NEPAL

Table 1	2021
Population, million	29.7
GDP, current US$ billion	35.1
GDP per capita, current US$	1182.0
International poverty rate ($1.9)[a]	15.0
Lower middle-income poverty rate ($3.2)[a]	50.9
Upper middle-income poverty rate ($5.5)[a]	83.0
Gini index[a]	32.8
School enrollment, primary (% gross)[b]	142.1
Life expectancy at birth, years[b]	70.8
Total GHG Emissions (mtCO2e)	54.4

Source: WDI, Macro Poverty Outlook, and official data.
a/ Most recent value (2010), 2011 PPPs.
b/ Most recent WDI value (2019).

After an initial recovery in FY21, growth momentum continued during H1FY22 with progress in vaccination and ongoing COVID-19 related fiscal and monetary support. Growth is expected to accelerate in FY22 to 3.7 percent, weathering new variant waves and rising fuel prices. Going forward, the economy is forecast to grow 4.1 and 5.8 percent in FY23 and FY24, respectively. Downside risks include new COVID-19 variants, the severity of the Russia-Ukraine conflict, and potentially stronger import compression measures to support international reserves.

Key conditions and challenges

Nepal has achieved an average growth rate of 4.9 percent between FY09 and FY19 and attained lower middle-income status in 2020. The country has reduced poverty, thanks in large part to remittances inflows which averaged 21.9 percent of GDP over the same period. Structural constraints to achieving inclusive and sustainable growth remain, including a significant share of population in low-quality low-productivity jobs, high vulnerability to natural disasters and climate change, large infrastructure gaps, and highly concentrated trade markets. Ensuring continued transition to a federalized system of governance and public finance and managing the rising debt levels, in recent years, through prudent fiscal management will be additional challenges that need to be managed.

Recent developments

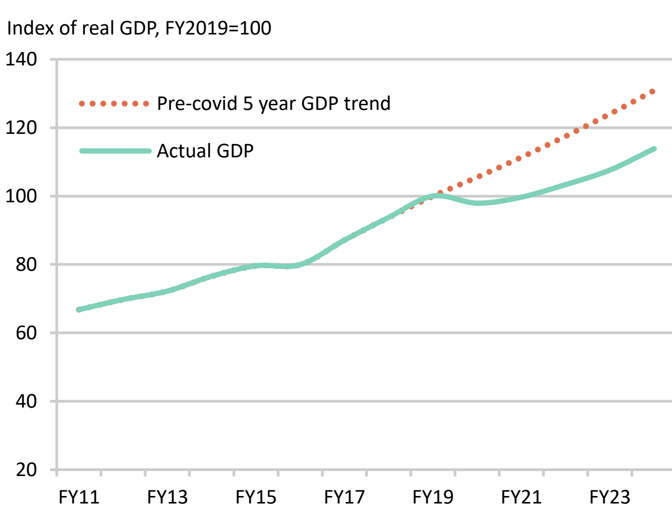
After growing 1.8 percent in FY21, the economy maintained recovery momentum in the first half of FY22 with increased international tourist arrivals and continued expansion of credit to the private sector. Significant progress on vaccination has allowed Nepal to weather a renewed COVID-19 wave in early 2022 with less stringent containment measures, supporting a rebound of activity in the services and industrial sectors. Growth in the agricultural sector has been muted following a reduction in paddy production amid unseasonal rains in October 2021.

Average inflation accelerated from 3.4 percent in FY21 to 5 percent in H1FY22, reflecting higher transportation prices associated with global fuel price hikes and an increased educational fees and housing prices. However, food price inflation slowed to 4.2 percent (year-on-year) in H1FY22 from 4.6 percent in FY21, reflecting a lower vegetable price increase.

The current account deficit widened in H1FY22 relative to H1FY21. Drivers include a surge in imports and a drop in official remittance inflows, which in absolute terms far outpaced an increase in exports. In the absence of significant FDI inflows, the current account deficit was financed by trade credits, external concessional borrowing, and reserve drawdown. Official gross foreign exchange reserves fell to USD 9.9 billion in mid-January 2022 (6.6 months of imports coverage) from USD 11.8 billion in mid-July 2021. In response, the central bank adopted measures to mitigate pressure on reserves, including limiting imports of luxury goods.

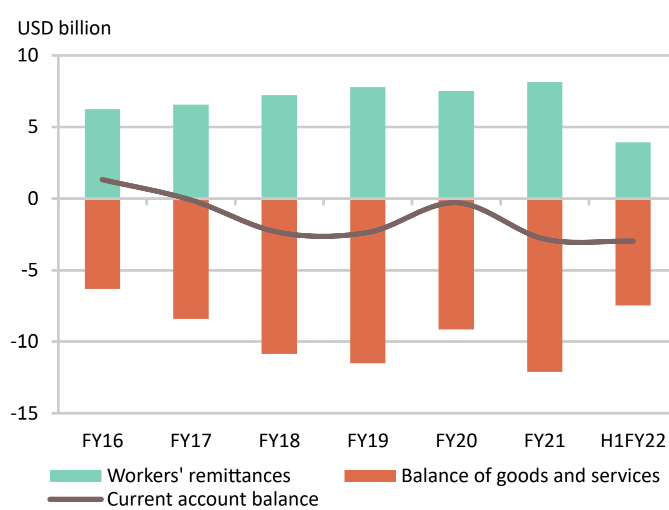
As observed in previous years, a federal fiscal surplus was recorded in H1FY22 as revenue outstripped expenditure growth, as the budget execution tends to accelerate in the last quarter of the fiscal year. Revenue expanded by 28 percent year-on-year in H1FY22 on the back of a strong recovery in trade-related taxes, income taxes, and non-tax revenues especially with strong increase in royalties,

FIGURE 1 Nepal / Real GDP levels: Actual vs. pre-covid trend



Sources: World Bank staff projections and Nepal Central Bureau of Statistics.

FIGURE 2 Nepal / The current account deficit has widened



Sources: World Bank staff calculations and Nepal Rastra Bank.

dividends, and passport and visa fee collections. Compared to H1FY21, total expenditure rose due to higher social security spending and intergovernmental fiscal transfers to sub-national governments, while capital expenditure remained close to H1FY21 levels. While public debt has risen from 22.7 percent to 41.8 percent of GDP from FY17 to FY21, the risk of debt distress is currently assessed as low as per the Joint Bank-Fund Debt Sustainability Analysis of December 2021.

New analysis based on the World Bank COVID-19 phone monitoring survey (conducted during the later half of 2020) shows that 45 percent of those who recovered from a job loss have switched sectors and taken jobs with lower earnings and skill requirements. This indicates that many households have been pushed to marginally above or below the poverty line. New data on jobs and recovery from January 2022 will help better understand the impacts of the COVID-19 on the labor markets and its welfare implications. Higher inflation will increase the cost of basic needs, which will adversely impact the poor and vulnerable, although this may be partially mitigated by rising remittances.

Outlook

The baseline scenario assumes: (i) that no new nationwide strict containment measures are imposed; (ii) a near complete vaccination of the eligible population by the end of FY22 (81.7 percent of the population aged 18 and higher have received full doses of vaccine by March 25, 2022); and (iii) a gradual increase in international migration and tourist arrivals, reaching pre-pandemic levels by FY24.

The baseline forecast projects a gradual medium-term recovery, with growth accelerating from 3.7 percent in FY22 to 5.8 percent by FY24. Vaccination deployment is expected to unleash pent-up demand for most service sub-sectors. Industry sector growth is projected to be supported by increased production of hydropower including from the recently completed Upper Tamakoshi plant. Agricultural growth is projected to decelerate in FY22, reflecting a decline in paddy production and the rise of global fertilizer prices earlier in the fiscal year. Increasing fuel prices are expected to weigh on aggregate demand.

Inflation is expected to rise to 6 percent during FY22 reflecting higher global commodity prices. From FY22 to FY24, annual inflation is expected to average 5.6 percent.

The current account deficit is projected to widen to 11.9 percent of GDP in FY22 and begin to narrow after. Imports are expected to peak at 43.1 percent of GDP in FY22, driven by resurgent consumption and increased commodity prices. Merchandise exports are projected to grow from a low base as Nepal continues to take advantage of tariff exemptions under the South Asian Free Trade Area agreement and expands electricity exports to India. Remittances are projected to average 21.8 percent of GDP over the medium term, assuming stronger demand for migrant workers in the GCC countries due to stronger economic performance driven by higher oil prices. Larger current account deficits are expected to be financed primarily by concessional borrowing and moderate drawdown on reserves, while FDI is assumed to remain marginal as a funding source.

The fiscal deficit is projected to narrow to 3.7 percent of GDP in FY22 as growth rebounds continue to support revenue collection. Over the medium-term, the fiscal deficit is projected to further narrow gradually, supported by expected rollback of COVID-19 related tax breaks and modest policy reforms. Total public debt is projected to peak at 44.5 percent of GDP in FY24.

The economic outlook is subject to downside risks. A major uncertainty is the speed of booster dose deployment and vaccine effectiveness to stop transmission of a new COVID-19 variant. The outcomes of local elections in May 2022 and federal and provincial elections in FY23 will pose additional political uncertainty. Risks on the external side stem from increasing pressure on reserves driven by the increasing imports.

Stronger import control measures to mitigate pressures on international reserves could affect growth through lower trade-related tax revenues, depressed private consumption and production, and lower capital expenditures. The ongoing Russia-Ukraine conflict, if it deepens further, could lower travel demand and may threaten the recovery of tourism and tourism related sectors.

TABLE 2 Nepal / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2019	2020	2021e	2022f	2023f	2024f
Real GDP growth, at constant market prices	6.7	-2.1	1.8	3.7	4.1	5.8
Private Consumption	8.1	3.6	2.4	2.1	1.9	2.5
Government Consumption	9.8	3.8	-5.0	23.6	0.8	-4.1
Gross Fixed Capital Investment	11.3	-12.4	1.2	7.6	5.5	9.6
Exports, Goods and Services	5.5	-15.9	-19.8	30.7	12.5	15.1
Imports, Goods and Services	5.8	-15.2	16.9	10.2	2.3	3.1
Real GDP growth, at constant factor prices	6.4	-2.1	1.8	3.7	4.1	5.8
Agriculture	5.2	2.2	2.7	1.3	1.8	2.3
Industry	7.4	-3.7	0.9	5.1	5.3	6.9
Services	6.8	-4.0	1.6	4.7	5.0	7.4
Inflation (Consumer Price Index)	4.6	6.1	3.4	6.0	5.7	5.2
Current Account Balance (% of GDP)	-6.9	-0.9	-8.1	-11.9	-9.5	-6.8
Fiscal Balance (% of GDP)	-5.0	-5.3	-4.6	-3.7	-3.5	-3.4
Debt (% of GDP)	27.2	36.3	41.8	43.1	44.2	44.5
Primary Balance (% of GDP)	-4.5	-4.7	-3.7	-2.8	-2.5	-2.3
GHG emissions growth (mtCO2e)	1.3	-2.3	0.8	1.0	1.3	2.3
Energy related GHG emissions (% of total)	42.7	40.5	39.5	39.1	38.9	39.1

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices. Emissions data sourced from CAIT and OECD.