



Monetary Policy Review 2025/26

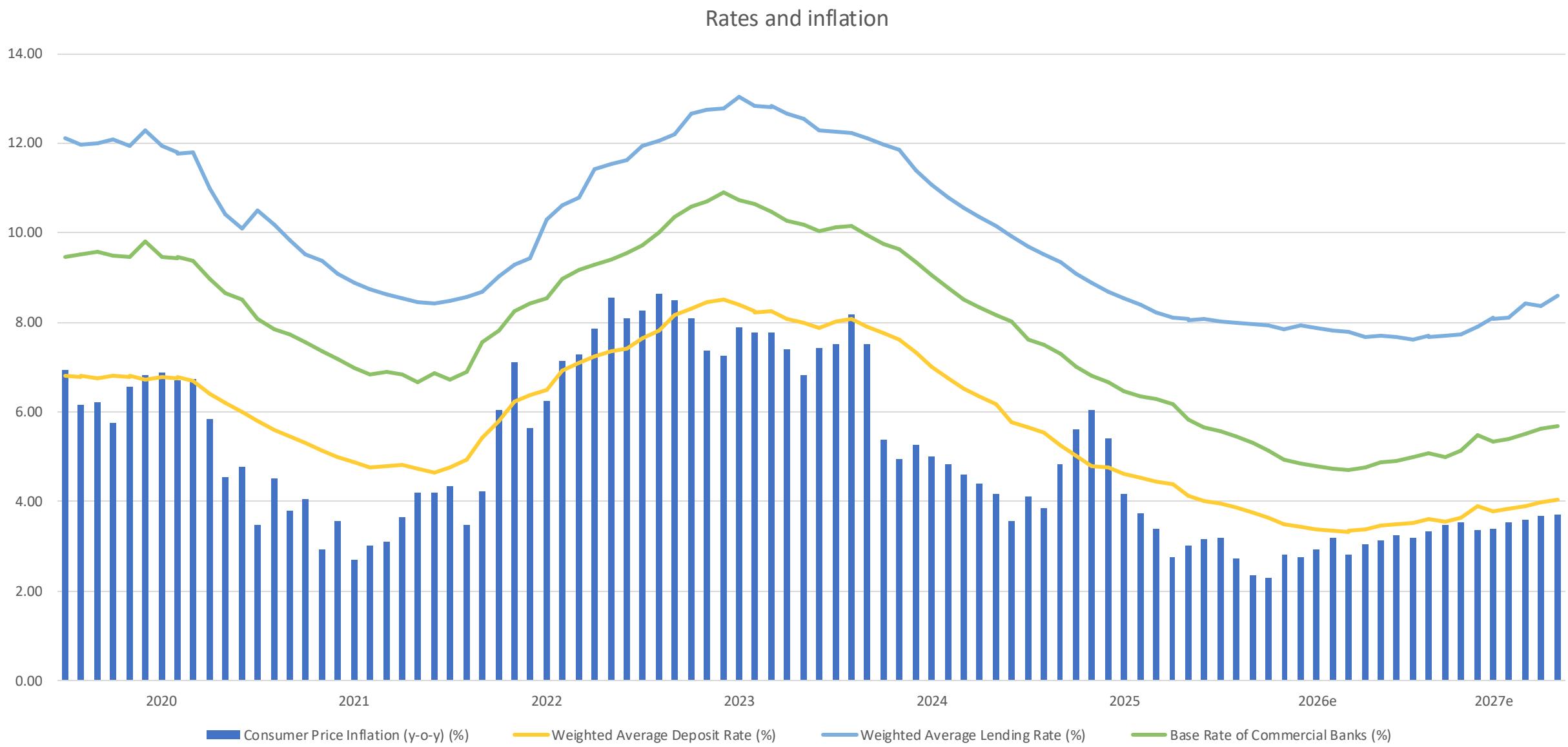
A.R. Bhattarai
CEO
N.R.N. Nepal Development Fund

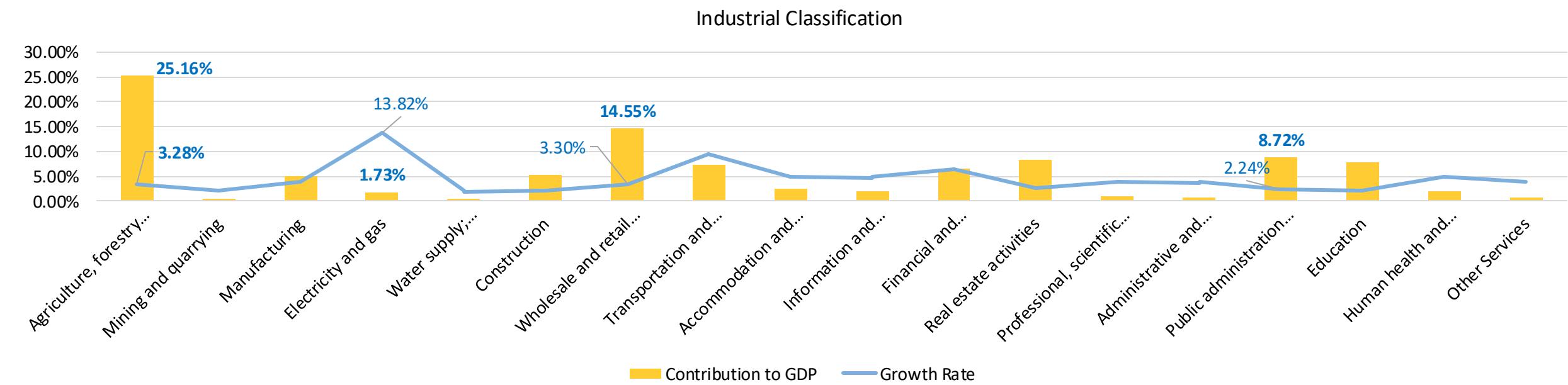
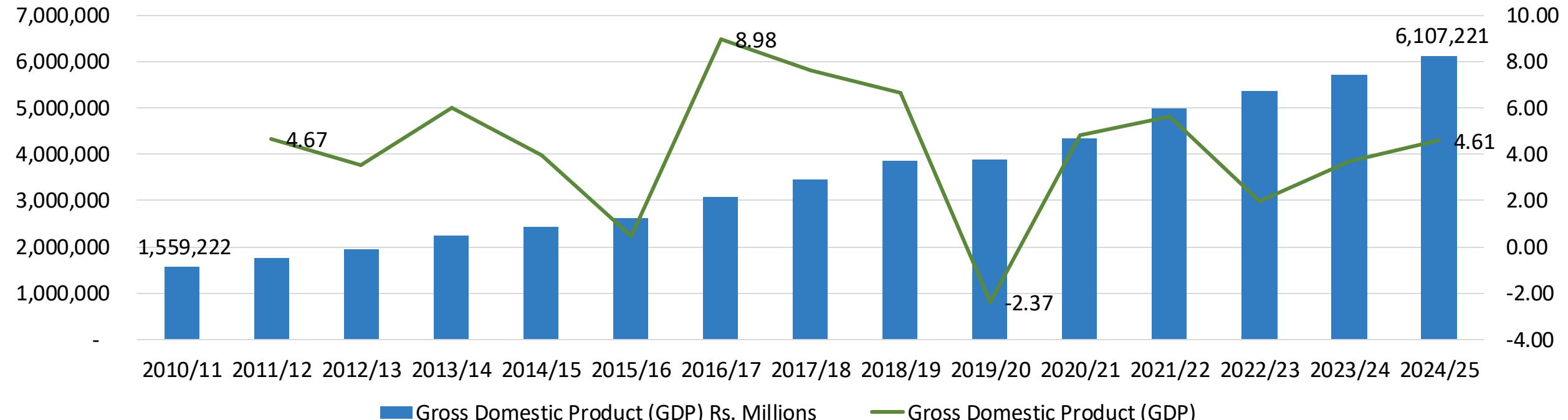
Opinions expressed are solely my own and do
not express the views or opinions of the NDF.

Key Indicators

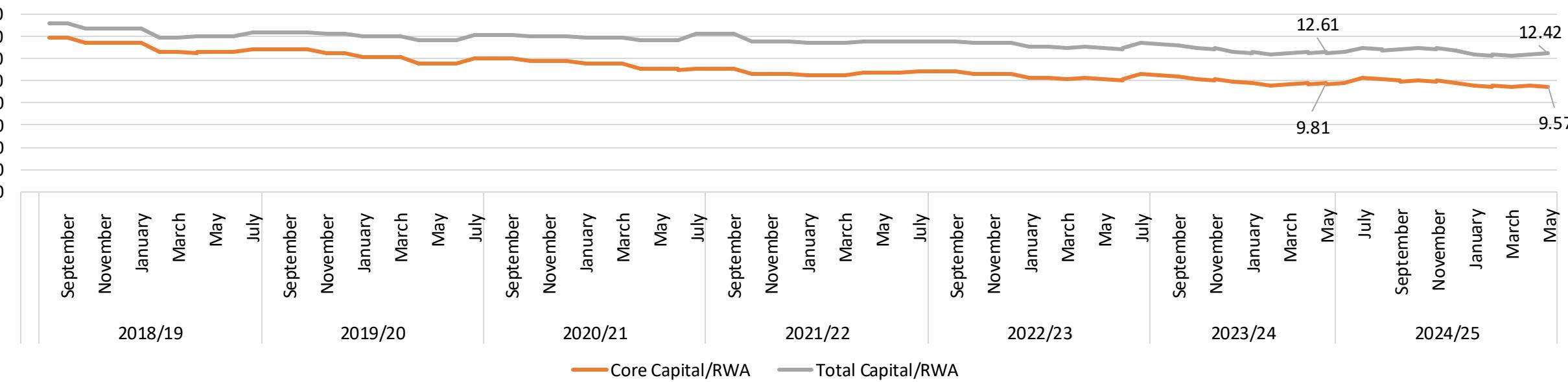
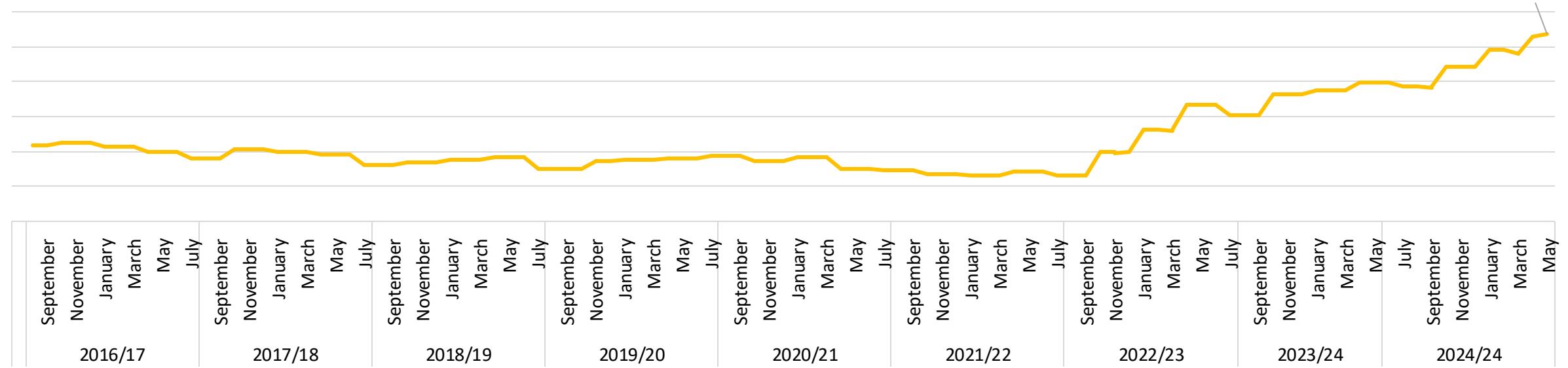
Key Financial Indicators		Jul-20	Jul-21	Jul-22	Jul-23	Jul-24	Apr-25	May-25
Core Capital / RWA (Tier-1)		11.78%	10.92%	10.73%	10.53%	10.10%	9.52%	9.57%
Capital Adequacy (Total CAR)		14.02%	14.14%	13.53%	13.37%	12.84%	12.35%	12.42%
Deposit. Rs. In Million		34,89,390	42,04,016	45,44,362	50,86,244	57,56,771	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%	13.9%
Hydropower/Energy			6.00%	5.71%	6.96%	8.08%	8.80%	9.00%
SME			10.13%	9.39%	9.85%	8.76%	10.92%	10.8%

Interest rates and Inflation





NPL/ Total Loan



Core Capital/RWA

Total Capital/RWA

Risk Matrix

Risks	Likelihood	Impact	Mitigation Measures
Political Instability	High	High	<i>Strengthen governance frameworks and prioritize bipartisan support for key projects.</i>
Climate Disruptions	High	High	<i>Invest in disaster management and climate-resilient infrastructure.</i>
Weak Spending Execution and Revenue Mobilization	High	High	<i>Streamline budgetary processes and enhance accountability in capital expenditure and revenue mobilization.</i>
Declining Private Sector Confidence	Medium	High	<i>Implement tax incentives, regulatory reforms, and ease of doing business measures.</i>
External Shocks (e.g., remittance or export decline)	High	Severe	<i>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.</i>
Rising Non-Performing Assets (NPAs)	Medium	High	<i>Establish an Asset Management Company (AMC) to address banking sector vulnerabilities.</i>

Risk Matrix

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



External perceptions of Nepal

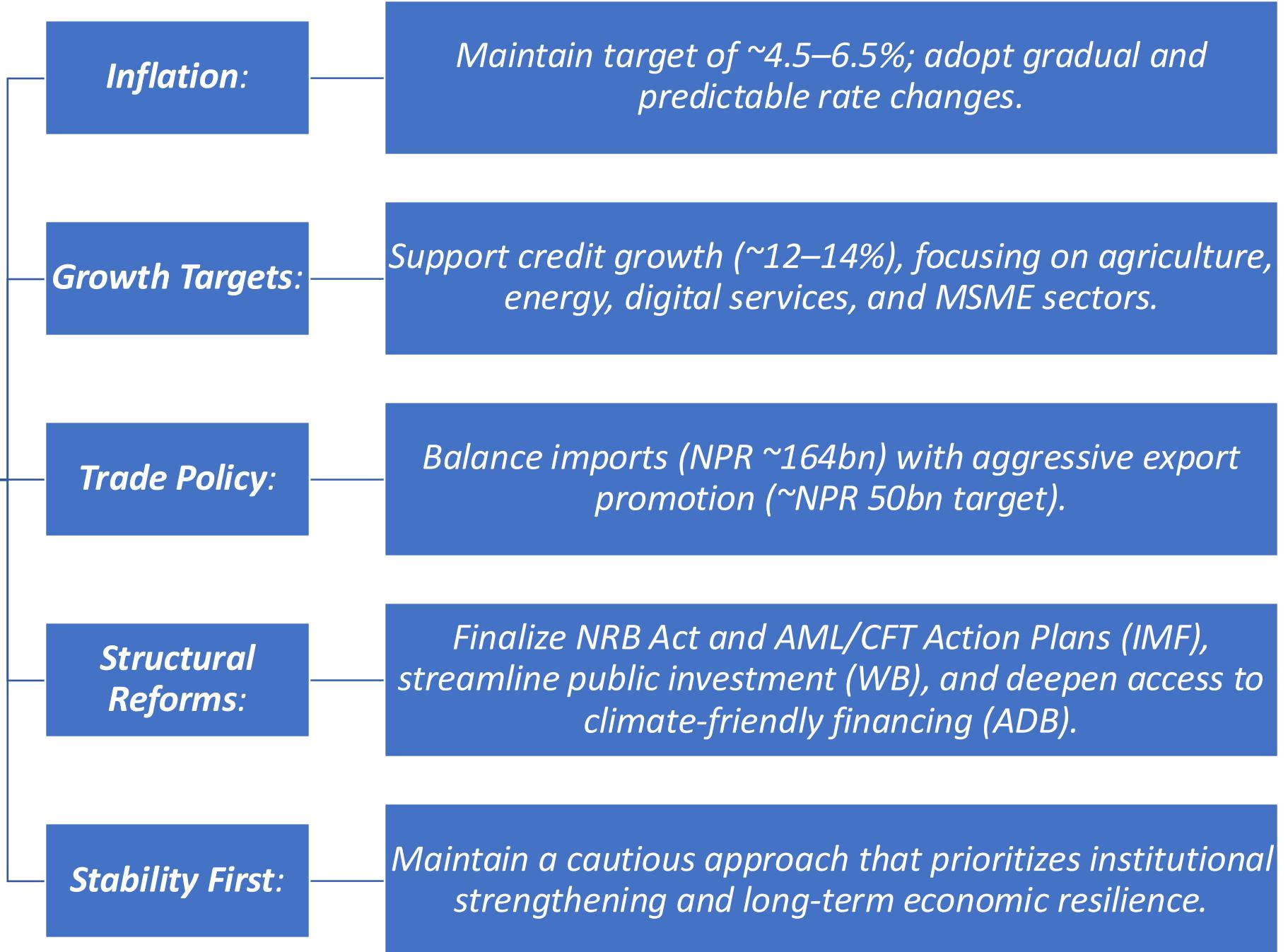
Area	Current Context (May 2025)	Policy Expectation (FY25–26)	Metrics/measures (IMF/WB/ADB)	NRB Response
Inflation Target	Inflation cooled sharply to ~2.8%; Food prices remain volatile (e.g., peaked ~9.9% in Dec 2024).	<ol style="list-style-type: none"> 1. Maintain target at 4.5–6.0% range, aligning with the government's FY25–26 goal. 2. Gradual adjustment avoids shocks. 	IMF advocates inflation stability via cautious monetary policy	Acknowledged Maintain inflation ~5%
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	Acknowledged Bank rate Reduced by 50 bps
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	Acknowledged Introduce new provision for MSMEs, hydropower and agriculture

Area	Current Context (May 2025)	Policy Expectation (FY25–26)	Metrics/measures (IMF/WB/ADB)	NRB Response
Credit Growth	<i>Credit growth sharply dropped from ~27.5% (FY21) to ~3.5% (FY23), now hovering ~5–7%.</i>	<i>Target recovery in credit growth to 11–13%, focusing on productivity and climate-friendly loans.</i>	<i>ADB emphasizes financing climate-friendly agriculture & MSME loans</i>	Acknowledged Maintain credit growth ~12%
Trade Balance	<i>Exports surged from NPR 8.6bn (2019) → NPR 30.97bn (March 2025), imports remain high (~NPR 164bn).</i>	<i>Maintain balanced approach: support import financing for productive sectors, intensify export promotion incentives.</i>	<i>1. WB encourages export diversification, 2. ADB supports reducing import-dependence.</i>	Acknowledged Maintain forex reserves covering >7 months
NPLs	<i>NPL levels rising (~5–7%), with risk of further deterioration.</i>	<i>1. Accelerate Asset Reconstruction Company (ARC) establishment, 2. Move towards loss-given-default provisioning, and upgrade recovery frameworks.</i>	<i>1. IMF promotes stronger NPL resolution and aligning loan classifications with Basel III 2. Strengthen corporate governance & loan review standards (ADB)</i>	Acknowledged Provisioning Norms will be reviewed

Area	Current Context (May 2025)	Policy Expectation (FY25–26)	Metrics/measures (IMF/WB/ADB)	NRB Response
Previous Policy Mistakes	<ol style="list-style-type: none"> 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. 	<ol style="list-style-type: none"> 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	Acknowledged Initiate various structural reform
AML/CFT Framework	FATF grey listing due to deficiencies, impacting international credibility and long-term FDI.	<ol style="list-style-type: none"> 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	Acknowledged Initiate various procedure reform
Forex & Export Policy	<ol style="list-style-type: none"> 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	Acknowledged Initiate various procedure reform
Government Spending	Capital expenditure ~63%; rising social security burdens and slow revenue mobilization.	<ol style="list-style-type: none"> 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)	NRB Response
Outlook FY25–26	Gradual recovery in manufacturing, services & energy (~3–14%), but agriculture (3.28%) and construction (2.21%) remain subdued.	<p><i>Push reforms for:</i></p> <ol style="list-style-type: none"> 1. Climate-friendly agriculture 2. Sustainable hydropower financing 3. Export promotion & digitalization 4. Stronger MSME focus and rural financial inclusion. 	<ol style="list-style-type: none"> 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 	<p>Acknowledged Initiate various procedure reform</p>
Structural Challenges	<ol style="list-style-type: none"> 1. Import dependence, 2. Rising NPLs (~7%), 3. Low efficiency of monetary transmission. 	<ol style="list-style-type: none"> 1. Review the Provisioning norms, 2. Establish ARCs, 3. Adopt forward-looking risk-based supervision, 4. Build digital platforms for credit access. 	<ol style="list-style-type: none"> 1. IMF suggests institutional reforms, 2. ADB emphasizes corporate governance & SME support, 3. WB advocates for climate & digital reforms. 	<p>Acknowledged Initiate various structural reform</p>

Summary for FY 2025–26 Outlook



Prudential Norms and Policy Recommendations



Expected actions- NOW FOR NOW(Immediate Actions)	NRB's Policy Actions
<p>Strengthen Regulatory Capacity: Enhance supervision quality by upgrading data and regulatory frameworks. Reinforce NRB's autonomy and accountability.</p>	<p>Partial Action Taken Introduce Domestic Systemically Important Bank Framework</p>
<p>Review Monetary Policy Stance: Maintain neutral-to-accommodative stance, keeping a watch on rising defaults, especially within MSME segment.</p>	<p>Maintain Cautiously accommodative, special provision for MSMEs segment agriculture sector</p>
<p>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.</p>	<p>Partial Action Taken Restructuring of housing developer's loan</p>
<p>Interest Rate Spread Regulations: Begin review of interest rate spread ceiling constraints. Interest rates constrain the ability of financial institutions to price loans based on risk</p>	<p>No Action Taken</p>
<p>Review Working Capital Framework: Tailor working capital lending guidelines for sectoral needs.</p>	<p>Action Taken Tailor working capital guidelines for sectoral needs.</p>
<p>Accounting Treatments for Capitalized Interests: Clarify treatments, especially prior to CCDO status, in sectors like infrastructure and tourism.</p>	<p>Partial Action Taken Interest Capitalization of Energy sector will be reviewed</p>
<p>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.</p>	<p>Partial Action Taken FDI regulations will be reviewed</p>
<p>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.</p>	<p>Action Taken Provisioning Norms will be reviewed</p>

NOW FOR THE FUTURE (Structural & Strategic Actions)	Policy Actions
<p>Modernize Loan Classification and Provisioning Norms: Align with Nepal's evolving economic conditions and global best practices.</p>	<p>Partial Action Taken Current Provisioning Norms will be reviewed, initiate legal reform to establish AMC</p>
<p>Reevaluate Asset and Liability Pricing: Assess pricing policies for both assets and liabilities to balance institutional stability and economic recovery.</p>	<p>No Action Taken</p>
<p>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.</p>	<p>Partial Action Taken Regulatory reserve will qualify Tier II capital</p>
<p>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.</p>	<p>Partial Action Taken</p> <ol style="list-style-type: none"> 1. New rules for MSMEs segment agriculture sector 2. Introduce Credit score system
<p>Prioritize Productive Sectors: Encourage lending in sectors utilizing domestic resources, improving productivity and competitive capabilities..</p>	<p>Partial Action Taken</p>
<p>Support Impacted Sectors: Design long-term targeted regulatory forbearance and incentives for highly impacted sectors like MSMEs, construction, and retail.</p>	<p>Partial Action Taken</p>
<p>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</p>	<p>Partial Action Taken Ease Repatriation, FDI regulations will be reviewed</p>
<p>Liquidity and Refinancing Policy: Maintain adequate liquidity in the banking system and review the efficacy and structure of refinance facilities</p>	<p>Partial Action Taken Introduce Internal Liquidity Adequacy Assessment Process – ILAAP, implement Liquidity Coverage Ratio (LCR) and Net Stable Funding Ratio (NSFR)</p>

Monetary Policy Expectations 2025/26

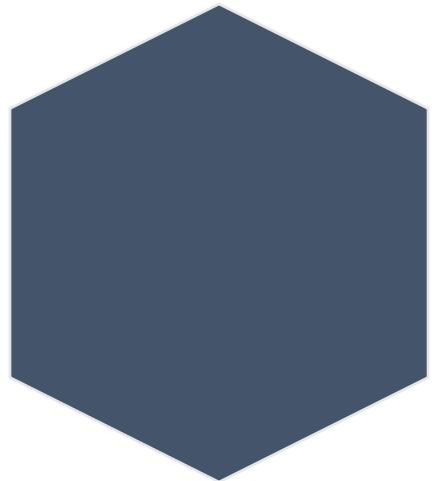
*We observed that the monetary policy stance failed to address the **impact of low-interest rates on the economy and shortfall in government revenue due to contraction in economic activities** and the **impact of low interest rates on government fiscal allocations.***

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.*

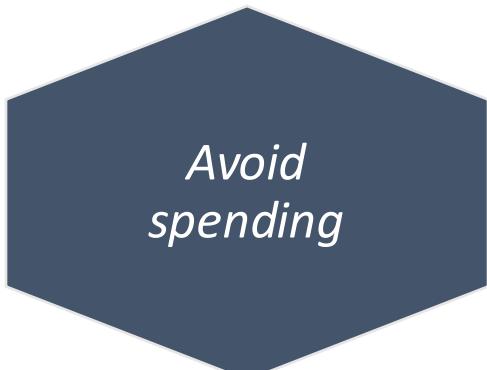
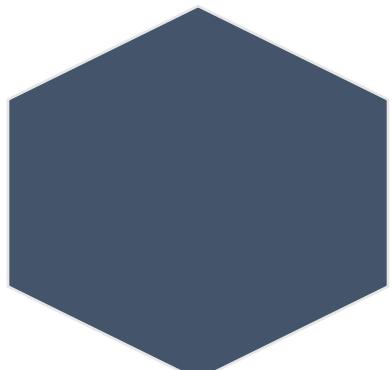
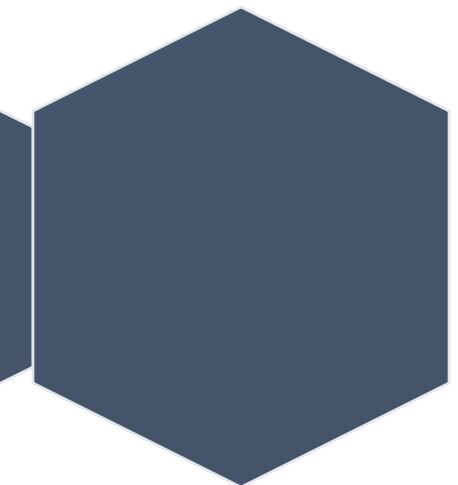
Policy stance failed

Monetary Policy Expectations 2025/26



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

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.



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

	Expected Policy Action	Impact	NRB Actions
Monetary Policy Measures	Policy Stance: Shift from neutral to accommodative	Stabilizes market rates, increases confidence, and stimulates demand	Cautiously accommodative
	Policy Rates: Reduce by >75 bps (initial ~25 bps)	Enables lending rate adjustment, reducing borrowing costs	Reduced by 50 bps
	Liquidity Ratios: Raise CRR by 25 bps	Market lending rate may settle around ~9.00% by year-end	While maintaining the existing policy stance, NRB has reduced both the lower and upper bounds of the interest rate corridor by 25/50 basis points. This measure is expected to further ease interest rates. To mitigate policy shocks and absorb excess liquidity from the financial system, NRB will also issue NRB Bonds.
	Balance of Payments: Maintain forex reserves covering >7 months	Supports external sector stability and maintains FX rate credibility	Maintain forex reserves covering >7 months
	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.	<ol style="list-style-type: none"> Credit Growth: Private sector at ~12% Loan to value ratios increased to 80% for residential property In light of capital limitations and unresolved issues surrounding the BAFIA amendments, the set target seems particularly ambitious
	Broad Money Growth: Maintain ~10%	Supports deposit mobilization, promotes savings, reduces consumption pressure	Broad Money Growth: Maintain ~13%
	Growth Target: Sustainable 4–5% annual GDP growth	Enables stable economic environment for long-term growth	Support Government growth target
	Inflation: Maintain within 5.5% ($\pm 2\%$) range	Provides room for NRB to adjust policies supporting fiscal objectives	Maintain inflation ~5%

Monetary policy Expectation 2025/26

Prudential Norms & Regulatory Suggestions	Policy Stance / Action	Impact	NRB Actions
Bank Supervision	<i>Introduce stringent policies and market-based supervision.</i>	<i>Enables more complex, forward-looking risk assessments vs historical methods</i>	Partial Action Taken <ol style="list-style-type: none"> 1. Introduce stringent policies and risk-based supervision. 2. Identify Domestic Systemically Important Bank, DSIB 3. PCA policy will be reviewed
Capital Market	<i>Evaluate dual pricing of bank shares and assess characteristics of margin lending</i>	<i>Improves market efficiency and promotes transparency</i>	Partial Action Taken <p>Increase personal loan limit to Rs 250 million</p>
Digitization	<i>Promote digital payment systems for enhanced security and efficiency</i>	<i>Reduces reliance on informal markets and lowers transaction costs</i>	Action Taken <ol style="list-style-type: none"> 1. Open license to establish neobank 2. Review National Payments System Development Strategy 3. Introduce Digital Lending Guidelines 4. Implement Framework for Identifying Systemically Important Payment Systems (SIPS) and Regulatory Sandbox

Thank You!

Best regards,
Bhattarai

<https://www.linkedin.com/in/analrajbhattarai/>