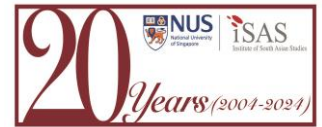


# Nepal's Political and Economic Challenges

Puspa Sharma



## Summary

*Nepal has a new coalition government in place, formed with the promise of providing political stability and reviving economic activities. Keeping these promises are challenging but necessary to instill hope in the Nepali people that their future is not doomed.*

On 15 July 2024, K P Sharma Oli, Chairman of the Communist Party of Nepal (United Marxist and Leninist) [CPN (UML)], was [sworn in a Nepal's prime minister](#) of a coalition government. CPN (UML) is the second largest party in Nepal's current Parliament. The largest party, the Nepali Congress, is the other major coalition partner.

Oli has become the prime minister for the fourth time. He is the country's [15<sup>th</sup> prime minister](#) since it became a Federal Democratic Republic in 2008. Since the promulgation of the new constitution in 2015, Oli's current prime ministership is the eighth in succession. On average, Nepal has seen its prime minister change once every year. Not a single prime minister has been in office for a full five-year term. This shows the state of political instability in Nepal.

The major partners of the current coalition have said that this coalition of the two largest political parties has been formed to make some [amendments to the country's constitution](#) that would help ensure political stability. This is because the structure of the current electoral system, with a mix of both first past-the-post and proportional representation, makes it almost impossible for any political party to form a majority government. The expediency for the current coalition was provided by the unstable nature of the preceding prime minister, Pushpa Kamal Dahal. Despite being the leader of the third largest party in the current Parliament, Dahal was able to become the prime minister and remain in office for almost 19 months by changing the [coalition partners thrice](#) and seeking a vote of confidence in the Parliament four times.

A two-thirds majority is necessary to make amendments to Nepal's constitution. The current coalition with the two largest political parties might be able to garner this number with the support of other smaller parties. However, amending the constitution is not only about numbers. It is necessary to get onboard all the major political parties in the process of constitutional amendment to make the changes acceptable to all and avoid any internal conflict. The Maoist party, led by Dahal, has [warned against potential amendments](#).

The current coalition is also faced with significant economic challenges. The country's economic mood, particularly since the COVID-19 pandemic, has been one of despair. Subdued economic activities in almost all sectors have led to [gloom in the country](#).

The external sector has fared [relatively better](#). In the first 11 months of the fiscal year (FY) 2023-24, Nepal's current account and the balance of payments registered surpluses of US\$1.5 billion (S\$2.04 billion) and US\$3.2 billion (S\$4.33 billion) respectively. The gross foreign

exchange reserves were nearly US\$15 billion (S\$20.37 billion), sufficient for 15 months of goods import and more than 12 months of goods and services import.

The healthy foreign exchange reserves are due to the huge inflow of remittances sent by Nepali workers abroad. Remittance receipts of the first 11 months of FY2023-24 stood at nearly US\$10 billion (S\$13.57 billion), which is more than 20 per cent of Nepal's gross domestic product. Such huge remittance receipts have swelled Nepali banks' deposits. This should have translated into much-needed investment in a least-developed, lower-middle-income country like Nepal, where financial resource scarcity is a perpetual problem. However, the sad reality is that the banks have been unable to effectively lend their deposits. Hence, the Central Bank has had to frequently [draw excess liquidity](#) from the banks.

A major reason for this excess liquidity has been [low credit demand](#) by the private sector. The private sector has been hesitant to borrow money from the banks for two main reasons. First, there has been a [reduction in aggregate demand](#) for goods and services in the country, and therefore, industrialists and traders are cautious in making further investments. Second, even if there are avenues for investments, the private sector is reluctant because of what it has recently experienced with [huge fluctuations in interest rates](#).

During FY2022-23, Nepal's economy faced significant issues both on the external and internal fronts. Among other challenges, the liquidity crunch of the time led to the [rapid rise in interest rates](#). The inter-bank interest rate of 4.96 per cent in November 2021 reached 8.5 per cent in November 2022. Single-digit interest rates on bank loans reached double digits, significantly burdening the borrowers. Such a situation has resulted in an increase in commercial banks' [non-performing loans](#) (NPLs). Therefore, the banks have also become selective in providing loans, which has contributed to the current situation of excess liquidity.

An important reason for the economic malaise in Nepal has been investments made in [unproductive sectors](#) such as real estate (primarily land) for speculative purposes. Nepal's commercial banks have been highly exposed to the real estate sector for two reasons – first, they have provided huge amounts of direct loans to the sector, and second, even in cases of loans provided to the productive sectors, real estate is the banks' major collateral. Policy changes made by the Central Bank to regulate the banks' loans to the real estate sector, which was a necessary step, have reduced real estate transactions. This has contributed to the slump in aggregate demand. The current government is faced with the challenge of stimulating private investments in the productive sectors and raising aggregate demand. It needs to find a delicate balance in ensuring that banks' NPLs are within the limit, interest rates are low and inflation is managed.

Political stability and the revival of economic activities are the promises of the current coalition government. The challenge is to fulfil these promises and instill hope in the Nepali people that their future is not doomed.

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Dr Puspa Sharma is a Visiting Senior Research Fellow at the Institute of South Asian Studies (ISAS), an autonomous research institute in the National University of Singapore (NUS). He can be contacted at [puspa.sh@nus.edu.sg](mailto:puspa.sh@nus.edu.sg). The author bears full responsibility for the facts cited and opinions expressed in this paper.