), support from the World Bank, Asia Development Bank and other development partners, debt relief under the Catastrophe Containment and Relief Trust (CCRT) and debt reprofiling under the G20 Debt Service Suspension Initiative (DSSI). However, additional financing gaps have emerged as the pandemic has persisted, with Nepal hit by a second wave at the end of FY2020/21, and livelihoods are at risk due to job and income losses.



Source: ourworldindata.org/coronavirus/country/Nepal

3. **Implementation of COVID-19 response measures is taking place amid a transition to fiscal federalism.** As mandated by the Constitution of Nepal, responsibility for many public services is being devolved to 7 provincial and 753 local governments (MEFP, ¶17). While federalism can improve service delivery and strengthen accountability, weak capacity of subnational governments (SNGs) is a challenge that has been exacerbated by the COVID-19 shock.

4. **The new government has committed to comprehensively address the health, economic, and social impact of the pandemic**. On July 18, 2021, Prime Minister Deuba obtained a vote of confidence from Parliament and took office, and his government is now expected to remain until the next elections in late 2022. The authorities issued a Status Paper on the economy in August 2021, and its vision and priorities are consistent with the polices supported by the ECF, including the prioritization of the pandemic response. In September 2021 a revised 2021/22 budget was approved, which kept total expenditure broadly unchanged—increasing COVID-19 vaccine expenditures while cutting administrative expenses. Poverty reduction and social protection were also prominent.

RECENT DEVELOPMENTS, OUTLOOK AND RISKS

A. Recent Developments

5. **The pandemic continues to impact health and livelihoods.** From April to July 2021, Nepal suffered a devastating second wave of COVID-19, interrupting a gradual recovery in economic activity. There have been over 800,000 confirmed cases and over 11,000 recorded COVID-19 deaths, the majority of which were during the second wave, and healthcare capacity remains very low. GDP contracted 2.1 percent in FY2019/20, and staff estimate a partial recovery at 2.7 percent growth for FY2020/21. The drop in tourism and services led to a collapse of a key growth industry that will take time to recover. Households are experiencing an ongoing shock to income and social assistance programs have limited coverage, implying a likely setback to poverty alleviation gains in recent years. Vaccine procurement is increasing, however widespread vaccination is not expected until well into calendar year 2022.

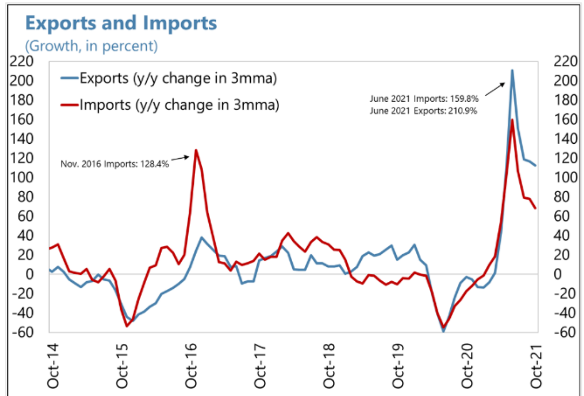
6. **The authorities responded proactively.** Despite implementation difficulties related to the lockdown, disease prevention, containment, and health management policies were strengthened, with implementation by both the federal and subnational governments. Existing cash transfer programs were maintained and, in some cases increased, while temporary measures included daily food rations to the most vulnerable and utility bills subsidies. Measures to mitigate job loss included an expansion of the Prime Minister's Employment Program and skills training. Several federally financed measures have been implemented by local governments. Tax relief measures included extension of tax deadlines, VAT and customs duty exemptions for COVID-19 related imports, and income tax rebates for MSMEs and highly affected industries. Liquidity and credit measures were implemented and macroprudential policies eased, while the NRB is allowing for loan deferral programs. The authorities enhanced the refinance facility and concessional loan program to support entrepreneurs, MSMEs, and affected businesses including in the tourism industry.

7. **The COVID-19 shock affected both revenues and expenditures.** Temporary factors led to a narrowing of the overall fiscal deficit from 5.3 percent of GDP in FY2019/20 to 4.2 percent of GDP in FY2020/21. Specifically, increases in import related taxes and deferred tax receipts raised revenues by 2.2 percent of GDP. Concurrently, budget execution, which usually increases in the 2nd half of the fiscal year, was severely constrained by the second wave and associated lockdown measures. Public debt in FY2020/21 was 47.2 percent and Nepal remains at low risk of debt distress. Nepal's external and domestic debt are roughly equal (Annex V). External creditors are mainly multilateral (88 percent of all external debt including the World Bank's International Development Association and the Asian Development Bank). Japan is the largest bilateral creditor, followed by China, India, and Korea.

8. **Banks' financial performance has likely been impacted by the COVID-19 shock, but the reported impact is masked by COVID-19 related support measures and regulatory forbearance.** Deposits increased year-on-year by 17.2 percent as of October 2021 and despite a 29.7 percent increase in total loans, by October 2021 the NPL ratio had decreased to 1.4 percent (from 1.8 percent in January 2021 and 1.5 percent as of August 2021), reflecting the high level of

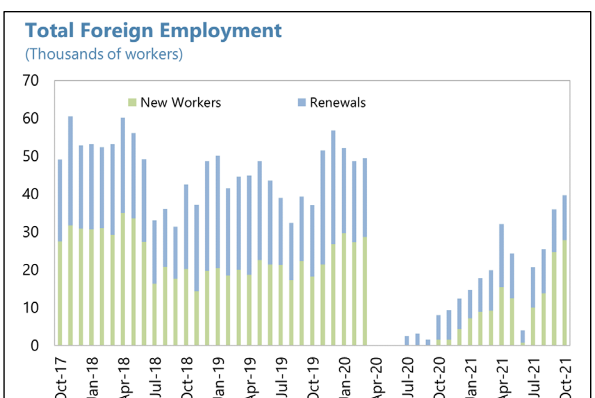
masking effects of COVID-related forbearance measures. The NRB does not yet have any concrete plans for unwinding the temporary COVID-mitigating measures, and full exit from these measures and recognition of COVID-impacted loans are likely to lead to an increase in the overdue loans and NPL ratios.

9. After an initial collapse in 2020, imports have rapidly grown, fueling a large current account deficit (8.3 percent of GDP). Buoyed by formalization and the ongoing global recovery, remittances remained robust, and combined with accommodative monetary policy they supported consumption, driving import growth of 25.7 percent year-on-year in FY2020/21. Goods exports have grown at 30.0 percent year-on-year but remain an order of magnitude smaller than imports. Tourism, which fell 90 percent during the pandemic, is forecast to only partially recover in FY2021/22 and not reach pre-pandemic levels until later in FY2022/23. Q1 data for FY2021/22 shows that import growth has further increased, while remittances have begun to soften.

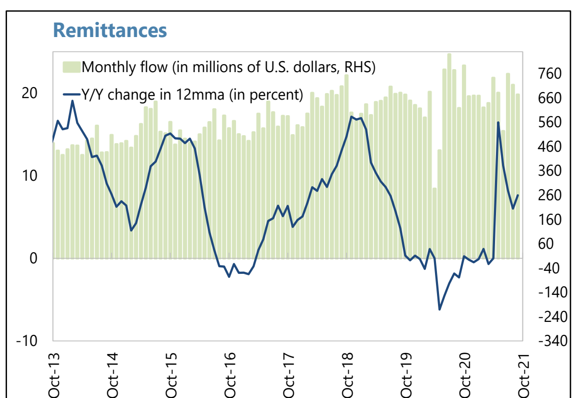


Sources: Nepali authorities; IMF staff estimates.

10. Gross international reserves remain adequate but have begun to decline in recent months. In October 2021, gross official reserves stood at US$10.22 billion (7.9 months of prospective imports), a decrease from $10.56 billion in July 2020. Reserves accumulated during the first three quarters of FY2020/21 due to temporary factors such as strong trade credit, COVID-19 related official loans, the 2021 SDR allocation of SDR 150.4 million (US$214 million, 0.18 months of imports[1]), as well as the limited expenditure capacity due to the lockdowns and remittance formalization. However, as the import recovery strengthened, reserve coverage has begun to fall in recent months and is projected to continue its downward path through the program period. External and fiscal financing will be needed to support the response to the pandemic, which remains uncertain in duration and intensity—as well as to facilitate a continued recovery. Structural issues



Sources: Nepali authorities; IMF staff estimates.



Sources: Nepali authorities; IMF staff estimates.

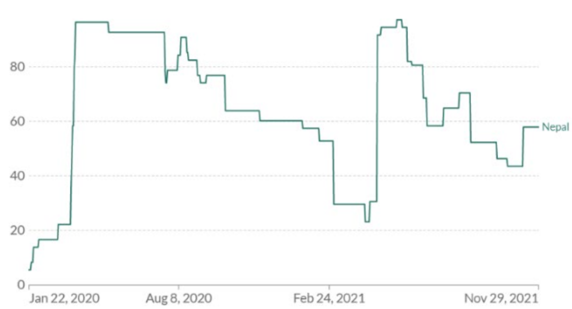
[1] The authorities plan to hold the SDR allocation in reserves.

also give rise to a protracted BoP need unrelated to the pandemic, given Nepal's high import and remittance dependence, and narrow export base. Maintaining a comfortable level of reserves is key to protecting the credibility of the exchange rate peg, and to maintain buffers in case other possible risks materialize (including natural disasters).

B. Outlook and Risks

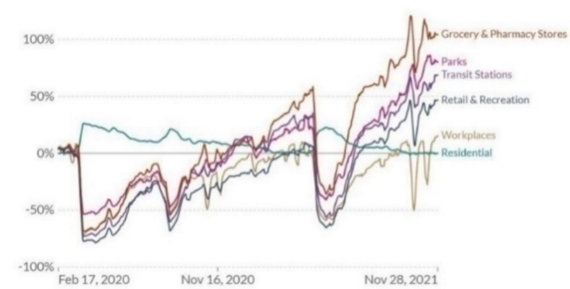
11. The trajectory of the pandemic is extremely uncertain, weighing on the economic outlook. Movement restrictions were maintained through much of 2021 as COVID-19 cases remain elevated. The acute phase of the pandemic is assumed to be over by mid-2022/23 as local transmission is reduced to low levels. Nepal however remains vulnerable to further infection waves. The recent global emergence of the omicron variant poses immediate risks, as does the impact of potential further new variants, especially if vaccination rates remain low.

Containment Measures, Stringency Index



Source: https://ourworldindata.org/covid-stringency-index

Community Google Mobility Index

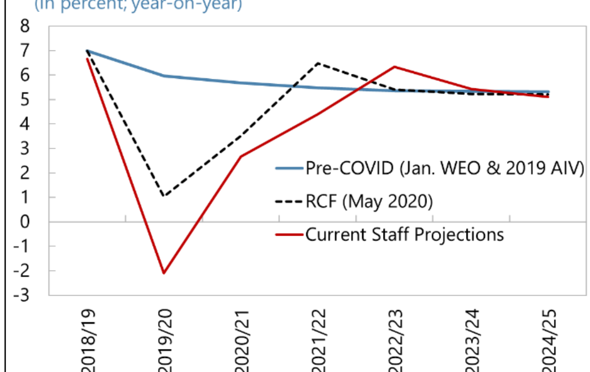


Source: https://ourworldindata.org/covid-google-mobility-trends

12. Growth is expected to gradually resume in FY2021/22, with a deterioration in the external and fiscal accounts.

- *Growth*. Growth is forecast at 4.4 percent in FY2021/22 driven by a tepid recovery in sectors hard hit by pandemic shut downs, such as construction, manufacturing and services. The outlook for tourism—a bedrock of the Nepali economy and key source of employment—remains fragile. Growth in the following years will be supported by greater and more efficient public infrastructure and development spending, and expansion of hydropower.

Annual Growth Projections
(In percent; year-on-year)

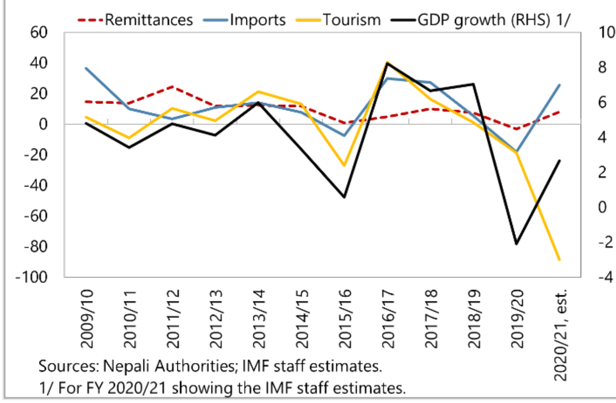


Sources: IMF staff projections

- *Inflation*. With the peg to the Indian rupee, inflation in Nepal is expected to broadly follow developments in India. Inflation is expected to rise to 5.7 percent during-FY2021/22, as higher oil and food prices globally exert moderate inflationary pressures.

- *Fiscal accounts*. The overall fiscal deficit is expected to widen to 6.3 percent of GDP in FY2021/22 as higher expenditure needs arise from the resumption of capital projects and the governments' pandemic response.

Real GDP Growth and External Sector Development
(In percent; year-on-year)



Sources: Nepali Authorities; IMF staff estimates.
1/ For FY 2020/21 showing the IMF staff estimates.

- *Current account*. Nepal's current account deficit is expected to remain wide at -9.1 percent in FY2021/22. Imports are projected to remain at high levels given significant fiscal and monetary support for the economic recovery, as well as higher oil and food prices, COVID-19 related health spending, inventory rebuilding, and government capital spending. However, while the outlook is uncertain, the very large increases in imports seen in Q1 FY2021/22 are expected to dissipate somewhat as some of these temporary factors unwind. At the same time, given recent increases in the number of Nepali migrant workers seeking employment abroad, remittances should also begin to recover, providing further support to the current account. The external position of Nepal in FY2020/21 was moderately weaker than the level implied by fundamentals and desirable policies

13. **The depth and duration of the pandemic are the main risks to the outlook**. The economic impacts of the pandemic and associated physical distancing measures are expected to gradually decline during FY2021/22 under the baseline. Should the pandemic intensify more than expected through the program period (including because of new variants and uncertainty regarding the widespread availability of COVID-19 vaccines), it will weaken recovery prospects in major economic partners, and create disruptions to Nepal's domestic activity, remittances, and tourism, resulting in larger and more protracted balance of payments and fiscal financing needs. If financing were not available to fill such increased external and fiscal needs, growth would be weaker than in the baseline, given the insufficient support to the economy, further hurting poverty alleviation efforts. Rising vulnerabilities in the banking system generate additional risks to the outlook, as well as those related to implementation capacity and fiscal pressures from the transition to fiscal federalism. The global response to rising inflation also weighs on the outlook. Rising commodity prices, risk of social and political instability also weigh on the outlook, and Nepal is vulnerable to climate related shocks and natural disasters (flooding, landslides, earthquakes).

THE EXTENDED CREDIT FACILITY

A. Program Objectives and Policies

14. The ECF program has three main objectives, aligned with the government's Relief, Restructuring, and Resilience (3R) plan to address the economic and social impacts of the pandemic and the medium-term recovery:

- *Mitigate the COVID-19 impact on health and economic activity, and protect vulnerable groups,* including by making room in the budget for health, social assistance, and job support, while enhancing fiscal transparency and governance.

- *Preserve macroeconomic and financial stability,* including by maintaining a prudent fiscal stance, preserving reserve adequacy, and strengthening financial sector regulation and supervision.

- *Support a reform agenda that leads to sustained growth and poverty reduction over the medium-term,* including by implementing cross-cutting institutional reforms that improve governance and reduce corruption vulnerability. Specifically, upgrading the tax system, strengthening public spending efficiency, advancing fiscal federalism, improving fiscal risk and public debt management, and strengthening the NRB institutional framework.

15. Strong ownership, sustained support from development partners, and the appropriate prioritization and sequencing of reforms is critical. Nepal continues to face considerable uncertainties as the COVID-19 shock strains Nepal's pre-existing institutional and capacity constraints, with the pandemic's magnitude, duration and impact still unclear. The program therefore aims at careful prioritization and parsimony, focusing first on attending the most urgent needs and critical reforms to effectively and sustainably tackle the pandemic shock, followed by a gradual stepping up in the pace of reforms during the program period. The program also supports a consistent, well-articulated policy mix based on all policy levers. The program will seek complementarity with other development partner programs whenever possible, and implementation of reforms will be supported by IMF technical assistance, including through HQ and SARTTAC. Table 10 provides an overview of the conditionality under the program.

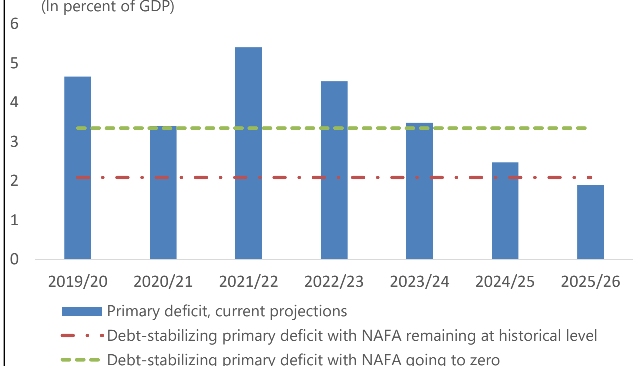
B. Fiscal Policy

16. Fiscal policy in the early part of the program accommodates spending to address health needs, support the economy, and protect the most vulnerable, but fiscal deficits will gradually decline once the health crisis wanes. The FY2021/22 budget kept many COVID-19 response measures of FY2020/21 and further increased all types of social security allowance and Child Protection Grants by one third, expanded grants and free lunch program to poor families, and increased COVID-19 vaccine purchases. The budget also provides tax relief to sectors adversely impacted by COVID-19 pandemic, in addition to measures of strengthening invoice monitoring and control to reduce tax leakage and introducing digital service taxes to expand tax bases. These

measures together will widen the overall fiscal deficit to 6.3 percent of GDP in FY2021/22, though it is still less than the budgeted deficit in part due to underspending of the capital budget. However, fiscal deficits are expected to decline to 3.5 percent of GDP by FY2024/25. Revenues will improve with the rebound in economic activity and upgrades to the tax system, including the reduction of ineffective tax exemptions, improving revenue administration efficiencies, and modernizing tax policy framework. A revenue mobilization strategy (MEFP ¶15) will be developed, building on the existing efforts to enhance tax administration and drawing on recommendations from FAD TA (SB, 3rd review). The authorities have taken steps to estimate tax expenditures related to international trade and will report tax expenditures comprehensively after the domestic component is also estimated to enhance transparency and allow for a cost-benefit analysis (SB, 2nd review, MEFP ¶15). Spending will be lower, facilitated by roll-off of temporary support measures and less duplication of spending responsibilities across levels of governments. The federal government primary deficit in the program period (indicative target (IT)) has been calibrated at a level consistent with stabilizing the debt by the end of the program period while preserving priority expenditures, including social spending and support for the economic recovery. The authorities have expanded social programs in FY2021/22, and an indicative target will be introduced in the second review, which will initially focus on child grant spending (MEFP ¶20). Staff will continue to actively engage with other development partners (including World Bank, UNICEF, FCDO) on social spending issues.

17. The fiscal deficit trajectory under the program will help stabilize public debt. Nepal continues to be assessed at low risk of distress. Public debt is projected to peak at 55.3 percent of GDP in FY2024/25, declining thereafter, as the primary deficit moves below the debt-stabilizing level of 2.1 percent of GDP (similar to the five-year average prior to the COVID-19 pandemic). Debt-to-GDP would stabilize much earlier if Net Acquisition of Financial Assets (NAFA), mostly loans and capital injections to SOEs, incorporated in the baseline forecast were to be smaller[2].

Debt-Stabilizing Primary Deficits
(In percent of GDP)



Source: IMF staff estimates.

18. The program supports a comprehensive fiscal structural reform agenda—with both revenue mobilization and public financial management reforms. The key measures (MEFP ¶14-18) include: i) An action plan to address the public investment efficiency gap (SB, 2nd review), drawing on recommendations from the public investment management assessment (PIMA) and its climate change component (PIMA CC) conducted in March and April 2021. ii) A fiscal risk register will be developed (SB, 2nd review) followed by a comprehensive fiscal risk statement to be published with the budget speech (SB, 4th review). iii) A fiscal risk monitoring system for subnational

[2] NAFA has averaged 1.3 percent of GDP per year and includes financing of SOEs to implement the authorities' development program (see DSA). Envisaged technical assistance related to fiscal risks will help specify further steps to enhance SOE sustainability as needed, including in the context of the program.

governments will also be established, supported by Fund TA (SB, 3rd review). iv) All operational funds will be reported to the Financial Comptroller General Office (FCGO) for inclusion in the consolidated financial statements (SB, 1st review), cash flow forecasting will be prepared and shared with the PDMO and the NRB on a regular basis (SB, 2nd review), and debt management function transferred from NRB to the PDMO (SB, 6th review).

19. The program will also support fiscal transparency and measures to enhance governance and combat corruption (MEFP ¶33-34). The program includes several cross-cutting institutional reforms that address governance, vulnerability to corruption, and efficiency of the public sector. In addition, the authorities continue to implement spending transparency commitments, including that the Office of the Auditor General (OAG), an independent Constitutional body, audits the government accounts on an annual basis, as per its mandate, and publishes the results on the OAG website. The latest OAG report for FY2019/20 was published in August 2021[3]. In addition, spending from the COVID-19 Fund—an extra-budgetary fund with financing from government, development partners, and the private sector—is being published monthly and the OAG is also expected to audit this Fund in 2022[4]. In the context of commitments made at the time of the Rapid Credit Facility disbursed in May 2020, the authorities have since published a quarterly report on federal government spending on the COVID-19 response, and a further report will be published by March 2022 (SB, 1st Review). Furthermore, the authorities have issued a Public Information Notice (PIN) on the collection and publication of beneficial ownership information[5]. Consistent with the published PIN, implementation agencies will publish on a government website large public procurement documentation, ex-post validation of delivery, the name of awarded companies, and the name of their beneficial owner(s) for all new, large, COVID-19 related procurement contracts (Prior Action).

C. Monetary and Financial Sector Policies

20. Inflation has remained generally stable despite some heightened risk factors. The year-on-year consumer price inflation and wholesale price inflation stood at 4.2 percent and 3.8 percent, respectively as of October 2021. Heightened risk factors on inflation are the appreciation of Indian rupee, increase in the prices of petroleum products and disruptions to the agricultural production due to climate related factors such as monsoons and floods. The authorities remain committed to having price and external sector stability as overarching objectives of monetary policy and preserving the credibility of the exchange rate peg by maintaining an adequate level of reserves (MEFP ¶22).

21. The NRB is gradually unwinding accommodative monetary policy. The accommodative monetary policy adopted in FY2020/21 resulted in high credit growth with generally stable inflation. The NRB announced moving to a more neutral monetary policy framework for the current fiscal year

[3] Auditor General Nepal (oag.gov.np)

[4] https://www.fcgo.gov.np/storage/uploads/reportpublication/2021-07-29/20210729153015_2078%20Ashad.pdf

[5] https://ppmo.gov.np/download/bids/MOE%2012-8-2021.pdf

(FY2021/22). Within this framework, the NRB increased the deposit collection rate (the lower boundary for the interest rate corridor) from 1 percent to 2 percent and policy rate from 3 percent to 3.5 percent while keeping the Standing Liquidity Facility (SLF -the upper boundary for the interest rate corridor) constant at 5 percent.

22. Credit growth remains high, leading to greater liquidity needs in the banking system. With the gradual lifting of restrictions on economic activities after the first quarter of FY 2020/21 coupled with the availability of refinance facilities at concessional rates, imports, supported by high credit growth, increased substantially. Given the lower level of remittance inflows, the surge in imports have mostly been financed by loans. Despite the 17.2 percent year-on-year increase in deposits, loans increased by 29.7 percent as of October 2021. As of October 2021, the cash balances of Banking and Financial Institutions (BFIs) at the NRB are only marginally above the cash reserve requirement and around 7 percent of its level in the previous year. In the first three months of the current fiscal year, the NRB injected over Rs. 1 billion of liquidity in the market and interbank transactions across commercial banks have substantially increased with interbank interest rates approaching the SLF rate. The NRB remains committed to restricting annual credit growth to 19 percent while the expected deposit growth is around 15 percent in FY 2021/22. Additionally, the NRB stands ready to provide liquidity in the system, where necessary, through SLF and repo facilities while the refinancing facility will gradually be scaled back. The authorities will also continue to closely monitor inflation developments and credit supply and stand ready to adjust policy settings in case signs of overheating appear (MEFP ¶23). Staff reiterated that the interest rate corridor framework should be strengthened in the medium term.

23. The reported capital adequacy levels are above the regulatory minima and NPL ratios are at low levels, but the banking system requires close monitoring. As of October 2021, the capital adequacy ratio of the banking system is 13.5 percent, and despite the high level of credit growth (evident even before the pandemic), the NPL ratio stands at 1.4 percent. The high share of revolving loans, evergreening practices, the difficulty in monitoring consolidated borrower exposures, unavailability of bank-level forbearance data, and insufficient level of COVID-19 related monitoring raise concerns that NPLs are understated, provisioning for loan losses is inadequate, and capital adequacy is overstated. At the same time, there are ongoing COVID-19 related borrower support and regulatory forbearance measures, which are likely to hide the vulnerabilities in asset quality (Annex I)[6]. The authorities have a firm intention to gradually phase them out. Concrete plans, yet to be announced, should be based on a fuller view of potential impacts. Further clarity is needed for the assessment of the health of the banking sector. Staff will work with the authorities ahead of the first review to analyze the banking system using bank level forbearance data[7].

24. The NRB should continue to closely monitor the impact of COVID-19 on the financial sector. The effects of the potential deterioration in the asset quality, as well as the rising level of

[6] As of July 2021, approximately 32 percent of profits stem from the written off provisions (reversals), which is a one-off source.

[7] Staff will also work to gain a fuller understanding of the banking sector exposures to the public sector, including SOEs, to complement the assessment of fiscal risks (¶18).

loan loss provisions, on the profitability and capital adequacy levels of banks should be assessed. The effects of rising leverage on the real sector should also be monitored. It is welcome that the NRB stands ready to tighten macroprudential policies[8] to curb credit growth and mitigate the buildup of financial vulnerabilities (MEFP ¶24), and staff will further discuss with the authorities the calibration of macroprudential measures. COVID-19 related support measures in the financial sector should however be gradually unwound, and the remaining ones should be targeted and time bound (MEFP ¶32).

25. The program follows a carefully sequenced strategy to further strengthen financial sector regulation and supervision. The strategy (1) prioritizes actions to ensure the provision of adequate and timely supervisory data, including those relating to COVID-19 response measures; (2) updates the regulatory framework to enable more accurate assessment of the asset quality of banks and that better captures existing risks; (3) provides an accurate assessment of the banks' asset quality based on the new regulation through auditor-assisted on-site inspections; and (4) continues to enhance the quality of supervision, supported by the data and regulatory upgrades. Specific actions include the following and the authorities remain committed to implementing these actions (MEFP ¶28-31):

- To enhance monitoring of the impact of COVID-19 and related policy measures on asset quality, the NRB will enhance and customize its current reporting template to regularly collect information on forbearance, provisioning levels, asset classifications, and payback capacity of borrowers (SB, 1st review). The NRB's analyses of this information will be used to inform future on-site inspections to further increase its effectiveness and planning of the phase-out of the COVID-19 measures as well as taking appropriate supervisory and enforcement actions.

- The NRB will approve an action plan (SB, 1st Review) and complete the full implementation of the Supervisory Information System (SIS) for class A banks (SB, 2nd review) and proceed in a second stage with the implementation of SIS for Class B and C banks[9].

- Asset classification in Nepal, including NPLs, is mostly defined in terms of the days past due and does not adequately incorporate qualitative factors that could affect borrowers' creditworthiness. Additionally, the current regulatory framework does not include clear definitions of forborne loans and NPLs, and guidance on how these loans should be treated in reclassifications. The NRB will draft amendments to the regulatory framework to address these shortcomings (SB, 1st review), in line with MCM recommendations. The new regulation will be issued while allowing an adequate transition period for the banks to implement (SB, 2nd review).

[8] The following macroprudential measures are currently implemented: The single obligor limit (the single obligor limit of the margin nature loan is fixed at Rs. 40 million from one institution and Rs. 120 million in total), credit to deposit ratio (CD, currently 90%), debt service to income ratio (currently 50%), and loan to value ratio (LTV, 70% for margin loans and 60 percent for the business housing projects licensed by the government).

[9] Class A banks are commercial banks, class B banks are development banks, and class C banks are finance companies.

- The NRB will launch (SB, 3rd review) and complete (SB, 4th review)—for the 10 largest banks—in-depth on-site inspections assisted by independent third-party auditors to review loan portfolios in line with the new regulatory framework and with special attention to loan and collateral valuation, evergreening, group borrowing, concentration risks, and the impact of COVID-19 on loan portfolios and reclassification of loans. Any banks found to be undercapitalized based on the diagnostics will be required to present a recapitalization plan.

26. The authorities have expressed their commitment to ensuring a stable and well-capitalized banking system. Enhanced monitoring and the updated regulatory framework will facilitate an accurate assessment of the health of the financial sector. To ensure the effectiveness of the supervisory process, the NRB have committed to take relevant and timely enforcement actions where necessary. If any bank becomes undercapitalized, the NRB will use the set of relevant early intervention measures, including further suspension of dividend payments and taking other corrective measures[10] such as limitations in loans, deposits, and investments, requiring changes in the business structure and the removal of management. The NRB will ensure that banks' loan classification correctly reflects the asset quality of the banking system and regulatory forbearance measures will be gradually withdrawn. Once the acute phase of the pandemic is over, the authorities will develop a strategy to continue strengthening financial sector regulation and supervision, with support from IMF technical assistance and a potential Financial Sector Stability Review (FSSR) (MEFP ¶32).

27. Strengthening the AML/CFT framework remains a priority. The authorities have committed to make progress on the implementation of their AML/CFT framework, while remaining vigilant and ready to act upon any new or emerging AML/CFT risks (MEFP ¶35). The authorities have also committed to continuing their efforts to increase access to financial services and to develop financial markets, while maintaining financial stability (MEFP ¶36).

28. The program will seek to improve the autonomy and accountability framework of the NRB. Specific reforms will be guided by key recommendations from the 2021 safeguards assessment. The assessment found limited progress in implementing previous safeguards recommendations and emphasized needed reforms related to the current shortcomings in the external audit of NRB's accounts, financial reporting processes that fall short of international standards, and the need for modernization of the central bank framework to strengthen the autonomy and accountability of the NRB. The authorities will therefore submit to the Parliament amendments to modernize the NRB Act, addressing key recommendations of the safeguards assessment report (SB, 2nd review). Furthermore, the Auditor General will appoint reputable international auditors with experience in applying International Standards on Auditing and auditing central banks to audit of the NRB financial statements starting with FY2021/22 (SB, 1st review, MEFP ¶25).

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[10] Corrective measures are listed in Article 86C of the NRB Act.

Text Table 1. Nepal: Sequencing of Reforms under the ECF Arrangement, FY2021/22-FY2024/25

IMF Program Objectives	Policy Objectives	Priorities and Sequencing					
Phase		Containment (stabilization phase)		Recovery (macro- and structural adjustment phase)			
Fiscal year		FY2021/22	FY2022/23		FY2023/24		FY2024/25
Review		1st Review	2nd Review	3rd Review	4th Review	5th Review	6th Review
Board meeting date		12-Jun-22	12-Jan-23	12-Jul-23	12-Jan-24	12-Jul-24	12-Jan-25
I. Mitigate the Covid-19 impact on health and economic activity, and protect vulnerable groups	Make room in the budget for health, social assistance, and job support		Floor on social spending by the federal government as a indicative target				
	Enhance fiscal transparency and governance	Publish a report on federal government spending on the Covid-19 response					
II. Preserve macroeconomic and financial stability	Protect external stability	Floor on NRB net international reserves as quantitative performance criterion					
		Non-accumulation of new external payments arrears on external debt contracted or guaranteed by the nonfinancial public sector and the NRB as a continuous performance criterion					
		Non-introduction of exchange restrictions and multiple currency practices as a continuous performance criterion					
	Protect fiscal sustainability	Ceiling on federal government primary deficit as indicative target (QPC starting in 3rd review), with adjustor on revenue and project financing					
					Floor on tax revenues of the federal government as indicative target		
	Enhance the regulatory framework	(1) Draft regulation on revised definitions of forbearance and non-performing loans	Issue revised regulation, with adequate transition period for banks to implement				
		Introduce a customized bank reporting template to enhance monitoring of the impact of Covid-19					
	Enhance the supervisory framework	NRB Board approval of action plan for implementation of the Supervisory Information System (SIS) for class A banks	Complete the full implementation of the SIS among class A banks as per the action plan				
				Launch for 10 largest Banks in-depth on-site inspections assisted by independent 3rd party auditors	Complete for 10 largest Banks in-depth on-site inspections assisted by independent 3rd party auditors		
III. Support a solid economic recovery that would lead to sustained growth and poverty reduction	Poverty Reduction and Growth Strategy Paper		Poverty Reduction and Growth Strategy Paper				
	Upgrade the tax system, to preserve fiscal sustainability and make room for priority spending	MOF publishes a report on tax exemptions related to customs	MOF publishes a report on tax exemptions including those taxes outside customs	Cabinet approval of a domestic revenue mobilization strategy	Implementation of domestic revenue mobilization strategy		
	Strengthen spending efficiency, to support growth and strengthen climate resilience		Cabinet approval of action plan to strengten public investment management	Implementation of action plan to improve public investment manangement			
	Advance fiscal federalism in a fiscally prudent manner, for better delivery of public services			Cabinet approval of fiscal risk monitoring system for subnational government	Issue regulations to subnational governments mandating implementation of the Budget Management Information System and Treasury Regulatory System	Implementation of fiscal risk monitoring system for subnational government	
	Strengthen fiscal risk management, to support fiscal sustainability		A fiscal risk register is developed at the MOF to capture various dimensions of major fiscal risks		A fiscal risk statement is published with the Budget speech	Cabinet approval of action plan to manage and control the major fiscal risks	Implement action plan to manage and control major fiscal risks
	Improve public debt and cash management, to enhance debt transparency and risk management	FCGO regularly consolidates all operational funds and report the financial information of these funds in annual financial statements	Cash flow forecasting developed by MOF is shared on regular basis with PDMO and NRB				Complete the transfer of domestic debt management function from NRB to PDMO
	Strengthen NRB institutional framework, in support of NRB's policy mandates	An external audit of the NRB financial statements for FY2021/22 is commissioned, consistent with the recommendation in the 2021 Safeguards Assessment	Submit to Parliament ammendments to modernize the NRB Law, addressing recommendations of the 2021 Safeguards Assessments Report				

Reform areas have been identified and measures are to be specified, where possibble by drawing on recommendations from IMF technical assistance.

FINANCING AND PROGRAM MODALITIES

29. **Staff considers access of 180 percent of quota (SDR 282.42 million; US$398.8 million) under the 38-month ECF to be appropriate.** The ECF would help Nepal address immediate BOP and fiscal financing needs (Text table 2) related to the pandemic that have been compounded by a

pre-existing protracted balance of payments need resulting from high import-dependency, a narrow export base and a heavy reliance on remittances. Waves of the COVID-19 pandemic and the economic disruptions from prolonged periods of lockdown therefore give rise to balance of payments and fiscal financing gaps in the near term.

Text Table 2. Nepal: Projected Financing Gap in FY2021/22 (percent of GDP)

External financing need in FY 2021/22	Current Projection	Fiscal financing need in FY 2021/22	Current Projection
External financing requirement	**9.2**	Total revenue and grants[2/]	24.7
of which:		Expenditure	31.0
current account balance[1/]	10.0	**Fiscal deficit**	**6.3**
Available Financing	**4.4**	**Total financing**	**4.6**
of which:		Net acquisition of financial assets	1.3
Foreign borrowing	2.8	Net incurrence of liabilities	5.8
Current and capital grants[2/]	1.3	Foreign borrowing	2.1
FDI, net	0.3	Domestic borrowing	3.7
External financing gap[3/]	**4.8**	**Fiscal financing gap[3/]**	**1.7**
Financing commitments so far:	**4.8**	Financing commitments so far:	**1.7**
IMF: Prospective arrangement	0.4	IMF: Prospective arrangement	0.4
Asian Development Bank	0.3	Asian Development Bank	0.3
World Bank	0.9	World Bank	0.9
Drawdown of foreign reserves	3.1		
Of which: SDR allocation	0.6		

Sources: Nepali authorities; and IMF staff estimates.
1/ Current account excludes official transfers
2/ IMF-CCRT debt relief (US$4.9 mil) is included.
3/ IMF-ECF (US$166.2 mil), WB (US$350 mil), and ADB (US$100 mil).
Note: Current baseline forecast is as of December 7, 2021.

30. **The program is fully financed, with firm commitments in place for the next 12 months and there are good prospects for the remainder of the program.** The pandemic response, including the urgent procurement of vaccines and continued economic support measures, have created an immediate balance of payments gap, estimated at 4.9 percent of GDP in FY2021/22, which would be financed with the ECF and budget support from development partners (1.2 percent of GDP in firm commitments so far) and a drawdown of reserves (3.1 percent of GDP). Alternative budget financing options are not available, particularly given the limited absorptive capacity of domestic markets.

31. **Phasing will be somewhat frontloaded to match the timing of acute COVID-related needs.** The fiscal financing gap is large in the first year of the program and insufficient financing

would directly hinder the government's COVID-19 response, which would have a lasting impact on poverty and the economy. Fiscal and external financing needs will decline over the medium term supported by the economic recovery process, the gradual dissipation of uncertainty related to the pandemic, and the authorities' steadfast implementation of policies to promote macroeconomic stability and inclusive growth. Further, development partners are supportive of Nepal's reform commitments under the ECF arrangement, thus providing policy assurances that could catalyze additional support over the medium term. In this context, a combined access of 100 percent of quota will be available within the first 12 months (50 percent at Board approval, and 25 percent at the first and second reviews), with the remaining 80 percent distributed in the subsequent reviews (table 7).

32. Program performance will be monitored by semi-annual reviews. Indicative targets (ITs) will be set on the primary deficit of the federal government (a deficit ceiling, converting to QPCs in the 3rd review), and tax revenues (a floor, to be incorporated in the second year of the program). Applying ITs before their conversion to QPCs would support the authorities' capacity building efforts and effective implementation of the strong fiscal indicators. The ITs on the primary deficit would be adjusted (i) upward (downward) to accommodate revenue shortfalls (windfalls) and (ii) upward (downward) if concessional project loans disbursed exceed (fall short of) the programmed amounts (TMU, ¶9 and ¶10). Quantitative performance criteria (QPCs) will be set on net international reserves, and the standard continuous QPCs on non-accumulation of external arrears and non-introduction of exchange restrictions and multiple currency practices will apply. The QPCs on net international reserves would be adjusted (i) downward to accommodate revenue shortfalls and (ii) downward if concessional budget support loans disbursed fall short of the programmed amounts. Any downward adjustment to the QPC on net international reserves is capped to maintain reserve adequacy levels (TMU, ¶5). Structural benchmarks (SBs) for the first year of the program will be tightly focused on actions critical to addressing urgent needs in the face of the pandemic, with a broader structural reform agenda implemented once the recovery phase takes hold. The design of structural benchmarks complements other development partner programs where possible. A Poverty Reduction and Strategy Paper (PRSP) will be prepared (SB, 2nd review).

33. The program helps anchor and leverage the Fund's capacity development strategy with Nepal. Fiscal policy support will focus on domestic revenue mobilization, public investment, and fiscal risk management. Financial sector technical assistance will include work on financial sector supervision, as well supporting the authorities' efforts on central bank governance and modernization. A Financial Sector Stability Review is also envisaged.

34. A new safeguards assessment of the central bank has been completed. Its findings (see para 28 above) form the basis for structural conditionality related to institutional reforms. An agreement between the NRB and the MOF clarifying responsibilities for servicing obligations to the Fund will be put in place.

35. Capacity to repay remains adequate. IMF credit outstanding is projected to peak at 282.3 percent of quota in FY2024/25 (SDR 442.9 million), within the cumulative normal access limit

of the PRGT. This amount corresponds to 7.9 percent of official reserves and 1.3 percent of GDP in FY2024/25. The authorities' track record of servicing IMF debt is strong.

36. Staff and the authorities discussed contingency plans for a possible adverse scenario. The outlook is subject to considerable uncertainty from the depth and duration of the pandemic. Nepal's buffers provide an important first line of defense, but additional fiscal and monetary policy measures could be needed, alongside further measures and financing to support the financial sector, should BoP pressures continue for longer than projected. The current fiscal framework includes 0.8 percent of GDP to support the financial sector, but given the vulnerabilities in the system, a significantly larger fiscal allocation would be needed in the event of a downside scenario materializing. Close engagement will allow for consultation with Fund staff if these shocks were to materialize.

STAFF APPRAISAL

37. The COVID-19 pandemic severely impacted Nepal's economy. Tourist arrivals collapsed, domestic activity plummeted, remittances have been volatile, and growth was lower than expected in 2019/20. The authorities reacted proactively**,** implementing a wide-ranging set of fiscal, monetary and financial sector policies, as well as disease prevention, containment, and health management measures.

38. A gradual resumption in economic activity and a corresponding surge in imports and related tax receipts led to higher growth and improved fiscal outturns in 2020/21. However, important fiscal and external financing needs remain, and the trajectory of the pandemic remains extremely uncertain, weighing on the economic outlook, and risks remain high. Both external and overall debt in Nepal are assessed at low risk of debt distress, while the external position of Nepal in FY2020/21 was moderately weaker than the level implied by fundamentals and desirable policies.

39. The ECF arrangement supports the government's priorities. The arrangement would help mitigate the pandemic's impact on health and economic activity and protect vulnerable groups; preserve macroeconomic and financial stability; implement reforms to support sustained growth and poverty reduction; and catalyze additional external financing.

40. Fiscal policy in the early part of the ECF would accommodate spending to address health needs, support the economy, and protect the most vulnerable. Fiscal deficits would gradually decline once the health crisis wanes, helping to stabilize public debt, while accommodating the authorities' commitment to further enhance social safety nets. The program will also support a comprehensive fiscal structural reform agenda, with both revenue mobilization and public financial management reforms to address the public investment efficiency gaps, strengthen fiscal risk management, improve public debt and cash management, and help advance fiscal federalism in a fiscally prudent manner.

41. Fiscal transparency and measures to enhance governance and combat corruption will also be prominent. Several cross-cutting institutional reforms that address governance, vulnerability to corruption, and efficiency of the public sector will be taken forward, in addition to the continued implementation of spending transparency commitments.

42. The NRB should prudently monitor the level of liquidity in the banking system. They should stand ready to provide liquidity in the system where necessary while gradually scaling down the refinance facility**.** The NRB's gradual unwinding of accommodative monetary policy and commitment to remain vigilant toward emerging risks in the external and financial sectors due to high levels of increase in the credit supply are welcome, and they should stand ready to adjust policy settings in case signs of overheating appear.

43. Financial sector regulation and supervision needs to be strengthened. The carefully sequenced strategy defined in the ECF will help preserve the stability of the financial system and support growth though ensuring the provision of adequate and timely supervisory data, updating the regulatory framework to enable more accurate assessment of the asset quality of banks and that better captures existing risks, providing an accurate assessment of the banks' asset quality, and enhancing the quality of supervision, supported by the data and regulatory upgrades. The NRB should stand ready to tighten macroprudential policies to prevent overheating in the economy. Measures to improve the autonomy and accountability framework of the NRB would support this agenda.

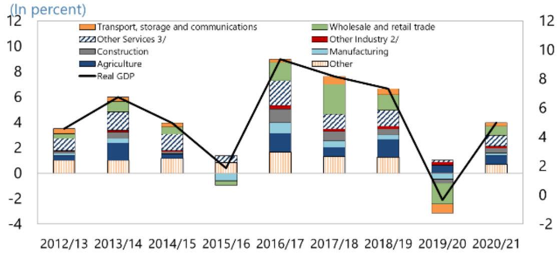
44. Based on the protracted balance of payment need and policy commitments, staff supports the authorities' request for a 38-month arrangement under the ECF, with access equivalent to 180 percent of quota (SDR 282.42 million).

Figure 1. Nepal: Recent Macro-Economic Developments

Wholesale and retail trade have led the collapse during FY2019/20 and subsequent recovery in FY2020/21.

Contribution to Real GDP Growth by Sector 1/

(In percent)

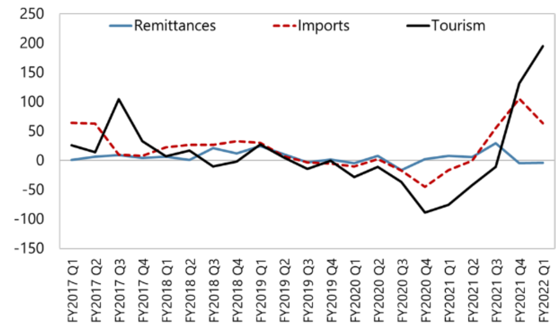


Sources: Nepal Central Bureau of Statistics; IMF staff estimates.
1/ The CBS announced its GDP projection for FY 2020/21 on 30th April, 2021. The CBS estimates combine actual data through mid-April and projections for the rest of the FY. It assumes that activities in all sectors—except for accomodation and food services— resumed in two weeks after the release. However, accomodation and food services may take more time to operate in normal condition.
2/ Electricity, gas and water, and Mining and quarrying.
3/ Hotels and restaurants, financial intermediation, Real estate, renting and business activities, Public administration and defence, Education, Health and social work, other community, social and personal service activities.
*Preliminary.

Tourism is on the rebound after a near total collapse.

External Sector Developments

(Year-on-year change, in percent)

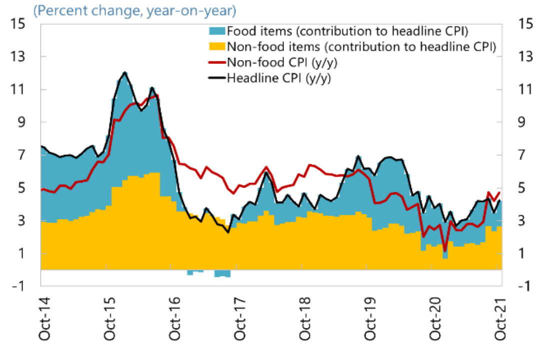


Sources: Nepali authorities; IMF staff estimates.
Note: Nepal fiscal year begins in mid-July.

Inflation was 4.2 percent in October 2021, with low non-food inflation reflecting subdued domestic demand.

Consumer Price Index

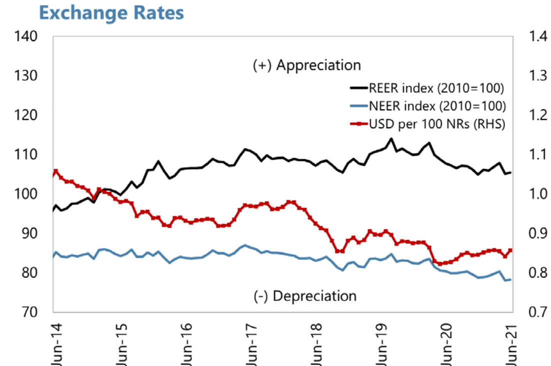
(Percent change, year-on-year)



Sources: Nepali authorities; and IMF staff estimates.

The nominal and real exchange rates depreciated at the start of the pandemic but have stabilized in recent months.

Exchange Rates

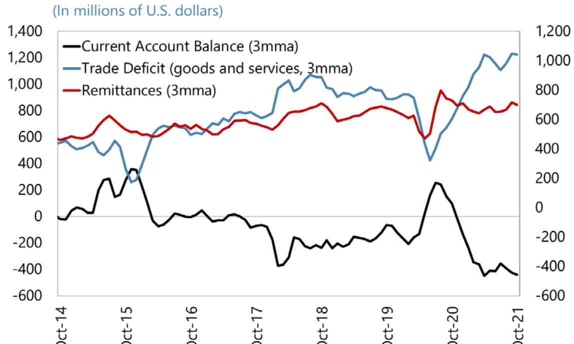


Sources: Nepali authorities; and IMF staff estimates.

A sharp rise in imports led to a rapid deterioration in the current account.

Current Account Balance

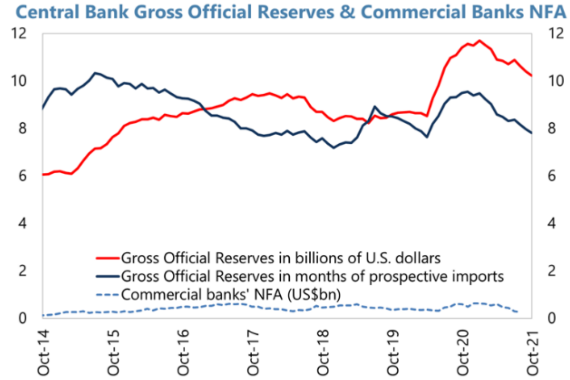
(In millions of U.S. dollars)



Source: Nepali authorities.

Gross international reserves remain adequate but have begun to decline in recent months.

Central Bank Gross Official Reserves & Commercial Banks NFA



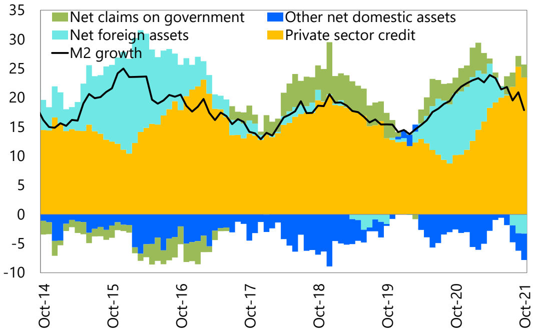
Sources: Nepali authorities; IMF staff estimates.

Figure 2. Nepal: Recent Monetary Sector Developments

Broad Money growth was at 17.9 percent (y/y) in October 2021, driven by growth in private sector credit.

Broad Money Growth

(In percent, contribution to broad money growth)

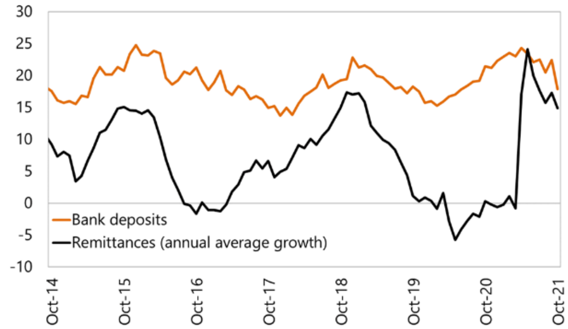


Sources: Nepali authorities; IMF staff estimates.

Growth in Bank deposits (17.9 percent, y/y) and remittances (14.9 percent, annual average growth) slowed in October 2021.

Bank Deposits and Remittances

(Year-on-year change, in percent)

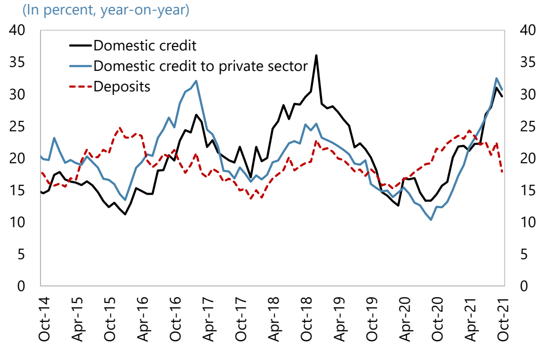


Sources: Nepali authorities; and IMF staff estimates.

Private sector credit growth declined in October 2021 to 30.7 percent (y/y).

Deposits and Credit Growth

(In percent, year-on-year)

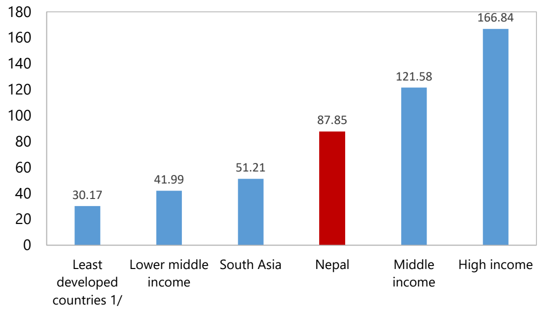


Sources: NRB; and IMF staff estimates.

Nepal's private sector credit-to-GDP ratio remains among the highest in its peer group.

Domestic Credit to Private Sector

(In percent of GDP, 2020)



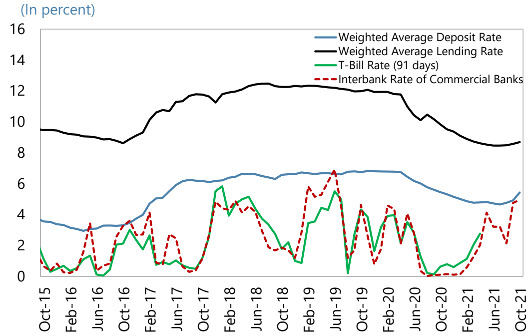
Source: World Bank, *World Development Indicators.*

1/ UN Classification.

The NRB is gradually unwinding its accommodative monetary policy stance.

Interest Rates

(In percent)

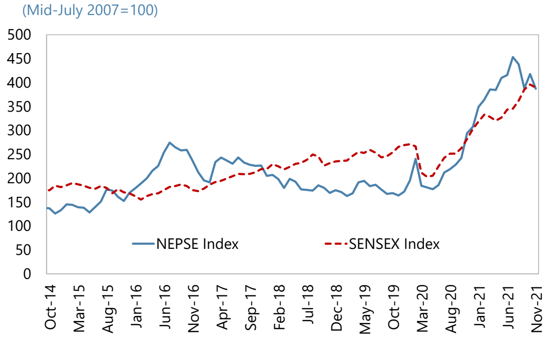


Source: NRB.

Stock market performance slowed in recent months.

Stock Market Performance in Nepal and India

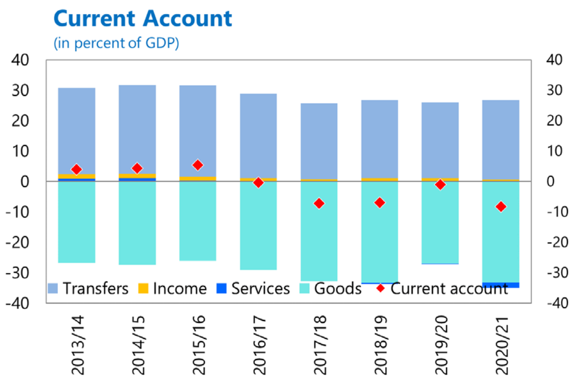
(Mid-July 2007=100)



Sources: CEIC; and IMF staff estimates.

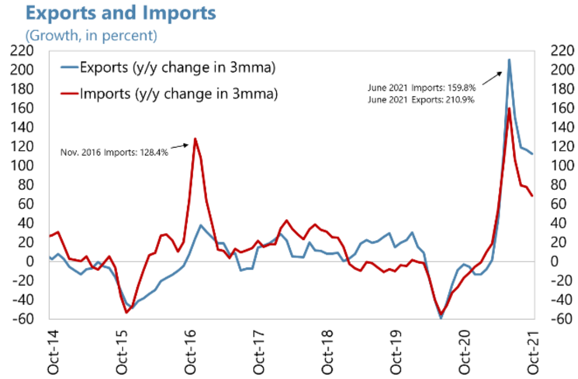
Figure 3. Nepal: External Sector Developments

The FY2020/21 current account deficit was -8.3 percent of GDP, driven by a large rise in imports.



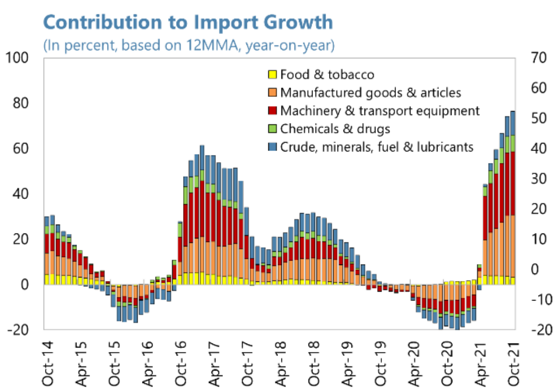
Sources: Nepali authorities; IMF staff estimates.

Following a collapse in trade during the first wave, imports and exports have rebounded strongly.



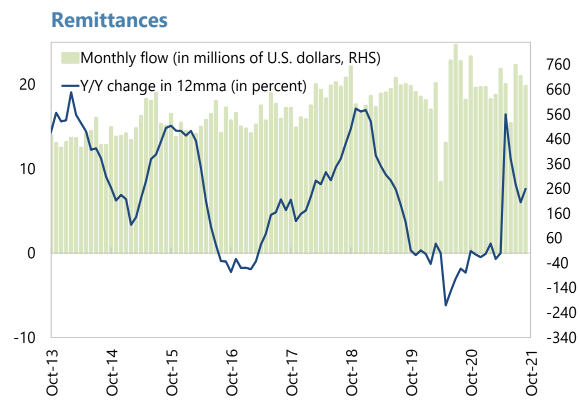
Sources: Nepali authorities; IMF staff estimates.

Machinery, transport and equipment, followed by manufactured goods are behind the rise in imports.



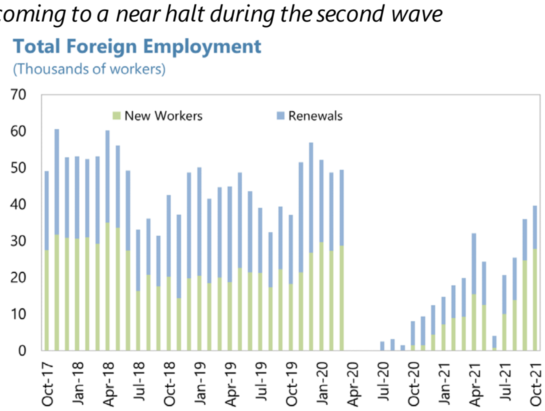
Sources: Nepali authorities; IMF staff estimates.

Remittances have been volatile during the pandemic and were at $706 million in October 2021.



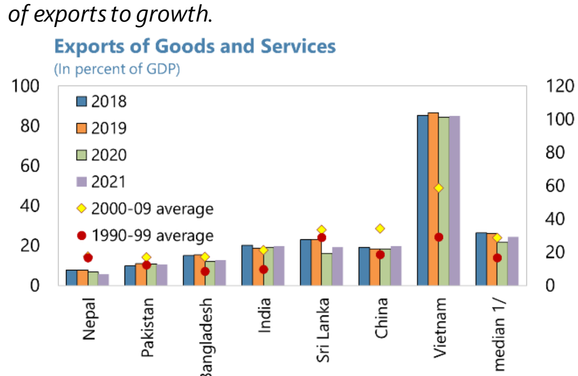
Sources: Nepali authorities; IMF staff estimates.

The total number of foreign workers (new and renewals of Nepali workers abroad) increased significantly after coming to a near halt during the second wave



Sources: Nepali authorities; IMF staff estimates.

Prior to the crisis, Nepal already had a comparatively low, and falling, export to GDP ratio, limiting the contribution of exports to growth.

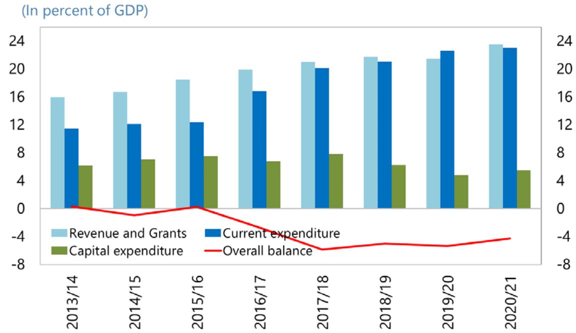


Sources: IMF, *World Economic Outlook*; IMF staff estimates.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

Figure 4. Nepal: Recent Fiscal Developments

Increase in import related taxes and other temporary factors led to a narrowing of fiscal deficit in FY2020/21.

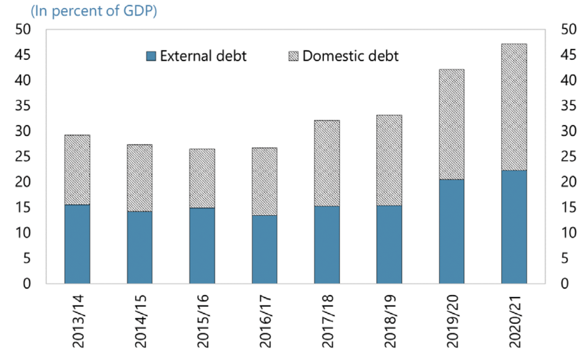
Central Government Fiscal Performance
(In percent of GDP)



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

Total public debt increased to 46.7 percent of GDP in FY2020/21, lower than previously envisaged.

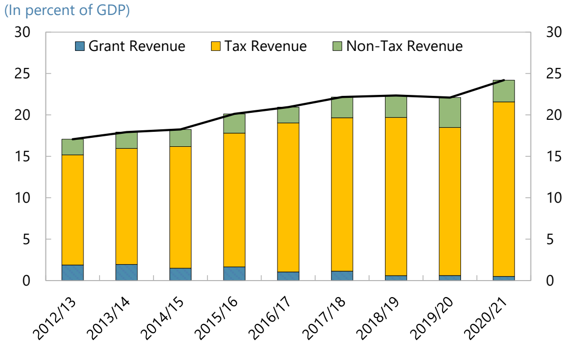
Public Debt
(In percent of GDP)



Sources: Nepali authorities; IMF staff estimates.

Revenue increased in FY2020/21 contributed by import surge and deferred tax receipts.

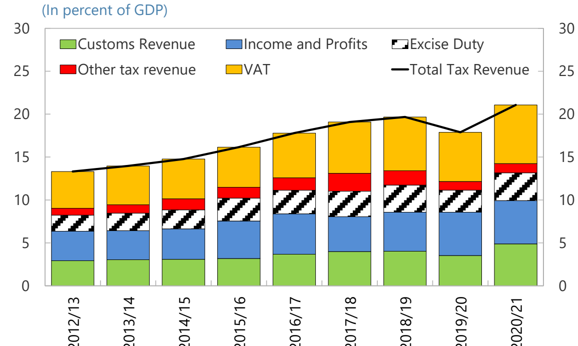
Central Government Fiscal Revenues (Incl. Grants)
(In percent of GDP)



Sources: Nepali Authorities, and IMF staff estimates.

Customs, VAT and excise duty overperformed in FY2020/21, mainly driven by import recovery.

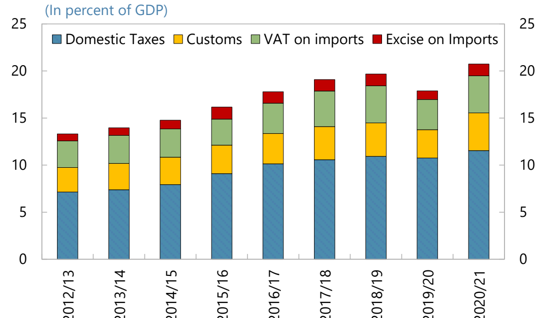
Central Government Tax Revenues
(In percent of GDP)



Sources: Nepali Authorities, and IMF staff estimates.

The jump of import related tax revenue was the main driver of the tax revenue recovery while domestic tax only marginally increased.

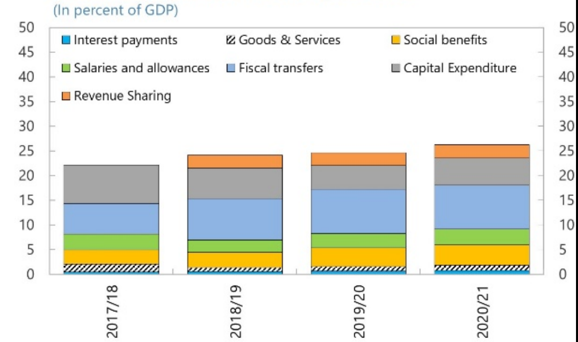
Tax Revenue by Source
(In percent of GDP)



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

Capital expenditure continued being impacted and social benefits and grants (including transfers) were maintained as part of the COVID-19 response.

Central Government Fiscal Expenditure
(In percent of GDP)

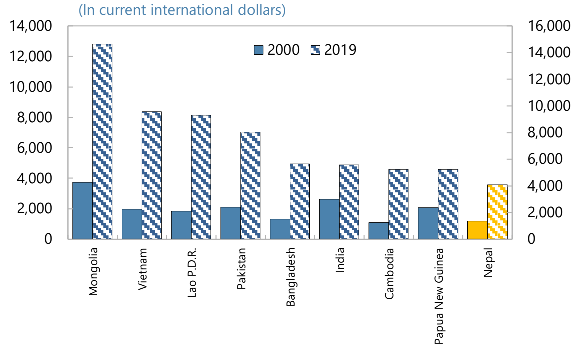


Sources: Nepali Authorities, and IMF staff estimates.

Figure 5. Nepal: Socio-Economic Indicators

Nepal is among the lowest income countries in South Asia.

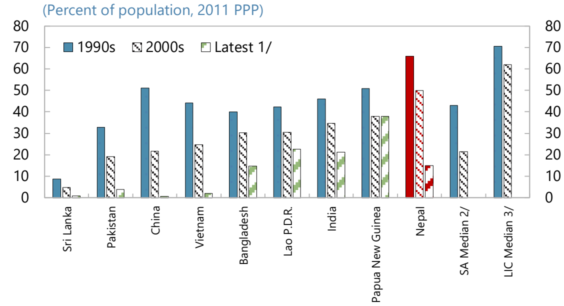
Per Capita GDP (PPP)
(In current international dollars)



Source: World Bank, *World Development Indicators*.

Poverty has fallen significantly in the last decade, partially due to high remittance flows.

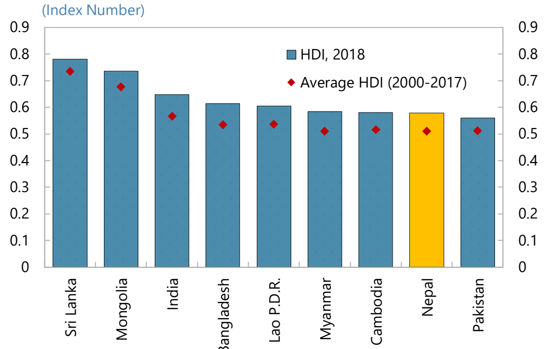
Poverty Headcount Ratio at $1.90 a day
(Percent of population, 2011 PPP)



Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ Sri Lanka, Vietnam, Bangladesh (2016); Pakistan, China (2015); Lao P.D.R. (2012); India (2011); Nepal (2010); Papua New Guinea (2009).
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

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

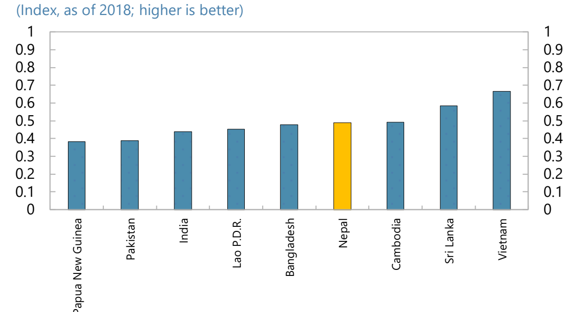
Human Development Index (HDI)
(Index Number)



Sources: UNDP, and IMF staff calculations.

Expected human capital development is somewhat hampered by incomplete education and health factors.

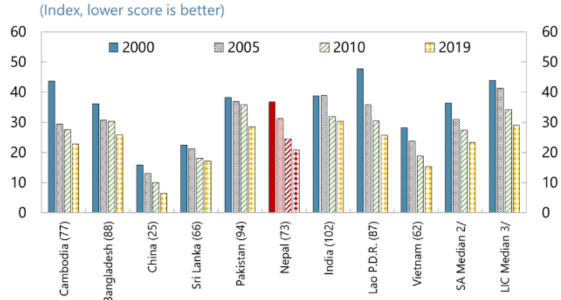
Human Capital Index 1/
(Index, as of 2018; higher is better)



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 poverty metrics, including relating to hunger.

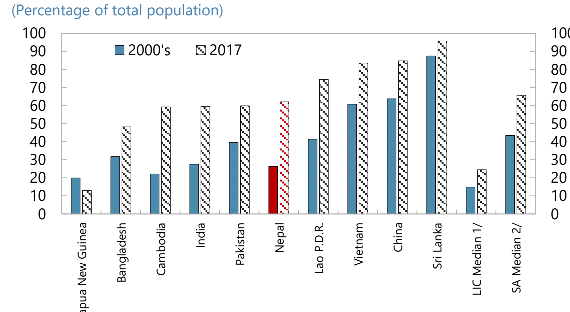
Global Hunger Index 1/
(Index, lower score is better)



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 2019 rank out of 117 countries.
2/ South Asia (SA) includes only India, Nepal, Bangladesh and Sri Lanka.
3/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.

Substantial gains have been made in sanitation, thought there is scope for further improvement.

People Using At Least Basic Sanitation Services
(Percentage of total population)



Sources: World Bank, *World Development Indicators*, and IMF staff calculations.
1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between $1,025 or less in 2018.
2/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.

Table 1. Nepal: Selected Economic Indicators, 2018/19-2025/26 1/

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
			Est.	Projections				
Output and prices (annual percent change)								
Real GDP	6.7	-2.1	2.7	4.4	6.3	5.4	5.1	5.1
Headline CPI (period average)	4.6	6.1	3.6	5.7	5.8	5.6	5.4	5.3
Headline CPI (end of period)	6.0	4.8	4.2	5.9	5.6	5.6	5.3	5.4
Fiscal Indicators: Central Government (in percent of GDP)								
Total revenue and grants	22.4	22.1	24.2	24.7	25.6	26.4	27.0	27.1
of which: Tax revenue	19.1	17.9	20.9	21.2	22.1	23.0	23.7	23.8
Expenditure	27.3	27.4	28.5	31.0	31.1	30.9	30.6	30.2
Expenses	21.1	22.6	23.0	24.6	24.7	24.7	24.6	24.4
Net acquisition of nonfinancial assets	6.3	4.8	5.5	6.4	6.4	6.2	6.0	5.8
Operating balance	1.3	-0.5	1.3	0.1	0.9	1.7	2.5	2.7
Net lending/borrowing	-5.0	-5.3	-4.2	-6.3	-5.5	-4.5	-3.5	-3.1
Statistical discrepancy	-0.4	-0.7	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	4.6	4.6	4.2	6.3	5.5	4.5	3.5	3.1
Net acquisition of financial assets	-0.3	1.9	3.3	1.3	1.3	1.3	1.3	1.3
Net incurrence of liabilities	4.3	6.5	7.6	7.6	6.8	5.8	4.8	4.3
Foreign	2.7	2.4	3.1	3.8	2.7	2.2	1.8	1.2
Domestic	1.6	4.1	4.5	3.7	4.0	3.5	3.0	3.1
Money and credit (annual percent change)								
Broad money	15.8	18.1	21.8	7.4	7.3	7.6	10.8	10.7
Domestic credit	21.7	14.6	26.8	16.1	12.2	11.7	11.5	12.4
Private sector credit	19.1	12.6	26.3	15.8	9.8	10.0	10.5	11.6
Saving and Investment (in percent of nominal GDP)								
Gross investment	41.4	28.4	41.5	44.6	41.8	39.9	38.5	37.1
Private	27.6	23.6	30.4	32.1	29.8	28.3	27.3	26.3
Central government	6.3	4.8	5.5	6.4	6.4	6.2	6.0	5.8
Change in Stock	7.6	0.0	5.6	6.0	5.7	5.4	5.2	5.0
Gross national saving	34.4	27.4	33.3	35.5	35.6	34.9	34.3	33.5
Private	33.8	28.5	32.7	36.3	35.7	34.2	32.8	31.7
Central government	0.7	-1.1	0.5	-0.8	-0.1	0.7	1.5	1.8
Balance of Payments								
Current account (in millions of U.S. dollars)	-2,369	-339	-2,844	-3,377	-2,520	-2,153	-1,946	-1,790
In percent of GDP	-6.9	-1.0	-8.2	-9.1	-6.2	-4.9	-4.1	-3.6
Trade balance (in millions of U.S. dollars)	-11,373	-9,186	-11,510	-12,803	-12,820	-13,132	-13,528	-13,914
In percent of GDP	-33.3	-27.0	-33.2	-34.4	-31.7	-30.1	-28.8	-27.6
Exports of goods (y/y percent change)	12.1	-6.4	30.0	7.8	8.8	11.4	12.3	12.4
Imports of goods (y/y percent change)	5.4	-18.2	25.7	10.9	0.9	3.3	4.0	4.0
Workers' remittances (in millions of U.S. dollars)	7,769	7,533	8,150	8,231	8,609	9,004	9,418	9,850
In percent of GDP	22.7	22.2	23.5	22.1	21.3	20.6	20.1	19.6
Gross official reserves (in millions of U.S. dollars)	8,545	10,559	10,884	9,727	8,946	8,434	8,230	8,503
In months of prospective imports	8.9	9.0	8.4	7.3	6.5	5.9	5.5	5.6
Memorandum items								
Public debt (in percent of GDP)	33.1	42.2	47.2	51.6	53.6	54.9	55.3	55.0
Nominal GDP (in billions of U.S. dollars)	34.2	34.0	34.7	37.2	40.5	43.7	46.9	50.4
Nominal GDP (in billions of Nepalese Rupees)	3,859	3,915	4,164	4,596	5,168	5,755	6,378	7,063
Net International Reserves (in millions of U.S. dollars)	8,536	10,687	10,844	9,725	8,944	8,432	8,229	8,734
Primary Deficit (in billions of Nepali Rupees)	172	183	141	248	235	201	158	134
Primary Deficit (in percent of GDP)	4.5	4.7	3.4	5.4	4.5	3.5	2.5	1.9
Tax Revenue (in billions of Nepalese Rupees)	737	700	870	974	1,143	1,324	1,511	1,681
Tax Revenue (In percent of GDP)	19.1	17.9	20.9	21.2	22.1	23.0	23.7	23.8
UN Human Development Index 2/	0.602	...	...	...	...	...	...	...
Health Expenditure (in percent of GDP)	...	1.0	1.5	2.0	2.0	2.0	2.0	2.0
Social Protection/Assistance (in percent of GDP)	...	1.7	1.7	3.3	3.3	3.3	3.3	3.3
CCRT debt relief (in millions of SDR) 3/	...	2.9	7.1	3.6	...	...	...	...
Private sector credit (in percent of GDP)	75.4	83.7	99.4	104.3	101.9	100.6	100.3	101.2
Exchange rate (NPR/US$; period average)	112.9	115.2	...	...	...	...	...	...
Real effective exchange rate (average, y/y percent change)	0.0	1.7	...	...	...	...	...	...

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

1/ Fiscal year ends mid-July.

2/ The UN Human Development Index is a composite index measuring average achievement in three basic dimensions of human development—a long and healthy life, knowledge and a decent standard of living.

3/ 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: Current baseline forecast is as of December 7, 2021.

Table 2. Nepal: Summary of Central Government Operations, 2018/19-2025/26 [1/]

	2018/19		2019/20	2020/21		2021/22		2022/23	2023/24	2024/25	2025/26
	Rev. Budget			Budget	Current Baseline Proj.	Budget	Current Baseline Proj.	Projections			
					(In billions of Nepalese rupees)						
Total revenue and grants	907	863	865	1,072	1,010	1,241	1,134	1,323	1,518	1,725	1,917
Total revenue	860	840	841	1,012	979	1,181	1,094	1,273	1,462	1,664	1,851
Tax revenue	777	737	700	913	870	1,068	974	1,143	1,324	1,511	1,681
of which: Income and profits tax		188	213	230	231	274	254	297	342	391	437
Customs		143	124	178	179	222	203	226	253	280	311
Excise duty		124	101	155	134	173	150	174	208	247	271
VAT		242	224	302	282	306	317	391	460	523	586
Other		40	38	47	45	94	49	56	62	69	76
By source: Domestic taxes		400	421	496	484	616	533	631	748	872	976
Import-related taxes		337	279	417	386	452	440	512	576	639	705
Non-tax revenue & Other Receipts	83	103	141	99	109	113	120	130	139	154	170
Of which: Non Tax Revenue		93	94	99	68	113	75	90	106	130	158
Other Receipts		10	48	0	40	0	45	40	33	24	12
Grants 2/	47	23	24	61	31	60	41	51	55	60	66
Expenditure	1,158	1,055	1,074	1,424	1,186	1,573	1,424	1,607	1,777	1,950	2,134
Recurrent expenditure	885	813	884	1,071	957	1,195	1,131	1,278	1,421	1,568	1,725
Of which: Interest payments	26	21	26	32	35	44	42	49	58	68	82
Salaries and allowances	117	100	117	135	118	139	135	152	169	187	207
Grants & subsidies	168	122	104	137	101	131	126	137	144	150	155
Social benefits		117	147	189	157	260	256	288	320	355	393
Goods & services		33	35	74	37	60	55	57	55	51	46
Fiscal transfers	270	321	350	363	395	387	387	436	485	538	595
Revenue sharing 3/	102	97	100	122	111	130	122	151	180	210	234
Other current expenditure		3	5	19	5	43	7	8	9	10	11
Capital expenditure	273	242	189	353	228	378	293	330	356	382	408
Operating balance	21	49	-19	1	52	45	3	46	97	156	192
Net lending/borrowing	-251	-192	-209	-352	-176	-333	-290	-284	-259	-225	-217
Statistical discrepancy	-22	-16	-29	0	1	0	0	0	0	0	0
Net financial transactions	230	176	179	352	177	333	290	284	259	225	217
Net acquisition of financial assets	94	-10	75	104	139	106	58	65	72	80	89
Foreign	0	0	0	0	0	0	0	0	0	0	0
Domestic (net)	94	-10	74	104	139	106	58	65	72	80	89
Sale of equity	56	58	12	44	25	17	27	31	34	38	42
Lending minus repayment	37	39	48	60	19	89	30	34	38	42	47
Change in cash/deposit	0	-108	14	0	95	0	0	0	0	0	0
Net incurrence of liabilities	324	166	254	456	316	439	348	349	331	305	305
Foreign	187	104	93	276	128	248	177	141	128	113	83
Domestic	137	62	161	180	187	191	171	208	204	193	222
					(In percent of GDP, unless otherwise indicated)						
Total revenue and grants	23.5	22.4	22.1	25.8	24.2	27.0	24.7	25.6	26.4	27.0	27.1
Total revenue	22.3	21.8	21.5	24.3	23.5	25.7	23.8	24.6	25.4	26.1	26.2
Tax revenue	20.1	19.1	17.9	21.9	20.9	23.2	21.2	22.1	23.0	23.7	23.8
of which: Income and profits tax		4.9	5.4	5.5	5.5	6.0	5.5	5.7	5.9	6.1	6.2
Customs		3.7	3.2	4.3	4.3	4.8	4.4	4.4	4.4	4.4	4.4
Excise duty		3.2	2.6	3.7	3.2	3.8	3.3	3.4	3.6	3.9	3.8
VAT		6.3	5.7	7.3	6.8	6.6	6.9	7.6	8.0	8.2	8.3
Other		1.0	1.0	1.1	1.1	2.0	1.1	1.1	1.1	1.1	1.1
By source: Domestic taxes		10.4	10.8	11.9	11.6	13.4	11.6	12.2	13.0	13.7	13.8
Import-related taxes		8.7	7.1	10.0	9.3	9.8	9.6	9.9	10.0	10.0	10.0
Non-tax revenue & Other Receipts	2.2	2.7	3.6	2.4	2.6	2.5	2.6	2.5	2.4	2.4	2.4
Of which: Non Tax Revenue	0.0	2.4	2.4	2.4	1.6	2.5	1.6	1.7	1.8	2.0	2.2
Other Receipts	0.0	0.3	1.2	0.0	1.0	0.0	1.0	0.8	0.6	0.4	0.2
Grants 2/	1.2	0.6	0.6	1.5	0.7	1.3	0.9	1.0	1.0	0.9	0.9
Expenditure	30.0	27.3	27.4	34.2	28.5	34.2	31.0	31.1	30.9	30.6	30.2
Recurrent expenditure	22.9	21.1	22.6	25.7	23.0	26.0	24.6	24.7	24.7	24.6	24.4
Of which: Interest payments	0.7	0.5	0.7	0.8	0.8	1.0	0.9	1.0	1.0	1.1	1.2
Salaries and allowances	3.0	2.6	3.0	3.2	2.8	3.0	2.9	2.9	2.9	2.9	2.9
Grants & subsidies	4.3	3.2	2.7	3.3	2.4	2.8	2.7	2.6	2.5	2.3	2.2
Social benefits	7.0	3.0	3.8	4.5	3.8	5.7	5.6	5.6	5.6	5.6	5.6
Goods & services	2.7	0.9	0.9	1.8	0.9	1.3	1.2	1.1	1.0	0.8	0.7
Fiscal transfers		8.3	9.0	8.7	9.5	8.4	8.4	8.4	8.4	8.4	8.4
Revenue sharing 3/		2.5	2.6	2.9	2.7	2.8	2.7	2.9	3.1	3.3	3.3
Other current expenditure		0.1	0.1	0.5	0.1	0.9	0.2	0.2	0.2	0.2	0.2
Capital expenditure	7.1	6.3	4.8	8.5	5.5	8.2	6.4	6.4	6.2	6.0	5.8
Operating balance	0.6	1.3	-0.5	0.0	1.3	1.0	0.1	0.9	1.7	2.5	2.7
Net lending/borrowing	-6.5	-5.0	-5.3	-8.4	-4.2	-7.2	-6.3	-5.5	-4.5	-3.5	-3.1
Statistical discrepancy	-0.6	-0.4	-0.7	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	5.9	4.6	4.6	8.4	4.2	7.2	6.3	5.5	4.5	3.5	3.1
Net acquisition of financial assets	2.4	-0.3	1.9	2.5	3.3	2.3	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	0.0
Domestic (net)	2.4	-0.3	1.9	2.5	3.3	2.3	1.3	1.3	1.3	1.3	1.3
Sale of equity	1.5	1.5	0.3	1.1	0.6	0.4	0.6	0.6	0.6	0.6	0.6
Lending minus repayment	1.0	1.0	1.2	1.4	0.5	1.9	0.7	0.7	0.7	0.7	0.7
Change in cash/deposit	0.0	-2.8	0.4	0.0	2.3	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	8.4	4.3	6.5	11.0	7.6	9.5	7.6	6.8	5.8	4.8	4.3
Foreign	4.8	2.7	2.4	6.6	3.1	5.4	3.8	2.7	2.2	1.8	1.2
Domestic	3.5	1.6	4.1	4.3	4.5	4.1	3.7	4.0	3.5	3.0	3.1
Memorandum items											
Primary balance (billions of Nepali Rupees)		-172	-183	905	-141	1,011	-248	-235	-201	-158	-134
Primary balance (in percent of GDP)	0.0	-4.5	-4.7	21.7	-3.4	22.0	-5.4	-4.5	-3.5	-2.5	-1.9
Social Spending (in percent of GDP)		3.0	3.7	5.6	4.2	7.7	6.3	6.3	6.3	6.3	6.3
Public debt (in percent of GDP)		33.1	42.2	…	47.2	…	51.6	53.6	54.9	55.3	55.0
External (in percent of GDP)		15.4	20.5	…	22.3	…	25.2	25.8	26.3	26.4	25.7
Domestic (in percent of GDP)		17.7	21.7	…	24.9	…	26.4	27.7	28.5	28.9	29.3
Resources for sub-national governments (billions of Nepalese Rupees)	372	1,081	451	485	506	517	510	586	665	747	830
(in percent of GDP)	9.7	28.0	11.5	11.6	12.2	11.3	11.1	11.3	11.6	11.7	11.7
Nominal GDP (billions of Nepalese Rupees)	3,859	3,859	3,915	4,164	4,164	4,596	4,596	5,168	5,755	6,378	7,063

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

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

Note: Current baseline forecast is as of December 7, 2021.FY2020/21 budget is as of May 28, 2020; FY2021/22 budget is as of September 10, 2021.

Table 3. Nepal: Monetary Indicators, 2018/19-2025/26 1/

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
			Est.	Projections				
	(In billions of Nepalese rupees, end-period)							
Nepal Rastra Bank								
Reserve money	699	886	932	930	914	893	898	947
Net domestic assets	-237	-388	-367	-296	-251	-239	-242	-268
Claims on public sector	-29	-74	-137	-136	-124	-124	-125	-125
Claims on private sector	4	4	3	4	4	5	5	6
Claims on banks & financial institutions	23	7	123	96	98	98	98	98
Other items (net)	-234	-326	-356	-260	-229	-218	-221	-247
Net foreign assets	936	1,274	1,299	1,226	1,165	1,133	1,140	1,215
Monetary Survey								
Broad money	3,582	4,231	5,155	5,537	5,941	6,394	7,087	7,848
Narrow money	727	856	1,049	1,023	1,098	1,181	1,309	1,450
Quasi-money	2,855	3,375	4,105	4,514	4,843	5,213	5,777	6,398
Net domestic assets	2,597	2,903	3,804	4,256	4,724	5,211	5,896	6,579
Domestic credit	3,309	3,793	4,811	5,585	6,269	7,002	7,809	8,777
Credit to public sector	399	516	671	792	1,004	1,212	1,410	1,632
of which : Credit to central government	346	461	593	696	893	1,087	1,270	1,482
Credit to private sector	2,910	3,277	4,140	4,793	5,265	5,790	6,399	7,145
Other items(net)	-712	-890	-1,007	-1,329	-1,545	-1,790	-1,913	-2,197
Net foreign assets	985	1,328	1,351	1,281	1,216	1,183	1,191	1,269
	(Twelve-month percent change)							
Reserve money	-1.5	26.7	5.2	-0.2	-1.7	-2.3	0.5	5.5
Broad money	15.8	18.1	21.8	7.4	7.3	7.6	10.8	10.7
Net domestic assets	27.3	11.8	31.1	11.9	11.0	10.3	13.1	11.6
Domestic credit	21.7	14.6	26.8	16.1	12.2	11.7	11.5	12.4
Credit to public sector	44.2	29.3	30.1	18.0	26.8	20.7	16.3	15.7
Credit to private sector	19.1	12.6	26.3	15.8	9.8	10.0	10.5	11.6
Net foreign assets	-6.6	34.9	1.7	-5.2	-5.0	-2.8	0.7	6.6
Memorandum items								
Private credit (in percent of GDP)	75.4	83.7	99.4	104.3	101.9	100.6	100.3	101.2
Net international reserves (in mil. U.S. dollars) 2/	8,536	10,687	10,844	9,725	8,944	8,432	8,229	8,734
Net Foreign Assets, NRB (in percent of GDP)	24.3	32.5	31.2	26.7	22.5	19.7	17.9	17.2
Nominal GDP (in billions of Nepalese Rupees)	3,859	3,915	4,164	4,596	5,168	5,755	6,378	7,063

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 December 7, 2021.

Table 4. Nepal: Balance of Payments, 2018/19–2025/26 1/

	2018/19	2019/20	2020/21	2021/22	2022/23	2023/24	2024/25	2025/26
			Est.	Projections				
			(in millions of US dollars)					
Current account	-2,369	-339	-2,844	-3,377	-2,520	-2,153	-1,946	-1,790
Current account (excluding official transfers)	-2,667	-552	-3,052	-3,706	-2,916	-2,573	-2,389	-2,159
Trade balance	-11,373	-9,186	-11,510	-12,803	-12,820	-13,132	-13,528	-13,914
Exports, f.o.b.	1,002	938	1,219	1,314	1,429	1,591	1,786	2,007
Imports, f.o.b.	-12,375	-10,124	-12,729	-14,117	-14,249	-14,723	-15,314	-15,921
Services (net)	-147	-10	-618	-167	103	267	351	483
Receipts	1,654	1,354	671	1,317	1,805	2,061	2,310	2,526
Of which: tourism	651	530	62	218	635	797	953	1,103
Payments	-1,801	-1,364	-1,290	-1,484	-1,702	-1,793	-1,959	-2,043
Income	358	399	198	249	340	367	380	509
Credit	708	588	517	543	599	646	727	882
Debit	-350	-189	-318	-294	-259	-280	-347	-373
Current transfers	8,793	8,459	9,086	9,344	9,858	10,345	10,851	11,132
Credit, of which:	8,889	8,506	9,137	9,391	9,909	10,401	10,911	11,196
General government	298	213	208	328	396	420	444	369
Workers' remittances	7,769	7,533	8,150	8,231	8,609	9,004	9,418	9,850
Debit	-96	-47	-51	-48	-52	-56	-60	-64
Capital account 2/	137	123	130	148	186	206	231	230
Financial account	689	1,963	2,139	2,072	1,553	1,435	1,511	1,833
Direct investment	115	169	166	117	162	223	361	387
Portfolio investment	0	0	0	0	0	0	0	0
Other investment (net)	573	1,794	1,974	1,955	1,391	1,212	1,150	1,446
Of which: Trade credit	427	635	856	659	528	573	593	629
Official loans 3/	546	1,176	881	1,430	1,106	971	828	592
Errors and omissions	839	561	553	0	0	0	0	0
Overall balance	-704	2,309	-22	-1,157	-781	-512	-204	273
			(in percent of GDP)					
Current account	-6.9	-1.0	-8.2	-9.1	-6.2	-4.9	-4.1	-3.6
Current account (excluding official transfers)	-7.8	-1.6	-8.8	-10.0	-7.2	-5.9	-5.1	-4.3
Trade balance	-33.3	-27.0	-33.2	-34.4	-31.7	-30.1	-28.8	-27.6
Exports, f.o.b.	2.9	2.8	3.5	3.5	3.5	3.6	3.8	4.0
Imports, f.o.b.	-36.2	-29.8	-36.7	-37.9	-35.2	-33.7	-32.6	-31.6
Services (net)	-0.4	0.0	-1.8	-0.4	0.3	0.6	0.7	1.0
Receipts	4.8	4.0	1.9	3.5	4.5	4.7	4.9	5.0
Of which: tourism	1.9	1.6	0.2	0.6	1.6	1.8	2.0	2.2
Payments	-5.3	-4.0	-3.7	-4.0	-4.2	-4.1	-4.2	-4.1
Income	1.0	1.2	0.6	0.7	0.8	0.8	0.8	1.0
Credit	2.1	1.7	1.5	1.5	1.5	1.5	1.6	1.8
Debit	-1.0	-0.6	-0.9	-0.8	-0.6	-0.6	-0.7	-0.7
Current transfers								
Credit, of which:	26.0	25.0	26.3	25.2	24.5	23.8	23.3	22.2
General government	0.9	0.6	0.6	0.9	1.0	1.0	0.9	0.7
Workers' remittances	22.7	22.2	23.5	22.1	21.3	20.6	20.1	19.6
Debit	-0.3	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital account 2/	0.4	0.4	0.4	0.4	0.5	0.5	0.5	0.5
Financial account	2.0	5.8	6.2	5.6	3.8	3.3	3.2	3.6
Direct investment	0.3	0.5	0.5	0.3	0.4	0.5	0.8	0.8
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	1.7	5.3	5.7	5.3	3.4	2.8	2.5	2.9
Of which: Trade credit	1.2	1.9	2.5	1.8	1.3	1.3	1.3	1.2
Official loans 3/	1.6	3.5	2.5	3.8	2.7	2.2	1.8	1.2
Errors and omissions	2.5	1.7	1.6	0.0	0.0	0.0	0.0	0.0
Overall balance	-2.1	6.8	-0.1	-3.1	-1.9	-1.2	-0.4	0.5
Memorandum items								
Imports (y/y percent change)	5.4	-18.2	25.7	10.9	0.9	3.3	4.0	4.0
Exports of G&S (in percent of GDP)	7.8	6.7	5.4	7.1	8.0	8.4	8.7	9.0
Imports of G&S (in percent of GDP)	41.5	33.8	40.4	41.9	39.4	37.8	36.8	35.7
Remittances (y/y percent change)	7.6	-3.0	8.2	1.0	4.6	4.6	4.6	4.6
Total external debt (in percent of GDP)	15.2	19.9	21.3	24.3	25.1	25.5	25.5	25.0
Gross official reserves (in mil U.S. dollars)	8,545	10,559	10,884	9,727	8,946	8,434	8,230	8,503
In months of prospective imports	8.9	9.0	8.4	7.3	6.5	5.9	5.5	5.6
As a share of broad money (in percent)	26.2	...	...	...	...	...	...	...
Exceptional Financing: Use of IMF Resources (Net)	-4.1	210	-5	156	89	78	34	...
World Bank	0.0	100	150	350	200	100	100	...
Asian Development Bank & others	0.0	450	53	125	75	100	50	...
Net international reserves (in mil. U.S. dollars) 4/	8,536	10,687	10,844	9,725	8,944	8,432	8,229	8,734
Gross foreign exchange reserves (in mil. U.S. dollars) 5/	9,474	11,617	...	...	...	...	...	...
In months of prospective imports	9.9	9.9	...	...	...	...	...	5.6
In months of current imports	8.0	12.1	...	...	...	...	...	...
Nominal GDP (in mil U.S. dollars)	34,186	33,983	34,692	37,208	40,467	43,678	46,922	50,376

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/ Official loans only includes firm financing commitments so far. This includes IMF-ECF (US$166.2 mil), WB (US$350 mil), and ADB (US$125 mil) in FY2021/22. The ECF is expected to catalyze additional financing from development partners.

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

5/ The authorities define gross foreign exchange reserves as follows: Gross official reserves - gold/SDR/IMF reserve position + bank and financial institutions'

Note: Current baseline forecast is as of December 7, 2021.

Table 5. Nepal: External Financing Requirements and Sources, FY2021/22–2024/25

	2021/22	2022/23	2023/24	2024/25
		Projections		
		(In millions of U.S. dollars)		
Gross external financing requirements	**3424**	**2898**	**2617**	**2371**
Current account excluding official transfers (+ = deficit)	3706	2916	2573	2389
Amortization of medium- and long-term debt	243	267	285	304
Of which: Asian Development Bank	85	85	85	85
Of which: World Bank	56	56	56	56
Of which: Paris Club	23	23	23	23
Other net capital flows (- = outflow)/1	525	285	241	322
Available financing	**1625**	**1742**	**1816**	**1973**
Current and capital grants/2	476	582	625	674
Medium- and long-term borrowing excluding exceptional financing	1032	998	967	938
Of which: Vaccine support (World Bank and ADB)	165	0	0	0
FDI, net	117	162	223	361
Portfolio investment, net	0	0	0	0
Financing gap	**1798**	**1156**	**801**	**398**
Exceptional/additional financing/3	**1798**	**1156**	**801**	**398**
IMF: Prospective arrangement	166.2	99.7	88.7	44.3
Asian Development Bank/3	125	75	100	50
World Bank/3	350	200	100	100
Other development partners/4	0	0	0	0
Vaccine support (World Bank and ADB)/5	165	0	0	0
Gross reserves accumulation (+ = decrease)	1157	781	512	204
Memorandum items				
Gross official reserves (in millions of U.S. dollars)	9727	8946	8434	8230
Of which, Aug 2021 SDR allocation (in millions of U.S. dollars)	214			
In months of prospective imports	7.3	6.5	5.9	5.5

Sources: Nepali authorities; and IMF staff estimates and projections

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

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/ Exceptional financing includes firm financing assurances for the first year of the program and good prospects of financing over the program and projection period.

4/ Debt Service Suspension Initiative (DSSI) of US$32.5 million in FY2020/21. In line with the Revised Paris Club MOU, repayments are projected to start in FY2022/23 for a period of five years with a one-year grace period.

5/ Vaccine support is project financing and is therefore included in the medium and long term borrowing of the authorities. The World Bank disbursed US$75 million in FY2020/21 and the ADB is expected to disburse US$165 million in FY2021/22.

Note: Current baseline forecast as of December 7, 2021.

Table 6. Nepal: Financial Soundness Indicators, 2014/15–2020/21

	2014/15	2015/16	2016/17	2017/18	2018/19	2019/20	2020/21
Capital adequacy							
Total Capital to risk weighted assets	12.9	12.9	15.4	15.2	14.3	14.2	14.2
Core capital to risk weighted assets	11.4	11.5	14.1	13.9	12.8	12.0	11.1
Asset quality							
NPLs to total loans	3.3	2.2	1.8	1.6	1.5	1.9	1.5
Loan loss provision to total loans	3.8	2.9	2.6	2.3	2.2	3.6	2.5
Deposits and credits							
Credit to deposit ratio	76.8	79.8	83.6	85.4	86.9	83.2	88.1
Credit to core captial cum deposit	71.9	75.6	79.2	76.8	75.2	69.6	76.3
Liquidity							
Cash & bank balance to total deposits	16.2	15.2	15.5	13.2	11.6	12.2	9.5
Total liquid assets to total deposits	30.2	27.6	26.7	25.9	25.1	27.9	26.2
Exposure to real estate							
Share of real estate and housing loans	15.0	14.9	14.8	14.2	13.2	12.7	11.5
Share of loans collateralized by fixed assets	70.3	71.8	73.2	73.8	75.8	76.2	74.7
o/w collaterized by lands and buildings (share of total loans)	…	…	…	61.7	64.4	65.7	…
Revolving loans							
Overdraft	…	…	…	17.0	15.7	15.0	15.2
Demand & working capital loans	…	…	…	20.6	21.1	21.5	21.1

Source: Nepali authorities.

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

Table 7. Nepal: Proposed 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 mid-Jan 2022 performance criteria, completion of first review	39.20	25%
Second Review	January 12, 2023	Observance of mid-July 2022 performance criteria, completion of second review	39.20	25%
Third Review	July 12, 2023	Observance of mid-Jan 2023 performance criteria, completion of third review	31.40	20%
Fourth Review	January 12, 2024	Observance of mid-July 2023 performance criteria, completion of fourth review	31.40	20%
Fifth Review	July 12, 2024	Observance of mid-Jan 2024 performance criteria, completion of fifth review	31.40	20%
Sixth Review	January 12, 2025	Observance of mid-July 2024 performance criteria, completion of six review	31.32	20%
Total			**282.42**	**180%**

Source: IMF staff estimates

1/ Nepal's quota is SDR 156.9 million.

Table 8. Nepal: Indicators Proposed for Quantitative Performance Criteria and Indicative Targets, First Two Reviews [1/]

(Rs. million unless otherwise indicated)

	FY2020/21	FY2021/22	
	Mid-Jul.2021	Mid-Jan.2022	Mid-Jul.2022
	Initial level	Program target	Program target
Quantitative performance criteria:			
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	212,611	..	..
Stock of NBR's net international reserves (floor; in U.S. dollars million) 1,8/	10,884	8,640	8,640
Accumulation of external payments arrears (ceiling) 2/	0	0	0
Indicative targets:			
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	212,611	417,248	333,591
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	4,200	..	5,300
Memorandum items:			
Budget support from development partners (in U.S. dollars million) 1,3/	182.5	150	641
Projected revenues of the budgetary central government under the program 1,3/	827,012	278,030	926,767
Foreign-financed project loan disbursements 1,3/	129,883	19,482	129,883
Revenue targets of the budgetary central government 1,3/	889,618	475,757	1,050,821

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.

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 124,003 million for FY2021/22.

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

8/ The program targets for net international reserves include adjustors for budget support from development partners and for revenue collection. Any downward adjustment to the NIR floor will be capped at USD 1040 million for FY2021/22 to maintain reserve adequacy.

Table 9. Nepal: Projected Payments and Indicators of Capacity to Repay the Fund, 2022-2035 1/

(In millions of SDRs)

	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
Fund obligations based on existing credit (millions of SDRs)/2														
Principal	3.6	7.1	7.1	7.1	35.0	31.4	31.4	31.4	31.4	0.0	0.0	0.0	0.0	0.0
Charges and interest	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Fund obligations based on existing and prospective credit (millions of SDRs)														
Principal	3.6	7.1	7.1	7.1	35.0	39.2	58.8	72.2	84.7	56.5	48.6	29.0	15.7	3.1
Charges and interest	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Total obligations based on existing and prospective credit														
Millions of SDRs	3.6	7.2	7.2	7.2	35.0	39.3	58.9	72.2	84.8	56.5	48.7	29.1	15.7	3.2
Billions of Nepali Rupees	0.6	1.3	1.3	1.4	7.0	8.2	12.7	16.1	19.4	13.4	11.9	7.3	4.1	0.9
Percent of exports of goods and services	0.2	0.3	0.3	0.3	1.1	1.2	1.6	1.8	2.0	1.2	0.9	0.5	0.3	0.0
Percent of debt service	0.5	0.9	0.8	0.8	3.3	3.5	4.8	5.4	5.8	3.7	3.0	1.7	0.8	0.2
Percent of GDP	0.0	0.0	0.0	0.0	0.1	0.1	0.1	0.2	0.2	0.1	0.1	0.0	0.0	0.0
Percent of government revenue	0.1	0.1	0.1	0.1	0.4	0.4	0.6	0.6	0.7	0.4	0.3	0.2	0.1	0.0
Percent of quota	2.3	4.6	4.6	4.6	22.3	25.0	37.5	46.0	54.0	36.0	31.0	18.5	10.0	2.0
Outstanding IMF credit based on existing and prospective drawings														
Millions of SDRs	299.6	363.0	418.7	442.9	407.9	368.7	309.9	237.7	153.0	96.5	47.8	18.8	3.1	0.0
Billions of Nepali Rupees	51.4	64.7	78.0	85.8	82.2	77.1	66.8	52.9	35.1	22.8	11.7	4.7	0.8	0.0
Percent of exports of goods and services	16.2	16.1	16.6	15.8	13.2	10.9	8.3	5.9	3.5	2.0	0.9	0.3	0.1	0.0
Percent of debt service	44.1	47.5	49.3	47.6	38.5	32.9	25.5	17.9	10.5	6.4	2.9	1.1	0.2	0.0
Percent of GDP	1.1	1.3	1.4	1.3	1.2	1.0	0.8	0.5	0.3	0.2	0.1	0.0	0.0	0.0
Percent of government revenue	4.7	5.1	5.3	5.2	4.4	3.7	2.9	2.1	1.2	0.7	0.3	0.1	0.0	0.0
Percent of quota	190.9	231.4	266.9	282.3	260.0	235.0	197.5	151.5	97.5	61.5	30.5	12.0	2.0	0.0
Net use of IMF credit (millions of SDRs)	114.1	63.5	55.7	24.2	-35.0	-39.2	-58.8	-72.2	-84.7	-56.5	-48.6	-29.0	-15.7	-2.1
Disbursements	117.7	70.6	62.8	31.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	1.0
Repayments and repurchases	3.6	7.1	7.1	7.1	35.0	39.2	58.8	72.2	84.7	56.5	48.6	29.0	15.7	3.1
Memorandum items:														
Exports of goods and services (millions of SDRs)	1,850	2,250	2,522	2,809	3,090	3,394	3,728	4,010	4,318	4,753	5,127	5,651	6,231	6,635
Debt service (billions of NPR)	116.7	136.3	158.4	180.1	213.5	233.9	261.8	296.1	333.2	358.3	398.4	436.7	480.9	528.3
Nominal GDP (at market prices, billions of NPR)	4,596	5,168	5,755	6,378	7,063	7,892	8,773	9,753	10,842	12,052	13,397	14,893	16,556	18,404
Government revenue (billions of NPR)	1,094	1,273	1,462	1,664	1,851	2,077	2,306	2,562	2,850	3,165	3,518	3,915	4,349	4,833
Quota (millions of SDRs)	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 SDR2.9 million in FY2019/20 and SDR3.6 million in FY2020/21 covered by grants from the CCRT. 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.

Table 10. Nepal: Proposed Structural Benchmarks: 12-Months After Board Approval

Measure	Target Date	Macro-criticality
Cross-Cutting Institutional Reforms to enhance Fiscal Transparency, 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	Enhance fiscal transparency and governance and reduce vulnerability to corruption
The MOF publishes the federal government budget expenditures related to COVID-19 on a government website.	1st Review (end-April 2022)	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 FY2020/21	1st Review (end-May 2022)	Improve cash management and fiscal transparency
An external audit of the NRB financial statements for FY2021/22 is commissioned, consistent with the recommendation in the 2021 Safeguards Assessment	1st Review (end-April 2022)	Strengthen NRB institutional framework, in support of NRB's policy mandates
The MOF submits to Parliament amendments to modernize the NRB Law, addressing key recommendations of the 2021 Safeguards Assessments Report	2nd Review (end-October 2022)	Strengthen NRB institutional framework, in support of NRB's policy mandates
Revenue mobilization		
The MOF publishes a report on tax exemptions related to customs	1st Review (end-April 2022)	Enhance fiscal transparency and lay the foundation for revenue mobilization
The MOF publishes a report on tax exemptions for all other non-customs related taxes	2nd Review (end-October 2022)	Enhance fiscal transparency and lay the foundation for revenue mobilization
Fiscal Sustainability and Fiscal Risk Management		
The MOF implements a fiscal risk register to capture various dimensions of major fiscal risks	2nd Review (end-October 2022)	Enhance fiscal sustainability by strengthening fiscal risk management
The MOF develops cash flow forecasting to be shared with the PDMO and NRB on a regular basis	2nd Review (end-October 2022)	Improve public debt and cash management, to improve debt transparency and risk management
Equitable and Sustainable Growth		
Cabinet 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)	2nd Review (end-October 2022)	Raise the quality of growth through more efficient of capital expenditures that support climate resilience
The National Planning Commission (NPC) issues a Poverty Reduction and Growth Strategy Paper	2nd Review (end-October 2022)	Promote equitable and sustainable growth
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	1st Review (end-April 2022)	Preserve financial stability
The NRB Board approves an action plan for full implementation of the Supervisory Information System (SIS) for class A banks	1st Review (end-April 2022)	Strengthen financial sector supervision
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	1st Review (end-April 2022)	Strengthen financial sector regulation
The NRB issues the updated regulation on asset classification	2nd Review (end-October 2022)	Strengthen financial sector regulation
The NRB completes the full implementation of the SIS among the class A banks	2nd Review (end-October 2022)	Strengthen financial sector supervision

Annex I. Key COVID-19 Financial Sector Relief Measures

Objective	Measures
Liquidity Provision	Keep the cash reserve ratio at 3 percent.[1/] Keep the standing liquidity facility rate at 5 percent, increase the deposit collection rate from 1 to 2 percent and policy rate from 3 to 3.5 percent.[2/]
Support to Borrowers	The NRB is to provide Refinance Facility as subsidized funding to banks willing to lend COVID-19 affected businesses, by widening the coverage and prioritizing MSMEs as well as increasing the fund size.[3/] The government is to provide a concessional loan facility, with subsidies for interest and insurance premium, to selected commercial agricultural and livestock businesses, women enterprises, and other sectors.[4/] The government is to provide business continuity loans to COVID-19 affected tourism, cottage, small and medium industries for payment of salaries to workers and employees in line with 'Business Continuity Loan Procedure, 2077.[5/] Allow banks to provide additional amount on working capital loans by 20 percent above the limit as of April 2020, based on borrowers' needs and viability. Allow banks to extend the payment of loans extended to hard-hit sectors such as party palace, restaurant, education institutions and SMEs facing cash flow crisis by one year after an evaluation of the loan.[6/] Due to the prohibitory order of the government, allow banks to defer the payments to be made by the borrowers unable pay their installments due by July 2021 to January 2022. Allow banks to separately record the interest amount for the tourism businesses depending on international tourists separately till July 2022 and prohibit the banks to charge interest penalties or late fees to be charged on such loans. Allow banks to restructure and reschedule loans that were performing in January 2020 after collecting 10 percent of the accrued interest, based on the borrower's repayment plan. For the borrowers who were unable to restructure/reschedule by January 2021 by paying 10 percent of the accrued interest, further allow banks to restructure/reschedule these loans by taking 5 percent of the due interest by January 2022. Allow banks to permit borrowers to change their business model for once by April 2022 and not to count such changes as loan misuse, restructuring or rescheduling, provided that the borrower is affected by COVID-19.[7/] Require banks to provide at least 12 percent of their total loans to MSME sector (loans up to Rs. 10 million) by July 2022.[8/]
Temporary Regulatory Forbearance	Allow loans that were in pass category in January 2020 and of which payment was not met in July 2020 to remain in pass category with the increased provisioning at 5 percent. Allow banks to extend repayments of working capital loan and term loans up to 1 year.

Objective	Measures
	Allow banks to defer provisioning for priority sector lending on a quarterly basis (based on the amount of previous quarter loan) until January 2022. Allow banks to classify firms having a net loss of three years in the watch list category compared to a net loss of two years in the existing provision. Allow banks to capitalize the interest of the loan provided to the long-term agricultural projects.
Relaxation of Macroprudential Policies	Suspend the build up of the 2 percent countercyclical capital buffer that was due in July 2020 until July 2022. Increase the loan-to-value ratio (LTV) to 60 percent for the housing projects licensed by the government. Keep the LTV ratio on margin nature loans at 70 percent.[9/] Waive the debt-equity ratio and single obligor limits for vehicle operation and maintenance loans to public transport services till July 2022.[10/ 11/]
Revisions to Dividend Policy	Allow banks to distribute cash dividend only when their profit is higher than 5 percent of total paid-up capital, while limiting the dividend amount to 30 percent of the FY 2019/20 profit.

Source: The NRB

1/ CRR was reduced from 4 to 3 percent as of July 2020. Remained unchanged in the Monetary Policy 2021/22 First-Term Review

2/ SLF rate was kept at 5 percent, deposit collection rate was reduced from 2 to 1 percent and policy rate was reduced from 3.5 to 3 percent as of July 2020. Remained unchanged in the Monetary Policy 2021/22 First-Term Review

3/ The outstanding amount of refinance provided by NRB remained Rs.119.35 billion in mid-October 2021.Banks, not the NRB, bear the related credit risks.

4/ The government subsidizes interest rates by 2 percent and 50 percent of insurance premium. As of mid-October 2021, the outstanding concessional loan is Rs.198.92 billion extended 148,750 borrowers. The authorities expect credit risks to the banks to be mitigated by loan insurance.

5/ Under this provision, Rs. 1 billion loan has been approved as of mid-October 2021.

6/ However, such loans should be recovered in four installments after the end of relaxation period.

7/ Interest is not allowed to be capitalized in such cases.

8/ Deprived sector credit will be redirected to MSMEs gradually. Currently, loans up Rs. 1.5 million provided to the self-employed businesses who lost their employment in tourism sector due to COVID; loans up to Rs. 2.5 million to purchase a vehicle for self-employment purpose; project loans up to Rs. 2 million provided to female entrepreneur and project loans up to Rs. 2 million provided to agricultural businesses are accepted as deprived sector loans.

9/ Increased the limit on a bank's lending to 90 percent of the sum of its deposits and core capital from 85 percent until July 2022 (while removing carveouts), but any bank exceeding such limit was required to bring it down to 90 percent by mid-July 2022. As of August 2021, credit to deposit ratio (CD) was restricted to 90%

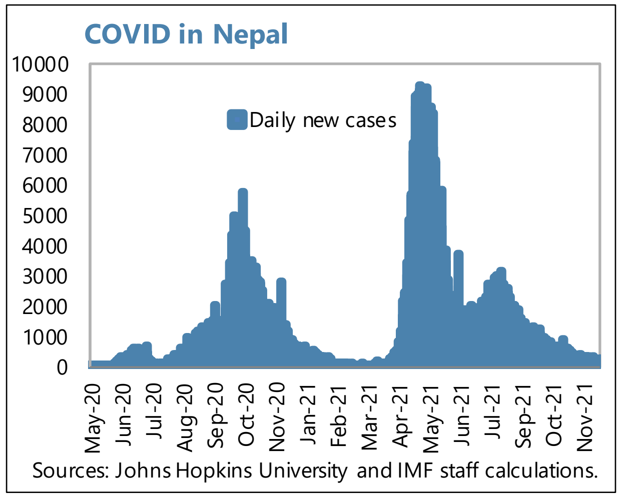
10/ It was increased from 65 percent to 70 percent in July 2020.

11/ Debt-equity ratio for other loans is kept at 50%. The single obligor limit of the margin nature loan is fixed at Rs. 40 million from one institution and Rs. 120 million in total.

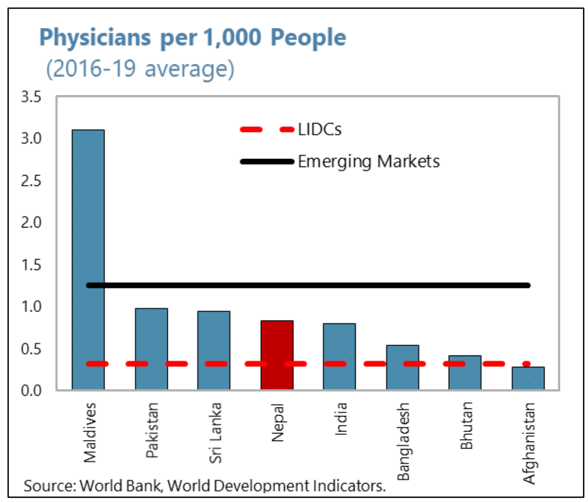
Note: Measures as of November, 2021.

Annex II. Nepal's Pandemic Health Response

1. The government has been proactive in addressing COVID-19 in Nepal.[1] Nepal has seen intermittent surges of rising infections ever since its first confirmed COVID-19 case on January 23, 2020. As of December 1, 2021, a total of 821,651 cases and 11,529 deaths have been reported. Measures taken to address the transmission of infections include: (i) public sensitization campaign for mask wearing social distancing and vaccine acceptance; (ii) tailored mobility restrictions particularly during surges; (iii) expanded COVID-19 testing facilities. Relatedly, the number of RT-PCR testing laboratories increased to 102 in December 2021 compared to 63 in September 2020.



2. A core element of the agenda is to improve access and to strengthen healthcare capacity. The government of Nepal provides free basic healthcare for all. With the onset of the pandemic, the government covered the cost of testing and treatment for the poor and vulnerable, frontline health, and other essential workers. To strengthen capacity, the government also increased hospital beds, set up quarantine centers and temporary hospitals, eliminated duties on the importation of medical supplies which helped expand the availability of equipment's such as oxygen cylinders and generators. To address capacity constraints especially at the subnational level the government in partnership with the WHO is investing in training healthcare workers



3. The government is leveraging support from the international community to vaccinate its eligible population by April 2022. As of December 1, 2021, 2.3 million vaccine doses have been administered and 28 percent of the eligible population have been fully vaccinated.[2] To this end, the government has been proactive in getting vaccines, ultra-cold storage facilities, including through grants, bilateral procurement and GAVI's COVAX multilateral vaccine sharing facility. In addition to the IMF's RCF financing in May 2020, the government mobilized resources from development partners (ADB, WB, WHO, UN).

[1] Measures related to social assistance and support to business are discussed in the main text.

[2] https://covid19.mohp.gov.np/covid/englishSituationReport/61a757a74fbe8_SitRep661_COVID-19_01-12-2021_EN.pdf

Annex III. Implementing Fiscal Governance Commitments of RCF

Overview. The Government of Nepal continues to implement spending transparency commitments, based on existing frameworks and practices notwithstanding the ongoing impact of COVID-19, which affected government operations and exacerbated capacity constraints. In the context of the Rapid Credit Facility (RCF) disbursed in May 2020, the authorities committed to take further steps, including publication of budget expenditures related to Covid-19 and publication of beneficial ownership information for new, large, Covid-19 related procurement contracts. The authorities have reiterated their intention to fully meet these commitments and have taken important steps in this regard.	
Fiscal Reporting	Financial Comptroller General Office (under the Ministry of Finance) publishes budget revenue and expenditures daily. In addition, FCGO publishes monthly expenditure by economic classification, and yearly consolidated financial statement. In addition, aggregate spending from the COVID-19 Fund—an extra-budgetary fund with financing from government, development partners, and the private sector—is being published. To meet the commitment on the publication of budget expenditures related to COVID, the authorities with the support of the Asian Development Bank, have published a comprehensive report on government spending on the COVID-19 response on the MOFs website. The 3rd COVID-19 Active Response and Expenditure Support (CARES) report details the government's COVID-19 response measures, expenditure, and action plan around three priority areas: health system; social protection for the poor and vulnerable; and economic recovery for affected sectors.
Audit	The Office of the Auditor General (OAG), an independent Constitutional body, audits the government accounts on an annual basis, as per its mandate, and publishes the results on the OAG's website. The latest OAG report for FY2019/20 was published in August 2021.[1/] The OAG is expected to audit COVID-19 budgetary expenditures, together with other expenditures during its annual audit of FY2020/21 expected in CY2022. No further action is needed to meet the audit related RCF commitment.
Public Procurement	The Public Procurement Act and its regulation require implementation agencies to publish key contract information. The authorities have reiterated their intention to fully meet this commitment and have taken important steps in this regard. Specifically: (i) the MOF has issued a public information notice (PIN)[2/] to announce that it will collect and publish beneficial ownership information for all new COVID-19 related contracts. This will apply to all new contracts as of Dec 9, 2021. (ii) Consistent with the PIN, the government will publish large public procurement documentation, ex-post validation of delivery, name of awarded companies, and name of beneficial owner(s) for all new COVID-19 related contracts (as of Dec 9, 2021).
1/ Auditor General Nepal (oag.gov.np) 2/ https://ppmo.gov.np/download/bids/MOE%2012-8-2021.pdf	

Annex IV. Social Spending in Nepal

1. **The authorities are committed to protecting and strengthening social spending in Nepal but face several challenges in the sector.** The social policy system in Nepal is complex and faces coordination issues. There are numerous social policy programs administered by different agencies, with no single, overarching social support agency responsible for the overall system. The shift to fiscal federalism is exacerbating the challenges. The role of each level of government is under transition, and capacity issues for newly established subnational governments limit policy implementation.

2. **Social spending in Nepal currently focusses on older individuals, with more limited support directed towards children and working age populations.** Two thirds of social spending is allocated to public sector pensions covering seven percent of the population. The remainder of spending is dominated by five core allowances with the most generous in access and amount being the Old Age Allowance (universal to all over 65s). By comparison, the child protection allowance targets young children in impoverished areas but is set at less than one fifth of the Old Age Allowance. The new flagship Prime Ministers Employment Program (PMEP) guaranteeing minimum employment to vulnerable households will provide support to working age individuals if effectively implemented. The World Bank estimates that 49% of the population is currently covered by social safety nets, and that the social security and employment programs reduce poverty by less than eight percent.

3. **The authorities' COVID-19 response so far has relied mainly on expanding existing social assistance programs and introducing some temporary additional measures.** The government recently announced a 33 percent increase in the five core social spending allowances, raising the Old Age Allowance to 4,000 NPRs per month. The child grant has also been expanded to an additional 11 impoverished areas. Health actions such as temporarily free COVID-19 testing and treatment were introduced, and effective emergency food support was disbursed during the first lockdown. Expansion of the PMEP and retraining programs are at the center of the government's recovery plan once the crisis abates and are supported by World Bank programs.

4. **Looking ahead, the authorities intend to improve the targeting and strengthen the accountability of social assistance programs.** The five core allowances and Prime Ministers Employment Program will remain a centerpiece of the social spending sector. In addition, the development of a National Social Registry (NSR), also supported by the World Bank, will allow for improved administration and targeting of policies. Local authorities' ongoing capacity development will also assist with targeting and delivery. The IMF program supports the authorities' agenda through protecting budgetary space for social spending and indicative targets on key programs.

Annex V. Decomposition of Public Debt and Debt Service by Creditor, 2020-2022

	Debt Stock (end of period)			Debt Service					
	2020			2020	2021	2022	2020	2021	2022
	(In million US$)	*(Percent total debt)*	*(Percent GDP)*	*(In million US$)*			*(Percent GDP)*		
Total[1]	13,844	100	40.7	2,265	2,363	2,197	6.664	6.952	6.466
External	6,723	48.6	19.8	226	284	310	0.67	0.84	0.91
Multilateral creditors[2]	5,930	42.8	17.5	197	235	260	0.58	0.69	0.76
IMF	280	2.0	0.8						
World Bank	3,341	24.1	9.8						
ADB	2,243	16.2	6.6						
Other Multilaterals	66	0.5	0.2						
Bilateral Creditors	793	5.7	2.3	29	49	51	0.09	0.14	0.15
Paris Club	358	2.6	1.1	16	16	15	0.05	0.05	0.04
o/w: JICA	296	2.1	0.9						
EXIM Bank of Korea	52	0.4	0.2						
Non-Paris Club	435	3.1	1.3	13	33	36	0.04	0.10	0.10
o/w: EXIM Bank of China	216	1.6	0.6						
EXIM Bank of India	206	1.5	0.6						
Bonds	0	0.0	0.0	0	0	0	0	0	0
Commercial creditors	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
Domestic	7,121	51.4	21.0	2,038	2,079	1,887	6.00	6.12	5.55
Held by residents, total	7,121	51.4	21.0	2,038	2,079	1,887	6.00	6.12	5.55
Held by non-residents, total	0	0.0	0.0	0	0	0	0	0	0
T-Bills	1,763	12.7	5.2	1,769	1,804	1,109	5.21	5.31	3.26
Bonds	3,338	24.1	9.8	269	275	778	0.79	0.81	2.29
Loans[3]	1,818	13.1	5.3	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	201	1.5	0.6						
o/w: Public guarantees	201	1.5	0.6						
o/w: Other explicit contingent liabilities[5]	0	0.0	0.0						
Nominal GDP	33,983								

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$.

2/ Multilateral creditors" are simply institutions with more than one official shareholder and may not necessarily align with creditor classification under other IMF policie:

3/ Loans here refer to the negative Treasury Single Account (TSA) balance.

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).

Annex VI. Risk Assessment Matrix

Source of Risk[1/]	Location of Source	Relative Likelihood	Time Horizon	Expected Impact	Direction of Impact	*Main Impacts* → Recommended Policy Actions
Higher frequency and severity of natural disasters related to climate change	Domestic	M	MT, LT	H	↓	*Earthquakes, flooding, climate and other disasters cause severe damage and economic disruption. Fiscal deficits and debt ratios increase in response.* → Focus on risk management and resilience in infrastructure, building codes and public investment. Enact recommendations from climate module as part of a PIMA. Build and maintain fiscal and reserve buffers
Financial sector vulnerabilities develop	Domestic	M	ST, MT	H	↓	*Financial sector risks are likely to have accumulated during the extended period of accommodative monetary policy. A disorderly exit from pandemic measures, or other catalytic domestic and external events, risk triggering financial sector stability concerns.* → Enhance the monitoring of the banking system to assess the impact of COVID-19 on asset quality and the health of the system. Ensure the banks' compliance with prudential requirements and ensure that the banks' asset classifications reflect their true state of asset quality, Implementation of the financial sector reforms under the program. Protect fiscal policy space to allow for an appropriate response if downside scenarios eventuate.
Widespread Social Discontent and political instability	Domestic	M	ST, MT	M	↓	*Social tensions erupt as the withdrawal of pandemic-related policy support results in unemployment and, amid increasing prices of essentials, hurts vulnerable groups (often exacerbating pre-existing inequities).* → Focus on a strong public health response to bring pandemic under control. Maintain and strengthen social safety nets and policy responses to pandemic. Ensure transparency, accountability and inclusion in policy implementation.
Risks from poor implementation capacity and fiscal pressures from switch to fiscal federalism	Domestic	M	MT	M	↓	*This would lead to higher budget deficits, increased debt ratios, ineffective public services delivery, and ultimately weaker growth.* → 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 Risk	**Location of Source**	**Relative Likelihood**	**Time Horizon**	**Expected Impact**	**Direction of Impact**	***Main Impacts*** **→ Recommended Policy Actions**
Global resurgence of the COVID-19 pandemic.	External	M	ST, MT	H	↓	*Local outbreaks lead to a global resurgence of the pandemic (possibly due to vaccine-resistant variants), which requires costly containment efforts and prompts persistent behavioral changes rendering many activities unviable.* → Prioritize health response to bring the virus under control, including a strong focus on vaccine procurement and distribution. Donor engagement to ensure immediate pandemic financing needs are met
Weaker than expected recovery, or further virus waves, in major trading partners.	External	M	ST, MT	M	↓	*Nepal is heavily dependent on trading partners for exports (including tourism), imports and remittances. A slower than expected recovery will impact macroeconomic stability and growth.* → Maintain adequate reserve levels and fiscal policy space as buffers.
Rising commodity prices amid bouts of volatility	External	M	ST, MT	M	↓	*Commodity prices increase by more than expected against a weaker U.S. dollar, post-pandemic pent-up demand and supply disruptions, and for some materials, accelerated plans for renewable energy adoption. Uncertainty surrounding each of these factors leads to bouts of volatility, especially in oil prices.* → Continue to develop hydropower to diversify energy sources. Maintain adequate reserve levels and fiscal policy space as a buffer. Ensure adequate social safety net for the most vulnerable.

Annex VII. External Sector Assessment[1]

Overall Assessment: The external position of Nepal in FY2020/21 was moderately weaker than the level implied by fundamentals and desirable policies. The assessment, however, is subject to larger than usual uncertainties given the severity of the COVID-19 shock. The current level of foreign reserves is assessed to be adequate, supporting the peg to the Indian rupee.

Potential Policy Responses: Nepal is 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. In this context, the peg to the Indian rupee reduces exchange rate uncertainty for trade and investment with its main trading partner. Nevertheless, real appreciation of the Nepali rupee can negatively affect Nepal's competitiveness. Structural reforms to improve competitiveness—for example, through closing the infrastructure gap, improving the business climate, and reducing product and labor market frictions—can help Nepal address its medium- and long-term external vulnerabilities and stimulate economic development.

Foreign Assets and Liabilities: Position and Trajectory

Background. Nepal's net IIP is estimated at US$722 million (2.1 percent of GDP) at the end of FY2020/21 (mid-July 2021). 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 70 percent, and foreign direct investment (FDI) was still relatively small at less than 20 percent owing to Nepal's weak business climate, which has held back private investment. Nepal's IIP has declined substantially in recent years, reflecting large current account deficits in FY2017/18, FY2018/19, and FY2020/21.

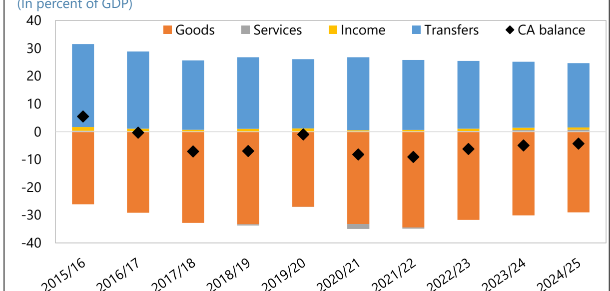
Assessment. The declining trend in Nepal's net IIP is likely to continue in the coming years. As Nepal is at present still a net creditor, there are no immediate sustainability concerns.

FY2020/21 (% GDP)	NIIP: 2.1	Gross Assets: 35.8	Debt Assets: 0.0	Gross Liab.: 33.7	Debt Liab.: 24.0

Current Account

Background. Driven by reconstruction after the 2015 earthquake, Nepal ran large current account (CA) deficits in FY2017/18 and FY2018/19, respectively at 7.1 and 6.9 percent of GDP. However, imports collapsed, and remittances remained strong during the first wave of the COVID-19 pandemic, narrowing the current account deficit to 1.0 percent in FY2019/20. As the economy recovered in FY2020/21, imports soared, and CA deficit is estimated at 8.2 percent of GDP. CA deficit is projected to further increase to 9.1 percent of GDP in FY2021/22 before gradually moderating to 3.6 percent of GDP in FY2025/26. The trends reflect a number of factors, including declining COVID-19 related imports, recoveries in exports and tourism, and gradually declining remittances.

Nepa: Current Account
(In percent of GDP)



Sources: Nepali authorities and IMF staff calculations.

[1] The assessment is based on FY2020/21 (mid-2021) data for Nepal and end-2020 data for other countries.

Assessment. The EBA-lite CA model indicates a CA gap of -1.6 percent of GDP in FY2020/21, with an adjusted CA deficit of 7.3 percent of GDP and adjusted CA norm of -5.7 percent of GDP. The adjusted CA deficit reflects a cyclical component of -0.1 percent of GDP, COVID-19 adjustors for tourism and remittances of 0.67 and 0.01 percent of GDP respectively, and an adjustor of -0.1 percent of GDP for natural disasters and conflicts. Assuming an elasticity of the trade balance with respect to changes in the REER of -0.14, the estimate implies that the REER would need to depreciate about 11 percent to close the CA gap. The CA gap cannot be explained by gaps in macroeconomic policies, as macroeconomic policies in Nepal appear in fact tighter than its trading partners. The CA gap could reflect structural factors of the Nepal economy, particularly the overvaluation of the Rupee, as well as the sharp rebound in imports as the economy was recovering, for example, to rebuild inventory and for COVID-19 related imports.

Nepal: Model Estimates for 2020/21 (in percent of GDP)

	CA model	REER model
CA-Actual	**-8.2**	
Cyclical contributions (from model) (-)	-0.1	
COVID-19 adjustor (+) 1/	0.7	
Natural disasters and conflicts (-)	-0.1	
Adjusted CA	**-7.3**	
CA Norm (from model) 2/	**-5.7**	
Adjusted CA Norm	**-5.7**	
CA Gap	**-1.6**	**-2.3**
o/w Relative policy gap	2.6	
Elasticity	-0.14	
REER Gap (in percent)	**11.3**	**16.2**

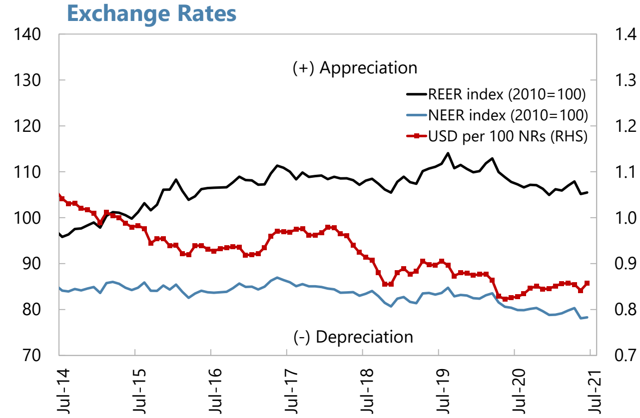
1/ Additional cyclical adjustment to account for the temporary impact of the pandemic on tourism (0.67 percent of GDP) and remittances (0.01 percent of GDP). The adjustors here are computed for FY2020/21.
2/ Cyclically adjusted, including multilateral consistency adjustments.

Real Exchange Rate

Background. After a period of continued appreciation (2014-2017), Nepal's real effective exchange rate (REER) had been broadly stable prior to the COVID-19 pandemic (2017-2019). Following the onset of COVID-19, REER depreciated 5.6 percent between March and August 2020 while NEER depreciated about 4.4 percent, reflecting a period of tight global financial conditions. REER has been largely stable since August 2020.

Assessment. The EBA-lite IREER model indicates a REER overvaluation of 16.2 percent over the equilibrium level in FY2020/21. This would imply a CA gap of -2.3 percent, with an elasticity of the trade balance with respect to changes in the REER of -0.14. Similar to the CA model, gaps in macroeconomic policies do not appear to explain the REER gap.

Exchange Rates



Sources: Nepali authorities; and IMF staff estimates.

Capital and Financial Accounts: Flows and Policy Measures
Background. Capital flows consist mostly of concessional loans and trade credit. Nepal's capital account remains mostly closed, and portfolio flows are negligible. Net capital and financial account inflows increased considerably, to 6.5 percent of GDP in FY2019/20 from 2.6 percent of GDP in FY2018/19, driven mostly by higher official loans and trade credits (1.9 and 0.6 percent of GDP respectively). FDI has been small and was only 0.5 percent of GDP in FY2019/20. Official loans are expected to remain strong in the coming years, as support from multilateral and bilateral sources helps Nepal fight against and recover from the COVID-19 pandemic. **Assessment**. As Nepal's capital account remains mostly closed and financial inflows consist of mostly long-term concessional loans from multilateral and bilateral development partners, vulnerabilities related to capital flows are limited for Nepal.
FX Intervention and Reserves Level
Background. Nepal's central bank reserves reached US$11.7 billion (11.5 months of prospective imports of goods and services) in mid-January 2021, on the back of a sharp drop in imports, resilient remittance performance, and continued financing inflows from development partners including the IMF. Driven primarily by rising imports as the economy recovers, reserves dropped to US$10.9 billion (10.0 months of prospective imports) by July 2021. While reserves are still well above the reserve adequacy metric for Nepal, and will be supported by the policies under the ECF, they will likely remain under some pressure in the coming years as the current account deficit is projected to remain large. **Assessment.** Nepal is assessed to be "credit constrained" for the purpose of Assessing Reserve Adequacy (ARA), given that it rarely borrows from international capital markets. According to this methodology, Nepal's economy is classified as non-resource rich, with a fixed exchange rate regime. This methodology balances the benefits of holding reserves against the costs (assumed at 6.2 percent) and estimates the optimal level of reserves at 4.1 months of prospective imports of goods and services. The estimate is based on projections when applicable, given the turbulent macroeconomic indicators since the onset of the COVID-19. Given Nepal's high vulnerability to natural disasters, a modification to the ARA methodology raises the optimal level of reserves to 4.8 months (by lowering external demand by 2 percentage points). An increase of another 0.7 month is included to provide additional buffer for vulnerability related to remittances and tourism, resulting in an overall optimal level of reserves of 5.5 months of prospective imports of goods and services.

Appendix I. Letter of Intent

Kathmandu, Nepal

December 22, 2021

Ms. Kristalina Georgieva

Managing Director

International Monetary Fund

Washington, D.C. 20431

Dear Ms. Georgieva,

We would like to thank the IMF for its continued support over the years. The expeditious approval of the $214 million emergency disbursement under the Rapid Credit Facility in May 2020, and ongoing debt relief provided under the Catastrophe Containment and Relief Trust, have made a substantial contribution to addressing the financing needs that emerged in the wake of the COVID-19 pandemic. Further, the recently approved SDR allocation for Nepal has helped preserve our foreign reserve buffers and the credibility of the exchange rate peg, and ensure we remain nimble to address other risks that materialize (including natural disasters).

Nepal has suffered two devastating waves of COVID-19 which derailed our growth momentum. The burden of the pandemic has been significant in Nepal. The decisive containment measures that we took to limit the spread of the virus and save lives imposed unprecedented economic costs. GDP contracted 2.1 percent in FY2019/20, and we have only seen a partial recovery at 2.7 percent growth for FY2020/21. Tourism a key source of foreign exchange and employment creation in Nepal collapsed at the onset of the pandemic and the prospects for recovery remain weak until the pandemic is under control globally. As a result, external and fiscal financing gaps have emerged alongside a widespread increase in unemployment and poverty, that threatens achieving the goals outlined in our 2018-2022 National Development Plan 'Prosperous Nepal, Happy Nepali'.

The ongoing pandemic and uncertain global economic outlook weigh on Nepal's prospects. Remittances is a major source of our foreign financing and key driver of growth. While the flow of remittances has been broadly resilient in the last fiscal year (FY2020/21), we are concerned about recent bouts of volatility, and the impact of a decline in remittances if economic activity slows in source countries and travel restrictions intensify for Nepali workers.

We are determined to protect the significant gains in poverty alleviation that Nepal has made over the past decades despite the heavy toll the pandemic has inflicted on our economy. To this end, we issued a status paper in September 2021 that highlights the government's reform priorities which is consistent with the attached Memorandum of Economic and Financial Policies (MEFP). In the near term, the pandemic response is our clear priority. We will vaccinate all eligible citizens by Mid-April 2022 and provide support to those hard-hit by the pandemic. We also recognize the need to

improve economic performance, create jobs, and restore hope. To this end, we also committed to reforms to maintain fiscal discipline, promote fiscal federalism and intergovernmental fiscal management, improve the efficiency of public investment, and enhance the delivery of public services. The expanded social safety net announced in the FY2021/22 replacement budget will help protect the vulnerable and prevent additional households from falling into poverty. However, we are acutely aware of the significant task that is still ahead of us in meeting our commitments to providing relief for sectors most affected by COVID-19; strengthen our health infrastructure; modernize our economy; and reduce poverty and inequality.

Against this backdrop, we are requesting a 38-month ECF arrangement in the amount of SDR282.42 million (about US$398.8 million,180 percent of Nepal quota) to support a more robust COVID-19 response that can help mitigate the COVID impact on health and economic activity, protect vulnerable groups, and preserve macroeconomic and financial stability. The ECF program will also help facilitate the implementation of reforms to support sustained growth and poverty reduction; and catalyze additional financing from Nepal's development partners. Beyond this much needed immediate financial assistance, we reaffirm our willingness to remain engaged with the IMF and to benefit from its policy advice and its capacity development support.

We believe that the economic and financial policies set forth in the Memorandum of Economic and Financial Policies (MEFP) are adequate to achieve the objectives of the ECF program and help to achieve sustainable and equitable growth in Nepal. Measures to boost revenues and public spending efficiency, strengthen financial sector regulation and supervision, and build institutions will support our goals of economic modernization and transformation, and poverty reduction. We commit to take any additional measures that may become appropriate for this purpose. We will consult with the IMF on the adoption of such measures and in advance of any revisions to the policies contained in the MEFP, in accordance with the Fund's policies on such consultation. We intend to remain in close consultation with Fund staff and provide timely information necessary for monitoring economic developments and implementation of policies under the ECF-supported program.

We request that the ECF disbursement SDR282.42 million be made directly to the Federal Consolidated Fund. We intend to use the ECF disbursement to help fill the projected fiscal financing gap that will emerge as higher spending on health, social assistance, and policy measures is needed to support the economy. We commit to update the Memorandum of Understanding (MOU) between Nepal Rastra Bank and the Ministry of Finance regarding the use of IMF resources for budget support (signed May 08, 2020). The MOU will specify (i) the maintenance of a specific government account at the central bank (as a subaccount of the Federal Treasury) to receive IMF resources under the ECF arrangement; and (ii) the establishment of a clear framework agreement between the NRB and the Ministry on the responsibilities for timely servicing financial obligations to the IMF.

We do not intend to introduce measures or policies that would exacerbate the current 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 TMU, the staff report and other ECF-related documents, on the IMF's website.

Sincerely yours,

/s/	/s/
Hon. Janardan Sharma Finance Minister	Mr. Maha Prasad Adhikari Governor, Nepal Rastra Bank

Attachment I. Memorandum of Economic and Financial Policies

This memorandum sets out our economic and financial policy commitments to support the request for a 38-month arrangement under the Extended Credit Facility (ECF) of the International Monetary Fund. The economic program has three main objectives: First, to mitigate the COVID-19 impact on health and economic activity and protect vulnerable groups. Second, to preserve macroeconomic and financial stability. Third, to implement a reform agenda that leads to sustained growth and poverty reduction. These goals are in line with the government's immediate priorities elucidated in the August 2021 Status Paper on the current economic situation of Nepal and the medium-term strategic priorities in our 2018-2022 National Development Plan 'Prosperous Nepal, Happy Nepali' and our Relief, Restructuring and Resilience (3R) plan to address the economic and social impacts of the pandemic.

A. Introduction

1. **The COVID-19 pandemic continues to pose a severe threat to health conditions and economic activities in Nepal and across the globe.** While the economy was seeing glimpses of recovery in early 2021, between April and July 2021 Nepal suffered a devastating second wave of rising Covid-19 infections that necessitated the reintroduction of lockdowns and containment measures. Tourist arrivals collapsed and remittances have been volatile because of weaker economic activity in destination countries and travel restrictions for migrant workers. Services and construction projects (including major infrastructure projects) have been affected because of the implementation of measures to contain the spread of the virus. With the economy hard-hit, there has been a significant shortfall in government revenue and greater spending needs, increasing the fiscal deficit. Losses of jobs and income may likely be a setback to the important social development gains of the past decade.

2. **The government of Nepal is comprehensively addressing the health, economic, and social impact of the pandemic.** The government took measures to contain the spread of the pandemic. Widespread COVID-19 testing and treatment was rolled out during the early stages of the pandemic, which was cost free for all in government testing facilities. The rollout of vaccines started in January 2021, though has been constrained because of limited availability and capacity constraints. Fiscal measures to address the pandemic have included (1) increased health spending which has enabled a rapid scale-up of COVID-19 testing and treatment facilities; (2) tax relief to households and businesses; (3) the expansion of social assistance, including in-kind food transfers, subsidies for utility bills, and wage support for informal sector workers—including through expansion of the Prime Minister's Employment Program (PMEP) which offers 100 days of subsistence wage work in public works projects; (4) a concessional loan facility to support affected businesses and micro, small, and medium-sized enterprises; (5) a business continuity fund for the payment of workers' wages in cottage, small and medium enterprises, and tourism sector; and (6) cash transfers for poor families highly affected by COVID. To support the continued supply of credit, the Nepal Rastra Bank (NRB) has ensured adequate liquidity (lowering the policy rate and cash reserve ratio), increased the size of the Refinance Facility Fund to provide subsidized interest rates to banks for on-

lending to priority sectors, eased macroprudential measures (no longer requiring banks to build a counter cyclical capital buffer and increasing the limit on loan to value ratios), and provided temporary relief to affected borrowers (introducing loan moratoria and regulatory forbearance measures).

3. **More recently, we are implementing additional measures to reduce poverty and boost Nepal's health infrastructure.** Specific measures announced in the FY2021/22 replacement budget include a 33 percent increase in all social security allowances including the child protection grant; and expanding the scope of Social Security Fund to informal sector workers. While continuing to provide vaccination for all Nepali citizens as well as free tests and treatment of COVID in all government laboratories and hospitals, we have also purchased additional medical equipment and supplies, including ICUs, ventilators, oxygen cylinders and mobilized additional health workers to boost capacity.

4. **Strong policy buffers built before the COVID-19 pandemic have aided our proactive response to date.** Growth in 2018/19 was 6.7 percent, with continued growth momentum in the first half of FY2019/20 (fiscal year ends mid-July), supported by more reliable electricity supply and post-earthquake reconstruction. Inflation was stable around 6 percent with the exchange rate peg to the India rupee providing a credible anchor. In February 2020, prior to the onset of the global pandemic, gross official reserves were comfortable at USD 8.7 billion, about 8.6 months of prospective imports. Further, strong revenue collection and prudent fiscal management over the years, buffered by concessional financing from development partners, meant that our deficits were modest and public debt in FY2018/19 was assessed to be at low risk of external and overall debt distress. While these buffers created policy space for an initial rapid response to the pandemic, the depth and duration of the COVID-19 shock is giving rise to additional financing needs to support our efforts to protect health and livelihoods.

5. **The economy faces downside risks from the COVID-19 pandemic.** The uneven pace of global vaccination efforts and new Covid-19 variants create much uncertainty about the timing and strength of the economic recovery in Nepal and our major economic partners. As a result, the outlook for remittances and tourism—key sources of foreign currency earnings—remains subdued.

6. **The ECF arrangement will support our efforts to respond to COVID-19, preserve macroeconomic and financial stability, and support the transition towards sustainable and inclusive growth.** The macroeconomic framework and reform agenda underpinning the ECF will help support a sustained recovery while continuing to mitigate the social and economic impact of COVID-19. The program will contribute to strengthening institutional frameworks and capacity building. The ECF is also expected to catalyze additional financing from development partners.

B. Recent Macroeconomic Developments and Outlook

7. **COVID-19 has taken a heavy toll on Nepal's economy, derailing earlier growth momentum.** The COVID-19 shock hit Nepal in the second half of FY2019/20 through a decline in tourism, construction, and economic activity, and volatility of remittances. The economy slumped

into a recession with FY2019/20 growth at -2.1 percent, which was partially offset by an estimated 2.7 percent growth rate in FY2020/21. Inflation slowed to 4.2 percent in July 2021 from 4.8 percent in July 2020, mainly due to the lower housing and utilities prices. After an initial collapse in 2020, imports have rapidly grown, fueling a large current account deficit. Buoyed by formalization and the ongoing global recovery, remittances remained robust throughout FY2020/21. Combined with accommodative monetary policy, remittances have supported consumption, driving import growth of 25.7% year on year in FY2020/21.

8. **Our fiscal position was affected by the COVID-19 pandemic.** While COVID-19 related expenditures increased as we quickly responded to the pandemic, temporary factors led to a narrowing of the overall fiscal deficit from 5.3 percent of GDP in FY2019/20 to 4.2 percent of GDP in FY2020/21. Specifically, increases in import related taxes and deferred tax receipts raised revenues by 2.2 percent of GDP. Ultimately, budget execution was severely constrained by the second wave and associated lockdown measures. Public debt is estimated at 47.2 percent of GDP in FY2020/21, as defined in the Joint Bank-Fund Debt Sustainability Analysis[1].

9. **Banks' financial performance has likely been impacted by the COVID 19 shock.** Despite the high level of credit growth, the non-performing loan (NPL) ratio remains at 1.4 percent and reported capital adequacy ratios of all banks remain above the regulatory minima in October 2021. Nonetheless, given the economic fallout of Covid-19, we are monitoring the system closely to ensure NPLs are appropriately measured, and that provisioning and capital remain adequate for all banks.

10. **Our growth outlook will depend on the timing and pace of recovery from COVID-19, which remains highly uncertain.** To align with the IMF's global assumptions on the pandemic in the October 2021 World Economic Outlook, for Nepal it is assumed that fiscal year 2021/2022 will continue to be impacted by Covid-19 and that vaccines will be widely available in the first half of FY2022/23. Based on these assumptions and considering the severity of the second Covid-19 wave in the last quarter of this FY and the widespread flooding seen in October, growth is projected to be 4.4 percent in FY2021/22. Inflation is expected to rise to about 5.9 percent toward the end-FY2021/22 due to inflationary pressure from higher global oil and food prices and continued supply disruptions. We also expect the current account deficit to remain wide at -9.1 percent of GDP in FY 2021/22 as imports rebound. We expect growth to accelerate in FY2022/23 as the economy continues to recover from COVID-19.

C. Economic and Financial Policies

Fiscal Policy

11. **Fiscal deficits for FY2021/22 and FY2022/23 accommodate COVID-19 pandemic related spending to support health and livelihoods.** The impact of the pandemic has been more severe

[1] The coverage of public debt includes general government debt (including the negative Treasury Single Account (TSA) balance), government guarantees, and central bank borrowing on behalf of the government.

and longer lived than expected, creating fiscal pressures. The fiscal deficit is now projected at 4.2 percent of GDP for FY2020/21 and 6.3 percent of GDP for FY2021/22. On the expenditure side, the budgets include spending on COVID-19 related healthcare, social assistance, and labor support, and concessional loans to businesses to provide economic relief. Budgeted social spending (including health, education and social protection) has been significantly increased by 24 percent in FY2020/21 and 52 percent in FY2021/22, to build a robust health system, provide quality education opportunities and life skills, and boost the level of social protection. We have adopted measures to reduce administrative expenditures—such as office operation, fuel, low priority workshops, consultancy, purchase of furniture and vehicles, and allowances—to make room for our priority spending. Furthermore, operational grants to public entities other than those providing basic services have been stopped. Revenues are expected to recover to 23.8 percent of GDP in FY2021/22. The deficits are financed with support from our development partners—including the prospective IMF-ECF arrangement, World Bank and Asian Development Bank's project loans and policy-based loans, and financing from official bilateral creditors, including the DSSI—as well as domestic debt issuance.

12. Procurement and distribution of Covid-19 vaccines will add further pressure on the budget, and vaccine availability remains a major constraint. Nepal has started receiving vaccines under the COVAX facility, which would provide coverage for 20 percent of the population. Countries including India and China have provided vaccines as direct bilateral grants to Nepal. [2] We are also purchasing additional vaccines to extend coverage. However, limited supply of vaccines and infrastructure constraints has impeded a more rapid rollout. We are mobilizing additional resources, including from development partners, to accommodate the additional spending needs on vaccines.

13. Once the pandemic dissipates, we will begin to gradually reduce fiscal deficits to stabilize debt and protect fiscal sustainability. We plan to phase-out temporary support measures as the recovery takes hold. We will develop a domestic revenue mobilization action plan (further discussed below) to enhance revenue collection and make room for priority spending. At the same time, we will reduce redundant expenditures of the federal government once the corresponding responsibilities are further transferred to local and provincial governments. The path for primary deficits will be consistent with maintaining medium-term fiscal sustainability while preserving priority expenditures, including social spending and other expenditures critical to support economic recovery. We will also strengthen the financial oversight of public enterprises, with support of IMF technical assistance, and take steps to reduce associated fiscal risks as soon as feasible after the pandemic.

Revenue Mobilization

14. In the near term, our focus has been to provide tax relief to people and businesses impacted by COVID-19 pandemic and support economy recovery. In FY2019/20 and again in FY2020/21, we deferred tax deadlines during the lockdown periods. We exempted customs duties

[2] Several countries including Japan and the USA donated vaccines through the COVAX facility.

for medical supplies, provided VAT exemptions on Covid-19 related medical supplies and equipment, and offered tax rebates for micro, cottage and small businesses and industries highly affected by COVID-19, such as air service, transport service, hotel, travel, and trekking businesses.

15. In the medium term, we will continue our efforts to enhance our tax system to sustainably finance our national development efforts. Our tax revenue had increased from less than 10 percent of GDP in FY2006/2007 to over 19 percent before COVID-19 (FY2018/19). Both policy and structural measures contributed to this impressive increase over the years. Specifically, policy measures such as the enhancement of revenue administration (including the implementation of Inland Revenue Management Strategic Plans and Customs Reforms and Modernization Strategies and Action Plan) contributed to these achievements. On the structural side, the significant increase in imports fueled by substantial growth in remittances and capital expenditures supported the increase in revenues. Building on past progress, we will develop a domestic revenue mobilization action plan to enhance taxation on domestic economic activity (structural benchmark, 3rd review), with support from IMF technical assistance. We have estimated the related cost of tax exemption at the Department of Customs and will publish this data by March 2022 (structural benchmark, 1st review). With the support of IMF technical assistance, we will estimate the costs of other tax exemptions and publish their costs where feasible by September 2022 (structural benchmark, 2nd review) to enhance transparency and allow for a cost-benefit analysis approach to the use of exemptions.

Expenditure Reforms

16. We will improve our public investment management to enhance the efficiency of capital spending. Public investment is a critical component of our development plan 'Prosperous Nepal, Happy Nepalis', and will play a critical role in supporting the recovery. According to the public investment management assessment (PIMA) conducted by the IMF in 2021, there is significant room to improve the efficiency of our public investment management system. The weaknesses in this system, especially those institutions related to resource allocation and project implementation, have contributed to the low efficiency. Given our high vulnerability to climate change and natural disasters, the climate change module of the PIMA also highlighted opportunities to further integrate climate change considerations in public investment management. We will develop an action plan to improve the efficiency of public investment spending and strengthen climate resilience (by September 2022, structural benchmark, 2nd review), drawing on recommendations from the PIMA.

17. Advancing fiscal federalism will continue to be on the top of our reform agenda. As mandated by the Constitution of Nepal, we have been moving towards fiscal federalism and devolving responsibility for the provision of many public services to 7 provincial and 753 local governments. The legal framework governing fiscal federalism has been largely established, including the enacted Intergovernmental Fiscal Arrangement Act, the Local Government Operation Acts, and the Federal, Provincial and Local Level (Coordination and Interrelation) Act 2020. In addition, the regulation of the Financial Procedures and Fiscal Responsibility Act has been approved, which will facilitate adequate budget formulation and incentivize fiscal responsibility of subnational

governments. All 7 provincial governments have implemented the Provincial Line Ministry Budget Information System (PLMBIS), and all 753 local governments have implemented the Subnational Treasury Regulatory Application (SuTRA), which will support reporting and monitoring of subnational governments. Legislation authorizes subnational governments to borrow but this is subject to pre-approval by the federal government and subject to certain limits that are set by the National Natural Resources and Fiscal Commission every year. To manage spending pressures, create adequate incentives for fiscal discipline among subnational governments, and contain possible fiscal risks, we agree to implement a framework that will allow the government to closely monitor and contain possible fiscal risks from subnational governments, with the specific measures to be based on recommendations from IMF technical assistance support (by March 2023, structural benchmark, 3rd review).

18. We will step up our efforts to strengthen fiscal risk management. We expect public-private partnerships (PPPs) to play a large role in accelerating infrastructure development in the coming years, including at the local and provincial government level. While PPPs would improve the efficiency of public investment and accelerate infrastructure delivery, they may also entail explicit and/or contingent liabilities to the government. The financial position of public enterprises has improved in recent years. However, some public enterprises continuously suffer financial losses and have defaulted on loans to the government. While subnational governments do not have debt so far, their borrowing could rise as spending capacity increases. Furthermore, the various loan and loan guarantee programs of the government in the context of COVID-19, which were necessary to support the economic recovery, may also increase fiscal risks. We also face significant risks from natural disasters and climate change. As the first step, we will take stock of these risks and develop a fiscal risk register by September 2022 to help better understand the fiscal risk exposure (structural benchmark, 2nd review). Subsequently, by September 2023, a comprehensive fiscal risk statement will be prepared and published to systematically analyze the sensitivity of budget estimates and public debt projections to various fiscal risks (structural benchmark, 4th review). These efforts will help us develop and implement an action plan with clear steps to manage and control major fiscal risks. We plan to request IMF TA to assist us with these reforms.

19. We will continue to enhance debt transparency and debt risk management by revamping our public debt and cash management. We have established the Public Debt Management Office (PDMO) to consolidate the public debt management functions currently scattered among various entities. We will prepare the medium-term debt management strategy that weighs the cost and risk of the government's entire debt portfolio and update it at least annually. Comprehensive debt bulletins, including details on individual borrowings, will also be published in a portal of the PDMO's website, with support from World Bank technical assistance. In this ECF program, we will complete the transfer of the domestic debt management function from the NRB to the PDMO to further delineate monetary policy and fiscal policy. We will improve our cash management transparency by reporting all operational funds in the consolidated financial statements, starting with FY2020/21 (by May 2022, structural benchmark, 1st review). By September 2022, we will also develop cash flow forecasting by the Ministry of Finance to be shared with the FCGO, PDMO and NRB on a regular basis (structural benchmark, 2nd review).

Social Spending

20. Social spending has played a key role in the government response to the Covid-19 shock. The pandemic has resulted in job and income losses, which may contribute to higher poverty and vulnerabilities in the near term. The government maintained existing cash transfer programs, increased coverage of the child grant to an additional 11 districts (25 in total, selected based on human development index), and expanded the PMEP and skills training to mitigate job losses. Healthcare spending is expected to increase to 2 percent of GDP in FY2021/22 from 1 percent of GDP in FY2018/19, due to expenditures on COVID-19 pandemic containment measures, strengthening basic healthcare services, extending health insurance coverage to additional districts, and building new hospital facilities.

21. We are committed to further enhance our social safety net to support our poverty alleviation efforts. The NPC will issue a Poverty Reduction and Growth Strategy Paper based on our 15thNational Development plan by September 2022 (structural benchmark, 2nd review), which will outline the priorities in coming years. We are developing a National Social Registry (NSR), including a system of national identification cards, supported by the World Bank. We are also rolling out the Poverty Identification Program (PIR) registry. The NSR and PIR will facilitate the identification of vulnerable households and allow for more efficient targeting of social transfers. We will also preserve social spending, in particular the child grant.

Monetary and Exchange Rate Policy

22. The overarching objectives of monetary policy in Nepal continue to be price and external sector stability. Inflation has remained generally stable despite some heightened risk factors such as increase in the prices of petroleum products, and disruptions to agricultural production due to climate related factors such as monsoons and floods. We will continue to preserve the credibility of the exchange rate peg by maintaining an adequate level of reserves. We remain committed to improving the effectiveness of the interest rate corridor to manage short-term liquidity and provide a credible anchor for short-term interest rates.

23. We are gradually unwinding accommodative monetary policy. Monetary policy has been accommodative in the previous fiscal year resulting in high credit growth with moderate inflation. In line with moving to a more neutral monetary policy framework for this fiscal year FY2021/22, we increased the deposit collection rate (lower boundary for the interest rate corridor) from 1 to 2 percent and policy rate from 3 to 3.5 percent while keeping the standing loan facility rate (SLF) constant. The NRB will continue to provide liquidity in the system, where necessary, through SLF and repo facilities. The refinancing facility will be gradually scaled back. We are committed to restricting the annual credit growth to 19 percent while the expected deposit growth is around 15 percent in FY2021/22. We will continue to closely monitor inflation developments and credit supply and stand ready to adjust policy settings in case signs of overheating appear. In the program, we will maintain adequate level of reserves (QPC) to preserve the credibility of the exchange rate peg, to prepare in case of further weakening of remittances, and in case other risks materialize.

24. We remain committed to closely monitoring the risks in the loan portfolios and prudently stand ready to tighten macroprudential policies. Macroprudential measures that we have in place include: the single obligor limit (the single obligor limit of the margin nature loan is fixed at Rs. 40 million from one institution and Rs. 120 million in total); credit to deposit ratio (CD, currently 90%); debt service to income ratio (currently 50%); and loan to value ratio (LTV, currently 60%). We remain committed to monitor the effects of rising leverage on the real sector and the possible deterioration in the loan portfolios and stand ready to further tighten macroprudential policies to curb credit growth and mitigate the buildup of financial vulnerabilities.

25. We are committed to enhancing the autonomy and accountability framework of the NRB. By September 2022, we will submit to Parliament amendments to modernize the prevailing NRB Act, guided by key recommendations from the IMF safeguards assessment of the NRB (structural benchmark, 2nd review). The amendments will clarify the primacy of the NRB's price stability objective, strengthen the NRB's institutional and financial autonomy as well as personal autonomy of its key officials, clarify the roles and responsibilities of the NRB's governance bodies, strengthen oversight over the NRB, and establish the independence of the Board's Audit Committee. Limits on the government's borrowing from the NRB as defined in the NRB Act will be maintained. The external audit of Nepal Rastra Bank for FY2021/22 will be commissioned as per the recommendations of the 2021 Safeguards Assessment Report (structural benchmark, 1st review) by the Auditor General of Nepal on the basis of the Constitution and prevailing laws of Nepal.

26. We do not intend to introduce measures or policies that would exacerbate balance of payments difficulties. We do not intend to impose new or intensify existing restrictions on the making of payments and transfers for current international transactions, import restrictions for balance of payments reasons, or multiple currency practices, or to enter into bilateral payments agreements which are inconsistent with Article VIII of the IMF's Articles of Agreement.

Financial Sector Policies

27. We have taken steps to preserve financial stability and strengthen financial sector regulation and supervision. Following the issuance of the Risk Management Guidelines (RMG) in 2018, commercial banks started to prepare self-assessment reports of their compliance with the guidelines. We further plan to enhance credit risk management capacities of banks by incorporating the topics of implementation of the IRB approach, credit risk assessment, expected credit loss calculation under IFRS 9, and the adoption of the simplified standardized approach in the credit risk management guidelines with technical assistance support from the IMF. We continue to develop on-site supervisory capacity for risk-based supervision. Banks were required to build up 2 percent countercyclical capital buffer by July 2020, but this requirement has been suspended until July 2022 due to the Covid outbreak. Efforts have been made to enhance offsite supervision activities and the update of the offsite supervision manual is a work in progress. We are making progress in the implementation of the Supervisory Information System (SIS) to enable timely and reliable collection and analysis of supervisory data and started designing templates and training of banks to facilitate submissions. We will approve an action plan by March 2022 (Structural benchmark, 1st Review) and complete the full implementation of the SIS for class A banks as per the action plan by September

2022 (Structural benchmark, 2nd review). We need capacity building for the implementation of the SIS in class B, C, D banks. We plan to enhance the risk management capacity of the NRB through the TA we will receive from the IMF.

28. **We will enhance oversight of banks' asset quality for timely monitoring of the COVID-19 related impact.** Covid-19 has deteriorated some borrowers' capacity to repay their loans. We will introduce, by March 2022, customized bank reporting templates to collect information on forbearance, provisioning levels and asset classifications on an ongoing basis (structural benchmark, 1st review). The updated reporting template will help precisely identify borrowers and exposures subject to the measures taken in response to the pandemic, including loan moratoria, and allow for close monitoring of affected loans. We will prepare an assessment of the financial stability implications of COVID-19 based on the collected information to inform our future on-site inspections, contingency planning, and further calibration of policy measures.

29. **To preserve stability of the financial system while supporting growth, banks will be encouraged to engage in restructuring of loans for firms that are viable but have temporary liquidity shortages.** We will enhance our regulatory framework to provide clear guidance on restructuring, encourage banks to watch for the creditworthiness of the borrowers on an ongoing basis, and lay out the rules of asset classification and reclassification that enables accurate assessment of banks' asset quality. We will draft 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. We will draft the amendments and publish for a public consultation by March 2022 (structural benchmark, 1st review). By September 2022, we will issue the new regulation (structural benchmark, 2nd review), while allowing an adequate phase-in period for the banks to implement.

30. **We will continue to ensure banks' compliance with prudential requirements**. By March 2023, we will launch in-depth on-site inspections for the largest 10 banks assisted by a third-party international audit firm (structural benchmark, 3rd review) to review loan portfolios in line with the new regulatory framework and paying special attention to loan and collateral valuation, evergreening, group borrowing, and concentration risks. We will seek IMF support for the preparation of the terms of reference for the hiring of the third-party international audit firm and the design of the loan portfolio reviews. We will complete the reviews and have the review results endorsed by the NRB Board by September 2023 (structural benchmark, 4rth review). We will develop a plan to deal with the review's findings, and any bank with capital shortfalls will be required to submit capital management plans setting out how they will return to full compliance with regulatory requirements. We will prudently monitor the relevant reclassification of loans and proactively provide guidance on the prudential treatment of moratoria and NPL management strategies.

31. **We are committed to the full implementation of the Supervisory Information System (SIS).** By June 2022, the NRB Board will approve a strategic plan for the full implementation of the SIS among class A banks (structural benchmark, 1st review) that ensures sufficient data quality and will complete the full implementation of the SIS among class A banks and allow supervisors to rely

fully on the SIS reporting by November 2022 (structural benchmark, 2nd review). We will use SIS as a tool to enhance the efficiency of the supervisory framework, protecting the supervisory judgement in the process. We will improve off-site surveillance assisted by the information and analyses available through the SIS to provide better feedback to on-site inspections. At a second stage, we will aim to achieve the full implementation for class B and class C banks.

32. We remain committed to ensuring a stable and well-capitalized banking system that can support the recovery by effectively monitoring and supervising the health of the financial system. Enhanced monitoring and the updated regulatory framework will facilitate an accurate assessment of the health of the financial sector. To ensure effectiveness of the supervisory process, we stand ready to take relevant and timely enforcement actions where necessary. If any bank becomes undercapitalized, the NRB will use the set of relevant early intervention measures, including further suspension of dividend payments. Covid related support measures in the financial sector will be gradually unwound, and the remaining ones will be targeted and time-bound. We will ensure that banks' loan classification correctly reflects the asset quality of the banking system and regulatory forbearance measures will be gradually withdrawn. Once the acute phase of the pandemic is over, we will develop a strategy to continue strengthening financial sector regulation and supervision, with support from IMF technical assistance and a potential Financial Sector Stability Review (FSSR).

Governance and Other Reforms to Support the Business Environment

33. Recognizing that corruption can hurt growth, the government of Nepal has taken important steps to improve governance. We remain committed to strengthening governance and combatting corruption. We have ratified the United Nations Convention Against Corruption (UNCAC), established several anti-corruption bodies, and enacted anti-corruption related legislation. The Prevention of Corruption Act (PCA) is the country's main anti-corruption law. The Commission for the Investigation of Abuse of Authority (CIAA) is Nepal's constitutional body for corruption control. We are in the process of ensuring the PCA is fully in line with UNCAC and its implementation and enforcement are adequate.

34. We commit to ensure the transparency of COVID-related expenditures. We have achieved considerable progress in public financial management reforms in recent years. We have implemented the cash basis International Public Sector Accounting Standards and all expenditures are available online daily. The monthly aggregate expenditures of the COVID-19 Fund continue to be published on the FCGO website. To meet the commitment on the publication of budget expenditures related to COVID, we have published a comprehensive report that includes government spending related to the COVID-19 response on the MOFs website with the support of the Asian Development Bank. The report focuses on our response around three priority areas: health systems; social protection for the poor and vulnerable; and economic recovery for affected sectors. We will publish a further report by March 2022 (structural benchmark). We expect government expenditure on COVID to decline in FY2022/23 as the pandemic comes under control in Nepal and globally. With this background, we will continue to monitor and publish a streamlined set of information on the remaining budgetary expenditures related to COVID on a semi-annual basis. The

annual comprehensive audit of the Office of the Auditor General for FY2020/21 to be published in 2022 will cover all government spending. Further, we have issued a Public Information Notice (PIN) on the collection and publication of beneficial ownership information. Consistent with the published PIN, implementation agencies will publish on a government website large public procurement documentation, ex-post validation of delivery, the name of awarded companies, and the name of their beneficial owner(s) for all new, large, Covid-19 related procurement contracts (as of December 9 2021, prior action).

35. Strengthening the AML/CFT framework remains a priority. The Asia/Pacific Group on Money Laundering (APG) is to assess Nepal's compliance with the global AML/CFT standards through a mutual evaluation (peer review) program in 2022. We intend to make progress on the implementation of the AML/CFT framework. We recognize the importance of Nepal not being listed by the FATF as a country with strategic AML/CFT deficiencies and the potential impact that this could have on Nepal's correspondent banking relationships and access to the global financial network. We remain vigilant and stand ready to act upon any new or emerging AML/CFT risks, and will undertake further measures to strengthen governance and combat corruption as necessary

36. We will continue our effort to increase access to financial services and to develop financial markets, while maintaining financial stability. We will closely monitor the cooperative sector, including the cooperates' increasing role as financial services providers and their linkages to banks and financial institutions. Payment systems are an integral part of monetary policy implementation and capital market development. We will continue our effort to develop safe and efficient payment system infrastructure and practices with a special focus on the retail side and strengthen the legal and regulatory framework. We are implementing the Retail Payment Strategy, with support from the World Bank, to deepen digital retail payment system, promote the channeling of government and remittance payment to transaction accounts, increase financial literacy with targeted interventions towards women, and strengthen the legal and regulatory framework. Toward the development of capital markets, we will adopt a medium-term debt management strategy to build and maintain a functioning yield curve and upgrade the securities depository system. We believe these measures will be critical to supporting the development of the private sector.

D. Risks and Contingencies

37. The trajectory of the COVID-19 pandemic in Nepal and globally is extremely uncertain and will continue to weigh on the economic outlook. Until vaccines are widely distributed, it is likely that Nepal, like many other countries, will continue to experience health and economic disruptions from the impact of the COVID-19 pandemic. If Covid-19 developments were to deteriorate compared to our baseline, economic outcomes would worsen. There are also potential upside risks to growth if Covid-19 developments are more benign than assumed in the baseline.

38. We believe that Nepal's buffers—strong levels foreign exchange reserves and low risk of debt distress—can provide the needed policy space to address the pandemic in the near term with financing from development partners. However, if the pandemic further intensifies or

tail risks materialize leading to a financing shortfall, we commit to close the gap with additional expenditure compression of lower priority recurrent and capital expenditures and to seek additional financing from development partners.

E. Financing and Program Monitoring

39. We will continue to mobilize resources from international development partners to support our COVID-19 response, and the economic stabilization and recovery program. The government estimates that the financing needs for the FY2021/22-FY2024/25 program will be covered by assistance from the International Monetary Fund, the World Bank, the Asia Development Bank, and official bilateral creditors. We will work with our international development partners, especially the IMF and the World Bank, to successfully implement the reforms outlined above. IMF disbursements will be made available to the budget during the program period.

40. 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 describes the definitions as well as data provision requirements. The first two program reviews are scheduled to be completed in June 2022 and January 2023 (based on mid-January and mid-July 2022 test dates, respectively). Thereafter, the program will continue with monitoring on a semi-annual basis by the IMF Executive Board.

Table 1. Nepal: Proposed Structural Benchmarks, January 2022 to December 2022

Measure	Target Date	Macro-criticality
Cross-Cutting Institutional Reforms to enhance Fiscal Transparency, 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	Enhance fiscal transparency and governance and reduce vulnerability to corruption
The MOF publishes the federal government budget expenditures related to COVID on a government website.	1st Review (end-April 2022)	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 FY2020/21	1st Review (end-May 2022)	Improve cash management and fiscal transparency
An external audit of the NRB financial statements for FY2021/22 is commissioned, consistent with the recommendation in the 2021 Safeguards Assessment	1st Review (end-April 2022)	Strengthen NRB institutional framework, in support of NRB's policy mandates
The MOF submits to Parliament amendments to modernize the NRB Act, addressing key recommendations of the 2021 Safeguards Assessments Report	2nd Review (end-October 2022)	Strengthen NRB institutional framework, in support of NRB's policy mandates
Revenue mobilization		
The MOF publishes a report on tax exemptions related to customs	1st Review (end-April 2022)	Enhance fiscal transparency and lay the foundation for revenue mobilization
The MOF publishes a report on tax exemptions for all other non-customs related taxes	2nd Review (end-October 2022)	Enhance fiscal transparency and lay the foundation for revenue mobilization
Fiscal Sustainability and Fiscal Risk Management		
The MOF develops a fiscal risk register to capture various dimensions of major fiscal risks	2nd Review (end-October 2022)	Enhance fiscal sustainability by strengthening fiscal risk management
The MOF develops cash flow forecasting to be shared with the PDMO and NRB on a regular basis	2nd Review (end-October 2022)	Improve public debt and cash management, to improve debt transparency and risk management
Equitable and Sustainable Growth		
Cabinet 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)	2nd Review (end-October 2022)	Raise the quality of growth through more efficient of capital expenditures that support climate resilience
The National Planning Commission (NPC) issues a Poverty Reduction and Growth Strategy Paper	2nd Review (end-October 2022)	Promote equitable and sustainable growth
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	1st Review (end-April 2022)	Preserve financial stability
The NRB Board approves an action plan for the full implementation of the Supervisory Information System (SIS) for class A banks	1st Review (end-April 2022)	Strengthen financial sector supervision
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	1st Review (end-April 2022)	Strengthen financial sector regulation
The NRB issues the updated regulation on asset classification	2nd Review (end-October 2022)	Strengthen financial sector regulation
The NRB completes the full implementation of the SIS among the class A banks as per the action plan.	2nd Review (end-October 2022)	Strengthen financial sector supervision

Table 2. Nepal: Quantitative Performance Criteria and Indicative Targets, July 2021 to July 2022 1/

(NPR million unless otherwise indicated)

	FY2020/21	FY2021/22	
	Mid-Jul.2021	Mid-Jan.2022	Mid-Jul.2022
	Initial level	Program target	Program target
Quantitative performance criteria:			
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	212,611	..	..
Stock of NBR's net international reserves (floor; in U.S. dollars million) 1,8/	10,884	8,640	8,640
Accumulation of external payments arrears (ceiling) 2/	0	0	0
Indicative targets:			
Primary deficit of the federal government (ceiling; in NPR million) 1,3,4,6,7/	212,611	417,248	333,591
Indicative target: federal government spending on child allowance (floor; in NPR million) 5/	4,200	..	5,300
Memorandum items:			
Budget support from development partners (in U.S. dollars million) 1,3/	182.5	150	641
Projected revenues of the budgetary central government under the program 1,3/	827,012	278,030	926,767
Foreign-financed project loan disbursements 1,3/	129,883	19,482	129,883
Revenue targets of the budgetary central government 1,3/	889,618	475,757	1,050,821

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.

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 124,003 million for FY2021/22.

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

8/ The program targets for net international reserves include adjustors for budget support from development partners and for revenue collection. Any downward adjustment to the NIR floor will be capped at USD 1040 million for FY2021/22 to maintain reserve adequacy.

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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) during January 2022–March 2025. 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 119.19 per one USD, which corresponds to the exchange rate on November 3, 2021. Gold holdings will be valued at USD 1,777 per troy ounce, the price in September 2021 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 September 30, 2021 exchange rates reported in the Table 1:

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

Currency	Program Exchange Rate
U.S. dollars / Nepali rupee	0.008
U.S. dollars / U.K. pound	0.744
U.S. dollars / Indian rupee	0.013
U.S. dollars / Chinese Yuan	0.155
U.S. dollars / Euro	0.864
U.S. dollars / Japanese yen	0.009
U.S. dollars / Brunei dollar	0.735
U.S. dollars / Korean won	0.001
U.S. dollars / Kuwaiti dinar	3.315
U.S. dollars / Malaysian ringgit	0.239
U.S. dollars / Omani rial	2.601
U.S. dollars / Qatari riyal	0.275
U.S. dollars / Russian ruble	0.014
U.S. dollars / Saudi Arabian riyal	0.267
U.S. dollars / Thai baht	0.030
U.S. dollars / U.A.E. dirham	0.272
U.S. dollars / Singapore dollar	0.735
U.S. dollars / SDR	0.694

1/The reference date for Nepali Rupee is November 3, 2021.

B. Performance Criteria and Indicative Targets

2. The quantitative performance criteria and indicative targets for January and July 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

3. 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.

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

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

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

- *Revenue collection.* The program targets for NIR include adjustors for revenue collection, reflecting the strong link between the revenue base to remittances and other foreign exchange

flows. In case revenue collection is below the level projected under the program, the NIR target will be adjusted by the equivalent USD amount of the revenue adjustor to the primary deficit ceiling described in paragraph 10 below.

- *Cap on downward adjustment.* Any downward adjustment to the NIR floor for the conditions described in the two preceding bullets will be capped at USD 1040 million for FY2021/22.[1]

Table 2. Nepal: Budget Support from Development Partners Projected under the Program	
Date	**Cumulative over the Respective Fiscal Year (USD million)**
January 15, 2022	150
July 15, 2022	641

Indicative Target on the Primary Deficit of the Budgetary Central Government

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

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

Table 3. Nepal: Institution Coverage of Budgetary Central Government

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

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

- 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.

8. 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.

9. The program targets for the primary deficit include adjustors for revenue collection.

- *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 124,003 million for FY2021/22. This adjustor would prevent having to tighten fiscal policy under the program if the economy is weaker than projected.

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

- The level of revenues projected under the program and MOF revenue collection targets for the first 2 test dates are presented in Table 4.

Table 4. Nepal: Revenues of the Budgetary Central Government Projected under the Program and Revenue Collection Targets		
Date	**Revenues Projected under the Program, Cumulative over the Respective Fiscal Year (NPR million)**	**MOF Revenue Collection Targets, Cumulative over the Respective Fiscal Year (NPR million)**
January 15, 2022	278,030	475,757
July 15, 2022	926,767	1,050,821

10. 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. 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 first 2 test dates are presented in Table 5.

Table 5. Nepal: Foreign-Financed Project Loan Disbursements Projected under the Program	
Date	**Cumulative over the respective fiscal year (Million NPR)**
January 15, 2022	19,482
July 15, 2022	129,883

Indicative Target on Social Spending of the Budgetary Central Government

11. **The indicative target will initially 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 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.

Continuous Performance Criteria

12. **Continuous quantitative performance criteria apply 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 external debt service obligations (principal and interest) 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 external arrears that are subject to debt rescheduling agreements or negotiations.

13. **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

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

15. **In addition, the MOF and NRB will send to the IMF a quarterly report documenting progress with implementing structural benchmarks under the program**. These reports will include: relevant documentation such as draft legislation and implementation plans; explain any deviations from the initial reform timetable and remedial measures taken to minimize such deviations (if any); specify expected revised completion date; and details on major economic and

social measures taken by the government and expected to have an impact on program sequencing (such as changes in legislation, regulations, or any other pertinent information).

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

Table 6. Nepal: Data Reporting Requirements [1/]		
Data	**Frequency**	**Submission Lag[2/]**
Ministry of Finance		
Summary of budgetary central government accounts, including revenues (broken down by economic classification) and grants, expenditures (broken down by economic classification), and net acquisition of financial assets (broken down by loan investment and share investment) on a cash basis, consistent with the presentation in budget. The Financial Comptroller General Office (FCGO) monthly reports will be used as the basis for program monitoring.	M	30 calendar days
Summary of budgetary central government's net incurrence of liabilities (broken down by domestic borrowing disbursement and principal repayment, as well as external borrowing disbursement and principal repayment) consistent with the presentation in budget. The Public Debt Management Office (PDMO) monthly reports will be used as the basis for program monitoring.	Q	30 calendar days
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; using actual and program exchange rates. The PDMO quarterly reports will be used as the basis for program monitoring.	Q	45 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
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.	Q	30 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).	Q	30 calendar days
Data on the child grant program: (1) the amount budgeted, (2) the amount dispersed, (3) the number of recipients.	M	30 calendar days
The Annual Budget. The Budget speech (with annex) and MOF budget reports will be used as the basis for program monitoring.	A	30 calendar days[3/]
Mid-year budget review. The MOF Mid-year budget review reports will be used as the basis for program monitoring.	A	30 calendar days[4/]
Annual budget execution report. The FCGO annual reports will be used as the basis for program monitoring.	A	90 calendar days
National accounts data.	A, Q	90 calendar days

Table 6. Nepal: Data Reporting Requirements (continued)		
Data	**Frequency**	**Submission Lag**
Public Debt Management Office		
Stock of outstanding external debt payment arrears of the general government (if any) by creditor.	Q	30 calendar days
Amortization schedule for external debt payments, interest and amortization.	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 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
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
Central bank daily purchases and sales of foreign exchange by counterparts (commercial banks, government).	W	2 working days after the end of the week
Daily interbank turnover in the FX spot market.	W	15 working days

Table 6. Nepal: Data Reporting Requirements (concluded)

Data	Frequency	Submission Lag
Commercial bank-by-bank data: i) balance sheet by currency (foreign exchange and Nepali Rupee); ii) income statements; iii) breakdown of loan classification and provisioning levels for borrower types (corporate, commercial, retail, SMEs, etc.), product type (overdrafts, working capital loans, demand loans, etc.), economic sectors, and restructured loans; iv) loan write-offs; v) information on forborne loans (payback, reclassification and provisioning) by type of forbearance (deductions in interests, payment deferrals, restructuring of performing loans, restructuring of non-performing loans); vi) breakdown of deposits and net open positions; vii) FSI indicators (capital, asset quality, liquidity, earnings).	M	75 calendar days
Data on foreign currency loans and deposits. Commercial bank-by-bank data: i) breakdown of foreign currency loans for borrower types (corporate, commercial, retail, SMEs, etc.), product types (overdrafts, working capital loans, demand loans etc.), economic sectors, and restructured loans; ii) share of foreign currency deposits by deposit types (current, call, fixed, savings etc.).	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; 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.

INTERNATIONAL MONETARY FUND

NEPAL

December 22, 2021

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—DEBT SUSTAINABILITY ANALYSIS

Approved By
Anne-Marie Gulde-Wolf and Maria Gonzalez (IMF) and Marcello Estevão and Zoubida Allaoua (IDA)

Prepared by the staff 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	Not Applicable
Application of Judgment	Yes

Both external and overall debt in Nepal are assessed at low risk of debt distress..[1] Two external debt indicators, PV of PPG external debt-to-exports ratio and debt service-to-exports ratio, breach the indicative thresholds under three shock scenarios, suggesting a mechanical rating of moderate risk of debt distress. However, staff has applied judgement to assess Nepal's external debt to be at low risk of debt distress due to low ratios of PV of PPG external debt-to-GDP and PPG external debt service-to-revenue and unusually high remittance levels; the PV of public debt-to-GDP does not breach the benchmark under any stress test. Remittances, rather than exports, are the major source of foreign exchange to balance the current account and service external debt. Both external debt and public debt are projected to peak in FY2024/25, reflecting declining fiscal deficits and increasing reliance on domestic borrowing as Nepal's financing markets gradually deepen. These findings stress the importance of implementing reforms to increase the economy's resilience to external shocks through, for example, encouraging diversification, improving productivity and competitiveness, and enhancing monitoring of risks related to contingent liabilities.

[1] Nepal's debt carrying capacity remains strong. Nepal's composite indicator (CI) score is calculated at 3.18, based on the October 2021 World Economic Outlook (WEO) and the 2020 World Bank Country Policy and Institutional Assessment (CPIA) index.

PUBLIC DEBT COVERAGE

1. **The coverage of public debt in this analysis is broad.** Public debt includes general government debt, government guarantees, and central bank borrowing on behalf of the government, domestic and external (Text Table 1). Nepal's provincial and local governments have no debt. Their borrowing framework is under consideration and should be monitored carefully. The social security fund and extra budgetary funds currently are not allowed to borrow and thus do not have any outstanding debt. The Nepal Rastra Bank (NRB, Nepal's central bank) borrowed from the IMF through the Rapid Credit Facility and on-lent the funds (about US$50 million) to the government in 2015.[2] Bond issuances by the central bank are 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—totaling NPR 24 billion (0.6 percent of GDP)—is included in the debt stock. SOEs cannot borrow externally. On domestic borrowings by SOEs, the majority of the medium- and long-term loans are from the central government, and thus are already covered under central government debt. SOE liabilities not covered by public debt appear limited and the government is working to improve its debt statistics, including that of SOEs.[3]

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 central, state, and local governments plus central bank (borrowed on behalf of the government)		
		Default	Used for the analysis	Reasons for deviations from the default settings
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	2.0	
4	PPP	35 percent of PPP stock	2.9	
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)		9.9	

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%.

2. **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 (2.9 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

[2] The 2020 IMF disbursement of around US$214 million under the Rapid Credit Facility was used for direct budget support.

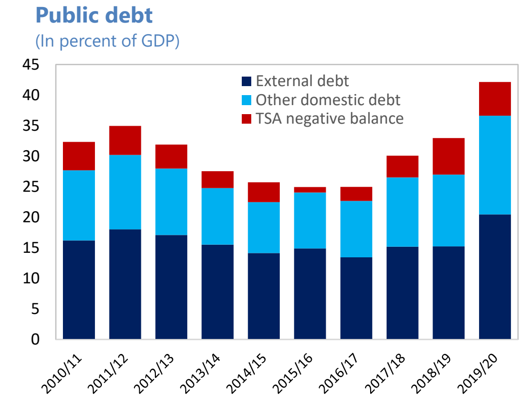
[3] Strengthening fiscal risk management through structural reforms remains critical, including through the development of a fiscal register to identify, disclose, and manage fiscal risks, including those emanating from SOEs and guarantees, drawing on Fund TA. Efforts are also bolstered by the establishment of the PDMO to consolidate public debt management functions, prepare a medium-term debt management strategy, and develop comprehensive debt bulletins.

estimated to account for 8.4 percent of GDP as of 2020. Already incorporated in the baseline debt figures is the Net Acquisition of Financial Assets (NAFA), likely representing loans and capital injections to SOEs from the government.[4] The NAFA has averaged around 1.3 percent of GDP annually in recent years and the program baseline assumes NAFA of this size will continue in the foreseeable future because winding down government support to SOEs will take time. The stress test on contingent liabilities from SOE debt is thus in addition to the NAFA assumed in the baseline.

BACKGROUND ON DEBT

3. **Nepal's total public debt has been increasing over recent years, particularly in FY2019/20 due to the COVID-19 pandemic (Text Figure 1).** Following a gradual decline from 35 percent of GDP in FY2011/12 to 25 percent in FY2016/17, and against the background of the country's transition to fiscal federalism, Nepal's public debt has risen over the last several years to 42.2 percent of GDP in FY2019/20. The substantial increase in FY2019/20 is driven by the impact of and responses to the COVID-19 pandemic.[5] Although Nepal's access to concessional financing has kept external debt servicing requirements low, total public debt service represented around 31 percent of fiscal revenues in FY20. Looking forward, new large-scale investments are expected to be financed in part through new borrowings. To the extent that debt finances capital expenditure, concerns about growing debt burdens negatively impacting growth may be mitigated.

Text Figure 1. Evolution of Public Debt



Sources: Nepal authorities and IMF staff estimates.

4. **Public debt includes negative balance of the Treasury Single Account (TSA).** 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. While there are positive cash balances in other bank accounts under the control of the Financial Comptroller General Office (FCGO) and the net balance across all government accounts was positive, those 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. The negative TSA balance has been rising over recent years and is estimated at 5.5 percent of GDP by the end of FY2019/20.

[4] Within the NAFA there is financing of SOEs to implement the authorities' development program, including financing to the Nepal Electricity Authority to increase electrification across the country and financing for airport construction to support tourism.

[5] The shift in debt levels for historical figures compared to the last LIC DSF reflects the GDP rebasing to FY2010/11 (from FY2000/01 previously) issued in March 2021 by the Central Bureau of Statistics.

5. **External public debt had been largely stable prior to COVID-19.** The external debt-to-GDP ratio declined from 18 percent of GDP in FY2011/12 to 14.2 percent in FY2014/15 and stayed relatively flat until FY2018/19. External public debt rose by about 5 percent of GDP in FY2019/20, partially reflecting development partner support for Nepal's COVID-19 response. The net present value (PV) of external debt is estimated at 12.5 percent of GDP in FY2019/20, due to the high degree of concessionality. Nepal's external debt was owed mainly to multilateral creditors (88 percent of all external debt), such as the World Bank's International Development Association (IDA) and the Asian Development Bank (ADB). Their loans had low interest rates (1 percent on average) and long maturities (around 25 years on average). For the bilateral loans, Japan was the largest bilateral creditor, followed by China, India, and Korea (Text Table 2).

Text Table 2. Nepal: External Public Debt, at end FY2019/20 1/

	In millions of US$s	In percent of GDP	In percent of external debt
Total external	6,723	20.5%	100%
Multilateral	5,930	18.1%	88%
ADB	2,243	6.8%	33%
IDA	3,341	10.2%	50%
Bilateral	793	2.4%	12%
Paris Club	358	1.1%	5%
Non-Paris Club	435	1.3%	6%

Sources: Nepalese authorities; and IMF staff estimates.
1/ Nepal's fiscal year starts in mid-July. For example, FY2019/20 covers mid-July 2019 to mid-July 2020.

6. **Domestic public debt has been increasing more rapidly in recent years.** Domestic public debt rose from 10.1 percent of GDP in FY2015/16 to 21.7 percent in FY2019/20. About one-quarter of domestic debt is in short-term treasury bills with a maturity of up to 1 year (28-days, 91-days, 182-days, and 364-days) and is held mainly by domestic financial institutions. Close to half of domestic debt is in medium- to long-term development bonds with maturities of 3-15 years and interest rates of 3-6.5 percent per annum (Text Table 3). The negative TSA balance accounts for about one-quarter of total domestic debt in FY2019/20. All domestic public debt was held by residents, so the analysis is currency-based.

Text Table 3. Nepal: Public Domestic Debt, at end FY2019/20 1/

	In billions of Nepalese rupees	In percent of GDP	In percent of domestic debt
Total domestic	849	21.7%	100%
Treasury bills	210	5.4%	25%
Treasury bonds	398	10.2%	47%
Development bonds	390	10.0%	46%
Others	8	0.2%	1%
TSA negative balance	217	5.5%	26%
Government guarantees	24	0.6%	3%

Sources: Nepalese authorities; and IMF staff estimates.
1/ Nepal's fiscal year starts in mid-July. For example, FY2019/20 covers mid-July 2019 to mid-July 2020.

7. **The stock of private external debt in Nepal has not been published by the authorities, but it is estimated to be very small.** While the government and the NRB are encouraging commercial banks to access external loans to alleviate Balance of Payments (BOP) pressures, bank external borrowing has been constrained by limited access and high relative cost. Regulations by the authorities—such as imposing a maximum spread limit on banks' foreign loans—hamper banks' ability to borrow overseas. So far, there has been very little foreign borrowing by the non-public

sector. Reflecting recent government efforts to encourage foreign loans, private external debt is assumed to increase to 1 percent of GDP in the long term.[6]

BACKGROUND ON MACRO FORECASTS

8. **While Nepal has achieved respectable growth in the past, the country has been hard hit by the COVID pandemic and is facing significant challenges going forward.** Ongoing disruptions from the pandemic are compounded by structural constraints such as slow domestic job creation, vulnerability to natural disasters including those caused by climate change and environmental degradation, and large infrastructure gaps. Nepal needs to invest in education and health and to strengthen its social protection system, while recognizing the intertemporal tradeoff[7]. Reforms to improving the business climate and reducing product and labor market frictions would also help improve Nepal's competitiveness.[8] These reforms would also strengthen the country's aspiration to reach middle-income country status by 2030[9].

9. **The proposed Extended Credit Facility (ECF) is designed to support Nepal's COVID responses and post-COVID recovery in the near term and to pave the way for sustained growth and poverty reduction over the medium term.** The ECF and financing from other development partners, particularly the World Bank and the ADB, will help fill the external and fiscal financing gaps that have emerged due to the pandemic. The ECF in its early part would accommodate spending to address health needs, support the economy, and protect the most vulnerable. Fiscal deficits would gradually decline once the health crisis wanes, helping to stabilize public debt, while creating fiscal space for public investment in education, health, and infrastructure and for strengthening social safety net. The program also supports a comprehensive fiscal structural reform agenda, particularly in the areas of revenue mobilization and public financing management. The program follows a carefully sequenced strategy to further strengthen financial sector regulation and supervision.

10. **Growth and inflation**: Growth had been strong prior to the COVID-19 pandemic, due to strong performances in agriculture, reconstruction activities, and tourism (Text Table 4). Real GDP growth reached 6.7 percent in FY2018/19. With the COVID-19 shock, growth fell to -2.1 percent in FY2019/20, as tourist arrivals collapsed, and domestic activities declined substantially due to containment measures. The economy is expected to gradually recover—at 2.7 percent in

[6] Private external borrowings were estimated at about 0.1 percent of GDP at mid-July 2019, and given the current regulations, the scope for further increase will likely be limited.

[7] Less borrowing today would mean fewer resources available toady for priority areas such as education, health, and infrastructure, but at the same time would help lower interest spending in the future, creating more room for priority spending.

[8] See page 10 of WB Nepal Country Economic Memorandum for a discussion of the impact of migration and remittances on competitiveness.

[9] World Bank Country and Lending Groups – World Bank Data Help Desk

FY2020/21—and eventually stabilize at around 5 percent over the mid- to long-term. The FY2020/21 growth forecast assumes a modest rebound as containment measures have been lifted and various economic sectors, other than tourism, gradually recover. While vaccination efforts have started, and vaccines are expected to be widely available only in the first half of FY2022/23, further supporting the recovery. The inflation rate rose from 4.6 percent y/y in FY2018/19 to 6.1 percent in FY2019/20 owing to a surge in food prices. Inflation is estimated at 3.6 percent in 2020/21 and is expected to rise to 5.7 percent in FY2021/22 and peak at 5.8 percent in 2022/23 before gradually moderating to around 5.3 percent in FY2025/26.

Text Table 4. Nepal: Selected Macroeconomic Assumptions 1/

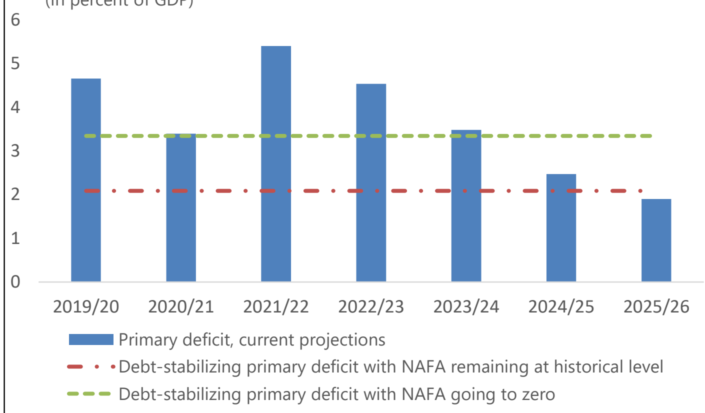
	Previous DSA 2/				Current DSA				Current vs. Previous	
	2019/20	**2020/21**	**MT**	**LT**	**19/20**	**20/21**	**MT**	**LT**	**MT**	**LT**
Real growth (%)	1.0	3.5	5.2	5.2	-2.1	2.7	5.3	5.1	0.1	-0.1
CPI (period average, %)	6.7	6.5	5.3	5.0	6.1	3.6	5.6	5.0	0.3	0.0
Revenues and grants (% GDP)	24.0	25.2	25.2	25.1	22.1	24.2	26.3	27.0	1.1	1.9
Grants (% GDP)	1.2	1.5	1.4	1.2	0.6	0.7	0.9	0.7	-0.5	-0.5
Primary expenditure (% GDP)	30.6	31.0	28.9	27.7	26.8	27.6	29.7	29.0	0.7	1.2
Net acquisition of non-financial assets (% GDP)	6.1	7.0	6.7	6.0	4.8	5.5	6.1	5.8	-0.6	-0.2
Primary balance (% GDP)	-6.6	-5.8	-3.8	-2.6	-4.7	-3.4	-3.4	-1.9	0.4	0.7
Net incurrence of liabilities (% GDP)	8.8	7.5	5.6	4.8	6.5	7.6	5.7	4.4	0.0	-0.5
Net domestic financing (% GDP)	5.2	5.9	4.2	3.8	4.1	4.5	3.5	3.0	-0.7	-0.8
Exports of G&S (y/y growth)	-7.0	7.8	10.7	8.7	-13.7	-17.5	19.6	9.2	8.9	0.5
Imports of G&S (y/y growth)	-12.3	7.6	5.9	6.6	-19.0	22.0	5.1	6.7	-0.8	0.1
Remittances (y/y growth)	-22.6	9.3	6.3	5.1	-3.0	8.2	3.9	7.7	-2.4	2.6
Current account balance (% GDP)	-7.6	-7.1	-5.3	-4.2	-1.0	-8.2	-5.4	0.3	-0.1	4.5

Note: MT (medium term) is the average over the next 5 years, and LT (long term) is the average over the following 7-20 years.
Sources: Nepalese authorities; and IMF staff estimates
1/ Nepal's fiscal year starts in mid-July. For example, FY2019/20 runs from mid-July 2019 to mid-July 2020.
2/ Previous DSA refers to RCF Request IMF CR 20/155.

11. **The outlook for growth and inflation is subject to high uncertainty**. The depth and duration of the pandemic, as well as the associated disruption to the supply chain, are the main risks to the outlook. Should the pandemic intensify more than expected through the program period (including because of new variants and uncertainty regarding the widespread availability of COVID-19 vaccines), it will weaken recovery prospects in major economic partners, and create disruptions to Nepal's domestic activity, remittances, and tourism. Rising vulnerabilities in the banking system generate additional risks, and global responses to rising inflation also weigh on the outlook.

12. **Fiscal**: The overall fiscal deficit of the central government in FY2019/20 was 5.3 percent of GDP, similar to that in FY2018/19. The deficit in 2020/21 is estimated at 4.2 percent of GDP, reflecting surprisingly strong revenue collection and a moderate spending increase from the previous year. However, spending is projected to increase substantially in FY2021/22 as the economy recovers, widening the overall deficit to 6.3 percent of GDP. The deficit will gradually decline over the medium term, with primary deficit decreasing from 5.4 percent of GDP in FY2021/22 to 3.5 percent of GDP (overall deficit of 4.5 percent) in FY2023/24 and stabilize at around 2 percent of GDP from FY2025/26 onwards (Text Figure 2). The improvements in fiscal balances are driven by continued revenue mobilization efforts by the government, tapering of Covid-19 related

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

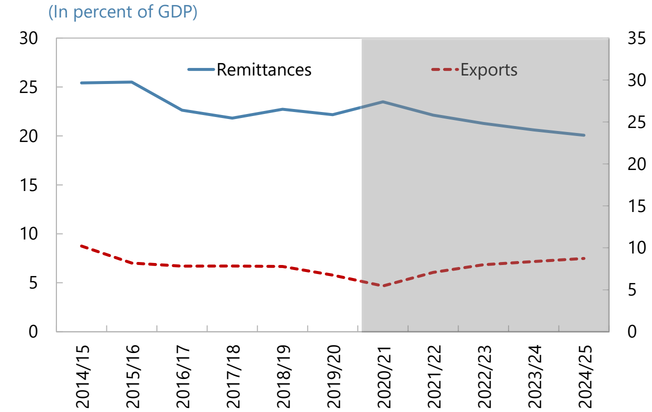


Source: IMF staff estimates.

expenditure, and less duplication of spending responsibilities across levels of government. While the debt dynamics of existing debt stock and the fiscal path suggest a debt-stabilizing primary deficit of around 3.3 percent of GDP, the continuation of the sizeable NAFA would lead to a much lower level of about 2.1 percent. As a result, the proposed fiscal path is expected to stabilize public debt even when the NAFA is assumed to remain in place. This likely represents a conservative scenario, as the authorities are expected to take steps to improve SOE operations over the medium- and long-term and the public debt outlook would improve relative to the program baseline.[10]

13. External sector: The current account deficit was high at 6.9 percent of GDP in FY2018/19 but narrowed considerably in FY2019/20 to around 1 percent of GDP, driven primarily by a reduction in imports from 36.2 percent of GDP to 29.8 percent (Text Figure 3). Remittances also declined slightly, from 22.7 percent of GDP to 22.2 percent. Large inflows, mainly official loans and trade credits, alongside a still significant positive net errors and omissions (1.7 percent of GDP), more than financed the current account deficit and led to an increase in gross official reserves from US$8.5 billion at the end of FY2018/19 to US$10.6 billion at the end of FY2019/20. The current account deficit is estimated to have deteriorated to 8.2 percent of GDP in FY2020/21, reflecting primarily a substantial increase in imports (by 6.9 percent of GDP) and only a moderate increase in remittances (by 1.3 percent of GDP). The overall BOP deficit is estimated at -0.1 percent of GDP and reserves at US$10.9 billion for FY2020/21. The current account is projected to improve gradually through FY2025/26. Exports as a share of GDP are expected to gradually recover to their pre-COVID level by FY2022/23 (around 8 percent of GDP). Even as 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— they will remain sizeable at about 20 percent of GDP over the medium- and long-term.[11]

Text Figure 3. Remittances and Exports
(In percent of GDP)



Sources: Nepali authorities and IMF staff estimates.

[10] Subnational government are not expected to have any borrowings except from the central government.

[11] Remittances in the first eight months of FY2020/21 have held up, though volatile. Several factors have affected the performance of remittances, including the repatriation of savings by returning migrants, an increase in amounts

(continued)

14. Financing: In the near term, the large BOP and fiscal financing needs are expected to be filled by concessional loans from development partners, mainly multilateral development banks, as well as from debt service relief through the Catastrophe Containment and Relief Trust (CCRT) and the G20 Debt Service Suspension Initiative (DSSI).[12] Over the longer term, as Nepal gradually deepens its financial markets, it is assumed that a larger share of its fiscal financing needs will be met by domestic borrowings (Table 2).

15. Realism of baseline (Figure 4): The overall fiscal deficit is estimated to be 4.2 percent of GDP in FY2020/21 and is projected to then widen to 6.3 percent of GDP by FY2021/22. Under various assumptions on fiscal multipliers, growth would be lower than in the baseline scenario. The deviation of the growth projection from what is implied by the fiscal multipliers can be explained by the fact that growth in FY2020/21 and FY2021/22 to a large extent reflects the gradual normalization of economic activities from COVID-19 as well as a large base effect from the sharp contraction in FY2019/20. Finally, on the contribution of public capital to GDP growth, the difference between the baseline projection and historical experiences to a large extent reflects the GDP rebasing and the revised investment classifications in the national account.

COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

16. 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 captures the impacts of the different factors through 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 world 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 3.18, based on the October 2021 World Economic Outlook and the 2020 World Bank CPIA index, which lies in a range of a *strong* rating (Text Table 5).

17. Tailored stress tests: The revised LIC-DSF includes stress tests to assess the sensitivity of projected debt burden indicators to changes in assumptions. In this analysis, all stress tests were kept at their default settings (historical average minus one standard deviation, or the baseline projection minus one standard deviation, whichever is lower). In addition, to reflect Nepal's vulnerability to natural disasters, such as the 2015 earthquakes, 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

remitted, and greater formalization of remittance flows. In the near-term, the baseline scenario incorporates a conservative assumption that these factors are temporary, and remittances will remain subdued. In the medium term, remittances are projected to moderate as a share of GDP as large infrastructure projects in migrant-hosting countries are completed (e.g., the Dubai Expo 2020, Qatar World Cup 2022). If remittances overperform, it would strengthen Nepal's international reserve position.

[12] Nepal received CCRT debt relief of SDR2.9 million in FY2019/20 and SDR7.13 million in FY2020/21. The debt service suspension under the DSSI is projected at around US$32.5 million in FY2020/21.

in the second year of the projection period (FY2021/22) 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

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 vintages
Strong	Strong	Strong	Strong
	3.18	3.18	3.15

Calculation of the CI Index

Components	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.403	1.31	41%
Real growth rate (in percent)	2.719	4.466	0.12	4%
Import coverage of reserves (in percent)	4.052	56.689	2.30	72%
Import coverage of reserves^2 (in percent)	-3.990	32.136	-1.28	-40%
Remittances (in percent)	2.022	15.494	0.31	10%
World economic growth (in percent)	13.520	3.137	0.42	13%
CI Score			3.18	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 benchmark	
PV of total public debt in percent of GDP	70

Cut-off Values of the CI

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

EXTERNAL DEBT SUSTAINABILITY

18. **All external debt indicators point to low risk of debt distress under the baseline (Figure 1, Table 1, Table 3).** Under the baseline scenario, the PV of PPG external debt-to-exports ratio is projected at 254 percent in the first year—LIC-DSF allows to discount this one-off breach of

the PV of PPG external debt-to-exports ratio (240 percent)—and declines to 122 percent in FY2039/2040. Other indicators (PV of external debt-to-GDP ratio, debt service-to-exports ratio, and debt service-to-revenue ratio) are all well below the respective thresholds.

19. External debt is most vulnerable to shocks to exports. The PV of PPG external debt-to-exports ratio breaches the threshold in two of the shock scenarios. This includes the shock to exports and the combined shock (to real GDP growth, primary balance, export, other flows, and depreciation).

OVERALL RISK OF PUBLIC DEBT DISTRESS

20. Under the baseline scenario, public debt in PV terms as a share of GDP remains firmly below the 70 percent benchmark during the projection period (Figure 2, Table 2, Table 4). Public debt is projected to gradually increase from 42.2 percent of GDP at the end of FY2019/20, to peak at 55.3 percent in FY2024/25 under the baseline scenario. The PV of the debt-to-GDP ratio is expected to increase from 34.6 percent of GDP in FY2019/20 to peak at 44.6 percent in FY2025/26, which is well below the 70 percent benchmark.

21. 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 10-year historical average growth minus one standard deviation or projected growth minus one standard deviation, whichever is lower. The shock would raise PV of debt-to-GDP ratio close to the threshold of 70 percent over a number of years. The PV of debt-to-revenue ratio and debt service-to-revenue ratio also rise significantly under such a shock. Under all other shock scenarios, the PV of debt-to-GDP ratio remains well below the indicative thresholds.

RISK RATINGS AND VULNERABILITIES

22. The risk of both public external debt distress and overall debt distress are assessed as low. All debt indicators remain below thresholds/benchmarks under the baseline except for the PV of external debt-to-exports, which shows a short-lived breach that is to be discounted from the analysis. The PV of public debt remains below its benchmark under all stress tests. Two indicators for external debt (PV of external debt-to-exports ratio and debt service-to-exports ratio) breach the indicative thresholds under three shock scenarios. However, staff judge the risk of external and public debt distress to be low, given that remittances, rather than exports, are the major source of foreign exchange to balance the current account and service external debt.[13] More specifically, (i) remittances (averaged 22.2 percent of GDP during 2016-2025) dwarf exports (7.6 percent of GDP) as the main source of foreign exchange for Nepal, but are only captured to a limited extent by the LIC DSF; (ii) the PV of PPG external debt is 13.6 percent of GDP in FY2020/21, well below the indicative

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

threshold; and (iii) external debt is well below thresholds in baseline and shock scenarios across all other metrics (e.g., external debt service/revenues, external debt service/exports). Nevertheless, uncertainty in unwinding rolling back pandemic related forbearance measures and climate related shocks pose a risk on the assessment of low risk of debt distress

23. **While Nepal's debt remains sustainable, a number of steps could be taken to mitigate any potential risks.** Both external debt and public debt are projected to peak in FY2024/25, reflecting declining fiscal deficits and increasing reliance on domestic borrowing as Nepal's financing markets gradually deepen. To build up Nepal's resilience to shocks, the Nepalese authorities should continue to make efforts to improve productivity and competitiveness through stepping up quality investment in infrastructure, as well as streamlining regulations and administrative processes. It is also important to pursue rigorous analysis of the risks related to contingent liabilities, for example, related to non-guaranteed commercial SOE debt, PPP projects, and budget support for the financial sector. Closing the data gap by compiling PPP projects and private sector external debt would help improve debt sustainability analysis and monitor related risks. The authorities will also need to make significant progress in implementing a medium-term debt strategy and developing the government bond market to facilitate greater domestic financing. Finally, improvements are needed in subnational governments' public financial management and reporting, along with the implementation of a prudent framework for subnational borrowing.

AUTHORITIES' VIEWS

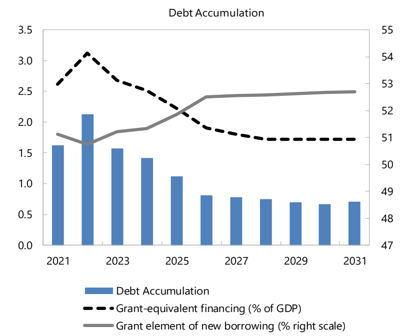
24. **The authorities broadly agreed with the assessment of the DSA**. They underscored that the government's effective management of public finances in past years reduced public debt risk, providing fiscal room to maneuver when the COVID shock hit. The authorities stressed that, with the establishment of Public Debt Management Office (PDMO) in FY 2018/19, significant progress has been made in public debt statistics, public debt management and fiscal risk management. The authorities argued against the inclusion of the negative TSA balance as part of domestic public debt, on the grounds that the government also has offsetting positive balances in its many other accounts with the NRB and the net balance across all government accounts is positive. A working group with representatives of the MOF, PDMO and NRB has been formed to look at the issue.

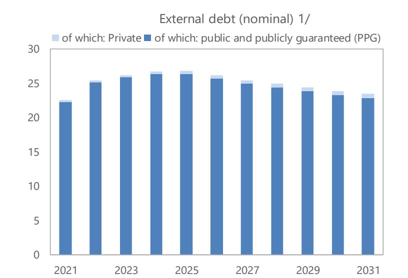
Table 1. Nepal: External Debt Sustainability Framework, Baseline Scenario, 2020-2040

(In percent of GDP, unless otherwise indicated)

	Actual 9/	Projections								Average 8/	
	2020	2021	2022	2023	2024	2025	2026	2031	2040	Historical	Projections
External debt (nominal) 1/	20.7	22.5	25.4	26.1	26.7	26.8	26.2	23.4	22.1	16.4	25.1
of which: public and publicly guaranteed (PPG)	20.5	22.3	25.2	25.8	26.3	26.4	25.7	22.8	21.1	16.3	24.6
Change in external debt	5.3	1.8	2.9	0.7	0.6	0.1	-0.6	-0.4	0.0		
Identified net debt-creating flows	0.6	7.2	7.8	4.3	3.1	2.1	1.5	-1.9	-2.8	-1.7	1.7
Non-interest current account deficit	0.9	8.0	8.9	6.0	4.7	3.9	3.4	-0.1	-1.1	-0.6	3.4
Deficit in balance of goods and services	27.1	35.0	34.9	31.4	29.5	28.1	26.7	23.2	18.2	26.5	27.7
Exports	6.7	5.4	7.1	8.0	8.4	8.7	9.0	9.5	9.8		
Imports	33.8	40.4	41.9	39.4	37.8	36.8	35.7	32.7	28.0		
Net current transfers (negative = inflow)	-24.9	-26.2	-25.1	-24.4	-23.7	-23.1	-22.1	-22.1	-22.0	-26.0	-23.2
of which: official	-0.6	-0.6	-0.9	-1.0	-1.0	-0.9	-0.7	-0.6	-0.7		
Other current account flows (negative = net inflow)	-1.3	-0.8	-0.9	-1.1	-1.1	-1.0	-1.2	-1.2	2.7	-1.1	-1.1
Net FDI (negative = inflow)	-0.5	-0.5	-0.3	-0.4	-0.5	-0.8	-0.8	-0.9	-0.9	-0.4	-0.7
Endogenous debt dynamics 2/	0.2	-0.3	-0.7	-1.3	-1.1	-1.0	-1.1	-0.9	-0.8		
Contribution from nominal interest rate	0.1	0.2	0.2	0.2	0.2	0.2	0.1	0.2	0.2		
Contribution from real GDP growth	0.3	-0.5	-0.9	-1.5	-1.3	-1.3	-1.3	-1.1	-1.0		
Contribution from price and exchange rate changes	-0.2	...	...	...	...	...	...	...	...		
Residual 3/	4.7	-5.3	-4.9	-3.6	-2.5	-2.0	-2.1	1.5	2.8	2.0	-1.5
of which: exceptional financing	-2.2	-0.6	-1.7	-0.9	-0.6	-0.4	0.0	0.0	0.0		
Sustainability indicators											
PV of PPG external debt-to-GDP ratio	12.5	13.8	14.9	15.1	15.3	15.3	15.0	13.1	12.0		
PV of PPG external debt-to-exports ratio	185.6	254.1	210.7	189.4	183.5	175.5	166.9	138.5	122.4		
PPG debt service-to-exports ratio	10.0	15.0	11.8	10.8	10.3	9.8	9.4	8.9	6.3		
PPG debt service-to-revenue ratio	3.1	3.5	3.5	3.5	3.4	3.3	3.2	3.2	2.3		
Gross external financing need (Million of U.S. dollars)	402.5	2959.1	3582.4	2724.1	2339.9	2041.0	1949.9	340.3	-615.9		
Key macroeconomic assumptions											
Real GDP growth (in percent)	-2.1	2.7	4.4	6.3	5.4	5.1	5.1	5.1	5.1	4.4	5.0
GDP deflator in US dollar terms (change in percent)	1.5	-0.6	2.7	2.3	2.4	2.2	2.1	2.5	2.5	0.8	2.2
Effective interest rate (percent) 4/	0.8	1.0	0.9	0.9	0.9	0.9	0.6	1.0	1.1	0.9	0.9
Growth of exports of G&S (US dollar terms, in percent)	-13.7	-17.5	39.1	22.9	12.9	12.2	10.7	10.1	8.6	4.7	11.4
Growth of imports of G&S (US dollar terms, in percent)	-19.0	22.0	11.3	2.2	3.5	4.6	4.0	7.5	7.4	7.9	7.1
Grant element of new public sector borrowing (in percent)	...	51.1	50.7	51.2	51.3	51.9	52.5	52.7	52.9	...	52.0
Government revenues (excluding grants, in percent of GDP)	21.5	23.5	23.8	24.6	25.4	26.1	26.2	26.3	26.5	17.7	25.6
Aid flows (in Million of US dollars) 5/	205.9	903.1	1109.6	1056.7	1072.9	1032.3	966.3	1270.7	2492.9		
Grant-equivalent financing (in percent of GDP) 6/	...	2.6	3.1	2.7	2.5	2.2	1.9	1.7	1.7	...	2.2
Grant-equivalent financing (in percent of external financing) 6/	...	59.3	59.0	62.3	63.1	65.2	68.3	66.1	66.3	...	64.4
Nominal GDP (Million of US dollars)	33983.4	34692.3	37207.9	40466.8	43678.4	46922.3	50376.2	73607.9	144326.2		
Nominal dollar GDP growth	-0.6	2.1	7.3	8.8	7.9	7.4	7.4	7.8	7.8	5.3	7.3
Memorandum items:											
PV of external debt 7/	12.7	14.1	15.2	15.4	15.7	15.7	15.5	13.8	13.0		
In percent of exports	188.3	258.2	214.4	193.3	187.6	180.0	171.7	145.1	132.6		
Total external debt service-to-exports ratio	12.1	18.6	15.0	14.1	13.9	13.7	13.7	15.1	15.9		
PV of PPG external debt (in Million of US dollars)	4252.9	4803.7	5541.1	6126.0	6699.7	7189.6	7567.2	9678.5	17352.4		
(PVt-PVt-1)/GDPt-1 (in percent)		1.6	2.1	1.6	1.4	1.1	0.8	0.7	0.9		
Non-interest current account deficit that stabilizes debt ratio	-4.4	6.1	6.0	5.3	4.2	3.9	4.0	0.3	-1.1		

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





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.
2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.
3/ Includes exceptional financing (ie. changes in arrears and debt relief including CCRT and DSSI); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes. The residuals in this table are mainly related to reserve drawdown and 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.
9/ Fiscal year. For example, year 2020 means FY2019/20 (mid-July 2019 to mid-July 2020).

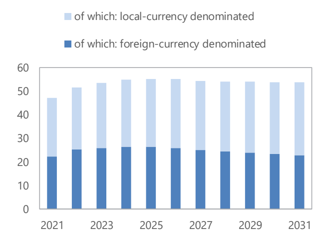
Table 2. Nepal: Public Sector Debt Sustainability Framework, Baseline Scenario, 2020-2040

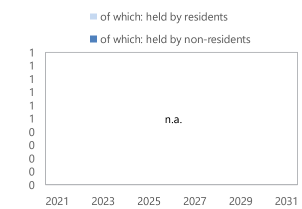
(In percent of GDP, unless otherwise indicated)

	Actual 7/	Projections								Average 8/	
	2020	2021	2022	2023	2024	2025	2026	2031	2040	Historical	Projections
Public sector debt 1/	**42.2**	**47.2**	**51.6**	**53.6**	**54.9**	**55.3**	**55.0**	**53.8**	**53.2**	**31.1**	**53.4**
of which: external debt	**20.5**	**22.3**	**25.2**	**25.8**	**26.3**	**26.4**	**25.7**	**22.8**	**21.1**	**16.3**	**24.6**
Change in public sector debt	9.2	5.0	4.4	2.0	1.3	0.4	-0.2	-0.1	-0.3		
Identified debt-creating flows	**8.0**	**5.3**	**3.9**	**2.0**	**1.3**	**0.4**	**-0.2**	**0.0**	**-0.2**	**1.2**	**1.1**
Primary deficit	**4.7**	**3.4**	**5.4**	**4.5**	**3.5**	**2.5**	**1.9**	**2.0**	**1.7**	**1.0**	**2.8**
Revenue and grants	22.1	24.2	24.7	25.6	26.4	27.0	27.1	27.0	27.3	**19.2**	**26.4**
of which: grants	0.6	0.7	0.9	1.0	1.0	0.9	0.9	0.7	0.7		
Primary (noninterest) expenditure	26.8	27.6	30.1	30.1	29.9	29.5	29.0	29.0	29.0	**20.3**	**29.2**
Automatic debt dynamics	**1.5**	**-1.4**	**-2.8**	**-3.8**	**-3.4**	**-3.3**	**-3.4**	**-3.3**	**-3.2**		
Contribution from interest rate/growth differential	0.4	-1.4	-2.8	-3.8	-3.4	-3.3	-3.4	-3.3	-3.2		
of which: contribution from average real interest rate	-0.3	-0.3	-0.8	-0.7	-0.7	-0.6	-0.7	-0.6	-0.6		
of which: contribution from real GDP growth	0.7	-1.1	-2.0	-3.1	-2.8	-2.7	-2.7	-2.6	-2.6		
Contribution from real exchange rate depreciation	1.0	...	...	...	...	...	...	...	...		
Other identified debt-creating flows	**1.9**	**3.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.3**	**1.4**
Privatization receipts (negative)	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		
Debt relief (HIPC and other) 2/	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)	1.9	3.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3		
Residual	**1.1**	**-0.3**	**0.5**	**0.0**	**0.0**	**0.0**	**0.0**	**-0.1**	**-0.1**	**-0.2**	**0.0**
Sustainability indicators											
PV of public debt-to-GDP ratio 3/	**34.6**	**38.7**	**41.6**	**43.2**	**44.1**	**44.5**	**44.6**	**44.4**	**44.4**		
PV of public debt-to-revenue and grants ratio	**156.7**	**159.4**	**168.6**	**168.6**	**167.4**	**164.6**	**164.4**	**164.4**	**162.8**		
Debt service-to-revenue and grants ratio 4/	**31.2**	**27.9**	**23.2**	**24.0**	**30.0**	**33.2**	**32.4**	**37.2**	**39.7**		
Gross financing need 5/	13.5	13.5	12.4	12.0	12.7	12.7	12.0	13.3	13.8		
Key macroeconomic and fiscal assumptions											
Real GDP growth (in percent)	-2.1	2.7	4.4	6.3	5.4	5.1	5.1	5.1	5.1	**4.4**	**5.0**
Average nominal interest rate on external debt (in percent)	0.8	1.0	0.9	0.9	0.9	0.9	0.5	0.9	0.9	**0.9**	**0.8**
Average real interest rate on domestic debt (in percent)	-0.7	-0.5	-2.3	-1.8	-1.5	-1.3	-1.2	-1.3	-1.1	**-2.8**	**-1.5**
Real exchange rate depreciation (in percent, + indicates depreciation)	6.8	...	...	...	...	...	...	...	...	**1.8**	**...**
Inflation rate (GDP deflator, in percent)	3.6	3.6	5.7	5.8	5.6	5.5	5.3	5.8	5.8	**6.1**	**5.5**
Growth of real primary spending (deflated by GDP deflator, in percent)	-2.2	6.1	13.6	6.5	4.4	3.9	3.4	5.1	5.1	**11.6**	**5.8**
Primary deficit that stabilizes the debt-to-GDP ratio 6/	-4.5	-1.6	1.0	2.5	2.2	2.0	2.1	2.1	2.0	**-0.9**	**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		

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

Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The central, state, and local governments plus central bank (borrowed on behalf of the government). Definition of external debt is Currency-based.

2/ CCRT is already included in primary balance and thus not show separately here.

3/ 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.

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

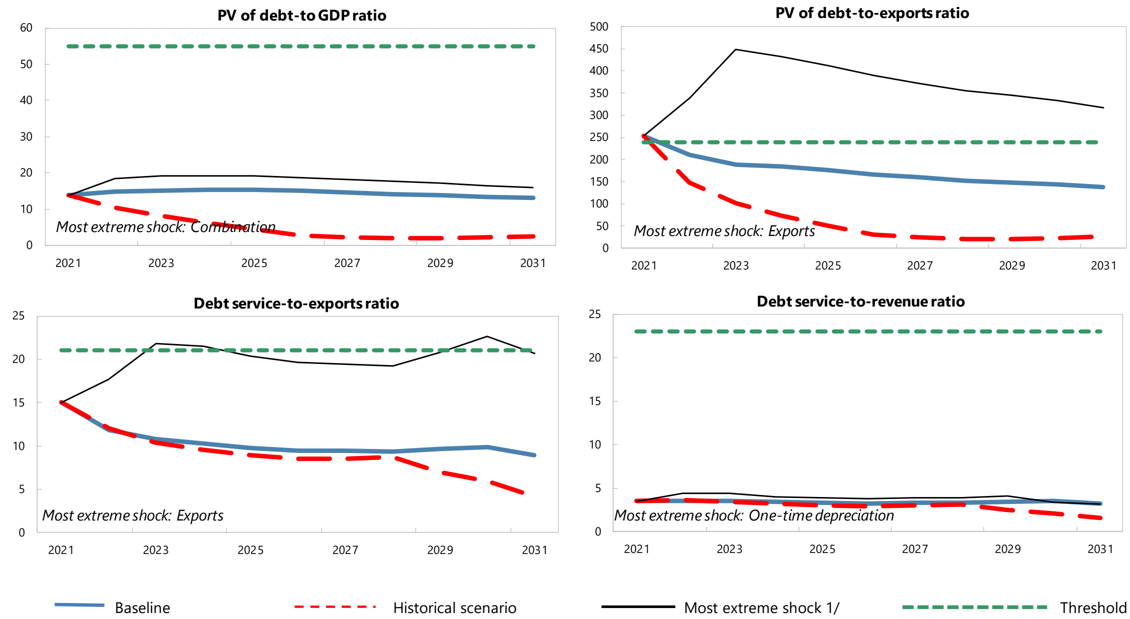
5/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

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

7/ Fiscal year. For example, year 2020 means FY2019/20 (mid-July 2019 to mid-July 2020).

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.

Figure 1. Nepal: Indicators of Public and Publicly Guaranteed External Debt under Alternatives Scenarios, 2021-2031



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.

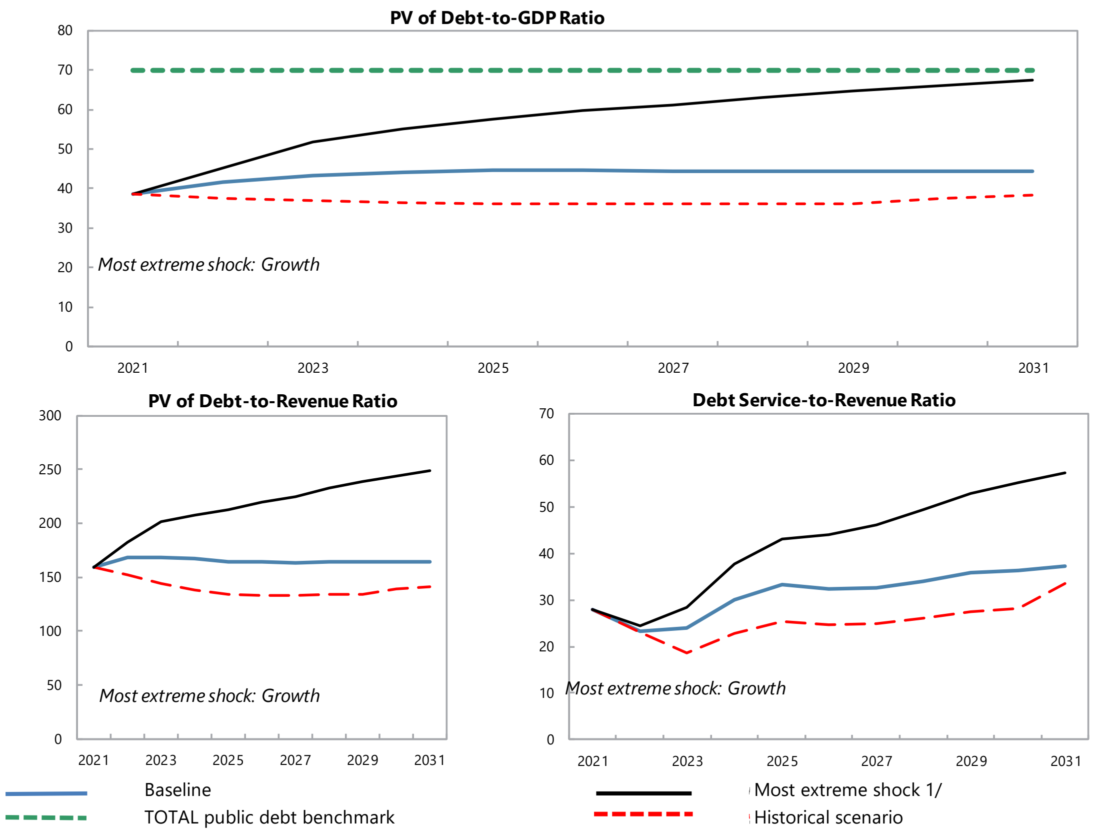
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	0.8%	0.8%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	6	6

* 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.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. 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 Alternative Scenarios, 2021-2031



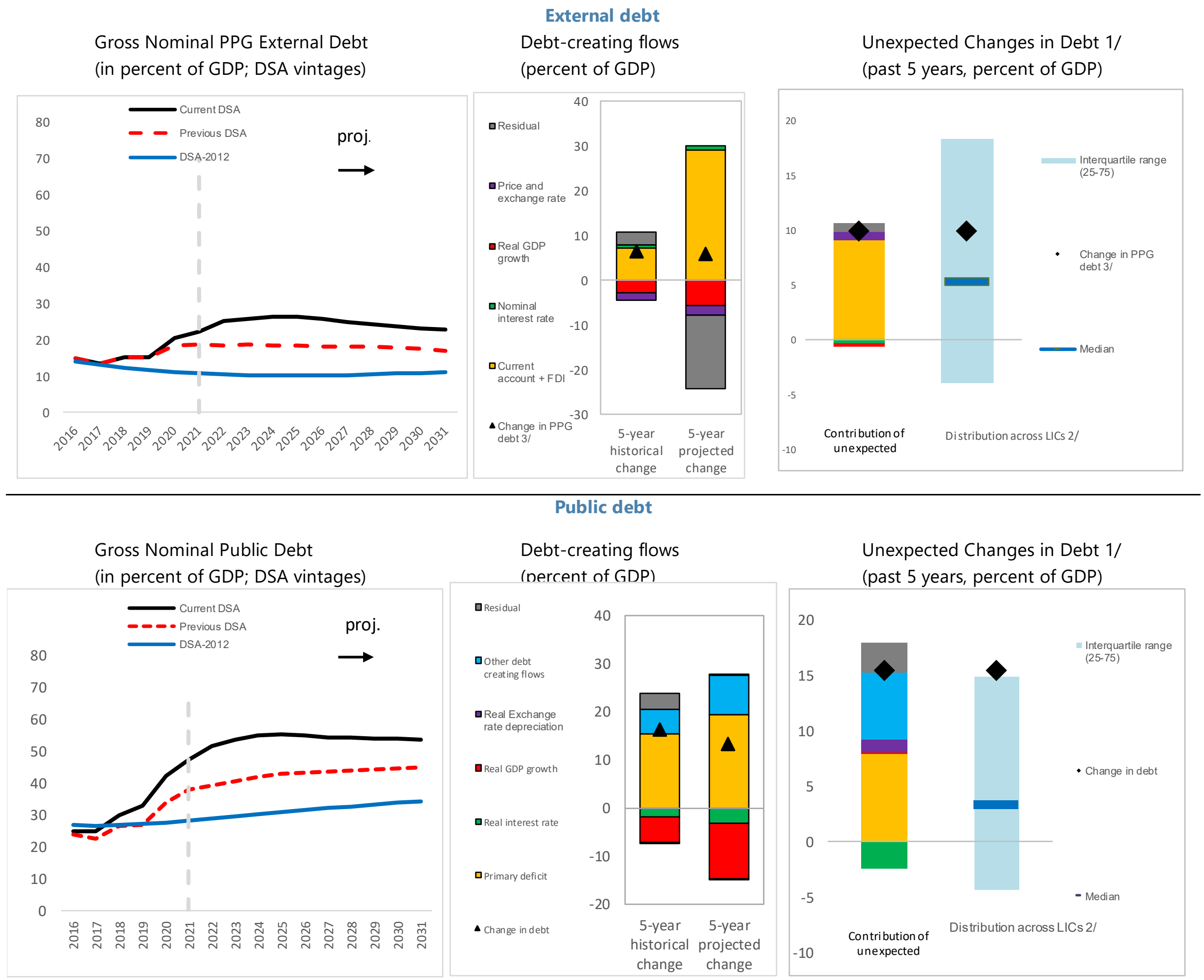
Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	20%	20%
Domestic medium and long-term	54%	54%
Domestic short-term	26%	26%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	0.8%	0.8%
Avg. maturity (incl. grace period)	36	36
Avg. grace period	6	6
Domestic MLT debt		
Avg. real interest rate on new borrowing	-0.8%	-0.8%
Avg. maturity (incl. grace period)	7	7
Avg. grace period	0	0
Domestic short-term debt		
Avg. real interest rate	-1.8%	-1.8%

* 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.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2031. 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

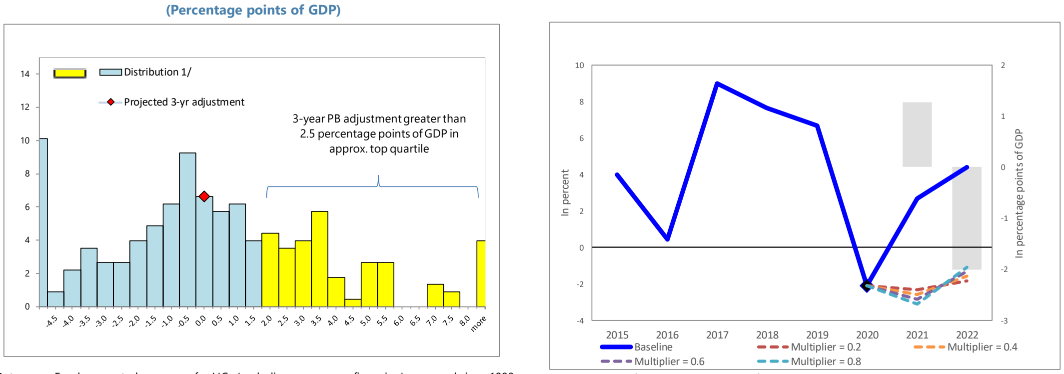


1/ Difference between anticipated and actual contributions on debt ratios.
2/ Distribution across LICs for which LIC DSAs were produced.
3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

Figure 4. Nepal: Realism Tools

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

Fiscal Adjustment and Possible Growth Paths 1/

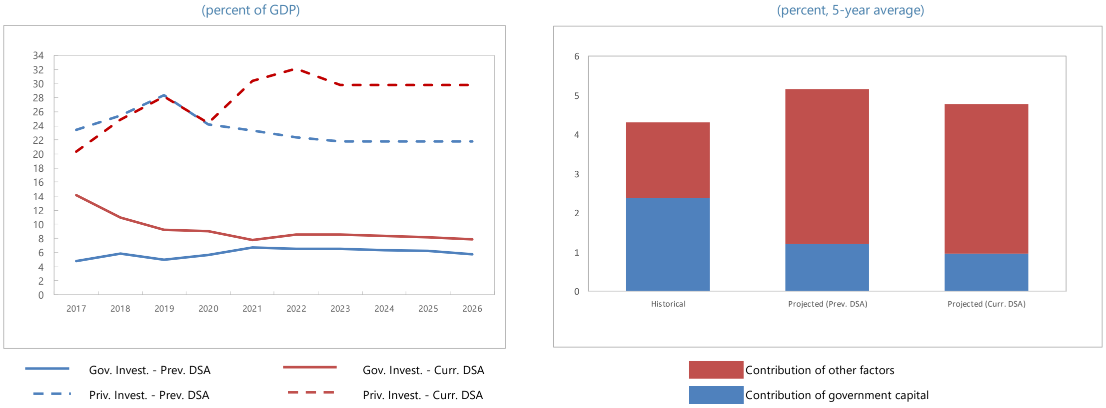


1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

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 1/
(percent of GDP)

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



1/ Investments for the current DSA reflect rebased GDP series.

Table 3.Nepal: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2021-2031

(In percent)

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of debt-to GDP ratio											
Baseline	14	15	15	15	15	15	15	14	14	13	13
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	14	10	8	6	4	3	2	2	2	2	3
B. Bound Tests											
B1. Real GDP growth	14	16	17	17	17	17	16	16	15	15	15
B2. Primary balance	14	15	16	16	16	16	16	15	15	15	14
B3. Exports	14	16	18	18	18	18	17	17	16	16	15
B4. Other flows 3/	14	16	18	18	18	18	17	17	16	16	15
B5. Depreciation	14	19	14	14	15	14	14	14	13	13	13
B6. Combination of B1-B5	14	18	19	19	19	19	18	18	17	16	16
C. Tailored Tests											
C1. Combined contingent liabilities	14	16	16	17	17	17	16	16	16	15	15
C2. Natural disaster	14	16	17	17	17	17	17	17	16	16	16
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	**254**	211	189	183	176	167	159	153	149	145	138
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	**254**	148	101	74	51	31	25	21	21	23	27
B. Bound Tests											
B1. Real GDP growth	**254**	211	189	183	176	167	159	153	149	145	138
B2. Primary balance	**254**	215	198	193	185	177	170	163	160	156	149
B3. Exports	**254**	**339**	**449**	**432**	**411**	**390**	**372**	**356**	**346**	**334**	**316**
B4. Other flows 3/	**254**	232	226	218	207	197	188	179	174	168	159
B5. Depreciation	**254**	211	139	137	132	126	121	116	113	112	109
B6. Combination of B1-B5	**254**	**346**	218	**367**	**350**	**332**	**317**	**303**	**293**	**284**	**269**
C. Tailored Tests											
C1. Combined contingent liabilities	**254**	224	205	200	192	184	177	171	168	165	158
C2. Natural disaster	**254**	231	211	207	199	192	185	180	177	174	168
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	15	12	11	10	10	9	9	9	10	10	9
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	15	12	10	10	9	8	9	9	7	6	4
B. Bound Tests											
B1. Real GDP growth	15	12	11	10	10	9	9	9	10	10	9
B2. Primary balance	15	12	11	10	10	10	10	9	10	10	9
B3. Exports	15	18	**22**	**21**	20	20	19	19	21	**23**	21
B4. Other flows 3/	15	12	11	11	10	10	10	10	11	11	10
B5. Depreciation	15	12	11	10	9	9	9	9	9	8	7
B6. Combination of B1-B5	15	17	20	19	18	17	17	17	19	19	18
C. Tailored Tests											
C1. Combined contingent liabilities	15	12	11	11	10	10	10	10	10	10	9
C2. Natural disaster	15	12	11	11	10	10	10	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	3	4	4	3	3	3	3	3	3	3	3
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	3	4	3	3	3	3	3	3	2	2	2
B. Bound Tests											
B1. Real GDP growth	3	4	4	4	4	4	4	4	4	4	4
B2. Primary balance	3	4	4	3	3	3	3	3	4	4	3
B3. Exports	3	4	4	4	3	3	3	3	4	4	4
B4. Other flows 3/	3	4	4	4	3	3	3	3	4	4	4
B5. Depreciation	3	4	4	4	4	4	4	4	4	3	3
B6. Combination of B1-B5	3	4	4	4	4	4	4	4	4	4	4
C. Tailored Tests											
C1. Combined contingent liabilities	3	4	4	3	3	3	3	3	4	4	3
C2. Natural disaster	3	4	4	3	3	3	3	3	4	4	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.
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, 2021-2031

	Projections 1/										
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031
PV of Debt-to-GDP Ratio											
Baseline	39	42	43	44	45	45	44	44	44	44	44
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	39	38	37	36	36	36	36	36	36	38	38
B. Bound Tests											
B1. Real GDP growth	39	45	52	55	58	60	61	63	65	66	68
B2. Primary balance	39	44	48	49	49	49	48	48	47	47	47
B3. Exports	39	43	46	47	47	47	47	47	47	47	46
B4. Other flows 3/	39	43	46	47	47	47	47	47	47	47	46
B5. Depreciation	39	41	41	41	40	39	38	37	37	36	35
B6. Combination of B1-B5	39	42	44	45	45	45	44	44	44	44	44
C. Tailored Tests											
C1. Combined contingent liabilities	39	50	51	51	51	51	50	50	49	49	49
C2. Natural disaster	39	51	52	53	53	53	52	52	52	52	52
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	159	169	169	167	165	164	163	164	164	164	164
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	159	152	144	138	134	133	133	134	134	139	142
B. Bound Tests											
B1. Real GDP growth	159	182	201	208	212	219	225	232	238	244	249
B2. Primary balance	159	179	188	185	180	179	177	177	176	175	174
B3. Exports	159	173	181	179	175	175	173	174	173	172	172
B4. Other flows 3/	159	175	180	178	175	174	173	173	173	172	172
B5. Depreciation	159	169	159	155	149	146	141	139	136	133	130
B6. Combination of B1-B5	159	171	173	169	165	164	163	163	163	163	163
C. Tailored Tests											
C1. Combined contingent liabilities	159	205	200	195	190	188	185	184	183	181	180
C2. Natural disaster	159	208	205	201	196	195	193	193	193	192	192
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	28	23	24	30	33	32	33	34	36	36	37
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2021-2031 2/	28	23	19	23	25	25	25	26	28	28	34
B. Bound Tests											
B1. Real GDP growth	28	24	28	38	43	44	46	49	53	55	57
B2. Primary balance	28	23	28	36	37	36	36	37	39	39	40
B3. Exports	28	23	24	30	33	33	33	34	36	37	38
B4. Other flows 3/	28	23	24	30	33	33	33	34	36	37	38
B5. Depreciation	28	22	23	27	31	30	31	32	33	34	34
B6. Combination of B1-B5	28	23	24	32	34	33	33	34	36	36	37
C. Tailored Tests											
C1. Combined contingent liabilities	28	23	37	37	39	38	38	39	41	40	41
C2. Natural disaster	28	24	38	38	40	40	40	42	44	43	43
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.
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.

NEPAL

REQUEST FOR AN ARRANGEMENT UNDER THE EXTENDED CREDIT FACILITY—SUPPLEMENTARY INFORMATION

January 6, 2022

Approved By
Anne-Marie Gulde-Wolf (APD) and Maria Gonzalez (SPR)

Prepared by the Asia and Pacific Department, in consultation with other departments.

1. **This supplement provides an update on the completion of the prior action on procurement contracts and presents new information that became available since the staff report was issued to the Board.** It does not alter the thrust of the staff appraisal.

2. **The authorities have provided information regarding their compliance with the envisaged prior action.** The authorities had committed to publish 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 (PIN) (as of December 9, 2021). The authorities have informed staff that the implementing agency of COVID-related spending (the Ministry of Health and Population) has not awarded any COVID-19 related procurement contracts since December 9th. The authorities have instead relied entirely on existing stocks and donated inventories. However, given concerns about a potential surge of the Omicron variant (see below), the authorities are now beginning a new round of procurement. The first tender, for syringes[1], was issued on December 24th, closed on December 31st, 2021, and will be awarded in the next few weeks. The authorities have confirmed that information related to this contract—and all others that may follow—will be published, within two weeks of being awarded, on the Ministry of Health and Population's website and will include the name of the ultimate beneficial owner, in line with the December PIN. The authorities have also conveyed that they expect to issue further procurement bid notices in the coming weeks related to COVID-19, and that all of these will be published consistent with the PIN. Staff considers that the prior action has therefore been met

[1] https://dohs.gov.np/procurement-of-syringes-for-covid-19-immunization/.

3. Staff will continue monitoring governance reforms. Although progress has been achieved in a number of important areas, including on the transparency of COVID-19 related spending, Nepal has not fully met the procurement-related governance commitments made at the time of the 2020 RCF, including due to capacity constraints. However, all public procurement contract information for contracts above NPR 2million[2] is currently published as per the requirements in the Public Procurement Act, which includes details on the awarded procurement contracts, the name of awarded company, values, and type of contract. Building on this, the issuance of the PIN on December 8th enhances the information transparently available to the public by adding beneficial ownership information on COVID-related procurement contracts in the health sector. Staff and the authorities agree that it will be important for the Fund-supported program to maintain its emphasis on macro-critical governance reforms, including through ensuring the continued, frequent, timely and easily accessible publication of the COVID-19 related procurement contracts—as set out in paragraph 2 above—on the Ministry of Health and Population's website. This will be assessed at the time of the first review. Finally, while the December 8th PIN covers only COVID-19 related health procurement in light of capacity constraints, it can now be used as a basis for a gradual expansion into other areas of procurement, and staff will discuss with the authorities how the ECF can support those efforts.

4. The number of COVID-19 cases is rising but remain at a low level. According to the Ministry of Health and Population, there were 326 new COVID-19 cases on January 3, 2022 and 34.9 percent of the total population are fully vaccinated. However, the rising number of cases suggests elevated risks in the coming months due to a potential surge of the Omicron variant in the region.

5. Macroeconomic developments since the staff report was issued have evolved broadly as envisaged. November data shows a continued deterioration of the current account, as imports have remained strong. While preliminary data in more recent weeks indicates some moderation, important drivers of the import surge include a rebuilding of inventories, stockpiling to guard against any further pandemic-related trade disruption, and a transition to more normal consumption patterns following two episodes of widespread mobility restrictions in FY2020/21. As a result, foreign exchange reserves further declined to US$10 billion (7.6 months of imports) from US$10.2billion (7.9 months of imports) in October but remain adequate. Further, inflationary pressures have emerged, and consumer price inflation rose to 5.32 percent in November (y-o-y) on account of domestic and global factors (the NRB target is 6.5 percent). As paragraph 15 of the staff report describes, the program is designed to recognize the considerable uncertainties, with the pandemic's magnitude, duration, and impact still unclear.

[2] NPR 2 million applies to consultancy services, other services, and goods. For public construction, the threshold is 20 million.

Statement by Ms. Rosemary Lim, Executive Director for Nepal,
Firman Mochtar, Alternate Executive Director,
and David Ong, Senior Advisor to Executive Director
January 12, 2022

Introduction

On behalf of our Nepali authorities, we would like to express our appreciation to the Executive Board and Management for their continued support to Nepal. We also thank Mr. Gregory (mission chief), Mr. Breuer (Senior Resident Representative) and the entire country team, as well as Ms. Jaramillo (former mission chief), for the in-depth and constructive engagement with our authorities.

Nepali authorities have requested an arrangement under the Extended Credit Facility (ECF) to meet four broad sets of objectives. First, to mitigate the pandemic's impact on health and economic activity and protect vulnerable groups. Second, preserve macroeconomic and financial stability. Third, implement reforms to support sustained growth and poverty reduction. And finally, to catalyze additional external financing that would be instrumental to support Nepal's response to the pandemic and facilitate a continued recovery. These objectives are well-aligned with Nepal's domestic policy priorities as elucidated in the government's Relief, Restructuring and Resilience (3R) plan to address the economic and social impacts of the pandemic, the August 2021 Status Paper on the current economic situation of Nepal and the medium-term strategic priorities set out in the 15th National Development Plan (2019-2023) with a long-term vision of 'Prosperous Nepal, Happy Nepali'.

Given the country's pre-existing institutional and capacity challenges, the proposed program appropriately prioritizes focus on attending to Nepal's most urgent needs and critical reforms to effectively and sustainably tackle the pandemic shock, before gradually stepping up the pace of reforms during the program period. Authorities also welcome the proposed reform implementation roadmap, which would be supported by a robust suite of IMF technical assistance, including through HQ and SARTTAC. Against this backdrop, and considering the scale of the reform agenda, they deem a 38-month engagement to be appropriate.

Recent Developments and Outlook

The pandemic has exerted a heavy toll on Nepal, with the country thus far recording over 800,000 in confirmed cases, and more than 11,000 recorded COVID-19 deaths partly owing to limitations in healthcare capacity. While the current daily COVID-19 cases remain low, it is starting to rise and authorities are preparing to mitigate the risks of a third wave of infections stemming from the potential surge of the Omicron variant in the region. GDP contracted by 2.1 percent in FY2019/20, and authorities expect only a partial recovery of 2.7% for the current fiscal year. The ensuing spillover impact on unemployment has also resulted in a significant

setback to poverty alleviation gains in recent years and threatened the attainment of goals outlined in Nepal's 15th National Development Plan.

Pre-existing buffers, multilateral support and responsive policy actions helped dampen the immediate impact of the pandemic. The country's strong policy buffers, built before the pandemic, including its relatively low fiscal deficit and public debt to GDP, and adequate gross official reserves, acted as a key first line of defense against the immediate impact of the pandemic by enabling a timely initial rapid response. As the depth and duration of the pandemic shock gave rise to additional financing needs, Nepal also benefited from support from international and development partners, including the Fund's Rapid Credit Facility disbursement (100 percent of quota), debt relief under Catastrophe Containment and Relief Trust (CCRT) and debt service suspension under the G20 Debt Service Suspension Initiative (DSSI), the latter which however does not cover loans from multilateral banks that account for a major share of Nepal's public debt.

However, the COVID-19 pandemic continues to rage and the ensuing healthcare and economic impact means that financing gaps will remain persistent. The financing gaps emerge as additional waves of COVID-19 infections continue to impede a return to normalcy and cast a long shadow of uncertainty on the timing and pace of recovery in Nepal's key economic sectors including tourism and remittances. This is exacerbated by Nepal's moderate pace of vaccination, with challenges in vaccine procurement and rollout infrastructure constraining widespread vaccination until well into 2022. Financing gaps also stem from Nepal's needs to build resilience against shocks emanating from natural disasters such as flooding, landslides and earthquakes as well as other climate change-related events. For example, Nepal saw extreme rainfall in the third week of October 2021, triggering catastrophic landslides, floods and inundation in 20 districts across the country, killing over 100 people and leaving settlements in several districts submerged in water. Many roads across the country were blocked owing to the floods. Rice paddy production was also severely impacted just as the country approached harvesting season, and total paddy production in this fiscal year is estimated to be 8.74% lower compared to that a year ago, representing a total loss of USD 72.2 million to Nepali farmers. Repeated landslides and flooding in Melamchi areas have also impeded progress in the country's long-awaited Melamchi Hydropower Project.

Authorities view that the ECF would help facilitate recovery and support sustained growth as well as fill the financing gaps. Nepal is at a low risk of debt distress, although its external position is moderately weaker than the level implied by fundamentals and desirable policies, in part owing to its high import dependency, a narrow export base, and a heavy reliance on remittances. At the onset of the COVID-19 pandemic, Nepal's external position has been sustained by stronger-than-expected remittances, partly owing to increased formalization of the remittance sector and a sharp fall-off in imports. More recently, there has been a sustained deterioration in the current account owing to a surge in imports, in turn stemming from a rebuilding of inventories, stockpiling to guard against any further pandemic-related trade disruption, and a transition to normal consumption patterns following two bouts of widespread

mobility restrictions in FY2020/21. As a consequence, Nepal's gross international reserves have declined steadily to US$10 billion (7.6 months of imports) in November 2021, from a peak of just under US$12 billion in October 2020. A successful IMF program will be critical to catalyze greater external financing. Authorities also look forward to further engagement with the Fund and to benefit from the Fund's policy advice and its capacity development support.

Fiscal Policy

The authorities are fully cognizant of the need for ongoing fiscal discipline to ensure adequate policy space to deal with the multitude of risks that Nepal faces (including natural disasters). Over the short term, however, it is imperative to continue to accommodate spending to address health needs, support the economy and protect the most vulnerable as the country, like many other parts of the world, remain in the thick of the health crisis. It is thus crucial that the program financing is phased to be somewhat front-loaded to match the timing of acute COVID-related needs.

The authorities are committed to develop a revenue mobilization strategy and to advance an action plan to address the public investment efficiency gap. The revenue mobilization strategy would benefit from Fund technical assistance, and efforts will be devoted to upgrades to the tax system and modernize the tax policy framework. The proposed program will also engender significant public financial management reforms including the development of a fiscal risk register and establishment of a fiscal risk monitoring system for subnational governments, initiatives that are very much aligned with the country's broader shift towards fiscal federalism. Leveraging recommendations from the Fund's recent Public Investment Management Assessment (PIMA), and its climate change component (PIMA CC), authorities are committed to develop an action plan to address the public investment efficiency gap and strengthen climate resilience, which is especially critical given Nepal's high vulnerability to climate change and natural disasters.

Monetary Policy

The Nepal Rastra Bank's (NRB's) accommodative monetary policy stance has helped alleviate the macroeconomic impact of the pandemic shock. NRB remains fully committed to maintaining price and external sector stability as the overarching objectives of monetary policy and preserving the credibility of Nepal's exchange rate peg by keeping an adequate level of reserves. Against this backdrop, the NRB has commenced a gradual unwinding of its accommodative monetary policy stance amidst heightened inflationary risks, triggered by the depreciation of the Indian rupee against the US dollar, increases in commodity prices, and disruptions to agricultural production owing to climate change-related factors.

Financial sector

Authorities recognize the need to closely monitor the enduring impact of COVID-19 on the financial sector. The NRB hence welcomes the proposed program's carefully sequenced

strategy to help enhance its financial sector regulation and supervisory capabilities, including through collecting adequate and timely supervisory data, updating the regulatory framework to enable more accurate assessments of bank asset quality, and more generally improving the quality of supervision. The NRB has also requested, and received a favorable response from, the Fund's Monetary and Capital Markets Department for a Financial Sector Stability Review program, which will help establish a clear roadmap of prioritized technical assistance to help it enhance its financial supervisory and regulatory capabilities over the medium term.

Authorities are prepared to employ macro-prudential policy to secure financial stability. The NRB stands ready to tighten macro-prudential policies to curb any excessive credit growth and mitigate the buildup of financial vulnerabilities. Authorities look forward to constructive engagements with Fund staff on the calibration of macro-prudential measures, and policy advice on how to appropriately unwind COVID-19-related support measures in the financial sector to become more targeted.

Authorities are committed to reforms proposed under the program to improve the autonomy and accountability framework of the NRB, drawing from recommendations from the 2021 safeguards assessment, in collaboration with the Auditor General of Nepal and on the basis of the Constitution and prevailing laws of Nepal. The authorities will submit to the Parliament legislative amendments to modernize the NRB Act and address key recommendations of the safeguards assessment including the OAG's appointment of reputable international auditors with relevant experience to audit the NRB's financial statements for FY 2021/22.

Governance and Transparency

Authorities remain committed to reforms that address governance, stem corruption, and enhance the efficiency of the public sector. Nepal has ratified the United Nations' Convention Against Corruption (UNCAC), established several anti-corruption bodies, and enacted anti-corruption related legislation, including the Prevention of Corruption Act, and establishing the Commission for the Investigation of Abuse of Authority (CIAA), the constitutional body for corruption control. The authorities will continue to implement spending transparency commitments, including that the Office of the Auditor General (OAG) audits the government accounts on an annual basis and publishes the results on its website. The fiscal authorities have created a dedicated sub-heading in the federal government budget to capture all COVID-19-related expenses for easier tracking. In terms of crisis spending, Nepal has also established a standalone COVID-19 Fund, an extra-budgetary fund with financing from government, development partners and the private sector. Spending information under the COVID-19 Fund is published regularly and the OAG conducted a special audit which culminated in a report submitted to the Hon'ble Right President on August 20, 2021, and ultimately forwarded to the parliament per the constitution. In line with commitments made at the time of the Rapid Credit Facility disbursed in May 2020, authorities have published a quarterly report on federal government spending on the COVID-19 response, and issued a Public Information Notice (PIN) in December 2021 regarding the collection and publication of beneficial ownership information.

The implementation agency for COVID-related spending, the Ministry of Health and Population, will henceforth, consistent with the PIN, publish on its website large public procurement documentation, ex-post validation of delivery, the name of awarded companies, and the name of their beneficial owner(s) for all new, large, COVID-19 related procurement contracts within two weeks of being awarded.

Conclusion

Our Nepali authorities reiterate their commitment to the proposed program's objectives. Nepal has a strong track record both in terms of servicing IMF debt[1], and the adherence to policy prudence to create loss absorption capacity to deal with the materialization of a variety of risks that the country confronts. The proposed program will help catalyze external financing to secure buffers for the country's reserve levels and fiscal policy space. The accompanying structural reforms are also well-aligned with the country's domestic policy priorities, and authorities look forward to greater Fund support for technical assistance and capacity development to sustainably address the country's pre-existing institutional and capacity constraints.

Authorities would also like to take the opportunity to thank international partners for their continued support.

[1] These include a three-year arrangement under the Poverty Reduction and Growth Facility that concluded in 2007 and disbursements from the Rapid Credit Facility in 2010 and 2015.