SUPPORTING ECONOMIC TRANSFORMATION

Economic impacts of and policy responses to the coronavirus pandemic: early evidence from Nepal

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9 April 2020

Key messages

- Nepal has closed its borders and introduced significant restrictions on movement to mitigate the spread of COVID-19.
- GDP growth is expected to be at least 1.0 percentage point lower as remittances and tourism decline.
- Remittances contribute around 25.4% of GDP and could decline in Q4 2020 as migrant foreign employment ceases as a result of the pandemic.
- Annual food inflation is expected to rise to 6.0% in 2020; food inflation has also been on a rise since the lockdown.
- The Nepal Rastra Bank has reduced the cash reserve ratio to 3%, the bank rate to 5%, the ceiling rate to 5% and the repo and floor rates to 3.5% and 2%, respectively.
- Government has established a Central Relief Fund of about $5 million to combat the COVID-19 pandemic along with an insurance package of NRs 2.5 million provided to healthcare and security personnel involved in treating COVID-19 patients.

Introduction

As of 7 April 2020, Nepal has nine confirmed cases of COVID-19 and no deaths reported. The country has gone into lockdown since 25 March, with only gas stations and pharmacies operating. The government has imposed fines and jail terms for people violating the lockdown. Nepal has also closed its borders to India and China. A 14-day quarantine has been put in place for those returning from India.

The economy grew at an estimated 7.1% in 2019[1] – a three-year streak of over 6% growth for Nepal. The fiscal deficit remained a high 7.7% of GDP, with public debt at 31.3% of GDP. In 2017, the government spent $150 per capita on health care; external health expenditure was $23 per capita (PPP international $).

Economic and social impacts

ADB has revised GDP growth forecasts from 6.3% to 5.3% for 2020. There is scope for a further downward revision to 4.3% if the pandemic and the lockdown continue. In 2021, ADB expects a growth acceleration of 6.4%, though this is likely to be revised downward. Slowdowns in remittance and tourism flows constitute the two biggest risks, with the former making up 25% of Nepal's GDP. Tourism makes up around 2–3% of GDP. Nepal's tourism industry will be particularly hit, with initiatives such as Visit Nepal 2020 having been cancelled, international travel suspended and hotels and restaurants closed. Since the outbreak, tourist arrivals have declined by 2% y/y in January 2020 and 1% y/y in February 2020. This could worsen if the lockdown and the pandemic go on for long. Services contribute over 50% of GDP and would be hard hit if remittances and tourism decline.

The outlook for Nepal's external position is mixed. The slowdown in international trade is expected to reduce the deficit to 5.4% of GDP in 2020 from 7.7% in 2019, largely through a reduction in imports. However, this could be limited by a sharp fall in remittances in 2020. Hydropower is a key export to India; the lockdown has brought down demand for electricity as industrial activity has halted. This could negatively affect key hydroelectricity export receipts. The rupee is trading at 121.5/$. Since the start of March, it has lost 4.7% of its value against the US dollar.

ADB has forecast that the services sector could lose 1.2–2% of GDP depending on how prolonged the lockdown becomes, while the hotels and restaurants sector could lose around 1% of GDP. Industry is expected to record a loss of 1.3% of GDP if things return to normal soon and 3.1% of GDP if the lockdown continues. China's economic slowdown poses a key risk to Nepal's industrial outlook. Nepal depends on China for a variety of raw material inputs into its production of handicrafts; these supply chains have been disrupted.

[1] The fiscal year in Nepal ends in mid-July (FY2019 is mid-July 2018 to mid-July 2019).

ADB expects the annual inflation rate to rise to 6% in 2020, from 4.6% in 2019. The key risk stems from food prices, which have risen owing to a delayed monsoon and supply channel disruption. Food price inflation increased to 9.8% in mid-February. The border closure is already pushing up food prices further.

FDI pledges increased in the first six months of fiscal year 2020 by 315%. As most commitments are from China – one of the worst hit countries – there may be cancellations.

Fiscal impacts

Revenue mobilisation increased by 27% y/y for 2020 up to mid-February, thanks to the Custom Reforms and Modernisation for Trade Facilitation Programme introduced in 2017. The 2020 mid-year budget review put the fiscal deficit at 6.5% of GDP, but this is expected to decline as actual capital expenditure continues below planned, and could decline further as a result of project delays caused by the lockdown. As revenues from customs decline while expenditure on social safety nets, health care and sanitation increase to combat the pandemic, the fiscal deficit could rise.

Nepal's external debt-to-GDP ratio in 2019 was 17%. In Q1 2020, it increased to 18.2%. Total public debt has increased by 3.5% and reached 31.3% of GDP in Q1 2020. Public debt may increase as the rupee continues to weaken, tax revenues are deferred and expenditure rises on to tackling the impact of COVID-19 on people and businesses. However, the chances of debt distress are low, given Nepal's high level of official concessional borrowing at longer maturity.

Monetary and financial policy

On 29 March, the Nepal Rastra Bank announced a sizeable reduction (100bp to 3%) in the cash reserve ratio for commercial banks, development banks and finance companies. The bank rate and ceiling rate have both been reduced by 100bp to 5%, and the repo and floor rates by 100bp to 3.5% and 2%, respectively. Loans for the import, distribution and sale of medical equipment essential items such as food will be processed within five days of application.

Monthly amortisation on loans can be deferred until the end of 2020 (mid-July), with no penalties levied. SMEs will be prioritised for Nepal's refinancing facility. Banks and financial institutions can also extend by 60 more days the deadline on short-term working capital that needs to be repaid by mid-April. Short-term loans processed within five days will be available for tourism and transport enterprises. Finally, workers unable to depart for foreign employment will be eligible for subsidised loans to initiate their own businesses, to be approved within seven days of application.

Fiscal policy

On 29 March, the government established a Central Relief Fund of about $5 million to combat the pandemic. It will divert NRs 136 billion ($1.1 billion) from the existing annual budget from 14 titles including recurrent contingencies (NRs 29.39 billion, $0.24 billion), programme expenses (NRs 28.26 billion, $0.23 billion) and land acquisition (NRs 28 billion, $0.23 billion). Employers can use the fund to pay salaries during the lockdown. The government will now pay workers' contributions to the social security fund for mid-March to mid-April, which were to be deposited by employees and employers. However, it has been stipulated that tourism enterprises must pay staff wages for the month. The tax payment deadline of 12 April for businesses has been extended until 7 May.

A 10% discount on rice, flour, dal, salt, sugar and oil supplies from Nepal Food Corporation and Salt Trading Corporation has been announced for those whose wages have been affected by the lockdown. Provincial and municipal governments will also distribute food aid, with special priority for expecting mothers, orphans, the disabled and those with chronic illnesses. The government has asked private house owners to waive a month's home rent for organised workers residing in urban areas. In return, the government will waive the rental tax for the period. Individuals unable to depart for foreign employment despite receiving permission will be provided with employment opportunities through the Local Level Employment Service Centre and the Prime Minister's Employment Programme. Nepal Electricity Authority will provide a discount of 25% on electricity tariffs for mid-March to mid-April to households consuming 150 units of electricity. Nepal Telecom will provide a 25% discount on internet services during the lockdown.

An insurance package of NRs 2.5 million ($0.02 million) has been provided to health care and security personnel involved in treating COVID-19 patients. The government will provide all equipment needed for treatment for free. Imports of health and medical equipment by government, private and community sectors are exempt from custom duties until further notice. All private medical facilities have been instructed to provide discounted services until 12 April.

Donor support

The World Bank has approved a fast-track $29 million Emergency Response and Health Systems Preparedness Project to help Nepal prevent, detect, and respond to the pandemic and strengthen its public health preparedness to detect cases and ensure prompt contact tracing consistent with WHO guidelines. The government has finalised agreements to accept a NRs 13.9 billion ($0.11 billion) no-interest loan from the IMF and $50 million from ADB.

Information in this note is correct as of 9 April 2020. The authors are ODI Fellows in Ghana and Albania; this note is written in a personal capacity. Comments welcome to s.pandey.fs@odi.org.uk and i.baby.fs@odi.org.uk