Monetary Policy Expectations 2025/26

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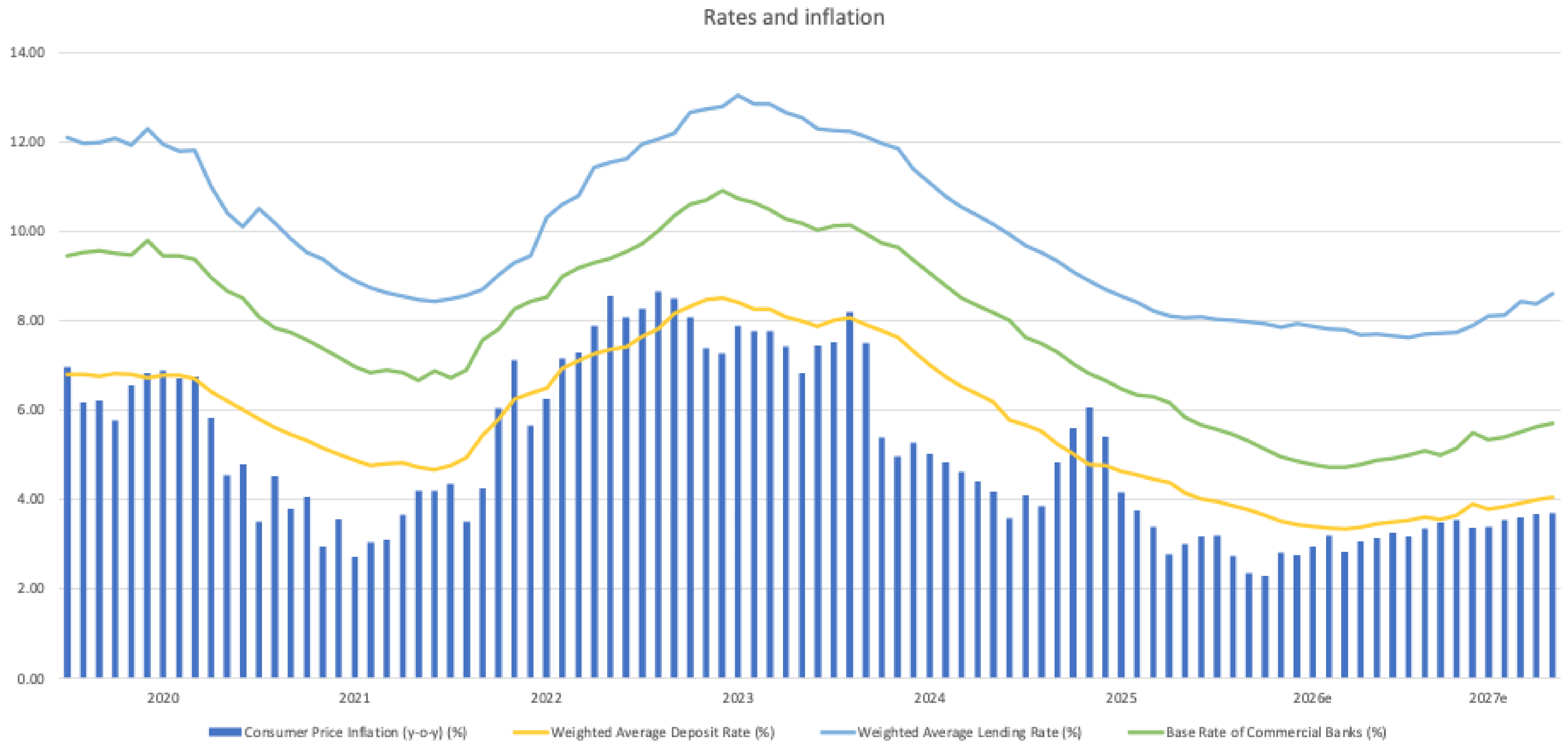
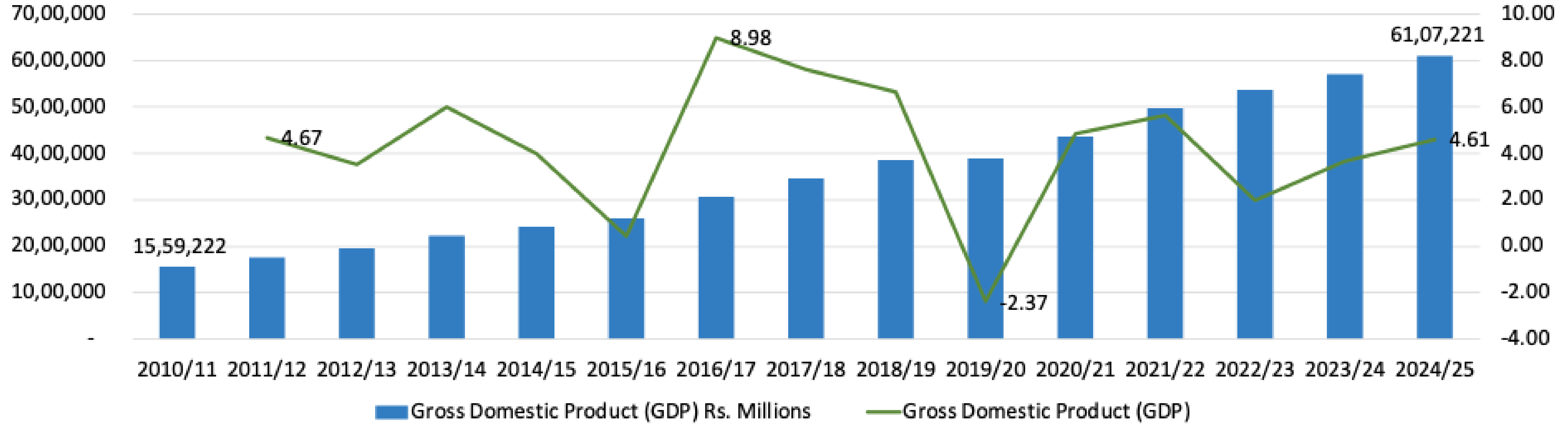
Opinions expressed are solely my own and do not express the views or opinions of the NDF.

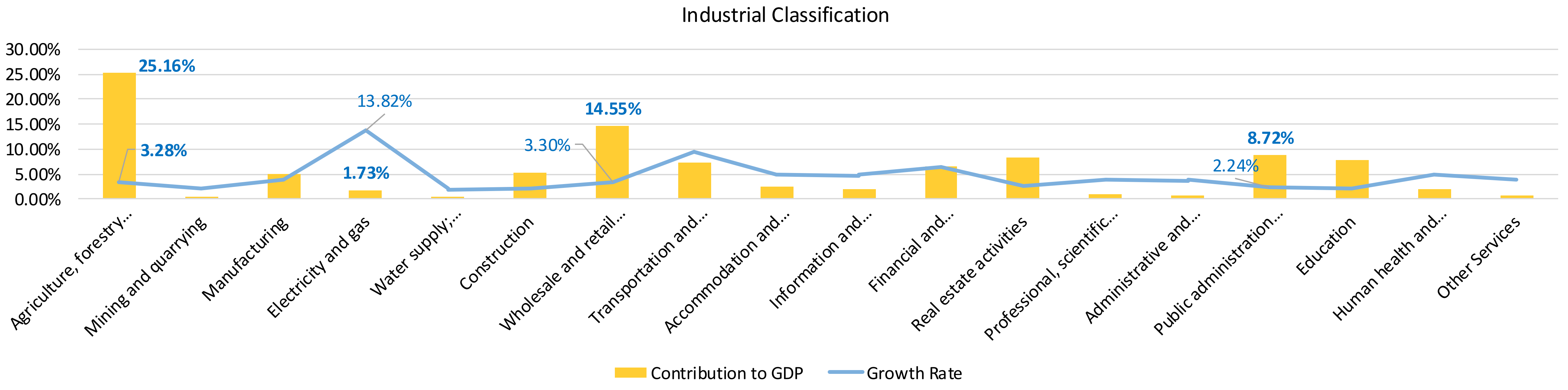
Key Indicators

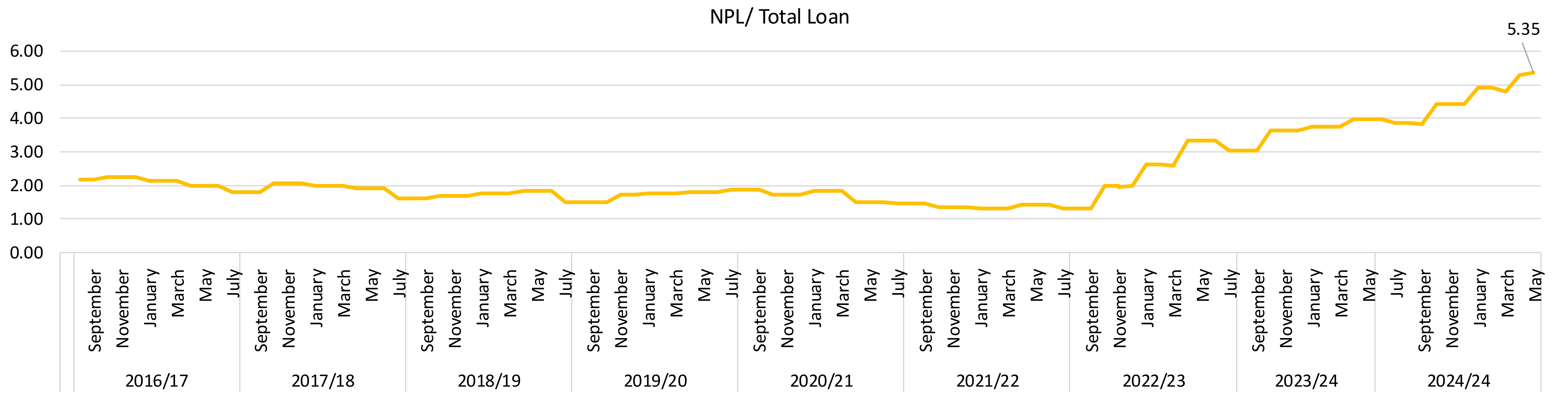
Key Financial Indicators	Jul-20	Jul-21	Jul-22	Jul-23	Jul-24	Apr-25	May-25
Core Capital / RWA (Tier-1)	11.78%	10.92%	10.73%	10.53%	10.10%	9.52%	9.57%
Capital Adequacy (Total CAR)	14.02%	14.14%	13.53%	13.37%	12.84%	12.35%	12.42%
Deposit. Rs. In Million	34,89,390	42,04,016	45,44,362	50,86,244	57,56,771	61,23,322	61,48,794
Loan Rs. In Million	29,03,588	37,16,941	41,33,616	42,90,768	45,13,904	48,20,200	48,30,442
CD Ratio (Credit/Deposit)	70.14%	77.78%	86.47%	83.00%	78.65%	78.80%	78.56%
Liquidity Ratio (Liquid Assets/Deposits)	29.96%	27.77%	25.48	29.10%	32.21%	31.18%	
Statutory Liquidity Reserve and minimum requirement 10% (SLR)	24.02%	21.97%	19.88%	24.35%	28.73%	27.41%	29.60%
Base Rate	8.50%	6.88%	9.54%	9.98%	8.01%	6.28%	5.84%
Spread	4.10%	3.61%	41.90%	4.45%	3.98%	3.77%	3.73%
Loan Loss Provision/Loan	1.81%	1.40%	1.20%	2.98%	3.76%	5.05%	5.35%
Agriculture	12.63%	13.16%	12.53%	12.89%	13.12%	13.78%	
Hydropo wer/Ene rgy		6.00%	5.71%	6.96%	8.08%	8.80%	8.73%
SME		10.13%	9.39%	9.85%	8.76%	10.92%	

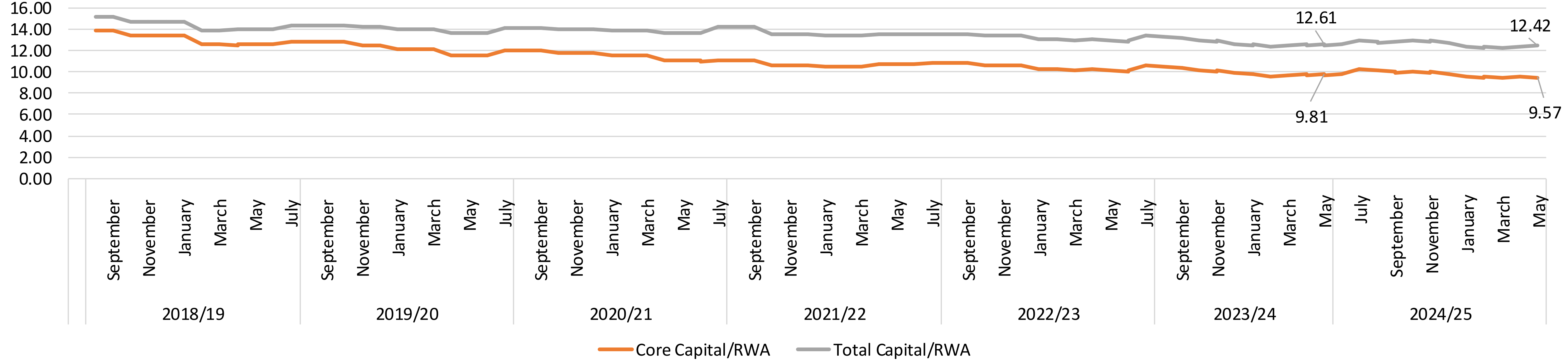
Interest rates and Inflation




70,00,000
60,00,000
50,00,000
40,00,000
30,00,000
20,00,000
10,00,000
-
10.00
8.00
6.00
4.00
2.00
0.00
-2.00
-4.00
15,59,222
4.67
8.98
-2.37
61,07,221
4.61
2010/11
2011/12
2012/13
2013/14
2014/15
2015/16
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
Gross Domestic Product (GDP) Rs. Millions
Gross Domestic Product (GDP)


Industrial Classification
30.00%
25.00%
20.00%
15.00%
10.00%
5.00%
0.00%
25.16%
3.28%
13.82%
1.73%
14.55%
3.30%
8.72%
2.24%
Agriculture, forestry...
Mining and quarrying
Manufacturing
Electricity and gas
Water supply;...
Construction
Wholesale and retail...
Transportation and...
Accommodation and...
Information and...
Financial and...
Real estate activities
Professional, scientific...
Administrative and...
Public administration...
Education
Human health and...
Other Services
Contribution to GDP
Growth Rate


NPL/ Total Loan
5.35
6.00
5.00
4.00
3.00
2.00
1.00
0.00
September
November
January
March
May
July
2016/17
2017/18
2018/19
2019/20
2020/21
2021/22
2022/23
2023/24
2024/24


16.00
14.00
12.00
10.00
8.00
6.00
4.00
2.00
0.00
12.61
12.42
9.81
9.57
September
November
January
March
May
July
2018/19
2019/20
2020/21
2021/22
2022/23
2023/24
2024/25
Core Capital/RWA
Total Capital/RWA

Risk Matrix

Risks	***Likelihood***	***Impact***	***Mitigation Measures***
Political Instability	*High*	*High*	*Strengthen governance frameworks and prioritize bipartisan support for key projects.*
Climate Disruptions	*High*	*High*	*Invest in disaster management and climate-resilient infrastructure.*
Weak Spending Execution and Revenue Mobilization	*High*	*High*	*Streamline budgetary processes and enhance accountability in capital expenditure and revenue mobilization.*
Declining Private Sector Confidence	*Medium*	*High*	*Implement tax incentives, regulatory reforms, and ease of doing business measures.*
External Shocks (e.g., remittance or export decline)	*High*	*Severe*	*Nepalese government revenue heavily relies on customs duties. However, the risk of reciprocal tariffs from trading partners and a potential reduction in grants from friendly nations could threaten fiscal stability. To mitigate these challenges, Nepal should focus on boosting local production, reducing government expenditures, downsizing the government structure, and increasing investment in research and development.*
Rising Non-Performing Assets (NPAs)	*Medium*	*High*	*Establish an Asset Management Company (AMC) to address banking sector vulnerabilities.*

Risk Matrix

Condition		Related effect	Trend	Risk
Low Investment/low domestic income/ High migration	Sluggish wholesale and retail operations.	Aggregate demand	Decline	High
	High unemployment	Aggregate demand	Decline	High
	Slow Corporate cash recovery/low productivity	Firm Investment	Decline	High
	Failure of SACCOs	Disposable saving	Decline	High
Trade war	Increasing commodities prices	Import Bill	Increase	High
	Energy Price	Cost of production	Increase	High
Interest Rates outlook	Excess Liquidity	Deposit rates go below inflation	Decline	High
Informal Economy	Erode trust among investors and consumers	Government Revenue	Decline	High
FDI inflow Outlook	Excessive bureaucracy, outdated regulations, weak governance	FDI inflows	Decline	High
Level of loan Default	NPA reaching all time high	Pressure on Capital	Increase	High
Demand for Working capital	Low consumer confidence	Unutilized liquidity	Low	High
Inflation outlook	Lower consumer demand	Cost of living	Decline	Low

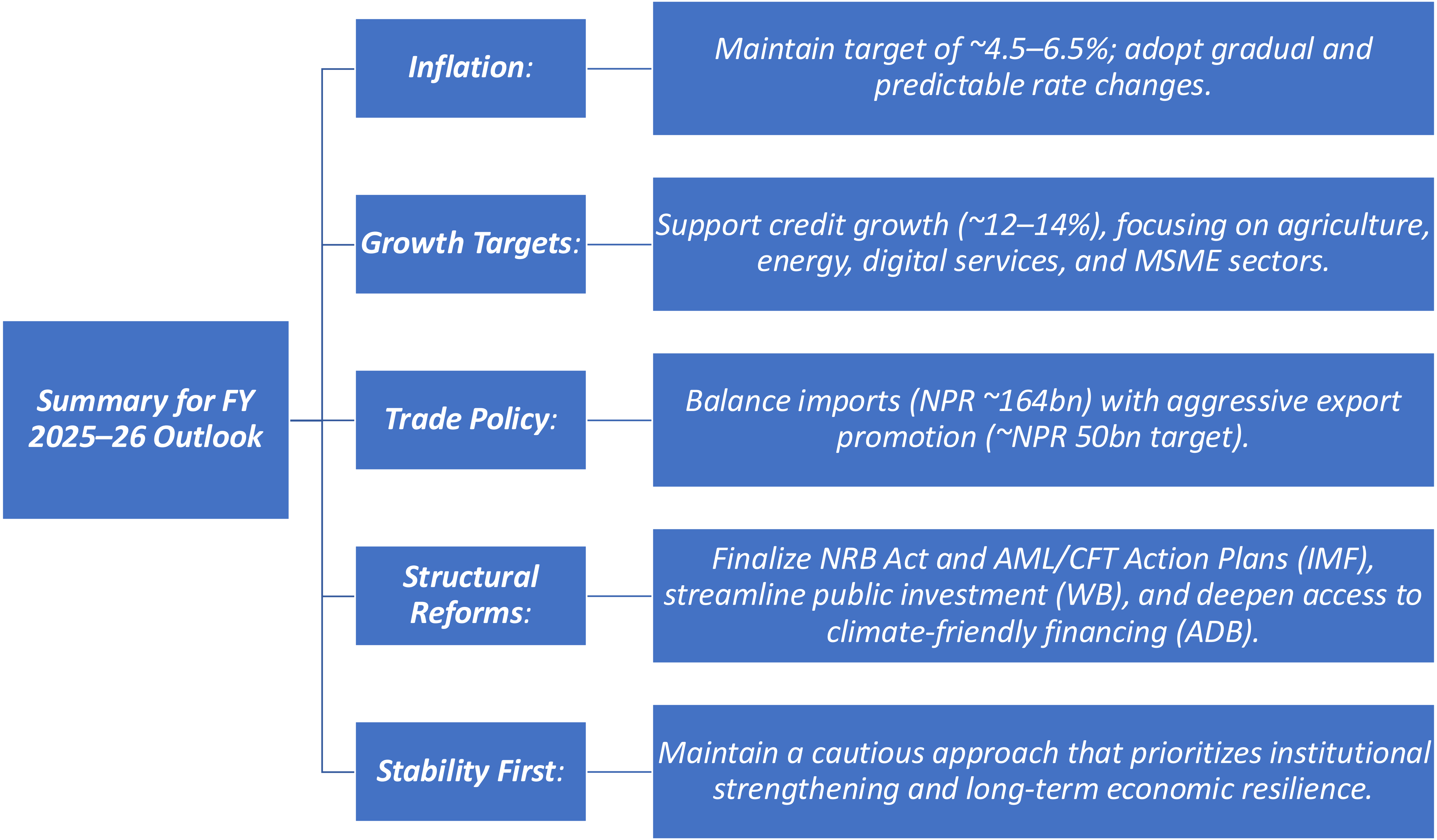
External perceptions of Nepal

Area	*Current Context (May 2025)*	*Policy Expectation (FY25–26)*	*Metrics/measures (IMF/WB/ADB)*
Inflation Target	*Inflation cooled sharply to ~2.8%; Food prices remain volatile (e.g., peaked ~9.9% in Dec 2024).*	*1. Maintain target at* ***4.5–6.0%*** *range, aligning with the government's FY25–26 goal.* *2. Gradual adjustment avoids shocks.*	*IMF advocates inflation stability via cautious monetary policy*
Policy Rates	*High rates (~6.5–8.5%) haven't boosted investment due to low credit demand.*	*Moderation by ~25–75 bps while keeping liquidity neutral for long-term stability.*	*WB highlights need for balanced rates and strong credit channels*
Liquidity Position	*Surplus liquidity (~NPR 600bn) indicating low loan utilization despite available funds.*	*Maintain open market operations and target surplus liquidity towards productive sectors (MSMEs, hydropower, agriculture).*	*ADB suggests targeted lending towards green infrastructure & inclusive projects*

Area	*Current Context (May 2025)*	*Policy Expectation (FY25–26)*	*Metrics/measures (IMF/WB/ADB)*
Credit Growth	*Credit growth sharply dropped from ~27.5% (FY21) to ~3.5% (FY23), now hovering ~5–7%.*	*Target recovery in credit growth to **11–13%**, focusing on productivity and climate-friendly loans.*	*ADB emphasizes financing climate-friendly agriculture & MSME loans*
Trade Balance	*Exports surged from NPR 8.6bn (2019) ➔ NPR 30.97bn (March 2025), imports remain high (~NPR 164bn).*	*Maintain balanced approach: support import financing for productive sectors, intensify export promotion incentives.*	*1. WB encourages export diversification,* *2. ADB supports reducing import-dependence.*
NPLs	*NPL levels rising (~5–7%), with risk of further deterioration.*	*1. Accelerate Asset Reconstruction Company (ARC) establishment,* *2. Move towards **loss-given-default provisioning**, and upgrade recovery frameworks.*	*1. IMF promotes stronger NPL resolution and aligning loan classifications with Basel III* *2. Strengthen corporate governance & loan review standards (ADB)*

Area	*Current Context (May 2025)*	*Policy Expectation (FY25–26)*	*Metrics/measures (IMF/WB/ADB)*
Previous Policy Mistakes	*1. Aggressive post-COVID credit expansion (~27%),* *2. Import restrictions causing supply bottlenecks,* *3. Delays in fiscal spending (~63%),* *4. Low effectiveness of rate transmission.*	*1. Adopt gradual and predictable rate adjustments.* *2. Focus on structural reforms over quick fixes.* *3. Avoid reactive measures that hamper long-term growth.*	*WB advocates for structural reform over short-term interventionism*
AML/CFT Framework	*FATF grey listing due to deficiencies, impacting international credibility and long-term FDI.*	*1. Finalize and implement NRB Act amendments, AML/CFT Action Plan* *2. Operationalize the High-Level Committee recommendations.*	*IMF, WB, ADB emphasize institutional strengthening and global compliance*
Forex & Export Policy	*1. Surplus Forex reserves (~17 months),* *2. Unrealized potential for export growth.*	*Maintain reserves for crisis resilience while providing structured export financing and incentives for high-tech, agriculture, and hydropower products.*	*WB & ADB call for balanced import/export policies and promoting higher value industries*
Government Spending	*Capital expenditure ~63%; rising social security burdens and slow revenue mobilization.*	*1. Enhance **public financial management*** *2. Implement WB-recommended reforms for sustainable fiscal policies.*	*WB & ADB recommend institutional reforms, improved procurement, and accountability*

Area	*Current Context (May 2025)*	*Policy Expectation (FY25–26)*	*Metrics/measures (IMF/WB/ADB)*
Outlook FY25–26	*Gradual recovery in manufacturing, services & energy (~3–14%), but agriculture (3.28%) and construction (2.21%) remain subdued.*	*Push reforms for:* *1. Climate-friendly agriculture* *2. Sustainable hydropower financing* *3. Export promotion & digitalization* *4. Stronger MSME focus and rural financial inclusion.*	*1. Finalize NRB Act amendments and AML/CFT Action Plan (IMF & WB)* *2. Accelerate climate-friendly agriculture financing & MSME access (ADB)* *3. Strengthen institutional capacity for fiscal and monetary efficiency (WB)* *4. ADB and WB emphasize climate resilience and inclusive growth policies*
Structural Challenges	*1. Import dependence,* *2. Rising NPLs (~7%),* *3. Low efficiency of monetary transmission.*	*1. Review the Provisioning norms,* *2. Establish ARCs,* *3. Adopt forward-looking risk-based supervision,* *4. Build digital platforms for credit access.*	*1. IMF suggests institutional reforms,* *2. ADB emphasizes corporate governance & SME support,* *3. WB advocates for climate & digital reforms.*


Summary for FY 2025–26 Outlook
Inflation:
Maintain target of ~4.5–6.5%; adopt gradual and predictable rate changes.
Growth Targets:
Support credit growth (~12–14%), focusing on agriculture, energy, digital services, and MSME sectors.
Trade Policy:
Balance imports (NPR ~164bn) with aggressive export promotion (~NPR 50bn target).
Structural Reforms:
Finalize NRB Act and AML/CFT Action Plans (IMF), streamline public investment (WB), and deepen access to climate-friendly financing (ADB).
Stability First:
Maintain a cautious approach that prioritizes institutional strengthening and long-term economic resilience.

Prudential Norms and Policy Recommendations

NOW FOR NOW (Immediate Actions)	NOW FOR THE FUTURE (Structural & Strategic Actions)
Strengthen Regulatory Capacity: Enhance supervision quality by upgrading data and regulatory frameworks. Reinforce NRB's autonomy and accountability.	*Modernize Loan Classification and Provisioning Norms: Align with Nepal's evolving economic conditions and global best practices.*
Review Monetary Policy Stance: Maintain neutral–to–accommodative stance, keeping a watch on rising defaults, especially within MSME segment.	*Reevaluate Asset and Liability Pricing: Assess pricing policies for both assets and liabilities to balance institutional stability and economic recovery.*
Clear Guidance for Loan Restructuring: Issue comprehensive loan rescheduling and restructuring guidelines, especially for hard-hit sectors and MSMEs. Despite lower interest rates and reduced debt servicing costs, rising default rates increase financial stability risks.	*Phase-in Countercyclical Capital Buffer: Gradually implement buffers and introduce policies to mitigate one-off impacts related to accounting treatments for debentures, bonds, and retroactive taxes.*
Interest Rate Spread Regulations: Begin review of interest rate spread ceiling constraints. Interest rates constrains the ability of financial institutions to price loans based on risk.	*Review Risk Weights and New Products: Revisit risk weighting for margin loans and private vehicle loans, and introduce home equity financing as a new product line.*
Review Working Capital Framework: Tailor working capital lending guidelines for sectoral needs.	*Prioritize Productive Sectors: Encourage lending in sectors utilizing domestic resources, improving productivity and competitive capabilities.*
Accounting Treatments for Capitalized Interests: Clarify treatments, especially prior to CCDO status, in sectors like infrastructure and tourism.	*Support Impacted Sectors: Design long-term targeted regulatory forbearance and incentives for highly impacted sectors like MSMEs, construction, and retail.*
FDI Rules: Issue interim guidelines for FDI retention and repatriation policies. Clarify overlap between central bank and other authorities (DOI, OIBN) for swift approvals and operational clarity.	*FDI Rules: Gradually evolve policies from project-based FDI to fund-based and sector-based FDI regimes. Streamline approvals, harmonize regulations across ministries, and establish predictable incentives for long-term FDI aligned with national priorities.*
*Provisioning Norms: Review and gradually shift from the **current conservative, risk-averse approach to a more risk-sensitive, resolution-linked framework**. This will enable provisions that better reflect the actual credit risk and recovery prospects, strengthening the resilience of the banking sector.*	*Liquidity and Refinancing Policy: Maintain adequate liquidity in the banking system and review the efficacy and structure of refinance facilities*

Monetary Policy Expectations 2025/26

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Tough decisions:

Authorities face tough decisions about the appropriate measures: what restrictions to impose & when to loosen them, where money will be spent & how it will be raised. The policy that economic analysis indicates is best for the economy may not be politically feasible.

Policy stance failed

We observed that the monetary policy stance failed to address the impact of low-interest rates on the economy and shortfall in government revenue due to contraction in economic activities and the impact of low interest rates on government fiscal allocations.

Monetary Policy Expectations 2025/26

Impact of Policy Mistakes

In the recent past, bank deposit and lending rates moved downwards. However, deposit growth remains impressive. Bank credit growth remained significantly lower than the average credit growth of the last ten years. Industries capacity utilization was reduced below 40% and government revenue was reduced by 15% of GDP. Consumers perception remains low

Financial distress

The share of nonfinancial firms (especially MSMEs) in financial distress has reached a level that is higher than during most previous tightening episodes. Access to external financing deteriorates even for healthy firms and the firms that are in distress are facing challenging situations.

Avoid spending

We feel that debt-ridden companies will avoid spending money on new developments or facilities, hiring, or production.

Monetary policy Expectation 2025/26

Category	**Policy Action**	**Impact**
Monetary Policy Measures	***Policy Stance****: Shift from neutral to accommodative*	*Stabilizes market rates, increases confidence, and stimulates demand*
	Policy Rates*: Reduce by >75 bps (initial ~25 bps)*	*Enables lending rate adjustment, reducing borrowing costs*
	Liquidity Ratios*: Raise CRR by 25 bps*	*Market lending rate may settle around ~9.00% by year-end*
	Balance of Payments*: Maintain forex reserves covering >7 months*	*Supports external sector stability and maintains FX rate credibility*
	Credit Growth*: Cap total credit growth at 13%; private sector at 10.5%*	*Restricts easy credit flow to import-heavy trading sectors while* ***promoting financing for mineral- and domestic raw material–based industries, household lending, productivity enhancement, energy efficiency, infrastructure, and tourism to ensure balanced and sustainable economic growth.***
	Broad Money Growth*: Maintain ~10%*	*Supports deposit mobilization, promotes savings, reduces consumption pressure*
	Growth Target*: Sustainable 4–5% annual GDP growth*	*Enables stable economic environment for long-term growth*
	Inflation*: Maintain within 5.5% (±2%) range*	*Provides room for NRB to adjust policies supporting fiscal objectives*

Monetary policy Expectation 2025/26

Prudential Norms & Regulatory Suggestions	***Policy Action***	***Impact***
Bank Supervision	*Introduce stringent policies and market-based supervision.*	*Enables more complex, forward-looking risk assessments vs historical methods*
Capital Market	*Evaluate dual pricing of bank shares and assess characteristics of margin lending*	*Improves market efficiency and promotes transparency*
Digitization	*Promote digital payment systems for enhanced security and efficiency*	*Reduces reliance on informal markets and lowers transaction costs*

Thank You!

Best regards,
Bhattarai

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