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The decline of foreign exchange reserve in Nepal and its effects

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The tourism sector's contribution to the foreign exchange reserves were over 75 billion in the fiscal year 2018/19 which dropped by 90% to NRS 7.26 billion in 2020/21. At the same time, total imports rose by 75.9% marking a rise to NRS 314.52 billion in the first two months of the fiscal year and remittances decreased by 6.3% to 155.37 billion. Remittance and tourism were both the aftermath of the Covid-19 pandemic and its mitigation even today is highly circumstantial. This has caused an impending foreign exchange crunch where the government does not have enough foreign exchange reserves to support its import.

In order to control for foreign exchange reserve, Nepal Rastra Bank has introduced import controls. In the end of the fiscal year 2020/21, in mid-July, Nepal's foreign exchange reserves stood at $11.75 billion which is only sufficient to import merchandise for 10.2 months. In two months, the foreign exchange reserves dipped to less than $100 billion which can sustain imports for only 7.8 months. Rise in imports and significant decline in tourism is one of the many causes behind this dip (The Kathmandu Post, 2021). This was an impact caused by overdependence on remittances for foreign currency reserve.

In situations like these, central banks must carefully consider its foreign payments associated with letters of credit for the next two to three months.

Similarly, as the effect of Covid-19 and layoffs in tourism, Nepalese working in foreign employment were subsequently more interested in other forms of investment such as cryptocurrency. According to the the World Bank, Nepal has untapped export potential worth an estimated $9.2 billion.

On Feb 09, 2022, Nepal Rastra Bank issued a circular for banks and financial institutions stating that the following products must 100% reserve while importing the following products.

S.N.	HS Code	Description
1.	0907	Cloves
2.	17	Sugar and sugar confectionery
3.	22	Beverages, Spirits and vinegar
4.	24	Tobacco and tobacco substitutes
5.	3303	Perfume and toilet waters
6.	3304	Beauty products and makeup preparation
7.	3305	Hair products
8.	44	Wood, articles of wood and wood charcoal
9.	64	Footwear, gaiters and like
10.	65	Headgear, hats and parts

11.	66	Umbrellas, walking sticks, seat sticks
12.	67	Feathers, human hair, bird skins
13.	68	Stone, plaster, cement, asbestos, mica and such
14.	69	Ceramic products
15.	7010	Carbons, bottles, flasks, jars, pots, and other containers
16.	7106	Silver
17.	9403	Prefabricated buildings
18.	95044000	Playing cards
19.	03	Fish, crustaceans and aquatic invertebrates
20.	04	Dairy produce, bird's eggs, natural honey, edible products of animal origin
21.	06	Live trees and parts of plants
22.	07131000	Freeze dried peas
23.	08028000/08029000	Areca nuts and other nuts
24.	0803	Bananas including Plantain
25.	08041000	Fresh/ Dried dates
26.	09041100	Black Pepper, not crushed
27.	16	Preparation of meat, fish or other aquatic crustaceans and invertebrates
28.	18	Cocoa and cocoa preparation products
29.	20	Preparation of vegetables, fruits, nuts and other parts of the plants
30.	21	Miscellaneous edible preparations
31.	23	Residues and waste from food industries including animal fodder
32.	32	Tanning and dyeing extracts
33.	34	Soaps, surfactants
34.	39	Plastic and articles thereof
35.	42	Articles of leather
36.	57	Carpets or textile floor covering

37.	60	Knitted or crocheted fabrics
38.	71	Natural/ cultured pearls, precious or semi-precious stones, precious metals, metal clad with precious metals
39.	82	Tools, implements, cutlery, spoons and fork of base metals, parts of base metals
40.	91	Clocks and watches
41.	94	Furniture
42.	97	Works of Art, collectors piece and antiques

Similarly, the products with the following HS Codes must have 50% cash reserve while importing.

S.N.	HS Code	Description
1.	61 [50%]	Articles of apparel and clothing accessories, knitted or crocheted
2.	62 [50%]	Articles of apparel and clothing accessories, not knitted or crocheted
3.	63 [50%]	Other made up textiles including rags
4.	8703 [50%]	Motor cycles
5.	8711 [50%]	Motor cars

There are various ways of curbing the foreign exchange deficit which has been implemented by the central banks in the past. Import control measures may be one of the quickest ways to slow down the outflow of foreign currency, however, it is far from sustainable. Bringing in Foreign direct investments (FDIs) is one of the most effective, sustainable ways of increasing foreign exchange reserves in the country. Similarly, finding ways of increasing import through manufacturing, service through skills training and entrepreneurship and innovation can not only bring foreign reserve in the country but also increase domestic employment which will work in line with reducing overdependence in remittance.

Finally, proactive research guided by the central bank in understanding market fluctuations can enable preparation of foreign reserve depletion. Indirect measures such as control of bank lending based on consumer spending patterns can ultimately allow less flight of foreign currency in import expenditures. Research will also back the government decision in differential taxation for different goods.

With the lifting of restrictions and the vaccination drive all over the world, the end of the pandemic is imagined to be closer. In such circumstances, we can assume that the tourism sector will flourish and the foreign reserve lost will circumvent its way back to the government treasury.