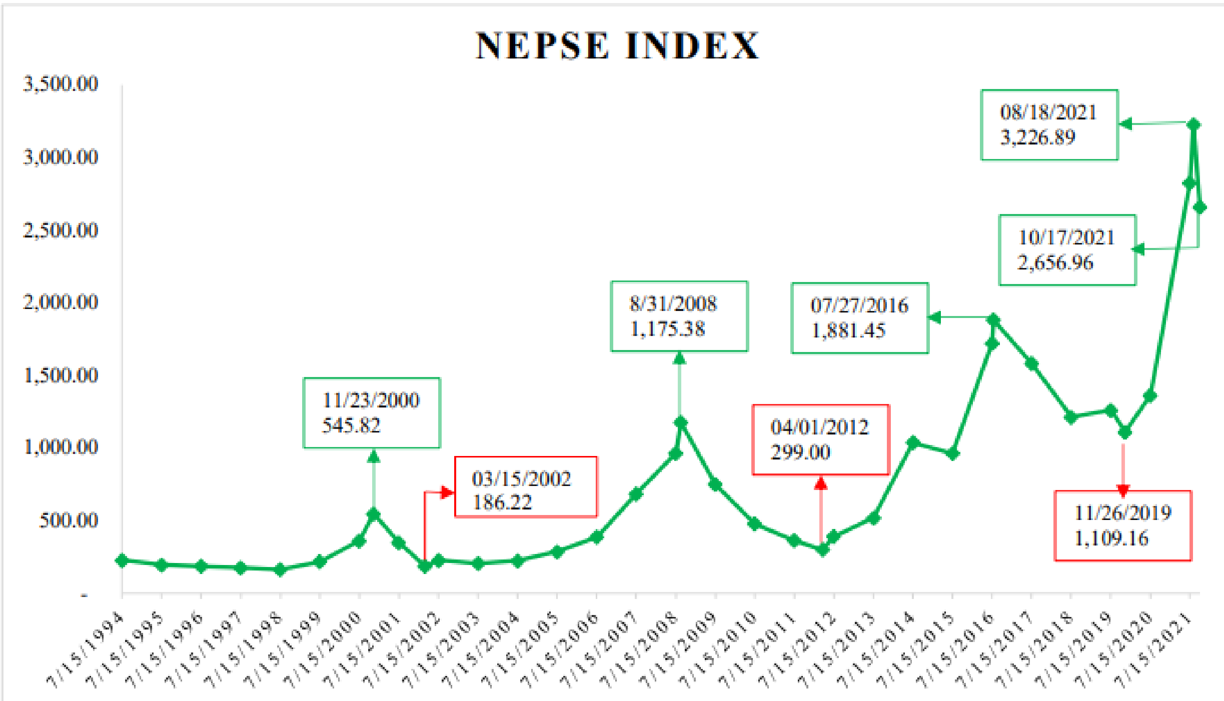
History of market downtrend in Nepal

Booms and busts are part of the market cycle. Following a euphoric year in the stock market last fiscal year, the first quarter saw our benchmark index decline by 7.85%. Below we have discussed various economic as well as political factors that played a role in bursts of stock market bubbles.



First market downtrend of 2002

From 1994 to 1999, our country witnessed robust GDP growth, growing on average by 6% every year. This led to a euphoria in the capital market too. But by the year 2000, the GDP growth had reduced to 4.80% followed by further deteriorating GDP growth of 0.10% in 2001. At the time, Nepal's economy was dominated by the agricultural and service sectors, with agriculture output accounting for a substantial portion of the country's GDP. Drought and poor weather, as well as a lack of improved irrigation facilities, hampered the agricultural sector's production.

Apart from the economic condition, politics was another key issue that resulted in the market downfall. Civil war had resulted in killing and occupying public property unlawfully and that had changed the government's focus from the development of the country to the protection of citizens. Uncertainty in the political environment fostered insecurity in several businesses, including tourism, as a result of which output in all of these sectors declined, resulting in a sharp drop in GDP growth. Furthermore, the Royal family massacre also occurred at the same time.

The unstable political and economic situation discouraged investors from entering the stock market as the focus of the general people was to save their current wealth rather than grow it. As a result the index declined by 65.88% from a then all-time high of 545.82 on 23rd November, 2000 to 186.22 on 15th March, 2002.

Second market downtrend (2008 to 2012)

The market reached the lowest level of 186.22 points in 2002 after its first bull run due to increase in violence during the civil war. The formal end of civil war with the peace accord signed in November 21, 2006 brought the war to its end and gave hope to all the investors that stability and revolutionary industrial growth will be the new era, thus, elating the stock market. Furthermore, the announcement of the constitution assembly election on April 10, 2008 led to a bull run with the highest closing index level at 1175.38 points generating a sizable return of 531.18% (32.77% annual compounded returns) to the investors. However, the result of the election jolted the investors and capitalists as the Maoists the strongest force with 220 seats in the constitution assembly. Both the Prime minister (Prachanda) and the finance minister (Baburam Bhattarai) were from Maoist having an unfavorable attitude towards the capital market, the finance minister stating it to be no different than a gamble house and an unproductive sector. Naturally concern was elevated regarding the future of private enterprises and the possible cap on profitability by the communism leaning regime igniting fear and inducing sell off in NEPSE.

The sell-off pushed the market downward with investors losing almost 75% (31.78% compounded loss) of their wealth within a time span of just three and a half years as the market went to the lowest level at 299 points on 1 April, 2012.

Third market downtrend (2017 to 2019)

With the NRB increasing the paid-up capital of the banks by 4 times, investors rushed into the market in anticipation of a lucrative dividend and right shares. The recent earthquake had already depressed the loan demands and caused the interest rates to decline. Furthermore, the economic blockade imposed by India brought a halt to our imports. Being a net import nation, halt in imports further depressed the loan demands. With no other avenues to invest in, the liquidity started flowing in towards the stock market. This was the key reason for the boom in the market in 2016.

However, the very policy which triggered the bull market also was responsible for the burst too. The main reason for the central bank to increase the paid-up capital was to encourage the already competitive banks to go into mergers with one another. However, they instead opted to issue various primary instruments like right shares, bonus dividends and FPO to raise their paid-up capital. It resulted in increased competition among the banks as they got pressure to increase their profitability on par with their increased capital. This ushered in some unhealthy competition, and to attract the customers, deposit rates began soaring as additional deposit creation remained modest. The increased deposit rates raised the loan rates and the high loan rates discouraged investors to invest in the stock market with borrowed money. Furthermore, return from the banking sector was comparable to the return from the stock market and that attracted institutional investors to invest in FDs as that provides a larger margin of safety. Despite the institutional investors depositing their funds in the banks, it was still not enough to maintain high profitability and the interest rates kept swelling owing to the liquidity crunch. The final trigger for the burst was the appointment of Dr. Yubaraj Khatiwada as the new finance minister. High hopes were placed on him after his appointment to develop the capital market given his robust background. However, in his first speech as the finance minister he called the stock market an unproductive sector. Following his remarks, the market, which had been trading sideways with negative sentiment, began to fall even more.

Lack of faith shown by the government followed by a persisting liquidity crunch was the main reason to trigger the downfall. The NEPSE index declined by 41.05% from a then all-time high of 1,881.45 on 27th July, 2016 to 1,109.16 on 26th November, 2019.

Current market downtrend (2021)

COVID-19 created an environment for high liquidity in the banking system due to partial to complete shutdown of domestic businesses and halt in imports. With increase in deposits through remittance growth and significant reduction in credit flow the fixed income instruments provided meager returns and the surplus funds were channelized into the capital market booming both the transaction volume as well as the NEPSE index. The investors reaped a total return of 190.93% at the highest level of 3226.89. However, in recent days the business activities have resurfaced to 60% to 80% of the pre covid level largely due to herd immunity and vaccination drive. This has led to increase in credit demand, while, on the other hand YOY decrease in remittance inflow has significantly decreased liquidity in the banking system. Decrease in liquidity has led to a spike in interest rates of directly competing fixed deposit instruments to nearly 9.5% inducing investors to switch the assets class. Furthermore, the provisions in monetary policy demanding the adoption of CD ratio along with cap on single obligor limit to Rs.120 million on margin lending have firstly added to liquidity crunch and secondly kindled the need to sell shares to meet the requirement.

The increase in interest rates, escalation in selling pressure due to monetary policy, and profit booking by early entered investors, and sell for festive season cash requirement have led to the recent downtrend in NEPSE index wiping out 17.66% of investors’ wealth in just two months with index at 2656.96 points.