Nepal Rastra Bank’s Monetary Policy
2074/75
(Highlights & Analysis)

The following is a summary of Nepal Rastra Bank’s Monetary Policy for the Fiscal Year 2074/2075. Factors most relevant to the Capital Market have been included.

Analysis

Nepal Rastra Bank has set out the new monetary policy for the FY 2074/75 with the primary objective of achieving a high economic growth rate with a target of 7.4% growth for the year while at the same time managing inflation rates to low levels and also reducing the credit to unproductive sectors, especially real estate and increasing the loans to productive sectors. It has listed energy, agriculture, tourism and SMEs as the top priority sectors and has allotted proportion of lending by BFIs to these sectors.

The central bank seems comfortable with the current high interest rates and therefore hasn’t provided any measures or efforts to lower the prevailing high interest rates. It has even ended the provision of reducing 50% of lending to priority sector in the calculation of credit to core capital and deposits ratio. This reluctance is in part because the current high interest rates have helped with its policy to the increase deposit rates.

The maintenance of high interest rates should help in limiting high inflation rates which can provide substantial relief to consumers who have experienced extremely high inflation rates the year before. Although maintaining high interest rates seems counterproductive to achieving high economic growth as it discourages borrowing and capital expenditures, the central bank’s allocation and requirement for BFIs to lend at least 25% for productive sectors can provide substantial boost to private sector spending and capital expenditures. This can be seen as a positive move for economic growth as higher portion of investment will now be channeled into the productive sectors and less to other sectors such as consumables, autos and real estate.

The Loan to Valuation ratio (LTV ratio) for real estate inside the Kathmandu Valley has been reduced from the already lowered 50% to 35%. One of the major impacts that the lowering of loans to valuation for Real Estate inside the Kathmandu Valley will have is that it would significantly reduce the demand side for real estate creating a downward pressure on real estate prices. Also, this will create leftover money that would have
normally gone into real estate at the 50% LTV level than the now reduced 35% LTV level (since less investors will be able to purchase real estate at the 35% LTV level). The investors with the leftover money will start to seek other investment options such as bank deposits and the capital market. This will lead to lower interest rates and higher stock market valuations.

The new monetary policy will provide some relief to the automobile sector with banks now being able to loan upto 65% of the purchase price. Although increased from the current 50%, this value is still low as in the past, banks used to finance much larger portions of vehicle loans.

The overall impact of the new monetary policy will be in taming the exponential increase in real estate prices, lowering the amount of imports of automobiles which will help in reducing the trade deficit of the country. Help to fight inflation as it encourages savings and discourages borrowing. The necessary capital will also be channeled to more significant sectors for economic growth such as agriculture, energy, tourism and entrepreneurial firms.
The following are the key highlights from the speech by Nepal Rastra Bank’s Governor Dr. Chiranjivi Nepal:

**Background**

Nepal Rastra Bank is excited by the 2073/74 economic situation of the country. There was high growth rate, low inflation and surplus in balance of payment which creates more optimism for the year ahead. There has been improvement in the low interest rates of the bank deposits which has been taken positively by NRB.

**Summary of Economic conditions**

NRB expects a growth of 6.9% for the fiscal year 2073/74. The target inflation rate is below 7.5% and the average inflation rate for the first 11 months was 4.6%.

**Summary of Monetary and financial situation**

**Inflation, liquidity management and interest rates**
- There has been a year over year growth of 16.8% in money supply. There also has been an increase of private sector loans of 21.8% and an increase in deposits of 15.5%.
- For the current fiscal year Rs 546.29 arab liquidity has been supplied while Rs 115.5 arab liquidity has been absorbed.
- There has been an increase in short term interest rates and increase in interest rates on short term loans and deposits. This has cause a positive growth in deposits.

**Financial Programs update**

There has been an expansion in the private sector loans. Till Jestha of 2074 17.5% of total loans have been floated to priority sectors of agriculture, energy, tourism and small and household businesses. Also 5.9% of the total loans of the BFI’s have been floated to the deprived sector.

**The framework of the monetary policy**

**Guidelines for the Monetary Policy**
- The monetary policy has been drafted in view of the internal and external scenario and to work in tandem with the government’s 14th plan, the strategic plan, financial sector development strategy and the policies, programs and priorities listed in the budget.
• To achieve the target growth rate of 7.2% while at the same time keeping in mind the inflationary pressures that can be created and also keep the financial statistics in the desired range.

• The monetary policy will be focused on keeping the interest rates in the appropriate levels and minimize the fluctuations in the interest rates.

• High priority has been given to providing loans to the priority sectors of agriculture, energy, tourism and small and other entrepreneurial enterprises.

• High priority has been given to the extension of banking services to the 744 local levels according to the federal structure.

**Economic and Monetary Targets for the fiscal year 2074/75**

• Keep inflation below 7%.

• Maintain foreign exchange reserves worth goods and services imports of at least 8 months.

• Implement liquidity management to support the government to achieve its target growth of 7.2%.

• Make arrangements for the continuation of the pegged system with the Indian Rupees.

• Limit the growth rate of private sector loans to within 20%.

**Implementation of the Monetary Policy and instruments used**

• The continuation of the Interest Rate Corridor system implemented since 2073/74 and alter it on a time appropriate fashion.

• The required cash reserves level and liquidity ratios for BFI’s will be left unchanged.

• Hydropower, agriculture, tourism, export, SMEs, pharmaceuticals, cement, garments and other productive sectors will be defined as priority sectors.

• Commercial Banks will be required to lend 25% of their total loans to priority sectors with 10% to agriculture sector, 5% to hydropower, 5% to tourism and the remaining of the 25% allotment for priority sectors to other priority sectors by Asadh 2075.

• Development banks and finance companies will also have to lend a minimum of 15% and 10% respectively to the priority sectors.

• Commercial banks will have to lend 5%, development banks 4.5% and finance companies 4% of their total loans to deprived sectors.
Financial sector related Programmes for 2074/75

Overall prudential supervision

- Arrangements will be made to implement BASEL III on national level development banks and Financial institutions also.
- Commercial banks will have to maintain the level of institutional deposits to 45% of total deposits by Asadh 2075.
- The provision of reducing 50% of lending to priority sector in the calculation of credit to core capital and deposits ratio will be discontinued.
- BFIs can only lend upto 40% of their core capital in loans with shares(securities) as collateral with the maximum of 10% of the core capital against any one particular stock.
- The limit of personal home loans has been increased from Rs. 1 crore to 1.5 crore.
- The LTV ratio, (loan to value) for real estate loans within Kathmandu valley has been reduced from the current 50% to 40%. However, the LTV ratio of 50% will be continued in other areas of the country. This is believed to help in the development of the federal structure of the country.
- To proportion of the loans to value for auto loans has been increased from 50% to 65%. This means that lower down payments will be required for auto loans which should come as a relief for the auto dealers. BFIs can lend upto 80% of the value for electric vehicles.
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