



NEPAL

March 2025

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF A PERFORMANCE CRITERION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR NEPAL

In the context of the Fifth Review Under the Extended Credit Facility Arrangement and Request for Modification of a Performance Criterion, the following documents have been released and are included in this package:

- A **Press Release** including a statement by the Chair of the Executive Board.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on March 12, 2025, following discussions that ended on January 19, 2025, with the officials of Nepal on economic developments and policies underpinning the IMF arrangement under the Extended Credit Facility. Based on information available at the time of these discussions, the staff report was completed on February 26, 2025.
- A **Staff Supplement** updating information on recent developments.
- A **Statement by the Executive Director** for Nepal.

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International Monetary Fund
Washington, D.C.



NEPAL

February 26, 2025

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF A PERFORMANCE CRITERION

EXECUTIVE SUMMARY

Context. Political uncertainty remains high with another change of government in July 2024—the fifth since the beginning of the Fund-supported program. Substantial flooding and landslides in September 2024 further weighed on sluggish domestic demand, though conversely helping strengthen the external position and easing inflation pressures. Non-performing loans have risen, bank profitability has weakened, and the financial health of savings and credit cooperatives (SACCOs) has deteriorated. Growth is expected to pick up to 4.2 percent in FY2024/25, supported by further expansion in hydropower generation and a higher execution rate of public capital expenditure, including on post-flood reconstruction. Average inflation is expected to remain close to the authorities' target of about 5 percent.

Program developments. Program performance was broadly adequate with all quantitative performance criteria (QPCs)—on net international reserves and the primary fiscal deficit—met. All continuous PCs were met. The indicative target (IT) on tax revenues was missed due to economic weakness, and the IT on child spending was missed although all children that applied received payments. Progress was adequate on reform implementation, with three structural benchmarks (SBs) completed (two met on time). Tangible progress was made on the remaining SBs with clear commitment for completion. All missed SBs except one have been reset allowing the authorities more time to complete the reforms. A prior action is proposed for this review on issuing the request for proposal—to ensure the loan portfolio review procurement proceeds apace—and is expected to be completed by early March. A new SB is proposed to address a previously implemented SB that was partially reversed, and conditionality is proposed to remediate the impact on other key reforms. The challenging political situation remains a risk for reform implementation. Staff support the authorities' request for modification of the quantitative performance criterion on net international reserves.

Policy recommendations.

- **Fiscal policy.** Executing the planned increase in capital spending and modernizing public investment management are critical to support domestic demand and medium-term growth prospects. Domestic revenue mobilization is needed for development spending and to preserve medium-term fiscal sustainability. To support the most vulnerable, eligibility for the child grant should be expanded.
- **Monetary and financial sector policies.** Monetary policy should maintain the current cautious, data-driven approach to preserving price and external stability. Aligning bank regulations on asset classification and lending with international standards and incentivizing banks to accelerate NPL recovery will support balance sheet repair and more sustainable credit creation. Completing a high-quality loan portfolio review is essential to identifying potential asset quality issues. As vulnerabilities in the SACCO sector deepen, it is important to resolve problematic SACCOs in the near term while reforming the regulatory framework and supervisory architecture.
- **Governance and structural reforms.** Advancements in the draft amendments to the NRB Act should be sent to Parliament promptly to better align the NRB operating framework with international standards. The authorities have made significant progress to improve the anti-money laundering/combating the financing of terrorism (AML/CFT) framework and should continue to bring the framework and its effectiveness in line with international standards and peer evaluations. Ongoing efforts to improve the anticorruption framework and enhance anticorruption institutions by amending the corresponding legal acts should continue.

Approved By
Rupa Duttagupta
(APD) and Koshi
Mathai (SPR)

Discussions took place in Kathmandu, Nepal, during January 7-19, 2025. The staff team comprised S. Jahan (Head), R. Green, Y. Hul (all APD), G. Sher (FAD), M. Gort (MCM), M. Firat (SPR), P. Gupta (Resident Representative for Nepal), R. Ghimire and S. Sharma (local office). Y. Kurniati and W. Mahraddika (OED) also participated in some meetings. S. Lee, A. Sinjar and J. Flinner (APD) supported the preparation of the report. The team met with Deputy Prime Minister and Finance Minister, B. P. Paudel, National Planning Commission Vice-Chairman S. R. Adhikari, Nepal Rastra Bank Governor M. Adhikari, other senior government and central bank officials, development partners and representatives of the business community.

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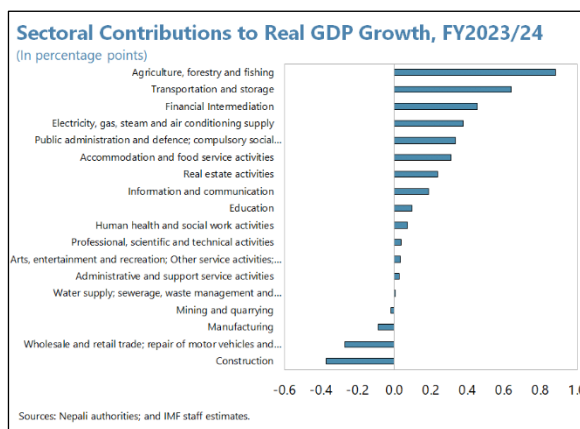
CONTEXT

1. The heaviest rains in twenty years fell during September 2024 causing devastating floods and landslides. The death toll surpassed 250 along with extensive damage to infrastructure, especially major highways and bridges, and residential housing. Agriculture in the affected provinces was hit just before harvest, with significant losses to crop and livestock. Damage also occurred to hydroelectric power plants and transmission lines, disrupting roughly one-third of power generation capacity at the peak of impact. Based on the preliminary damage assessment, the economic cost from the floods and landslides is estimated at close to 1 percent of GDP, but the realized losses could be higher (Annex I).

2. The political situation in Nepal remains volatile with the July 2024 change of government, the fifth since the beginning of the program. A new coalition government was formed between the two largest parties in Parliament, Nepali Congress Party (NC) and the Unified Marxist-Leninist Party (UML). Frequent political changes have adversely impacted the government's capacity and reform momentum.

RECENT DEVELOPMENTS

3. The economy showed early signs of recovery prior to the floods, although domestic demand remained subdued. Real GDP growth is estimated to have reached 3.1 percent in FY2023/24, with strong performance from export-oriented sectors and increased agricultural production partially offsetting continued sluggishness in domestic demand.¹ Inflation eased from a peak of 8.2 percent year-on-year (y/y) in September 2023 to 3.9 percent y/y in September 2024 before accelerating to 6.1 percent y/y in December due to a temporary spike in food prices and supply shortages caused by floods. Capital spending remained weak at 3.3 percent of GDP in FY2023/24 (Text Table 1). Imports have started to recover except for a temporary dip in September-October due to flood-induced transportation disruptions. Weak import demand and lower commodity prices, coupled with buoyant remittances and a rebound in tourism, underpinned a reversal in the current account balance, which turned positive to 3.8 percent of GDP in FY2023/24. Gross international reserves increased to USD15.9 billion as of December 2024 (9.8 months of prospective imports).² Fitch recently rated Nepal as BB-, its first sovereign



¹ The fiscal year in Nepal begins in mid-July.

² The external sector assessment in Annex II of [Nepal: Fourth Review under the Extended Credit Facility Arrangement](#) still holds, i.e. the external position assessment to be stronger than the level implied by medium-term fundamentals and desirable policies is expected to remain applicable.

credit rating, reflecting a favorable debt position, strong reserves and solid growth prospects, in part anchored by the IMF-supported program.

4. The credit/GDP ratio continued to subside from post-pandemic high levels, as weak demand and capital-constrained banks limited credit growth. Credit growth to the private sector stayed below nominal GDP growth at 6.1 percent y/y in FY2023/24 and 6.8 percent y/y in December 2024, while the NPL-to-loan ratio for commercial banks increased from 3.9 percent in July to 4.4 percent in October 2024. Challenges include (i) weak domestic demand and investment, reflecting low business sentiment and political uncertainty, (ii) ongoing deleveraging and balance sheet repair and (iii) capitalization of several banks approaching regulatory limits. Difficulties in the Savings and Credit Cooperatives (SACCOs) sector have also continued with more institutions being classified as problematic.

5. Revenue growth has been subdued in the context of weak economic activity.

Despite several new tax measures in the FY2023/24 budget, weak domestic demand and imports meant that tax revenue only grew by 9.1 percent that fiscal year, broadly in line with

nominal GDP growth.³ Spending restraint in FY2023/24 more than offset the lower-than-expected revenue collection, leading to a larger-than-anticipated improvement in the primary balance (+1.7 percentage points of GDP). The FY2024/25 budget included new tax measures on alcohol, tobacco, petroleum products, and coal, which have supported a 22 percent y/y increase in excise duties in the first five months of the fiscal year. Tax revenues have so far shown strong momentum in FY2024/25, growing 14 percent y/y in the first four months of the fiscal year.⁴

Text Table 1. Nepal: Fiscal Outcome 1/

	2022/23		2023/24	
	Preliminary	4th review	5th review	Difference
(In percent of GDP, unless otherwise indicated)				
Total revenue and grants	19.3	19.3	19.2	-0.1
Total revenue	18.9	18.7	18.7	0.0
Tax revenue	16.2	16.4	16.4	0.0
<i>Of which:</i> Income and profits tax	4.5	4.6	4.9	0.3
Customs	2.8	3.0	2.7	-0.3
Excise duty	2.7	3.0	2.5	-0.5
VAT	5.4	5.1	5.4	0.3
<i>By source:</i> Domestic taxes	9.8	10.0	9.8	-0.2
Import-related taxes	6.4	6.4	6.5	0.1
Non-tax revenue & other receipts	2.7	2.3	2.4	0.1
Grants	0.4	0.6	0.4	-0.2
Expenditure	25.2	24.0	21.9	-2.1
Recurrent expenditure	20.8	20.3	18.6	-1.7
<i>Of which:</i> Interest payments	1.4	1.7	1.4	-0.3
Capital expenditure	4.4	3.7	3.3	-0.4
Memorandum items				
Overall balance	-5.8	-4.7	-2.7	2.0
Primary balance	-4.5	-3.0	-1.3	1.7
GDP (in NPR billions)	5,348.5	5,792.8	5,776.2	-0.3%

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

³ Some of the increase in FY2023/24 fiscal revenue reflected a one-off collection from retroactively taxing the gains made through follow-on public offers, mergers and acquisitions, and sales of shares (0.2 percent of GDP).

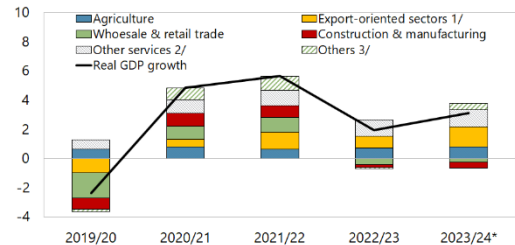
⁴ The December 2024 revenue data continues the trend except for being distorted by large one-off tax receipts in December 2023.

Figure 1. Nepal: Recent Developments

A good harvest and strong export-oriented sectors underpinned a modest recovery in FY2023/24 growth.

Contribution to GDP Growth by Sector

(In percent)

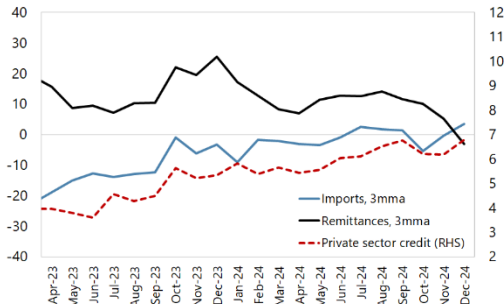


Note: 2023/24 GDP is an estimate.
 1/ Electricity, gas, steam and air conditioning supply; Transportation & storage; Accommodation and food service activities; Information and communication; 2/ Financial and insurance activities; Real estate activities; Professional, scientific, and technical activities; Administrative and support service activities; Public administration and defense; compulsory social security; Education; Human health and social work activities; Arts, entertainment and recreation; Other service activities; Activities of households as employers; 3/ Mining and quarrying; Water supply; sewerage, waste management and remediation activities; Indirect taxes less subsidies.
 Sources: Nepali authorities; and IMF staff calculations and estimates.

Imports and private credit growth are rebounding since the floods, but remittance growth has declined markedly.

High Frequency Indicators

(In percent, year-on-year change)

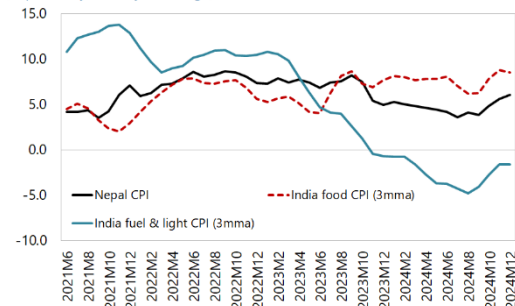


Sources: Nepali authorities; and IMF staff calculations.

Pre-flood inflation was falling due to weak domestic demand and lower commodity prices but has accelerated since on temporary food supply shortages.

Consumer Price Index Trends

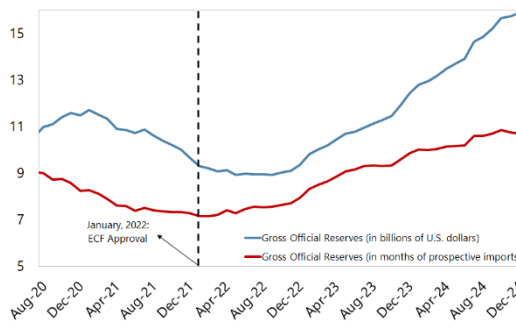
(In percent, year-on-year change)



Sources: Nepali authorities; Haver Analytics; and IMF staff calculations.

External sustainability continued improving with higher reserves in a context of subdued import demand.

Central Bank's Gross Official Reserves

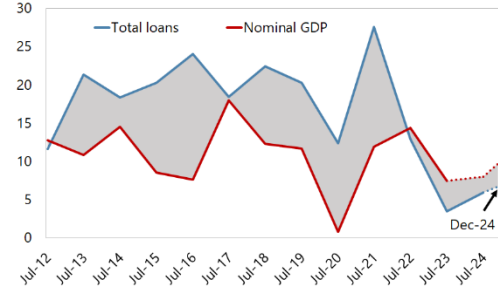


Sources: Nepali authorities; and IMF staff estimates.

Credit growth remains below, but in trend with, nominal GDP growth.

Total Loans and Nominal GDP Growth

(In percent, year-on-year change)

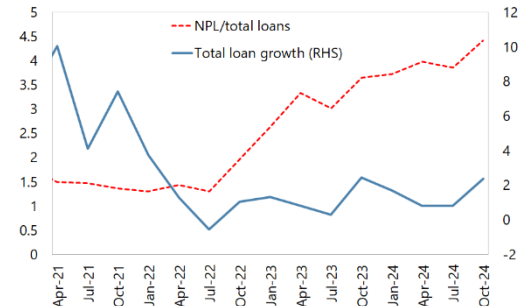


Sources: NRB; Nepal Central Bureau of Statistics; and IMF staff estimates.
 Note: 2023/24 GDP growth is an estimate, while 2024/25 GDP growth is a forecast.
 Note: 2024 December loan growth rate is compared to that of 2023 December.

NPLs continue to rise amid slow economic growth and subdued lending.

Total Loans and NPLs

(In percent, quarter-on-quarter change)



Sources: NRB; and IMF staff calculations.

OUTLOOK AND RISKS

6. The growth recovery will continue in FY2024/25, though muted due to the impact of the floods, and the medium-term outlook remains broadly favorable. Given the damages to agriculture and infrastructure resulting from the floods and continued under-execution of capital expenditure, the real GDP growth projection has been revised down to 4.2 percent in FY2024/25 from 4.9 percent in the 4th review (Annex I). Economic recovery, which is expected to accelerate in the second half of the fiscal year, will be supported by accommodative monetary policy, continued remittance inflows and increased capital spending, including on reconstruction. Supply-side pressures are expected to be short-lived, and average inflation is projected to remain close to the NRB's target of about 5 percent for FY2024/25. Over the second half of the fiscal year imports are expected to revive, driven by pent-up demand and higher execution of capital expenditure, particularly in the construction and energy sectors.⁵ Slower remittance growth and stronger imports are expected to result in a gradual decline in the level of reserves and align the external position with fundamentals over the medium term.

7. Domestic risks dominate the outlook arising from stronger-than-projected negative effects from the floods, the possibility of political volatility and weak policy execution (Annex II). Growth may remain muted if reconstruction does not accelerate following the floods or domestic demand remains subdued, including because of failure to raise the execution rate of capital projects.⁶ Lower domestic demand would reduce import growth with knock-on effects on revenues, which could lead the authorities to cut spending procyclically. Continued political fragility could disrupt policy continuity and reform implementation. Intensification of financial sector vulnerabilities—such as a further rise in NPLs, weak bank capitalization or more failures of cooperative lenders—could endanger banking system soundness, while forbearance could mask existing and emerging vulnerabilities.⁷ Continued large emigration would further reduce the labor force, weighing on medium-term growth prospects. Externally, high commodity prices and global trade tensions as well as bilateral trade restrictions by partner economies could slow the recovery in energy-intensive sectors, aggravate food insecurity, and impose fiscal costs. Moreover, Nepal remains vulnerable to natural disasters and climate shocks.

⁵ Based on the latest power purchase agreements data, Nepal's hydropower generation capacity (3000 MW) is projected to double within the next four years and triple in the medium term. In addition, under the government's 16th Development Plan, 10 percent of total energy is targeted to be generated from other renewable energy sources, including solar and wind (up from 7.4 percent currently).

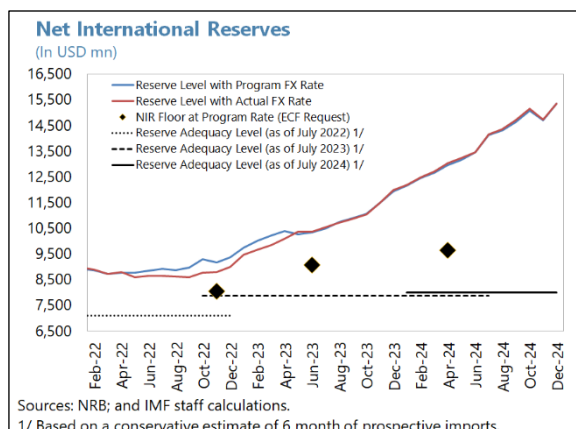
⁶ More broadly, the budget's low credibility reduces its influence on actual execution, raising uncertainty about fiscal outcomes.

⁷ NPLs could be revised once the loan portfolio review is completed.

PROGRAM PERFORMANCE

8. Program performance has been broadly adequate. The July 2024 performance criteria (PC) on net international reserves (floor) and the primary deficit (ceiling) were met (Text Table 1). However, the indicative target (IT) for tax revenue (floor) was missed, mostly due to a weaker-than-expected economic recovery (Annex III). The IT on child allowance spending (floor) was missed for the third time in a row, despite all children who applied receiving the due amount. Meeting the target would require expanding coverage or increasing the per-beneficiary amounts. All continuous PCs were met (Table 8).

9. Progress on implementation of other reforms was mixed (Table 10). Amendments to the AML/CFT law were passed in April 2024, meeting the structural benchmark (SB). The SB on the NRB audit was also met. The SB on completing the financial statement audits of four key public enterprises (PEs) was completed with delay (¶15). The procurement of international advisors for the loan portfolio review (LPR) was terminated due to cost and has been re-initiated. This also caused two February 2025 SBs on LPR completion and the LPR roadmap to be missed, both of which are proposed to be reset. A prior action is proposed on issuing the LPR Request for Proposals (RFP) to ensure the procurement moves apace (¶19). Despite significant tangible progress, the SBs on the NRB Act (¶22) and publishing financial statements of other nonfinancial PEs (¶15) were missed. The former is proposed to be reset. A previously implemented SB on the bank asset classification regulation (ACR) was partially reversed amid a recent regulatory relaxation to support credit growth. A new SB is proposed to re-align the ACR with the Basel Committee on Banking Supervision (BCBS) standards (¶18) and the RFP prior action specifies that the LPR will also be done based on BCBS standards (¶19). The January 2025 SB on producing a tax expenditure report was also missed and is proposed to be reset (¶13). Information to assess the January 2025 SB to incorporate financial information of operational funds in the financial statements will become available only in late March 2025.



POLICY DISCUSSION

A. Safeguarding Growth-Friendly Consolidation

10. The authorities' FY2024/25 budget plans are within the program targets. In the budget, the authorities planned to increase tax revenue by 3.9 ppts to 20.3 percent of GDP, driven by increases in customs tax (1.6 ppts), value-added tax (VAT) (1.2 ppts), and income tax (1.1 ppt). The budget planned for a 4.2 ppt increase in expenditure to 26.1 percent of GDP, due to a 2.2 ppt increase in capital expenditure and a 2 ppt increase in current expenditure. While staff considers these targets as optimistic (¶111), the authorities' budget would still imply a federal primary deficit under the QPC definition of around Rs. 130 billion, and revenues under the IT definition of around Rs. 1.1 trillion, both of which are within the program parameters (Table 2). Going forward, Fund staff stands ready to support the authorities to further improve their budget forecasts given underlying macroeconomic projections.

11. Staff expects a modest increase in revenues this year. Staff projects an increase in the revenue-to-GDP ratio of 0.6 percentage points of GDP in FY2024/25, reflecting import recovery and gains from ongoing tax reforms.⁸ Staff expects an acceleration in the second half of the fiscal year as the economic recovery strengthens and imports pick up for reconstruction, resulting in a 14 percent growth rate for the year. Compared to the projections under the 4th review, revenues are expected to be lower in FY2024/25 by 0.4 ppts of GDP given the continued sluggish domestic demand, while expenditures are expected to be lower by only 0.2 ppts of GDP as the reconstruction spending picks up in H2. Over the medium term, staff expect that tax revenues will increase by 3.2 percentage points of GDP as the authorities implement reforms from their Domestic Revenue Mobilization Strategy (DRMS), which contains measures amounting to 4.6 percentage points (¶113).

Text Table 2. Nepal: Total Revenue and Grants 1/

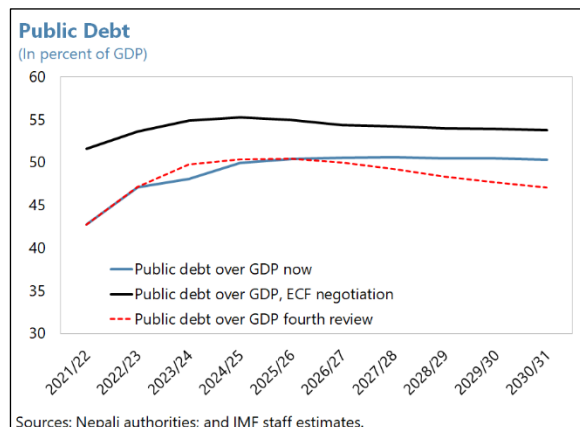
	2023/24	2024/25	Difference
	Est.	Proj.	
(In percent of GDP, unless otherwise indicated)			
Total revenue and grants	19.2	19.8	0.6
Total revenue	18.7	19.2	0.4
Tax revenue	16.4	17.0	0.6
<i>Of which: Income and profits tax</i>	4.9	4.8	(0.1)
Customs	2.7	3.3	0.5
Excise duty	2.5	2.6	0.1
VAT	5.4	5.5	0.1
<i>By source: Domestic taxes</i>	9.8	10.0	0.2
Import-related taxes	6.5	6.9	0.4

Sources: Nepali authorities; and IMF staff estimates and projections.
1/ Fiscal year ends mid-July

⁸The forecasted 0.6-percentage point of GDP rise in tax revenue for FY2024/25 mainly results from a rebound in imports (0.4 percentage points), but also reflects excise duty measures and tax administration improvements. After the FY2024/25 budget, the Inland Revenue Department announced a 10 percent VAT rebate for electronic payments to hotels, restaurants, and bars, aimed at promoting tax compliance and electronic transactions.

12. The projected deficit level based on measures in the FY2024/25 budget is consistent with program objectives of gradual fiscal consolidation to stabilize public debt at a low risk of distress.

Staff project the primary deficit to reach 2.9 percent of GDP in FY2024/25, which entails a consolidation of 1.6 percentage points relative to FY2022/23—though an expansion of 1.6 percentage points relative to FY2023/24—given the unexpectedly sharp fiscal consolidation last year (Table 2a). The current fiscal consolidation path is expected to stabilize public debt at 50 percent of GDP by FY2028/29, keeping debt sustainable over the medium term, which is the key fiscal anchor for the program.⁹ The June 2024 Debt Sustainability Analysis shows that both public and external debts are assessed at low risk of debt distress.



13. Further efforts to mobilize domestic revenues would support development spending and medium-term fiscal sustainability.

In FY2024/25, the Ministry of Finance (MoF) established a new tax revenue intelligence unit, increased the frequency of taxpayer audits, and offered incentives to encourage e-invoicing for VAT. The authorities published a DRMS in 2024 that seeks to broaden the tax base by rationalizing tax expenditures and improving compliance in the medium-term. These initiatives are in line with staff advice and should be used to inform next year's budget. They could be complemented by further revenue-raising measures that would promote equality and efficiency (Annex III).¹⁰ Staff also recommends improving the collection of VAT and income tax arrears by developing a plan to manage arrears and an automated system to send reminders and other administrative and legal notifications, as highlighted in DRMS. The comprehensive tax expenditure report is delayed due to capacity limitations in gathering data and setting benchmarks (end-January 2025 SB, not met and proposed to be reset to end-July 2025). In the interim, to inform the FY2025/26 budget, separate reports on domestic and import-related tax expenditures should be prepared (new SB, end-April 2025). The government should also enhance customs revenue collection by developing a Customs Compliance Improvement Strategy (CIMS), which includes enhanced measures to monitor compliance, educate stakeholders on regulatory requirements, detect non-compliance, enforce compliance, and provide incentives for compliance and sanctions against non-compliance (new end-December SB). IMF TA is available to assist with this strategy,

⁹ There are two operational fiscal anchors under the program: the primary deficit PC and the revenue IT. In addition, the authorities have two fiscal anchors: (i) the legislative limit on external debt set by the Public Debt Management Act (at 33 percent of the previous year's GDP); and (ii) the annual limits on domestic borrowing set by the Natural Resource Commission.

¹⁰ These include equalizing the treatment of labor and capital income within personal income tax, phasing out tax holidays and concessions for special industries, eliminating VAT exemptions on jewelry and residential property, collecting more of the property tax that is due, and clearing tax arrears.

which would serve as an input to the next Customs Reform and Modernization Plan after the current plan expires in 2026.

14. Further efforts to boost public investment and protect the most vulnerable would enhance medium-term economic growth and equality. In the remainder of this fiscal year, staff expects an increase in capital spending—largely due to reconstruction—supported by a high capital allocation in the FY2024/25 budget. An ordinance issued in January 2025 should make it easier to reallocate funds from stalled to ongoing capital projects during the year and to top-up external financing for projects. To enhance the design, prioritization, and selection of investment projects, the authorities have drafted revised Operational Procedures and Unified Directives related to the National Project Bank and are incorporating comments from stakeholders (end-March 2025 SB).¹¹ Clarifying, clearing, and avoiding further overdue amounts to the construction sector would support project completion. To protect the vulnerable and meet the IT on child allowance spending, which amounts to just 0.1 percent of GDP, the authorities should expand the eligibility for the child grant, for example to more districts, or increase the grant amount per beneficiary (when fiscal and logistical resources are not a constraint), which has declined 20 percent in real terms since the last increase in January 2022.

15. Enhancing fiscal transparency will help contain fiscal risks and further strengthen medium-term fiscal sustainability. The audits of all four priority PEs were completed (end-August 2024 SB, not met, completed with delay). For the other nonfinancial PEs, 16 of 20 wholly-owned and 19 of 20 majority-owned either published their financial statements or are no longer operational, showing gradual but steady progress (end-August 2024 SB, not met). The remaining 5 PEs have not published due to companies' desire to have their reports audited and approved by the Office of the Auditor General (OAG). The Financial Comptroller General Office (FCGO) included 90 extra budgetary units (EBUs) at the federal level and 9 at the provincial level in the FY2023/24 annual financial statements (end-January 2025 SB). Assessment will require reconciliation of EBU counts between the FCGO and the OAG, which is expected to be completed in March. EBU financial information that became available after the publication deadline should be published in a supplementary annex to the FY2023/24 financial statements. Last year, the MoF issued, and Cabinet approved, Guidelines on Cash Flow Management. The cash flow forecasting framework is functioning, but frequent staff turnover means that additional capacity development efforts are needed. The authorities should transfer special project funds at the NRB and commercial bank accounts for autonomous bodies and EBUs to the Treasury Single Account.

B. Preserving Macroeconomic and Financial Stability

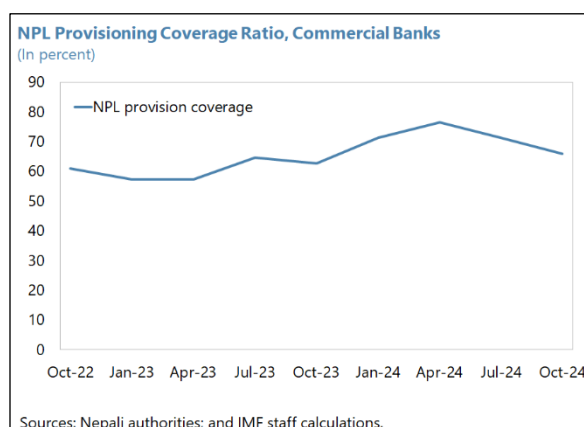
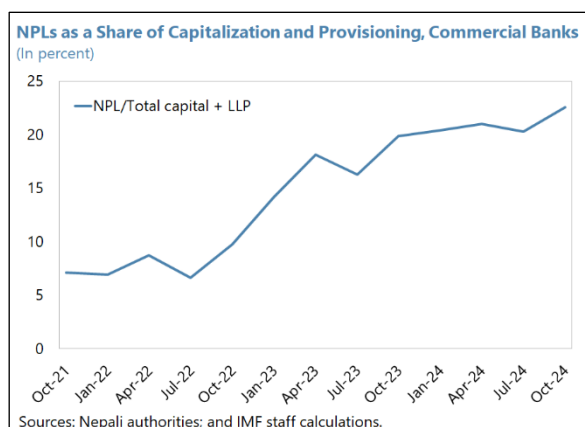
16. Monetary policy remains appropriate as the NRB balances price and financial stability. With significant excess liquidity in the system and the *de facto* policy rate—the Deposit Collection Rate at the bottom of the 350 basis point-wide interest rate corridor (IRC)—below the inflation rate, the monetary policy stance is appropriately accommodative. Lending rates have fallen

¹¹ These are the first two steps in the Public Investment Management Action Plan.

steadily since July 2023, with a cumulative decline through December 2024 of 340 basis points versus the *de facto* decline in the policy rate by about 400 basis points. Accordingly, credit growth is slowly rising but well below nominal GDP growth, which is appropriate to allow a gradual deleveraging.¹² The excess liquidity has largely been absorbed by the Standing Deposit Facility (SDF), with an average balance of about 36 percent of GDP so far this fiscal year. The NRB continues to improve the IRC framework by increasing access to the SDF and relaxing conditions for access. Further reforms to governance—e.g. separating monetary policy formulation from implementation—and aligning regular open market operations with the reserve maintenance period are important next steps.

17. Financial sector vulnerabilities are becoming more pronounced. With NPLs rising, Commercial (Class A) banks, on aggregate, are provisioned at 65 percent in October 2024, a five percent decrease since July 2024. NPLs as a share of capitalization and provisioning are elevated at around 23 percent, indicating limited loan loss-absorbing capacity. Other indicators of loan portfolio health also show stress (Annex IV). In this context, the NRB’s commissioned study on deprived sector lending will be timely as it will allow the NRB to assess its implications and effectiveness. Directed lending requirements could force banks to increase exposures to already-weak sectors and should be applied to a narrower set of borrowers and types of credit before eventual phasing out. NPL recoveries have been slow due to the unattractiveness of NPL restructuring and difficulties selling collateral. Capitalization generally remains tight as increasing NPLs and lower profitability hamper organic capital creation. Although the aggregate Tier-1 capital ratio of all commercial banks of 10 percent in October 2024 meets the minimum requirement, several individual banks struggle to meet the capital conservation buffer requirement. The NRB released the 0.5 percent countercyclical buffer in view of subdued credit growth. To increase available capital for lending, the NRB introduced measures including reducing required provisioning for pass loans by 10 basis points; adjusting risk-weights for residential housing; and allowing a partial reversal of the 3rd review reforms on the ACR (¶118). The NRB ended forbearance for construction-related NPLs and going forward should ensure regulatory forbearance is phased-out and avoided, with any intervention being timebound and limited. NRB recently intervened in a small development bank and is intensifying its supervision of some of the microfinance institutions.

¹² Detail on the post-pandemic credit boom and an analysis of the drivers of credit growth can be found in Annex I of [Nepal: Fourth Review under the Extended Credit Facility Arrangement](#).



18. The authorities have agreed to realign the asset classification regulation (ACR) with international standards. In July 2024 the NRB partially revised the ACR, removing rules agreed as part of the 3rd Review to allow non-forborne NPLs to immediately be reclassified as “watchlist” (not an NPL) following clearance of arrears.^{13,14} This change was implemented to remove non-performing borrowers from the blacklist sooner and to allow banks to begin releasing provisions earlier, freeing up capital for banks to lend.¹⁵ To reinforce prudence on asset classification, the authorities have agreed to align the ACR with the ‘continuous repayment period of three months’ for reclassification of non-forborne NPLs, as prescribed by the BCBS Guidelines on “Prudential Treatment of Problem Assets” (the BCBS standard), by end-December 2025 (new end-December 2025 SB). This will allow the NRB to incorporate LPR findings (¶19) pertaining to the application of the BCBS standard and ensure it has an appropriate legal base to require banks to provision in accordance with the standard. Until the ACR’s alignment with the BCBS-standard has been finalized, banks, monitored by the NRB, should anticipate the regulatory change and not prematurely release provisions that will be covered by the revision. The authorities, in addition, should continue to improve bank lending practices, including through sustaining and improving the Working Capital Loan (WCL) guidelines to tackle evergreening and gradually reduce misuse of WCLs.

19. The LPR of the ten largest banks has been delayed and will be rephased. This exercise is an important first step for the NRB to get a better overview of loan portfolio quality and devise a strategy to address any capital shortfalls or other shortcomings. In September 2024, the NRB terminated the procurement of the independent international advisor for the LPR for budgetary reasons, which delayed its launch by 5-6 months. The procurement process restarted in December 2024 with the expression of interest phase closing mid-January 2025. To allow NRB to complete the procurement and onboard the consultant, the launch of the LPR has been reset to end-May 2025

¹³ Non-forborne NPLs refers to the definition in the BCBS Guidelines on “Prudential Treatment of Problem Assets” of NPLs that are not restructured or rescheduled.

¹⁴ Watchlist is equivalent to the ‘special mention’ performing loan classification with 5 percent required provisioning.

¹⁵ The regulatory framework in Nepal requires banks to put non-performing borrowers and their related parties on a blacklist until a solution has been found that addresses the overdue payments. Persons on the blacklist and their related parties lose access to financial services and products.

(end-August 2024 SB, not met and proposed to be reset to end-May 2025). To show their commitment to complete the procurement of the consultants that are critical to launching the LPR, the authorities will complete a prior action by early March to issue the RFP for the procurement (prior action, pending). The prior action requires the RFP to specify that the LPR will be conducted based on both existing and BCBS standards to also assess NPL classification and provisioning against this standard. In view of the new launch date, the LPR of all ten banks will be completed by end-December 2025 (end-December 2024 SB, not met and proposed to be reset to end-December 2025). To address the LPR's findings, the authorities will develop a roadmap by end-April 2025 (end-February 2025 SB, not met and proposed to be reset to end-April 2025). The roadmap will require any bank with capital shortfalls to submit time bound capital plans setting out how they will return to full compliance with regulatory requirements. As an additional signal of the intention to remediate the partial ACR reversal, the roadmap will also include the December 2025 alignment of the ACR with BCBS-standard. Finally, to ensure the bank resolution framework is fully equipped to deal with problematic banks identified by the LPR, the authorities will submit to Parliament amendments to the NRB Act that address the gaps identified in the 2023 Financial Sector Stability Report by end-April 2025 (new end-April 2025 SB).¹⁶ The authorities should use this opportunity to also identify topics in the NRB Act and Bank and Financial Institutions Act that require alignment going forward.

20. The NRB continues to introduce regulatory reforms to enhance the bank supervision framework with the help of IMF TA. The NRB is reviewing its Capital Adequacy Framework with a view to further aligning it with international standards. A recast of the rules on blacklisting of non-performing borrowers—to address disproportional effects of the blacklisting of borrowers with bounced checks, which left them and certain related parties without access to financial products—has been publicly consulted and is expected to be issued this fiscal year. The NRB published Expected Credit Loss guidelines as part of Nepal Financial Reporting Standard (NFRS) 9 implementation that began in July 2024 and is introducing a Basel III liquidity coverage ratio (LCR) to strengthen bank liquidity risk management this fiscal year.¹⁷ Finally, the NRB has agreed to a TA workplan with staff to address the recommendations of the 2023 FSSR, focusing on developing off-site analytical tools, improving credit risk supervisory practices and consolidated supervision. Implementation of the workplan should be given priority given the recent delays in starting TA projects and the regulatory changes introduced by NRB.

21. The authorities are planning to reregulate SACCOs and should prioritize dealing with problematic institutions. Weaknesses among SACCOs have continued with further failures due to inadequate governance and lack of regulation, resulting in a loss or freeze of client savings. Although the SACCO sector is relatively small, with SACCO deposits around 1/12th that of banks, continued failures undermine confidence and could result in contagion to small regulated banks.

¹⁶ The 2023 FSSR Report and accompanying Background Note on the Financial Sector Safety Net have identified gaps in areas such as emergency liquidity assistance, the early intervention mechanism, recovery and resolution planning, group resolution, resolution objectives and principles, resolution tools and powers and legal safeguards.

¹⁷ NFRS 9 is the International Financial Reporting Standard (IFRS) 9 applied to Nepal.

The authorities have suspended the registration of new SACCOs, have started a project to improve collection of data and issued an ordinance to reregulate SACCOs.¹⁸ In view of the proposed caps on the size of SACCO deposits, it will be important for authorities to closely monitor liquidity in the SACCO sector. Including SACCOs in the Deposit and Credit Guarantee Fund (DCGF) risks unviable SACCOs draining the limited available funds for bank depositor payout, especially given the limited capacity of DCGF. Further legislation should be introduced to strengthen the DCGF and ensure funds protecting banks and funds protecting SACCO depositors are clearly separated. In addition, the authorities need to ensure that the SACCO sector is cleaned up and better supervised and regulated before institutions are covered by deposit insurance. A comprehensive and centralized strategy regarding failed SACCOs has been slow to materialize in view of the current decentralized responsibilities regarding SACCOs and large data gaps. This requires improving interagency coordination to develop a centralized approach.¹⁹ The planned establishment of SACCO Credit Recovery Tribunals should assist in the recovery of problematic SACCO assets to repay depositors.

C. Enhancing Governance and Other Structural Reforms to Boost Growth

22. The authorities have made progress on implementing the 2021 Safeguards Assessment (SGA) recommendations. Notably, additional advancements towards SGA recommendations have been made in the NRB Act amendments. Staff look forward to reviewing the amendments, ideally well in advance of submission to Parliament to ensure the draft law is aligned with best practices. The SB was not met and is proposed to be reset to end-April 2025 to allow time to finalize and prepare the bill for submission (end-September 2024 SB, not met, reset to end-April 2025). Other than the three recommendations related to the NRB Act, all but one SGA recommendations have been implemented.²⁰ In addition, the end-July 2024 SB to involve auditors with central banking and international auditing experience in auditing the FY2023/24 financial statement of the NRB was met (end-July 2024 SB, met), and the authorities agreed to continue the practice for the FY2024/25 audit (proposed end-July 2025 SB).

23. The government has strengthened the legal framework in line with the FATF standards through a series of AML/CFT reforms, although challenges remain in improving its effective implementation. The authorities amended the AML/CFT laws in line with Financial Action Task Force (FATF) standards (end-July 2024 SB, met). The FATF added Nepal to the list of jurisdictions under the increased monitoring (“grey list”) in February 2025. In the run-up to grey listing, the authorities have made progress upgrading the legal framework based on the findings of

¹⁸ The ordinance seeks to establish a second-tier institution to license and regulate SACCOs, includes licensing, capital, liquidity (including caps on the maximum size of deposits), governance and risk management requirements, and membership in the DCGF, and ensures their membership of the Credit Information Center.

¹⁹ Detail on the proposed approach to SACCOs can be found in Annex IV of [Nepal: Fourth Review under the Extended Credit Facility Arrangement](#).

²⁰ Four recommendations have been implemented since the 4th review, improving internal audit reports to the Audit Committee, certifying the training of the Chief Information Security Officer and two on creating staff capacity development plans. The remaining one not linked to the NRB Act amendments—revising the Foreign Exchange Investment Directive—is close to completion.

the Asia/ Pacific Group on Money Laundering's (APG) 2023 assessment, including the amendment of the AML/CFT laws and the publication of the National Strategy, issuing new Targeted Financial Sanctions guidelines and developing Fit and Proper Test guidelines. Challenges remain in improving the effectiveness of its AML/CFT regime.

24. Addressing structural barriers and governance and corruption vulnerabilities remains a priority to unlock the country's potential and increase resilience. The recently-approved Bill on Facilitating Investment is a positive development that addresses some long-standing challenges faced by investors.²¹ The sovereign credit rating provides further tailwinds to investment but must be supported by further progress in addressing structural hurdles. The recent findings and recommendations of a High-Level Economic Reform Commission offer a comprehensive list of legal and institutional measures to help restore economic dynamism, improve macroeconomic stability, and build resilience.²² Ongoing efforts to improve the anticorruption framework by modernizing legal acts on corruption prevention, investigation, and prosecution and enhancing anticorruption institutions will help restore business confidence (MEFP ¶126). Strengthening governance, digitalizing public administration and further bolstering legal recourse would reduce the high costs of doing business, promote market competition, and improve the investment climate. Investing in climate adaptation efforts and agricultural and food security would reduce the economy's vulnerability to climate shocks.²³ Effective implementation of the recently approved 16th Development Plan—the guiding policy agenda on investment, adaptation and employment for the next five years—should enhance Nepal's resilience and economic potential.²⁴

PROGRAM MODALITIES

25. An upward modification is requested by the authorities to the QPC on net international reserves. The floor on net international reserves for July 15, 2025 is proposed to be revised up (Table 8). Staff anticipate requesting a technical extension of the program by several

²¹ The Bill amends nine legal acts, including on simplifying business registration and compliance requirements for startups and foreign investors (Industrial Enterprises Act, 2020); streamlining the approval process for foreign investments (Foreign Investment and Technology Transfer Act, 2019); simplifying land acquisition for investment projects (Lands Acquisition Act, 1977); and easing restrictions on investments in forest areas (Forest Act, 2019), among others.

²² The High-Level Economic Reform Commission has been formed by the Nepal government in October 2024 to study and recommend on legal, structural, and institutional adjustments to help revive economic growth, improve investment climate, and boost resilience and economic potential. The Commission submitted an interim report to the Ministry of Finance in January 2025.

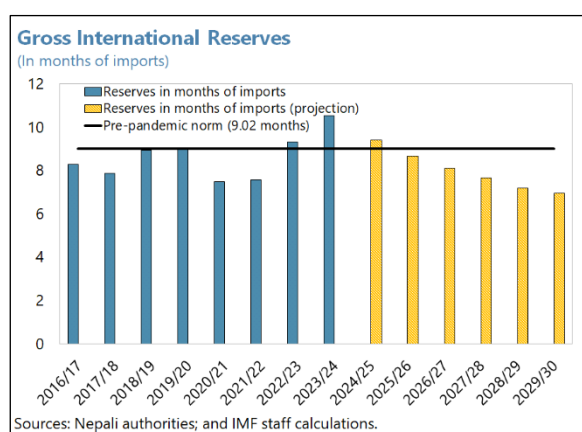
²³ The Nepal CCDR (<https://hdl.handle.net/10986/38012>) provides detailed recommendations on improving food security and resilience under climate change. This includes development of climate-resilient infrastructure; modernization and expansion of food storage, processing, and distribution systems; and scaling up climate-smart agriculture practices. Implementing robust social safety nets, disaster risk financing mechanisms, and insurance schemes to protect farmers against natural disasters are key to local-level resilience.

²⁴ The 16th Development Plan prioritizes efforts to improve agricultural productivity and food security; invest in export-oriented sectors (hydropower, tourism, IT) and climate adaptation; and expand social safety nets.

months before the 7th review to accommodate assessment of the completion of the December 2025 SBs.

26. Capacity to repay remains adequate. IMF credit outstanding is projected to peak this fiscal year at 262.3 percent of quota (SDR 411.6 million). This represents 16.5 percent of exports and 1.1 percent of GDP (Table 9). Upcoming Fund obligations remain low relative to current and projected international reserves, fiscal revenues and GDP. The authorities' track record of servicing IMF debt is strong.

27. Pressing fiscal financing and prospective balance of payments needs remain. Domestic borrowing limits in the budget make external financing critical to avoiding expenditure cuts or a large negative Treasury balance at the NRB (Text Table 3).²⁵ Prospective balance of payments needs have not meaningfully changed from the 4th review even though substantial flood-related imports are expected in FY2024/25. Accordingly, as public investment execution is scaled up, the recovery firms and imports pick up, reserves are expected to return to levels seen at the program request, below Nepal's pre-pandemic norm. Lastly, program reforms are critical to encouraging greater foreign investment by building a framework for macroeconomic stability, which undergirded the recent sovereign credit rating.



28. The program is fully financed, with firm commitments in place for the remainder of the program. Budget support financing pledges for FY2024/25 through FY2025/26 are in line with the level recorded during the 4th review (Text Table 3 and Table 5).^{26,27} The authorities intend to use the ECF arrangement for budget support.

²⁵ Concessional financing (both budget support and project financing) from development partners is available to help support flood response, but capacity to absorb project financing remains low due to shortages of administrative staff and high government turnover.

²⁶ The lack of implementation of the reforms underpinning their budget operations caused delay and uncertainty in disbursement from development partners.

²⁷ The increase in projected budget support by development partners over the next few years is mainly due to an increase in climate-related financing by the World Bank and the Asian Development Bank within the Nepal Green, Resilient, and Inclusive Development action plan, adopted in November 2023 by the government of Nepal and 16 development partners.

Text Table 3. Nepal: Projected Financing Gap
(In percent of GDP)

External financing need			Fiscal financing need		
	FY2024/25	FY2025/26		FY2024/25	FY2025/26
External financing requirement	1.1	3.8	Total revenue and grants	19.8	20.9
<i>of which:</i>			Expenditure	24.3	25.0
Current account deficit ^{1/}	1.9	4.7	Fiscal deficit	4.5	4.1
Financing sources	0.1	3.0	Total financing	3.5	3.2
Foreign borrowing	1.5	1.5	Net acquisition of financial assets	1.3	1.3
Current and capital grants	0.9	1.3	Net incurrence of liabilities	4.8	4.5
FDI, net	0.3	0.4	Foreign borrowing	0.7	0.7
Change in reserves (+ decreas	-2.6	-0.2	Domestic borrowing	4.1	3.9
External financing gap	1.0	0.9	Fiscal financing gap	1.0	0.9
Financing commitments so far:	1.0	0.9	Financing commitments so far:	1.0	0.9
IMF: ECF	0.2	0.1	IMF: ECF	0.2	0.1
Asian Development Bank	0.2	0.4	Asian Development Bank	0.2	0.4
World Bank	0.6	0.4	World Bank	0.6	0.4

Sources: Nepali authorities; and IMF staff estimates.
1/ Current account excludes official transfers.
Note: Current baseline forecast is as of January 29, 2025.

29. The program continues to face important risks, but ample reserves provide a backstop. Political uncertainty is mitigated by an abiding commitment to the program across all major political parties. Fiscal measures and guardrails under the program will bolster fiscal buffers. Likewise, the strengthened reserve position provides an increasingly potent backstop to external shocks. The NRB has developed facilities to provide liquidity support to prevent potential systemic financial concerns.

30. Mobilization of capacity development (CD) has intensified to support reforms envisaged under the program. CD provided the foundation for the implementation of SBs in several areas, including on fiscal risks management, tax reforms, cash flow forecasting, execution of capital expenditures, financial sector regulation and supervision, strengthening the central bank's institutional framework, and enhancing AML/CFT legal framework (Annex V).

STAFF APPRAISAL

31. Following disruptions brought by the floods, economic growth is expected to pick up and the surge in inflation to be transitory. Real GDP growth is projected to reach 4.2 percent in FY2024/25 as economic activity gathers momentum in the second half of the fiscal year supported by stronger capital spending, including on post-flood recovery and reconstruction efforts. Inflation is expected to ease as transport networks are repaired and agricultural output recovers. Although the external position remains stronger than the level implied by medium-term fundamentals and desired policies, it is projected to weaken as import-intensive capital projects scale up, remittance growth normalizes from the post-pandemic surge, and pent-up import demand picks up.

32. Program performance was broadly adequate with all PCs met, several critical SBs completed, and corrective actions planned for missed SBs. The PCs on net international reserves and the primary fiscal deficit were met, together with all standard continuous PCs. The ITs on revenue and child allowance spending were missed. Three SBs were completed (two met on time), with a commitment and clear process to finish the remaining SBs. All missed SBs except one have been reset within a structure to support their timely completion. The one not reset (on PEs publishing their financial statements) is close to completion, with the pending few non-published statements (5 of 40) no longer macro-critical. Similarly, the partially reversed 3rd review SB has new conditionality supporting its remediation and measures to mitigate the impact on other key reforms.

33. To support domestic demand and medium-term growth, the authorities should boost public investment. A generous budget allocation and legal amendments made in January 2025 should help, as will the continued implementation of the government's Public Investment Management Action Plan. Ongoing technical assistance by the IMF and development partners will help to diagnose obstacles to public investment.

34. Further efforts to mobilize revenues could support development spending and fiscal sustainability. The authorities should accelerate implementation of their DRMS. Other priorities include completing assessments of tax expenditures and developing a CIMS.

35. Monetary policy should maintain its current cautious, data-driven approach to preserve price and external stability. Unless credit growth picks up rapidly, currently high liquidity levels are appropriate to support balance sheet repair. Greater efforts should be made to improve the functioning of the IRC.

36. Increasing vulnerabilities in the financial sector warrant a proactive approach. Aligning regulations on asset classification and lending practices with international standards and incentivizing banks to accelerate NPL recovery will support balance sheet repair and more sustainable and pro-growth credit creation. With banks facing weak credit demand, increasing NPLs and reduced profitability, the NRB needs to assertively address emerging issues in the banking sector. In this context, the LPR will contribute to improving visibility on potential asset quality issues. Other scheduled financial sector reforms aimed at improving capital and liquidity frameworks in line with international standards and adjusting blacklisting practices will further enhance financial sector

stability. As vulnerabilities in the SACCO sector deepen, it is important that the authorities expedite a cohesive strategy that prioritizes resolving problematic SACCOs in the near term, while reforming the regulatory framework and supervisory architecture. When reregulating SACCOs, deposit insurance coverage is not advisable before the SACCO sector has been cleaned up and is better regulated and supervised.

37. Aligning the NRB operating framework with international standards is essential to conduct effective monetary policy and undergird financial stability. Most important in this regard is amending the NRB Act to strengthen its governance, independence and accountability. It also includes conducting the audit of the NRB assisted by experts with international experience in auditing central banks and implementing the final recommendations of the 2021 SGA.

38. The strong drive to strengthen the AML/CFT regime must be maintained with a focus on achieving concrete results in implementation. FATF grey listing underscores the importance for Nepal to sustain its reforms in line with the FATF action plan. Most importantly, implementing the remaining reforms would include additional upgrades for the legal, regulatory, supervisory and operational frameworks, primarily focusing on their effectiveness. Staff will continue to support Nepal's AML/CFT reforms through program commitments and the ongoing CD program.

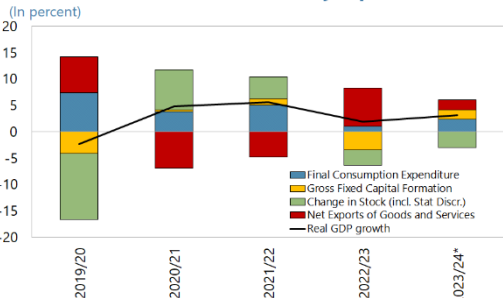
39. Further reforms to address barriers to growth and improve the investment climate, social safety nets and anticorruption institutions are needed to support growth. Building on the ongoing legal efforts to improve the business environment, reduce the cost of doing business and strengthen governance and anticorruption institutions, continuous advancement in line with international best practices and effective implementation of these initiatives remain key. Further reforms to develop climate change-resilient infrastructure and climate-smart agriculture practices, build human capital, and strengthen social protection frameworks remain essential to fostering investment, promoting more inclusive and green growth, and enhancing resilience. Coverage of the child grant program should continue to improve, including by extending it to all districts.

40. Staff supports completion of the 5th review of the ECF-supported program and disbursement of 6th tranche in the amount of SDR 31.4 million and the request for modification of a performance criterion.

Figure 2. Nepal: Recent Macroeconomic Developments

Domestic demand remained anemic, making for a frail recovery in FY2023/24.

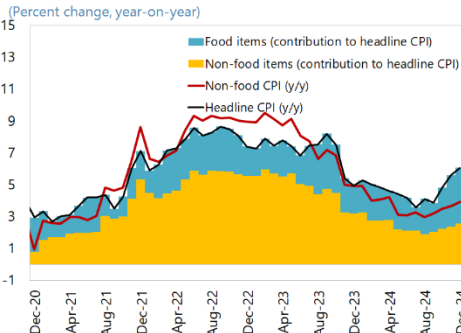
Contribution to Real GDP Growth by Expenditure



Note: 2023/24 data are estimates.
Sources: Nepali authorities; and IMF staff calculations.
Note: IMF staff estimates. There is a large statistical discrepancy between the GDP from expenditure approach, and the headline GDP from the industry approach.

Inflation has accelerated due to transitory effects of flood-induced crop losses and supply disruptions.

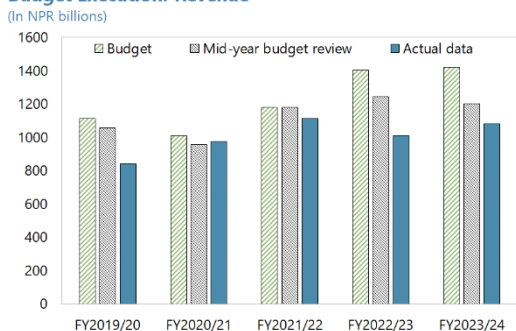
Consumer Price Index



Sources: Nepali authorities; and IMF staff estimates.

Revenue collection dropped markedly in FY2022/23 and did not recover much in FY2023/24...

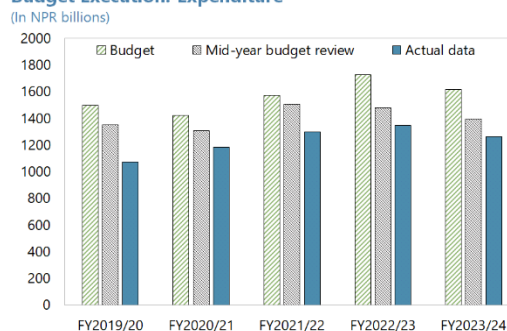
Budget Execution: Revenue



Sources: FCGO and MOF. Note: Fiscal year begins mid-July.

...again constraining spending and reinforcing the systemic pattern of expenditure under-execution.

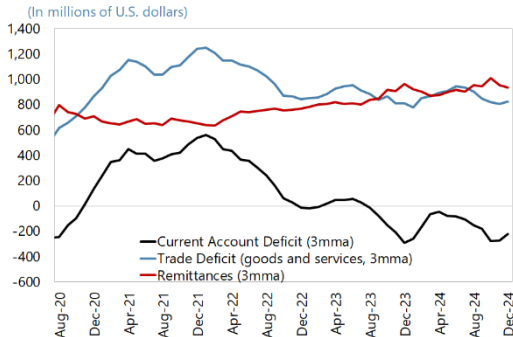
Budget Execution: Expenditure



Sources: FCGO and MOF. Note: Fiscal year begins mid-July.

The trade deficit has recently started increasing again as imports begin to recover.

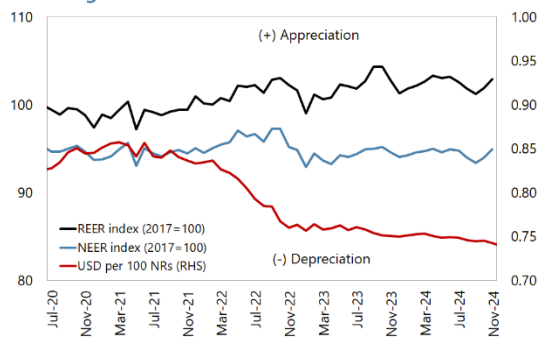
Current Account Deficit



Source: Nepali authorities.

The NEER and REER have been broadly stable since 2023 as the Rupee slowly depreciates against the US dollar.

Exchange Rates

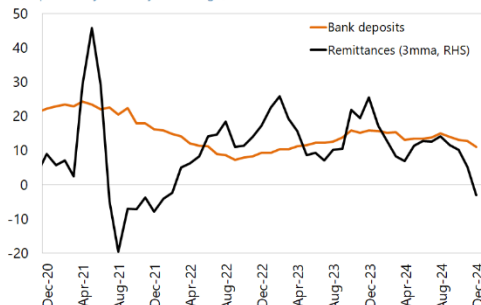


Sources: Nepali authorities; and IMF staff estimates.

Figure 3. Nepal: Recent Monetary Sector Developments

Bank deposit growth has only weakly followed the recent dip in remittance growth...

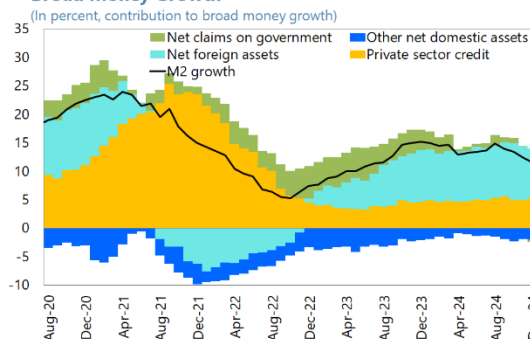
Bank Deposits and Remittances
(In percent, year-on-year change)



Sources: Nepali authorities; and IMF staff calculations.

...as net foreign asset accumulation continues to dominate broad money growth.

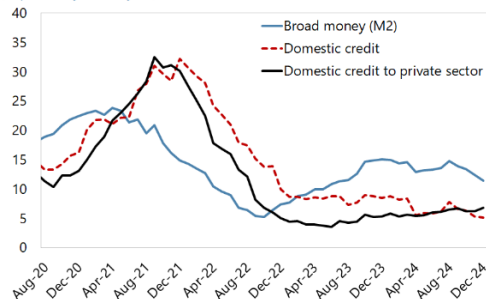
Broad Money Growth



Sources: Nepali authorities; and IMF staff estimates.

Private sector credit growth recently outpaced overall credit growth as mid-year government borrowing has subdued.

Credit and Money Growth
(In percent, year-on-year)

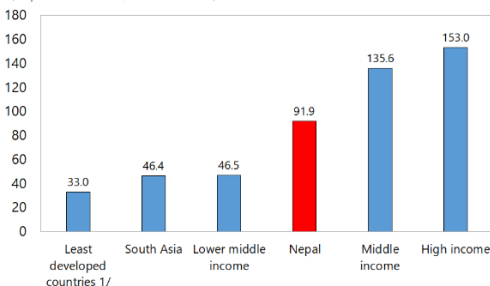


Sources: NRB; and IMF staff calculations.

Private sector credit/GDP remains among the highest in its peer group.

Domestic Credit to Private Sector

(In percent of GDP, 2023 or latest)

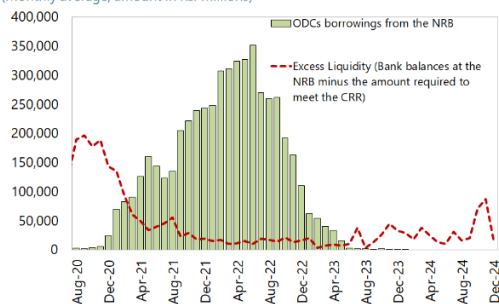


Source: World Bank, World Development Indicators.
1/ UN Classification.

Liquidity absorption is the focus, especially through the Standing Deposit Facility (not shown)...

Liquidity Conditions

(Monthly average, amount in Rs. millions)

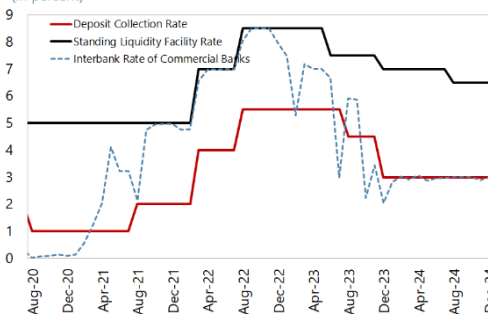


Source: Nepali authorities.

...yet such amounts are not sufficient to lift interbank rates from the bottom of the interest rate corridor.

Short-term Interest Rates

(In percent)



Source: NRB.

Figure 4. Nepal: External Sector Developments

In FY2023/24 the current account turned positive due to persistent import weakness and remittance strength.

However, imports growth rebounded and turned positive in H1 FY2024/25, signaling improving domestic demand.

Current Account

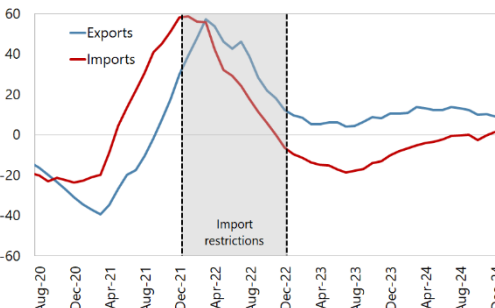
(In percent of GDP)



Note: 2023/24 GDP is an estimate. Sources: Nepali authorities; and IMF staff estimates.

Exports and Imports

(In percent, year-on-year change, 12MMA)



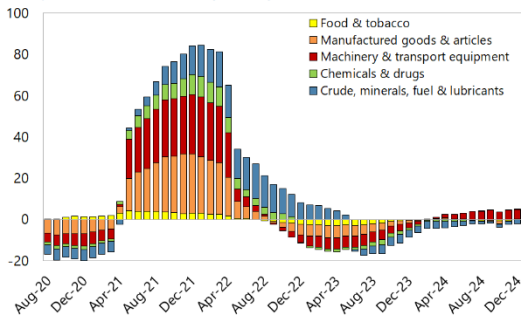
Sources: NRB; and IMF staff calculations.

Lower energy prices have slowed the import recovery, but capital goods imports have picked up in recent months.

Foreign employment of Nepalis remains resilient, driving robust growth in remittances.

Contribution to Import Growth

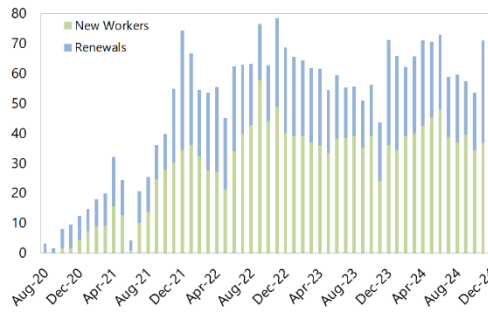
(In percent, based on 12MMA, year-on-year)



Sources: Nepali authorities; and IMF staff calculations.

Total Foreign Employment

(Thousands of workers)



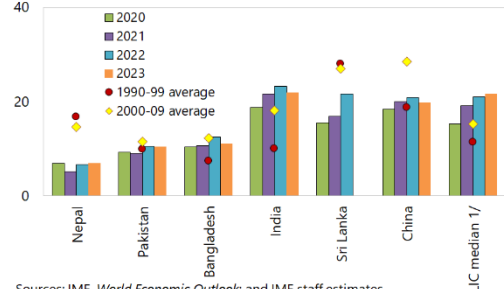
Sources: Nepali authorities; and IMF staff estimates.

Exports have rebounded since 2021, but remain well below the 1990-2009 levels, and below peers.

Tourism returned to pre-pandemic levels in H2 FY2023/24, but airport closures starting in October in Kathmandu may have impacted H1 FY2024/25.

Exports of Goods and Services

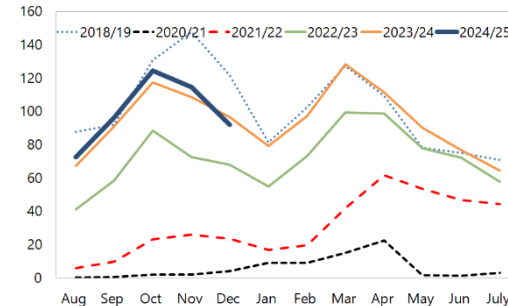
(In percent of GDP)



Sources: IMF, World Economic Outlook; and IMF staff estimates. 1/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between \$1,145 or less in 2023.

International Visitor Arrivals

(In thousands of visitors)

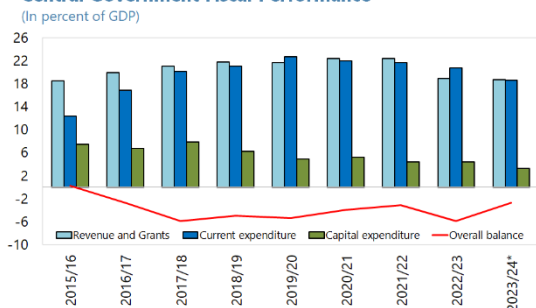


Source: Nepali authorities.

Figure 5. Nepal: Recent Fiscal Developments

In FY2023/24, the fiscal deficit narrowed on restrained spending.

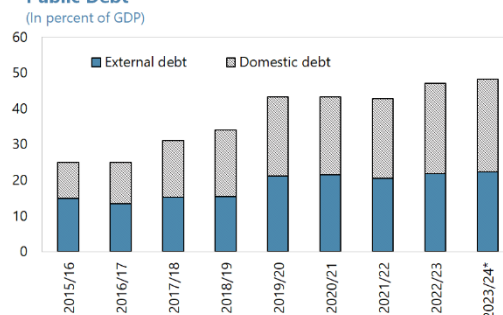
Central Government Fiscal Performance



Sources: Nepali authorities; and IMF staff estimates.
 Note: 2023/24 GDP is an estimate.
 Note: Overall balance calculated as total revenue and grants minus expenditure.

Total public debt increased to 49.9 percent of GDP in FY2023/24.

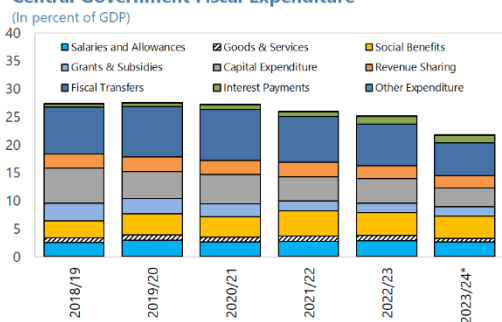
Public Debt



Note: 2023/24 GDP is an estimate.
 Sources: Nepali authorities; and IMF staff estimates.

The reduction in expenditure in FY2023/24 was driven by fiscal transfers and capital expenditure.

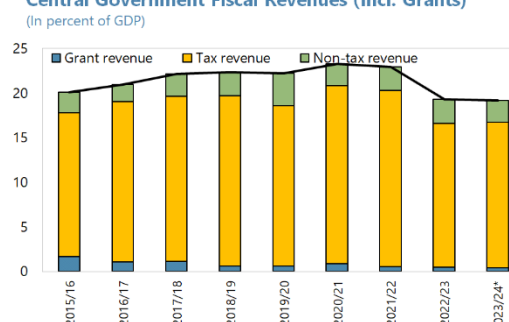
Central Government Fiscal Expenditure



Note: 2023/24 GDP is an estimate.
 Sources: Nepali authorities; and IMF staff estimates.

Tax and non-tax revenues remained stable relative to GDP in FY2023/24.

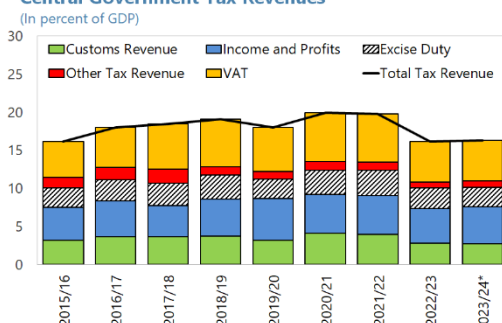
Central Government Fiscal Revenues (Incl. Grants)



Note: 2023/24 GDP is an estimate.
 Sources: Nepali authorities; and IMF staff estimates.

The composition of tax revenues remained stable in FY2023/24, whether looking at the mix of tax types....

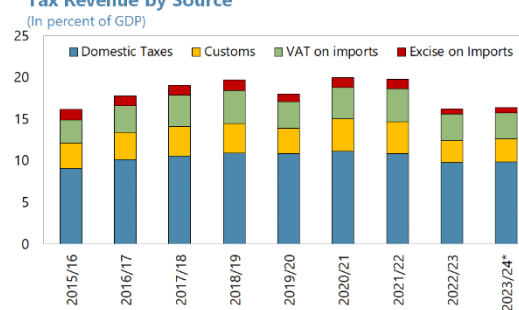
Central Government Tax Revenues



Note: 2023/24 GDP is an estimate.
 Sources: Nepali authorities; and IMF staff estimates.

...or the mix between taxes on imports vs. domestic activity.

Tax Revenue by Source



Sources: Nepali authorities; and IMF staff estimates.
 Note: 2023/24 GDP is an estimate.
 Note: Domestic taxes are calculated as the residual by subtracting customs, VAT on imports and excise on imports from total tax revenue.

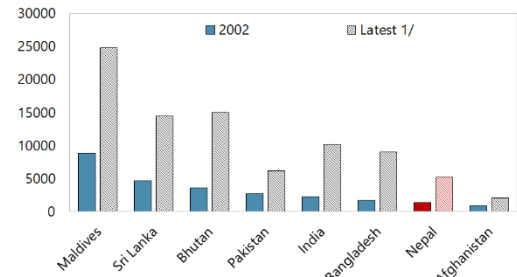
Figure 6. Nepal: Socio-Economic Indicators

Nepal is one of the lowest income countries in Asia and South Asia...

...yet poverty fell significantly in the last decade.

Per Capita GDP (PPP)

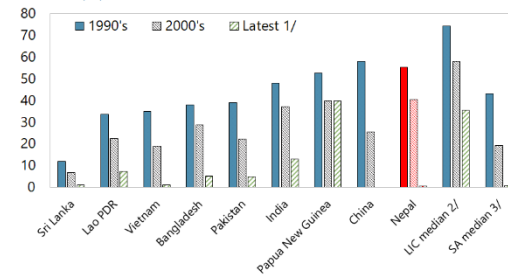
(In current international dollars)



Sources: World Bank, *World Development Indicators*; and IMF staff calculations.
 1/ Maldives (2023); Sri Lanka (2023); Bhutan (2022); Pakistan (2023); India (2023); Bangladesh (2023); Nepal (2023); Afghanistan (2022)

Poverty Headcount Ratio at USD 1.90 per Day

(Percent of population, 2011 PPP)



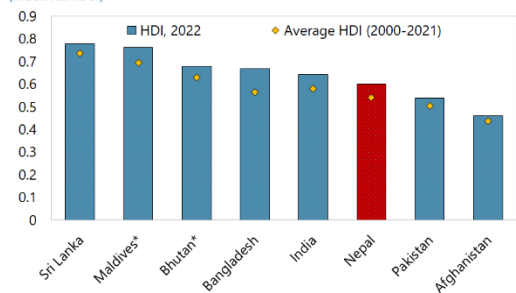
Sources: World Bank, *World Development Indicators*; and IMF staff calculations.
 1/ Sri Lanka (2019), Vietnam (2022), Bangladesh (2022), Pakistan (2016), China (2020); Lao P.D.R. (2016); India (2021); Nepal (2022); Papua New Guinea (2009).
 2/ LIC: Low Income Countries are defined by the World Bank as those with a GNI per capita between \$1,145 or less in 2023.
 3/ South Asia (SA) includes India, Nepal, Bhutan, Bangladesh, Maldives and Sri Lanka.

The decline in poverty is reflected in an improvement in Nepal's UNDP Human Development Index.

Although human capital levels are similar to comparators, there is scope for improvement.

Human Development Index

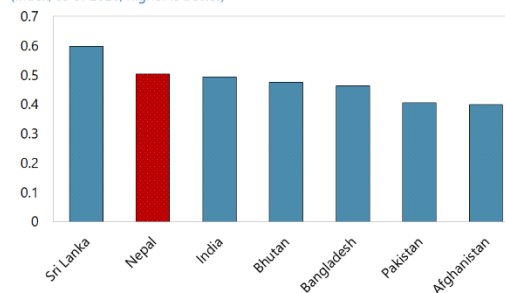
(Index number)



Sources: UNDP; and IMF staff calculations.
 Note: Historical HDI averaged using partial data for Maldives and Bhutan.

Human Capital Index 1/

(Index, as of 2020; higher is better)



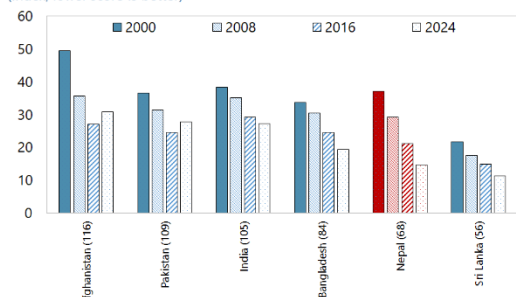
Source: The World Bank, *Human Capital Project*.
 1/ Measures the human capital that a child born today can expect to attain by her 18th birthday, given the risks of poor health and poor education in the country where she lives. Units represent productivity relative to a benchmark of complete education and full health, on a scale of 0 to 1.

There is substantial need to improve living standards, including relating to hunger.

One of Nepal's most important safety nets comes from remittances.

Global Hunger Index 1/

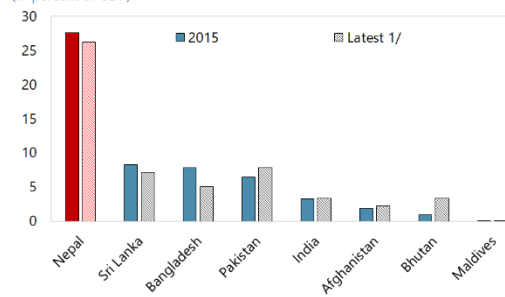
(Index, lower score is better)



Sources: Global Hunger Index; and IMF staff calculations.
 1/ The Global Hunger Index is a multidimensional indicator that captures undernourishment, child wasting, child stunting, and child mortality. Number in parenthesis represents the country's 2024 rank out of 125 countries.

Remittances Received

(In percent of GDP)

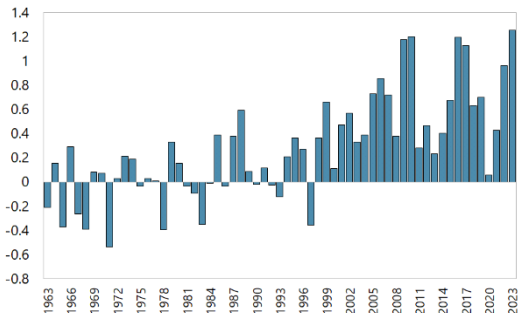


Sources: World Bank, *World Development Indicators*
 1/ Nepal (2023), Sri Lanka (2023), Bangladesh (2023), Pakistan (2023), India (2023), Afghanistan (2022), Bhutan (2022), Maldives (2023)

Figure 7. Nepal: Climate Change and Pollution

Average temperatures have risen in Nepal.

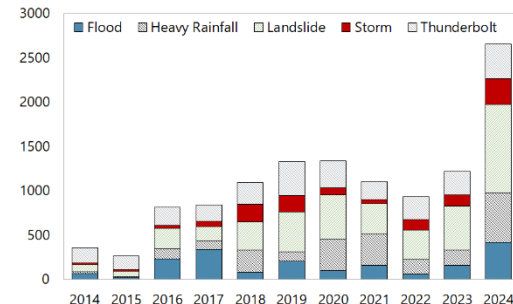
Mean Temperature Change of Meteorological Year
(Change centigrade from 1951-1980 baseline)



Sources: FAO; and IMF Climate Dashboard.

The country is subject to significant and growing climate related shocks including landslides, floods, and storms.

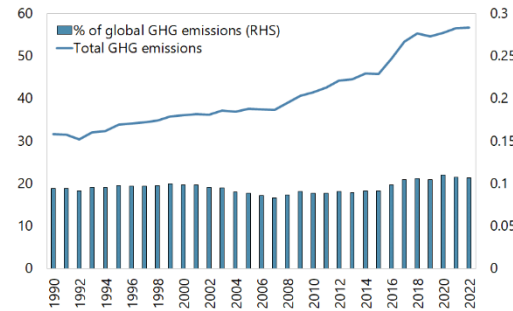
Number of Climate Related Incidents
(Count)



Sources: BIPAD Government of Nepal; and IMF staff calculations.

Total GHG emissions are growing but represent a small percentage of global emissions.

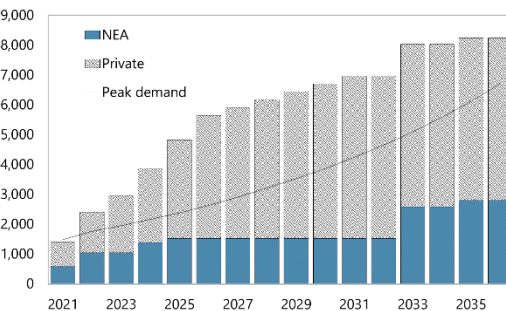
Total GHG Emissions
(MTCO2e)



Source: IMF Climate Dashboard

Hydropower accounts for 90 percent of current electricity production and is set to become a major export good.

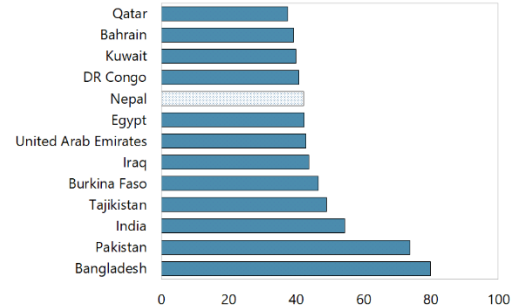
Forecast of Hydropower and Projected Electricity Demand
(Installed capacity in MW)



Source: World Bank CCDR 2022.

Pollution is trapped by Nepal's mountainous geography making it the 9th most polluted country...

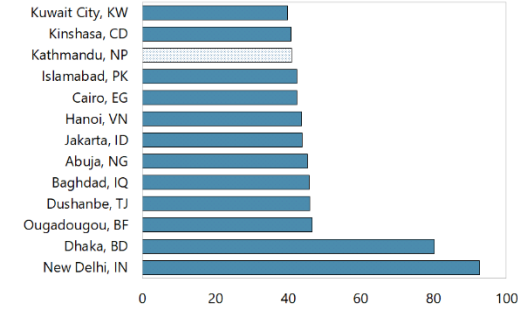
PM2.5 Concentration of the Most Polluted Countries
(Micrograms per cubic meter of air, 2023)



Source: 2023 World Air Quality Report.

... and Kathmandu is the 11th most polluted capital city.

PM2.5 Concentration of the Most Polluted Capitals
(Micrograms per cubic meter of air, 2023)



Source: 2023 World Air Quality Report.

Table 1. Nepal: Selected Economic Indicators, 2021/22-2029/30 1/

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
			Est.	Projections					
Output and Prices (annual percent change)									
Real GDP	5.6	2.0	3.1	4.2	5.4	5.0	5.0	5.0	5.0
Headline CPI (period average)	6.4	7.7	5.4	5.2	5.4	5.4	5.4	5.4	5.4
Headline CPI (end of period)	8.1	7.4	3.6	5.5	5.4	5.4	5.4	5.4	5.4
Fiscal Indicators: Central Government (in percent of GDP)									
Total revenue and grants	22.9	19.3	19.2	19.8	20.9	21.5	22.1	22.6	22.6
of which: Tax revenue	19.8	16.2	16.4	17.0	17.8	18.4	19.1	19.6	19.6
Expenditure	26.1	25.2	21.9	24.3	25.0	25.4	25.8	26.2	26.2
Expenses	21.7	20.8	18.6	19.3	19.4	19.5	19.6	19.8	19.8
Net acquisition of nonfinancial assets	4.3	4.4	3.3	5.0	5.6	5.9	6.2	6.4	6.4
Operating balance	1.2	-1.4	0.6	0.5	1.5	2.1	2.5	2.8	2.8
Net lending/borrowing	-3.1	-5.8	-2.7	-4.5	-4.1	-3.8	-3.7	-3.6	-3.6
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	3.1	5.8	2.7	4.5	4.1	3.8	3.7	3.6	3.6
Net acquisition of financial assets	2.6	-0.9	0.5	1.3	1.3	1.3	1.3	1.3	1.3
Net incurrence of liabilities	5.8	4.9	3.2	5.8	5.4	5.1	5.0	4.9	4.9
Foreign	2.0	1.7	1.6	1.7	1.5	1.4	1.3	1.3	1.4
Domestic	3.7	3.3	1.6	4.1	3.9	3.7	3.7	3.5	3.5
Money and Credit (annual percent change)									
Broad money	6.8	11.4	13.6	10.1	10.1	10.3	10.5	10.7	10.7
Domestic credit	17.9	8.8	6.2	8.2	9.6	10.3	10.5	10.7	10.7
Private sector credit	13.3	4.6	6.1	7.2	8.1	9.1	10.0	10.7	10.7
Saving and Investment (in percent of nominal GDP)									
Gross investment	37.6	31.7	32.9	37.5	39.4	38.3	37.0	35.8	34.7
Gross fixed investment	29.0	25.1	26.1	29.7	31.2	30.4	29.3	28.3	27.5
Private	23.6	21.7	22.7	24.7	25.6	24.5	23.1	21.9	21.1
Central government	5.3	3.4	3.3	5.0	5.6	5.9	6.2	6.4	6.4
Change in Stock	8.7	6.6	6.8	7.8	8.2	8.0	7.7	7.4	7.2
Gross national saving	25.1	30.8	36.7	36.2	35.5	34.5	33.2	32.2	31.0
Private	24.4	32.7	36.5	36.3	34.9	33.3	31.6	30.1	29.1
Central government	0.7	-1.9	0.2	-0.1	0.6	1.2	1.7	2.0	2.0
Balance of Payments									
Current account (in millions of U.S. dollars)	-5,174	-361	1,663	-630	-1,969	-2,166	-2,321	-2,479	-2,760
In percent of GDP	-12.6	-0.9	3.8	-1.3	-3.8	-3.8	-3.7	-3.6	-3.7
Trade balance (in millions of U.S. dollars)	-13,759	-10,699	-10,431	-12,481	-15,053	-15,957	-16,797	-17,678	-18,664
In percent of GDP	-33.4	-26.2	-24.0	-26.7	-29.2	-28.2	-27.0	-25.8	-24.8
Exports of goods (y/y percent change)	43.9	-19.9	-2.5	8.9	9.6	9.1	9.7	9.4	9.4
Imports of goods (y/y percent change)	21.9	-22.0	-2.5	18.4	19.4	6.3	5.7	5.7	6.0
Workers' remittances (in millions of U.S. dollars)	8,326	9,485	10,864	11,151	11,680	12,258	12,766	13,283	13,767
In percent of GDP	20.2	23.2	25.0	23.8	22.7	21.6	20.5	19.4	18.3
Gross official reserves (in millions of U.S. dollars)	8,956	10,954	14,547	15,301	15,004	14,821	14,876	14,897	15,289
In months of prospective imports	7.6	9.3	10.5	9.4	8.7	8.1	7.7	7.2	7.0
Memorandum Items									
Public debt (in percent of GDP)	42.7	47.1	48.2	50.0	50.4	50.6	50.6	50.5	50.5
Nominal GDP (in billions of U.S. dollars)	41.2	40.9	43.4	46.8	51.5	56.6	62.3	68.5	75.3
Nominal GDP (in billions of Nepalese Rupees)	4,977	5,349	5,776	6,333	7,040	7,792	8,623	9,543	10,562
Net International Reserves (in millions of U.S. dollars)	8,821	10,507	14,064	14,744	14,451	14,321	14,440	14,541	15,027
Primary Deficit (in billions of Nepalese Rupees)	110	239	76	183	179	175	180	182	204
Primary Deficit (in percent of GDP)	2.2	4.5	1.3	2.9	2.5	2.2	2.1	1.9	1.9
Tax Revenue (in billions of Nepalese Rupees)	984	866	945	1,074	1,250	1,436	1,648	1,868	2,065
Tax Revenue (in percent of GDP)	19.8	16.2	16.4	17.0	17.8	18.4	19.1	19.6	19.6
Private sector credit (in percent of GDP)	94.2	91.7	90.1	88.0	85.6	84.3	83.8	83.8	83.9
Exchange rate (NPR/US\$; period average)	120.8	130.8	133.0	...	...	...	...	...	...
Real effective exchange rate (average, y/y percent change)	1.6	1.2	1.4	...	...	...	...	...	...

Sources: Nepalese authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

Note: The NSO adopts a 3 year cycle in its national accounts producing preliminary, revised and final estimates for real GDP growth. In May 2023 growth was revised up in FY2020/21 from 4.2 percent to 4.8 percent and from 5.3 percent to 5.6 percent in FY2021/22 in light of new data.

Note: Current baseline forecast is as of January 29, 2025.

Table 2a. Nepal: Summary of Central Government Operations, 2021/22-2029/30 1/

(In Billions of Rupees)

	2021/22	2022/23	2023/24		2024/25			2025/26	2026/27	2027/28	2028/29	2029/30
			4th Review	5th Review	Budget	4th Review	5th Review	Projections				
			Proj.	Est.		Proj.	Proj.					
	(In billions of Nepalese rupees)											
Total Revenue and Grants	1,141	1,034	1,119	1,106	1,472	1,294	1,252	1,469	1,677	1,907	2,156	2,383
Total revenue	1,114	1,011	1,084	1,083	1,419	1,256	1,214	1,406	1,609	1,838	2,079	2,299
Tax revenue	984	866	950	945	1,284	1,115	1,074	1,250	1,436	1,648	1,868	2,065
of which: Income and profits tax	252	243	268	283	380	306	306	358	412	473	543	600
Customs	199	151	171	158	260	210	206	229	254	281	311	344
Excise duty	167	143	171	146	195	202	165	202	237	277	323	355
VAT	314	287	294	310	387	347	346	406	473	549	617	683
Other	52	42	45	46	62	50	50	55	61	68	75	83
By source: Domestic taxes	541	522	577	568	761	656	636	760	895	1,051	1,211	1,340
Import-related taxes	443	344	373	377	524	458	438	491	541	596	657	725
Non-tax revenue & Other Receipts	130	145	134	138	135	141	140	156	172	191	211	234
Of which: Non Tax Revenue	81	92	99	114	135	110	109	121	134	148	164	181
Other Receipts	49	53	35	24	0	32	31	35	39	43	47	52
Grants 2/	27	23	35	23	52	38	38	62	68	69	76	85
Expenditure	1,297	1,346	1,390	1,264	1,652	1,559	1,537	1,757	1,976	2,228	2,497	2,767
Recurrent expenditure	1,081	1,111	1,175	1,072	1,300	1,239	1,220	1,363	1,516	1,694	1,886	2,091
Of which: Interest payments	45	73	99	82	103	106	102	109	125	141	159	180
Salaries and allowances	136	156	157	152	160	160	160	178	197	218	242	267
Grants & subsidies	87	90	101	101	130	112	111	123	136	151	167	185
Social benefits	225	219	251	227	259	253	253	281	311	345	381	422
Goods & services	48	50	55	39	55	60	53	59	66	73	80	89
Fiscal transfers	406	397	382	339	409	396	396	441	480	531	588	650
Revenue sharing 3/	128	120	125	126	159	147	140	166	195	229	262	290
Other current expenditure	5	6	5	6	24	5	5	5	6	6	7	8
Capital expenditure	216	235	215	192	352	320	317	394	460	535	611	676
Operating balance	61	-77	-56	34	172	55	32	106	160	214	270	292
Net lending/borrowing	-155	-312	-271	-158	-180	-265	-285	-289	-300	-321	-341	-384
Statistical discrepancy	0	0	0	0	0	0	0	0	0	0	0	0
Net financial transactions	155	312	271	158	180	265	285	289	300	321	341	384
Net acquisition of financial assets	132	-49	75	28	68	83	83	92	102	112	124	138
Foreign	0	0	0	0	0	0	0	0	0	0	0	0
Domestic (net)	131	-50	75	28	67	83	82	92	101	112	124	137
Sale of equity	36	37	14	14	11	16	16	17	19	21	24	26
Lending minus repayment	37	41	61	61	56	67	67	74	82	91	101	111
Change in cash/deposit	58	-127	0	-47	0	0	0	0	0	0	0	0
Net incurrence of liabilities	287	263	347	186	248	348	368	380	401	434	466	522
Foreign	101	88	91	91	108	102	108	107	113	113	129	150
Domestic	186	174	256	95	139	246	259	274	288	321	337	372
Memorandum Items												
Primary balance (billions of Nepali Rupees)	-110	-239	-173	-76	-77	-158	-183	-179	-175	-180	-182	-204
Primary balance (in percent of GDP)	-2.2	-4.5	-3.0	-1.3	-1.2	-2.5	-2.9	-2.5	-2.2	-2.1	-1.9	-1.9
Public debt (in percent of GDP)	42.7	47.1	49.7	48.2	50.0	50.4	50.0	50.4	50.6	50.6	50.5	50.5
External (in percent of GDP)	20.6	21.8	22.2	22.2	22.2	21.5	22.2	21.6	21.1	20.6	20.1	19.8
Domestic (in percent of GDP)	22.2	25.3	27.6	26.0	27.8	28.8	27.8	28.8	29.5	30.0	30.4	30.7
Resources for sub-national governments (billions of Nepalese Rupees)	534	518	507	465	568	543	536	606	675	760	850	940
(in percent of GDP)	10.7	9.7	8.8	8.0	9.0	8.5	8.5	8.6	8.7	8.8	8.9	8.9
Nominal GDP (billions of Nepalese Rupees) 4/	4,977	5,349	5,793	5,776	6,333	6,393	6,333	7,040	7,792	8,623	9,543	10,562

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020.

The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15,

2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on

3/ 30 percent of VAT and domestic excise revenues are shared with sub-national governments.

4/ 2023/24 GDP is an estimate.

Note: Current baseline forecast is as of January 29, 2025.

Table 2b. Nepal: Summary of Central Government Operations, 2021/22-2029/30 1/
(In Percent of GDP)

	2021/22	2022/23	2023/24		2024/25			2025/26	2026/27	2027/28	2028/29	2029/30
			4th Review	5th Review	4th Review	5th Review	Projections					
			Proj.	Est.	Budget	Proj.	Proj.					
	(In percent of GDP, unless otherwise indicated)											
Total Revenue and Grants	22.9	19.3	19.3	19.2	23.2	20.2	19.8	20.9	21.5	22.1	22.6	22.6
Total revenue	22.4	18.9	18.7	18.7	22.4	19.6	19.2	20.0	20.6	21.3	21.8	21.8
Tax revenue	19.8	16.2	16.4	16.4	20.3	17.4	17.0	17.8	18.4	19.1	19.6	19.6
of which: Income and profits tax	5.1	4.5	4.6	4.9	6.0	4.8	4.8	5.1	5.3	5.5	5.7	5.7
Customs	4.0	2.8	3.0	2.7	4.1	3.3	3.3	3.3	3.3	3.3	3.3	3.3
Excise duty	3.4	2.7	3.0	2.5	3.1	3.2	2.6	2.9	3.0	3.2	3.4	3.4
VAT	6.3	5.4	5.1	5.4	6.1	5.4	5.5	5.8	6.1	6.4	6.5	6.5
Other	1.1	0.8	0.8	0.8	1.0	0.8	0.8	0.8	0.8	0.8	0.8	0.8
By source: Domestic taxes	10.9	9.8	10.0	9.8	12.0	10.3	10.0	10.8	11.5	12.2	12.7	12.7
Import-related taxes	8.9	6.4	6.4	6.5	8.3	7.2	6.9	7.0	6.9	6.9	6.9	6.9
Non-tax revenue & Other Receipts	2.6	2.7	2.3	2.4	2.1	2.2	2.2	2.2	2.2	2.2	2.2	2.2
Of which: Non Tax Revenue	1.6	1.7	1.7	2.0	2.1	1.7	1.7	1.7	1.7	1.7	1.7	1.7
Other Receipts	1.0	1.0	0.6	0.4	0.0	0.5	0.5	0.5	0.5	0.5	0.5	0.5
Grants 2/	0.6	0.4	0.6	0.4	0.8	0.6	0.6	0.9	0.9	0.8	0.8	0.8
Expenditure	26.1	25.2	24.0	21.9	26.1	24.4	24.3	25.0	25.4	25.8	26.2	26.2
Recurrent expenditure	21.7	20.8	20.3	18.6	20.5	19.4	19.3	19.4	19.5	19.6	19.8	19.8
Of which: Interest payments	0.9	1.4	1.7	1.4	1.6	1.7	1.6	1.6	1.6	1.6	1.7	1.7
Salaries and allowances	2.7	2.9	2.7	2.6	2.5	2.5	2.5	2.5	2.5	2.5	2.5	2.5
Grants & subsidies	1.8	1.7	1.8	1.8	2.1	1.7	1.8	1.7	1.8	1.8	1.8	1.8
Social benefits	4.5	4.1	4.3	3.9	4.1	4.0	4.0	4.0	4.0	4.0	4.0	4.0
Goods & services	1.0	0.9	0.9	0.7	0.9	0.9	0.8	0.8	0.8	0.8	0.8	0.8
Fiscal transfers	8.2	7.4	6.6	5.9	6.5	6.2	6.3	6.3	6.2	6.2	6.2	6.2
Revenue sharing 3/	2.6	2.2	2.2	2.2	2.5	2.3	2.2	2.4	2.5	2.7	2.7	2.7
Other current expenditure	0.1	0.1	0.1	0.1	0.4	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Capital expenditure	4.3	4.4	3.7	3.3	5.6	5.0	5.0	5.6	5.9	6.2	6.4	6.4
Operating balance	1.2	-1.4	-1.0	0.6	2.7	0.9	0.5	1.5	2.1	2.5	2.8	2.8
Net lending/borrowing	-3.1	-5.8	-4.7	-2.7	-2.8	-4.1	-4.5	-4.1	-3.8	-3.7	-3.6	-3.6
Statistical discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net financial transactions	3.1	5.8	4.7	2.7	2.8	4.1	4.5	4.1	3.8	3.7	3.6	3.6
Net acquisition of financial assets	2.6	-0.9	1.3	0.5	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic (net)	2.6	-0.9	1.3	0.5	1.1	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Sale of equity	0.7	0.7	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Lending minus repayment	0.8	0.8	1.1	1.1	0.9	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Change in cash/deposit	1.2	-2.4	0.0	-0.8	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	5.8	4.9	6.0	3.2	3.9	5.4	5.8	5.4	5.1	5.0	4.9	4.9
Foreign	2.0	1.7	1.6	1.6	1.7	1.6	1.7	1.5	1.4	1.3	1.3	1.4
Domestic	3.7	3.3	4.4	1.6	2.2	3.8	4.1	3.9	3.7	3.7	3.5	3.5
Memorandum Items												
Primary balance (billions of Nepali Rupees)	-110	-239	-173	-76	-77	-158	-183	-179	-175	-180	-182	-204
Primary balance (in percent of GDP)	-2.2	-4.5	-3.0	-1.3	-1.2	-2.5	-2.9	-2.5	-2.2	-2.1	-1.9	-1.9
Public debt (in percent of GDP)	42.7	47.1	49.7	48.2	50.0	50.4	50.0	50.4	50.6	50.6	50.5	50.5
External (in percent of GDP)	20.6	21.8	22.2	22.2	22.2	21.5	22.2	21.6	21.1	20.6	20.1	19.8
Domestic (in percent of GDP)	22.2	25.3	27.6	26.0	27.8	28.8	27.8	28.8	29.5	30.0	30.4	30.7
Resources for sub-national governments (billions of Nepalese Rupees)	534	518	507	465	568	543	536	606	675	760	850	940
(in percent of GDP)	10.7	9.7	8.8	8.0	9	8.5	8.5	8.6	8.7	8.8	8.9	8.9
Nominal GDP (billions of Nepalese Rupees) 4/	4,977	5,349	5,793	5,776	6,333	6,393	6,333	7,040	7,792	8,623	9,543	10,562

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ CCRT debt relief is included in grants and net incurrence of liabilities (foreign). The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for SDR 3.6 million.

3/ 30 percent of VAT and domestic excise revenues are shared with sub-national governments.

4/ 2023/24 GDP is an estimate.

Note: Current baseline forecast is as of January 29, 2025.

Table 3. Nepal: Balance of Payments, 2021/22-2029/30 1/

	2021/22	2022/23	2023/24	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30
	Projections								
	(in millions of US dollars)								
Current Account	-5,174	-361	1,663	-630	-1,969	-2,166	-2,321	-2,479	-2,760
Current account (excluding official transfers)	-5,312	-460	1,575	-910	-2,426	-2,659	-2,819	-3,027	-3,363
Trade balance	-13,759	-10,699	-10,431	-12,481	-15,053	-15,957	-16,797	-17,678	-18,664
Exports, f.o.b.	1,754	1,406	1,371	1,493	1,635	1,784	1,957	2,141	2,342
Imports, f.o.b.	-15,513	-12,104	-11,802	-13,973	-16,688	-17,741	-18,754	-19,819	-21,006
Services (net)	-893	-612	-421	-822	-531	-544	-509	-531	-556
Receipts	1,008	1,470	1,899	1,784	2,283	2,454	2,700	2,969	3,264
Of which: tourism	268	476	619	702	1,030	1,133	1,246	1,370	1,507
Payments	-1,901	-2,081	-2,320	-2,606	-2,814	-2,997	-3,208	-3,500	-3,820
Income	238	479	704	390	438	425	468	514	565
Credit	474	737	988	797	826	852	937	1,031	1,134
Debit	-237	-258	-284	-407	-388	-427	-470	-517	-568
Current transfers	9,241	10,470	11,810	12,283	13,177	13,909	14,518	15,216	15,895
Credit, of which:	9,305	10,530	11,861	12,343	13,243	13,982	14,597	15,304	15,991
General government	138	100	88	281	457	493	499	548	603
Workers' remittances	8,326	9,485	10,864	11,151	11,680	12,258	12,766	13,283	13,767
Debit	-64	-59	-50	-60	-66	-72	-80	-88	-96
Capital Account 2/	83	58	44	146	229	247	249	274	302
Financial Account	2,546	1,731	1,215	1,682	1,867	2,060	2,249	2,499	2,775
Direct investment	155	47	63	162	230	252	278	305	336
Portfolio investment	0	0	0	0	0	0	0	0	0
Other investment (net)	2,391	1,684	1,152	1,521	1,638	1,807	1,971	2,194	2,439
Of which: Trade credit	858	917	576	488	570	623	694	774	839
Official loans	760	652	633	799	780	820	816	924	1,068
Errors and Omissions	980	663	747	0	0	0	0	0	0
Overall Balance	-1,566	2,091	3,668	1,199	127	140	178	295	317
	(in percent of GDP)								
Current Account	-12.6	-0.9	3.8	-1.3	-3.8	-3.8	-3.7	-3.6	-3.7
Current account (excluding official transfers)	-12.9	-1.1	3.6	-1.9	-4.7	-4.7	-4.5	-4.4	-4.5
Trade balance	-33.4	-26.2	-24.0	-26.7	-29.2	-28.2	-27.0	-25.8	-24.8
Exports, f.o.b.	4.3	3.4	3.2	3.2	3.2	3.1	3.1	3.1	3.1
Imports, f.o.b.	-37.7	-29.6	-27.2	-29.9	-32.4	-31.3	-30.1	-28.9	-27.9
Services (net)	-2.2	-1.5	-1.0	-1.8	-1.0	-1.0	-0.8	-0.8	-0.7
Receipts	2.4	3.6	4.4	3.8	4.4	4.3	4.3	4.3	4.3
Of which: tourism	0.7	1.2	1.4	1.5	2.0	2.0	2.0	2.0	2.0
Payments	-4.6	-5.1	-5.3	-5.6	-5.5	-5.3	-5.1	-5.1	-5.1
Income	0.6	1.2	1.6	0.8	0.9	0.8	0.8	0.8	0.8
Credit	1.2	1.8	2.3	1.7	1.6	1.5	1.5	1.5	1.5
Debit	-0.6	-0.6	-0.7	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8
Current transfers	22.4	25.6	27.2	26.3	25.6	24.6	23.3	22.2	21.1
Credit, of which:	22.6	25.7	27.3	26.4	25.7	24.7	23.4	22.3	21.2
General government	0.3	0.2	0.2	0.6	0.9	0.9	0.8	0.8	0.8
Workers' remittances	20.2	23.2	25.0	23.8	22.7	21.6	20.5	19.4	18.3
Debit	-0.2	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1
Capital Account 2/	0.2	0.1	0.1	0.3	0.4	0.4	0.4	0.4	0.4
Financial Account	6.2	4.2	2.8	3.6	3.6	3.6	3.6	3.6	3.7
Direct investment	0.4	0.1	0.1	0.3	0.4	0.4	0.4	0.4	0.4
Portfolio investment	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Other investment (net)	5.8	4.1	2.7	3.3	3.2	3.2	3.2	3.2	3.2
Of which: Trade credit	2.1	2.2	1.3	1.0	1.1	1.1	1.1	1.1	1.1
Official loans	1.8	1.6	1.5	1.7	1.5	1.4	1.3	1.3	1.4
Errors and Omissions	2.4	1.6	1.7	0.0	0.0	0.0	0.0	0.0	0.0
Overall Balance	-3.8	5.1	8.4	2.6	0.2	0.2	0.3	0.4	0.4
Memorandum Items									
Imports (y/y percent change)	21.9	-22.0	-2.5	18.4	19.4	6.3	5.7	5.7	6.0
Exports of G&S (in percent of GDP)	6.7	7.0	7.5	7.0	7.6	7.5	7.5	7.5	7.4
Imports of G&S (in percent of GDP)	42.3	34.7	32.5	35.4	37.9	36.6	35.2	34.0	33.0
Remittances (y/y percent change)	2.2	13.9	14.5	2.6	4.7	4.9	4.1	4.0	3.6
Total external debt (in percent of GDP)	25.0	26.6	25.8	26.0	25.6	25.3	25.0	24.7	24.5
Gross official reserves (in mil U.S. dollars)	8,956	10,954	14,547	15,301	15,004	14,821	14,876	14,897	15,289
In months of prospective imports	7.6	9.3	10.5	9.4	8.7	8.1	7.7	7.2	7.0
As a share of broad money (in percent)	20.8	23.5	27.9	27.2	24.4	22.0	20.1	18.3	17.1
Net international reserves (in mil. U.S. dollars) 3/	8,821	10,507	14,064	14,744	14,451	14,321	14,440	14,541	15,027
Nominal GDP (in mil U.S. dollars) 4/	41,183	40,907	43,419	46,778	51,501	56,636	62,310	68,521	75,342

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ The first tranche of CCRT debt relief covering the period April 14, 2020 to October 13, 2020 for SDR 2.9 million in FY 2019/20 was approved on April 13, 2020. The second tranche of CCRT debt relief covering the period October 14, 2020 to April 13, 2021 for SDR 3.6 million was approved on October 2, 2020. The third tranche of CCRT debt relief covering the period April 14, 2021 to October 15, 2021 for SDR 3.6 million was approved on April 1, 2021. The fourth and fifth (final) tranche of CCRT debt service relief covering the period from October 16, 2021 to January 10, 2022 and January 11 to April 13, 2022 was approved on October 6, 2021 and December 15, 2021 respectively for SDR 3.6 million.

3/ Net international reserves program definition, see Technical Memorandum of Understanding.

4/ 2023/24 GDP is an estimate.

Note: Current baseline forecast is as of January 29, 2025.

Table 4. Nepal: Monetary Indicators, 2021/22-2025/26 1/

	2021/22	2022/23	2023/24	2024/25	2025/26
	Projections				
Nepal Rastra Bank	(In billions of Nepalese rupees, end-period)				
Reserve money	826	912	987	1,136	1,252
Net domestic assets	-319	-528	-970	-948	-805
Claims on public sector	-175	3	-78	-78	-78
Claims on private sector	7	7	9	10	10
Claims on banks & financial institutions	270	1	0	4	4
Other items (net)	-420	-539	-901	-884	-742
Net foreign assets	1,145	1,440	1,958	2,085	2,058
Monetary Survey					
Broad money	5,505	6,130	6,964	7,668	8,442
Narrow money	948	947	939	1,514	1,667
Quasi-money	4,557	5,184	6,025	6,154	6,775
Net domestic assets	4,285	4,588	4,884	5,484	6,273
Domestic credit	5,672	6,169	6,553	7,091	7,772
Credit to public sector	983	1,266	1,350	1,516	1,747
<i>of which</i> : Credit to central government	744	1,005	1,052	1,299	1,559
Credit to private sector	4,689	4,903	5,202	5,575	6,025
Other items (net)	-1,386	-1,581	-1,669	-1,607	-1,499
Net foreign assets	1,220	1,542	2,080	2,184	2,169
	(Twelve-month percent change)				
Reserve money	-11.4	10.4	8.3	15.1	10.2
Broad money	6.8	11.4	13.6	10.1	10.1
Net domestic assets	12.6	7.1	6.4	12.3	14.4
Domestic credit	17.9	8.8	6.2	8.2	9.6
Credit to public sector	46.4	28.8	6.7	12.3	15.3
Credit to private sector	13.3	4.6	6.1	7.2	8.1
Net foreign assets	-9.7	26.4	34.9	5.0	-0.7
Memorandum Items					
Private credit (in percent of GDP)	94.2	91.7	90.1	88.0	85.6
Net international reserves (in mil. U.S. dollars) 2/	8,821	10,507	14,064	14,744	14,451
Net Foreign Assets, NRB (in percent of GDP)	23.0	26.9	33.9	32.9	29.2
Nominal GDP (in billions of Nepalese Rupees) 3/	4,977	5,349	5,776	6,333	7,040

Sources: Nepali authorities; and IMF staff estimates and projections.

1/ Fiscal year ends mid-July.

2/ Net international reserves program definition, see Technical Memorandum of Understanding

3/ 2023/24 GDP is an estimate.

Note: Current baseline forecast is as of January 29, 2025.

Table 5. Nepal: External Financing Requirements and Sources, FY2023/24-2026/27 1/

(In Millions of U.S. Dollars)

	2023/24	2024/25	2025/26	2026/27
		Projections		
Gross external financing requirements	-2,547	532	1,977	2,100
Current account excluding official transfers (+ = deficit)	-1,575	910	2,426	2,659
Amortization of medium- and long-term debt	294	343	409	427
Other net capital flows (- = outflow) 2/	1,266	721	858	987
Available financing	-2,985	69	1,535	2,100
Current and capital grants	131	427	686	740
Medium- and long-term borrowing excluding exceptional financing	558	679	747	1,247
FDI, net	63	162	230	252
Portfolio investment, net	0	0	0	0
Change in reserves (+ = decrease) 3/	-3,738	-1,199	-127	-140
Financing Gap	438	464	442	0
Exceptional/additional financing 4/	369	464	442	0
IMF: ECF arrangement	94.1	83.7	41.8	0
Asian Development Bank	150	100	200	0
World Bank	125	280	200	0
Memorandum items				
Gross official reserves (in millions of U.S. dollars)	14,547	15,301	15,004	14,821
In months of prospective imports	10.5	9.4	8.7	8.1

1/ Fiscal year ends mid-July.

2/ Other includes currency and deposits, trade credits and other financial flows, as well as net errors and omissions.

3/ Net of valuation changes.

4/ Includes exceptional financing with good prospects over the the projection period.

Note: Current baseline forecast as of January 29, 2025.

Table 6. Nepal: Financial Soundness Indicators, FY2019/20-2023/24

	2019/20	2020/21	2021/22	2022/23	2023/24
Capital Adequacy					
Regulatory capital to risk weighted assets	14.16	14.19	13.58	13.42	12.92
Tier 1 capital to risk weighted assets	12.01	11.12	10.81	10.59	10.20
Asset Quality					
NPLs to total gross loans	1.89	1.48	1.31	3.02	3.86
Loan loss provisions to NPLs	65.90	70.24	68.25	62.17	70.51
Deposits and Credits					
Credit to deposit ratio 1/	...	...	86.22	81.63	79.09
Credit to core capital cum deposit 1/	69.58	76.32	...	...	...
Liquidity					
Cash & bank balance to total deposits	12.21	9.51	8.03	8.05	7.43
Total liquid assets to total deposits	27.90	26.18	27.52	27.10	26.44
Exposure to Real Estate					
Share of real estate and housing loans	12.71	11.54	12.01	12.27	12.68
Share of loans collateralized by fixed assets	76.04	74.71	75.06	76.87	76.22
Revolving Loans					
Overdraft 2/	14.93	15.19	15.25	15.32	14.96
Demand & working capital loans	21.45	21.09	21.51	18.05	14.04

Sources: NRB; and IMF staff calculations.

Note: Data reflects all banks and financial institutions and is presented at the end of the fiscal year (i.e. mid-July) for the relevant year unless indicated otherwise.

1/ Credit to core capital cum deposit was replaced by the Credit to deposit ratio in 2021/2022.

2/ As of April 2023, NRB has started to report separately on 'overdrafts' and 'cash credit'. For the purposes of compiling the FSIs, these have been added back together.

Table 7. Nepal: Access and Phasing Under the Extended Credit Facility 1/

Review	Available from	Conditions	Disbursement	
			SDR Million	Percent of Quota
	January 12, 2022	Board approval of the Arrangement	78.50	50%
First Review	June 12, 2022	Observance of performance criteria on Jan 14, 2022, completion of first review	19.60	13%
Second Review	January 12, 2023	Observance of performance criteria on Jul 14, 2022, completion of second review	19.60	13%
Third Review	November 1, 2023	Observance of performance criteria on Jul 16, 2023, completion of third review	39.20	25%
Fourth Review	May 1, 2024	Observance of performance criteria on Jan 14, 2024, completion of fourth review	31.40	20%
Fifth Review	November 1, 2024	Observance of performance criteria on Jul 15, 2024, completion of fifth review	31.40	20%
Sixth Review	May 1, 2025	Observance of performance criteria on Jan 13, 2025, completion of sixth review	31.40	20%
Seventh Review	November 1, 2025	Observance of performance criteria on Jul 15, 2025, completion of seventh review	31.32	20%
Total			282.42	180%

Source: IMF staff estimates.

1/ Nepal's quota is SDR 156.9 million.

Table 8. Nepal: Quantitative Performance Criteria (PC) and Indicative Targets (IT) 1/

(Cumulative Rs. Million unless Otherwise Indicated)

	FY2023/24								FY2024/25	
	14-Jan-24				15-Jul-24				13-Jan-25	15-Jul-25
	Program target	Adjusted target	Outturn	Status	Program target	Adjusted target	Outturn	Status	Program target	Program target
Quantitative performance criteria under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 2,3,4,5,6/	435,959	440,278	178,827	met	315,628	311,931	122,918	met	233,270	256,943
Stock of NRB's net international reserves (floor; in U.S. dollars million) 7,8/	9,076	9,014	12,144	met	9,076	8,851	14,130	met	9,649	10,229
Accumulation of external payments arrears (ceiling) 9/	0	0	0	met	0	0	0	met	0	0
Indicative targets under the ECF-supported program:										
Indicative target: federal government spending on child allowance (floor; in NPR million) 10/	3,092	3,092	1,674	not met	6,987	6,987	6,841	not met	3,092	6,987
Indicative target: floor on tax revenue of the federal government 11,12/					845,938	845,938	818,657	not met	392,743	902,288
Memorandum items:										
Revenues of the budgetary central government under the program (in NPR million) 2/	341,044		438,939		..		932,999		..	..
Revenue targets of the budgetary central government (in NPR million) 2/	563,983				1,248,620				..	1,125,209
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 4/	61,009				..				..	..
Foreign-financed project loan disbursements (in NPR million) 2/	13,977		18,295		83,832		80,134		9,191	91,912
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 2/	..		4,319		..		-3,698		..	..

Sources: Nepali authorities; and IMF staff estimates/projections based on the Nepali fiscal year and calendar.

1/ The quantitative targets, indicative targets, program exchange rates and adjustors are defined in the Technical Memorandum of Understanding (TMU).

2/ Cumulative from the beginning of the fiscal year.

3/ Excludes interest payments. The program primary deficit definition also excludes grants and other receipts from the revenue side, so figures in this table are higher than those reported in the macroeconomic framework.

4/ The program target for the primary deficit for the January 14, 2024 test date includes an adjustor for the level of revenue collection, which was capped at NPR 61,009 million. Subsequent test dates have no such adjustor.

5/ The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms. Foreign-financed project loan disbursements is the difference between total external financing and budget support from development partners.

6/ Revenue sharing for province and local levels and other receipts are also excluded.

7/ Foreign currency deposits of commercial banks and other financial institutions held at the NRB are considered reserve related liabilities and excluded.

8/ NIR floor target for July 15, 2024 testing date is set about 0.8 months of imports above the adequacy level to provide margin in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy. The margin was gradually reduced to 0.6 months of imports for the targets.

9/ This quantitative target is applied on a continuous basis.

10/ The social spending indicative target will initially be a floor on spending on the child protection grant. This indicative target will start in the second review with the test dates beginning in July 2022. The initial floor will be FY2020/21 outturns plus an additional amount to reflect the announced one third increase in budget.

11/ This is a program indicative target, not a revised target of the Budget. The Budget target remains NPR 1,248.620 million.

12/ Revenue sharing for province and local levels, nontax revenue and other receipts are also excluded.

Table 9. Nepal: Indicators of Capacity to Repay the Fund, FY2024/25-2037/38 1/

	2024/25	2025/26	2026/27	2027/28	2028/29	2029/30	2030/31	2031/32	2032/33	2033/34	2034/35	2035/36	2036/37	2037/38
Fund obligations based on existing credit (millions of SDR)														
Principal	7.1	34.9	39.2	47.1	58.8	69.0	37.7	29.8	22.0	10.2	0.0	0.0	0.0	0.0
Charges and interest	3.1	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Fund obligations based on existing and prospective credit (millions of SDR)														
Principal	7.1	34.9	39.2	47.1	58.8	69.0	53.4	48.6	40.8	29.0	18.8	3.1	0.0	0.0
Charges and interest	3.1	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Total obligations based on existing and prospective credit														
Millions of SDR	10.2	37.8	42.1	49.9	61.7	71.9	56.2	51.5	43.6	31.9	21.7	6.0	2.9	2.9
Billions of Nepali Rupees	1.8	6.7	7.5	9.0	11.2	13.2	10.3	9.4	8.0	5.8	4.0	1.1	0.5	0.5
Percent of exports of goods and services	0.4	1.3	1.3	1.4	1.6	1.7	1.2	1.0	0.8	0.5	0.3	0.1	0.0	0.0
Percent of debt service	0.7	2.1	2.1	2.2	2.5	2.7	1.9	1.6	1.2	0.8	0.5	0.1	0.1	0.0
Percent of GDP	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Percent of government revenue	0.1	0.5	0.5	0.5	0.5	0.6	0.4	0.3	0.3	0.2	0.1	0.0	0.0	0.0
Percent of quota	6.5	24.1	26.8	31.8	39.3	45.8	35.8	32.8	27.8	20.3	13.8	3.8	1.8	1.8
Outstanding IMF credit based on existing and prospective drawings														
Millions of SDR	411.6	407.9	368.7	321.6	262.8	193.8	140.4	91.8	51.0	22.0	3.1	0.0	0.0	0.0
Billions of Nepali Rupees	72.7	72.5	66.1	58.1	47.8	35.5	25.7	16.8	9.3	4.0	0.6	0.0	0.0	0.0
Percent of exports of goods and services	16.5	13.6	11.4	9.0	6.7	4.5	3.0	1.8	0.9	0.4	0.0	0.0	0.0	0.0
Percent of debt service	26.2	22.9	18.4	14.5	10.7	7.2	4.7	2.8	1.4	0.6	0.1	0.0	0.0	0.0
Percent of GDP	1.1	1.0	0.8	0.7	0.5	0.3	0.2	0.1	0.1	0.0	0.0	0.0	0.0	0.0
Percent of government revenue	6.0	5.2	4.1	3.2	2.3	1.5	1.0	0.6	0.3	0.1	0.0	0.0	0.0	0.0
Percent of quota	262.3	260.0	235.0	205.0	167.5	123.5	89.5	58.5	32.5	14.0	2.0	0.0	0.0	0.0
Net use of IMF credit (millions of SDR)														
Disbursements	55.7	-3.6	-39.2	-47.1	-58.8	-69.0	-53.4	-48.6	-40.8	-29.0	-18.8	-3.1	0.0	0.0
Repayments and repurchases	62.8	31.3	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
	7.1	34.9	39.2	47.1	58.8	69.0	53.4	48.6	40.8	29.0	18.8	3.1	0.0	0.0
<i>Memorandum items:</i>														
Exports of goods and services (millions of SDR)	2,489	3,001	3,243	3,559	3,899	4,273	4,686	5,141	5,639	6,186	6,785	7,443	8,165	8,956
Debt service (billions of NPR)	277.7	316.9	359.0	400.9	448.0	496.4	545.7	602.4	659.9	726.5	799.5	882.5	971.2	1,063.9
Nominal GDP (at market prices, billions of NPR)	6,333	7,040	7,792	8,623	9,543	10,562	11,688	12,935	14,315	15,843	17,533	19,404	21,474	23,765
Government revenue (billions of NPR)	1,214	1,406	1,609	1,838	2,079	2,299	2,564	2,861	3,163	3,498	3,868	4,277	4,730	5,231
Quota (millions of SDR)	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9	156.9

Sources: IMF staff estimates and projections.

1/ Reporting Year: August to July.

Table 10. Nepal: Structural Benchmark Status and Modifications

(July 2024-December 2025)

Measure	Original Target Date	Status	Proposal
Cross-Cutting Institutional Reforms to Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption			
The FCGO reports the consolidated financial information of all operational funds in annual financial statements, starting with FY2021/22. ^{1/}	End-January 2025		
The MOF submits to Parliament amendments to modernize the NRB Law, addressing key recommendations of the 2021 Safeguards Assessments Report. ^{2/}	End-September 2024	Not met	Reset to end-April 2025
An audit of the FY2023/24 financial statement of the NRB is conducted involving the service of experts with international experience in auditing and central bank auditing.	End-July 2024	Met	
An audit of the FY2024/25 financial statement of the NRB is commissioned involving at least one member of the Institute of Chartered Accountants of Nepal belonging to a global auditing network.		New	End-July 2025
Report that the <i>Amendments to Some Laws Relating to AML and Business Promotion</i> bill has been enacted in line with Financial Action Task Force AML/CFT international standards.	End-July 2024	Met	
Revenue Mobilization			
The MOF publishes a comprehensive report on tax expenditures. ^{3/}	End-January 2025	Not met	Reset to end-July 2025
The MOF approves a report on domestic tax expenditures and a report on import-related tax expenditures.		New	End-April 2025
The MOF will adopt a Customs Compliance Improvement Strategy that covers compliance monitoring, understanding regulatory requirements, detecting non-compliance, enforcement, and incentives and sanctions.		New	End-December 2025
Fiscal Sustainability and Fiscal Risk Management			
A comprehensive fiscal risk statement is published by the MOF with the FY2025/26 Budget.	End-August 2025		
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements.	End-August 2024	Not met	
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Telecom) will have their FY2022/23 financial statements audited. ^{4/}	End-August 2024	Not met, completed with delay	
Equitable and Sustainable Growth			
NPC approval of the revised National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection.	End-March 2025		
^{1/} This SB was originally set for end-May 2022, was not met, was reset at the combined 1st and 2nd Review to end-August 2023, was not met, and was reset at the 3rd Review to end-January 2025.			
^{2/} This SB was originally set for End-October 2022, was not met, and was reset at the combined 1st and 2nd Review to end-August 2023, was not met, was reset at the 3rd Review to end-April 2024, was not met, and was reset at the 4th Review to end-August 2024.			
^{3/} This SB was originally set for End-April 2024 and was reset at the 3rd Review to end-April 2025.			
^{4/} This SB was originally set for End-April 2024 and was reset at the 3rd Review to end-August 2024.			

Table 10. Nepal: Structural Benchmark Status and Modifications (Concluded)

(July 2024-December 2025)

Measure	Original Target Date	Status	Proposal
Financial Sector Regulation & Supervision			
The NRB issues the Request for Proposal Notice for the independent international third-party auditors, incorporating the Terms of Reference agreed with IMF staff that include a provision that the in-depth on-site inspections will be conducted on the basis of both the existing regulatory framework and a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the BCBS Guidelines on "Prudential Treatment of Problem Assets".		Pending	Prior Action
The NRB re-issues the regulation on asset classification, aligned with a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the Basel Committee on Bank Supervision (BCBS) Guidelines on "Prudential Treatment of Problem Assets". ^{5/}		New	End-December 2025
Launch for 10 largest Banks in-depth onsite inspections assisted by independent international third-party auditors. ^{6/}	End-August 2024	Not met	Reset to end-May 2025
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors. ^{7/}	End-February 2025	Not met	Reset to end-December 2025
The MOF submits to Parliament amendments to the NRB Act that address the key relevant gaps in the current bank resolution framework in line with recommendations of the 2023 Financial Sector Stability Report.		New	End-April 2025
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections.	End-February 2025	Not met	Modified and reset below
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections which will reference the end-December 2025 timing of the alignment of the ACR with a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the BCBS Guidelines on "Prudential Treatment of Problem Assets".		Modified and reset	End-April 2025

^{5/} This SB corresponds to the August 2023 SB that was met by issuing updated regulations, but later partially reversed.

^{6/} This SB was originally set for End-April 2024 and was reset at the 4th Review to end-August 2024.

^{7/} This SB was originally set for End-December 2024 and was reset at the 4th Review to end-February 2025.

Annex I. Analyzing the Effects of the September 2024 Floods¹

The September 2024 floods in Nepal caused by intense monsoon rains became a major disaster, affecting lives, infrastructure and economic activities. This annex examines the socio-economic impacts of the floods, focusing on the damage assessment, the broader implications for growth and fiscal stability, and the policy responses needed to support recovery and build resilience.

A. Background

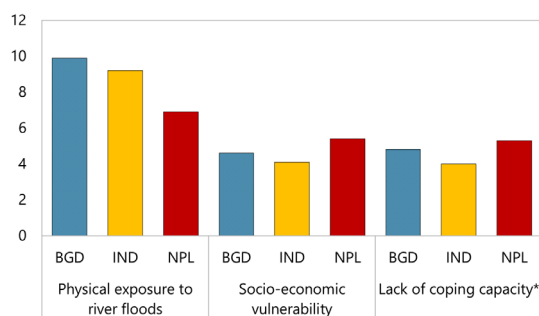
1. Nepal’s vulnerability to floods and landslides is rooted in its geography and monsoon-dependent climate, with adverse implications for economic stability and development. Recurrent disasters displace communities, destroy critical infrastructure such as roads and bridges, and pose persistent threats to livelihoods. The agricultural sector, contributing a quarter of GDP and employing two-thirds of the workforce, is particularly exposed, with flooding triggering livelihood losses, food insecurity, increased dependence on remittances and higher reliance on costly imports. The housing sector also suffers disproportionately, with widespread destruction of homes leading to displacement and compounding reconstruction demands. The energy sector, reliant on hydropower, faces recurring damages to plants and transmission lines, hindering economic activity and disrupting electricity supply, as well as essential services like healthcare and education. These vulnerabilities underscore the urgent need for resilient infrastructure and adaptive strategies to mitigate the socio-economic impacts of Nepal’s recurrent natural disasters.

2. Nepal’s vulnerability to floods is exacerbated by limited adaptive capacity and low resilience of public infrastructure, including when compared to regional peers (Figure 1).

Nepal’s disaster response mechanisms remain constrained by its challenging topography and resource limitations. Nepal’s regional peers have been able to achieve progress in flood management. India has adopted a proactive approach, leveraging advanced technologies, centralized institutional frameworks, and substantial structural investments, while Bangladesh is recognized for its integrated flood management strategy, combining infrastructure with community engagement to enhance resilience. Nepal has recently strengthened its disaster risk reduction and management legislation and governance architecture, improved early warning

Annex I. Figure 1. Nepal: INFORM Risk Index, 2025

(Index; higher number corresponds to higher risk)



Source: Inter-Agency Standing Committee and the European Commission, INFORM REPORT 2024.
* Lack of coping capacity has two dimensions: (i) 'Institutional', consisting of 'Disaster Risk Response (DRR)' and 'Governance' subindexes, and (ii) 'Infrastructure', consisting of 'Communication', 'Physical Infrastructure', and 'Access to Health Systems' subindexes

¹ Prepared by Yaroslav Hul.

dissemination, and has mandated dedicated risk financing.^{2, 3} Yet critical gaps persist, especially in structural and post-disaster resilience, as insufficient investment in preparedness, weak intergovernmental coordination and capacity constraints within the civil service undermine the country's ability to mitigate flood impacts, leaving vulnerable populations disproportionately exposed to the risks of recurrent flooding. Chronic under-execution of capital budgets further limits progress in structural resilience.

B. Socio-Economic Impact of the September 2024 Floods

3. The September 2024 floods and landslides rank among Nepal's most catastrophic disasters in recent years, with profound socio-economic and infrastructural impacts.

Record-breaking rainfall on September 27-28 in central and eastern regions, including Kathmandu Valley, triggered devastating floods and landslides, claiming over 250 lives and affecting 2.6 million people—the largest social impact since the 2015 earthquake (Table 1).⁴ Infrastructure sustained extensive damage, with landslides severing all major roads to Kathmandu at one point and impairing critical transportation networks. The energy sector was heavily disrupted, with 20 percent of the installed 3000 MW hydropower capacity and multiple projects under construction affected. Agriculture faced acute losses in the affected provinces, with 65,000 hectares of farmland inundated (about 3 percent of the country's total cultivated area) and over 26,000 livestock lost, threatening food security and rural livelihoods. The residential housing sector has sustained extensive damage—with over 19,000 homes either destroyed or badly damaged—exacerbating displacement and increasing reconstruction demands. The preliminary damage assessment estimates losses at USD \$420 million, nearly 1 percent of GDP, and the realized losses could be even higher, highlighting the urgent need for comprehensive recovery and resilience-building measures (Table 2).

² Improvements in disaster risk reduction and management legislation and governance architecture include establishing in 2019 a National Disaster Risk Reduction and Management Authority (NDRRMA) and adopting a number of legislative acts and regulations to govern emergency preparedness and response.

³ Improved early warning dissemination includes launching a Bipad portal (<https://bipadportal.gov.np>) as a key national information platform for disaster management and a data repository for disaster-related geospatial data.

⁴ Climate models suggest that the September 2024 floods were about 10 percent more intense than they would have been in a climate 1.3°C cooler, with the probability of such extreme events rising by approximately 70 percent (Zachariah et al., 2024).

Annex I. Table 1. Nepal: Socio-Economic Impact of Major Natural Disasters

	Total Deaths	Population Affected	Total Damage	
			in million USD	in % of preceding year's GDP
Major floods/landslides				
Avg 2000-2014	194	178,052	--	--
2017 Aug	176	1,700,134	595	2.0
2019 Jul	119	82,541	204	0.6
2020 Jun-Sep [#]	448	117,677	100	0.3
2024 Sep	268	2,590,178	420*	1.0 [^]
Major earthquakes				
2015 Apr	8,969	5,642,150	5,174	22.8
2023 Nov	154	300,366	100	0.2

Sources: EmDat, National Disaster Risk Reduction and Management Authority (NDRRMA), and IMF staff estimates.

[#] For 2020, the EmDat database reports an aggregated figure for a series of consecutive floods and landslides that occurred across Nepal during the period from June to September 2020.

* EmDat estimated losses at USD \$338 mln; NDRRMA in its Preliminary Loss and Damage Assessment report (Oct 28, 2024) estimates the cost at close to NPR 46.7 billion (USD \$351 mln), which excludes the cost of housing sector damages; the staff estimate is based on the NDRRMA's report but additionally assuming the housing sector losses at NPR 9 billion (USD \$68 mln), based on the total amount of insurance claims submitted by the general public for the losses/damages in residential housing.

[^] Based on staff estimate for the FY2023/24 nominal GDP

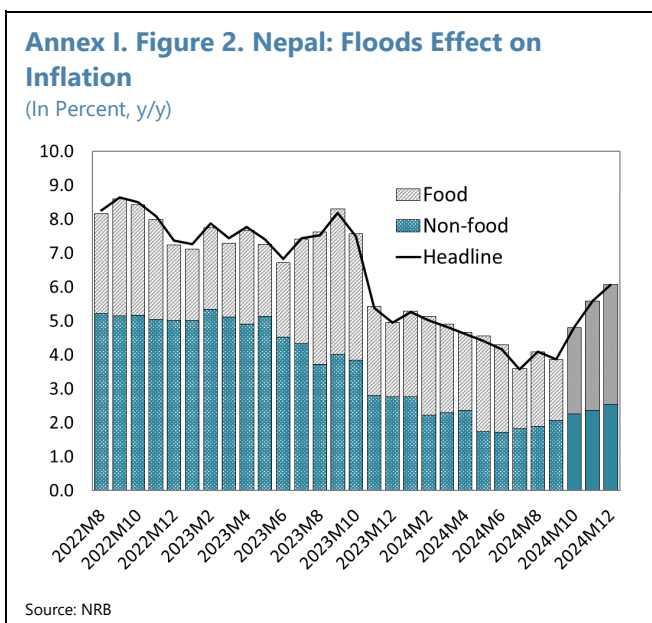
Annex I. Table 2. Nepal: Comparing Losses and Economic Cost from Floods (2017 vs 2024)

	2017		2024	
	Numbers	Losses (Rs billions)	Numbers	Losses (Rs billions)
Deaths	134		250	
Affected population	1.7 mln		2.6 mln	
Housing (damaged)	192,136	19.5	19,045	9.0 ^e
Education facilities (damaged)	-	1.2	142	0.1
Health facilities (damaged)	99	0.6	39	0.5 ^e
Agriculture (area affected, ha)	139,000	7.2	65,358	5.7
Livestock (heads)	820,000	10.7	26,672	0.6 ^e
Water (supply, sanitation)		0.9		5.9
Irrigation		17.8		1.4
Energy (hydro & transmission)		0.2		3.1
Transport (roads, bridges)		2.9		29.0
Other				1.0
TOTAL (in billion Rs)		61.0		56.2
<i>in million USD</i>		590		420
<i>in % preceding year's GDP</i>		2.0		1.0

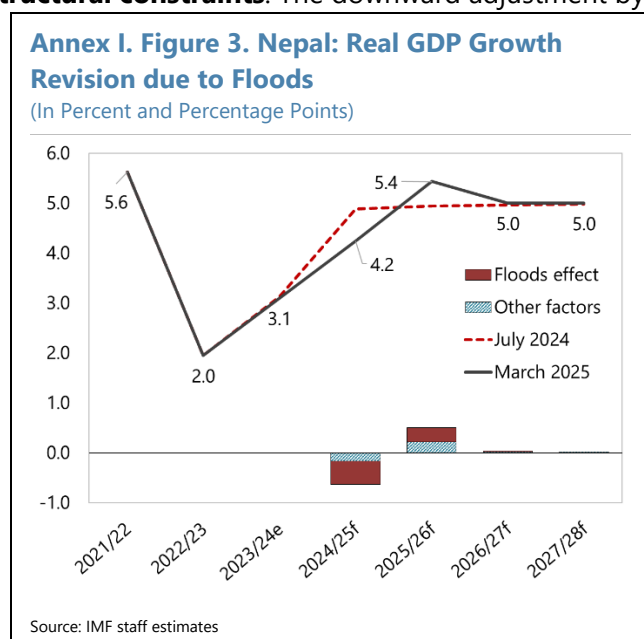
Sources: NPC, NDRRMA, UN Office of the Resident Coordinator for Nepal, UNICEF

^e IMF staff preliminary estimates based on available information as of January 21, 2025

4. The September 2024 floods disrupted Nepal’s nascent economic recovery, triggering a temporary surge in food prices and compounding existing vulnerabilities. The economic impact has been multifaceted. Already-sluggish domestic demand has further weakened as population displacement, income losses and disrupted supply chains curtailed purchasing power and economic activity in affected regions. Productive capacity has been reduced in areas where flooding affected farmland and destroyed crops and livestock, and where extensive damage to critical infrastructure occurred. This led to a sharp rise in food prices and an increase in transportation costs, pushing inflation from 3.9 percent just before the floods to 6.1 percent in December 2024. These challenges are magnified by fragile economic conditions that limit resilience, such as poverty, a vulnerable financial sector and constrained fiscal space, underscoring the urgent need for targeted policy measures to aid recovery and build resilience.



5. We have revised Nepal’s growth projections to reflect the significant impact of the September 2024 floods, alongside broader structural constraints. The downward adjustment by 0.6 percentage points from the 4th review for FY2024/25 reflects disruptions to both demand and supply caused by the floods, compounded by weaker-than-anticipated capital expenditure execution in the first half of the fiscal year (Figure 3). On the demand side, population displacement and income losses have suppressed economic activity. On the supply side, damages to farmlands, critical infrastructure, and productive assets, along with supply chain bottlenecks, have constrained output, particularly in agriculture and transport-dependent sectors. Inflationary pressures resulting from rising food prices and higher transportation costs have further eroded real incomes, dampening consumption and investment.



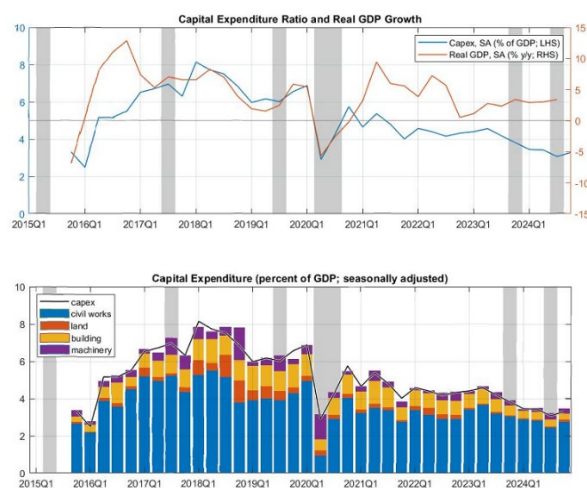
6. The medium-term outlook anticipates a rebound in growth, driven by post-flood reconstruction efforts and enhanced productive capacity. Growth is expected to overshoot prior projections in FY2025/26 as reconstruction efforts gain momentum (Figure 3). Repairs to critical infrastructure and residential housing, coupled with higher agricultural output from the recultivation of flood-affected farmlands, will directly boost economic activity. These developments are also anticipated to generate indirect knock-on effects, such as improved domestic demand through increased employment and income opportunities in construction and related sectors.

7. However, achieving this recovery depends on the government’s ability to significantly scale up capital expenditure execution, raise public investment efficiency and effectively mobilize financial resources. Past disasters

have typically led to a sizeable increase in capital expenditure with a lag, which contributed to post-disaster recovery (Figure 4). This time, in the immediate aftermath of the September 2024 floods, government relief efforts, supported by international humanitarian assistance, appropriately focused on mitigating the impact on the most affected and vulnerable populations. The transition to recovery phase now necessitates a sharp increase in capital investment to rebuild damaged infrastructure, revitalize economic activity and strengthen resilience across key sectors. Weak capital expenditure execution has long been a barrier to accelerating growth, and the extensive damage to major highways, bridges and residential housing underscores the urgency of addressing this constraint.

Implementing the PIMA action plan will enhance the efficiency and impact of public investments, while the effective implementation of the DRMS will help mobilize fiscal resources to enable higher development spending. Additionally, the availability of concessional financing from development partners—including on disaster relief, preparedness, and prevention—presents a timely opportunity to secure cost-effective resources for recovery and resilience-building, especially ahead of expected graduation from the Least Developed Countries (LDC) status in 2026.⁵ Leveraging international climate adaptation support can help build technical capacity and further bridge financing gaps.

Annex I. Figure 4. Nepal: Capital Expenditure Following Major Historical Natural Disasters ^{1/}



Source: MoF, IMF staff estimates

^{1/} Highlighted areas correspond to the following major natural disasters in Nepal: 2015 earthquake, 2017 floods, 2019 floods, 2020 floods, 2023 earthquake, 2024 floods (see Table 1)

⁵ The Nepal Disaster Resilience Development Policy Credit with Catastrophe Deferred Drawdown Option (Cat DDO) approved by the World Bank in October 2024 is one such example. Contingent concessional financing through the Cat DDO provides access for the government to immediate liquidity in the aftermath of floods. It also supports policy and regulatory reforms to increase disaster resilience and strengthens institutional mechanisms for effective disaster response.

C. Conclusion

8. The September 2024 floods highlight Nepal's acute vulnerability to natural disaster risks. The disaster underscored the structural challenges posed by the country's Himalayan geography, monsoon-dependent climate, and high reliance on agriculture, combined with limited adaptive capacity and weak infrastructure. Deforestation and rapid urban expansion into flood-prone areas further increases the number of people directly exposed to floodwaters. Furthermore, climate models indicate a worrying trend of increasing flood intensity and frequency as global temperatures continue to rise. These factors amplify the socio-economic impacts of disasters, disproportionately affecting vulnerable populations and key economic sectors such as agriculture, energy, and transportation.

9. To build a resilient recovery, Nepal must prioritize the efficient execution of capital investments and mobilization of financial resources. Strengthening disaster preparedness through improved information management and dissemination and fostering community engagement is essential. Investments in resilient infrastructure—particularly in agriculture, energy, and transportation—will mitigate future risks and bolster economic stability. Among the IMF program's reforms, swift and effective implementation of the PIMA action plan and the DRMS is critical to enhance public investment efficiency and expand fiscal resources. Additionally, leveraging concessional financing and international partnerships can address immediate recovery needs while creating a foundation for long-term resilience. A sustained focus on these policy priorities will not only aid recovery but also equip Nepal to better manage future floods and other natural disasters and safeguard long-term economic stability and growth.

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Annex II. Risk Assessment Matrix^{1,2}

Source of Risks	Likelihood / Time Horizon	Expected Impact on Economy	Policy Response
Potential Domestic Shocks			
Financial sector vulnerabilities intensify	High Short to Medium Term	High. Financial sector risks are likely to have accumulated during the credit boom, on the back of pandemic-related relaxation and an extended period of accommodative monetary policy. The impact of unwinding pandemic-related support measures and deterioration in repayment capacity of borrowers or other catalytic domestic or external events, risks triggering financial sector instability. Increasing forbearance could mask latent vulnerabilities, delaying their eventual emergence.	<ul style="list-style-type: none"> • Continue implementing risk-based supervision to limit potential financial sector consequences. • Continue implementation of the amended regulatory framework, to ensure (i) appropriate use of working capital loans, (ii) relevant asset classification for loans in line with international standards, and (iii) sufficient provisioning. • Take structural actions to address increasing stress in the savings and credit cooperative sector, to prevent negative spillovers to the banking sector. • Continue implementation of the financial sector reforms under the program. • Protect fiscal policy space to allow for an appropriate response to downside risks. • Implement FSSR recommendations.
Frequent and/or severe natural disasters	High Medium to long term	High. Earthquakes, flooding, climate and other disasters cause severe damage and economic disruption. Fiscal deficits and debt ratios increase in response and long-term growth is impeded.	<ul style="list-style-type: none"> • Improve risk management and resilience in public investment and building codes. • Build and maintain fiscal and reserve buffers. • Maintain and strengthen social safety nets. • Implement recommendations from the climate module of the PIMA. • Accelerate enacting recommendations of the CCCR on reducing vulnerability to climate change while promoting growth.
Lower than expected tax revenue collection	High Short to Medium Term	Medium. Cuts to public expenditure and/or higher public debt.	<ul style="list-style-type: none"> • Achieve program fiscal targets and reforms. • Implement the DRMS. • If revenues turn out lower than projected, preserve public investment and social safety nets. Make more use of concessional financing that is available for capital projects.

¹ The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("L" (low) is meant to indicate a probability below 10 percent, "M" (medium) a probability between 10 percent and 30 percent, and "H" (high) a probability of 30 percent or more). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly.

² The RAM was coordinated by Yaroslav Hul.

Source of Risks	Likelihood / Time Horizon	Expected Impact on Economy	Policy Response
Lower than expected execution of public investment	High Short to Medium Term	Medium. This would lead to lower economic growth and private investment.	<ul style="list-style-type: none"> • Improve public investment management, including implementation of PIMA recommendations to enhance capex. • Improve the budgeting process to underpin budgets with realistic analysis.
Political uncertainty and social unrest	High Short to Medium Term	Medium. A political cycle or a disaffection with incumbent political elites generates governance and/or social instabilities, restricting policy-making and delivery. Economic activity is disrupted. Economic policy and reform continuity is jeopardized.	<ul style="list-style-type: none"> • Secure policy continuity, including on reform implementation under the program, if political instability occurs. • Ensure transparency, accountability, and inclusion in policy implementation. • Restore and preserve public confidence in policymaking and communicate the benefits of structural reforms clearly, while protecting the most vulnerable from possible adverse impacts.
Potential External Shocks			
Commodity price volatility	High Short to Medium Term	Medium. Balance of payment pressures and drag on energy-intensive sectors (agriculture, tourism, transportation, infrastructure development) increase. Disruption of food and/or fuel supply could increase import prices and reduce food availability. High food inflation and food insecurity further impacts vulnerable populations. Fiscal pressure from energy subsidization.	<ul style="list-style-type: none"> • Continue to develop hydropower to diversify energy sources. • Accelerate structural reforms to diversify import sources and improve agricultural and food security. • Use ample reserves and fiscal policy space as a buffer. • Ensure convergence between domestic and global commodity prices, while protecting the vulnerable. • Stand ready to tighten monetary policy in case of second-round effects.
Global growth surprises: Slowdown	Medium Short to Medium Term	High. Lower growth in major trading partners, particularly India and the GCC countries, could adversely affect exports (including tourism) and remittances, with significant effects on GDP growth and external accounts.	<ul style="list-style-type: none"> • Maintain adequate reserve levels and fiscal policy space as buffers. • Provide targeted policy support to the vulnerable within the available fiscal space. • Accelerate structural reforms to (i) diversify and expand exports, (ii) generate domestic jobs to stem outward migration and reduce dependence on remittances, and (iii) increase FDI.

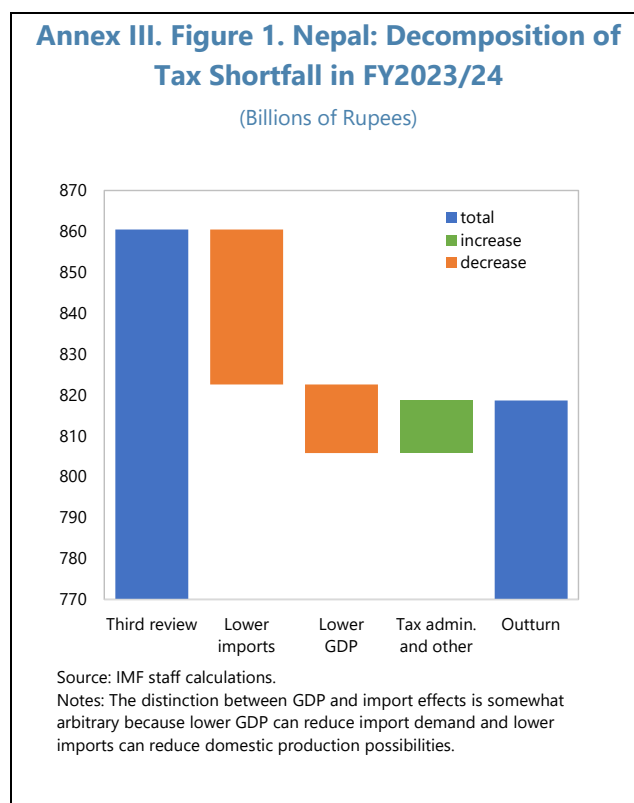
Annex III. Mobilizing Fiscal Resources¹

Tax revenue in FY2023/24 underperformed the target set in the Fund program. This annex shows that this underperformance seems to have been driven by economic factors, especially lower-than-expected imports, and not a lack of tax policy initiatives. Implementing policies outlined in the authorities' new Domestic Revenue Mobilization Strategy (DRMS) and enhancing the efficiency of public spending could substantially boost fiscal resources while reducing inequality, mitigating climate change, and reducing distortions to economic activity.

A. Accounting for Tax Revenue Shortfalls in FY2023/24

1. Tax revenue in FY2023/24 missed the indicative target under the Fund's Extended Credit Facility (ECF) program. Tax revenue grew in line with GDP in FY2023/24, maintaining a stable ratio of 16.3 percent of GDP. Nevertheless, tax revenue net of revenue sharing with provincial and local governments reached only Rs 819 billion in FY2023/24, falling short of the indicative target of Rs 846 billion (14.6 percent of GDP).

2. Analysis suggests that this underperformance can be attributed to weaker-than-expected economic conditions, despite some progress in tax policy. Imports in FY2023/24 were 9 percent lower than projected at the time of the 3rd review under the ECF, which reduced the tax base for both customs and import-related VAT and excise taxes. In turn, the lower import tax base can account for Rs 38 billion in lower import-related tax revenues in FY2023/24 than projected at the 3rd review (Annex III. Figure 1). Furthermore, nominal GDP was 3 percent lower in FY2023/24 than at the 3rd review, which reduced the tax base for both income and domestic value added and excise taxes,



¹ Prepared by Yongquan Cao and Galen Sher (lead).

accounting for Rs 17 billion less in revenue.² The remainder—an increase in tax revenue of Rs 13 billion—can be attributed to all other factors, including tax policy changes, such as: (i) a one-off collection from retroactively taxing the gains made through follow-on public offers, mergers and acquisitions and the sale of shares (Rs 12 billion); (ii) establishing a 39 percent top income tax rate for income above NPR 5 million; (iii) increasing the tax rate for interest paid to bank depositors; and (iv) removing VAT exemptions for 170 items.³

B. Policy Options to Mobilize Tax Revenue

3. There is substantial scope for raising additional revenue under the authorities' DRMS.

The government published the DRMS in 2024. It targets a tax-to-GDP ratio of 20.9 percent in FY2028/29, which represents an increase of 4.6 percentage points over FY2023/24. It envisages achieving this through an increase of approximately 1 percentage point in revenues from PIT, CIT, VAT, and customs tax, and a further smaller contribution from excise tax. This targeted increase in the tax-to-GDP ratio is in line with estimates from IMF technical assistance and was achieved previously in the five years to mid-2019.

4. Critical components of the strategy are to make personal income taxes more progressive and improve the collection of property tax, which would also reduce inequality.

The DRMS aims to review tax rates on investment income, as well as the standard tax-free allowance within PIT and the top income bracket. Equalizing the tax rates on capital income (especially dividends) with labor income within the PIT system, for example, could generate some 0.3 percent of GDP in additional revenue. Nepal has a property tax, but collections are negligible due to a lack of local government capacity. Collecting more property tax would reduce inequality without materially distorting economic activity. Under the DRMS, the central government plans to share data with local governments to help them collect property taxes. The central government could go further, offering grants to local governments to build capacity, or assigning the Inland Revenue Department (IRD) the responsibility for collecting property taxes on behalf of local governments.⁴

5. Reducing tax expenditures could also help to mobilize revenue while keeping tax rates constant, promoting equality, reducing negative externalities, and enhancing transparency.

IMF staff estimates that tax expenditures in Nepal amount to 2.7 percent of GDP for VAT and 1.7 percent for excise taxes, at current compliance rates, suggesting that substantial revenue could

² For domestic taxes, this analysis effectively assumes an elasticity of nominal taxes to nominal GDP (i.e., a buoyancy ratio) of 1, in line with historical evidence.

³ In principle, the remainder also reflects non-tax policy changes, including conservatism in setting the program target and changes in the mix between revenue-sharing and non-revenue-sharing revenues.

⁴ International Monetary Fund. 2023. "Nepal: Simplifying Tax Policy to Enhance Revenue and Efficiency." Technical Assistance Report. Fiscal Affairs Department. January.

be raised by rationalizing them.^{5,6} On VAT, the authorities should reduce the number of exempt goods. The authorities could eliminate regressive VAT exemptions such as those on precious metal jewelry and the first sale of a residential property, which could raise 0.4 percent and 0.2 percent of GDP in additional revenue respectively. Refining the VAT exemptions on selected foodstuffs and educational services can also generate substantial additional revenues while enhancing the progressivity of the VAT and ensuring that the vulnerable remain protected. On *excise taxes*, the DRMS aims to impose these on petroleum products and coal, given their high climate costs that are not borne by their consumers (i.e., externalities). The authorities should review excise tax exemptions on alcoholic spirits, loose tobacco, and heavy vehicles like buses, given their high potential to generate additional revenue and their substantial health and infrastructure externalities. On *PIT* and *CIT*, the authorities should estimate tax expenditures, which are not yet available, with the help of IMF technical assistance if necessary. The DRMS commits to rationalizing CIT incentives. The authorities should gradually phase out tax holidays and concessions for special industries, which make the economy less efficient, and for exporters, which leak out of Nepal, primarily benefiting foreign consumers.⁷

6. Improving voluntary tax compliance and enforcement would also help to raise revenues through a broader tax base, while keeping tax rates constant. Compliance in Nepal is low at 33 percent for PIT, 47 percent for CIT, 67 percent for VAT, and 61 percent for excise tax.^{8,9} Collectible tax arrears amounted to some 1.3 percent of GDP in FY2021/22. Increasing the number of risk-based taxpayer audits could improve compliance. The authorities could improve data collection, especially at the transaction level, and data sharing between government agencies so that indicators of the risk of non-compliance can be developed. Once the authorities have a better understanding of the nature and drivers of non-compliance, they could take mitigation measures and develop a compliance improvement plan, containing further measures to improve compliance and steps to evaluate these measures.¹⁰ Clearance of arrears could be improved by identifying the largest debtors and using a graduated approach to enforcing payment (e.g., calling, offering a payment plan, and using enforcement powers). Sending reminders and mandating electronic payment for large taxpayers could help prevent further buildup of arrears.

⁵ International Monetary Fund. 2024. "Nepal: Developing Tax Expenditure Policy for Domestic Revenue Mobilization." Technical Assistance Report. Fiscal Affairs Department. September.

⁶ Although some tax expenditures can be desirable, like VAT exemptions on basic food items that help the poor, they are expensive for the government because they are untargeted and they are not transparent because they do not appear in the budget, making them vulnerable to abuse. Tax expenditures should therefore be minimized.

⁷ Section 11 of the ITA provides tax holidays for certain business areas, like hydropower, manufacturing, and tourism. Section 12 of the ITA provides further tax incentives, including tax reductions or full tax exemptions for certain business areas, like agriculture, forestry, and manufacturing.

⁸ Tax Administration Diagnostic Assessment Tool (TADAT). 2023. "Performance Assessment Report: Nepal." February.

⁹ Compliance rates for PIT and CIT refer to FY2020/21, while those for VAT and excise tax refer to FY2021/22.

¹⁰ See for example, Brondolo, John, Annette Chooi, Trevor Schloss, and Anthony Siouclis. 2022. "Compliance Risk Management: Developing Compliance Improvement Plans." Technical Notes and Manuals. Fiscal Affairs Department, International Monetary Fund.

C. Policy Options to Enhance Spending Efficiency

7. Further development of the National Project Bank (NPB) would help increase the efficiency of public investment. The public capital stock in Nepal declined to around 36 percent of GDP in 2019, from 50 percent in 1993, underscoring the need for more efficient public investment.¹¹ Moreover, public investment execution needs to increase from its current rate of around 60 percent. The government's PIMA Action Plan of May 2024 aims to link the NPB to the Line Ministries' Budget Information System (LMBIS) and Provincial Project Bank Management Information System (PPBMIS); it also seeks to include all multi-year projects in the project bank for monitoring and budgeting. Additional measures could include (i) revising the operational procedures of the NPB related to project development, prioritization, and selection; (ii) fully documenting project proposals and developing a detailed methodology for project appraisal; and (iii) covering all large, complex projects, such as PPPs, externally financed projects, and those exceeding a given threshold in the NPB.¹²

Annex III. Table 1. Nepal: Revenue Mobilization Options

Category	Reform	percent of GDP
PIT	Equalizing the tax rates on capital income with labor income.	0.3
	Lower tax free allowance and top income bracket.	0.4
CIT	Phase out tax holidays and concessions for special industries.	0.5
VAT	Eliminate exemptions on jewelry and residential property.	0.6
	Refining the exemptions on foodstuffs and educational services and rationalizing other tax expenditures.	2.1
Excise tax	Eliminating exemptions for spirits.	0.6
	Eliminating exemptions for tobacco.	0.3
	Eliminating exemptions for heavy vehicles.	0.8
Property tax	Increase property tax rates.	
	Support local governments to collect property tax, or assigning responsibility for collection to the IRD.	0.5
Tax administration	Increase compliance.	unknown
	Collect tax arrears.	1.3

Sources: IMF staff technical assistance reports.
Note: Revenue impacts are estimated based on the available data at the time of producing the technical assistance reports and are tentative

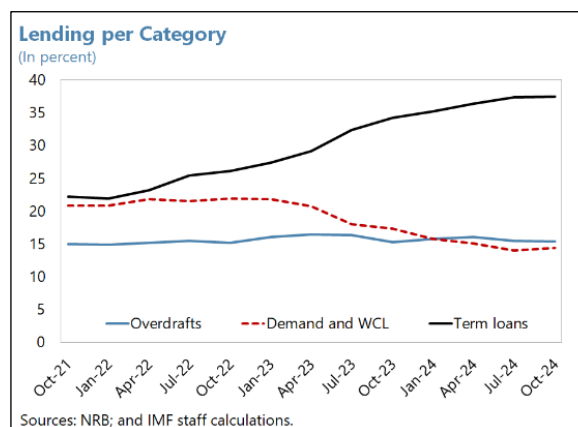
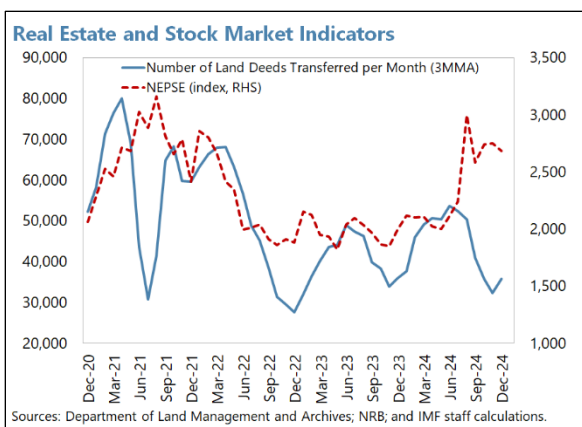
¹¹ These estimates are based on the IMF's Investment and Capital Stock Dataset and use prices that are comparable in terms of purchasing power across countries.

¹² See Annex 4 of International Monetary Fund. 2021. "Nepal: Public Investment Management Assessment – PIMA." Technical Report, Fiscal Affairs Department. November.

Annex IV. Indicators of Bank Portfolio Stress¹

Stress in bank loan portfolios can be identified through many different indicators. NPLs are the primary indicator of bank portfolio stress and continue to show an upward trend. Accrued interest may signal that borrowers are experiencing difficulties in repaying their loans. After a sharp rise, it has plateaued. Non-bank assets can indicate future losses that will hit bank capital, and they continue to rise. The overall picture is of elevated stress in bank loan portfolios. Supervisory diligence, such as provided by completing the LPR, is recommended.

1. The banking sector is in the midst of a credit cycle and regulatory transition. Nepal experienced a post-pandemic credit boom, anecdotally resulting in substantial diversion of loans into real estate and the stock market. Both of these markets and the economy cooled dramatically in FY2022-23, as indicated by lower land transaction volume and—except for a recent spike—the NEPSE index, which came down sharply after the credit boom ended.² As a result, banks face reduced customer ability to repay, higher NPLs and associated recovery issues, such as not being able to auction seized real estate collateral. In addition, the strengthening of the regulatory framework improved lending quality, asset classification practices and tackled forbearance and evergreening practices, which caused a healthy shift to term lending but also a reassessment of client relationships and an increase in gross NPLs.



2. When analyzing bank portfolios, several indicators can anticipate or indicate stress. One indicator that may signal that borrowers are experiencing difficulties in repaying their loans is the on-balance sheet accrued interest. This indicator refers to interest that is owed to a bank over the reporting period but has not been paid. Although interest accrual is part of the normal course of business of a bank, and borrowers typically only become non-performing once their payment is 90 days past due, significant increases in the on-balance sheet accrued interest, especially in an economic downturn, could be an early sign of future borrower distress. Other indicators of bank

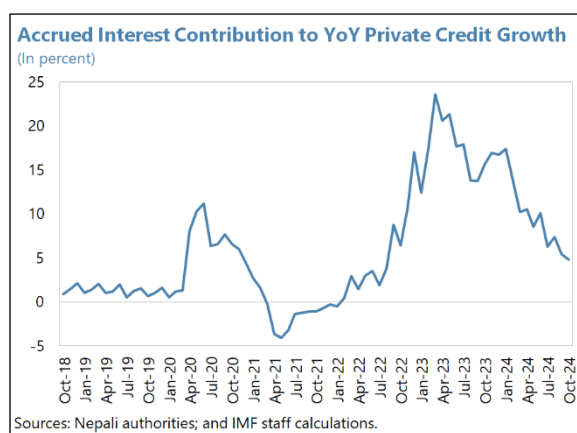
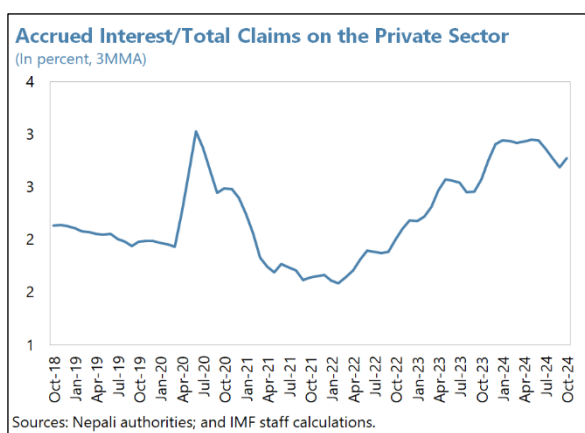
¹ Prepared by Minke Gort and Russell Green (lead).

² Tax revenue collected per deed, a crude indicator of the value of real estate changing hands, has seen a modest recovery since a low in February 2024.

portfolio stress and difficulties with loan recovery are NPLs and non-bank assets (NBAs). An increase in NBAs signals that while banks are seizing collateral to cure NPLs, they are having difficulty selling it due to issues in the underlying asset market.

3. NPLs are the primary indicator of bank portfolio stress and continue to show an upward trend. Trends in gross NPLs indicate how borrowers are faring. NPLs in Nepal have continued to increase since July 2022 (Figure 1 of the body of the report). However, if banks adequately provision for gross NPLs, net NPLs will grow more slowly. Provisioning nevertheless is a cost for the banks that can reduce reserves and therefore capital ratios. The impact of deteriorating loan quality on a bank is shown by a combination of net NPLs and capital ratios. As indicated in the body of the report (¶17), Commercial (Class A) banks on aggregate have adequate provisions at 65 percent as of October 2024. NPLs as a share of capitalization and provisioning, however, remain elevated at around 20 percent. Further, capital adequacy ratios of commercial banks on aggregate hover just above the regulatory minimum, indicating that significant additional provisioning would stress capital adequacy.

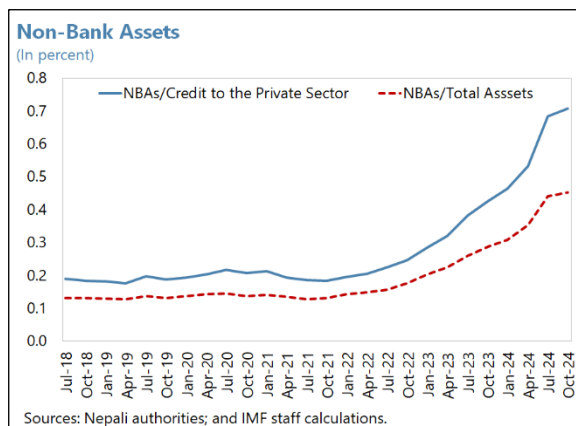
4. Interest accrual in Nepal can provide a window into borrower health and also the components of credit growth. Starting around the beginning of FY2022/23, accrued interest has climbed and recently reached nearly the levels seen at the beginning of the pandemic before forbearance measures appropriately provided relief to borrowers. As accrued interest in nominal terms continues to trend upward, this may signal that the peak of NPLs in Nepal has not yet been reached. In addition, the elevated accrued interest levels have impacted the composition of credit growth. Beginning in FY2022/23 a significant share of credit growth to the private sector represented accrued interest rather than fresh credit, although the share has come down since about February 2024.



5. Rising NBAs can expose banks to further losses related to NPLs and indicate asset market stress. When a bank forecloses on a loan and seizes the collateral, it typically tries to sell the collateral to recover as much as possible. If the market value of the asset has fallen since the loan was made, e.g. real estate cannot be sold for its book value, selling the collateral forces the bank to

recognize the loss.³ Instead, banks can hold the asset as an NBA, allowing them to maintain the asset's book value. Eventually, however, banks will need to set aside capital to deal with NBA losses. Hence, rising NBAs can indicate future losses that will hit their capital.

6. In Nepal, the impact of price corrections in the stock and real estate market and economic weakness continue to propel higher NBAs. In Nepal, around 75 percent of loans are collateralized by fixed assets like real estate. Stocks may also be pledged as collateral. NBAs have risen as both markets have cooled. Although the stock market has started to recover and accrued interest accumulation has decreased in relative terms, the real estate market has not yet recovered, and NBAs have continued to climb. This indicates that banks hold a growing portfolio of real estate that they cannot sell. Hence, a growing share of bank capital is tied up in illiquid assets. Although small, even relative to NPLs, which are around 4.5 percent of loans, NBAs could be impacting banks' ability to lend and support the economic recovery.

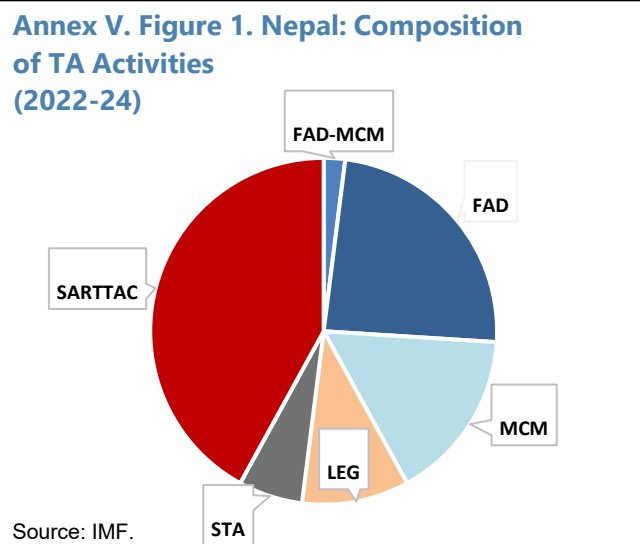


7. In sum, indicators of bank loan portfolio health indicates that stress factors remain elevated. In the charts in this Annex, April 2022 is about the time that asset stress began. More recently, accrued interest has plateaued, but NPLs and NBAs continue to grow. The indicators underscore the importance of conducting the LPR, which will shine greater light on bank portfolios and asset quality. Growing NBAs also indicate the need to improve NPL workout solutions and increase real estate market transparency.

³ Book value is the assessed value of the collateral originally entered onto the bank's books when the loan was first made.

Annex V. Integration of Capacity Development with Extended Credit Facility Objectives¹

1. Fund TA has been critical to ensure timely and proper implementation of reforms under the ECF-supported program. The implementation of ECF reforms has required the deployment of large amount of capacity building, which has helped to ensure the continuity of technical work and the knowledge transfer, in a highly volatile political environment and large turnover of the government officials. These capacity development efforts have been delivered both through SARTTAC and HQ (text graph). Nepal has benefitted from several areas including fiscal risks management, tax reforms, cash flow forecasting, execution of capital expenditures, financial sector regulation and supervision, strengthening the central bank's institutional framework, and enhancing AML/CFT legal framework. In addition, Nepal has received a large volume of TAs that has built capacity in other areas and also indirectly supported reforms under the ECF implementation. Examples of such TAs include capacity building in national accounts and government financial statistics, forensic auditing, debt management, custom administration, and the implementation of a central bank digital currency.



¹ Prepared by Teresa Daban Sanchez (lead), IMF Resident Representative to Nepal May 2022-November 2024, and Saraswati Sharma, Economist at IMF Nepal Office.

Annex V. Table 1. Nepal: Capacity Development in Support of Program Objectives and Reforms		
Priority TA Area	Main Activities Done/Planned	Objective/ Conditionality
Improve Governance and Fiscal Transparency (Enhancing coverage of fiscal accounts)	SARTTAC TA mission (in person) to advice on the adoption of GFS 2014 standards, including consolidation of operational extra-budgetary funds into annual financial statements (July 2022); SARTTAC TA mission (in person) to provide advice in expanding the coverage of EBUs (August 2023).	Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption
Improve Governance (Enhancing AML/CFL legal framework)	Participation of two LEG Staff Members in the Asia Pacific Group SIP mission (February 2024).	Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption
Strengthening the Nepal Rastra Bank (NRB) institutional framework, in support of NRB's policy mandates and implementation of SAG recommendations	LEG mission on Central Bank Risk Management (virtual) (February 2022); LEG-FIN TA several missions (in person and virtual) to assist in drafting of amendments to the NRB Act (May-August 2022); FIN desk-based TA (virtual calls) to provide advice to the Office of the Auditor General in conducting the NRB audit through experienced international auditors (July, October 2022); MCM Workshop with NRB Board on Governance and Risk Management (Hybrid) (April 2023); SARTTAC mission (in person) on the improvement of the NRB's Foreign Reserves Management Framework (September 2023).	Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption
Enhance Fiscal Transparency and lay the foundations for a Domestic Revenue Mobilization Strategy (DRMS)	FAD TA mission (in person) to assess Nepal's tax systems, identify tax exemptions, and to support formulate mobilization plan (August-September 2022); FAD follow-up mission (in person) on the preparation of Domestic Revenue Mobilization (February 2024); FAD TA mission (in person) for developing tax expenditure policy for domestic revenue mobilization (September 2024).	Domestic Revenue Mobilization, with an emphasis on Tax Policy Matters
Enhance Tax Administration and provide inputs for the DRMS	FAD TA mission (in person) to access Nepal's revenue administrations for developing the DRMS (August--September 2022); Pre-TADAT training conducted by SARTTAC (November 2022); TADAT mission (in person) to assess in detail Nepal's tax administrations (December 2022); FAD TA mission (in person) on stocktaking progress of reforms to the Inland Revenue Department (August 2023); SARTTAC mission (in person) to improve the risk -based audit in the Large Taxpayers Office (April 2023); FAD Post TADAT Study Tour (virtual)	Tax Administration Component of Revenue Mobilization

Priority TA Area	Main Activities Done/Planned	Objective/ Conditionality
	<p>(December 2023); FAD Post-TADAT to developing a strategic response to TADAT Findings (December 2023); FAD-SARTTAC mission (in person) to support the finalization of the Domestic Revenue Mobilization Strategy (DRMS) (April 2024); FAD-SARTTAC TA mission (in person) for customs reforms roadmap for Domestic Revenue Mobilization (October 2024). SARTTAC training workshop (in person) on Risk Based Audit Techniques in Nepal (December 2024).</p>	
<p>Enhance Fiscal Transparency and Strengthening Fiscal Risks Management</p>	<p>FAD TA (virtual) on identification of fiscal risks (April 2022); SARTTAC training mission (in person) to MOF officials for the setting of a fiscal risk register, (September 2022); SARTTAC training (in person) on the design of a full-fledged Medium-Term Fiscal Framework and Macro-Fiscal Forecasting (February 2023); Follow up SARTTAC training mission (virtual) provided to MOF officials to finalize the establishment of a fiscal risk register (February 2023).</p>	<p>Fiscal Sustainability and Fiscal Risks Management</p>
<p>Improve Public Debt and Cash Management, to improve Debt Transparency and Risk Management</p>	<p>SARTTAC mission (in person) in June 2023, on the development of a cash-flow forecasting framework; SARTTAC training (in person) to follow up on the implementation of the cash-flow forecasting framework (June 2024); MCM-FAD TA mission (in person) to assist authorities in strengthening the public debt management functions (January 2024).</p>	<p>Fiscal Sustainability and Fiscal Risks Management</p>
<p>Raise the Quality of Growth through more Efficient Capital Expenditures Execution that Support Climate Resilience</p>	<p>FAD TA mission (virtual) to conduct a Public Investment Management Assessment Climate Change Module, which covers planning, allocation, and implementation (March-April 2021); SARTTAC mission (in person) for the formulation of an Action Plan for implementation of PIMA recommendations (February 2024); SARTTAC TA mission (in person) on addressing issues in capital budget execution (January 2025).</p>	<p>Equitable and Sustainable Growth</p>
<p>Enhanced Financial Sector Regulations & Supervision</p>	<p>MCM desk-based TA (virtual) on draft amendments to regulations on asset classification and LOLR (May-November 2022). Financial Sector Stability Review (FSSR) several missions (in person and virtual), with a focus on banking supervision and regulation, payment systems, stress-testing, financial inclusion, financial sector statistics, and crisis management (May-November 2022); STA TA mission (in person) on developing a framework for compiling the Monetary and Financial Statistics and</p>	<p>Preserve and Strengthen Financial Sector Stability</p>

Priority TA Area	Main Activities Done/Planned	Objective/ Conditionality
	dissemination (March 2023) ; SARTTAC follow-up mission on Banking Supervision (December 2023) ; MCM follow--up TA mission (in person) to devise a medium-term TA road map to implement FSSR recommendations (March 2024) ; STA TA mission (in-person) on the External Sector Statistics (June 2024) ; SARTTAC training (in person) on strengthening supervisory framework for IFRS9 and ECL (September 2024) . MCM TA missions (in person and virtual) on the feasibility analysis of CBDC and its preparation (July-November 2024) .	

Appendix I. Letter of Intent

Kathmandu, Nepal
February 25, 2025

Ms. Kristalina Georgieva
Managing Director
International Monetary Fund
Washington, D.C. 20431

Dear Ms. Georgieva,

1. This Letter of Intent (LOI), along with the attached updates to the Memorandum of Economic and Financial Policies (MEFP) and Technical Memorandum of Understanding (TMU), outlines our continued commitments to the policies and objectives of the economic program supported by the Extended Credit Facility (ECF) arrangement. The ECF-supported program is fully consistent with the priorities and objectives of the Government of Nepal, and is vital for maintaining macroeconomic and financial stability, facilitating a sustained economic recovery, and promoting stronger and more inclusive growth over the medium and long term. We describe the progress that has been made so far, the challenges that were overcome, and further policy steps and reform initiatives that we will undertake to meet the ECF-supported program's objectives.
2. Nepal's external position has strengthened, supported by decisive policy actions, buoyant remittances, and slow import growth. However, on the domestic front, the economy continues to face challenges, with Q1 growth of only 3.4 percent y/y. The nascent recovery was further hindered by devastating floods and landslides in September 2024. The ensuing loss of life, extensive damages to agriculture and infrastructure, and economic disruptions have added strain to the already weak domestic demand stemming from large post-pandemic outward migration for work and study and subdued business and consumer confidence. Nevertheless, tax revenues have improved and public investment has increased, which together anchor our growth-friendly fiscal consolidation and debt sustainability. Amid ongoing correction from the post-pandemic credit boom, financial sector vulnerabilities are rising. The banking sector's non-performing loans (NPLs) increased to 4.4 percent in October 2024, bank profitability declined, and the financial health of the savings and credit cooperatives (SACCO) sector has weakened. Inflation, which steadily decreased through FY2023/24, to 3.6 percent in July 2024 due to subdued domestic demand and favorable commodity prices, has accelerated following the floods to 6.1 percent in December 2024, owing to flood-related food price spike and supply disruptions.
3. Against this backdrop, we are pursuing growth-friendly fiscal consolidation—emphasizing acceleration of capital expenditure coupled with revenue mobilization—as a key tool to boost sustainable and inclusive economic growth. Tax revenues are improving in part due to new

measures on alcohol, tobacco, petroleum products, and coal, and current spending growth has been moderate. We are assessing tax expenditures with the help of IMF TA. This assessment will inform the FY2025/26 budget and be published in a tax expenditure report. The report will form the basis for rationalizing tax expenditures in line with our recently adopted Domestic Revenue Mobilization Strategy. We also aim to improve tax compliance, including through the development of a new Customs Compliance Improvement Strategy. To support medium-term economic growth, we recently adopted the Public Investment Management Action Plan and are drafting revised guidelines for the design and selection of projects in the National Project Bank.

4. On the monetary front, we will continue our data-driven approach to monetary policy to maintain price and external sector stability, while supporting growth. In this context, we are closely monitoring inflation developments following the floods, and stand ready to react with monetary policy measures to address any persistent second-round effects stemming from a food price spike. Low lending rates, continued strong remittance inflows and ongoing efforts to increase capital spending and improve capex execution, including on post-flood reconstruction, would help get domestic demand back on a recovery path and support a pick-up in growth in FY2024/25. The prudent monetary policy stance will help keep inflation in check and maintain reserve coverage at adequate levels, while allowing for fiscal policy to maintain a low risk of public debt distress. In addition, it will provide space for a gradual revival in productive credit activity as the economy transitions to a sustainable level of credit growth. We will endeavor to improve monetary policy implementation, including through proactive liquidity management aligned with the interest rate corridor.
5. The reforms envisaged under the ECF-supported program are vital to strengthen Nepal's financial sector. In the process of improving bank asset quality, we will align the Asset Classification Regulation rules with a continuous repayment period of three months for reclassification for non-restructured/non-rescheduled loans, as prescribed by the Basel Committee on Banking Supervision (BCBS) standards, by end-December 2025 and ensure the banking sector is provisioned accordingly. We are continuing other efforts to improve bank regulation and supervisory practices in line with international standards, through reviewing and amending our current capital, blacklisting and liquidity frameworks. We will limit regulatory forbearance and ensure it is targeted, timebound and phased-out as soon as possible. In view of ongoing repayment related pressures in the banking sector, we will remain vigilant to identify emerging vulnerabilities.
6. Following the cancellation of the procurement for budgetary reasons, we have restarted the process to hire an independent international consultant to assist with the LPR and will issue by early March the Request for Proposal Notice including the Terms of Reference agreed with the Fund that clarifies that the exercise will be based on both domestic regulation and the BCBS standards, to complete a prior action for the fifth review under the ECF. We are scheduled to launch the LPR by end-May 2025 to verify loan classification, provisioning and compliance with the regulatory framework, and will develop a roadmap to address the outcomes, including referencing the December 2025 alignment of the ACR with BCBS guidelines, which attests to our

commitment to implementing the BCBS standards. We will finalize the LPR of the ten largest banks by end-December 2025. To ensure our bank resolution regime is fully equipped to deal with problematic banks, we will amend the NRB Act to address the issues identified in the 2023 Financial Sector Stability Review. Recognizing the difficulties experienced by the savings and credit cooperatives (SACCO) sector, we have issued an ordinance to regulate SACCOs and going forward will prioritize implementing measures to deal with problematic SACCOs.

7. We remain committed to diligently implementing recommendations from the Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT) Mutual Evaluation conducted by the Asia Pacific Group on Money Laundering. Given that the banking sector and remittance providers are identified as Nepal's key vulnerable sectors in the Mutual Evaluation Report, addressing these risks would be essential for safeguarding the financial integrity and soundness of Nepal's financial sector and would be in line with the program objectives. With the amendments to the AML Law enacted, we are determined to ensure the effectiveness of the new legal framework, and have begun issuance of secondary regulations. We welcome technical support from the IMF and other donors on these matters.
8. We have progressed with the implementation of the recommendations in the 2021 Safeguards Assessment (SGA). The Office of the Auditor General (OAG) conducted the FY2023/24 audit with the assistance of a Nepal-based auditor with international experience in central bank auditing, and we will coordinate with the OAG to continue this best practice going forward. We will submit amendments to the NRB Act to Parliament in line with key recommendations of the SGA by end-April 2025.
9. We remain committed to the implementation of policies and reforms envisaged in the ECF and continue to make progress, with the support of Fund technical assistance. The attached MEFP and TMU update the versions dated July 9, 2024, and set out economic objectives of the government's reform program for the remaining program period 2025-26. The updated program will continue to be centered on policy actions and structural reforms aimed at maintaining macroeconomic and financial stability, enhancing regulatory framework and institutions, and achieving a sustainable and inclusive medium-term growth.
10. As detailed in the attached MEFP, we commit to realigning the NPL reclassification and provisioning framework with international standards. We will continue making progress on reporting the consolidated financial information of all extra-budgetary units in annual financial statements and adopting the revised National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection. We expect to continue to involve members of the Institute of Chartered Accountants of Nepal belonging to global auditing networks for the audit of the FY2024/25 financial statements of the NRB. Other important reforms require more time to advance, including amending the NRB Act, launching the LPR, producing the LPR roadmap, and publishing a comprehensive tax expenditure report. In light of institutional challenges, we propose to reset these reforms to later dates.

11. We believe that the commitments outlined in the MEFP are adequate to make progress with the objectives of the ECF-supported program and promote sustainable and equitable growth in Nepal. Implementation of the program will also help support macroeconomic stability and build the resilience needed to implement our objectives. We will take any additional measures that may become appropriate for this purpose. We will consult with the IMF in advance of any substantive revisions to the policies and reforms contained in the MEFP, in accordance with the Fund's policies. On behalf of the Government of Nepal and the NRB, we would like to communicate our appreciation of the technical assistance and capacity development support provided by the Fund to Nepal, especially since the approval of the ECF. We intend to remain in close consultation with the Fund and provide timely information necessary for the implementation of policies under the ECF-supported program. Though our macroeconomic program remains broadly in line with our plans at the fourth review under the ECF, additional time is needed to complete critical structural reforms. We request the completion of the fifth review under the ECF.
12. With this progress and commitment, we request SDR 31.4 million to be made available for the fifth review under the ECF. Considering the positive external development, we request an upward revision of the end-July 2025 quantitative performance criterion (QPC) on the floor of net international reserves. We do not intend to introduce measures or policies that could generate balance-of-payments difficulties, or which are inconsistent with Article VIII of the IMF's Articles of Agreement. We do not intend to accumulate external or domestic arrears. In line with our commitment to transparency, we hereby consent to the publication of this letter, the attached MEFP and Technical Memorandum of Understanding (TMU), the staff report and other ECF-related documents, on the IMF's website.

Sincerely yours,

/s/

Hon. Bishnu Prasad Paudel
Deputy Prime Minister and Finance Minister

/s/

Mr. Maha Prasad Adhikari
Governor, Nepal Rastra Bank

Attachment I. Memorandum of Economic and Financial Policies

We remain fully committed to the economic reform program supported by the arrangement under the Extended Credit Facility (ECF) of the International Monetary Fund approved in January 2022. This memorandum reiterates our commitment to the program and outlines in detail the progress we have made toward meeting the objectives of the economic reform program and our policy plans to advance these objectives. Tables 1 and 2 summarize performance to date and how we plan to update the quantitative targets and structural benchmarks going forward.

Background

1. The economy has been gradually recovering, but persistently weak domestic demand, constrained fiscal space, and rising financial vulnerabilities—exacerbated by the September 2024 floods—underscore the need for an integrated policy response to effectively address these challenges. The recovery in FY2023/24 from the post-credit boom slowdown was driven by a rebound in tourism, hydropower expansion, strong remittances, and robust agriculture output. However, subdued business and consumer confidence and rising financial sector risks—amid bank and household balance sheet repairs as well as significant outward migration for work and study—had kept domestic demand weak, weighing on growth. The devastating floods further strained the nascent economic recovery, amplifying existing pressures. Prompt execution of budgeted expenditures—especially capital expenditure, including on post-disaster reconstruction and recovery—is necessary to improve macroeconomic balance and unlock sustainable medium-term growth. Structural reforms to enhance productivity, expand fiscal space, and safeguard financial stability will play a critical role in ensuring long-term economic health and reducing vulnerability to future shocks.

2. In this context, we remain committed to the ECF to support our efforts to maintain macroeconomic and financial stability and transition towards sustainable and inclusive growth. The macroeconomic framework and reform agenda underpinning the ECF provide a critical path to returning to stable long-term growth. The program also contributes to strengthening our regulatory and institutional frameworks and helps build capacity while catalyzing additional financing from development partners. The fifth review quantitative performance criteria and continuous performance criteria were met. External sector strength has allowed amassing ample international reserve buffers. The primary balance target was met, contained *inter alia* due to prudent spending in a context of revenue weakness and low absorption of external project financing. Child grant spending as of July 2024 missed the program indicative target for the third time, although all eligible children received the grants (Table 2). Out of six structural benchmarks (SBs), three were completed, two met on time. The remaining three SBs were not completed and two are proposed to be reset for future reviews to allow time to advance needed reforms. Finally, an SB from the 3rd review on the asset classification regulation (ACR) was revised, but we are committed to aligning the ACR with the Basel Committee on Banking Supervision (BCBS) Guidelines by end-December 2025.

Recent Macroeconomic Developments and Outlook

3. The economic recovery that gained momentum in FY2023/24 has been disrupted by the severe floods in September 2024, which caused widespread damage across critical sectors.

Growth in FY2023/24 was supported by strong performance in tourism, hydropower, transportation, and agriculture, while signs of recovery in imports and improvements in tax and customs revenues pointed to strengthening domestic activity. However, the budding economic recovery was interrupted by the devastating floods and landslides in September 2024. The disaster resulted in over 200 fatalities along with extensive damage to key infrastructure, including roads, bridges, and hydropower facilities. The agricultural sector was adversely affected by inundation of farmland and livestock losses, threatening rural livelihoods and food security. The housing sector sustained significant losses, with over 19,000 homes destroyed or badly damaged. Preliminary estimates place economic losses at close to NPR 50 billion (0.9 percent of GDP). Inflation, which had declined to 3.6 percent by July 2024, has accelerated again to 6.1 percent in December, on the back of food price spike driven by supply disruptions and agricultural losses. The economic fallout from the floods has weighed on near-term growth prospects.

4. The growth recovery is expected to gather pace by the end of FY2024/25, supported by post-flood recovery and reconstruction efforts, with inflation remaining contained.

The economic impact of the floods is expected to be transitory, with economic activity rebounding in the second half of the fiscal year as public spending, including on relief and reconstruction, accelerates. Government expenditure on physical infrastructure, coupled with targeted support for affected sectors and population, and a cautiously accommodative monetary stance, are expected to stimulate domestic demand and restore growth momentum. The multiplier effects from infrastructure investment and sectoral recovery are expected to reinforce broader economic activity. Continued growth in tourist arrivals, rising imports, and additional hydropower capacity will further support the recovery. Flood-driven food inflation is expected to ease as transport networks are repaired, agricultural output recovers, and policy measures stabilize markets. As domestic demand gains traction, monetary policy will adjust as necessary to keep inflation about 5 percent. With a rebound in imports and a moderation in remittance inflows, the current account balance is expected to decline in FY2024/25, while international reserves will remain substantially above the adequate level. The medium-term outlook remains positive, supported by our strategic investments into priority infrastructure projects including in hydropower generation and transmission.

5. The outlook faces important downside risks. We recognize that improving public expenditure execution for growth-enhancing capital projects is critical to the economic recovery. Additionally, improving the business and investment climate is essential to sustainable medium-term growth, along with creation of jobs that can compete with work opportunities overseas. The financial sector would require actions to identify and address potential further rise in bank NPLs and more failures among cooperatives. Addressing strategic deficiencies in the Anti-Money Laundering/Countering Financing of Terrorism (AML/CFT) framework identified by the Financial Action Task Force (FATF) in the February 2025 plenary has become critical to avoid hindering access to the global financial system. Continued capital budget under-execution and

overly optimistic budgeting creates fiscal policy uncertainty. Other important risks include a sharp growth slowdown in Nepal's major trade- and remittance-partner economies or volatile and higher global commodity prices—especially for fuel and food. These external shocks would have a pronounced impact on inflation, food security and economic activity, and a disproportionate impact on the poor and vulnerable. Despite its minimal contribution to global carbon emissions, Nepal is vulnerable to climate change-induced natural disasters and weather variability which can impact food production, poverty reduction and growth. To help manage these risks, we intend to take forward-looking, data-driven approaches to monetary and fiscal policies and undermining stand ready to adjust the policy stance.

Economic and Financial Policies

Fiscal Policy

6. Our fiscal position has been anchored by the program targets, despite a challenging economic environment. The slow growth of imports in FY2023/24 meant that, despite the tax measures introduced in the budget, tax revenues increased marginally faster than nominal GDP. In response, we pursued strict spending discipline, especially in fiscal transfers to subnational governments and capital spending, with the overall fiscal deficit declining to 2.7 percent of GDP. However, the negative balance of the Treasury Single Account (TSA) increased to about 4.0 percent of GDP at the end of FY2023/24, which suggests a need for enhanced monitoring and consolidating extra-budgetary funds.

7. We remain committed to a gradual growth-friendly fiscal consolidation to stabilize public debt consistent with the program framework. Our FY2024/25 budget is broadly consistent with the target set out in the program to stabilize public debt at a moderate level. The budget includes new tax measures on alcohol, tobacco, petroleum products, and coal, and seeks to improve tax compliance. The budget also allocates more to capital expenditure, curtails spending duplication with subnational governments, and increases social security expenditure, though not the child grant program. In addition, we aim to support growth while maintaining debt stability by increasing the absorption of external concessional financing, in particular project loans.

Revenue Mobilization

8. We are committed to enhancing revenue collection, focusing on domestic sources for revenue collection for sustainable development. The QPC on the primary deficit for July 2024 was met, but due to weaker-than-expected economic activity, the IT on revenue collection was not met. Drawing on recommendations of IMF technical assistance and our high-level committee for tax reform, we developed and adopted a comprehensive Domestic Revenue Mobilization Strategy (DRMS; end-April 2024 SB) that seeks to increase collections of PIT, CIT, VAT, and customs and excise taxes through a combination of tax policy and administration reforms. We will select reforms from the DRMS for our forthcoming FY2025/26 budget. We will develop and adopt a Customs Compliance Improvement Strategy (new SB, end-December 2025). This will include enhanced measures to monitor compliance, educate stakeholders on regulatory requirements, detect

non-compliance, enforce compliance, and provide incentives for compliance and sanctions against non-compliance.

9. Key tax policy reforms will include rationalizing tax expenditures, making personal income tax more progressive, and reviewing tax rates on investment income. Under the DRMS, we will reduce the number of goods that are exempt from VAT, building on such reductions in the FY2023/24 and FY2024/25 budgets. To support these reforms, we have been assessing the costs of non-customs-related tax (excise tax, VAT, CIT, and PIT) exemptions, with the help of IMF TA. We commit to preparing a report on domestic tax expenditures and a report on import-related excise and VAT expenditures by end-April 2025 (new SB, end-April 2025), which will inform the FY2025/26 budget. We will then publish a consolidated report on all tax expenditures by end-July 2025 (end-January 2025 SB, not met and proposed to be reset to end-July 2025). On the PIT, we aim to review the standard tax-free allowance within PIT and the top income bracket, making the PIT more progressive.

10. To enhance tax administration, we will improve voluntary tax compliance and enforcement. Under the DRMS, we will make it easier for taxpayers by expanding e-invoicing and reviewing the threshold for VAT filing. We will improve data collection and analysis to identify the factors driving non-compliance, which will help to enhance the yield of taxpayer audits. We will impose sanctions, including suspension of licenses, on importers that do not file tax returns. This will help ensure that subsequent revenue ITs will be met. To help local governments collect property taxes, the central government plans to improve data sharing with local governments.

Expenditure Reforms

11. We will enhance the efficiency of capital spending to support medium-term economic growth. Following a large increase in the capital budget in FY2024/25, capital spending grew 13 percent year-on-year in the first five months of the fiscal year. To improve the efficiency of public investment and strengthen climate resilience, the National Planning Commission (NPC) approved a Public Investment Management Action Plan, drawing on recommendations from the Public Investment Management Assessment (PIMA) (end-April 2024 SB). The Cabinet approved the 16th Plan, which reflects steps from our Action Plan. To be included in the budget, all projects have to be entered into the National Project Bank and undergo the associated planning and appraisal steps. To enhance the design, prioritization, and selection of investment projects, the NPC has drafted revised Operational Procedures and Unified Directives related to the National Project Bank which is currently being reviewed (end-March 2025 SB). We aim to update and link the National Project Bank Management Information System (NPBMIS) with the Line Ministries Budget Information System (LMBIS) to allow a consistent and complementary approach to project development, selection, and prioritization across government. We plan subsequently to incorporate the Provincial Project Bank Management Information System with the NPBMIS.

12. We will continue strengthening cash flow management and improve its implementation. Last year, the MoF issued, and Cabinet approved, Guidelines on Cash Flow Management. Regular cash flow forecasts (end-September 2023 SB, met) help enhance short-term

management of government funds, avoid negative balances in the Treasury Single Account, improve debt management and budget formulation, and inform liquidity forecasting by the Nepal Rastra Bank (NRB). We have issued an ordinance amending the Financial Procedures and Fiscal Responsibility Act, which will facilitate the consolidation or transfer of commercial bank accounts for autonomous bodies and extra budgetary units to the Treasury Single Account.

13. We will continue to enhance fiscal risk management. We have introduced a fiscal risk registry (end-August 2023 SB, met), the coverage of which we will gradually expand to cover PPPs. We published a fiscal risk section in the Fiscal Policy Statement of the FY2024/25 budget. We will prepare and publish with the FY2025/26 budget a comprehensive fiscal risk statement in the Fiscal Policy Statement to analyze systematically the sensitivity of budget estimates and public debt projections to various fiscal risks (end-August 2025 SB). Supported by IMF TA, we intend to build an inventory of key risk indicators of all subnational entities to help identify the largest potential risks.

14. We will also endeavor to limit fiscal risks by strengthening the financial oversight of PEs, extra-budgetary funds, and subnational governments. The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation (NAC) and Nepal Telecom) have had their FY2022/23 financial statements audited (end-August 2024 SB, not met, completed with delay). The audit of NAC's financial statement in particular will help to measure important potential fiscal risks. Out of 20 wholly-owned PEs, 16 have either published FY2022/23 financial statements or discontinued operations, and out of 20 majority-owned PEs, 19 have published or discontinued operations (end-August 2024 SB, not met). This achievement, although incomplete, returned many PEs to good practice of their corporate governance obligations. We will continue to follow up with the remaining 5 PEs and commit to having their financial statements published by end-April 2025.¹ The FCGO included 90 extra budgetary units (EBUs) at the federal level and 9 EBUs at the provincial level in the FY2023/24 annual financial statements (end-January 2025 SB). The recently issued ordinance amending the Financial Procedures and Fiscal Responsibility Act will strengthen the FCGO's authority to request information on EBUs from line ministries and subnational governments. The FCGO will work with the OAG to compile a list of all EBUs, to enable assessment of the SB. We commit to publishing a supplementary annex to the FY2023/24 financial statements that covers additional EBUs. We intend to include all EBUs in the Nepal Public Sector Accounting Standard (NPSAS)-based financial statements for FY2024/25.²

¹ All PEs covered in the Annual Status Review of Public Enterprises 2022, except those PEs not in operation.

² We will include all the non-budgetary entities of the Nepal government, whose annual income or expenditure is more than Rs. 5 crore, and the non-budgetary entity of the provincial government, whose annual income or expenditure is more than Rs. 2 crore, and the non-budgetary bodies of the local level whose annual income or expenditure is more than 5 million.

Social Spending

15. We are committed to further enhancing our social safety net to support our poverty alleviation efforts. The Cabinet approved the 16th National Development Plan last year, which will guide our medium-term strategy to enhance governance, social justice, and prosperity. We are continuing to develop the National Social Registry (NSR), including a system of national identification cards. The NSR will facilitate the identification of low-income households and allow for more efficient targeting of social transfers. We will continue to support food security, poverty reduction, and human capital development, including through child grants, the mid-day meal program, scholarship program, and the Prime Minister’s Employment Program. We executed 94 percent of the budget for child grants in FY2023/24, covering all eligible children. In the FY2025/26 and future budgets, we will consider expanding the eligibility for the child grant to more districts, or within each district increasing the amount per beneficiary, as resources become available.

Monetary and Exchange Rate Policy

16. Our monetary policy stance has remained cautiously accommodative. In an environment of ample liquidity, we have maintained the interbank rate at the bottom of the interest rate corridor (IRC) so far this fiscal year. Accommodative monetary policy stance has led lending rates to come down by more than 300 basis points since July 2023. While credit growth has not significantly picked up, in the context of ongoing deleveraging following the post-pandemic credit boom, we anticipate that improvement in economic activity will boost credit growth. We will continue to adhere to data-driven monetary policy to achieve our primary target of price stability, while also maintaining banking and financial sector stability and external sector stability.

Financial Sector Policies

17. Banks are continuing their efforts to repair balance sheets amid rising pressures. Banks are also adjusting lending practices following the post-pandemic credit surge and reforms to the regulatory framework. Aggregate gross NPL levels of the banking sector rose to approximately 4.4 percent in October 2024 and are likely to rise further due to still-weak economic demand and loan recovery difficulties. Aggregated bank core capital ratios continue to hover around 10 percent, but some banks are having difficulty meeting capital conservation buffers and improving their capitalization. Provision coverage for NPLs at the commercial banks is around 65 percent in October 2024. Bank profitability has been impacted in the context of weak domestic demand and declining bank income. Banks are facing increasing difficulties in NPL management, resulting in increases in non-bank assets and accrued interest. Recently, we intervened to resolve issues in one development bank and are taking regular supervisory actions through close monitoring in other banks and financial institutions.

18. We remain committed to bank regulation reforms that align with international standards. To that end, we implemented reforms to the asset classification regulation (Unified Directive 2, ACR) and the Working Capital Loan (WCL) guidelines in 2022/2023. However, in July

2024 the ACR-related provisions were amended, by which banks and financial institutions need to classify non-restructured/non-rescheduled NPLs as 'watchlist' with five percent provisioning for six months after the repayment of all overdue amounts. We remain committed to align the ACR with continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the Basel Committee on Banking Supervision (BCBS) Guidelines on "Prudential Treatment of Problem Assets", by end-December 2025 (new end-December 2025 SB) and to ensure the banking sector is provisioned accordingly. This will allow the BCBS standards to be applied after the results are obtained from the loan portfolio review (LPR) of the ten largest banks. Further, we will continue to enhance the WCL guidelines in a sustained manner to gradually reduce misuse of WCLs, ensuring that any adjustments are targeted and time bound and do not impact the core purpose of the guidelines. Going forward, we will ensure regulatory forbearance is phased-out and avoided, with any intervention being timebound and limited. We will continue to prudently monitor the banking sector to ensure appropriate loan classification, restructuring, provisioning and capitalization.

19. The loan portfolio review of the 10 largest banks will be rephased. The aim of the LPR is to ensure that loans are classified and provisioned in line with the existing regulatory framework and international best practices. In addition, the LPR exercise will also apply a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the BCBS Guidelines on "Prudential Treatment of Problem Assets". The initial procurement process was canceled due to budgetary issues, delaying the appointment of an international independent consultant. This has prevented us from launching the LPR by end-August 2024. We restarted the procurement on December 20, 2024 and will issue the Request for Proposal by early March including the Terms of Reference agreed with the Fund that includes both existing and BCBS standards (prior action). To allow us to onboard the consultant, we propose to reset the launch of the LPR to end-May 2025 (end-August 2024 SB, not met and proposed to be reset to end-May 2025). We will finalize the LPR of the ten largest banks by end-December 2025 (end-December 2024 SB, modified and proposed to be reset to end-December 2025). In order to address the review's findings, we will develop a roadmap by end-April 2025 (end-February 2025 SB, proposed to be reset to end-April 2025). The roadmap will reference the December 2025 alignment of the ACR with BCBS Guidelines and will require any bank with capital shortfalls to submit time bound capital plans setting out how they will return to full compliance with regulatory requirements. Relatedly, to ensure our bank resolution framework is fully equipped to deal with problematic banks, we will introduce amendments to the NRB Act that address the key relevant gaps in the current bank resolution framework in line with recommendations of the 2023 Financial Sector Stability Report by end-April 2025 (new end-April 2025 SB). We will use this opportunity to also identify topics in the NRB Act and Bank and Financial Institutions Act that require alignment going forward.

20. We have taken further steps to strengthen bank regulation and supervision. We are improving risk-based supervision with Fund support, taking into account the recommendations in the 2023 Financial Sector Stability Report (FSSR). We are reviewing our capital adequacy and blacklisting frameworks with a view to amending them. We have set the countercyclical capital buffer at 0 percentage points for this fiscal year. We are developing and enhancing our credit risk

modelling assessment capabilities with technical assistance from the Fund as banks implement NFRS-9 in FY2024/25. We are finalizing the policies for the implementation of the Liquidity Coverage Ratio and expect to start an implementation pilot in FY2024/25, while consulting with banks. We stand ready to use other macro-prudential tools to mitigate the buildup of financial vulnerabilities.³

21. We remain committed to policy actions that ensure a stable and well-capitalized banking system. We are reviewing the uses of deprived sector lending and will closely monitor the quality of these loans and, if needed, adjust directed lending policies.⁴ We will streamline our prompt corrective action framework with a clear escalation process across various states of distress and ensure consistency with the bank resolution framework. For banks that are facing capital issues, NRB has taken remedial action including suspension of dividend payments and taking control. NRB will remain vigilant and use the relevant early intervention measures where necessary.

22. We have started efforts to reregulate the savings and credit cooperatives (SACCOs) to avoid contagion and spillovers to the banking sector. While we are addressing the issues, the registration of new SACCOs has been suspended. We are seeking to improve data availability on SACCOs, starting at the federal and provincial level. We have issued regulations to improve the regulatory framework, establish a regulatory and supervisory agency, license SACCOs, improve their governance and ensure their membership of the Credit Information Center. We have made arrangements to establish a SACCO Credit Recovery Tribunal to improve the recovery of problematic SACCO assets to repay depositors. We will closely monitor liquidity in the SACCO sector following the introduction of the cap on the size of deposits. As regards participation of the SACCOs in the Deposit and Credit Guarantee Fund (DCGF), we will introduce the necessary legal amendments to strengthen DCGF to ensure there are sufficient safeguards in place to prevent problematic and unviable SACCOs from joining and will establish a separate Fund from that of the banking sector. We acknowledge that resolving the problematic SACCOs requires a strategic plan, a centralized approach and sufficient financial and human resources. We are furthermore incorporating the SACCO sector reforms in the 2nd Financial Sector Development strategy. We are devising a strategy to deal with problematic SACCOs.

Governance and Other Structural Reforms to Boost Growth

23. We are committed to further enhancing the autonomy and accountability framework of the NRB. By including a Nepali auditor belonging to a global auditing network, the Office of the Auditor General (OAG) conducted the audit of the NRB's FY2023/24 financial statements with adequate international experience in auditing other central banks (end-July 2024 SB, met). To continue this good practice for the FY2024/25 audit, we will request the OAG, as per the prevailing

³ The NRB implements several macroprudential measures, including (1) single obligor limits (between 25 to 50 percent of capital depending on the sector), (2) a credit to deposit ratio (90 percent), (3) a debt service to income ratio (50 to 70 percent), (4) a debt-to-equity ratio (4:1), (5) loan to value ratios (between 50 and 70 percent), and (6) a sectoral limit (40 percent of total outstanding loans).

⁴ The NRB requires banks to gradually extend 28 percent of their total loans to the agricultural and energy sectors and MSMEs.

laws of Nepal, to once again conduct the audit with at least one member of the Institute of Chartered Accountants of Nepal belonging to a global accounting network (new, end-July 2025 SB). We will submit amendments to the NRB Act to Parliament by end-April 2025, with a view to implement the key recommendations of the 2021 Safeguards Assessment (SGA) to strengthen the NRB's autonomy and governance practices (end-September 2024 SB, not met and proposed to be reset to end-April 2025).

24. We will accelerate progress on the remaining recommendations in the 2021 SGA. We have made good progress since the last review, completing seven additional recommendations and bringing the total completed to 12 of 16. The only remaining recommendation that does not depend on passage of the NRB Act is updating the Foreign Exchange Investment Directive to reduce commercial bank placements and review the optimal currency allocation, which we will complete by mid-March 2025.

25. We are urgently strengthening our AML/CFT framework. We have amended Nepal's AML Law and enacted secondary legislation in line with the international standards (end-July 2024 SB, met). The Financial Action Task Force (FATF) has put Nepal on the list of jurisdictions under increased monitoring. We will work closely with the Asia/Pacific Group on Money Laundering and with the International Cooperation Review Group to complete our plan of action to address the deficiencies. We are committed to implementing the remaining reforms in line with the FATF action plan, assisted by technical assistance from the Fund and other development partners. These include additional upgrades for the legal, regulatory, supervisory and operational frameworks, primarily focusing on their effectiveness. Upgrades include i) improving the understanding of money laundering and terrorist financing (ML/TF) risks and the setting of policy priorities in line with such risks, ii) upgrading market entry requirements for banks through robust licensing and "fit and proper" tests, iii) strengthening AML/CFT supervision of the financial and non-financial sectors (e.g., real estate, precious metals, and casinos), and iv) enhancing enforcement against ML/TF and confiscating illegal proceeds.

26. We are stepping up our efforts to address structural barriers to growth. Enhancing the business and investment climate is key to sustainable medium-term growth. The recent adoption of the Bill on Facilitating Investment marks a key step toward addressing long-standing investor challenges, with further efforts underway to streamline regulations and improve the foreign investment environment. Priorities include reducing the cost of doing business by strengthening governance and anticorruption frameworks, expanding digitalization of public administration and services, and fostering greater coordination across government tiers to advance fiscal federalism. We have established a High-Level Economic Reform Commission tasked with recommending structural, legal, and institutional reforms to enhance economic resilience, promote investment, and accelerate growth. To that effect, we have issued five ordinances to amend legal provisions related to information technology, land purchase, foreign investment, and service delivery to promote a more conducive business environment. We are continuously working on enhancing our anticorruption framework, including by improving capacity in detection of fraud and corruption and

modernizing legal acts related to corruption prevention, investigation, and prosecution.^{5,6} On climate agenda, we will continue advancing investments in climate-resilient and sustainable infrastructure, agricultural productivity, and financial resilience to help mitigate climate and disaster risks and reinforce sustainable and inclusive growth. Our implementation strategy in this regard is guided by the Nationally Determined Contribution (NDC) and National Adaptation Plan (NAP) with a focus on climate-smart agriculture, sustainable forest management, and disaster risk financing. We are also devising a detailed implementation plan for our 16th Plan, focusing on boosting productivity in agriculture, industry, and trade-related services (IT, tourism, and hydropower), supporting job creation, and enhancing social inclusion to reduce inequality and promote labor mobility. These measures are expected to strengthen economic resilience and position Nepal for robust, green, and inclusive long-term growth.

Risks and Contingencies

27. Downside risks and global uncertainty remain, but we stand ready to adjust policies as needed to respond. The effectiveness of monetary policy is constrained by credit market disruptions. On the other hand, improved revenue mobilization would allow more fiscal space to spend on growth-enhancing infrastructure projects while remaining within the guardrails of the ECF program. Any expenditure compression should prioritize protecting critical capital and social spending. A major commodity price shock could require monetary policy tightening to maintain external stability and keep inflation in check. Foreign exchange reserve buffers are currently adequate to cushion against temporary shocks. In the event of a shock too large to be offset exclusively with our buffers and needed policy adjustment, we will seek assistance from our development partners for increased external support. Our ability to mobilize additional resources from development partners is aided by our low risk of debt distress, strong track record of repayment and anchored by our ECF-supported program commitments. The NRB has been improving its tools and remains vigilant to prevent potential problems in the banking system. In the event of bank stress, the NRB stands ready to provide systemic liquidity support while triaging deeper solvency problems.⁷ Finally, we will adopt policies to prevent spill-overs from the difficulties in SACCOs.

Financing and Program Monitoring

28. We will continue to mobilize resources from international development partners to support our reform program. In addition to mobilizing domestic resources, the government estimates that remaining financing needs for the program will be covered by assistance from the

⁵ The OAG officials participated in a forensic audit workshop, organized by the Fund in November 2023, that focused on enhancing the understanding of key forensic audit concepts, tools, and techniques to assist in the detection of corruption and fraud.

⁶ Amendments to two legal acts—Prevention of Corruption Act (2002) and Commission for the Investigation of the Abuse of Authority Act (1991)—have been submitted to parliamentary committee for review.

⁷ Triaging refers to addressing solvency problems through (i) using banks' resources, (ii) restructuring, or (iii) resolution/liquidation.

IMF, the World Bank, the Asia Development Bank, and other development partners. We will continue to work with our development partners, including the IMF, the World Bank and the Asian Development Bank, to successfully implement the reforms outlined above. IMF disbursements will be made available to the budget during the program period.

29. The program will be closely monitored through quantitative performance criteria, indicative targets, and structural benchmarks as listed in Tables 1 and 2. The Technical Memorandum of Understanding (TMU) describes the definitions as well as data provision requirements. The ECF program is monitored on a semi-annual basis by the IMF Executive Board. We are requesting that an amount of SDR 31.4 million is made available for the fifth review. The sixth and seventh reviews are respectively scheduled to be completed on or after May 1, 2025 and November 1, 2025; these reviews will be based on January 13, 2025 and July 15, 2025 test dates, respectively. The government undertakes to adopt, in consultation with IMF staff, any new financial or structural measures, which may be necessary for the success of the program.

Table 1. Nepal: Structural Benchmark Status and Modifications
July 2024-December 2025

Measure	Original Target Date	Status	Proposal
Cross-Cutting Institutional Reforms to Enhance Fiscal Transparency and Governance and Reduce Vulnerability to Corruption			
The FCGO reports the consolidated financial information of all operational funds in annual financial statements, starting with FY2021/22. ^{1/}	End-January 2025		
The MOF submits to Parliament amendments to modernize the NRB Law, addressing key recommendations of the 2021 Safeguards Assessments Report. ^{2/}	End-September 2024	Not met	Reset to end-April 2025
An audit of the FY2023/24 financial statement of the NRB is conducted involving the service of experts with international experience in auditing and central bank auditing.	End-July 2024	Met	
An audit of the FY2024/25 financial statement of the NRB is commissioned involving at least one member of the Institute of Chartered Accountants of Nepal belonging to a global auditing network.		New	End-July 2025
Report that the <i>Amendments to Some Laws Relating to AML and Business Promotion</i> bill has been enacted in line with Financial Action Task Force AML/CFT international standards.	End-July 2024	Met	
Revenue Mobilization			
The MOF publishes a comprehensive report on tax expenditures. ^{3/}	End-January 2025	Not met	Reset to end-July 2025
The MOF approves a report on domestic tax expenditures and a report on import-related tax expenditures.		New	End-April 2025
The MOF will adopt a Customs Compliance Improvement Strategy that covers compliance monitoring, understanding regulatory requirements, detecting non-compliance, enforcement, and incentives and sanctions.		New	End-December 2025
Fiscal Sustainability and Fiscal Risk Management			
A comprehensive fiscal risk statement is published by the MOF with the FY2025/26 Budget.	End-August 2025		
All majority- and wholly-owned PEs will publish their FY2022/23 annual financial statements.	End-August 2024	Not met	
The four priority nonfinancial PEs (Nepal Electricity Authority, Nepal Oil Corporation, Nepal Airlines Corporation and Nepal Telecom) will have their FY2022/23 financial statements audited. ^{4/}	End-August 2024	Not met, completed with delay	
Equitable and Sustainable Growth			
NPC approval of the revised National Project Bank Operational Procedures and the Unified Directives related to project development, prioritization, and selection.	End-March 2025		
<p>^{1/} This SB was originally set for end-May 2022, was not met, was reset at the combined 1st and 2nd Review to end-August 2023, was not met, and was reset at the 3rd Review to end-January 2025.</p> <p>^{2/} This SB was originally set for End-October 2022, was not met, and was reset at the combined 1st and 2nd Review to end-August 2023, was not met, was reset at the 3rd Review to end-April 2024, was not met, and was reset at the 4th Review to end-August 2024.</p> <p>^{3/} This SB was originally set for End-April 2024 and was reset at the 3rd Review to end-April 2025.</p> <p>^{4/} This SB was originally set for End-April 2024 and was reset at the 3rd Review to end-August 2024.</p>			

Table 1. Nepal: Structural Benchmark Status and Modifications (Concluded)
July 2024-December 2025

Measure	Original Target Date	Status	Proposal
Financial Sector Regulation & Supervision			
The NRB issues the Request for Proposal Notice for the independent international third-party auditors, incorporating the Terms of Reference agreed with IMF staff that include a provision that the in-depth on-site inspections will be conducted on the basis of both the existing regulatory framework and a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the BCBS Guidelines on "Prudential Treatment of Problem Assets".		Pending	Prior Action
The NRB re-issues the regulation on asset classification, aligned with a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the Basel Committee on Bank Supervision (BCBS) Guidelines on "Prudential Treatment of Problem Assets". ^{5/}		New	End-December 2025
Launch for 10 largest Banks in-depth onsite inspections assisted by independent international third-party auditors. ^{6/}	End-August 2024	Not met	Reset to end-May 2025
NRB completes in-depth on-site inspections for the 10 largest Banks, assisted by independent international third-party auditors. ^{7/}	End-February 2025	Not met	Reset to end-December 2025
The MOF submits to Parliament amendments to the NRB Act that address the key relevant gaps in the current bank resolution framework in line with recommendations of the 2023 Financial Sector Stability Report.		New	End-April 2025
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections.	End-February 2025	Not met	Modified and reset below
NRB finalizes a roadmap outlining its approach to the outcome of the in-depth on-site inspections which will reference the end-December 2025 timing of the alignment of the ACR with a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the BCBS Guidelines on "Prudential Treatment of Problem Assets".		Modified and reset	End-April 2025

^{5/} This SB corresponds to the August 2023 SB that was met by issuing updated regulations, but later partially reversed.
^{6/} This SB was originally set for End-April 2024 and was reset at the 4th Review to end-August 2024.
^{7/} This SB was originally set for End-December 2024 and was reset at the 4th Review to end-February 2025.

Table 2. Nepal: Indicators Proposed for Quantitative Targets ^{1/}

(Cumulative Rs. million unless otherwise indicated)

	FY2023/24								FY2024/25	
	14-Jan-24				15-Jul-24				13-Jan-25	15-Jul-25
	Program target	Adjusted target	Outturn	Status	Program target	Adjusted target	Outturn	Status	Program target	Program target
Quantitative performance criteria under the ECF-supported program:										
Primary deficit of the federal government (ceiling; in NPR million) 2,3,4,5,6/	435,959	440,278	178,827	met	315,628	311,931	122,918	met	233,270	256,943
Stock of NRB's net international reserves (floor; in U.S. dollars million) 7,8/	9,076	9,014	12,144	met	9,076	8,851	14,130	met	9,649	10,229
Accumulation of external payments arrears (ceiling) 9/	0	0	0	met	0	0	0	met	0	0
Indicative targets under the ECF-supported program:										
Indicative target: federal government spending on child allowance (floor; in NPR million) 10/	3,092	3,092	1,674	not met	6,987	6,987	6,841	not met	3,092	6,987
Indicative target: floor on tax revenue of the federal government 11,12/					845,938	845,938	818,657	not met	392,743	902,288
Memorandum items:										
Revenues of the budgetary central government under the program (in NPR million) 2/	341,044		438,939		..		932,999		..	..
Revenue targets of the budgetary central government (in NPR million) 2/	563,983				1,248,620				..	1,125,209
Ceiling of primary deficit adjustor for revenue shortfalls (in NPR million) 4/	61,009				..				..	..
Foreign-financed project loan disbursements (in NPR million) 2/	13,977		18,295		83,832		80,134		9,191	91,912
Primary deficit adjustor for foreign-financed project loan disbursements (in NPR million) 2/	..		4,319		..		-3,698		..	..

Sources: Nepali authorities; and IMF staff estimates/projections based on the Nepali fiscal year and calendar.

1/ The quantitative targets, indicative targets, program exchange rates and adjustors are defined in the Technical Memorandum of Understanding (TMU).

2/ Cumulative from the beginning of the fiscal year.

3/ Excludes interest payments. The program primary deficit definition also excludes grants and other receipts from the revenue side, so figures in this table are higher than those reported in the macroeconomic framework.

4/ The program target for the primary deficit for the January 14, 2024 test date includes an adjustor for the level of revenue collection, which was capped at NPR 61,009 million. Subsequent test dates have no such adjustor.

5/ The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms. Foreign-financed project loan disbursements is the difference between total external financing and budget support from development partners.

6/ Revenue sharing for province and local levels and other receipts are also excluded.

7/ Foreign currency deposits of commercial banks and other financial institutions held at the NRB are considered reserve related liabilities and excluded.

8/ NIR floor target for July 15, 2024 testing date is set about 0.8 months of imports above the adequacy level to provide margin in case of external shocks or if imports pick up faster than projected, while keeping reserves well above adequacy. The margin was gradually reduced to 0.6 months of imports for the targets.

9/ This quantitative target is applied on a continuous basis.

10/ The social spending indicative target will initially be a floor on spending on the child protection grant. This indicative target will start in the second review with the test dates beginning in July 2022. The initial floor will be FY2020/21 outturns plus an additional amount to reflect the announced one third increase in budget.

11/ This is a program indicative target, not a revised target of the Budget. The Budget target remains NPR 1,248.620 million.

12/ Revenue sharing for province and local levels, nontax revenue and other receipts are also excluded.

Attachment II. Technical Memorandum of Understanding

This memorandum reflects understandings between the Nepali authorities and the IMF staff in relation to the Extended Credit Facility (ECF). It specifies valuation for monitoring quantitative performance criteria under the program (Section A), performance criteria and indicative targets (Section B), and data reporting (Section C). The authorities will consult with the IMF before modifying measures contained in this TMU or adopting new measures that would deviate from the goals of the program.

Program Exchange Rates and Gold Valuation

1. Program exchange rates are used for formulating and monitoring quantitative performance criteria. All assets and liabilities denominated in U.S. dollars (USD) will be converted into Nepali Rupees (NPR) at a program exchange rate of NPR 137.6 per one USD, which corresponds to the exchange rate on January 13, 2025. Gold holdings will be valued at USD 2652.2 per troy ounce, the price in November 2024 from [the IMF website on primary commodity prices](#). Assets and liabilities denominated in SDRs and in foreign currencies not in USD will be converted into USD at the January 13, 2025 exchange rates reported in the Table 1:

Currency	Program Exchange Rate
U.S. dollars / Nepali rupee	0.007
U.S. dollars / U.K. pound	1.212
U.S. dollars / Indian rupee	0.012
U.S. dollars / Chinese yuan	0.136
U.S. dollars / Euro	1.020
U.S. dollars / Japanese yen	0.006
U.S. dollars / Brunei dollar	0.728
U.S. dollars / Korean won	0.001
U.S. dollars / Kuwaiti dinar	3.238
U.S. dollars / Malaysian ringgit	0.222
U.S. dollars / Australian dollar	0.615
U.S. dollars / Bahrain dinar	2.660
U.S. dollars / Canadian dollar	0.694
U.S. dollars / Danish krone	0.137
U.S. dollars / Hong Kong dollar	0.128
U.S. dollars / Swedish krona	0.089
U.S. dollars / Swiss franc	1.091
U.S. dollars / Omani rial	2.601
U.S. dollars / Qatari riyal	0.275
U.S. dollars / Russian ruble	0.010
U.S. dollars / Saudi Arabian riyal	0.267
U.S. dollars / Thai baht	0.029
U.S. dollars / U.A.E. dirham	0.272
U.S. dollars / Singapore dollar	0.728
U.S. dollars / SDR	1.292

^{1/} The reference date for exchange rates is January 13, 2025.

2. For purposes of this TMU, “external” and “domestic” shall be defined on a residency basis.

Performance Criteria and Indicative Targets

3. The quantitative performance criteria and indicative targets for relevant test dates are specified in Table 2 of the Memorandum of Economic and Financial Policies.

Quantitative Performance Criteria on Net International Reserves of the Nepal Rastra Bank

4. Net international reserves (NIR) are defined as reserve assets minus reserve related liabilities of Nepal Rastra Bank (NRB) expressed in U.S. dollars.

- Reserve assets of the NRB, as defined in the 6th edition of the Balance of Payments Manual (BPM6), are claims on nonresidents denominated in foreign convertible currencies and Indian rupee controlled by the NRB and are readily and unconditionally available to the NRB for meeting balance of payments financing needs, intervention in exchange markets, and other purposes. They include NRB holdings of monetary gold, SDRs, Nepal’s reserve position in the IMF, foreign currency cash (including foreign exchange banknotes in the vaults of NRB), and readily available deposits abroad (including balances on accounts maintained with overseas correspondent banks). Excluded from reserve assets are any assets that are pledged, collateralized, or otherwise encumbered; claims on residents; precious metals other than monetary gold; illiquid assets; and claims on foreign exchange arising from derivatives in foreign currencies vis-à-vis domestic currency (such as futures, forwards, swaps, and options).
- Reserve related liabilities are defined as foreign exchange liabilities of the NRB to nonresidents; Nepal’s outstanding credit to the IMF; foreign currency reserves and deposits of commercial banks and other financial institutions held at the NRB; commitments to sell foreign exchange arising from derivatives (such as futures, forwards, swaps, and options); and all arrears on principal or interest payments to commercial banks, suppliers, or official export credit agencies.
- To measure the program NIR, all foreign-currency related assets and liabilities will be converted into USD at the exchange rates specified in paragraph 1, Table 1.

5. Targets for the program NIR are set as a floor.

6. The program targets for net international reserves include an adjustor for budget support from development partners.

- Should the actual disbursement of budget support from development partners be below the projections under the program, the NIR floor will be adjusted downward by the difference between the actual level and the projected level of disbursements under the program. The projections of budget support from development partners for the next 12 months are presented in Table 2.

- A downward adjustment to the NIR floor for the condition described above will be capped at USD 743 million.¹

Table 2. Nepal: Budget Support from Development Partners Projected under the Program

Date	Cumulative over the period from July 15, 2024 to July 15, 2025 (USD million)
January 13, 2025	190
July 15, 2025	411

Quantitative Performance Criterion on the Primary Deficit of the Budgetary Central Government

- 7. The budgetary central government, for the purpose of the program, consists of all the entities listed in the Administrative Expenditure Estimate table of the budget (Table 3).**

Table 3. Nepal: Institution Coverage of Budgetary Central Government

President
 Deputy President
 Chief of Provinces
 Federal Parliament
 Courts
 Commission for Investigation of Abuse of Authority
 Office of the Auditor General
 Public Service Commission
 Election Commission
 National Human Rights Commission
 Council of Justice
 National Natural Resources and Fiscal Commission
 National Women Commission
 National Dalit Commission
 National Inclusion Commission
 Indigenous Nationalities Commission
 Madhesi Commission
 Tharu Commission
 Muslim Commission
 Office of Prime Minister and Council of Ministers
 Ministry of Finance
 Ministry of Industry, Commerce and Supply
 Ministry of Energy, Water Resources and Irrigation
 Ministry of Law, Justice and Parliamentary Affairs
 Ministry of Agriculture and Livestock Development
 Ministry of Water Supply
 Ministry of Home Affairs
 Ministry of Culture, Tourism and Civil Aviation
 Ministry of Foreign Affairs

¹ The cap ensures that any downward adjustment maintains reserve adequacy levels.

**Table 3. Nepal: Institution Coverage of Budgetary Central Government
(concluded)**

Ministry of Forest and Environment
 Ministry of Land Management, Cooperative and Poverty Alleviation
 Ministry of Physical Infrastructure and Transport
 Ministry of Women, Children and Senior Citizen
 Ministry of Youth and Sports
 Ministry of Defense
 Ministry of Urban Development
 Ministry of Education, Science and Technology
 Ministry of Communications and Information Technology
 Ministry of Federal Affairs and General Administration
 Ministry of Health and Population
 Ministry of Labour, Employment and Social Security
 National Planning Commission
 MOF- Domestic Debt Service
 MOF- External Debt Service (Multilateral)
 MOF- External Debt Service (Bilateral)
 MOF Staff Benefits and Retirement Benefits
 MOF Miscellaneous
 Province (Equalization, Special and Complementary)
 Local Level (Equalization, Special and Complementary)

8. The primary deficit of the budgetary central government is defined as primary expenditures minus revenues.

- Primary expenditures include capital expenditures and recurrent expenditures except interest payments. Financing expenditures (the amortization of domestic and external borrowing, loan and share investment in public enterprises and other enterprises, and foreign share investments) are excluded. Capital expenditures are the same as the capital expenditures defined in the budget. Recurrent expenditures (excluding interest expenditure) include the following items in the budget: compensation of employees, use of goods and services, subsidies, grants, social security, other current expenditure. Revenue sharing for province and local levels is excluded.
- Revenues of the budgetary central government are those revenues to be deposited in the Federal Treasury. They include all taxes and non-tax revenue as defined in the budget. Revenue sharing for province and local levels is excluded. Other receipts are also excluded.
- Revenues and primary expenditures should be recognized on a cash basis.
- The Financial Comptroller General Office monthly reports will be used as the basis for program monitoring.

9. Targets for the primary deficit of the budgetary central government are set as a ceiling. Targets are set for cumulative flows from the end of the previous fiscal year.

10. The program targets for the primary deficit include adjustors for foreign-financed project loan disbursements on concessional terms.

- *Adjustor for higher than projected foreign-financed project loan disbursements on concessional terms.* Should the actual disbursement of foreign-financed project loans be above the projections under the program, the primary deficit ceiling will be adjusted upward (higher deficit) by the difference between the actual level and the projected level of disbursements under the program. This adjustor means that the program does not constrain foreign-financed project loan disbursements on concessional terms.
- *Adjustor for lower than projected foreign-financed project loan disbursements on concessional terms.* Should the actual disbursement of foreign-financed project loans be below the projections under the program, the primary deficit ceiling will be adjusted downward (lower deficit) by the difference between the actual level and the projected level of disbursements under the program. This adjustor would align project spending with the actual disbursement of foreign-financed project loans on concessional terms.
- The projections of foreign-financed project loan disbursements for the following 2 test dates are presented in Table 4.

Table 4. Nepal: Foreign-Financed Project Loan Disbursements Projected under the Program	
Date	Cumulative over the respective fiscal year (Million NPR)
January 13, 2025	9,191
July 15, 2025	91,912

Indicative Target on Social Spending of the Budgetary Central Government

11. The indicative target will focus on the child grant spending. The child grant reaches vulnerable households, is implemented by the federal government, and is monitorable in a timely way. Health and education spending, while key pillars of social spending, are being devolved to local and provincial governments and implementation is not fully under control of the federal government. Indicative targets on the child grant, including the activity code 7.1.1.10 (dalit children), 7.1.1.41 (areas designated children), and 7.1.1.43 (areas designated children), are set as a floor for cumulative flows from the end of the previous fiscal year. Spending should be recognized on a cash basis and flows should be recorded when cash is paid.

Indicative Target on tax revenues of the federal government (starting with the July 15, 2024 test date)

12. The indicative target will be defined as the tax revenue of the federal government.

This includes tax revenues of the budgetary central government to be deposited in the Federal Treasury. Non-tax revenue and revenue sharing for provinces and local levels are excluded. Other receipts are also excluded.

- Import-related tax revenue includes import-related customs, VAT, and excise duty.
- The monthly data from MoF will be used as the basis for program monitoring.

13. Indicative targets are set as a floor. Targets are set for cumulative flows from the end of the previous fiscal year.

Continuous Performance Criteria

14. A continuous quantitative performance criterion applies to the non-accumulation of new external payments arrears on external debt contracted or guaranteed by the budgetary central government or NRB. External payment arrears consist of the total amount of external debt service obligations (principal and interest)—deriving from loans arranged or guaranteed by the central government and the NRB, penalties, and interest charges deriving from these loans not paid at maturity—falling due to nonresidents after approval of this arrangement and that have not been paid when due in accordance with the relevant contractual agreements (including any contractual grace period). Excluded from the prohibition on the accumulation of new arrears are (i) external arrears that are subject to debt rescheduling agreements or negotiations and/or (ii) disputed external debt service obligations.

15. Debt will be understood to mean—as specified in paragraph 8 of the Guidelines on Public Debt Conditionality in Fund Arrangements, adopted by the Decision No. 16919-(20/103) of the Executive Board of the IMF on October 28, 2020—a current, i.e., not contingent, liability, created under a contractual arrangement through the provision of value in the form of assets (including currency) or services, and which requires the obligor to make one or more payments in the form of assets (including currency) or services, according to a specific schedule; these payments will discharge the obligor of the principal and/or interest liabilities incurred under the contract. Debts can take a number of forms, the primary ones being as follows: (i) loans, i.e., advances of money to the obligor by the lender made on the basis of an undertaking that the obligor will repay the funds in the future (including deposits, bonds, debentures, commercial loans, and buyers' credits) and temporary exchanges of assets, that are equivalent to fully collateralized loans, under which the obligor is required to repay the funds, and usually pay interest, by repurchasing the collateral from the buyer in the future (such as repurchase agreements and official swap arrangements); (ii) suppliers' credits, i.e., contracts where the supplier permits the obligor to defer payments until sometime after the date on which the goods are delivered or services are provided; and (iii) leases,

i.e., arrangements under which property is provided that the lessee has the right to use for one or more specified period(s) of time that are usually shorter than the total expected service life of the property, while the lessor retains the title to the property. For the purpose of this guideline, the debt is the present value (at the inception of the lease) of all lease payments expected to be made during the period of the agreement, excluding those payments necessary for the operation, repair, or maintenance of the property. Under the definition of debt set out above, arrears, penalties, and judicially awarded damages arising from the failure to make payment under a contractual obligation that constitutes debt are debt. Failure to make payment on an obligation that is not considered debt under this definition (e.g., payment on delivery) will not give rise to debt.

16. Standard continuous performance criteria include: (1) prohibition on the imposition or intensification of restrictions on making of payments and transfers for current international transactions; (2) prohibition on the introduction or modification of multiple currency practices; (3) prohibition on the conclusion of bilateral payments agreements that is inconsistent with Article VIII; and (4) prohibition on the imposition or intensification of import restrictions for balance of payments reasons.

Provision of Information to the IMF

17. Performance under the program will be monitored using data supplied to the IMF by the Ministry of Finance (MOF) and the NRB as specified in Table 5 below, consistent with the program definitions above and within the time frame specified. The authorities will transmit promptly to the IMF staff any data revisions within 14 days after being made. Any data and information indicating the non-observance of the continuous performance criteria will be provided immediately. In addition, the authorities will transmit to IMF staff any information or data not defined in this TMU but pertinent for assessing or monitoring performance relative to the program objectives. All reports and data should be transmitted to the IMF electronically and in English.

18. The authorities will inform IMF staff of the creation of any new extra-budgetary funds or programs immediately. This includes any new funds, or other special budgetary and extra-budgetary programs that may be created during the program period to carry out operations of a fiscal nature as defined in the IMF's Manual on Government Finance Statistics 2014.

Table 5. Nepal: Data Reporting Requirements ^{1/}

Data	Frequency	Submission Lag^{2/}
Ministry of Finance		
Summary of budgetary central government accounts, including revenues (broken down by economic classification) and grants, expenditures (broken down by economic classification), and net acquisition of financial assets (broken down by loan investment and share investment) on a cash basis, consistent with the presentation in budget. The Financial Comptroller General Office (FCGO) monthly reports will be used as the basis for program monitoring.	M	30 calendar days
Summary of budgetary central government's net incurrence of liabilities (broken down by domestic borrowing disbursement and principal repayment, as well as external borrowing disbursement and principal repayment) consistent with the presentation in budget. Foreign-financed project loan disbursements and budget support disbursements. The Public Debt Management Office (PDMO) monthly reports will be used as the basis for program monitoring.	Q	30 calendar days
Domestic and external public debt stock (broken down by currency, maturities, creditors, and instruments), disbursements, and debt service costs of the budgetary central government, including interest payments and amortization schedules until full loan repayment. The PDMO quarterly reports will be used as the basis for program monitoring.	A	60 calendar days
Debt guarantees issued by budgetary central government and the NRB. The PDMO and NRB quarterly reports will be used as the basis for program monitoring.	Q	45 calendar days
Audited Financial statements of public enterprises.	A	210 calendar days
Social spending data on: (1) the amount budgeted, (2) the amount dispersed, (3) the number of recipients. Data provided separately for each of the following programs: old age pension, widows grant, indigenous allowance, disabled persons allowance and Prime Minister's Employment program (PMEP).	H	30 calendar days
Data on the child grant program: (1) the amount budgeted, (2) the amount dispersed, (3) the number of recipients.	H	30 calendar days
The Annual Budget. The Budget speech (with annex) and MOF budget reports will be used as the basis for program monitoring.	A	30 calendar days ^{3/}
Mid-year budget review. The MOF Mid-year budget review reports will be used as the basis for program monitoring.	A	30 calendar days ^{4/}
Annual budget execution report. The FCGO annual reports will be used as the basis for program monitoring.	A	90 calendar days
National accounts data.	A, Q	90 calendar days

Table 5. Nepal: Data Reporting Requirements (continued)

Data	Frequency	Submission Lag
Public Debt Management Office		
Stock of outstanding external debt payment arrears of the general government (if any) by creditor.	Q	30 calendar days
Nepal Rastra Bank		
Exchange rate data: (i) Monthly official exchange rates NPR/\$ (data to be submitted once a week for the previous week). (ii) Monthly average buy and sell exchange rates NPR/\$ as quoted by foreign exchange bureaus and banks.	M	5 working days after the end of the month
Monthly consumer price indexes (CPIs).	M	30 calendar days
Program net international reserves and its components (foreign reserve assets, deposits from banks and financial institutions in foreign currency, and foreign reserve-related liabilities of the NRB) at program and current exchange rates.	M	7 working days
Breakdown of gross foreign assets and liabilities (including foreign currency liabilities to residents) of the NRB by currency at actual and program exchange rates.	M	15 calendar days
Balance of payments consistent with the 6 th edition of the Balance of Payments Manual (BPM6).	M	30 calendar days
International investment position and private and public external debt data.	Q	90 calendar days
Data on remittances including remittance flows in USD by country, and total approved Nepali migrant workers permit by new/renewed permits and if possible, by destination country.	M	30 days
Tourist arrivals by nationality and country of residence.	M	30 days
Imports and exports data by commodity at HS-2 classification level.	M	30 days
Central bank balance sheet in NPR (Summary).	M	30 calendar days
Balance of government's accounts/funds at NRB, including treasury accounts, pre-funding accounts, VAT refund, custom fund, federal divisible fund, and other funds outside treasury operation. The FCGO and NRB monthly reports (after reconciliation) will be used as the basis for program monitoring.	M	30 calendar days
Data on monetary operations in NPR.	M	30 calendar days
Interbank rates, Treasury bill rates, and volumes of Treasury bills and treasury bonds issued.	M	30 calendar days
Central bank liquidity data: (1) BFI's balance at the NRB; (2) amount required to meet cash reserve ratios in NPR.	M	30 calendar days
Update on the progress on the implementation of the in-depth on-site loan portfolio review.	M	5 working days after the end of the month
Central bank daily purchases and sales of foreign exchange by counterparts (commercial banks, government).	W	2 working days after the end of the week
Daily interbank turnover in the FX spot market.	W	15 working days

Table 5. Nepal: Data Reporting Requirements (concluded)

Data	Frequency	Submission Lag
Commercial bank-by-bank data: i) balance sheet by currency (foreign exchange and Nepali Rupee); ii) income statements; iii) breakdown of loan classification and provisioning levels for borrower types (corporate, commercial, retail, SMEs, etc.), product type (overdrafts, working capital loans, demand loans, etc.), economic sectors, and restructured loans; iv) breakdown of deposits and net open positions; vii) FSI indicators (capital, asset quality, liquidity, earnings).	M	75 calendar days
With regard to non-performing loans (NPLs) specifically: i) NPLs per category and sector, ii) provisioning, iii) NPL restructuring/rescheduling (forborne loans) and type of restructuring (deductions in interests, payment deferrals, restructuring of performing loans, restructuring of non-performing loans), iv) NPL reclassification and v) loan write-offs.	Q	30 calendar days
Data on foreign currency loans and deposits. Commercial bank-by-bank data: i) breakdown of foreign currency loans for borrower types (corporate, commercial, retail, SMEs, etc.), product types (overdrafts, working capital loans, demand loans etc.), economic sectors, and restructured loans; ii) share of foreign currency deposits by deposit types (current, call, fixed, savings etc.). Other depository corporations survey data in NPR.	M	75 calendar days
Condensed assets and liabilities of commercial banks and all BFIs in NPR.	M	30 calendar days
Data specific to class A and B banks: (i) CAMEL rating for class A and B banks (ii) Ratio of Cash & Bank Balance/Total Deposit (iii) Ratio of Investment in Government Securities/Total Deposit (iv) Total Liquid Assets/Total Deposit ratios	M	30 calendar days
NRB's claims on the government with breakdown by type (debt types, loan type, including the gross amounts of overdrafts).	M	30 calendar days
Banks and financial institutions' claims on the government with breakdown by type (debt types, loan types including the gross amount of overdrafts).	M	30 calendar days
<p>Note: A = Annually; Q = Quarterly; H=Half-yearly; M = Monthly; W = Weekly. 1/ Reports and data are provided in English. Data are provided in excel files. 2/ After the end of respective week, month, quarter, or fiscal year in Nepali calendar, unless otherwise indicated. 3/ 30 calendar days after the delivery of the budget speech. 4/ 30 calendar days after January 15.</p>		



NEPAL

March 7, 2025

FIFTH REVIEW UNDER THE EXTENDED CREDIT FACILITY ARRANGEMENT AND REQUEST FOR MODIFICATION OF A PERFORMANCE CRITERION—SUPPLEMENTARY INFORMATION

Approved By:
Rupa Duttgupta (APD)
and **Koshy Mathai (SPR)**

Prepared by the Asia and Pacific Department (APD) in consultation with the Strategy, Policy and Review (SPR) Department.

This supplement provides an update on recent developments and program performance since the issuance of the report on February 27, 2025. The update does not alter the thrust of the staff appraisal.

- 1. This supplement provides updates regarding the implementation of the prior action (PA) under the ECF arrangement.** The PA pertains to the issuance of the Request for Proposals (RFP) to hire independent international third-party auditors to conduct a Loan Portfolio Review (LPR).
- 2. The PA on the issuance of the RFP was met.** The Nepal Rastra Bank (NRB) issued the RFP and transmitted it to the shortlisted firms on March 6, 2025. Staff confirmed that the RFP incorporates the Terms of Reference agreed with IMF staff that include a provision that the in-depth on-site inspections will be conducted on the basis of both the existing regulatory framework and a continuous repayment period of three months for reclassification of non-restructured/non-rescheduled loans, as prescribed by the Basel Committee on Banking Supervision (BCBS) Guidelines on “Prudential Treatment of Problem Assets.”

**Statement by Ms. Yati Kurniati, Executive Director for Nepal, and Mr. Wishnu Mahraddika,
Senior Advisor to Executive Director
March 12, 2025**

Introduction

The Nepali authorities sincerely appreciate the IMF team, led by Ms. Jahan, for their close and constructive engagement throughout the fifth review of the Extended Credit Facility (ECF). They highly value the critical support provided by the ECF program and are grateful to the IMF Board, Management, and Staff for their contributions. **The authorities broadly concur with the staff's analysis and are committed to implementing the agreed-upon reforms under the ECF program to ensure macroeconomic and financial stability, facilitate a sustained economic recovery and foster stronger, more inclusive growth.**

Nepal's economy is showing positive signs of recovery, evidenced by a resurgence in economic activity, contained inflation, and robust external sector performance. The economic growth is expected to accelerate in FY2024/25 and strengthen further in FY2025/26. Inflation remains contained, averaging 4.97% in the first half of FY2024/25, within the target of containing inflation around 5.0%. The current account recorded a surplus, and the international reserve position has significantly improved, providing an ample buffer for the economy. Financial sector consolidation is progressing as planned, reinforcing stability and alignment with program goals. The authorities broadly concur with the Staff's economic outlook assessment and remain vigilant in addressing potential risks.

Despite a challenging environment, the implementation of the ECF program remains broadly on track. The authorities have demonstrated strong commitment to reform, successfully meeting all performance criteria (PCs), despite setbacks from devastating natural disasters in September 2024. While the indicative target (IT) for child grant spending was not fully achieved, all eligible children who applied have received payments. The implementation of reforms has progressed adequately, with three structural benchmarks (SBs) have been met. Some SBs have been proposed for modifications to address budgetary issues, ensuring sufficient coverage of regulatory reform, and capacity constraints. A prior action under SB on financial sector reform was completed in early March, reaffirming the authorities' commitment to completing the remaining SBs in a timely manner.

Monetary Policy

The Nepal Rastra Bank (NRB) will continue its data-driven monetary policy that ensures price and external stability while supporting economic growth. Post-flood inflation is being closely monitored, and the central bank stands ready to address any lingering secondary effects from food price increases. Low lending rates, strong remittance inflows, and increased capital spending, including post-flood reconstruction, are expected to stimulate domestic demand and accelerate growth in FY2024/25. Improvement in economic activity is expected to boost credit growth. As such, the prudent monetary policy stance will continue to contain inflation and foster sustainable growth. Efforts to strengthen monetary policy implementation, including proactive liquidity management within the interest rate corridor, remain priority to enhance policy effectiveness.

Fiscal Policy & Debt Sustainability

The authorities are implementing a growth-friendly fiscal consolidation strategy, prioritizing accelerated capital expenditure and enhanced revenue mobilization to foster sustainable and inclusive economic growth. Tax revenue is demonstrating improvement, supported by newly introduced measures on alcohol, tobacco, petroleum products, and coal, while current spending growth remains contained. With IMF support, a comprehensive assessment of tax expenditures is currently underway to inform the FY2025/26 budget, culminating in a dedicated tax expenditure report. This report will serve as a guidance for rationalizing tax incentives in alignment with the Domestic Revenue Mobilization Strategy. Furthermore, the authorities are strengthening tax compliance through a new Customs Compliance Improvement Strategy. The authorities are committed to enhancing the social safety net to support poverty alleviation more effectively. They are developing the National Social Registry (NSR) integrated with a national identification card system to enable targeted and efficient social transfers to low-income households. Initiatives such as child grants, the mid-day meal program, scholarship programs, and the Prime Minister’s Employment Program will continue to support food security, poverty reduction, and human capital development. The authorities are also exploring options to expand child grant eligibility to additional districts or increase the amount per beneficiary support within each district, subject to available fiscal space.

The authorities have strengthened fiscal transparency and risk management. The fiscal risk registry has been established, with plans to progressively expand its coverage to include public-private partnerships (PPPs). Recognizing the fiscal risks posed by public enterprises (PEs), extra-budgetary funds, and subnational governments, the authorities are enhancing financial oversight in these areas. Notably, a significant share of PEs has now either published their financial statements or ceased operations. While ongoing efforts continue, this progress represents a significant step toward restoring sound corporate governance.

To bolster medium-term economic growth, the authorities focus on enhancing capital spending efficiency. In line with recommendations from the Public Investment Management Assessment (PIMA), the National Planning Commission (NPC) has approved a Public Investment Management Action Plan, aimed at improving public investment efficiency and strengthening climate resilience. Further, the NPC has drafted revised Operational Procedures and Unified Directives for the National Project Bank, currently under review, to refine project design, prioritization, and selection. The authorities also intend to foster a consistent approach to project development and prioritization across government, ensuring a more strategic and result-driven approach to public investment.

Financial Sector Policy

The authorities are maintaining prudent oversight of the banking sector, ensuring appropriate loan classification, responsible restructuring, adequate provisioning, and robust capitalization. Amid mounting pressures, banks are actively repairing balance sheets and adjusting lending practices following the post-pandemic credit surge and regulatory reforms. The authorities remain committed to aligning bank regulations with international standards, notably by adopting the Basel Committee on Banking Supervision (BCBS) guidelines on “Prudential Treatment of Problem Assets” through an updated Asset Classification Regulation by December 2025. Moving forward, the authorities will phase out and avoid regulatory forbearance, ensuring any interventions are time-bound and limited to preserve financial stability.

To further safeguard the banking sector, the authorities will complete a Loan Portfolio Review (LPR) of the ten largest banks by end-December 2025. Demonstrating decisive action, they issued the request for proposal in early March 2025, a prior action in SB for this review, ensuring timely procurement for the loan portfolio review to proceed. This review will ensure proper loan classification and provisioning in line with the existing regulatory framework and international best practices. With regard to Savings and Credit Cooperatives (SACCOs), the authorities have launched a comprehensive restructuring of the regulatory framework. The registration of new SACCOs has been suspended while existing operational deficiencies are being addressed. Concurrently, efforts are underway to enhance SACCO data availability, commencing with improved reporting at the federal and provincial levels.

Governance & Structural Reforms

The authorities commit to amending the NRB Act to close gaps in the bank resolution framework and enhance NRB's autonomy and governance. These amendments will align with the 2023 Financial Sector Stability Report recommendation. Additionally, the key recommendations of the 2021 Safeguards Assessment (SGA) will be implemented to further strengthen NRB's independence and governance practices. This revision will also harmonize provisions between the NRB Act and the Bank and Financial Institutions Act, ensuring a consistent legal framework.

Following the July 2024 AML law amendment and secondary legislation enactment, the authorities are committed to strengthening the implementation of the law. The reform will be undertaken through close collaboration with the APG and ICRG, supported by technical assistance from the Fund and development partners. The focus now shifts to effectively implementing the remaining FATF action plan reforms, which include: improved ML/TF risk assessment and policy prioritization; strengthened bank licensing and fit-and-proper tests; enhanced AML/CFT supervision of financial and non-financial sectors; and rigorous ML/TF enforcement, including asset confiscation.

The authorities are accelerating structural reforms to foster sustainable growth. Key initiatives include enhancing the business and investment climate through the recent Investment Facilitation Bill and ongoing regulatory streamlining. Efforts focused on reducing business costs, strengthening governance, expanding digitalization, and advancing fiscal federalism. The High-Level Economic Reform Commission is driving legal and institutional reforms, and a detailed 16th plan implementation strategy focusing on productivity, job creation, and social inclusion to bolster economic resilience and inclusive growth is being prepared. Climate-resilient growth is pursued via Nationally Determined Contribution (NDC) and National Adaptation Plan (NAP) implementation, focusing on climate-smart agriculture and disaster risk financing.

Conclusion

The Nepali authorities strongly reaffirm their commitment to the ECF program and its crucial role in safeguarding macroeconomic stability, strengthening governance and advancing structural reforms. They adhere to the policies and the program's objectives, recognizing the associated reforms are fully consistent with their domestic policy priorities. In this spirit, the authorities request the support from the Board Executives for the completion of the Fifth Review, the disbursement of the sixth tranche, and the associated proposed decisions, underscoring their determination to uphold reform momentum.