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Post-COVID-19 Economic Conditions in Nepal and Political Instability

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## Post-COVID-19 Economic Conditions in Nepal and Political Instability

By Dr Bikram Timilsina

[ANALYSIS](#)



Although politicians claimed [political stability](#) was the driving force behind the new Constitution in 2015, Nepal has witnessed six changes of government in the last seven years. Economic recovery, from both the devastating 2015 earthquakes and the COVID-19 pandemic, [will be a long](#) process.

The November 2022 Nepali elections are over now, and a new federal government has been formed with the Maoist leader Pushpa Kamal Dahal as the prime minister. The Nepali Congress, the Communist Party of Nepal (CPN) (Maoist Centre), the CPN (Unified Socialist), Loktantrik Samajwadi Party Nepal, and Rastriya Janamorcha – the coalition partners in the government – decided in August 2022 to form a pre-election alliance called the Democratic-Left Alliance. Although the Nepali Congress became the largest party in the parliament, the CPN (Maoist Centre) was not ready to support the Congress leader, Sher Bahadur Deuba, to be the prime minister. The CPN (United Marxist Leninist) supported the CPN (Maoist Centre), the third-largest party, to form the government. Consequently, the pre-election alliance has been wrecked, and the new alliance is perceived to have been founded on fragile grounds. This is because the new alliance, like the earlier one, is neither ideologically cohesive, nor formed to achieve a certain national goal. The projection, therefore, is that political instability will likely continue, driving down expectations about the future of the country's economic health.

The devastating earthquake of April 2015 has played a tragic role in contributing to these economic hardships, with the [immediate impact](#) costing as much as half of Nepal's GDP. In FY2019/20, the COVID-19 pandemic further damaged the slowly recovering economy, which [contracted](#), for the first time in four decades, by 1.9 percent. Moreover, the ongoing Russia-Ukraine war has had [direct repercussions](#), and [2021](#) and [2022](#) were turbulent years domestically as the political crises deepened.

According to [data](#) from the central Nepal Rashtra Bank (NRB), lifting of the COVID-19 restrictions elevated domestic demand, which drove economic growth in 2021 by 4.01 percent. Although growth in FY2021/22 is estimated to be 5.8 percent, the World Bank [projects](#) that it will decrease to 5.1 percent in FY2022/23 and 4.9 percent in FY2023/24. The newly appointed finance minister, Bishnu Prasad Paudel, recently said that the country had reached a [disappointing stage of economic growth](#). He added that he was

identifying the troubles ahead before bringing out concrete plans and programs. At closer inspection, it is not too hard to figure out the problems the Nepali economy is facing.

According to the annual [Macroeconomic and Financial Situation reports](#) published by the NRB, with the exception of FY2020/21, inflation has risen consistently in the last five years. Inflation was 4.6 percent in FY2018/19 and 6.32 percent in FY2021/22. It has reached 7.38 percent in FY2022/23, based on the data from the first five months. The Russia-Ukraine war has further [escalated domestic inflation](#), which has resulted in [more expensive commodities](#) such as fuel, food, and transportation.

Nepal has witnessed a massive decline in economic activity in the post-pandemic era. There has been a [dramatic decrease of 34.6 percent](#) in exports in FY2022/23 so far. During the same period, imports also shrunk by 20.7 percent. In addition, the country's [agricultural production](#) declined from 2.8 percent in FY2020/21 to 2.3 percent in FY2021/22. These declines have contributed to a more general fall in foreign reserves and revenues respectively, with further reductions in GDP growth expected – exacerbated by the reduction in agricultural production.

[Reports](#) show that the fiscal position of the country has been trending in a continuous deficit over the past two decades. Nepal's [trade deficit](#) between FY2003/4 and FY2019/20 has skyrocketed 13-fold, which has also been impacted by the COVID-19 pandemic. According to the [NRB](#), while there was a deficit of ₹180 billion (A\$194 million) in FY2018/19, this amount increased to ₹260 billion in FY2021/22. The [outstanding government debt](#) as of mid-July 2022 was ₹2011.58 billion, which is 41.5 percent of total GDP. The share of the foreign debt is 51 percent. There was a deficit of US\$2 billion in balance of payments in the FY2021/22. This all presents a gloomy picture for Nepal's economy.

There are, however, some positive trends. The [increase in remittances by 13.1 percent](#) in FY2022/23 is a silver lining, which is up from 2.2 percent from the last year. Gross foreign exchange reserves have increased to [US\\$9.82 billion](#) from \$9.54 billion last fiscal year. It is, however, also important to note that a [million more Nepalis have left the country](#) for overseas employment in the last three years. Although this will increase remittances and foreign exchange reserves, this may depress the country's economy by encouraging people to buy imported goods while discouraging domestic production.

The government's [restriction on the import of luxury goods](#) from April to December

2022 helped increase foreign reserves, but it also resulted in [reduced revenue](#). The ban was lifted last month to meet new conditions set by the International Monetary Fund. That said, the continuity of the ban would have further [hurt the trade and economy](#) of the country. This import-dependent and remittance-driven nature of the economy will no doubt continue to strain the national economy.

According to the [2022 Index of Economic Freedom](#) published by the Heritage Foundation, except for the year 2020, Nepal's economic freedom score has been decreasing since 2017, falling from 55.1 to 49.7 in 2022.. Higher economic freedom scores are associated with [higher prosperity](#). The country's economy sits at a low 148th on the freedom scale, its classification has been downgraded from "Mostly Unfree" to "Repressed." The [index](#) measures economic freedom based on factors such as property rights, government integrity, judicial effectiveness, government spending, tax burden, fiscal health, business freedom, monetary freedom, and investment freedom. The index notes that the Nepali economy is lightly taxed, and investment and financial freedoms are very low. This indicates that a lack of economic freedom has made it difficult to achieve greater economic prosperity. This situation is, in fact, very frustrating for both foreign and domestic investors.

The trends of an increasing trade deficit, decreasing foreign exchange reserves, and increasing inflation have battered the economic health of the country and economic life of the people. Though the devastating earthquakes of 2015, COVID-19 pandemic, and the Russia-Ukraine crisis have contributed to this bleak economic situation, a [lack of good governance and apathy by the state](#), fuelled by political instability, are no less responsible for this depressing picture of the national economy. Thus, how stable the newly formed government will be, how effectively it will operate its governance system, and what level of willpower it will show to improve the economic conditions going forward, will largely determine the future of Nepal's economy.

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