Determinants of Money Supply in Nepal

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INTRODUCTION: The Federal Democratic Republic of Nepal is one of the least developed nations in the world. Following a long history of political instability due to Maoist insurgency and governmental instability as well as a 7.9 earthquake in 2015, Nepal's potential for growth has been disastrously slow. Reports from the World Bank Group, the International Monetary Fund, and the Asian Development Bank indicate that stronger governmental stability is necessary along with stimulated spending and investment in order to progress. The central bank of the country, Nepal Rastra Bank (NRB) implements the monetary policies in Nepal- which is a significant factor when it comes to interest rates, level of investments, as well as monetary behavior of consumers as well as other private sectors.

PURPOSE: The purpose of this study is to add to the literature available about the monetary composition of the Nepalese Economy not just by recreating an older paper with more data but also by offering more updated analysis about the non-numerical factors affecting the results of the model.

METHODS: This paper analyses the major money supply determinants in Nepal from 1960 to 2019. Data on Foreign Assets, Domestic Assets, Currency Reserves, Time Deposit Reserves, Reserve Money, Demand Deposits, Narrow Money supply, and other data values have been extracted from the Quarterly Economic Bulletin published by NRB on their website every January, April, July, and October. For the purpose of this paper, the month of July for each year has been chosen. Net Foreign Assets and Net Domestic Assets are taken as the main components of the Base Money while the Money Multiplier has been taken as a function of Currency to Demand Deposits, Reserve to Total Deposits, and Time to Demand Deposits. Then, Money Supply is taken as the function of Base Money and the Money Multiplier. Lastly, based on the results from the model, analysis is made regarding which determinants are the most impactful on Money Supply.

RESULTS: The paper finds the Reserve to Demand Deposits ratio to be negatively impacting the Money Multiplier while the Currency to Demand Deposit ratio was positively impacting the Money Multiplier. Time Deposits to Demand Deposits ratio was found to be insignificant to the multiplier based on the model set up. On the other hand, both Net Foreign Assets and Net Domestic Assets explained variability in the reserve money significantly and positively. Changes in Net Foreign Assets increase the Reserve Money by a proportionate amount twice as much as the change in Net Domestic Asset would.

CONCLUSION: Recommendations made to the central bank of Nepal, NRB, are such that controlling Money Supply should be done with the following as key players: reserve ratio, foreign assets, and currency in circulation in the public.