NEPAL · Monetary Policy Expectations FY 2026/27

Monetary Policy and Economic Growth: Priorities for Nepal's Productive Sector.

Sources: Kala Legal analysis "Economic Outlook (May 2026)"; IMF 2026 Article IV & 7th ECF Review; Nepal Rastra Bank; Ministry of Finance Budget Speech FY 2026/27; Reserve Bank of India

"Role of Monetary Policy in Accelerating Economic Growth"
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Keynote Speech
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ROADMAP

What this briefing covers

01 Macro Starting Point
Mid-year FY2025/26 scorecard: growth, NPLs, capex execution, reserves

02 Transmission Diagnosis
Why rate cuts failed to move credit — and the FY27 policy pivot

03 Banking Sector & NPAs
Provisioning overhaul, AMC, capital-market deepening mandates

04 Policy Stance & IRC
Rate corridor mechanics, the SDF floor problem, and six regulatory areas

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Where Nepal stands and the cost of continued delay

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Rs 2.124tn budget vs execution track record

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STARTING POINT

Where Nepal stands — FY 2025/26

The base case the FY 2026/27 monetary policy must respond to

3.85%
GDP growth (est.)
vs 6.0% target

5.60%
Banking sector NPLs
vs ~4.23% target

35.12%
Capital expenditure
executed of budget

Rs 3,704bn
Forex reserves
+38.3% y/y, ample cover

+41.2%
Remittance growth
y/y — key external anchor

5.04%
CPI inflation
within NRB band, rising

+5.7%
Private sector credit
y/y vs 11.5% MP target

6.73%
Avg. lending rate
down from 7.66% a year ago

Source: NRB mid-month macroeconomic indicators (up to mid-May 2026); Kala Legal-Economic Outlook, May 2026

DIAGNOSIS

Why rate cuts didn't move the real economy

Four blocked channels from FY 2025/26 — the case for a structural pivot

Lending Rates Channel

Not Effective

Credit growth stalled at 5.7% vs an 11.5% target — banks capital-constrained, asset quality weak.

Interest Rate Channel

Less Effective

Policy-rate reductions did not lift credit demand; core structural lending barriers remained unaddressed.

Asset Price Channel

Not Effective

Low consumer and market confidence insulated real estate and asset markets from lower interest rates.

Exchange Rate Channel

Not Effective

The fixed NPR–INR peg keeps the exchange rate independent of domestic reserves, isolating BOP from rate moves.

Compounding factor: divergent maturity profiles between fixed deposits and risk assets heighten repricing risk and asset-liability mismatches (ALM).

FY 2026/27 DIRECTIVE

From passive rate cuts to structural reform

*Policy focus should shift entirely **from passive rate cuts to capital base optimization and structural corporate financing overhauls.***

Overhaul Loan Loss Provisioning (LLP)

Replace the rigid 100%-within-one-year default rule with a risk-adjusted, graduated provisioning framework tied to delinquency duration and collateral.

Disciplined Large-Exposure Guidelines

Mandatory credit ratings or due diligence on corporate borrowings above NPR 250 million, extended to formal *restructuring of stressed loans.*

Corporate Diversification into Debt Markets

Encourage large borrowers to diversify their funding sources by shifting a portion of their bank borrowing to bonds and debentures, thereby deepening the domestic capital market.

Liquidity stays ample, credit growth stays flat

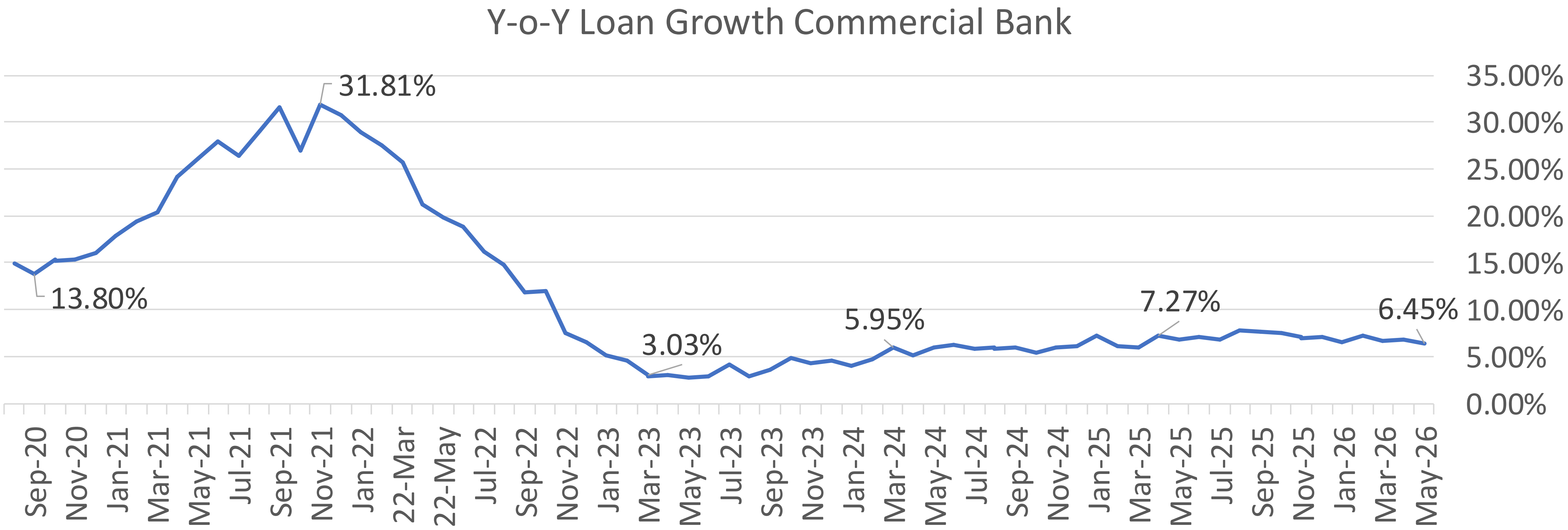
Banking system snapshot as of 21 June 2026

Rs 8,047bn
Total deposits
Broadly stable

Rs 5,919bn
Total lending
Broadly stable

72.88%
CD ratio
Unchanged — comfortable liquidity

2.75%
Interbank rate
Low — abundant liquidity



Headroom is ample — the constraint is demand/capital

Rs 2,128bn

Deposits in excess of lending — a large liquidity buffer that keeps funding costs and interbank rates low.

Scenario	CD Ratio	
Current	72.88%	
At 80%		Additional lending capacity available
At 90%		Significant room for credit expansion

Conclusion: *the banking sector can support substantially more private-sector lending without needing fresh deposit mobilization.*

Positive factors

- Strong liquidity position
- Low interbank rates
- Stable deposit base
- Significant lending capacity

Key risks

- Weak credit demand
- Slow private investment growth
- Continued excess liquidity
- Pressure on bank profitability from low rates

Key message: the banking sector is liquid, stable, and well-positioned to support recovery — the challenge is no longer liquidity but stimulating quality credit demand and adding fresh capital.

Capital — Not Liquidity — Is the Binding Constraint

NRB Key Financial Indicators | Commercial Banks | Chaitra End 2082

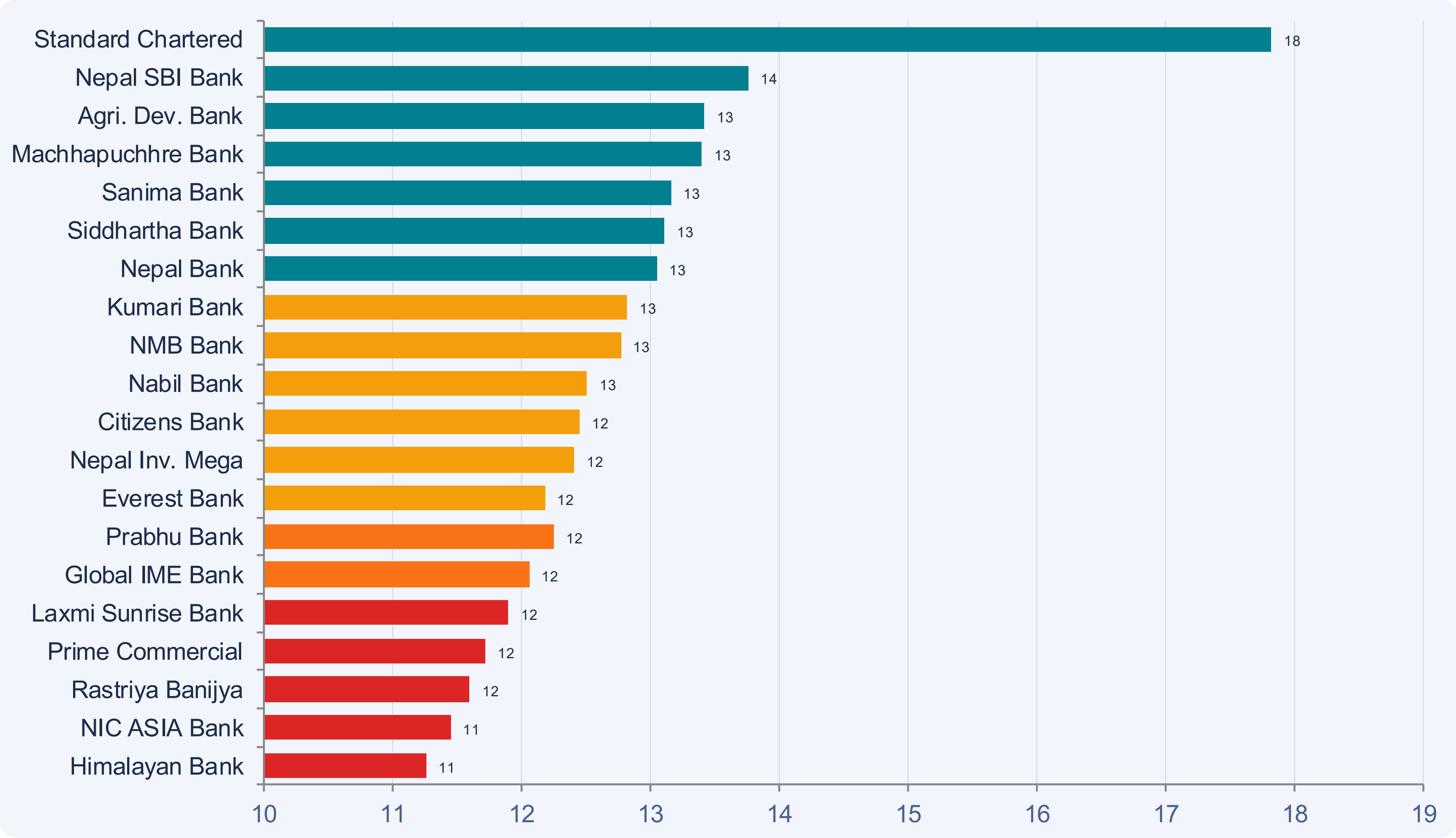
Core Capital (CCAR)	Total Capital (CAR)	CD Ratio	Net Liquidity	Gross NPL
9.61%	**12.53%**	**72.89%**	**35.95%**	**5.41%**
Min 8.50%	Min 11.00%	Max 90.00%	Min 20.00%	No floor
Limited Buffer	**+1.53pp Cushion**	**Ample Liquidity**	**Comfortable**	**Elevated Stress**

With a CD ratio of 72.89%, well below the regulatory ceiling of 90%, liquidity and funding are not the primary constraints on lending. Instead, the sector's **average Capital Adequacy Ratio (CAR) of 12.53% provides only a 1.53 percentage point buffer** above the regulatory minimum, making capital the binding constraint on further credit expansion. Based on the available capital headroom, the banking sector has the capacity to extend approximately NPR 800 billion in additional lending, with Standard Chartered Bank (SCB) accounting for roughly 20% of this potential capacity.

Source: NRB Key Financial Indicators, Chaitra End 2082 (Provisional)

Capital Adequacy Ratio by Bank vs. 11% Regulatory Minimum

Total CAR (%) — Chaitra End 2082 | Ranked highest to lowest



Buffer Above 11%

- Very Strong / Strong (≥ +2pp buffer)
- Moderate (+1.0 – 1.99pp buffer)
- Limited (+0.75 – 0.99pp buffer)
- Tight (< +0.75pp buffer)

Regulatory Minimum: 11.00%

5 banks within 0.75pp of floor — capital-constrained.

*Source: NRB Key Financial Indicators, Chaitra End 2082 (Provisional). * Axis starts at 10% to show inter-bank differences.*

Nepal's Capital Landscape: Framework vs Market Reality

What Nepali banks can issue today — and the AT1 market gap that remains

Available Instruments for Nepali Banks

Instrument	Tier
Perpetual Debt Instruments (PDI)	AT1
Perpetual Non-Cumul. Pref. Shares (PNCPS)	AT1
Subordinated Debentures (≥ 5 years)	Tier 2
Redeemable Cumulative Pref. Shares (RCPS)	Tier 2
Redeemable Non-Cumul. Pref. Shares (RNCPS)	Tier 2
Perpetual Cumulative Pref. Shares (PCPS)	Tier 2
Hybrid Capital Instruments	Tier 2

† While NRB permits both PDI and PNCPS as regulatory capital instruments, PDIs have not yet been issued by any Nepali bank, and the PNCPS market lacks sufficient liquidity to serve as a viable source of capital.

Additional Tier 1 (AT1) Market Gap

Despite NRB permitting PNCPS and PDI, few major Nepali banks report small outstanding AT1 capital. The regulatory framework exists — but the market has not yet adopted these instruments.

Subordinated Debt: Most Established

Tier 2 subordinated debentures are already used by several Nepali banks and represent the most mature non-equity capital instrument available in Nepal's capital market today.

AT1 Instruments: Untapped Opportunity

Developing AT1 instruments (PDI / PNCPS) could provide banks with going-concern capital, reducing reliance on dilutive equity — mirroring India's well-developed AT1 bond market.

NRB's Basel III framework is broadly aligned with RBI's rules — but Nepal's AT1 capital market remains at an early stage of development..

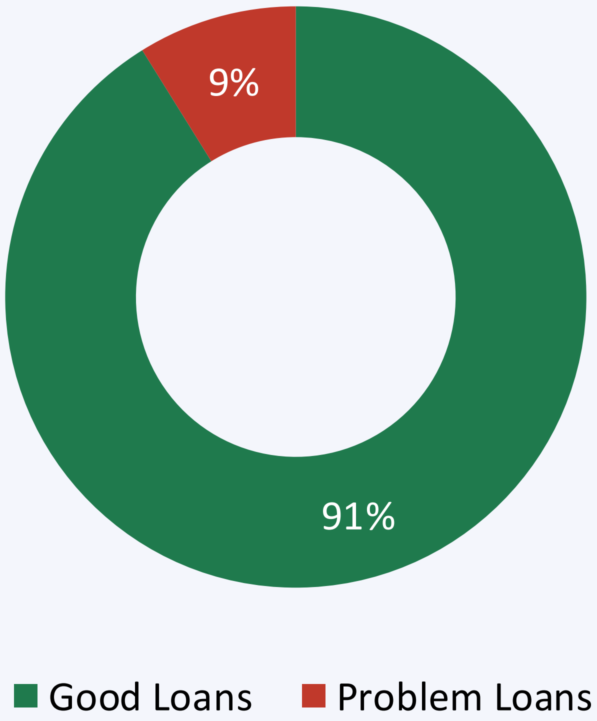
NRB vs RBI: Basel III Capital Instruments

Comparison of eligible capital instruments (excl. common equity, retained earnings & reserves)

Capital Tier	Nepal Rastra Bank (NRB)	Reserve Bank of India (RBI)	Status
Common Equity Tier 1	Common Shares	Common Equity Shares	Same
Additional Tier 1 (AT1)	• PNCPS • Perpetual Debt Instruments (PDI) • Share premium related to PNCPS	• Perpetual Non-Cumul. Pref. Shares (PNCPS) • Basel III AT1 Bonds • Securities premium related to AT1	Same
Tier 2 Capital	• Subordinated Term Debt (min. 5yr) • RCPS & RNCPS • Perpetual Cumulative Pref. Shares (PCPS) • Hybrid Capital Instruments	• Tier 2 Bonds / Sub. Debt (min. 5yr) • Redeemable Preference Shares • Hybrid Debt Capital Instruments (legacy) • PCPS not commonly recognized	Similar*
AT1 Market	PNCPS and PDI are permitted under the NRB regulatory framework but have seen limited market adoption.	Large, active market — held by pension funds, insurers & mutual funds	Different

** PCPS explicitly listed under NRB Tier 2 but rarely recognized under RBI's Basel III framework. NRB's framework was originally adapted from RBI regulations.*

NPAs:- Another constraint on credit growth



5.93%

Current banking-sector LLP to total Loan ratio

4.23%

Monetary Policy's NPL target

Rs 349.67bn

Locked in static loan-loss provisions, awaiting the new graduated framework

Source: NRB Risk Assets Classification, mid-May 2026; loan-loss provision build per Kala-Legal's Economic Outlook, May 2026

BANKING SECTOR

Resilience against problem loans — a stress test

Mid-May 2026 · amounts in NPR billion

Particulars	NPR Bn	% Gross Loan	% Gross RWA
Gross Loan Portfolio	**5,889.28**	**100.00%**	**6,523**
Good Loans	5,367.43	91.14%	—
Problem Loans	521.85	8.86%	—
Provision Made	349.67	5.94%	—
Additional Provision Required	**172.18**	**2.92%**	**—**
Paid-up Capital & Statutory Reserves	603.39	10.25%	9.25%
Total Regulatory Capital	824.52	14.00%	12.64%
Net Capital After Full Provisioning	431.21	7.32%	6.61%
Total Capital After Full Provisioning	**652.34**	**11.08%**	**10.00%**

Source: Kala Legal, mid-May 2026 banking sector data

Key Messages

- 91.14% of loans remain performing.
- Existing provisions cover a substantial share of problem loans.
- Only NPR 172.18 billion additional provisioning required under extreme stress.
- Capital remains around 10% of Gross RWA even if all problem loans turn bad.
- ***Asset quality may remain manageable, but capital constraints—not liquidity—are likely to be the binding constraint on credit growth in the banking sector***

Provisioning overhaul: from a flat cliff to a graduated curve

Current framework: 100% provisioning required within one year of default, regardless of collateral quality—far more stringent than India's graduated provisioning framework and inconsistent with supporting stronger GDP growth.

New proposed graduated framework: **(banks recognize default immediately, consider collateral quality)**

5%	25%	50%	75%	100%
1 day – 3 months overdue	3 – 6 months overdue	6 – 12 months overdue	12 – 36 months overdue	More than 36 months
Early detection & tracking	*Sub-standard asset adjustment*	*Doubtful — Stage 1*	*Doubtful — Stage 2*	*Full loss asset categorization*

+NPR 105bn
Injected into Tier 1 & 2 capital

+NPR 45bn
Government revenue via corporate tax + new CGT

+NPR 700bn
Potential private-sector credit expansion unlocked

Tying capital adequacy to credit discipline

Mandatory Credit Ratings/due diligence

Required on all corporate borrowings above NPR 250 million, extending to workouts and formal restructuring of problem loans above the same threshold.

The 10% Debenture Rule

*Large corporates with bank-debt exposure above NPR 2 billion must raise at least 10% of financing via bonds or debentures — **diversifying funding and deepening the domestic debt market.***

Regional precedent shaping NRB's approach — RBI's revised Basel III risk-weight mapping (effective April 2027)

Rating	ODR Range	Old Risk Weight	New Risk Weight
AAA	< 0.05%	20%	20%
AA	0.05 – 0.10%	30%	20%
A	0.10 – 0.20%	50%	50%
BBB	0.20 – 0.40%	100%	75%
BB	0.40 – 1.00%	150%	100%
Unrated	—	100%	100% / 150% above Rs 500cr

*Three rating bands account for 43% of live-rated debt — **releasing meaningful (58,000 crore) regulatory capital** for lenders while disincentivizing exposures that stay unrated.*

BANKING SECTOR

“Ring fenced” so relief doesn't become loose credit

Profit-preservation pathway

1. **Write-back capital realized**

   Released as legacy provisions are reclassified

2. **Years 1 & 2 — Regulatory Reserve**

   0% cash outflow; multiplies the risk cushion

3. **Tier 1 & 2 alignment**

   Reserves count toward Tier 1 capital, up to 50% of Tier 1

4. **Post Year 2 — Stock-only dividends**

   Bonus shares retain capital inside the BFI

Asset Management Company (AMC)

Gon/NRB will finalize a specialized AMC to acquire distressed real estate and construction assets, taking bad loans off BFI balance sheets while preserving market confidence.

IMF caution

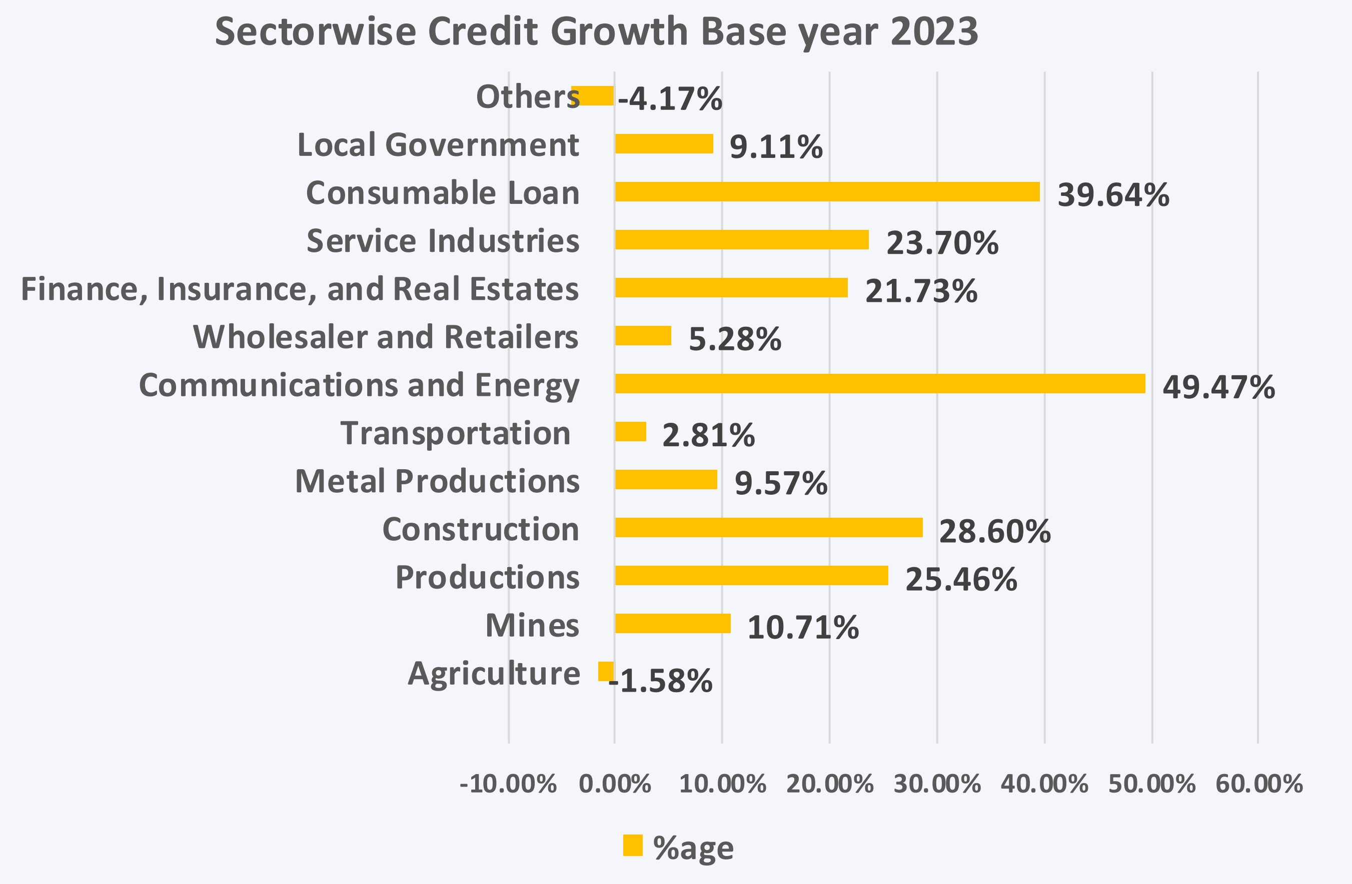
The IMF has warned that an AMC will only work if Nepal first strengthens debt-recovery and insolvency frameworks and improves the real-estate market for disposing of repossessed collateral.

It must enforce timely loss recognition by banks, set a sufficiently discounted acquisition price, prioritize cash recoveries, and carry a sunset date that pushes banks toward genuine loan workouts rather than indefinite warehousing.

CREDIT ALLOCATION

Where unlocked credit will be steered first

High-momentum sectors prioritized for FY 2026/27 credit flows



Consumable Loan

Growth surges of up to 39.64% — strong case for urban consumers credit demand. Loan against Gold and Silver surged 69.81%.

Accommodation & Food Service

Sustained double-digit growth (28%), tracking tourism recovery and domestic consumption.

Heavy Constructions (Highway, Bridges, etc.)

Solid momentum at 66.32% — critical for trade logistics and infrastructure efficiency.

POLICY STANCE

Accommodative — the corridor has already moved

Stance: flexible/accommodative — ample forex reserves, inflation still within band. The H1 FY2025/26 corridor cut already happened; the open question for FY2026/27 is fixing how the floor binds.

5.75%	4.25%	2.75%	2.75%
Bank rate	**Overnight Liquidity Facility**	**Deposit collection rate (floor)**	**Weighted avg. interbank rate**
down 2.75% within last three years	down 4.5% within last three years	unchanged since FY25/26 start	trading at the floor — surplus liquidity

3rd Quarter Review (15 May 2026):

NRB flagged that the Standing Deposit Facility arrangement itself will be reconsidered — via amendment to the Unified Directives — to make the interest-rate corridor more effective and systematic.

CRR and SLR remain unchanged.

POLICY STANCE

Accommodative — the corridor has already moved

Six strategic areas for regulatory review

Secondary Market Development

Build a robust secondary market for liquidity and price discovery of debt instruments.

Liquidity Risk Management

Re-evaluate NDF and Net Open Position (NOP) limits for systemic FX management.

Non-Banking Assets (NBAs)

Amend BAFIA to streamline utilization, monetization, or disposal of acquired NBAs.

Deprived Sector Lending (DSL)

Harmonize DSL directives with the budget and reduce the directed lending.

Digital Payment Interoperability

Adopt Open Banking,
QR interoperability to deepen financial inclusion.

Fraud & Mule Accounts

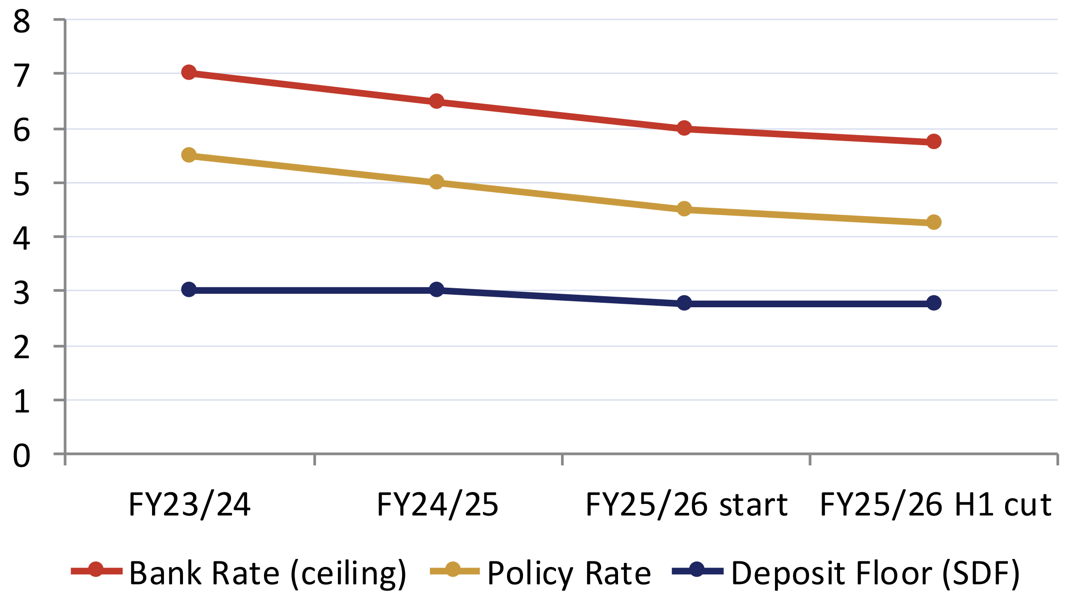
Streamline zero-balance account closure and digital fraud mitigation.

INTEREST RATE CORRIDOR

The corridor keeps narrowing — but the floor doesn't hold

NRB's IRC: bank rate (ceiling) to policy/repo rate (target) to deposit collection / SDF rate (floor)

Corridor trend, FY 2023/24 to FY 2026/27



The floor problem

*NRB Working Paper No. 62 (June 2026) finds the interbank rate frequently breaches below the SDF floor, **because the facility is not continuously accessible**: manual checks, not automated and overnight like RBI or the ECB.*

The fix in motion

*The 3rd Quarter Review (May 2026) commits to redesigning the SDF arrangement via the Unified Directives — **a structural fix to the corridor's plumbing, not another rate cut.***

Key message: the corridor's narrowing (200bps over three years) signals accommodation, ***but a narrower corridor with a non-binding floor is mostly cosmetic —*** transmission depends on fixing the SDF's operational plumbing, not on further headline rate cuts.

Source: NRB Monetary Policy 2025/26 and quarterly reviews; NRB Working Paper No. 62, June 2026

COMPLIANCE RISK

FATF grey list: a financial-credibility clock, not a paperwork issue

Feb 2025	2025–2026	Now	Ahead
High-level political commitment to FATF/APG; Nepal placed on the grey list	*Technical gaps on terrorist/proliferation financing sanctions addressed*	***Enhanced monitoring continues — supervision, enforcement & coordination gaps remain***	***Exit requires measurable AML/CFT enforcement outcomes, not further commitments***

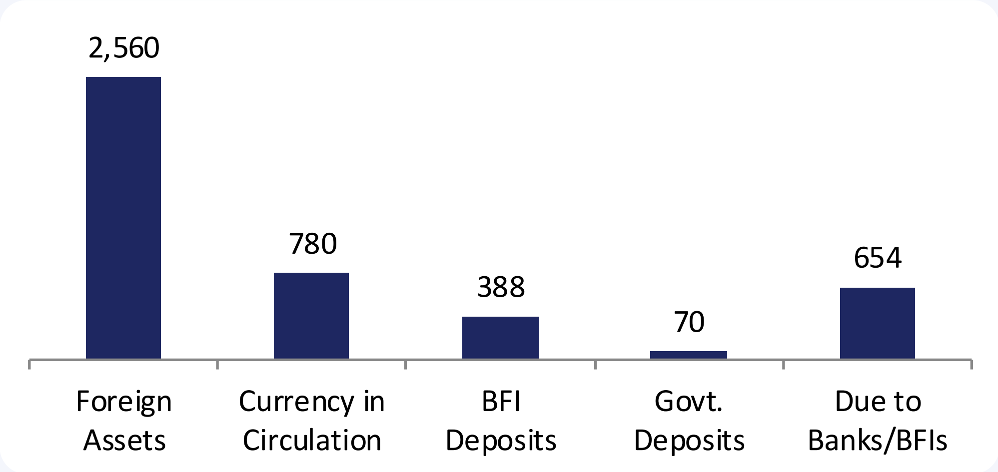
Every month of delay carries a rising cost

- Correspondent banks impose additional compliance requirements on Nepali institutions
- Remittance inflows face higher transaction costs and tighter scrutiny
- Foreign investors adopt a more cautious posture toward Nepal
- Sovereign risk perceptions rise across rating and lending relationships

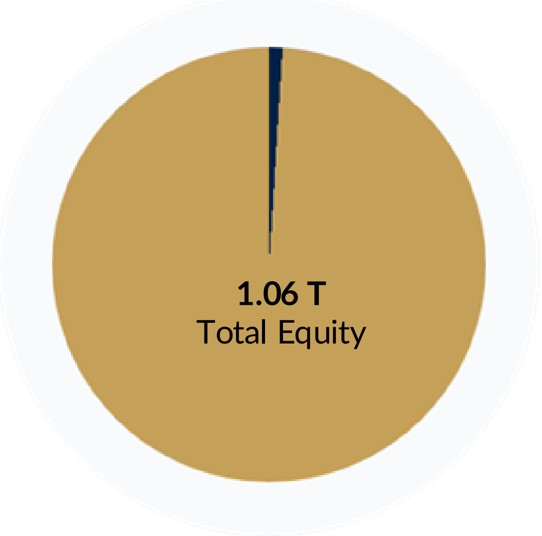
IMF's remarks: achieving concrete AML/CFT implementation results is explicitly tied to expediting Nepal's exit from the grey list.

Reserves are not the same thing as investable wealth

NRB balance sheet, Ashadh 2082 (Rs bn)



NRB CAPITAL VS. RESERVES MAY 2026



Reserves: NPR 1.054 Trillion (99.5%)

Paid-up Capital: NPR 5.00 Billion (0.5%)

The robust reserve position of **NPR 1.05 Trillion** underscores Nepal Rastra Bank's strong solvency and operational autonomy.

The crucial question

Are we investing surplus national wealth, or reallocating assets that are already matched by liabilities? The distinction is fundamental to monetary stability — not merely an accounting nuance.

A genuine SWF should instead be capitalized by:

- Future fiscal surpluses
- Hydropower export revenues
- Natural-resource royalties
- Privatization proceeds
- SOE dividends

Genuine sovereign wealth, not assets already pledged against monetary liabilities.

Source: NRB Statement of Financial Position, Ashadh 2082; Kala Legal's Economic Outlook, May 2026

Nepal Rastra Bank

Reserve Position Comparison

+23.4%
Total Reserves YoY

32 Asar 2082 vs. 31 Asar 2081

Reserve / Fund	32 Asar 2082 (NPR)	31 Asar 2081 (NPR)	Change (NPR)	Change (%)
General Reserve	87,394,781,104	103,645,754,705	(16,250,973,601)	-15.7%
Monetary Liabilities Reserve	18,882,771,816	22,906,904,338	(4,024,132,522)	-17.6%
Financial Stability Fund	15,685,257,818	19,709,390,340	(4,024,132,522)	-20.4%
Open Market Operation Stabilization Fund	12,863,593,549	23,337,077,181	(10,473,483,632)	-44.9%
Exchange Equalization Fund	221,813,526,867	266,843,486,049	(45,029,959,182)	-16.9%
Gold & Silver Equalization Reserve	92,362,529,636	139,249,215,401	(46,886,685,765)	-33.7%
Net Cumulative Surplus Fund	2,169,130,410	3,971,688,506	(1,802,558,096)	-45.4%
Development Fund	76,595,989,244	77,595,989,244	(1,000,000,000)	-1.3%
Banking Development Fund	1,601,941,806	1,601,941,806	-	0.0%
Mechanisation Fund	1,891,316,414	1,891,316,414	-	0.0%
Scholarship Fund	61,594,504	61,594,504	-	0.0%
Mint Development Fund	1,097,712,943	1,097,712,943	-	0.0%
Gold Replacement Fund	4,799,085,589	5,606,163,443	(807,077,854)	-14.4%
Rural Self Reliance Fund	253,400,000	253,400,000	-	0.0%
Rural Self Reliance Fund (Admin. Expense Reimbursement Fund)	51,087,606	50,912,107	175,499	+0.3%
Actuarial Gain Reserve	2,634,091,770	(1,149,741,717)	3,783,833,487	N/A*
Fair Value Reserve	3,660,326,514	4,353,518,021	(693,191,507)	-15.9%
Total Reserves	**671,026,323,285**	**543,818,137,590**	**127,208,185,695**	**+23.4%**

Note: Percentage change is not meaningful (N/A) for the Actuarial Gain Reserve — it moved from a negative balance in 2081 to a positive balance in 2082.*

Key Takeaways

Reserve Position Comparison — 32 Asar 2082 vs. 31 Asar 2081

+NPR 127.2 bn

(+23.4%)

Total Reserves increased, mainly reflecting accounting and valuation adjustments.

–NPR 45.0 bn

(-16.9%)

Exchange Equalization Fund declined.

–NPR 46.9 bn

(-33.7%)

Gold & Silver Equalization Reserve fell sharply.

–NPR 16.3 bn

(-15.7%)

General Reserve decreased.

-44.9%

largest % decline

Open Market Operation Stabilization Fund recorded the steepest drop.

Turned positive

from deficit in 2081

Actuarial Gain Reserve improved significantly into a positive balance.

What India's Rajan–Patel standoff actually settled

Nepal's SWF debate is a smaller-scale version of a fight India already had — and resolved with a formula, not a one-off raid

Raghuram Rajan (RBI Governor, 2013–16)

Argued RBI surplus transfers are clean recycling: interest income on government securities and capital gains already earned, not fresh money creation. He distinguished this from tapping the RBI's core capital or reserve assets.

Urjit Patel (RBI Governor, 2016–18)

Resisted Finance Ministry pressure to release “excess” capital/reserves, prioritizing adequate buffers for financial stability. The standoff over the Economic Capital Framework was central to his December 2018 resignation.

Bimal Jalan Committee (2019, post-resignation)

Resolved the dispute with a rules-based Economic Capital Framework: distinguishing non-distributable revaluation reserves from a distributable contingency buffer, set as a percentage band of the balance sheet. *Maintain a contingency Fund (CF) within the range of 6.5% to 5.5% of the economic capital.*

What India's Rajan–Patel standoff actually settled

What was actually transferred: the INR 1.76 trillion transfer (2019) came from excess provisions and the distributable contingency buffer — never from the RBI's core foreign-currency reserve assets. The line between “surplus profit” and “reserve assets” was the entire point of the framework.

Feasibility test for Nepal: NRB would need its own rules-based formula for distributable surplus — a Jalan-style framework — **before any reserves-linked SWF discussion**, not an ad hoc allocation from gross reserves.

(NRB declared a dividend of Rs. 42 billion to the GoN for the fiscal year 2081/82.)

Can government directly use reserves for fiscal purposes?

No

Not directly, not under the current legal and monetary architecture.

Why: NRB Act 2002 operational autonomy

Reserves sit on NRB's **balance sheet matched 1:1 by monetary liabilities** (currency in circulation, BFI deposits, government deposits).

*Diverting them for budget financing **means either printing equivalent NPR liabilities — monetizing the deficit,** threatening the peg — or drawing down the FX cover that backs currency convertibility, just when it would be needed most.*

SOVEREIGN WEALTH FUND · TEST 3

Can government directly use reserves for fiscal purposes?

What government can legitimately access

NRB's annual distributable surplus / profit, transferred to government each year under existing NRB Act provisions — already a routine flow, governed by NRB's own income and provisioning, not a reserves drawdown. A Jalan-style formalized formula would make this larger and more rules-based, but it remains a profit transfer, not a balance-sheet raid.

Bottom line

A genuine Nepal SWF needs ring-fenced fiscal-side capitalization — future fiscal surpluses, hydropower export revenues, natural-resource royalties, privatization proceeds, SOE dividends — not a reserves transfer. The reserves themselves stay with NRB, doing the job they already do: external-sector stability, currency convertibility, and shock absorption.

NRB's D-SIB Framework 2025 — the basics

Modeled on the Basel Committee's 2012 D-SIB framework and its 2011 G-SIB methodology, in response to lessons from the 2008 crisis

10 of 20

As per the regulation Issued via Notice 12/2082-83, Nov 2025 **10 Class-A commercial banks can be designated as D-SIBs**

40% / 30%

Weight on Size / Interconnectedness

Remaining 30% split across substitutability & complexity

FY 2026/27

Higher Loss Absorbency capital (HLA) a regulatory banking buffe surcharge phase-in begins

Fully effective by 2027

1 year

Cooling period if a bank's score falls

Before HLA requirement is reduced

How a bank gets flagged?

Size	40%
Interconnectedness	30%
Substitutability (incl. digital payments)	~15%
Complexity	~15%

Benchmark: India's RBI

RBI names just 3 D-SIBs — SBI, HDFC Bank, ICICI Bank — out of dozens of scheduled commercial banks, **placed into 4 HLA buckets with Common Equity Tier 1 (CET1) surcharges of 0.20%–0.80%. SBI** alone sits in the top bucket.

*NRB has **not yet published the official list** of designated D-SIBs*
Listing 10 covers half of all Class-A banks — a far broader net than India's tightly selective 3.

SYSTEMICALLY IMPORTANT BANKS

Are they genuinely systemic — or is the label diluted?

The dilution risk

If half the commercial banking sector is "too big to fail," the label stops differentiating concentrated risk from sector-wide norm.

India's 3-of-dozens list preserves the term's signaling value; Nepal's 10-of-20 list risks normalizing systemic status rather than flagging it.

The timing risk

D-SIBs face the new **Higher Loss Absorbency capital (**HLA capital) surcharge (from FY2026/27) at the same time as the NPA provisioning overhaul (Rs 172bn in additional provisioning, 5.60% NPL ratio).

Banks may need fresh Tier 1/2 capital for both pressures simultaneously — a capital math that could double-count.

Are they genuinely systemic — or is the label diluted?

Regulatory steps for genuine resilience

Publish bucket-level detail

Disclose **Higher Loss Absorbency capital** (HLA) tiers and bank names annually, as RBI does, for market discipline.

Mandate recovery & resolution plans

Tie designation to ICAAP submission and resolution planning, not capital math alone.

Sequence the capital build

Stagger HLA phase-in with the provisioning overhaul to avoid a simultaneous capital squeeze.

Re-calibrate as the sector consolidates

Revisit weights and bucket counts as ***NRB's own merger push shrinks the Class-A roster.***

The peg debate now has a political mandate — not yet a study

1.6

NPR per 1 INR — fixed since 1993 (rooted in a 1960 arrangement)

The government's mandate

Following the 5 March 2026 election, the Rastriya Swatantra Party (RSP) — now in government — committed in its manifesto to a formal study reviewing the NPR–INR fixed exchange rate since 1993.

NRB may soon start technical study — NRB's own FY2026/27 monetary policy and working papers analyze the peg's effects but show no active task force to redesign the regime.

CURRENCY PEGGING & POLICY MANDATE

Options on the table

Maintain the peg	Crawling peg	Managed float / basket	Currency board	Switch peg currency
Preserve stability and predictability; absorb shocks via tariff adjustment instead.	*Allow gradual, controlled adjustments to the parity over time.*	*Move to a trade-weighted basket reflecting major economic partners.*	*A rigid arrangement — acknowledged as politically and institutionally demanding.*	*Re-peg to another major currency as a longer-term strategic option.*

Key message: record reserves (~18 months import cover) reopened the case for review, but a full float was assessed as impractical given the open 1,400km border. Expect a review process in FY2026/27 — not a regime change.

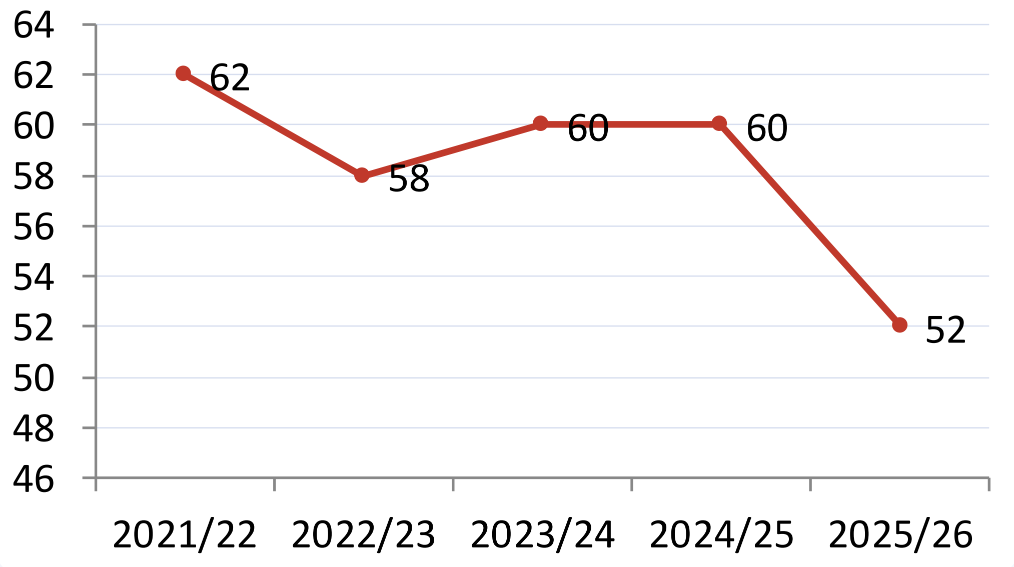
(Nepal normally anchored the currency fluctuation through duties adjustments)

Monetary policy inherits the budget's credibility gap

Rs 2.124 trillion FY 2026/27 budget against a weak execution track record

Rs 2.124tn	Rs 1.405tn	7.0%	Rs 431bn	5.2% GDP	47–50% GDP
Total Budget	Revenue Target	GDP Growth Target	Capital Expenditure	Fiscal Deficit	Public Debt

Capital expenditure execution — the chronic shortfall



Why this matters for monetary policy

Capex execution has averaged just 60% over five years, with 2025/26 at 52%. Weak capital spending starves the multiplier effect that monetary easing depends on to translate into real credit demand — keeping the lending-rate channel structurally blocked regardless of NRB's stance.

EXTERNAL ANCHOR

IMF's 7th ECF Review & 2026 Article IV — the read-through

Indicator	6th Review (Oct '25)	7th Review (Feb '26)	June '26 Final
FY2025/26 Growth	5.2% (proj.)	3.0–3.5%	~3.0% (confirmed)
Inflation (y/y)	~4–5% expected	2.4% (Jan '26)	Rising toward ~5% target
Banking NPLs	~4.4% (rising)	5.4% (Jan '26)	Elevated; LPR may revise higher
Capital Spending	Weak	Persistently weak	Still weak — no structural fix

Reforms completed in the 7th review

- Customs Compliance Improvement Strategy adopted
- Loan Portfolio Review (LPR) on-site inspection completed
- Asset classification realigned with Basel Committee (BCBS) guidelines
- Agreement reached on draft NRB Act amendments

What the IMF still wants to see

NRB Act amendments — strengthening central-bank independence and the ***bank-resolution regime***. The ***AMC must adopt international best practice***. Concrete ***AML/CFT enforcement results*** remain key to expediting the FATF grey-list exit.

Underlying message: growth in FY2025/26 stayed well below potential as protest-related damage and uncertainty delayed private investment.

Four signals to watch over FY 2026/27

1 NPL containment

A graduated provisioning framework may smooth the impact of credit stress, but it is unlikely to prevent the eventual recognition of asset-quality deterioration.

2 FATF exit progress

Measurable AML/CFT enforcement outcomes, not further action-plan commitments.

3 Capital expenditure execution

Whether FY 2026/27 breaks the five-year pattern of capex utilization below 65%.

4 Peg-review & D-SIB capital build

Whether the government commitment becomes an actual NRB-led technical study, and whether D-SIB capital surcharges are sequenced around the provisioning overhaul rather than stacked on top of it.

RISK ASSESSMENT

Where the monetary-fiscal program is most exposed

Risk Area	Probability	Impact	Overall
Revenue mobilization shortfall	High	Critical	Critical
Capital expenditure execution	High	Critical	Critical
Rising non-performing assets	Medium	High	High
External shock — remittance / export decline	Medium	Severe	Severe
FATF grey-list prolongation	Medium	High	High
Development-partner financing absorption	Medium	High	High
D-SIB capital surcharge vs. NPA provisioning overlap	Medium	High	High
Currency-peg review uncertainty	Low	Medium	Moderate
Political / governance continuity (post-election)	Low	High	Moderate

Probability × Impact assessed against FY 2026/27 program design and execution history through mid-June 2026.

THE VERDICT

Fix the Plumbing, Not Just the Price of Money

FY 2026/27 monetary policy must look past the rate lever to the structural constraints choking credit and investment.

Shift the Focus

Address structural constraints — **banking-sector capital limits and corporate financing gaps** — rather than leaning on policy rate adjustments alone.

Reform, Don't Just React

Targeted regulatory and institutional reforms are needed to **improve monetary transmission** and support sustainable growth.

Diagnosis Is Done

The challenge is no longer identifying the constraints — considerable consensus already exists on the underlying issues.

Execution Will Decide It

Success depends on practical, well-calibrated solutions that address these bottlenecks while preserving financial stability.

Questions & Answers

Thank you for your attention!