

Yuba Raj Khatiwada: Overview of Nepal's recent macroeconomic performances

Speech by Dr Yuba Raj Khatiwada, Governor of the Central Bank of Nepal, at the 43rd Asian Clearing Union (ACU) Board of Directors Meeting, Kish Island, Iran, 23 May 2014.

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Honorable Chairperson Mr. Valiollah Seif, Fellow Governors and members of the ACU Board of Directors, ACU Secretary General Mrs. Lida Borhan-Azad, Other attending delegates and observers, ladies and gentlemen

Let me join fellow governors to express my sincere thanks to Governor Mr. Valiollah Seif and the entire team of Central Bank of Islamic Republic of Iran for the warm hospitality extended to us and also for the excellent arrangements made for the meeting in this beautiful Kish Island. I also thank the Governor of State Bank of Pakistan for successfully handling the chairpersonship of ACU for 2013 and the Secretary General of ACU for efficiently managing the Union's operation during the same period.

Fellow governors and distinguished delegates,

We are meeting at this forum to foster regional trade through the promotion of a credible payment system. While talking regional trade, we have our eyes on the global recovery from the crisis, as it has significant bearing on our trade and investment activities. As we know, the global economic growth has shown marginal improvements in the later part of the last year and early part of the current year, impetus coming especially from advanced economies with supportive monetary conditions and fiscal consolidation; but their growth remains uneven. Inflation in these economies, however, has undershot projections reflecting commodity price decline and output gaps. Activities in emerging market economies and developing economies have not shown very encouraging trend, although they continue to contribute more than two-thirds of global growth. The challenges of the emerging market economies and developing economies have increased with financial volatility posed by unexpected normalization of US monetary policy. Despite that low-income countries have succeeded in maintaining strong growth reflecting better macro-economic policies, their external environments remain challenging. In essence, the global recovery is still fragile despite improved prospects and significant downside risks. The challenge to growth has further fueled by recent geo-political risks, a sort of deflation in Euro zone and external environment, which could result in further financial turmoil.

Fellow governors and distinguished delegates,

I take this opportunity also to shed some lights on Nepal's recent macroeconomic performances. As an upshot of the economic and financial slowdown of the world economy in recent years and its subsequent repercussion on the Nepalese economy coupled with prevailing political instability, Nepal is grappling with the challenges of low economic growth, inflationary pressure and vulnerable external sector. However, on the basis of recent improvements in the domestic political and economic environment along with improvements in world financial market and prospective outlook of the global economy in the year 2014, a positive impact is expected in some major areas of the economy specially tourism, foreign employment, foreign investments and exports. The outlook for 2014 is a higher growth of around 5.5 percent, compared with less than 4 per cent in 2013, contributed mainly by sound performance of agriculture sector. The consumer price inflation is expected to remain at around 9 percent in 2014. On the external front, exports have increased slower than imports thus further widening the trade deficit to nearly 30 percent of GDP. However, improvements in the service incomes, grants and remittance inflows exceeding 31 per cent of GDP have

contributed to a surplus in the current account amounting to 4 per cent of GDP estimated for 2014. The overall balance of payments has registered a surplus for the last several years and is estimated to remain at USD 1.05 billion in 2014. As a result of the balance of payments surplus, gross foreign exchange reserves of the banking system have reached to US\$ 6.7 billion at April 2014; and the reserves of the banking system are sufficient for financing merchandise imports of more than 11 months and merchandise and service imports of more than 10 months.

Fellow governors and distinguished delegates,

In the fiscal sector, a higher rate of growth in resource mobilization relative to government expenditure has resulted in budget surplus. Fiscal prudence over the last several years has helped to confine outstanding domestic debt at 12.9 percent of the GDP. The country remains lowly indebted, as outstanding total public debt, both domestic and foreign together, accounts for little over 31 percent of GDP.

Due to strong balance of payments situation mostly contributed by high remittance inflows, liquidity in the banking system has remained high for some time now. Monetary growth has remained at 18 per cent in April 2014 on point to point basis while most interest rates have come down to single digit. Despite high monetary liquidity, growth of credit to the private sector remains within targeted band. Further, the degree of financialization is still low and total credit of banks and financial institutions stands at just 63 per cent of GDP.

The financial sector strategy of the Nepal Rastra Bank has now been to consolidate the institutional expansion along with ensuring wider and better access to financial services. Hence, while merger of urban-centered institutions is encouraged, expansion of micro finance institutions in the rural areas establishment of bank branches in the underserved areas is given a priority. On the whole, financial policy comprises of a two-pronged strategy – consolidating the urban financial institutions and expanding the institutional presence in the rural areas. Bank licensing, bank branch expansion, refinance, and credit policies are geared towards this direction. The NRB is of the view that the expansion of the financial sector will be constrained without the growth of the real sector. Thus, priority has been accorded to the productive use of bank credit to the promotion of the real sector through judicious use of credit and macro-prudential policies. As a competitive, efficient and healthy financial system is vital for enhancing economic growth, ensuring economic efficiency and maintaining macro-economic stability, a reasonable growth of the real economy is equally important to sustain the expansion of the financial services.

As financial stability has been a primary concern of Nepal Rastra Bank, it has been addressing pertinent issues such as productive use of credit, enhancing access to financial services, deposit guarantee, exercise of macro-prudential measures, strengthened bank supervision and enforcement of good governance measures. It has introduced some measures such as early warning, prompt corrective actions, know-your customer, stress testing and risk based supervision to ensure resilience of the financial system. We are also embarking on a strong legal framework for anti-money laundering and financial crisis management.

Fellow governors and distinguished delegates,

While going through the overall ACU transaction, trade routed through ACU in last three years has declined significantly by about 30 percent, 37 percent and 8 percent in 2011, 2012 and 2013 respectively. Similarly, following the trend of preceding years, total transactions have declined by about 12 percent during the first three months of the current year on y-o-y basis compared to the figure of last year. Further, the trade is concentrated, primarily, within a few member countries. All these facts warrant member countries to evaluate the trend; and I urge all the fellow governors to rethink on how we can better serve the enshrined objectives

of establishment of the ACU mainly promoting regional trade and monetary co-operation amongst the members.

As regards to our activities under ACU, the share of Nepal on total transactions of the ACU member countries routed through ACU mechanism accounts for roughly 0.40 percent, which is fluctuating around same figure over the last few years and its transactions during 2013 has declined by about 30 percent compared to 2012. Similarly, there is a decline of its transactions by about 23 percent over the first three months of the current year compared to the same period of the previous year. Its exports to ACU member countries is hovering around 5 percent of our total exports and the share of imports from ACU member countries has been around half percent of our total imports excluding the trade data with India. As more efforts are needed to promote trade through the ACU mechanism, Nepal Rastra Bank is committed to work together with other member central banks towards creating an enabling environment for the same.

In this opportune occasion, I would reiterate Nepal rastra Bank's commitment and belief in the mission of our Union. I am confident that this meeting would be instrumental in exploring new avenues of co-operation and further simplification in the existing payment mechanism in the pursuit of fostering its effectiveness for facilitating trade amongst member countries and enhancing monetary as well as technical co-operation among us. Before concluding, I would like once again to thank Dr. Seif and the Central Bank of IR of Iran for the kind hospitality and excellent arrangements made in hosting this meeting.

Thank you Mr. Chairman.