



Understanding Various Dimensions of Nepali Economy in the Changing Context

Over the past three decades, Nepal has experienced a series of political transitions, from democracy to monarchy and back to a democratic federal system. These changes have been accompanied by social and economic transformations. Although the promulgation of the new constitution in 2015 and the subsequent elections of the federal structure in 2017 marked the end of this long political transition, public aspirations and expectations for a new economic discourse have become very high. Despite ongoing efforts to achieve sustained and high growth, various challenges remain on the path to greater prosperity.

In our pursuit of prosperity, we have faced long-standing challenges, particularly regarding policy choices and limited resources. Additionally, a number of global challenges have come to the forefront, including shifting geopolitical conditions, trade fragmentation and supply chain disruptions, climate change and technological and digital innovations.

Macroeconomic situation

In the last 10 years, we suffered from a series of shocks, especially the 2015

earthquake, and COVID-19 in 2020. When our economy was on track for full recovery from post-earthquake along with the newly established federal structure, COVID-19 severely hit the economy in 2020. I believe we are still experiencing the ongoing effects of COVID-19, both directly and through the policy changes it necessitated. Currently, our economy is in the recovery phase after a slowdown created along with the pressure on the external sector, and asset prices boom. Recently released Nepal Statistics Office estimates show a GDP growth of 3.87 percent for this fiscal year. The recovery seems to be mainly supported by electricity, and robust tourism growth, but construction and manufacturing are still in slowdown, with negative growth. While the speed up in economic recovery is an immediate concern, our major worry must be a very low potential growth of about 4 percent, indicating a low-growth trap for Nepal. In recent months, inflation seems moderated and favourable if we look back at the last year. Annual average Consumer Price Inflation (CPI) in the Fiscal Year 2023/24 stood at 5.44 percent. Inflationary pressure has gradually eased along with the improvement in the external sector.

Now, our external sector is in a comfortable position after a very high pressure two years ago. Both the current account and balance of payment are in surplus, resulting in foreign exchange reserves sufficient to cover 15 months of imports of merchandise goods. But, the buildup of the reserve is primarily coming from the huge influx of workers' remittances, and negative import growth due to low aggregate demand. Looking at the role of imports and remittances, we often view Nepal as import-based economy driven by remittances which also an indication of why the growth is jobless.

Despite the stable financial system, there are some reflections of a slowdown in economic activity. Private sector credit growth is only 5.22 percent in Fiscal Year 2023/24 despite the low interest rates in the last few months. Despite enough liquidity, credit has not picked up due to the weakness on the demand side. Our banking sector has remained sound, resilient and stable even in the large shocks such as the 2015 earthquake, and the COVID-19 pandemic.

Opportunities abound

When I think about the various issues of the Nepali economy, several

questions come to my mind. Are we not living in the land of opportunities? What factors are holding us back in the path of sustainable growth?

In fact, we are living in the land of opportunities in various dimensions. We are rich in natural capital in terms of biodiversity, water and energy, and minerals. Even I believe that Nepal can begin its path of sustainable development through resource-based growth.

Nepal has abundant potential for long-term, sustained high growth in the tourism sector. Our rich topography, including the world's highest mountains, diverse culture, and biodiversity are undeniable assets. However, the question remains: are we fully harnessing this potential? All stakeholders must consider this.

Last year, tourist arrivals surpassed one million, and even in 2024, monthly arrivals have exceeded 100,000, indicating a strong recovery and growth in the tourism sector. Nepal's strategic location between two of the world's most populous economies offers significant opportunities. A McKinsey & Company report from November 2023 predicts that India will become the fourth largest global spender on travel by 2030, driven by increasing purchasing power and travel expenditure. The study also found that seventy percent of Indian tourists prefer nearby destinations. Similarly, China, with its massive population, rising middle class, and growing economic power, presents another opportunity. By investing in better tourism infrastructure, policies, and promotion, Nepal can capitalise on the travel spending growth of these neighbouring countries.

Another key driver of sustained high growth in Nepal is hydropower. By producing sufficient clean energy, we can reduce our reliance on imported petroleum products and even export hydroelectricity to neighbouring countries, particularly India and Bangladesh. India, as the world's fastest-growing economy, faces a significant energy demand that is currently heavily reliant on coal. The country aims to



achieve over 64 percent of its energy capacity from non-fossil fuel sources by 2030. Nepal can play a crucial role in meeting this demand, contributing to its own long-term development. Recent energy agreements with India and Bangladesh are positive steps in this direction. However, significant investments in transmission lines, roads and related policies are still needed to fully tap the potential of this sector. Harnessing hydropower will also help address environmental concerns and disaster risks in the Himalayan region.

Third, Nepal must capitalise on its demographic dividend. According to the Population Council and UNICEF, this window of opportunity lasts approximately 55 years, from 1992 to around 2047. Nepal still has 23 years to leverage its high working-age population. However, the rampant outflow of skilled workers, particularly students seeking opportunities in developed nations like the USA, Australia, and Canada, poses a significant long-term challenge if not

addressed through reverse migration policies. To reap the benefits of the demographic dividend in the form of accelerated human development and economic growth, Nepal must overcome this hurdle.

Another emerging opportunity lies in harnessing the benefits of technological advancements and promoting the IT sector. Even while operating within Nepal, we can export IT services and create employment opportunities. This sector has the potential to transform our economy from one that exports labour to one that exports services. Offshore outsourcing in software development and digital services is a prime example. Unlike other export-oriented sectors, IT services are not hindered by Nepal's landlocked status. The key to success lies in developing competitive skills and technologies.

Beyond these specific areas, Nepal has several other opportunities for sustainable development. Our rich biodiversity, land resources and

associated agricultural potential are unique features. Additionally, our geographical location can make Nepal a hub for financial centres, connecting our large neighbours.

Challenges ahead

While we often discuss high-sustained green growth, several challenges impede our progress toward long-term sustainable development. One significant obstacle is the high level of climate and disaster risk Nepal faces. Every year, we are affected by climate-related shocks such as earthquakes, landslides and floods, which are becoming increasingly frequent due to global climate change. Nepal is ranked fourth most vulnerable country according to the Climate Vulnerability Index by Maplecrafter, and is also ranked 11th most vulnerable to earthquakes and 16th most vulnerable to multi-hazards. A key challenge is achieving sustainable growth while simultaneously mitigating the worsening impacts of climate change and disasters.

Another pressing challenge is how to address the current trend of outmigration. Approximately two thousand Nepalis leave the country for foreign employment each month. Annually, around 400,000 young people enter our labour market, but the domestic job market is limited and unstable, forcing many to seek employment abroad. This has led to labour shortages in agriculture and manufacturing. Additionally, a significant number of students pursue higher education in developed nations. The loss of these skilled individuals, both in terms of physical labour and intellectual capital, represents a missed opportunity for Nepal's growth. The challenge lies in attracting skilled workers back to Nepal and reversing the outmigration trend to foster robust and sustainable development.

Third, how can we capitalise on global trends in technology, economic dynamics, and our proximity to two major economic powers? As mentioned earlier, India and China have become central players in the global economy.

Tourism and attracting foreign investment are other areas where we can initiate sustainable growth.

The challenge lies in implementing the right policy measures to benefit from these neighbouring economies.

Fourth, how can we increase productivity while also generating job growth? According to the International Labour Organisation, Nepal's labour productivity is very low, ranking just above Pakistan and Bangladesh among South Asian economies. Additionally, a recent South Asia Update by the World Bank highlights that Nepal's growth, like other South Asian economies, has not led to significant job creation. Therefore, a key challenge is to create more jobs and enhance productivity.

Numerous challenges hinder the Nepali economy. How can we ensure stable policies despite frequent changes in government? How can we implement effective governance reforms? How can we strengthen the rule of law and improve the business environment? How can we generate sufficient resources to finance high and sustained growth? How can we invest in both physical and human capital infrastructure to reduce transaction costs and ensure sustainable growth? These are additional challenges we must address moving forward.

Key takeaways to move forward

To move forward, we must prioritise reforms in key sectors. Governance reforms, particularly bureaucratic

reforms at all levels of government, are essential. Additionally, reforms in agriculture, education, health, and the financial sector are crucial.

Our growth strategy should initially focus on our natural resources. For example, harnessing water resources for hydropower can be a key driver of growth. In the medium term, we can also extract other natural resources while maintaining environmental sustainability. The cement industry is one example.

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Fourth, we must develop a plan to capitalise on the demographic dividend. Creating jobs domestically and utilising the skills of returning migrants are key strategies. Fifth, investing in quality infrastructure and upgrading existing infrastructure is essential for long-term, sustained growth.

If we were to compile a comprehensive list of policy actions, it would be extensive. For example, developing policies and resilient infrastructure to address climate and disaster risks is a crucial task. Legal reforms, including strengthening the rule of law and infrastructure, are also essential for attracting foreign investment and capital formation.

Economic diplomacy is crucial for benefiting from our growing neighbours, India and China. A long-term, stable policy towards our neighbours is essential. Additionally, we must carefully navigate the changing global geopolitical landscape to maximise the benefits of economic diplomacy.

All stakeholders should play a collaborative role in achieving long-term economic prosperity, despite our differences in views and agendas on other issues. Let us unite behind a common economic strategy for a prosperous Nepal, ensuring that future generations are proud of our work today.

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