



# BHUTAN

September 2024

## 2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR BHUTAN

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2024 Article IV consultation with Bhutan, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its September 9, 2024, consideration of the staff report that concluded the Article IV consultation with Bhutan.
- The **Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on September 9, 2024, following discussions that ended on June 4, 2024, with the officials of Bhutan on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on August 2, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Bhutan.

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**International Monetary Fund**  
**Washington, D.C.**



# BHUTAN

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

August 2, 2024

### KEY ISSUES

**Context.** Bhutan achieved significant improvements in social conditions during the last decade, raising living standards. Poverty and inequality have declined, while extreme poverty has been eliminated. However, the pandemic hindered economic development, and external shocks and domestic policies have prevented a more robust recovery and resulted in large external imbalances leading to a sharp decline in reserves and placing pressure on the exchange rate peg.

**Outlook and Risks.** Growth is projected to accelerate over the medium term as a large hydro-project is commissioned and capital spending is boosted with the support of external grants. Pull factors are expected to slow down emigration, thereby reducing pressures on the supply side. Risks remain elevated including downside risks from commodity prices' increases, slippages on hydro-projects, and vulnerabilities to climate change. There is also significant uncertainty related to the authorities' crypto-mining operations.

**Main Policy Recommendations.** Policies need to be geared towards reducing domestic and external imbalances to support the exchange rate peg, as well as to rebuild policy buffers. Specifically:

**Fiscal Policy.** A gradual fiscal consolidation based on revenue mobilization and accompanied by some spending restraint is needed to increase fiscal space and to reduce reliance on external grants in the longer term. The implementation of the goods and service tax is a key component of such adjustment.

**Monetary and Exchange Rate Policy.** Monetary policy ought to be tightened to protect the peg and support a gradual buildup of reserves. In the medium term, the authorities need to move towards a well-functioning domestic liquidity management framework.

**Financial Sector Policies.** While financial stability indicators have improved, loan deferrals granted during the pandemic mask underlying vulnerabilities. New guidance and regulations have been introduced to address poor credit quality, but policies should continue to be normalized and remaining vulnerabilities need to be addressed.

**Other Policies.** Structural policies should focus on fostering high-quality private sector jobs, as well as diversifying exports. There is scope to strengthen the Royal Monetary Authority's (RMA) governance framework, as well as to step up AML-CFT efforts. Improvements in data quality have been significant, but further actions are needed to address remaining weaknesses. These include a need for greater transparency on crypto assets operations.

Approved By  
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**(APD) and Boileau**  
**Loko (SPR)**

A mission visited Thimphu, Bhutan on May 21–June 4, 2024. The staff team comprised Enrique Flores Curiel (head), Cristian Alonso, Dinar Prihardini and Ranil Salgado (resident representative, all APD). Mr Anand Singh (OED) joined the concluding meetings. Tommy Lee and Anggia Sinjar (both APD) assisted the team.

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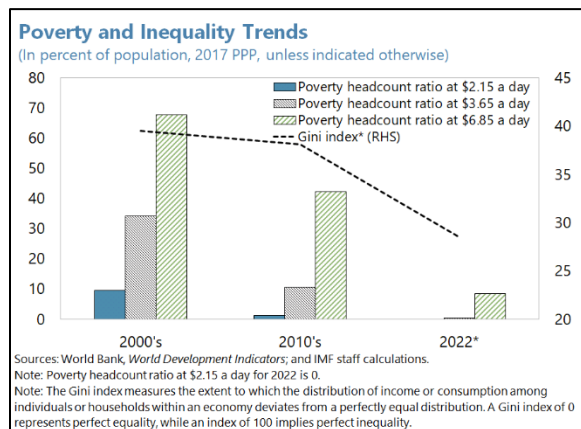
## CONTEXT

### 1. Bhutan's social conditions have improved significantly during the last decade.

Sustained growth increased gross national income per capita, lifting living conditions and—by 2022—eliminating extreme monetary poverty.<sup>1</sup>

Multidimensional poverty declined from 5.8 percent of the population in 2017 to 2.1 percent in 2022. All indicators across the three dimensions—health, education, and living standards—show a decline in poverty.<sup>2</sup> Inequality also declined, with improvements in both the Gini coefficient as well as the income share held by the lowest quintile. The UN assessed that Bhutan met the thresholds for the Human Assets Index and national income per capita to graduate from Least Developed Countries (LDC)

category in 2015 and 2018, and graduated Bhutan in December 2023. These are important achievements for a small land-locked country, with a population of about three-quarters of a million.



### 2. Bhutan has a long-standing history of taking a leadership role in environmental conservation and climate change action.

The 2008 Constitution provides that the government of Bhutan shall ensure that a minimum of sixty percent of Bhutan's total land shall be maintained under forest cover for all time. Climate change is covered by a range of national policies and the country's engagement under the United Nations Framework Convention on Climate Change. Across all strategies and policies, Bhutan commits consistently to remain carbon neutral. Bhutan is one of the 36 biodiversity hotspots in the world as assessed by Conservation International and Critical Ecosystem Partnership Fund.

### 3. The pandemic hindered economic development, but strong policies limited its health impact.

The government closed Bhutan's international borders in March 2020, instated lockdowns, and pursued an aggressive vaccination campaign.<sup>3</sup> The pandemic's economic impact was mitigated by a strong fiscal stimulus package, as well as accommodative monetary policy and regulatory forbearance, which limited the impact on consumption. Nonetheless, output declined by about 10¼ percent in 2020. Moreover, the pandemic affected Bhutan's main exports: tourism faced a 2½ year closure of Bhutan's borders (opening in Q4 2022) and hydro-electric projects suffered from important delays. As a result, employment and tourism are yet to recover to pre-crisis levels.

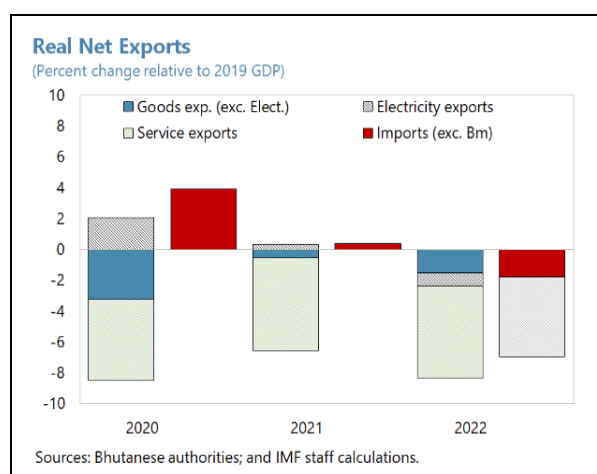
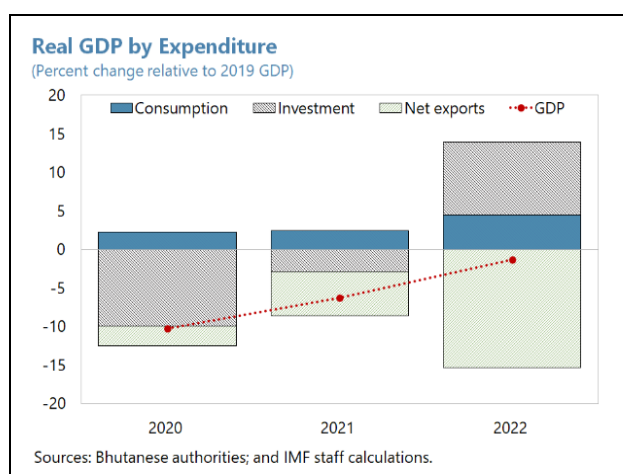
<sup>1</sup> Extreme poverty measure at US\$2.15 a day (2017 PPP). The headcount poverty using the national poverty line stood at 12.4 percent in 2022.

<sup>2</sup> A report by the National Statistics Bureau on the [Multidimensional Poverty Index 2022](#) provides a detailed analysis.

<sup>3</sup> Appendix 1 of the [2022 Staff report](#) provides a detailed description of the COVID-19 policy response.

**4. External shocks and domestic policies hindered a more robust recovery and depleted policy buffers.** Economic growth in 2021 and 2022 averaged 4.8 percent, driven by a strong recovery in investment which exceeded pre-pandemic levels in 2022. The increase in commodity prices, following Russia’s invasion of Ukraine, drove up import prices and hindered the demand for non-tradables. The sharp increase in the Sustainable Development Fee (SDF)—a tax on tourism—likely prevented a speedier recovery of tourism.<sup>4</sup> Fiscal policy remained expansionary, with a deficit of 7 percent of GDP in FY2021/22. Moreover, the use of reserves to finance a large investment in crypto assets mining led to a sharp decline in reserves.

**5. Securing diverse sources of growth that provide quality employment opportunities while preserving Bhutan’s long-term commitment to environmental sustainability remains a key medium-term challenge.** Growth and productivity have concentrated on a few sectors—like hydro-power-based electricity generation—and most employment remains in low productivity sectors. Addressing these challenges remains a top priority for the country.



## RECENT DEVELOPMENTS

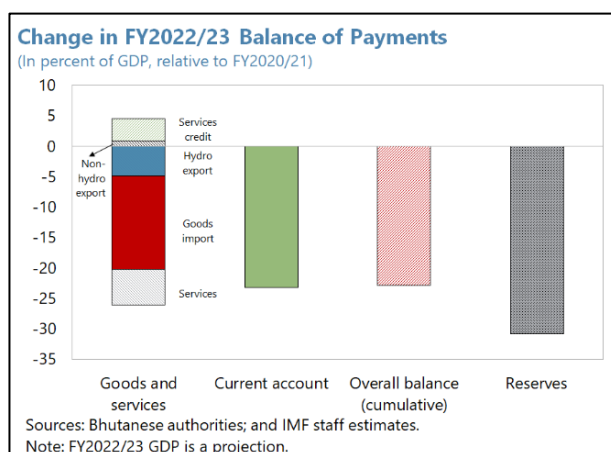
**6. Growth is expected to have remained subdued during 2023 while inflation resurfaced in the second half of the year.** Output likely exceeded pre-crisis levels as employment showed continued improvement, albeit unemployment remained above pre-pandemic levels in part due to higher labor force participation. Growth was likely below the 5.2 percent achieved in 2022, driven by several factors. From the supply side, large-scale emigration—particularly of high-skilled working age people, and policies to curb imports hindered a more robust recovery. On the demand side, factors limiting growth include fiscal restraint in FY2022/23 and the likely low capital spending execution during the second half of 2023. On the other hand, the sharp increase in public sector wages implemented in June 2023 boosted demand and placed pressure on prices. While inflation was moderate in the first half of 2023—averaging 3.7 percent—it accelerated to an average of

<sup>4</sup> The SDF was increased from \$65 to \$200 per day in June 2022 for tourists from countries other than India, ahead of the re-opening of tourism in September 2022. At the same time, an SDF of INR1,200 (\$14) per day was introduced for Indian tourists. The SDF for non-Indian tourists was later decreased to \$100 in September 2023.

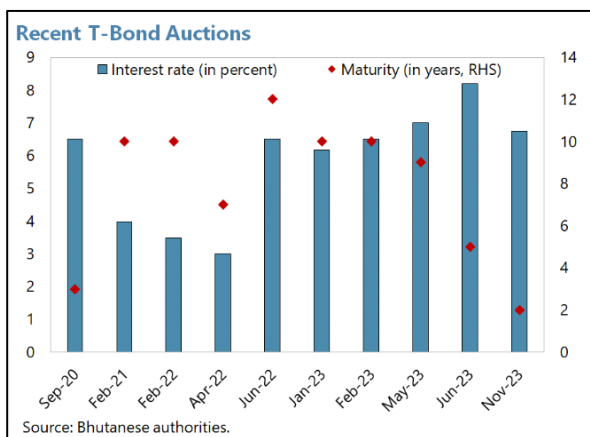
4.7 percent in the second half of 2023 driven by domestic components as imported inflation remained low.

**7. Crypto mining led to large balance of payments pressures.** In 2022, Druk Holding Company and Investments (DHI)—a state-owned company—started a crypto assets mining operation. The investment was financed through a US\$539 million loan (19 percent of GDP) from the RMA—drastically reducing their reserve holdings—and involved sizable imports of crypto assets mining machines. Pressures on the balance of payments resulted not only from these imports, but also from lower electricity exports as domestic demand, including from crypto mining, ramped up. In August 2023, a Singapore-based company also began crypto mining operations in Bhutan. However, DHI’s exposure to these operations is limited, ameliorating the impact on reserves (Box 1).

**8. In part due to large external imbalances, reserves declined sharply, placing pressure on the exchange rate peg.** The current account deficit (CAD) widened to around 30 percent of GDP in FY2021/22 and FY2022/23. While the crypto mining operations played an important role, additional factors contributed to such a large increase. These include a drop in tourist arrivals due to COVID-19-related border closures (borders were reopened only at end-September 2022) and a sharp increase in tourism fees which slowed the recovery. At the same time, there was a jump in services imports due to high levels of emigration, as residents migrated to pursue higher education. Reserves, which stood at US\$1,332 million (15.6 months of imports) in June 2021, fell to a historic low of US\$505 million (3.9 months of imports) at end-October 2023. They recovered somewhat to \$609 million (4.7 months of imports) by end-May 2024, owing to continued recovery in tourism and non-hydro exports, as well as a jump in inward remittances.



**9. While the fiscal deficit has declined, it remains high.** At 4.8 percent of GDP in FY2022/23, the fiscal deficit remains elevated even if it has declined from an average of 6.4 percent of GDP in the previous two years.<sup>5</sup> The improvement is driven by the post-COVID-19 pandemic economic recovery and a degree of restraint on current expenditure. Undersubscription of the last three T-bond auctions, as well as their increasing rates and declining maturities, reflect lower domestic liquidity. Non-hydro debt rose to 45 percent of



<sup>5</sup> It also represented a major improvement compared to the initial budget estimate of 11.3 percent of GDP.

GDP at the end of FY2022/23, up from 25.5 percent of GDP before the pandemic.<sup>6</sup> A 50-percent increase in the minimum wage scale for public sector workers, complemented by additional increases for specific groups, was announced in June 2023 to dampen attrition in the civil service. This further compounded fiscal pressures despite partial temporary financing through an exceptional crypto dividend for two years. Moreover, the implementation of the Goods and Services Tax (GST) is still pending, largely due to setbacks in the procurement process of the new IT system for revenue administration, exacerbated by recent attrition in the Department of Revenue and Customs.

**10. Financial sector balance sheets have improved, but vulnerabilities remain.** At end-March 2024, capital adequacy ratios stood at 17 percent and gross non-performing loans (NPLs) including write-offs declined to 8.4 percent of total loans (from 12 percent in 2019). However, pandemic-related forbearance measures remained in place until June 2024, masking financial sector risks. Credit growth accelerated to 19 percent at end-June 2023, exceeding its pre-pandemic pace, driven by housing and education loans. Credit concentration risks to large borrowers and the housing sector have intensified. Strong credit growth and slower growth in deposits have reduced liquidity.

**11. A new administration took office in late January 2024.** The leader of the People's Democratic Party, Tshering Tobgay, began his second term as Prime Minister after winning the national assembly elections on January 9<sup>th</sup>.<sup>7</sup> His electoral platform focused on rebuilding the economy by accelerating energy projects, attracting FDI and improving the business environment to foster private sector growth and boosting youth employment—including upgrading education and skills. It also envisaged an Economic Stimulus Plan (ESP) worth Ngu 15 billion (5.8 percent of GDP).

**12. An ambitious 13<sup>th</sup> Five Year Plan (FYP) will run from FY2024/25 to FY2028/29.**<sup>8</sup> It centers on Prosperity, People, and Progress, and aims to achieve the longer-term goal for Bhutan to become a high-income nation by 2035. India has announced their support for the 13<sup>th</sup> FYP in the amount of Ngu 85bn, providing space for a significant acceleration in capital expenditure.

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<sup>6</sup> The fiscal year in Bhutan runs from July to June.

<sup>7</sup> He was Prime Minister from 2013 to 2018.

<sup>8</sup> The Minister of Finance presented the 13<sup>th</sup> FYP to Parliament in June 2024, but the document is yet to be published.

### Box 1. Bhutan's Crypto Assets Mining Investment

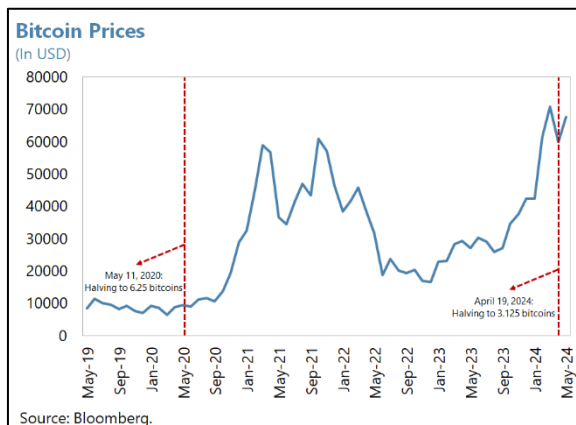
**State-owned Druk Holdings and Investment (DHI) has invested in crypto assets mining.** Given its access to low-cost hydropower and cool-climate conditions, Bhutan has a comparative advantage in crypto assets mining. Mining, mainly of bitcoin, at DHI's 420 MW facility began in 2022. It continued to expand in August 2023, as Bitdeer Technologies Group, a Singapore-based company, began crypto assets mining in Bhutan (100 MW). A second Bitdeer mine (500 MW) is under construction and is expected to begin operations in mid-2025.

**DHI's initial investment was funded using a loan from the Royal Monetary Authority (RMA).** Between August 2020 and April 2022, the RMA acquired dollar-denominated securities issued by DHI totaling US\$539 million. In contrast, DHI's exposure to Bitdeer's operations are limited to the sale of electricity to the facilities through a power purchase agreement. Bitdeer pays a premium relative to other high voltage domestic consumers, with the tariff being broadly in line with the average tariff under the power purchase agreements with India.

**The RMA loan placed significant pressure on reserves and raises governance concerns.** These securities amounted to about 40 percent of the pre-transaction level of reserves. The crypto assets mining investment was publicly disclosed by DHI only in April 2023.

**The returns on this investment are uncertain, given the high volatility of bitcoin prices.** If bitcoin prices remain at around US\$60,000 per coin, then DHI would be able to comfortably repay the RMA and earn a profit. Thus far, DHI made repayments to the RMA in March 2024, while also providing a special dividend of Ngu 2.7 billion (US\$33 million) to the government. They have committed to provide another special dividend of Ngu 5.3 billion (US\$64 million) in FY2024/25. At the same time, the RMA agreed to extend the maturity of the outstanding DHI securities by two years, so that the timing of crypto assets asset sales can be optimized based on current and projected market prices. The securities are now due to be repaid to the RMA between 2026 and 2027. The extension entails coupon payments at a 4 percent rate, compared to the original bullet bond at a 1.5 percent rate. However, the longer maturities imply a slower buildup of reserves: under staff's baseline scenario, reserves reach an adequate level (6.8 months of imports) only by FY2026/27. The RMA has the right to request the sale of the crypto assets should it assess that reserves would decline below the constitutional minimum,

**The macroeconomic impact of this operation is significant.** The RMA financing entailed a large drop in reserves. While the authorities stressed the importance of taking advantage of the investment opportunity—which could spur other technology investments—this operation resulted in the need to impose policies which restricted select imports to support the peg. Going forward, it can increase exports and fiscal revenues, but it also creates the challenges of dealing with volatile returns as well as to carefully assessing the competing demands for electricity (electrification, diversification of domestic production and exports). The authorities are prioritizing domestic consumption for households and other industries, including through their pricing policies.



## OUTLOOK AND RISKS

**13. Boosted by hydro-projects and grant-financed capital investment, growth is projected to accelerate over the medium term but to remain volatile.**<sup>9</sup> In FY2024/25, growth is expected to accelerate as a large hydro project is commissioned, the 13<sup>th</sup> FYP capital spending projects start to be implemented, and emigration pull factors wind down. These positive supply-side factors (lower net emigration, improved infrastructure, improved business environment) should dominate demand pressures as capital spending is import-intensive. This should allow a gradual easing of inflation, which, supported by the peg, is expected to move closer to 4 percent, in line with the midpoint of India's inflation target.

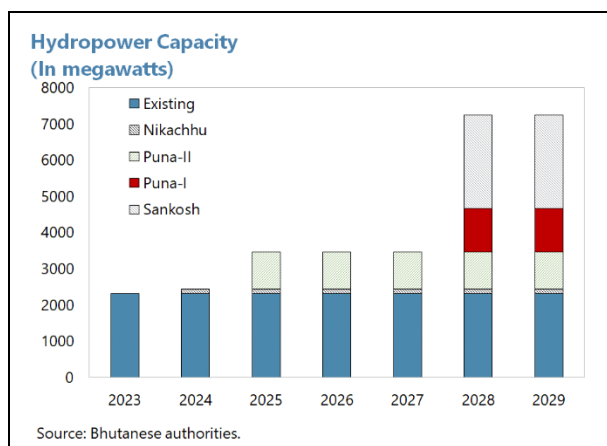
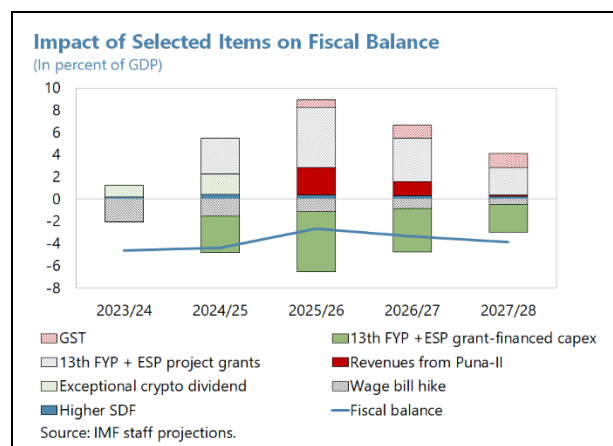
**14. The fiscal deficit is expected to remain elevated at around 4 percent of GDP in the medium term.** Two-thirds of the cost of the wage bill increase will be financed by an exceptional crypto dividend in FY2023/24 and FY2024/25, with the recovery in tourism providing additional revenues through SDF collections. Capital investment projects for the 13<sup>th</sup> FYP and ESP financed with foreign grants will not impact the deficit.<sup>10</sup> The fiscal deficit will improve in FY2025/26 helped by the commissioning of the large hydro-project Punatsangchhu II, which will deliver especially high dividends in its first year of operation. The GST is assumed to be implemented in July 2025. These developments are expected to offset an underlying worsening trend in the fiscal balance, mostly driven by stagnant dividends as SOEs embark in investment projects. Public debt is expected to increase to 130 percent of GDP by FY2028/29 as commissioning of Punatsangchhu I and II leads to the recognition of interest earned during their construction.<sup>11</sup> However, these higher costs would be fully reflected in the electricity tariff, and would thus not represent a fiscal burden for the government. Borrowing for the Dorjilung hydropower project and other smaller energy projects will also contribute to debt accumulation.<sup>12</sup> Non-hydro debt is expected to remain well-below 50 percent of GDP.

<sup>9</sup> The historical GDP data and projections are underestimated because they do not reflect the full impact of the crypto assets mining operations due to lack of available data.

<sup>10</sup> Most of the grants and associated investment projects will begin in FY2024/25. A first installment of Rs. 2.5bn was already received from India as part of the grant financing for the ESP in FY2023/24.

<sup>11</sup> The recognition of interest earned during construction is expected to raise public debt by about 17 percent of GDP on average after the commission of each plant.

<sup>12</sup> The Dorjilung hydropower project is not part of the intergovernmental agreement with India. Financing arrangements for this project are yet to be finalized, but it is assumed that concessional financing, particularly from the World Bank, could be complemented by commercial financing. The construction costs for the project, excluding financial expenses, is assumed to amount to US\$ 1.4 billion ([https://www.drukgreen.bt/wp-content/uploads/2023/12/20231211\\_Bhutan-Dorjilung-Client-Financial-Advisor-TOR-dated-Nov-23-2023-V3-2\\_CPD.pdf](https://www.drukgreen.bt/wp-content/uploads/2023/12/20231211_Bhutan-Dorjilung-Client-Financial-Advisor-TOR-dated-Nov-23-2023-V3-2_CPD.pdf)).



**15. Uncertainty remains elevated with the balance of risks tilted to the downside.** With reduced fiscal and external buffers, domestic risks include slippages on GST implementation, delays in hydro projects, and fiscal risks from the materialization of contingent liabilities in the financial sector, which are currently masked by pandemic-era support measures. External risks include volatile commodity prices—particularly of fuel—and a global slowdown that could hinder non-hydro exports and the recovery of tourism. Bhutan is also vulnerable to climate change, given the importance of hydroelectricity generation and agriculture—including the risks of glacial-lake outburst floods. The crypto-mining operations entail significant upside and downside risks given their price volatility. Overall, the large external debt and medium-term current account deficits—while supporting growth-enhancing investments and financed by development partners—are nonetheless a source of vulnerability. On the upside, the pursuit of stronger-than-envisaged fiscal consolidation would accelerate the pace at which fiscal and external buffers are rebuilt (Appendix I).

**16. Bhutan’s recent graduation from LDC status is not expected to have a material impact on grants or trade benefits in the short term.**<sup>13</sup> During the 12<sup>th</sup> FYP, Bhutan received an average of 6.7 percent of GDP in foreign budgetary grants per year, with 71 percent of them coming from India. Neither India nor other development partners use LDC status as an automatic trigger for grants to Bhutan, so no immediate impact is expected. Moreover, India has already pledged what amounts to a large increase in their support for the 13<sup>th</sup> FYP. Over the long term, grants are expected to decline as Bhutan organically advances in its development process.

**17. The authorities broadly agreed that the economy will accelerate as large hydro-projects are commissioned and investments materialize.** However, they envisaged somewhat faster growth in the medium-term. They concurred with staff about risks including from a global slowdown and from volatile commodity prices, as well as those related to climate change.

<sup>13</sup> These were also the findings of the “Ex-ante Impact Assessment of likely Consequences of Graduation of Bhutan from the Least Developed Country Category,” United Nations Committee for Development Policy, 2018.

## POLICY DISCUSSIONS

*Discussions centered on how the peg to the Indian rupee has served the country well given close trade linkages with India and has provided a nominal anchor. To support the peg, policies need to focus on addressing external and domestic imbalances and gradually rebuilding policy buffers. A faster fiscal consolidation pace, including revenue mobilization efforts as well as spending restraint, would be appropriate. Measures should include implementing the GST by July 2025 as currently envisaged, improving tax administration, restraining the wage bill, and improving spending efficiency. Monetary policy should be tightened to support the fiscal consolidation and rebuild external buffers. In terms of structural reforms, the challenge is to generate high-quality jobs and diversify the economy. An improved business environment would help address these challenges, including by enhancing governance and transparency in the public sector.*

**18. The mission advocated for fiscal and monetary adjustment to support the peg, reduce imbalances, and rebuild buffers.** A revenue-based fiscal consolidation would allow a decline in non-hydro debt and limit the increase in total public debt. The envisaged implementation of the GST is a cornerstone of such efforts, but should be complemented with additional permanent revenue measures amounting to around 1 percent of GDP over the 13<sup>th</sup> FYP. A downward trajectory for non-hydro debt could serve as a fiscal anchor over the medium term. Supported by tighter monetary policy, it would allow for an easing of import restrictions while contributing to a faster buildup of reserves. These efforts would result in additional policy space which would prove handy if downside risks materialize.

### A. External Sector Policies

**19. The exchange rate peg with India has served Bhutan well, acting as an effective nominal anchor and facilitating trade between both countries.** India is the destination of 86 percent of Bhutan's exports and is the source of 73 percent of Bhutan's imports. The bulk of external debt (68 percent of GDP and 61 percent of total debt) and hence most of the debt service (2 percent of GDP and 51 of total debt service payments) is in INR. India continues to be the largest source of FDI (51 percent) for Bhutan. However, these benefits do come at some cost, as flexible exchange rates are useful shock absorbers. Nonetheless, countries with similar characteristics to Bhutan often have fixed exchange rate regimes (Appendix V).

**20. Staff assesses Bhutan's external position to be substantially weaker than warranted by fundamentals and desirable policies.** Even after taking into account the temporary effects of crypto assets mining equipment imports, the current account gap is 12 percent, implying an exchange rate overvaluation of 48 percent (Appendix II). As a result of persistently large current account deficits, the negative NIIP is elevated at more than 130 percent of GDP as of end-June 2023, comprising mainly of long-term debt from development partners. Bhutan's reserves at 4.8 months of imports as of end-May 2024 are below the adequate level, estimated to be around 6.8 months of imports. Maintaining adequate reserves is needed to support the credibility of the peg. Accommodative fiscal and monetary stances, which were appropriate during the pandemic, put pressure on reserves and need to be reversed. Over the medium term, exports from upcoming large

investment projects, as well as reforms to support competitiveness and diversification, will also help address the external imbalances.

| <b>Bhutan: External Financing Needs and Sources (USD million)</b> |             |            |              |              |              |              |              |
|---|-------------|------------|--------------|--------------|--------------|--------------|--------------|
|   | 2022/23     | 2023/24    | 2024/25      | 2025/26      | 2026/27      | 2027/28      | 2028/29      |
|   | Act.        | Proj. →    |              |              |              |              |              |
| <b>A. External financing needs</b>                                | <b>934</b>  | <b>835</b> | <b>1,408</b> | <b>1,095</b> | <b>852</b>   | <b>1,255</b> | <b>1,135</b> |
| Current account deficit (net of errors/omissions)                 | 657         | 559        | 1,130        | 799          | 532          | 797          | 728          |
| Loan amortization   | 77          | 76         | 78           | 96           | 121          | 258          | 207          |
| Repayment of swap with RBI  | 200         | 200        | 200          | 200          | 200          | 200          | 200          |
| <b>B. External financing sources</b>                              | <b>708</b>  | <b>874</b> | <b>1,410</b> | <b>1,462</b> | <b>1,505</b> | <b>1,404</b> | <b>1,265</b> |
| Grants  | 120         | 98         | 289          | 382          | 367          | 310          | 152          |
| Foreign direct investment, net                                    | 12          | 168        | 491          | 16           | 21           | 28           | 31           |
| Portfolio investment, net   | 0           | 0          | 0            | 0            | 0            | 0            | 0            |
| Medium- and long-term loan disbursements                          | 218         | 235        | 259          | 678          | 712          | 639          | 629          |
| Swap with RBI   | 200         | 200        | 200          | 200          | 200          | 200          | 200          |
| Commercial banks' net borrowing from abroad                       | 10          | 4          | 4            | 4            | 5            | 5            | 5            |
| Other   | 147         | 168        | 167          | 183          | 201          | 222          | 249          |
| <b>C. Change in reserves (B-A)</b>                                | <b>-227</b> | <b>39</b>  | <b>2</b>     | <b>367</b>   | <b>653</b>   | <b>150</b>   | <b>130</b>   |
| <b>Reserves (eop)</b>   | <b>574</b>  | <b>606</b> | <b>604</b>   | <b>969</b>   | <b>1,616</b> | <b>1,759</b> | <b>1,879</b> |

Source: IMF staff projections.

**21. Tighter fiscal and monetary policies are needed to alleviate the stress on reserves in the short term.** Stop-gap measures, such as import restrictions on vehicles,<sup>14</sup> lending bans, and increasing the incentives on remittances,<sup>15</sup> are not addressing the underlying imbalances, though they have temporarily slowed the fall in reserves. New initiatives, such as allowing residents to open a foreign currency account with commercial banks in Bhutan should be accompanied by appropriate prudential measures.<sup>16</sup> Going forward, the external position is expected to improve, with

| <b>Bhutan: Hydropower Project Pipeline</b> |                              |                      |                                |
|--|------------------------------|----------------------|--------------------------------|
|  | <b>Start of Construction</b> | <b>Commissioning</b> | <b>Installed Capacity (MW)</b> |
| <b>Under construction</b>                  |                              |                      |                                |
| Punatsangchu I                             | 2008                         | 2029                 | 1,200                          |
| Punatsangchu II                            | 2010                         | 2025                 | 1,020                          |
| Kholongchu                                 | 2016                         | 2031                 | 600                            |
| <b>Undergoing feasibility assessment</b>   |                              |                      |                                |
| Dorjilung                                  | 2025                         | 2032                 | 1,125                          |

Sources: Bhutanese authorities; and IMF staff calculations.

<sup>14</sup> Import restrictions on vehicles are scheduled to end in August 2024.

<sup>15</sup> In May 2021, the RMA introduced a 1 percent incentive for remittances from the diaspora to their personal accounts or their family member's, to offset the transaction cost associated with remittances. The incentive was raised to 2 percent in July 2022 and 10 percent in June 2023. It expired at end December, was reinstated for the month of February 2024, but it is no longer in place.

<sup>16</sup> Commercial banks can hold foreign currency up to a limit, beyond which they are required to sell it to the RMA. Resident banks provide letters of credit for importers, but lending is conducted only in Ngultrum. Prudential measures could include limits on the net foreign exchange open position and introducing a foreign exchange liquidity coverage ratio to manage balance sheet and maturity mismatches, respectively.

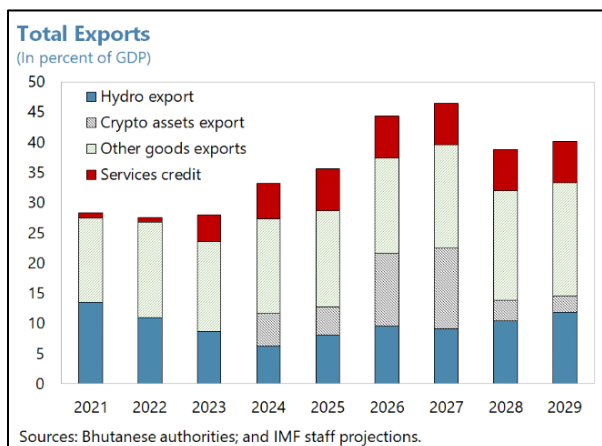
reserves returning to adequate levels over the medium term. This is supported by new hydro plants, continued recovery in tourism crypto assets exports and support from development partners. The current account deficit will nevertheless remain elevated, reflecting project-related imports, including hydropower, financed partly by development partners.

**22. Staff emphasized that the crypto assets operations increase risks to external stability, which need to be carefully managed.**

In the baseline, it is assumed that the RMA-financed operation will generate sufficient crypto asset exports to fully repay the RMA loan, finance the DHI special dividend for the FY2023/24 and

FY2024/25 budgets and cover its electricity expenses.<sup>17</sup> Crypto assets exports are expected to taper down from FY2027/28 onwards, in line with the expected lifetime of the mining equipment.<sup>18</sup> Going forward, the authorities envisage that further investments in crypto assets mining operations will be funded through FDI, and should not be a drain on reserves. Exports from the private venture are expected to cover the cost of electricity. Crypto assets prices are highly volatile and strategies are needed to:

(i) ensure that the risk and return profile from DHI's crypto assets investment and holding strategy are appropriate for Bhutan; (ii) minimize the effects of these fluctuations on the domestic economy (e.g., by avoiding boom-and-bust cycles in crypto-related profits translating into sharp ups-and-downs cycles of recurrent government spending); (iii) mitigate fiscal risks; and (iv) ensure that the benefits are shared equitably across generations of Bhutanese.



**Authorities' Views**

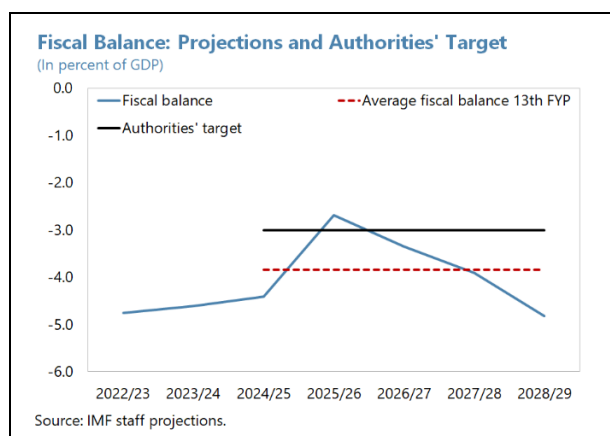
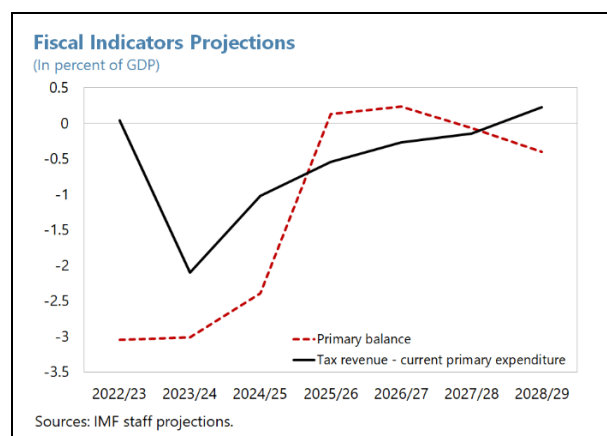
**23. The authorities agreed that Bhutan's external buffers have been eroded.** They stressed that policies to restrict imports are temporary and will be lifted as scheduled. The RMA has been able to nimbly manage the demand for foreign currency under these challenging conditions, moderating its effect on the broader economy. The crypto assets investment is a strategic decision, designed to exploit Bhutan's comparative advantage and diversify the economy. The expertise built through managing the crypto assets mines can be utilized in other industries, such as data centers. The holding strategy is well thought out and includes measures to minimize the risk of default on the outstanding DHI securities.

<sup>17</sup> DHI made a repayment to the RMA of US\$ 18 million in March, and Nu 2.7 billion in dividends have been transferred to the budget.

<sup>18</sup> The expected lifetime of crypto assets mining equipment is approximately five years.

## B. Fiscal Policy

**24. A gradual but sustained fiscal consolidation is appropriate for Bhutan.** Staff continues to assess the risk of debt distress as moderate, unchanged from the 2022 AIV DSA. Although public debt in Bhutan is high, it has declined slightly more than envisaged in the past DSA and the FDI-like nature of Bhutan's hydro debt significantly mitigates debt sustainability risks.<sup>19</sup> However, the expected recognition of interest earned during construction for the intergovernmental hydro projects will significantly worsen debt dynamics by leading to two one-off increases over the medium term.<sup>20</sup> Overall, there is limited fiscal space left to absorb significant negative shocks, if they were to materialize. A credible medium-term consolidation plan would put non-hydro debt firmly on a declining path and boost macroeconomic stability by rebuilding fiscal buffers and reducing external imbalances while providing space for Bhutan's development needs. The authorities are committed to implementing the GST, advancing revenue administration reforms, and exercising some expenditure restraint, particularly on the wage bill. Staff estimates that these measures would yield a deficit of 3.8 percent of GDP on average during the 13<sup>th</sup> FYP, higher than the authorities' target of 3 percent of GDP, which is appropriate. Additional permanent tax policy measures amounting to around 1 percent of GDP would be needed to achieve the 13<sup>th</sup> FYP target, and would entail a deficit of about 3 percent of GDP in FY2027/28.



**25. Revenue mobilization efforts should be at the core of Bhutan's fiscal strategy.** Recent tax policy efforts such as reforms to property and sales taxes in 2022 are welcome but are expected to only have a limited impact.<sup>21</sup> Implementation of the GST, currently planned for July 2025 by the

<sup>19</sup> Most of Bhutan's outstanding debt is linked to hydropower project loans from the Government of India. These projects are implemented under an intergovernmental agreement under which the Government of India covers both financial and construction risks of the projects and commits to buy all surplus electricity at a price reflecting cost plus a profit margin.

<sup>20</sup> Earned interests during construction are recognized when the project is commissioned. While these interests are capitalized and therefore lead to higher debt levels, such debt does not accrue interest after commissioning and the debt service is reflected in the export tariff—which implies no additional fiscal burden.

<sup>21</sup> The Tax Act of Bhutan 2022 broadly raised sales tax rates, while streamlining custom duties. The Property Tax Act of 2022 constitutes a major modernization of real estate taxation and is expected to raise 0.2 percent of GDP.

authorities, is essential and should proceed without further delay.<sup>22</sup> The authorities could complement these efforts with a selection of other tax policies to achieve their deficit target, as well as streamlining GST exemptions. In addition to the procurement and launch of the Bhutan Integrated Tax System (BITS), necessary for GST introduction, revenue administration can be enhanced through the establishment of a Large Taxpayers Unit, implementation of a tax debt management framework, and development of risk-based compliance improvement plans. The authorities' efforts in this area are welcome and are being supported by IMF CD, including through a field-based long-term expert. The authorities' recently-completed Medium-Term Revenue Strategy will help anchor their efforts.

| <b>Bhutan: Possible Tax Policy Measures</b>                                     |  |
|---|--|
| Measure   | Medium-Term Yield<br>(in percent of GDP) |
| Reform personal income tax  | 0.8                                      |
| Introduce a minimum alternative tax for unincorporated businesses and companies | 0.2 - 0.4                                |
| Raise tax deducted at the source on non-residents                               | 0.5                                      |
| Tax telecom services with sales tax and GST                                     | 0.3 - 0.4                                |
| Source: IMF CD.   |  |

**26. Expenditure restraint, particularly on the wage bill, would be necessary.** Attrition among civil servants was 17.2 percent in 2023, almost six times higher than pre-pandemic levels. To mitigate this attrition, the authorities granted a 50 percent increase in the minimum pay scale for all public servants with additional targeted increases in the health sector (Appendix IV). Bhutan's wage bill does not appear excessively high compared to other small states and no across-the-board wage increases had been granted since 2019. However, while the large wage hike may have been needed to prevent further attrition, it also increased the public sector wage premium compared to the private sector. Cautious management of the wage bill going forward is advisable. This could include:

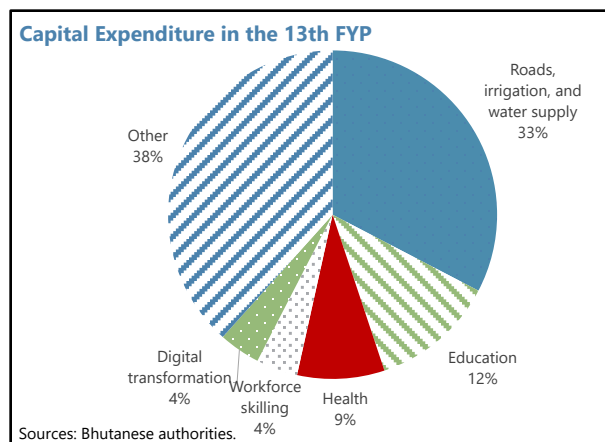
- Avoiding across-the-board wage increases.
- Granting targeted increases to critical positions only.
- Considering carefully which positions need to be filled and which could be discontinued, taking advantage of opportunities to further streamline the civil service.
- Deploying flexible hiring strategies for critical positions in health care and education.
- Assessing the adequacy of the current wage setting mechanism (e.g., convening the Pay Commission at regular intervals).

<sup>22</sup> The procurement process for the BITS has been advancing. The authorities have identified their preferred vendor and the letter of contract intent was signed in June 2024. Work by the vendor on the ground is expected to commence in mid-September. Around ten months of preparation would be needed before the launch of the system, targeted for July 2025. In addition, the authorities have requested IMF CD to streamline exemptions in GST and the schedule for the EET, with the aim of submitting a reform bill for Parliament consideration in the winter session. Extensive outreach to taxpayers should follow over the next year to ensure a smooth implementation.

- Considering potential reforms to strengthen transparency and enhance targeting of the salary increases as alternative measures to improve public servants' careers at a lower budgetary cost. For instance, through the ongoing enhancement of public servants' evaluation.

**27. Staff agreed that capital investment can advance Bhutan's development agenda but noted that it should be allocated wisely.**<sup>23</sup> The 13<sup>th</sup> FYP envisages capital expenditure of Ngu

245bn deployed between FY2024/25 and FY2028/29, 51 percent of which would be financed by foreign grants, including Ngu 85bn from India. This large capital expansion has the potential to raise the productivity of the Bhutanese economy and improve quality of life if projects are assessed properly and prioritized carefully across the different sectors. The Ngu 15bn (equivalent to around 5 percent of GDP) India-financed ESP aims to reinvigorate the economy in the short term by raising productivity in agriculture, facilitating high-value exports by cottage and small industries,



skilling workers through targeted programs, and supporting quality improvements in tourism. The ESP would be primarily channeled through the financial system as loans, as well as some acquisition of equipment, capital grants, and subsidies. To maximize the effectiveness of the ESP while preserving stability of the financial sector, it would be important to consider appropriate financial instruments and mechanisms that facilitate aggregation and strengthen commercial value chains in agribusinesses, given that in the past directed subsidized lending has led to high NPLs.

**28. Stronger public financial management would help improve spending efficiency.** With support from IMF CD, the authorities have developed a new Unified Chart of Accounts fully consistent with GFSM 2014 that will allow improved planning, budgeting, monitoring, and fiscal reporting. While the Department of Revenue and Customs has begun using the new chart of accounts, its full implementation will require an upgrade to the IT systems, which is only targeted to be completed over the medium term. The authorities have also taken a positive first step towards introducing a medium-term budget framework (MTBF) by asking budget entities to formulate estimates for two outer years. A rolling MTBF would help enhance coordination between planning (notably the Five-Year Plans) and budgeting, improve efficiency, and reduce the volatility in capital spending, and, more broadly, in the fiscal stance.<sup>24</sup> Transition to a Treasury Single Account is ongoing with the authorities consolidating accounts held by budget entities. Further progress in this area will improve cash management. Finally, compilation and dissemination of fiscal accounts under GFSM 2014 standards for central and general government, as well as stronger transparency on SOE

<sup>23</sup> Capital investment is defined more broadly in Bhutan than what is classified as Net Acquisition of Non-Financial Assets in GFSM 2014 for instance by including training, capital grants, and equity injections.

<sup>24</sup> The current framework centered on FYPs leads to sharp discontinuities in the transitional periods between plans, which is disruptive for public service delivery and economic activity.

operations, would be essential for enhanced reporting and policy design.<sup>25</sup> SOE operations should be subject to the same disclosure requirements that apply to publicly-listed companies.

**29. Staff highlighted that domestic debt management could be enhanced.** Public debt declined in the post-pandemic recovery, driven especially by hydro debt repayments. However, non-hydro debt increased, fueled by sizable fiscal deficits. Domestic debt, which before the pandemic was negligible, has become quite significant at 12.8 percent of GDP (end-June 2023). In 2023, the authorities issued a new debt management policy which appropriately captures central government domestic debt as part of their key debt anchor, although a broader institutional coverage would have been advisable. It would also be important to enhance domestic debt management, particularly by releasing a periodic calendar of issuances of T-bills and T-bonds. Concessional external debt should remain the core source of investment financing. Alternative financing mechanisms should be explored for new large hydropower projects.

### ***Authorities' Views***

**30. The authorities agreed on the importance of enacting a revenue-based fiscal consolidation during the next five years, including by implementing additional tax policy measures.** They emphasized their commitment to implement GST by July 2025 and are exploring additional tax policy options. They noted their progress in advancing revenue administration reforms despite limited staff. They considered the 2023 Pay Revision as essential to curb attrition and preserve public service delivery, but agreed that cautious management of the wage bill going forward will be important. They agreed that further progress on public financial management would help improve the quality of spending and reduce macroeconomic volatility. The authorities concurred with staff's assessment of a moderate risk of debt distress, but highlighted the limited risks associated to hydropower projects and the need for Bhutan to quickly capitalize on this sector.

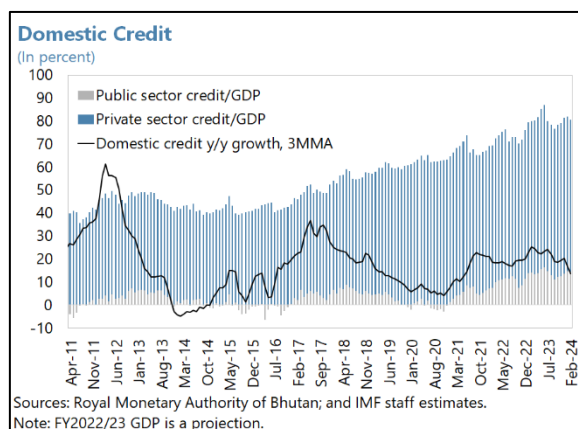
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<sup>25</sup> The budget reports provide a qualitative discussion of fiscal risks. This could be strengthened with a quantification and reporting of fiscal risks related to SOEs. Moreover, the reporting of the financial sector position of public institutions should transparently discuss and quantify DHI liabilities to the RMA, as well as elaborate on appropriate risk mitigation strategies. FAD's fiscal risk tools, including the Fiscal Risk Assessment Tool, the SOE Healthcheck Tool, and the Public Sector Balance Sheet Assessment could be helpful to quantify government's fiscal risk exposure.

## C. Monetary Policy

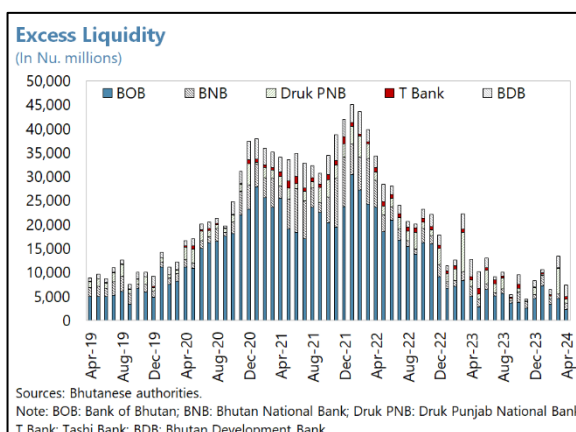
### 31. The pandemic-era accommodative monetary stance is yet to be fully unwound.

The RMA's main monetary policy instrument, the Cash Reserve Ratio (CRR) was raised by 100 basis points to 8 percent in October 2022, however, it is still below its long-term level of 10 percent. The Capital Conservation Buffer was reinstated in December 2022, nine months earlier than originally envisaged.<sup>26</sup> To address pockets of vulnerabilities, the RMA instated a ban on lending for new housing and hotel construction, which tightened financial conditions. As a result, credit growth slowed in the first quarter of 2024<sup>27</sup>.



**32. Monetary policy needs to be tightened, in coordination with fiscal consolidation, to support the peg.** Balance-of-payments pressures continue, with reserves remaining below adequate levels in the short term (relative to the ARA metric), while some inflationary pressures remain from public sector wage increases. The CRR should be raised to its pre-pandemic level to help address these pressures.

**33. A well-functioning domestic liquidity management framework (DLMF) is a priority, given that the liquidity buildup during the pandemic has now dissipated.** Liquidity in 2024Q1 was below the levels seen pre-pandemic and some banks experienced episodes of liquidity stress in mid-2023. Regulatory measures were used to ease liquidity conditions.<sup>28</sup> Market-based measures, such as DLMF, are preferable to manage system-wide liquidity because they are more efficient, help develop money markets and allow banks to



<sup>26</sup> Financial institutions are required to hold a capital conservation buffer of 2.5 percent of total risk weighted assets, met from Tier 1 capital. This is designed to avoid breaches of minimum capital requirements during times of stress. In response to the pandemic, the buffer was released in September 2020.

<sup>27</sup> The restriction does not apply to loans for repairs and renovations and disbursements for existing facilities can continue.

<sup>28</sup> To address the liquidity stress, in end June 2023, the RMA suspended the practice of sweeping project accounts. The arrangement was introduced to sterilize large inflows from hydropower projects, and covered government and hydropower projects accounts maintained with the commercial banks. The RMA would sweep those balances at the end of each day, and were therefore excluded from banks' liquidity.

respond based on their own liquidity conditions and risk tolerance.<sup>29</sup> Operationalization of the DLMF has been stymied by persistent excess liquidity, high variations in liquidity holdings amongst banks and challenges in forecasting liquidity. Ongoing efforts, with the support of CD, to operationalize the DLMF, should continue. Over the medium term, expanding the coverage of the TSA would help smooth the functioning of the money market, so that government-related deposits and hence liquidity are not tilted in favor of any one bank. The TSA would also help to better gauge the government's cash position and liquidity in the banking sector. Persistent liquidity pressures could indicate that an increase in deposit rates, or other avenues of raising long-term funding (e.g., corporate bond issuance), is needed.

**34. Staff also emphasized that the DLMF should be reformed so that it can support RMA's monetary policy objective, rather than focusing on market intermediation.** A monetary policy operation function can be added to the existing weekly liquidity management operation. After matching the bids and offers by banks, RMA can inject or absorb liquidity at the announced policy rates. This policy interest rate corridor would allow RMA to align short-term money market rates at a level needed to achieve price stability and support the peg<sup>30</sup>. While the money market is thin, staff suggested that a starting interest rate corridor of +/- 150 basis points around a policy rate of 6.5 percent would be appropriate. The corridor is above the informal interbank rate of between 3-5 percent (at tenors of 90-180 days) and the 90-day T-bill rate of 4.24 percent (last auction in March 2024). The proposed policy rate is in line with India's policy rate and, with inflation at about 5 percent, it implies a monetary policy tightening with a positive real rate.

**35. Staff recommended for the authorities to publish a regular issuance calendar for government securities, to help banks manage their liquidity and support the development of the domestic debt markets.** Part of the liquidity stress in mid-2023 was due to an uptick in lending to the public sector, which reached 16 percent of total assets, from 4 percent in January 2020. That said, bank claims on the public sector are relatively low compared to peers. An issuance calendar for T-bills and bonds, specifying the tenors and volumes of instruments to be issued would allow market participants to better plan their investments.

### ***Authorities' Views***

**36. The authorities acknowledged the importance of improving domestic liquidity management and are continuing to develop their monetary policy framework.** They mentioned several challenges in forecasting liquidity, particularly due to volatility of the government's deposits in commercial banks, which will continue until the TSA is well established. RMA staff's proposed policy rate is close to the IMF staff's proposed rate, but with a wider band. The RMA would welcome

<sup>29</sup> The DLMF facilitates: (i) an overnight marginal lending facility; (ii) an interbank lending market with maturity of one week; and (iii) long-term liquidity management operations (30-90 days) by the RMA.

<sup>30</sup> Ide, S., Laurens, B. J., & Solonar, N. (2021). *Domestic Liquidity Management Framework: Operational Aspects*. SARTTAC Technical Assistance Report

further capacity development for operationalizing the monetary policy and liquidity management framework.

## D. Financial Sector Policy

**37. Although financial sector stability has improved following pandemic-related stress, staff highlighted remaining vulnerabilities.** Bank profitability has increased but remains low

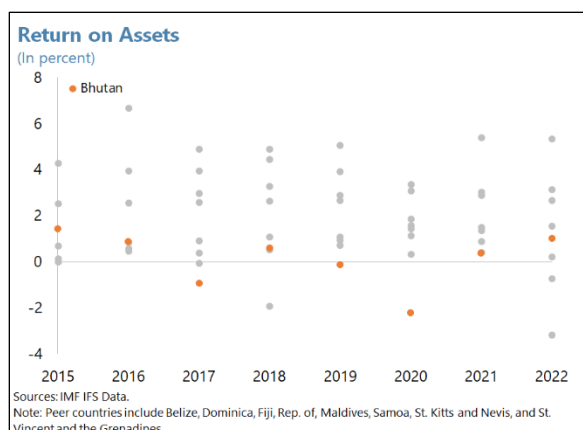
compared to peers, with a return on assets of around one percent, partly driven by previously high levels of non-performing loans (NPLs). State-owned banks are less profitable compared to private counterparts. NPLs are now at historical lows reflecting reclassification of selected NPLs and support measures. For example, nearly all hotel and tourism loans, which are 12 percent of total credit outstanding, are currently under deferment. Credit concentration risks have also intensified; the housing sector accounts for more than 30 percent of total outstanding loans from 25 percent in 2019. While credit quality in this sector is currently strong overall, 10 percent of housing loans are under deferment and are at risk of deteriorating into NPLs.

| Bhutan: Financial Sector (end 2022) |     |                      |                   |
|-------------------------------------|-----|----------------------|-------------------|
|                                     | No. | Assets (Ng millions) | Assets (% of GDP) |
| Banks                               | 5   | 232,109              | 102               |
| State-Owned                         | 2   | 132,742              | 58                |
| Insurance and pension funds         | 4   | 79,075               | 35                |
| State-Owned                         | 2   | 71,035               | 31                |

Source: Bhutanese authorities.  
Note: The financial sector also includes five microfinance institutions, one fund manager, a securities exchange, two insurance brokers and seven securities brokers.

**38. The authorities have introduced new guidelines and regulations to address credit quality issues in financial institutions.** The new guidelines cover loan restructuring, reclassification of NPLs, tightening credit report requirements, loan origination and monitoring and directives designed to reduce evergreening. Lending by three financial institutions, which together accounted for 23 percent of loans, was suspended in May 2022 due to their high level of NPLs. Close monitoring by the RMA under the Prompt Corrective Action framework has supported a reduction in NPLs and the suspension has been lifted. Two of the institutions affected, which focus on servicing rural communities and small enterprises, have been merged due to their overlapping mandates.

Continued provision of financial services to these sectors is important given that they are relatively underserved.<sup>31</sup>



<sup>31</sup> In rural areas, 24.9 percent of the population do not have a bank account compared to 8.5 percent of the urban population (RMA, 2023).

**39. The authorities should continue to normalize financial sector policies and address remaining vulnerabilities.** Staff welcome the expiration of broad-based policy support, as planned, at end-June 2024. The pandemic-era relaxation of prudential regulations related to housing loans should be reversed. Loans to hotels, tourism and housing sectors warrant close monitoring given the large exposure of banks and risks from the slow pick up in international visitors and continued emigration, which could exert downward pressure on house prices. RMA is considering increasing risk weights to these higher risk sectors; this is an appropriate policy response to the build-up of exposure by banks. Vulnerabilities in the financial sector could translate into contingent liabilities for the government; particularly as state-owned banks represent over half of total banking system assets. Bhutan should continue making progress on its AML/CFT framework and effectiveness (for both financial institutions and designated non-financial businesses and professions), particularly in the area of preventive measures, entity transparency and criminal justice, and, with the support of CD, updating the National ML/TF Risk Assessment.

### ***Authorities' Views***

**40. Remaining regulatory forbearance measures expired as planned.** They highlighted that RMA and financial institutions have worked together to develop criteria for transitioning borrowers out of the deferment period, with an emphasis on analyzing borrowers' cash flows to determine their repayment capacity. The authorities also agreed that higher risk weights for the housing sector would be appropriate. The RMA continues to make progress in moving towards risk-based supervision; implementing of loan loss provisioning under the IFRS for banks; reviewing connected lending guidelines; and piloting the Basel III LCR Framework, with the support of SARTTAC. The RMA has completed a pilot of a credit risk scoring model for loan applications, and this will be rolled out to all financial institutions in FY2024/25.

## **E. Structural Reforms and Other Policies**

**41. To address emigration, reforms are needed to foster the creation of private sector jobs for high-skilled workers.** The private sector is dominated by microenterprises with relatively low productivity and little growth prospects. They concentrate on the wholesale and retail trade and accommodation and food service sectors. High-skilled workers tend to be employed in the public sector. While the public sector wage premium is a factor, job security and other working conditions are more cited as reasons behind the preference for public sector employment—which is more acute among the youth. These challenges call for efforts to improve the business environment and encourage FDI, strengthen human capital accumulation, and improve active labor market policies.<sup>32</sup> The new FDI policy, to be introduced in July 2024, relaxes some restrictions including access to foreign currency, local employment requirements, and caps on foreign ownership in some sectors. It also expands the sectors under the priority list, which receives expedited approval. The authorities are building on the success of the single-window platform, which streamlines licensing and

<sup>32</sup> See “Bhutan Labor Market Assessment Report”, The World Bank, 2024.

regulatory requirements, for micro and small enterprises and are aiming to expand this to large and medium enterprises in FY2025/26.

**42. There is a need to diversify exports to support inclusive growth and resilience.** Electricity generation and energy-intensive industries (like Ferroalloy) account for about 70 percent of total exports, but are not labor intensive. Tourism, which is labor intensive, is the other large export-oriented sector. The pandemic hit tourism and had a large impact on employment. There is also limited diversification of export markets, with exports to India accounting for 86 percent of the total. The ESP and 13<sup>th</sup> FYP include initiatives to address barriers to export diversification by improving transportation and warehousing, streamlining export processes, and seeking bilateral trade agreements with countries in the region. The authorities seek to complement these efforts with the Gelephu Mindfulness City (GMC) project (Box 2).

**43. Tourism is recovering supported by a reduction in the SDF but lags other countries in the region.** Bhutan's strategy has long sought to attract "high value, low volume" tourism, with a focus on wellness tourism. After the pandemic, the country remained closed to tourism until late Sep-2022. The reopening was accompanied by an increase in the Sustainable Development Fee (SDF) from US\$65 per day to US\$200 per day.<sup>33</sup> Facing a slow recovery, and following some discounts provided during the summer months, the SDF was lowered to US\$100 per day in September 2023.<sup>34</sup> The recovery in tourism has accelerated after the lower fee was instated.

**44. Staff noted that there is scope to strengthen governance in the public sector, including RMA's governance framework.** RMA's efforts to strengthen its reserve management strategy in collaboration with SARTTAC are welcome. Nonetheless, broader governance reforms, including greater transparency on the role and responsibility of the government, RMA and other decision makers would help improve accountability for policy decisions (e.g., monetary policy and reserves management) and strengthen the internal control framework. Transparency and accountability can also be enhanced by making explicit in the RMA Act that the audit committee will be composed of non-executives, and by introducing reforms to the audit framework. Similarly, the independence and autonomy of the RMA Board can be improved by excluding government officials, other than the representative from MOF, from holding non-executive positions. Introduction of stricter limits on RMA lending to the government would also be helpful, whereby such lending should be carried out at market rates and only to smooth fiscal fluctuations,<sup>35</sup> without exceptions for foreign currency instruments issued or guaranteed by the government. The use of reserves to finance crypto assets operations also highlighted the need of further enhance transparency and reporting of SOE operations. Forthcoming efforts to produce audited statements of the crypto-mining operations are

<sup>33</sup> Tourist from India are charged a significantly lower fee at 1,200 Ngu per day.

<sup>34</sup> In addition, Druk Air the country flagship carrier and a SOE, charges significantly higher fares to foreigners relative to those available for locals, which is an implicit tax on tourism and a cross subsidy.

<sup>35</sup> Currently, the RMA is able to lend to the government as long as these loans are temporary and repaid within three months of the end of the FY. The size of the loan is capped at 10 percent of the average government revenue in the preceding two years. The rates of interest applicable is agreed between the RMA and government.

a step in the right direction. For transparency and to ensure efficient allocation of public resources, investments in export diversification initiatives are best funded through the budget process.

**45. Recent efforts to improve the timeliness and quality of statistics are impressive despite limited resources.** While there still are shortcomings that somewhat impair economic analysis, recent achievements include the rebasing of the national accounts, the CPI and the PPI, and the improved frequency of the labor force survey (from annual to quarterly). Moreover, national accounts on a quarterly basis are forthcoming. All these efforts have been supported by Fund capacity developments. However, the lack of reporting of holdings and sales of crypto assets could lead to mismeasurement in the national accounts, including underreporting of GDP, exports, and inventories. This highlights the importance of timely, detailed financial reporting by SOEs, given their economic importance.

#### ***Authorities' Views***

**46. The authorities agreed on the need to foster high-quality private sector jobs to spur growth and to reduce youth emigration.** They plan to spearhead their efforts through the 13<sup>th</sup> FYP and the economic stimulus package. Moreover, they expect that the Gelephu Mindfulness City will provide direct and indirect opportunities for all Bhutanese.

### Box 2. Gelephu Mindfulness City

**The Gelephu Mindfulness City (GMC) project seeks to create a high-end market for Bhutanese goods and services.** The project involves building a new city spanning 2,600 square km at the border with India. It seeks to develop an economic center—unique in South-East Asia—that integrates equitable economic growth, cultural preservation, environmental sustainability, and good governance. The vision is to attract high wealth individuals and global entrepreneurs with a focus on the technology and financial sectors. His Majesty the King is personally leading the project, including the efforts to attract large amounts of foreign equity and debt financing needed for the success of the project.

**Ring-fencing the project will be key to limit downside fiscal risks for Bhutan.** The city is envisaged as a Special Administrative Region (SAR) with legal independence and work on the relevant legal framework is ongoing. Bhutan has limited fiscal space and other pressing financial needs, therefore securing equity and debt financing with no liability for Bhutan is critical.

**GMC aims to be a sustainable cutting-edge city.** The project envisages fostering environmental sustainability by leveraging abundant green power from hydroelectric power dams, promoting clean mobility solutions, and employing carbon neutral building design. The project is being developed with the support of a team of international experts, including leading architecture firms from Denmark and the Netherlands.

**An international airport will anchor the initial stages of the project.** In addition to the legal framework, initial efforts focus on increasing the hydroelectric energy production capacity, expanding digital and physical connectivity—including an international airport as well as a railway connection to Northeast India, and upskilling local Bhutanese so that they can be part of these efforts. The search for financing is ongoing, but construction is envisaged by April 2025 with works finalizing in 2028-29.

## STAFF APPRAISAL

**47. Growth is expected to accelerate over the medium term, boosted by hydro-projects and grant-financed capital investment.** In FY2024/25, growth is expected to accelerate as a large hydro-project is commissioned, the 13<sup>th</sup> FYP capital spending plans start to be implemented, and emigration pull factors wind down. The positive supply-side factors should dominate demand pressures given import-intensive capital spending, allowing a gradual easing of inflation which is expected to move closer to 4 percent, in line with the midpoint of India's inflation target band.

**48. Fiscal and monetary policy adjustment are needed to support the peg, reduce imbalances, and rebuild buffers.** The external position of Bhutan in FY2022/23 was substantially weaker than the level implied by medium-term fundamentals and desirable policies. Bhutan maintains two exchange restrictions under Article XIV, Section 2, to help manage the peg. Bhutan also maintains three exchange restrictions subject to approval under Article VIII, Sections 2(a), and staff is not recommending approval of these measures. A revenue-based fiscal consolidation would allow a decline in non-hydro debt and limit the increase in total public debt. Supported by tighter monetary policy, it would allow for an easing of import restrictions while contributing to a faster buildup of reserves. These efforts would result in additional policy space which would prove handy if downside risks materialize.

**49. A gradual but sustained fiscal consolidation is appropriate for Bhutan.** There is limited fiscal space left to absorb significant negative shocks, if they were to materialize. The authorities'

commitment to a fiscal deficit of 3 percent of GDP on average during the 13<sup>th</sup> FYP is welcomed, but 1 percent of GDP in additional policy measures would be needed to achieve that target. Revenue mobilization efforts should be at the core of Bhutan’s fiscal strategy, anchored by the implementation of the GST in July 2025, and complemented by additional revenue measures and some expenditure restraint—particularly on the wage bill. Judicious allocation of capital investment is key to advance Bhutan’s development agenda. Domestic debt management should also be strengthened, including by releasing a periodic calendar of issuances.

**50. Monetary policy needs to be tightened in tandem with fiscal policy.**

Balance-of-payments pressures continue and reserves remain below adequate levels (relative to the ARA metric). In the short term, the CRR should be raised to its pre-pandemic level. A move towards a well-functioning domestic liquidity management framework is a priority, as market-based measures are preferable to manage system liquidity. The framework should support the monetary policy operation function, allowing the RMA to inject or absorb liquidity at a level needed to achieve price stability and support the peg.

**51. Remaining financial sector vulnerabilities ought to be addressed.** Bank profitability has increased but remains low, and the recent expiration of support measures such as loan deferment is yet to be reflected in NPL levels—with particular concerns for the tourism and housing sectors. The new guidelines and regulations to address credit quality are a welcome development. Policies should continue to be normalized and remaining vulnerabilities addressed, including reversing the pandemic-era relaxation of prudential regulations for housing loans and increasing risks weights for excessive exposure to hotels, tourism, and housing sectors. Staff welcomes continued progress in moving towards risk-based supervision.

**52. Reforms are needed to foster the creation of private sector jobs for high-skilled workers.** Efforts should focus on improving the business environment and encourage FDI, strengthen human capital accumulation, and improve active labor market policies.<sup>36</sup> The new FDI policy which relaxes some restrictions including access to foreign currency, local employment requirements, and caps on foreign ownership in some sectors is a welcome step, as well as efforts to pursue bilateral trade agreements with countries in the region. The economic stimulus plan and 13<sup>th</sup> FYP should include initiatives to address barriers to export diversification by improving transportation and warehousing, and streamlining export processes. The Gelephu Mindfulness City project could potentially complement these efforts, provided fiscal risks are contained.

**53. There is scope to strengthen governance in the public sector, including RMA’s governance framework.** RMA’s efforts to strengthen its reserve management strategy in collaboration with SARTTAC are welcome, but there is scope for further reforms to ensure greater transparency on the role and responsibility of the government, RMA and other decision makers. The use of reserves to finance crypto assets operations also highlights the need for greater

<sup>36</sup> See “Bhutan Labor Market Assessment Report”, The World Bank, 2024.

transparency of SOE operations. The forthcoming production of audited statements of the crypto-mining operations are a step in the right direction.

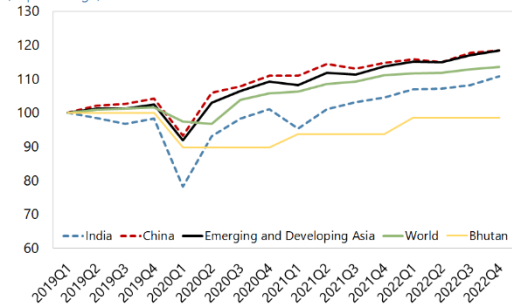
**54. Staff recommends that the next Article IV consultation with Bhutan takes place on a 12-month cycle.**

**Figure 1. Bhutan: Real Sector Developments**

*Bhutan's post-pandemic economic recovery has been steady yet slower compared to other countries.*

**Real GDP Growth Rate**

(In percentage)

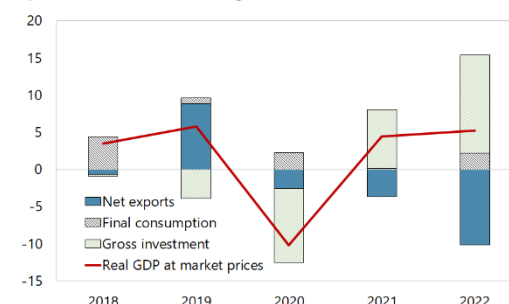


Sources: Haver Analytics; IMF WEO Data; and IMF staff calculations.  
Note: Data for Bhutan represented annually for all quarters within the same year.

*While consumption was resilient, investment took time to recover, and tourism is still yet to rebound.*

**Sources of Growth**

(In percent contribution to real GDP growth)

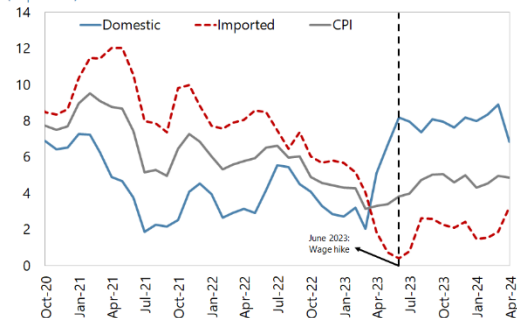


Sources: Haver Analytics; and IMF staff calculations.

*Inflation increased, pressured by domestic prices following a hike in public sector wages...*

**Consumer Price Inflation**

(In percent)

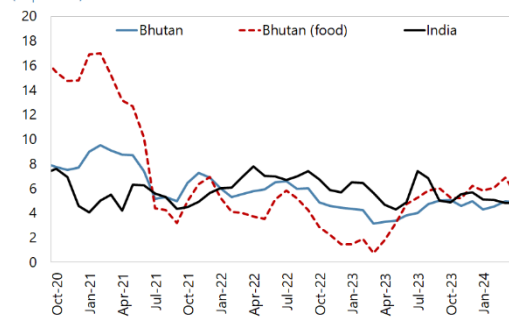


Sources: Haver Analytics; and IMF staff calculations.

*...albeit food prices have abated following the pandemic.*

**CPI Inflation Relative to India**

(In percent)

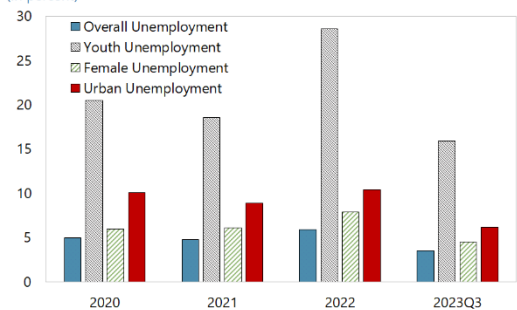


Sources: Haver Analytics; and IMF staff calculations.

*The labor market is tightening, but unemployment remains above its pre-pandemic level.*

**Unemployment Rate**

(In percent)

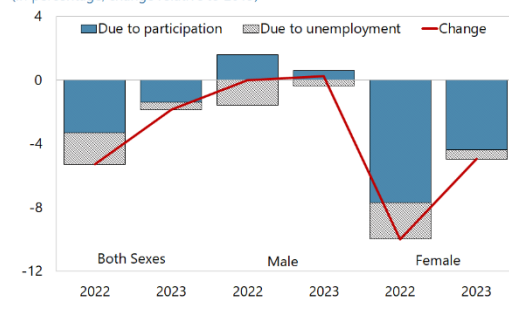


Source: Bhutan National Statistics Bureau Labor Force Survey Report.

*While male employment is back to pre-pandemic levels, female participation is far from a full recovery.*

**Employment to Population**

(In percentage, change relative to 2019)



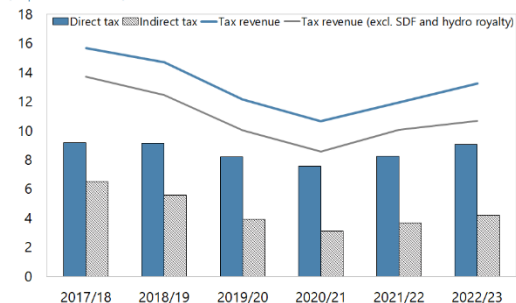
Sources: Bhutan National Statistics Bureau Labor Force Survey Report; and IMF staff calculations.

**Figure 2. Bhutan: Fiscal Developments**

*Tax revenue has recovered recently, but the delay in implementing the GST has structurally hindered indirect taxes*

**Tax Revenue**

(In percent of GDP)

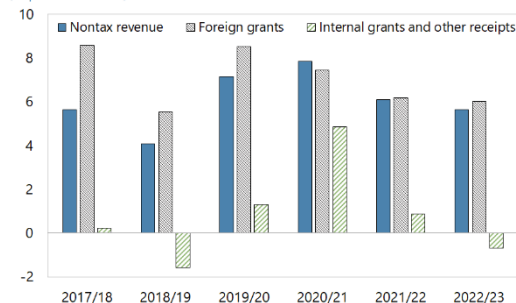


Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

*...while nontax revenue and grants have decreased.*

**Other Revenues and Grants**

(In percent of GDP)

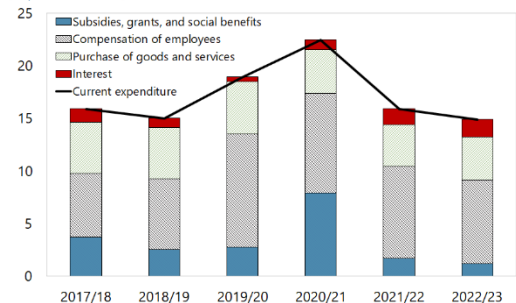


Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

*Current expenditure has declined mostly due to the unwinding of Covid support measures...*

**Current Expense**

(In percent of GDP)

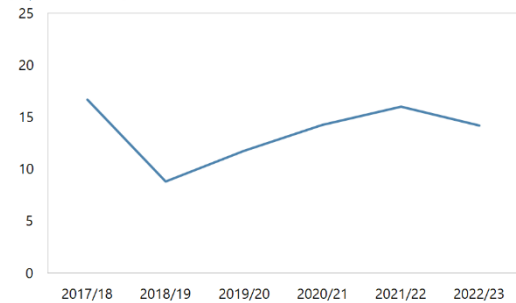


Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

*...while capital expenditure declined in the most recent year as the 12<sup>th</sup> FYP came to an end.*

**Capital Expenditure**

(In percent of GDP)

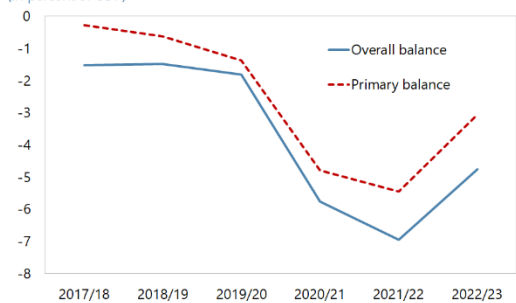


Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

*Despite improving significantly, the fiscal deficit has yet to return to its pre-pandemic level.*

**Fiscal Balance**

(In percent of GDP)

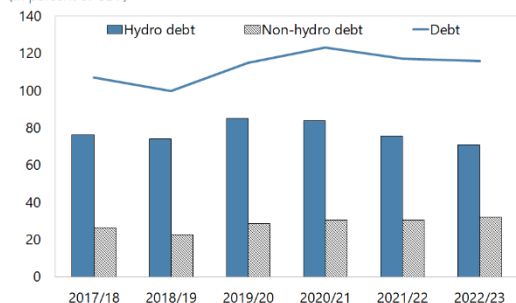


Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

*Public debt steadily declined post-pandemic driven by hydro repayments, yet non-hydro debt keeps increasing.*

**Public Debt**

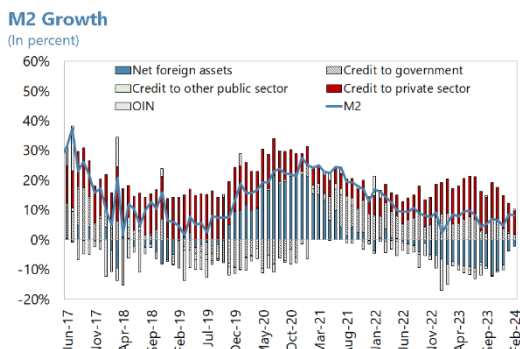
(In percent of GDP)



Sources: Bhutanese authorities; and IMF staff calculations.  
Note: FY2022/23 GDP is a projection.

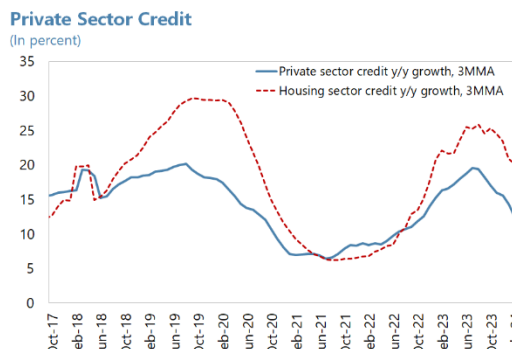
**Figure 3. Bhutan: Financial and Monetary Developments**

*Growth in broad money slowed down post-pandemic, albeit credit to the private sector remained strong...*



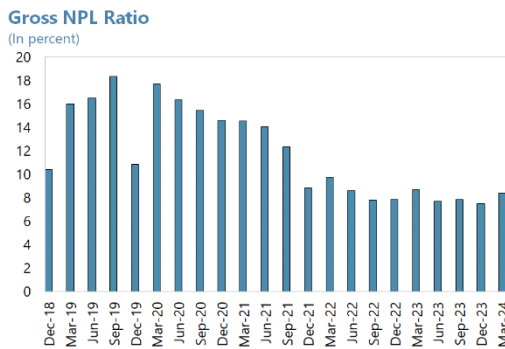
Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations.

*...predominantly led by housing loans.*



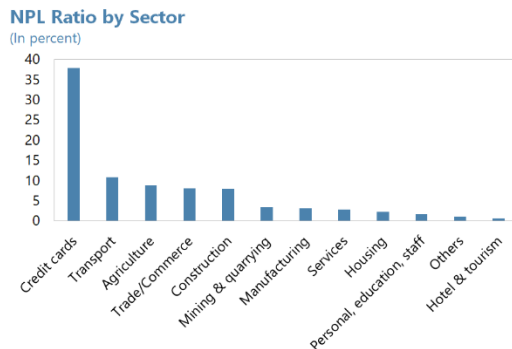
Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations.

*Gross NPL levels have moderated partly due to forbearance measures and recent NPL resolution efforts...*



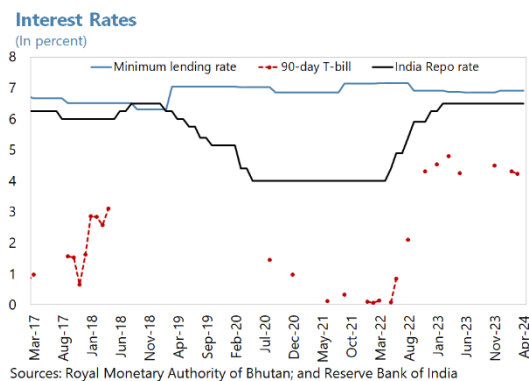
Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations.

*...however sectoral concentration of NPLs remains an issue.*



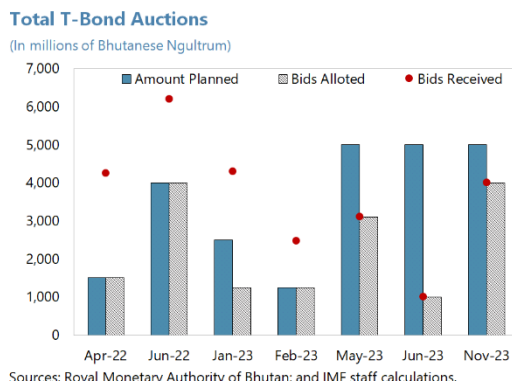
Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations. Note: Based on March 2024 data.

*Liquidity conditions have tightened, but this has not been reflected in minimum lending rates.*



Sources: Royal Monetary Authority of Bhutan; and Reserve Bank of India

*Latest T-bond auctions were undersubscribed.*

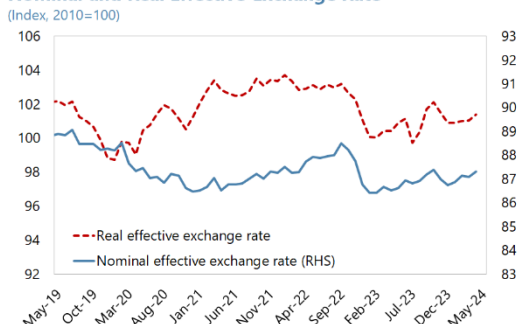


Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations.

**Figure 4. Bhutan: External Developments**

*The REER appreciated in the second half of 2023, partly unwinding the depreciation which began in late 2022.*

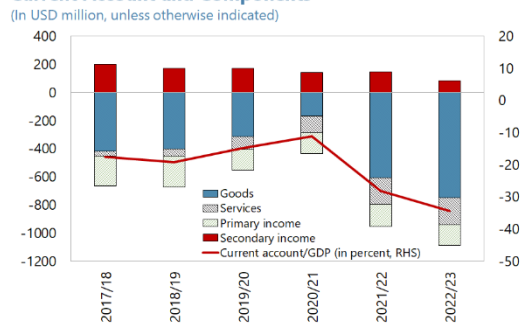
**Nominal and Real Effective Exchange Rate**



Sources: IMF INS data.

*The current account deficit widened significantly in FY 2021/22 and FY2022/23.*

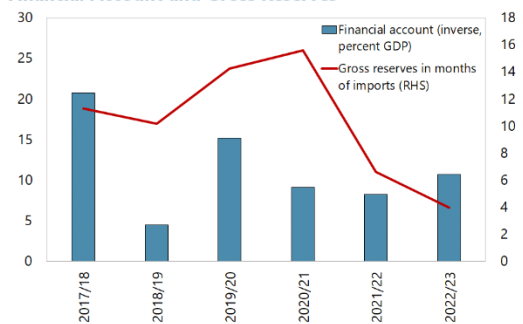
**Current Account and Components**



Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations. Note: FY2022/23 GDP is a projection.

*Reserves continued to fall due to imports of crypto assets mining equipment.*

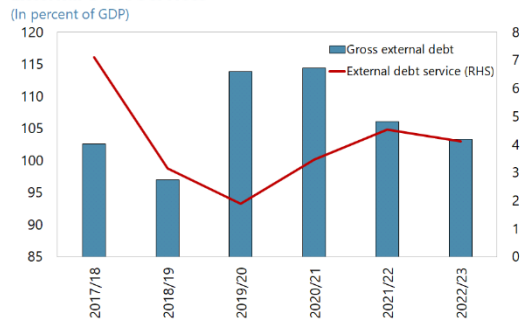
**Financial Account and Gross Reserves**



Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations. Note: FY2022/23 GDP is a projection.

*External debt service dynamics continue to be driven by the lifecycle of hydro projects.*

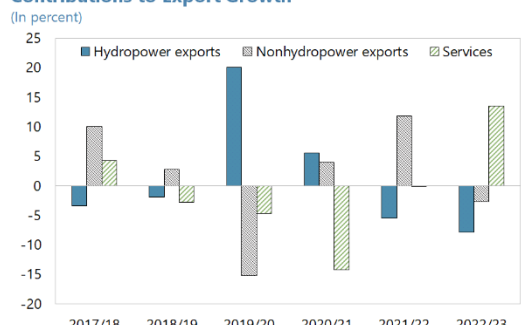
**External Debt Services**



Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations. Note: FY2022/23 GDP is a projection.

*Resumption of tourism helped offset the decline in other export sectors*

**Contributions to Export Growth**



Sources: Royal Monetary Authority of Bhutan; and IMF staff calculations.

*...and India remains Bhutan's major trading partner.*

**Foreign Trade**

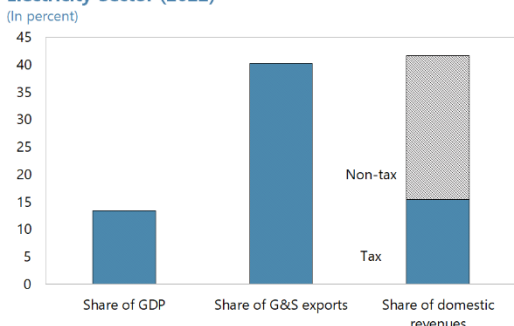


Sources: IMF DOT database; and IMF staff calculations.

**Figure 5. Bhutan: Hydropower Sector Developments**

The energy sector dominates output and exports while serving as a main source of financing the budget.

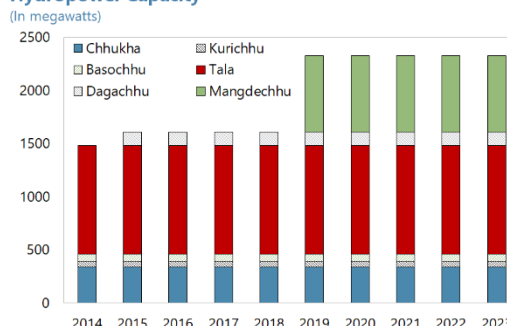
**Electricity Sector (2022)**



Sources: Bhutan authorities; and IMF staff calculations.

However, power generation capacity has remained largely unchanged since the pandemic.

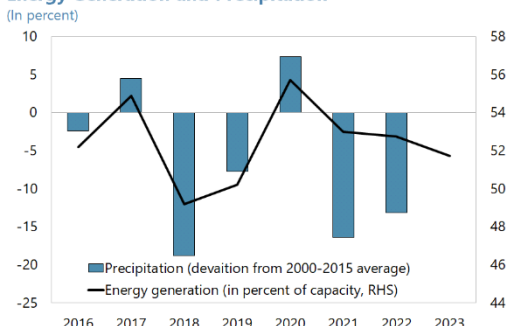
**Hydropower Capacity**



Sources: Bhutanese authorities.

Energy generation has recently declined due to unfavorable weather.

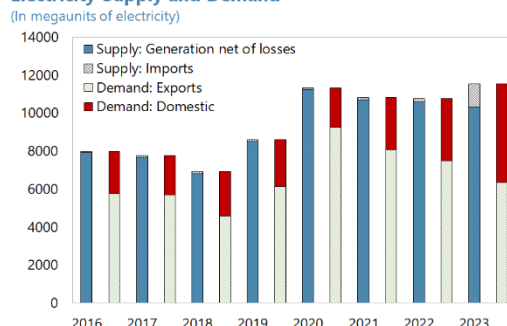
**Energy Generation and Precipitation**



Sources: Bhutanese authorities; and IMF staff calculations.

Lower generation and rising domestic demand have reduced exports and increased imports.

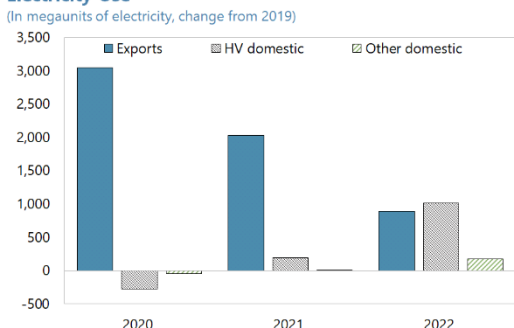
**Electricity Supply and Demand**



Sources: Bhutanese authorities; and IMF staff estimates. Note: For 2023, estimates based on partial data.

Domestic electricity demand has been mostly driven by high voltage demand likely from crypto mining, with electrification playing only a small part...

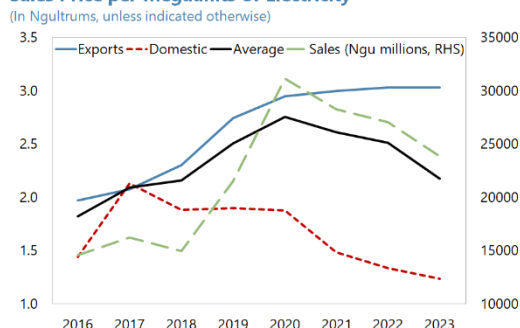
**Electricity Use**



Sources: Bhutan Ministry of Energy and Natural Resources; and IMF staff calculations.

...while the shift from higher priced exports to lower priced domestic sales is lowering revenues.

**Sales Price per Megaunits of Electricity**



Sources: Bhutan Power System Operator; Bhutan National Statistics Bureau; and IMF staff calculations.

**Table 1. Bhutan: Selected Economic and Financial Indicators, 2018/2019–2028/2029**

|   | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23   | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 | 2028/29 |
|---|---------|---------|---------|---------|-----------|---------|---------|---------|---------|---------|---------|
|   | Act.    | Act.    | Act.    | Act.    | ← Proj. → |         |         |         |         |         |         |
| (In percent of GDP, unless otherwise indicated)   |         |         |         |         |           |         |         |         |         |         |         |
| <b>National Accounts</b>  |         |         |         |         |           |         |         |         |         |         |         |
| Nominal GDP (in millions of ngultrum) 1/  | 184,660 | 187,378 | 193,386 | 216,239 | 237,322   | 261,026 | 292,837 | 325,812 | 357,677 | 393,607 | 438,906 |
| Real GDP growth (percent change) 1/   | 4.6     | -2.5    | -3.3    | 4.8     | 5.0       | 5.2     | 7.2     | 6.4     | 5.2     | 5.6     | 7.2     |
| <b>Prices</b>   |         |         |         |         |           |         |         |         |         |         |         |
| Consumer prices (EoP; percent change)   | 2.8     | 4.5     | 7.4     | 6.5     | 3.9       | 4.8     | 4.7     | 4.4     | 4.0     | 4.0     | 4.0     |
| Consumer prices (avg; percent change)   | 2.8     | 3.0     | 8.2     | 5.9     | 4.6       | 4.6     | 4.7     | 4.5     | 4.2     | 4.0     | 4.0     |
| GDP deflator (percent change)   | 2.2     | 4.0     | 6.7     | 6.7     | 4.5       | 4.6     | 4.6     | 4.6     | 4.4     | 4.2     | 4.1     |
| <b>General Government Accounts</b>  |         |         |         |         |           |         |         |         |         |         |         |
| Total revenue and grants  | 22.8    | 29.1    | 30.9    | 25.1    | 24.2      | 24.2    | 28.1    | 31.5    | 30.1    | 28.2    | 27.3    |
| Domestic revenue  | 18.8    | 19.3    | 18.5    | 18.1    | 18.9      | 20.3    | 19.3    | 20.7    | 20.7    | 20.8    | 22.4    |
| Tax revenue   | 14.7    | 12.2    | 10.7    | 12.0    | 13.3      | 13.4    | 14.0    | 14.4    | 14.8    | 14.8    | 15.2    |
| Non-tax revenue   | 4.1     | 7.2     | 7.9     | 6.1     | 5.6       | 6.9     | 5.4     | 6.3     | 5.9     | 6.0     | 7.3     |
| Foreign grants  | 5.5     | 8.5     | 7.5     | 6.2     | 6.0       | 3.9     | 8.8     | 10.8    | 9.4     | 7.4     | 4.9     |
| Internal and other receipts   | -1.6    | 1.3     | 4.9     | 0.9     | -0.7      | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| Total expenditure 2/  | 24.2    | 30.9    | 36.6    | 32.1    | 29.0      | 28.8    | 32.5    | 34.2    | 33.4    | 32.1    | 32.2    |
| Current expenditure   | 15.0    | 19.0    | 22.5    | 15.9    | 14.9      | 17.1    | 17.0    | 17.8    | 18.7    | 18.8    | 19.4    |
| Capital expenditure   | 8.8     | 11.8    | 14.3    | 16.1    | 14.2      | 11.8    | 15.5    | 16.4    | 14.8    | 13.3    | 12.8    |
| Primary expenditure 2/  | 23.4    | 30.5    | 35.7    | 30.6    | 27.3      | 27.2    | 30.5    | 31.4    | 29.9    | 28.3    | 27.7    |
| Primary balance   | -0.6    | -1.4    | -4.8    | -5.5    | -3.1      | -3.0    | -2.4    | 0.1     | 0.2     | -0.1    | -0.4    |
| Overall balance   | -1.5    | -1.8    | -5.8    | -7.0    | -4.8      | -4.6    | -4.4    | -2.7    | -3.3    | -3.9    | -4.8    |
| General government debt 3/  | 100     | 115     | 123     | 117     | 116       | 114     | 109     | 123     | 122     | 119     | 130     |
| Domestic  | 3       | 1       | 9       | 11      | 13        | 14      | 15      | 12      | 11      | 13      | 13      |
| External  | 97      | 114     | 114     | 106     | 103       | 100     | 94      | 111     | 111     | 106     | 117     |
| <b>Monetary Sector</b>  |         |         |         |         |           |         |         |         |         |         |         |
| Broad money (M2) growth (percent change)  | 5.6     | 19.3    | 24.4    | 9.4     | 9.8       | 12.6    | 13.2    | 12.3    | 13.0    | 12.2    | 11.5    |
| Private credit growth (percent change)  | 20.5    | 13.3    | 6.5     | 10.8    | 19.3      | 9.1     | 11.2    | 11.1    | 11.5    | 10.0    | 10.2    |
| <b>Balance of Payments</b>  |         |         |         |         |           |         |         |         |         |         |         |
| Current account balance   | -19.2   | -14.8   | -11.2   | -28.1   | -34.4     | -17.7   | -32.1   | -20.5   | -12.5   | -17.1   | -14.1   |
| Goods balance   | -15.3   | -12.1   | -6.4    | -21.1   | -25.7     | -12.9   | -26.9   | -15.0   | -6.1    | -10.1   | -8.8    |
| Hydropower exports  | 6.0     | 12.1    | 13.5    | 11.0    | 8.7       | 6.3     | 8.2     | 9.5     | 9.1     | 10.4    | 11.9    |
| Non-hydropower exports  | 17.3    | 13.0    | 13.9    | 15.8    | 14.9      | 15.7    | 15.9    | 15.8    | 17.1    | 18.1    | 18.8    |
| Imports of goods  | 38.6    | 37.1    | 33.9    | 47.9    | 49.2      | 40.2    | 55.6    | 52.4    | 45.6    | 42.1    | 42.2    |
| Services balance  | -1.9    | -3.5    | -4.4    | -6.5    | -6.7      | -3.7    | -2.8    | -3.6    | -3.8    | -3.6    | -3.0    |
| Primary balance   | -8.4    | -5.7    | -5.7    | -5.5    | -5.0      | -5.6    | -4.5    | -4.2    | -4.6    | -4.9    | -4.8    |
| Secondary balance   | 6.5     | 6.6     | 5.4     | 5.1     | 2.9       | 4.5     | 2.1     | 2.2     | 2.0     | 1.6     | 2.5     |
| Capital account balance   | 8.0     | 7.1     | 3.8     | 3.6     | 4.1       | 3.1     | 8.2     | 9.8     | 8.6     | 6.6     | 2.9     |
| Financial account balance   | -4.5    | -15.1   | -9.1    | -8.2    | -10.7     | -15.9   | -24.0   | -20.2   | -19.2   | -13.6   | -13.6   |
| Net errors and emissions  | 10.4    | 5.4     | -4.8    | 1.2     | 11.8      | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| Overall balance   | 3.7     | 12.9    | -3.0    | -15.1   | -7.8      | 1.2     | 0.1     | 9.4     | 15.3    | 3.2     | 2.5     |
| Gross official reserves (in USD millions)   | 1065    | 1344    | 1332    | 840     | 574       | 606     | 604     | 969     | 1616.3  | 1758.9  | 1878.7  |
| (In months of imports)  | 12.4    | 17.5    | 17.9    | 7.6     | 4.8       | 5.8     | 3.7     | 5.7     | 10.0    | 10.8    | 10.3    |
| (In months of goods and services imports)   | 10.1    | 14.2    | 15.6    | 6.6     | 3.9       | 4.6     | 3.2     | 4.8     | 8.1     | 8.6     | 8.4     |
| <b>Memorandum Items</b>   |         |         |         |         |           |         |         |         |         |         |         |
| Hydropower exports growth rate 4/   | -1.2    | 105.6   | 15.8    | -9.4    | -13.2     | -20.7   | 46.2    | 30.4    | 4.5     | 26.1    | 27.3    |
| Non-hydropower exports growth rate 4/   | 13.7    | -24.1   | 11.0    | 26.8    | 3.2       | 16.2    | 13.5    | 10.7    | 18.8    | 16.5    | 16.0    |
| Hydropower good imports 4/  | -15.3   | -3.5    | -21.2   | -11.6   | 14.9      | 50.8    | 18.4    | 61.1    | 14.0    | 3.3     | -19.1   |
| Non-hydropower good imports 4/  | 10.3    | -2.3    | -4.3    | 63.8    | 12.7      | -13.0   | 58.1    | 1.5     | -6.1    | 1.4     | 15.2    |
| Population in million (eop)   | 0.7     | 0.7     | 0.8     | 0.8     | 0.8       | 0.8     | 0.8     | 0.8     | 0.8     | 0.8     | 0.8     |
| External financing gap in US million  | ...     | ...     | ...     | ...     | 0         | 0       | 0       | 0       | 0       | 0       | 0       |
| Sources: Bhutanese authorities; and Fund staff projections.   |         |         |         |         |           |         |         |         |         |         |         |
| 1/ The GDP series does not reflect the value added from cryptocurrency mining due to lack of data.  |         |         |         |         |           |         |         |         |         |         |         |
| 2/ The expenditure for FY2020/21 and FY2021/22 includes an estimated amount for income support provided to individuals and loan interest payment support to borrowers financed by the National Resilience Fund. |         |         |         |         |           |         |         |         |         |         |         |
| 3/ Public and publicly guaranteed debt, including loans for hydropower projects.  |         |         |         |         |           |         |         |         |         |         |         |
| 4/ Nominal growth rates in local currency. No actual data on the breakdown of imports is available. The decomposition are estimates based on reported project spending and assumptions on import shares.        |         |         |         |         |           |         |         |         |         |         |         |

Table 2. Bhutan: Summary of Central Government Operations, 2018/2019–2028/2029

|   | 2018/19   | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 | 2028/29 |
|---|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|   | Act.  | Act.    | Act.    | Act.    | Prov.   | ←       | →       | Proj.   | →       | →       | →       |
|   | (in millions of ngultrum, unless otherwise specified) |         |         |         |         |         |         |         |         |         |         |
| <b>Revenue and Grants</b>                 | 42,033  | 54,604  | 59,696  | 54,355  | 57,543  | 63,173  | 82,314  | 102,741 | 107,623 | 111,000 | 119,972 |
| Domestic revenue                          | 34,708  | 36,219  | 35,855  | 39,043  | 44,875  | 53,008  | 56,573  | 67,406  | 74,177  | 81,789  | 98,521  |
| Tax revenue                               | 27,171  | 22,793  | 20,662  | 25,843  | 31,487  | 34,889  | 40,887  | 47,014  | 52,966  | 58,259  | 66,589  |
| Direct tax                                | 16,889  | 15,408  | 14,668  | 17,882  | 21,537  | 23,946  | 28,610  | 31,074  | 33,714  | 36,758  | 42,614  |
| Indirect tax                              | 10,282  | 7,385   | 5,993   | 7,961   | 9,950   | 10,943  | 12,277  | 15,940  | 19,252  | 21,501  | 23,975  |
| Nontax revenue                            | 7,537   | 13,426  | 15,194  | 13,200  | 13,388  | 18,119  | 15,686  | 20,391  | 21,212  | 23,530  | 31,932  |
| Foreign grants                            | 10,221  | 15,958  | 14,418  | 13,398  | 14,309  | 10,164  | 25,740  | 35,335  | 33,446  | 29,212  | 21,451  |
| India                                     | 6,485   | 11,444  | 10,324  | 9,644   | 10,968  | 5,618   | 19,654  | 24,771  | 22,171  | 18,104  | 12,800  |
| Other                                     | 3,737   | 4,514   | 4,094   | 3,754   | 3,341   | 4,547   | 6,086   | 10,564  | 11,275  | 11,107  | 8,651   |
| Internal grants and other receipts        | -2,896  | 2,427   | 9,423   | 1,913   | -1,640  | 0       | 0       | 0       | 0       | 0       | 0       |
| <b>Expenditure</b>                        | 44,777  | 57,989  | 70,836  | 69,387  | 68,820  | 75,196  | 95,219  | 111,511 | 119,605 | 126,396 | 141,129 |
| Current expenditure                       | 27,769  | 35,525  | 43,516  | 34,445  | 35,428  | 44,524  | 49,775  | 57,976  | 66,731  | 73,970  | 85,014  |
| Compensation of employees                 | 12,427  | 20,213  | 18,351  | 18,963  | 18,827  | 26,051  | 27,805  | 29,614  | 31,437  | 33,311  | 37,144  |
| Purchase of goods and services            | 9,090   | 9,302   | 7,986   | 8,603   | 9,699   | 11,168  | 12,529  | 14,591  | 16,734  | 18,808  | 20,973  |
| Interest                                  | 1,609   | 832     | 1,863   | 3,244   | 4,037   | 4,153   | 5,906   | 9,185   | 12,811  | 15,131  | 19,404  |
| Subsidies, grants, and social benefits    | 4,642   | 5,179   | 15,316  | 3,635   | 2,865   | 3,152   | 3,536   | 4,585   | 5,749   | 6,720   | 7,494   |
| Capital expenditure                       | 16,285  | 22,047  | 27,576  | 34,712  | 33,798  | 30,672  | 45,444  | 53,536  | 52,874  | 52,426  | 56,115  |
| Structure                                 | 11,007  | 14,598  | 20,450  | 24,193  | 27,133  | 18,127  | 28,442  | 36,900  | 38,903  | 37,052  | 38,971  |
| Other                                     | 5,278   | 7,449   | 7,126   | 10,519  | 6,665   | 12,545  | 17,002  | 16,636  | 13,971  | 15,374  | 17,143  |
| Advance/suspense (Net)                    | 723   | 417     | -256    | 230     | -406    | 0       | 0       | 0       | 0       | 0       | 0       |
| <b>Primary Balance</b>                    | -1,134  | -2,554  | -9,276  | -11,788 | -7,240  | -7,870  | -7,000  | 414     | 829     | -265    | -1,754  |
| <b>Overall Balance</b>                    | -2,743  | -3,385  | -11,140 | -15,032 | -11,277 | -12,023 | -12,906 | -8,771  | -11,982 | -15,396 | -21,157 |
| <b>Financing</b>                          | 2,743   | 3,385   | 11,140  | 15,032  | 11,277  | 12,023  | 12,906  | 8,771   | 11,982  | 15,396  | 21,157  |
| Net lending                               | -1,319  | 711     | 779     | -3,678  | -6,883  | 5,664   | 7,962   | 70,286  | 22,620  | 12,635  | 80,118  |
| Net borrowings                            | 1,424   | 4,096   | 11,919  | 11,354  | 4,394   | 17,688  | 20,868  | 79,057  | 34,602  | 28,030  | 101,275 |
| Net external                              | 1,101   | 3,527   | 1,487   | 4,087   | 2,372   | 13,339  | 12,708  | 85,586  | 34,650  | 24,079  | 97,793  |
| Borrowings                                | 3,433   | 5,303   | 5,212   | 9,521   | 8,022   | 19,040  | 18,304  | 92,679  | 43,892  | 37,920  | 114,402 |
| Repayments                                | 2,331   | 1,776   | 3,725   | 5,434   | 5,651   | 5,701   | 5,595   | 7,094   | 9,242   | 13,841  | 16,609  |
| Net domestic                              | 323   | 569     | 10,432  | 7,268   | 1,967   | 4,349   | 8,160   | -6,529  | -48     | 3,952   | 3,482   |
| Borrowings                                | 334   | 569     | 10,445  | 7,281   | 1,967   | 21,336  | 16,271  | 487     | 641     | 5,557   | 10,319  |
| Repayments                                | 11  | 0       | 13      | 13      | 0       | 16,987  | 8,111   | 7,016   | 689     | 1,605   | 6,837   |
| <b>Memorandum Items</b>                   |   |         |         |         |         |         |         |         |         |         |         |
| Tax revenue (excl. SDF and hydro royalty) | 23,065  | 18,852  | 16,565  | 21,826  | 25,319  | 27,776  | 31,161  | 37,114  | 42,675  | 47,473  | 53,622  |
| Public debt 1/                            | 184,175   | 215,370 | 238,399 | 253,744 | 275,448 | 296,950 | 319,910 | 400,955 | 437,469 | 467,593 | 571,583 |
| External                                  | 179,115   | 213,383 | 221,324 | 229,439 | 245,128 | 261,434 | 274,975 | 361,325 | 397,033 | 415,378 | 515,273 |
| Hydro                                     | 137,005   | 159,360 | 162,359 | 163,427 | 168,663 | 174,438 | 182,831 | 252,049 | 270,247 | 293,602 | 389,189 |
| Non-hydro                                 | 42,110  | 54,024  | 58,965  | 66,011  | 76,465  | 86,996  | 92,144  | 109,276 | 126,786 | 121,776 | 126,084 |
| Domestic                                  | 5,060   | 1,987   | 17,074  | 24,305  | 30,320  | 35,517  | 44,935  | 39,630  | 40,436  | 52,215  | 56,310  |
| Non-hydro debt                            | 47,170  | 56,010  | 76,040  | 90,317  | 106,785 | 122,513 | 137,079 | 148,907 | 167,222 | 173,991 | 182,394 |

Sources: Data provided by the Royal Government of Bhutan; and IMF staff estimates and projections.

1/ Public debt covers the non-financial public sector and the RMA. From 2021/22 onwards, it includes non-guaranteed SOE debt and consolidates intra-public sector holdings.

**Table 3. Bhutan: Summary of Central Government Operations, 2018/2019–2028/2029**

|   | 2018/19   | 2019/20 | 2020/21 | 2021/22 | 2022/23 | 2023/24 | 2024/25 | 2025/26 | 2026/27 | 2027/28 | 2028/29 |
|---|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|   | Act.  | Act.    | Act.    | Act.    | Prov.   |         |         | Proj.   |         |         |         |
|   | (In percent of GDP, unless otherwise indicated) |         |         |         |         |         |         |         |         |         |         |
| <b>Revenue and Grants</b>                 | 22.8  | 29.1    | 30.9    | 25.1    | 24.2    | 24.2    | 28.1    | 31.5    | 30.1    | 28.2    | 27.3    |
| Domestic revenue                          | 18.8  | 19.3    | 18.5    | 18.1    | 18.9    | 20.3    | 19.3    | 20.7    | 20.7    | 20.8    | 22.4    |
| Tax revenue                               | 14.7  | 12.2    | 10.7    | 12.0    | 13.3    | 13.4    | 14.0    | 14.4    | 14.8    | 14.8    | 15.2    |
| Direct tax                                | 9.1   | 8.2     | 7.6     | 8.3     | 9.1     | 9.2     | 9.8     | 9.5     | 9.4     | 9.3     | 9.7     |
| Indirect tax                              | 5.6   | 3.9     | 3.1     | 3.7     | 4.2     | 4.2     | 4.2     | 4.9     | 5.4     | 5.5     | 5.5     |
| Nontax revenue                            | 4.1   | 10.1    | 8.6     | 10.1    | 10.7    | 10.6    | 10.6    | 11.4    | 11.9    | 12.1    | 12.2    |
| Foreign grants                            | 5.5   | 8.5     | 7.5     | 6.2     | 6.0     | 3.9     | 8.8     | 10.8    | 9.4     | 7.4     | 4.9     |
| India                                     | 3.5   | 6.1     | 5.3     | 4.5     | 4.6     | 2.2     | 6.7     | 7.6     | 6.2     | 4.6     | 2.9     |
| Other                                     | 2.0   | 2.4     | 2.1     | 1.7     | 1.4     | 1.7     | 2.1     | 3.2     | 3.2     | 2.8     | 2.0     |
| Internal grants and other receipts        | -1.6  | 1.3     | 4.9     | 0.9     | -0.7    | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| <b>Expenditure</b>                        | 24.2  | 30.9    | 36.6    | 32.1    | 29.0    | 28.8    | 32.5    | 34.2    | 33.4    | 32.1    | 32.2    |
| Current expenditure                       | 15.0  | 19.0    | 22.5    | 15.9    | 14.9    | 17.1    | 17.0    | 17.8    | 18.7    | 18.8    | 19.4    |
| Compensation of employees                 | 6.7   | 10.8    | 9.5     | 8.8     | 7.9     | 10.0    | 9.5     | 9.1     | 8.8     | 8.5     | 8.5     |
| Purchase of goods and services            | 4.9   | 5.0     | 4.1     | 4.0     | 4.1     | 4.3     | 4.3     | 4.5     | 4.7     | 4.8     | 4.8     |
| Interest                                  | 0.9   | 0.4     | 1.0     | 1.5     | 1.7     | 1.6     | 2.0     | 2.8     | 3.6     | 3.8     | 4.4     |
| Subsidies, grants, and social benefits    | 2.5   | 2.8     | 7.9     | 1.7     | 1.2     | 1.2     | 1.2     | 1.4     | 1.6     | 1.7     | 1.7     |
| Capital expenditure                       | 8.8   | 11.8    | 14.3    | 16.1    | 14.2    | 11.8    | 15.5    | 16.4    | 14.8    | 13.3    | 12.8    |
| Structure                                 | 6.0   | 7.8     | 10.6    | 11.2    | 11.4    | 6.9     | 9.7     | 11.3    | 10.9    | 9.4     | 8.9     |
| Other                                     | 2.9   | 4.0     | 3.7     | 4.9     | 2.8     | 4.8     | 5.8     | 5.1     | 3.9     | 3.9     | 3.9     |
| Advance/suspense (Net)                    | 0.4   | 0.2     | -0.1    | 0.1     | -0.2    | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     | 0.0     |
| <b>Primary Balance</b>                    | -0.6  | -1.4    | -4.8    | -5.5    | -3.1    | -3.0    | -2.4    | 0.1     | 0.2     | -0.1    | -0.4    |
| <b>Overall Balance</b>                    | -1.5  | -1.8    | -5.8    | -7.0    | -4.8    | -4.6    | -4.4    | -2.7    | -3.3    | -3.9    | -4.8    |
| <b>Financing</b>                          | 1.5   | 1.8     | 5.8     | 7.0     | 4.8     | 4.6     | 4.4     | 2.7     | 3.3     | 3.9     | 4.8     |
| Net lending                               | -0.7  | 0.4     | 0.4     | -1.7    | -2.9    | 2.2     | 2.7     | 21.6    | 6.3     | 3.2     | 18.3    |
| Net borrowings                            | 0.8   | 2.2     | 6.2     | 5.3     | 1.9     | 6.8     | 7.1     | 24.3    | 9.7     | 7.1     | 23.1    |
| Net external                              | 0.6   | 1.9     | 0.8     | 1.9     | 1.0     | 5.1     | 4.3     | 26.3    | 9.7     | 6.1     | 22.3    |
| Borrowings                                | 1.9   | 2.8     | 2.7     | 4.4     | 3.4     | 7.3     | 6.3     | 28.4    | 12.3    | 9.6     | 26.1    |
| Repayments                                | 1.3   | 0.9     | 1.9     | 2.5     | 2.4     | 2.2     | 1.9     | 2.2     | 2.6     | 3.5     | 3.8     |
| Net domestic                              | 0.2   | 0.3     | 5.4     | 3.4     | 0.8     | 1.7     | 2.8     | -2.0    | 0.0     | 1.0     | 0.8     |
| Borrowings                                | 0.2   | 0.3     | 5.4     | 3.4     | 0.8     | 8.2     | 5.6     | 0.1     | 0.2     | 1.4     | 2.4     |
| Repayments                                | 0.0   | 0.0     | 0.0     | 0.0     | 0.0     | 6.5     | 2.8     | 2.2     | 0.2     | 0.4     | 1.6     |
| <b>Memorandum Items</b>                   |   |         |         |         |         |         |         |         |         |         |         |
| Tax revenue (excl. SDF and hydro royalty) | 12.5  | 10.1    | 8.6     | 10.1    | 10.7    | 10.6    | 10.6    | 11.4    | 11.9    | 12.1    | 12.2    |
| Public debt 1/                            | 99.7  | 114.9   | 123.3   | 117.3   | 116.1   | 113.8   | 109.2   | 123.1   | 122.3   | 118.8   | 130.2   |
| External                                  | 97.0  | 113.9   | 114.4   | 106.1   | 103.3   | 100.2   | 93.9    | 110.9   | 111.0   | 105.5   | 117.4   |
| Hydro                                     | 74.2  | 85.0    | 84.0    | 75.6    | 71.1    | 66.8    | 62.4    | 77.4    | 75.6    | 74.6    | 88.7    |
| Non-hydro                                 | 22.8  | 28.8    | 30.5    | 30.5    | 32.2    | 33.3    | 31.5    | 33.5    | 35.4    | 30.9    | 28.7    |
| Domestic                                  | 2.7   | 1.1     | 8.8     | 11.2    | 12.8    | 13.6    | 15.3    | 12.2    | 11.3    | 13.3    | 12.8    |
| Non-hydro debt                            | 25.5  | 29.9    | 39.3    | 41.8    | 45.0    | 46.9    | 46.8    | 45.7    | 46.8    | 44.2    | 41.6    |

Sources: Data provided by the Royal Government of Bhutan; and IMF staff estimates and projections.

Note: FY2022/23 GDP is a projection.

1/ Public debt covers the non-financial public sector and the RMA. From 2021/22 onwards, it includes non-guaranteed SOE debt and consolidates intra-public sector holdings.

Table 4. Bhutan: Balance of Payments, 2018/2019–2028/2029

|  | 2018/19             | 2019/20     | 2020/21     | 2021/22     | 2022/23       | 2023/24     | 2024/25       | 2025/26     | 2026/27     | 2027/28     | 2028/29     |
|--|---------------------|-------------|-------------|-------------|---------------|-------------|---------------|-------------|-------------|-------------|-------------|
|  | Act.                | Act.        | Act.        | Act.        | Act.          | ←           | ←             | Proj.       | →           | →           | →           |
| (In millions of U.S. dollars, unless otherwise indicated)  |                     |             |             |             |               |             |               |             |             |             |             |
| <b>Current Account Balance (including official grants)</b> | <b>-502</b>         | <b>-382</b> | <b>-293</b> | <b>-806</b> | <b>-1,001</b> | <b>-559</b> | <b>-1,130</b> | <b>-799</b> | <b>-532</b> | <b>-797</b> | <b>-728</b> |
| Trade balance (Goods, net)                                 | -402                | -314        | -169        | -606        | -746          | -406        | -947          | -582        | -258        | -474        | -458        |
| Exports  | 609                 | 647         | 720         | 768         | 684           | 860         | 1,007         | 1,456       | 1,685       | 1,493       | 1,725       |
| Hydropower   | 156                 | 312         | 355         | 315         | 252           | 197         | 287           | 372         | 387         | 486         | 615         |
| Crypto assets  | 0                   | 0           | 0           | 0           | 0             | 168         | 162           | 469         | 570         | 162         | 135         |
| Other  | 453                 | 335         | 366         | 453         | 432           | 495         | 558           | 615         | 728         | 845         | 975         |
| Imports  | 1,011               | 960         | 889         | 1,374       | 1,431         | 1,266       | 1,954         | 2,039       | 1,943       | 1,967       | 2,183       |
| Hydropower-related   | 93                  | 88          | 68          | 59          | 62            | 93          | 109           | 175         | 199         | 205         | 165         |
| Services, net  | -51                 | -91         | -114        | -188        | -194          | -117        | -97           | -139        | -160        | -170        | -154        |
| Credit   | 169                 | 133         | 22          | 22          | 129           | 185         | 244           | 268         | 289         | 316         | 350         |
| Debit  | 219                 | 224         | 136         | 210         | 322           | 303         | 341           | 407         | 449         | 485         | 504         |
| Primary income   | -221                | -148        | -151        | -158        | -146          | -176        | -158          | -165        | -197        | -230        | -247        |
| Credit   | 37                  | 29          | 22          | 24          | 36            | 42          | 44            | 49          | 53          | 58          | 65          |
| Debit  | 258                 | 178         | 172         | 182         | 182           | 218         | 202           | 213         | 250         | 288         | 312         |
| Interest paid on hydropower loans                          | 11                  | 118         | 144         | 162         | 28            | 36          | 9             | 19          | 43          | 68          | 92          |
| Other interest   | 32                  | 27          | 19          | 23          | 10            | 10          | 47            | 67          | 84          | 85          | 100         |
| Other  | 17                  | -134        | -132        | -134        | 144           | 171         | 147           | 128         | 123         | 135         | 120         |
| Secondary income   | 171                 | 171         | 141         | 146         | 85            | 141         | 73            | 87          | 83          | 76          | 131         |
| Credit   | 202                 | 191         | 182         | 188         | 170           | 232         | 175           | 200         | 207         | 212         | 281         |
| o.w. Budgetary grants                                      | 99                  | 94          | 78          | 82          | 53            | 49          | 40            | 55          | 52          | 45          | 101         |
| Debit  | 31                  | 21          | 41          | 41          | 84            | 91          | 102           | 113         | 124         | 135         | 150         |
| <b>Capital Account Balance 1/</b>                          | <b>208</b>          | <b>184</b>  | <b>101</b>  | <b>103</b>  | <b>120</b>    | <b>98</b>   | <b>289</b>    | <b>382</b>  | <b>367</b>  | <b>310</b>  | <b>152</b>  |
| Budgetary grants for investment                            | 58                  | 89          | 83          | 83          | 66            | 74          | 269           | 367         | 347         | 301         | 152         |
| Grants for hydropower development                          | 150                 | 95          | 17          | 20          | 54            | 24          | 20            | 14          | 20          | 8           | 0           |
| <b>Financial Account Balance</b>                           | <b>-118</b>         | <b>-391</b> | <b>-238</b> | <b>-235</b> | <b>-310</b>   | <b>-500</b> | <b>-843</b>   | <b>-785</b> | <b>-818</b> | <b>-636</b> | <b>-706</b> |
| Direct investment, net                                     | -13                 | 9           | -5          | -9          | -12           | -168        | -491          | -16         | -21         | -28         | -31         |
| Portfolio investment, net                                  | 0                   | 0           | 0           | 0           | 0             | 0           | 0             | 0           | 0           | 0           | 0           |
| Other Investment, net                                      | -105                | -400        | -233        | -227        | -298          | -332        | -352          | -769        | -796        | -608        | -675        |
| Budget   | -26                 | -107        | -56         | -98         | -80           | -99         | -90           | -305        | -413        | -179        | -262        |
| Hydro loans  | -75                 | -125        | -39         | -5          | -61           | -60         | -91           | -277        | -261        | -202        | -160        |
| RMA loans  | 0                   | 0           | 0           | 0           | 0             | 0           | 0             | 0           | 83          | 0           | 0           |
| Decrease in commercial banks net assets                    | -3                  | -2          | 2           | 7           | -10           | -4          | -4            | -4          | -5          | -5          | -5          |
| Private sector loans                                       | 8                   | -11         | -4          | 3           | 2             | -21         | -2            | -3          | -7          | -13         | -19         |
| Other  | -9                  | -154        | -136        | -134        | -149          | -147        | -165          | -180        | -194        | -210        | -229        |
| Net errors & omissions                                     | 273                 | 140         | -125        | 35          | 343           | 0           | 0             | 0           | 0           | 0           | 0           |
| <b>Overall Balance</b>                                     | <b>97</b>           | <b>333</b>  | <b>-79</b>  | <b>-432</b> | <b>-227</b>   | <b>39</b>   | <b>2</b>      | <b>367</b>  | <b>653</b>  | <b>150</b>  | <b>130</b>  |
| <b>Financing</b>   | <b>97</b>           | <b>333</b>  | <b>-79</b>  | <b>-432</b> | <b>-227</b>   | <b>39</b>   | <b>2</b>      | <b>367</b>  | <b>653</b>  | <b>150</b>  | <b>130</b>  |
| Accumulation of reserve assets                             | 33                  | 277         | -55         | -430        | -227          | 39          | 2             | 367         | 653         | 150         | 130         |
| SDR allocation   | 0                   | 0           | 0           | -28         | 0             | 0           | 0             | 0           | 0           | 0           | 0           |
| <b>Memorandum Items</b>                                    | (In percent of GDP) |             |             |             |               |             |               |             |             |             |             |
| Current account balance                                    | -19.2               | -14.8       | -11.2       | -28.1       | -34.4         | -17.7       | -32.1         | -20.5       | -12.5       | -17.1       | -14.1       |
| Trade balance (goods)                                      | -15.3               | -12.1       | -6.4        | -21.1       | -25.7         | -12.9       | -26.9         | -15.0       | -6.1        | -10.1       | -8.8        |
| Services balance   | -1.9                | -3.5        | -4.4        | -6.5        | -6.7          | -3.7        | -2.8          | -3.6        | -3.8        | -3.6        | -3.0        |
| Primary income   | -8.4                | -5.7        | -5.7        | -5.5        | -5.0          | -5.6        | -4.5          | -4.2        | -4.6        | -4.9        | -4.8        |
| Secondary income   | 6.5                 | 6.6         | 5.4         | 5.1         | 2.9           | 4.5         | 2.1           | 2.2         | 2.0         | 1.6         | 2.5         |
| Capital account balance                                    | 8.0                 | 7.1         | 3.8         | 3.6         | 4.1           | 3.1         | 8.2           | 9.8         | 8.6         | 6.6         | 2.9         |
| Financial account balance                                  | 4.5                 | 15.1        | 9.1         | 8.2         | 10.7          | 15.9        | 24.0          | 20.2        | 19.2        | 13.6        | 13.6        |
| Direct investment, net                                     | -0.5                | 0.3         | -0.2        | -0.3        | -0.4          | -5.3        | -14.0         | -0.4        | -0.5        | -0.6        | -0.6        |
| Overall balance  | 3.7                 | 12.9        | -3.0        | -15.1       | -7.8          | 1.2         | 0.1           | 9.4         | 15.3        | 3.2         | 2.5         |
| External debt  | 97.0                | 113.9       | 114.4       | 105.8       | 102.9         | 99.3        | 93.7          | 99.3        | 104.5       | 103.4       | 101.2       |
| Trade balance  | -15.3               | -12.1       | -6.4        | -21.1       | -25.7         | -12.9       | -26.9         | -15.0       | -6.1        | -10.1       | -8.8        |
| Gross official reserves (in USD millions)                  | 1,065               | 1,344       | 1,332       | 840         | 574           | 606         | 604           | 969         | 1,616       | 1,759       | 1,879       |
| (In months of goods imports)                               | 12.4                | 17.5        | 17.9        | 7.6         | 4.8           | 5.8         | 3.7           | 5.7         | 10.0        | 10.8        | 10.3        |
| (In months of goods and services imports)                  | 10.1                | 14.2        | 15.6        | 6.6         | 3.9           | 4.6         | 3.2           | 4.8         | 8.1         | 8.6         | 8.4         |
| (In months of essential imports)                           | 19.7                | 24.5        | 23.2        | 15.5        | 11.5          | 12.1        | 12.1          | 19.3        | 32.3        | 35.1        | 37.5        |
| (ratio to short-term external debt) 2/                     |                     |             |             |             |               | 102         | 536           | 10304       | 19          | ...         | 997         |

Sources: Data provided by the Royal Government of Bhutan; IMF staff estimates and projections.

1/ Including grants for hydropower projects (Tala, Puna I, Puna II, Mangdechhu, Kholongchhu, Bunakha, Chamkarchhu, and Wangchhu).

2/ Includes debt with residual maturity of less than 1 year.

Table 5. Bhutan: Monetary Aggregates, 2014/2015–2022/2023

|  | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23              |
|--|---------|---------|---------|---------|---------|---------|---------|---------|----------------------|
|  | June    | June    | June    | June    | June    | June    | June    | June    | June                 |
| <b>Monetary Survey</b>                                 |         |         |         |         |         |         |         |         |                      |
| (In millions of ngultrum, unless otherwise indicated)  |         |         |         |         |         |         |         |         |                      |
| Net foreign assets                                     | 58,249  | 67,816  | 68,187  | 66,006  | 63,921  | 84,091  | 98,552  | 97,558  | 79,757               |
| Indian Rupee   | 4,034   | 7,315   | 18,237  | 6,423   | 5,592   | 6,583   | -245    | -12,452 | -15,828              |
| Other  | 54,214  | 60,499  | 50,239  | 60,351  | 58,329  | 77,507  | 98,797  | 110,194 | 95,747               |
| Net domestic assets                                    | 10,096  | 11,347  | 35,927  | 48,967  | 57,496  | 60,800  | 81,762  | 99,743  | 136,937              |
| Net claims on government 1/                            | -7,740  | -5,570  | 2,853   | 5,029   | 2,407   | -3,840  | 6,404   | 16,135  | 31,411               |
| Claims on nongovernment                                | 63,995  | 71,263  | 82,232  | 95,291  | 111,081 | 125,953 | 136,418 | 149,162 | 174,393              |
| Public enterprises 2/                                  | 7,174   | 6,106   | 7,047   | 8,306   | 6,231   | 7,141   | 9,856   | 8,907   | 7,010                |
| Private sector 3/                                      | 56,821  | 65,157  | 75,185  | 86,985  | 104,851 | 118,812 | 126,561 | 140,255 | 167,384              |
| Other items (net) 4/                                   | 46,160  | 54,346  | 49,158  | 51,353  | 55,992  | 61,313  | 61,059  | 65,554  | 68,868               |
| Broad money  | 68,344  | 79,163  | 104,114 | 114,974 | 121,417 | 144,890 | 180,314 | 197,301 | 216,694              |
| Narrow money   | 41,676  | 44,934  | 60,723  | 66,295  | 69,203  | 85,576  | 101,826 | 110,575 | 121,235              |
| Currency   | 5,946   | 6,102   | 8,788   | 9,234   | 9,744   | 11,783  | 11,875  | 10,242  | 9,535                |
| Demand deposits  | 35,729  | 38,832  | 51,936  | 57,061  | 59,459  | 73,793  | 89,951  | 100,333 | 111,700              |
| Quasi-money 5/   | 27,180  | 33,863  | 42,874  | 48,269  | 53,526  | 59,855  | 78,615  | 86,917  | 94,799               |
| <b>RMA</b>   |         |         |         |         |         |         |         |         |                      |
| Net foreign assets                                     | 55,113  | 64,173  | 64,821  | 61,418  | 59,109  | 79,127  | 93,730  | 93,296  | 74,692               |
| Indian Rupee   | 2,827   | 5,214   | 16,496  | 4,838   | 3,259   | 4,862   | -2,002  | -14,053 | -17,586              |
| Other  | 52,286  | 58,959  | 48,325  | 56,580  | 55,850  | 74,265  | 95,732  | 107,349 | 92,278               |
| Net domestic assets                                    | -28,864 | -36,370 | -30,493 | -27,948 | -27,135 | -34,077 | -31,452 | -37,146 | -30,975              |
| Net claims on government                               | -7,780  | -10,200 | -7,152  | -3,020  | -1,810  | -5,705  | -8,147  | -7,758  | 3,043                |
| Claims   | 0       | 0       | 0       | 0       | 2,500   | 0       | 0       | 0       | 3,637                |
| Minus: deposits  | -7,780  | -10,200 | -7,152  | -3,020  | -4,310  | -5,705  | -8,147  | -7,758  | -594 <sup>1</sup>    |
| Claims on DMB  | 1,697   | 267     | 578     | 709     | 725     | 760     | 884     | 1,278   | 1,207 <sup>1</sup>   |
| Claims on private sector                               | 28      | 33      | 36      | 32      | 26      | 21      | 17      | 14      | 9 <sup>1</sup>       |
| Minus: RMA bills                                       | 0       | 0       | 0       | 0       | 0       | 0       | 0       | 0       | 0 <sup>1</sup>       |
| Other items (net)                                      | -22,809 | -26,470 | -23,955 | -25,669 | -26,076 | -29,153 | -24,206 | -30,680 | -35,233 <sup>1</sup> |
| Reserve money  | 26,249  | 27,803  | 34,328  | 33,470  | 31,974  | 45,050  | 62,278  | 56,149  | 43,718 <sup>1</sup>  |
| <b>Memorandum Items</b>                                |         |         |         |         |         |         |         |         |                      |
| (Change in percent of initial stock of broad money)    |         |         |         |         |         |         |         |         |                      |
| Broad money  | 7.8     | 15.8    | 31.5    | 10.4    | 5.6     | 19.3    | 24.4    | 9.4     | 9.8 <sup>1</sup>     |
| Net foreign assets                                     | 6.9     | 14.0    | 0.5     | -2.1    | -1.8    | 16.6    | 10.0    | -0.6    | -9.0 <sup>1</sup>    |
| Net domestic assets                                    | 0.9     | 1.8     | 31.0    | 12.5    | 7.4     | 2.7     | 14.5    | 10.0    | 18.9 <sup>1</sup>    |
| Net claims on government                               | -9.1    | 3.2     | 10.6    | 2.1     | -2.3    | -5.1    | 7.1     | 5.4     | 7.7 <sup>1</sup>     |
| Claims on private sector                               | 11.0    | 12.2    | 12.7    | 11.3    | 15.5    | 11.5    | 5.3     | 7.6     | 13.7 <sup>1</sup>    |
| Other items (net)                                      | 5.3     | 12.0    | -6.6    | 2.1     | 4.0     | 4.4     | -0.2    | 2.5     | 1.7 <sup>1</sup>     |
| (Change in percent of initial stock of reserve money)  |         |         |         |         |         |         |         |         |                      |
| Reserve money  | -1.5    | 5.9     | 23.5    | -2.5    | -4.5    | 40.9    | 38.2    | -9.8    | -22.1 <sup>1</sup>   |
| Net foreign assets                                     | 17.0    | 34.5    | 2.3     | -9.9    | -6.9    | 62.6    | 32.4    | -0.7    | -33.1 <sup>1</sup>   |
| Net domestic assets                                    | -18.5   | -28.6   | 21.1    | 7.4     | 2.4     | -21.7   | 5.8     | -9.1    | 11.0 <sup>1</sup>    |
| Money multiplier                                       | 2.6     | 2.8     | 3.0     | 3.4     | 3.8     | 3.2     | 2.9     | 3.5     | 5.0 <sup>1</sup>     |
| Velocity of money                                      | 1.9     | 1.9     | 1.6     | 1.5     | 1.5     | 1.3     | 1.1     | 1.1     | 1.1 <sup>1</sup>     |
| Broad money/GDP  | 0.5     | 0.5     | 0.6     | 0.7     | 0.7     | 0.8     | 0.9     | 0.9     | 0.9 <sup>1</sup>     |
| Broad money growth (12-month percent change)           | 7.8     | 15.8    | 31.5    | 10.4    | 5.6     | 19.3    | 24.4    | 9.4     | 9.8 <sup>1</sup>     |
| Reserve money growth (12-month percent change)         | -1.5    | 5.9     | 23.5    | -2.5    | -4.5    | 40.9    | 38.2    | -9.8    | -22.1 <sup>1</sup>   |
| Credit to the private sector (12-month percent change) | 14.0    | 14.7    | 15.4    | 15.7    | 20.5    | 13.3    | 6.5     | 10.8    | 19.3 <sup>1</sup>    |

Sources: Royal Monetary Authority of Bhutan; and IMF staff estimates.

Note: FY2022/23 GDP is a projection.

1/ Includes deposits of some public enterprises and off-budgetary entities; as such, data differ from bank financing data reported in the fiscal accounts

2/ From 2011/12 onward, public enterprises include government corporations and other public corporations as in the previous definition.

3/ From 2011/12 onward, private sector credit includes joint corporations, NBFIs and private sector as in the previous definition.

4/ Includes foreign exchange valuation adjustments and capital accounts.

5/ Includes time and foreign currency deposits.

**Table 6. Bhutan: Selected Economic and Financial Stability Indicators, 2014/2015–2022/2023**

|  | 2014/15 | 2015/16 | 2016/17 | 2017/18 | 2018/19 | 2019/20 | 2020/21 | 2021/22 | 2022/23 |
|--|---------|---------|---------|---------|---------|---------|---------|---------|---------|
|  | June    | June    | June    | June    | June    | June    | June    | June    | June    |
| <b>Risk-Weighted Capital Adequacy Ratio</b>        |         |         |         |         |         |         |         |         |         |
| Financial sector                                   | 17.2    | 16.9    | 17.3    | 16.2    | 12.6    | 11.6    | 13.5    | 15.0    | 15.1    |
| Banks  | 17.5    | 17.9    | 17.2    | 16.4    | 15.8    | 12.1    | 13.9    | 14.4    | 15.1    |
| Nonbanks   | 15.7    | 13.0    | 17.4    | 15.1    | -5.1    | 9.1     | 10.9    | 19.0    | 25.9    |
| <b>Non-Performing Loans</b>                        |         |         |         |         |         |         |         |         |         |
| Financial sector                                   | 9.5     | 9.1     | 11.4    | 10.4    | 15.0    | 16.3    | 14.1    | 8.6     | 7.7     |
| Banks  | 9.7     | 9.8     | 12.5    | 10.8    | 9.9     | 14.5    | 11.5    | 6.5     | 7.9     |
| Nonbanks   | 7.9     | 5.8     | 6.8     | 9.4     | 30.6    | 21.8    | 22.4    | 15.8    | 17.0    |
| <b>Return on Assets (Banks Only) 1/</b>            | 1.2     | 0.3     | -1.1    | 1.2     | 0.3     | -3.1    | 0.1     | 1.1     | 1.3     |
| <b>Credit to Deposit Ratio (Banks Only)</b>        | 86.4    | 86.6    | 73.4    | 78.9    | 87.4    | 81.1    | 75.0    | 74.3    | 79.2    |
| <b>Statutory Liquidity Requirement Ratio (SLR)</b> |         |         |         |         |         |         |         |         |         |
| Banks  | 29.6    | 26.0    | 33.8    | 31.0    | 22.6    | 27.6    | 32.9    | 31.1    | 25.1    |
| Nonbanks   | 23.5    | 12.8    | 10.4    | 13.1    | 10.5    | 11.9    | 17.5    | 16.1    | 17.4    |

Sources: Data provided by the Royal Government of Bhutan; and IMF FSI database.

1/ ROA data from IMF FSI quarterly series ending in June.

## Appendix I. Risk Assessment Matrix

| Source of Threat             | Likelihood | Direction | Impact   | Policies to Minimize impact  |
|------------------------------|------------|-----------|--|--|
| <b>Domestic risks</b>        |            |           |  |  |
| Hydro project implementation | Medium     | ↓         | Delays in the completion of hydropower projects could lower exports and hinder the external and fiscal balances.   | Implement measures to broaden the tax base, improve tax administration and further diversify the economy   |
| GST Implementation           | Medium     | ↓         | Delays would hinder the medium-term outlook for tax revenues and the fiscal balances.  | Continue the recent progress on IT solutions to avoid further delays   |
| Banks Balance sheet risks    | Medium     | ↓         | The expiration of Covid-related loan deferment and interest relief policies could weigh on credit growth, as these support measures had masked weaknesses. | Support the exit of non-viable firms, ensure efficient restructuring. Banks should continue to build buffers and recognize problem loans                 |
| <b>External risks</b>        |            |           |  |  |
| Commodity price volatility   | High       | ↓         | Bhutan imports fuel for transportation and electricity during the dry season, higher fuel prices would hinder the external balance                         | Low external buffers imply little space to ameliorate the impact on fuel prices. Avoid delays on hydro projects and revisit domestic electricity prices. |
| Abrupt global slowdown       | Medium     | ↓         | Would hurt non-hydro exports and tourism hindering the external balance  | Tighten fiscal and monetary policy to protect reserves.  |
| Extreme climate events       | Medium     | ↓         | Bhutan is particularly sensitive to glacial lake outburst flows.   | Continue to invest in climate change adaptation  |

## Appendix II. External Sector Assessment

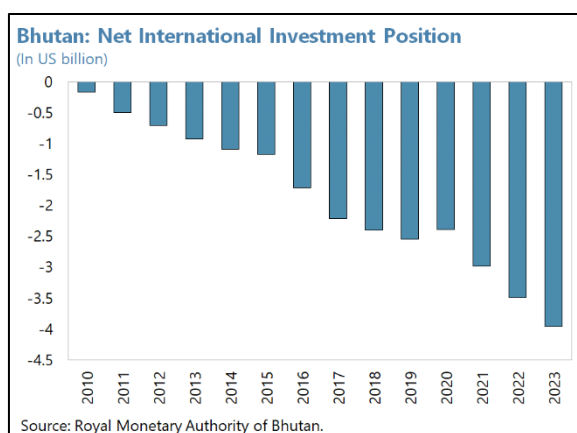
**Overall Assessment:** The external position of Bhutan in FY2022/23 was substantially weaker than the level implied by medium-term fundamentals and desirable policies. The current account deficit widened significantly, due to accommodative fiscal and monetary policies and large imports associated with investment in crypto mining equipment, while a slow recovery in tourism and delays in hydro projects weighed on exports. As a result, international reserves shrank further; as of end-June 2023, they amounted to less than half of their pre-pandemic level. The current account deficit is expected to narrow in FY2023/24 as returns from crypto assets mining are realized, tourism continues to recover, and imports of crypto mining equipment fall. Going forward, gradual fiscal consolidation, an increase in electricity and crypto assets exports should lead to an improvement in the current account balance. The net international investment position will continue to deteriorate as Bhutan develops its hydropower sector.

**Potential Policy Responses:** While part of the sizable current account deficit should reduce mechanically once one-off effects dissipate, these factors eroded reserve buffers and made apparent structural imbalances. Accommodative fiscal and monetary stances, which were appropriate during the pandemic, put pressure on reserves and now need to be reversed. In the long term, external imbalances will not be resolved without reforms to diversify exports. A credible fiscal consolidation plan accompanied by a tighter monetary policy stance is needed to limit the pressure on reserves and reduce non-hydro debt over the medium term, while helping to rebuild reserve buffers. Grants and concessional financing from development partners should continue to support Bhutan's development efforts.

### Foreign Assets and Liabilities: Position and Trajectory

**Background.** The net international investment position (NIIP) continues its downward trend, largely driven by developments in the financial account balance and the drawdown on reserves in FY2021/22, with some valuation effects stemming from the depreciation observed since 2017 (as a large share of external liabilities are in Indian rupees). The net IIP stood at US\$-4.0 billion (136 percent of GDP) by end-June 2023, US\$0.5 billion lower than by end-June 2022. External assets were US\$706 million (24 percent of GDP), mainly consisting of reserve assets (US\$554 million), currency and deposits and trade credits representing US\$153 million. External liabilities were US\$4.6 billion (160 percent of GDP), mainly consisting of loans (US\$4.4 billion). The loans are mostly long-term debt largely held by non-financial corporations; in particular, the hydropower debt is financed by India under an intergovernmental agreement, whereby India has a contractual obligation to purchase the electricity at a cost-plus-margin price, decreasing risks associated with high external debt (see DSA).

**Assessment.** Large financial inflows are needed for Bhutan to develop its hydropower potential. This implies an elevated negative NIIP, which poses a significant risk to external sustainability, and thus, requires careful monitoring going forward. The risk is partially mitigated by the composition of liabilities, which are mainly long-term debt, including intergovernmental debt with India and concessional debt from development partners. The ratio of reserves to short-term external debt is high. At its trough, reserves remain 18 times the level of short-term external debt. The current account deficit is expected to taper as one-off effects dissipates, tourism recovers, hydropower-related exports pick up and returns from crypto currency investments are realized.



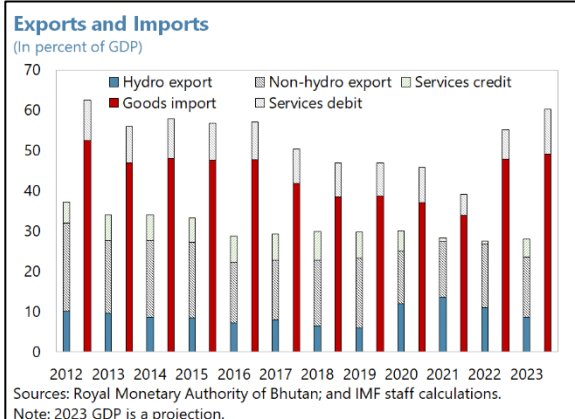
|                   |            |                  |                |                  |                 |
|-------------------|------------|------------------|----------------|------------------|-----------------|
| June 2023 (% GDP) | NIIP: -136 | Gross Assets: 24 | Debt Assets: 5 | Gross Liab.: 160 | Debt Liab.: 154 |
|-------------------|------------|------------------|----------------|------------------|-----------------|

## Current Account

**Background.** Bhutan's current account deteriorated significantly in FY2022/23 due to external shocks and strategic policy decisions which entailed short-term costs. The pandemic and Russia's war in Ukraine led to significant pressures; tourism came to a halt as the country closed its borders until end-September 2022, hydropower construction was delayed, pandemic relief measures kept imports buoyant, and higher commodity prices further increased imports. Several developments on the domestic front further worsened the external position. A lumpy investment in crypto mining technology was financed by the RMA, through a series of foreign currency bonds issued by a SOE, thereby depleting reserve assets and worsening import pressures. An increase in domestic demand for electricity lowered export earnings. The dramatic hike in the tax on tourism led to a slower recovery in service exports. At the same time, costs associated with emigration, particularly as many choose to pursue higher education, led to a spike in service imports. In addition, the authorities postponed the roll out of the GST, contributing to the fiscal deficit.

As a result of this conjunction of external shocks and domestic policies, the current account (CA) deficit widened to 34.4 percent of GDP in FY2022/23. The crypto mining investment contributed to about half of the worsening in the merchandise trade balance. The CA deficit is expected to narrow in FY2023/24, as one-off factors dissipate, tourism continues to recover and returns to crypto mining are realized. Going forward, gradual fiscal consolidation, an increase in electricity exports as new hydropower plants come online and crypto assets exports should reduce the current account deficit.

**Assessment.** The EBA-lite current account (CA) approach suggests that Bhutan's external position is substantially weaker than the level implied by fundamentals and desirable policies. The FY2022/23 current account balance reflects a lumpy one-off import (-13.4 percent of GDP). After filtering these temporary factors, the adjusted CA comes out at -21 percent of GDP. The CA norm based on the regression method is estimated at a deficit of 8.7 percent of GDP, implying that the actual CA deficit was around 12 percentage points too large. The relative policy gap explains about half of this gap (6.5 percentage points of GDP), reflecting the drop in reserve assets, and strict capital controls.<sup>1/</sup>



| <b>Bhutan: EBA-lite Model Results, 2023</b>   |                     |                      |
|---|---------------------|----------------------|
|   | <b>CA model 1/</b>  | <b>REER model 1/</b> |
|   | (in percent of GDP) |                      |
| <b>CA-Actual</b>  | <b>-34.4</b>        |                      |
| Cyclical contributions (from model) (-)   | 0.0                 |                      |
| Additional temporary/statistical factors (-) 2/                                     | -13.4               |                      |
| <b>Adjusted CA</b>  | <b>-21.0</b>        |                      |
| <b>CA Norm</b> (from model) 3/  | <b>-8.7</b>         |                      |
| Adjustments to the norm (+)   | 0.0                 |                      |
| <b>Adjusted CA Norm</b>   | <b>-8.7</b>         |                      |
| <b>CA Gap</b>   | <b>-12.3</b>        | <b>3.5</b>           |
| o/w Relative policy gap   | -6.5                |                      |
| Elasticity  | -0.3                |                      |
| <b>REER Gap</b> (in percent)  | <b>47.7</b>         | <b>-13.5</b>         |
| 1/ Based on the EBA-lite 3.0 methodology  |                     |                      |
| 2/ Additional adjustment to account for imports of crypto currency mining equipment |                     |                      |
| 3/ Cyclically adjusted, including multilateral consistency adjustments.             |                     |                      |

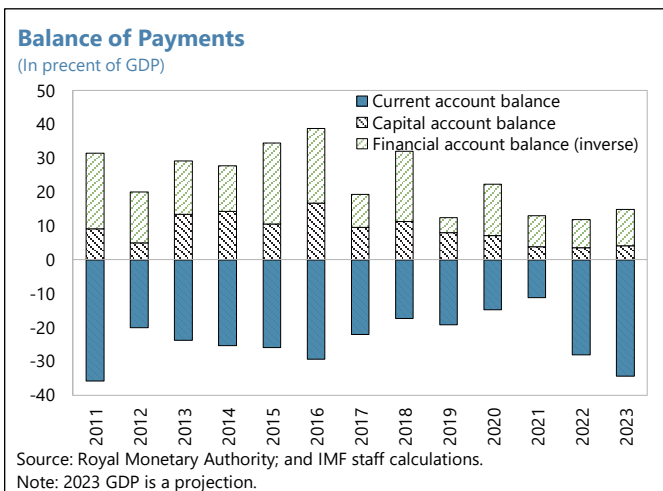
## Real Exchange Rate

**Background.** The ngultrum is pegged to the Indian rupee at par and has been broadly stable in real effective terms since pre-Covid-19. Specifically, the average real effective exchange rate (REER) based on trade partners and consumer prices depreciated by 2 percent between 2022 and 2023, and by 0.4 percent since 2019. Movements in the REER mostly follow developments of the rupee. The peg has been an adequate nominal anchor and remains appropriate as India is Bhutan’s largest trade and development partner. However, there are trade-offs as flexible exchange rates are useful shock absorbers. Maintaining the peg requires adequate reserves and appropriate fiscal and monetary policies to prevent large REER gaps relative to fundamentals.

**Assessment.** Both the EBA-lite CA and the REER methodologies are used to assess the REER gap for Bhutan. Based on the CA approach, the implied REER gap was estimated to be 47.7 percent, where the elasticity between the CA and REER gaps is calculated as the difference between the elasticity of exports and imports weighted by their respective GDP shares. This would mean that the exchange rate is substantially stronger than what would align with the level implied by fundamentals and desirable policies. Additional policy measures may be needed should reserves persist below required levels, with a one-step depreciation an option in the policy mix. However, given the structure of Bhutan’s current account—where the main export items are invoiced in Indian rupee (electricity and commodities) and the imports are driven by large infrastructure projects—the elasticity is lower than in other countries (Devarajan, Go and Robinson, 2023). The low elasticity might weaken the impact of a one-step depreciation on the CA gap. The rebuilding of reserves implies a gradual narrowing of the REER gap. The REER methodology, on the other hand, yields a negative REER gap of 13.5 percent. The policy gap is estimated to be 3.5 percentage points of this gap, due to reserve losses. However, the REER model is less reliable for a country like Bhutan.<sup>2/</sup>

### Capital and Financial Accounts: Flows and Policy Measures

**Background.** Bhutan’s capital account closed FY2022/23 at US\$120 million (4.2 percent of GDP), a slight pick-up from FY2021/22, but still lower than an average of 10.5 percent of GDP during FY2016-20. The capital account consists of budgetary grants for investment (US\$66 million) and grants for hydropower development (US\$54 million). Net financial account inflows increased to US\$310 million (10.7 percent of GDP) in FY2022/23, lower than the pre-Covid average (14.4 percent of GDP during FY2016-20), which was characterized by large inflows to finance hydropower. The financial account balance reflects net direct investment of US\$12 million, and net other investments of US\$298 million that include hydropower long-term loans in rupees and sovereign debt. The current account deficit is thus financed by both grants (capital account) and loans (financial account), with a sizable negative overall balance of US\$354 million (12.3 percent of GDP).

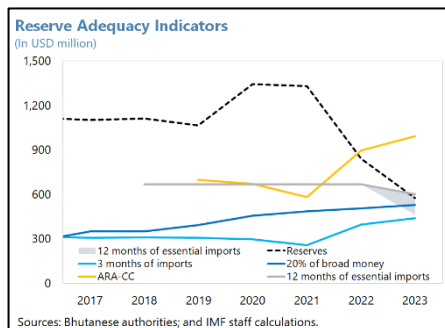
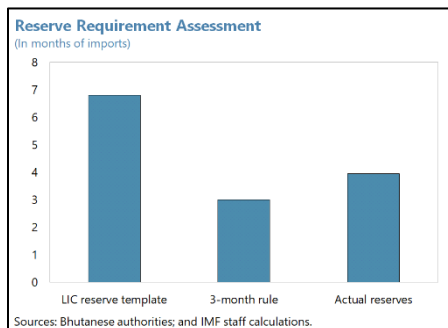


**Assessment.** In the medium term, the capital account will remain elevated as grants from India finances the 13<sup>th</sup> Five Year Plan. The financial accounts are expected to increase in the medium term, reflecting disbursements related to hydro power and other development projects. Given the concessional nature of financing and the long-term FDI-type of loan liability structure, the risks of imminent external financing stress related to capital flows are low in both the short- and medium-term.

### FX Intervention and Reserves Level

**Background.** Reserves fell from US\$1,332 million (16 months of imports of goods and services) at end-June 2021 to US\$609 million (4.7 months) at end-May 2024. This is explained by a worsening of the current account balance, which could not be entirely financed by capital inflows and was compounded by the on-lending of reserves to an SOE. The crypto mining investment contributed about two-thirds to the reserves decline.

**Assessment.** Bhutan’s reserves are below levels recommended by the reserve adequacy metric for credit constrained economies. Given Bhutan’s classification as a resource-rich economy, the fixed exchange rate regime, and the estimated cost of holding reserves of 6.2 percent (based on the marginal product of capital), the adequate level of reserves is assessed to be around 6.8 months of imports.



<sup>1</sup>The policy gap corresponding to reserves is usually meant to capture foreign exchange market interventions. In the case of Bhutan, the large, unwarranted drop in reserves is a consequence of the loan granted to DHI and loose domestic policies.

<sup>2</sup>The REER methodology is less reliable, as the model is not calibrated on a sample that includes Bhutan. Uncertain fixed effects thus play an important role in the result.

## Appendix III. Uptake of Previous IMF Advice

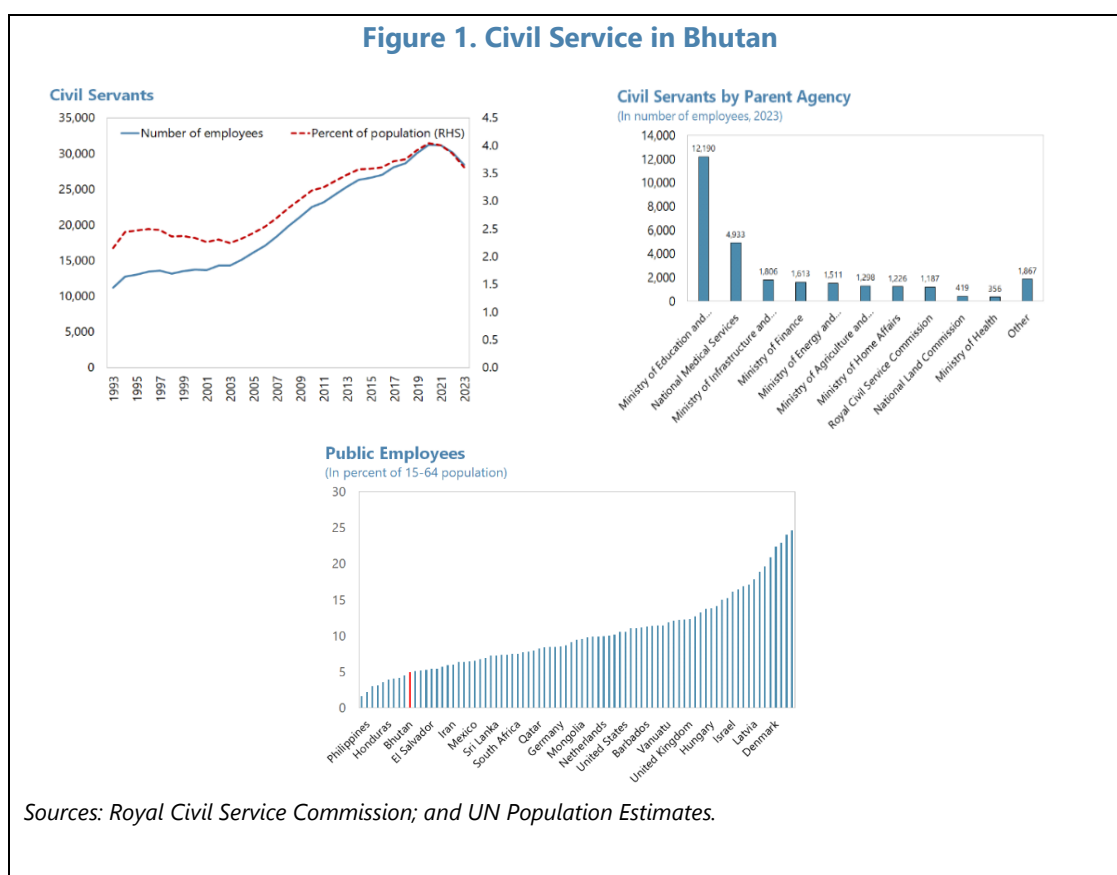
- 1. The authorities undertook a gradual fiscal consolidation, but it was not underpinned by revenue mobilization.** Fiscal consolidation was broadly in line with that envisaged during the last Article IV, albeit tax revenues have not picked up in line with expectations. Restraint on the wage bill was stronger than envisaged in FY2021/22 and FY2022/23, but the sharp increase in public sector wages in FY2023/24 increased budget rigidity. The shift in spending towards capital expenditures to address infrastructure needs is yet to materialize, but the expected increase in grants bodes well with a future shift.
- 2. The implementation of the GST remains delayed.** The GST was not implemented in June 2022, the timeline envisaged during the last Article IV consultation. While the authorities remain committed to implement it, they have not been able to overcome IT issues. The GST is now envisaged for FY2025/26, and it is being supported by the Fund CD.
- 3. There has been little progress towards implementing a new liquidity management framework.** While liquidity conditions are now more conducive to establishing an interest rate corridor, it has yet to materialize. The fiscal and financial support has been largely withdrawn and the liquidity position of the financial system is tighter, which should help progress in the future.
- 4. Broad-based forbearance measures have expired as planned.** Banks will determine any required loan restructuring to transition borrowers out of the blanket support measures on a case-by-case basis. Guidelines and regulations to reduce evergreening have been introduced. However, the pandemic-era relaxation of prudential regulations for housing loans are yet to be reversed. In line with Fund advice, the RMA is making progress towards risk-based supervision—including implementing of loan loss provisioning under IFRS for banks.

## Appendix IV. Bhutan’s Wage Bill Management

Faced with record levels of attrition in the civil service in 2022 and early 2023, the Bhutanese authorities approved a significant wage increase in June 2023. This appendix explores the context in which the wage revision was enacted and its implications.

### Background

**1. Bhutan’s civil service expanded significantly in the last three decades.**<sup>1</sup> The size of the civil service stood at 28,406 employees as of December 2023, compared to an average of 13 and 16 thousand employees in the 1990s and 2000s, respectively. Over this period, the civil service has grown faster than the population, whose growth rate remains positive but has been declining in recent decades. In 2008, there were 3 civil servants per 100 inhabitants. By 2020, the ratio had grown to 4.2 civil servants per 100 inhabitants, before declining to 3.7 by 2023. The size of the civil service is relatively small compared to other countries.

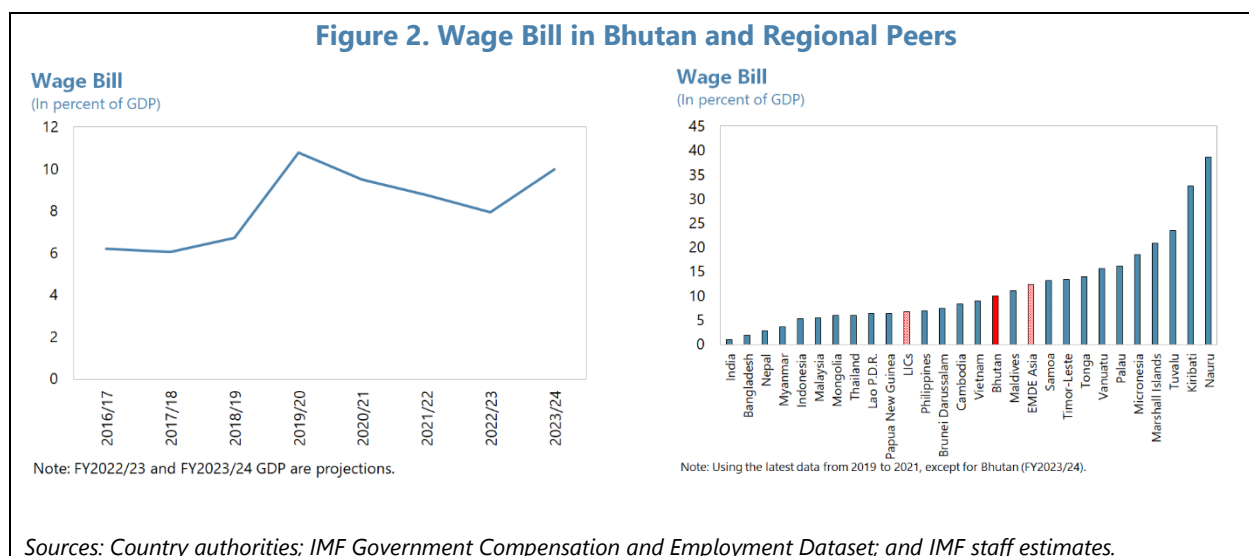


<sup>1</sup> Civil service coverage in this note is as per the definition of the Royal Civil Service Commission. It includes employees in Legislative, Constitutional bodies (except Election Commission of Bhutan), Ministries, Autonomous Agencies, Dzongkhags and Thromdes (subnational governments), and seconded to Non-civil Service Agencies. It does not include employees working in state-owned enterprises. It covers both regular and contract employees. It does not include armed forces personnel. Before 2022, civil service also included employees in the Judiciary (around 380), which have since been delinked.

**2. Most civil servants are employed in the provision of social services.** The Ministry of Education has the largest number of employees in Bhutan, representing 43 percent of the civil service. The National Medical Services is the next largest employer, with 17 percent of the total. In total, public education and health accounts in total for 60 percent of the civil service.

**3. Bhutan's wage bill has been growing.** Bhutan's wage bill averaged 6.3 percent of GDP between 2016/17 and 2018/19. With the implementation of the recommendations of the Fourth Pay Commission in 2019, which advised for pay hikes ranging from 14 to 29 percent, the wage bill increased substantially, surpassing 10 percent of GDP in FY2019/20. The wage bill declined afterwards and amounted to 8 percent of GDP in FY2022/23 because no further across-the-board increases were granted. With implementation of the recommendations of the Fifth and Sixth Pay Commissions, the wage bill is now expected to reach 10 percent of GDP in 2023/24.

**4. Bhutan's wage bill is relatively high compared to low-income peers, which may reflect the challenges of being a small economy.** Bhutan's wage bill in FY2022/23 was greater than the average wage bill among low-income countries and that of its larger neighbors in the region such as India, Bangladesh, and Nepal. However, Bhutan's wage bill is lower than in other small states in Asia such as the Maldives and Pacific Island countries.



## Recent Developments

**5. Bhutan has been faced with massive civil service attrition in recent years.** The number of separations from the civil service almost doubled in 2023 to 5,202 compared to 2,646 in 2022, which was already high by historical standards.<sup>2</sup> In fact, the number of separations from the civil service averaged 427 per year between 2018 and 2020. The number of separations in 2023 represented 17.2 percent of the civil service as of end-2022, compared to 8.5 percent in 2022,

<sup>2</sup> Separations include voluntary resignations, superannuation (retirement), and contract termination.

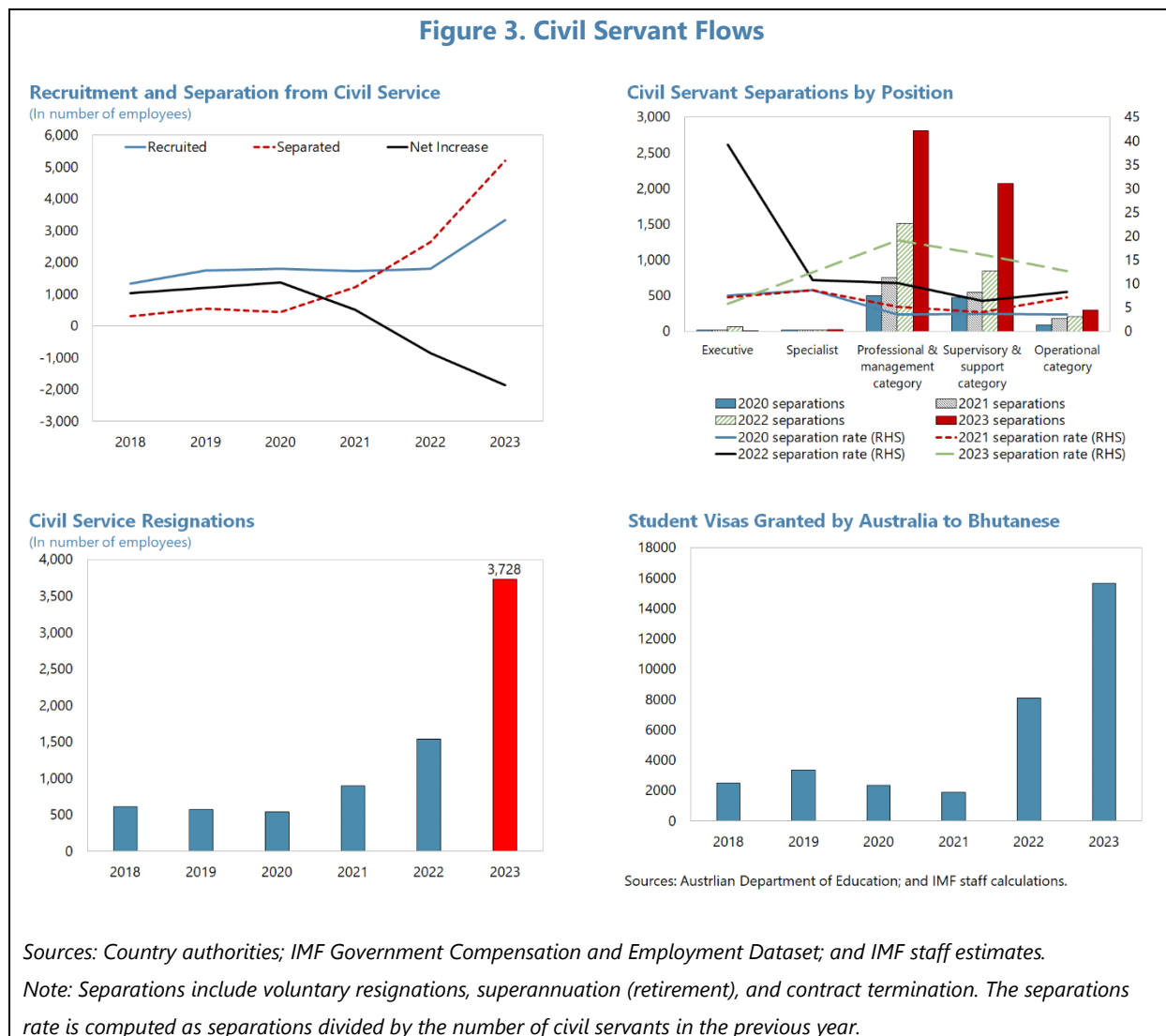
4.8 percent in 2021, and 1.5 percent on average between 2018 and 2020. Despite steady recruitment, the civil service shrank by 1,870 employees in 2023.

**6. Attrition is evident across the spectrum of civil servants.** Nineteen percent of the employees in the professional and management category separated in 2023, amounting to 2,810 employees and 54 percent of the separations. Thirteen percent of employees in the operational category and sixteen percent of those in the Supervisory and Support Category also separated in 2023. The attrition was lower for the more senior positions of executive and specialist in percentage, but those had already experienced high attrition in 2022. Narrowing pay compression ratios and restructuring of the civil service may have contributed to relatively higher attrition at the more senior positions in 2022, albeit further analysis would be needed to better understand its drivers.

**7. Attrition accelerated in 2023 despite a significant pay increase.** In the first five months of 2023, before the release of the report of the Sixth Pay Commission, 1,722 civil servants resigned voluntarily, already surpassing the record set by 2022. This included 183 resignations by health professionals and 488 resignations by teachers. Despite the announcement of the pay increase, two thousand additional resignations were submitted between June and December 2023. The impact of this exodus of civil servants is reportedly already affecting public service delivery and increasing the workload for the employees that remain. For instance, nurses remaining in their post are reportedly overburdened by having to take care of more patients and 132 out of the 420 government-run Early Childhood Care and Development Centers remain closed due to lack of facilitators (caregivers). To address attrition, the Royal Civil Service Commission has endeavored to hire aggressively. In 2023, it recruited 3,332 civil servants, particularly in education (1,607 new hires) and health care (549 new hires). Hiring procedures have been relaxed. For example, local governments have been allowed to hire teachers during the school year, rather only once a year; hiring of foreign nurses on a temporary contract has been approved; and applicants are now permitted to take the entry exam into the civil service as many times as desired provided they meet the age requirements. Going forward, digitalization could help improve efficiency and ensure continuity in public service delivery.

**8. There may be multiple reasons for the exodus of civil servants.** A vast majority of the attrition among civil servants is explained by migration out of Bhutan, particularly to Australia. The number of student visas granted by Australia to Bhutanese students skyrocketed to 13,503 between January and October 2023, an increase of 67 percent from the total number of visas granted in the whole 2022, which was in itself 331 percent higher than in 2021. High cost of living, poor pay and benefits, and work pressures have also been reported as reasons for quitting the civil service, although wages in the public sector do not appear lower than those in the private sector. In fact, even before the recent hike, civil servant's compensation was estimated to be 7.7 percent higher

than their private sector peers on average after controlling for education and demographic characteristics (Alaref and others, 2024).<sup>3</sup>



### Pay Revision Act of Bhutan 2023

**9. A significant increase in wages was recommended by the Sixth Pay Commission.** In view of the exodus of civil servants, the authorities decided to convene a new Pay Commission in early 2023, even though the Fifth Pay Commission had finished its work in October 2022, with its recommendations having been adopted by Parliament in November 2023 with effect in FY2023/24. The Commission recommended a uniform increase of 50 percent of the minimum pay scale across all positions in the civil service (in addition to the 5 percent increase already endorsed by the Pay

<sup>3</sup> Alaref, J., L. Martinoty, M. Viollaz, E. Bartl, P. Leite, and A. E. Ndip. 2024. "Bhutan Labor Market Assessment Report." World Bank, Washington, DC. The analysis uses the 2022 Bhutan Labor Force Survey. It finds that the average unadjusted public-private wage gap is 23.8 percent.

Structure Reform Act of 2022 and coming into effect also in July 2023). The recommended revision was complemented with a 10-20 percentage point increase in professional allowances in the health sector (that is, the professional allowance for general doctors was raised from 45 to 55 percent, for specialist doctors was raised from 55 to 70 percent, and for subspecialist doctors was raised from 60 to 80 percent). For the education sector, the Commission recommended shifting tenure-based professional allowances to competency-based allowances.

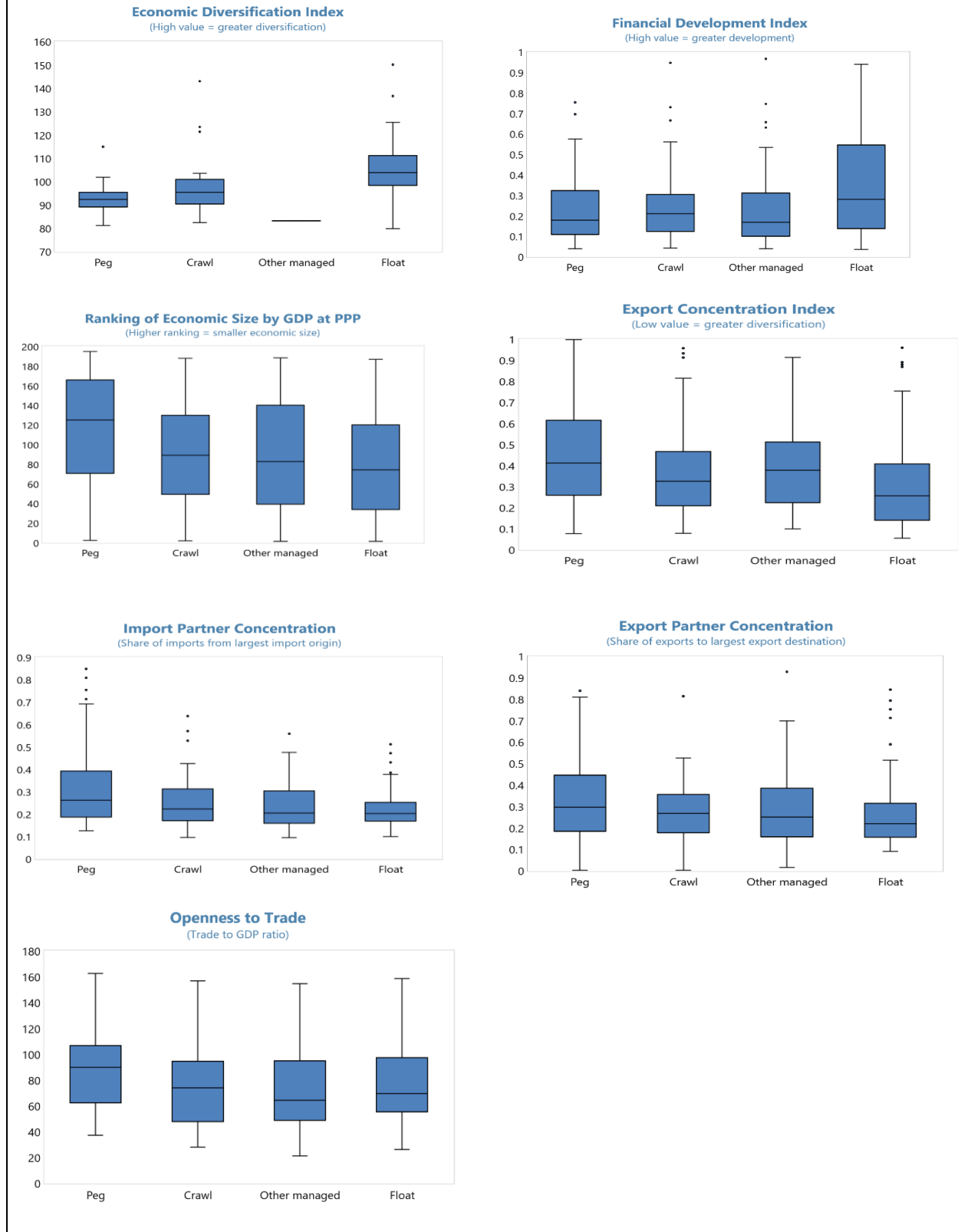
**10. Parliament adopted most of the recommendations of the Sixth Pay Commission through the Pay Revision Act of Bhutan 2023.** The pay increases recommended by the Commission were approved in June 2023. The Commission's recommendation to change educational professional allowances to be based on competencies, rather than length of service, was not taken on board. Annual leave for civil servants has been increased from 12 to 21 days.

**11. The wage hike will have significant and permanent fiscal implications.** The cost of this increase in wages is estimated at BTN 6 billion per year, which represents 2.3 percent of GDP in 2023/24. An exceptional dividend from state-owned holding company DHI would cover two thirds of the increase on average in 2023/24 and 2023/24. However, the remaining third would represent a worsening of an already fragile fiscal position with persistent effect into the medium term.

## Appendix V. The Choice of Exchange Rate Regime

- 1. A fixed exchange rate regime is simple to operate, supports price stability, and reduces trading costs.** The ngultrum has been pegged at parity to the Indian rupee since its inception. Provided reserves are sufficient, Bhutan 'borrows' the monetary policy credibility of the Reserve Bank of India, providing an effective nominal anchor and supporting price stability. Transaction costs are lower without frequent changes in the exchange rate, and this facilitates trade. These benefits come at a cost, as flexible exchange rate regimes are useful shock absorbers and allow monetary policy to respond to domestic economic conditions.
- 2. Bhutan's economic characteristics provide a strong case for a fixed regime.** It is a small economy, open to trade, and with tight economic linkages to India; shocks affecting the Indian economy have high spillover effects on Bhutan. Although export and output bases are narrow, Bhutan is less exposed to terms of trade shocks since hydropower, the main export, is sold under long-term contracts. Hence the benefits from a flexible exchange rate as an external shock absorber are moderated. The peg also allows Bhutan to have an effective nominal anchor, with operational simplicity. In contrast, flexible exchange rates, especially those accompanied by an inflation targeting regime require greater institutional capacity to implement.
- 3. Countries with similar characteristics to Bhutan often have fixed exchange rate regimes.** Those with pegged regimes tend to be smaller, with less developed financial markets and greater concentration in trading partners compared to those with floating regimes. For example, Nepal, Eswatini and Lesotho are countries with pegged regimes that have high trading partner concentration and a similar level of financial development as Bhutan. The Bahamas have a more developed financial market, but a trade partner concentration that is as high as Bhutan's.

**Figure 1. Comparison Among Different Exchange Regimes**



# Appendix VI. Data Adequacy Assessment

Appendix VI. Table 1. Bhutan: Data Adequacy Assessment for Surveillance

| Data Adequacy Assessment Rating 1/  |  |        |                               |                            |                                   |                            |               |
|---|--|--------|-------------------------------|----------------------------|-----------------------------------|----------------------------|---------------|
| C   |  |        |                               |                            |                                   |                            |               |
| Questionnaire Results 2/  |  |        |                               |                            |                                   |                            |               |
| Assessment  | National Accounts  | Prices | Government Finance Statistics | External Sector Statistics | Monetary and Financial Statistics | Inter-sectoral Consistency | Median Rating |
|   | C  | B      | C                             | C                          | B                                 | C                          | C             |
| Detailed Questionnaire Results  |  |        |                               |                            |                                   |                            |               |
| Data Quality Characteristics  |  |        |                               |                            |                                   |                            |               |
| Coverage  | B  | B      | C                             | B                          | B                                 |                            |               |
| Granularity 3/  | C  |        | B                             | B                          | B                                 |                            |               |
|   |  |        | A                             |                            | A                                 |                            |               |
| Consistency   |  |        | C                             | C                          |                                   | C                          |               |
| Frequency and Timeliness  | D  | B      | C                             | C                          | C                                 |                            |               |
| <p>Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.</p> <p>1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.</p> <p>2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF <i>Review of the Framework for Data Adequacy Assessment for Surveillance</i>, January 2024, Appendix I).</p> <p>3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.</p> |  |        |                               |                            |                                   |                            |               |
| A   | The data provided to the Fund is adequate for surveillance.                                    |        |                               |                            |                                   |                            |               |
| B   | The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.  |        |                               |                            |                                   |                            |               |
| C   | The data provided to the Fund has some shortcomings that somewhat hamper surveillance.         |        |                               |                            |                                   |                            |               |
| D   | The data provided to the Fund has serious shortcomings that significantly hamper surveillance. |        |                               |                            |                                   |                            |               |
| <p><b>Rationale for staff assessment.</b> While there has been significant progress in several areas, certain shortcomings somewhat hamper surveillance. Key issues are the lack of quarterly national accounts and limited release of high-frequency indicators (including tourism arrivals), lack of quarterly reports of fiscal operations, the limited release of data surrounding the bitcoin mining operations, and the large errors and omissions in the Balance of Payments.</p>  |  |        |                               |                            |                                   |                            |               |
| <p><b>Changes since the last Article IV consultation.</b> The national accounts improved significantly as they were rebased from 2000 to 2017, while the CPI was rebased from 2012 to 2019. FSI are compiled based on IMF's methodology. Quarterly budget reports have not been available since 2023. In July 2022, as part of their year-end reconciliation, the RMA revised downwards the historical reserves data to reflect their claims on a domestic SOE.</p>   |  |        |                               |                            |                                   |                            |               |
| <p><b>Corrective actions and capacity development priorities.</b> Supported by the IMF, the authorities are in the process of producing quarterly national accounts, enhancing their CPI reporting to disaggregate by regions, improving their BOP statistics, and improving their fiscal reporting--including compliance with GFSM2014 and updating their chart of accounts.</p>   |  |        |                               |                            |                                   |                            |               |
| <p><b>Use of data and/or estimates different from official statistics in the Article IV consultation.</b> None</p>  |  |        |                               |                            |                                   |                            |               |
| <p><b>Other data gaps.</b> Data on migration flows is crucial to assess the impact of the recent surge in emigration--particularly to Australia.</p>  |  |        |                               |                            |                                   |                            |               |

Appendix VI. Table 2. Bhutan: Data Standards Initiatives

|  |
|--|
| Bhutan participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since June 2017. |
|--|

### Appendix VI. Table 3. Bhutan: Table of Common Indicators Required for Surveillance

As of June 2024

|  | Data Provision to the Fund |               |                                |                                     | Publication under the Data Standards Initiatives through the National Summary Data Page |        |                                    |        |
|--|----------------------------|---------------|--------------------------------|-------------------------------------|---|--------|------------------------------------|--------|
|  | Date of Latest Observation | Date Received | Frequency of Data <sup>6</sup> | Frequency of Reporting <sup>6</sup> | Expected Frequency <sup>6,7</sup>   | Bhutan | Expected Timeliness <sup>6,7</sup> | Bhutan |
| Exchange Rates   | May-24                     | Jun-24        | M                              | M                                   | D   | D      | NA                                 | 1D     |
| International Reserve Assets and Reserve Liabilities of the Monetary Authorities <sup>1</sup>            | Apr-24                     | Jun-24        | M                              | M                                   | M   | M      | 1M                                 | 1M     |
| Reserve/Base Money   | Apr-24                     | Jun-24        | M                              | M                                   | M   | M      | 2M                                 | 1Q     |
| Broad Money  | Feb-24                     | Jun-24        | M                              | M                                   | M   | M      | 1Q                                 | 1Q     |
| Central Bank Balance Sheet   | Apr-24                     | Jun-24        | M                              | M                                   | M   | M      | 2M                                 | 1Q     |
| Consolidated Balance Sheet of the Banking System   | Feb-24                     | Jun-24        | M                              | M                                   | M   | M      | 1Q                                 | 1Q     |
| Interest Rates <sup>2</sup>  | Dec-23                     | Jan-24        | M                              | M                                   | M   | D      | NA                                 | 1D     |
| Consumer Price Index   | Apr-24                     | May-24        | M                              | M                                   | M   | M      | 2M                                 | 1M     |
| Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —General Government <sup>4</sup> | Jun-23                     | Oct-23        | Q                              | Q                                   | A   | Q      | 3Q                                 | 1M     |
| Revenue, Expenditure, Balance and Composition of Financing <sup>3</sup> —Central Government              | Jun-23                     | Oct-23        | Q                              | Q                                   | Q   | Q      | 1Q                                 | 1M     |
| Stocks of Central Government and Central Government-Guaranteed Debt <sup>5</sup>                         | Mar-24                     | Apr-24        | Q                              | Q                                   | Q   | Q      | 2Q                                 | 1M     |
| External Current Account Balance   | Dec-23                     | May-24        | Q                              | Q                                   | Q   | Q      | 1Q                                 | 1Q     |
| Exports and Imports of Goods and Services  | Dec-23                     | May-24        | Q                              | Q                                   | M   | Q      | 12W                                | 1Q     |
| GDP/GNP  | 2022                       | May-23        | A                              | A                                   | Q   | Q      | 1Q                                 | 2Q     |
| Gross External Debt  | Dec-23                     | May-24        | Q                              | Q                                   | Q   | Q      | 2Q                                 | 1Q     |
| International Investment Position  | Dec-23                     | May-24        | M                              | M                                   | A   | Q      | 3Q                                 | 1Q     |

<sup>1</sup> Includes reserve assets pledged or otherwise encumbered, as well as net derivative positions.

<sup>2</sup> Both market-based and officially determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

<sup>3</sup> Foreign, domestic bank, and domestic nonbank financing.

<sup>4</sup> The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

<sup>5</sup> Including currency and maturity composition.

<sup>6</sup> Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual; ("I") irregular; and ("NA") not available.

<sup>7</sup> Recommended frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected.



# BHUTAN

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

August 2, 2024

Prepared By

Asia and Pacific Department

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| RELATIONS WITH OTHER IFIS | 5 |

## FUND RELATIONS

(As of June 30, 2024)

**Membership Status:** Joined: September 28, 1981; Article XIV.

### General Resources Account

|   | SDR Million | Percent of Quota |
|---|-------------|------------------|
| Quota                                     | 20.40       | 100.00           |
| Fund Holdings of Currency (Exchange Rate) | 15.85       | 77.72            |
| Reserve Tranche Position                  | 4.55        | 22.29            |
| Lending to the Fund                       |             |                  |

### SDR Department:

|                           | SDR Million | Percent of Allocation |
|---------------------------|-------------|-----------------------|
| Net Cumulative Allocation | 25.54       | 100.00                |
| Holdings                  | 25.98       | 101.71                |

**Outstanding Purchases and Loans:** None

**Latest Financial Arrangements:** None

**Projected Payments to Fund**<sup>1/</sup> (SDR million; based on existing use of resources and present holdings of SDRs):

|                  | Forthcoming |      |      |      |      |
|------------------|-------------|------|------|------|------|
|                  | 2024        | 2025 | 2026 | 2027 | 2028 |
| Principal        |             |      |      |      |      |
| Charges/Interest | 0.00        | 0.00 | 0.00 | 0.00 | 0.00 |
| <b>Total</b>     | 0.00        | 0.00 | 0.00 | 0.00 | 0.00 |

<sup>1/</sup>When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

**Implementation of HIPC Initiative:** Not Applicable

**Implementation of Multilateral Debt Relief Initiative (MDRI):** Not Applicable

**Implementation of Post-Catastrophe Debt Relief (PCDR):** Not Applicable

### Exchange System

Since its introduction in 1974, the ngultrum has been pegged to the Indian rupee at par. Bhutan continues to avail itself of transitional arrangements under Article XIV, Section 2, pursuant to which it maintains exchange restrictions in connection with: (i) foreign exchange balancing requirement on remittances of income in convertible currencies or other foreign currencies from FDI; and (ii) on the

availability of FX for importers who have not provided evidence that goods for which payments have been made were actually imported.

Bhutan also maintains exchange restrictions subject to Fund approval under Article VIII, Section 2(a) in connection with: (i) the foreign exchange balancing requirements for imports of capital goods (for projects involving FDI) and primary raw materials (for certain industrial projects); (ii) requiring FDI companies to pay for their operational expenses (including insurance payments) from their own foreign exchange resources; and (iii) requiring Bhutanese companies to pay the interest on and amortization of external loans from their own foreign currency resources.

Bhutan has continued to liberalize the exchange system, including through the new Foreign Exchange Rules and Regulations (FERR) 2022 and the External Commercial Borrowing (ECB) Guidelines 2023. Under the FERR, residents and non-residents can open foreign currency accounts with authorized banks in Bhutan. Non-residents can also open domestic currency accounts with authorized banks in Bhutan. Under the new ECB guidelines borrowers do not need to earn foreign currency to be eligible for ECB, if the loan is from a multilateral credit institution and the repayment liability is fixed in Ngultrum. At the same time, the INR travel allowance for Bhutanese was tightened from INR 30,000 during pilgrimage season and 10,000 per month at other times, to INR 25,000 semi-annually.

Finally, Bhutan provided an incentive to promote inward remittance. It started in 2021 with the RMA providing a 1 percent incentive amount on every converted convertible currency remitted to Bhutan by non-resident Bhutanese (Bhutanese Living Abroad); it was subsequently increased to 2 percent, and lastly to 10 percent. It was discontinued at end-2023 and later reinstated but only for the month of February 2024.

### **Article IV Consultation**

Bhutan has been on a 24-month consultation cycle. The 2022 Article IV consultation was concluded by the Executive Board on May 13, 2022.

### **Technical Assistance**

In recent years Bhutan has received technical assistance in the areas of tax policy, macro-fiscal capacity building, budget planning, treasury and cash management, national accounts statistics, balance of payments statistics, e-GDDS, government debt markets, producer price index, and the consumer price index. Bhutan has also received technical assistance and training from the South Asia Regional Training and Technical Assistance Center (SARTTAC) covering most recently reserve management, liquidity management and forecasting, implementation of the goods and services tax, tax administration, national accounts and BOP statistics.

A Resident Tax Administration Advisor was installed at the Ministry of Finance since 2023.

**Resident Representative**

Mr. Ranil Salgado has been the Senior Resident Representative since February 2024. He is based in New Delhi.

## RELATIONS WITH OTHER IFIS

Information on the activities of other IFIs in Bhutan can be found at:

- World Bank: <http://www.worldbank.org/en/country/bhutan/overview>
- Asian Development Bank: <https://www.adb.org/countries/bhutan/main>



# BHUTAN

## STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION —DEBT SUSTAINABILITY ANALYSIS

August 2, 2024

Approved By  
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Prepared by the staffs of the International Monetary Fund (IMF) and the International Development Association (IDA)<sup>1</sup>

| Joint Bank-Fund Debt Sustainability Analysis |   |
|--|---|
| <b>Risk of external debt distress</b>        | <i>Moderate</i>   |
| <b>Overall risk of debt distress</b>         | <i>Moderate</i>   |
| <b>Granularity in the risk rating</b>        | <i>Limited space to absorb shocks</i>   |
| <b>Application of judgment</b>               | <i>Yes. The risk of debt distress is assessed as moderate due to the FDI nature of hydro related-loans.</i> |

*Bhutan's risk of overall and external debt distress is assessed as moderate, unchanged from the 2022 DSA.<sup>2</sup> While the mechanical results point to a high risk of overall and external debt distress, with breaches in the thresholds for some indicators under the baseline scenario, judgement was applied given the unique mitigating factors. Most of the outstanding public and publicly-guaranteed debt is linked to hydropower project loans from the Government of India. These projects are implemented under an intergovernmental agreement under which the Government of India covers both financial and construction risks of the projects and commits to buy all surplus electricity at a price reflecting cost plus a margin. Overall, within the moderate rating, Bhutan is assessed to have limited space to absorb additional shocks, particularly export shocks. Going forward, a robust fiscal consolidation underpinned by revenue mobilization, a stable peg with the Indian rupee, reforms to improve productivity and competitiveness of the non-hydropower sector, and enhanced debt management would help to reduce the risk of debt distress.*

<sup>1</sup> Prepared in accordance with the [Guidance Note of the Joint Bank-Fund Debt Sustainability Framework for Low Income Countries](#), February 2018.

<sup>2</sup> Bhutan's debt carrying capacity is assessed as strong. The composite index (CI), estimated at 3 based on the April 2024 World Economic Outlook (WEO) and the 2022 World Bank Country Policy and Institutional Assessment (CPIA) data, indicates a medium debt-carrying capacity for Bhutan, but another medium signal in the upcoming WEO round would be necessary to downgrade Bhutan's debt carrying capacity from its current strong level determined by previous rounds. This represents an improvement compared to the medium debt-carrying capacity assessed in the 2022 DSA. If the CI were to remain below the lower bound of a strong debt carrying capacity (that is, 3.05) in the October 2024 WEO, the classification would revert back to medium debt carrying capacity.

## PUBLIC DEBT COVERAGE

**1. The coverage of public debt in this debt sustainability analysis (DSA) includes public and publicly-guaranteed (PPG) debt.** PPG debt covers the non-financial public sector and the central bank. It includes debt contracted by the central government, central bank (that is, the Royal Monetary Authority or RMA) debt (such as the standby credit facilities extended by the Government of India), and non-financial state-owned enterprises (SOE) debt, both external and domestic.<sup>3</sup> Bhutan's local governments, social security fund, and extra budgetary funds do not have any outstanding debt. The external debt definition is based on residency. Central bank debt for the purposes of monetary policy or reserves management is excluded in line with the guidance note (e.g., bilateral currency swap with the Reserve Bank of India, deposit from the Central Bank of Kuwait). The addition of non-guaranteed domestic SOE debt represents an expansion of coverage with respect to the 2022 DSA in line with the authorities' commitment under the World Bank's First Green and Resilient Growth Development Policy Credit (DPC) operation.<sup>4</sup> Because of full coverage of SOE external and domestic debt, the default shock of 2 percent of GDP for incomplete coverage in the contingent liability stress tests is removed. The calibration of the contingent liability shock includes the outstanding amount of the National Credit Guarantee Scheme as of end-June 2023 (0.2 percent of GDP). The calibration of the contingent liability shock also preserves the default value for the financial market risk (5 percent of GDP) and includes an additional 2 percent of GDP for public private partnerships (PPPs), estimated as 35 percent of their capital stock from the World Bank's database.

**Table 1. Bhutan: Debt Coverage**

| Subsectors of the public sector |  | Sub-sectors covered |   |
|---------------------------------|--|---------------------|---|
| 1                               | Central government   |                     | X |
| 2                               | State and local government   |                     | X |
| 3                               | Other elements in the general government   |                     | X |
| 4                               | o/w: Social security fund  |                     | X |
| 5                               | o/w: Extra budgetary funds (EBFs)  |                     | X |
| 6                               | Guarantees (to other entities in the public and private sector, including to SOEs) |                     | X |
| 7                               | Central bank (borrowed on behalf of the government)                                |                     | X |
| 8                               | Non-guaranteed SOE debt  |                     | X |

| 1 | The country's coverage of public debt   | The entire public sector, including SOEs |                       |   |
|---|---|--|-----------------------|---|
|   |   | Default                                  | Used for the analysis | Reasons for deviations from the default settings                          |
| 2 | Other elements of the general government not captured in 1.                   | 0 percent of GDP                         | 0.2                   | Outstanding amount of the National Credit Guarantee Scheme as of Jun 2023 |
| 3 | SoE's debt (guaranteed and not guaranteed by the government) 1/               | 2 percent of GDP                         | 0.0                   |   |
| 4 | PPP   | 35 percent of PPP stock                  | 2.0                   |   |
| 5 | Financial market (the default value of 5 percent of GDP is the minimum value) | 5 percent of GDP                         | 5.0                   |   |
|   | Total (2+3+4+5) (in percent of GDP)   |  | 7.3                   |   |

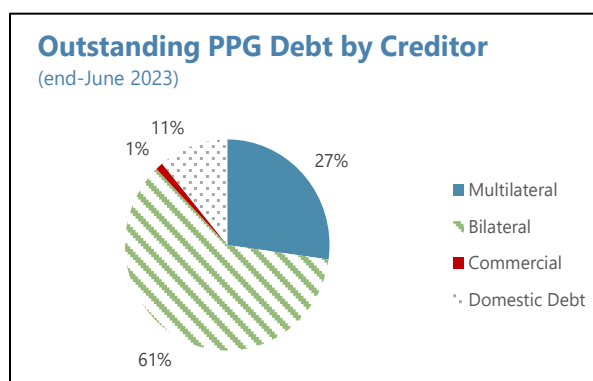
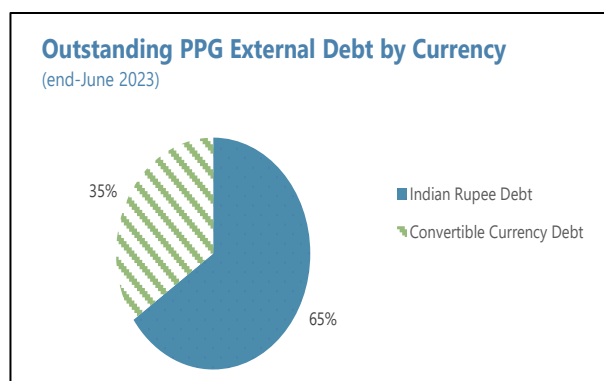
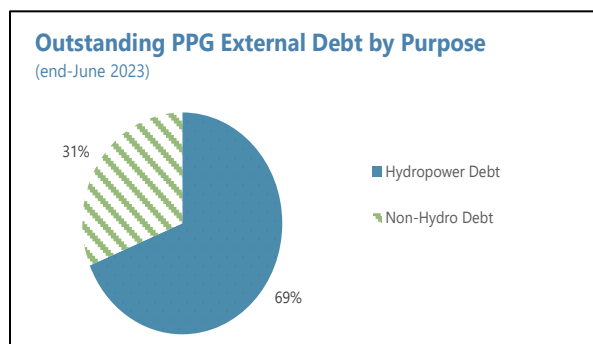
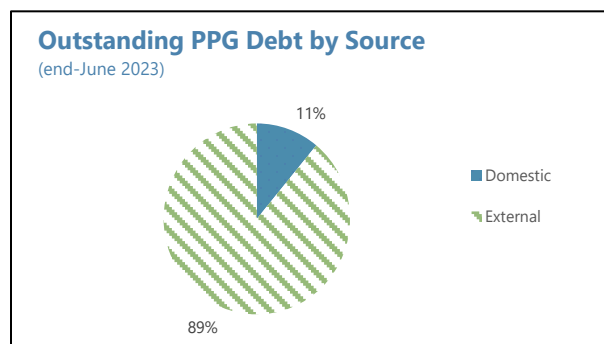
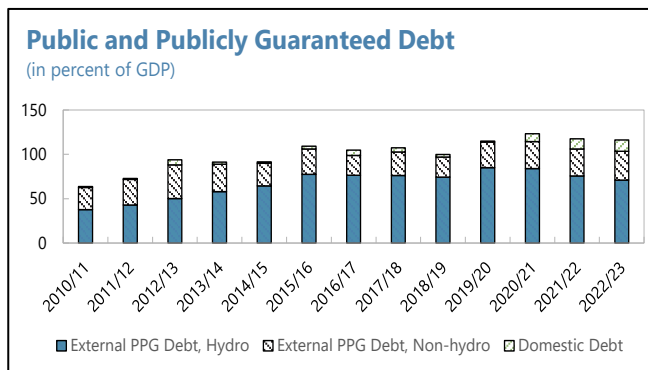
1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

<sup>3</sup> According to the Public Finance Act of Bhutan 2007, SOEs are required to seek approval from the Minister of Finance and Cabinet to contract any debt, actual or contingent.

<sup>4</sup> As part of the Sustainable Development Policy Financing (SDFP) of the IDA, Bhutan has been implementing Performance and Policy Actions (PPAs) to improve debt management and transparency, as well as to manage fiscal risks. For instance, during FY2020/21 to 2022/23, the authorities published quarterly public debt reports, the Medium-Term Debt Management Strategy, mandated the annual publication of the national DSA to strengthen the institutional capacity for risk assessment and monitoring of public debt, and published a new public debt policy. In addition, the authorities have improved the reporting of SOEs to strengthen the fiscal oversight of SOEs and related fiscal risks. During FY2023/24, the PPAs focused on i) the establishment of the legal entity for the running of

## BACKGROUND

**2. Public debt has increased substantially in the last decade due to investments in hydropower projects and the COVID-19 pandemic.** Public debt in Bhutan increased from 72.8 percent of GDP in FY2011/12 to 116.1 percent of GDP at the end of FY2022/23.<sup>5</sup> Out of this 43 percentage points increase, 28 percentage points were due to hydropower projects, primarily in the context of bilateral agreements with India. External non-hydro debt increased by only 3 percentage points over the decade and has helped finance infrastructure projects focusing on urban development, rural electrification, and the agriculture sector. Domestic debt rose from only 1.1 percent of GDP in FY2011/12 to 12.8 percent of GDP in FY2022/23, reflecting the authorities' development of the domestic debt market and the need to finance larger deficits in the context of the COVID-19 pandemic when tax revenues declined sharply, and spending pressures mounted.



crypto assets mining operations and publication of financial statements as per the legal requirement of the legal entity, and ii) improvements of service delivery and compliance management of large taxpayers in the Thimphu and Phuntsholing Regional Revenue and Customs Offices.

<sup>5</sup> Bhutan's fiscal year runs from July 1 to June 30. For tables and charts in this DSA, we adopt the convention 2024 = FY2023/24.

**3. Public debt stood at 116.1 percent of GDP at the end of FY2022/23.** External debt accounted for 89 percent of total debt. Hydropower debt was the largest part of external debt, comprising 69 percent of the external debt stock at the end of FY2022/23. Most of the hydropower projects were financed by the Government of India, with 65 percent of PPG external debt denominated in Indian rupees.<sup>6</sup> Non-hydropower external debt is predominantly owed to multilateral and bilateral creditors, with a small amount of guaranteed SOE debt. Overall, 61 percent of total debt is owed to bilateral creditors and 27 percent is owed to multilaterals. Domestic debt was mostly in the form of treasury bills and bonds, held primarily by domestic banks, insurance companies, and the public pension fund. Public sector debt is consolidated to remove intra-public sector lending (Text Table 1). This includes pension fund (that is, NPPF's holdings of treasury bills and bonds (Nu. 2.8 billion) and loans to SOEs (Nu. 2 billion), RMA's holdings of bonds issued by DHI (that is, Druk Holdings and Investments, an SOE) for US\$539 million, and a loan from the central government to Drukair (the public airline company) for Nu. 2.7 billion.<sup>7</sup>

**Text Table 1. Bhutan: Public Sector Debt Compilation**

(In Percent of GDP, End-June 2023)

| <i>(in percent of GDP)</i> | Central Government | RMA        | NPPF | Non-financial SOEs | Aggregated Public Sector | Consolidation | Consolidated Public Sector |
|----------------------------|--------------------|------------|------|--------------------|--------------------------|---------------|----------------------------|
| Domestic                   | 13.8               |            |      | 20.7               | 34.6                     | -21.8         | 12.8                       |
| External                   | 100.0              | 2.9        |      | 0.3                | 103.3                    |               | 103.3                      |
| <b>Total</b>               | <b>113.8</b>       | <b>2.9</b> |      | <b>21.1</b>        | <b>137.9</b>             | <b>-21.8</b>  | <b>116.1</b>               |

Note: It excludes on-lent debt.

**4. The hydropower-related debt from the Government of India is akin to foreign direct investment (FDI).**<sup>8</sup> As emphasized in the last seven DSAs, India provides financing for hydropower projects under an intergovernmental agreement, which guarantees returns from electricity exports and mitigates risks.<sup>9</sup> The Government of India bears the construction and financial risks and commits to buy all surplus electricity at a purchase price at cost (including costs of the project, financing costs, and operation and maintenance charges) plus a margin. The price of electricity is set at the time of project commissioning, when actual costs are known, and is set to allow revenue to service debt and a financial return, with the rate revisited every three years to incorporate changes in costs. Project

<sup>6</sup> The recently-completed and ongoing hydropower development projects with the Government of India (Punatsangchhu I, Punatsangchhu II, and Mangdechhu) are financed through commercially-priced loans (with a repayment period of 15 years beginning after the hydropower plant has been commissioned and an interest rate of 10 percent in Indian rupees), and capital grants from India, with the share of capital grants in the total capital cost ranging from 30 to 40 percent depending on the project.

<sup>7</sup> The NPPF's annual report for 2022/23 is not available yet, so their holdings of treasury bills and bonds are assumed to have remained stable as a share of the total from the levels in 2021/22.

<sup>8</sup> At present, there are three recently-completed and ongoing hydropower projects in this category: Punatsangchhu I, Punatsangchhu II, and Mangdechhu. Debt from previously-completed hydropower projects has already been repaid in full.

<sup>9</sup> For more details, please see Box 1 of the 2014 Bhutan Article IV DSA.

delays are not a concern for risk assessment because debt service begins only after the project is commissioned and the price of electricity is set based on the actual project costs.<sup>10</sup> Hydropower projects are insured (and re-insured) against the risk of natural disasters. The financing arrangements mitigate exchange rate risks because both the electricity export receipts and the hydropower debt services are denominated in Indian Rupees, to which the Ngultrum is pegged.<sup>11</sup> Debt default concerns are also mitigated given that the creditor is also the project's main client. In other words, risks associated with hydropower-related debt are largely mitigated.

### Box 1. Bhutan: Public Debt Management Policy 2023

Cabinet approved a new debt management policy in June 2023. The Public Debt Management Policy 2023 replaces the Public Debt Policy 2016 and aims to provide a framework to ensure prudent financing decisions and to guide investment plans. The new policy revises thresholds for public debt and maintains rules on government guarantees and the existing framework for debt monitoring and reporting (Text Table 2).

Government guarantees can be issued by the Minister of Finance after receiving Cabinet approval. In accordance with the Public Finance Act of Bhutan 2007, public companies can borrow, both domestically and externally, only after having received written consent from the Ministry of Finance.

A robust debt monitoring and reporting framework includes an annual Debt Sustainability Analysis, an annual Medium-Term Debt Management Strategy, and quarterly Public Debt Situation Reports.<sup>1</sup>

Compared to the previous Debt Policy, thresholds are broadly loosened for non-hydro debt. The policy adequately preserves an escape clause in case of economic crises. Importantly, the new debt policy covers domestic debt, which has become more relevant following the pandemic. However, it could have been useful to establish thresholds at a broader public sector level, in line with the coverage of this Debt Sustainability Analysis.

<sup>1</sup> The authorities are working on updating their Medium-Term Debt Management Strategy. The most recent version was issued in March 2021 covering FY2020/21 to 2022/23.

<sup>10</sup> Interest during construction is capitalized upon the commissioning of the hydropower plants and does not accrue further interest afterwards.

<sup>11</sup> While domestic demand has been rising sharply due to crypto assets mining operations and new ferroalloy plants limiting the scope for exports, the output produced by those industries is still exported and generates foreign currency to pay back debt service.

**Text Table 2. Bhutan: Comparison of Thresholds in Debt Management Policies**

|   | Public Debt Management                  |   |
|---|---|---|
|   | Policy 2023                             | Public Debt Policy 2016                     |
| <b>Central/General government debt</b>  |   |   |
| Total debt stock (excl. hydro) <sup>1,3</sup>   | 55 percent of GDP                       |   |
| Non-hydro external debt stock <sup>2</sup>  |   | 35 percent of GDP                           |
| Annual debt service (routed through the budget)   | 35 percent of total revenues            |   |
| Annual debt service   |   | 22 percent of domestic revenue              |
| Annual debt service of external debt  |   | 25 percent of exports of goods and services |
| Issuances of government guarantees <sup>1</sup>   | 10 percent of GDP                       | 5 percent of GDP                            |
| Short-term external debt (by original maturity and including debt contracted by the RMA) <sup>1</sup> |   | 30 percent of surplus reserves              |
| <b>Hydropower debt</b>  |   |   |
| Debt service coverage ratio   | 1.2                                     | 1.2   |
| Hydropower debt service <sup>1</sup>  | 50 percent of hydropower export revenue | 40 percent of hydropower export revenue     |
| Debt-to-equity ratio for hydropower projects  |   | 70:30                                       |

Notes:

1/ At any given year.

2/ During a 5-year plan period.

3/ Includes external and domestic debt.

## ASSUMPTIONS ON MACRO PROJECTIONS

**5. The near-term growth outlook reflects a gradual recovery from the severe COVID-19 pandemic shock, with hydropower exports and tourism supporting medium-term growth and a gradual decline in the current account deficit.** Growth had been strong prior to the COVID-19 pandemic, due to solid performance in the hydropower and service sectors but deteriorated sharply in 2020 and 2021 as the country went into lockdown, delaying construction of hydropower plants, and bringing tourism to a halt. Mining, manufacturing, and construction also slowed down considerably. Over the medium term, GDP growth, current account, and fiscal positions are expected to improve, with hydropower-related imports declining, electricity exports picking up, and tourism recovering, broadly in line with the assumptions in the 2022 DSA, albeit reflecting delays from major hydro projects and a slower pace of recovery in tourism.<sup>12</sup>

### Box 2. Bhutan: Status of Hydropower Projects

Hydropower projects will continue to play a major role in Bhutan's economy (Text Table 3). Two major hydropower projects, developed as part of the intergovernmental agreement with India, are expected to be commissioned before the end of this decade: Punatsangchhu II (1,020 MW, expected in CY2025, FY2025/26), and Punatshangchhu I (1,200 MW, expected in CY2029, FY2028/29). Within 5 years, the commissioning of these two projects will double the installed generation capacity as of end-2023 to 4,664MW.

<sup>12</sup> The slower-than-expected recovery in tourism partly reflects the changes in the Sustainable Development Fee (SDF) that was raised from US\$65 per person per day to US\$200 per person per day for international travelers in 2022. The fee was also extended to tourists from India, previously untaxed, with a cost of Rs. 1,200 per person per day. In August 2023, the SDF for international travelers was reduced to US\$100 per person per day to stimulate tourism.

### Box 2. Bhutan: Status of Hydropower Projects (concluded)

The timeline for commissioning the Kholongchhu plant (600 MW) is uncertain. Construction of the Kholongchhu project, a joint venture between DGPC (Druk Green Power Corporation, the Bhutanese SOE managing the hydropower projects) and an Indian SOE was halted in CY2022. DGPC has since acquired the Indian SOE's equity shares and is the sole shareholder of the project. New sources of financing are being explored, so that some delay in commissioning is expected. This DSA conservatively assumes Kholongchhu's commission early next decade.

The Dorjilung project is at an early stage. The Dorjilung hydro plant would have an installed capacity of 1,125 MW. The electricity would be produced in Bhutan and a significant share of it would be exported. Preliminary cost estimates amount to US\$ 1.3 billion. Financing from the World Bank to Bhutan in the form of loans and grants would cover some US\$ 300 million. The authorities are exploring additional concessional and commercial sources of financing, as well as reinvestment of profits from DGPC.

DGPC is also developing other smaller hydropower plants, which is financed with its own resources and debt. For example, a renewable energy loan worth EUR 150 million was recently signed with the EIB to finance construction of small to mid-size run-of-river hydropower plants and solar projects.

### Text Table 3. Bhutan: Major Hydropower Projects

|                                     | Construction |               | Installed     | Modality   |
|-------------------------------------|--------------|---------------|---------------|--|
|                                     | Started      | Commissioning | Capacity (MW) |  |
| <b>Existing Projects</b>            |              |               |               |  |
| Chukha                              | 1974         | 1988          | 336           | Intergovernmental  |
| Tala                                | 1997         | 2007          | 1,020         | Intergovernmental  |
| Kurichhu                            | 1995         | 2002          | 60            | Intergovernmental  |
| Basochhu                            | 1997         | 2005          | 64            | Financed by the Government of Austria                            |
| Dagachhu                            | 2009         | 2015          | 126           | Financed by the Government of Austria and Asian Development Bank |
| Mangdechhu                          | 2010         | 2019          | 720           | Intergovernmental  |
| Nikachhu                            | 2014         | 2024          | 118           | Financed by Asian Development Bank and State Bank of India       |
| <b>Total</b>                        |              |               | <b>2,444</b>  |  |
| <b>Projects under Construction</b>  |              |               |               |  |
| Punatsangchhu I                     | 2008         | 2029          | 1,200         | Intergovernmental  |
| Punatsangchhu II                    | 2010         | 2025          | 1,020         | Intergovernmental  |
| Kholongchhu                         | 2016         | TBD           | 600           | Non-intergovernmental (specific modality to be determined)       |
| <b>Total</b>                        |              |               | <b>2,820</b>  |  |
| <b>Projects under Consideration</b> |              |               |               |  |
| Dorjilung                           | -            | TBD           | 1,125         | Non-intergovernmental (specific modality to be determined)       |
| <b>Total</b>                        |              |               | <b>1,125</b>  |  |

Note: Years in this table correspond to Calendar Year (CY).

**6. The main baseline macroeconomic assumptions underpinning the 2024 DSA are as follows** (Text Table 4):

- Real GDP growth and inflation:**<sup>13</sup> Growth in FY2023/24 is expected to accelerate to 5.2 percent, compared to 5 percent in 2022/23.<sup>14</sup> Over the medium term, growth will be driven by new hydropower plants coming on stream, implementation of the 13<sup>th</sup> Five Year Plan (FYP)<sup>15</sup>, a recovery of the tourism sector, and a recovery in services and manufacturing.<sup>16</sup> Compared to the 2022 DSA, medium-term growth is higher due to the revised timeline of hydro plants' construction and the ambitious path for investment in the 13<sup>th</sup> FYP.<sup>17</sup> Long-term growth is projected to be around 5.2 percent, slightly lower from the 5.8 percent assumed in the 2022 DSA. Long-term growth remains underpinned by structural reforms that will support economic diversification, digitalization, and private sector-led growth. Inflation is expected to continue its steady decline towards 4 percent in the medium term, having already declined from 8.2 percent in FY2020/21. The GDP deflator is assumed to move in tandem with inflation, after adjusting for exchange rate depreciation.

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<sup>13</sup> The authorities' Gelephu Mindfulness City (GMC) project seeks to create a high-end market for Bhutanese goods and services. The project involves building a new city spanning 2,600 square km at the border with India. Ring-fencing the project will be key to limit downside fiscal risks for Bhutan. The city is envisaged as a Special Administrative Region (SAR) with legal independence and work on the relevant legal framework is ongoing. The current DSA does not account for financing of GMC.

<sup>14</sup> The historical GDP data and projections are underestimated because they do not reflect the full impact of the crypto assets mining operations due to lack of available data.

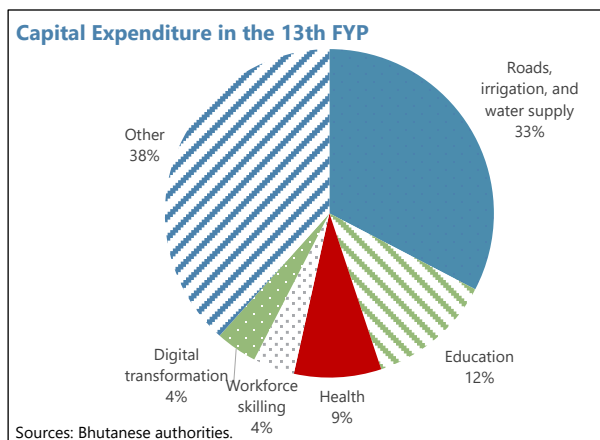
<sup>15</sup> The ambitious 13<sup>th</sup> FYP will run from 2024/25 to 2028/29 and will center on Prosperity, People, and Progress aiming to achieve the longer-term goal for Bhutan to become a high-income nation by 2035. It outlines key strategies for enhancing productivity, diversifying markets, and boosting contributions from strategic sectors to GDP.

<sup>16</sup> The volatility in the growth projections is due to: (i) the hydro/electricity sector and the commissioning of new hydropower projects. In the past, GDP growth has been driven by an expansion of investment during the construction phase of new hydropower plants and by generating discrete jumps in electricity exports to India when new plants are commissioned. On the supply side, this is reflected in discrete jumps in output in the electricity sector; (ii) the Five-Year Plan (FYP) planning cycle, which typically results in lower public investments in the first one to two years of the FYP.

<sup>17</sup> Past delays in hydropower projects have been caused by technical challenges. Good progress has been reported on the construction of Punatshangchhu II with filing of the reservoir having begun earlier this year. Other ongoing and future projects are not exempt from the risk of delays, which could add volatility to GDP projections. However, the impact of delays on debt sustainability are minimal because under the intergovernmental agreement with India, repayment of debt service only begins after commissioning of the hydropower plants.

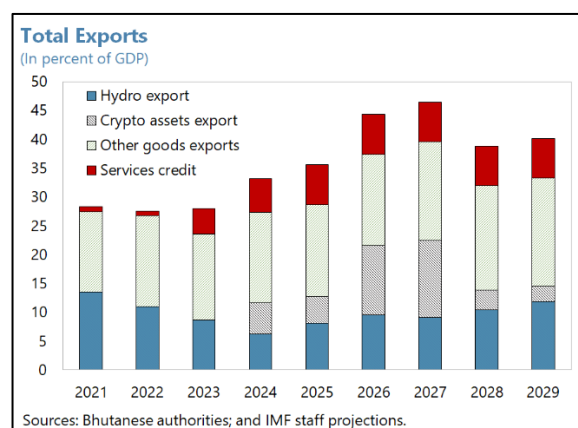
- Fiscal balance:** The general government fiscal deficit is projected to reach 4.6 percent of GDP in FY2023/24, a small improvement from the 4.8 percent of GDP achieved in FY2022/23.<sup>18</sup> A

substantial increase in public sector wages (2 percent of GDP) was granted in June 2023. An average of two thirds of that increase is being financed by an extraordinary dividend from DHI’s crypto assets operations in FY2023/24 and FY2024/25 (Box 3). Revenues net of grants would increase in the coming years because (i) hydropower revenues are expected to increase in FY2025/26 with the commissioning of Punatshangchhu II, (ii) a further pick-up in tourism would increase revenues from the SDF and (iii)



implementation of the Goods and Service Tax (GST) is expected by July 2025. External grants are projected to increase in the coming years as the 13<sup>th</sup> FYP goes underway, driven by India’s commitment for grants amounting Nu. 100 billion and access to IDA financing on small economy terms (50 percent grant and 50 percent credit), and investment projects are executed.<sup>19</sup> However, in the long run, they are expected to decline as Bhutan’s GDP per capita rises. A primary balance of around 0.2 percent of GDP is expected for the long run, more do conservative than the assumptions in the 2022 DSA.

- External balance:** The non-interest current account deficit (CAD) is expected to narrow to 16.3 percent of GDP in FY2023/24, after having reached 33.1 percent in FY2022/23. The spike in the CAD was mostly due to the lumpy imports of crypto assets mining equipment, higher imports for the construction of new hydropower plants, a slow post-COVID-19 recovery of tourism, and a jump in services imports due to high levels of emigration. The CAD is expected to worsen again to 30.6 percent of GDP in FY2024/25 due to another round of lumpy imports of crypto assets mining equipment, financed by FDI. Despite one-off factors subsiding and the start of crypto assets exports, imports are expected to remain elevated over the medium term as investment projects are executed and the CAD is expected to average 16.5 percent of GDP over the medium term. By



<sup>18</sup> There is a small difference between the fiscal balance at the general government level and that of the combined public sector as covered in this DSA due to off-budget debt service. The fiscal balance for the combined public sector is expected to have been 4.9 percent of GDP in 2023/24.

<sup>19</sup> External grants are low in 2023/24 because formulation of the 13<sup>th</sup> FYP was ongoing. With the 13<sup>th</sup> FYP adopted in [July 2024], external grants financing projects under the plan are expected to pick up.

2028/29, the CAD is expected to decline to 10.4 percent of GDP.<sup>20</sup> In the long term, the CAD is expected to average 4.4 percent of GDP thanks to the pickup in electricity exports, diversification of the export base and a decline in imports following the completion of the hydropower projects.

- **Financing mix:** The gross financing needs in the projection period are expected to be covered by both external and domestic debt. The financing mix envisages that external loans (including from IDA, ADB, EIB, and the Government of India for hydro projects) would finance around 82 percent of annual gross financing needs on average over the medium term, with the remainder financed by domestic borrowing. Recent domestic auctions for T-bills have yielded a rate of around 4 percent and the most recent T-bond auction resulted in a rate of 6 percent for a 2-year bond issued in November 2023. In the long term, the share of domestic financing is expected to increase and average 57 percent of annual gross financing needs, with a gradual shift from short-term treasury bills to medium- and long-term bonds. The share of concessional external debt is expected to decline over the long term as Bhutan develops. The cost of domestic debt is assumed to be 7.5 percent for longer-dated bonds.

**Text Table 4. Bhutan: Key Macroeconomic Assumptions**

|  | Current DSA |       |                |                | 2022 DSA |      |                |                |
|--|-------------|-------|----------------|----------------|----------|------|----------------|----------------|
|  | 2023        | 2024  | MT (2025-2029) | LT (2030-2044) | 2021     | 2022 | MT (2023-2027) | LT (2028-2042) |
| Real GDP growth (in percent)                             | 5.0         | 5.2   | 6.3            | 5.2            | -3.7     | 4.4  | 5.6            | 5.8            |
| GDP deflator in US dollar terms (in percent)             | -3.5        | 3.0   | 3.9            | 3.4            | 3.1      | 6.0  | 5.1            | 4.0            |
| Non-interest current account balance (in percent of GDP) | -33.1       | -16.3 | -16.5          | -4.4           | -10.4    | -8.9 | -4.7           | 4.0            |
| Growth of exports of G&S (US dollar term, in percent)    | 3.0         | 28.5  | 15.7           | 8.0            | -5.3     | 7.9  | 14.1           | 5.4            |
| Growth of imports of G&S (US dollar term, in percent)    | 10.7        | -10.5 | 12.5           | 7.5            | -6.2     | 15.2 | 7.4            | 4.9            |
| Primary fiscal balance (in percent of GDP)               | -3.1        | -3.0  | -0.5           | 0.2            | -5.3     | -8.8 | -2.9           | 1.7            |

Source: Bhutanese authorities and staff estimates.

Note: 2021 refers to FY 2020/21.

### Box 3. Bhutan's Crypto Assets Mining Investment

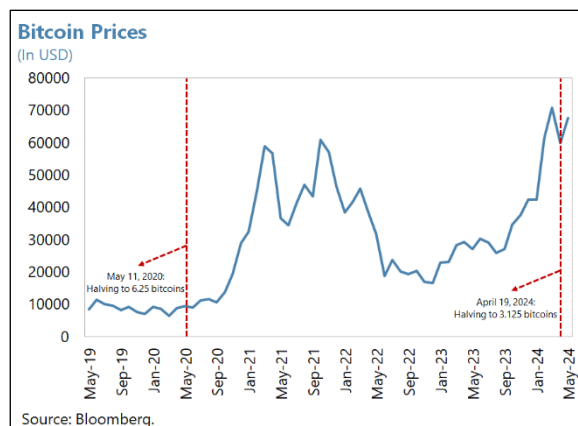
**State-owned Druk Holdings and Investment (DHI) has invested in crypto assets mining.** Given its access to low-cost hydropower and cool-climate conditions, Bhutan has a comparative advantage in crypto assets mining. Mining, mainly of bitcoin, at DHI's 420 MW facility began in 2022. Crypto assets mining has continued to expand. In August 2023, Bitdeer Technologies Group, a Singapore-based company, began crypto assets mining in Bhutan (100 MW). A second Bitdeer mine (500 MW) is under construction and is expected to begin operations in mid-2025.

**DHI's investment was funded using a loan from the Royal Monetary Authority (RMA).** Between August 2020 and April 2022, the RMA acquired dollar-denominated securities issued by DHI totaling US\$539 million. In contrast, DHI's exposure to Bitdeer's operations are limited to the sale of electricity to the facilities through a power purchase agreement. Bitdeer pays a premium relative to other high voltage domestic consumers, with the tariff broadly in line with the average tariff under the power purchase agreements with India.

<sup>20</sup> Crypto assets exports from the RMA-financed operation are assumed to be sufficient to fully repay the RMA, finance the DHI special dividend for the FY2023/24 and FY2024/25 budgets, and cover its electricity expenses.

### Box 3. Bhutan's Crypto Assets Mining Investment (concluded)

**The returns on this investment are uncertain, given the high volatility of bitcoin prices.** If bitcoin prices remain at around \$60,000 per coin, then DHI would be able to comfortably repay the RMA and earn a profit. Thus far, DHI made repayments in March 2024, as well as providing a special dividend of Ngu 2.7 billion (US\$ 33 million) to the government. They have committed to provide another special dividend of Ngu 5.3 billion (US\$ 64 million) in FY2024/25. The RMA agreed to extend the maturity of the outstanding DHI securities by two years, and these are now due to be repaid to the RMA between 2026 and 2027. The extension entails coupon payments at a 4 percent rate, compared to the original bullet bond at a 1.5 percent rate. The RMA has the right to request the sale of the crypto assets should it assess that reserves would decline below the constitutional minimum,



**The macroeconomic impact of this operation is significant.** The RMA financing entailed a large drop in reserves. While the authorities stressed the need to take advantage of the investment opportunity—which could spur other technology investments—it resulted in the need to impose policies which restricted select imports to support the peg. Going forward, it can increase exports and fiscal revenues, but it also creates the challenges of dealing with volatile returns as well as to carefully assess the competing demands for electricity (electrification, diversification of domestic production and exports). The authorities are prioritizing domestic consumption for households and other industries, including through their pricing policies.

**7. The realism tools suggest that macroeconomic and fiscal assumptions are broadly reasonable** (Figures 3 and 4). The 3-year adjustment in the primary balance is larger than the median of the sample of the 3-year fiscal adjustments for low-income countries (LICs) that were under an IMF-supported program since 1990, but it partly reflects a mechanical improvement of the fiscal position as Punatshangchhu II is commissioned and tourism recovers further. Growth would be higher than what would be implied by alternative assumptions on fiscal multipliers because the growth pick-up reflects hydro developments and implementation of the 13<sup>th</sup> FYP. The contribution of government capital to GDP growth is assumed to be low, in line with the previous DSA and the historical average.<sup>21</sup> Compared to the previous DSA, the debt dynamics feature two significant increases upon the commissioning of Punatshangchhu I and II when interest during construction will be recognized, yet those higher costs will be reflected in the electricity tariff to India, ensuring the resources needed for servicing this higher debt. Finally, historically, the PPG external debt has been driven by a large CAD, reflecting large hydro-related imports, similar to the medium-term projection.<sup>22</sup>

<sup>21</sup> In addition, the relative contribution of government capital to GDP growth (11 percent) is significantly lower than in the historical period (49 percent).

<sup>22</sup> Significant residuals on external debt drivers partly reflect weaknesses in balance of payments and international investment position data.

## COUNTRY CLASSIFICATION AND DETERMINATION OF SCENARIO STRESS TESTS

**8. Bhutan's debt carrying capacity (DCC) is assessed to be strong.** The Composite Indicator (CI) is based on a weighted average of several factors such as the country's real GDP growth, remittances, international reserves, world growth, and the World Bank CPIA score. The CI for this DSA is calculated based on the April 2024 World Economic Outlook (WEO) and the 2022 World Bank Country Policy and Institutional Assessment (CPIA) data, and indicates a medium debt carrying capacity. However, Bhutan's debt carrying capacity was previously assessed to be strong and so, another medium signal would be needed in the October 2024 WEO round for Bhutan's debt carrying capacity to be assessed as medium.<sup>23</sup>

**9. The DSA thresholds applicable for Bhutan are correspondingly high.** For external debt, the thresholds are 240 percent for the present value (PV) of external debt to exports ratio and 55 percent for the PV of external debt to GDP ratio. For external debt servicing, the thresholds are 21 percent for the debt service to exports ratio and 23 percent for the debt services to revenue ratio. Finally, the public debt benchmark is 70 percent for the PV of total public debt in percent of GDP.

**Text Table 5. Debt Carrying Capacity and Threshold**

|                        |   |  |  |
|------------------------|---|--|--|
| Country                | Bhutan                                  |  |  |
| Country Code           | 514                                     |  |  |
| Debt Carrying Capacity | Strong                                  |  |  |
| Final                  | Classification based on current vintage | Classification based on the previous vintage | Classification based on the two previous vintage |
| Strong                 | Medium<br>3.00                          | Strong<br>3.06                               | Strong<br>3.07                                   |

Note: Until the April 2019 WEO vintage is released, the two previous vintages ago classification and corresponding score are based solely on the CPIA per the previous framework.

**Text Table 6. Calculation of the CI Index**

| Components  | Coefficients (A) | 10-year average values (B) | CI Score components (A*B) = (C) | Contribution of components |
|---|------------------|----------------------------|---------------------------------|----------------------------|
| CPIA  | 0.385            | 3.857                      | 1.48                            | 49%                        |
| Real growth rate (in percent)                         | 2.719            | 3.029                      | 0.08                            | 3%                         |
| Import coverage of reserves (in percent)              | 4.052            | 40.329                     | 1.63                            | 54%                        |
| Import coverage of reserves <sup>2</sup> (in percent) | -3.990           | 16.264                     | -0.65                           | -22%                       |
| Remittances (in percent)                              | 2.022            | 2.715                      | 0.05                            | 2%                         |
| World economic growth (in percent)                    | 13.520           | 2.909                      | 0.39                            | 13%                        |
| CI Score  |                  |                            | 3.00                            | 100%                       |
| CI rating   |                  |                            | Medium                          |                            |

<sup>23</sup> As per the Guidance Note of the Joint Bank-Fund Debt Sustainability Framework for Low Income Countries, the country classification is revised only if two consecutive signals suggest the need for an upgrade or downgrade.

Text Table 7. Applicable Thresholds

| APPLICABLE                             |     | APPLICABLE                         |    |
|--|-----|------------------------------------|----|
| <b>EXTERNAL debt burden thresholds</b> |     | <b>TOTAL public debt benchmark</b> |    |
| <b>PV of debt in % of</b>              |     | <b>PV of total public debt in</b>  |    |
| <b>Exports</b>                         | 240 | <b>percent of GDP</b>              | 70 |
| <b>GDP</b>                             | 55  |                                    |    |
| <b>Debt service in % of</b>            |     |                                    |    |
| <b>Exports</b>                         | 21  |                                    |    |
| <b>Revenue</b>                         | 23  |                                    |    |

## DEBT SUSTAINABILITY

### A. External Debt Sustainability Analysis

**10. Under the baseline scenario, Bhutan’s PPG external debt indicators exceed the thresholds for several years, before falling below the thresholds in later years.** The present value (PV) of debt to GDP ratio would exceed the threshold until FY2035/36, with the PV of debt to exports falling sustainably below the threshold in FY2030/31, reflecting a projected pick-up in hydro-related exports. Regarding liquidity indicators, the debt service to exports ratio would breach the threshold briefly in FY2027/28 and in FY2030/31-FY2031/32 and the debt service to revenue ratio would fall below its respective threshold only from FY2041/42, suggesting liquidity pressures despite significant increases in government revenues and grants (Figure 1).<sup>24</sup> The external debt-to-GDP ratio is expected to increase from 106.4 percent in FY2022/23 to about 120 percent in the medium term (by FY2028/29), and to decrease to 79.7 percent by 2033/34 and further to about 37 percent in the long term (by FY2043/44, Table 1). Similarly, the external PPG debt-to-GDP ratio will rise from 103.3 percent in FY2022/23 to 117.4 percent in the medium term, and to decline to 29.3 percent in the long term (Table 1).

**11. Stress tests suggest that Bhutan’s external debt trajectory could be vulnerable to export shocks.** A depreciation in the ngultrum could increase the value of Bhutan’s external liabilities, which are largely denominated in foreign currency. However, because most external debt is denominated in rupees, to which the ngultrum is pegged, this risk does not appear significant.<sup>25</sup> In any case, an exchange rate shock could then imply a higher debt stock and higher debt service, with the PV of debt-to-GDP ratio and debt service-to-revenue ratio falling below the thresholds only a couple of years after doing so in the baseline. A shock to exports would imply a deterioration in Bhutan’s repayment capacity, with the PV of debt to exports ratio and debt service to exports ratio above the thresholds until FY2037/38 and FY2042/43, respectively. Export shocks could stem from

<sup>24</sup> External debt service indicators present a spike in 2027/28 reflecting the maturity date of the two Standby Credit Facilities granted by India to the Royal Government of Bhutan and deposited at the Royal Monetary Authority.

<sup>25</sup> The ngultrum is pegged to the rupee at par and has been depreciating in real effective terms in recent years. Movements in the real effective exchange rate (REER) are heavily influenced by the rupee. The peg has been an adequate nominal anchor and remains appropriate as India is Bhutan’s largest trade and development partner. A stable peg could help mitigate the impact of exchange rate shocks on the economy.

delays in the commissioning or construction of hydropower projects. In addition, Bhutan is vulnerable to climate shocks. The historical scenario, while alarming, is not relevant because it does not reflect an adequate forecast for macroeconomic variables.<sup>26</sup>

**12. Bhutan's non-FDI-like external debt is comfortably below the thresholds in the baseline and most stress scenarios.**<sup>27</sup> Excluding Bhutan's hydro debt associated to intergovernmental projects with India (IG), which is closer to FDI than to debt in nature and risks, the PV of external debt to GDP remains broadly stable, fluctuating between 27 and 33 percentage points between FY2023/24 to FY2033/34, significantly below the threshold of 55 percent of GDP (Figure 6). No stress test breaches the threshold either, except for a one-off marginal breach in the case of an export shock and a marginal breach for the combined shock. Debt service-to-exports ratio and debt service-to-revenue ratio only experience one-off marginal breaches. The PV of debt-to-exports ratio only breaches the threshold due to an exports shock between FY2027/28 and FY2030/31.

## B. Public Debt Sustainability Analysis

**13. Bhutan's public debt follows closely the dynamics of external debt and does not pose an additional risk to the debt profile.** Under the baseline scenario, the PV of debt to GDP would exceed the threshold until FY2036/37. Under different stress scenarios, the thresholds for the PV of debt to GDP would be exceeded until FY2036/37 (primary balance and combination of shocks), FY2037/38 (exports and other shocks), and FY2042/43 (depreciation). The PV of debt to GDP would exceed the threshold even by FY2043/44 in the case of a real GDP growth shock. The PV of debt to revenue ratio would increase over the medium term, before setting on a downward trajectory after hydropower projects are commissioned (Figure 2). Similarly, the debt service-to-revenue ratio shows an inverted-U dynamic because it is expected to increase over the medium term as new hydro power plants are commissioned and repayment of their debt begins. It is important to note that domestic debt is subject to risks as evidenced by the undersubscription of recent bond auctions, underscoring the need to enhance domestic debt management.

## RISK RATING AND VULNERABILITIES

**14. This DSA assesses Bhutan at moderate risk of external and overall debt distress, similarly to the 2022 DSA.** While the mechanical results point to a high risk of overall and external debt distress, with breaches in the thresholds under the baseline scenario, judgment was applied given unique mitigating factors supporting the sustainability of Bhutan's debt stock. Sixty-one percent of Bhutan's PPG external debt is linked to hydropower project loans from the Government of India, which covers both financial and construction risks of the projects and commits to buy all

<sup>26</sup> The historical scenario is based on the 10-year historical average of key macroeconomic variables, instead of the baseline projection. The historical scenario differs from the baseline scenario due to several factors, including a contraction in growth due to the COVID shock, higher government spending and weaker current account position in recent years. These factors resulted in an increase in higher future gross financing needs and total PPG debt levels under the historical scenario. In contrast, the baseline scenario envisages a recovery in GDP growth following the pandemic shock and more favorable current account dynamics, reflecting the increase in electricity exports and a gradual decline in hydropower-related imports. Thus, the historical scenario does not constitute an adequate forecast.

<sup>27</sup> This exercise excludes debt service from IG hydro projects and removes from hydro exports the amount needed to pay the debt service of those projects. So, that the exports factored in the stress tests are what is available for Bhutan to pay non-IG debt.

surplus electricity at a price reflecting cost plus profits. Overall, the analysis shows that external debt sustainability could be jeopardized by export shocks. Within the moderate rating, Bhutan is assessed to have limited space to absorb additional shocks (Figure 5). The baseline debt trajectory is subject to important risks, including uncertainties related to geopolitical tensions, further delays in the completion of hydropower plants, failure to address external imbalances, and the materialization of financial sector contingent liabilities. Going forward, robust fiscal consolidation and revenue mobilization efforts, including timely implementation of the GST, a stable peg with the Indian rupee, reforms to improve productivity and competitiveness of the non-hydropower sector, and enhanced debt management could help support debt sustainability.

Table 1. Bhutan: External Debt Sustainability Framework, Baseline Scenario, 2021–2044

(In percent of GDP, unless otherwise indicated)

|  | Actual | Projections |        |        |        |        |        |        |        | Average 8/ |             |
|--|--------|-------------|--------|--------|--------|--------|--------|--------|--------|------------|-------------|
|  | 2023   | 2024        | 2025   | 2026   | 2027   | 2028   | 2029   | 2034   | 2044   | Historical | Projections |
| External debt (nominal) 1/                                       | 106.4  | 103.7       | 97.1   | 113.9  | 113.9  | 108.4  | 120.4  | 79.7   | 37.2   | 106.1      | 103.6       |
| of which: public and publicly guaranteed (PPG)                   | 103.3  | 100.2       | 93.9   | 110.9  | 111.0  | 105.5  | 117.4  | 74.9   | 29.3   | 102.1      | 100.2       |
| Change in external debt  | -2.7   | -2.7        | -6.6   | 16.8   | 0.0    | -5.5   | 11.9   | -7.5   | -1.4   |            |             |
| Identified net debt-creating flows                               | 32.5   | 7.3         | 11.5   | 14.5   | 6.6    | 10.6   | 6.5    | -1.6   | 5.1    | 18.6       | 6.7         |
| Non-interest current account deficit                             | 33.1   | 16.3        | 30.6   | 18.3   | 9.5    | 13.8   | 10.4   | -0.4   | 6.6    | 21.2       | 11.4        |
| Deficit in balance of goods and services                         | 32.3   | 16.6        | 29.7   | 18.5   | 9.8    | 13.8   | 11.8   | 0.1    | 7.8    | 21.7       | 11.8        |
| Exports  | 28.0   | 33.2        | 35.6   | 44.3   | 46.4   | 38.8   | 40.1   | 44.7   | 35.8   |            |             |
| Imports  | 60.3   | 49.8        | 65.3   | 62.8   | 56.2   | 52.5   | 51.9   | 44.9   | 43.6   |            |             |
| Net current transfers (negative = inflow)                        | -2.9   | -4.5        | -2.1   | -2.2   | -2.0   | -1.6   | -2.5   | -1.7   | -1.2   | -5.7       | -2.2        |
| of which: official   | -4.1   | -3.1        | -8.2   | -9.8   | -8.6   | -6.6   | -2.9   | -2.1   | -1.7   |            |             |
| Other current account flows (negative = net inflow)              | 3.7    | 4.1         | 2.9    | 2.0    | 1.6    | 1.6    | 1.1    | 1.2    | -0.1   | 5.2        | 1.8         |
| Net FDI (negative = inflow)                                      | -0.4   | -5.3        | -14.0  | -0.4   | -0.5   | -0.6   | -0.6   | -0.6   | -0.6   | -0.2       | -2.2        |
| Endogenous debt dynamics 2/                                      | -0.1   | -3.6        | -5.1   | -3.4   | -2.4   | -2.6   | -3.3   | -0.6   | -0.9   |            |             |
| Contribution from nominal interest rate                          | 1.4    | 1.5         | 1.6    | 2.2    | 3.0    | 3.3    | 3.7    | 3.4    | 0.9    |            |             |
| Contribution from real GDP growth                                | -5.4   | -5.1        | -6.7   | -5.6   | -5.4   | -5.9   | -7.0   | -4.0   | -1.8   |            |             |
| Contribution from price and exchange rate changes                | 3.9    | ...         | ...    | ...    | ...    | ...    | ...    | ...    | ...    |            |             |
| Residual 3/  | -35.3  | -10.0       | -18.1  | 2.2    | -6.6   | -16.1  | 5.5    | -5.9   | -6.6   | -17.4      | -9.1        |
| of which: exceptional financing                                  | 0.0    | 0.0         | 0.0    | 0.0    | 0.0    | 0.0    | 0.0    | 0.0    | 0.0    |            |             |
| <b>Sustainability indicators</b>                                 |        |             |        |        |        |        |        |        |        |            |             |
| PV of PPG external debt-to-GDP ratio                             | 93.1   | 92.0        | 88.3   | 100.5  | 101.3  | 97.2   | 104.1  | 66.3   | 22.2   |            |             |
| PV of PPG external debt-to-exports ratio                         | 333.0  | 277.3       | 248.1  | 227.0  | 218.6  | 250.8  | 259.7  | 148.4  | 62.1   |            |             |
| PPG debt service-to-exports ratio                                | 13.2   | 11.1        | 10.2   | 10.2   | 12.2   | 22.3   | 18.9   | 17.9   | 8.0    |            |             |
| PPG debt service-to-revenue ratio                                | 20.2   | 18.1        | 18.8   | 21.7   | 27.3   | 41.6   | 33.7   | 38.3   | 16.6   |            |             |
| Gross external financing need (Million of U.S. dollars)          | 1068.9 | 466.7       | 717.3  | 879.0  | 631.2  | 1026.7 | 904.4  | 570.7  | 1630.2 |            |             |
| <b>Key macroeconomic assumptions</b>                             |        |             |        |        |        |        |        |        |        |            |             |
| Real GDP growth (in percent)                                     | 5.0    | 5.2         | 7.2    | 6.4    | 5.2    | 5.6    | 7.2    | 5.0    | 5.0    | 3.5        | 5.8         |
| GDP deflator in US dollar terms (change in percent)              | -3.5   | 3.0         | 4.1    | 4.1    | 4.0    | 3.7    | 3.5    | 3.4    | 3.1    | 0.6        | 3.6         |
| Effective interest rate (percent) 4/                             | 1.3    | 1.5         | 1.7    | 2.5    | 2.9    | 3.2    | 3.8    | 4.2    | 2.5    | 1.6        | 3.3         |
| Growth of exports of G&S (US dollar terms, in percent)           | 3.0    | 28.5        | 19.7   | 37.9   | 14.5   | -8.4   | 14.7   | 6.8    | 1.1    | 2.2        | 15.0        |
| Growth of imports of G&S (US dollar terms, in percent)           | 10.7   | -10.5       | 46.3   | 6.6    | -2.2   | 2.5    | 9.6    | 4.7    | 6.9    | 6.0        | 7.4         |
| Grant element of new public sector borrowing (in percent)        | ...    | 25.2        | 15.2   | 25.3   | 16.9   | 14.0   | 26.8   | 32.6   | 18.8   | ...        | 22.1        |
| Government revenues (excluding grants, in percent of GDP)        | 18.2   | 20.3        | 19.3   | 20.7   | 20.7   | 20.8   | 22.4   | 20.9   | 17.2   | 19.6       | 21.3        |
| Aid flows (in Million of US dollars) 5/                          | 175.3  | 239.1       | 388.7  | 563.6  | 561.1  | 439.1  | 345.4  | 465.4  | 771.5  |            |             |
| Grant-equivalent financing (in percent of GDP) 6/                | ...    | 5.7         | 9.7    | 18.1   | 11.4   | 8.8    | 11.9   | 4.6    | 3.6    | ...        | 8.1         |
| Grant-equivalent financing (in percent of external financing) 6/ | ...    | 51.2        | 64.7   | 45.9   | 52.9   | 51.4   | 38.4   | 68.0   | 61.3   | ...        | 54.3        |
| Nominal GDP (Million of US dollars)                              | 2,908  | 3,151       | 3,516  | 3,894  | 4,259  | 4,668  | 5,177  | 7,993  | 18,126 |            |             |
| Nominal dollar GDP growth  | 1.4    | 8.4         | 11.6   | 10.8   | 9.4    | 9.6    | 10.9   | 8.6    | 8.3    | 4.1        | 9.6         |
| <b>Memorandum items:</b>   |        |             |        |        |        |        |        |        |        |            |             |
| PV of external debt 7/   | 96.2   | 95.5        | 91.5   | 103.5  | 104.2  | 100.1  | 107.1  | 71.1   | 30.2   |            |             |
| In percent of exports  | 344.2  | 288.0       | 257.2  | 233.7  | 224.8  | 258.2  | 267.1  | 159.1  | 84.3   |            |             |
| Total external debt service-to-exports ratio                     | 14.7   | 11.7        | 10.7   | 10.5   | 12.6   | 22.7   | 19.2   | 18.2   | 8.3    |            |             |
| PV of PPG external debt (in Million of US dollars)               | 2707.1 | 2897.7      | 3103.0 | 3915.0 | 4316.6 | 4537.1 | 5389.6 | 5302.8 | 4030.7 |            |             |
| (PVt-PVt-1)/GDPt-1 (in percent)                                  | 6.6    | 6.5         | 23.1   | 10.3   | 5.2    | 18.3   | -2.0   | 0.5    |        |            |             |
| Non-interest current account deficit that stabilizes debt ratio  | 35.8   | 19.0        | 37.1   | 1.6    | 9.5    | 19.2   | -1.6   | 7.1    | 8.0    |            |             |

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as  $[r - g - p(1+g) + \alpha(1+r)] / (1+g+p+g)$  times previous period debt ratio, with  $r$  = nominal interest rate;  $g$  = real GDP growth rate,  $p$  = growth rate of GDP deflator in U.S. dollar terms,  $\alpha$  = nominal appreciation of the local currency, and  $\alpha$  = share of local currency-denominated external debt in total external debt.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Current-year interest payments divided by previous period debt stock.

5/ Defined as grants, concessional loans, and debt relief.

6/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

7/ Assumes that PV of private sector debt is equivalent to its face value.

8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

| Definition of external/domestic debt                     | Residency-based |
|--|-----------------|
| Is there a material difference between the two criteria? | No              |

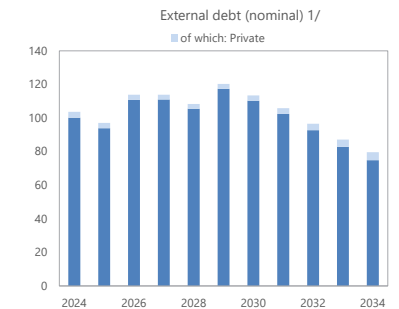
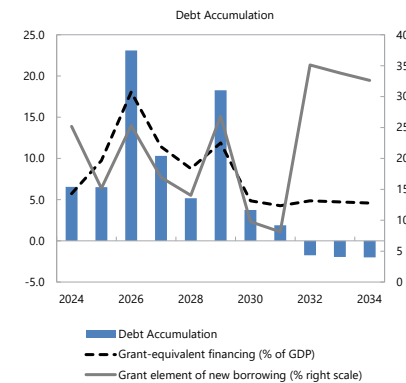


Table 2. Bhutan: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021–2044

(In percent of GDP, unless otherwise indicated)

|  | Actual | Projections |       |       |       |       |       |       |       |      | Average 6/ |             |
|--|--------|-------------|-------|-------|-------|-------|-------|-------|-------|------|------------|-------------|
|  |        | 2023        | 2024  | 2025  | 2026  | 2027  | 2028  | 2029  | 2034  | 2044 | Historical | Projections |
| <b>Public sector debt 1/</b>   | 116.1  | 113.8       | 109.2 | 123.1 | 122.3 | 118.8 | 130.2 | 92.4  | 44.1  |      | 107.5      | 114.6       |
| of which: external debt  | 103.3  | 100.2       | 93.9  | 110.9 | 111.0 | 105.5 | 117.4 | 74.9  | 29.3  |      | 102.1      | 100.2       |
| Change in public sector debt   | -1.3   | -2.3        | -4.5  | 13.8  | -0.8  | -3.5  | 11.4  | -7.4  | -3.1  |      |            |             |
| Identified debt-creating flows   | -3.8   | -2.6        | -2.7  | 15.7  | 1.3   | -1.7  | 12.9  | -6.2  | -2.7  |      | -2.9       | -0.7        |
| Primary deficit  | 3.1    | 3.0         | 2.4   | -0.1  | -0.2  | 0.1   | 0.4   | -0.2  | -0.2  |      | 1.3        | 0.4         |
| Revenue and grants   | 24.2   | 24.2        | 28.1  | 31.5  | 30.1  | 28.2  | 27.3  | 24.4  | 20.2  |      | 27.6       | 27.1        |
| of which: grants   | 6.0    | 3.9         | 8.8   | 10.8  | 9.4   | 7.4   | 4.9   | 3.5   | 3.0   |      |            |             |
| Primary (noninterest) expenditure                                      | 27.3   | 27.2        | 30.5  | 31.4  | 29.9  | 28.3  | 27.7  | 24.2  | 20.0  |      | 29.0       | 27.5        |
| Automatic debt dynamics  | -3.9   | -7.8        | -7.8  | -5.7  | -4.8  | -4.9  | -5.8  | -2.3  | -1.5  |      |            |             |
| Contribution from interest rate/growth differential                    | -11.3  | -7.8        | -7.8  | -5.7  | -4.8  | -4.9  | -5.8  | -2.3  | -1.5  |      |            |             |
| of which: contribution from average real interest rate                 | -5.7   | -2.0        | -0.2  | 0.8   | 1.3   | 1.6   | 2.2   | 2.4   | 0.8   |      |            |             |
| of which: contribution from real GDP growth                            | -5.6   | -5.7        | -7.7  | -6.6  | -6.1  | -6.5  | -7.9  | -4.7  | -2.2  |      |            |             |
| Contribution from real exchange rate depreciation                      | 7.4    | ...         | ...   | ...   | ...   | ...   | ...   | ...   | ...   |      |            |             |
| Other identified debt-creating flows                                   | -2.9   | 2.2         | 2.7   | 21.6  | 6.3   | 3.2   | 18.3  | -3.7  | -1.0  |      | -1.1       | 3.8         |
| Privatization receipts (negative)                                      | 0.0    | 0.0         | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |      |            |             |
| Recognition of contingent liabilities (e.g., bank recapitalization)    | 0.0    | 0.0         | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |      |            |             |
| Debt relief (HIPC and other)   | 0.0    | 0.0         | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |      |            |             |
| Other debt creating or reducing flow (please specify)                  | -2.9   | 2.2         | 2.7   | 21.6  | 6.3   | 3.2   | 18.3  | -3.7  | -1.0  |      |            |             |
| Residual   | 2.5    | 0.3         | -1.8  | -1.9  | -2.1  | -1.8  | -1.5  | -1.1  | -0.3  |      | 5.1        | -1.4        |
| <b>Sustainability indicators</b>                                       |        |             |       |       |       |       |       |       |       |      |            |             |
| PV of public debt-to-GDP ratio 2/                                      | 106.4  | 105.8       | 103.8 | 112.9 | 112.9 | 110.7 | 117.2 | 84.0  | 37.1  |      |            |             |
| PV of public debt-to-revenue and grants ratio                          | 438.7  | 437.2       | 369.3 | 358.0 | 375.1 | 392.4 | 428.6 | 344.0 | 183.6 |      |            |             |
| Debt service-to-revenue and grants ratio 3/                            | 38.0   | 40.8        | 25.4  | 23.9  | 21.9  | 34.6  | 36.2  | 46.0  | 34.2  |      |            |             |
| Gross financing need 4/  | 9.4    | 15.1        | 12.2  | 29.0  | 12.7  | 13.0  | 28.5  | 7.4   | 5.7   |      |            |             |
| <b>Key macroeconomic and fiscal assumptions</b>                        |        |             |       |       |       |       |       |       |       |      |            |             |
| Real GDP growth (in percent)   | 5.0    | 5.2         | 7.2   | 6.4   | 5.2   | 5.6   | 7.2   | 5.0   | 5.0   | 3.5  | 5.8        |             |
| Average nominal interest rate on external debt (in percent)            | 1.3    | 1.5         | 1.7   | 2.6   | 2.9   | 3.2   | 3.9   | 4.4   | 2.8   | 1.6  | 3.3        |             |
| Average real interest rate on domestic debt (in percent)               | -1.8   | -0.8        | 1.2   | 1.7   | 2.3   | 2.5   | 2.4   | 3.0   | 3.4   | -1.1 | 2.1        |             |
| Real exchange rate depreciation (in percent, + indicates depreciation) | 7.7    | ...         | ...   | ...   | ...   | ...   | ...   | ...   | ...   | 1.5  | ...        |             |
| Inflation rate (GDP deflator, in percent)                              | 4.5    | 4.6         | 4.6   | 4.6   | 4.4   | 4.2   | 4.1   | 4.0   | 3.7   | 4.6  | 4.2        |             |
| Growth of real primary spending (deflated by GDP deflator, in percent) | -6.3   | 4.9         | 20.1  | 9.6   | 0.0   | 0.0   | 5.1   | 2.4   | 3.5   | 3.2  | 4.8        |             |
| Primary deficit that stabilizes the debt-to-GDP ratio 5/               | 4.3    | 5.3         | 6.9   | -13.9 | 0.5   | 3.6   | -11.0 | 7.2   | 2.9   | 4.1  | 2.6        |             |
| PV of contingent liabilities (not included in public sector debt)      | 0.0    | 0.0         | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   | 0.0   |      |            |             |

Sources: Country authorities; and staff estimates and projections.

1/ Coverage of debt: The entire public sector, including SOEs. Definition of external debt is Residency-based.

2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.

3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.

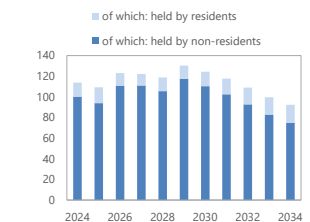
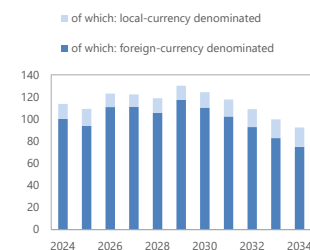
4/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period and other debt creating/reducing flows.

5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio (-): a primary surplus, which would stabilize the debt ratio only in the year in question.

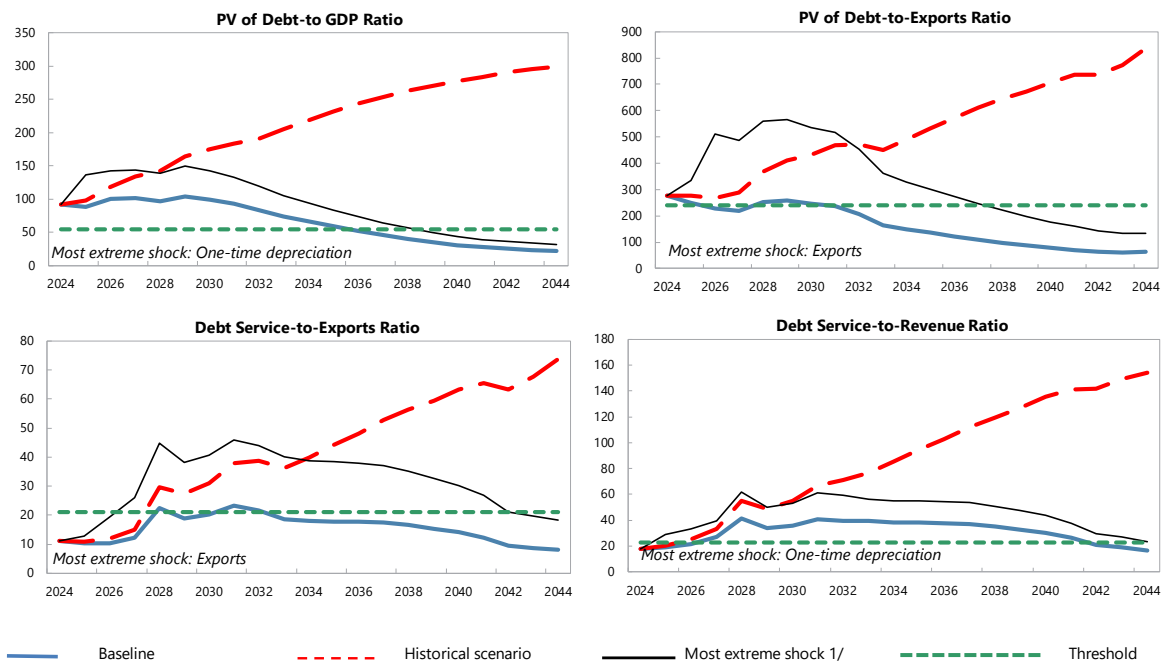
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

|  |                 |
|--|-----------------|
| Definition of external/domestic debt                     | Residency-based |
| Is there a material difference between the two criteria? | No              |

Public sector debt 1/



**Figure 1. Bhutan: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios, 2024–2044 1/ 2/**



| Customization of Default Settings |      |              |
|-----------------------------------|------|--------------|
|                                   | Size | Interactions |
| <b>Tailored Stress</b>            |      |              |
| Combined CL                       | Yes  |              |
| Natural disaster                  | n.a. | n.a.         |
| Commodity price                   | No   | No           |
| Market financing                  | n.a. | n.a.         |

| Borrowing assumptions on additional financing needs resulting from the stress tests* |         |              |
|--|---------|--------------|
|  | Default | User defined |
| <b>Shares of marginal debt</b>   |         |              |
| External PPG MLT debt  | 100%    |              |
| <b>Terms of marginal debt</b>  |         |              |
| Avg. nominal interest rate on new borrowing in USD                                   | 4.0%    | 4.0%         |
| USD Discount rate  | 5.0%    | 5.0%         |
| Avg. maturity (incl. grace period)   | 21      | 21           |
| Avg. grace period  | 6       | 6            |

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

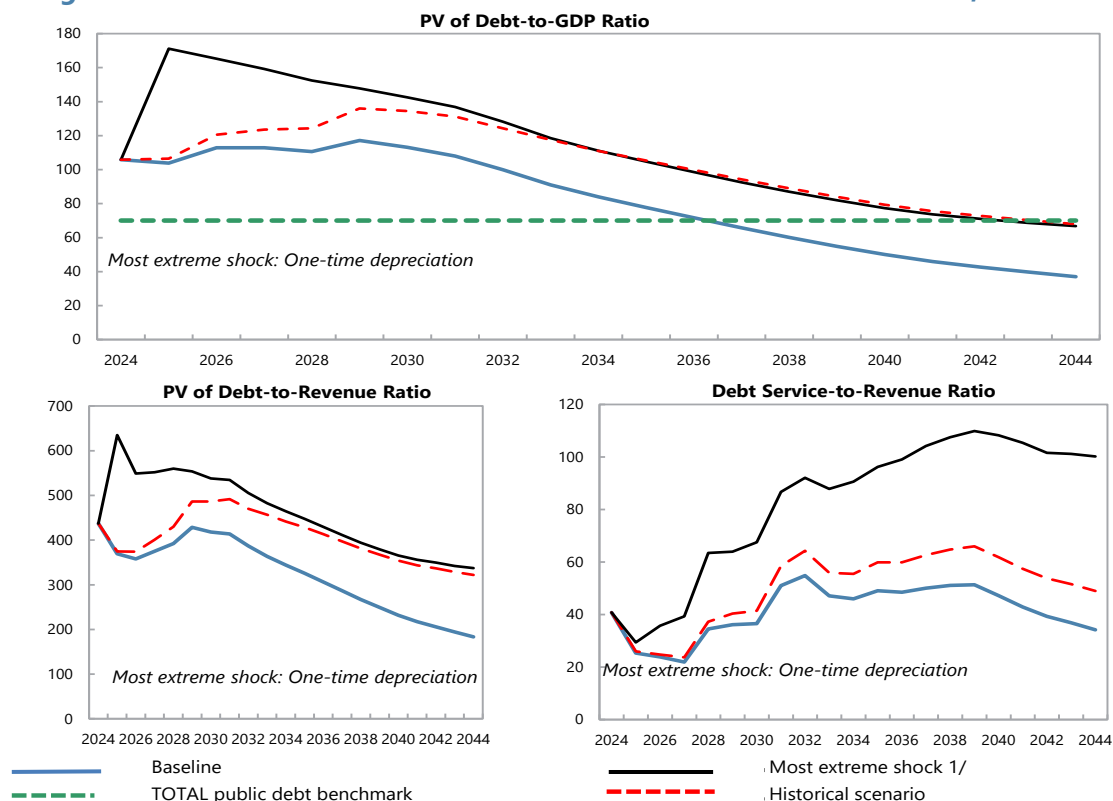
\* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

**Figure 2. Bhutan: Indicators of Public Debt Under Alternative Scenarios, 2024–2044 1/**



| Borrowing assumptions on additional financing needs resulting from the stress tests* | Default | User defined |
|--|---------|--------------|
| <b>Shares of marginal debt</b>   |         |              |
| External PPG medium and long-term  | 63%     | 63%          |
| Domestic medium and long-term  | 24%     | 24%          |
| Domestic short-term  | 12%     | 12%          |
| <b>Terms of marginal debt</b>  |         |              |
| <b>External MLT debt</b>   |         |              |
| Avg. nominal interest rate on new borrowing in USD                                   | 4.0%    | 4.0%         |
| Avg. maturity (incl. grace period)   | 21      | 21           |
| Avg. grace period  | 6       | 6            |
| <b>Domestic MLT debt</b>   |         |              |
| Avg. real interest rate on new borrowing   | 3.2%    | 3.2%         |
| Avg. maturity (incl. grace period)   | 6       | 6            |
| Avg. grace period  | 5       | 5            |
| <b>Domestic short-term debt</b>  |         |              |
| Avg. real interest rate  | -0.2%   | -0.2%        |

\* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

**Table 3. Bhutan: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2024–2034**  
(In percent)

|  | Projections 1/ |      |      |      |      |      |      |      |      |      |      |
|--|----------------|------|------|------|------|------|------|------|------|------|------|
|  | 2024           | 2025 | 2026 | 2027 | 2028 | 2029 | 2030 | 2031 | 2032 | 2033 | 2034 |
| <b>PV of debt-to-GDP ratio</b>                                 |                |      |      |      |      |      |      |      |      |      |      |
| <b>Baseline</b>  | 92             | 88   | 101  | 101  | 97   | 104  | 99   | 93   | 83   | 74   | 66   |
| <b>A. Alternative Scenarios</b>                                |                |      |      |      |      |      |      |      |      |      |      |
| A1. Key variables at their historical averages in 2024-2034 2/ | 92             | 98   | 118  | 135  | 142  | 164  | 175  | 183  | 191  | 205  | 219  |
| <b>B. Bound Tests</b>  |                |      |      |      |      |      |      |      |      |      |      |
| B1. Real GDP growth  | 92             | 99   | 124  | 125  | 120  | 129  | 122  | 114  | 103  | 92   | 82   |
| B2. Primary balance  | 92             | 90   | 104  | 105  | 101  | 107  | 102  | 96   | 87   | 77   | 70   |
| B3. Exports  | 92             | 96   | 127  | 127  | 122  | 128  | 121  | 114  | 104  | 92   | 83   |
| B4. Other flows 3/   | 92             | 103  | 117  | 117  | 112  | 118  | 112  | 105  | 95   | 85   | 76   |
| B5. Depreciation   | 92             | 137  | 142  | 144  | 138  | 150  | 142  | 133  | 119  | 106  | 94   |
| B6. Combination of B1-B5                                       | 92             | 127  | 145  | 145  | 139  | 147  | 140  | 131  | 118  | 105  | 94   |
| <b>C. Tailored Tests</b>                                       |                |      |      |      |      |      |      |      |      |      |      |
| C1. Combined contingent liabilities                            | 92             | 92   | 105  | 106  | 101  | 108  | 103  | 97   | 88   | 78   | 70   |
| C2. Natural disaster   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price  | 92             | 88   | 101  | 101  | 97   | 104  | 99   | 93   | 83   | 74   | 66   |
| C4. Market Financing   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <b>Threshold</b>   | 55             | 55   | 55   | 55   | 55   | 55   | 55   | 55   | 55   | 55   | 55   |
| <b>PV of debt-to-exports ratio</b>                             |                |      |      |      |      |      |      |      |      |      |      |
| <b>Baseline</b>  | 277            | 248  | 227  | 219  | 251  | 260  | 245  | 236  | 205  | 163  | 148  |
| <b>A. Alternative Scenarios</b>                                |                |      |      |      |      |      |      |      |      |      |      |
| A1. Key variables at their historical averages in 2024-2034 2/ | 277            | 277  | 267  | 290  | 368  | 409  | 433  | 468  | 471  | 450  | 489  |
| <b>B. Bound Tests</b>  |                |      |      |      |      |      |      |      |      |      |      |
| B1. Real GDP growth  | 277            | 248  | 227  | 219  | 251  | 260  | 245  | 236  | 205  | 163  | 148  |
| B2. Primary balance  | 277            | 253  | 235  | 226  | 260  | 268  | 253  | 245  | 214  | 170  | 156  |
| B3. Exports  | 277            | 334  | 511  | 487  | 558  | 565  | 535  | 517  | 454  | 361  | 329  |
| B4. Other flows 3/   | 277            | 289  | 264  | 252  | 289  | 294  | 278  | 269  | 234  | 186  | 170  |
| B5. Depreciation   | 277            | 248  | 208  | 201  | 231  | 242  | 228  | 219  | 190  | 150  | 137  |
| B6. Combination of B1-B5                                       | 277            | 366  | 259  | 420  | 481  | 491  | 464  | 448  | 390  | 309  | 282  |
| <b>C. Tailored Tests</b>                                       |                |      |      |      |      |      |      |      |      |      |      |
| C1. Combined contingent liabilities                            | 277            | 260  | 237  | 228  | 262  | 270  | 255  | 247  | 216  | 172  | 157  |
| C2. Natural disaster   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price  | 277            | 248  | 227  | 219  | 251  | 260  | 245  | 236  | 205  | 163  | 148  |
| C4. Market Financing   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <b>Threshold</b>   | 240            | 240  | 240  | 240  | 240  | 240  | 240  | 240  | 240  | 240  | 240  |
| <b>Debt service-to-exports ratio</b>                           |                |      |      |      |      |      |      |      |      |      |      |
| <b>Baseline</b>  | 11             | 10   | 10   | 12   | 22   | 19   | 20   | 23   | 22   | 19   | 18   |
| <b>A. Alternative Scenarios</b>                                |                |      |      |      |      |      |      |      |      |      |      |
| A1. Key variables at their historical averages in 2024-2034 2/ | 11             | 11   | 12   | 15   | 30   | 27   | 31   | 38   | 39   | 36   | 40   |
| <b>B. Bound Tests</b>  |                |      |      |      |      |      |      |      |      |      |      |
| B1. Real GDP growth  | 11             | 10   | 10   | 12   | 22   | 19   | 20   | 23   | 22   | 19   | 18   |
| B2. Primary balance  | 11             | 10   | 10   | 13   | 23   | 19   | 21   | 24   | 22   | 19   | 18   |
| B3. Exports  | 11             | 13   | 19   | 26   | 45   | 38   | 41   | 46   | 44   | 40   | 39   |
| B4. Other flows 3/   | 11             | 10   | 11   | 14   | 24   | 20   | 22   | 25   | 24   | 21   | 20   |
| B5. Depreciation   | 11             | 10   | 10   | 11   | 21   | 18   | 20   | 23   | 21   | 17   | 17   |
| B6. Combination of B1-B5                                       | 11             | 12   | 20   | 23   | 40   | 34   | 36   | 41   | 42   | 35   | 34   |
| <b>C. Tailored Tests</b>                                       |                |      |      |      |      |      |      |      |      |      |      |
| C1. Combined contingent liabilities                            | 11             | 10   | 11   | 13   | 23   | 19   | 21   | 24   | 22   | 19   | 18   |
| C2. Natural disaster   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price  | 11             | 10   | 10   | 12   | 22   | 19   | 20   | 23   | 22   | 19   | 18   |
| C4. Market Financing   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <b>Threshold</b>   | 21             | 21   | 21   | 21   | 21   | 21   | 21   | 21   | 21   | 21   | 21   |
| <b>Debt service-to-revenue ratio</b>                           |                |      |      |      |      |      |      |      |      |      |      |
| <b>Baseline</b>  | 18             | 19   | 22   | 27   | 42   | 34   | 36   | 41   | 40   | 39   | 38   |
| <b>A. Alternative Scenarios</b>                                |                |      |      |      |      |      |      |      |      |      |      |
| A1. Key variables at their historical averages in 2024-2034 2/ | 18             | 20   | 26   | 33   | 55   | 49   | 55   | 67   | 71   | 77   | 85   |
| <b>B. Bound Tests</b>  |                |      |      |      |      |      |      |      |      |      |      |
| B1. Real GDP growth  | 18             | 21   | 27   | 34   | 52   | 42   | 44   | 50   | 49   | 49   | 47   |
| B2. Primary balance  | 18             | 19   | 22   | 28   | 42   | 34   | 36   | 41   | 41   | 41   | 40   |
| B3. Exports  | 18             | 19   | 23   | 33   | 47   | 38   | 40   | 45   | 45   | 48   | 47   |
| B4. Other flows 3/   | 18             | 19   | 25   | 30   | 45   | 36   | 38   | 43   | 45   | 44   | 43   |
| B5. Depreciation   | 18             | 29   | 34   | 40   | 62   | 50   | 53   | 61   | 60   | 57   | 55   |
| B6. Combination of B1-B5                                       | 18             | 22   | 32   | 38   | 56   | 45   | 48   | 54   | 57   | 55   | 54   |
| <b>C. Tailored Tests</b>                                       |                |      |      |      |      |      |      |      |      |      |      |
| C1. Combined contingent liabilities                            | 18             | 19   | 23   | 28   | 42   | 34   | 36   | 41   | 40   | 40   | 39   |
| C2. Natural disaster   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| C3. Commodity price  | 18             | 19   | 22   | 27   | 42   | 34   | 36   | 41   | 40   | 39   | 38   |
| C4. Market Financing   | n.a.           | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. | n.a. |
| <b>Threshold</b>   | 23             | 23   | 23   | 23   | 23   | 23   | 23   | 23   | 23   | 23   | 23   |

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the threshold.

2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.

3/ Includes official and private transfers and FDI.

Table 4. Bhutan: Sensitivity Analysis for Key Indicators of Public Debt, 2024–2034

|  | Projections 1/ |            |            |            |            |            |            |            |            |            |            |
|--|----------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|------------|
|  | 2024           | 2025       | 2026       | 2027       | 2028       | 2029       | 2030       | 2031       | 2032       | 2033       | 2034       |
| <b>PV of Debt-to-GDP Ratio</b>                                 |                |            |            |            |            |            |            |            |            |            |            |
| <b>Baseline</b>  | <b>106</b>     | <b>104</b> | <b>113</b> | <b>113</b> | <b>111</b> | <b>117</b> | <b>113</b> | <b>108</b> | <b>100</b> | <b>91</b>  | <b>84</b>  |
| <b>A. Alternative Scenarios</b>                                |                |            |            |            |            |            |            |            |            |            |            |
| A1. Key variables at their historical averages in 2024-2034 2/ | 106            | 107        | 121        | 124        | 124        | 136        | 134        | 131        | 124        | 117        | 111        |
| <b>B. Bound Tests</b>  |                |            |            |            |            |            |            |            |            |            |            |
| B1. Real GDP growth  | 106            | 118        | 146        | 151        | 152        | 164        | 164        | 161        | 155        | 147        | 142        |
| B2. Primary balance  | 106            | 107        | 118        | 118        | 116        | 122        | 118        | 112        | 104        | 95         | 88         |
| B3. Exports  | 106            | 110        | 137        | 136        | 133        | 138        | 133        | 127        | 118        | 107        | 99         |
| B4. Other flows 3/   | 106            | 118        | 129        | 128        | 125        | 131        | 126        | 121        | 112        | 102        | 94         |
| B5. Depreciation   | 106            | 171        | 165        | 159        | 152        | 148        | 143        | 137        | 128        | 119        | 111        |
| B6. Combination of B1-B5                                       | 106            | 103        | 117        | 117        | 114        | 121        | 117        | 112        | 103        | 94         | 87         |
| <b>C. Tailored Tests</b>                                       |                |            |            |            |            |            |            |            |            |            |            |
| C1. Combined contingent liabilities                            | 106            | 111        | 119        | 119        | 117        | 123        | 118        | 113        | 105        | 96         | 89         |
| C2. Natural disaster   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |
| C3. Commodity price  | 106            | 107        | 123        | 129        | 132        | 144        | 145        | 144        | 140        | 135        | 132        |
| C4. Market Financing   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |
| <b>TOTAL public debt benchmark</b>                             | 70             | 70         | 70         | 70         | 70         | 70         | 70         | 70         | 70         | 70         | 70         |
| <b>PV of Debt-to-Revenue Ratio</b>                             |                |            |            |            |            |            |            |            |            |            |            |
| <b>Baseline</b>  | <b>437</b>     | <b>369</b> | <b>358</b> | <b>375</b> | <b>392</b> | <b>429</b> | <b>418</b> | <b>414</b> | <b>387</b> | <b>364</b> | <b>344</b> |
| <b>A. Alternative Scenarios</b>                                |                |            |            |            |            |            |            |            |            |            |            |
| A1. Key variables at their historical averages in 2024-2034 2/ | 437            | 375        | 374        | 401        | 430        | 486        | 486        | 492        | 470        | 457        | 442        |
| <b>B. Bound Tests</b>  |                |            |            |            |            |            |            |            |            |            |            |
| B1. Real GDP growth  | 437            | 406        | 429        | 466        | 508        | 576        | 583        | 598        | 581        | 569        | 562        |
| B2. Primary balance  | 437            | 379        | 375        | 392        | 410        | 446        | 435        | 431        | 403        | 380        | 360        |
| B3. Exports  | 437            | 393        | 434        | 452        | 470        | 504        | 492        | 487        | 457        | 429        | 404        |
| B4. Other flows 3/   | 437            | 421        | 409        | 427        | 445        | 480        | 468        | 463        | 432        | 406        | 383        |
| B5. Depreciation   | 437            | 635        | 549        | 552        | 560        | 554        | 538        | 535        | 506        | 483        | 464        |
| B6. Combination of B1-B5                                       | 437            | 370        | 368        | 385        | 403        | 441        | 430        | 426        | 399        | 376        | 356        |
| <b>C. Tailored Tests</b>                                       |                |            |            |            |            |            |            |            |            |            |            |
| C1. Combined contingent liabilities                            | 437            | 393        | 378        | 395        | 413        | 449        | 438        | 434        | 406        | 383        | 363        |
| C2. Natural disaster   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |
| C3. Commodity price  | 437            | 381        | 390        | 429        | 470        | 526        | 535        | 552        | 543        | 539        | 539        |
| C4. Market Financing   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |
| <b>Debt Service-to-Revenue Ratio</b>                           |                |            |            |            |            |            |            |            |            |            |            |
| <b>Baseline</b>  | <b>41</b>      | <b>25</b>  | <b>24</b>  | <b>22</b>  | <b>35</b>  | <b>36</b>  | <b>37</b>  | <b>51</b>  | <b>55</b>  | <b>47</b>  | <b>46</b>  |
| <b>A. Alternative Scenarios</b>                                |                |            |            |            |            |            |            |            |            |            |            |
| A1. Key variables at their historical averages in 2024-2034 2/ | 41             | 26         | 25         | 24         | 37         | 40         | 41         | 59         | 64         | 56         | 55         |
| <b>B. Bound Tests</b>  |                |            |            |            |            |            |            |            |            |            |            |
| B1. Real GDP growth  | 41             | 27         | 28         | 28         | 44         | 48         | 49         | 69         | 77         | 69         | 70         |
| B2. Primary balance  | 41             | 25         | 25         | 24         | 36         | 37         | 37         | 54         | 58         | 49         | 48         |
| B3. Exports  | 41             | 25         | 25         | 25         | 38         | 39         | 40         | 54         | 59         | 54         | 52         |
| B4. Other flows 3/   | 41             | 25         | 26         | 24         | 37         | 38         | 39         | 53         | 59         | 51         | 50         |
| B5. Depreciation   | 41             | 29         | 36         | 39         | 63         | 64         | 68         | 87         | 92         | 88         | 91         |
| B6. Combination of B1-B5                                       | 41             | 25         | 24         | 23         | 35         | 37         | 37         | 52         | 57         | 49         | 47         |
| <b>C. Tailored Tests</b>                                       |                |            |            |            |            |            |            |            |            |            |            |
| C1. Combined contingent liabilities                            | 41             | 25         | 27         | 23         | 36         | 37         | 38         | 56         | 57         | 48         | 47         |
| C2. Natural disaster   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |
| C3. Commodity price  | 41             | 25         | 26         | 27         | 41         | 43         | 45         | 62         | 70         | 64         | 65         |
| C4. Market Financing   | n.a.           | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       | n.a.       |

Sources: Country authorities; and staff estimates and projections.

1/ A bold value indicates a breach of the benchmark.

2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.

3/ Includes official and private transfers and FDI.

**Figure 3. Bhutan: Drivers of Debt Dynamics—Baseline Scenario**

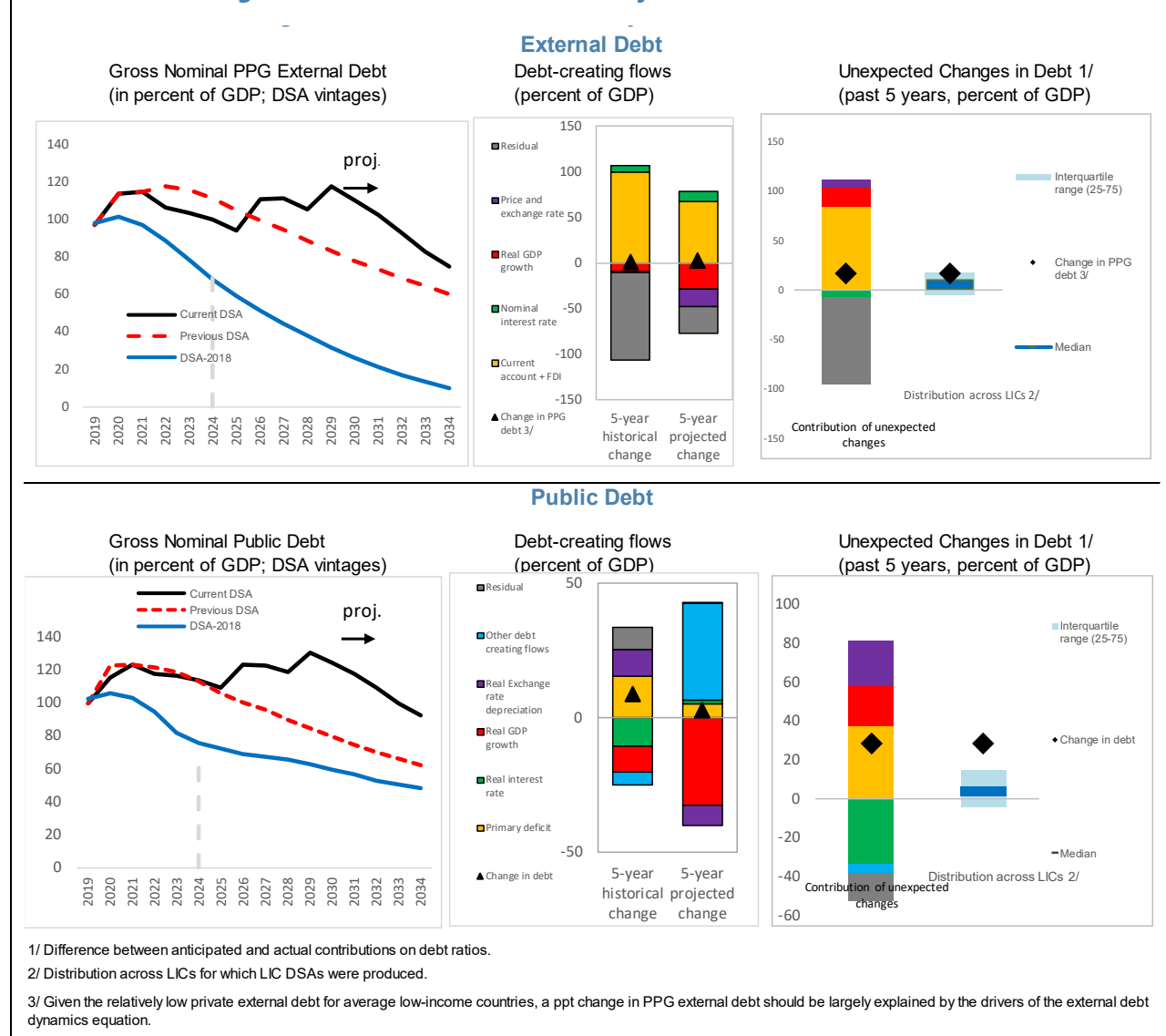
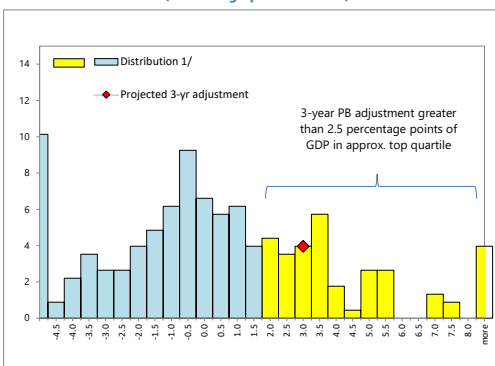


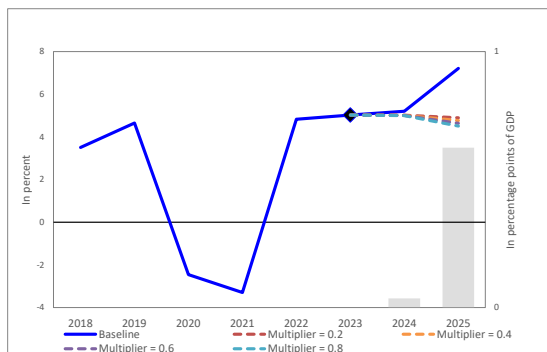
Figure 4. Bhutan: Realism Tools

3-Year Adjustment in Primary Balance  
(Percentage points of GDP)



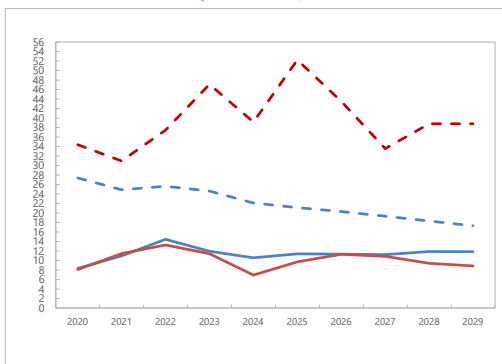
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



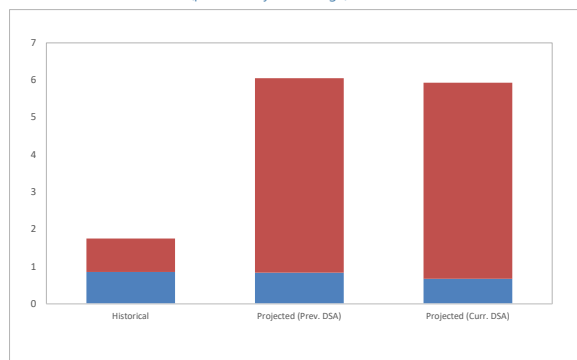
1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates  
(percent of GDP)



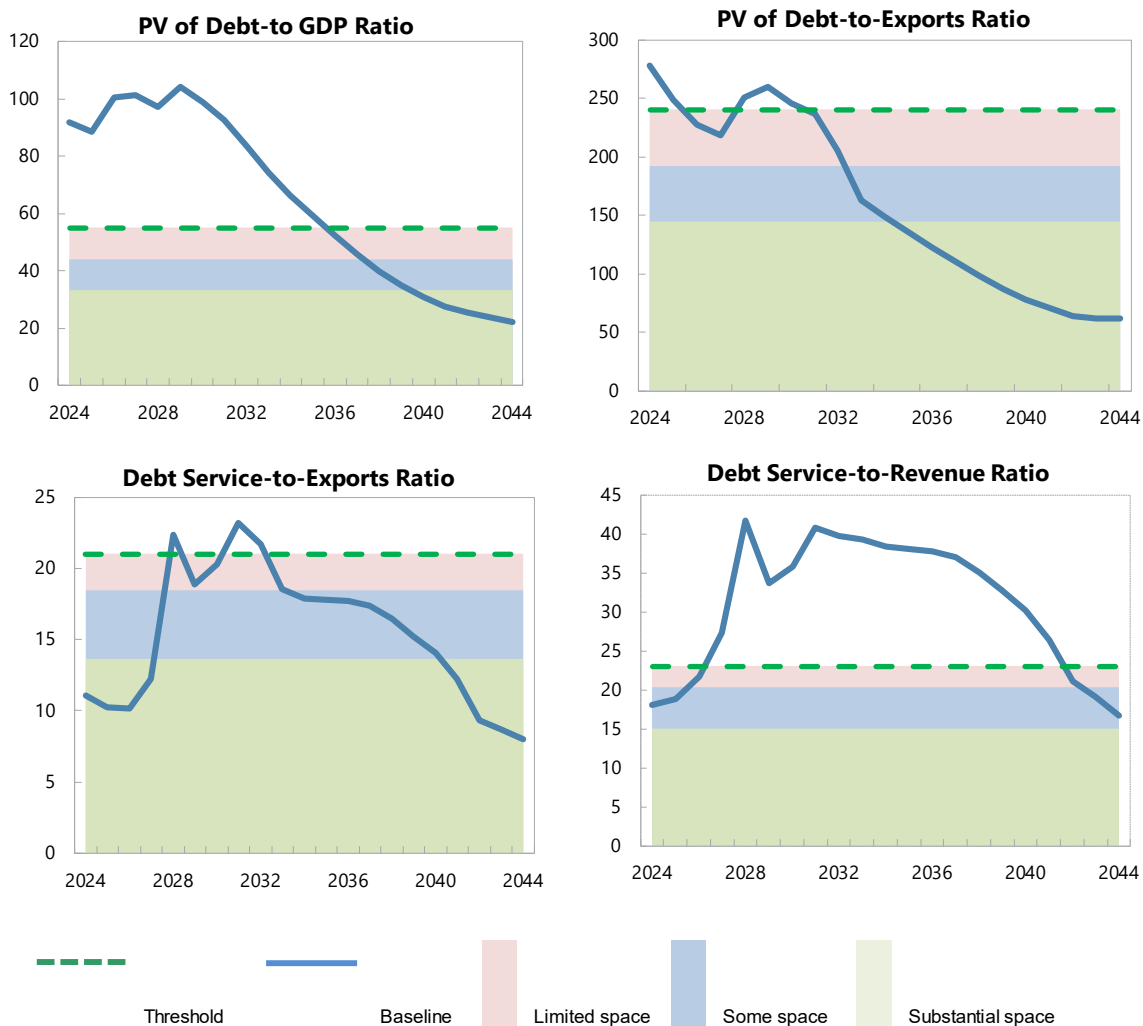
— Gov. Invest. - Prev. DSA      — Gov. Invest. - Curr. DSA  
- - - Priv. Invest. - Prev. DSA      - - - Priv. Invest. - Curr. DSA

Contribution to Real GDP growth  
(percent, 5-year average)



■ Contribution of other factors  
■ Contribution of government capital

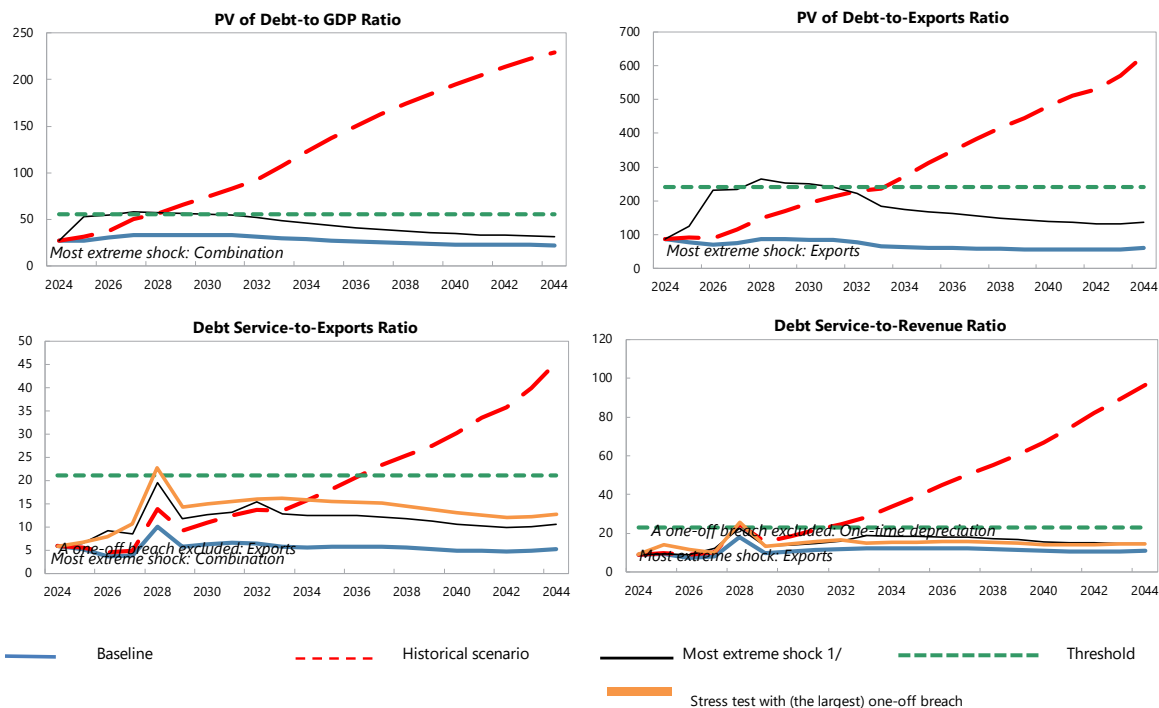
Figure 5. Bhutan: Qualification of the Moderate Category, 2024–2044 1/



Sources: Country authorities; and staff estimates and projections.

1/ For the PV debt/GDP and PV debt/exports thresholds, x is 20 percent and y is 40 percent. For debt service/Exports and debt service/revenue thresholds, x is 12 percent and y is 35 percent.

**Figure 6. Bhutan: Indicators of Public and Publicly Guaranteed External Debt Under Alternatives Scenarios (excluding IG hydro debt), 2024–2044 1/ 2/**



| Customization of Default Settings |      |              |
|-----------------------------------|------|--------------|
|                                   | Size | Interactions |
| <b>Tailored Stress</b>            |      |              |
| Combined CL                       | Yes  |              |
| Natural disaster                  | n.a. | n.a.         |
| Commodity price                   | No   | No           |
| Market financing                  | n.a. | n.a.         |

| Borrowing assumptions on additional financing needs resulting from the stress tests* |         |              |
|--|---------|--------------|
|  | Default | User defined |
| <b>Shares of marginal debt</b>   |         |              |
| External PPG MLT debt  | 100%    |              |
| <b>Terms of marginal debt</b>  |         |              |
| Avg. nominal interest rate on new borrowing in USD                                   | 3.5%    | 3.5%         |
| USD Discount rate  | 5.0%    | 5.0%         |
| Avg. maturity (incl. grace period)   | 25      | 25           |
| Avg. grace period  | 6       | 6            |

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

\* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most extreme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

**Statement by Mr. Krishnamurthy Subramanian, Executive Director for Bhutan, and Mr.  
Anand Singh, Senior Advisor to Executive Director  
September 9, 2024**

On behalf of our Bhutan authorities, we thank the IMF team led by Mr. Flores Curiel for the productive engagement during the Article IV consultations. Our authorities appreciate the constructive discussions on various policy issues and highly value the staff reports, assessments, and recommendations. Our remarks will focus on the macroeconomic outlook and important policy issues.

**Recent Economic Developments and Macroeconomic Outlook**

1. Since Bhutan shifted to a democratic constitutional monarchy in 2008, the country has embarked on a development strategy founded on the principle of Gross National Happiness. The sustained growth in Bhutan over the last decade has increased the gross national income per capita and has lifted living conditions. The UN recognized Bhutan's achievements in meeting the Human Assets Index and national income per capita thresholds, and Bhutan graduated from the Least Developed Countries category in December 2023. These are significant achievements for a small land-locked country, with a population of about three-quarters of a million and a topology characterized by steep mountains and deep valleys, leading to scattered population settlement patterns. Efforts continue to address social inequality issues and regional disparities.

2. Bhutan has effectively balanced economic growth, poverty reduction, and environmental sustainability over the past decade to maximize Gross National Happiness. Bhutan has a long history of leading ecological conservation and climate change action and remains committed to maintaining at least sixty percent of its total land under forest cover and remaining carbon neutral. Bhutan, being one of the three carbon-negative countries with large forest cover and rich biodiversity, is expected to attract more financial support as the World agenda shifts more and more toward supporting nature and climate action.

3. Bhutan's economy grew by 4.9% in 2023 and is estimated to grow by 6% in 2024, driven by domestic demand and recovery in the tourism sector. Growth will accelerate in the medium term, primarily from hydropower projects and grant-financed capital investment. The inflation rate was moderate in the first half of 2023, averaging 3.7 percent, but it increased to 4.7 percent in the second half of 2023, while imported inflation remained low.

4. The 13th FYP (2024-29) capital expenditure is expected to be Ngu 245bn, with 51 percent financed by foreign grants, including Ngu 85bn from India. Additionally, the Ngu 15bn India-financed Economic Stimulus Programme aims to reinvigorate the economy in the short term.

**Fiscal Policy**

5. A gradual fiscal consolidation based on revenue mobilization and accompanied by spending restraint is underway. In FY 2024-25, the fiscal deficit is estimated at 4.5% of GDP. Thanks to the large hydro-project Punatsangchhu II commissioning, the fiscal deficit will improve in FY2025/26. New hydro plants, continued recovery in tourism, cryptocurrency exports, and support from development partners will further support the fiscal position. Within five years, the commissioning of Punatsangchhu I and II will double the installed generation capacity as of end-2023 to

4,664MW. The Dorjilung hydro plant would have an installed capacity of 1,125 MW, and a significant portion of its electricity would be exported. The average deficit for the 13th FYP will be 3% of GDP.

6. The wage bill has shown restraint despite the increase in public sector wages in FY2023/24. Bhutan's civil service has expanded significantly over the last three decades, with education and health sectors employing most civil servants. High-skilled workers are primarily employed in the public sector. The increase in public sector wages in FY2023/24 addressed the high attrition rate due to emigration. Exceptional dividends from the state-owned holding company DHI primarily financed this. The authorities remain committed to improving efficiency and continuity in public service delivery through various means, including digitalization.

7. The authorities remain committed to implementing the Goods and Services Tax (GST) by 2025/26 and undertaking other tax reforms to increase the tax base and improve tax administrative efficiency.

### **Public Debt**

8. Although public debt in Bhutan seems high, the FDI-like nature of Bhutan's hydro debt significantly mitigates debt sustainability risks. In the hydropower projects implemented under a special intergovernmental agreement between Bhutan and India, the Government of India (GoI) covers financial and construction-related risks and commits to buying all surplus electricity at a price reflecting cost plus a net return. Further, earned interests during construction are capitalized and, therefore, lead to higher debt levels; such debt does not accrue interest after commissioning, and the debt service is reflected in the export tariff, implying no additional fiscal burden. The Central Government Debt (excluding Inter governmental Hydro-debt) in FY 2023-24 is 43% of the GDP, well within the debt threshold of 55% of GDP mandated by the Public Debt Management Policy 2023. However, addressing the rising public debt continues to be a policy concern and a government priority for the long-term sustainability of public finance.

### **Monetary Policy**

9. The domestic liquidity management framework is geared up to address the dissipation of pandemic liquidity buildup. Authorities are open to adding a proposed monetary policy operation to the existing weekly liquidity management operation. This policy interest rate corridor would allow RMA to align short-term money market rates at a level needed to achieve price stability and support the peg. The IMF's technical support would help authorities further validate the proposed policy rate and implementations (open market operations and determining the haircut for eligible securities).

10. The authorities remain committed to enhancing transparency and independence in the RMA's functioning and strengthening the internal control framework. The RMA lends to the government as long as the loans are temporary and repaid within three months of the end of the fiscal year. The loan size is capped to equivalent of 10 percent of the annual average government revenue in the preceding two years.

### **Financial Stability**

11. The authorities are cognizant of the underlying vulnerabilities in the financial sector, which may surface after the lapse of forbearance measures in June 2024. Loans to hotels, tourism, and housing sectors warrant close monitoring due to banks' significant exposure and risks from the slow pick-up in international visitors and continued emigration, which could exert downward pressure on house prices. In response to pockets of vulnerabilities, the RMA instated a ban on lending for new housing and hotel construction. The new guidelines issued by RMA cover loan restructuring, reclassification of NPLs, tightening credit report requirements, loan origination and monitoring, and directives designed to reduce evergreening. Moreover, with lifting of ban on new housing and hotel construction, RMA imposed the risk weight of 150% for sanctioning of new housing loans if bank's exposure has exceeded 30%.

### **External sector and Exchange rate policy**

12. The exchange rate peg with the Indian Rupee has served well as India is Bhutan's major trading partner and source of FDI. India is the destination of 86 percent of Bhutan's exports and is the source of 73 percent of Bhutan's imports. The bulk of external debt (68 percent of GDP and 61 percent of total debt) and most of the debt service (2 percent of GDP and 51 percent of total debt service payments) is in INR. India continues to be Bhutan's largest source of FDI (51 percent). The authorities acknowledge that maintaining adequate reserves is needed to support the peg's credibility.

13. External shocks have resulted in a reserve decline and put pressure on the exchange rate peg. Tourist arrivals dropped due to COVID-19-related border closures, and there was a jump in service imports due to high levels of emigration. However, reserves recovered to \$609 million (4.7 months of imports) by the end of May 2024, owing to continued recovery in tourism and non-hydro exports and a jump in inward remittances. Further, external reserves remain adequate to meet the 12 months of Essential Imports coverage. The measures, such as import restrictions on vehicles, lending bans, and increased incentives on remittances, have also slowed the reserve decline.

### **Crypto Currency operations**

14. The cryptocurrency investment is a strategic decision leveraging on idle reserves, aimed at exploiting Bhutan's comparative advantage and diversifying the economy. The expertise acquired through managing the cryptocurrency mines can be utilized in other industries, such as data centers. The holding strategy is well-conceived and incorporates measures to minimize the risk of default on the outstanding DHI securities.

15. The RMA has agreed to extend the maturity of the outstanding DHI securities by two years, allowing the timing of cryptocurrency asset sales to be optimized based on current and projected market prices. The extension entails coupon payments at a 4 percent rate, compared to the original bullet bond at a 1.5 percent rate. Further, the RMA has the right to request the sale of the crypto assets should it assess, that reserves would decline below the constitutional minimum.

### **Structural Reforms**

16. The concentration of growth and productivity in a few sectors, such as hydro-power-based electricity generation, has resulted in the majority of employment being in low-productivity sectors. The private sector mainly comprises microenterprises with relatively low productivity and

limited growth prospects. While hydropower has provided a reliable source of growth, non-hydro sectors, facing constraints related to the country's challenging investment climate, including high trade costs and a small domestic market, remain less competitive. As a result, job creation outside of the public sector and agriculture has been limited. The lack of economic diversification and limited private sector activity poses risks to long-term growth and job creation. Addressing these challenges is a top priority for the authorities. Authorities are actively considering appropriate financial instruments and mechanisms that facilitate aggregation and strengthen commercial value chains in agribusinesses.

17. The new Foreign Direct Investment (FDI) policy is under consideration to relax some restrictions, including access to foreign currency, local employment requirements, and caps on foreign ownership in certain sectors. The success of the single-window platform for micro-enterprises will be extended to large and medium enterprises by FY2025/26.

18. Efforts to address barriers to export diversification include improving transportation and warehousing and streamlining export processes. The Gelephu Mindfulness City project would complement these efforts by creating a market for goods and services produced in Bhutan. The city is envisioned as a Special Administrative Region (SAR) with legal independence, and work on the relevant legal framework is ongoing.

### **Capacity Development**

19. The RMA has successfully tested a credit risk scoring model for loan applications under the Basel III LCR Framework with the support of SARTTAC. This model will be implemented across all financial institutions by FY2024/25. Noteworthy recent accomplishments include the recalibration of national accounts, CPI, and PPI, as well as the transition from annual to quarterly labor force surveys. Furthermore, there are plans to introduce quarterly national accounts. These initiatives have benefitted from the Fund's capacity development Programs.

20. Authorities have requested IMF for TA support (CD) on Government Finance Statistics Manual (GFSM), considering the importance of GFSM reforms in Bhutan, and proposed to receive the TA mission in December 2024. The RMA has been undertaking significant HR reforms and has a growing need for expertise. In this regard, the reinstatement of the attachment program for RMA officials at the Asia and Pacific Department (APD) of the IMF, which was discontinued in 2013, would be an opportunity for RMA staff to grow and learn under an esteemed institution like the IMF.