External Sector: Balance of Payments, Other Related Statistics and Issues

By

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Date: January 22, 2024 (2080/10/8)
Time: 10:30 – 12:30
Venue: ..................Surkhet
प्रस्तुतिको रुपरेखा

I. विषय प्रवेश : समर्पितगत आर्थिक सूचकहरू (Compilation) को प्राविधिक पक्ष

II. प्रमुख वाट्य सूचकहरू : शोधनान्तर (BOP) विदेशी विनिमय संचिति, विनिमय दर र IIIP

III. विदेशी विनिमय व्यवस्थापन र सो सम्बन्धी सूचकहरू

IV. विदेशी विनिमय दर प्रणाली र मौद्रिक नीति को सैदान्तिक पक्ष
I. विषय प्रवेश : समष्टिगत आर्थिक सूचकहरू compilation को प्राविधिक पक्ष

- समष्टिगत आर्थिक सूचकहरू र समष्टिगत आर्थिक नीति
- समष्टिगत आर्थिक सूचकहरूको तथ्याङ्कीय ढाँचा (Statistical framework of macroeconomic accounts)
- नेपाल राष्ट्र बैंक र समष्टिगत आर्थिक सूचकहरू
समष्टिगत आर्थिक सूचकांक र समष्टिगत आर्थिक नीति

समष्टिगत आर्थिक नीति तर्जुमाको तथ्याङ्कीय आधार

• समष्टिगत आर्थिक नीति तर्जुमा र आर्थिक मुद्राहरू सम्बोधनको आधार।
• अर्थतन्त्रको संरचना र अन्तरसम्बन्धको आधार
• आर्थिक विश्लेषणको आधार

• मूख्य समष्टिगत सूचकांक (Macroeconomic accounts) :
  • राष्ट्रिय आय लेखा तथ्याङ्क (National income accounts)
  • मौद्रिक तथा वित्तीय तथ्याङ्क (Monetary and financial accounts)
  • सरकारी वित्त तथ्याङ्क (Government finance accounts ) and
  • वात्य क्षेत्र सम्बन्धी तथ्याङ्क (External sector )
• यी चारवटा सम्पूर्णता लेखाहरुले समग्र अर्थरत्न र अर्थरत्नका क्षेत्र विशेषको चित्र दिने गर्दछन।
• उदाहरणका लागि राष्ट्रिय आय लेखाले अर्थरत्नको चित्र, आकार र वृद्धिकर देखाउँछ।
• आर्थिक गतिविधिको पहिचान र वर्गीकरण गरेर राष्ट्रिय लेखा तयार पारिन्छ र निम्न क्षेत्रहरुमा आर्थिक गतिविधी विभागक गर्न सकिन्छ।
  • प्राथमिक आर्थिक गतिविधि (Primary economic activities)
  • द्वितीय आर्थिक गतिविधि (Secondary economic activities)
  • सेवा (Tertiary economic activities)
• The SNA 2008 has reclassified NI accounts into 21 sectors by industrial origin.
• National Statistics Office (NSO) has adopted the SNA 2008 and started publishing NI accounts into 18 sectors by industrial origin.
• This classification gives the structure (the sectoral shares) of the economy.
• From expenditure side the popular NI identity is:
  \[ AD = GDP = C+I+G+X – M \] ..........(1)
• Inclusive of income redistribution, the popular NI identity is:
  \[ GNDI = GDP + Yf + CF \] ............(2)
  Where, GNDI = gross national disposable income, GDP= gross domestic product, Yf = income earned from abroad, Cf = current transfers.
• NI account also includes price statistics including producer and consumer price indices
Monetary and financial accounts provide overall size of the financial sector, liquidity, bank credit and money supply.

Some monetary identities are:

\[ M_2 = NFA + NDA \ldots (3) \]
\[ M_2 = M_1 + TD \ldots \ldots (4) \]
\[ M_1 = CiC + DD \ldots \ldots (5) \]

Where,

- \( M_2 \) = broad money,
- \( M_1 \) = narrow money,
- \( CiC \) = currency in circulation,
- \( DD \) = demand deposits,
- \( TD \) = time deposits including savings and call

\( M_2 \) measures overall monetary liquidity.
The Government Finance Statistics

- The government finance statistics capture the economic role of the government and consequences of government borrowing.
- Three indicators are important.
- First, बजेट घाटा
  
  Fiscal balance = Total revenue and grants – Total expenditure and net lending.

  \[ T - (Cg + Ig + Tr) = CB \] ....(6)

  Where,
  
  CB is the conventional balance,
  
  T is tax and non-tax revenue and grants.
  
  Cg + Ig is absorption,
  
  Tr = government transfer payments (interest, subsidies, and social insurance benefits).

- Second, the public debt ratio सार्वजनिक ऋण अनुपात
- Third, sources of government borrowing घाटा वजेटको पूर्ति
How are these accounts compiled?

- Statistical frameworks are used to identify, classify and compile these macroeconomic statistics.
  - Currently, Nepal is using the system of national accounts (SNA) 2008 to compile and publish national income accounts of Nepal.
  - The SNA is the mother for all other macroeconomic accounts.
  - The SNA is an international standard system of national accounts developed and updated by the United Nations, among others.
• Like wise, the monetary and financial statistics manual (MFSM) and Compilation Guide 2016 are used for compiling monetary accounts.

• The government finance statistics manual (GFSM) 2014 is used for compiling general government statistics.

• NRB is making transition to the balance of payment (BOP) manual sixth (edition) 2008 for compiling BOP statistics.

• The IMF develops and updates the other macroeconomic accounts and makes sure that member economies adopt them for compiling these statistics.
Who compiles macroeconomic accounts in Nepal?

- Of these four accounts, while the NSO compiles national income accounts, the Ministry of Finance prepares annual government finance.
- NRB compiles and publishes the government finance, monetary, BOP and price statistics on a monthly basis.
- On the basis of these macroeconomic accounts, NRB prepares and publishes a macroeconomic update called Macroeconomic and Financial Situation of Nepal every month.
II. Exploring external sector accounts: BOP and IIP

• What are the core external sector statistics?

• शोधनान्तर र यस्को संरचना BOP and its structure

• विदेशी विनिमय संचिती International reserve position

• अन्तराष्ट्रिय लगानी स्थिति International investment position (IIP)

• के सधैै शोधनान्तर सन्तुलनमा रहन्छ? Does BOP always balance?
External Sector Accounts: BOP and IIP

Core external sector statistics

• वात्य क्षेत्रको स्थिति भफल्काउने मुख्य सूचकहरू
  i. शोधानान्तर र यस्को संरचना (BOP and its structure)
  ii. विदेशी विनिमय संचिति International reserve position (gross foreign assets of the banking sector) of the country and
  iii. अन्तराष्ट्रिय लगानी स्थिति International investment position (IIP)

• While BOP is the flow of transactions, IIP is the position (stock ) of transactions with nonresidents.

• International reserve position, which measures the accumulation of foreign exchange especially by the central bank, is also closely linked with the BOP of the country.

• Hence, both international reserve position and IIP complement the BOP.
BOP refers to the summary of transactions of one country (residents) with non-residents (the rest of world (ROW)).

- **Current account** (Current account)
- **Capital and financial account** (Capital and financial account) and
- **Reserve account** (Reserve account)

When all components of the BOP are included they must sum to zero.

\[
\text{BOP} = \text{current A/C} + \text{capital A/C} + \text{financial A/C} + \text{reserve account} = 0
\]

**Current account** (Current account)

- Current account includes, merchandise, services, income and transfers accounts.
• Services refer to the transportation and insurance of merchandise shipments, transport fares paid by travelers, tourist services, royalties and license fees, communications, expenditures of foreign contractors such as wages, house rentals, government purchase, embassy and consulate services (visa fee).

• Income may be derived from labor (wages paid to employees living in foreign countries) and from financial assets or liabilities.

• Financial income (investment income) represents receipts and payments of interest on financial assets and liabilities and dividends on corporate stocks.

• Transfers which includes, grants, workers’ remittances, pensions, gifts, donations, INGOs.
• Current account transactions do not give rise to future claims.
• The current account balance is identical ex-post to the economy's resource gap as measured by the difference between economy-wide saving and investment.

\[ S-I = CAB = X-M + Yf + Tr \] \hspace{1cm} (7)

• Alternatively, the current account reflects the gap between income and absorption in the economy,

\[ GNDI - A + CAB \] \hspace{1cm} (8)

• The S-I gap can be rewritten as

\[ (Sp + Sg) - (Ip + Ig) = CAB \] \hspace{1cm} (9)
\[ (Sp - Ip) + (Sg - Ig) = CAB \] \hspace{1cm} (10)

where,

\[ S=\text{savings}, I=\text{investment}, CAB=\text{current account balance}, X=\text{export of G/S}, M=\text{imports of G/S}, Yf=\text{foreign income}, Tr=\text{current transfers}, GNDI=\text{gross national disposable income}, Sp=\text{private sector savings}, Ip=\text{private sector investment}, Sg=\text{government savings}, Ig=\text{government investment}.\]

• Equation (10) is used to discuss the concept of twin deficits — a situation when a country suffers from both the fiscal deficit and the external current account deficit.
Capital and financial account

Capital account

- Capital accounts lead to change in ownership of foreign assets. It includes:
  
  i. Acquisition or disposal of non-produced non-financial assets such as trademarks, patents, copyrights, leasing agreements and mineral rights, land sold to embassies, among other items.
  
  ii. Capital transfer including debt forgiveness, conditional grants for capital projects such as foreign aid to build roads, dam and schools. And also transfer of goods and financial assets by migrants leaving the country, transfer of fixed assets.
वित्तीय खाता (Financial account)

• The financial account has five functional categories:
  • प्रत्यक्ष वैदेशिक लगानी (Direct investment- equity capital and reinvested earnings),
  • Portfolio investment (long term debt and equity securities, money market instruments) and
  • Borrowing by general government, the private sector (ECB), multilateral forms from their parent countries.
  • Trade credit includes export and import trade credit.
  • Tradable financial derivatives including currency and interest rate swaps.
• There could be cases of exceptional financing of rescheduling of existing debt, arrears on debt servicing, bond issued for BOP support, transfers
Reserve account サンチティ カタ

• Reserve account is classified as ‘below the line’ and acts as a balancing item.
• The reserve account records the activity of the nation’s central bank.

  \[\text{CA} + \text{Capital account} + \text{FA} + \text{Balancing item} = 0\]

• A BOP surplus is accompanied by an accumulation of foreign exchange by the central bank.
• When a BOP is in surplus, the balancing item will carry a negative sign.
• When a BOP is in deficit, the balancing item, i.e. reserve account will carry a positive sign.
International reserve position

• NRB in its macro update calls it gross foreign exchange assets of the banking sector.
• The sign of the balancing item (reserve account) will indicate a surplus or a deficit in BOP at any given period of time.
• BOP and country’s international reserves are closely interlinked.
• When BOP is in surplus, country will accumulate (add to its) international reserves.
• On the other hand, when BOP is in deficit, country will lose its international reserves.
• Hence, accumulation and depletion of country’s international reserves are closely linked with its BOP position.
International Investment Position (IIP)

- The financial crises of 1990s underscored the importance of stock data for assessing country’s external vulnerability.
- IIP is the balance sheet of financial assets and liabilities of an economy with respect to the ROW.
- IIP consists of external debt statistics, direct investment, portfolio investment and international reserves.
- The net IIP constitutes the net worth of the economy.
- The statistical framework used for the compilation of external sector accounts is the BOP manual Sixth edition (BPM6) 2008.
- However, NRB is compiling and publishing BOP statistics using both the BPM5 (1993) as well as BPM6 (2008) on a parallel run basis.
Table 1: BOP and its structure

<table>
<thead>
<tr>
<th>S.No</th>
<th>Account</th>
<th>2022 July</th>
<th>2023 July</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>A</td>
<td>Current</td>
<td>-623</td>
<td>-72</td>
<td>• Current A/C convertibility status on May 30, 1994</td>
</tr>
<tr>
<td>1</td>
<td>Merchandise trade balance</td>
<td>-1662</td>
<td>-1399</td>
<td>• FERA, 1962,</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Foreign Investment and Loan Management By-Law, 2021</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Net wealth</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• 1st generation reforms</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• OGL system</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• De-licensing</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Deregulation</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Opening up for oversees employment</td>
</tr>
<tr>
<td>i</td>
<td>Exports inc. electricity</td>
<td>212</td>
<td>183</td>
<td></td>
</tr>
<tr>
<td>ii</td>
<td>Services, net</td>
<td>-108</td>
<td>-84</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Travel</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Government n.i.e. embassy, consulate services (R/E)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Others (maintenance, construction (exp. of foreign contractors, all other services)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>iii</td>
<td>Income, net</td>
<td>29</td>
<td>62</td>
<td></td>
</tr>
<tr>
<td>iv</td>
<td>Transfers, net (G, R, P, gifts, INGOs)</td>
<td>1118</td>
<td>1348</td>
<td></td>
</tr>
</tbody>
</table>
## Table 2: BOP and its structure Continued

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Account</th>
<th>2022 July</th>
<th>2023 July</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>B</td>
<td>Capital account</td>
<td>10.0</td>
<td>7.45</td>
<td>• Act Restricting Investment Abroad (ARIA ) 1964 governs the financial account.</td>
</tr>
</tbody>
</table>
| i      | Capital transfer                             | 10.0      | 7.5       | • Related to financial globalization  
• Capital account convertibility  
• Capital market reforms  
• Banking/financial sector reforms  
• 2nd generation reforms  
• Twin crises of banking and financial  
• De-licensing FDI inflows |
|        | Debt forgiveness                             |           |           |                                                                                                                                                                                                       |
|        | Transfer of goods by migrants                |           |           |                                                                                                                                                                                                       |
|        | Conditional grants to build roads, dams, schools |           |           |                                                                                                                                                                                                       |
| ii     | Acquisition/disposal of non-produced, non-financial assets |           |           |                                                                                                                                                                                                       |
|        | Brand names, copy rights, trade marks       |           |           |                                                                                                                                                                                                       |
|        | Right to use land, water for mining and fishing |           |           |                                                                                                                                                                                                       |
| C      | Financial account                            | 313.0     | 237       |                                                                                                                                                                                                       |
| i      | FDI, net                                     | 18.6      | 6.0       |                                                                                                                                                                                                       |
| ii     | Portfolio investment                         | 0.0       | 0.0       |                                                                                                                                                                                                       |
| iii    | Other investment, assets                     | -14.1     | - 7.4     |                                                                                                                                                                                                       |
### Table 3: BOP and its structure

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Account</th>
<th>2022 July</th>
<th>2023 July</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>a</td>
<td>Trade credits: export receivables</td>
<td>-14.3</td>
<td>-2.3</td>
<td>• ARIA 1964 governs the financial account.</td>
</tr>
<tr>
<td>b</td>
<td>Other: nonlife insurance claim</td>
<td>.02</td>
<td>0.298</td>
<td>• Related to financial globalization.</td>
</tr>
<tr>
<td>iv</td>
<td>Other investment, liabilities</td>
<td>308.5</td>
<td>238.6</td>
<td>• Capital account convertibility</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Capital market reforms</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Banking/financial sector reforms</td>
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<td></td>
<td></td>
<td></td>
<td>• 2nd generation reforms</td>
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<td></td>
<td></td>
<td></td>
<td></td>
<td>• Twin crises of banking and currency</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• De-licensing FDI inflows</td>
</tr>
<tr>
<td>a</td>
<td>Trade credit, M payables</td>
<td>118.5</td>
<td>128.9</td>
<td></td>
</tr>
<tr>
<td>b</td>
<td>Loans</td>
<td>116.0</td>
<td>91.8</td>
<td></td>
</tr>
<tr>
<td></td>
<td>General government</td>
<td>92.6</td>
<td>67.5</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Other sectors, ECB, loans from parent country</td>
<td>23.4</td>
<td>24.3</td>
<td></td>
</tr>
<tr>
<td>c</td>
<td>Currency and deposits</td>
<td>37.5</td>
<td>16.4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NRB</td>
<td>-0.0437</td>
<td>0.046</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DMBs</td>
<td>37.5</td>
<td>16.3</td>
<td></td>
</tr>
<tr>
<td>d</td>
<td>Other liabilities</td>
<td>36.6</td>
<td>2.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Total group A through C</td>
<td>-300.3</td>
<td>172.5</td>
<td></td>
</tr>
</tbody>
</table>

24
Table 4: BOP and its structure Continued

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Account</th>
<th>2022 July</th>
<th>2023 July</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>D</td>
<td>Miscellaneous items, net</td>
<td>119.1</td>
<td>136.7</td>
<td>• ARIA 1964 governs</td>
</tr>
<tr>
<td></td>
<td>Total group A through D</td>
<td>-181.2</td>
<td>309.2</td>
<td>• Related to financial globalization</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Capital account convertibility</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• Capital market reforms</td>
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<tr>
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<td></td>
<td></td>
<td>• Banking/financial sector reforms</td>
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<td>• 2nd generation reforms</td>
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<td></td>
<td>• Twin crises of banking and currency</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>• De-licensing FDI inflows</td>
</tr>
<tr>
<td>E</td>
<td>Reserve and related items</td>
<td>181.2</td>
<td>-309.2</td>
<td></td>
</tr>
<tr>
<td>i</td>
<td>Reserve assets</td>
<td>181.2</td>
<td>-309.2</td>
<td></td>
</tr>
<tr>
<td></td>
<td>NRB</td>
<td>186.0</td>
<td>-275.3</td>
<td></td>
</tr>
<tr>
<td></td>
<td>DMBs</td>
<td>-4.8</td>
<td>-33.9</td>
<td></td>
</tr>
<tr>
<td>ii</td>
<td>Use of Fund Credit and loans</td>
<td>0</td>
<td>0</td>
<td></td>
</tr>
<tr>
<td>F</td>
<td>Change in reserve, net I-increase)</td>
<td>255.3</td>
<td>-290.5</td>
<td></td>
</tr>
</tbody>
</table>
• In an accounting sense it is true as it is based on the system of double-entry book keeping.
• BOP has the settlement account which balances the whole system of BOP.
• However, it is not fully true that BOP is always balanced. It can be in deficit or in surplus. For that we will have to look at the structure of BOP.
• There could be cases of trade, current account, capital and financial account deficits/surpluses.
• Most importantly, we will have to see how these deficits are financed?
• Is it through the foreign exchange reserves, borrowing or exceptional financing?
III. Statistical tables for foreign exchange management

- **First**, भारत सरकार वित्त व्यवस्थापन (Indian currency reserve management)
- **Second**, विदेशी विनिमयको संरचना (the composition of foreign exchange)
- **Third**, समग्र विदेशी विनिमय व्यवस्थापन (Overall reserve management)
- **Fourth**, SDR, IMF र विदेशी विनिमय (Concepts of SDR, reserve position in the Fund and SDR allocation)
Linking statistical tables with foreign exchange management issues

• NRB publishes a number of external sector statistics other than core through its monthly macro update, “Current Macroeconomic and Financial Situation of Nepal,”.

• Some of core and other statistical tables of the external sector are given below.

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Table</th>
<th>Table title</th>
<th>S. No.</th>
<th>Table</th>
<th>Table title</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>19</td>
<td>Imports from India against $ payment</td>
<td>8</td>
<td>27</td>
<td>Exchange rate of US$</td>
</tr>
<tr>
<td>2</td>
<td>23 A</td>
<td>Summary BOP (BPM5)</td>
<td>9</td>
<td>32</td>
<td>Monetary survey</td>
</tr>
<tr>
<td>3</td>
<td>23 B</td>
<td>Summary BOP (BPM6)</td>
<td>10</td>
<td>33</td>
<td>Monetary survey (y/Y)</td>
</tr>
<tr>
<td>4</td>
<td>24 A</td>
<td>Summary BOP (BPM5) $</td>
<td>11</td>
<td>34</td>
<td>Central bank survey</td>
</tr>
<tr>
<td>5</td>
<td>24 B</td>
<td>Summary BOP (BPM6)$</td>
<td>12</td>
<td>35</td>
<td>Central bank survey (y/Y)</td>
</tr>
<tr>
<td>6</td>
<td>25</td>
<td>G foreign assets of BS</td>
<td>13</td>
<td>49</td>
<td>Purchase/sale of FC</td>
</tr>
<tr>
<td>7</td>
<td>26</td>
<td>G foreign assets of BS $</td>
<td>14</td>
<td>An 33</td>
<td>IIP (Annual macro update)</td>
</tr>
</tbody>
</table>
• वात्य क्षेत्रको मुख्य तालिका
• शोधनान्तर तालिका sables 23-24 are summary BOP tables.
• BPMS र BPM 6 अनुसार BOP तालिका Tables 23 A and 24 A are as per BPM5 and Tables 23 B and 24 B are as per BPM6.
• Tables 23A and 23 B are in Nepali rupee and tables 24 A and 24 B are in US dollar.
• Table 27 is used to convert BOP table in Nepali rupee to US dollar.
• As indicated in the relevant table, monthly average exchange rate is used for converting BOP data into US dollar terms.
• Tables 25 and 26 are foreign exchange (assets) accumulation related tables.

• A surplus in BOP would lead to an increase in foreign exchange holdings of the country and a deficit would cause a depletion in it.

• Foreign exchange valuation gain/loss amounts (calculations) explain the difference in the change in reserve position in table 26 and the BOP position in table 23 A.

• Table 25 shows the calculations and tallies the BOP position and the change in net foreign assets.
Comment on Tables 32, 33, 34 and 35

- These tables are of monetary survey and central bank survey.
- Tables 32 and 34 are used to show changes during the particular year.
- Tables 33 and 35 are used to show year-on-year changes in the monetary items (variables).
- These tables are important for compilation of BOP and gross foreign assets.
- The change in NFA in table 32 (monetary survey) is exactly same with the changes in reserve net (-increase) line of BOP table 23 A.
- In fact, the figure of the change in NFA of monetary survey table 32 is exactly copied for the last line of BOP table 23 A.
- Monetary survey and central bank survey are used for compiling the Gross Foreign Assets of the Banking Sector of table 25.
- Statistical tables 19, 25 and 49 are important from foreign exchange management standpoint which are discussed below.
Statistical tables for foreign exchange management

- There are some statistical tables used for managing IC and overall reserve and defending the peg (table 49).

First, Indian currency reserve management भारत संचिति व्यवस्थापन

- **Table 19: Imports from India against payment in convertible currency** and **table 49: Purchase/sale of foreign currency** are associated for IC reserve management following two adverse policy developments initiated by India with respect to Nepal:

  i. **Unfavorable trade and transit treaty with India signed in 2002**
  - This treaty imposed quantitative restrictions on the export of vegetable ghee (100000MT), acrylic yarn (10000MT), copper based products (7500MT) and zinc oxide (2500MT) and also the value addition clause of 30% for export to India.

  ii. **India banning the use of IC of denomination above 100 in Nepal through FEMA on May 3, 2000**
  - These two policy developments initiated by India created adverse impact on Nepali tourism and manufacturing sectors.
  - It made challenging of IC reserve management for Nepal, given the Nepal’s excessive reliance on imports from India.
In order to finance trade deficit with India, Nepal has introduced 3 policy measures.


b) Allowed Nepali business people to import (182 items) from India against the US dollar payments.

c) Started buying IC cash from RBI and importing into the country since February 2004 (Fagun 2061).

RBI fixes limit (currently IC 6 billion) for IC cash every year.

However, Nepal has not utilized it fully in recent times.

Lately, export cash subsidy is in place to reduce trade deficit with India.

Before 2002, Nepal did not face problem in IC reserve management because of liberal trade and transit treaty of 1996, stand by loan agreement with RBI (Nepal has not used since 1994) and constant flow of Indian tourists as there was no banning of IC of denomination above 100.
Nepal’s monetary policy is directed towards defending the peg, which currently acts as the nominal anchor of monetary (table 49).

Second, the composition of foreign exchange विदेशी बिनिमयको संरचना

- Statistical tables, 25, and 34 are used to show the composition of foreign exchange, which consists of:
  - Monetary gold,
  - SDR holdings,
  - Reserve (tranche) position in the Fund and
  - foreign exchange (currencies).
- Monetary gold is used for the issuance of bank notes.
- SDRs and reserve (tranche) position in the Fund are associated with the IMF.
Third, overall reserve management

The statistical tables used for overall reserve management are monthly table 25: gross foreign assets of banking sector and the annual statistical table 33: IIP.

**Table 2: Adequacy of reserves**

<table>
<thead>
<tr>
<th>S. No.</th>
<th>Indicators</th>
<th>Threshold</th>
<th>Nepal: mid-July 2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Import cover, months</td>
<td></td>
<td></td>
</tr>
<tr>
<td>i.</td>
<td>Goods</td>
<td>11.7 months</td>
<td></td>
</tr>
<tr>
<td>ii.</td>
<td>Goods and services</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a.</td>
<td>Advanced</td>
<td>3-4 months</td>
<td></td>
</tr>
<tr>
<td>b.</td>
<td>Developing</td>
<td>6 months</td>
<td></td>
</tr>
<tr>
<td>c.</td>
<td>NRB target</td>
<td>7 months</td>
<td>10.0 months</td>
</tr>
<tr>
<td>2</td>
<td>Reserve/GDP</td>
<td>10%</td>
<td>28.6%</td>
</tr>
<tr>
<td>3</td>
<td>Reserve/imports</td>
<td>30-50%</td>
<td>83.0%</td>
</tr>
<tr>
<td>4</td>
<td>Reserve/M2</td>
<td>20%</td>
<td>25.1%</td>
</tr>
</tbody>
</table>
NRB takes the following factors to decide the level of reserves:

i. Import requirement: benchmark for reserve-to-import ratio

ii. External exposure: the level of foreign debt and debt servicing

iii. Exchange rate regime

Nepal does not have short term capital. The benchmark for this is 1:1.

This indicates that Nepal needs adequate level of international reserves for import financing, debt servicing and FDI servicing.

Table 49: Purchase and sale of foreign currency is reflective of foreign exchange intervention and the policy measure that NRB is active in defending the currency.

This is key to avoid large cross rates and a situation of financial/currency arbitrage.
Fourth, अवधारणा (concepts of SDR, reserve position in the Fund and SDR allocation)

• SDRs were introduced in 1969 to supplement international liquidity by the IMF.
• SDRs are assets, units of account for the IMF, used to settle obligation and can be exchanged for hard currencies.
• The value of SDR is linked with the basket of five currencies: US dollar, Euro, Pound Sterling, Japanese Yen and Chinese Yuan.
• Allocation (creation) of SDR to IMF member countries is done in proportion to their quotas in the IMF.

• IMF, so far, has allocated SDR 660.7 billion ($935.7 billion) from 4 general and a one time special allocation.

• IMF Quotas are membership fee (share capital).

• The total IMF quotas currently stand at SDR 476.2 billion.

• Every five year, IMF quotas are reviewed to reflect the change in the global economy.

• The structure of quota underlies the governance structure of the IMF, the voting power and borrowing by membership.

• Associated with the composition of foreign exchange and SDR is the reserve position in the Fund.

• It is normally 25% of quota kept in hard currencies.

• It is a difference between the country’s IMF designated quota and the IMF’s holding of that country’s currency.
• Nepal is currently under IMF’s 48–month ECF program with the borrowing arrangement of SDR 282.42 million (US$ 384.8 million) during the program period.

• It is 180% of Nepal’s Quota (SDR 156.90 million).

• Nepal has already availed SDR 117.7 million (US$ 156.6 million).

• IMF has designed RCF, SCF and ECF for LICs.
IV. विदेशी विनिमयदर प्रणाली र मौद्रिक नीति (Theoretical issues of exchange rate regime and monetary policy)

• विदेशी विनिमयदर प्रणाली र विनिमयदर निर्धारण पद्धति (Exchange rate regime and exchange rate determination mechanism)
• चालु खाता पूंजी खाता परिवर्त्यता (Current and capital account convertibility)
• विनिमयदर प्रणाली र मौद्रिकनीति (Exchange rate regime and monetary policy)
Theoretical issues of exchange rate regime and monetary policy

Nepal has adopted dual exchange rate regime: it is fixed but adjustable currency peg system with the Indian currency (IC) and flexible with others.

Table 3: Devaluation and Revaluation of NC with IC

<table>
<thead>
<tr>
<th>Sr. No.</th>
<th>Date</th>
<th>NC/IC</th>
<th>Revaluation/devaluation</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>April 13, 1960</td>
<td>1.60</td>
<td></td>
</tr>
<tr>
<td>2</td>
<td>June 6, 1966</td>
<td>1.01</td>
<td>Revaluation by 58.4%</td>
</tr>
<tr>
<td>3</td>
<td>November 8, 1967</td>
<td>1.35</td>
<td>Devaluation by 25.2%</td>
</tr>
<tr>
<td>4</td>
<td>December 22, 1971</td>
<td>1.39</td>
<td>Devaluation by 2.9%</td>
</tr>
<tr>
<td>5</td>
<td>March 22, 1078</td>
<td>1.45</td>
<td>Devaluation by 4.1%</td>
</tr>
<tr>
<td>6</td>
<td>November 30, 1985</td>
<td>1.70</td>
<td>Devaluation by 14.7%</td>
</tr>
<tr>
<td>7</td>
<td>May 31, 1986</td>
<td>1.68</td>
<td>Revaluation by 1.2%</td>
</tr>
<tr>
<td>8</td>
<td>July 1, 1991</td>
<td>1.65</td>
<td>Revaluation by 1.8%</td>
</tr>
<tr>
<td>9</td>
<td>February 12, 1993</td>
<td>1.60</td>
<td>Revaluation by 3.1%</td>
</tr>
</tbody>
</table>
• As the exchange rate regime is fixed, the exchange rate of NC with US $ is computed on the basis of cross rate between IC and US$ in the international market on a daily basis.

• The exchange rates of NC with other 20 currencies are determined on the basis of individual currencies‘ cross rates with US$ and NC-US$ rate.

चालु खाता पूंजी खाता परिवर्त्यता (Current and Capital Account Convertibility)

• Nepal since February 12, 1993 adopted full convertibility for current account transactions and removed foreign exchange controls for current account transactions.

• Nepal obtained the Article VIII status of IMF on May 30, 1994.

• Nepal has yet to go for capital account convertibility.
Exchange rate regime and monetary policy

- It is said that a country with free capital mobility and a fixed exchange rate can not have an independent monetary policy.
- With capital controls, Nepal is using monetary policy to achieve some macro goals.

**Figure 1: Monetary Trilemma**

![Figure 1: Monetary Trilemma](image)