ALPHA CAPITAL
Fund for Contrarian Investors

NEWSLETTER

Second Quarter 2082/83

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INSIDE

HOW WE VIEW

How We View | Economy

The September 8–9 Gen Z–led unrest took a heavy toll on Nepal's already weakening economy. Industrialists were already grappling with low confidence prior to the protests; however, as the movement escalated into widespread vandalism, looting, and arson, confidence among industrialists and entrepreneurs deteriorated further. A government committee assessment found that the unrest inflicted physical damage amounting to around NPR 84.45 billion, affecting thousands of buildings and vehicles nationwide, and projected that approximately NPR 36 billion will be needed to rebuild public infrastructure. The resulting uncertainty and losses have directly weakened business sentiment, contributing to sluggish credit demand and subdued loan growth in the banking sector.

The economy is now flush with excess liquidity, characterized by record-high reserves and decade-low interest rates. Despite this, banks remain hesitant to lend due to rising non-performing assets (NPAs) and impairment charges that continue to weigh on profitability. Compounding these challenges, Nepal's efforts to exit the Financial Action Task Force (FATF) grey list have yet to succeed, a process that requires the country to demonstrate sustained improvements in anti–money laundering and counter-terrorism financing frameworks, as well as effective enforcement and regulatory oversight.

Nevertheless, Fitch Ratings reaffirmed Nepal's 'BB-' rating with a Stable Outlook, highlighting strong external liquidity and foreign-exchange reserves covering 18 months of payments. While constrained by structural weaknesses like low GDP per capita, governance challenges and vulnerability to natural disaster, the Stable Outlook implies these credit strengths continue to outweigh risks, supporting Nepal's access to international financing.

Fiscal Stance (Amounts in Lakhs)

Topic	Target Budget (FY 2082/83)	Actual up to Q2 End FY 2082/83	Percentage (FY 2082/83)	Target Budget (FY 2081/82)	Actual up to Q2 End FY 2081/82	Percentage (FY 2081/82)
1. Revenue	14,800,000	5,773,999	39.01%	14,193,030	5,596,074	39.43%
a) Tax Revenue	13,255,839	5,161,151	38.93%	12,842,096	4,893,992	38.11%
b) Non-Tax Revenue	1,544,161	612,848	39.69%	1,350,934	702,082	51.97%
2. Grants	534,469	71,069	13.30%	523,265	73,706	14.09%
3. Other Receipts	0	40,074	0.00%	0	77,899	0.00%
Total Receipts of GoN	15,334,469	5,885,142	38.38%	14,716,295	5,747,679	39.06%
Total Expenditure	19,641,100	6,902,154	35.14%	18,603,030	6,676,019	35.89%
a. Recurrent	11,809,800	4,871,431	41.25%	11,406,645	4,520,030	39.63%
b. Capital	4,078,880	494,254	12.12%	3,523,540	569,350	16.16%
c. Financing	3,752,420	1,536,469	40.95%	3,672,845	1,586,639	43.20%

Source: FCGO

Comparing Nepal's second-quarter budget execution with that of the previous fiscal year, the government increased both revenue and expenditure levels by approximately 3.18% and 3.39%, respectively; however, the proportion of overall annual targets achieved declined, with tax revenue being the only major category to show a marginal improvement in target achievement, rising from about 38.11% to 38.93% year-on-year. In response to the post-unrest environment, the interim government has prioritized the reconstruction of damaged infrastructure and the conduct of timely elections, reinforcing a policy stance centered on institutional and political stability.

Major dissatisfaction has arisen regarding the state of capital expenditure, particularly as development spending has contracted precisely when it is most needed to stimulate the economy. Despite the government increasing the capital budget target to NPR 407.89 Billion this fiscal year—up from NPR 352.35 Billion previously—actual utilization has paradoxically declined. By the end of the second quarter, spending stood at only NPR 49.43 Billion (12.12%), a sharp drop compared to the NPR 56.94 Billion (16.16%) recorded during the same period last year. This slowdown reflects a strategic pivot prioritizing stability and fiscal discipline over expansion. To correct inefficiencies, the administration cancelled "sick" contracts—including 25 stalled road and 22 irrigation projects—and is now restricting funding exclusively to non-delayed projects that demonstrate accountability and tangible progress.

Monetary Stance

NPR in Billion

Indicator	As of Poush end FY 2082/83	As of Poush end FY 2081/82	% Change
Total Deposits	7,662	6,734	14%
Total loan	5,762	5,435	6%
CD Ratio	74.37	79.43	-6%
Inte Bank Rate	2.75%	3.00%	-8%
Treasury Bill			
28 Days (As of Dec 30, 2025)	2.19%	2.75%	-14%
91 Days (As of Dec 30, 2025)	2.36%	2.80%	-18%
182 Days	2.29%	2.81%	-19%
364 Days	2.58%	2.94%	-12%

Source: NRB

At the beginning of the year the Central bank proposed meaningful 12% credit growth for the private sector aiming to stimulate economic growth on its monetary policy. But halfway through the year, the credit growth has only reached half of what was targeted (6%) from quarter to same quarter previous year(but only 3% after the year end of 81/82 BS). Although the banking sector are plenty of loanable funds, as seen in the deposit growth of 14%, the credit demand of the public is merely nothing. This is evident from the decrease in the CD ratio of the banking sector by 6%. The banks have also parked NPR 621 billion on Central bank through open market instruments. This clearly shows that banks are facing challenges to channel loans from the deposits. To address increasing Non-Performing Assets (NPAs), slow dues collection, and a stagnant real estate market, banks have started issuing non-cumulative preference shares to institutional investors to increase their capital base and risk appetite. The depth of this liquidity surplus is further reflected in market rates: the interbank rate has stayed pinned to the lower bound of the Interest Rate Corridor (IRC) for an extended period. When viewed alongside the simultaneous decline in Treasury Bill rates, it is evident that banks are struggling to manage excess liquidity as they search for safe, yet scarce, lending opportunities.

Macroeconomic Indicators

Indicator	As of Mangsir FY 2082/83	As of Mangsir FY 2081/82	Y-O-Y Change
Inflation	1.63%	6.05%	-73.06%
Export (in billion)	116.51	73.66	58.17%
Import (in billion)	766.19	661.49	15.83%
Trade Deficit	649.68	587.83	10.52%
Export to Import	15.21%	11.14%	36.56%
Travel Income (in billion)	33.97	35.19	-3.47%
Travel Payment (in billion)	88.97	85.01	4.66%
Remittance (in billion)	870.31	640.43	35.89%
Forex Reserve in USD ($)	22.13	16.76	32.04%
Forex Reserve Sufficiency (in Months)	18.20	14.60	24.66%

Source: NRB

As of the end of Mangsir in FY 2082/83, Nepal's macroeconomic conditions show a notable easing of domestic price pressures on paper alongside a strengthening of external sector buffers. Inflation declined sharply to 1.63% year-on-year, a reduction of more than 73% compared to the previous fiscal year. While this supports household purchasing power, it also signals subdued domestic demand amid cautious private-sector activity.

On the external front, exports rose significantly by 58.17% to NPR 116.51 billion, outpacing the 15.83% growth in imports to NPR 766.19 billion. This improvement lifted the export-to-import ratio to 15.21%, up from 11.14% a year earlier, indicating a modest but meaningful improvement in trade competitiveness. Nevertheless, the trade deficit widened by 10.52% to NPR 649.68 billion, underscoring the continued structural dependence on imports and the scale of the export base relative to domestic consumption and investment needs.

Remittance inflows remained a key pillar of external stability, increasing by 35.89% to NPR 870.31 billion, providing strong support to household income, consumption, and foreign exchange liquidity. This was reflected in a substantial buildup of foreign exchange reserves, which rose by 32.04% to USD 22.13 billion, extending reserve sufficiency to 18.2 months of imports.

In contrast, travel income declined by 3.47% to NPR 33.97 billion, while travel payments increased by 4.66%, indicating a net outflow in the services account and highlighting the need to further strengthen tourism receipts and value-added services. Overall, the data point to an economy that is externally resilient but domestically cautious, with strong remittance-driven liquidity and reserve accumulation offset by weak inflation momentum and a still-elevated trade gap. Sustaining this stability will require policies that translate external strength into productive domestic investment, particularly through export diversification, tourism sector recovery, and improved credit transmission to the real economy.

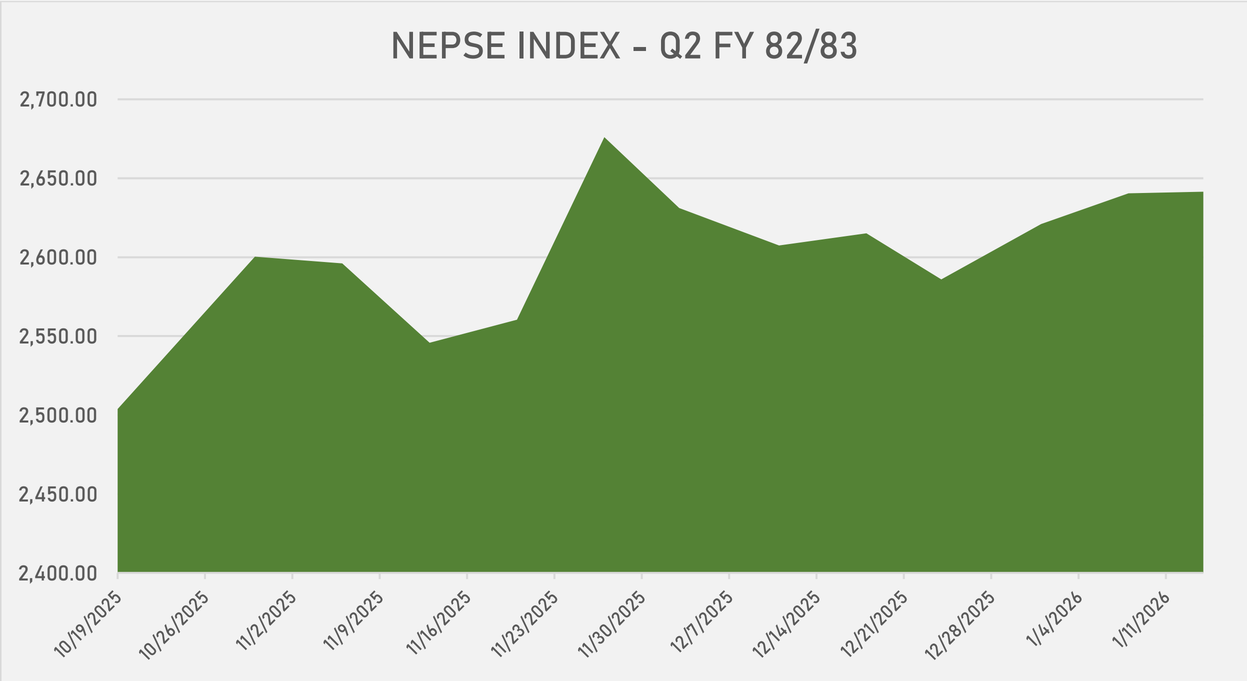
Conclusion

Amid a challenging macroeconomic environment, the government has undertaken targeted reforms to strengthen trade governance and align taxation practices with international standards. Measures such as the introduction of a new customs valuation system, stricter penalties for customs fraud, and ongoing efforts to modernize cross-border trade procedures—particularly with India—aim to improve transparency, reduce revenue leakages, and enhance export competitiveness, signaling a commitment to restoring institutional credibility.

At the same time, steps to ease overseas investment rules for Nepali IT firms reflect a push to integrate the digital services sector into global markets and diversify sources of foreign earnings. Together, these initiatives underscore the government's focus on stability, accountability, and long-term confidence-building as foundations for sustainable economic recovery.

How We View | Capital Market

The NEPSE index remained largely steady during the second quarter, opening at 2,503.85 and moving cautiously amid selective investor participation. It reached a brief high of 2,676.03 in late November, but the momentum was not sustained, keeping the market range-bound for much of the quarter. Sentiment improved slightly toward mid-January, with the index closing at 2,641.43, an increase of 154.26 points, or 6.20%, from the previous quarter's close of 2,487.17.



Sector Wise Sub-Indices	This Quarter Close	Previous Quarter Close	Change %
Finance	2,423.26	2161.7	12.10%
Manufacturing & Processing	8,821.31	7057.22	25.00%
Micro Finance	4,888.18	4685.17	4.33%
Hydro	3,382.09	3147.74	7.45%
Trading	3,810.00	3692.66	3.18%
Investment	102.09	100.44	1.64%
Development Bank	5,577.85	5270.31	5.84%
Others	2,357.74	2231.59	5.65%
Non- Life Insurance	10,949.02	10484.79	4.43%
Banking	1,369.44	1337.71	2.37%
Hotel and Tourism	7,044.37	5930.17	18.79%
Life Insurance	12,867.38	12066.3	6.64%
NEPSE Index	**2,641.43**	**2487.17**	**6.20%**

Source: NEPSE official website

Sectoral Dissection

Banking Sector

The banking sector continued to face challenging conditions this quarter, with excess liquidity, weak credit demand, and rising pressures on asset quality. Nepal Rastra Bank (NRB) stepped in to support lending by raising overdraft limits, increasing loan ceilings for microfinance institutions, and allowing targeted rescheduling for struggling borrowers. These measures give banks the flexibility they need while encouraging credit flow.

Despite these measures, credit growth remained subdued, with a large volume of surplus liquidity parked at the central bank through deposit collection auctions and other instruments. Interest rates on deposits and loans continued to trend downward as banks adjusted to excess liquidity and limited private-sector demand for borrowing amid economic and political uncertainty. Asset quality pressures persisted, with non-banking assets increasing due to recovery challenges and subdued real-estate activity. In this context, the Supreme Court's interim relief allowing banks and financial institutions to sell non-banking assets without prior government approval has provided timely support for balance-sheet management. Overall, while regulatory easing provided some relief, banks continued to face challenges in reviving credit growth and managing the rising pressures of recovery.

Hydropower

This quarter, the hydropower sector made significant progress through major project approvals and the finalization of long-standing investment frameworks. The Investment Board Nepal (IBN) advanced capacity expansion by granting full investment approval to the 439 MW Betan Karnali project and moving the 669 MW Lower Arun project through the draft production license stage, representing semi-reservoir and storage developments. The long-awaited 1,200 MW Budhi Gandaki project also finalized its investment structure under a 70:30 debt-to-equity model, with 80 percent government and 20 percent NEA ownership.
Meanwhile, agreements were signed to construct two 400 kV cross-border transmission lines—Inaruwa–New Purnea and Lamki–Bareilly—strengthening bilateral power trade infrastructure, while Bangladesh increased its seasonal import quota to 60 MW. These developments underscore the sector's strategic role in enhancing long-term energy capacity, boosting export potential, and reinforcing investor confidence in the market.

Tourism Sector

The tourism sector showed a steady recovery in the second quarter, with overall visitor numbers remaining resilient despite modest growth. According to the NTB report, tourist arrivals were slightly above last year's levels through December, while arrivals from major markets like India and China declined slightly. Other regions, including Europe, the Middle East, and North America, recorded steady gains, reflecting varied trends as the industry rebuilds momentum.

To improve accessibility to remote destinations, the government revised the restricted-area permit for the Upper Mustang region, replacing the previous flat fee with a more flexible US$ 50 per day charge for foreign trekkers. This change aims to boost tourism while preserving cultural and environmental safeguards.

Regulatory oversight was also strengthened, with the Department of Tourism issuing a 12-point directive for casinos. The directive requires biometric identification, detailed reporting, and stricter controls for high-value transactions to align with international anti-money-laundering standards. These developments reflect ongoing efforts to balance sector growth with security and sustainability as tourism rebounds.

Microfinance

The microfinance sector saw regulatory easing as Nepal Rastra Bank moved to support credit growth amid an economic slowdown. The ceiling for collateral-based loans was raised from NPR 700,000 to NPR 1.5 million, alongside updated guidelines that included revised loan restructuring provisions. Under the new framework, performing loans rescheduled for the first time require 12.5% provisioning, while other active loans must maintain 25%. For loans classified as Sub-standard, Doubtful, or Loss, the existing higher provision must be maintained and cannot be reduced until the restructured loan has remained regular for two consecutive years. These measures aim to strengthen financial discipline, reduce systemic risk, and support sustainable growth.

Insurance Sector

The insurance sector showed a mixed but resilient performance despite economic challenges. Non-life insurers achieved modest growth by expanding their business across regions, while life insurers maintained steady sales and stable premium collections during the review period.

Regulatory oversight strengthened as the Nepal Insurance Authority directed all insurance entities, including life, non-life, microinsurance, and reinsurance companies, to adopt mandatory digital payment systems for all transactions, including claim settlements and payouts. This initiative enhances transparency and curbs money laundering risks. These developments reflect ongoing efforts to ensure operational integrity and align the industry with evolving regulatory expectations.

This quarter, the real estate sector has seen a positive policy development, as the government introduced a regulation requiring companies to obtain a brokerage license for property transactions exceeding NPR 30 million in metropolitan and sub-metropolitan cities under the amended Land Revenue Act, 1977. The rule applies to company-to-company and individual-to-company deals, with license fees of NPR 500,000 for transactions up to NPR 50 million and NPR 1 million for higher amounts. Introduced in line with FATF and APG recommendations, the policy aims to curb money laundering and has been welcomed by entrepreneurs for enhancing transparency and regulation in the sector.

In the long run, this regulatory move is expected to bring greater discipline to the real estate market, reduce informal transactions, and support a more transparent and sustainable property sector in Nepal.

Nepal's real estate market has shown signs of recovery since Mangsir, bouncing back after months of slowdown caused by protests, loan delays, and office disruptions. This resurgence reflects renewed confidence in the sector and has brought positive momentum to market activity and government revenue.

Infrastructure Development

Narayanghat–Butwal Road Update

Construction to widen the 114-km Narayanghat–Butwal section of the East–West Highway, originally slated for completion by mid-2024, has now been pushed back to mid-2026, primarily due to repeated landslips along the problematic 14-km Daunne stretch. The project aims to improve road safety and connectivity, addressing long-standing transport challenges outside Kathmandu.

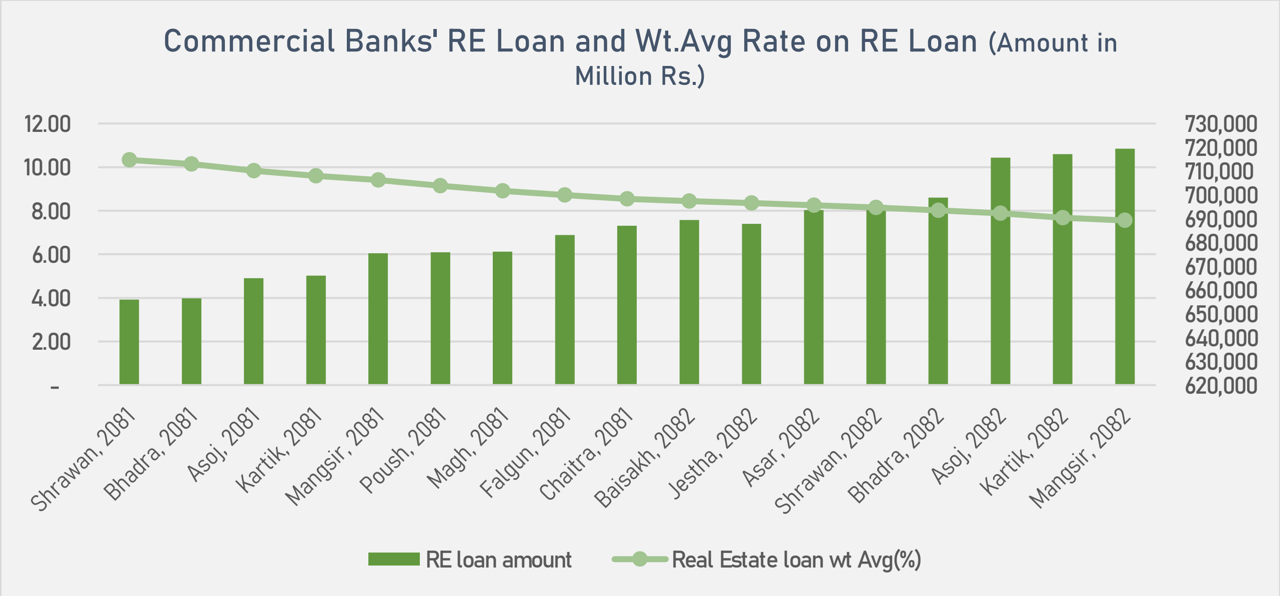
Kathmandu–Terai/Madhesh Expressway (National Pride Project)

The Nepali Army says the 70.98 km Kathmandu–Tarai Expressway will be completed by mid-April 2027 within the estimated NPR 213 billion cost. So far, 43.6% physical and 44.7% financial progress has been made. Over 87 bridges and 5 tunnels remain, with breakthroughs achieved in two. Once finished, the expressway will be the shortest route between Kathmandu Valley and central Tarai, cutting travel time significantly.

MCC-Nepal Road Contracts

MCA-Nepal signed $23.66 million in contracts: $20 million with Sharma–Kumar JV to upgrade 40 km of Dhankhola–Lamahi road using full-depth reclamation and superpave technology, and $3.66 million with Intercontinental Consultants for consulting services for supervision of upgrading this road and design and construction supervision for periodic maintenance of the Narayanghat to Mugling road section.

Banking and Finance



Source: NRB

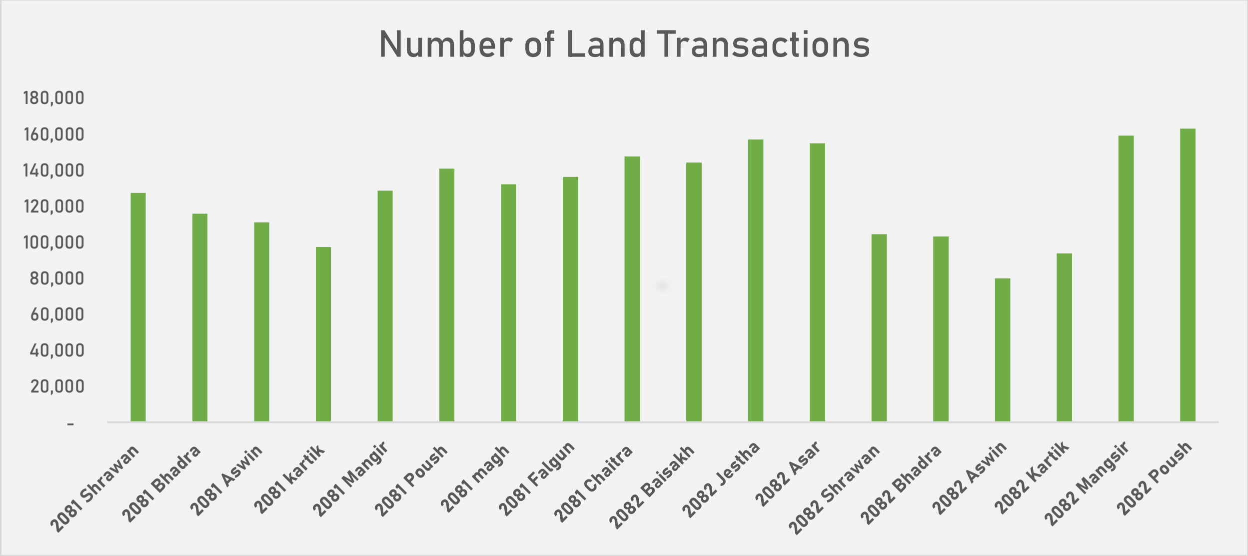
Due to several easing measures by the Nepal Rastra Bank, interest rates have declined, and the LTV ratio for first-time homebuyers has been raised to 80%, with the loan ceiling increased from NPR 20 million to NPR 30 million, signaling a stronger focus on retail investors and encouraging homeownership. On a year-on-year basis, Residential Personal Home Loans have grown by 11.74%, reflecting rising demand from individual borrowers taking advantage of favorable financing conditions, while the broader real estate sector has contracted by 1.02%, indicating that investment in larger property and land projects remains cautious amid economic and political uncertainties. Overall, comparing both segments, loan growth stands at around 6%, suggesting a gradual, consumption-driven normalization in Nepal's housing market rather than a speculative property boom

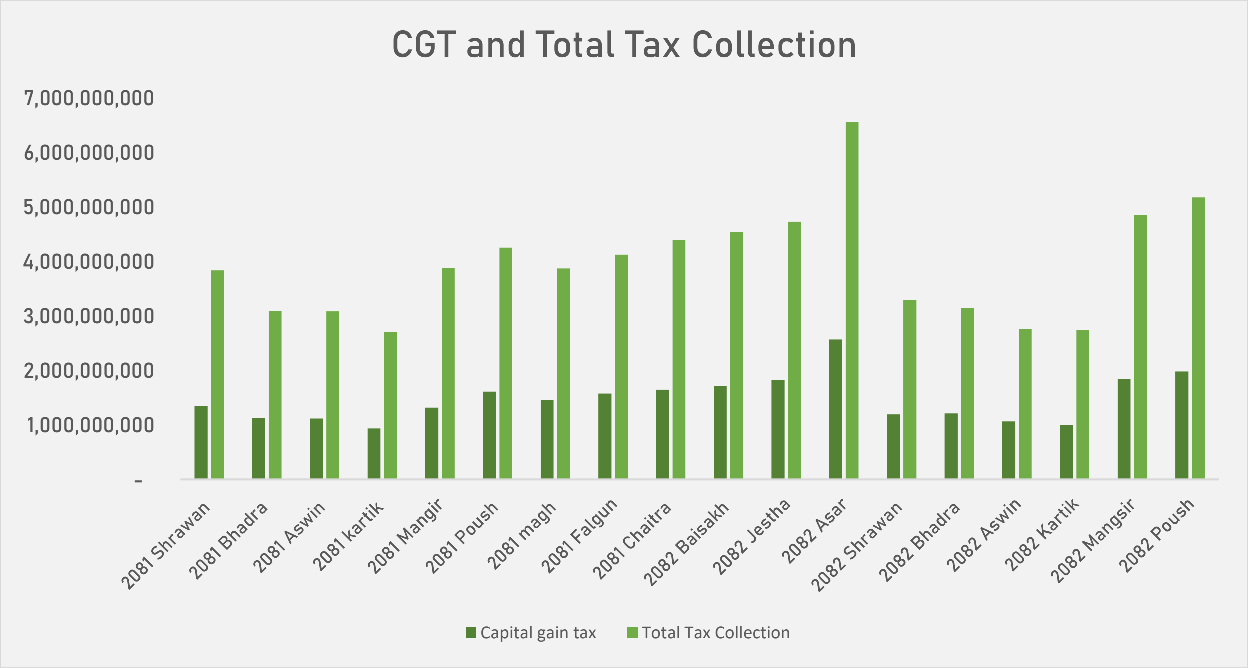
Transaction Records

Time	Number of Transactions	CGT	Total Tax collection
2082 Kartik	93,669	997,844,392	2,745,172,199
2082 Mangsir	158,899	1,838,957,178	4,848,154,832
2082 Poush	162,877	1,981,844,014	5,173,214,222

Time	Number of Transactions	CGT	Total Tax collection
2081 Kartik	97,196	937,791,820	2,704,046,645
2081 Mangsir	128,382	1,316,343,714	3,874,826,976
2081 Poush	140,621	1,608,328,172	4,252,221,779

Source: DOLMA





Source: DOLMA

In the year-on-year comparison, Nepal's real estate sector has demonstrated a notable fiscal recovery, with total tax collection rising by 22% (reaching Rs 21.95 billion in the first six months of the current fiscal year) and capital gains tax increasing by 23%. This financial growth is anchored by a 15.83% increase in transaction volumes, a surge largely attributed to the government's strategic decision to reopen land plotting (Kitta Kat). By amending the Land Use Regulations to allow for the subdivision of parcels, the government has reactivated the supply of smaller, residential-ready plots, directly meeting pent-up consumer demand.

Despite this quantitative growth, the market sentiment remains bifurcated. Banks are increasingly eager to provide retail loans to individual homebuyers, viewing residential mortgages as stable assets to deploy excess liquidity. However, both lenders and institutional investors maintain a rigid caution toward large-scale commercial real estate and land projects due to persistent economic and political uncertainties

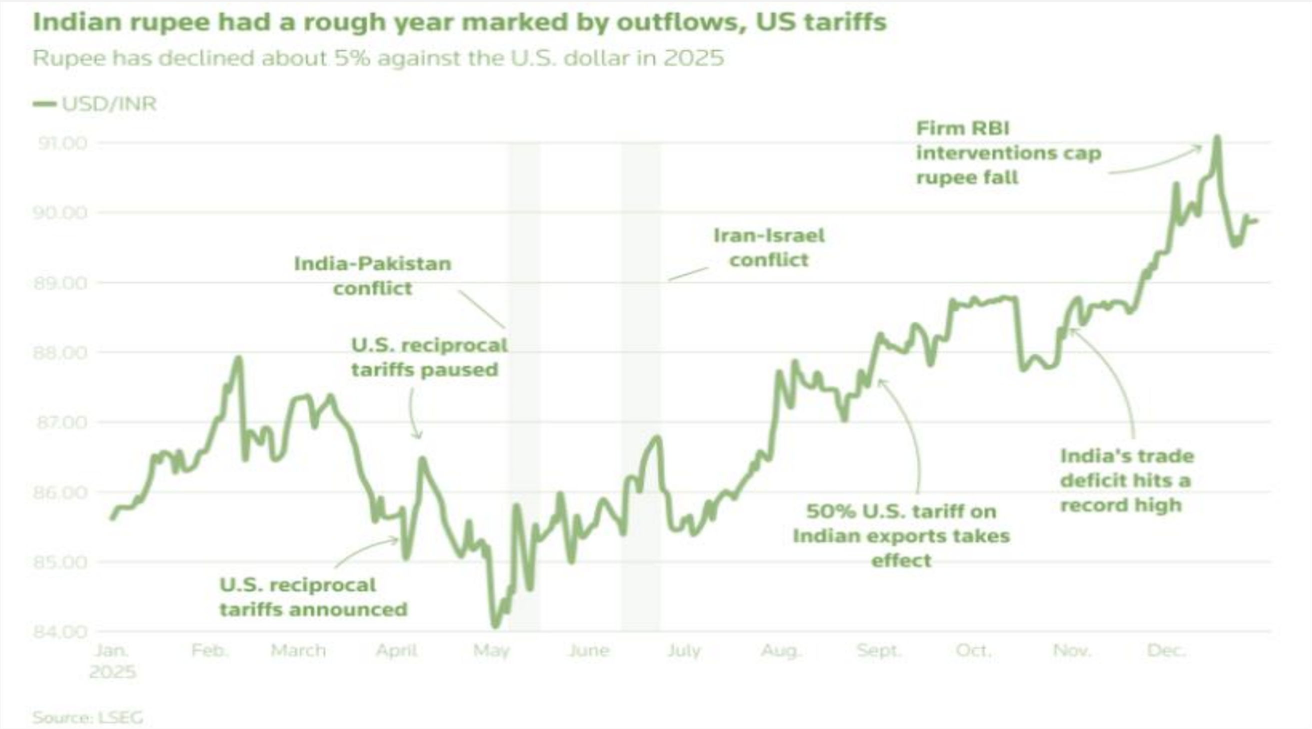
THIS QUARTER

FOCUS

This Quarter Focus | The Indian Rupee Is Depreciating Against the US Dollar - but What Does It Mean for Nepal?

The resurgence of tariff-driven trade policy under the renewed President Donald Trump's "America First" agenda has once again altered global trade and currency dynamics. In August 2025, the United States imposed a 25 percent reciprocal tariff on selected Indian exports. Within days, an additional 25 percent tariff was announced on certain product categories, with limited exemptions, effectively raising the tariff's burden to as high as 50 percent, citing reason as India's continued purchase of Russian oil and its sizable trade surplus with the United States. While these actions were framed as bilateral trade corrections, their impact extended beyond trade flows, feeding into currency markets and capital movements.

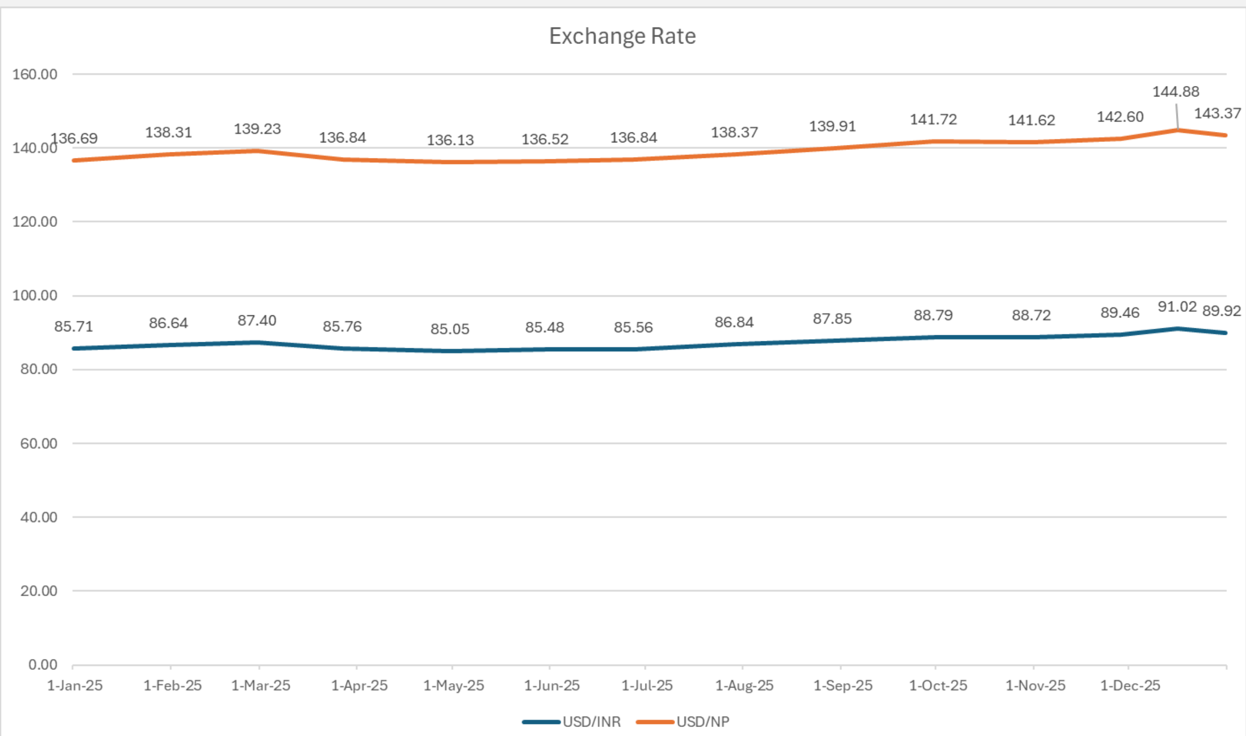
After a relatively stable period of two to three years, the Indian Rupee came under renewed pressure in 2025. From May onward, the currency entered a sustained depreciating trend, reflecting a combination of trade uncertainty, reduced export competitiveness in the US market (because of tariffs), capital outflows, and broad global dollar strength. Pressure intensified toward the end of the year, with the rupee breaching the INR 90 per USD level multiple times in December. On December 16, 2025, it touched INR 91 per USD, before closing the year at INR 89.8—an annual depreciation of 4.72 percent and its weakest performance since 2022. Over a twelve-month period, the depreciation approached around 6 percent on high.



Source: Reuters

But why does it matter most for Nepal? While such movements are often analyzed primarily through India's domestic macroeconomic conditions, their significance is magnified in Nepal due to the structure of its exchange-rate regime. The Nepali Rupee is pegged to the Indian Rupee, and Nepal does not maintain an independent exchange rate vis-à-vis the US dollar. As a result, any appreciation or depreciation of the INR against the USD is automatically transmitted to the NPR, regardless of Nepal's own economic fundamentals. In practical terms, Nepal does not choose its dollar exchange rate; it inherits it. When the Indian Rupee weakens against the US dollar, the Nepali Rupee weakens automatically, even if nothing has changed inside Nepal's domestic economy. Nepal is therefore best understood as a passenger, not a driver, in the exchange-rate system.

This arrangement has been in place since 1993, with the NPR currently fixed at 1.6 per INR. While India operates under a managed floating exchange-rate regime, Nepal effectively imports India's currency movements against the dollar. The indirect linkage between the NPR and the USD is therefore structural rather than incidental. Exchange-rate data illustrate this clearly: as the dollar appreciated against the INR during 2025, it also appreciated against the NPR in near lockstep, confirming Nepal's passive exposure to external currency shocks originating outside its borders.



Sources: NRB and RBB

A weakening currency, however, is not inherently harmful. In export-oriented economies with huge manufacturing bases and flexible supply capacity (e.g. China), depreciation can improve competitiveness and stimulate export growth. Even in countries with trade deficits, export-focused sectors may benefit as firms earn more domestic currency for each dollar of foreign revenue. In Nepal, this effect is visible in narrow segments such as IT services and freelance exports, where earnings are largely dollar denominated. For these sectors, depreciation increases rupee income for the same volume of foreign contracts. Whether depreciation ultimately benefits or harms an economy, however, cannot be assessed by exchange-rate movements alone. What matters is how an economy trades, how much it trades, and with whom it trades. This leads to a broader analysis of Nepal's trade dynamics.

Nepal's trade structure fundamentally limits its ability to benefit from currency depreciation. The economy is predominantly import-based (i.e. How do we trade?); a reality clearly reflected in its long-term trade patterns. Over the past five decades, Nepal's trade deficit has widened persistently. While the deficit accounted for roughly 25 percent of total trade around 50 years ago, it has now expanded to around 70–80 percent, underscoring Nepal's growing dependence on foreign goods and services. In simple terms, Nepal consistently buys far more from the rest of the world than it sells. This imbalance is not confined to merchandise trade alone. Nepal also runs a persistent deficit in the services account, driven by payments for education, transport, insurance, health, and financial services that exceed earnings from tourism and other service exports. In FY 2081/82 (2024/25), the services deficit stood at NPR 90.04 billion, while the merchandise trade deficit reached NPR 1,527.09 billion, highlighting the scale and persistence of Nepal's external imbalance. Because international trade in goods and services is predominantly invoiced and settled in foreign currencies, especially the US dollar, these deficits translate directly into recurring demand for foreign exchange.

Measured relative to the size of the economy (i.e. How much we trade?), the imbalance becomes even more pronounced. According to Nepal Rastra Bank, total international trade in FY 2081/82 amounted to about 34.1 percent of GDP. Exports accounted for only 4.5 percent of GDP, while imports reached around 29.5 percent, resulting in a trade deficit close to 25 percent of GDP. In effect, for every NPR 100 of domestic value added generated, Nepal earned only NPR 4.5 from exports but required imports worth almost NPR 29.5. The gap must therefore be financed through non-trade inflows (such as remittances, capital inflows, and external borrowing) rather than export earnings. The imbalance was even more severe in FY 2075/76 (2018/19), when the trade deficit reached approximately 38.31 percent of GDP.

Nepal's external vulnerability is further reinforced by extreme concentration in its trading partners (i.e. With whom we trade?). On the import side, approximately 86.6 percent of total imports originate from just five countries, with India accounting for nearly 60 percent and China about 18 percent. On the export side, more than 81 percent of Nepal's exports are destined for India. Other major destinations—such as the United States (6.6 percent), Germany (1.6 percent), the United Kingdom (1.1 percent), the UAE (1.0 percent), and China (0.95 percent)—collectively account for most of the remaining exports, with these six markets together covering around 92.5 percent of Nepal's total export value. Such geographic concentration limits diversification and reduces resilience to external shocks. Over the past three years, exports have accounted for only around 10.3 percent of total trade on average, indicating limited production depth and insufficient capacity to scale up exports in response to currency depreciation. Moreover, the dominance of India as Nepal's primary export destination further weakens the depreciation channel. A large share of exports to India is invoiced and settled in Indian Rupees under the fixed peg, significantly further limiting any gain from depreciation against the US dollar. The composition of trade compounds this constraint. Nearly 48 percent of Nepal's exports to India consist of refined soybean oil, where raw materials are imported and invoiced in US dollars while exports are settled in Indian Rupees. Although this trade benefits from tariff concessions under SAFTA, it exposes Nepal to significant currency mismatch and exchange-rate risk. On the import side, petroleum products, Nepal's single largest import category are sourced almost entirely from India but priced in line with global crude oil markets denominated in US dollars. As a result, when the INR weakens against the USD, Nepal's import bill rises sharply without a compensating increase in export earnings, transmitting inflationary pressure into the domestic economy.

These outcomes can be explained through the elasticity framework, although its application in small, pegged import-dependent economies is inherently constrained. Nepal's export elasticity is low due to limited diversification and supply constraints, while import elasticity is also low because imports consist largely of essential goods whose demand is relatively insensitive to price changes. When the sum of export and import elasticities is less than one, currency depreciation raises the domestic cost of imports without improving the trade balance. Under Nepal's fixed exchange-rate regime, this constraint becomes binding: depreciation amplifies costs rather than facilitating external adjustment.

The costs of depreciation extend beyond trade into Nepal's external debt structure. As of mid-December 2025, Nepal's outstanding external debt stood at approximately NPR 1.49 trillion, with over 92 percent effectively linked to the US dollar, either directly or through SDR denomination. Although only about one-fifth of the debt is explicitly denominated in USD, nearly three-quarters are denominated in SDRs, whose value is heavily influenced by movements in the dollar. On the creditor side, multilateral institutions account for more than 90 percent of Nepal's external debt, with the International Development Association (IDA) alone comprising nearly half, followed by the Asian Development Bank (ADB) and the International Monetary Fund (IMF). Although these loans are largely concessional, they nonetheless expose Nepal to foreign-currency repayment obligations. As a result, depreciation automatically increases the NPR value of outstanding debt and debt-servicing obligations, even without any new borrowing. The magnitude of this effect is not merely theoretical. Between mid-July to mid-November, and by mid-December 2025, exchange-rate movements alone added approximately NPR 44.22 billion and NPR 77.67 billion respectively to Nepal's public debt burden, intensifying fiscal pressure and foreign-exchange demand simultaneously.

Thanks to remittances, Nepal still bridges a significant portion of its trade and services deficits. With a narrow export base and weak net travel earnings, remittances averaging around 25–26 percent of GDP, continue to be Nepal's largest source of foreign currency. While depreciation does not increase remittance inflows in dollar terms, it raises their rupee conversion value, easing near-term balance-of-payments pressure and providing temporary liquidity support. However, this gain is largely arithmetical rather than real. Most remittance income is spent on import-intensive consumption, meaning higher NPR receipts are quickly offset by imported inflation. Moreover, remittances are not highly responsive to exchange rate movements; their volume depends primarily on overseas employment conditions, wage growth, migration policies, and global economic stability.

Underlying these dynamics are India's own dollar flows. In FY 2024, India recorded a trade surplus of roughly USD 45 billion with the United States when goods and services are combined. At the same time, around 86 percent of India's total trade is invoiced in US dollars, even though the US accounts for only 9–11 percent of India's total trade. This invoicing structure makes India's foreign exchange market highly sensitive to developments affecting dollar inflows and outflows. Tariffs on Indian exports weaken dollar earnings, while capital outflows—for example, foreign institutional investors sold around USD 18 billion of Indian equities in 2025—along with rising gold imports and overseas education payments, sustain strong dollar demand. Together, these forces exert downward pressure on the Indian Rupee, an outcome that Nepal inherits mechanically through the exchange-rate peg.

Taken together, the evidence leads to a conclusion. For Nepal, INR depreciation against the US dollar does not function as an adjustment mechanism. Under a fixed exchange-rate regime, low trade elasticities, high import dependence, USD-linked debt, and concentrated trade patterns, depreciation manifests as higher inflation, rising debt burdens, increased foreign-exchange demand, and pressure on reserves. Remittances soften the impact but do not resolve the structural imbalance. Currency depreciation, in Nepal's case, operates not as a tool for competitiveness, but as a transmission channel for external shocks—making it a structural macroeconomic cost rather than a source of economic adjustment.