

Monetary Policy

2022/23

HIGHLIGHTS



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The Governor, CA Maha Prasad Adhikari unveiled the Monetary Policy 2079-80 (2022-23) on 22 July 2022. The reviving world economy after the pandemic has been challenged due to the ongoing war between Russia and Ukraine which in turn has led to substantial rise in the price of petroleum products and food items. Monetary policy has been formulated keeping in mind the relevant theoretical basis and challenge in the overall economic stability of the nation.

Key highlights addressed by Monetary Policy are summarized hereunder:

Overall Economic Situation

Central Bureau of Statistics has made an initial projection of growth of the economy by 5.84% in the FY 2021-22 against the growth of 4.25% during FY 2020-21.

	Fiscal Year:	2021/22	2020/21
A Economic Growth Rate		5.84%	4.25%
B Gross Domestic Saving to GDP		9.27%	7.71%
- Gross National Savings to GDP		31.95%	33.30%
- Gross Fixed Capital to GDP		29.37%	29.85%
C Average Annual consumer Inflation Rate		6.09%*	3.6%
* Average inflation of last 11 months (i.e. up to mid-June 2022)			
D Branch Networks as of mid-July		11,528	10,683
- Average Population to Branch Ratio		2,532	2,844
E Overall BOP - Surplus (NPR in billion)(as of Mid-June)		269.81	15.15
Foreign Exchange Reserve - Sufficient for goods and service import		6.73 months	10.2 months
Weighted Average 91-day Treasury Bills Rate (as of mid-July)		10.66%	4.55%
Weighted Average base Rate of commercial banks (as of mid-June)		9.39%	6.66%
Weighted Average interest rate on deposits of the commercial banks (as of mid-June)		7.34%	4.72%
Weighted Average interest rate on loan of the commercial banks (as of mid-June)		11.54%	8.46%

International Economic Situation

- Growth rate in world economy seems to be falling due to Russia-Ukraine war. Against IMF's initial projection of growth of the global economy by 6.1% in 2021, there shall be contraction and the growth is expected to be limited to around 3.6% in 2022.
- The growth rate of the economy of developed nations which was 5.2% in 2021 shall contract and be limited to 3.3% in 2022. Similarly, the growth rate of the economy of the emerging and developing countries which was 6.8% in 2021 is expected to contract to 3.8% in 2022.
- The average inflation rate of the developed nations which has been 1.5% for the past decade is now expected to reach 5.7% in 2022. Similarly, for the emerging and developing countries, the average inflation rate is expected to reach 8.7% in 2022 against the average rate of 5.1% for the past decade.
- World trade which expanded by 10.1% in 2021 is expected to contract to 5% in 2022 due to the ongoing Russia-Ukraine war.
- In order to combat the high increase in prices, interest rates have been raised through tight monetary policy by Central banks of different countries. American Federal Reserve on June 2022 has

increased the base point of the Federal rate by 75 and has reached 1.5% to 1.75%. Similarly, the Reserve Bank of India has made increments on the Policy point (interest rate) of 40 and 50 base point, respectively in May and June 2022 and has reached 4.9%.

Financial Sector Situation

Banking and Financial Institutions

Description	FY 2021/22	FY 2020/21
Increment in Deposits	5.7%	21.4%
Increment in Private Sector Investments	13.5%	27.3%

- The BFIs have issued debentures of NPR 23.38 billion up to the 11th month in the FY 2021-22 and accordingly, mobilized the financial resources. In the comparative period for FY 2020-21, the BFIs had issued debentures of NPR 37.10 billion.
- As of mid-April 2022, average non-performing loans in respect of commercial banks, development banks and finance companies stood at 1.32%, 1.49% and 7%, respectively (last year mid-July 2021, such ratio stood at 1.41%, 1.30% and 6.19%).
- After the facilitation from NRB for the Merger of BFIs through the formulation of Policy, altogether 245 BFIs have been engaged in the Merger /Merger process as of 16 July 2022. Out of the total 245 institutions, licenses of 178 institutions have been revoked and a total of 67 institutions have been retained.

Share Market

- NSE index plunged to 2,009.46 on 16 July 2022 from 2,883.41 on 15 July 2021. Likewise, total market capitalization stood at NPR 2,869.34 billion on 16 July 2022.
- In FY 2021/22, SEBON has approved the issue of debentures, ordinary shares, right shares and mutual fund units of NPR 11.28 billion, 6.51 billion, 3.46 billion and 6.90 billion, respectively.
- In FY 2021/22, seven commercial banks and one development bank have obtained approval from SEBON for the issuance of debentures of NPR 11.28 billion in total.

Summary of the Provisions for Bank and Financial Institutions

Agriculture and Energy Sector Loans

- Commercial banks are required to extend at least 12%, 13%, 14% & 15% of the total credit investment for the development of the agricultural sector by mid-July 2022, 2023, 2024 & 2025, respectively. As of mid-April 2022, the Commercial banks have extended loans amounting to NPR 490.15 billion (12.28% of total credit) to the agricultural sector.
- Commercial banks are required to extend at least 6%, 7%, 8% and 10% of the total credit investment for the development of the energy sector by mid-July 2022, 2023, 2024 & 2025, respectively. As of mid-April 2022, the Commercial banks have extended loans amounting to NPR 220.8 billion (5.51% of total credit) to the energy sector.

Micro, Cottage, small and medium Scale Industries Loan

- Commercial banks are required to extend at least 11%, 12%, 13% and 15% of the total credit investment for the development of micro, cottage and SMEs sector availing loans up to NPR 10 million by mid-July 2022, 2023, 2024 and 2025, respectively. As of mid-April 2022, the Commercial banks have extended loans amounting NPR 393.28 billion (9.85% of total credit) to such sector.
- Development banks are required to extend at least 17%, 19% & 20% of the total credit investment for the development of agriculture, micro, cottage and SMEs, energy and tourism sector by mid-July 2022, 2023, and 2024, respectively. As of mid-April 2022, the Development banks have extended loans amounting NPR 111.92 billion (26.62% of total credit) to such sector.
- Finance companies are required to extend at least 12%, 14% & 15% of the total credit investment for the development of agriculture, micro, cottage and SMEs, energy and tourism sector

by mid-July 2022, 2023, and 2024, respectively. As of mid-April 2022, the finance companies have extended loans amounting NPR 16.15 billion (21.92% of total credit) to such sector.

Refinancing and Concessional Loans

- 24,305 borrowers have benefitted from the refinancing facility implemented with a view to recover the economy through aid to the specified industries, businesses affected by COVID-19 through discounts in interest rate and a total of NPR 115.68 billion has been approved in FY 2078/79. As on 16 July 2022, a total of NPR 111.96 billion has been utilized in refinancing investment.

Concessional Loans

- Under the concessional loan scheme introduced by GON for the purpose of production increment, employment creation, and skill development, a total of NPR 215.91 billion was extended to 147,147 borrowers (comprising NPR 139.84 billion in agriculture and animal husbandry business, NPR 72.38 billion to female entrepreneur and NPR 3.69 billion to other remaining headings of concessional loans).

Business Continuity Loan

- Total loan approved under business continuity loan scheme facility by Government to COVID-19 affected tourism and domestic, SMEs business for purpose of continuity of business and salary payments to employees amounts to NPR 1.15 billion till mid-June 2022.

Regulation and Supervision

- BFI were required to maintain a Credit Deposit Ratio (CD) of 90% by mid-July 2022. However, the average CD ratio as on 16 July 2022 stood at 86.22%.
- Premium in excess of 2% above the base rate cannot be charged for loans availed up to NPR 10 million to agriculture, handicraft and skill-based businesses.
- Provision for the consideration of loans up to NPR 2 million extended to agriculture business against collateral to commence the agricultural project and to female entrepreneurs against collateral to commence micro industry and self-employment project under deprived sector lending has come into effect. Similarly, vehicle loans up to NPR 2.5 million extended with a view to creating self-employment shall also be considered as deprived sector lending. BFI have extended 7.88% of total credit investment to the deprived sector as of mid-April 2022.
- Institutions except BFI facilitating payment services or arranging payment systems are required to submit returns of transactions of suspicious nature and transactions above the prescribed limit to the Financial Information Unit.
- Arrangements have been made so as to facilitate the commercial banks to utilize deposits collected in convertible currency from Non-Resident Nepali (NRN) or foreign-based institutions associated with NRN and repatriation in accordance with prescribed guidelines.
- Digital Lending Guideline has been implemented with a view to bringing ease to the loan sanction process, reduction in the cost of lending and extending credit facility.

Economic Scenario of Financial Year 2022-23

- The Russia-Ukraine war has made the international economic environment uncertain and prices are under pressure. As a result, GDP growth rate and trade expansion is projected to decline in 2022 and 2023. Due to the pressure on prices and tight policy regime, the World Bank and IMF have predicted that interest rates in developed and developing countries will increase further and the world economy might go into recession.
- In the financial year 2021-22, the current account and Balance of Payment deficit has reached the highest level so far. Considering the status of domestic production and demand, the current trend of import-export and remittance flows, the devaluation of Nepalese currency and the increase in the price of imported goods, it seems challenging to maintain the balance of payment in the coming year despite the mobilization of foreign grants and external loans as mentioned in the budget speech of the FY 2022-23. Therefore, as the foreign reserves and liquidity position of the banking sector will come under pressure, it seems that a balance must be maintained

between foreign exchange reserves at an appropriate level and managing liquidity.

- There has been a current account deficit from 2017-18 and in the FY 2021-22 the current account deficit has increased further and reached 13% of GDP.
- Direct impact on the exchange rate and the interest rate is created due to the expansion in the import-oriented economy. Pressure on banking liquidity and interest rates seems to continue until there is a sustainable improvement in domestic production and the external sector.

Monetary Policy Framework for FY 2022-23

Monetary Policy Stance

- The stance of the monetary policy has been cautiously tightened in order to promote macroeconomic stability while maintaining price and external sector stability and to support economic growth through increasing productivity by channeling financial instruments to the productive sector.
- In the context of a high credit-GDP ratio, priority will be given to the flow of credit in the productive sector rather than focusing on credit growth.
- Easy regulatory arrangements adopted during COVID-19 will be reduced gradually and be made in accordance with prudent regulatory standards. The refinancing facility will be reviewed and be extended only to productive sectors including agriculture, exports and highly affected areas that are yet to recover from the COVID pandemic.
- Access to credit facilities for small, domestic, small and medium enterprises shall be gradually increased reducing the over-centralization of credit. In addition, gap shall be maintained in the interest rate of loans towards productive sectors and commercial sectors.
- Emphasis will be given to maintaining financial stability through aggregate discretionary regulation as well as credit quality improvement.
- The scope of monetary policy will be increased by increasing financial literacy, financial access and financial inclusion through the digitization of the payments and financial transactions

Structure and Objectives of Monetary Policy

- Weighted average interbank interest rate between banks and financial institutions has been continued as an operational target while strengthening interest rate as a means of disseminating monetary policy.
- The ability of foreign exchange reserve to support the import of goods and services and inflation will be considered as the main basis for determining the policy rate and so the determined rate will not be less than the annual target inflation rate.
- The growth rate of comprehensive money lending is expected to be 12% and the growth rate of loans to the private sector is expected to be 12.6% in the FY 2022-23.
- Target has been set for achieving an economic growth rate of 8% and maintaining inflation within 7% through Budget Speech.

Monetary Measures

- To ensure the overall economic stability, rates under the interest rate corridor have been increased by 1.5% points for macroeconomic stability and the bank rate has been maintained at 8.5%, policy rate at 7%, and deposit collection rate at 5.5%.
- If the weighted average interest rate of interbank transactions differs from the policy rate by more than 2% points, arrangements will be made to open repo/reverse repo. In case the weighted average interest rate of interbank transactions decreases by more than 3% points compared to the policy rate, arrangements will be made to open deposits.
- Open market transaction stabilization funds will be arranged and implemented in order to increase the effectiveness of liquidity management.

- ❑ Existing Intraday Liquidity Facility (ILF) provided by NRB to banks and financial institutions on the collateral of government bonds will be made available for overnight period as per the requirement and such facility will be made available at the bank rate.
- ❑ BFs will be provided permanent liquidity facilities at the bank rate for a maximum period of 5 days on the collateral of the bonds specified by this bank, provided that the outstanding balance of the total deposits in the domestic currency of the respective institutions at the end of the previous week is not more than 1 %. This arrangement will be implemented by making necessary amendments to the existing procedures.
- ❑ BFs that are unable to manage the necessary liquidity through the interbank market, daily liquidity facility, open market transactions and permanent liquidity facility will be provided with the Lender of Last Resort Facility - LOLR by adding a penalty rate of 2% points to the bank rate if requested by that institution. Procedures related to the Lender of Last Resort facility will be issued.
- ❑ Mandatory Cash Reserve Ratio (CRR) to be maintained by BFs will be increased by 1% point with effect from mid-August 2022 to 4%.
- ❑ By mid-January 2023, the Statutory Liquidity Ratio (SLR) to be maintained by BFs will be increased and arrangements shall be made such that SLR for commercial banks will have to reach 12% and development banks and finance companies will have to reach 10%.

Arrangements related to financial sector for FY 2022-23

Financial Sector Reform and Regulatory Provision

- ❑ Necessary review will be done on the regulatory arrangements such as loan restructuring and rescheduling, interest capitalization, dividend distribution, etc. adopted to speed up the economic revival during the COVID pandemic.
- ❑ Necessary arrangements will be made to implement the Countercyclical Capital Buffer from mid-July 2023, which was postponed from FY 2019-20 due to COVID-19. Studies will be conducted regarding the implementation of the above provision on a regional basis as well.
- ❑ Arrangements will be made to provide rebates and facilities related to mergers and acquisitions from NRB with a condition that commercial banks and microfinance financial institutions merge within their own categories or are acquired and start joint operation by the end of mid-January 2023.
- ❑ Large Exposure Framework will be prepared for the identification of the borrowers utilizing large-scale loans. The existing limit on single-customer loans will be reviewed.
- ❑ Macro Stress Testing Framework will be prepared and implemented to test the pressure on the banking sector due to fluctuations in macroeconomic variables.
- ❑ Arrangements will be made to ensure non-chargeability of the penal interest in case of the loan up to NPR 50 million from BFs availed for running businesses if the payment of the principal amount of loan along with interest up to the period of mid-July 2022 is done by the end of mid-October 2022.
- ❑ There will be a gap in the interest rate of credit extended toward productive sectors and commercial sectors. As of now, banks and financial institutions will be allowed to determine the interest rate by adding a maximum of 2% points of premium to the base rate when extending credit up to NPR 20 million on the productive sectors.
- ❑ Arrangements will be made to determine the interest rate by adding a maximum of 2% points to the base rate when extending credit to the private sector for the construction of information technology and industrial parks.
- ❑ Arrangements will be made for BFs required to maintain the ratio between loan amount and the fair market value of mortgage security at a maximum of 30% inside Kathmandu valley and at a maximum of 40% in the case of other places wherein the home/land as kept as collateral when providing working capital loans without a specific purpose, mortgage loans, property loans, personal term loans.

Nepal Infrastructure Development Bank established to invest in the infrastructure sector will be encouraged to increase the paid-up capital

through mergers and acquisitions with other financial institutions established and operating in order to invest in the infrastructure sector itself.

- ❑ Existing provisions as issued from NRB regarding the suspension of securities transactions at the time of merger and acquisitions of BFs will be repealed and provisions will be made in accordance with the regulations of the Securities Board.
- ❑ An individual or institution can take margin loans against the collateral of shares maximum up to NPR 120 million from one financial institution or from the entire financial institutions. Provision for margin loans shall be removed once the regularization and systematic process through the stock broker is established.
- ❑ A draft of Green Taxonomy will be prepared, including issuing green bonds, climate risk reporting, identifying capital needs, etc. to encourage Green Financing.

Foreign Exchange Management

- ❑ Necessary amendments in Foreign Investment and Foreign Loan Management Regulations, 2078 shall be made in order to simplify the process of automation of the foreign investment flows, support foreign investment, simplification in the process of repatriation of branch office's profit and repatriation to other countries etc.
- ❑ Existing policy regarding derivatives will be reviewed to ease in process of mobilization of foreign currency loans from foreign countries by BFs for the purpose of managing foreign exchange risk.
- ❑ To widen the scope of remittance flow into Nepal from Nepali citizens, foreign citizens and overseas organizations/associations, the existing arrangements related to remittance will be reviewed.
- ❑ Nepali citizens going abroad for foreign employment shall be required to have compulsory bank account to get foreign currency equivalent facilities. In addition to this, Nepali citizen will get various services and facilities from GoN based on evidence to prove that remittances were brought in through formal means. For this necessary coordination will be done with related agencies.
- ❑ Appropriate policy and arrangements shall be made in order to facilitate remittance from electronic and digital card issued by foreign BFs directly into cards issued by Nepali BFs (card to card).
- ❑ Necessary policy arrangements shall be made for encouraging the export of information technology and other services to bring in foreign currency.
- ❑ The existing system of maintaining a cash margin while issuing a letter of credit for the import of certain items shall be reviewed sequentially.
- ❑ Arrangements shall be made for implementation of the provision by BFs such that they can issue draft, T.T. / Letter of Credit only after analyzing international market price and proforma price of concerned goods.
- ❑ Provisions for compulsory training arrangement shall be made for employees of BFs who are involved in trade finance and credit operations for methods of import-export of goods and services, methods of payments used, country-wise challan for goods and credit analysis at regular intervals.
- ❑ To manage the risk in the foreign exchange market, NRB will conduct necessary studies/research regarding USD/NPR swap with commercial banks.

Refinancing and concessional loans

- ❑ Refinancing facility shall be continued for productive sectors including agriculture sector, small enterprises, export oriented business and highly affected area from COVID-19. Refinancing facility shall be gradually decreased such that by the end of mid-July 2024, such loans shall be equal to the balance of the respective fund.
- ❑ Studies will be conducted regarding the usability and effectiveness of the programs related with refinancing facilities in operation with the aim of increasing credit flow in the productive sector, concessional loans, underprivileged loans etc.

- ❑ A study will be done in relation to alternative forms of financing such **Peer-to-Peer Lending, Crowdfunding** to increase credit access to start-up businesses.

Provisions relating to Microfinance

- ❑ Microfinance financial institutions will be encouraged to provide financial services to remote and backward areas as per social banking concept.
- ❑ Arrangements will be made for wholesale loans by BFIs to microfinance, financial institutions under underprivileged class loans in a manner that the interest rate shall be determined by adding a premium of only 2% points to the base rate while disbursing.
- ❑ Necessary arrangements will be made for microfinance financial institutions to issue bonds equal to their treasury to mobilize resources.

Payment System

- ❑ Continuation has been given to encourage electronic payment and transactions. Necessary institutional coordination shall be made in order to celebrate FY 2022-23 as the promotion of electronic transactions and payments year. Studies will be done for the establishment of the Innovation Center/ Regulatory Sandbox.

Financial Literacy and Financial Inclusion

- ❑ A financial inclusion index will be prepared to measure the real status of financial access in Nepal with expanding the scope of the financial sector.
- ❑ Financial Customer Protection, Digital Financial Literacy, and Financial Literacy Training Guide will be issued under the Financial Literacy Framework 2022. Necessary coordination will be done among GoN, the Ministry of Education, Centre for Syllabus Development for the inclusion of Financial Literacy in the school syllabus.

right people
right size
right solutions

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