Nepal Rastra Bank

Press Release

Monetary Policy Focus: Price control, financial stability, productive sector credit, and outreach

Nepal Rastra Bank (NRB) unveiled its Monetary Policy for the fiscal year 2012/13 that focuses on controlling inflation, stimulating credit to productive areas, monitoring the trend of interest rate, increasing outreach of financial services and ensuring financial stability.

While continuing many successful policy instruments of the past years, on Wednesday the Central Bank also introduced new measures for attaining the broad policy objective of facilitating economic growth and financial stability.

“The major challenges we face are controlling inflation, credit to productive sectors, expanding financial outreach to the unbanked area of the country and financial stability,” said Yuba Raj Khatiwada, Governor NRB.

“The overall goal is to create an enabling environment to facilitate economic growth of 5.5 percent,” said Khatiwada.

The policy for 2012/13 aims at primarily enhancing the stability of the financial sector, increasing access, easing credit to export industries, relaxing foreign exchange controls, and encouraging savings in foreign currencies.

Accordingly, the bank will initiate a process towards controlling volatility in interest rates gradually through an Interest Rate Corridor Policy to maintain short-term market rates within a band. To enhance transparency in lending rates and strengthen monetary transmission mechanism, base rate system is proposed, which requires banks and financial institutions (BFIs) to establish and announce the base rate.

The policy measures aimed at ensuring financial stability focus on strengthening the capital structure of BFIs, implementing risk based supervision and enhancing the regulation and supervision of electronic transactions.

Other measures include effective coordination with other regulatory authorities, improving corporate governance at BFIs, distinguishing between bankers and industrialists, reviewing and updating laws and regulations relating to BFIs and enhancing financial intelligence for making transactions transparent.

The policy has introduced additional monetary measures for controlling money supply, revised refinancing arrangements and has adjusted the rules on sector specific investments.

The Bank expects broad money supply to increase by 15 percent, private sector credit by 16 percent, claims on government by 15.8 percent and deposit mobilization by banks and financial institution by 15.1 percent.

The bank rate has been aligned to standing liquidity facility (SLF) and fixed at 8 percent. The previous SLF rate was 10 percent.

The central bank has lowered the rates for refinancing from existing 6.5 percent for agriculture and hydroelectricity sectors, and 7 percent for other productive sectors, to a single rate 6 percent. This rate would also apply to loans extended by BFIs to livestock and fisheries, and institutions using this facility would be barred from charging customers more than 9 percent as interest.

The refinancing rates for sick indusries, cottage and small industries, export oriented businesses, and foreign employment remains unchanged at 1.5 prcent. Additionally, NRB has introduced special refinancing for loans extended to women and fargeted social groups. BFIs are barred from charging more than 4.5 percent interest on such loans.

It has also given continuity to the provision on loans provided for export refinancing in foreign currency will be provided at Libor Rate plus 25 basis point. Furthermore, NRB has made arrangements to simplify the procedures for obtaining all kinds of refinance facilities.

NRB has increased lending in the deprived sectors by 0.5 percentage point to 4 percent, 3.5 percent and 3 percent of total credit respectively by commercial banks, development banks and finance companies by the end of the fiscal year.

Further, taking into account the increased liquidity position of BFIs, it has also revised the mandatory cash reserve ratio from five percent to 6 percent for 'A' class, 5.5 percent for 'B' class and 5 percent for 'C' class licensed institutions.

It has given continuity to the liquidity ratio and has included commercial banks, development banks and finance companies in the Liquidity Monitoring and Forecasting Framework (LMFF) for regular monitoring.

The Central Bank has lowered the term for repurchase and reverse-repurchase agreements (28 days), and the term for interbank transactions between BFIs (7 days).

Financial sector reform

NRB has committed to make appropriate changes in the macro-prudential regulatory measures to manage liquidity and necessary and facilitating the issuance of long-term bonds in the Nepali currency for directing investment in national priority projects, and developing the secondary market for the bonds.

The policy has given continuity to the moratorium on establishing new A, B & C class BFIs except for special financial institutions established to facilitate financing in the national priority sectors such as agriculture, energy and infrastructure.

It has accorded priority to promoting D-class BFIs in areas with minimal financial services, and mobile and branchless banking for expanding outreach in other areas.

The policy also envisages providing interest free loans to BFIs for taking services to selected districts unreached by banking services, while encouraging mergers for consolidation. NRB has committed to initiate the policy process on acquisitions too. To safeguard the small depositors and enhance confidence towards the banking industry, deposit guarantee threshold will be increased to Rs 300 thousand by the end of this fiscal year.

Under the new policy, NRB will require BFIs to periodically publish their base interest rate to enhance transparency; whereas NRB initiates to formulate a National Financial Literacy Policy and a Financial Sector Strategy.

The bank will closely monitor implementation of BFIs proposed plan to increase loans to productive sectors to 20 percent, and revise the definition of agriculture for credit purposes to include agro-implements, fertilizer, seeds, livestock feed, irrigation, agro-production storage and processing for specific agro-products.

Based on risk management, corporate governance, business connectivity and real estate loans, NRB will select 20 BFIs for diagnostic reviews in 2012/13 as part of the process of enhancing supervision. Prompt corrective actions will be taken based on capital adequacy, liquidity and non-performing assets.

Further, BFIs mobilizing deposit more than Rs 2 billion are required to start stress testing according to the Stress Testing Guidelines and report periodically to the Central Bank.

Background

The Monetary Policy comes against a background of satisfactory level of economic growth in the just-ended fiscal year compared to previous years, and a budget deficit that remained within limits, resulting in considerable savings in the current account and increasing foreign reserves, despite a widening trade deficit.

However, credit to the productive sector did not respond encouragingly to the improved economic environment of improving liquidity and declining interest rates on deposits.

Total domestic credit during the 11 months of fiscal year 2011/12 increased by six percent but is expected to grow further alongside the end-of-year increase in government spending to reach around 10 percent.

The deposit mobilization of financial institutions increased by 18.2 percent in 2011/12, compared to a lower growth (8.9%) in the same period-earlier year. The loans and investments by banks and financial institutions grew by 14.1 percent–the same rate it had grown in 2010/2011.

The NRB said liquidity of BFIs has improved making it possible for them to maintain the required credit-deposit ratio, and lower interest rates to private sector productive credit.

The central bank had provided Rs.868.6 million in refinancing loans to the productive sectors, and Rs. 1.28 billion for refinancing loans to hydroelectric projects.

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