Term Paper

Monetary Economics

"MONETARY POLICY OF NEPAL 2079/80 CORRESPONDING TO THE CHANGES MADE ON THE FIRST QUARTERLY REVIEW MANGSIR 11, 2079"

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Abstract

The central bank's tools and instruments for adjusting monetary policy, as well as its visionary goals, are examined in this paper. The study investigates the transmission of Nepal's monetary policy framework and its implementation. Regarding Nepal's current economic situation, the new monetary policy of 2079/80, which incorporated the changes made at the first quarterly review on Mangsir 11, 2079, has been analyzed or studied, and opinions and individual recommendations have also been provided.

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4. Introduction to Monetary Policy

Monetary policy is what a central bank does to control an economy's money supply, interest rates, and credit. The Nepal Rastra Bank is an example of a central bank. The supreme monetary authority is the central bank, also known as the banker of banks. In most cases, central banks function independently of political influence and interference. The primary objective of monetary policy is to maintain equilibrium in the four economic sectors by stabilizing prices and preserving the value of the economy's currency: the real, external, financial, and monetary sectors. and encourage long-term economic expansion.

When putting monetary policy into action, central banks primarily employ two tools: operation of the market and setting interest rates In order to boost or decrease the amount of money in circulation, open market operations involve buying or selling government securities on the open market. The process of adjusting the interest rate at which banks can borrow money from the central bank is known as "setting interest rates." This can affect how much it costs businesses and consumers to borrow money and how much economic activity takes place.

It is also possible to classify monetary policy as either expansionary or contractionary. The term "expansionary monetary policy" refers to the actions taken by the central bank to increase the money supply and reduce interest rates to boost economic expansion. Typically, this is done during a recession or when economic activity is low. On the other hand, contractionary monetary policy is what the central bank does to lower the money supply and raise interest rates to keep prices stable and reduce inflation. Monetary policy instruments like OMOs, bank rates, CRR, and SLR, among others, the economy is affected by these monetary policies.

1. History of Monetary Policy of Nepal

Nepal's monetary policy has been in place since the middle of the 20th century when the country still had a traditional agrarian economy. At that time, the main goals of monetary policy were to control inflation and keep the exchange rate stable. Nepal implemented a fixed exchange rate system at the beginning of the 1960s, with the Nepali rupee pegged to the Indian rupee. Nepal was forced to devalue its currency because of a balance of payments crisis at the beginning of the 1990s, and this system was in place until then. Nepal implemented a more adaptable exchange rate system in the middle of the 1990s, allowing for greater market-based exchange rate fluctuations. This system was in place until the beginning of the 2000s, when Nepal experienced yet another crisis in its balance of payments and was forced to devalue its currency once more. Nepal's monetary policy adopted an inflation targeting framework toward the end of the 2000s with the goals of reducing inflation and maintaining a stable exchange rate. This framework was in place until the beginning of the 2010s, when Nepal experienced yet another crisis in its balance of payments and was forced to devalue its currency once more.

Nepal has been working to strengthen its financial sector and enhance its monetary policy framework over the past few years. This includes initiatives like making the central bank more transparent and accountable, enforcing stricter regulations for banks and other financial institutions, and expanding financial inclusion (Dhakal & Timsina, 2020). In general, Nepal's monetary policy history has been marked by several difficulties and setbacks; however, the nation has also made significant progress in recent years in enhancing its monetary policy framework and bolstering its financial sector.

1. Instruments of Monetary policy In Nepal

NRB achieves the economic objectives by applying its various instruments and tools in a variety of ways.

1. Operational Open Market: Nepal Rastra Bank, Nepal's central bank, buys and sells government securities on the open market as part of its open market operations. The economy's money supply and interest rate are both controlled with this tool.
2. Ratio of Cash Reserves (CRR): Commercial banks in Nepal are required by the Central Bank of Nepal to keep a certain amount of their deposits in cash with the central bank. The economy's money supply and interest rate are both controlled with this tool.
3. Ratio of Statutory Liquidity (SLR): Commercial banks in Nepal are required by the Central Bank of Nepal to keep a certain amount of their deposits in liquid assets like cash and government securities. The economy's money supply and interest rate are both controlled with this tool.
4. Rates for repo and reverse repo: The repo rate, or the rate at which commercial banks can borrow from the central bank, is set by the Nepalese Central Bank. The rate at which commercial banks can lend to the central bank is known as the reverse repo rate. The economy's money supply and interest rate are both controlled by these instruments.
5. Cap on Credit: The maximum amount of credit that a commercial bank can lend to a particular sector or group of borrowers is set by the Central Bank of Nepal. The economy's money supply and interest rate are both controlled with this tool.
6. Take Action: The economy's money supply and interest rate can both be controlled directly by Nepal's Central Bank. This could be accomplished by altering the interest rate on central bank loans or increasing or decreasing the amount of credit available to commercial banks.
7. Credit Restriction: To keep the economy's money supply under control and the interest rate under control, the Nepalese Central Bank has the power to limit the amount of credit available to commercial banks. This could mean limiting the amount of credit a bank can give to a particular sector or group of borrowers or setting a maximum loan-to-deposit ratio for banks.
8. Moral Influence: The Nepalese Central Bank has the power to influence the actions of commercial banks and other financial institutions through moral suasion. This could be done by making it harder for banks to lend to certain parts of the economy or making them more likely to do so.
9. Management of Foreign Exchange Reserves: Nepal's foreign exchange reserves are managed by the Central Bank of Nepal by buying and selling foreign currencies on the open market. The economy's money supply is controlled, and the exchange rate is stabilized with this tool.
10. Capital Control: Capital controls can be imposed by Nepal's Central Bank to control money entering and leaving the country. This could be accomplished by imposing taxes on capital flows or limiting the amount of money that can leave the country. The economy's money supply is controlled and the exchange rate is stabilized with this tool.
11. Objectives of Monetary Policy Of Nepal
12. Stability in Prices: Nepal's monetary policy's main goal is to keep prices stable by keeping inflation under control and keeping average prices within a reasonable range.
13. Economic Expansion: By ensuring an adequate supply of money and credit to support investment and consumption, the monetary policy aims to encourage economic growth.
14. Payments in Balance: By controlling the flow of foreign currency into and out of the country, monetary policy also aims to maintain a balance of payments.
15. Stability in the economy: By regulating and supervising financial institutions and promoting a sound and effective financial system, the monetary policy aims to maintain the stability of the financial system.
16. Reduction of Poverty: By encouraging economic expansion and employment opportunities, the monetary policy also aims to reduce poverty.
17. Credit Distribution: The goal of monetary policy is to ensure that credit is distributed fairly to various regions and economic sectors.
18. Rate of Interest: The goal of monetary policy is to keep the interest rate environment stable to help the economy grow and stay stable.
19. Reserve for foreign exchange: To support the balance of payments and ensure the stability of the exchange rate, the goal of monetary policy is to maintain a sufficient foreign exchange reserve.
20. Foreign Exchange: By providing export-oriented industries with credit facilities and maintaining an appropriate exchange rate, the monetary policy aims to encourage international trade.
21. Responsibility and Transparency: By providing regular updates on the policy stance and actions taken, the monetary policy aims to ensure transparency and accountability in the conduct of monetary policy.
22. Methodology

An undergraduate student used references from the Nepal Government's website and other websites with information about monetary policy's instruments, tools, objectives, and transmission mechanism to conduct the study. The paper contains highlights of the current macroeconomic situation or scenario. As part of the research for the term paper, several opinions were voiced. These opinions are also included in the paper as suggestions. All the steps necessary to finish a term paper "MONETARY POLICY OF NEPAL 2079/80 CORRESPONDING TO THE CHANGES MADE ON THE FIRST QUARTERLY REVIEW MANGSIR 11, 2079" has been taken.

1. Monetary Policy of Nepal 2079/80

a. Current Macroeconomic Situation of Nepal

A challenging economic environment characterizes Nepal's current macroeconomic situation in 2079/80. High inflation, a growing trade deficit, and a significant fiscal deficit are just a few of the country's economic issues. In recent years, inflation has been a major concern for Nepal, with a rate of 8.2% in 2079/80 (NRB, 2022). Inflation has been primarily driven by rising costs of food and fuel, as well as increased demand for goods and services. To keep inflation under control, the Nepal Rastra Bank (NRB) has been increasing the cash reserve ratio and raising interest rates.

Nepal's trade deficit, in which the country imports more goods than it exports, has also been a major source of concern. The Nepalese rupee has appreciated, and foreign exchange reserves have diminished as a result. Incentives for export-oriented industries and the implementation of trade agreements with other nations are two examples of the measures that the government has been putting into place to increase exports and decrease imports. Nepal's fiscal deficit has also been a major source of concern, as the government spends more money than it makes. The country's economy has been put under pressure because of this, as well as a high level of public debt. Austerity measures and an increase in revenue collection have been implemented by the government to reduce the fiscal deficit.

In conclusion, Nepal's macroeconomic situation in 2079/80 is marked by high inflation, a growing trade deficit, and a significant fiscal deficit. To address these issues, the government and the NRB have been implementing measures like monetary and fiscal policies to control inflation and reduce trade and fiscal deficits. However, to effectively address these issues, ongoing efforts will be required.

b. Highlights of Monetary Policy of Nepal 2079/80

1. By controlling inflation and ensuring monetary stability, the policy aims to promote economic growth and price stability.
2. The goal for fiscal year 2079/80 was to keep annual average consumer inflation below 7.0%, but the first quarter only saw a 5% increase.
3. The National Rationing Board (NRB) has made it clear that it will keep an eye on inflation and take the necessary steps to keep prices stable.
4. Compared to the fiscal year 2079–80, when it was only sufficient to cover at least seven months of goods and services imports, the foreign exchange reserve appears to have been sufficient to fund 8.5 months of imports at the end of the first quarter of the year.
5. In the fiscal years 2079–2080, a 12% annual increase in the detailed money supply is anticipated; however, as of the first quarter of the current fiscal year, the annual point growth rate was only 5%.
6. The interbank rate was 4.95 percent in Ashoj 2078; In the year 2078, it remained at 8.51 percent. In the year 2079, these interest rates were 7.01 percent, Ashad.
7. For commercial banks, the Statutory Liquidity Ratio (SLR) has been maintained at 12% of NDTL.
8. Additionally, the NRB has set a goal of 13% deposit growth for the first quarter of fiscal year 2079/80.
9. Additionally, the National Rationing Board (NRB) has emphasized that commercial banks must adhere to credit risk management, anti-money laundering, and terrorism financing regulations.
10. For the fiscal years 2079–2080, a 12.6% increase in claims against the private sector is anticipated; however, at the end of October 2071, this annual point growth rate was 6.8%.
11. After taking inflation into account, real interest rates have decreased in Ashoj 2079, but nominal interest rates have increased. In Ashoj 2078, the weighted average real interest rate for deposits was 1.19 percent, while the weighted average real interest rate for loans was 4.45 percent. In the first quarter of 2079/80, the weighted average real interest rate on loans is 3.69 percent, which is negative by 0.34 percent.
12. The poor category accounts for at least 5% of all loans in the portfolios of banks and other financial institutions. In the first quarter of the fiscal year 2079/80, investments in the poor received an average of 7.4% of loans from finance companies, 11.5% from development banks, and 6.7% from commercial banks.
13. For the first quarter of the fiscal year 2079/80, the NRB has set a goal for credit growth of 14%, with a focus on lending to agriculture, small and medium-sized businesses, and priority sectors.
14. In the first quarter, goods exports decreased by 35.7%, goods imports decreased by 16.2%, and the trade deficit decreased by 13.1%.
15. In the first quarter, the inflow of remittances increased by 16.8 percent, indicating an improvement in the flow.
16. In the first quarter of the fiscal year 2079–80, there was an increase of 110.4% in the number of international visitors to Nepal.
17. Recommendations with individual points of view

The first quarter report shows that the Monetary Policy of FY 2079/80 had taken the necessary steps to address Nepal's current economic crisis. These improvements can be seen in the report. By employing measures like a contractionary approach to tools like the CRR and interest rate, we can conclude that there is hope for this monetary policy to transform Nepal's status and economy. To evaluate the efficacy of these policies and observe this shift, we must wait at least another quarter. The fiscal policy's introduction of a growth rate ought to have reflected the contractionary nature of the monetary policy. Another argument is that Nepal's import-export imbalances must be corrected or else it will continue to face economic difficulties in the future. The fact that monetary policy aims to boost economic growth while maintaining a tight stance is the source of the inconsistency. This is important because monetary and fiscal policies depend on each other.

1. Conclusion

The paper concludes that Nepal's economic situation appears to be quite difficult. The fact that the monetary policy has attempted to create a self-sustaining economy by supporting productive sectors and reducing imports is encouraging. Nepal, on the other hand, lacks an environment that is favorable to new businesses or rapid economic expansion to prevent inflation. Policymakers or economists working for the central bank are employing the appropriate tools to stabilize the economy and protect it from randomness. The economy experiences ups and downs, and both of these ups and downs are looked at by the monetary authority before appropriate policies are implemented.

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