
Effectiveness of the Overall Monetary Policy 2082/083 in Promoting Credit Growth

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ABSTRACT

This study provides an analytical review of Nepal Rastra Bank's Monetary Policy for Fiscal Year 2082/83 (2025/26), with a particular focus on credit expansion and the role of quarterly policy reviews in policy adjustment. The research examines the background and objectives of monetary policy in Nepal, key policy instruments adopted during the fiscal year, and trends in private sector credit growth. Using secondary data from Nepal Rastra Bank publications, monetary policy statements, quarterly reviews, and macroeconomic indicators, the study evaluates the effectiveness of monetary policy measures in stimulating credit flow and supporting economic recovery. The analysis shows that although the monetary policy adopted an accommodative stance and ensured adequate liquidity in the banking system, credit growth remained moderate, especially during the early months of the fiscal year.

The study further finds that weak private sector demand, risk-averse lending behavior of banks, slow monetary policy transmission, and structural constraints in productive sectors significantly limited the effectiveness of credit expansion measures. While the quarterly review played a supportive role in stabilizing liquidity conditions, guiding interest rates, and reinforcing policy credibility, its impact on accelerating credit growth was constrained by broader economic uncertainty and confidence-related issues. The study concludes that effective credit-led economic growth in Nepal requires not only accommodative monetary policy but also stronger monetary-fiscal coordination, targeted sectoral incentives, improved risk-sharing mechanisms, and structural reforms to enhance policy transmission and private sector confidence.

Keywords: Monetary Policy; Credit Expansion; Quarterly Review; Nepal Rastra Bank; Policy Effectiveness; Monetary Policy Transmission; Private Sector Credit; Financial Stability; Nepal Economy.

Introduction

Monetary policy refers to the central bank's use of policy tools to regulate money supply, influence interest rates, and ensure financial stability to meet macro-economic objectives such as price stability and economic growth. In Nepal, Nepal Rastra Bank (NRB) is responsible for formulating and implementing monetary policy. The first monetary policy was introduced in 2010 BS which aims to regulate money supply, interest rates, and banking operations. In the early years, policies were mostly basic, focusing on currency issuance, credit regulation, and controlling inflation. After establishment of Nepal Rastra Bank in 2013 BS, the monetary policy is supposed to be more formal and well-focused. This first policy devoted for regulating money circulation in the economy, controlling inflation and maintaining price stability, promoting savings and investment through the banking system and encouraging economic development by regulating credit. At that time, the country was transitioning from a traditional economy to a modern financial system. After that by the 1970s–1980s, NRB began formalizing monetary policy annually, with clear objectives like price stability, credit expansion to productive sectors, banking sector development. Since the 1990s, NRB has issued monetary policies every fiscal year (FY), usually announced in July (Shrawan/Ashad) before the new fiscal year starts. In addition to annual policies, NRB sometimes issues quarterly reviews to adjust monetary measures in response to economic changes (e.g., inflation, liquidity, credit flow). Lastly, NRB with the governance of Dr. Bisow Nath Paudel, has published Monetary Policy in 11th July 2025 and quarterly reviewed in 1st December 2025.

Nepal Rastra Bank Act- 2002 has mandated for announcing Monetary Policy through its act and Monetary Policy- 2025/26 is twenty fourth official monetary policy of Nepal. The fiscal year 2025/26 presented significant economic challenges, including slow investment activity, cautious private sector expansion, and lingering effects of external shocks. The effectiveness of monetary policy in stimulating credit growth during this period warrants rigorous examination. Regarding the current macro-economic situations, NRB has issued the Monetary Policy aiming to control inflation, maintain price stability, ensure financial sector stability, promote economic, growth, regulate credit expansion, maintain balance of payments stability. Among these objectives, here we analyze the role macro-economic adjustments for credit expansion and its impact on it along with understanding view on the quarterly review.

Problem Statement

Credit expansion is a crucial mechanism through which monetary policy influences economic growth and financial stability. In the context of Nepal, the Monetary Policy for FY 2082/83 (2025/26), was designed with several objectives, including the regulation of credit flow to productive sectors. The policy aimed to encourage lending to sectors such as agriculture, small and medium enterprises (SMEs), energy, and tourism, which are critical for sustainable economic development.

Despite the issuance of this Policy and its first quarterly review, Nepal continues to face significant economic challenges. Private sector investment remains cautious, credit growth is slow, and the transmission of monetary policy measures to the broader economy appears limited. Banks hold sufficient liquidity, yet lending to productive sectors has not reached the desired level, partly due to rising non-performing loans and risk-averse behavior. Additionally, external factors such as remittance dependency, import-driven inflation, and global economic uncertainties complicate the effectiveness of policy interventions.

Weighted average interest rates on both deposit and lending are in falling trend as a response to adequate liquidity in the banking sector. The average interest rate on deposits has remained higher than the average inflation rate. The economy is in a position to reap benefit from ample liquidity and the falling interest rates. The financial sector remains broadly stable. However, the context of a rise in non-performing loan ratio and non-banking assets (NBAs) of banks and financial institutions (BFIs) as well as the number of blacklisted borrowers warrant us to be cautious. (Monetary Policy -2025/26)

This study seeks to examine whether the monetary policy and its quarterly review have been effective in stimulating credit growth, supporting productive sector financing, and maintaining financial stability. It also aims to understand the challenges in policy transmission and the practical impact of macroeconomic adjustments introduced in FY 2082/83. However, despite these measures, the actual credit growth has remained sluggish, raising concerns about the effectiveness of monetary policy transmission.

Due to the low short-term interest rates of the BFIs, deposit and lending rates have also been declining. In mid-June 2024, the weighted average deposit rate of commercial banks, development banks, and finance companies were 6.17 percent, 7.07 percent, and 8.28 percent respectively. This rate for the commercial banks, development banks, and finance companies stood at 4.29 percent, 5.02 percent, and 6.09 percent in mid-June 2025. Similarly, the weighted average lending rate of commercial banks, development banks, and finance companies were 10.15 percent, 11.63 percent, and 12.85 percent respectively in mid-June 2024. This rate for the commercial banks, development banks, and finance companies decreased to 7.99 percent, 9.40 percent, and 10.22 percent respectively in mid-June 2025. (Monetary Policy -2025/26)

These challenges indicate a gap between the objectives of monetary policy and its practical outcomes in credit expansion. Therefore, it is essential to investigate how the Monetary Policy FY 2082/83 and its quarterly review have influenced the flow of credit, particularly to productive sectors, and whether the policy measures have been adequate in promoting investment, economic growth, and financial stability.

After around two months of announcement of monetary policy, on August 8 and 9, we suffer from a serious political movement, called Gen Z Movement. Many business firms are destroyed and politics get some new course correction. Due to these movements, will power of entrepreneur is also demoralized and the credit expansion remains trapped.

This study aims to explore the effectiveness, limitations, and impact of monetary policy adjustments on credit expansion, providing insights for policymakers and financial institutions on improving the efficiency of credit distribution in Nepal.

Objectives

As our economy is facing sluggish movement and the monetary policy should be a motor to driven it in a desired motion and path. Does our monetary policy play the key role on this matter? is our major concern. General objective of this study is to analyze the effectiveness of the Monetary Policy for FY 2082/83 and its quarterly review in promoting credit expansion in Nepal, particularly toward productive sectors of the economy. The main objectives of this study are:

- To examine the credit expansion measures introduced in the Monetary Policy FY 2082/83 on overall credit growth in the economy.
- To assess the contribution of the quarterly review in addressing credit slowdown and improving lending conditions.
- To identify the key challenges and constraints faced by banks and borrowers in expanding credit despite policy support.
- To provide policy-oriented suggestions for enhancing the effectiveness of monetary policy in promoting

sustainable credit growth in Nepal.

Literature Review

Monetary policy's influence on credit growth has been extensively studied globally. The theoretical basis lies in the credit-creation function of banks, where central banks influence lending through interest rates, reserve requirements, and liquidity provisions (Mishkin & Eakins, 2018).

In the context of developing economies, credit growth is also sensitive to financial infrastructure, borrower confidence, and sectoral demand (Shrestha, 2019).

The Monetary Policy for FY 2082/83 set an ambitious target of about 12 % credit expansion to the private sector, aiming to stimulate economic activity and support investment in production-oriented sectors such as agriculture, SMEs, tourism, and housing. This target reflects NRB's intention to counteract weak credit demand following years of economic slowdown. (Investpaper+1)

Several analyses note that credit expansion was designed as a central tool for growth under the policy — with lower policy rates and eased lending regulations intended to make credit more accessible and affordable. For example, reducing the bank rate and lowering the interest rate corridor were seen as moves to ease borrowing costs and encourage greater bank lending. (Corporate Nepal+1)

Nepal Rastra Bank (NRB) introduced the Monetary Policy for FY 2082/83 (2025/26) with the primary objective of reviving economic activity through enhanced credit expansion, while maintaining price stability and financial sector soundness. The policy was formulated in response to weak private sector investment, subdued credit demand, and rising risk aversion in the banking sector. The policy adopted a cautiously accommodative stance, targeting approximately 12 percent growth in private sector credit. Key policy instruments included reductions in the policy rate, adjustments in the interest rate corridor, and relaxed credit provisions for productive sectors such as agriculture, small and medium enterprises (SMEs), tourism, and energy. These measures were expected to reduce borrowing costs and stimulate lending activity. (Nepal Rastra Bank [NRB], 2025).

Empirical Findings in Nepalese Context

Monetary policy affects credit through multiple channels:

- **Interest rate channel:** Lower policy rates reduce borrowing costs.
- **Liquidity channel:** Increased liquidity encourages lending.
- **Credit risk channel:** Central bank guidance affects risk perception.

Previous studies report mixed outcomes: while monetary easing often correlates with increased lending, Nepal's credit growth has been inconsistent due to structural issues such as collateral constraints, non-performing loans (NPLs), and limited investment demand.

Methodology

Research Design

This study uses a descriptive and analytical research design combining qualitative narrative and quantitative data analysis.

Data Sources

- **Primary data:** Official monetary policy documents, NRB reports (2082/83).
- **Secondary data:** Academic journals, economic surveys, annual reports of banks.

Data Analysis Tools

- Growth rate calculations
- Trend analysis
- Sectoral distribution comparison

Overview of Monetary Policy 2082/83

Policy Objectives

The Monetary Policy for FY 2025/26 was introduced in a context of slow economic recovery, weak credit demand, and financial sector risks. The major objectives are as follows:

1. **Control Inflation and Maintain Price Stability:** The primary objective of the monetary policy is to control inflation and maintain overall price stability in the economy. Stable prices are essential for protecting purchasing power and ensuring macroeconomic stability.

The inflation was set to contain within 5.0 percent for 2024/25. The average consumer inflation up to mid-June 2025 stood at 4.24 percent. In mid-June 2025, year-on-year (y-o-y) inflation stood at 2.72 percent. (Monetary

Policy -2025/26)

- 2. Promote Credit Expansion to Productive Sectors:** The policy aims to expand credit flow to productive sectors such as agriculture, small and medium enterprises (SMEs), tourism, energy, and manufacturing in order to stimulate investment, output, and employment.
As of mid-May 2025, out of the total outstanding credit of commercial banks, 13.9 percent (Rs. 647.85 billion) was in the agriculture sector; 9.0 percent (Rs. 418.74 billion) in the energy sector, and 10.8 percent (Rs. 503.39 billion) in the micro, cottage, small and medium enterprises sector. Similarly, development banks have 26.4 percent (Rs. 132.88 billion) of their total credit in the agriculture, micro, cottage, and small enterprises, energy, and tourism sectors, while finance companies have 18.8 percent (Rs. 19.06 billion) in these sectors. As of mid-April 2025, out of the total credit of commercial banks, an average of 5.6 percent (Rs. 262.22 billion) credit is in the deprived sector. Likewise, development banks have 7.1 percent (Rs. 36.17 billion) and finance companies have 5.5 percent (Rs. 5.60 billion) of their total credit in the deprived sector. Under the concessional credit program with interest subsidy by the GoN, a Rs. 85.10 billion credit is on outstanding to 98,528 borrowers, as of mid-June 2025. (Monetary Policy -2025/26)
- 3. Support Economic Growth and Recovery:** By adopting a cautiously accommodative stance, the policy seeks to support economic growth and revive sluggish private sector investment without compromising financial stability.
National Statistics Office (NSO) has estimated an economic growth of 4.61 percent for 2024/25. The economic growth rate stood at 3.67 percent in the previous fiscal year. The agriculture sector is expected to grow by 3.28 percent, industrial sector by 4.53 percent, and service sector by 4.21 percent in 2024/25. After two years of contraction in manufacturing, construction, and wholesale and retail sub-sectors, these sectors are expected to expand in 2024/25. As per the latest estimates of the NSO, the economy is estimated to have grown by 4.8 percent in the third quarter of 2024/25. (Monetary Policy -2025/26)
- 4. Ensure Financial Sector Stability:** Another key objective is to maintain stability in the banking and financial system by monitoring liquidity, managing non-performing loans (NPLs), and strengthening risk management practices in banks and financial institutions.
- 5. Improve Monetary Policy Transmission:** The policy aims to enhance the effectiveness of policy transmission, ensuring that changes in policy rates and liquidity conditions are reflected in market interest rates and actual lending behavior.
- 6. Manage Liquidity in the Banking System:** NRB seeks to maintain adequate liquidity in the financial system through tools such as open market operations, interest rate corridor management, and reserve requirements.
- 7. Maintain Balance of Payments Stability:** By regulating credit growth and managing liquidity, the policy also contributes to external sector stability, helping to manage imports, foreign exchange reserves, and balance of payments pressures.
- 8. Encourage Financial Inclusion:** The policy promotes access to finance for underserved sectors and populations by encouraging lending to priority sectors and supporting inclusive banking practices.

Key Policy Measures

- 1. Policy Rate and Interest Rate Corridor Adjustment:** NRB reduced/ maintained a lower policy rate to support economic recovery. The interest rate corridor (Standing Liquidity Facility and Standing Deposit Facility rates) was adjusted to stabilize short-term market interest rates.
The bank rate, which is considered as the upper bound of the interest rate corridor, has been reduced to 6.0 percent from 6.5 percent, while the deposit collection rate, which is considered as the lower bound of the interest rate corridor, has been reduced to 2.75 percent from 3.0 percent. Likewise, the policy rate has been reduced from 5.0 percent to 4.5 percent. (Monetary Policy -2025/26)
Objective: Encourage borrowing and improve credit flow.
- 2. Liquidity Management through Open Market Operations (OMO):** NRB actively used repo, reverse repo, and outright transactions. Excess liquidity was absorbed when necessary, while shortages were addressed promptly.
Objective: Maintain adequate liquidity and stable interest rates.
- 3. Credit Expansion Target:** The policy set a target of around 12% growth in private sector credit. Emphasis was placed on quality credit expansion rather than aggressive lending.
Objective: Stimulate investment while minimizing financial risks.
- 4. Priority Sector Lending:** Banks were encouraged to expand credit to: Agriculture, Small and Medium Enterprises (SMEs), Tourism, Energy and infrastructure. Certain loan limits were revised to improve access to finance.

Objective: Promote productive and employment-generating sectors.

- 5. Relaxation in Selected Lending Provisions:** Some flexibility was provided in: Housing loans, Share-backed loans, SME credit classification

Objective: Improve credit accessibility without encouraging speculation.

- 6. Measures to Address Non-Performing Loans (NPLs):** Banks were directed to: Strengthen loan recovery mechanisms, improve credit risk assessment, Maintain adequate provisioning. The provision of upgrading non-performing loan, which has become regular for six months, to the pass category has been revised through this policy. After revision, such loans must first be classified under the watch-list category for 6 months before it is classified under the pass category.

The loan recovery of the BFIs has been affected due to the economic slowdown in the last two years. The ratio of non-performing loans increased to 5.24 percent in mid-April 2025, compared to 3.98 percent in the corresponding month of the previous fiscal year. However, the minimum capital ratio and liquid assets of the BFIs remain within the regulatory limits. (Monetary Policy -2025/26)

Objective: Ensure financial sector stability and prudent lending.

- 7. Base Rate and Interest Rate Transparency:** Continued implementation of the base rate system. Banks required to ensure transparency in interest rate determination.

Objective: Improve monetary policy transmission.

- 8. Financial Sector Stability and Regulation:** Strengthening of: Capital adequacy, Risk management practices, Supervisory oversight.

Objective: Maintain confidence in the banking system.

- 9. Support for Financial Inclusion:** Encouragement of lending to: Marginalized groups, Rural areas, Small borrowers, Promotion of digital banking and formal financial access.

Objective: Inclusive economic growth.

- 10. Quarterly Review and Policy Flexibility:** NRB committed to reviewing the policy periodically. The first quarterly review (December 2025) maintained an accommodative stance while fine-tuning liquidity and credit measures.

Objective: Respond quickly to changing economic conditions.

Credit Growth Trends in FY 2082/83

Overall Credit Growth

During FY 2025/26, credit growth in Nepal exhibited a moderate and uneven trend, despite the accommodative stance of the Monetary Policy. The policy targeted a revival of private sector credit expansion to stimulate economic recovery; however, actual credit growth remained below policy expectations.

- 1. Overall Credit Growth Trend:** In the initial months of FY 2025/26, private sector credit growth remained sluggish, reflecting weak investment demand and cautious lending behavior by commercial banks. Private sector credit grew only 1.5% compared to the same period last year. The absolute increase was Rs 82.93 billion, and total outstanding credit reached Rs 5,580.64 billion. Although banks possessed adequate liquidity, credit expansion did not accelerate proportionately, indicating a gap between liquidity availability and credit utilization.

As the fiscal year progressed, credit growth showed gradual improvement, particularly after policy rate adjustments and liquidity management measures. Nevertheless, the overall pace of credit expansion remained moderate rather than robust, suggesting limited effectiveness of monetary easing in stimulating borrowing.

- 2. Sector-wise Credit Growth:** Credit growth trends during FY 2025/26 were sectorally imbalanced. Productive sectors such as agriculture, SMEs, tourism, and energy experienced slow but positive growth, supported by priority sector lending provisions. Real estate and housing loans showed relatively better momentum compared to other sectors, though under tighter regulatory oversight. Import-oriented and trading sectors witnessed restrained credit flow due to external sector concerns and regulatory caution. This pattern indicates that while policy measures encouraged productive lending, risk perceptions and demand constraints limited strong sectoral credit expansion.

- 3. Factors Affecting Credit Growth:** Several factors influenced credit growth trends in FY 2025/26:

Risk aversion among banks due to rising non-performing loans (NPLs)

Weak private sector confidence and delayed investment decisions

Slow monetary policy transmission, where reductions in policy rates did not fully translate into lower lending rates

External uncertainties, including global economic slowdown and import-driven inflation

- 4. Impact of Quarterly Review:** The first quarterly review of monetary policy (December 2025) reaffirmed the

accommodative stance and focused on improving liquidity management. While the review helped stabilize interest rates, its immediate impact on accelerating credit growth was limited. Credit expansion remained gradual, indicating that structural and behavioral constraints outweighed short-term policy adjustments.

- 5. Impact of Gen Z Movement:** The mass protests known as the Gen Z movement (often dated to early September 2025, including August 23–24 protests that contributed to unrest) had significant economic repercussions that have important implications for the conduct and effectiveness of Nepal’s monetary policy in FY 2082/83.
 - a. Economic Disruption and Confidence Shock:** The movement led to widespread disruptions in major cities and sectors: infrastructure damage, business closures, and sharp declines in economic activity—especially in tourism and services. This disruption weakened private sector confidence, a key driver of investment and credit demand. Weak demand for loans reduces the effectiveness of monetary policy when the primary mechanism for boosting growth is credit expansion. In such an environment, lower policy rates do not automatically stimulate borrowing if businesses and consumers do not expect stable economic conditions.
 - b. Impact on Revenue and Public Finance:** Economic activity directly affects government revenue. Due to the unrest, revenue collection fell short of targets in early FY 2025/26. By mid-Bhadra (mid-September), revenue collected was Rs 158.71 billion against a target of Rs 218.46 billion, leading to a shortfall of about Rs 59.75 billion. Lower revenue can constrain fiscal policy support and limit the government’s ability to complement monetary easing. This increases pressure on monetary policy to act alone, which is less effective in times of political and economic uncertainty.
 - c. Reduced Investment and Credit Demand:** The protests and resulting instability further discouraged new investment, a critical determinant of credit demand. Many firms postponed investment decisions anticipating continued uncertainty. Tourism and hospitality sectors - previously important borrowers - faced losses and reduced borrowing capacity. This weak demand dampened the passive transmission of monetary easing into increased credit, making the policy less effective in stimulating credit growth.
 - d. Negative Growth and Forecast Revisions:** Major economic forecasts were downgraded due to protest-related disruption. The World Bank and other analysts projected slower GDP growth in 2025 than earlier expected because of the protests and resulting political uncertainty. Slower growth reduces expectations of return on investment, further reducing private borrowing and investment — a condition that monetary policy alone struggles to offset.
 - e. Financial Sector Risk Aversion:** Financial institutions became more risk-averse after the protests. Losses in sectors like tourism and retail increased concern over loan repayment capacity. Banks tightened credit standards, making lending more selective despite accommodative policy settings. This cautious behavior reduces the responsiveness of banks to monetary policy signals (slow transmission), weakening the impact of policy rate cuts or liquidity injections on credit growth.
- 6. Overall Assessment:** Overall, credit growth in FY 2025/26 can be characterized as cautiously improving but below potential. The monetary policy provided a supportive framework for credit expansion, but demand-side weaknesses, financial sector risks, and transmission challenges constrained its effectiveness. Credit distribution across sectors reveals uneven lending patterns. Highlights major sectors.

Period (FY 2025/26)	Credit Growth	Outstanding Credit	Source
Mid-October (Q1)	1.5%	Rs 5,580.64 bn	(HimalPress)
Mid-November	1.2%	Rs 5,562.75 bn	(HimalPress)
Mid-September	1.6%	Rs 5.70 trillion	(Nepse Trading)
Year-on-Year	7.4%	~Rs 5.7 trillion	(Nepse Trading)

Analysis of Policy Effectiveness

The Monetary Policy for FY 2082/83 (2025/26) adopted an accommodative stance with the primary objective of stimulating private sector credit expansion, reviving economic activities, and maintaining macro-financial stability. An assessment of policy effectiveness requires examining the extent to which policy intentions translated into actual credit growth and economic outcomes.

Effectiveness in Stimulating Credit Expansion: Despite policy measures such as policy rate adjustments, flexible liquidity management, and refinancing facilities, credit growth remained moderate rather than expansionary, especially during the early months of the fiscal year. Data indicate that private sector credit growth stood at around 1–1.5% in the first quarter, which is significantly lower than the desired level for accelerating economic recovery.

This suggests that while liquidity conditions improved, the policy was less effective in translating liquidity into credit demand. The weak response highlights a demand-side constraint, where businesses and households remained cautious about borrowing due to uncertain economic prospects.

Monetary Transmission Mechanism: The effectiveness of the monetary policy was further constrained by a slow and incomplete transmission mechanism. Although the central bank eased monetary conditions, commercial banks were slow to reduce lending rates proportionately, limiting the incentive for borrowers to expand investment.

Moreover, banks demonstrated risk-averse behavior, prioritizing asset quality over aggressive credit expansion. Rising concerns over non-performing loans (NPLs) reduced banks' willingness to lend, particularly to productive but risk-prone sectors such as SMEs and agriculture.

Sectoral Impact of Credit Policies: Policy measures aimed at channeling credit toward productive sectors showed mixed results. While some improvement was observed in housing and service-related lending, credit flow to agriculture and manufacturing remained weak. This indicates that policy incentives alone were insufficient to overcome structural barriers such as low profitability, market uncertainty, and weak business confidence.

Thus, the policy was partially effective in influencing the direction of credit but less effective in expanding the overall volume of productive lending.

Role of Quarterly Review: The first quarterly review (December 2025) reaffirmed the accommodative stance and focused on liquidity stabilization. Although it helped prevent interest rate volatility, its immediate impact on accelerating credit growth was limited. This reflects that short-term policy adjustments cannot fully address deeper structural and confidence-related issues affecting credit expansion.

External and Structural Constraints: External factors such as global economic slowdown, weak export performance, and balance of payments pressures also diluted policy effectiveness. Domestically, structural issues including low investment appetite, regulatory rigidity, and limited financial deepening constrained the responsiveness of credit growth to monetary easing.

Overall, the Monetary Policy 2082/83 was moderately effective in maintaining financial stability and liquidity, but less effective in achieving robust credit expansion. The gap between policy intent and actual outcomes indicates that monetary policy alone is insufficient to stimulate credit-led growth without complementary fiscal measures, structural reforms, and confidence-building initiatives.

Constraints to Credit Growth

Despite the accommodative stance of the Monetary Policy for FY 2082/83 (2025/26), private sector credit growth in Nepal remained moderate. Several structural, institutional, and macroeconomic constraints limited the effectiveness of monetary policy in stimulating credit expansion

1. **Weak Credit Demand from the Private Sector:** One of the primary constraints to credit growth was low demand for loans, especially from the productive sectors. Business confidence remained weak due to slow economic recovery, uncertain market conditions, and limited investment opportunities. Many firms preferred to postpone expansion plans, reducing their demand for bank financing even when interest rates softened.
2. **Impact of Gen Z Movement:** The Gen Z movement's economic effects significantly influenced the environment in which the Monetary Policy for FY 2082/83 (2025/26) was implemented. Specifically:
 - It depressed credit demand, limiting the policy's ability to stimulate lending through rate cuts or liquidity support.
 - Financial uncertainty and reduced revenue meant that monetary policy had to work under constraints, without strong fiscal support.
 - Banks increasingly prioritized risk management over credit expansion, undermining policy transmission mechanisms.
3. **Risk-Averse Lending Behavior of Banks:** Commercial banks adopted a cautious lending approach, prioritizing asset quality over credit expansion. Rising concerns about non-performing loans (NPLs) discouraged banks from extending new credit, particularly to small and medium enterprises (SMEs), agriculture, and startups. This risk aversion significantly reduced credit flow to productive but higher-risk sectors.
4. **Slow Monetary Policy Transmission:** Although Nepal Rastra Bank eased monetary conditions, the transmission of policy rate changes to lending rates was slow and incomplete. Banks were reluctant to reduce lending rates proportionately due to concerns about profitability, funding costs, and credit risk. As a result, borrowing costs remained relatively high for potential borrowers.
5. **Structural Weaknesses in Productive Sectors:** Nepal's productive sectors face structural challenges such as low productivity, limited market access, weak infrastructure, and informal business practices. These weaknesses reduce bankability and discourage financial institutions from providing long-term credit, limiting

overall credit expansion.

6. **Regulatory and Collateral-Related Constraints:** Strict collateral requirements and limited availability of credit guarantees constrained access to bank credit. Many potential borrowers, especially SMEs and agricultural enterprises, lacked sufficient collateral or formal documentation, excluding them from the formal credit system despite policy incentives.
7. **External Sector Uncertainty:** External factors such as global economic slowdown, import dependency, and pressure on the balance of payments influenced credit decisions. Banks remained cautious about financing import-oriented activities due to regulatory restrictions and foreign exchange risks, further constraining credit growth.
8. **Limited Effectiveness of Policy Incentives:** While NRB introduced refinancing facilities and priority sector lending provisions, utilization remained below potential. Procedural complexity, limited awareness, and risk concerns reduced the effectiveness of these incentives in stimulating broad-based credit expansion.

Therefore, the constraints to credit growth in FY 2082/83 were largely non-monetary in nature, indicating that monetary policy alone cannot drive strong credit expansion. Structural reforms, improved investment climate, enhanced credit guarantee mechanisms, and coordinated fiscal support are essential to complement monetary easing.

Role of Quarterly review

Quarterly reviews of monetary policy play a crucial role in enhancing the flexibility, responsiveness, and effectiveness of monetary policy implementation. In Nepal, Nepal Rastra Bank (NRB) uses quarterly reviews as an interim policy instrument to reassess macroeconomic conditions and fine-tune monetary measures without waiting for the next annual policy cycle.

1. Role in Policy Adjustment

a. Responding to Changing Macroeconomic Conditions. Quarterly reviews allow NRB to respond promptly to changes in key macroeconomic indicators such as inflation, liquidity conditions, credit growth, interest rates, external sector performance, and financial stability risks. Since these variables can change rapidly, quarterly reviews help bridge the gap between policy formulation and economic realities.

b. Liquidity Management Adjustment: One of the most important roles of the quarterly review is the adjustment of liquidity management tools, including:

- Open market operations (OMO)
- Standing liquidity facility (SLF)
- Repo and reverse repo operations

By recalibrating these tools, NRB can address excess liquidity or liquidity shortages, thereby stabilizing short-term interest rates and supporting orderly credit flow.

c. Fine-Tuning Credit-Related Measures: Quarterly reviews provide scope for:

- Revising refinancing facilities
- Modifying credit ceilings or risk-weighted provisions
- Clarifying priority sector lending guidelines

Such adjustments help align credit flow with evolving sectoral needs and risk conditions.

Role in Strengthening Monetary Policy Transmission: Quarterly reviews improve the **transmission mechanism** by signaling the central bank's policy stance clearly and consistently. Regular communication through reviews:

- Anchors market expectations
- Guides banks' interest rate decisions
- Enhances transparency and predictability

This reduces uncertainty and improves confidence among financial institutions and investors.

Implications for Credit Expansion: In FY 2082/83, the quarterly review reinforced the accommodative stance of monetary policy amid **sluggish credit growth and weak private sector demand**. While the review helped:

- Stabilize interest rates
- Improve liquidity conditions

its impact on accelerating credit expansion was **limited**. This indicates that quarterly reviews are more effective in **correcting short-term imbalances** than in overcoming deeper structural constraints affecting credit demand. The Nepal Rastra Bank (NRB), in its first quarterly review of the fiscal year 2025/26 Monetary Policy, adopted a flexible stance by lowering the rates in its interest rate corridor. The standing liquidity facility (SLF) rate, which is the upper limit, has been reduced from 6.00 percent to 5.75 percent, and the policy rate has been cut from 4.50

percent to 4.25 percent. The NRB also removed the mandatory provision that institutional fixed deposit rates must be at least one percentage point lower than individual fixed deposit rates.

Financial Stability Implications: Quarterly reviews also play a preventive role in safeguarding **financial sector stability**. By monitoring:

- Non-performing loans (NPLs)
- Credit concentration
- Asset price trends

NRB can introduce corrective measures early, reducing systemic risk. This balance between growth support and risk containment is critical in a fragile economic environment.

Limitations of Quarterly Reviews: Despite their importance, quarterly reviews have certain limitations:

- They cannot address structural economic weaknesses such as low investment confidence or productivity constraints.
- Their effectiveness depends heavily on fiscal coordination and political stability.
- Frequent adjustments may create uncertainty if policy signals are inconsistent.

Discussion

While monetary policy provided the necessary framework for credit expansion, its effectiveness was curtailed by structural and behavioral factors. The policy was more effective in improving liquidity and stabilizing markets than in generating robust credit growth.

Policy Recommendations

Based on the analysis of monetary policy effectiveness, credit growth trends, and constraints observed during FY 2082/83, the following policy recommendations are proposed to enhance the effectiveness of monetary policy in promoting sustainable credit expansion and economic growth.

1. Strengthen Monetary Policy Transmission: Nepal Rastra Bank should improve the transmission mechanism by ensuring quicker pass-through of policy rate changes to lending rates. This can be achieved by:

- Enhancing transparency in base rate and lending rate calculations
- Encouraging competitive interest rate pricing among banks
- Strengthening the interbank market to improve rate signaling

Expected Outcome: Lower and more responsive lending rates, stimulating credit demand.

2. Demand-Side Credit Stimulation: Given weak private sector demand, monetary easing alone is insufficient. Coordinated measures are needed to stimulate borrowing, such as:

- Targeted **interest rate subsidies** for productive sectors
- Credit guarantee schemes for SMEs and startups
- Risk-sharing mechanisms between banks and the government

Expected Outcome: Increased borrowing confidence and expanded access to credit.

3. Sector-Specific Credit Incentives: NRB should refine priority sector lending policies by:

- Offering enhanced refinance facilities for agriculture, manufacturing, energy, and tourism
- Linking credit incentives to productivity and employment outcomes
- Simplifying procedures for accessing refinancing windows

Expected Outcome: Improved allocation of credit toward productive and employment-generating sectors.

4. Address Risk Aversion in Banking Sector: To reduce excessive risk aversion:

- Introduce partial credit guarantees for high-impact sectors
- Improve credit information systems to reduce information asymmetry
- Strengthen loan restructuring frameworks for viable borrowers

Expected Outcome: Greater willingness of banks to extend credit without compromising asset quality.

5. Improve Collateral and Financial Inclusion Framework: NRB should promote alternative collateral mechanisms such as:

- Movable asset-based lending
- Warehouse receipt financing
- Expanded use of credit scoring and digital financial data

Expected Outcome: Increased credit access for SMEs, farmers, and informal businesses.

6. Enhance Role of Quarterly Reviews: Quarterly reviews should be more **outcome-oriented** by:

- Explicitly linking policy adjustments with credit growth targets
- Publishing impact assessments of previous measures
- Using data-driven thresholds for automatic policy adjustments

Expected Outcome: Improved policy responsiveness and accountability.

7. Strengthen Monetary–Fiscal Coordination: Monetary policy effectiveness depends on fiscal support. Therefore:

- Government should accelerate capital expenditure
- Align fiscal incentives with monetary credit objectives
- Avoid policy inconsistencies that dampen investor confidence

Expected Outcome: Stronger investment environment and effective credit-led growth.

Overall Recommendation: A balanced approach combining monetary easing, structural reforms, risk-sharing mechanisms, and fiscal coordination is essential to overcome credit constraints and enhance the effectiveness of monetary policy in Nepal.

1. **Strengthen credit guarantee schemes** to mitigate risk.
2. **Enhance monetary transmission** by improving interest rate pass-through.
3. **Promote financial literacy** to improve borrower confidence.
4. **Coordinate with fiscal policy** to stimulate investment demand.
5. **Targeted interventions** for sectors with high growth potential.

Conclusion

The monetary policy of 2082/83 had a **moderate positive influence** on credit growth but fell short of achieving strong expansion. While liquidity improved and priority sector lending increased, overall performance was dampened by weak demand, risk-averse behaviors, and structural challenges. Future policy design should integrate broader economic incentives and strengthen transmission mechanisms.

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