Drivers of Nepal's Current Account Deficit and its Policy Path



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Current Account Balance

- Current Account = Trade Balance + Income
 Balance + Current Transfers Balance
- Measure of macroeconomic stability and economic growth
- Current account imbalances as a major source of macroeconomic vulnerability and a constraint on economic growth

Objectives of the Study

- i) What are the major drivers of the current account deficit in least developed country like Nepal?
- ii) How can Nepal maximize the impact of current account balance in economy?

Overview of Current Account Balance of Nepal

- Fair stability despite of weak export due to large inflows of remittances
- Last year, external situation took a turn which resulted to current account deficit not seen since fiscal year 1995-96
- In fiscal year 2017-18, the current account deficit widened to 8.2 percent of the Gross Domestic Product (GDP)

Overview of Current Account Balance of Nepal

- Around \$2.4 billion, up from a deficit of just 0.4 percent in the preceding year
- Trade deficit reached a record 37.7 percent of GDP (export :3.1 percent of GDP ;imports comprising of 40.8 percent of GDP)

Major Determinants of Current Account Balance in Nepal

- Pegged Exchange Rate with India
- Trade Deficit
- Remittances and its effect
- Real Effective Exchange Rate (REER)
- Government Expenditures post 2015
 Earthquake

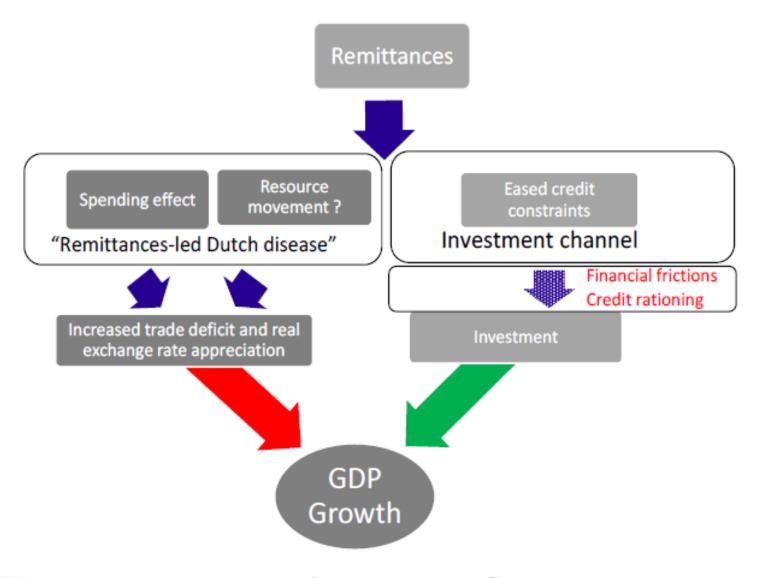


Figure: Impact of remittance inflows in an economy Source: From evidence to Policy: Supporting Nepal's Trade Integration Strategy (Portugal & Zildzovic, 2014)

Impact of earthquake

Lower economic growth

 GDP growth slowdown in 2015 will be followed by a pick up driven by earthquake related reconstruction works Impact on CAB (TB

Output gap (lower CAB)

Higher inflationary pressures

 Inflation is expected to pick up due to lower agriculture supply and higher domestic demand

REER appreciation (lower CAB) Macro uncertainty (higher CAB)

Increase in fiscal spending

 Higher government expenditures related to reconstruction works will increase the domestic demand

Government expenditures (lower CAB)

Remittances

Initial increase of remittances will increase imports but have positive impact on CA balance as not all of the inflows are spent on foreign produced goods

Remittances (lower TB/higher CAB)

Figure: Impact of Earthquake on Current Account Balance Source: From evidence to Policy: Supporting Nepal's Trade Integration Strategy (Portugal & Zildzovic, 2014)

Policy Paths

- Improve Investment Environment
- Update trade and industry related laws, policies
- Address constraints on the supply-side
- Promote Nepalese products through branding / marketing
- Explore on competitive advantage sector
- Control consumption oriented public spending

Thank You.