

NEPAL

Key conditions and challenges

Table 1 **2020**

Population, million	29.1
GDP, current US\$ billion	33.9
GDP per capita, current US\$	1163.7
International poverty rate (\$ 19) ^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	70.5

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2010), 2011 PPPs.

(b) WDI for School enrollment (2019); Life expectancy (2018).

After contracting in FY20, Nepal's economy is expected to grow in FY21, as COVID-19 related disruptions fade and government relief spending materializes. Significant jobs and income losses, however, are likely to have increased vulnerability. To ensure the recovery is sustained and resilient, policy priorities will need to include: strengthening health systems, supporting agriculture production, and a focus on green, resilient, and inclusive development. Downside risks to the outlook stem from new waves of COVID-19 infections and political uncertainties.

Growth averaged 4.9 percent, over FY09-FY19, supported by remittance inflows but constrained by structural vulnerabilities and periodic shocks. Natural disasters (such as the April 2015 earthquake and recurring floods and landslides) and external developments (such as border closures, trade disruptions, and the recent pandemic) depressed growth and impacted livelihoods. Meanwhile, high political instability (including episodes of civil unrest) and infrastructure gaps impede private investment. The adoption of a new constitution in 2015, created a federal system that decentralizes some responsibilities to the seven provincial and 753 local governments. This is expected to improve service delivery and reduce geographical disparities. At the same time, it has exacerbated pre-existing weaknesses in administrative and implementation capacity that need to be addressed. Against this backdrop, scarce domestic employment opportunities have triggered mass outmigration. The resulting high remittance inflows, averaging around 22 percent of GDP over the past decade, have supported private consumption and poverty reduction, but contributed to a real appreciation of the exchange rate and eroded external competitiveness. In FY20, COVID-19 related social distancing measures and lockdowns triggered the first economic contraction in 40 years,

likely reversing past progress in poverty reduction. While lockdowns impacted all sectors of the economy, they disproportionately affected workers engaged in subsistence activities, who make up over half of the employment. International border restrictions and economic downturns abroad also forced thousands of Nepalese migrants to return home, elevating the risk that many households who have relied on remittances and informal sector jobs may fall back into poverty.

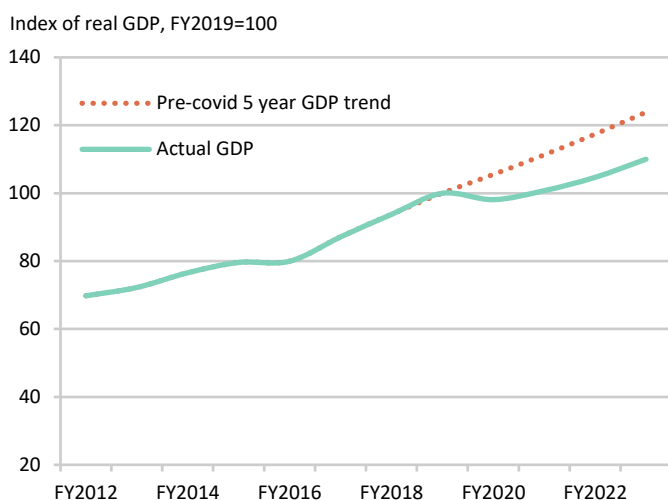
Sources of risk to the outlook include possible new waves of COVID-19, as well as increased political uncertainties, following the dissolution of Parliament's lower house in December 2020 and the Supreme Court's February 2021 decision to reinstate it.

Recent developments

A nation-wide lockdown, implemented during March-July 2020, impacted economic activity in the last four months of FY20. As a result, output contracted by an estimated 1.9 percent in FY20. Wholesale and retail trade, tourism, transport, and associated services such as hotels and restaurants – which are all important drivers of growth – were particularly impacted.

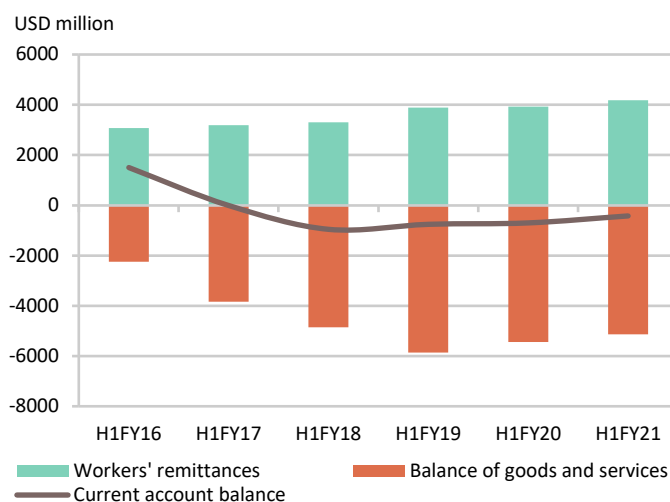
In the first half of FY21 (mid-July 2020 – mid-January 2021), growth has remained sluggish, given that tourism activity was stalled, and private investment constrained by risk aversion and uncertainty. However, there were incipient signs of

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 narrowed



Sources: World Bank staff calculations and Nepal Rastra Bank.

recovery in wholesale and retail trade, transport, and financial services, as containment measures were gradually eased. Subdued demand and adequate food supply brought consumer price inflation to a three-year low of 3.7 percent y-o-y.

Against the backdrop of muted economic activity, the current account deficit declined by 39.6 percent year-on-year in the first half of FY21. This was driven by a sharp contraction in imports (11.8 percent y-o-y) which, in absolute terms, far outweighed a parallel decline in exports (of 36.6 percent), as well as an increase in remittance inflows (by 6.7 percent). Given modest levels of foreign direct investment, external concessional loans financed the current account deficit. The central bank's foreign exchange reserves reached US\$ 11.3 billion by mid-January 2021—equivalent to 11.3 months of imports.

Spending was higher and revenue lower, y-o-y, over the first half of FY21. Higher spending was driven by purchases of COVID-related health equipment and investments at the subnational levels (which offset a 19 percent y-o-y reduction in capital spending). Meanwhile, tax revenues fell by 2.1 percent y-o-y, with trade and consumption taxes as well as corporate income taxes performing poorly. Non-tax revenues continued to suffer from the near standstill in tourism. As a result, public debt increased by 7.4 percent over

the first half of FY21 to 36.1 percent of projected FY21 GDP.

A recent World Bank COVID monitoring survey suggests that the pandemic-related economic slowdown had a major impact on jobs and incomes, with more than 2 in 5 economically active workers reporting a job loss or prolonged work absence in 2020.

Outlook

Economic growth is projected to recover gradually, to 5.1 percent by FY23. The baseline projections assume a successful domestic and global vaccination rollout, and a gradual resumption of international tourism. Agriculture should continue to contribute positively to growth. However, industrial activity is expected to remain below pre-pandemic levels up until early FY22, and services are expected to recover only gradually as domestic confinement measures are lifted.

With roughly a third of the population living close to the poverty line before the pandemic, widespread jobs and earning losses are likely to have increased poverty, particularly for women, younger age cohorts, and workers in non-agricultural sectors.

The current account deficit is expected to widen over the medium term. Import

growth is expected to accelerate as consumption resumes, while service exports should remain subdued until FY22 (as tourism is only expected to recover fully in FY23). Consequently, the current account deficit is projected to reach 3.2 percent of GDP by FY22, financed primarily by long-term concessional borrowing.

The fiscal deficit is projected to remain elevated over the medium term. While revenue performance is expected to remain weak, additional spending on economic relief measures, vaccinations, and the resumption of project implementation will widen the fiscal deficit to just under 8 percent of GDP in FY22. Thereafter it is projected to stabilize at 6.5 percent of GDP in FY23 as revenues recover. Total public debt is expected to reach 41.9 percent of GDP in FY21 and gradually increase to 51.3 percent by FY23.

The economic outlook is subject to downside risks. Delays in vaccination and/or new outbreaks of COVID-19 both domestically and globally would dampen prospects of economic recovery. The resumption of tourism would be delayed if international travel restrictions are imposed. Domestic risks include political uncertainty, which could undermine investment sentiment. On the upside, effective vaccination campaigns in Nepal and abroad could facilitate the resumption of tourism.

TABLE 2 Nepal / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018	2019	2020 e	2021 f	2022 f	2023 f
Real GDP growth, at constant market prices	7.6	6.7	-1.9	2.7	3.9	5.1
Private Consumption	6.2	5.6	3.7	4.0	4.2	4.5
Government Consumption	2.1	7.3	6.2	11.8	15.4	4.1
Gross Fixed Capital Investment	11.8	11.3	-3.5	4.2	9.2	12.2
Exports, Goods and Services	7.7	5.5	-16.0	-18.0	11.1	17.2
Imports, Goods and Services	19.0	5.8	-15.3	4.5	12.4	11.4
Real GDP growth, at constant factor prices	7.4	6.4	-2.0	2.7	3.9	5.1
Agriculture	2.6	5.2	2.2	2.5	2.7	2.8
Industry	10.4	7.4	-4.2	3.1	4.6	6.9
Services	9.3	6.8	-3.6	2.7	4.4	5.9
Inflation (Consumer Price Index)	4.1	4.6	6.1	4.8	5.1	5.7
Current Account Balance (% of GDP)	-7.1	-6.9	-0.9	-1.2	-3.2	-4.4
Fiscal Balance (% of GDP)	-5.8	-5.0	-5.2	-6.9	-7.7	-6.5
Debt (% of GDP)	26.5	27.2	36.0	41.9	47.9	51.3
Primary Balance (% of GDP)	-5.4	-4.4	-4.5	-6.2	-6.8	-5.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

Notes: e = estimate, f = forecast.