

Monetary Policy 2020/21

HIGHLIGHTS







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Nepal Rastra Bank (Central Bank) announced the monetary policy for the fiscal year 2020/21 (FY 2077/78) on 17 July 2020. The monetary policy has been formulated amidst challenging times with unprecedented economic and public health crisis due to the COVID-19 pandemic. The impact of the pandemic is expected to cause severe humanitarian crisis with increase in unemployment and poverty rates. This monetary policy has attempted to address challenges created by COVID-19 maintaining external stability to achieve long and sustainable economic growth as envisioned in the budget. Key highlights addressed by the monetary policy are summarized below in this document.

Overall Economic Situation

	Fiscal Year:	2019/20	2018/19
A	Economic Growth Rate	2.28%	7%
	- Agriculture sector	2.6%	5%
	- Industrial sector	3.2%	8.1%
	- Service sector	2%	7.3%
B	Avg Annual Consumer Inflation Rate	6.28%	4.51%
C	Branch Networks as of mid-June 2020	9,716	8,564
	- Average Population to Branch Ratio	3,075	3,411
D	Overall BOP - Surplus (NPR in billion)	179.37	(90.83)
	- Foreign Exchange Reserve - Sufficient for goods and service import	11.7 months	7 months
	- Weighted Average 91 day Treasury Bills Rate (as of mid-July 2020)	1.27%	4.97%
	- Weighted Average Inter Bank Rate among commercial banks (as of mid-July 2020)	0.35%	4.52%
	- Average interest rate for deposits of the commercial banks (as of mid-June 2020)	6.17%	6.60%
	- Average interest rate for loan of the commercial banks (as of mid-June 2020)	10.43%	12.13%

Monetary Policy Stance

- Considering current national and international economic status & scenario, monetary policy has been prepared under provision of Nepal Rastra Bank Act, 2058. Fifteenth five-year plan, financial sector development strategy, budget of FY 2077/78 & third strategic plan of NRB has also been taken as basis for preparation of monetary policy.
- Monetary policy has focused on economic recovery hit by COVID-19 through management & easing of loan facilities to COVID-19 affected businesses and entrepreneurship development, production

growth & job creation through effective management of financial resources.

Economy and Monetary Targets

- To maintain consumer inflation rate within 7% for FY 2077/78.
- To maintain foreign exchange reserve adequate to sustain 7 month's import of goods and services.
- To manage liquidity to help to achieve economic growth rate by prioritizing economic recovery.
- To maintain broad money supply at 18% & credit expansion rate of private sector below 20%.

Monetary Management

The Central Bank has proposed the following measures to achieve the economic & monetary targets:

- The permanent liquidity facility rate of 5% is to be maintained as the upper limit of the interest rate corridor (IRC) and the lower band of IRC is decreased from 2% to 1%.
- Repo rate is reduced to 3% from 3.5%. Long term repo service will be made available to improve needed liquidity for financial rehabilitation.
- Cash Reserve Ratio (CRR) for Class A, B and C BFLs to be maintained at 3%.
- Statutory Liquidity Ratio (SLR) to be maintained at 10%, 8% and 7% by Class A, B and C BFLs, respectively.
- The bank rate applied for the purpose of Lender of Last Resort (LOLR) facility at 5% kept unchanged.

Major Provisions Relating to COVID-19

Considering impact of COVID-19, the Central Bank has already implemented following provisions:

- With effect from 16 March 2020, mandatory cash reserve ratio reduced from 4% to 3%.
- Bank rate reduced from 6% to 5%.
- Repo rate decreased from 4.5% to 3.5%.
- Countercyclical buffer requirement under Capital Adequacy Framework 2015 suspended.
- Provision to specified sectors of BFLs, including Class 'D' financial institutions dealing in bulk loans, to reduce interest rates on loans for the fourth quarter of FY 2076/77 by 2% from prevailing rates charged during third quarter ending Chaitra 2076. The reduction in interest was by 3% for 'D' class institutions.
- Monthly or quarterly installment on loans and interest for the months of Chaitra 2076, Baisakh & Jestha 2077 deferred till Ashad end 2077.

- 10% discount on interest provided to borrowers on payment of monthly or quarterly installment due during Chaitra 2076.
- Provision of extension of tenure, for all type of short term loans extended for working capital nature to be repaid during Chaitra 2076, by further 60 days.
- Loans provided to private health service provider institutions for the expansion of their services to make them capable of treating COVID-19 patients categorized as priority sector lending.
- Provision of approval of concessional loan within 7 days of application, to start own business or industry for those people having permission but not able to travel for foreign employment due to COVID-19 pandemic.
- Limit of electronic payment through e-banking, mobile banking, wallet & other electronic medium increased. Charges waived for electronic payment made through RTGS during lockdown period.

Financial Sector Program for FY 2020/21

Credit Management

- Adopt a policy to encourage credit investment in agriculture, energy, tourism and SMEs to revive the economy affected by COVID-19. From the FY 2077/78, the provision regarding loans and investments to be made by BFLs in the priority sectors shall be modified.
- Access to refinancing has been decentralized. The scope of the concessional loan program has been widened by restructuring.

Agriculture Loans

- Commercial banks to disburse at least 15% of the total credit investment for the development of agricultural sector by Ashad end, 2080. Modifications to be made in methods of agriculture loans.
- Loan loss provisions for the loan taken for cultivation of fruits like mango, orange, kiwi, dragon fruit, lemon, litchi, avocado to be maintained at 0.2% and 0.6% only for first and

second year, respectively.

- Flexible debt management will be adopted to encourage the flow of credit towards the development of agriculture including silk, jute and cotton.
- Agriculture Development Bank will be developed as a leading bank to promote agriculture lending. In order to facilitate the availability of long-term resources in the agricultural sector, an arrangement will be made for the banks to issue Agricultural Bond which helps to maintain the prescribed agricultural loan ratio.
- The swapping of agricultural loans among the BFI's to be simplified.
- Agriculture Development Bank to provide "Kishan Credit Card" to facilitate the farmers with financial instruments and agriculture information.
- Necessary institutional and structural arrangements will be made to expand agricultural training.

Energy Sector Loans

- To achieve the target of generation of 5,000MW hydropower, commercial banks to invest at least 10% of their total credit in the energy sector by Ashad end 2081.
- Commercial banks having experience of investing in energy sectors can issue 'Energy Bonds' which will facilitate long term financing in energy sector and help BFI's with low credit flow to maintain the minimum loan ratio.
- BFI's to add only 1% to the base rate for first 5 years of export in case of the loans taken by export-oriented electricity projects. In order to encourage investment in reservoir based hydropower projects, loans will be made available by adding only 1% to the base rate.
- Approval of NRB is not required for capitalizing the partial interest amount in case the project is not fully operational due to non-construction of transmission line even after completion of hydropower project.

Tourism Sector and SME Loans

- Priority to be given to working capital loans, concessional loans, and refinancing loans for

revival of highly affected sectors by COVID-19 like tourism sector, aviation business, transportation, hotels and restaurants.

- BFI's will provide loan for projects facing lack of capital to complete the construction of projects related to the tourism sector.
- Commercial banks to disburse loans of less than Rs 10 million, up to minimum 15% of the total loan investment for MSMEs by Ashad end 2081.

Concessional Loans

- BFI's to provide concessional loans at an interest rate of 5% for the production, growth, employment generation and entrepreneurship development.
- The number of concessional loans disbursed by commercial banks to be minimum 500 or at least 10 per branch and by national level development banks to be 300 or at least 5 per branch, whichever is higher.

Miscellaneous

- Class 'B' & 'C' BFI's to disburse at least 20% and 15%, respectively of its total loan investment to the specified sectors like agriculture, micro, household and small enterprises, energy and tourism by Ashad end 2081.
- The debt security ratio has been increased to 60% for loans under residential housing projects and personal residential home loan.
- The debt security ratio of 40% & 50% to be maintained for real estate loans within Kathmandu valley and other places, respectively.
- Loans against value of shares (margin lending) increased from 65% to 70% with valuation consideration reduced to 120 days average instead of the existing 180 days.

Special Programs aimed for Economic Recovery

Refinancing

- For expansion of economic activities affected by COVID-19 and to simplify funding borrowers

from rural areas, loans at concessional rate will be provided by increasing refinancing fund limit up to 5 times.

- Refinancing up to 20% to be provided on the basis of credit evaluation by NRB. Apart from this, refinance up to 70% to be provided by Class 'A', 'B' & 'C' BFIs and up to 10% through MFIs.
- BFIs to be provided special refinancing in the specified areas like export-oriented industries and sick industries at 1% interest rate, for MSEs at 2% interest rate and for general refinancing at 3% interest rate. The interest charged to the borrowers on such refinancing to be 3%, 5% and 5%, respectively.
- Under the lump sum refinancing provided to BFIs, limit per borrower for MSEs to be up to Rs 15 lacs, for special and general refinancing up to Rs 5 crore and general refinancing through credit evaluation to be up to Rs 20 crore.

Profession/ Business Operation Loans highly affected by COVID-19

- To facilitate the smooth running of the highly affected industries and businesses from COVID-19, BFIs can disburse additional loans maximum up to 20% of the working capital loan maintained at Chaitra 2076.
- Use of the fund of Rs 50 billion set aside through the budget of FY 2077/78 in the areas affected by COVID-19 like tourism, MSEs, salary disbursement to the staff of such sectors and to provide opportunity to develop skills to support those who lost their job with only 5% interest rate based on prescribed standard.

Extension of Repayment Period, Debt Restructuring and Rescheduling

- Provisions shall be made to restructure and reschedule debts, extend repayment of loans extended to tourism, education, health, communication, entertainment and all loans for profession, industries and businesses keeping in view of the difficulties faced due to COVID-19.
- Renew short term working capital loans e.g.: demand draft, cash credit due up to Ashad

2077 to be paid by the end of Poush 2077.

- The principal and interest due up to Ashad 2077 on loans taken for profession and business, less affected by COVID-19 to be repaid by the end of Poush, 2077.
- The principal and interest due up to Ashad 2077 on loans taken for profession and business, moderately affected by COVID-19 to be repaid by Chaitra end 2077.
- The principal and interest due up to Ashad 2077 on loans taken for profession and business, highly affected by COVID-19, to be repaid by Ashad end 2078. Additional period to be provided for repayment in case of sectors which will take time for revival like tourism.
- Restructure and reschedule 'Pass' loans as on Poush 2076 to Poush 2077 after payment of at least 10% of interest due after analyzing the written plan submitted by the borrowers.
- Arrangements to coordinate with the related authority to restructure the loans with Private Equity, Venture Capital, Debt Equity Conversion and Special Purpose Vehicle, if the restructuring and rescheduling of existing loans from BFIs is not sufficient.
- In case prior approval has been taken to capitalize interest for the grace period on loans taken by infrastructure project, capitalization can be allowed up to Poush end 2077.
- One time moratorium period can be provided for projects which could not be completed during grace period due to COVID-19: maximum 2 years for tourism and hotels, 1 year for highly affected areas, 9 months for moderately affected areas and 6 months for the less affected areas.
- The loan installments which could not be repaid up to Ashad 2077 in case of MFIs could be extended by a maximum period of 6 months by evaluating its necessity and business continuity.

Financial Sector Strengthening

- To strengthen capacity of BFIs the M&A of commercial banks shall be encouraged.
- The merged commercial banks which

commence joint operations by Ashad 2078 will be provided following additional incentives up to Ashad 2079:

- Discount of 0.5% in CRR and 1% in SLR.
- Increment in collection of institutional term deposit by an additional 10% point.
- Increment in deposit collection per institution by an additional 5% point.
- The existing provision of cooling period of six months will not be applicable for the members of board of directors and high ranking employees while joining other institutions licensed by NRB.
- Arrangements will be made for M&A for those institutions having direct or indirect ownership or control of a single person/group, single family or non-household group and BFI's having business relation.
- Encourage M&A of MFIs to strengthen their capital base.
- Amendments proposed in the Banking Offence and Punishment Act 2064 and Negotiable Instruments Act 2034.

Regulation and Supervision

- Core capital plus deposit ratio (CCD Ratio) has been increased from 80% to 85% up to Ashad 31, 2078 and the existing adjustments for computation has been removed.
- BFI's can only distribute cash dividend up to 30% of the total distributable profit (not more than weighted average interest rate on deposit of concerned institution maintained on Ashad 31, 2077). However, BFI's whose total net distributable profit is less than 5% of paid up capital shall be prohibited to distribute cash dividend.
- Existing provision for BFI's not to transfer to regulatory fund when receiving interest within 15 days of end of fiscal year from borrowers, is now extended to 90 days for FY 2076-77.
- Provision for commercial banks to issue debenture of 25% of their paid-up capital by the end of 2077, is now extended to the end of 2079.
- With the intention of further refining the existing capital adequacy situation, rating from licensed credit rating agency will be taken as base to

manage loan risk.

- The existing loan loss provisions and risk assessment will be made flexible for project loans extended to infrastructure projects.
- In order to provide additional financial facility to industries and professions affected by COVID-19, the following flexibility has been provided without affecting existing capital adequacy:
 - Suspension of the requirement of Countercyclical Buffer.
 - The current maximum additional risk burden kept under supervision for operating risk, market risk, and composite risk of 5%, 3% and 5% is reduced to 3%, 1% and 3%, respectively.
 - Requirement to deduct the investment made in Private Equity, Debt Equity Conversion & Special Purpose Vehicle for calculating the CAR has been removed.
 - The risk specified outside the balance sheet will be reviewed.
- Pass' loans as of Poush end 2076 will continue to be classified as 'Pass' at Ashad end 2077. However, if principal and interest due is not received till Ashad end 2077, a 5% loan loss provision should be applied for fiscal year 2076/77, even if classified as 'Pass'.
- Stress testing guidelines of BFI's will be reviewed and brought in line with international standards.
- The existing provision for the commercial banks, to submit their annual plan relating to deposit mobilization and loan disbursement duly approved by Board of Directors within Shrawan-end of every fiscal year and review the implementation of action plan on quarterly basis, shall also be made applicable to all development banks and financial institutions.
- From FY 2077-78, Basel-3 will also be implemented in national level development banks.
- Arrangement will be made to publish in the BFI's website on quarterly basis the details of concessional loans and refinancing loans offered by BFI's.
- For the prevention of financial investment in money laundering and terrorist activities, in

addition to BFs, other indicative institutions will also be included in the scope of goAML system.

Micro Finance Regulation

- Issue of new licenses to MFIs has been suspended and all applications in process at NRB has been cancelled.
- Province level MFIs should limit their transactions only to designated province by selling, closing or relocating branches from other provinces by Ashad end 2078.
- The limit of loan to be provided to farmers, firms or groups who are willing to engage in agriculture, micro-enterprises and other businesses being low-income earners and who are eligible for collateral for business relocation has been increased to Rs 15 lacs from Rs 7 lacs.
- The interest rate that can be charged by MFIs has been capped at 15%.
- Provision will be made for the licensed 'A', 'B', 'C' and 'D' class BFs to charge not more than 0.5 percent service fee on loans disbursed to MFIs as deprived sector loans.
- MFIs will be permitted to open branches only in such wards where there are no branches of MFI in line with the principle of providing financial access to all.
- MFIs collecting bulk deposits and from the public will be required to publish their financial statements of FY 2077-78 in accordance with NFRS.

Payment Systems

- In line with the spirit of Digital Nepal Framework implemented by the GoN all types of financial transactions will be encouraged through electronic means.
- A national payment switch will be established to further facilitate the payment system by maintaining records of all types of electronic transactions within Nepal.
- Issue of new licenses to payment service operators and payment service institutions is suspended.
- PSP license will be revoked if customer base

is lower than 300,000 by Ashad 2078 and the average number of monthly transactions do not reach at least 600,000.

- Guidelines will be issued to manage the payments made through QR Code in electronic payments.
- Payment System Development Indicator (PSDI) will be published.
- Government bonds will be dematerialized in coordination with the concerned agencies to manage the business of government bonds.

Foreign Exchange Management

- While importing industrial raw materials and machinery through sight LC, the existing arrangement regarding interest rate of loan to be converted into convertible foreign currency by commercial banks will be reviewed. In addition, in order to facilitate the payment of LC, discounting from foreign banks to convert the sight LC to deferred payment will be done as per need.
- Necessary policy arrangements have been assured to procure insurance and transportation related services related to import from Nepali service providers, as far as possible.
- The foreign currency limit provided for import will be maintained at US\$ 50,000 in accordance with the provisions of the Documents Against Payment (DAP) & Documents Against Acceptance (DAA).
- The limit for foreign currency exchange for importing goods from third countries through Draft/TT medium shall be increased to US\$ 35,000 at a time from US\$ 30,000.
- The range of goods that can be imported from India in convertible foreign currency through LC shall be increased.
- Arrangement to receive foreign currencies in the foreign currency bank account or card of concerned exporter or service provider who exports information and technology along with various services through online or electronic medium shall be made.
- Arrangement shall be made for the determination of fee to be charged by

institutions licensed to carry out remittance transactions and BFs to encourage to receive remittance income from formal channel.

- The foreign currency and exchange facilitation unit of One Stop Service Centre established under Department of Industry, will be made more effective.
- The validity period of usance LC in relation to the import made by business firm will be increased from 120 days to 180 days
- Time limit for issuance of Advance Payment Certificate in the name of Nepali exporter after receiving foreign currency shall be increased from 1 month to 4 months.
- Arrangements shall be made for directly depositing the amount collected by Nepali exporters in various exhibitions, business fair etc. in foreign nation in their convertible currency accounts in Nepal.
- Arrangements shall be made to infuse certain amount of foreign investment through the Automatic Route in BFs under the prescribed covenants and guidelines.
- Arrangements shall be made for ongoing infrastructure development projects operating under foreign investment to avail loans up to a specified limit of their capital investments at a fixed interest rate from their parent company/ group of companies.
- Hedging business shall be encouraged in a commercial manner through a specialized institution to mitigate the foreign exchange risks.

Corporate Governance, Financial Literacy & Customer Protection

- Zero tolerance for noncompliance of directives issued by Central Bank on corporate governance to licensed institutions.
- Remuneration and other facilities of Chief Executive Officer and other high level employees will be reviewed. Similarly, criteria on determination of meeting allowances and facilities of BOD will be formulated.
- Financial literacy program designed by NRB will be implemented.
- System of charging service fees, maximum at 0.75%, 1%, 1.25% & 1.50% by commercial banks, development banks, finance companies and MFIs, respectively, will be arranged while sanctioning loans to the customer.
- CSR expenditure to be incurred by the BFs will be reviewed. Arrangement of transferring unspent amount of CSR fund to Corona fund will be made.
- As long as impact of COVID- 19 remains, charge on use of ATM of another bank will be waived off.
- Penalty, charges & fees will be waived off for extension of payment period for payment of interest or principal amount of loan impacted due to COVID-19.
- Integrated KYC will be made available to BFs.
- BFs will be made more responsible towards concessional loan, refinancing facility, clean note policy, electronic payment system etc.

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We are a leading provider of audit, tax, business and financial advisory services in Nepal. The firm's approach to service delivery helps us respond efficiently and comprehensively to any client's complex business challenges. Our clients include large number of local, regional and international companies.

PKF Nepal provides its clients with full access to the resources and the infrastructure of a major firm and our team is uniquely positioned to integrate in-depth expertise in international accounting and business practices with local know how.

Our objective is to provide services of the highest possible standard to companies in Nepal and bring an international perspective to the management of their business.

right people
right size
right solutions

CONTACT US IN NEPAL

PKF T R Upadhy & Co.

📍 124 Lal Colony Marg, Lal Durbar
(Near Jai Nepal Hall), Kathmandu, Nepal

☎ +977 1 4410927 / 4420026

📞 + 977 1 4413307

✉ trunco@ntc.net.np

🌐 www.pkf.trunco.com.np

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