Nepal Development Update

International Migration and Well-being in Nepal

October 2024

WORLD BANK GROUP

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The Nepal Development Update is produced twice a year to report on key economic developments that occurred during the year, placing them in a longer-term and global perspective. The Update is intended for a wide audience including policymakers, business leaders, the community of analysts and professionals engaged in the economic debate, and the general public.

This report was produced by the World Bank Macroeconomics, Trade and Investment (MTI) team for Nepal, led by Nayan Krishna Joshi (Country Economist), and consisting of Abdoul Ganiou Mijiyawa (Senior Country Economist), Sebastian Michael Essl (Senior Economist), and Prabin Dongol (Consultant). The Special Focus of the report was prepared by Lokendra Phadera (Economist), Sarita Sapkota (Economist), and Alvin Etang Ndip (Senior Economist) of the Poverty and Equity Global Practice. Inputs were received from Prashant Raj Pandey (Economist, ESAF1), Yoshihiro Saito (Public Sector Specialist, ESAC1), and Yixin Zhang (Operation Analyst, SAROS). The report benefitted from data and consultations with Dr. Gunakar Bhatta (Executive Director, Nepal Rastra Bank), Mr. Mahesh Acharya (Joint Secretary, Ministry of Finance), Mr. Hikmat B. Bhandari (Undersecretary, Ministry of Finance), and Mr. Suresh Neupane (Deputy Manager, CDS and Clearing Limited). The team thanks Mathew Verghis (Director, Equitable Growth, Finance and Institutions (EFI), South Asia Region), David N. Sislen (Country Director for Maldives, Nepal and Sri Lanka), Shabih Ali Mohib (Practice Manager, MPSTI), Ximena Del Carpio (Practice manager, ESAPV), Preeti Arora (Manager, Operations), and Gregory Smith (Lead Country Economist and Program Leader, EFI) for their guidance and comments on the report. Akash Shrestha and Avinashi Paudel managed media relations and dissemination. Anima Maharjan managed the publication process.

The cutoff date is September 15, 2024, and includes data released up until that date.

The Nepalese fiscal year generally begins on July 16 and ends on July 15 of the following year.

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RECENT ECONOMIC DEVELOPMENTS

Nepal's real GDP growth accelerated to 3.9 percent in FY24, up from 2 percent in FY23. The services sector was the key driver, fueled by a 30.7 percent surge in tourist arrivals, which boosted activities in transportation, accommodation, and food services. Increased hydropower production, by over 450 MW, plus a 4.3 percent rise in paddy production also contributed to the growth.

On the demand side, private consumption was bolstered by strong remittance inflows. Private consumption, accounting for more then 80 percent of GDP, grew by 1.1 percent in FY24, up from record low growth of 0.7 percent in FY23. Private investment, on the other hand, slowed, as evidenced by declining high-frequency indicators such as lower private investment commitments, reduced imports of intermediate and capital goods, and decreased credit to non-financial businesses. Public investment remained weak due to persistently low capital expenditure implementation, with public consumption following a similar downward trend, partly influenced by austerity measures.

Reduced imports and robust remittance inflows bolstered the current account balance, resulting in a surplus of 3.9 percent of GDP—the first in eight years. Remittance inflows increased to a nine-year high on the back of record high migration in FY23. Trade-related measured led to lower merchandise imports, particularly of intermediate goods, including reduced imports of crude edible oil following India's tariff cuts, a drop in imports of broken rice and rice in husk (paddy or rough) driven by India's export restriction (on broken rice) and the imposition of a 20 percent export duty (on rice in husk), and a decrease in unwrought gold imports due to higher customs duties. Electricity exports reached a record high, and service exports grew on the back of increased tourist arrivals. As a result, official foreign exchange reserves grew, covering 13 months of imports by the end of FY24.

Nepal's fiscal deficit narrowed despite stagnating revenues, due to a sharp contraction in spending in FY24. The fiscal deficit (including grants) dropped to a seven-year low of 2.6 percent of GDP in FY24, largely due to a 2.2 percentage point reduction in recurrent spending, which resulted from lower fiscal transfers to subnational governments and austerity measures targeting recurrent expenditures. The spending reductions were focused on allowances, fuel, office supplies, and other administrative expenses. Government revenue (including grants) remained stable at around 19 percent of GDP in FY24, the lowest level of revenues in eight years.

The decline in spending also reflects deteriorating budget execution, a persistent issue since FY18, with budget execution rates falling below 80 percent both FY23 and FY24. Poor revenue collection and chronically low capital expenditure execution have affected budget execution since FY18. In addition, the common practice of bunching expenditures towards the last quarter or month of the fiscal year continues to be problematic, resulting in lower-quality investments and inflationary pressures from surges in aggregate demand.

The lower fiscal deficit led to a slight reduction in public debt to 42.7 percent of GDP in FY24 from 42.9 percent at end FY23. Public debt remains sustainable, supported by a high share of concessional external debt, with domestic debt comprising 49 percent of the total and external debt accounting for 51 percent as of end FY24. Banks and financial institutions hold the bulk of the domestic debt.

Average headline inflation moderated to 5.4 percent in FY24, down from 7.7 percent in FY23, below the Nepal Rastra Bank (NRB)'s target of 6.5 percent. This decline was driven by a significant drop in non-food and services inflation, which fell from 8.6 percent in FY23 to 4.6 percent in FY24. Lower housing and utility prices, as well as reduced transportation costs due to lower fuel prices, contributed to this easing. Food and beverage inflation saw a slight decline of 0.2 percentage points to 6.7 percent, largely due to lower ghee and oil prices.

Monetary policy remained cautiously accommodative. At the start of FY24, the NRB reduced the policy rate by 50 basis points to 6.5 percent, followed by a further 100-basis point reduction to 5.5 percent in December 2023. The NRB aggressively absorbed over NPR 3.5 trillion liquidity in the second half of FY24, through the newly introduced standing deposit facility, which kept the interbank rate close to the lower bound of the policy corridor. During the first half of FY24, the actual interbank rate remained below the corridor's lower bound.

Short- and medium-term nominal market interest rates declined, reflecting the lagged impact of lower policy rates and increased liquidity in FY24. Although real interest rates rose as inflation moderated, which, alongside higher remittance inflows, increased banking and financial institutions' deposits as a share of GDP by 6.3 percentage points to 113.3 percent in FY24. However, private sector credit as a share of GDP remained stagnant. In response, the NRB introduced several measures aimed at stimulating credit growth, particularly in the real estate and manufacturing sectors.

The banking sector faced mounting pressures on asset quality, profitability, and capital adequacy. The non-performing loans (NPLs) ratio reached a record high of 3.8 percent by mid-July 2024, leading to a 29.5 percent increase in loan-loss provisions. This, in turn, reduced net profits by 8.8 percent in FY24. While the banking sector's capital adequacy ratio (CAR) remained well above the regulatory minimum of 11.5 percent (including a countercyclical buffer of 0.5 percent), emerging pressures are starting to challenge the sector's resilience.

OUTLOOK, RISKS, AND CHALLENGES

Nepal's real GDP growth is projected to accelerate to 5.1 percent in FY25 and 5.5 percent in FY26. Wholesale, retail, construction, and manufacturing sectors- that collectively account for over one-fifth of GDP-are poised to benefit from the NRB's loosening of monetary policy and easing of regulatory requirements, including the relaxation of working capital requirements, easing of loan classification and loan-loss provisioning for businesses that continue servicing loans despite closures due to unforeseen circumstances. These measures are expected to stimulate private investment, while remittance-driven private consumption and increased exports of hydropower and tourism are anticipated to further bolster economic growth.

The services sector is forecasted to remain a key growth driver, with tourism, real estate, and trade leading the way. Accommodation and food services are expected to benefit from an increase in domestic and international tourism, fueled by government initiatives aimed at attracting 1.6 million international visitors in FY25 through various tourism promotion programs. This growth will also be supported by the presence of international five-star hotel chains currently operating in Nepal. Additionally, a recovery in merchandise imports is anticipated to boost the wholesale and retail sectors. Real estate services are poised for expansion, driven by NRB's policies that include increased loan limits, higher debt-to-income ratios, and reduced risk weights for first-time homebuyers.

Consumer price inflation is expected to remain moderate, supported by softer global commodity prices and increased agricultural production. Lower inflation in India would help mitigate imported inflation, given Nepal's currency peg. Although rising minimum paddy support prices, the removal of VAT exemptions on select goods, the imposition of VAT on services such as offline air transport and digital payments, and the introduction of excise duties on items like laptops may exert upward pressure on inflation, these effects are likely to be offset by the factors mentioned above.

The current account surplus is expected to narrow as the trade deficit widens. This widening will stem from a rise in both merchandise and service imports. Merchandise imports are projected to increase due to expected recovery of domestic demand, although their values may stay below the record high FY22 levels because of lower commodity prices and reduced electricity imports. On the export side, electricity exports are expected to rise significantly. Service imports are likely to increase as more Nepalese citizens emigrate for work and study, and as foreign exchange restrictions for outbound travel are relaxed. Conversely, service exports are expected to grow, driven by a strengthening tourism industry. Remittances are expected to stabilize at around 25 percent of GDP over the projection period, assuming peak migration in FY23. Under the baseline scenario, foreign exchange reserves are projected to remain sufficient to cover nine months of imports by the end of FY26. A low foreign direct investment (FDI) remains a key weakness.

A gradual reduction in the fiscal deficit is expected over the medium term, driven by decreased recurrent expenditure. New tax measures introduced in the FY25 budget, such as a green tax, the implementation of the recently approved Domestic Revenue Mobilization Strategy, the removal of VAT exemptions on select goods, and planned increases in duties on certain items, are expected to increase revenue collection. However, these effects may be partially offset by the reversal of certain tax amendments, for example, the cancellation of VAT on few food items. While capital expenditure is projected to rise, its execution is likely to remain constrained by the slow implementation of the national project bank. Public debt is projected to decline to 41.3 percent of GDP by the end of FY26, driven by smaller fiscal deficits and higher economic growth.

While the medium-term outlook for Nepal remains positive, it is subject to several downside risks. Increased vulnerabilities in the financial system, marked by a rise in non-performing loans, could curtail private sector credit growth. Policy discontinuity resulting from frequent changes in political administrations, along with the short tenures of officials, might deter investors. Delays in implementing capital expenditure could hinder infrastructure development, negatively impacting growth. Externally, regional instability and trade disruptions could reduce tourism and domestic demand. Natural disasters also pose additional risks to sustaining welfare gains.

There is also a risk that economic growth could slow if there is a shock in migrant-receiving countries. International remittances play a significant role in Nepal's economy, affecting household consumption, poverty reduction, and human capital development. However, migration also poses challenges, such as high costs, unequal opportunities, and poor working conditions for migrants. The special topic section of this Nepal Development Update on international migration and household well-being highlights these key challenges and the necessary reforms. To maximize migration benefits and ensure long-term economic growth, the reforms should focus on implementing an effective and inclusive migration management system. This includes reducing migration costs, investing in education and training, promoting entrepreneurship among returnees, and improving the domestic economic environment.

SPECIAL FOCUS: INTERNATIONAL MIGRATION AND WELL-BEING IN NEPAL: MAXIMIZING BENEFITS AND LEVERAGING LONG-TERM GROWTH

International migration remains integral to Nepal's economy and livelihood. In 2021, one-fourth of Nepali households had at least one member living abroad, and absentees represented 7.5 percent of the country's population. Remittance inflows to Nepal accounted for more than one-fourth of its GDP in FY24, far surpassing the low inflows of FDI and official development assistance, placing Nepal among the top remittances-receiving countries globally.

Overseas low-skilled employment, mainly in the Gulf Cooperation Council (GCC) countries and Malaysia, has become crucial in coping with inadequate domestic job creation. This is particularly the case for younger workers, who face disproportionately high unemployment in the domestic labor market. In 2023, 20.9 percent of men and 25.3 percent of women aged 15 to 24 were unemployed, significantly higher than the national unemployment rate of 12.5 percent. Consequently, international migration from Nepal is predominantly driven by young adults. Out of the 2.2 million individuals living abroad in 2021, 44.5 percent were between ages 15 and 24, and another 31.3 percent were between 25 and 34 when they left the country, while 80 percent were male. For many, migrating for work represents their first job entry into the labor market.

Financial inflows from Nepalis abroad play a pivotal role in uplifting the living standards and resilience, with remittances directly contributing to over 30 percent of Nepal's poverty reduction between 2011 and 2023. Remittances benefit households across the wealth distribution. The number of households receiving these incomes, and the average per capita receipts have increased over time, becoming a significant portion of households' budgets. This is especially notable when compared to households in other South Asian countries. Migration and remittances are associated with increasing household consumption, higher investment in education and health, better family living standards, and improved food security.

However, migration from Nepal is costly, opportunities remain unequal, and the economic benefits are not without costs. Liquidity constraints limit household migration and influence destination choices. While poorer households are likely to send members to low-cost and low-return destinations, the most lucrative destinations are predominantly accessible to the wealthiest, who can afford the high migration costs. Furthermore, migrant workers to the GCC countries and Malaysia often rely on informal loans with exorbitant interest rates to finance their costly moves. After daily consumption, repaying loans is households' most cited use of remittances. While the families left behind face disruption in their social and domestic lives, many migrant workers endure challenging working and living conditions without access to healthcare or social protection, even resulting in death. They also face contract fraud during the recruitment phase and, once abroad, employer exploitation, including withholding of travel and legal documents and likely without social support.

The lack of domestic economic opportunities that propel people to go abroad inhibits the reintegration of return migrants. Most returnees either remigrate or remain out of the labor force or unemployed. Based on the 2017/18 Nepal Labor Force Survey, one of the few available data on returnees, more than half (55.8 percent) of returnees were either out of the labor force or unemployed, and even among those with jobs, over 75 percent were employed in the informal sector, mainly in basic self-employment in agriculture or as an own account and contributing workers. The more advanced skills the returnees bring from abroad do not match the demand of the domestic labor market. Only a fraction of returnees utilizes the skills learned abroad. As a result, remigration remains high, reflecting the lack of a conducive economic environment to utilize the skills and capital from abroad.

The management of migration through an inclusive institutionalized system is critical for sustainability and maximizing the rewards from migration. Nepal's current predominantly low-skilled economic migration matches the strong demand at the destination countries. Policies, thus, should focus on reducing migration costs and increasing benefits for all stages of contemporaneous migrations with an eye for longer-run skill and destination diversification.

Incorporating migration explicitly within Nepal's poverty reduction and development strategy will provide a basis to work towards such a system. This will entail improving migrant preparedness through education and training, raising awareness, enhancing financial and regulatory literacy, establishing a transparent and systematic recruitment process, and planning for longer-term upskilling. It will be crucial to engage in bilateral agreements and actively participate in their implementation and timely update. At the same time, retraining and reskilling programs and initiatives promoting returnees' entrepreneurship could improve returnees' job matches in the domestic labor market. Improving the economic environment to utilize returnees' capital and skills from abroad is equally key. Ultimately, addressing the structural issues in the domestic economy will be important for Nepal in creating a vibrant place where local opportunities can retain people and/or harness new skills.

A
RECENT ECONOMIC DEVELOPMENTS

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A.1 REAL SECTOR

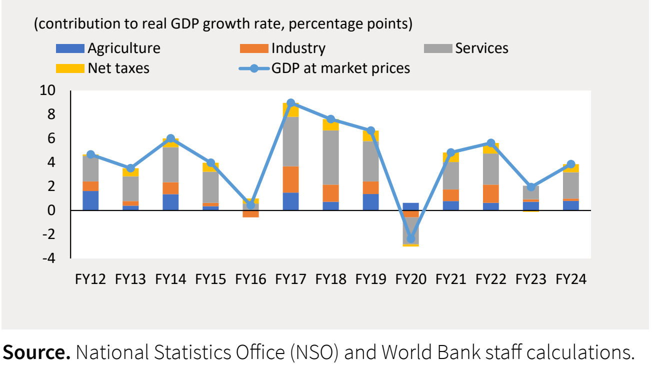
Nepal's economic growth increased, fueled by high tourist arrivals, increased agricultural production, and a boost in energy production.

Real GDP growth accelerated to 3.9 percent in FY24, up from 2 percent in FY23. The services sector was a key driver, fueled by a surge in tourist arrivals that boosted activities in transportation, accommodation, and food services (Figure 1). Increased hydropower production and higher paddy production also supported growth. On the demand side, private consumption was bolstered by high remittance inflows, while public investment remained subdued due to persistent low execution of capital spending budget.

GROSS DOMESTIC PRODUCT BY PROVINCE

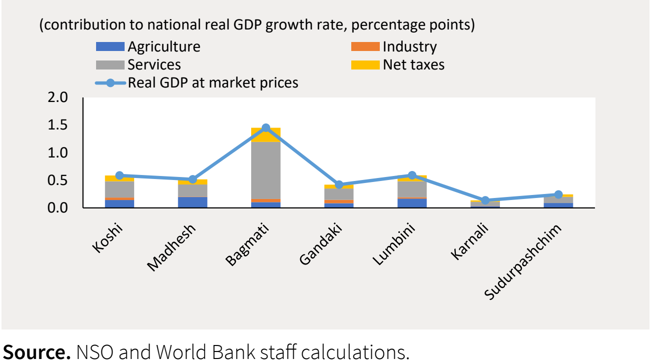
All provinces recorded growth rates exceeding 3 percent, with Bagmati, Nepal's economic powerhouse, contributing 1.5 percentage points to the nation's 3.9 percent overall national growth. Bagmati, accounting for 38.8 percent of Nepal's GDP, saw its services sector contribute a significant 1 percentage point to the national growth rate (Figure 2). In contrast, Karnali, with the smallest GDP share of 4.6 percent, contributed just 0.14 percentage points.

Figure 1. Real GDP growth increased in FY24 driven by the services sector.



Source. National Statistics Office (NSO) and World Bank staff calculations.

Figure 2. Bagmati contributed to more than one-third of overall national growth in FY24.



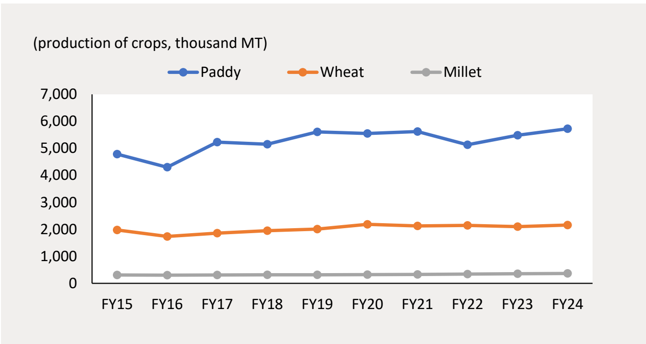
Source. NSO and World Bank staff calculations.

GROSS DOMESTIC PRODUCT BY INDUSTRIAL CLASSIFICATION

Agricultural sector

The agricultural sector grew by 3 percent in FY24. Paddy production, one of the three major cereal crops in terms of area coverage, increased by 4.3 percent (Figure 3). This growth reflects a combination of favorable summer monsoon conditions, improved fertilizer availability, and the ongoing advancement of agricultural mechanization. The sector also witnessed growth in the production of vegetables, cash crops, legumes, fruits, and other cereals, including wheat and millet, further contributing to the sector's steady expansion in FY24.

Figure 3. Agriculture expanded due to the increased production of paddy.

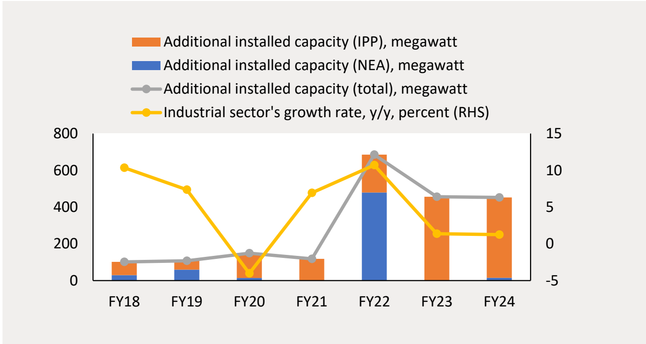


Source. Ministry of Agriculture and Livestock Development and World Bank staff calculations.

Industrial sector

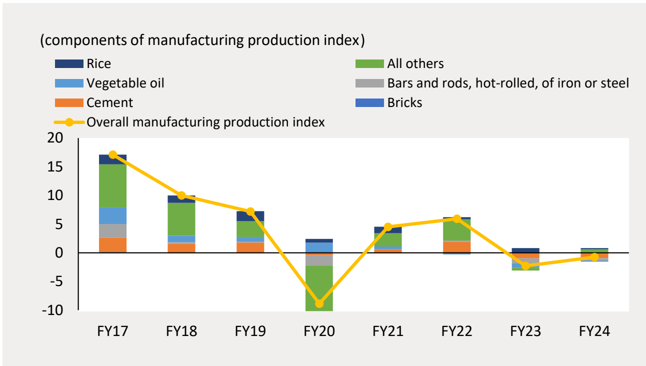
The electricity sub-sector expanded by 17.4 percent, preventing a further contraction of the industrial sector. In FY24, an additional 452.6 MW of hydroelectric capacity, primarily from the private sector, was installed (Figure 4). While the manufacturing and construction sectors faced headwinds and declined by 1.6 percent and 2.1 percent, respectively, as suggested by a drop in cement production and other key construction materials (Figure 5). These downturns were further reflected in slower producer price growth in manufacturing and decreasing prices for construction materials.[2] The lower refined oil production due to reduced export margins following India's tariff revision also contributed to the slowdown in the manufacturing sector.

Figure 4. Higher hydroelectric production from the private sector supported the industrial sector in FY24.



Source. Nepal Electricity Authority and World Bank staff calculations.

Figure 5. Manufacturing[1] and construction subsectors faced headwinds, as indicated by decline in the production of cement and other key construction materials.



Source. NSO and World Bank staff calculations.

Services Sector

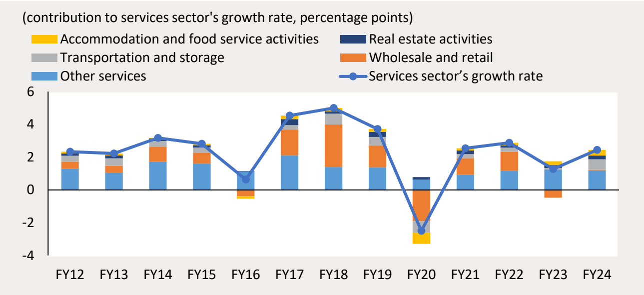
Accommodation, food service, and transport powered the services sector's 4.5 percent growth in FY24 (Figure 6). Transportation, accommodation, and food service subsectors experienced double-digit expansions, fueled by a substantial 30.7 percent surge in tourist arrivals. In contrast, wholesale and retail trade, Nepal's second-largest GDP contributor, grew marginally by 0.2 percent, reflecting a slow recovery in merchandise imports. The real estate subsector, however, benefited from a 16 percent increase in retail sales in FY24, driven by the August 2023 amendment to Land Use Regulations and a 9.6 percent expansion in real estate sector credit[3]. Credit growth was supported by an increased first residential home loan limit, a higher debt-to-income ratio, and reduced risk weights for real estate loans.

1 The major components of the Manufacturing Production Index are as follows: i) Cement, ii) Bars and rods, hot-rolled, of iron or steel, iii) Rice, and iv) Vegetable oils.

2 The input price index of construction materials and the construction materials component of the wholesale price index both contracted.

3 In April 2023, the government extended the deadline for land classification to mid-August 2024, temporarily allowing land fragmentation without classification. Before this extension, the sale and purchase of land, as well as using land as collateral, were prohibited without classification.

Figure 6. Transport and accommodation subsectors fueled services sector growth.



Source. NSO and World Bank staff calculations.

Gross Domestic Product by Demand

On the demand side, private consumption was bolstered by strong remittance inflows. Comprising over 80 percent of GDP, private consumption grew by 1.1 percent in FY24, slightly exceeding the record low of 0.7 percent in FY23. High-frequency indicators suggest that double-digit growth in remittances and digital payments contributed to this improvement. However, private investment slowed, reflected in declining high-frequency indicators such as private investment commitments, imports of intermediate and capital goods, and non-financial business credit (see External and Monetary and Financial Sector sections).

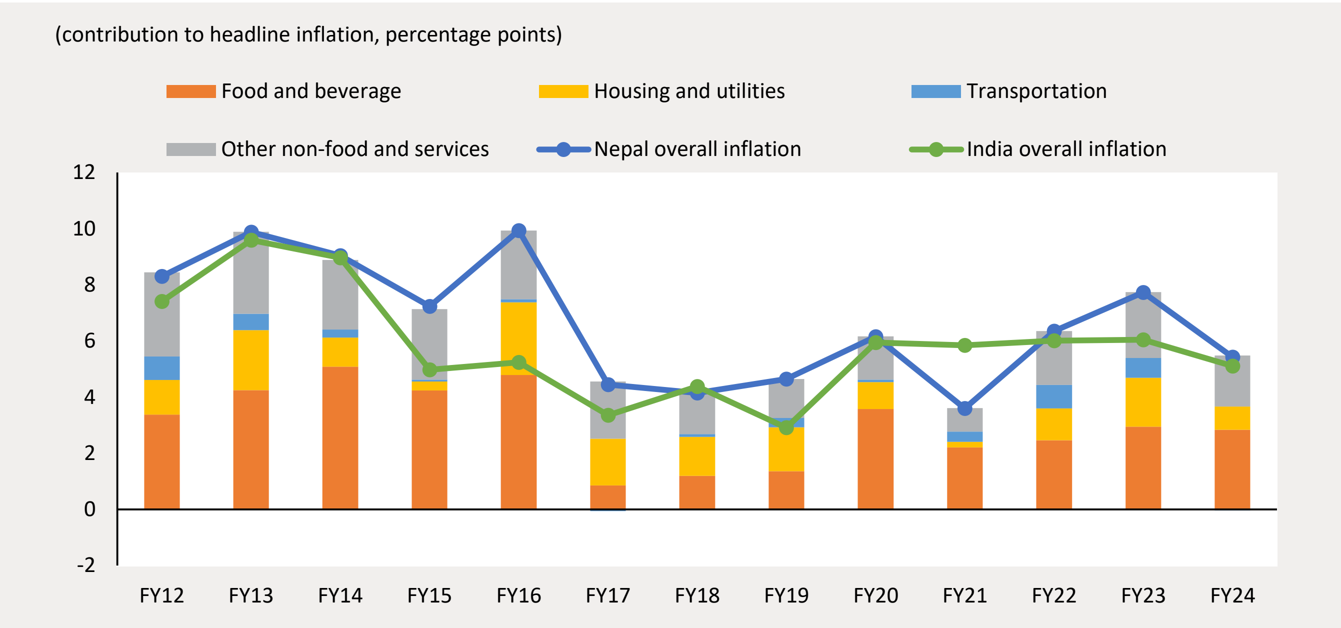
Public consumption and investment followed a similar downward trend. High-frequency data indicate public consumption declined, partly due to austerity measures (see Fiscal Sector section). Public investment also fell, driven by lower revenue execution and persistent structural challenges in the implementation of capital expenditure.

Inflation has moderated

Average headline inflation moderated to 5.4 percent in FY24 from 7.7 percent in FY23, falling below the NRB's target of 6.5 percent (Figure 7). This decline was primarily driven by a drop in non-food and services inflation, which fell from 8.6 percent in FY23 to 4.6 percent in FY24. The slowdown in housing and utility prices, along with a contraction in transportation prices-reflecting lower fuel costs-contributed to this easing.

Food and beverage inflation declined slightly by 0.2 percentage points to 6.5 percent, mainly due to lower ghee and oil prices. However, food prices remained elevated (Figure 7), driven by higher vegetable and cereals inflation. Key factors included increased minimum support prices for paddy and wheat, India's restrictive rice export measures, an export ban on onions by India, which lasted until early May 2024 before being replaced by a minimum export price, the removal of VAT exemptions on certain vegetables, and weather shocks. Moreover, Nepal's inflation is influenced by India's inflation due to the currency peg. Since India's inflation was on a declining trend, this has benefitted Nepal in FY24.

Figure 7. Average headline inflation moderated in FY24 due to lower non-food and services inflation.



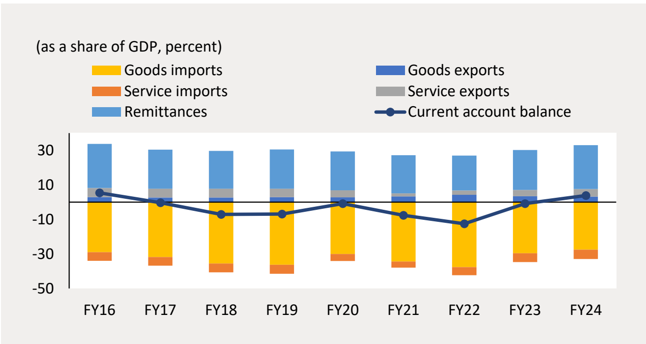
Source. NRB and World Bank staff calculations.

A.2 External Sector

The external sector strengthened further, with the first current account balance surplus in eight years, driven by a surge in remittances and a decline in imports, leading to an increase in foreign exchange reserves.

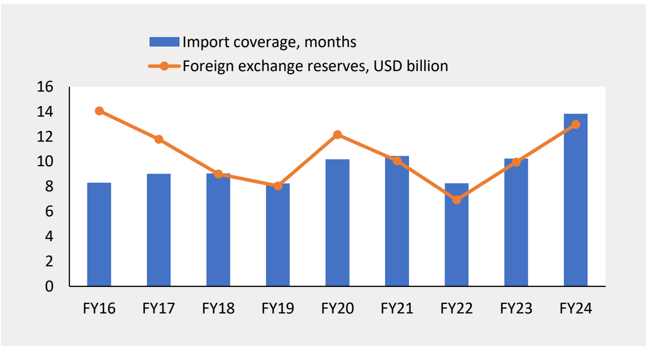
Nepal's current account balance turned positive for the first time in eight years in FY24, driven by a surge in remittances and a decline in imports (Figure 8). Remittances increased from 23.2 percent to 25.3 percent of GDP, while imports of goods and services decreased from 34.7 percent to 32.9 percent of GDP. Exports of goods and services also saw an increase, growing by 0.6 percentage points to 7.6 percent of GDP, primarily due to a boost in services exports. This combination of factors led to an improvement in foreign exchange reserves, which, by the end of FY24, covered 13 months of imports, well above the policy threshold of 7 months (Figure 9).

Figure 8. The current account balance turned positive in FY24…



Source. NRB and World Bank staff calculations.

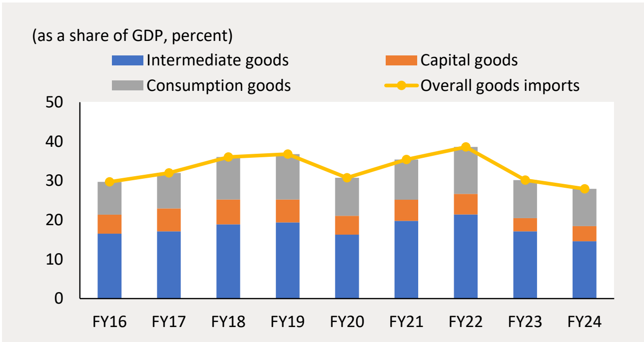
Figure 9. …leading to an accumulation of foreign exchange reserves.



Source. NRB and World Bank staff calculations.

Merchandise imports fell by 2.1 percentage points to 27.5 percent of GDP. This decline was largely due to lower imports of intermediate goods (Figure 10), influenced by several key factors. Among them were reduced imports of crude edible oil following India's tariff cuts[4], a drop in imports of broken rice and rice in husk (paddy or rough) driven by India's export restriction (on broken rice) and the imposition of a 20 percent export duty (on rice in husk), and a decrease in unwrought gold imports due to higher customs duties. Additionally, billet imports fell after the introduction of an excise duty and the removal of customs duties on sponge iron, while diesel imports dropped in response to falling global oil prices.

Figure 10. Merchandise imports continued to decline in FY24 due to a lower import of intermediate goods.

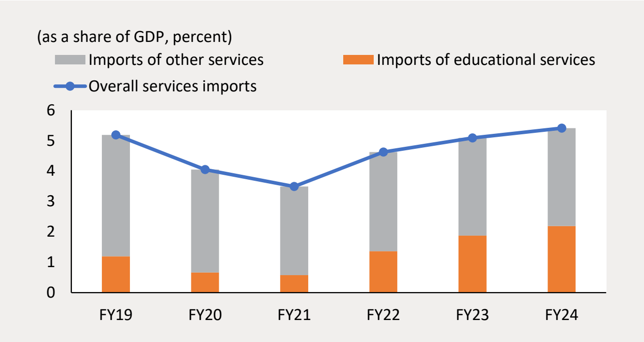


Source. Department of Customs, NRB, and World Bank staff calculations.
Note: Goods imports do not include electricity imports.

Services imports expanded by 0.3 percentage points, reaching 5.4 percent of GDP in FY24. The growth in service imports was mainly due to rising educational service imports (Figure 11), which grew from 1.9 percent to 2.2 percent of GDP, as more than 100,000 no-objection certificates (NOCs) were issued by the Ministry of Education to students seeking to study in more than 50 countries in FY24.

[4] Nepal has benefited in the past from trade preferences in edible oils, despite not producing crude edible oil domestically. When India reduced its import duties on crude and refined edible oils (palm and soybean) from non-SAARC countries, the advantage Nepal previously enjoyed by refining imported crude edible oils and exporting them to India diminished. This led to a decline in Nepal's imports of crude edible oils.

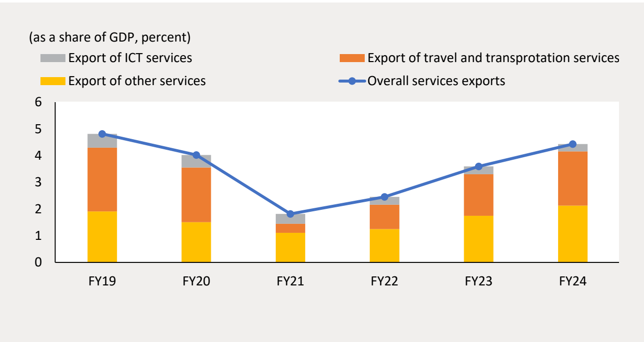
Figure 11. Service imports increased in part due to a higher import of educational services.



Source. NRB and World Bank staff calculations.

Nepal's export performance was largely driven by a significant increase in service exports, which rose by 0.8 percentage points to 4.4 percent of GDP, supported by more than 30 percent surge in tourist arrivals (Figure 12). While exports of ICT services remained steady at 0.3 percent of GDP, merchandise exports declined by 0.2 percentage points to 3.2 percent of GDP, mainly due to a reduction in refined palm and soybean oil exports (Figure 13). However, this decline was partially offset by a 0.2 percentage point increase in electricity exports, reaching 0.3 percent of GDP, and a rise in industrial supplies exports including cement and steel/iron, which added over 0.1 percentage points to GDP. Importantly, Nepal's electricity exports remain on par with its imports. To further enhance the export sector, the government added iron, steel, and electricity to its list of high-potential export items in the new Nepal Trade Integration Strategy, launched in July 2023.

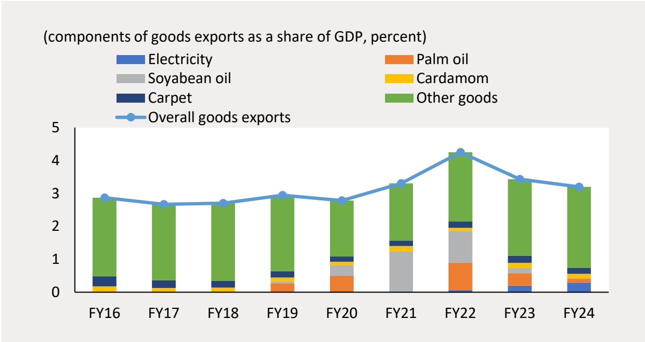
Figure 12. Service exports also expanded due to a surge of tourist arrivals[5].



Source. NRB and World Bank staff calculations.

Note: Goods imports do not include electricity imports.

Figure 13. In contrast, merchandise exports declined due to a reduction in refined edible oil exports[6].



Source. Department of Customs, NRB, and World Bank staff calculations.

Official remittance inflows reached a nine-year high in FY24 of 25.3 percent of GDP (Table 1), just slightly below the 25.5 percent recorded during the fiscal year of the Great Earthquake. The lagged effect of record-high migration in FY23 and the 1.8 percent depreciation of the Nepalese rupee (NPR) against the US dollar were key drivers of remittance growth. Additionally, there has been a gradual diversification of migration destinations, with more migrant workers increasingly heading to European countries such as Poland, Romania, Cyprus, and Malta. This diversification has contributed significantly to overall remittance inflows (Figure 14). However, over 80 percent of new migrant workers

Table 1. Selected External Sector Indicators (percent of GDP)

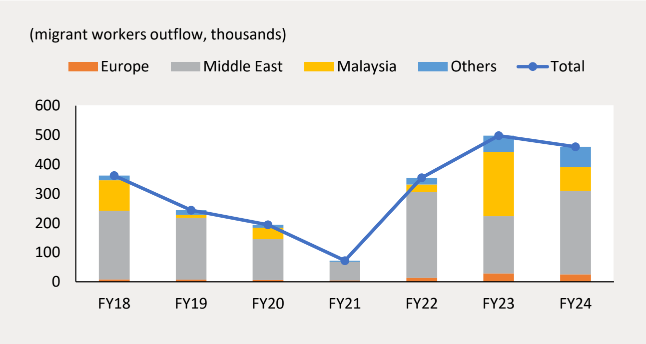
	FY18	FY19	FY20	FY21	FY22	FY23	FY24e
Current Account Balance	-7.1	-6.9	-0.9	-7.7	-12.5	-0.9	3.9
Balance of Goods and Services	-32.8	-33.7	-27.3	-32.8	-35.6	-27.7	-25.3
Total Exports of Goods and Services	7.8	7.8	6.8	5.1	6.7	7.0	7.6
Total Imports of Goods and Services	40.6	41.4	34.1	37.9	42.3	34.7	32.9
Remittances	21.8	22.8	22.5	22.1	20.2	23.2	25.3
Net Foreign Direct Investment	0.5	0.3	0.5	0.4	0.4	0.1	0.1
Gross Official Reserves (USD billion)	10.1	9.5	11.7	11.8	9.5	11.7	15.3

Source. Nepal Rastra Bank and World Bank staff calculations

[5] Other exported services include maintenance and repair services (n.i.e.), construction, insurance and pension services, charges for the use of intellectual property (n.i.e.), other business services, and government goods and services (n.i.e.).

[6] Other exported goods include fabrics, textiles, yarn and rope, iron and steel, dog and cat food, tea, and various other items.

Figure 14. Higher migration to European countries led to higher remittances

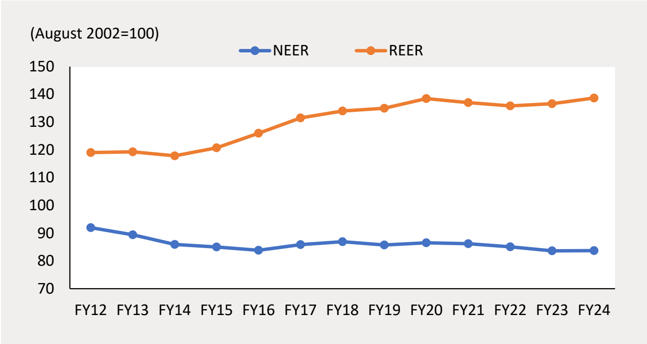


Source. NRB and World Bank Staff calculations.

continue to seek employment in the Middle East and Malaysia (Figure 14).

Nepal's exchange rate developments in FY24 reflected mixed trends. The nominal effective exchange rate (NEER), calculated as the geometric weighted average of nominal bilateral exchange rates between the NPR and a basket of currencies from major trading partners, remained relatively stable, appreciating slightly by 0.1 percent in FY24.

Figure 15. Nominal effective exchange rate remained relatively unchanged, while real effective exchange rate appreciated.



Source. World Bank Staff calculations.

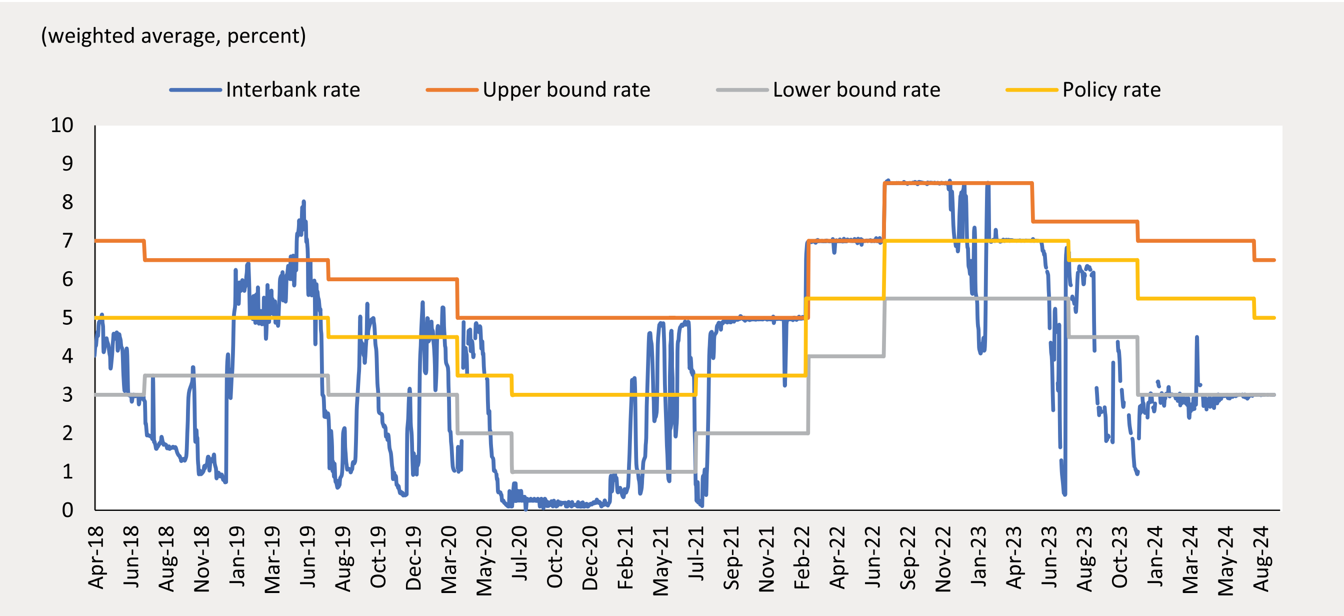
However, the real effective exchange rate (REER), which adjusts the NEER for relative changes in consumer prices, appreciated by 1.5 percent in FY24 (Figure 15). This REER appreciation, despite the stability in the NEER, indicates that consumer prices in Nepal rose at a faster pace than in its major trading partners.

A.3 Monetary and Financial Sector

Monetary policy remained cautiously accommodative.

The NRB sets the policy rate based on the annual inflation rate and foreign exchange reserve import capacity. Per the monetary policy rule, the policy rate increases if the actual inflation rate exceeds the ceiling or actual import capacity falls below the policy minimum and vice versa. Accordingly, the NRB reduced the policy rate by 50 basis points to 6.5 percent at the beginning of FY24 and by another 100 basis points to 5.5 percent in December 2023 (Figure 16).

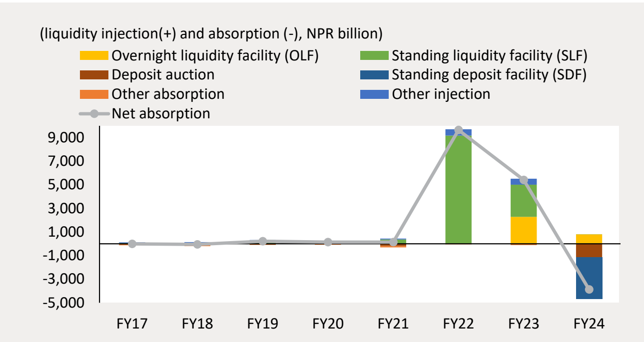
Figure 16. The NRB reduced the policy rate twice in FY24...



Sources: NRB and World Bank staff calculations.

The NRB employed open market operations to absorb liquidity and maintain the interbank rate within the bounds of the interest rate corridor in the second half of FY24 (Figure 17). During the first half of FY24, the actual interbank rate remained below the corridor's lower bound, indicating insufficient liquidity absorption. However, in the second half, the NRB aggressively absorbed over NPR 4 trillion (net) liquidity, keeping the interbank rate close to the lower bound. Of this amount, NPR 3.5 trillion was absorbed through the newly introduced standing deposit facility (FY24), designed to enhance the interest rate corridor's effectiveness. Despite these efforts, net liquidity - defined as net liquid assets to total deposits- remained above the regulatory requirement of 20 percent in FY24.

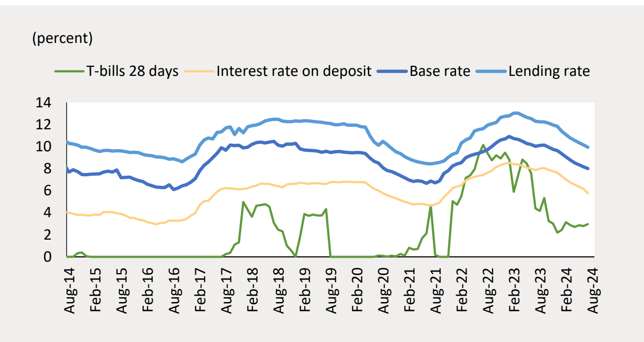
Figure 17. …and absorbed liquidity through the newly introduced standing deposit facility to keep the interbank rate within the interest rate corridor…



Source. NRB and World Bank staff calculations.

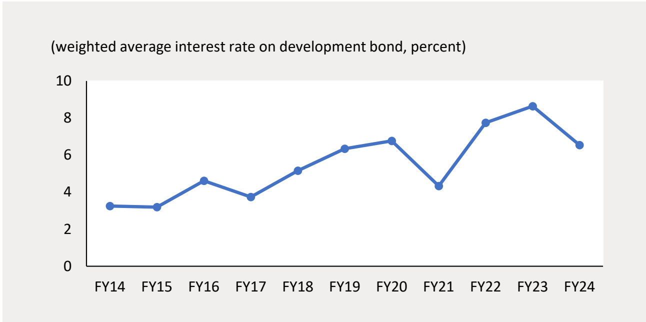
Short-term and medium-term nominal market interest rates declined, reflecting the lagged impact of lower policy rates and increased liquidity in the market (Figures 18 and 19). The weighted average interest rate on 28-day T-bills decreased by 1.4 percentage points, while the interest rates on 91-day, 182-day, and 364-day T-bills fell by over 3 percentage points. Medium-term development bonds also saw a 2.1 percentage point decline in their weighted average interest rate. Base rates and lending and deposit rates of commercial banks followed suit. The average base rate of commercial banks dropped by 2 percentage points to 8 percent in FY24, leading to a 2.1 and 2.4 percentage point decrease in weighted average deposit and lending rates, respectively. By the end of FY24, both deposit and lending rates remained in the single digits, at 5.8 percent and 9.9 percent, respectively.

Figure 18. … as a result, short-term and medium-term interest rate declined including…



Source. NRB and World Bank staff calculations.

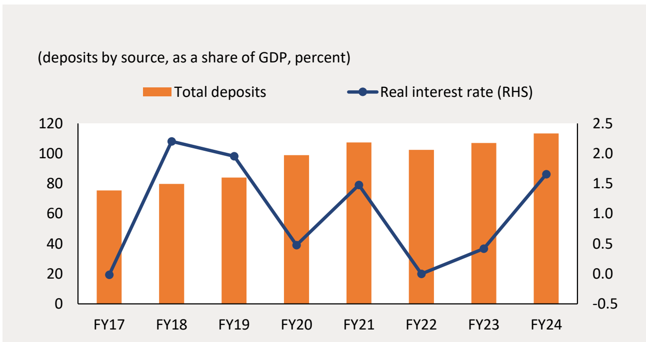
Figure 19. …the interest rate on development bond.



Source. NRB and World Bank staff calculations.

Nominal interest rates fell less than inflation rates, resulting in a rise in real interest rates (Figure 20). Together with higher remittances, the rise in real interest rate led to an increase in deposits as a share of GDP by 6.3 percentage points to 113.3 percent in FY24 (Figure 20). Individual deposits, accounting for over 60 percent of overall deposits, contributed significantly to this growth, with savings deposits leading among the various types of deposits.

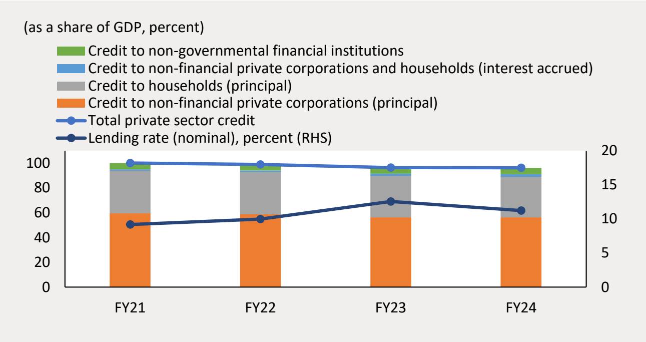
Figure 20. Real interest rate rose leading to the increase in deposits.



Source. NRB and World Bank staff calculations.

Despite the increase in deposits and the decrease in the lending rate, private sector credit as a share of GDP remained stagnant in FY24 (Figure 21). Non-financial business credit, the largest category, held steady at 56.3 percent of GDP in FY24. However, a closer look at the data reveals that this stability was due to a decline in working capital loans being offset by an increase in term loans. This shift was partly driven by the working capital guideline requirement that term loans be used to finance permanent working capital. Meanwhile, household credit—comprising over one-third of total private sector credit, including education, hire purchase, personal, and real estate loans—declined by 0.8 percentage points. This decrease more than outweighed the gains from accrued interest and the rise in private credit to non-government financial institutions, primarily microfinance institutions.

Figure 21. However, private sector credit remained stagnant...



Source. NRB and World Bank staff calculations.

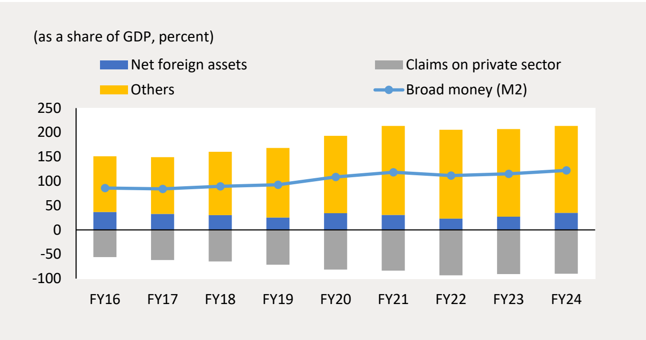
The stagnant private sector credit as a share of GDP could reflect: i) weak domestic demand; ii) the NRB's focus on reducing the over-concentration of credit, prioritizing small and medium-sized productive loans, and strengthening both the quality and accessibility of credit; and iii) an increasing number of blacklisted individuals, partly due to updates in existing provisions, including blacklisting individuals solely based on cheque dishonor, and freezing the bank accounts of blacklisted persons, restricting them from banking transactions, including the extension of credit.

In response, the NRB introduced several key measures aimed at stimulating private sector credit, particularly within the real estate sector. These initiatives included: i) raising the maximum loan amount for first-time residential home buyers from NPR 15 million to NPR 20 million; ii) increasing the loan-to-value (LTV) ratio for personal loans up to NPR 5 million from 30-40 percent to 50 percent; iii) boosting the LTV ratio for real estate loans within Kathmandu Valley from 40 percent to 50 percent; iv) raising the monthly debt-to-income ratio to 60 percent for home loans up to NPR 5 million; v) lowering the risk weight for real estate loans secured by shares above NPR 5 million from 150 percent to 125 percent; vi) increasing the single obligor limit for lending against shares as collateral; vii) reducing the loan loss provisioning requirement for 'good loans' from 1.3 percent to 1.2 percent; and viii) raising the debt service to gross income ratio for real estate loans from 50 percent to 70 percent

The NRB also relaxed working capital guidelines requirement with a focus on the manufacturing sector. Key changes for the manufacturing sector included: i) exemption from working capital guidelines for the use of working capital loans up to NPR 30 million; and ii) increase in the working capital loan limit from NPR 20 million to NPR 40 million. Moreover, amendments applicable to all businesses included: i) increase in the loan limit for fluctuating working capital needs to 40 percent of the annual turnover, up from the previous 25 percent; ii) requirement for maintaining less than 10 percent of outstanding loans for at least seven days during any fiscal year, up from zero percent previously; and iii) provision for emergency working capital loans for seasonal businesses (such as those involved in purchasing chemical fertilizers, and festival-related enterprises) based on specific justifications.

With private sector credit stagnant, broad money supply (M2) expanded due to a rise in foreign assets. In FY24, broad money supply increased by 6.8 percentage points to 122.1 percent of GDP (Figure 22). This growth was primarily driven by higher foreign assets, resulting from lower imports and increased remittances (see External Sector section for details).

Figure 22.... despite this, broad money supply (M2) expanded due to a rise in foreign assets.

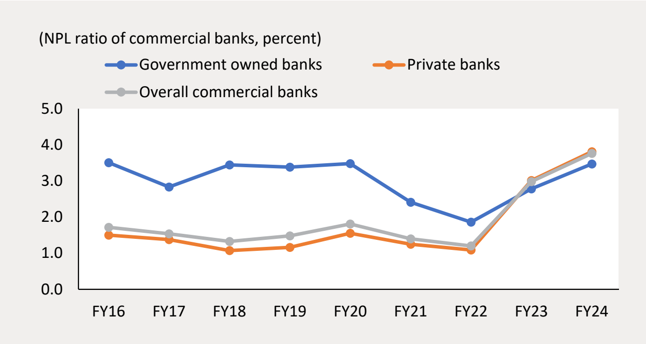


Source. NRB and World Bank staff calculations.

The banking sector faced growing pressures on asset quality, profitability, and capital adequacy.

The banking sector's asset quality continued to deteriorate, with the non-performing loans (NPLs) ratio reaching a record high of 3.8 percent by the end of mid-July 2024. This increase was broad-based across private and public commercial banks, but more pronounced in the private sector (Figure 23). Consequently, the number of blacklisted borrowers surged by over 70 percent in FY24. The NRB's policy in December 2023, which allowed for the restructuring and rescheduling of loans in select sectors, likely prevented a further spike in NPLs.

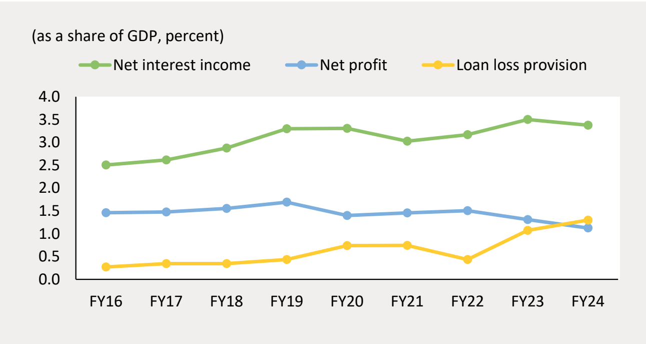
Figure 23. Banking sector's asset quality deteriorated and was more pronounced for private commercial banks…



Source. NRB and World Bank staff calculations.

Rising NPLs led to increased loan-loss provisions, dampening the profitability of the banking sector. Commercial bank net profits declined by 8.8 percent in FY24, as loan-loss provisions surged by 29.5 percent (Figure 24). This NPR 19.4 billion increase in provisions outweighed the NPR 5.5 billion increase in net interest income. The NRB's decision to lower the loan loss provisioning requirement for 'good loans' in FY24 helped mitigate the impact on loan-loss provisions.

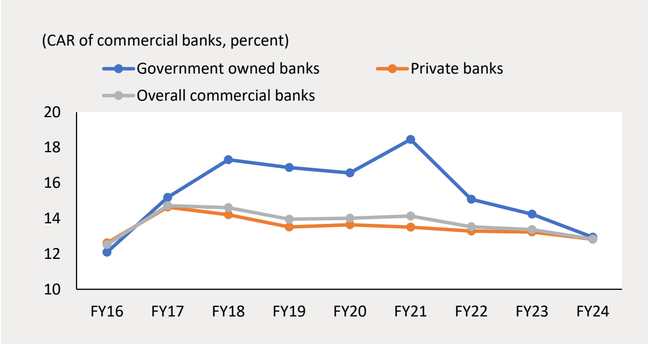
Figure 24. … leading to an increase in loan-loss provisions and lower profitability.



Source. NRB and World Bank staff calculations.

The banking sector's capital adequacy remained well above the regulatory minimum capital adequacy ratio (CAR) of 11.5 percent, including a countercyclical buffer of 0.5 percent, but recent pressures have emerged. At the end of FY24, the CAR of commercial banks stood at 12.8 percent, with state-owned and private commercial banks having CARs of 12.9 percent and 12.8 percent, respectively (Figure 25). To alleviate pressure on capital adequacy, the NRB implemented several measures, including: (i) reducing the loan loss provisioning requirement for 'good loans' from 1.3 percent to 1.2 percent, and (ii) increasing the threshold for loans extended to agricultural, small, cottage, and medium-scale enterprises under the 'Regulatory Retail Portfolio' from NPR 10 million to NPR 20 million. Despite these measures, one private commercial bank ended FY24 with a CAR below the regulatory minimum of 11.5 percent. Commercial banks that fail to meet this minimum face various corrective actions, such as restrictions on expanding lending activities and distributing dividends.

Figure 25. Banking sector's capital adequacy ratio remained above the regulatory minimum.

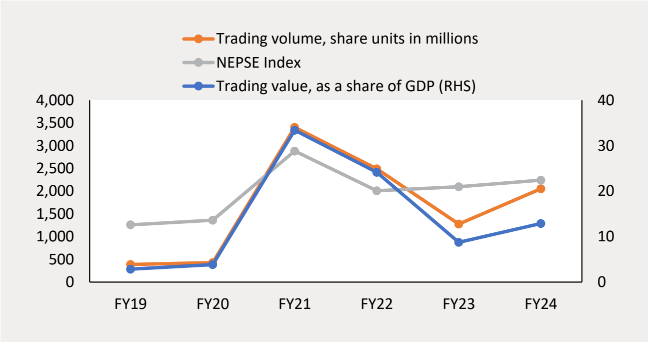


Source. NRB and World Bank staff calculations.

Nepal's stock market remained subdued relative to the peak of June 2021.

The stock market's performance remained below its June 2021 peak in FY24 (Figure 26). The index rose by 6.8 percent, surpassing the previous year's 4.4 percent growth, in part due to the lower interest rate. However, the index experienced

Figure 26. The stock market's performance remained below its June 2021 peak in FY24.



Source. NRB and World Bank staff calculations.

significant fluctuations throughout FY24, ranging from a low of 1852.1 in October 2023 to a high of 2240.4 in July 2024. Trading value and volume also increased by over 50 percent. Consequently, capital gains tax from the stock market surged by over 85 percent.

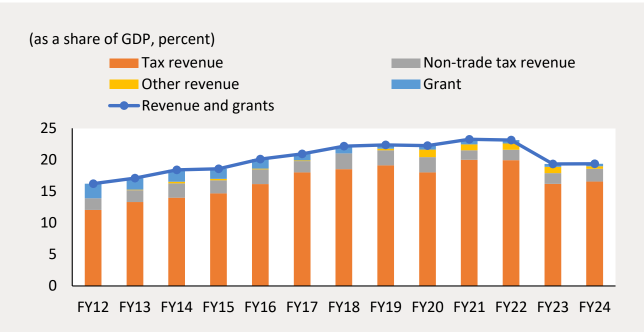
To bolster the stock market, the NRB modified the risk weighting for share mortgage loans, increasing the limit to NPR 5 million with a 150 percent risk weight for loans above NPR 5 million (up from NPR 2.5 million previously), while maintaining a 100 percent risk weight for loans up to NPR 5 million (extended from NPR 2.5 million under the previous policy). Additionally, the NRB raised the maximum single obligor limit for lending against shares from NPR 120 million to NPR 150 million for individual investors and NPR 200 million for institutional investors dedicated to the securities market.

A.4 Fiscal Sector

Nepal's fiscal deficit dropped sharply as spending contracted, while revenue stabilized at its lowest point in eight years. Public debt remains sustainable owing to a large share of concessional external debt and prudent fiscal management.

Government revenue (including grants) remained at an eight-year low in FY24 (Figure 27). The stagnation was the result of a 0.7 percentage point rise in tax and non-tax revenues, which offset a 0.6 percentage point decline in miscellaneous revenues. Tax revenue increased from 16.2 percent to 16.6 percent of GDP, primarily driven by a 0.3 percentage point increase in income tax. This was largely influenced by FY24 budget provisions that mandated banks, financial institutions, and insurance companies to pay income tax on profits derived from mergers, acquisitions, and Further Public Offerings (FPOs) at premium rates. VAT revenue increased in part due to VAT imposed on air travel (except for inbound in case of international travel), carriage service, and cargo services (except for export).

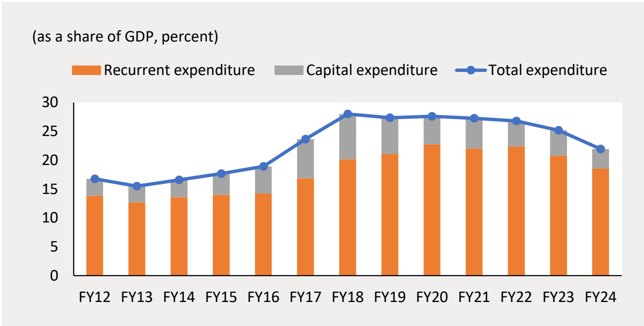
Figure 27. Revenue (including grants) remained steady at an eight-year low in FY24.



Source. Ministry of Finance (MoF) and World Bank staff calculations.

Government spending declined significantly from 25.2 percent of GDP in FY23 to 21.9 percent of GDP in FY24. This reduction was mainly driven by a 2.2 percentage point decrease in recurrent spending (Figure 28), which resulted from lower fiscal transfers to subnational governments and austerity measures targeting recurrent expenditures. These measures focused on reducing costs related to allowances, fuel, office supplies, and other administrative expenses. Additionally, the lower-than-expected revenue collection contributed to reduced capital spending, particularly in construction projects.

Figure 28. However, spending declined driven by a decrease in recurrent spending…



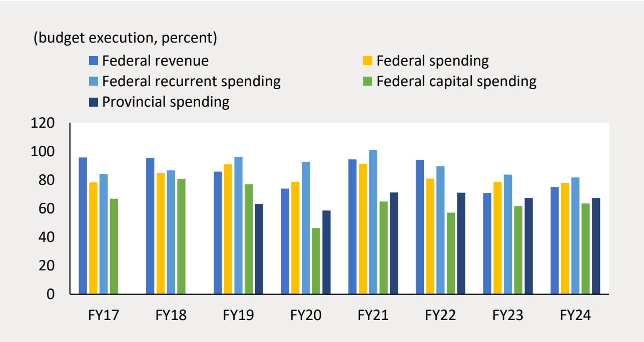
Source. MoF and World Bank staff calculations.

The overall decline in spending also reflects a continued deterioration in budget execution, with execution rates falling below 80 percent in both FY23 and FY24 (Figure 29). The execution rate for the capital spending budget has been lower than that for the recurrent spending budget. The latter deteriorated in FY23 and FY24[7], partly due to reduced fiscal transfers to subnational governments. At the provincial level, spending budget execution also worsened, remaining below the federal rate, with a rate of 67.4 percent in FY24. Unlike in previous years (except FY20), federal revenue (including grants) budget execution was lower than spending budget execution in FY23 and FY24, standing at around 71 percent and 75 percent, respectively, due to overly optimistic revenue growth projections. Key factors contributing to low spending budget execution rates include: (i) persistently low capital spending budget execution, attributed to weak technical

[7] In FY24, the execution rates for the recurring and capital budgets were 83.4 percent and 63.5 percent, respectively.

capacity, particularly at the subnational level, and high staff turnover among technical staff; and (ii) unrealistic budget revenue projections.

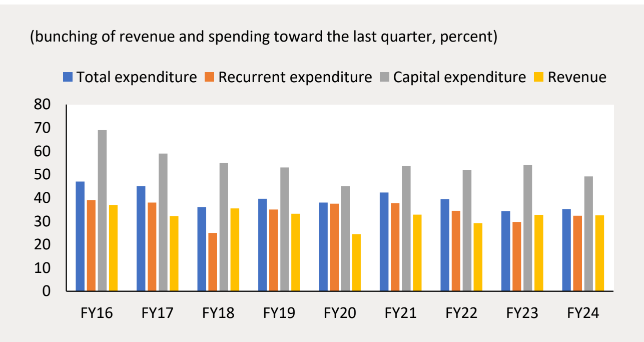
Figure 29. …reflecting a continued deterioration in spending budget execution.



Source. MoF and World Bank staff calculations.

The bunching of spending towards the last quarter or month of the fiscal year continues to persist. In FY24, 35.2 percent of overall spending occurred in the last quarter, with 16.5 percent being spent in the final month alone (Figure 30). This pattern was more pronounced for capital spending than for recurrent spending. Nearly half (50 percent) of capital spending took place in the last quarter, and 30 percent in the last month, compared to 32.4 percent and 13.7 percent of recurrent spending during the same periods, respectively. One contributing factor could be the mismatch between revenue and spending, which tends to affect capital spending more significantly than recurrent spending. Recurrent expenditures are often mandatory, while capital spending is more discretionary. This uneven distribution of spending towards the fiscal year's end can result not only in lower-quality project investments but also inflationary pressures, as the surge in spending may drive up the aggregate demand and prices during the final quarter or month.

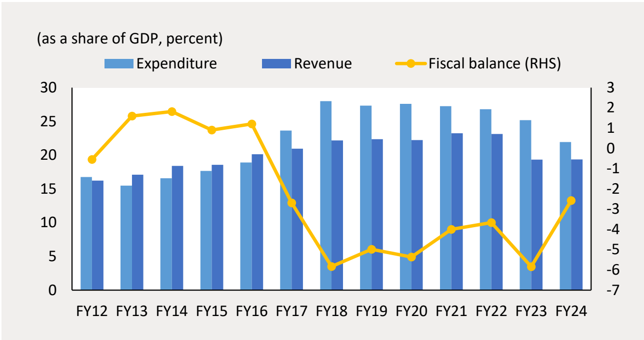
Figure 30. The bunching of spending towards the final quarter or month of the fiscal year also continues to persist.



Source. MoF and World Bank staff calculations.

Lower spending and steady revenue led to a significant narrowing of the fiscal deficit (including grants) to 2.6 percent of GDP in FY24, the lowest in seven years (Figure 31). This resulted in a slight decline in public debt to 42.7 percent of GDP[8]. Public debt remains sustainable, supported by a high share of concessional external debt and prudent fiscal management. The National Natural Resources and Fiscal Commission sets annual ceilings on domestic borrowing for all three tiers of government. For the federal government, the borrowing ceilings were set at 5.5 percent of projected GDP for FY24 and 5 percent for FY25. Additionally, the Public Debt Act limits external public debt to one-third of the previous fiscal year's GDP. In March 2024, the Public Debt Management Regulations were approved, which transferred all domestic debt management responsibilities from the NRB to the newly established Public Debt Management Office.

Figure 31. Lower spending and steady revenue led to a significant narrowing of the fiscal deficit (including grants).



Source. MoF and World Bank staff calculations.

Public debt is nearly evenly split between domestic and external sources, with domestic debt accounting for 49 percent of total public debt and external debt comprising the remaining 51 percent (Table 2). Domestic public debt, denominated in local currency, mainly consists of development bonds with maturities ranging from 2 to 15 years and Treasury bills (T-bills) with maturities of less than one year. By the end of FY24, T-bills constituted around 34 percent of domestic debt, while development bonds made up 65 percent. Citizen savings bonds and foreign employment bonds accounted for the remaining 1 percent. Banks and financial institutions hold 96.1 percent of domestic public debt, with the NRB holding 1.7 percent and other entities holding the remaining 2.2 percent. Compared to external debt, domestic debt poses greater refinancing and interest rate risks, largely because external debt consists predominantly of concessional loans, which offer lower interest rates and longer maturities.

[8] The figure excludes the negative balance of the Treasury Single Account, as it is not considered part of public debt by the authorities.

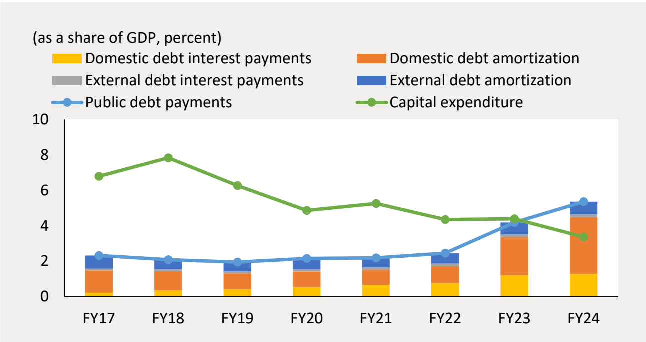
Table 2. Nepal's Stock of Public Debt in NPR billion and as a percentage of GDP

Financing Source	FY21 Stock	FY21 Share of total (%)	FY21 Share of GDP (%)	FY22 Stock	FY22 Share of total (%)	FY22 Share of GDP (%)	FY23 Stock	FY23 Share of total (%)	FY23 Share of GDP (%)	FY24e Stock	FY24e Share of total (%)	FY24e Share of GDP (%)
Public and publicly guaranteed external debt	**934.7**	**53.8**	**21.5**	**1025.8**	**51.0**	**20.6**	**1170.2**	**51.0**	**20.5**	**1253.2**	**51.5**	**22.0**
Multilateral	822.0	47.3	18.9	894.5	44.4	18.0	1029.8	44.9	18.1	1115.1	45.8	19.5
o/w World Bank	471.2	27.1	10.8	509.7	25.3	10.2	580.3	25.3	10.2	612.3	25.2	10.7
o/w ADB	293.8	16.9	6.8	315.0	15.6	6.3	370.1	16.1	6.5	406.1	16.7	7.1
o/w IMF	32.8	1.9	0.8	43.7	2.2	0.9	52.1	2.3	0.9	63.3	2.6	1.1
Bilateral	112.7	6.5	2.6	131.4	6.5	2.6	140.5	6.1	2.5	138.1	5.7	2.4
o/w Non-Paris Club	63.9	3.7	1.5	75.8	3.8	1.5	78.9	3.4	1.4	80.7	3.3	1.4
o/w China	31.3	1.8	0.7	35.3	1.8	0.7	34.6	1.5	0.6	35.3	1.4	0.6
o/w India	30.8	1.8	0.7	36.4	1.8	0.7	39.6	1.7	0.7	40.5	1.7	0.7
o/w Paris Club	48.8	2.8	1.1	55.6	2.8	1.1	61.5	2.7	1.1	57.4	2.4	1.0
Domestic public debt	**802.9**	**46.2**	**18.4**	**987.4**	**49.0**	**19.8**	**1125.2**	**49.0**	**19.7**	**1180.9**	**48.5**	**20.7**
Treasury Bills	279.6	16.1	6.4	355.8	17.7	7.2	457.8	19.9	8.0	403.7	16.6	7.1
Development Bonds	513.9	29.6	11.8	620.4	30.8	12.5	656.4	28.6	11.5	761.9	31.3	13.4
Others	9.4	0.5	0.2	11.2	0.6	0.2	10.9	0.5	0.2	15.3	0.6	0.3
Total	**1737.6**	**100.0**	**39.92**	**2013.3**	**100.0**	**40.5**	**2295.4**	**100.0**	**42.9**	**2434.1**	**100.0**	**42.7**
Nominal GDP (NPR billion)	4352.6			4976.6			5348.5			5704.8		
Nominal Exchange Rate Average (NPR/USD)	117.9			120.8			130.7			133.0		

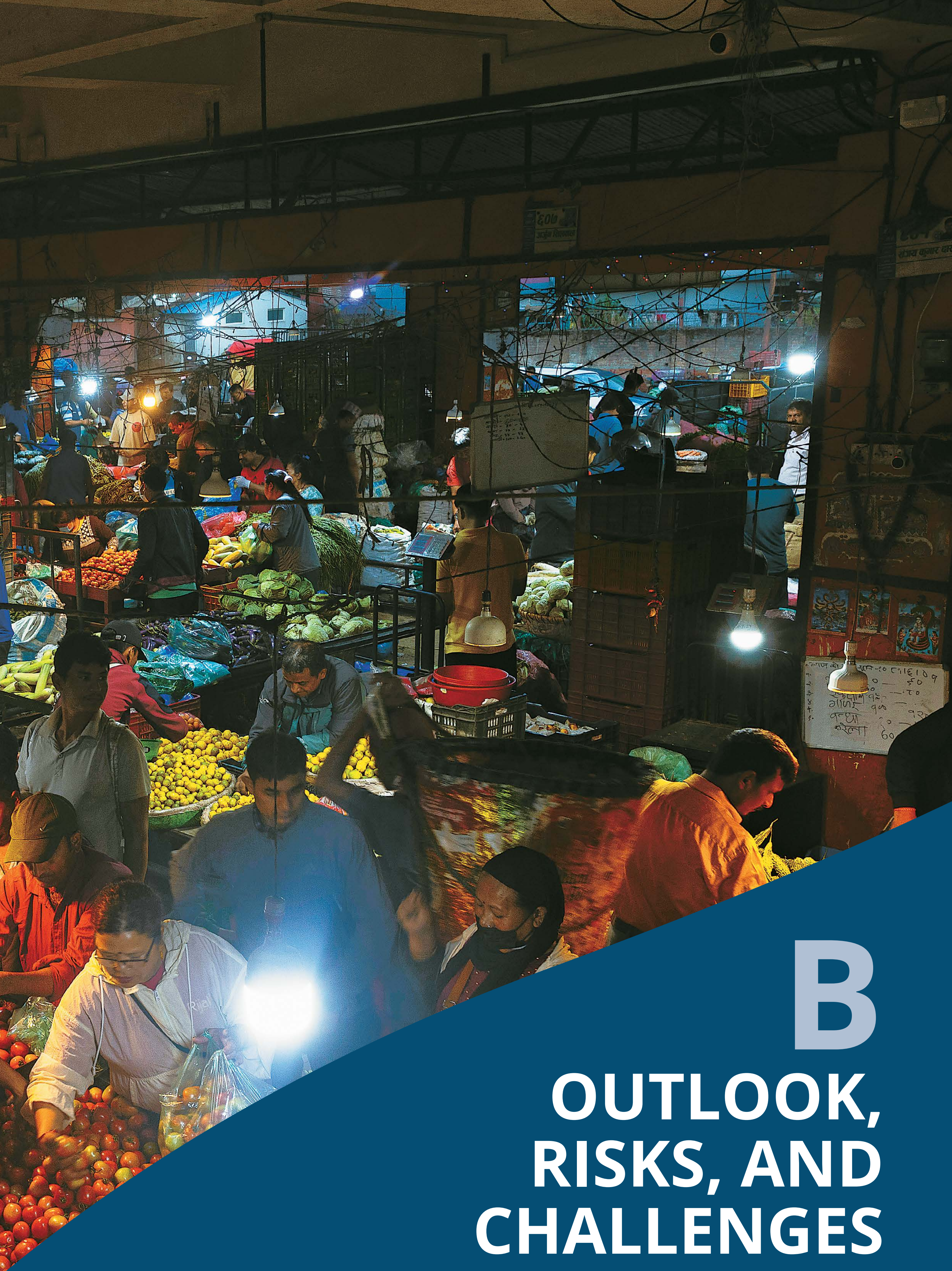
Source. Public Debt Management Office, NSO, and World Bank staff calculations.

Public debt servicing surged to a record high in FY24, surpassing capital expenditure for the first time. Amortization of public debt rose by 1.1 percentage points, reaching 3.9 percent of GDP (Figure 32). At the same time interest expenditure rose to a record high of 1.44 percent of GDP. The increase in both amortization and interest payments was driven by higher redemption of domestic debt and elevated interest rates on domestic debt from previous fiscal years (FY22 and FY23), a result of tighter liquidity conditions in the financial sector during that period.

Figure 32. However, public debt servicing surged to a record high in FY24, surpassing capital expenditure for the first time.



Source. MoF and World Bank staff calculations.



B

OUTLOOK, RISKS, AND CHALLENGES

B OUTLOOK, RISKS, AND CHALLENGES

B.1 REAL SECTOR

GDP growth is projected to accelerate to 5.1 percent in FY25 and 5.5 percent in FY26 (Table 3). The wholesale, retail, construction, and manufacturing sectors, which together account for over one-fifth of GDP, are expected to benefit from the NRB's loosening of monetary policy and relaxed regulatory requirements such as a lower working capital requirement and an easing of loan classification and loan-loss provisioning for business that continue servicing loans despite closures due to unforeseen circumstance. These measures are anticipated to stimulate private investment, while remittance-driven private consumption and exports of hydropower and tourism are expected to further bolster economic growth.

The services sector is forecasted to remain a key growth driver, with tourism, real estate, and trade leading the way. Accommodation and food services are expected to benefit from a surge in domestic and international tourism, fueled by government initiatives aimed at attracting 1.6 million international visitors in FY25 through various tourism promotion programs. This growth will be further bolstered by the presence of international five-star hotel chains currently operating in Nepal. Furthermore, a recovery in merchandise imports is anticipated to boost the wholesale and retail sectors.

Real estate services are poised for expansion, driven by a combination of the NRB's policies that include increased loan limits, higher debt-to-income ratios, and reduced risk weights for first-time homebuyers. Additionally, a recent amendment to the Land Use Regulation, which allows land fragmentation without classification until mid-July 2025, is expected to continue supporting the sector. As of August 2024, only 133 of the 753 municipalities have fully classified their land as agricultural or non-agricultural, while 325 have partially classified their land, and 295 have yet to begin.

Nepal's industrial sector is expected to grow over the medium term, driven by a significant expansion in electricity and construction. Over the past decade, more than 9,500 MW of hydropower projects have been licensed for construction, with many already underway and others expected to come online during the projection period, given their long gestation times. The government's ambitious goal of exceeding 11,700 MW of installed electricity capacity by FY29 is anticipated to fuel industrial growth. Meanwhile, a series of monetary policy measures aimed at supporting the construction sector—such as extensions for loan repayments, moratoriums on blacklisting, and relaxed credit rating requirements—are likely to stimulate activity in this crucial industry.

The agricultural sector is projected to grow over the medium term, primarily due to increased paddy production. A significant increase in the main season rice planted area from 94.6 percent in FY23 to 98.5 percent in FY24, thanks to favorable rainfall, is expected to boost output and drive growth to 3.3 percent in FY25. Assuming continued favorable monsoon conditions, growth is projected to reach 3.4 percent in FY26.

Consumer price inflation is expected to remain moderate, supported by declining global commodity prices and increased agricultural production. Lower expected inflation in India, combined with Nepal's currency peg, could help mitigate imported inflation. Although rising minimum paddy support prices, the removal of VAT exemptions on select goods, the imposition of VAT on services such as offline air transport and digital payments, and the introduction of excise duties on items like laptops may create upward pressure on inflation, these effects are likely to be offset by the aforementioned factors.

Table 3. Macroeconomic projections of selected key indicators.
(annual percent change unless indicated otherwise)

	FY22	FY23	FY24e	FY25f	FY26f
Real GDP growth, at constant market prices	5.6	2.0	3.9	5.1	5.5
Private Consumption	6.8	0.7	1.1	1.8	2.9
Government Consumption	9.6	-21.2	-11.1	5.8	5.5
Gross Fixed Capital Formation	3.4	-10.0	18.4	16.5	13.1
Exports, Goods and Services	34.1	3.3	18.1	11.3	13.2
Imports, Goods and Services	16.4	-18.7	-2.3	10.4	9.7
Real GDP growth, at constant factor prices	5.3	2.3	3.5	5.1	5.5
Agriculture	2.4	2.8	3.0	3.3	3.4
Industry	10.7	1.4	1.3	4.9	7.5
Services	5.3	2.4	4.5	6.1	6.0
Inflation (Consumer Price Index)	6.3	7.7	5.4	5.0	4.5
Current Account Balance (% of GDP)	-12.5	-0.9	3.9	2.6	1.7
Net Foreign Direct Investment (% of GDP)	0.4	0.1	0.1	0.2	0.2
Fiscal Balance (% of GDP)	-3.6	-5.8	-2.6	-2.2	-1.9
Revenues (% of GDP)	22.9	19.3	19.4	20.0	20.3
Debt (% of GDP)	40.5	42.9	42.7	42.2	41.3
Primary Balance (% of GDP)	-2.7	-4.5	-1.1	-0.8	-0.7

Sources: MoF, NRB, and NSO for history and estimates. World Bank staff for forecasts. Notes: e =estimate; f = forecast.

B.2 EXTERNAL SECTOR

The trade deficit is anticipated to widen in the medium term, though it will likely remain below the record high of FY22. This increase will primarily stem from a rise in both merchandise and service imports. Merchandise imports are projected to increase due to robust domestic demand, although they may remain below FY22 levels due to factors such as lower commodity prices, reduced electricity imports, and the cessation of one-time imports like COVID-19 vaccines. Moreover, the recent expansion of the exchange facility limit for merchandise imports will contribute to this growth. Service imports are likely to increase as Nepalese citizens continue to emigrate for work and study, and as foreign exchange restrictions for outbound travel are relaxed. Electricity exports are expected to rise significantly, and service exports are expected to grow due to the strengthening tourism industry.

The widening trade deficit, coupled with stable remittances, is anticipated to narrow the current account surplus from 3.9 percent of GDP in FY24 to an average of 2.2 percent of GDP over FY25-26. Remittances are projected to stabilize around 25 percent of GDP. Inflows of foreign direct investment (FDI) are projected to remain very low, despite efforts to attract more FDI. Under the baseline scenario, foreign exchange reserves are expected to remain sufficient to cover over nine months of imports by the end of FY26.

B.3 MONETARY AND FINANCIAL SECTOR OUTLOOK

The NRB is expected to gradually ease monetary policy over the medium term. After a 50-basis point reduction to 5 percent in the policy interest rate at the beginning of FY25, the rate is anticipated to remain unchanged throughout the year. However, a further 50-basis point cut is forecasted for the start of FY26, lowering the policy interest rate to 4.5 percent, which is slightly above the pandemic low but below pre-pandemic levels. The NRB is also expected to maintain the exchange rate peg of the Nepalese Rupee to the Indian Rupee as a nominal anchor for monetary policy throughout the forecast period.

Pressure on capital adequacy will be mitigated through various measures. Key measures, as announced in the FY25 monetary policy, include a reduction in loan-loss provisions, revisions to risk weights, and an increase in the regulatory retail portfolio. These measures are expected to continue into FY26.

B.4 FISCAL SECTOR

A gradual reduction in the fiscal deficit is expected over the medium term, driven by decreased recurrent expenditure and new revenue measures. Lower recurrent spending is expected to come from lower fiscal transfer to subnational governments. The FY25 budget introduces several tax measures, including a green tax, the implementation of the recently approved Domestic Revenue Mobilization Strategy[9], the removal of VAT exemptions on select goods, and planned increases in duties on certain items, all of which are expected to boost revenue collection. However, these gains may be partially offset by the reversal of certain tax amendments. While capital expenditure is projected to rise, its execution will likely remain constrained by the slow implementation of the national project bank.

The fiscal deficit is expected to be financed through external concessional and domestic borrowing. Public debt is projected to further decline to 41.3 percent of GDP by the end of FY26, driven by smaller fiscal deficits and higher economic growth. The forecast assumes that the government will adhere to the fiscal rule regarding the domestic borrowing ceiling, as recommended by the National Natural Resources and Fiscal Commission, and the external debt ceiling set by the Public Debt Management Act of 2022.

B.5 RISKS AND CHALLENGES

While the medium-term outlook for Nepal remains generally positive, it is subject to several downside risks. Increased vulnerabilities in the financial system, such as a rise in non-performing loans, could curtail private sector credit. Policy discontinuity resulting from frequent changes in political administrations, along with the short tenures of officials, might deter investors. Delays in implementing capital expenditure could hinder infrastructure development, negatively impacting growth. Externally, regional instability and trade disruptions could reduce tourism and domestic demand. Natural disasters pose additional risks to sustaining welfare gains.

There is also a risk of a growth slowdown in the event of economic shock in migrant-receiving countries. International remittances play a significant role in Nepal's economy, affecting household consumption, poverty reduction, and human capital development. However, migration also poses challenges, such as high costs, unequal opportunities, and poor working conditions for migrants. The Special Focus chapter of this Nepal Development Update on international migration and household well-being highlights these key challenges and the necessary reforms. To maximize the benefits of migration and ensure long-term economic growth, the government would need to focus on implementing an effective and inclusive migration management system, while creating conditions for job creation in the domestic market. For a more comprehensive analysis, please refer to the second part of this report.

9 The strategy projects an increase of 1.3 percentage points of GDP of revenue between FY24 and FY26.


पेटीका

C

SPECIAL FOCUS: INTERNATIONAL MIGRATION AND WELL-BEING IN NEPAL: MAXIMIZING BENEFITS AND LEVERAGING LONG-TERMGROWTH

C SPECIAL FOCUS: INTERNATIONAL MIGRATION AND WELL-BEING IN NEPAL: MAXIMIZING BENEFITS AND LEVERAGING LONG-TERM GROWTH

This special focus chapter summarizes the latest evidence on international migration from Nepal and its impacts on the domestic economy, household welfare, and human development. The first part of the chapter overviews the overall migration trend, its benefits to the sending households and the Nepali economy, and associated risks. Updated profiles of migrants, destination choices, and returnees' assimilation into the domestic economy are discussed in the second part. Part three concludes the chapter with policy discussion.

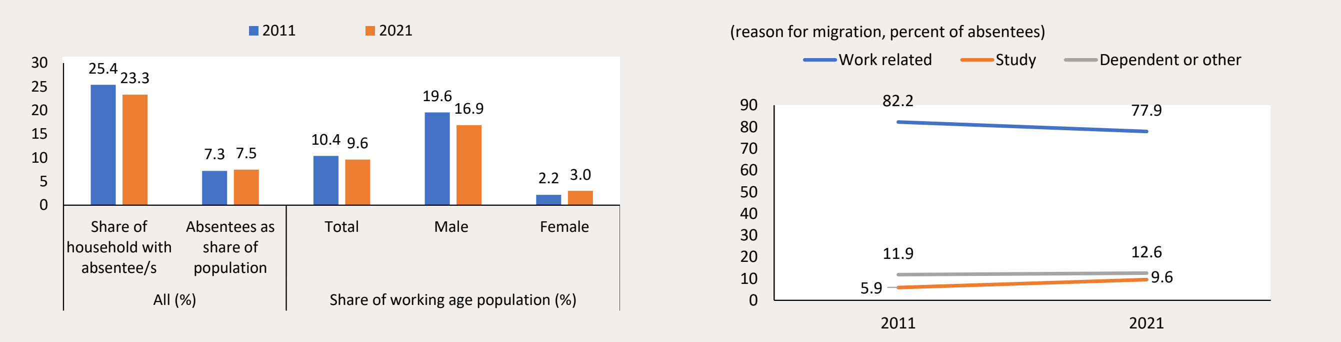
C.1 THE STATE OF MIGRATION

Temporary international migration remains integral to Nepal's economy, livelihood, poverty reduction, and human development. However, emigration from Nepal is expensive, and the benefits come with costs.

International migration has become integral to Nepal's economy and society. After a rapid rise in the previous decade, emigration has stabilized at a higher rate over the last decade (Figure 33). According to the latest Nepal Housing and Population Census in 2021, 23.3 percent of households had at least one member living abroad, and absentees accounted for 7.5 percent of the country's population.

Seeking employment abroad has been an important strategy to cope with structural domestic labor market issues, particularly for younger Nepalis. Although there has been a marginal increase in migration for educational purposes over the last decade, the primary reason for migration remains temporary employment (Figure 33). The propensity to migrate remains disproportionately high for the working-age population, especially youth, who experience disproportionately high domestic unemployment rates. Based on the 2023 Nepal Living Standard Survey (NLSS IV), nearly one-quarter of those aged 15 to 24 did not have a job, almost double the overall unemployment rate of 12.5 percent. The share of youth not in employment, education, or training (NEET) was 35.7 percent. These patterns have

Figure 33. International migration from Nepal is high and primarily for economic work.

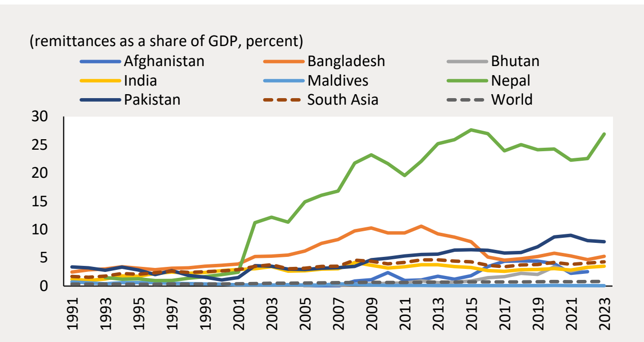


Source. World Bank staff calculation using the Nepal Housing and Population Censuses 2011 and 2021

increased slightly since 2018, underscoring the structural challenge of creating sufficient high-quality jobs in Nepal.

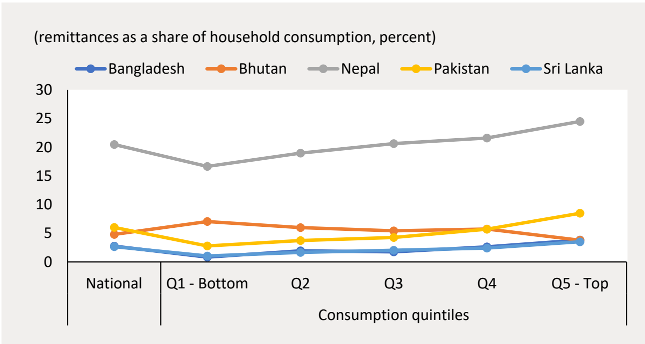
Remittance inflows to Nepal rank among the highest in the world and significantly contribute to sustaining household expenditures. In FY24, officially recorded remittance inflows to Nepal accounted for more than one-fourth of GDP, nearly three times as much as the second-highest remittance-receiving country in South Asia, Pakistan, with 7.8 percent of its GDP (Figure 34). This places Nepal in the top five countries receiving these financial flows globally. Remittances significantly surpass FDI and official development assistance and remain a vital source of foreign exchange. They benefit households across the income distribution, especially when compared to households in the neighboring countries (Figure 35). In 2023, a Nepali household, on average, was likely to receive more than 20 percent of its expenditure from remittances. This is almost three times higher than the average household in the regional peer countries. Remittances ranged from 17 percent of household expenditure among the bottom quintile to nearly 25 percent among Nepalis in the richest quintile.

Figure 34. Nepal's personal remittance to GDP ratio is among the highest in the world.



Source. World Development Indicators (BX.TRF.PWKR.DT.GD.ZS; accessed on September 15, 2024)

Figure 35. Financial flows from migrants abroad account for significantly more of Nepali households' finances across the distribution than their peers in the region.



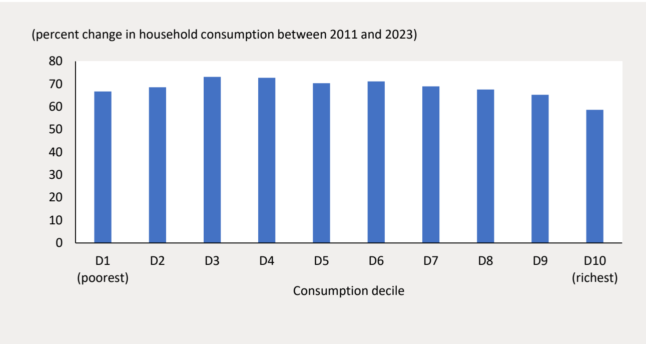
Source. World Bank staff estimates using Bangladesh's 2022 HIES, Bhutan's 2022 BLSS, Pakistan's 2018 HIES, Nepal's 2022/23 NLSS, and Sri Lanka's 2019 HIES.

Over 30 percent of the poverty reduction between 2011 and 2023 is directly attributed to personal remittances (World Bank, Forthcoming). Increasingly, more households across the wealth distribution are benefitting from international migration. The proportion of households receiving remittances and per capita remittances from an absentee household member abroad has increased substantially over the past decade, including for households at the lower end of the wealth distribution (World Bank, Forthcoming). This is in line with the historical role migration and remittances have played, having accounted for 27 percent of the poverty reduction between 1995 and 2010 at the national level and 33 percent in rural areas (Tiwari, 2016).[10]

[10] This is also true for other periods. For example, between 1995 and 2004, Lokshin et al. (2010) found that one-fifth of the poverty reduction was due to increased work-related migration and remittances. When accounting for local spillovers, Shrestha M. (2017a) found that migration to the Gulf and Malaysia explained 40 percent of poverty reduction between 2001 and 2011.

Fueled by increasing incomes from abroad, Nepali households experienced over a 65 percent rise in consumption over the last decade. The average per-person consumption expenditure increased by 66 percent between 2011 and 2023. This is more pronounced for the households at the bottom of the expenditure distribution (Figure 36). While it increased by 71 percent for the bottom 40 percent, consumption expenditure among those in the top 6 deciles increased by 68 percent. Increased consumption is consistent with the findings on the use of remittances.

Figure 36. Household expenditures have improved across the distribution.

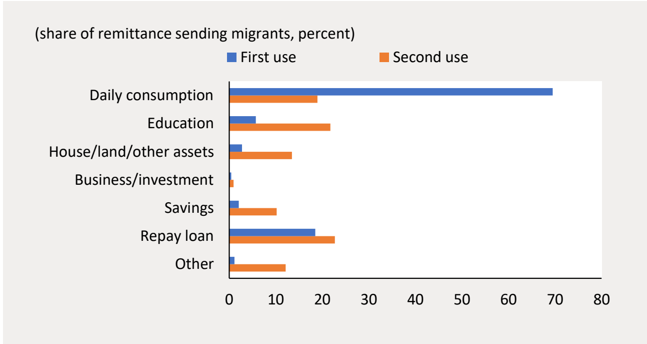


Source. World Bank staff estimates using the NLSS 2022/23 data.

Note: Figure 36 presents the share of migrants by usage of their remittances by their families at home. Refer to the NLSS IV methodological note (Nepal Statistics Office; World Bank, Forthcoming) for the 2011 and 2023 comparison and creation of welfare aggregate.

Household use of remittances from family members abroad primarily revolves around daily consumption and repaying loans (Figure 37). Most migrants (70 percent) send remittances mainly to support their family's daily consumption. Given high migration costs and Nepali workers relying on high-interest loans to finance their moves abroad (Kharel, Bhattarai, & Tumsa, 2023a), it is unsurprising that almost one-fifth of migrants send remittances to repay their loans.

Figure 37. Remittances are primarily used for daily consumption and repaying loans.



Source. World Bank staff estimates using the NLSS 2022/23 data.

Apart from household consumption, remittances from a member abroad are strongly linked with human capital investments. The NLSS 2022/23 data shows a strong association between remittances and decreasing probability of being poor, higher non-food consumption, and increased investment in education and health (Table 4). Remittances from family members living abroad positively correlate with non-food expenses, particularly education and healthcare. Controlling for other characteristics, a one percent increase in per capita remittances is associated with a 0.04 and 0.02 percent increase in per capita education and health expenditures. These findings are particularly significant given the track record of migration and remittances leading to positive educational outcomes in Nepal, particularly for girls (Shrestha, 2017a).

Controlling for other characteristics, having a family member abroad improves the subjective adequacy of household living standards and resilience to food insecurity (Figure 38). Households with a member abroad are significantly less likely to report less than adequate family living standards compared to non-migrant households. Similarly, migrant households tend to have less experience

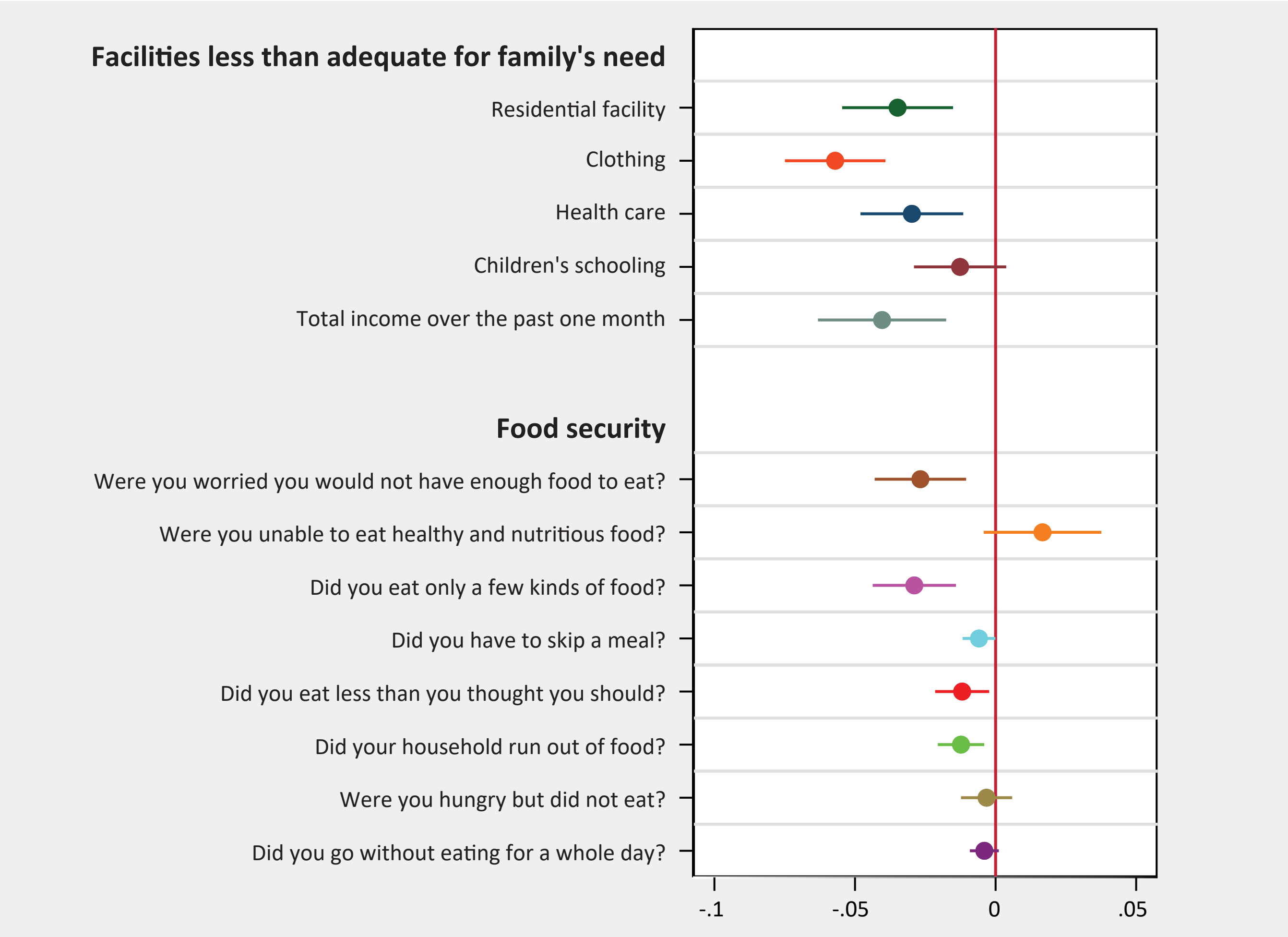
Table 4. Remittances from a member abroad are strongly linked with household consumption and human capital investments.

	Poverty status	Log (Per capita consumption)				
		Total	Food	Nonfood	Education	Health
Log (remittances)	-0.000807*	-5.00e-07	-0.000839	0.00155**	0.0403***	0.0198***
	(0.000412)	(0.000565)	(0.000537)	(0.000772)	(0.00839)	(0.00343)
Observations	9,600	9,600	9,600	9,600	9,600	9,600
R-squared	0.162	0.344	0.248	0.329	0.265	0.042
Number of clusters	800	800	800	800	800	800

Source. World Bank Staff estimates using the NLSS 2022/23 data.

Note: Controls used in the regressions are household head's caste/ethnicity, highest adult education in the household, household size, log of road distance of municipality from Kathmandu, Urban/Rural status of municipality, and province fixed effects. Standard errors, clustered at the primary sampling unit (PSU), are reported in parentheses. *** p<0.01, ** p<0.05, * p<0.1.

Figure 38. Adequacy of family's standard of living and food security.



Source. World Bank staff estimates using the NLSS 2022/23 data.

Note: Coefficient on a household with and without an international migrant indicator and its 95% CI reported in the figure. Each coefficient is a separate regression model. Controls used in the regressions are household head's caste/ethnicity, highest adult education in the household, household size, log of road distance of municipality from Kathmandu, Urban/Rural status of municipality, and province fixed effects. Standard errors are clustered at the primary sampling units (PSU).

of food insecurity in the past 12 months. Compared to non-migrant households, they are less likely to worry about not having enough food (2.3 percent), eating less variety of food (2.9 percent), skipping meals (0.6 percent), or running out of food (1.2 percent). These results align with the established evidence that migrant household members abroad act as insurance for the household in the context of high exposure to shocks and limited access to formal assistance (Yang & Choi, 2007). Relatedly, the correlation between the labor income loss during COVID-19 and economic distress was close to zero for migrant households in Nepal (World Bank, 2021).

International migration from Nepal, however, is costly, putting significant strain on those who migrate while discouraging others from migrating altogether. Based on the 2016 Migration Cost survey conducted by the World Bank's Global Knowledge Partnership on Migration and Development (KNOMAD) and the International Labour Organization (ILO), Nepali migrants faced the second highest costs of migrating to GCC countries after migrants from Pakistan. The average per-migrant cost of migrating to Qatar from Nepal in 2016 was 1.14 times Nepal's annual GDP per capita. The migration costs to Saudi Arabia and Malaysia were as high as 80 percent of the GDP per capita. Migration costs in South Asia are generally high and among the highest globally, often equaling several months of migrants' salary (Ahmed & Bossavie, 2022). This is particularly taxing for Nepali migrant workers. Despite the "free-visa, free-ticket" policy implemented in 2015 for the GCC countries and Malaysia, which allows recruitment agencies to charge a maximum of only 10,000 NPR as service fees, most recruitment agencies continue to charge more than ten times that amount (Kharel, Bhattarai, & Tumsa, 2023a). Additionally, 85 percent of migrant workers rely on informal loans to finance their moves, facing an average interest rate of 27 percent (Kharel, Bhattarai, & Tumsa, 2023a).

The economic rewards of sending family members abroad come with several costs. Much of social and domestic life in the household is put on hold when young male member/s go abroad temporarily and possibly for multiple stints (World Bank, 2018). While international remittances have improved investment in child health and education in Nepal, many children face the prospect of not having both parents present during their formative years. The absence of a parent may have important emotional and psychological implications for the left-behind children (Fellmeth, et al., 2018) and may even impact their academic performance (Antman, 2013). Additionally, a growing body of literature shows mixed evidence regarding the impacts of migration on left-behind members' non-monetary outcomes, especially on female members. It can reduce women's labor participation and increase their agricultural and unpaid family work (Bossavie, 2023; Lokshin & Glinskaya, 2009; Phadera, 2019; Binzel & Assaad, 2011). Moreover, it may overburden the left-behind members with extra pressure to take up additional household responsibilities (Démurger, 2015).

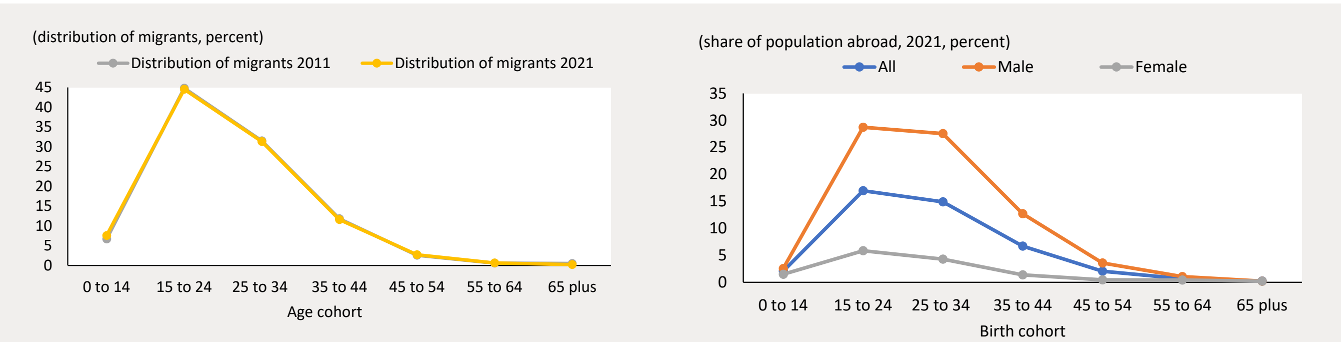
High levels of contract fraud during the recruitment phase continue to be a challenge, while migrants abroad face considerable health, safety, and legal challenges, including a high incidence of deaths. Prospective migrants often encounter contract deception about the nature of the job abroad and fake contracts altogether. Most of the complaints filed at the Migration Resource Centers (MRCs) are related to "cheating" during the pre-departure phase (MoLESS, 2020). Furthermore, the death toll has been rising over the years with an increasing number of international migrants. Yearly deaths of migrants have mounted to over 1,000 in recent years, with an annual rate of more than 150 in each of the Gulf and Malaysia destinations (MOLESS, 2022; Kathmandu Post, 2024). Migrants in these destinations endure harsh living and working conditions without access to healthcare, social protection, and other basic services while facing high occupational hazards and long working hours. These poor conditions and lack of social support, along with the persistent pressure to send remittance home, contribute to migrants' poor mental and physical health (MOLESS, 2022) and can remain persistent even during old age (Ghimire & Bhandari, 2020).

C.2 MIGRATION TRENDS

International migration from Nepal continues to be dominated by young men and remains concentrated on the GCC countries and Malaysia for largely unskilled work. Limited but important new destinations have emerged in recent years, and the average skills and wages of migrants have risen. However, migration and destination choices are still limited by socioeconomic factors, and reassimilation of returnees into the domestic labor market remains a challenge.

Going abroad for employment is predominantly a male youth phenomenon. Male youth, who experience higher domestic unemployment than older Nepalis, account for most international migrants; for many, it is their first job when entering the labor market. Out of the 2.2 million individuals living abroad in 2021, 80 percent were male, 44.5 percent were between the ages 15 and 24, and another 31.3 percent were between 25 and 34 when they left the country (National Statistics Office, 2023). The age profile of international migrants has remained unchanged since 2011 (Figure 39). Nepalis seek foreign employment early in their careers, with 17.0 percent of 15 to 24-year-olds and 14.9 percent of 25 to 34-year-olds having already left the country for work in 2021 (Figure 39). As a result, many Nepali workers spend most of their economically productive years employed abroad, often engaging in multiple migration spells, and moving across different destinations (World Bank, 2020).

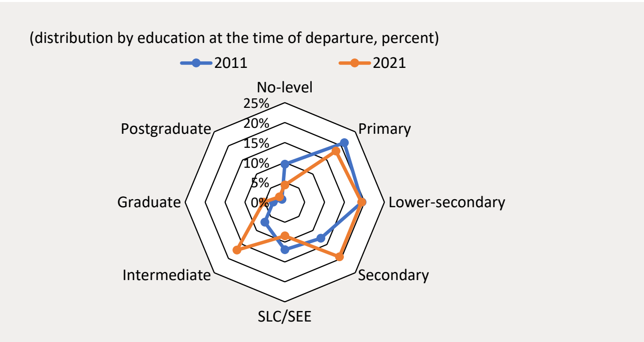
Figure 39. Economic migration is a young and male phenomenon.



Source. World Bank staff estimates using the Nepal Housing and Population Censuses 2011 and 2021

The education level of international migrants is generally low, reflecting Nepal's overall low education level. In 2021, over 60 percent of the absentee population had obtained only secondary education (grades 9 to 10) or less before leaving the country, while a quarter had achieved Intermediate and SLC/SEE levels and beyond (Figure 40). The average years of education of international migrants is 8.6 years, which mirrors Nepal's low overall education level. Despite some improvements over the last three decades (Ruppert Bulmer, Shrestha, & Marshalian, 2020), the average years of education among the working-age non-migrant population (15 plus) is only 6.3 years, which is lower than the average level of international migrants. Conversely, domestic migrants have the highest average education level at 10.2 years (authors' calculation using NLSS IV).

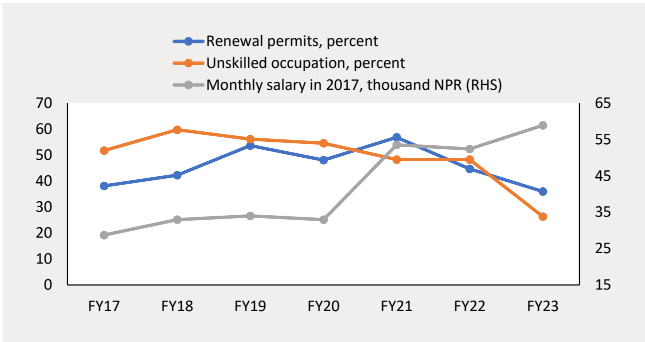
Figure 40. Emigration is concentrated among those with intermediate/high school education or less.



Source. World Bank staff estimates using the Nepal Housing and Population Censuses 2011 and 2021

Nepalis primarily migrate for elementary occupations to GCC countries and Malaysia, but new destinations have emerged in recent years, and migrants' average skills and wages have risen. Data from the Foreign Employment Information Management System (FEIMS) show a gradual decrease in the number of people migrating for unskilled occupations and an increase in migrant wages (Figure 41).[11] Between FY2017 and FY2022, the average monthly migrant salary increased by over 100 percent from NPR 28,701 to 58,856. Considering Nepali workers spent multiple stints abroad, migrants are likely to navigate to better opportunities with different employers. While there is a positive income trajectory during employment abroad (Sapkota, Shrestha, & Shrestha, 2021), the observed salary increase may not entirely be due to higher returns from re-migration. New migrants may have higher skill sets and migrate to newer, more remunerative destinations. Indeed, countries in Central and Eastern Europe, the UK, Malta, and Turkey have become more prominent new emerging destinations in recent years, especially among women migrants (MOLESS, 2022).

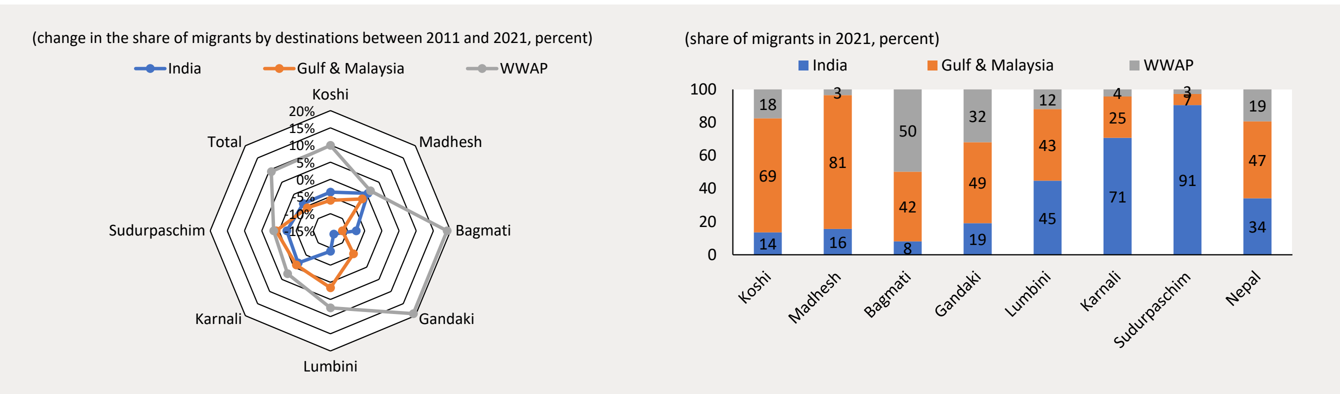
Figure 41. However, there is a gradual shift towards more skilled occupations, and average earnings overseas are also increasing.



Source. Foreign Employment Information Management System (FEIMS) data

Migration to more lucrative but more expensive destinations is increasing in wealthier provinces, while low-cost and low-return destinations remain a mainstay among the poorer provinces (Figure 42). Between 2011 and 2021, the share of migrants to India (low cost-low return

Figure 42. Access to higher remunerative migration destinations improved over the last decade but remained unequal across provinces.



Source. World Bank staff estimates using the Nepal Housing and Population Censuses 2011 and 2021

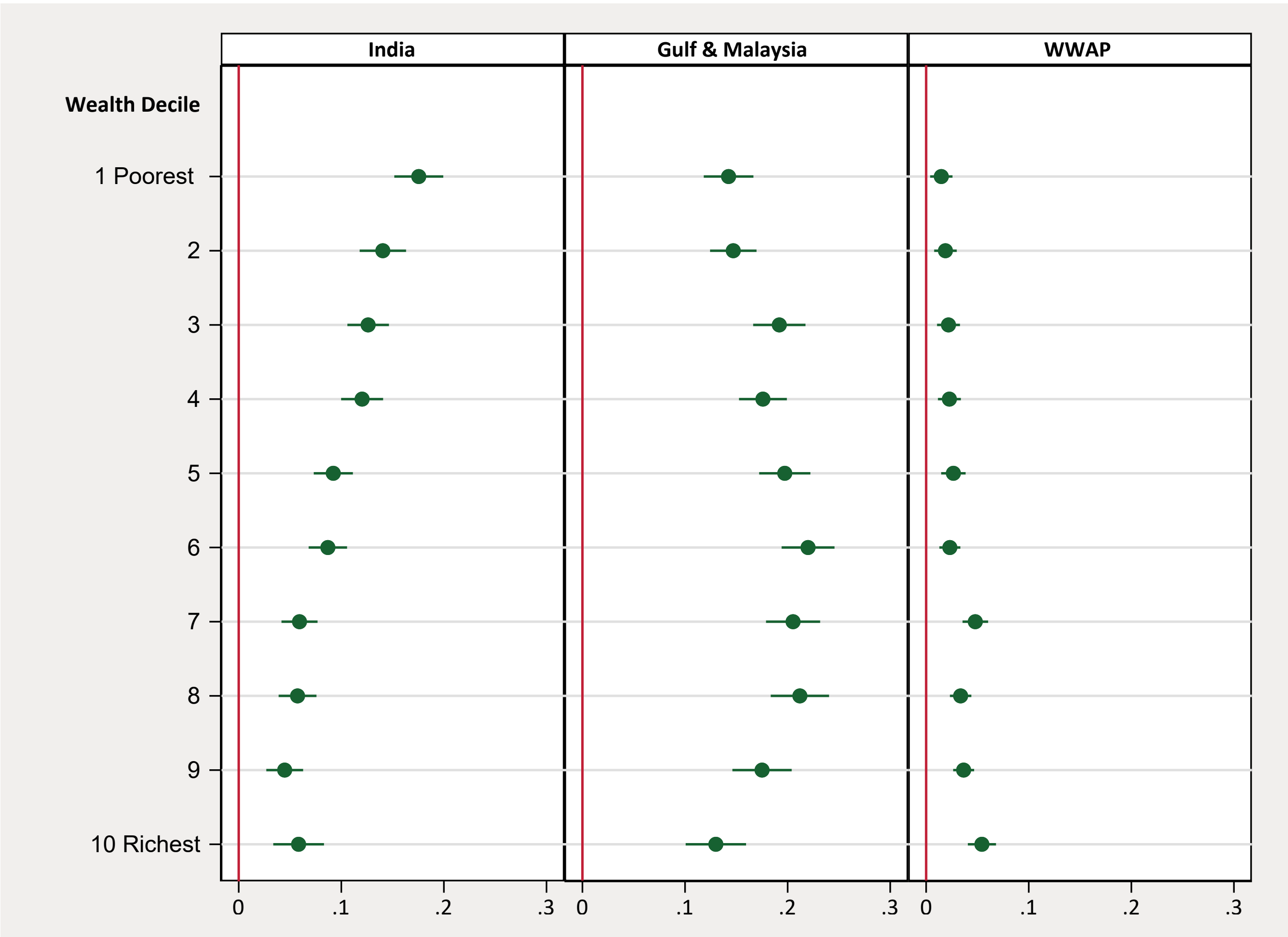
11 All migrants seeking foreign employment, except in India, require an employment permit from the Department of Foreign Employment (DOFE), and the information is collected in the FEIMS.

destination) and the GCC & Malaysia (medium cost-medium return destinations) decreased by 3.8 and 5.5 percentage points, respectively, while the share to most lucrative but with high migration cost Wealthy Western, Asia, and Pacific (WWAP) destinations increased by 9.3 percentage points. This trend is driven by migrants from the most well-off provinces of Bagmati and Gandaki, where migration to WWAP countries rose by over 19 percentage points. In Koshi and Madhesh provinces (medium wealthy), GCC and Malaysia are the most popular destinations, while India remains the dominant destination in the poorest provinces of Karnali and Sudurpashchim.

Similarly, there is a strong link between household wealth and the destination type, suggesting liquidity constraints restrict migration choices. There is a clear pattern of household wealth and destination choices (Figure 43). While the propensity to sending a member to India decreases with the wealth level, having a migrant in the GCC countries and Malaysia is highest among middle and upper-middle-class households (deciles 5 to 8). However, only households in the wealthiest decile have a meaningful and statistically significant probability of sending a migrant to a WWAP destination, most likely due to sufficient liquidity to cover the higher migration costs.

Once returned from abroad, migrants face significant challenges in reassimilating into the domestic economy, and the data on returnees is still limited. GCC countries and Malaysia do not offer a path to permanent residence; thus, most of the migration from Nepal is temporary. Nepal has yet

Figure 43. There is a strong wealth and migration association by destination.



Source. World Bank staff estimates using the NLSS 2022/23 data.

Note: Predictive margins and their 95% confidence levels after fitting logistic models are reported in the figure. Other controls used in the models are the household head's caste/ethnicity, highest adult education in the household, household size, number of adult male members, number of domestic migrants, log of road distance of municipality from Kathmandu, Urban/Rural status of municipality, municipality destination-specific international migration rates, and province fixed effects. Standard errors are clustered at the primary sampling unit (PSU) level.

to create a systematic record-keeping system for returnees. Once back in Nepal, returnees face limited opportunities to reassimilate into the domestic economy. Based on the 2017/18 Nepal Labor Force Survey (NLFS), one of the few surveys with returnees' information, the majority of the returnees were either unemployed (14.3 percent) or remained out of the labor force (41.5 percent) and even among those with jobs, over 75 percent were employed in the informal sector (MoLESS, 2020). Younger returnees faced even greater challenges, with lower employment and wages in the initial years and significantly lower labor force participation rates than non-migrant youths (Sapkota, Shrestha, & Shrestha, 2021).

The mismatch between the skill sets the returnees bring from abroad and the demand of the domestic labor market further adds to the challenge. Only a fraction of returnees utilizes the skills learned abroad. According to the NLFS 2017/18, only 15.1 percent of returnees were employed in the same occupational category as abroad (MoLESS, 2020). The migration experience is also likely to have increased reservation wages. Given the undersupply of jobs at the expected higher wages, returning migrants may be further discouraged from entering the job market.

Remigration is high and indicates structural weaknesses in the domestic economy, reflecting a poor environment to utilize the skills and capital from abroad. In a 2020 World Bank survey of 2000 returnees, 40 percent reported migrating more than once, and 32 percent reported migrating to more than one country, with individuals spending 1.5 years on average between adjacent migration spells (Sharma, Sherpa, & Goyal, 2020). The FEIMS data shows high renewal rates of labor permits, which is another indication of a lack of opportunities at home. Among the employed returnees in the NLFS 2017/18, almost half (43.7 percent) were either employers, own account workers, or contributing workers, mostly informally (MoLESS, 2020). Similarly, in a survey of 1,400 returnees conducted in Koshi province, the highest proportion were employed in basic self-employment agriculture, mainly farming and plantation (34.9 percent) (IOM, 2021).

C.3 MAKING THE MOST OF MIGRATION

Nepal's policy focus should be on reducing costs, increasing benefits, and leveraging long-term growth through an effective and inclusive migration management system.

Systematic migration management through an inclusive institutionalized system is critical for sustainability and maximizing the rewards from migration. Nepal's current predominantly low-skilled economic migration matches the strong demand at the destination countries. This provides a basis for designing policies that focus on increasing benefits and reducing migration costs (World Bank, 2023) for contemporaneous migrations with an eye for longer-run skill and destination diversification.

Incorporating migration explicitly within Nepal's development and poverty reduction strategy will provide a platform to work towards such a system and will have larger benefits that are shared across the distribution (World Bank, 2023). This will entail reducing costs and increasing benefits in all three stages of migration, namely before, during, and post-migration, which are discussed in this section.

Improving communication on available opportunities and domestic exit processes, including costs and formal financing opportunities, can help address unequal access, improve safety, and increase returns. Despite the significant improvements over the last decade, international migration opportunities remain unequal, and many continue to face contract fraud. To find jobs abroad, many rely on sub-agents, relatives, and friends (International Trade Union Confederation, 2023), which may provide inaccurate information leading to incorrect expectations and outright fraud. For example, potential migrants from Nepal overestimate the increase in earnings and mortality risk associated with working in Malaysia and the GCC countries (Shrestha M. , 2020). Thus, efforts to improve the reach of verifiable information on available destinations can help lower costs and increase returns for potential migrants. Furthermore, most of the migrant workers rely on very high-interest informal loans to finance their moves (Kharel, Bhattarai, & Tumsa, 2023a). Improving access to information and availability of low-cost capital can enable poorer populations to access higher-return jobs and destinations.

Pre-departure training should be improved with short language, financial planning, and other practical skills without increasing the cost burden to improve migrants' preparedness. The current 12-hour pre-departure orientation course has limited efficacy in improving the transition experience of migrants aboard (Aryal & Kharel, 2023). Many migrants report not having basic language skills when starting their work as a key impediment (Migration for development, 2023). Improved Pre-Departure Orientation Seminars (PDOS) with financial decision-making training increase the likelihood of migrant workers having a bank account, decrease travel-related difficulties and problems relating to settlement, such as obtaining a social security number and opening a bank account (Barsbai et al. 2020).

Expanding formal bilateral arrangements and mutual skills recognition with destination countries is key to reducing the cost of migration and ensuring protection and welfare of migrants. Out of the top thirteen countries where over 10,000 permits have been issued from 2020/21 to 2022/23, only 7 have formal labor relations. Saudi Arabia and Kuwait, the second and fifth largest destinations for Nepali workers, do not have a Bilateral Labor Agreement (BLA) or a Memorandum of Understanding (MoU) with Nepal. The lack of formal arrangements may result in informal labor movements, leading to high costs for migrants, making protection and welfare expensive or inaccessible, and preventing the labor market from reaching its full potential.

Strengthening provisions for worker protection and improvement in labor market outcomes in formal bilateral arrangements and building effective consular support abroad will likely improve safety and economic returns. The existing bilateral labor agreements do not adequately address worker protection and welfare to enhance labor market outcomes at the destination. While these agreements have helped open recruitment channels, they fail to ensure worker protection and welfare. Additionally, they do not address factors that can improve labor market outcomes for migrants abroad, such as job mobility, skills certification, and recognition (The Five Corridors Project, 2021). In addition to detailing workers' protection and ensuring rigorous implementation, it is crucial to include provisions that enhance labor market outcomes for workers. This may involve ensuring labor mobility, providing skill training, and recognizing skills in these agreements. Following the example of India and the Philippines, Nepal should prioritize establishing effective consular support in its missions abroad to monitor the welfare of migrants.

Programs focused on job matching, recognition of skills learned abroad (sector-specific and soft skills), reskilling per domestic labor demand, and promoting entrepreneurship among returnees through long-term support are some pathways Nepal can improve returnee reintegration. The current programs for retraining/reskilling and promoting returnee entrepreneurship with soft loans remain out of reach for most, with very few returnees having information or utilizing them (IOM, 2021). The efficacy of these programs is not obvious since no rigorous evaluations have been done. Unlike job-specific skills, soft skills such as work ethic, time management, and communication/customer care are highly transferable across different sectors. Returnees are most likely to report improvement in these skills while working abroad and can be easily applied to jobs in Nepal, particularly in the growing service sector. Attention to these skills remains limited, and a better understanding of which, when combined with industry-specific reskilling, can reduce friction, and improve placements.

Ultimately addressing the structural issues in the domestic labor market will be important for Nepal in creating a vibrant economy where local opportunities can retain people and/or harness new skills. A conducive domestic economic environment will not only foster the use of the capital and skills returnees bring from abroad, but it will also improve opportunities for those left behind and broaden choices if faced with migration decisions in the first place. If managed effectively, the current migration and remittances-based model can support and spur the economic growth needed for such an economy.

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