

## Governor Dr. Nepal Participates in WBGs/IMF Joint Annual Meeting



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Governor Dr. Chiranjibi Nepal participated in World Bank Groups (WBGs) and International Monetary Fund (IMF) joint annual meeting on October 18-20, 2019 in Washington DC, USA.

Governor Dr. Nepal attended the plenary session of IMF and WBGs where WBGs President Mr. David Malpass and IMF Managing Director Ms. Kristalina Georgieva delivered their address with Mr. Aiyaz Sayed-Khaiyum, Minister of Finance of Fiji, having chaired the session. On that occasion, Governor Dr. Nepal had also taken the opportunity and participated in the meetings

of South East Asia Voting Group (SEAVG), in 39th SAARCFINANCE Group Meeting and also participated in a program organized by the World Bank, on 50th year's cooperation between Nepal and International Development Association.

Similarly, Governor Dr. Nepal met separately with Executive Director of IMF'S SEAVG, Ms. Alisara Mahasandana; Deputy Managing Director of IMF, Mr. Tao Zhang and officials of IMF'S Asia Pacific Department. During these meetings, he discussed on state of Nepal's economy, bilateral issues of interests and matters relating to the upcoming IMF Article

IV Consultation and had also requested them to participate in 'International Conference on Finance and Economics', which is scheduled to be held on 28-29 February 2020 in Kathmandu.

The officials accompanying Governor Dr. Nepal had also met with officials of IMF'S departments namely: Statistics Department, Monetary and Capital Markets Department, Communications Department and Finance Department. He was accompanied by Executive Director Dr. Gunakar Bhatta of NRB'S Research Department and Deputy Director Mr. Pradeep Bhattarai of NRB'S Office of the Governor.

## Ensuring Financial Stability



**Dr. Gunakar Bhatta \***

Financial sector in Nepal has taken a stable course since 2018/19. Prior to that, financial sector experienced ups and downs for few years. Large fluctuations in interest rate, wide gap between deposit mobilization and lending, and excessive volatility in stock market were the matters of concern. However, these phenomena are largely absent today. Even the recent Article IV consultation mission of the IMF has lauded the macro prudential policy measures.

large remittance inflow owing to the migrant workers' behavior to send money back home to reconstruct houses and console earthquake stricken families, and the limited space to disburse credit since the economic activities were languish. The excessive surplus liquidity instigated banking sector to disburse huge credit to housing and stock market. Such credit expansion fuelled the asset market and the banking sector moved to a higher interest rate trajectory.

surpassed the deposit growth by 11.3 percentage point and culminated 32.1 percent on y-o-year basis in January 2016, has remained within the target of monetary policy for the last one year.

Another area of grave concern, few years ago, was the stock market. It was mainly due to an unexpected bullish trend in 2015/16. The NEPSE index which was 961 in mid-July 2015 climbed to 1881 on 27 July 2016. Such an unprecedented rise in the NEPSE index within a year was not supported by macro-

### Interest Rate and Inflation

	Mid- July					Mid-Dec
	2015	2016	2017	2018	2019	2019
<b>Weighted Average Deposit Rate</b>	3.94	3.28	6.15	6.49	6.60	6.80
<b>Weighted Average Lending Rate</b>	9.62	8.86	11.33	12.47	12.13	11.93
<b>Spread</b>	5.68	5.58	5.18	5.98	5.53	5.13
<b>Inflation</b>	7.20	9.90	4.40	4.20	4.60	6.33

This favorable situation is attributable to a number of policy interventions and moral suasions mainly by Nepal Rastra Bank.

In 2015, in the aftermath of the disastrous earthquake of 25 April and the Southern border obstructions immediately after the promulgation of new constitution, banking sector was operating at excessive surplus liquidity. Such liquidity resulted mainly from two sources:

Though the lending rate increased rapidly at that time, deposit rate in real terms was negative. The negative real deposit rate discouraged domestic savings and the ratio of such savings to GDP was only 4.1 percent in 2016. For the last three years, the real deposit rate has remained positive and the gross domestic saving ratio increased eventually. Such ratio has gone up to 20.5 percent in 2019. The credit growth, which had

economic fundamentals. The economy had grown merely by 0.6 percent in 2015/16. Such anomaly between macro fundamentals and stock market performance also challenged the efficient market hypothesis (EMH) of the Nobel laureate Eugene F. Fama. High lending rate, negative real deposit rate, wide gap between deposit collection and lending, and unexpected bearish and bullish trend in the stock market in a short span all were about to challenge

\*Executive Director, Nepal Rastra bank



country's financial stability. However, a positive development in all these fronts has been observed in the last one year. For this welcoming move, good policy measures are to be credited.

Moral suasion and courage to adopt the standard practice in interest rate spread calculation has narrowed the gap between lending rate and deposit rate in the last one year. Such a spread between lending and deposit in weighted average terms was around 6 percent in mid-July 2018, compared to 5.1 percent in mid-December 2019. The hue and cry about the interest rate particularly from business community has been addressed and there are no more complaints regarding lending rate this year. Depositors have also gained. The weighted average deposit rate that was 6.6 percent a year ago stands at 6.8 percent in mid-December 2019. Despite the inflationary pressure in 2019/20, the real deposit rate so far remains positive.

Another area of concern was excessive credit growth in the last few years particularly since 2015/16. Such credit growth irrespective of the deposit growth was alarming for financial stability. Even though some fundamentals such as continuous higher economic growth and unprecedented expansion of banking sector had supported the credit growth, there was a concern on loan ever-greening. The International Monetary Fund also raised this issue time and again. A

credit bubble like situation prevailed in the last three years propelling imports and ultimately costing balance of payments. However, a number of measures including tightening personal overdraft, enforcing reduced loan to value ratio for hire purchase and discouraging unnecessary foreign trips helped the credit bubble to restrain. Recent improvement in balance of payments and minimized gap between deposit mobilization and credit disbursement are the outcomes of good policies with respect to credit allocation.

Growing mismatch between maturity of assets and liabilities was another concern for the stability of the banking system in particular. Positive real deposit rate has altered the structure of deposit. Three years ago, share of fixed deposit was only around 30 percent. A higher share of saving and current deposit including call was putting huge pressure on banks to match the maturity of liabilities and assets in their balance sheets. Now the ratio of fixed deposit is around 49 percent and this has helped banks to address the asset liability mismatch. The recent provision regarding the compulsory issuance of debentures has further fortified banks position regarding asset liability management. Debenture is sure to help banks in stabilizing interest rate, investing in long term projects and preparing them for adopting net stable funding ratio under BASEL III. Debenture is also going

to guide the market to assess the position of banks and rank them. Moreover, the recent provision of allowing banks to invest cent percent of the amounts raised through debenture issuance has zeroed opportunity cost unlike the one in deposit given the CCD ratio.

Paving way for allocating more resources to the sectors such as agriculture, energy, tourism and ICT will support Nepal's agenda for long term growth. Only a stable and efficient financial system caters to the needs of sectors that embed higher sustainable growth. In the course of achieving higher sustainable growth, the issue of climate change comes to the fore and the financial system cannot remain aloof from that. Streamlining existing credit programs such as deprived sector, priority sector, refinance and concessional ones will help boost productivity and support growth. Stability is required to avert sudden crashes and chronic diseases in the financial system. Ceasing unwarranted boom of the asset market, minimizing asset liability mismatch, prioritizing sectors of national importance, expanding resource base and monitoring the quality of credit are prerequisites for ensuring financial stability. The current policy paradigm in banking sector is geared towards the same end.



## Governor Dr. Nepal Participates at SEACEN Governors Program



Governor Dr. Chiranjibi Nepal participated in 55th South East Asian Central Banks (SEACEN) Governors' Conference/High Level Seminar and 39th SEACEN Board of Governors' meeting held in Singapore on November 13-14, 2019 and hosted by Monetary Authority of Singapore. He was accompanied by Director Mr. Shiva Ram Dawadi of Information Technology Department, Ms. Pancha Laxmi Manandhar Deputy Director of Banks and Financial Institutions Regulation Department and Assistant Director Ms. Sudha Bista Thapa of Office of the Governor.

Governor Dr. Nepal made an observation visit to the fourth Singapore Fintech Festival and the Singapore Week of Innovation and Technology (SFF x Switch 2019). On this occasion, he also participated at a discussion program titled 'Impact of Technology on Financial Inclusion and Financial Stability Expanding International Cooperation

Among Financial Authorities' organized by Bank for International Settlement (BIS) and World Bank with the assistance of Monetary Authority of Singapore and UN Secretary-General's Special Advocate for Inclusive Finance for Development (UNSGSA).

Similarly, Governor Dr. Nepal participated at a meeting with Her Majesty Queen of Netherlands, Maxima Zorreguieta who is the UNSGSA for Inclusive Finance for Development. Contemporary issues of financial inclusion were discussed in the meeting.

On the second day of program, Governor Dr. Nepal participated in 39th SEACEN Board of Governors' meeting. This meeting elected Mr. Ravi Menon, Managing Director of Monetary Authority of Singapore as the Chairman of SEACEN Board of Governors for a one - year tenure for 2020. The meeting also approved the proposed budget and program for next year and the training and research programs organized

by the SEACEN center. The meeting also approved the proposal regarding Autoriti Monetari Brunei Darussalam to host the 56th Governor's conference and 40th Board of Governors Meeting. This was followed by SEACEN Governors' Conference/High Level Seminar. Governor Dr. Nepal also met with Governors of other Central Banks and discussed about bilateral assistance and cooperation.

During the program working papers were presented related to Data Driven Economy and Artificial Intelligence Driven Economy during the program, which had especially focused to Data & Technology: An Embracing Innovation.

The SEACEN Research and Training Centre was established in 1982 with the purpose of conducting research on the areas related to financial, monetary, banking, economic development and to train the members of central banks and monetary authorities. Nepal Rastra Bank is a founder member of SEACEN.

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### Editor:

Sushil Gyawali

### Editorial Team:

Vishnu Datta Pandey  
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