



**ALPHA CAPITAL**  
Fund for Contrarian Investors

# NEWSLETTER

First Quarter 2081/82



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**NEPAL**  
**THIS**  
**QUARTER**

## Nepal This Quarter | Politics

Pushpa Kamal Dahal, Chairman of the CPN (Maoist Centre) and opposition leader, condemned the Nepali Congress and CPN-UML, arguing that their coalition signals an impending political crisis. He highlighted that the formation of the government by the two largest parties is worrisome.

Minister of Communications and Information Technology, Prithvi Subba Gurung, warned that abolishing the proportional election system could trigger further conflict in the country. His comments come as concerns about the existing electoral system continue to grow. Gurung stressed that eliminating this system could result in significant political unrest.

The Supreme Court's constitutional bench will hear a writ petition challenging KP Sharma Oli's appointment as prime minister. Justice Bal Krishna Dhakal, leading a single bench, referred the case, highlighting the need for detailed constitutional interpretation.

Minister for Energy, Water Resources and Irrigation Deepak Khadka directed NEA Managing Director Kulman Ghising to

clarify the details and descriptions presented to the NEA's Board of Directors (BoD) and the decisions made by the Board concerning dedicated feeders and trunk lines. Additionally, the government has requested Ghising to submit a report outlining the authority he has delegated over the past four years. This move is seen as part of preparations to potentially remove Ghising from his position.

The CPN-UML's acceptance of a land donation and funding for its new headquarter from Min Bahadur Gurung, the owner of Bhatbhateni supermarket chain, who is under investigation for misappropriating government property, has sparked significant controversy. Political analysts are raising serious concerns about the ethics of a ruling party, like the UML, accepting such a donation from a businessman entangled in an unresolved legal matter.

A parliamentary probe panel's report stops short of directly implicating former Home Minister Rabi Lamichhane in diverting cooperative funds to his media company, but it does find him guilty of misusing the fund for the company. The panel

recommends prosecuting Lamichhane, along with his business partners GB Rai, Chhabi Joshi, and board member Kumar Ramtel.

Lawmakers' attempt to impose a five-year statute of limitations on corruption cases highlights the depth of corruption in Nepal and their efforts to shield wrongdoers. The proposed amendment to the Prevention of Corruption Act, 2002, sparked public outrage. In response, Home Minister Ramesh Lekhak announced in August that the KP Oli-led government would withdraw the amendment. The bill sought to limit corruption prosecutions to five years, except for cases involving misuse of public property, which would have further entrenched corruption.

The Supreme Court's decision to ban construction within an additional 20 meters of rivers in Kathmandu Valley was praised by environmentalists for protecting against encroachment and pollution. However, under local pressure, the federal government has requested a review, sparking debate over balancing environmental protection and development.



## Nepal This Quarter | Economy and Business

The International Monetary Fund (IMF) and the Asian Development Bank (ADB) have both highlighted positive recovery signs in Nepal's economy. The ADB projects Nepal's growth rate to rise to 4.9 percent in 2025, up from an estimated 3.9 percent in 2024. Similarly, the World Bank projects Nepal's real GDP growth to accelerate to 5.1 percent in FY25 and 5.5 percent in FY26, indicating a positive trajectory for the country's economic development.

The government has introduced the Inland Revenue Mobilization Strategy 2024, outlining a revenue framework for Fiscal Years 2024/25 to 2028/29. Developed in conjunction with the 16th periodic plan, the strategy aims to reform the tax system and improve administration while balancing revenue needs with the interests of taxpayers and the private sector.

The government is set to accept a concessional loan of approximately NPR 15.29 billion (USD 115 million) from the Asian Development Bank (ADB) for the Irrigation Modernization Enhancement Project.

The Inland Revenue Department (IRD) has introduced a 10% VAT

rebate for payments made electronically at hotels, restaurants, and bars. This initiative, aimed at promoting electronic transactions and improving tax compliance, applies to payments made through debit cards, credit cards, QR codes, and mobile payment systems. Based on the Value Added Tax Act of 1996, the rebate will be directly credited to consumers' bank accounts, making it easier for individuals to take advantage of this program and encouraging a shift towards digital payment methods in Nepal.

In the past fiscal year 2080/81, Nepal imported 11,701 electric vehicles, including cars, jeeps, and vans, valued at around NPR 29.48 billion. This influx generated NPR 13.28 billion in government revenue, according to data from the Customs Department. The rise in imports highlights the increasing demand for electric vehicles in the country.

Nepal's petroleum imports dropped by 4.35 percent to NPR 337.34 billion in the last fiscal year, primarily due to lower international prices. Despite the increasing use of electric vehicles (EVs) and rising electricity production, the country remains heavily reliant on fossil fuels.

Imports of diesel, kerosene, and liquefied petroleum gas collectively decreased by NPR 15.36 billion, underscoring the ongoing challenges Nepal faces in transitioning to sustainable energy sources.

The government's failure to match its high spending with sufficient revenue collection has led to a significant rise in public debt in recent years. In FY 2023/24, public debt grew by NPR 135 billion, reaching NPR 2.434 trillion by mid-July 2024, which accounts for 42.65 percent of Nepal's GDP. Over the same period, the government paid NPR 305 billion in principal and interest on its public debt.

Nepal Rastra Bank has introduced stricter regulations on loans and non-fund-based facilities for major shareholders, senior management, auditors, legal advisors, and employees of banks and financial institutions (BFIs) to reduce conflicts of interest. These revisions aim to enhance accountability and promote responsible financial practices.



## Nepal This Quarter | Capital Market

The Public Debt Management Office has introduced the Internal Debt (Issue and Management) Procedure, 2081, allowing Citizen Savings Bonds and Foreign Employment Savings Bonds to be traded in the secondary market. Similar to stock trading, these bonds can now be bought and sold through the 'Debt Operation and Management Software (DOMS)' and the Investor Portal. Additionally, Treasury Bills can be traded via DOMS, while development bonds will be listed on NEPSE for secondary market trading through broker companies after issuance. This enhances liquidity and accessibility for bond investors.

The Securities Board of Nepal (SEBON) has announced plans to extend the lock-in period for promoter shares of listed companies. Currently set at three years, this restriction prevents promoters from selling their shares immediately after a company is listed on the Nepal Stock Exchange. Despite requests from promoters to shorten the lock-in period, SEBON is planning to extend it further, aiming to ensure greater market

stability and protect investor interests.

Mahesh Baral, acting chairman of the Securities Board of Nepal (SEBON), announced the approval of a merchant banking license for Himalayan Merchant Banker. Himalayan Merchant Banker is supported by investments from prominent firms such as Golcha Group, Shankar Group, Ramesh Corp, and Infinity Group.

Secured Securities (Stock Broker No. 36) has launched a new Trade Management System (TMS) after four years of development. This enhanced platform includes multi-window support, faster collateral loading, and real-time portfolio access. Additionally, users can view technical charts, set sell limits, and monitor share quantities. With these advanced features, clients can now trade more efficiently and seamlessly.

Banks and financial institutions (BFIs) are now mandated to include clear provisions for issuing margin calls on share collateral loans in their loan product documentation as well as sale of pledged shares for loan

recovery. The updated NRB directive also allows unlisted rights and bonus shares to be used as collateral before official listing.

According to CDSC data, investors incurred Rs. 50 million in fines within the first two months of 2081/82, compared to Rs. 66.65 million for the entire previous year. This significant rise indicates that many new investors lack the necessary understanding of share trading. To avoid costly errors, it is crucial to provide better education and resources to guide them through the market effectively.

Interviews for the SEBON Chairman have been halted again after the government resumed the process following a Supreme Court order. The delay is due to the absence of Dr. Shivaraj Adhikari, the recommendation committee coordinator, and the candidates. Previously, only two of five shortlisted candidates attended interviews, leading to the process being canceled on June 28.



## Nepal This Quarter | Real Estate

All brick industries in Chitwan, once renowned for their quality production, have been shut down. Twenty years ago, 44 brick industries were operational, but none remain active today. This highlights the severe challenges faced by the local brick manufacturing sector.

A new three-star hotel, Siddharth Hotel Damauli, has officially opened in Damauli, Tanahun, with an investment of one billion rupees. Developed by Apex Hospitality, the hotel operates under the "Siddharth Batika" brand and is managed by Siddharth Hospitality, Nepal's largest hotel chain. This launch aims to boost local tourism by offering enhanced accommodation options in the region.

Construction of the 'Nepal Art Village' has started in Champi, Lalitpur Godavari, featuring the world's largest Bhairav face. The statue, made from panchadhātu, will stand 72 feet tall, 58 feet wide, and weigh 65 tons. It will be housed in a five-story RCC building, which will also include an art museum. The project spans 238 ropani, with 52 ropani allocated for the Bhairav statue and 186 ropani for the Kalagram,

aiming to become a cultural landmark.

Bharatpur Metropolitan City is nearing completion of its metropolitan ring road, a project with an investment exceeding 1.5 billion rupees. Developed in partnership with the Federal and Provincial Governments, the 88.6-kilometer road links key areas within the metropolis, utilizing the banks of the Rapti and Narayani rivers and passing through intermediate and community forest zones. Once completed, the ring road is expected to significantly improve connectivity and foster local development in the region.

Bharatpur Municipal City has resumed constructing the Gautam Buddha International Cricket Stadium in Bharatpur-15, with support from both provincial and central governments. Santosh Acharya, head of the urban infrastructure division, reported that the stone soling work under the parapet is progressing swiftly. This project is part of an effort to upgrade the region's sports infrastructure and promote cricket at the national level.

Amidst economic slowdown, Bhatbhateni Group is actively expanding its network across Nepal. Within just three days, Chairman Min Bahadur Gurung laid the foundation for two new stores in Pokhara and Chitwan, with a combined investment of three billion rupees. Once operational, these stores will bring Bhatbhateni's total number of outlets to 29, with a 30th store planned in Hattiban, Lalitpur.

Nepal's first granite industry has been launched in Simara SEZ, Bara, by businessman Guddu Srivastava with an investment of approximately 180 million rupees. The Laxmi Granite Industry can cut 200,000 square feet of granite per month, processing raw granite imported from Rajasthan, India, into various sizes. The factory is equipped with three cutting machines and offers around 18 varieties of granite slabs. Srivastava expects a strong demand for granite in Nepal, anticipating no issues in finding a market for the product.



**HOW WE  
VIEW**



## How We View | Politics

With the new fiscal year, Nepal saw a new coalition take the reins of the government. The two largest parties, CPN-UML and Nepali Congress, have come together to run the government with KP Oli as the Prime Minister. Unfortunately, it seems that the power struggle to topple the government has already begun.

Speculation is rife that external forces are displeased with Oli's leadership and are seeking to replace him. Adding fuel to the rumors was a coincidental visit to India by Arzu Deuba, wife of the Nepali Congress chairman and current Foreign Affairs Minister, which overlapped with a visit by Maoist Centre leader Prachanda's daughters, Renu and Ganga Dahal. Their stay at the same hotel sparked whispers of a potential government shake-up just two months after its formation. However, both Prachanda and Arzu Deuba have downplayed these rumors. Prachanda stated that he is no longer interested in power, while Arzu Deuba asserted that the coalition will last until the 2084 elections, denying any ambition for the Prime Minister's role. Additionally, it is believed that Deuba, known for his loyalty, is unlikely to betray his allies. Party insiders are also pressuring him to maintain the coalition, leading many to believe that the alliance will be difficult to break.

Yet, tensions simmer beneath the surface. The government's delayed response to recent floods has further fanned speculation of discord between the coalition partners. Deputy Prime Minister Prakash Man Singh blamed PM Oli for the delayed rescue operations, accusing him of withholding authority while he was absent, which prevented Singh from calling a cabinet meeting. This incident highlights a lack of coordination and suggests Oli's reluctance to fully share power with Nepali Congress, possibly igniting a power struggle in the near future. However, the coalition is still new and there are works to be done, for instance changes in the constitution which was one of the coalition's primary goals.

Upendra Yadav has expressed support for the constitutional amendment, provided his party's longstanding demands from the constitution's drafting are met. The Madhes-based leaders have been voicing discontent with certain provisions in the constitution since its inception. Whether the constitution amendment will be the tipping point that will topple the government or something else remains to be seen, as one thing is sure in Nepalese politics - instability. A writ petition has already been filed challenging KP Oli's appointment as Prime Minister. Time will tell whether the changes will affect just the leadership or the entire government.

In another significant development, an amendment to the Truth and Reconciliation Commission (TRC) bill has been finalized. All three major parties agreed on the terms, which have now been passed by the parliament. Under the new provisions, the consent of the victims will be required for case settlements, failing which human rights violation charges can be pursued. Serious human rights violations, however, remain non-amnestiable. As the Maoist Centre has approved the amendments, it is expected that most of its party leaders will face little to no consequence under the amended bill.



Speaking of the Maoist Centre, there seemed to be some dissatisfaction among its members. Some leaders of the party had publicly criticized and demanded a change in leadership. However, Prachanda assured that everything was well within the party.

Another party chairman that can't seem to catch a breath is Rastriya Swatantra Party (RSP) chairman and former home minister Rabi Lamichhane. The parliamentary committee investigating the cooperative related fraud submitted its final report. This report states that they could not find any proof that Rabi Lamichhane was involved in bringing illegal loan to Gorkha Media Network Pvt. Ltd. however he was involved in utilizing and directing the expenses of this fund. The committee recommended prosecuting Lamichhane along with others involved. In addition, coalition partners have moved to remove Deputy Speaker Indira Rana, a member of RSP, from her post following allegations of misconduct. Rana is accused of misusing her position to expedite visa interviews at the U.S. embassy. If removed, her position will likely go to a member of the Nepali Congress, granting the party representation in the Constitutional Council—a body responsible for nominating heads of constitutional bodies and the chief justice. Without this post, the RSP will be left without significant influence.

On the international front, rising tensions between Israel and Iran, along with the possibility of a full-scale war, pose serious risks to the global economy, with potential fallout similar to the Ukraine-Russia conflict. For Nepal, the situation could lead to the return of migrant workers from the region, bringing a new set of challenges and opportunities for the country.

To conclude, the current coalition seems to be on a shaky ground. As always, the future of Nepali politics remains unpredictable, with shifting alliances and unforeseen challenges shaping the path ahead.



## How We View | Economy

### Nepalese Economy

The first quarter of this fiscal year started with the expectations of an expansionary monetary policy encouraging money supply in the economy. Nepal Rastra Bank (NRB) tried to deliver on those expectations through some policy changes. Several revisions in the directives and guidelines were promised in the statement made by the governor including revisions in the capital adequacy framework, blacklisting provisions, provisions related to non-performing loans (NPLs), and more. Since then, NRB has been rolling out circulars to amend the Unified Directive, 2080, and others in many phases to deliver on those promises. For one of the major changes, NRB recently removed the obligation to maintain a counter-cyclical buffer of 0.5% and reduced it to 0% while calculating the Tier-1 capital. This would help increase the lending capacity of the banks. The provision percentage for the pass loan has been reduced to 1.10% from 1.20%.

Our discussion after the release of the monetary policy concluded that the monetary policy focuses on gradually increasing loans to the productive sector, especially targeting the construction industry and MSMEs. However, without significant changes to the Working Capital guidelines, large industries may see stagnant loan growth unless they work on expanding their revenues through alternative capital injections.

Nonetheless, with unchanged risk weight for Capital Adequacy Ratio (CAR) calculation and limited alternative capital expansion options for banks and financial institutions, there's a concern about how much credit banks can extend before their Tier 1 capital is again strained. Overall, the policy is balanced, with a major emphasis on supporting MSMEs and companies that contribute to economic development.

Nepal Development Update released by World Bank Group forecasts a real GDP growth rate of 5.1% for this fiscal year and 5.5% for the next fiscal year. Soon after this forecast was released, eastern and central parts of Nepal were hit by massive rainfall, floods, and landslides. Roads connecting Kathmandu from other parts of Nepal were blocked for a few days affecting transportation just before the festival season. Many hydropower projects including the country's largest Upper Tamakoshi Hydroelectric project were damaged. Also, the electricity transmission lines were swept away by floods and landslides halting electricity generation and distribution for many days. Preparations are still underway to resume operation of these hydropower projects and transmission lines. News of floods, landslides, and roadblocks just before the start of peak travel season hampered the tourism industry too. Citing this adverse scenario, the forecast by the World Bank Group is expected to be revised in its next update.



## Monetary Stance

Through the monetary policy for this fiscal year the bank rate, the upper bound of the interest rate corridor, and the policy rate have been reduced by 50 basis points each to 6.5 percent and 5 percent, respectively. The deposit collection rate, the lower bound of the interest rate corridor, has been kept unchanged.

|                         |       |
|-------------------------|-------|
| Bank rate               | 6.50% |
| Policy Rate             | 5.00% |
| Deposit Collection Rate | 3.00% |

By the first quarter's end, credit had only increased by NPR 124 billion, reflecting a year-to-date growth of 2.40% while deposits had grown by NPR 167 billion, a YTD growth of 2.57%. Total credit stood at NPR 5,293 billion, while deposits reached NPR 6,660 billion, resulting in a CD ratio of 78.14. Banks were flush with liquidity, and by October 17, the NRB absorbed NPR 8,165 billion through monetary operations. The yields on treasury bills with various maturities also decreased.

| Indicator                   | FY 2081/82 Q1 | FY 2080/81 End | FY 2080/81 Q1 |
|-----------------------------|---------------|----------------|---------------|
| Total Deposit (NPR billion) | 6,660         | 6,493          | 5,847         |
| Total Loan (NPR billion)    | 5,293         | 5,169          | 4,951         |
| CD Ratio                    | 78.14         | 77.67          | 81.81         |
| Inter Bank Rate             | 3.00%         | 2.96%          | 1.99%         |
| Treasury Bill:              |               |                |               |
| 28 days                     | 2.76%         | 2.95%          | 2.9%          |
| 31 days                     | 2.97%         | 2.99%          | 4.27%         |
| 182 days                    | 2.99%         | 3.03%          | 5.1%          |
| 364 days                    | 3.01%         | 3.18%          | 5.78%         |

## Fiscal Stances

Comparing the first quarter end of this fiscal year with the last fiscal year, capital expenditure has increased by NPR 11.54 billion and recurrent expenses have increased by NPR 16.46 billion. Also, an increase of NPR 20.62 billion in financing expenditure is seen in the current quarter as compared to last year. The financing expenditure is expected to grow significantly next fiscal year. The tax revenue of the government increased by NPR 20.22 billion while the non-tax revenue increased by NPR 8.92 billion contributing to an overall increase in government revenue by NPR 29.14 billion as compared to first quarter end of the last fiscal year.

The figures for the first quarter of this fiscal year indicate better progress in meeting fiscal targets compared to the previous year. However, despite signs of improvement, the key component of the government budget—capital expenditure—remains low at 8.34% of the already modest target of NPR 352 billion, especially in contrast to recurrent expenses.



Amount in Lakh (,00,000)

| Topic                                    | Target/Budget<br>(FY 2081/82) | Actual<br>up to Q1 End FY<br>2081/82 | Percentage<br>(FY<br>2081/82) | Target/Budget<br>(FY 2080/81) | Actual<br>up to Q1 End FY<br>2080/81 | Percentage<br>(FY<br>2080/81) |
|--|-------------------------------|--------------------------------------|-------------------------------|-------------------------------|--------------------------------------|-------------------------------|
| 1. Revenue                               | 14,193,030                    | 2,482,600                            | 17.49 %                       | 14,225,417                    | 2,191,151                            | 15.4 %                        |
| a) Tax Revenue                           | 12,842,096                    | 2,196,829                            | 17.11 %                       | 13,054,796                    | 1,994,621                            | 15.28 %                       |
| b) Non-Tax<br>Revenue                    | 1,350,934                     | 285,771                              | 21.15 %                       | 1,170,621                     | 196,530                              | 16.79 %                       |
| 2. Grants                                | 523,265                       | 0                                    | 0 %                           | 499,430                       | 618                                  | 0.12 %                        |
| 3. Other Receipts                        | 0                             | 47,533                               | 0 %                           | 0                             | 154,555                              | 0 %                           |
| <b>Total Receipts of<br/>GoN (1+2+3)</b> | <b>14,716,295</b>             | <b>2,530,133</b>                     | <b>17.19 %</b>                | <b>14,724,847</b>             | <b>2,346,324</b>                     | <b>15.93 %</b>                |
| <b>Total Expenditure:</b>                | <b>18,603,030</b>             | <b>3,292,011</b>                     | <b>17.7 %</b>                 | <b>17,513,121</b>             | <b>2,805,725</b>                     | <b>16.02 %</b>                |
| a. Recurrent                             | 11,406,645                    | 2,298,521                            | 20.15 %                       | 11,417,841                    | 2,133,904                            | 18.69 %                       |
| b. Capital                               | 3,523,540                     | 293,746                              | 8.34 %                        | 3,020,744                     | 178,331                              | 5.9 %                         |
| c. Financing                             | 3,672,845                     | 699,744                              | 19.05 %                       | 3,074,536                     | 493,490                              | 16.05 %                       |

### Macro Economics

The data below shows a significant decrease in the overall inflation rate to 3.85%, which was at 8.19% in mid-September a year ago. Inflation in India experienced an incline reaching 5.49% in September end 2024 from 5.02% a year ago.

Export seems to have declined by 38.61% with a total export of NPR 25.09 billion for the first two months of this fiscal year as compared to NPR 40.87 billion in the first two months of last fiscal year. The import seems to have increased by 1.07% only during the same period.

Travel income totaled NPR 10.53 billion for the first two months of this fiscal year as compared to NPR 9.34 billion in the first two months of last fiscal year. Travel income totaled at NPR 10.53 billion showing an increase of 12.74% this year as compared to last year. Travel income arises from sources like tourism, business visitors, and other international visitors spending money on accommodations, food, transportation, and other related expenses.

Remittance income increased by 15.23% in the first two months amounting to NPR 10.53 billion. The national foreign currency reserve stands at a record total of USD 16.04 billion at the mid-September of the fiscal year. The foreign currency reserve increased by USD 4.03 billion in a year. This reserve is sufficient to import merchandise and services for the next 13.7 months.

Amount in NPR billions

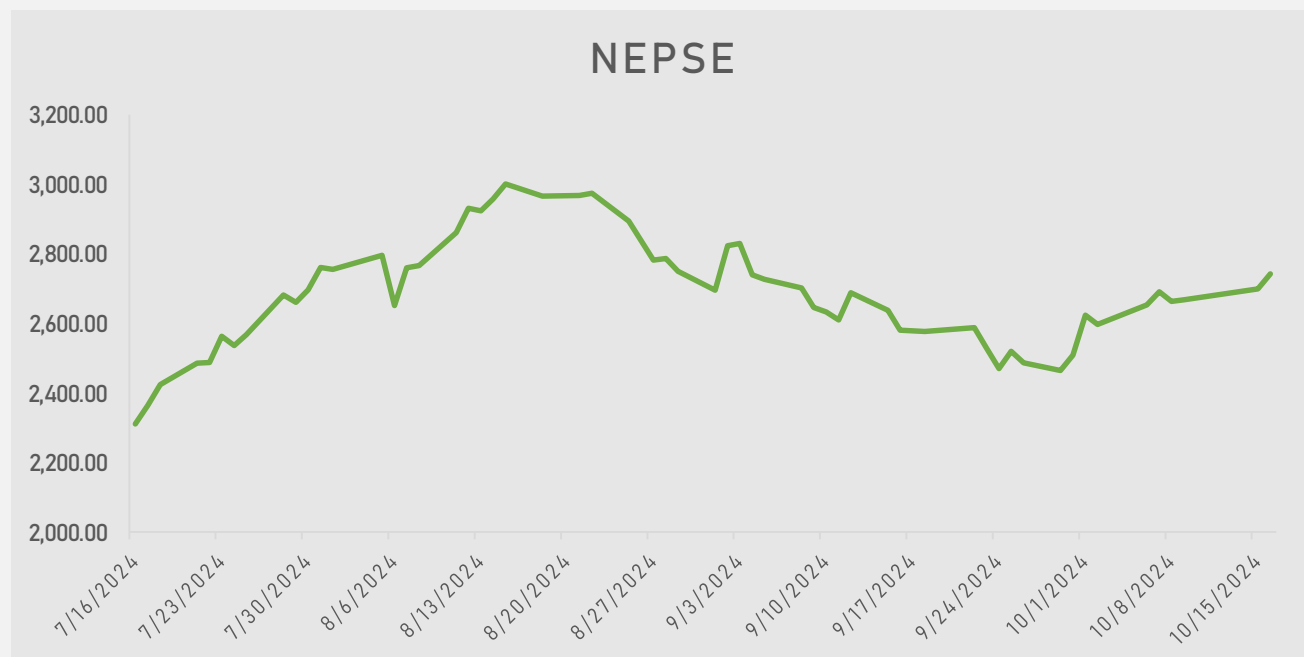


| Indicators                               | As of Bhadra End<br>FY 2081/82 | As of Bhadra End<br>FY 2080/81 | Y-O-Y Change |
|--|--------------------------------|--------------------------------|--------------|
| Inflation                                | 3.85 %                         | 8.19%                          | -52.99%      |
| Indian Inflation (Sept. End))            | 5.49 %                         | 5.02%                          | 9.36%        |
| Export                                   | 25.09                          | 40.87                          | -38.61%      |
| Import                                   | 262.54                         | 259.75                         | 1.07%        |
| Trade Deficit                            | 237.45                         | 233.3                          | 1.78%        |
| Export to Import (%)                     | 10.18%                         | 10.8%                          | -5.74%       |
| Travel Income                            | 10.53                          | 9.34                           | 12.74%       |
| Remittance                               | 263.14                         | 228.37                         | 15.23%       |
| Forex Reserve in USD (\$)                | 16.04                          | 12.01                          | 33.56%       |
| Forex Reserve Sufficiency (in<br>Months) | 13.7                           | 10.3                           | -            |



## How We View | Capital Market

NEPSE index displayed notable volatility this quarter, reaching an intraday high of 3,048.15 before dropping to a low of 2,442.63. It later recovered to close at 2,742.88, marking a gain of 502.47 points, or 22.43%, from the previous quarter's close of 2,240.41. The market's bullish sentiment was fueled by optimism surrounding the return of Bishnu Poudel as Finance Minister and expectations of monetary policy easing. However, without substantial policy changes for the capital market, the index began to decline. Nonetheless, it is once again trending upward with the start of dividend season.



| Sector-wise Sub-Indices      | This Quarter Close | Prev. Quarter Close | Change (%) |
|------------------------------|--------------------|---------------------|------------|
| Banking Index                | 1,601.81           | 1,221.24            | 31.16%     |
| Development Bank Index       | 5,445.56           | 4,433.50            | 22.83%     |
| Finance Index                | 3,419.58           | 2,604.16            | 31.31%     |
| Hotels And Tourism           | 6,772.31           | 5,559.65            | 21.81%     |
| Hydropower Index             | 3,314.71           | 2,783.55            | 19.08%     |
| Investment                   | 108.93             | 83.59               | 30.31%     |
| Life Insurance               | 13,403.96          | 10,767.60           | 24.48%     |
| Manufacturing And Processing | 7,186.29           | 6,727.70            | 6.82%      |
| Microfinance Index           | 5,082.37           | 4,818.40            | 5.48%      |
| Mutual Fund                  | 20.99              | 20.42               | 2.79%      |
| Non-Life Insurance           | 13,196.42          | 11,179.96           | 18.04%     |
| Others Index                 | 2,114.79           | 1,694.64            | 24.79%     |
| Trading Index                | 3,730.68           | 3,048.79            | 22.37%     |



## Sectoral Dissection

### Banking Sector

At the start of the quarter, banks had lowered interest rates, with the highest institutional fixed deposit rate at 6.5% in Shrawan. This rate rose to 7.41% in Bhadra but dropped to 6.41% in Aswin and further reduced to 6.18% for Kartik. Despite falling interest rates, credit growth remained sluggish. To support credit expansion, NRB's monetary policy relaxed blacklisting provisions, offering significant relief to the construction sector. Additionally, the central bank extended loan repayment periods and implementation of some aspects of the working capital guidelines. It also lowered pass loan provisions from 1.2% to 1.1%. Through a separate directive, NRB introduced a provision allowing BFIs to issue perpetual non-cumulative preference shares, aimed at enhancing their capital adequacy ratio (CAR). While these measures aim to boost credit growth, NRB also issued directives focused on strengthening risk management within BFIs.

### Hotels & Tourism

The number of tourists visiting Nepal has been steadily increasing. However, the recent rainy season and the subsequent flooding have caused a temporary dip in tourist arrivals, as many potential visitors were discouraged by the adverse weather conditions. Despite this setback, the outlook for tourism is optimistic with the onset of the trekking season. As the weather clears and popular trekking routes, such as those in the Annapurna and Everest regions, become more accessible, Nepal is poised to welcome a growing number of adventure enthusiasts. As of August 2024, a total of 72,719 tourists have already entered the country, marking a rise from 67,153 visitors during the same period last year. This upward trend reflects the growing appeal of Nepal as a prime tourist destination.

### Hydropower

The recent flooding has caused significant damage to several hydropower projects across Nepal. According to a preliminary report by the Ministry of Energy, Water Resources, and Irrigation, the hydropower sector alone has suffered losses of around NPR 2.45 billion due to floods and landslides. Minister for Energy, Water Resources, and Irrigation, Deepak Khadka, stated that approximately 1,100 megawatts of electricity production has been halted after the floods caused extensive damage to hydropower projects nationwide. Among the affected projects are 11 operational hydropower plants with a combined installed capacity of 625.96 MW, including the 456 MW Upper Tamakoshi Hydropower Project. Additionally, the floods and landslides have impacted 15 hydropower projects under construction, with a total installed capacity of 1,010.29 MW. Reconstruction may take several months to over a year, depending on the extent of the damage and resource availability.





## Insurance

According to the Nepal Insurance Authority, by October 15, a total of 3,244 claims have been filed with 14 non-life insurance companies and 4 micro non-life insurers. The companies are expected to pay out more than NPR 8.98 billion for these claims. So far, they have settled 97 claims, amounting to NPR 172.8 million in payments. Most insurance companies have reinsurance, which will significantly reduce their financial burden by nearly half. However, their profits will still be impacted due to the need for additional provisions for outstanding claims.

## Manufacturing & Processing

The manufacturing sector has been severely affected by the ongoing economic downturn, facing reduced demand and production challenges. However, the upcoming festival season presents an opportunity for recovery, with anticipated sales increases for companies like Unilever Nepal Limited (UNL) and Bottlers Nepal (BNT), as consumer spending typically rises during this period. Additionally, the need for reconstruction in flood-affected areas is expected to drive up demand for construction materials, particularly cement, providing a potential boost to the construction and manufacturing industries. This increased demand for essential goods and materials could help mitigate some of the losses experienced in recent months.



# How We View | Real Estate

## Infrastructure Development

### Roads

**Fast Track:** Over the past two years, the progress of the Fast Track project has been significant compared to other infrastructure developments in Nepal. The completion date is set for Chaitra 2083. The track includes 89 bridges (12.85 km in total length) and 6 tunnels (10.39 km total length).

**Araniko Highway:** The construction work from Suryabinayak to Dhulikhel is gaining momentum. In the 1.5 years since the project started, 27% of the work has been completed.

**Bharatpur Ring Road (Chakrapath):** The Bharatpur Chakrapath project has seen significant progress, with 90% of the road completed. The total project cost is estimated at NPR 1.5 billion for 88.6 km, averaging NPR 17 million per km for road construction in the Terai region.

**Muglin–Pokhara Highway:** Approximately 70% of the Muglin–Pokhara Highway has been completed. However, certain tasks, such as relocating electric poles and settling compensation claims for affected homes, are causing delays.

**Narayangadh–Butwal Highway:** A Chinese contractor has been delaying work on the Narayangadh–Butwal Highway, and they have been warned of possible removal from the project. To date, 45% of the work has been completed.

### Others

**Gautam Buddha Stadium:** Bharatpur Municipality has taken over the management of the Gautam Buddha Stadium. Construction has started with funding allocated from both state and national governments.

**Nepal Art Village (Lalitpur, Champi):** The construction of Nepal Art Village has begun. A 72 ft tall and 58 ft wide statue of Bhairab will be placed in the area, which spans 268 ropanis. The project will feature residential houses, an art exhibition hall, a jungle trail walk, and a center dedicated to natural herbs.

Nepal Chambers of Commerce hosted an Infrastructure Summit on Bhadra 27 and 28. For long-term sustainable growth by 2030 B.S., Nepal will require over NPR 20 trillion in investments.



## **Kitta-Kat (Land Segregation)**

The government has once again surprised many by halting the kitta kat (land parceling) process. Numerous local authorities are still in the midst of segregating agricultural and residential properties. In response, the government has extended the deadline for completing this process until the end of fiscal year 80/81. To date, only 21% of the required land segregation reports have been submitted, while 620 local authorities are still working on it, leaving their kitta kat operations temporarily halted.

The implications of this delay will likely hinder real estate transactions, further slowing growth in the sector. This stagnation will have a direct impact on those involved in the real estate business and individuals looking to liquidate property for essential needs.

## **Contraction in Construction**

Despite falling interest rates, the construction sector in Nepal continues to struggle due to a lack of confidence, with construction loans plummeting by 49%. If this trend persists, it could severely hinder the country's infrastructure development, pushing Nepal further behind.

In an attempt to stimulate the sector, the government has lifted the ban on blacklisted construction companies, aiming to encourage entrepreneurs and maintain cash flow from government projects. However, despite these favorable policies, the sector has shown little signs of recovery.

Many cement factories are operating at less than 50% capacity, raising concerns for the industry. Banks are also facing difficulties managing loans tied to the cement sector, adding to the economic strain. To address these challenges, the government must implement stronger, more effective policies to revive both the construction and manufacturing sectors.

## **Banking and Finance**

With liquidity accumulating in the banking sector, interest rates have fallen. By the end of Aswin 2081, home loans were being offered at rates as low as 7.7%, driving a surge in loan demand. In fiscal year 2079/80, loan disbursed to the real estate sector totaled NPR 31.51 billion, while in 2080/81, this figure rose to NPR 57.58 billion. The largest portion of this increase, NPR 38.89 billion, was in residential personal home loans (up to NPR 20 million). Loans for land purchases and plotting amounted to NPR 14.11 billion. However, loan growth in the commercial and residential apartment sectors has slowed significantly. Additionally, lending growth in income-generating commercial complexes turned negative, declining from 53.7% in FY 2079/80 to -18.5% in FY 2080/81. While loan disbursements have seen a sharp rise, this hasn't been reflected in real estate transactions. This suggests that much of the increased loan activity may be attributed to the refinancing of existing loans rather than new property acquisitions.



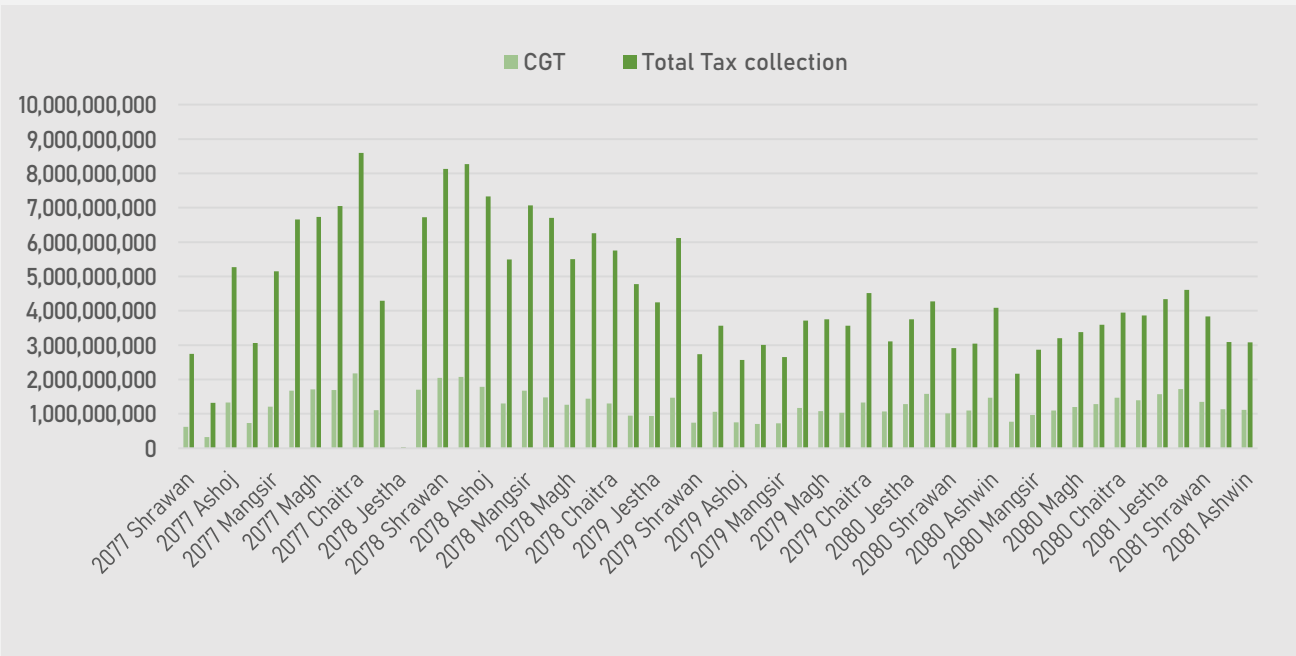
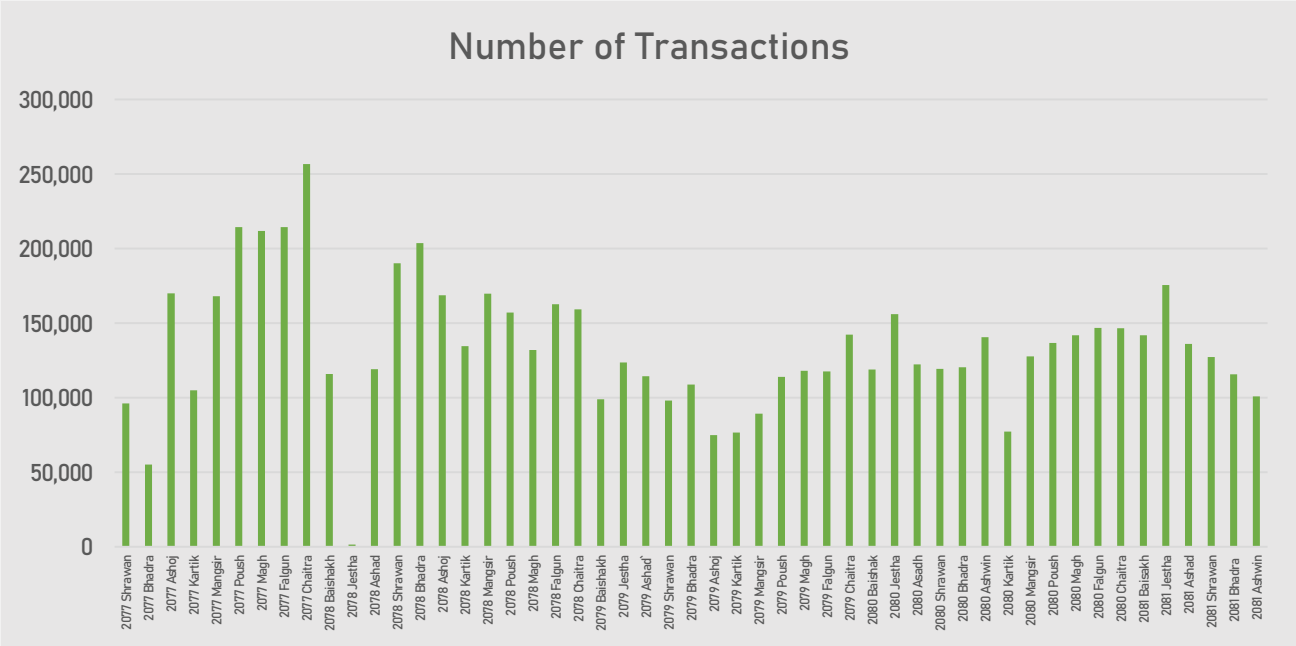
Banks are facing significant challenges in recovering loans. Many have resorted to creating separate websites for auctioning collateral. Despite these efforts, they have struggled to sell the collateral and have ended up seizing the properties in their own names, contributing to a rise in non-performing assets (NPAs). By Shrawan 2081, NPAs had reached NPR 36.92 billion, compared to NPR 19.09 billion a year earlier.

### Transaction Records

| Time         | Number of Transactions | CGT           | Total Tax collection |
|--------------|------------------------|---------------|----------------------|
| 2081 Shrawan | 127,206.00             | 1,346,948,866 | 3,835,082,885        |
| 2081 Bhadra  | 115,642.00             | 1,131,565,113 | 3,090,259,152        |
| 2081 Ashwin  | 100,848.00             | 1,116,271,769 | 3,081,241,481        |

| Time         | Number of Transactions | CGT           | Total Tax collection |
|--------------|------------------------|---------------|----------------------|
| 2080 Shrawan | 119,324                | 1,013,132,786 | 2,910,427,196        |
| 2080 Bhadra  | 120381                 | 1,092,946,429 | 3,045,946,811        |
| 2080 Ashwin  | 140590                 | 1,469,502,907 | 4,086,629,437        |





When analyzing the charts and transaction reports on a year-on-year (Y-O-Y) basis, it becomes clear that the market is not showing signs of improvement; in fact, it appears to be worsening. The number of transactions has been low over the past 21 months. This indicates that, despite home loan interest rates dropping to 7.7%, many people remain hesitant to invest in real estate. Over the last few quarters, even with more flexible real



estate policies and banks increasing loan disbursements to the residential sector, potential buyers are struggling to feel confident that real estate will yield profitable returns.

The data on tax collection paints an equally concerning picture. Tax revenue dropped from NPR 8.5 billion in Chaitra 2077 to NPR 4 billion in Ashwin 2081. Over the past four years, this represents a 47% correction, significant loss to the government.

When we examine transaction records, major cities are leading the market, while smaller cities continue to struggle to establish a foothold in the real estate sector.

Apartment sales also reflect this downturn. In Shrawan, only 16 units were sold, and in Bhadra, 24 units were sold, compared to the 50–70 units sold per month in the previous fiscal year. Despite many apartments being in the development pipeline, they are still struggling to find buyers, even in core urban areas. This financial crisis is affecting every asset category in Nepal, with real estate taking a particularly hard hit.



# THIS QUARTER FOCUS

## **This Quarter Focus** | A Buffer against Crisis: The Strategic Importance of the Countercyclical Capital Buffer

The global financial crisis of 2007-2008 triggered a significant overhaul of regulatory frameworks across the banking sector, with a key focus on mitigating systemic risks and enhancing financial stability. One such regulatory tool developed as a response is the Countercyclical Capital Buffer (CCyB), introduced under the Basel III framework. The CCyB is a capital reserve that banks must accumulate during periods of economic growth and prosperity, which they can draw upon during times of financial stress or economic downturns. In the context of Nepal, Nepal Rastra Bank (NRB), the central bank, adopted this tool in 2015 to ensure the stability of the country's financial system, given its growing credit market and the economy's exposure to both domestic and external risks.

### **The Concept of the Countercyclical Capital Buffer**

The Countercyclical Capital Buffer (CCyB) is a macroprudential regulatory tool designed to counter the pro-cyclicality of credit growth in the banking system. Pro-cyclicality refers to the tendency of credit markets to expand rapidly during economic booms and contract sharply during downturns. This can create asset bubbles during good times and exacerbate recessions when the economy slows down.

The Countercyclical Capital Buffer (CCyB) is designed to enhance the resilience of the banking system by requiring banks to accumulate additional capital during periods of excessive credit growth, often signaled by a rising credit-to-GDP ratio. This extra capital reserve serves as a protective buffer that can be drawn down during times of financial stress, allowing banks to absorb losses and continue lending without resorting to sudden credit cutbacks or raising emergency capital. By having this buffer in place, the broader financial system is shielded from potential shocks, reducing the likelihood of systemic crises and minimizing the need for government bailouts, thus supporting economic stability.

The Basel Committee on Banking Supervision (BCBS) introduced the CCyB under the Basel III regulatory framework, and it has since been adopted by many countries around the world, including Nepal.

### **Global Implementation of the Countercyclical Capital Buffer**

Globally, the implementation of the CCyB has been gradual. Countries apply the buffer differently depending on their specific economic conditions and credit trends. The framework allows national regulators to set the buffer rate anywhere from 0% to 2.5% of Common Equity Tier 1 (CET1) capital (refers to a bank's core capital, consisting of common shares, retained earnings, and reserves, which are the strongest buffer against financial losses. It is the most reliable form of capital to absorb losses and protect the bank during financial stress,





depending on the level of systemic risk in the economy.

Countries like the United Kingdom and Sweden have been proactive in using the CCyB, increasing the buffer rate during periods of economic growth to reduce the risks associated with rising household debt and overheated real estate markets. In contrast, the United States has been more conservative in applying the buffer, largely keeping it at 0% since the 2008 crisis.

The CCyB has proven effective in many jurisdictions as a tool to curb excessive credit growth and maintain financial stability. For example, in Sweden, the CCyB was raised to 2.5% during periods of strong credit growth to prevent an unsustainable increase in household debt.

### Countercyclical Capital Buffer in Nepal

Nepal implemented the CCyB as part of its macroprudential policy under the guidance of Nepal Rastra Bank (NRB) in 2015. NRB introduced the buffer to promote financial stability and ensure that the country's banking sector remains resilient during periods of economic downturn.

NRB sets the buffer requirement based on the credit-to-GDP gap, which is the difference between the actual credit-to-GDP ratio and its long-term trend. The following table shows the buffer requirement in terms of Common Equity Tier 1 (CET1) capital:

| Credit-to-GDP Gap | Buffer Requirement (% of CET1) |
|-------------------|--------------------------------|
| Up to 5 points    | 0%                             |
| 5 to 6 points     | 0.5%                           |
| 6 to 7 points     | 1%                             |
| 7 to 8 points     | 1.5%                           |
| 8 to 9 points     | 2.0%                           |
| above 9 points    | 2.5%                           |

The credit-to-GDP gap is calculated as the difference between the credit-to-GDP ratio and its trend:

$$\text{Credit to GDP Gap (t)} = \text{Credit to GDP Ratio(t)} - \text{Trend(t)}$$

Trend defines the average credit-to-GDP ratio of the past five years.

For instance, if the average credit-to-GDP ratio for past five years is 90% and this year's credit-to-GDP ratio is 97%, then gap equals 7 points (97%-90%), and the banks will have to maintain buffer of 1% usually by the end of next twelve months. A bank will not be permitted to disperse its profits if it cannot maintain the countercyclical buffer requirement.

The credit-to-GDP ratio is a critical indicator used by NRB to determine when the buffer should be activated. The table below highlights the trends in credit flow, GDP, and credit-to-GDP ratio from fiscal year 2074/75



(2017/18) to 2080/81 (2023/24 P):

(in NPR million)

| Year        | Credit Flow | GDP       | Credit-to-GDP Ratio |
|-------------|-------------|-----------|---------------------|
| 2080/81 (P) | 5,167,173   | 5,704,844 | 90.58%              |
| 2079/80 (R) | 4,879,279   | 5,348,528 | 91.23%              |
| 2078/79     | 4,709,130   | 4,976,558 | 94.63%              |
| 2077/78     | 4,172,785   | 4,352,550 | 95.87%              |
| 2076/77     | 3,266,012   | 3,888,704 | 83.99%              |
| 2075/76     | 2,911,897   | 3,858,930 | 75.46%              |
| 2074/75     | 2,422,779   | 3,458,793 | 70.05%              |

The data shows that the credit-to-GDP ratio in Nepal fluctuated significantly, peaking at 95.87% in 2077/78 (2020/21) before gradually declining to 90.58% in 2080/81 (2023/24 P).

NRB initially introduced the Countercyclical Capital Buffer (CCyB) at 2% for the fiscal year 2076/77, intending to implement it. However, due to the fear of adverse economic impact of COVID-19, the implementation was postponed to provide financial relief to industries, businesses, and professionals affected by the pandemic, while ensuring the financial sector remained stable. This postponement eased loan disbursements by reducing the capital requirements for banks. If the CCyB had been implemented, banks would have needed to maintain a Capital Adequacy Ratio (CAR) of 13%, but without it, the CAR requirement remained at 11%. The buffer was temporarily removed to promote easier loan access and sustain economic activity.

In the fiscal year 2080/81, the Countercyclical Capital Buffer (CCyB) was reinstated in Nepal after the credit-to-GDP gap reached 6.09%, exceeding the 5% threshold required for its activation. Banks were instructed to maintain a 0.5% CCyB by the end of that fiscal year. However, in the subsequent year, 2081/82, the CCyB was not triggered. The credit-to-GDP ratio was 90.58%, with a five-year average of 88.91%, resulting in a gap of only 1.66%. As this gap was below the 5% threshold, the CCyB remained inactive.

### Implications for Financial Stability in Nepal

NRB's application of the CCyB ensures that banks maintain adequate capital buffers to weather periods of financial instability. By adjusting capital requirements based on the credit-to-GDP ratio, NRB can mitigate the risk of a credit bubble or economic downturn.

The buffer also supports investor confidence by ensuring that banks have the necessary capital to absorb losses without threatening the overall financial system. This is particularly crucial in Nepal, where the banking sector plays a central role in economic development.



## Global Comparisons and Lessons for Nepal

When compared with other countries, Nepal's implementation of the CCyB is relatively conservative, reflecting the country's developing economy and unique credit dynamics. While countries like the UK and Sweden have applied buffers as high as 2.5%, Nepal's buffer requirements have remained moderate, focused on preventing credit bubbles rather than addressing large-scale financial crises.

However, as the economy grows and credit expansion accelerates, Nepal may need to adopt a more aggressive stance, particularly in sectors like real estate and unproductive sectors, where credit growth could become unsustainable.



