Nepal Development Update

July 2020

Post-Pandemic Nepal – Charting a Resilient Recovery and Future Growth Directions

WORLD BANK GROUP

NEPAL DEVELOPMENT UPDATE

Post-Pandemic Nepal – Charting a Resilient Recovery and Future Growth Directions

July 23, 2020

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Acknowledgments

The Nepal Development Update is produced once a year to report on key economic developments that occurred during the year, placing them in a longer-term and global perspective, and to examine (in the Special Focus section) topics of particular policy significance. The Update is intended for a wide audience including policy makers, business leaders, the community of analysts and professionals engaged in economic debate, and the general public.

This Update and Special Focus section was produced by the World Bank Macroeconomics Trade and Investment (MTI) team for Nepal consisting of Kene Ezemenari, Nayan Krishna Joshi, and Florian Blum. The Special Focus section benefitted from inputs provided by the following World Bank sector specialists: Aline Coudouel, Anastasiya Denisova, Soyesh Lakhey, Phillippe Leite, Jyoti Pandey, Jasmine Rajbhandary (Social Protection and Jobs); Karthika Radhakrishnan-Nair, Mohan Aryal, Maya Sherpa (Education); Jonas Parby (Urban); Kari Hurt and Manav Bhattarai (Health); Siddhartha Raja (Digital Development); Tijen Arin, Drona Ghimire, Andrea Kutter, Andrew Mitchell, Urvashi Narain, Annu Rajbhandari, and Josefo Tuyor (Forestry and Green Growth); Peter J. Mousley and Sabin Raj Shrestha (Private Sector Development and Financial Sector); Rubika Shrestha, Shyam KC, Feriha Mugisha (Water); Purna Chhetri and Karishma Wasti (Agriculture); Sri Kumar Tadimalla (Transport); Xiaoping Wang, Barsha Pandey, Teuta Kacaniku, Gailius Draugelis (Electricity); Hiroki Uematsu, Nethra Palaniswamy (Poverty and Data); Philippe De Meneval and Sumit Baral (Tourism). Oversight in preparing the report was provided by Mona Prasad under the overall guidance of Manuela Francisco, Faris H. Hadad-Zervos, and Zoubida Allaoua. Akash Shrestha managed media relations and dissemination. Diane Stamm edited the document. Sujata Bhandari processed the document. Overall administrative and logistical support was provided by Anima Maharjan. The report also draws from background studies on the impact of COVID-19 on Nepal's economy, commissioned by Department for International Development (DFID), Nepal and produced by the Economic Policy Incubator under the leadership of Dr. Shankar P. Sharma. Consultations were also held with private sector representatives from the following sectors: Hotel Association of Nepal; Nepal Airlines Operators Association; Nepal Bankers' Association, Independent Power Producers' Association, Nepal Retailers' Association, Federation of Contractors Association of Nepal. The report also benefitted from discussions and consultations held with The Roundtable on COVID-19 Response and Role of Development Assistance, co-Chaired by Dr. Swarnim Wagle (Institute for Integrated Development Studies-IIDS) and Faris H. Hadad-Zervos (Country Director, World Bank). Members of the Roundtable included: Rameshwor Khanal (former finance secretary); Dr. Shankar P. Sharma (former NPC vice chair); Dr. Bimala Rai Paudyal (National Assembly Member); Dr. Lhamo Yangchen Sherpa (Senior Research, Monitoring and Evaluation Advisor, Ipas Nepal); Shishir Khanal (Chief Executive Officer, Teach For Nepal); Pawan Kumar Golyan (Chairman, Golyan Group); Moushumi Shrestha (Director, Shreenagar Agritech Industries Pvt. Ltd.); Biswas Gauchan (Director of Economic Policy, IIDS) Mukhtor Khamudkhanov (Asian Development Bank); Lisa Honan (Department for International Development, Nepal); Chip Bury (USAID); Elisabeth von Capeller (Embassy of Switzerland).

The cutoff date for data included in this report was June 30, 2020.

Abbreviations

COVID	coronavirus disease
DHS	Demographic Health Survey
DOI	Department of Immigration
FY	fiscal year
H1FY	first half of fiscal year
ILO	International Labor Organization
IMF	International Monetary Fund
INR	Indian rupee
LIBOR	London Interbank Offered Rate
MOH	Ministry of Health
NPL	nonperforming loans
PPP	public-private partnership
VAT	value-added tax
WASH	water, sanitation, and hygiene
y/y	year-on-year

Executive Summary

Recent Economic Developments

1. **Nepal's economy faced headwinds in the first half of FY2020**. Following three consecutive years of substantial economic expansion, with growth averaging 7.3 percent per year, Nepal's economy experienced headwinds in the agriculture, manufacturing, and the service sectors in the first half of FY2020. The agriculture sector was impacted by a delayed monsoon coupled with an outbreak of armyworms, leading to a 1.7 percent (year-on-year) decline in paddy production. In the manufacturing sector, tightening domestic credit conditions, an increased foreign direct investment threshold, and continued low execution rates of public investment projects resulted in a contraction of investment and the number of new businesses registered. Services were impacted by the deceleration in remittances growth and lower tourist arrivals from India, leading to an overall drop in arrivals of 4.3 percent (year-on-year), and an associated slowdown in tourism receipts.

2. **With slower economic activity, imports declined in the first half of FY2020, narrowing the external deficit but adversely affecting revenue collection**. The decline in aggregate demand led to a contraction in goods imports by 3.9 percent (year-on-year) in the first half of FY2020. The contraction was broad based, encompassing construction material and machinery, industrial supplies, and food and beverages for household consumption. Services imports also contracted for the first time in four years on the back of lower travel and education service imports. At the same time, a strong goods export performance due to increased palm oil and soybean oil exports to India countered a contraction in services exports,

narrowing the current account deficit by 44 percent (year-on-year). The reduction in goods imports, however, contributed to a deceleration in government revenue collection, which is heavily reliant on duties, excise, and value-added taxes (VATs) collected at the border. Between July 2019 and March 2020, revenues grew by 12.2 percent compared to the same period in the previous year, which is the lowest rate since FY2016. Government expenditure expanded by 9.4 percent over the same period due to a higher recurrent spending on wages and compensation, goods and services, social assistance, and fiscal transfers.

3. **The global COVID-19 pandemic imposed both a supply and a demand shock on Nepal's economy, which adversely affected growth**. The global crisis induced by the pandemic initially impacted Nepal through the tourism sector, with arrivals from China dropping by around 70 percent in February and a full stop to the issuance of visitor visas taking effect in early March 2020, which has effectively dropped tourist arrivals to zero. The impacts of the pandemic did not remain limited to tourism. On March 21, the Government of Nepal announced a nationwide lockdown, which affected industrial and agricultural production, leading, for instance, to more than a 25 percentage point decline in capacity utilization of industry by early June 2020 and a 64.7 percent (y/y) drop in credit provision to the private sector during the two-month lockdown period. Demand for consumption and production products, such as diesel and petrol, slowed, with many Nepalese experiencing job losses or the inability to outmigrate due to widespread travel restrictions. A domestic outbreak of COVID-19 commenced in May, prolonging the lockdown and imposing substantial human and further economic costs. As a result of the impact of COVID-19, GDP growth in Nepal is estimated at 1.8 percent in FY2020, compared to 7 percent in FY2019. Growth in the service sector is now estimated at 1 percent, the lowest since FY2002, while growth in the industrial sector is estimated at 3.2 percent, a four-year low, due to the deceleration in overall growth.

4. **COVID-19 has increased external and fiscal pressure by reducing foreign currency inflows and revenues**. As a result of the pandemic, services exports, goods exports, and remittances contracted by 57.4 percent 62.1 percent, and 43.4 percent, respectively, between March and May 2020 compared to the same period in the previous year. The resulting pressure on foreign reserves was moderated by a substantial decline in goods and services imports, which decreased by 59.6 percent and 59.5 percent, respectively, between March and May 2020, year-on-year. As a result, the current account deficit is estimated to decrease to 7.2 percent of GDP in FY2020 from 7.7 percent in FY2019. While Nepal was able to contain external pressures resulting from COVID-19, the pressure on its finances has been rising. Government revenues contracted by 51 percent between March and May 2020 compared to the same period in the previous year. At the same time, COVID-19 relief measures have increased government spending and are estimated to result in a fiscal deficit of 7.3 percent of GDP in FY2020, compared to 2.6 percent in the previous year. The government aims to finance the deficit through concessional resources from international development partners and domestic borrowing.

5. **The Government of Nepal has responded to the crisis through fiscal and monetary measures. Fiscal measures targeted by the government fall into three broad categories**. First, there are immediate health measures aimed at increasing access to testing for COVID-19 infections and the establishment of quarantine facilities, as well as a waiver on customs duties for medical items related to COVID-19 such as masks, sanitizer, and surgical gloves. Second, to reduce the crisis' impact on livelihoods, the government has implemented food distribution programs, extended eligibility for the Prime Minister's Employment Program, and provided discounts on utility bills. Third, to provide economic support to firms, the government has deferred the payment of taxes and provided concessional loan facilities to severely affected sectors. The cumulative cost of these programs is estimated at 5 percent of GDP. Measures taken by the Nepal Rastra Bank

– the central bank – were aimed at providing liquidity support to banks and facilitating the provision of credit to the private sector. The key measures announced by the central bank included a relaxation of regulatory requirements for banks and financial institutions and a reduction of targeted interest rates as part of the country's interest rate corridor.

Outlook, Risks, and Challenges

6. **Nepal's economic outlook remains uncertain**. Despite efforts by the government to curb the economic fallout of the crisis, its impact on livelihoods and the economy is expected to be profound. Under a baseline scenario, where global infections and economic stress begin to ease, growth is projected at 2.1 percent (year-on-year) in FY2021. Even though this scenario assumes a gradual economic recovery, growth is expected to remain subdued due to the challenging outlook on tourism and remittances and lower industrial and agricultural production due to lasting supply chain disruptions. The current account deficit is projected to narrow to 6.5 percent of GDP, with imports remaining below precrisis levels due to lower economic activity and low oil prices. While lower imports will continue to limit revenue collection, fiscal measures announced as part of the FY2021 budget, including a revision of customs duties, will provide some support to the budget as spending levels on relief and recovery efforts remain elevated. Taken together, the fiscal deficit is projected to reduce marginally to 6.6 percent of GDP in FY2021.

7. **Risks are tilted to the downside**. Given its unprecedented nature, the global economic uncertainty associated with the COVID-19 pandemic is exceptional. Should cases in Nepal continue to rise and should a rebound in economic activity in the country's major trading partners and remittance-sending countries be delayed, growth in FY2021 risks turning negative, with a contraction of 2.8 percent possible. Due to the large share of the informal economy, an economic contraction would risk exacerbating poverty, inequality, and food insecurity. An associated risk relates to the potential of revenue shortfalls and further fiscal slippages: while the budget for FY2021 has proposed measures to manage an anticipated shortfall in revenue, a prolonged economic downturn risks reducing revenues further while requiring an increase in spending to manage the socioeconomic fallout of the crisis. Such a situation could elevate the deficit to 11.5 percent of GDP.

8. **In addition to the measures already adopted, a strategic and systematic approach is needed to address the above risks**. Such an approach that incorporates a medium- to long-term view would include the relevant reforms and measures to support an inclusive and green growth. This edition of the Special Focus outlines the key elements of a strategic approach to transition the economy from the relief stage through to restructuring and a resilient recovery.

Special Focus
Post-Pandemic Nepal – Charting a Resilient Recovery, and Future Growth Directions

9. **The global COVID-19 pandemic has altered economic behavior that will affect growth going forward**. With over 10 million infections, 400,000 deaths, and a global GDP contraction of 5.2 percent, the global impact of COVID-19 is unprecedented. The impact of the crisis is not temporary but is likely to induce lasting changes in the way that economies operate. The following four trends are indicative of how economies' modus operandi will change as they emerge from the crisis:

- **Inward Orientation**: Increased barriers to the movement of goods and people is likely to alter trade and tourism, and limit outmigration opportunities.

- **Increased Vulnerability and Inequality**: The economic crisis has resulted in job losses across the board and particularly affected workers in the informal and gig economy who have little or no access to safety nets, accelerating inequality and poverty.

• **Digitization**: Lockdowns have accelerated a push towards digitization, moving trade in goods and services, social interactions and the provision of public services, online.

• **Green Growth**: Climate change presents an equal if not larger economic risk than the pandemic, which has led to a global impetus towards an environmentally sustainable economic recovery post COVID-19.

• **Debt**: Given the large economic shock, leverage of governments, firms and individuals is likely to rise in the aftermath of the crisis, with the potential for systemic risks.

10. **For Nepal to emerge stronger from the crisis, it will be necessary to adapt quickly to this new reality**. Nepal is still at an early stage of the crisis, with a domestic outbreak having commenced only in May 2020 and infection rates continuing to rise. The crisis has forced the Government of Nepal (GoN) to make tough choices. The national lockdown that has been in place since March 2020 has been effective in curbing the rapid spread of the virus. However, it has adversely affected the livelihoods of workers in the informal sector. This has generated adverse knock-on-effects, for instance, leading households to neglect health care or education and contributing to a reported increase in gender-based violence. The GoN has initiated select policy measures to buffer the economic impact of the crisis and has started to gradually ease the lockdowns, but a comprehensive roadmap for the response and recovery will be necessary. By drawing on global experiences, this roadmap can allow Nepal to adjust to the new modus operandi induced by the crisis.

11. **An economic framework to chart Nepal's emergence from the crisis can be structured in three stages: relief, restructuring and a resilient recovery**. During the relief stage, the priority is on addressing the immediate health impacts of the pandemic and providing support to livelihoods and firms to reduce vulnerability. As the country brings the pandemic under control and infection rates level-off, the economy can re-open gradually, leading to the *restructuring stage*. The focus in this stage is on strengthening health systems and adjusting to a new normal that prioritizes domestic employment generation in a greener and more digital economy. The *resilient recovery stage* focuses on new opportunities to invest and reforms to promote more sustainable, inclusive and resilient growth in a post-COVID world.

12. **Each of the stages has been structured around four pillars.** These pillars include measures related to health, social protection, economic measures and cross-cutting priorities:

• **Health interventions are critical to save lives and ensure sustainable human capital growth going forward**. In the relief stage, the focus of health measures is to contain the spread of the virus and to preserve health services for non-COVID-related infections. Priorities thus involve testing, treating and isolating the infected, which includes the build-up of testing capacity, quarantine centers and specialized health facilities. Information flow among different levels of government will be critical at this stage. In the restructuring stage, efforts can focus on increasing the capacity of the health system, for instance through private sector participation and a strengthening of federalism and restarting crucial vaccination programs. Developing guidelines to manage the gradual easing of the lockdown will also be important. In the resilient recovery stage, building systems for future disease prevention, outbreak response and health surveillance will be critical. This would include developing standard operating procedures to address future pandemics and maintain health service delivery during crises.

• **Social support is needed to protect the livelihoods of the poor and vulnerable from current and future shocks and build human capital**. In the relief stage, a quick disbursement of cash or in-kind transfers to the most affected and vulnerable households will be critical. An expansion of the Prime Minister's Employment Program to cover newly unemployed workers and returning migrants will be key to protect livelihoods. Alternative approaches to distance learning could be adopted including radio, TV, and SMS to ensure broader coverage of students. In the restructuring stage, providing employment through public employment programs and supporting entrepreneurship would help along with continued provision of cash or in-kind transfers. The country will also benefit from support to mobile banking and digital financial services, and through the establishment of a digitized social registry. Efforts will also need to be made at getting children back to full-time schooling accompanied with enhanced school sanitation and health protocols. In the resilient recovery stage, the focus needs to be on a strengthened social protection system which can effectively address future shocks, employment support measures through reskilling and revised migration policies, and an education system which is more inclusive and digitally oriented.

- **Economic support to firms will be important to generate employment and pivot them towards a greener economy, while managing debt overhang**. In the relief stage, time-bound liquidity support should be provided to the most affected firms with the objective of increasing employment. The agriculture and tourism sectors could be prioritized, given their criticality for food security and employment. In the restructuring stage, continued support to firms, including through recapitalization, will be needed. Private sector recovery can be supported through targeted investments in digitization and by providing fiscal incentives for green investments. In the resilient recovery stage, efforts need to be aimed at strengthening physical, digital and financial infrastructure to develop e-commerce platforms, enhance access to finance and promote green growth.

- **Cross-cutting priorities would need to focus on fiscal sustainability, financial sector stability, a more digitally oriented and green economy and resilient public services**. In the relief stage, the focus needs to be on accommodative monetary and expansionary fiscal policy to support banking sector liquidity and provide relief to households and firms. Essential services also need to be maintained together with removing barriers to internet access. In the restructuring phase, expansionary fiscal and monetary policy will likely continue but with increased emphasis on raising revenues and maintaining debt sustainability. It will also be important to assess the impact of the crisis on the financial sector and the health of utility companies so as to plan for a sustainable recovery. Increased emphasis on broadening internet access will support service delivery, with some non-essential services also resuming during this stage. In the resilient recovery stage, it will be important to undertake efforts to rebuild fiscal buffers and strengthen financial sector stability. Pandemic preparedness, financial sustainability of utilities and a strengthened federalism architecture will enable smooth and resilient public service delivery. In addition, enhanced digital systems and connectivity will support service delivery and private sector growth and business continuity. Finally, key elements of green growth would include sustainable and resilient infrastructure, strengthened solid waste management and air and water pollution control.

13. **The table below proposes actionable measures that the government can undertake**. This crisis will require a multi-faceted response given the wide-ranging impact. These measures will support the government's efforts in providing relief and building a resilient recovery.

Table ES1: Priority Actions/Measures to move the economy to Resilience

	Relief	Restructuring	Resilient Recovery
Health	• Ensure quarantine facilities are well-equipped and build testing capacity • Deliver specific guidance to Provinces, Palikas, and facilities for delivery of essential health services during COVID-19 • Have a dedicated team at the Ministry of Health and Population (MoHP) and in each Province to monitor and report on essential service delivery	• Scale-up public health priorities like immunization campaigns, and surveillance and reporting systems • Allow greater private sector participation in COVID and non-COVID health service delivery • Develop guidelines for health and safety of the private sector as the economy opens up	• Adopt emergency response plans, including standard operating procedures for both emergencies and essential services. • Strengthen operational procedures for proper management of health care waste • Implement new service delivery modes such as telemedicine to increase resilience to shocks • Strengthen local level health service delivery mechanisms
Social	• Provide emergency cash or in-kind transfers using existing delivery systems for social safety nets or through employment programs • Expand coverage of existing programs (such as the Prime Ministers Employment Program) • Support distance learning programs for all using TV, radio, SMS, internet, printed materials	• Continue to provide cash or in-kind transfers to the poor and vulnerable and deploy electronic payment systems • Support employment through public works programs, revised migration policies and entrepreneurship support through banking and non-banking channels, together with business skills training • Establish a social registry, to help identify beneficiaries and coordinate programs • Take steps to get children back to school including re-enrolment campaigns and incentives together with measures to maintain social distance (staggered shifts, alternate week schedules) and enhanced school sanitation and health protocols • Re-direct short-term vocational training to essential and priority sectors	• Fully deploy the social registry, to ensure future shock-preparedness • Strengthen the social protection system by implementing social security allowances, strengthening the design of existing programs and including informal workers in contributory schemes • Provide employment support by reskilling and redeploy those who lost their livelihoods and adopting strong migration policies • Strengthen the education system to withstand further shocks by increasing connectivity, adopting the Emergency Education Operations Procedures and developing and delivering e-education services through local government or district office kiosks

Table ES1: Priority Actions/Measures to move the economy to Resilience

	Relief	Restructuring	Resilient Recovery
Economic Support	• Allow (temporarily) social security, tax and rental/ utility deferrals, provide wage subsidies, suspend import duties for critical supplies, and avoid the impact on credit scores • Announce a time bound subsidized emergency financial package for priority sectors like tourism and agriculture. • Support Palikas in the distribution of relief packages (seeds and fertilizers) to affected farmers and centrally procure agriculture produce to respond to food security needs	• Provide matching or conditional grants, loan restructuring and equity infusion to firms, in a selective and time-bound manner • Provide fiscal incentives for green investments, including enhancing energy efficiency, hygiene and sanitation, waste management, and the adoption of cleaner technologies • Streamline and simplify approval processes for investment • Strengthen corporate and consumer insolvency regimes and out-of-court settlement procedures • Expand the reach and coverage of mobile banking and digital financial services, and the use of non-collateral based lending • Support programs to promote digital literacy and establish information technology centers to facilitate access to the internet and computers	• For informal enterprises increase access to finance, through digital financial services, mobile banking, and digital literacy • Implement the Credit Information and Reporting Act and the amended Secured Transactions Act to expand the basis for lending beyond fixed collateral • Adopt comprehensive and long-term insolvency and out-of-court procedures • Accelerate key investment climate reforms impacting foreign direct investment (FDI) flows and firm entry and operation • Develop guidelines to support environmental management (waste management, air quality, water quality) investments at tourism destinations and promote eco-tourism. • Invest in food storage and distribution infrastructure

Table ES1: Priority Actions/Measures to move the economy to Resilience

	Relief	Restructuring	Resilient Recovery
Cross-Cutting Priorities	• Increase the fiscal allocation to health, social protection and employment programs • Mobilize concessional resources from development partners • Adopt monetary easing to provide liquidity to the banking system • Maintain the provision of essential services like water, sanitation and hygiene and electricity through the local governments • Remove barriers to internet access (access restrictions to under-utilized fiber-optic backbone) and digital infrastructure to enable social distancing and maintain business continuity	• Continue with increased budget allocation for income and employment programs • Explore additional sources of revenue through wealth and carbon taxes • Avoid imposing trade restrictions • Prepare a strategy to wind down fiscal incentives and strengthen debt management • Assess the impact of the crisis on the financial sector and prepare a financial recovery strategy • Strengthen and scale up the Deposit and Credit Guarantee Fund and explore regulatory amendments to enable financial institutions to offer digital financial products and services • Implement regulatory measures to broaden internet access by sharing telecom-ready infrastructure across sectors and strengthen competition • Continue to maintain essential services but also undertake critical repairs to infrastructure, resume some of the non-essential services, and prepare a plan to ensure financial sustainability of utilities • Reinforce the progress towards federalism with a focus on capacity building efforts	• Increase tax revenues through reforms in tax policy and administration including streamlining the import and export tax regimes and reducing tax expenditures • Strengthen the public investment program and prioritize growth and green investments as well as the development of essential and green infrastructure • Adopt targets for fiscal consolidation and debt reduction and monitor contingent liabilities arising from utilities and systemic firms and banks • Implement the financial recovery strategy and strengthen the regulatory and supervisory framework for the banking system • Implement pandemic preparedness plans for essential service delivery, restore the financial health of utilities, fully resume non-essential services and adopt increased digitization in service delivery, especially for payment collections and usage records • Strengthen the federalism architecture through appropriate laws and guidelines and capacity building to ensure improved service delivery • Strengthen cybersecurity laws and promote awareness on cybersecurity via an informational campaign • Promote broadband internet access and digital payments • Develop sustainable and resilient infrastructure and strengthen solid waste management and air and water pollution control

A. Recent Economic Developments

Real Sector

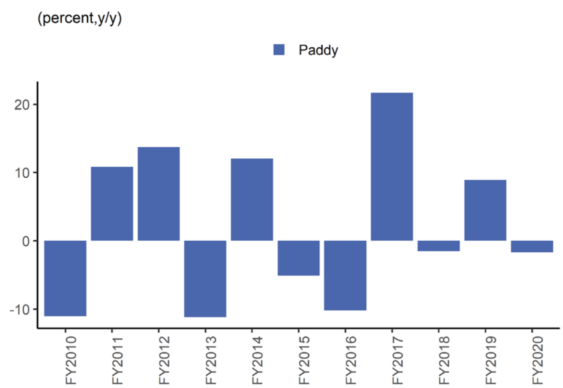
1. **After three years of growth that exceeded 6.5 percent**, Nepal's economy experienced significant headwinds in the first half of FY2020. Growth in remittances, tourism[1] , manufacturing, and agriculture slowed significantly and contributed to a deceleration in overall GDP growth in the first half of FY2020. Prior to the COVID-19 outbreak, agricultural output was already affected by delays in the monsoons; an outbreak of armyworms, which damaged crops in many parts of the country; and the proliferation of fake "Garima" paddy seeds, leading to a decline in paddy production by 1.7 percent, year-on-year (Figure 1). A deceleration in remittances growth and a 4.3 percent drop in international tourist arrivals, especially from India, adversely impacted earnings in the service sector (Figure 3). The industrial sector was impacted by an increased threshold for foreign direct investments and tightening domestic credit market conditions, which resulted in a contraction of newly established domestic and foreign businesses by 16.7 and 33.9 percent, respectively, compared to the previous year (Figure 2).

2. **Slower outmigration impacted remittances (and private consumption), while weak budget execution constrained public investment in the first half of FY2020**. Remittance receipts grew by a mere 1.3 percent in the first half of FY2020, significantly lower than the 17.6 percent achieved

1 Although tourist arrivals declined, travel earnings increased by 14.6 percent in the first half of FY2020.

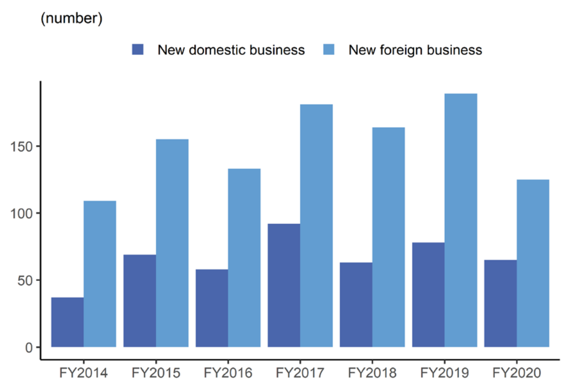
in the first half of FY2019, following a 16-month halt in labor migration to Malaysia (Figures 3 and 4). At the same time, public investment remained weak due to a low capital budget execution rate of only 15.4 percent, 2.3 percentage points below the level achieved in the first half of FY2019. As remittances are a key source of financing for private consumption, these developments jointly depressed demand, including imports of constructions materials and consumption goods, with aggregate imports declining by 3.4 percent in the first half of FY20. Demand did, however, receive support from increased government consumption, following salary increases for non-gazetted and gazetted[2] officers of 20 percent and 18 percent, respectively, and an expansion of merchandise exports, which grew by 22.2 percent following an increased demand for palm and soybean oil in India.

Figure 1. Delayed monsoons and armyworms caused paddy production to contract 1.7 percent in the first half of FY2020



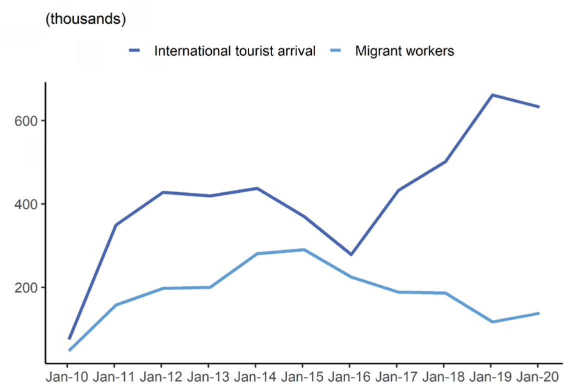
Sources: MoALD and World Bank staff calculations.
Note: Data for FY2020 cover only first six months.

Figure 2. The number of new businesses registered declined in the first half of FY2020



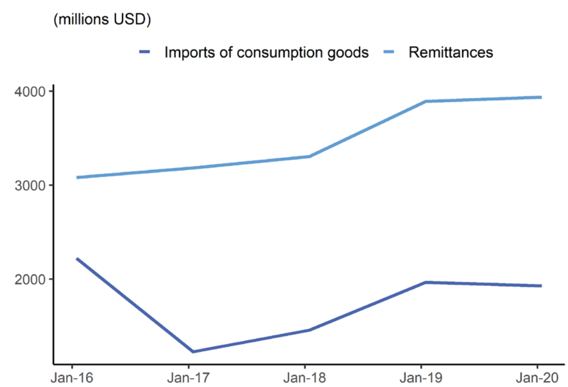
Sources: DoI and World Bank staff calculations.
Note: Data are for the first six months of the FY.

Figure 3. International tourist arrivals declined while international migration was subdued in the first half of FY2020…



Sources: NTB, DoFE, and World Bank staff calculations
Note: Data are for the first six months of the FY.

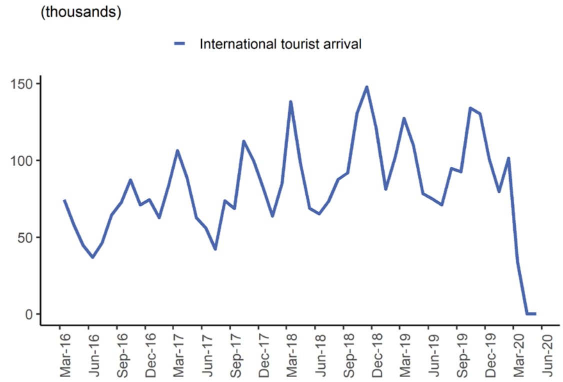
Figure 4. …contributing to slower remittance growth and impacting consumption in H1FY20



Sources: DoC, NRB, and World Bank staff calculations.
Note: Data are for the first six months of the FY. Private consumption is proxied by imports of consumption goods.

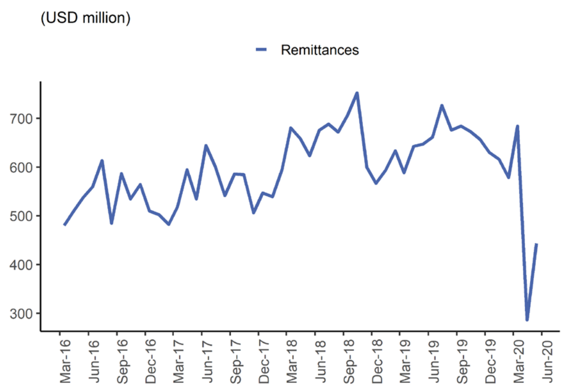
2 Gazetted officers are executive level ranked public servants in Nepal.

Figure 5. International tourist arrivals plummeted by 85.6 percent (y/y) between mid-March and mid-May 2020



Sources: NTB and World Bank staff calculations

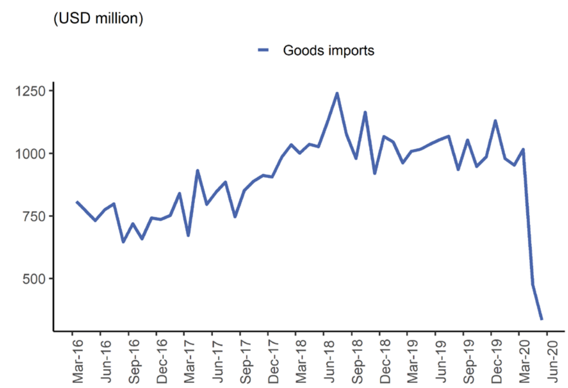
Figure 6. Remittances dropped by 43.4 percent (y/y) between mid-March and mid-May 2020



Sources: NRB and World Bank staff calculations

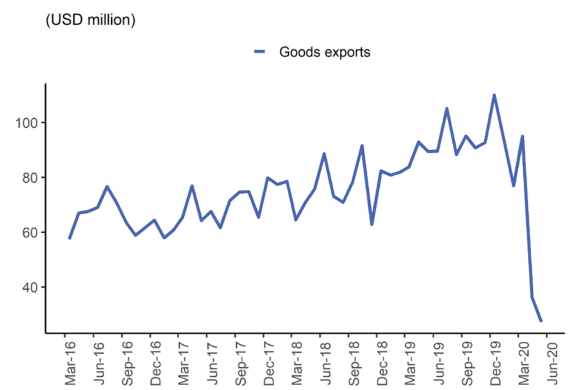
3. **The outbreak of the COVID-19 pandemic exacerbated existing headwinds through various channels, contributing to a forecasted deceleration of growth to 1.8 percent in FY2020**. The pandemic first hit the tourism sector in February 2020, causing arrivals from China, where the virus initially took hold, to contract by 70 percent. Travel restrictions were imposed by mid-March, including a moratorium on visas upon arrival and closure of the international airport. As a result, tourist arrivals dropped to zero from April 2020 onward (Figure 5). This was in stark contrast to the tourist arrival targets set as a part of the "Visit Nepal 2020" program. Under this program, international arrivals were targeted to increase from 1.2 million to 2 million and were expected to raise an estimated US$2 billion in tourism receipts. However, the onslaught of COVID-19 has resulted in an estimated revenue loss of US$1 billion and the destruction of 1 million jobs in restaurants, hotels, and the airline industry (ODI 2020). This caused service sector growth to reach its lowest level since FY2002, at 1 percent, with a significant contraction in the transport and hotel sectors. As the pandemic evolved, labor migrants from Nepal's main migrant destinations (that is India, Malaysia, and the Gulf countries) began to return. As a result, remittances dropped by 43.3 percent between mid-March and mid-May 2020 compared to the same period in the previous year (Figure 6).

Figure 7. Merchandise imports declined substantially between mid-March and mid-May 2020…



Sources: NRB and World Bank staff calculations

Figure 8. …as did merchandise exports



Sources: NRB and World Bank staff calculations

4. **A national lockdown, implemented in mid-March 2020, was initially successful at stopping the spread of the virus but led to significant economic disruptions**. The impacts of the lockdown were felt across the economy. In the service sector especially wholesale and retail, hotels, restaurants and transport, the effects were severe. There were also pronounced effects on the industrial and agriculture sectors. Industrial capacity utilization dropped from a pre-COVID baseline of 75 to 80 percent to 46 percent in June 2020. Daily peak energy consumption, which is closely correlated with industrial production, dropped from pre-COVID levels of 1000 megawatts (MW) to 700 MW in June 2020. The agriculture sector was affected through disruptions in the transport of agricultural products to and from farms, leading, for instance, to scarcities of fertilizer supplies, and through a lack of availability of farm labor. In addition, with corporate demand for dairy products affected by the lockdown, for example, by tea shops or sweets factories, dairy cooperatives were not collecting milk and farmers were forced to discard their produce. Disruptions in import supply, following Nepal's border closures with India and China, led to a scarcity of intermediate goods for large manufacturing firms and resulted in a 60 and 62 percent drop of merchandize imports and exports between mid-March and mid-May 2020 (Figures 7 and 8). As a result, growth in the industrial sector is estimated to have decelerated to a four-year low of 3.2 percent. The knock-on effects of the lockdown caused a contraction of construction, manufacturing, and mining, with growth in the sector as a whole lifted to positive levels only due to a substantial expansion of electricity production.

5. **Travel restrictions and the lockdown are estimated to have significantly increased unemployment, which in turn affects consumption**. Indications are that widespread layoffs coupled with the return of labor migrants have increased unemployment and created an excess supply of labor. For instance, the Federation of Contractors' Association of Nepal estimates that out of the 2 million workers in the construction sector, only around 200,000 were at work in April 2020. In addition, while an estimated 50 to 80 percent of workers are still employed, not all of them work at full capacity (ODI 2020). The loss of livelihoods has impacted demand. For instance, available daily data from the Ministry of Industry, Commerce, and Supplies show that average daily diesel and petrol consumption declined by 33.1 and 15.2 percent between April 1 and June 10, 2020. The Government of Nepal (GoN) has suggested initial measures to provide economic, social, and medical support to address the crisis as part of its FY2021 budget (see Box 1).

Box 1. Relief and recovery measures as announced in the FY2021 budget

Estimated cost[a]	Details
NPR 3 billion	(a) Work for relief program to workers in the informal sector impacted by COVID-19: The relief will be provided in the form of wages to workers willing to participate in construction works initiated by the federal, provincial, and local governments. For those who do not want to work, the relief will be continued in the form of food as before, but they will receive food relief equivalent to 25 percent of the daily wages paid to the workers who participate in construction works.
NPR 14 billion	(b) Concessional loans for small and medium-sized industries and COVID-19-affected tourism sector: A fund of NPR 50 billion will be createdb to provide loans at the interest rate of 5 percent for the purpose of operation of business and payment of salaries.
NPR 8 billion	(c) Discount on electricity fee: A discount of 25 percent on the electricity fee for individuals consuming electricity up to 150 units in a month and a discount of 15 percent for individuals consuming electricity up to 250 units in a month. The fee will be waived for individuals consuming electricity up to 10 units a month. A 50 percent discount will be provided on demand charges for industries during the lockdown period.

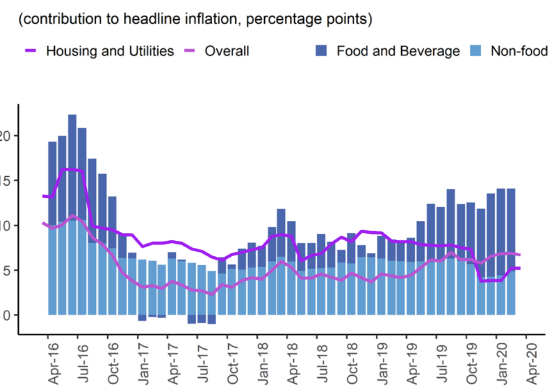
Estimated cost[a]	Details
NPR 20 billion	(d) Refinancing facility to COVID-19-affected sectors: A provision will be made through the Nepal Rastra Bank (NRB) to provide a refinance facility of up to NPR 100 billion at the interest rate of 5 percent for COVID-19-affected industries in the agriculture, cottage, small and medium-sized enterprise, hotel, and tourism sectors.
Not available	(e) Extension of insurance policy: The insurance policies of COVID-19-affected industries and transportation will be extended until the lockdown ends.
Not available	(f) Provision for bringing back foreign Nepalese migrant workers: These include those who lost jobs or whose visa expired or who have health risks.
NPR 1.5 billion	(g) Social security contribution waived for workers and firms during the lockdown period: The government will make contributions (on behalf of workers) to the contribution-based Social Security Fund during the lockdown period.
NPR 1.5 billion	(h) Discount for domestic airlines: Discounts will be provided on parking fees, airline licensing renewal fees, flight qualification certification charges, and the infrastructure tax on aviation fuel.

Note: a. These figures are based on information presented during the press conference held by the Ministry of Finance after the announcement of the budget speech on May 28, 2020. b. This will be operated through the NRB.

Inflation

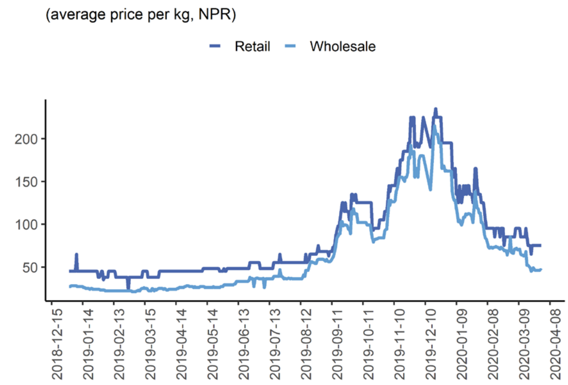
6. **Increases in food prices elevated inflation to a four-year high in the first half of FY2020**. Prices increased by an average of 6.4 percent during the first half of FY2020, significantly higher than the 4.2 percent recorded in the same period in FY2019 (Figure 9). The increase in the inflation rate stemmed from food prices, which grew to a four-year high of 8.6 percent, owing to a spike in vegetable prices as India imposed an export ban on onions from September 2019 to mid-March 2020 (Figure 10). Lower housing and utility prices kept non-food inflation at 5 percent in the first half of FY2020, the lowest since the corresponding period of FY2008. Due to the peg with the Indian rupee (INR) at 1.6 NPR to 1 INR, inflation follows the price movements in India with a lag (Figure 11). As a result, an increasing inflation wedge of 0.8 percent in the first half of FY2020 between Nepal and India contributed to a real effective exchange rate appreciation of 2.1 percent (Figure 12).

Figure 9. Inflation increased to a 4-year high from July to March FY2020, driven by food prices…



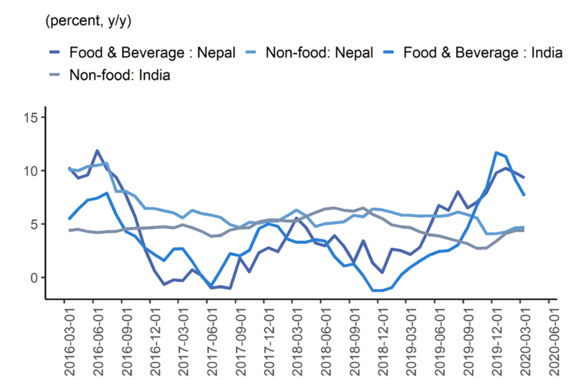
Sources: NRB and World Bank staff calculations.

Figure 10. …as vegetable prices rose, owing to the export ban on onions by India



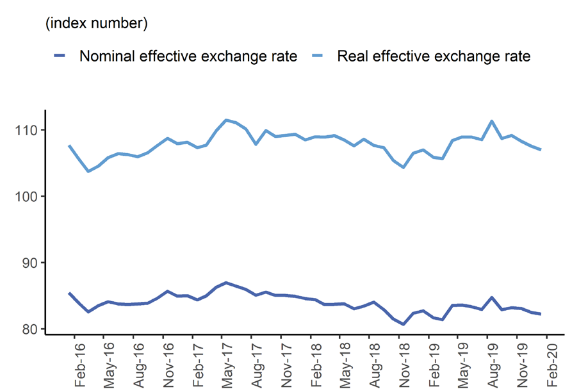
Sources: Kalimati Fruits & Vegetable Market Development Board and World Bank staff calculations.

Figure 11. Food prices in Nepal follow the movements of food prices in India



Sources: NRB, RBI and World Bank staff calculations.

Figure 12. The real effective exchange rate rose with the increased inflation wedge between Nepal and India



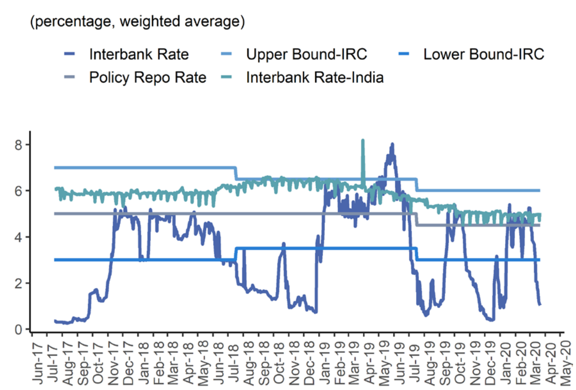
Sources: IMF and World Bank staff calculations.

7. **The drop in demand induced by the COVID-19 pandemic reduced inflation from late March onward**. The weak demand for non-food items and services due to the national lockdown and COVID-19 led to a decrease in average inflation to 6.3 percent from March to May 2020. Average non-food inflation during this period fell to 4.1 percent. By contrast, supply and trade disruptions in the agriculture sector caused an acceleration in average food inflation to 9.2 percent, significantly higher than the 8.6 percent recorded prior to the pandemic.

Monetary Policy and the Financial Sector

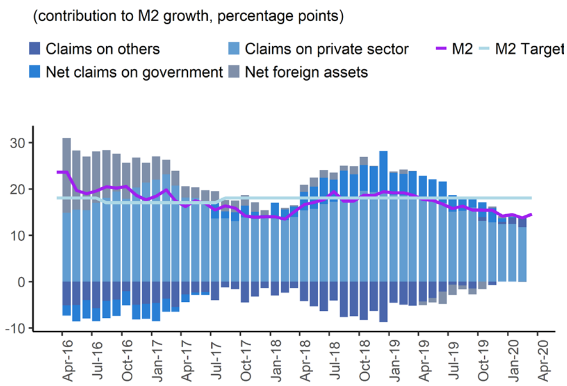
8. **The Nepal Rastra Bank (NRB) encountered difficulties in liquidity management in the first eight months of FY2020**. Nepal maintains a peg of its currency to the Indian rupee, which limits monetary policy to managing short-term liquidity in the banking system. Since FY2017, the NRB has aimed to use an interest rate corridor for the weighted average interbank rate in combination with repo and reverse-repo operations to manage short-term interest rates. At the beginning of FY2020, the NRB lowered the policy rate (and the associated target range) from 5 percent to 4.5 percent. However, realized interest rates fell below the lower bound for almost five of the first eight

Figure 13. Interest rates breached the lower bound of the interest rate corridor (remaining mostly ineffective) for five out of the first eight months in FY2020…



Sources: NRB, RBI, and World Bank staff calculations.

Figure 14. …and M2 growth remained below the FY2020 target of 18 percent, following slower private sector credit growth

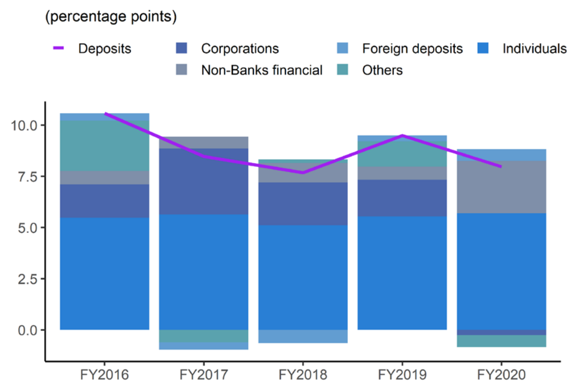


Sources: NRB and World Bank staff calculations.

months of FY2020 (Figure 13). This occurred as the NRB injected substantial liquidity into the system to address shortages during the Dashain festival (September 29, 2019 to October 13, 2019) and the period following the deadline for advance payment of taxes (January 14, 2020), but was unable to mop up excess liquidity once liquidity shortages had subsided, causing short-term interest rates to drop below the target range.

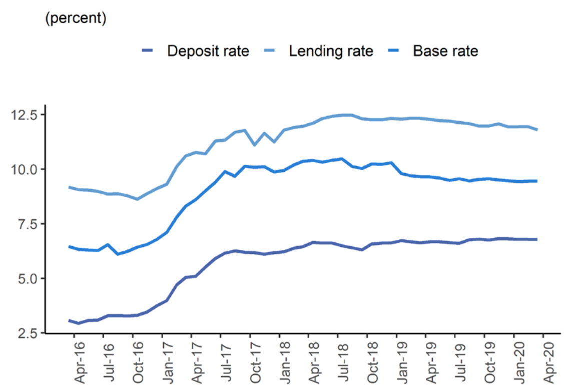
9. **Lower deposits and regulatory measures reduced credit provision to the private sector**. During the first eight months of FY2020, credit provided to the private sector grew by 11.3 percent, the lowest growth since the corresponding period of FY2017, leading aggregate money supply (M2) to remain below the 18 percent growth target for FY2020 (Figure 14). This followed regulatory reforms, which tightened provisioning requirements for financial institutions and eligibility criteria for non-business loans. In addition, loanable fund growth was limited as deposits grew by only 8 percent in the first eight months of FY2020, compared to 9.7 percent a year prior. This was because of the reduction in the NRB-mandated ceiling for institutional deposits and a slowdown in remittance growth, which limited personal deposits (Figure 15). As a result, the lending rate remained high at 11.8 percent in March 2020[1] (Figure 16). Credit provision has also become more concentrated in the real estate sector, following an easing of regulatory hurdles for first-time homebuyers. As a result, in the first eight months of FY2020, the share of new real estate loans to total new credit increased to 9.7 percent, compared to 6.9 percent in the previous year. The NRB has taken multiple measures to facilitate credit provision to the private sector (see Box 2).

Figure 15. Deposit growth slowed, driven by lower institutional deposits



Sources: NRB and World Bank staff calculations.
Note: Data are for the first eight months of the FY.

Figure 16. …keeping lending rates high

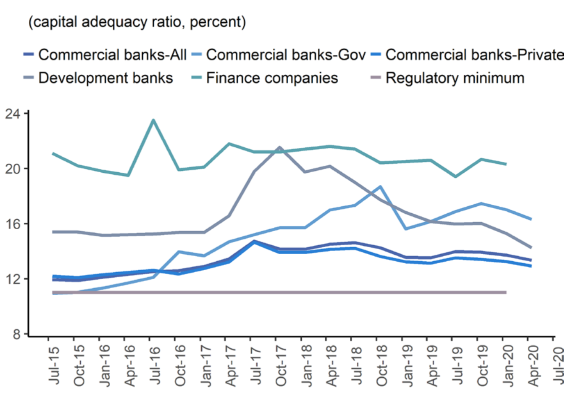


Sources: NRB and World Bank staff calculations.

1 While lending rates remain high, the weighted interest rate spread has reduced from 5.5 to 5 in the first eight months of FY20, and there has been a change in deposit mix, with time (term) deposits exceeding savings in order to take advantage of significantly higher returns on longer term deposits.

10. **Financial sector stability indicators remained adequate in the first half of FY2020**. The availability of liquid assets – measured as net liquid assets to total deposits – for all banks and financial institutions remained above the regulatory requirement of 20 percent during the first six months of FY2020. All of Nepal's banks and financial institutions also meet the regulatory capital adequacy ratio (CAR) of 11 percent. In January 2020, the CARs of state-owned and private commercial banks stood at 13.7 percent and 15.3 percent, respectively, while the CARs of development banks and finance companies were also above the regulatory requirement (Figure 17). The share of nonperforming loans (NPLs), defined as the loans that are overdue by 90 days or more, stood below 5 percent in January 2020 (Figure 18). However, in the first half of FY2020, aggregate NPLs increased (year-on-year) for all banks and financial institutions, with more than 15 percent growth for private and public sector commercial banks, and more than 30 percent growth for development banks and finance companies. This was because elevated lending rates pushed some borrowers into default. The 2018 NRB supervision report of commercial banks also suggests that loans are frequently evergreened, which is likely to artificially keep NPL ratios low

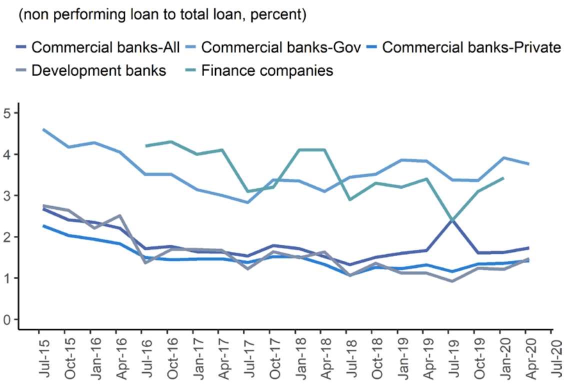
Figure 17. The CAR also remains above the minimum requirement of 11 percent



Sources: NRB and World Bank staff calculations.

and mask risks to asset quality. The number of commercial bank branches grew by 17.8 percent in the first eight month of FY2020, strengthening financial inclusion and enabling nearly 746 of the 753 local governments to have a bank branch in their locality.

Figure 18. NPLs remain below 5 percent, but there is a concern about evergreening



Sources: NRB and World Bank staff calculations.

11. **More recently, the crisis induced by the COVID-19 pandemic increased deposits and decreased private sector credit**. COVID-19 had three effects on the monetary and financial sector in Nepal. First, it led to a drop in private sector credit: new loans to the private sector decreased by 64.7 percent between March and May 2020 compared to the same period the previous year, reflecting a slowdown in economic activities and limited service hours of bank branches during the lockdown (Figure 19). Second, new deposits – driven by individuals – grew by 82.8 percent, reflecting precautionary savings and a deferment of tax payments. Third, monetary aggregates increased in May 2020 due to substantial growth in net foreign assets as COVID-19 led to a further decline in imports and an increase in foreign exchange reserves. As a result, M2 grew by 16.1 percent in May 2020 (y/y), higher than in March 2020, but still below the FY2020 monetary policy growth target of 18 percent.

Box 2. Policy measures to target credit to priority sectors and increase the availability of loanable funds

The NRB has taken measures to expand concessional and priority sector lending. This is being achieved through the following measures:

1. A minimum target for the number of beneficiaries to which each bank branch must extend concessional lending
2. An expansion of the definition of priority sectors
3. A reduction in the refinancing rate in the productive sectors
4. Easing the lending requirement in the productive sectors.

For example, on November 27, 2019, the NRB issued a directive that would require each commercial bank to disburse concessional loans[a] to at least 500 borrowers, development banks to 200, and finance companies to 100 by mid-July 2020. The directive was triggered by banks and financial institutions' (BFIs') unwillingness to extend such concessional loans to the targeted groups. In addition, the NRB also expanded the definition of priority sector for commercial banks by including the export sector; small and medium-sized enterprises; and the pharmaceutical industry, cement industry, and garment industry in addition to the already existing agriculture, energy, and tourism sectors. This definition of priority sector is consistent with the definition that has been used for development banks and finance companies.

As a result, priority sector lending of commercial banks increased to 42 percent of total lending in January 2020, compared to 31.1 percent in July 2019. Moreover, the NRB also reduced the interest rate on refinancing to 3 percent from the previous 5 percent for project loans of NPR 1 million to support small and medium-sized enterprises, and to 3 percent from the previous 4 percent for loans to the energy, agriculture, and livestock sectors, returnee migrants, and the construction of physical infrastructure. It also waived the requirement of tax payment certificates and allowed BFIs to extend loans of between NPR 5 million and NPR 20 million to agriculture, tourism, and small and medium-sized enterprises based only on tax filing documents.

The NRB also introduced several measures to increase the availability of loanable funds, which included:

1. Requiring commercial banks to issue a minimum of 25 percent of their paid-up capital as debentures (by FY2020) denominated in NPR and with a maturity period of at least five years, with proceeds to be used to extend loans
2. Allowing BFIs to borrow in convertible currencies from foreign pension funds, hedge funds, and other similar sources, in addition to the existing provision of borrowing from foreign BFIs, with interest rates and fees capped at the six-month LIBOR plus 4 percentage points[b]
3. Allowing BFIs to collect foreign currency fixed deposits with at least a two-year maturity from institutional foreign depositors and nonresident Nepalese and enabling BFIs to extend loans equivalent to 100 percent of such deposits in Nepalese rupees
4. Allowing BFIs to treat loans that have been received from a foreign bank, financial institution, or other organization in foreign currency for a duration of three years or more as deposits in calculating the core capital and extending loans accordingly.

As a result of these measures, the Local Currency Credit to Core Capital and Local Currency Deposit (CCD) ratio of BFIs – a measure of the availability of loanable funds – decreased in January 2020 but continues to remain elevated for all but finance companies and public sector commercial banks. Among BFIs, the decrease in the CCD ratio was the highest for finance companies and the lowest for development banks.

Finally, the NRB introduced several regulatory measures, which included:

1. Not allowing BFIs to include interest-income received from investments in government securities (August 2019) while computing the weighted average interest rate on credit. This would lead to a decrease in the weighted average interest rate on credit and in turn the base rate.
2. Requiring commercial banks to maintain the spread at not more than 4.4 percentage points by FY20, and development banks and finance companies at not more than 5 percentage points by end-FY20.
3. Not allowing BFIs to increase the premium rate that is added to the base rate in less than six months.

Note: a. The concessional loans are provided to the following loan categories as per the FY2019 budget: loans to youths with higher education to start their own business; project loans for returnee migrants; project loans for women; business loans to the Dalit community; education loans to economically deprived, marginalized, and targeted communities for pursuing higher studies and for technical and vocational education; loans for the construction of private housing of earthquake victims; and commercial agriculture and livestock loans. b. The maturity of such loans is set at one and five years and the loans are to be invested only in the productive sectors such as renewable energy, physical infrastructure, tourism, agriculture, and small and medium-sized enterprises, but not in real estate.

Figure 19. Amid COVID-19, new loans to the private sector contracted by 64.7 percent (y/y) in March–May 2020, driven mainly by slower service sector growth

Source: NRB and World Bank staff calculations.
Note: This figure is a tree map, where the total area represents the stock of private sector credit as of mid-March 2020, and the size of each rectangular box represents the share of components of private sector credit by industry categories. The color in the rectangular box indicates the growth rate of new private credit for March–May 2020; the light shaded box represents the component with the higher positive growth rate (for example, Health and Social Work).

12. **The NRB responded to the COVID-19 pandemic through measures aimed at providing liquidity and facilitating private sector credit**. To address anticipated liquidity shortfalls, the NRB lowered its policy rate and the associated bounds of the interest rate corridor from 4.5 to 3.5 percent in late March 2020. The NRB further directed banks and financial institutions on April 28, 2020, to apply interest rate discounts of up to 2 percentage points for borrowers from

COVID-19-affected sectors between mid-April and mid-July 2020. To increase the availability of loanable funds, the NRB further relaxed provisioning requirements for the banking sector, for instance, by allowing banks to disburse loans equal to all fixed deposits with more than one year remaining duration and allowing them to consider the loans or deposits that have been received from a foreign bank, financial institution, or other organization in foreign currency for a duration of one year or more as deposits. The measures taken by the NRB (see also Box 2), together with weaker demand for new credit resulted in a 0.8 percentage point decrease in the lending rate by May 2020, with its level remaining high at 11 percent.

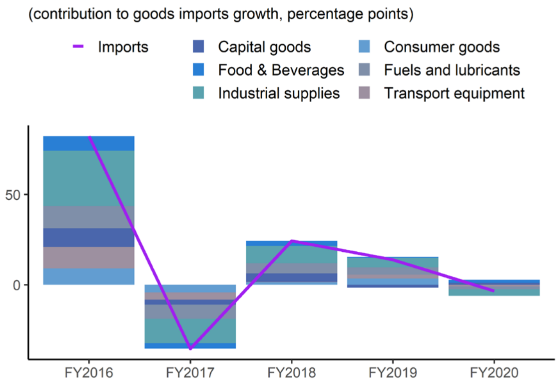
13. **COVID-19 impacted key stability indicators of the financial system**. The consolidated profit and loss statement of banks and financial institutions for the ninth and 10th months of FY2020 shows that key financial indicators were adversely impacted by the national lockdown and relief measures of the NRB. Interest income from March to May 2020 contracted by 10.7 percent compared to the same period the previous year. This was driven mainly by a reduction in interest income from loans and advances in response to NRB's directive to extend the repayment date of monthly and quarterly loan installments to after the lockdown. The CAR of major banks decreased in response to the lockdown, with 14 commercial banks reporting a decrease of over 5 percentage points for from July to April FY2020, but all banks remained above the regulatory threshold. Liquidity measures introduced by the NRB were effective in boosting banks' liquidity position, with net liquidity of public commercial banks increasing to 24.8 percent in April 2020 from 24.2 percent in January 2020, with smaller increases clocked by private commercial and development banks.

External Sector

14. **Nepal's current account balance improved due to a lower trade deficit in the first half of FY2020, before the crisis hit**. By the end of the first half of FY2020, the current account deficit stood at US$744 million, 44 percent lower than at the same point in FY2019. The contraction stemmed from a trade deficit that decreased from US$5.9 billion to US$5.5 billion over the same period. The trade deficit was partly financed by remittance receipts, which amounted to US$3.9 billion in January 2020, approximately equal to the value in January 2019.

15. **The trade deficit narrowed on the back of a contraction in merchandize imports, prior to the COVID-19 outbreak**. Aggregate merchandize imports for July to March FY2020 shrank by 2.8 percent in nominal terms compared to the same period the previous year due to a slowdown in reconstruction activities, an import ban on energy and flavored synthetic drinks, and a ban on onion exports by India between September and March 2020 (Figure 20).

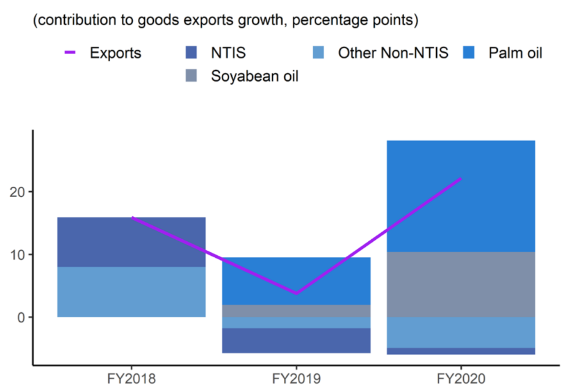
Figure 20. Goods imports contracted for the first time in 3 years



Sources: DoC and World Bank staff calculations.
Note: Data are for the first eight months of the FY.

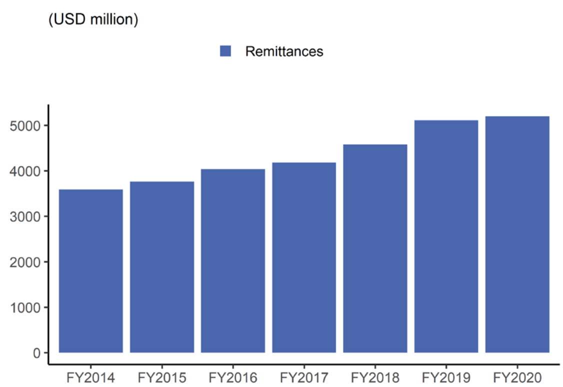
Services imports, whose share in total imports is significantly lower than that of goods, contracted by 8 percent in nominal terms over the same period. While merchandize exports are substantially smaller than imports in Nepal, accounting for only 3.3 percent of GDP in FY2019, they continued to grow in the first half of FY2020 and contributed to a narrowing trade deficit (Figure 21). Nominal merchandize export values expanded by 22.1 percent in the first eight months of FY2020, 3.6 percentage points more than in the previous year. The expansion in goods exports was propelled by exports of refined palm and soybean oil to India, which are exempted from import duties under the South Asian Free Trade Area Agreement (SAFTA), and partially compensated for a contraction in service exports, which decreased by 3.9 percent in the first eight months of FY2020 on the back of falling exports for government and other services. Travel service exports increased despite a decline in international tourist arrivals.

Figure 21. Merchandise exports continued to grow on the back of refined palm and soybean oil



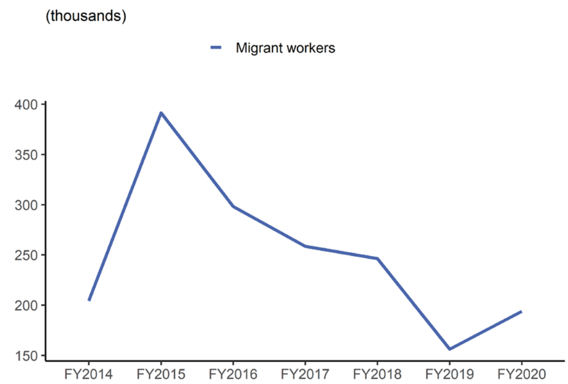
Sources: DoC and World Bank staff calculations.
Note: Data are for the first eight months of the FY.

Figure 22. …but remittances growth remained tepid during the first 8 months of FY2020



Sources: NRB and World Bank staff calculations.
Note: Data are for the first eight months of FY.

Figure 23. Migration outflows grew during the first 8 months of the FY as migration to Malaysia resumed…



Sources: DoFE and World Bank staff calculations.
Note: Data are for the first eight months of FY.

16. **Remittance inflows increased in nominal terms, albeit at a slower pace, following slower outmigration prior to FY2020.** Remittance inflows increased by 1.7 percent in the first eight months of FY2020 (Figure 22). While these elevated remittance inflows rose to a high of US$5.2 billion, remittance growth was significantly lower than the 11.7 percent recorded for the same period in FY2019. This resulted from a more than 60 percent contraction in migrant outflows between FY2014 and FY2019 following a labor dispute with Malaysia and slowing demand from Qatar and Kuwait. While migration to Malaysia resumed following a bilateral agreement signed in September 2019 and the number of migrant workers increased considerably in the first eight months of FY2020, this has yet to affect remittance inflows because of the lagged impact of migrant outflows on remittance inflows (Figure 23).

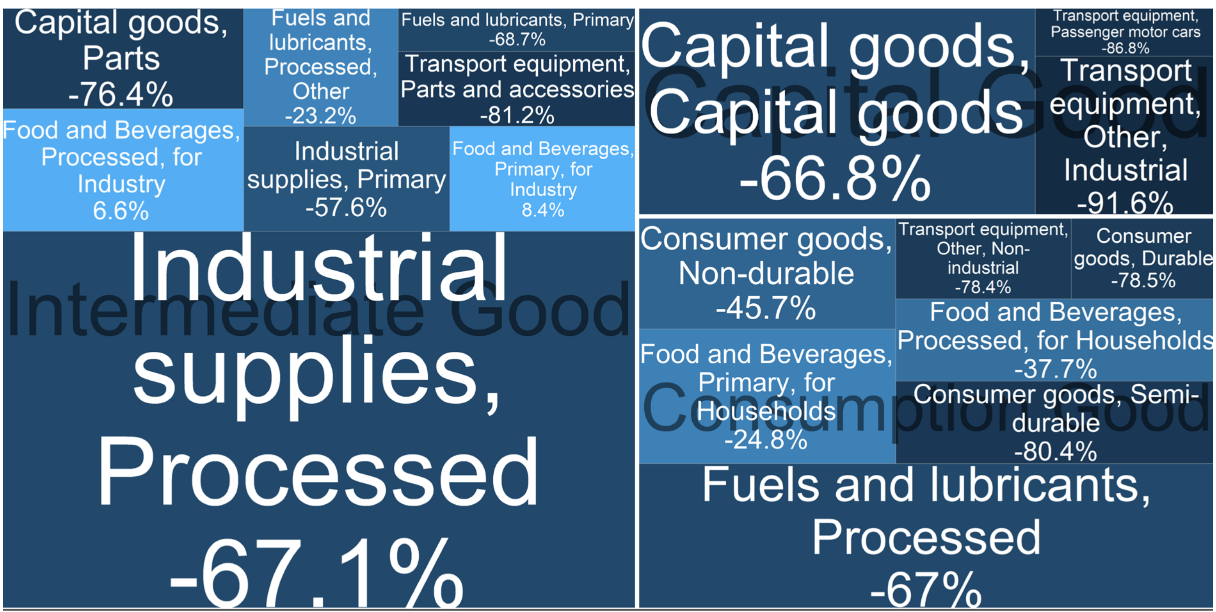
17. **The effects of the COVID-19 pandemic led to a substantial reduction in imports.** Between March and May 2020, merchandize imports contracted by 59.6 percent compared to the same period the previous year, with consumer durables and semi-durables and transportation equipment suffering the sharpest decline (Figure 24). Intermediate goods like food and beverages were least affected due to the increase in imports

of sugar and crude soybean and sunflower oil (for processed foods and beverages), and imports of rapeseed, husked rice, and durum wheat (for primary food and beverages). Services imports plummeted by 42.8 percent over the same period, mostly as a result of fewer students studying abroad during the pandemic.

18. **Goods and services exports nosedived as the pandemic hit**. As a result of COVID-19, goods exports during March to May 2020 tumbled by 62.1 percent compared to the same period in the previous year. Especially exports of agroforestry products (for which Nepal has a comparative advantage as listed under the Nepal Trade Integration Strategy), suffered a sharp decline due to COVID-19. Refined palm oil and soybean oil exports continued to expand with year-on-year growth of 7.6 percent and 22.5 percent, respectively. Services exports contracted by 42.6 percent owing to a fall in tourist arrivals, which contracted by 89.2 percent. Suspension of visas on arrival and the eventual shutdown of international commercial flights from March 22, 2020 until July 21, 2020, has dealt a severe blow to services exports.

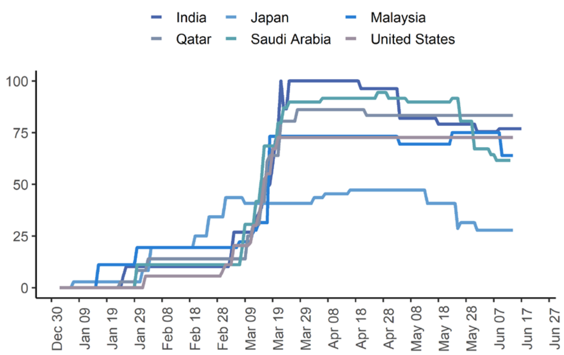
19. **Remittance inflows were also affected, with outmigration stopped and many migrants returning**. The government decided on March 12, 2020 to suspend all types of labor approval for foreign employment until further notice, which practically eliminated outmigration between March and July 2020, with only select groups allowed to return to work abroad from July. In addition, many migrants have returned from India and other countries as their jobs were impacted by the pandemic. As a result, remittance inflows during March to May 2020 declined markedly by 43.4 percent (Figure 25). On aggregate, the decline in imports outweighed the contraction of exports and remittances, leading the current account deficit to narrow by 52 percent (y/y) in the first 10 months of FY2020. On aggregate, Nepal's current account deficit is estimated to stand at 7.2 percent of GDP at the end of FY2020, 0.5 percentage points lower than in FY2019.

Figure 24. Amid COVID-19, goods imports during March–May 2020 decreased by 59.6 percent (y/y)



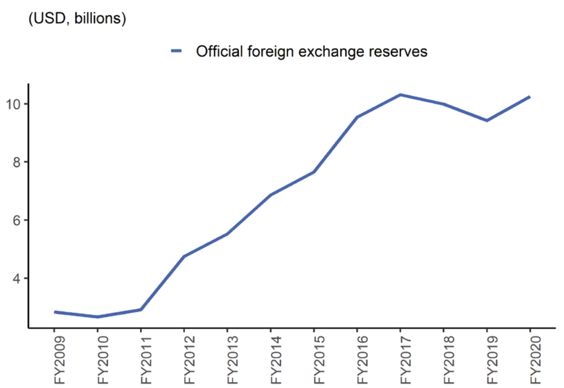
Sources: DoC and World Bank staff calculations.
Note: The figure is a tree map, where the total area represents the total goods imports for the first eight months of FY2020, and the size of each rectangular box represents the share of import components by "Broad Economic Classification." The color in the rectangular box indicates the growth rate for the ninth month of FY2020; the light-shaded box represents the component with the higher positive growth rate (for example, Food and Beverages, Primary, for Industry).

Figure 25. Remittances contracted by 43.4 percent following the coronavirus outbreak due to stricter lockdown measures in major remittance-sending countries



Sources: Oxford University and World Bank staff calculations.
Note: The Stringency Index takes a value between 0 and 100, with a higher value indicating stricter policies.

Figure 26. Foreign exchange reserves increased as foreign borrowing exceeded the current account deficit



Sources: NRB and World Bank staff calculations
Note: Data as of mid-May of the FY.

20. **The current account deficit was primarily financed through foreign borrowing**. The external deficit stood at US$938 million in May. Foreign direct investment inflows into Nepal are comparatively small and stood at US$145 million at the end of May 2020, US$30 million more than in FY2019. Portfolio flows are nonexistent. As a result, Nepal's current account deficit is primarily financed through borrowings. Until May of FY2020, Nepal had accumulated US$1.2 billion in foreign liabilities, 64 percent higher than the previous year. The public sector accounted for about half of these liabilities, much of which was accumulated as part of the country's response to the COVID-19 pandemic. As the accumulation of foreign liabilities exceeded the current account deficit, official reserves increased and covered approximately 10.8 months of imports by mid-May 2020 (Figure 26).

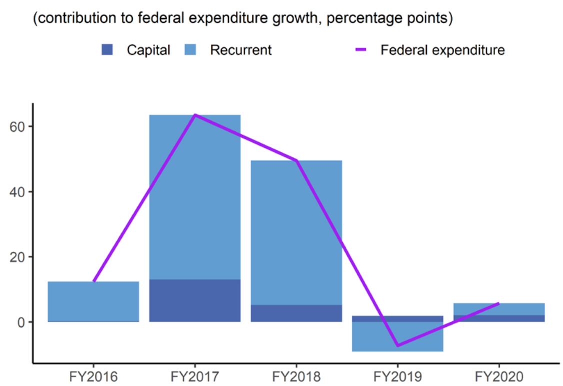
Fiscal Sector

21. **Nepal's fiscal position had seen some deterioration prior to the COVID-19 pandemic**. While Nepal had achieved budget surpluses until FY2016, the transition to federalism and associated spending increases had turned the country's fiscal balance negative, with deficits averaging 4.1 percent of GDP between FY2017 and FY2019. In addition to increased expenditure, a reliance on taxes collected at the border through customs duties, excise, and value-added taxes (VATs) has made revenue collection vulnerable to external shocks. These broad trends affected Nepal's fiscal stance in the first eight months of FY2020. Public expenditure between July and March FY2020 was 9.4 percent higher than in the same period the previous year, a substantial acceleration compared to a growth rate of 0.3 percent in FY2019 (Figure 27). The increase was mainly driven by recurrent spending, which contributed 8.2 percentage points to expenditure growth and accelerated on the back of increased wages and compensation, goods and services, social assistance, and fiscal transfers to subnational governments. Capital spending also increased by 6.9 percent, driven by a low base due to a contraction of capital spending in the previous year.

22. **In the first eight months of FY2020, a slowdown in imports resulted in central government revenue growth falling to its lowest level in four years**. Revenue collection for July to March FY2020 was only 12.2 percent higher than over the same period the previous year, which is a four-year low (Figure 28). The deceleration in revenue growth followed a contraction in goods

imports and was thus reflected in a slowdown in the growth of the VAT (9.1 percent year-on-year growth), most of which is collected at the border; excise tax (2 percent, year-on-year); and customs (which contracted by 2.2 percent). These tax components expanded by more than 10 percent (y/y) each in the first eight months of the previous three fiscal years. Unlike trade-related taxes, income tax collections grew at a three-year high of 29 percent due to an increase in public sector wages and enterprise profits. Non-tax revenues also rose by 40.6 percent on the back of an increase in interest and dividend receipts from service-oriented institutions including financial institutions. Tax enhancement measures also contributed to the increase in income and non-tax revenues (Box 3).

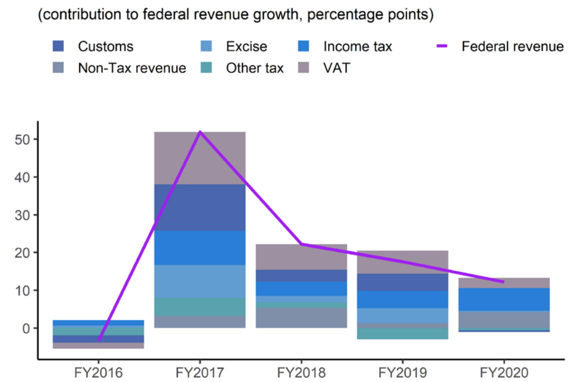
Figure 27. …but federal expenditure expanded on the back of higher recurrent spending



Sources: MoF and World Bank staff calculations.
Note: Data are for the first eight months of the FY.

23. **The GoN continued to significantly underspend its budget**. During the first eight months of FY2020 only 40 percent of the total budget, 46.9 percent of the recurrent budget, and 23.7 percent of the capital budget were spent (Figure 29). Aggregate budget execution was thus 3 percentage points lower than over the same period in FY2019. Drawbacks in the procurement process and a tendency to delay initiating contracts until late in the fiscal year have continued to contribute to underspending. As has been the practice in the past, the GoN adjusted to the persistent underspending by revising the FY2020 budget downward during the fiscal year, reducing targeted expenditure by 9.6 percent and targeted revenue by 5 percent, with most of the expenditure revision accounted for by the capital budget.

Figure 28. Revenue growth was at its lowest in four years driven mainly by a contraction in goods imports…



Sources: MoF and World Bank staff calculations.
Note: Data are for the first eight months of the FY.

24. **The COVID-19 pandemic significantly reduced revenues**. Following the COVID-19 outbreak, public revenue collection between March and May 2020 was 51 percent lower than in the same period a year prior. This was driven by three factors. First, a slowdown in economic activity reduced the domestic tax base. Second, a significant reduction in goods imports following trade disruptions and lower demand impacted Nepal's key trade-related tax bases. Finally, policy measures aimed at easing the tax burden during the crisis, including deferred tax payments and filing as well as customs and excise duty reductions for essential items to address the pandemic, impacted tax bases. As a result, customs and excise collection were most affected by the pandemic, with revenue contracting by 11 and 15 percent, respectively, in May 2020 compared to the previous year. VAT collection also dropped by 6 percent in May, whereas income tax collection continued growing, albeit at a significantly slower pace than in previous months and from a comparatively small base. In contrast to tax revenues, non-tax revenue collection from March to May 2020 was

Box 3. Tax enhancement measures introduced prior to COVID-19

The government implemented various tax enhancement measures between July and March FY2020. These included (a) mandatory requirement of a Permanent Account Number for all salaried workers and all wage workers in the private sector whose daily wage exceeds NPR 2000; (b) the requirement that fully or partially owned government agencies or organizations/corporations deposit 50 percent of their value added tax in the name of suppliers/contractors, supplying goods and services, with the amount to be deducted when making payments to suppliers; (c) introduction of an internet-based vehicle and consignment tracking system for transporters and truckers; (d) an increase in visa fees for foreigners from July 17, 2019, requiring foreigners with tourist visas to pay US$5 to US$25 more and those on business visas to pay up to US$200 more; (e) an increase in the infrastructure development tax on petroleum products by NPR 5 per liter to NPR 10 per liter to minimize the border price differences; (f) revision in the customs duty for imports of some goods, under which the government raised the customs duty on imported gold and silver to prevent the arbitrage opportunities arising from the price differentials on these goods between Nepal and India. The government also increased the customs duty on sanitary ware and parts thereof, of iron or steel, and coffee-related goods. However, the government reduced the customs duties on raw materials used in paints and in poultry farming to promote those industries; (g) reduction in the capital gains tax rates for individual stock investors and real estate businesses (to 5 percent from 7.5 percent) and an increase in the income tax slab for individuals and married couples by NPR 50,000 to NPR 400,000 and NPR 450,000, respectively; and (h) removal of the VAT exemption on wheat and meslin flour and on the transportation of all goods.

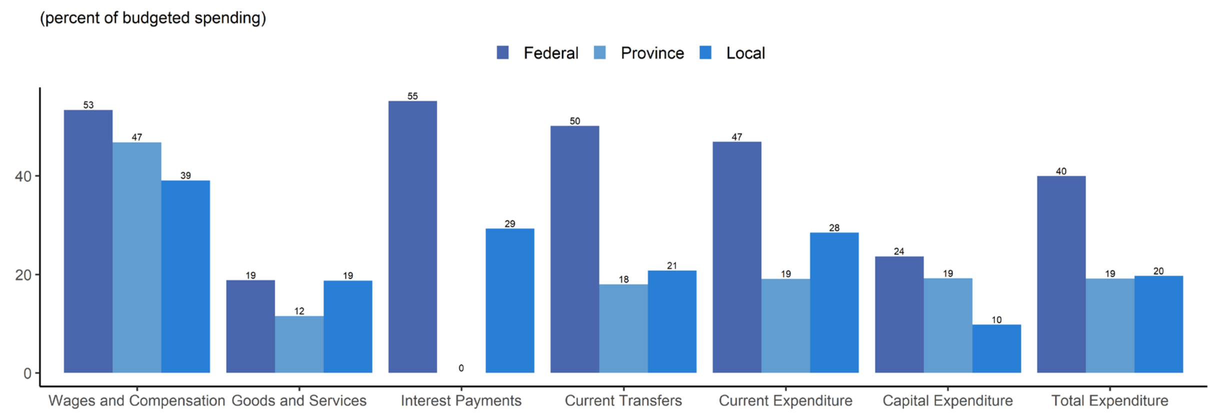
There were also changes in indirect taxes in FY2020 to promote import-substituting and export-oriented industries. These include increased import duties for some agro-based and industrial products (for example, eggs, tea, chicken meat, coffee, dairy products, biscuits, chocolates, noodles, potato chips, fruit juice, mineral water, sugar, footwear, zinc sheets, and tents); a 1 percent import duty levied on equipment, machinery, and chemicals used in the textile, thread, tea, basic medicine, sanitary pad, and feed supplement industries; reduction in the customs rate for imports of some industrial raw materials so that the rate is at least one level below the customs rate for the import of finished goods; customs duties exemption on exports of goods except alcohol and tobacco-based products, raw materials to be consumed domestically, and basic agricultural products; and bonded warehouse facilities for imports of all types of raw materials for industries whose exports exceed 20 percent of their production.
be consumed domestically, and basic agricultural products; and bonded warehouse facilities for imports of all types of raw materials for industries whose exports exceed 20 percent of their production.

18.3 percent higher than over the same period the previous year, boosted by interest and dividend receipts from service-oriented institutions, including financial institutions.

25. **To address the revenue shortfall, the GoN adjusted expenditure downward**. Faced with low government revenue and increased spending required for COVID-19 relief, the government halted spending under 14 different categories effective from April 2, 2020. In addition, following the national lockdown, the GoN was unable to execute its capital budget, with the total budget execution rate remaining at 50.3 percent in May 2020. As a result of these factors, expenditure between March and May 2020 was 13 percent lower than a year before, with recurrent and capital spending contributing 0.1 and 12.9 percentage points, respectively, to the decline.

26. **While the crisis associated with COVID-19 has elevated the fiscal deficit, Nepal's debt levels remain moderate**. Nepal's fiscal deficit is estimated at 7.3 percent of GDP for FY2020. This

Figure 29. The challenge of underspending continued at all levels of government



Sources: MoF and World Bank staff calculations.
Note: The underspending relates to the eight months of FY2020 for the federal government and six months of FY2020 for provincial and local governments.

would elevate aggregate public debt to 38 percent of GDP, 36 percent higher than the previous year. About 57 percent of all public debt is external and primarily concessional. The remainder, accounting for approximately 16 percent of GDP, is domestic debt and is denominated in Nepalese rupees.

27. **Subnational governments expanded their expenditure and revenue collection, but levels of budget under-execution remain large**. Expenditure undertaken by provincial governments from July to January of FY2020 was more than 300 percent higher than in the same period in FY2019, reflecting the low base of the previous year and driven mainly by increased capital spending. Underspending did, however, remain high. During the first half of FY2020, only 19.1 percent of the total budget (19.1 percent of the recurrent budget, and 19.2 percent of the capital budget) of provincial governments was spent. While budget execution is thus higher than the 5.5 percent achieved in FY2019, budget execution remained significantly below target. At the local level, only 19.7 percent of the total budget, 28.5 percent of the recurrent budget, and 9.8 percent of the capital budget were spent during the first half of FY2020 (Figure 29). Of the 682 (out of 753) local governments for which actual spending data for the first half of FY2020 was available, the median, minimum, and maximum budget execution rates were 20 percent, 0.6 percent, and 43.8 percent, respectively, indicating a large variation in budget execution across local governments. This was primarily due to variations, and more broadly, limitations in technical capacity of existing staff and delays in the hiring of new staff at the subnational levels. Between July and January FY2020, average revenue collection across all local governments was 43.4 percent of the target. As with the budget execution, there is a wide variation in revenue collection and achievement of fiscal targets in the first half of FY2020.

B. Outlook, Risks, and Challenges

The Outlook

28. **The rapid evolution of the global pandemic makes the outlook more uncertain than usual**. Projecting macroeconomic and fiscal variables is fraught with uncertainty in normal times. During these times, however, uncertainty is compounded by the unprecedented nature of the COVID-19 pandemic. Nepal's near-term economic future depends heavily on factors which are currently unknown and largely outside of its control. For instance, a complete resumption of tourism will most likely occur once a vaccine is available and has been commercially deployed globally, but the timing of when this will happen remains unclear. Similarly, many characteristics of the virus remain unknown, and will likely dictate the extent to which prolonged lockdowns will be necessary. To account for this uncertainty, this section discusses the economic outlook in two scenarios: (a) a baseline scenario, discussed in the outlook section, which assumes a gradual resolution of the crisis during FY2021; and (b) a downside scenario, discussed in the risks section, in which a second phase of a lockdown becomes necessary later in FY2021.

29. **Under the baseline scenario, growth is projected to increase slightly to 2.1 percent in FY2021** (Table 1). This projection assumes that the infection incidence curve begins to flatten during the year, and the government continues current measures to ease up on the lockdown. Growth in agriculture in FY2021 is projected at 2.2 percent,

slightly below the FY2020 growth rate due to an expected shortage of chemical fertilizers following trade restrictions during the crisis and despite favorable monsoon projections for the 2020 southwest monsoon season. Industrial production growth is expected to accelerate marginally but remain subdued at 3.9 percent in FY2021, with a potential boost provided by the addition of the Upper Tamakoshi Hydroelectric Project and other key hydropower projects to the grid, and associated improvements in electricity supply. Continued social distancing measures, localized lockdowns, the suspension of tourism and an expected continued slow growth of remittances are also projected to weigh on service growth and private consumption, which are projected to grow at 1.5 and 0.7 percent in FY2021, respectively. Government consumption (federal, provincial, and local) is expected to expand by 8.4 percent through increased spending to mitigate the effects of COVID-19.

30. **Inflation is expected to remain around 7 percent**. Inflation during FY2021 is expected to remain elevated at around 7 percent, reflecting a slowdown in agricultural growth due to COVID-19 and its impact on food prices. Depressed firm profits following widespread closures pose vulnerabilities and risks to the financial sector (as this will affect the ability to pay back loans), which could put upward pressure on inflation.

31. **With a deceleration in imports, the current account deficit is projected to narrow**. Imports are expected to remain subdued given the strain on economic activity and continued low oil prices. While some smaller rebound in trade and remittances could occur in FY2021 if restrictions on movement and social interactions are eased, they are still likely to remain below pre-COVID-19 levels. With imports projected to decline significantly more than remittances, and the latter projected at around 18 percent of GDP

Table 1. Macroeconomic projections of selected key indicators for the baseline scenario

				Baseline		Downside	
	FY17	FY18	FY19	FY20f	FY21f	2020f	2021f
Real GDP growth, at constant market prices	8.2	6.7	7.0	1.8	2.1	0.5	-2.8
Private Consumption	2.6	3.3	5.5	-1.6	0.7	-2.9	-2.3
Government Consumption	10.5	13.5	7.8	8.6	8.4	5.9	5.7
Gross Fixed Capital Investment	44.3	18.1	5.0	-23.2	-5.9	-37.8	-14.7
Exports, Goods and Services	11.3	6.2	4.7	-18.6	-6.9	-25.6	-15.9
Imports, Goods and Services	27.2	16.5	7.8	-16.6	-3.4	-25.5	-6.9
Real GDP growth, at constant factor prices	7.7	6.1	6.6	1.8	2.1	0.5	-2.8
Agriculture	5.2	2.8	5.1	2.6	2.2	2.1	0.9
Industry	12.4	9.6	7.7	3.2	3.9	1.3	-2.7
Services	8.1	7.2	7.3	1.0	1.5	-0.6	-5.0
Inflation (Consumer Price Index)	4.5	4.2	4.6	6.6	6.7	6.7	6.9
Current Account Balance (% of GDP)	-0.4	-8.1	-7.7	-7.2	-6.5	-6.9	-6.3
Fiscal Balance (% of GDP)	-3.1	-6.6	-2.6	-7.3	-6.6	-9.0	-11.5
Debt (% of GDP)	26.1	30.1	30.1	37.9	43.5	39.9	51.3
Primary Balance (% of GDP)	-2.7	-6.1	-2.0	-6.3	-5.5	-8.1	-10.2

Source: World Bank, Macroeconomics, Trade & Investment Global Practice.
Note: f = forecast.

in the medium term, the current account deficit is projected to narrow slightly to 6.5 percent of GDP in FY2021. This will be financed primarily by long-term borrowing and a drawdown of international reserves, which are expected to cover close to six months of imports in FY2021.

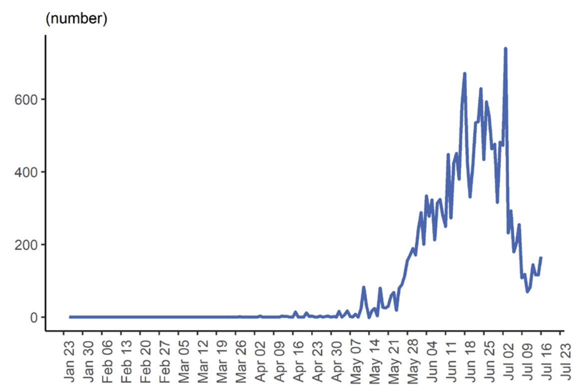
32. **The fiscal deficit is expected to remain elevated in FY2021 because of increased government spending**. Under the baseline scenario, which assumes a gradual reopening of the economy, revenues are expected to improve, aided by the measures proposed in the FY2021 budget. These measures include, for example, an increase in customs duties on select products, which are expected to offset the revenue impact of tax relief measures for the sectors most affected by COVID-19. Government expenditures on relief and recovery efforts in FY2021 are expected to keep spending levels elevated. As a result, the fiscal deficit is projected to slightly narrow from 7.3 percent of GDP in FY2020 to 6.6 percent in FY2021.

33. **The projected increase in the fiscal deficit is likely to raise debt levels**. Total public debt is expected to reach 43.5 percent of GDP in FY2021, with all indicators projected to remain below their policy-dependent indicative thresholds (including under the most extreme shock scenario). Stress tests show a vulnerability to growth and export shocks and natural disasters, underscoring the importance of implementing sound macroeconomic policies, including structural reforms in support of productivity-led growth and improved spending efficiency. There will be increased emphasis on mobilizing concessional financing from development partners. Nepal will also benefit from the Group of 20 Debt Service Suspension Initiative (DSSI) under which external debt service of approximately US$15 million in FY2020 and US$15 million in FY2021 (due between May and December 2020) are likely to be deferred.

Risks and challenges

34. **The main downside risk pertains to a protracted pandemic leading to a reintroduction of the national lockdown**. The current outlook is predicated on the assumption that the COVID-19 pandemic will begin to subside during FY2021, with localized lockdowns in specific areas, when needed. This outlook is, however, subject to significant uncertainty. As of early-July 2020, the COVID-19 epidemiological curve was still increasing, fueled partially by a continued inflow of Nepalese migrants through the open Nepal-India border. Recent indications show the number of daily cases may be declining. (Figure 30 and 31). This infection rate is expected to flatten during the year. However, should there be a second resurgence in the infection rate and fatalities, the impact on the economy could be substantial. In this case, the downside scenario is that growth in FY2021 could contract by as much as 2.8 percent, with contractions experienced across the board in all sectors (Table 1). Moreover, given the large share of the informal sector, the heavy reliance on subsistence agriculture, and the underdeveloped health system, a sharp slowdown in economic activity could exacerbate poverty, inequality, and food security.

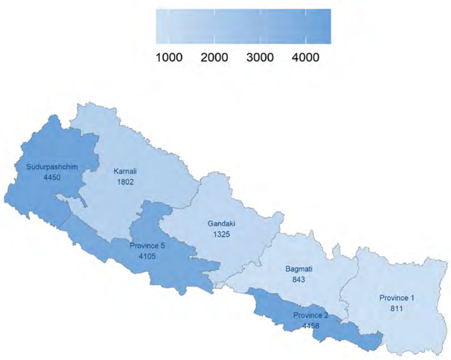
Figure 30. The epidemiological curve shows that the daily number of new COVID-19 cases reached a high of 740 on July 3, 2020…



Sources: Health Emergency Operation Center (GoN) and World Bank staff calculations.

35. **A second risk relates to continued revenue shortfalls**. The FY2021 budget proposes expenditure containment measures to reduce the fiscal impact of a continued shortfall in revenue, including cuts to administrative expenditure and recurrent grants. However, additional measures might become necessary to reduce the pressure on spending arising from the pandemic. These measures could potentially include improvements in the efficiency and effectiveness of spending and improvements in public investment management.

Figure 31. …as there is an increasing inflow of Nepalese migrant workers from India through the open border



Sources: Health Emergency Operation Center (GoN) and World Bank staff calculations.

36. **Finally, establishing adequate economic, social, and health relief measures will be crucial**. As noted previously, the government has adopted some immediate economic support measures to mitigate the impact of the crisis. However, a more systematic approach that incorporates a medium- to long-term view with the aim of strengthening resilience of the economy is needed. The focus on resilience will require measures that consider Nepal's vulnerability to climate shocks and that promote green and inclusive growth to ensure sustainability. This edition of the Special Focus outlines the key elements of a strategic approach to transition the economy from the relief stage through to restructuring and resilience.

C. Special Focus – Post-Pandemic Nepal – Charting a Resilient Recovery, and Future Growth Directions

37. **The global outbreak of COVID-19 has taken a heavy human toll, pushed economies into recession, and increased the risks of a financial crisis**. As of July 17, 2020, there were over 14 million confirmed cases worldwide, of which around 600,000 have died[1]. To contain the outbreak and limit community transmission, countries have adopted social distancing and lockdown measures. The resulting shutdown of business activity, travel restrictions, and border closures have caused a collapse in commodity prices, a contraction in economic activity, and adverse effects on financial markets. Consequently, global growth is projected to contract by 5.2 percent in 2020 and global poverty is projected to increase for the first time in 20 years[2].

38. **The COVID-19 pandemic presents policy makers with unprecedented challenges that go beyond managing the immediate impact of the crisis**. Charting a policy response to the crisis requires a two-pronged strategy. First, it involves addressing the medical component of the pandemic through testing, treatment, and advanced

1 World Health Organization COVID-19 Dashboard, https://covid19.who.int/; Johns Hopkins Corona Virus Resource Center, https://coronavirus.jhu.edu/

2 As measured by the international poverty line of US$1.90 a day and cited in the blog of Mahler et al. (2020).

planning for future disease outbreaks. Second, it also involves an adjustment to economic and fiscal policy, as COVID-19 is likely to bring about behavioral changes that can significantly alter the way economies operate. International experience shows that planning ahead and charting such a policy response early can help contain the crisis and maintain economic activity. The Republic of Korea, for instance, was able to draw on lessons it learned during the Middle Eastern Respiratory Syndrome (MERS)[3] outbreak to address the current crisis (see Box 4). Other countries that have handled the pandemic well include New Zealand and Germany, both of which have implemented measures similar to Korea. As Nepal is still at a comparatively early stage in the crisis, it can draw from other countries' experiences to develop a growth strategy that encompasses a medical response and accounts for the expected changes to the country's growth model as part of the pandemic.

39. **This special focus proposes a framework and reform areas to support economic recovery and sustainable growth in a post-pandemic world.** The section first outlines global trends that provide an indication of the deep-rooted changes that the COVID-19 pandemic could potentially bring about in economies around the world. It then lays out the current status of the crisis and the lockdown in Nepal and then presents a framework with potential areas of reform that can support Nepal's recovery in the next few years. The framework includes three stages of policy responses – relief, restructuring, and resilience – and is organized under the four pillars of health, social, economic, and long-term priorities.

Box 4: Lessons from South Korea in Containing the Pandemic

Based on data and analysis from its experience with the Middle Eastern Respiratory Syndrome (MERS), the Republic of Korea was able to devise a strategy and plan for dealing with the current COVID-19 pandemic. The lack of data on the path of infection for the Middle East respiratory syndrome (MERS) virus led to high infection rates. Drawing on this lesson, Korea took action in the very early phases of the pandemic (with just 30 confirmed COVID-19 infections), to engage biotech companies in developing a test kit for the virus. Thousands of kits were made available, enabling doctors to test potential cases. Also, the authorities implemented a well-planned contact tracing protocol involving systematic and quick tracing of everyone who had come in contact with an infected patient.

Legislation was also passed to allow the government to collect data on a patient and from security footage during an outbreak. Movements of patients are logged and shared (without identifying the infected individual) so that people are alerted to stay away from the path of infection. Text messages are also broadcast to the public to publicize localities where there is an outbreak or to let people know when they have crossed paths with an infected individual. This approach enabled Korea to test more people than any other country at the outset of the pandemic and to quickly flatten its disease incidence curve. It also enabled the country to circumvent the need for drastic containment measures.

Nepal could also draw from its experience using anonymized cell phone data to track the movement of people during the 2015 earthquake. Cell phone data along with other methods of rapid assessment could be used to collect real-time data to monitor COVID-19 effects and the movement of infected people. This could be complemented with a strategy for contact tracing in the Nepalese context. It might also be necessary to enact a law that would allow the use of anonymized cell phone data during national disasters or similar pandemic outbreaks in the future. Analysis of these data would then inform development of a tailored response to the pandemic in Nepal. It would also be important to have ongoing and open communication with the public and with local authorities on the progression of infections and the most affected localities.

Sources: Vox Media 2020; University of Southampton 2015.

3 Vox Media 2020.

C.1. Emerging Indications of the Economic Changes induced by COVID-19

40. **The design and implementation of a strategy to contain the crisis and strengthen economic activity would need to account for a post-COVID world that operates differently from before**. There are several debates on emerging global trends that could affect the design of a strategy to support economic recovery. Among these, five trends are likely to be influential for Nepal's post-pandemic growth model. First, a global backlash against globalization has been amplified by the pandemic, which can further reinforce the global trend toward inward-oriented trade policies and import substitution efforts, and complicate international mobility of workers. Second, global lockdowns and persistent remote working is likely to accelerate the digitization of workplaces, public services, and supply chains. Third, the crisis has shone a new spotlight on increased vulnerability and inequality and has highlighted the need to transition to a more equitable and socially inclusive growth model. Fourth, the crisis has emphasized the vulnerabilities of economies to large shocks. With substantial risks from climate change looming, COVID-19 is likely to put a larger emphasis on a greener and more sustainable growth model. Finally, the response to the crisis has led to an accumulation of debt in the public and private sector, which needs to be managed carefully.

41. ***Theme 1 – Inward Orientation*****: Persistent travel restrictions risk accelerating an increasing inward orientation of policy, complicating the global movement of goods and people**. This trend is likely to affect multiple economic sectors. For one, ongoing or periodic travel restrictions and social distancing will affect how the tourism and hospitality sectors operate for the foreseeable future or at least until a vaccine or cure has been found and widely applied. Countries that rely heavily on tourism will need to rethink the approach to the sector and this may mean greater attention to health considerations and to eco- or health tourism. Some countries are forming travel bubbles to enable the resumption of tourism with associated measures to improve hygiene and sanitation, increase the availability of hospital beds, and strengthen contact tracing. In addition, travel restrictions are also likely to limit outmigration of workers, which places an increased emphasis on facilitating domestic growth and employment generation.

42. ***Theme 2 – Increased Inequality and Vulnerability:*** **Economic contraction in several countries is likely to increase poverty and inequality, necessitating improvements in social assistance programs**. Many people in economies across the world (including in industrial countries) have little to no savings, with no employment protection or safety nets. In addition, many developing countries have large shares of informal workers who have limited protection and weak capacity to deal with shocks. There is a growing body of evidence that COVID-19 and the associated lockdowns have affected these workers more severely and have contributed to a rise in poverty and inequality. This has sparked renewed interest in the development of social protection nets, which will be crucial to maintain an inclusive growth model during and after the pandemic.

43. ***Theme 3 – Digitization:*** **The global economy is likely to be much more digitally oriented, and the current pandemic will speed up and reinforce that trend**[4]. Business and social interactions have had to take place virtually during the lockdown, increasing demand for online conferencing. Those firms that can engage customers through digital interactions or e-commerce have generally thrived. Many educational institutions have also provided online learning to students. Also, governments with well-established digital services have been better able to provide services to citizens during the lockdown. Once the pandemic is past, much of the increase

4 The Economist 2020.

in digital services will likely remain, with more trade in services and goods expected to go digital. Most likely, new value chains will emerge with the expansion of digital services and the focus on domestic and regional supply chains.

44. ***Theme 4 – Green Growth:*** COVID-19 has showcased the vulnerability of economies across the globe to unforeseen shocks and has put disaster mitigation and adaptation on the top of policy makers' agendas. After the pandemic, the focus is likely to shift to adverse economic consequences associated with climate change and can accelerate the adoption of green growth strategies. A transition to green growth requires actions to reduce pollution and emissions (for example, air, water, and soil pollutants) through cleaner consumption and production patterns. This will help manage natural capital (for example, land, forests, and water) more sustainably and efficiently, and reduce vulnerabilities to climate and disaster risks (for example, flooding, storms, and warming temperatures).

45. ***Theme 5 – Debt:*** **Leverage is likely to increase across the board and interest rates are likely to remain low in the foreseeable future**. To keep an economic depression at bay and prop up supply, policy makers will opt for keeping interest rates low. Leverage is likely to increase across the board for households, corporates, and the government. Since the government is the "lender of last resort" and must protect lives and livelihoods, a significant increase in public debt levels is anticipated. This in turn is expected to result in higher taxes in the future, to raise revenues to pay down the debt. Therefore, tax policy and administration reforms will be crucial in the future, coupled with structural reforms to support growth. In the case of firms, higher debt could result in a debt overhang, limiting growth prospects. This might necessitate equity infusions in firms to ensure that they remain viable. Reduced income and increased indebtedness of households is, however, likely to keep private demand depressed in the short to medium term.

C.2. Socioeconomic Impact of the Crisis in Nepal

46. **In Nepal, the pandemic has recently escalated, with a sharp increase in the number of cases in June 2020**. The first COVID-19 case was confirmed on January 23, 2020[5]. By March 23, there were only two cases and social distancing was imposed, with a shutdown of border entry points to India and China on March 23 and national lockdowns from March 24, 2020. International flights and long-haul buses were also shut down around the same time. All public and private services (except for essential services as defined in the Essential Services Operations Act, 2014) were closed down. An NPR 500 million fund was established for the treatment of COVID-19 cases, including quarantine areas and space set aside in key hospitals for treatment of cases. These measures helped keep the number of cases low until April. However, the number of confirmed cases began escalating in early May 2020. As of July 17, 17,344 COVID-19 cases have been confirmed, with 39 deaths and 11,249 recoveries[6].

47. **The pandemic, coupled with government lockdowns and travel restrictions, has impacted livelihoods in Nepal**. As discussed in part A, the economic consequences of the pandemic and the lockdown have been severe, with immediate impacts on peoples' livelihoods. Across all sectors, informal workers or those without social security or assistance will be most vulnerable to falling into extreme poverty. Within this group, informal sector workers and self-employed households in urban areas may be more vulnerable than rural households that can fall back on subsistence farming.

48. **As a result of the loss of livelihoods, poverty and vulnerability in Nepal are expected to rise**. An estimated 31.2 percent of the population live close to the poverty line

5 The first case was a student who had just returned from Wuhan, China.
6 Ministry of Health and Population; https://heoc.mohp.gov.np/ or https://covid19.mohp.gov.np/.

(earning between US$1.90 a day and US$3.20 a day) and are at high risk of falling into extreme poverty. At an international poverty line of US$1.90 a day, poverty is estimated at 8 percent of the population in 2019, and at the higher poverty line of US$3.20 a day, the poverty rate is estimated at 39 percent. Workers in the informal sector, including household enterprises and the self-employed, have been among the most affected by the lockdown. Informal businesses make up around 50 percent of enterprises in Nepal and are the main source of income for most of the labor force. Supply chain and demand disruptions put the earnings of workers, household enterprises, and the self-employed in the informal sector at risk. This risk jeopardizes existing businesses as well as the owners of these businesses, along with their families. Most informal firms operate with limited savings, and owners may face the difficult choice of staying home and facing starvation during the lockdown or running their business and risking infection. These scenarios accentuate financial difficulties as well as the spread of COVID-19.

49. **Increased vulnerability and the risk of falling into poverty mean households are likely to engage in depletive coping strategies**. These strategies include reduced consumption, foregoing health care, selling productive assets, engaging in early marriages, or pulling children out of school. A recent rapid assessment shows that the burden on unpaid care work has increased for women who are tasked with looking after children and the elderly in the household. Victims of domestic violence are also forced to quarantine with their abusers. This effectively isolates the victims, making it difficult to get assistance, and puts them in immense danger – physically, mentally, and emotionally. As the number of returnees increase and domestic unemployment rises, this is likely to compound the impact of COVID-19 on household welfare.

50. **Reduced household earnings may also lead to unsustainable extraction of natural assets as a coping mechanism, which will erode the natural capital base and undermine efforts to sustain green growth**. The widespread loss of livelihoods coupled with the return of migrant workers has made rural residents more reliant on natural resources as a coping strategy. COVID-19 will most likely increase the risk of unsustainable practices. In some cases, this increased reliance on natural resources to earn a living is done in a way that compromises the future productivity of forests and ecosystem services for tourism and agriculture. Prior to COVID-,19, there were already reports of unsustainable extraction of forest products, poaching, fire setting and illegal tree felling in various forest areas, including those managed by local communities[7]. There have also been reports of encroachment into protected areas and illegal hunting of wildlife. The pandemic is likely to increase these coping mechanisms, undermining the recovery and resilience of nature-based tourism.

51. **In response to the above disruptions, the government has adopted non-pharmaceutical and economic support measures** (Table 2). Non-pharmaceutical measures include lockdowns and social distancing. In addition, Nepal has established quarantine facilities and has imported needed tests, drugs, and protective gear. The government has also stepped up public campaigns advising the population on safety measures including measures to improve hygiene. Economic support measures have focused broadly on increasing liquidity in the financial sector and easing reserve and prudential requirements to provide low-interest loans to firms. Other support to firms has included debt deferments, extension of repayment periods, and lower interest rates, particularly for the most affected sectors. For both firms and households, support measures have included subsidies and deferment of utility bills

7 World Bank 2019.

Table 2. Economic support measures – including monetary, financial, and fiscal measures

Monetary and Financial Sector Measures	Support Measures for Households and Firms
• Reduced cash reserve ratio from 4 to 3 percent and reduced the interest rate on the standing liquidity facility rate from 6 to 5 percent • Revoked requirement for banks to build up the 2 percent countercyclical capital buffer provisions in the Capital Adequacy Framework by July 2020 • NRB temporarily relaxed reporting norms; bank and financial institutions will not be charged or penalized for noncompliance with regulatory and supervisory requirements in April • The Refinance Fund has been increased to provide subsidized funding for banks to lend at concessional rates to priority sectors, including the SMEs affected by the pandemic • NRB further announced at the end of April that banks will defer loan repayments due in April and May until mid-July • For working capital loans, banks will extend the repayment schedule of the amount due during the lockdown for up to 60 days • Businesses in affected sectors, if they can show need, qualify for additional working capital loans of up to 10 percent of the approved amount of their existing working capital loans, to be repaid within a year at most • Lower interest rates (of up to 2 percentage points) to be applied on bank loans from mid-April to mid-July for borrowers from affected sectors • Extension of the loan repayment period for sectors most affected by the pandemic (i.e., tourism, and for upgrading health facilities to contain the COVID-19 pandemic) • Priority refinancing for COVID-19-affected micro- and small enterprises and concessional loans to prospective migrants who are no longer able to migrate for employment due to COVID-19, but are willing to establish a domestic enterprise	• Deferred payment to mid-May of utility bills incurred between mid-February and mid-April • Discounted internet fees during the lockdown • Reduced duties on imports of medical equipment • One-month waiver by private schools on all fees (except boarding fees) • Extend deadline for VAT and income tax payment to mid-May • Tax deduction for contributing to the Corona Relief Fund • Expand Prime Minister's Employment Program to migrant laborers who can no longer go abroad • Pay wages of workers in tourism industry between mid-March and mid-April through the welfare fund • Waive one month's rent for unorganized informal labor • Government contribution to the social security fund for tourism enterprises that have closed due to COVID-19 • Broaden social assistance programs for workers in the informal sector • Expansion of labor-intensive work programs with strong emphasis on social inclusion

52. **Despite the recent pickup in infection rates, the government has started easing up on the lockdown[8], given the high costs from lost livelihoods**. In addition to the loss of monetary income, these costs include psychosocial stress reflected in a higher incidence of gender-based violence, crime, and suicide. There are also costs associated with loss in access to health care[9] and school closures, all of which could erode the gains in human capital. This could lower productivity and employment, increase inequality, and lead to poorer health outcomes and social unrest[10]. These trends point to the higher costs of lockdowns for low-income countries. The devastating impact on livelihoods and well-being coupled with a weak social protection system and limited fiscal resources means that most low-income countries will have to reopen even if health concerns dictate otherwise. In Nepal, an increase in these costs has resulted in an easing of the lockdown. Going forward, the government will need to adopt a strategy of selective or localized lockdowns in highly infected areas. This should be complemented with measures to maintain supply chains, employment, and trade to minimize widespread destitution.

53. **Nepal has adopted a phased approach to opening the economy and will need to take into account the heterogeneity in effects across localities and regions**. Employment opportunity costs of social distancing and lockdowns will likely vary by province and locality, especially with the

8 Kharel 2020.
9 Poudel 2020.
10 Rogers and Sabarwal 2020.

higher levels of infections observed along the border. Some sectors will be more amenable to continued social distancing and others less so, like tourism, hospitality, and restaurant sectors. The construction sector has been able to operate to some degree during the latter part of the lockdown and may be able to further scale up activity, with further rollback of the lockdown. In the agriculture sector, lockdowns have impeded the movement of farm produce and labor, especially during March and April. By late May, local governments had loosened the lockdown to allow farmers to work their fields during the peak planting season covering June to July. However, there are still reports of labor scarcity in certain localities[11].

C.3. A Framework for Recovery and Resilience

54. **Considering the adverse impacts and structural changes that COVID-19 is likely to impose on lives and livelihoods, Nepal needs a comprehensive strategy to inform policy making during and after the crisis**. This section proposes a policy strategy for Nepal with the objective of addressing the health impacts of the crisis and initiating reforms that can help adjust Nepal to a new normal shaped by the five emerging trends discussed previously: inward orientation, vulnerability, digitization, green growth, and increased leverage. Such a strategy could be phased over three stages: relief, restructuring, and resilience (Table 3). During the relief *stage*, the priority is addressing the immediate health impacts of the pandemic and providing support to livelihoods and firms to reduce vulnerability. As the country brings the pandemic under control and infection rates level off, the economy can reopen gradually, leading to the *restructuring stage*. The focus in this stage is on strengthening health systems and adjusting to a new normal that prioritizes domestic employment generation in a greener and more digital economy. The *resilient recovery stage* focuses on new opportunities to invest and reform to promote more sustainable, inclusive, and resilient growth in a post-COVID world.

55. **A comprehensive strategy for Nepal can focus on reforms in four areas**. Priority areas include (a) support for health interventions, (b) social response measures to reduce poverty and inequality, (c) economic responses to promote green business growth and job creation in a more inward-oriented and digitized Nepal, and (d) cross-sectoral support to strengthen investments and maintain macroeconomic stability.

56. **Policies will need to take into account spatial differences in the impact of the COVID-19 pandemic**. The government is currently undertaking an assessment of the impact of the pandemic to inform the design of economic and social support measures and reforms. Given Nepal's federal structure, the assessment captures the provincial and local effects of COVID-19 including differences across urban and rural areas. For example, Provinces 2 and 5 have experienced the largest rates of infection. In urban areas, population density, and informal settlements with limited access to basic services (water, sanitation, and solid waste management) are likely to be at greater risk of infection, relative to rural areas.

57. **Implementation of such a strategy requires intergovernmental cooperation**. There would need to be strong links among the ministries (particularly, health, social protection, education, and agriculture) and the provincial and local levels engaged in frontline service delivery. In general, the federal level (ministries and agencies) could be responsible for formulation of strategic visions, and formulation of plans and policies, and could also provide technical and financial resources to subnational levels. The provinces could monitor the use of resources and provide technical support for implementation by local governments. Designating the elected mayors and provincial governors as key stakeholders

11 Sah 2020.

Table 3. A Framework for Growth and Resilience

WBG COVID-19 Crisis Response	Stage 1: Relief	Stage 2: Restructuring	Stage 3: Resilient Recovery
Pillar 1: Saving Lives	**Public Health Emergency** • Public health and hygiene campaign - handwashing, masks, social distance • Testing, tracing and data collection on pandemic • Water, sanitation, hygiene	**Restructuring Health Systems** • Strengthen engagement of the private sector • Scale up immunization programs • Invest in telemedicine and improved management of medical waste	**Pandemic-ready Health Systems** • Include standard operating procedures in emergency response plans for both emergency and maintaining essential service delivery
Pillar 2: Protecting the Poor and Vulnerable	**Social Emergency** • Cash/in-kind (food) transfers for food security • Expand existing delivery systems for safety nets • Scale-up the Prime Minister's Employment Program	**Human Capital Building** • Labor-intensive public works for infrastructure investment • Business development through grants or microcredit institutions and banks (with business skills training) • Development of digital platforms for service delivery • Establish a social registry to target and coordinate services	**Equity and Inclusion** • Adaptive social protection • Develop e-services for distance learning
Pillar 3: Sustainable Business Growth and Job Creation	**Economic Emergency** • Liquidity support to firms • Debt payment deferment • Economic support targeted to most affected firms in a time-bound manner, with the objective of maintaining employment • Target agriculture and tourism sectors	**Firm Restructuring & Debt Resolution** • Public works programs for green growth and infrastructure • Job matching and redeployment, and safe migration measure • Engage returnee youth in agriculture production and forest-based activities, agribusiness-based and forest-based SMEs	**Green Business Growth and Job Creation** • Strengthen financial infrastructure to develop e-commerce platforms and engage the private sector
Pillar 4: Strengthening Policies, Institutions and Investments for Rebuilding Better	**Maintain Line of Sight to Long-term Goals** • Fiscal strengthening and service delivery	**Policy and Institutional Reforms** • Improve the business environment and programs to promote digital literacy	**Investments to Rebuild Better** • Developing digital infrastructure to contain the spread of COVID-19 and ensure business continuity of the government and the private sector. • Generate, publish, and analyze to guide recovery efforts
Macroeconomic Stability and Strong Fiscal Framework **Data and Analysis** **Communications, transparency, and trust in government and local level integrated with national effort** **Bridging the Digital Divide**			

in the development of recovery strategies is critical to ensure ownership and sustainability of interventions.

C.4. Charting Nepal's transition from Relief and Restructuring to a Resilient Recovery

Pillar 1: Health Measures

Relief Stage

58. **The priority in addressing the crisis involves containing the spread of the pandemic, safeguarding the health of the population, and flattening the peak of the disease incidence curve**. Nepal has taken initial steps in that direction; aside from nationwide lockdowns and social distancing, the government has adopted public campaigns to promote general hygiene. A next step could include testing, isolating, and treating the infected; tracing their contacts; quarantining the exposed; and ensuring border health security. Preserving other key health services is also important to minimize the deaths from day-to-day disruptions in health care. For example, there are reports of disruption of services due to the lockdown, while others fear going to the hospital because of the risk of catching COVID-19[12,13]. The task of saving lives therefore must extend well beyond stopping COVID-19 transmission to addressing the high risk of spillover effects of the pandemic and

12 Chhetri 2020.
13 Shrestha 2020.

economic crisis on mortality due to other causes.

59. **To contain the disease and reduce infection and death rates, Nepal will need to build its testing capacity and improve the process for isolating the infected, treating them, and tracing their contacts**. Quarantine facilities will need to be expanded and well-equipped, especially with needed food and water. The government will need to be clear about which policies on essential health services should be maintained and effectively communicate this both to service providers and health facilities and the population. This may require drawing on ministerial staff to monitor the impact of the pandemic. A dedicated Ministry of Health and Population (MoHP) team could be posted in each Province to monitor and report on essential service delivery. These reports would supplement information systematically reported in the health management information system (MIS). A well-developed health MIS would include data from testing centers that are aggregated and managed by the health ministry, in partnership with local governments. It could also entail drawing on community organizations and groups, or cooperatives and civil society, to monitor and collect information on the pandemic outbreak at the local level. This would require the provision of specific guidance to Provinces, Palikas, and facilities for delivering essential services during the COVID-19 outbreak, with a focus on vulnerable groups.

Restructuring Stage

60. **During the restructuring stage, the emphasis needs to be on beefing up health delivery systems and scaling up public health priorities like immunization programs**. Private sector participation in health service delivery for both COVID-19 and other health services in Nepal could help boost the capacity of the health system to deal with an increased number of patients. The private sector could be engaged as service providers, suppliers of goods and services, and innovations such as telemedicine, to help reboot the economy. In addition, any immunization programs, which took a backseat because of the pandemic, would need to be resumed to avoid long-term adverse health impacts. During this stage, greater use of telemedicine and proper management of health care waste could also be explored, particularly from the policy and regulatory angle. Surveillance and health reporting systems in the country could also be strengthened. In addition, guidelines for health and safety could be developed to support the opening of the economy and the operation of the private sector. This will be particularly important for socially oriented or entertainment services and industries.

61. **The government should also use this as an opportunity to strengthen federalism and service delivery at the local level**. Local governments are well positioned as first responders and operate over 90 percent of public health facilities in Nepal. An effective vertical (federal-provincial-local) coordination mechanism could be put in place that would enable the Ministry of Health to mobilize local government health departments at short notice. This would reduce the need to have all swab tests for COVID-19 in Kathmandu. It would support greater devolution of service delivery including the responsibilities as envisioned in the Constitution, and could give further impetus to federal government action on pending legislation and policy measures needed to empower provincial and local governments to perform their functional assignments.

Resilience Stage

62. **To achieve a resilient recovery, the focus should be on pandemic preparedness and developing and putting in place measures for maintaining essential health services during future shocks**. Emergency health response plans should include standard operating procedures not only for responding to the emergency but also for maintaining essential service delivery. A critical aspect of this will be the proper management of health care waste to ensure public safety. New service delivery modes such as telemedicine could be developed to help maintain essential services as insurance against future shocks and for greater resilience. Engaging the private sector could help support government capacity to ensure safe access to health services.

Pillar 2: Social Measures

Relief Stage

63. **Support to households is central to addressing the crisis**. Income support to the poor and vulnerable, including those who have lost their jobs during the lockdown and informal sector workers, will be critical to addressing the threat of rising inequality and poverty following the crisis. Income support will further facilitate and help shorten the transition to recovery by preventing households from adopting negative coping mechanisms such as cuts in education spending, reducing food intake, sales of productive assets, and accumulation of debt.

64. **Nepal has adopted initial fiscal stimulus and relief measures in support of vulnerable households but will need to scale up social assistance and social protection programs**. The immediate relief is being provided by the government through existing delivery systems for social safety nets or through employment programs. However, the existing programs do not include many of those who have been adversely impacted by the crisis, especially the informal sector workers and the migrant returnees. It will be important for the government to scale up these programs to include the newly vulnerable sections of the population and provide cash or in-kind (food) transfers to prevent the depletion of human and physical assets. In addition to the existing safety nets, the Prime Minister's Employment Program will be one of the key mechanisms for transfers to beneficiaries and will be scaled up to cover the most vulnerable, including migrant labor[14].

65. **Alternative measures could be adopted and scaled up to ensure that children continue to learn during the lockdown and beyond**. All educational institutions have been closed since March 2020. As a result, an estimated 8.2 million children are out of school. Some schools (predominantly private ones) have switched to online learning. However, poor and vulnerable children are at a disadvantage because of limited access to digital platforms and devices. These children, especially girls, with limited access to media and digital learning platforms are at greatest risk of experiencing a loss in learning or erosion of their human capital. Distance learning may need to incorporate a broader approach, including radio, TV, and SMS to ensure broader coverage of students. Additional training for teachers and students may be required in basic to intermediate-level digital skills. In this context, connectivity for higher education institutions could be expanded and the Emergency Education Operations Procedures adopted.

Restructuring Stage

66. **During the restructuring stage, continued support to vulnerable households will be important, together with the establishment of a robust social registry**. Labor-intensive public works could be undertaken, which would help address small-scale infrastructure rehabilitation and maintenance needs while providing employment opportunities. To generate more employment, entrepreneurship support programs through grants and/or through microcredit institutions and the banking system (together with business skills training) could support small and medium-sized enterprises. A revision of migration policies would help increase safe and productive employment for migrants. In addition to the above measures, it would be critical to establish a robust digitized social registry to help identify beneficiaries and to track and coordinate programs. This would be further facilitated through implementation of an electronic payment platform for all government-to-persons transfers.

67. **To get children back to school full time, measures would need to focus on ways to reduce contact**. This would involve staggered shifts or alternate week schedules. The federal government, in consultation with subnational

14 Existing channels will reach only about 4 million people and will need to be broadened to reach the majority of affected households.

governments and teacher unions, is developing a school reopening framework to help guide the safe reopening of schools and continued learning. The framework will provide guidance on enhanced school sanitation and health protocols including health screening and WASH facilities. This framework will be disseminated to subnational governments and made publicly available. There may be a need to adopt re-enrolment campaigns and incentives (through school feeding, provision of uniforms/books) to get children back to school. Also, once back in school, an adjustment of the academic calendar may be required to make up for the learning time lost. This may be supplemented with remedial programs. Vocational training could be redirected to essential and priority sectors to support economic recovery and employment. In higher education, tapping and extending the global educational resources through the Global National Research and Education Network[15] (NREN) and public private partnerships will be critical.

Resilience Stage

68. **The key focus in this stage is on strengthening the resilience of the social protection systems to effectively address future shocks**. Shock preparedness will involve a full deployment of the social registry to identify beneficiaries of all targeted programs and pre-identify those vulnerable to shocks. Measures to strengthen the social protection system will include (a) implementation of the social security allowances as per the Social Security Act, (b) refining the design of existing social protection programs to enhance the impact on human capital, and (c) promoting the inclusion of informal workers in compulsory schemes (such as the Social Security Fund). Employment support for the unemployed could be promoted through (a) reskilling and redeployment for those who lost their livelihoods or jobs; (b) implementation of strong migration policies and programs, to ensure reliable and safe migration and reintegration of returnees; and (c) productive public works programs to support the poor and vulnerable.

69. **Increased resilience in delivering education services will entail developing and delivering new e-services, particularly for the most vulnerable, who may not have access to the internet**. Remote learning modules for each grade/course, including manuals for teachers and students for distance learning and support for faculty members and students, would help ensure that students do not miss out on their education. In some countries, local governments or district offices provide kiosks that can facilitate access, eliminating the need for intended beneficiaries to travel to urban centers to access services. Nepal may consider adopting similar approaches by strengthening the connectivity of local and provincial offices and building up related capacity of these units.

Pillar 3: Economic Measures

Relief Stage

70. **In the relief stage, economic support measures should focus on providing immediate liquidity to the most affected firms**. The reduction in demand, disruption of distribution channels, tighter credit, and rising uncertainty have made working capital even more scarce and increased the need for liquidity to reduce firm closures/bankruptcies and reduce the number of layoffs. Government support should be based on clear eligibility criteria and ideally tied to maintaining employment and meeting immediate operational needs. Subsidized emergency packages could be designed for eligible firms and need to be time bound. Nepal should continue with ongoing economic measures including allowance for temporary social security, tax, rent, and utility deferrals; wage subsidies; and suspension of import duties for essential inputs. To date, Nepal's economic support to firms has included regulatory forbearance, refinance facilities, and the provision of subsidized loans.

15 Nepal is a member of the Global NREN network.

71. **A particular focus on the tourism and agriculture sectors may be warranted given the direct impact of COVID-19 on these two sectors, links between them, and their importance for growth and food security**. Tourism accounts for close to 8 percent of jobs and supports over 1 million jobs (directly and indirectly). The combined direct and indirect contribution of travel and tourism to Nepal's GDP was US$2.2 billion (7.9 percent of GDP) in 2018, and the sector provided 6.7 percent of total employment. In 2019, some 1.2 million tourists visited Nepal. An emergency financial support package for the tourism sector could be elaborated, in close consultation with the private sector, to prevent job losses in this crucial sector for Nepal's economy. Agriculture comprised around 24 percent of GDP in FY2019 and employed 63 percent of the labor force[16]. Measures could be adopted to limit and regulate (instead of banning), high-density markets, which are a vital part of the food chain, including spacing out markets and stalls where feasible to support physical distancing. This would help farmers sell their produce while also maintaining distribution to urban centers, thus helping to guarantee food security. Direct support to farmers, for example, through the subsidized distribution of fertilizer, could also be an option. Also important for food security will be the establishment of community grain stores and stronger engagement of the private sector in the distribution of fertilizer.

Restructuring Stage

72. **During the restructuring stage, firms will need continued support while steps toward reopening businesses can be taken**. This may entail a staggered and selective reopening of businesses based on the type of industry and the ability to maintain social distancing, as well as the degree of strategic importance of any related businesses and industries. Some standards and guidelines may need to be communicated to guide businesses and the population on business conduct that supports health safety. Continued support to firms in the form of subsidized loans and loan restructuring might be needed. With higher leverage, some critical but systemically important firms might need equity infusions. However, this support will need to be provided so as not to distort markets and to ensure that only viable firms are saved. Those firms receiving support should be critical to future growth and provide a revenue stream to the government in the form of future taxes. Streamlining and simplifying approval processes for investments will also support recovery. In addition, corporate and consumer insolvency regimes could be strengthened and out-of-court workout procedures introduced.

73. **Nepal can start leveraging the benefits of increased digitization as part of the restructuring stage**. Nepal is likely to face an increasing domestic labor supply as travel restrictions and reduced global mobility constrain outmigration. To generate more domestic employment, entrepreneurship support programs through grants and/or through microcredit institutions and the banking system (together with business skills training) could support small and medium-sized enterprises. A special focus can be on making these enterprises fit for the future, for instance, by providing them with the skills to leverage digital technologies. As such, further investments and reforms to expand the reach and coverage of mobile banking and digital financial services, use of non-collateral-based lending, and support to business development and skills upgrading could help support recovery of firms in the informal sector. Programs to promote digital literacy or subsidies for purchasing cell phones or laptops, or establishment of information technology (IT) centers to facilitate access to the internet and computers are some of the potential measures that could help increase overall firm growth and employment.

16 This includes those engaged in subsistence agricultural (see World Bank Jobs Diagnostic; http://datatopics.worldbank.org/JobsDiagnostics/).

74. **Nepal can also start promoting green businesses during the restructuring stage**. Fiscal incentives could be provided to enterprises for green investments, including enhancing energy efficiency, hygiene and sanitation, waste management, and the adoption of cleaner technologies. The promotion of agro- and forest-based SMEs would include startups and modernization of supply chains. This will require support to local-level planning and implementation of activities to increase agriculture and forest production and marketing. It will also require the appropriate financial products for agri- and forest-based businesses. Existing forestry-based enterprises could improve their capacity to further process and add value to forest-based products and substitute for market supplies currently covered through imports. This could engage returnee youth and contribute to new job opportunities for skilled and non-skilled labor. To control activities such as poaching and illegal tree felling, local communities could be given the resources and training to monitor these activities through increased patrols, and work with local authorities to address these threats.

Resilience Stage

75. **In the resilience stage, measures should be adopted to strengthen the physical, digital, and financial infrastructure to support firms**. For informal sector enterprises, and the self-employed, reforms should aim at increasing access to finance, including measures to promote digital financial services, mobile banking, and digital literacy for greater resilience. To strengthen the financial infrastructure, the government should enact the "Secured Transactions" legislation and introduce new forms of credit collateralization, including factoring or reverse factoring, which is key to maintaining viable supply chains. This should enable diversification of the types of permissible collateral beyond those that are fixed to those that include cash-flow and other forms of "moveable collateral." This could be complemented with key investment climate reforms, including investments in physical infrastructure, which impact FDI flows and firm entry and operation. More comprehensive and long-term insolvency and out-of-court procedures could help further facilitate private sector engagement.

76. **Support to firms could focus on green growth, especially in the tourism and forestry sectors**. The pandemic might lead to a permanent change in how international tourism operates. There may be more emphasis on environmental management (waste management, air quality, water quality) investments at tourism destinations and health safety. Guidelines and protocols would need to be developed along these lines. Effective communication and marketing of this reorientation would be important in selling this new approach to potential tourists. In addition, government could use the pandemic as an opportunity to refocus the tourism sector to ecotourism and establish certification schemes to facilitate compliance with the guidelines. This could include acquiring international accreditations and standardization. In addition, new investment opportunities for green jobs in the forestry sector could be developed. New forest-based SMEs related to both timber and non-timber production could be incentivized and developed. Offering an affordable credit line for forest-based activities and lifting policy barriers for establishing enterprises would help develop a modern and competitive forest-based private sector.

Pillar 4: Cross-cutting Measures

Relief Stage

77. **During the relief stage, an accommodative monetary and expansionary fiscal policy is needed to support liquidity and provide relief to households and firms**. Fiscal measures would focus on increased allocation to health, social protection, and employment programs, some of which have been implemented by the government. The government has also reduced import duties on essential medical supplies, a welcome measure. In addition, tax deferrals have been provided to firms and households to help them deal with reduced incomes. Government assistance might also be needed to keep some essential utilities like electricity and water functioning. Monetary policy has also been eased to provide increased liquidity

to the banking system (Table 2). The central bank has introduced some forbearance measures to support firms. It will be important to keep these extraordinary fiscal, financial, and monetary support measures time bound to maintain macroeconomic stability. With a shock to revenues and increased spending needs, the government will need to mobilize larger concessional resources from development partners.

78. **It will also be important to maintain essential services, which depend to a large extent on the subnational governments**. On essential services, it is critical to maintain water, sanitation, and hygiene services to enable proper handwashing and for safeguarding health. Water and electricity will also be critical to keep hospitals running at full capacity during the relief stage. Since several households and firms have experienced an income shock, it will be important to provide utility payment deferrals and avoid disconnections due to nonpayment. Here again, it will be important to keep these measures time bound to maintain the financial sustainability of these services in the long run. Also, local governments are well-positioned to deliver critical services, including health, and it will be important to coordinate across all three levels of government to ensure uninterrupted service delivery.

79. **Removing barriers to internet access and digital infrastructure can facilitate the implementation of social distancing measures and ensure business continuity of the government and the private sector**. Less than 10 percent of households have internet access (2017/18 Labor Force Survey), and the Demographic Health Survey (DHS) 2016 indicates that only 22 percent of females aged 15 to 49 used the internet in the month preceding the DHS. There is limited reach of high-quality connectivity outside of Kathmandu and other large cities as only a third of all mobile users subscribe to mobile broadband services. Digitization is also limited across the economy. To address these challenges, it will be necessary to remove access restrictions to any underutilized fiber optic backbone managed by the governments and public utilities (for example, electricity networks, broadband backbones), including introduction of appropriate rules to manage conditions of access, capacity allocation, and access pricing. To address congestion issues in selected areas, radio spectrum could be temporarily assigned.

Restructuring Stage

80. **Expansionary fiscal and monetary policy will likely continue during the restructuring phase but with increased emphasis on debt sustainability**. Income and employment support programs (through public works) will continue to require increased budget allocations to support the vulnerable. In this stage, an increased focus will be on ensuring the macrofiscal sustainability of these measure by avoiding a buildup of debt. This can be addressed through tax reforms and a focus on concessional financing. To increase revenue collection, the government could potentially consider options like a wealth tax and a carbon tax. There should also be a concerted effort to avoid imposing trade restrictions. Efforts to maximize concessional resources will need to continue to ensure fiscal and debt sustainability in the aftermath of the crisis. The government could develop an updated debt management strategy and prepare plans on how it would wind down some of the fiscal support measures in the future. Until the economy is back on a sustained growth path, an accommodative monetary policy stance will need to be maintained.

81. **Following an expected buildup of private sector debt, it will be important to ensure a stable and robust financial sector to support the economy through the restructuring phase**. Since the impact of the crisis on the financial sector will come with a lag, it will be important to assess the nonperforming assets and take measures to ensure sector-wide stability. The government could formalize this assessment in the form of a financial recovery strategy. Measures should also be adopted to strengthen and scale up the Deposit and Credit Guarantee Fund (DCGF) to increase confidence in deposit insurance and to share credit risks (and reduce the banking sector's risk aversion). The government could also

explore regulatory amendments to enable financial institutions to offer digital financial products and services tailored to the needs of households and firms.

82. **To enable digitization, reforms can focus on broadening internet access**. Potential measures include development of a regulatory framework that enables sharing of telecom-ready infrastructure across sectors (for example, ducts, poles) and promotes competition, including through measures to ensure nondiscriminatory and cost-based access to networks of dominant operators. To hasten the expansion of broadband connectivity in rural areas in competitively neutral ways, government should update the rules that govern universal service funds and introduce other support schemes. This should be complemented with promotion of increased use of and access to telecommunication and internet systems to support the capacity for telework of key public institutions, provision of e-health and Edutech services, and access to digital services in rural and remote areas, especially for low-income households and SMEs.

83. **Impact assessment of the crisis on essential service delivery could be undertaken during the restructuring stage, with continued provision of these services**. During this phase, the government could undertake an assessment and prepare a strategy to ensure financial viability of essential service delivery, which would be implemented gradually, COVID-19 permitting. It will also be important to undertake critical repairs to the infrastructure and, where feasible, public works programs could be prioritized in these sectors. Irrigation services will also need to be maintained to support agriculture and food security. Some of the nonessential services could be resumed. Since service delivery is the responsibility of the subnational governments, it will be important to resume the progress toward federalism, with a special focus on capacity-building efforts.

Resilience Stage

84. **In this stage, it will be important to signal a return to macroeconomic stability**. On the fiscal side, measures will be needed to raise revenues that have declined due to low economic activity and the lockdowns. These measures would include reforms in tax policy and administration, including streamlining of import and export tax regimes and reduction in tax expenditures. As part of the transition to investment and growth, it will be important to strengthen the public investment program and prioritize growth and green investments, as well as the development of essential and green infrastructure. Government policies should aim at strengthening the identification, prioritization, and implementation process for investment projects, as well as the procurement framework. Medium- to long-term fiscal sustainability would be supported by sound debt management, and this would be helped by adopting targets for fiscal consolidation and debt reduction. With a subdued economic recovery, the financial health of many public entities is likely to worsen. It will be important to monitor contingent liabilities arising from systemically important firms and banks Ongoing monitoring of key economic indicators should inform the timing of the fiscal consolidation process, given its trade-offs with growth, and changes in monetary policy.

85. **Maintaining financial sector stability will require enhanced liquidity, strengthened macroprudential measures, and increased supervision**. The crisis is likely to have a debilitating impact on the financial sector, and the implementation of the financial recovery strategy will be paramount. It will be important to have a robust regulatory and supervisory framework to ensure stability of the sector. The sector will require intensive monitoring, which will be facilitated by the implementation of the Credit Information and Reporting Act and the amended Secured Transactions Act. These acts would also help with expanding the basis for lending beyond fixed collateral, making credit more accessible to a broader segment of the private sector. The central bank could also operationalize the Supervision Information System and the anti-

money laundering and combating the financing of terrorism National Risk Assessment framework.

86. **Pandemic preparedness for essential services delivery and their financial sustainability will be critical**. The pandemic preparedness strategy will ensure uninterrupted access to essential services delivery in times of crisis. It could also include options to provide off-grid facilities to strategic locations when needed. With deferrals in utility payments and a subdued economic recovery, the financial health of many utilities is likely to worsen. It will be important to implement policies to restore their financial health to avoid an increase in the fiscal burden. It will also be important to fully restore nonessential services. There is also a need to resume greater devolution of service delivery to the local levels, as envisioned in the Constitution.

87. **Strengthening digital systems and connectivity will support service delivery and private sector growth**. To initiate a process of digital transformation, the government could adopt increased digitization in service delivery, especially for payment collections and usage records. With the increased emphasis on online learning, and digital or mobile banking, digital distribution of social protection benefits will require improved cybersecurity of essential government services. This would include building capacity and awareness on cybersecurity via an informational campaign for SMEs and individuals. Digital solutions for e-health, Edutech, and other key services, and for government to person (G2P), government to government (G2G), and government to business (G2B) transactions, could help increase resilience of the economy during future shocks. It will also be important for the government to support digitization of firms through promotion of broadband internet access, development of their capabilities, and by facilitating digital payments.

88. **Critical investments can help shape a green growth agenda**. Key elements of green growth include sustainable and resilient infrastructure designed and built to minimize damage to the environment and natural resources; solid waste management and air and water pollution control that provides health benefits; and improved delivery of water and sanitation services, especially in rural areas. Nepal could draw on its natural resources to develop labor-intensive green infrastructure such as terracing on slopes, afforestation and reforestation, slope stabilization, and trail maintenance and rehabilitation in protected areas.

89. **Other longer-term priorities also need to be brought back to the table**. These would include (a) supporting human capital accumulation, (b) improving the business and investment climate while simultaneously orienting it more toward the digital economy, (c) increasing infrastructure investments to close the infrastructure gap and raise the growth potential, and (d) continuing efforts to ensure environmental sustainability and mitigate the risks from climate change.

90. **For all three stages, it will be helpful to maintain a strong communication program and collect data to inform policy making**. As the economy moves from relief to restructuring to resilience, communication updates will be important to keep the public informed and to gain their trust and confidence, and for continued compliance with government rules and guidelines. This communication program will need a robust data system to monitor progress and inform the design of the COVID-19 response program. It will be important to strengthen existing data sources and collect new data. Data can come from nontraditional sources such as phone records or remittance transfer accounts or from rapid crisis monitoring mechanisms through surveys and geospatial data. Going forward, it will be important to improve the regularity of data production, sharing, and use (see Annex).

91. **The table below proposes actionable measures that the government can undertake.** This crisis will require a multi-faceted response given the wide-ranging impact. These measures will support the government's efforts in providing relief and building a resilient recovery.

Table 4. Priority actions/measures to move towards a resilient recovery

	Relief	Restructuring	Resilient Recovery
Health	• Ensure quarantine facilities are well-equipped and build testing capacity • Deliver specific guidance to Provinces, Palikas, and facilities for delivery of essential health services during COVID-19 • Have a dedicated team at the Ministry of Health and Population (MoHP) and in each Province to monitor and report on essential service delivery	• Scale-up public health priorities like immunization campaigns, and surveillance and reporting systems • Allow greater private sector participation in COVID and non-COVID health service delivery • Develop guidelines for health and safety of the private sector as the economy opens up	• Adopt emergency response plans, including standard operating procedures for both emergencies and essential services. • Strengthen operational procedures for proper management of health care waste • Implement new service delivery modes such as telemedicine to increase resilience to shocks • Strengthen local level health service delivery mechanisms
Social	• • Provide emergency cash or in-kind transfers using existing delivery systems for social safety nets or through employment programs • • Expand coverage of existing programs (such as the Prime Ministers Employment Program) • • Support distance learning programs for all using TV, radio, SMS, internet, printed materials	• Continue to provide cash or in-kind transfers to the poor and vulnerable and deploy electronic payment systems • Support employment through public works programs, revised migration policies and entrepreneurship support through banking and non-banking channels, together with business skills training • Establish a social registry, to help identify beneficiaries and coordinate programs • Take steps to get children back to school including re-enrolment campaigns and incentives together with measures to maintain social distance (staggered shifts, alternate week schedules) and enhanced school sanitation and health protocols • Re-direct short-term vocational training to essential and priority sectors	• Fully deploy the social registry, to ensure future shock-preparedness • Strengthen the social protection system by implementing social security allowances, strengthening the design of existing programs and including informal workers in contributory schemes • Provide employment support by reskilling and redeploy those who lost their livelihoods and adopting strong migration policies • Strengthen the education system to withstand further shocks by increasing connectivity, adopting the Emergency Education Operations Procedures and developing and delivering e-education services through local government or district office kiosks

Table 4. Priority actions/measures to move towards a resilient recovery

	Relief	Restructuring	Resilient Recovery
Economic Support	• Allow (temporarily) social security, tax and rental/utility deferrals, provide wage subsidies, suspend import duties for critical supplies, and avoid the impact on credit scores • Announce a time bound subsidized emergency financial package for priority sectors like tourism and agriculture. • Support Palikas in the distribution of relief packages (seeds and fertilizers) to affected farmers and centrally procure agriculture produce to respond to food security needs	• Provide matching or conditional grants, loan restructuring and equity infusion to firms, in a selective and time-bound manner • Provide fiscal incentives for green investments, including enhancing energy efficiency, hygiene and sanitation, waste management, and the adoption of cleaner technologies • Streamline and simplify approval processes for investment • Strengthen corporate and consumer insolvency regimes and out-of-court settlement procedures • Expand the reach and coverage of mobile banking and digital financial services, and the use of non-collateral based lending • Support programs to promote digital literacy and establish information technology centers to facilitate access to the internet and computers	• For informal enterprises increase access to finance, through digital financial services, mobile banking, and digital literacy • Implement the Credit Information and Reporting Act and the amended Secured Transactions Act to expand the basis for lending beyond fixed collateral • Adopt comprehensive and long-term insolvency and out-of-court procedures • Accelerate key investment climate reforms impacting foreign direct investment (FDI) flows and firm entry and operation • Develop guidelines to support environmental management (waste management, air quality, water quality) investments at tourism destinations and promote eco-tourism. • Invest in food storage and distribution infrastructure

Table 4. Priority actions/measures to move towards a resilient recovery

	Relief	Restructuring	Resilient Recovery
Cross-Cutting Priorities	• Increase the fiscal allocation to health, social protection and employment programs • Mobilize concessional resources from development partners • Adopt monetary easing to provide liquidity to the banking system • Maintain the provision of essential services like water, sanitation and hygiene and electricity through the local governments • Remove barriers to internet access (access restrictions to under-utilized fiber-optic backbone) and digital infrastructure to enable social distancing and maintain business continuity	• Continue with increased budget allocation for income and employment programs • Explore additional sources of revenue through wealth and carbon taxes • Avoid imposing trade restrictions • Prepare a strategy to wind down fiscal incentives and strengthen debt management • Assess the impact of the crisis on the financial sector and prepare a financial recovery strategy • Strengthen and scale up the Deposit and Credit Guarantee Fund and explore regulatory amendments to enable financial institutions to offer digital financial products and services • Implement regulatory measures to broaden internet access by sharing telecom-ready infrastructure across sectors and strengthen competition • Continue to maintain essential services but also undertake critical repairs to infrastructure, resume some of the non-essential services, and prepare a plan to ensure financial sustainability of utilities • Reinforce the progress towards federalism with a focus on capacity building efforts	• Increase tax revenues through reforms in tax policy and administration including streamlining the import and export tax regimes and reducing tax expenditures • Strengthen the public investment program and prioritize growth and green investments as well as the development of essential and green infrastructure • Adopt targets for fiscal consolidation and debt reduction and monitor contingent liabilities arising from utilities and systemic firms and banks • Implement the financial recovery strategy and strengthen the regulatory and supervisory framework for the banking system • Implement pandemic preparedness plans for essential service delivery, restore the financial health of utilities, fully resume non-essential services and adopt increased digitization in service delivery, especially for payment collections and usage records • Strengthen the federalism architecture through appropriate laws and guidelines and capacity building to ensure improved service delivery • Strengthen cybersecurity laws and promote awareness on cybersecurity via an informational campaign • Promote broadband internet access and digital payments • Develop sustainable and resilient infrastructure and strengthen solid waste management and air and water pollution control

Annex 1: Potential Data requirements and sources for monitoring COVID-19

Sector/Agency	Data requirements and sources
Health	Early Warning and Reporting System (EWARS) District Health Information System2 (DHIS2) National Public Health Laboratory network information system e-Logistics Management Information System
Social protection	Beneficiary data Phone or online data based on local-level beneficiary enrollment
Education	Labor force survey, media or pulse survey, and administrative school data
Agriculture	Periodic government updates World Food Program and the Food and Agriculture Association
Tourism	Nepal Tourism Board Periodic survey of the tourism sector using a high-frequency monitoring phone/online survey in collaboration with industry associations will be helpful
Forests and Environment	Monitoring of forest cover and drivers of deforestation and forest degradation Survey on impact of COVID-19 on forest-dependent people, especially indigenous peoples and other vulnerable groups Department of Forest Research and Training Center
Water	National water, sanitation, and hygiene (WASH) cluster
Energy	Data on oil and liquid petroleum gas subsidies, time and cost overruns of projects under construction, with power system demand projections in the post-COVID period
Transport	To address the lack of a reliable transport sector database with comprehensive or accurate data, develop a reliable transport database and the needed digital foundations
Telecom/Internet	Regulator, Central Bureau of Statistics
Central Bank/ Financial	National Accounts, Securities and Exchange Board, Insurance Board, financial intermediaries, supplemented by frequent real sector and financial intermediaries' sentiment survey data, Ministry of Finance, Credit Information Bureau
Private sector	Economic census for identifying and delivering support to firms In addition, regular business pulse and doing business surveys will provide up-to-date data on evolving business conditions
Macroeconomic	Economic data from several sources including the Central Bureau of Statistics, Ministry of Finance, central bank (Nepal Rastra Bank), and line ministries
Communications	Information on media reach and penetration to identify appropriate mass media channels for effective outreach

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