MONETARY POLICY STATEMENT

JULY 2023

ROYAL MONETARY AUTHORITY OF BHUTAN

Monetary Policy STATEMENT

2023

Contents

Acronyms

CPI	Consumer Price Index
CSI	Cottage and Small Industry
CRR	Cash Reserve Ratio
DGRK	Druk Gyalpo's Relief Kidu
EMDEs	Emerging Markets and Developing Economies
FIs	Financial Institutions
FY	Fiscal Year (July 1 – June 30)
FYP	Five Year Plan
GDP	Gross Domestic Product
IMF	International Monetary Fund
INR	Indian Rupees
M2	Broad Money
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MCF	Marginal Cost of Fund
MFIs	Microfinance Institutions
MoF	Ministry of Finance
MLR	Minimum Lending Rate
NPL	Non-Performing Loan
NFA	Net Foreign Assets
PPN	Purchasing Power of Ngultrum
RBI	Reserve Bank of India
RMA	Royal Monetary Authority of Bhutan
USD	US Dollars
WALR	Weighted Average Lending Rate
WADR	Weighted Average Deposit Rate
EMDEs	Emerging Markets and Developing Economies

Monetary Policy Statement

The Monetary Policy Statement is prepared by the Royal Monetary Authority of Bhutan in accordance with Chapter II, Section 10 of the Royal Monetary Authority Act of Bhutan 2010. The Statement is issued annually in July, coinciding with the first month of the new financial year. The Statement highlights recent economic developments and medium-term macroeconomic outlook. As a part of special analysis, the statement also highlights on key financial sector issues.

The outlook presented in this Statement are based on Multi-sectorial Macroeconomic Framework Coordination Technical Committee projections, endorsed by the policy-level Macroeconomic Framework Coordination Committee. The other related information contained in the Statement are sourced from the RMA.

Executive Summary

The Royal Monetary Authority (RMA) has intensified its efforts to enhance the management of foreign exchange reserves in 2022. Safeguarding the foreign exchange reserves to maintain stability of pegged exchange rate of the Ngultrum with Indian Rupee (INR) and also to meet the constitutional requirements of twelve months of essential import coverages continue to remain fundamental goal of RMA's monetary policy and reserve management policies. For Bhutan, the pegged exchange rate serves as nominal anchor for achieving a low and stable price, thereby maintaining the value and confidence in the Ngultrum. To sustain pegged exchange rate and support sustainable economic growth, the RMA continues to rely on the Cash Reserve Ratio (CRR) and macro prudential policy measures to regulate the domestic liquidity and credit growth.

The recent pressure on foreign exchange reserves were attributed to growing internal and external imbalances. The increased government expenditure and rapid expansion of domestic credit from the Financial Institutions (FIs) over the period were identified as the key factors driving Bhutan's external imbalances and vulnerability. The spillover impacts of government expenditure and expansion of domestic credit have been causing large and persistent current account deficits, leading to an unsustainable external sector imbalance.

Bhutan's external reserves were largely built-up with inflow of official aid and grants, hydro-electricity export earning, external borrowings and minimal export proceeds. Over the last three years, monthly average foreign exchange outflow stands at USD 144.0 million, while inflows amount to USD 128.3 million, resulting in overall negative flows. The imports of mechanized goods, which accounted for more than 90 percent of total foreign exchange outflows is found to be a key driver of reserves outflows, with an average annual outflow of USD 114.5 million. In contrast, export proceeds contributed only USD 66.2 million over the last five years. Given the widening of trade deficits and increasing demand for the foreign exchange, there is a need for prudent measures to address the challenges.

To mitigate the risks and address the increasing pressure on the external reserves, the RMA keeps close monitor of the credit growth in the FIs and its spillover impact on the imports and external reserves. Looking at the past trend, private sector credit has been growing at an average of 15 percent annually, with FIs disbursing new loans amounting to Nu 14,026 million. Of the total loan exposure of Nu 192,105.7 million as December 2022, more than 26.6 percent of the loans are in housing and constructions, 12.4 percent in service and tourism and 4.9 percent in transports, which directly translates to imports, putting further pressure on the external reserves. It was estimated that approximately 53 percent of domestic credit is translated into imports of goods for each new loan disbursed by the FIs.

In response to mitigate the rising external sector imbalances and to minimize the impact of external reserves, the RMA has implemented monetary and macroprudential policy measures. In October 2022, the RMA revised Cash Reserve Ratio (CRR) to 8 percent from 7 percent to moderate aggregate demand in the economy through management of liquidity in the banking sector and credit growth. Additionally, the RMA reviewed regulations related to debt-to-equity ratio, loan to value and loan to income, minimum ceiling on leverage ratio and capital provisioning. A moratorium was imposed on housing and hotel constructions, complementing the vehicle moratorium imposed by the Government, and given that these sectors have high loan concentrations and Non-Performing Loans (NPL). These measures are expected to contain monthly foreign exchange outflows on an average of USD 4.2 million for housing and hotel loans and USD 2.8 million for vehicle imports. Recently, in an effort to boost inflow of remittances, payment of incentive on convertible currency was increased from 2 percent to 10 percent.

The global economy is projected to grow at 2.8 percent in 2023 and 3.0 percent in 2024 driven by strong recovery in China and India (IMF World Economic Outlook Update, April 2023). The global headline inflation is estimated to moderate at 7.0 percent in 2023 from 8.7 percent in 2022, which expected to reach target levels by 2025. However, the global growth outlook remains highly uncertain with ongoing effects of Russia's invasion of Ukraine and lingering impact of monetary policy tightening in advanced economies.

On the domestic front, Bhutanese economy posed a gradual recovery from the impact of COVID-19 pandemic to 4.1 percent in 2021 from all-time low -10.1 percent in 2020, mainly supported by monetary and fiscal measures and relaxation of pandemic restrictions. The headline inflation also grew moderately at 3.3 percent in April 2023 from 5.8 percent in April 2022 due to slower growth in food prices. The current account deficit remains at 34.5 percent of GDP in FY 2022/23, primarily due to widening of trade deficit. While domestic credit growth picked up to 9 percent in December 2022, the growth still remains below the pre-pandemic level. The fiscal deficit was recorded at 7.9 percent of GDP (Nu 15,922 million), and public debt stood at 132.1 percent (Nu 267,401.3 million) as of March 2023.

Looking ahead, the domestic economic growth is estimated to grow at 4.7 percent in the medium term[1], driven by pent-up private consumption and investment demand, monetary and fiscal relief measures and revival of tourism sector. The headline inflation is expected to remain moderate at 5.2 percent in 2023/24 with non-food prices estimated to slow down due to restoration of global supply chain, moderation of fuel prices and Indian inflation returning to target levels. The RMA will pursue accommodative monetary policy stance that channels credit to growth drivers, while maintaining vigilance over import-heavy consumptions.

The current account deficit is expected to remain elevated at 34.5 percent of GDP in FY 2022/23, and deterioration of the current account remains one of the biggest challenges in the medium-term. The RMA emphasize the need for both monetary and fiscal policy measures, along with sector-specific reforms, to tackle these challenges and support sustainable economic growth.

The financial system of Bhutan shows resilience with the FIs well capitalized with their capital holding above the prudential requirements at 16.5 percent at the end of the December 2022. Credit to deposit ratios have improved from 73.0 percent in 2021 to 75.4 percent in 2022. While, there are still some concerns regarding the higher level of NPLs among the financial institutions, NPL across sectoral lending in all institutions improved to 7.9 percent for the quarter ending December 2022 from 8.9 percent in 2021. Sectors

[1]Macroeconomic Framework Coordination Technical Team (MFCTC) Update, April 2023

experiencing higher NPLs during the quarter (year-on-year) includes that of loan to transport (9.7%), loans to contractors (7.9%), trade and commerce (7.2%) and agriculture and livestock (6.3%).

Risks to the outlook are heavily skewed to the downside emanating from both external and domestic development as a result of widening government resources gap and persistent expansion of domestic credit. The widening of current account deficit still remains one of the single biggest challenges facing Bhutan in the medium-term, and addressing this challenge will require both monetary and fiscal policy measures as well as other structural sector-specific reforms. The RMA's monetary policy will be channeled through the prudent management of external reserves and credit with an objective to achieve the long-term exchange rate stability and support sustainable economic growth.

Under the noble guidance of His Majesty The Fifth Druk Gyalpo, a series of monetary measures were undertaken as part of the transformation reform with an objective to improve efficiency and effectiveness. To support the livelihoods and severely impacted economic sectors, deferment of loan repayment and Interest Payment Support (IPS) amounting to Nu. 16.12 billion were provided to all citizens of Bhutan. In view of ensuring uninterrupted flow of credit for financing business continuity, the RMA provided liquidity support of Nu. 4.2 billion in the banking sector by reducing the CRR from 10 percent to 7 percent. Through the reform exercises, the RMA also brought down the overall gross NPL to 5.1 percent as of March 2023.

Strengthening cooperation and coordination among stakeholders are essential to make progress in creating a more resilient economy, including by enhancing the domestic financial safety net, improving payment system, mitigating the costs of climate change, and reducing the adverse effects of ongoing geopolitical tension.

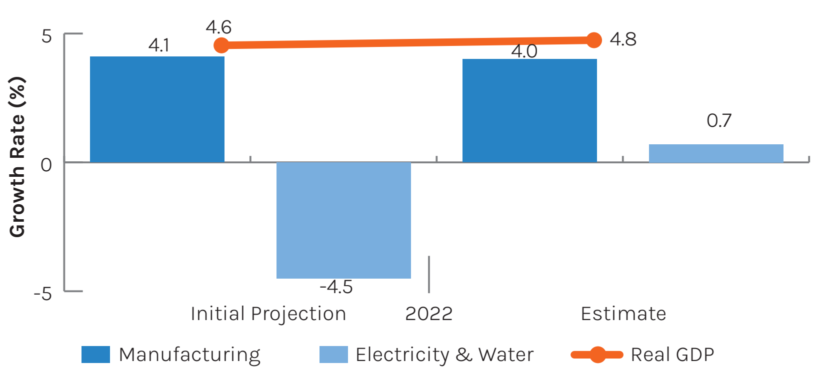
1. Recent Economic Developments[2]

Although, global supply chain and financial conditions are improving, the global economy continues to remain uncertain with ongoing geopolitical tensions. According to the World Economic Outlook (WEO) update by the International Monetary Fund (IMF) in April 2023, the global growth is expected to decrease from 3.4 percent in 2022 to 2.8 percent in 2023. The downward revision was mainly due to the direct impacts of Russia and Ukraine war and its spill-over-effect on the global trade and exchange rate. Particularly, the growth in advanced economies (USA, Japan, UK, Canada) is projected to have a sharper decline in comparison to emerging and developing economies.

Similarly, the economic prospects of the South Asian region were also adversely affected by Russia's invasion of Ukraine leading to higher food & energy prices and rising global interest rates. However, emerging economies particularly India maintained growth momentum and resilience despite the global economic fallout. In the first half of the Fiscal Year (FY) 2022/23, India, which accounted three-fourths of the region's output is expected to grow by 9.7 percent supported by strong private consumption and fixed investment.

On the domestic front, the economic growth is estimated to grow at 4.8 percent in 2022.

Chart 1.1 : Real GDP Growth (Supply)

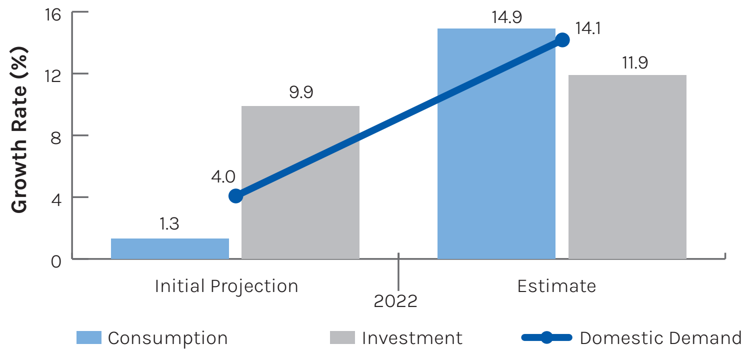


As per the latest estimate (April 2023), the economic growth is expected to increase to 4.8 percent in 2022, a slight increase from the initial projection

[2]Comparisons between initial projections and revised estimates/projections are based on the April 2022 and April 2023 projection results of the MFCC/MFCTC, respectively.

of 4.6 percent in 2021. The initial projection assumed a slower growth in the service sector, particularly the whole-sale and retail trade. With the implementation of business reopening strategies by the government, service sector grew by 5.6 percent in 2022 against the initial projection of 5.0 percent.

Chart 1.2: Domestic Demand

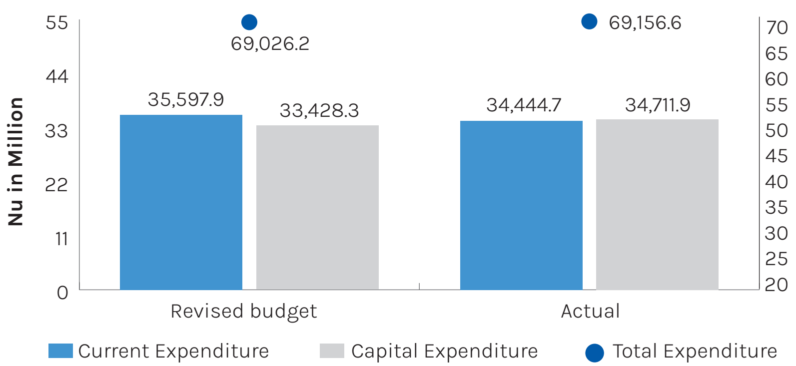


The headwinds related to the COVID-19 pandemic continued to affect industry sector. The industrial sector which was initially projected to grow at 4.1 percent witnessed a downward trend of 3.4 percent mainly due to the lower performance in the construction sectors. The moderation of the construction loans from the financial institutions and no new upcoming hydro power projects contributed to slower growth in construction sector.

The aggregate domestic demand in 2022 grew by 14.1 percent compared to 4.0 percent from the initial projection. The total consumption, both public and private sector, was estimated at 14.9 percent in 2022, against the initial projection of 1.3 percent in 2021. The private consumption which comprises for more than three-fourth of the total consumption grew by 17.7 percent from an initial projection of -0.01 percent. The gross fixed investment is estimated to grow by 11.9 percent from an initial projection of 9.9 percent. The upward revision of growth is mainly driven by an increase in government investment from 17.7 percent in 2021 to 23.3 percent in 2022, as a result of an increase in machinery and equipment purchases.

The fiscal deficit remained elevated at 7.7 percent of GDP in the FY 2021/22 attributing to higher government spending. In the FY 2021/22, the actual budget outlay which accounted for 35.9 percent of GDP stood at

Chart 1.3: Government Expenditure Allocation FY 2021/22

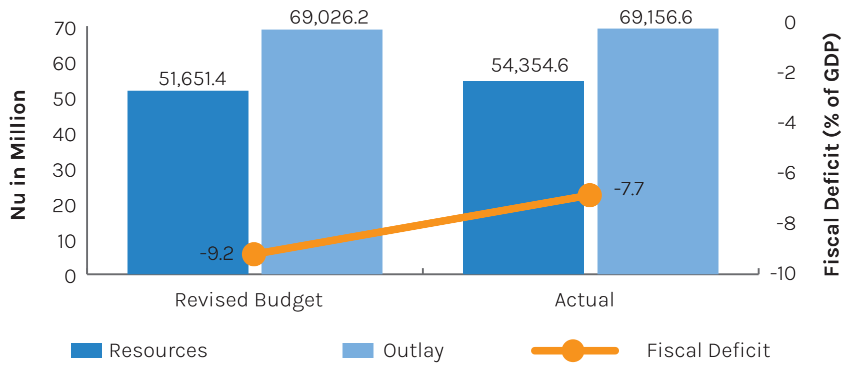


Nu 69,156.6 million broadly in line with estimates of Nu 69,026.2 million. The marginal upward revision is attributed to increase in capital expenditure by Nu 1283.6 million owing to increased expenditures on Disaster Relief Response and Infrastructures (Road and Buildings).

Given the constitutional requirement to meet the recurrent expenditure from domestic resources, the government continues to maintain the recurrent expenditure from the domestic revenue. From the total budget outlay of Nu 69,156.6 million, Nu 34,444.7 million was allocated for recurrent expenditure and Nu 34,711.9 million for capital expenditure in the FY 2021/22.

The total resources during the FY 2021/22 increased by Nu 2,703.3 million (5.2 %) from the initial estimates of Nu 51,651.4 million to Nu 54,354.6 million on account of improved domestic revenue due to higher collection of taxes. Domestic revenue increased significantly to Nu 39,043.1 million against the initial estimates of Nu 34,367.4 million on account of increased Corporate Income Tax, Sales Tax and Dividend Receipts from government corporate agencies. The domestic revenue accounted for 20.3 percent of the GDP and covered 56.5 percent of the total expenditure as against the initial estimate of 49.8 percent coverage.

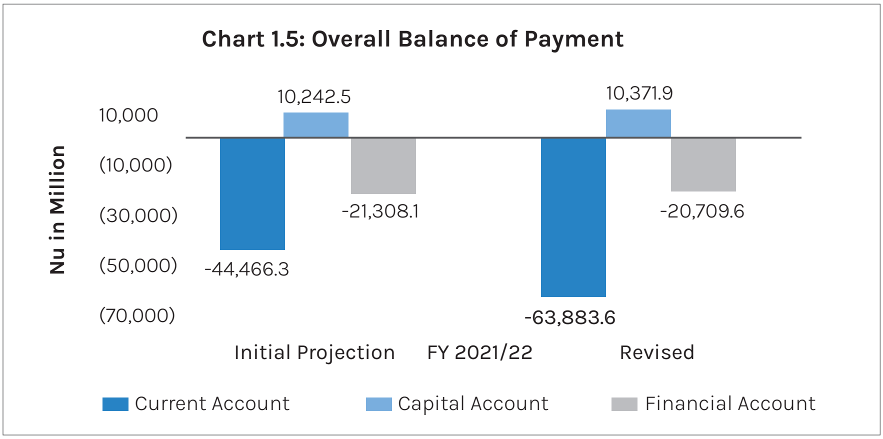
Chart 1.4 : Fiscal Position For FY 2021/22



The government received external grants of Nu 13,583.5 million, a drop by Nu 3,188.2 million against the initial estimate. The official grant inflow decreased in FY 2021/22 on account of lowered Program Grant received from the government of India (GOI). While the total revenue increased by 5.2 percent (Nu 39,043.1 million) from the initial estimates, the total expenditure increased slightly by 0.2 percent (Nu 69,156.6 million) during the FY 2021/22. Therefore, the fiscal deficit narrowed to 7.7 percent of GDP (Nu 14,802 million) against the initial projection of 9 percent of GDP (Nu 17,374.9 million) during the FY 2021/22.

The government financed the fiscal deficit mainly through external concessional loans and internal borrowings. The government has been consistently borrowing from the domestic market by issuing different financial instruments in the form of T-bills, Ways and Means Advances and overdraft facilities to meet its recurrent expenditure. As of FY 2021/22, the outstanding domestic debt amounted to Nu 28,061.3 million. Of this, the outstanding T-bills amounted to Nu 15,500 million, Ways and Means of Nu 12,200 million and overdraft loan of Nu 361.3 million. Likewise, the government borrowed Nu 9,520.8 million from bilateral and multilateral development partners like Asian Development Bank (ADB), International Development Association (IDA) and Japan International Cooperation Agency (JICA). As a result, the total domestic and external debt outstanding of the government stood at Nu 257,580.3 million, constituting about 133.6 percent of the GDP during the FY 2021/22.

The external vulnerability further worsened with the overall balance of payments at negative Nu 32,400.5 million in FY 2021/22 compared to the initial projection of Nu 12,915.7 million. The deviation of overall

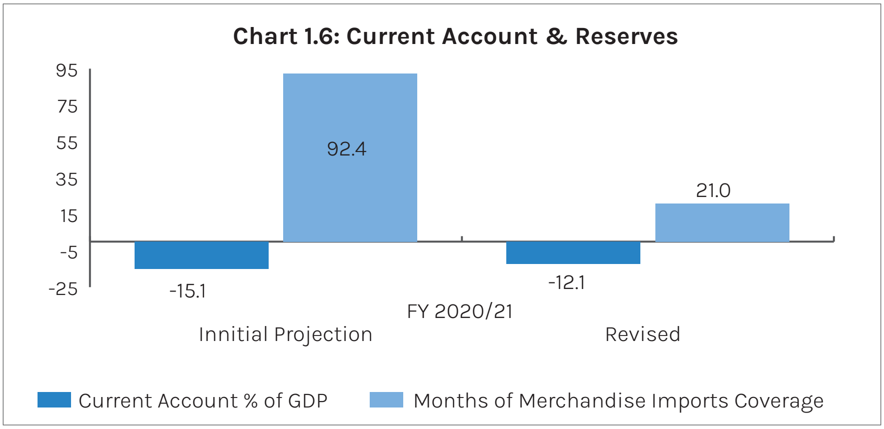


balance of payments from the initial projection is mainly on account of the deteriorating current account deficit to Nu 63,883.6 million (32.9 % of GDP) from the initial projection of Nu 44,466.3 million.

Trade deficit which was initially projected at Nu 31,545.91 million is recorded at Nu 46,270.7 million during the FY 2021/22. The high trade deficit contributed to the all-time high current account deficit of Nu 63,883.6 million. The higher merchandise imports such as metals, machineries and equipment (Nu 32,109.3 million) collectively have driven the trade deficit.

Net primary income payments marginally decreased by 4.2 percent from the initial projection of Nu 12,434.0 million due to drop in hydro power loan interest payments. Similarly, the net secondary income receipts fell by 11.3 percent to Nu 8,458.4 million owing to a substantial decline in non-investment budgetary grant inflows.

The capital account dominated by the investment budgetary grants inflow marginally increased to Nu 10,371.9 million from the initial projection of Nu 10,242.5 million. The Hydropower grant inflows increased by 12 percent from the initial projection of Nu 1,373.8 million. Similarly, the non-hydro power



grants on the other, dropped by 0.4 percent to Nu 8,833 million from the initial projections.

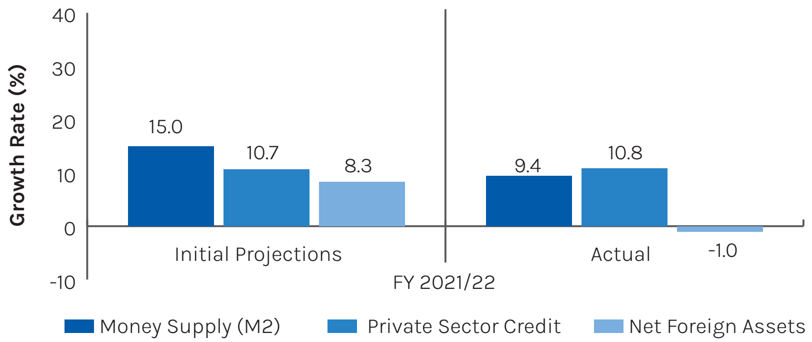
Unlike in the past trend, the financial inflows slightly dipped to Nu 20,709.6 million from the initial projection of Nu 21,308.1 million due to fall in Foreign Direct Investment (FDI).

The persistent current account deficit with limited financial inflows has resulted in the depletion of foreign exchange reserves. As of FY 2021/22, the foreign exchange reserves decreased to USD 832.9 million from the initial projection of USD 1,328.0 million, which however is adequate to finance 15 months of essential imports and 7.6 months of merchandise imports.

The broad money supply (M2) experienced a moderate increase primarily driven by steady growth in deposit liabilities and declined foreign assets in FY 2021/22. The broad money supply (M2) grew by 9.4 percent to Nu 197,301.4 million in FY 2021/22 against initial projection of 15.0 percent (Nu 207,361.3 million). A fall in the money supply growth is largely contributed by moderation of the deposit liabilities. The saving deposits which constitute around 35.6 percent of the total deposits grew by 8.9 percent (Nu 66,646.6 million) in FY 2021/22, compared to 31.7 percent in the previous year. The moderate growth in saving deposits was contributed by the private consumption and investments.

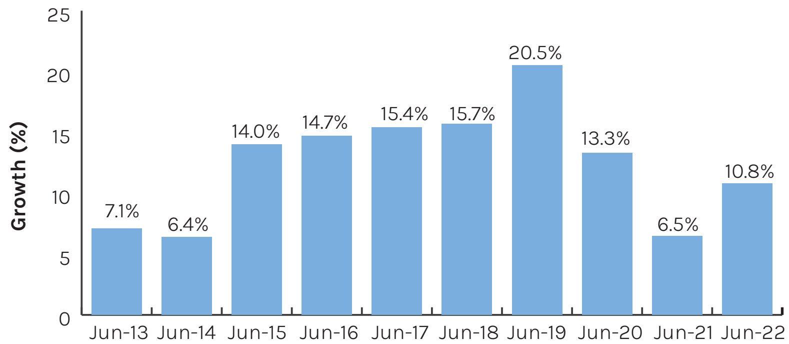
On the counterparts of the broad money, the Net Foreign Asset (NFA), which is the main contributor of the money supply, dropped by negative 1 percent against an initial projection of 8.3 percent growth. A substantial Indian Rupee (INR) obligation in terms of debt servicing, import payments and lower inflows of external grants contributed to decline in the foreign assets to Nu 97,558.1 million in FY 2021/22 compared to Nu 98,552.0 million in the previous year.

Chart 1.7: Key Monetary Aggregrates



The credit to private sector which constitutes 71.1 percent of the broad money supply grew by 10.8 percent (Nu 140,254.9 million) in FY 2021/22 against 10.7 percent (Nu 140,103.5 million) of initial projections. The demand for loan in sectors such as housing and service & tourism resulted in marginal growth

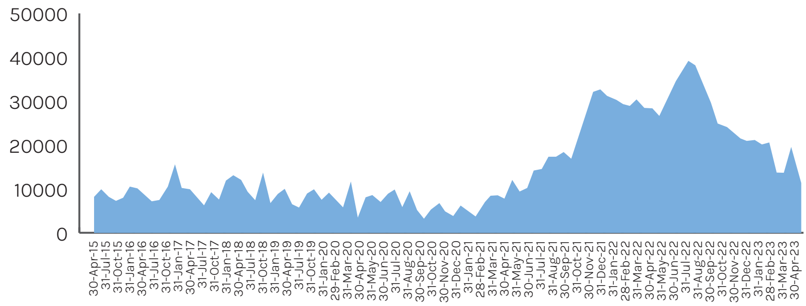
Chart 1.8: Private Sector Credit Growth



amounting to Nu 5,186.6 million in FY 2021/22 from Nu 83,812.2 million in FY 2020/21. In terms of credit exposures, housing (Nu 46,227.4 million), service & tourism (Nu 42,771.4 million) and trade & commerce sector (Nu 22,301.0 million) combinedly constituted 66.4 percent of the total loan portfolio.

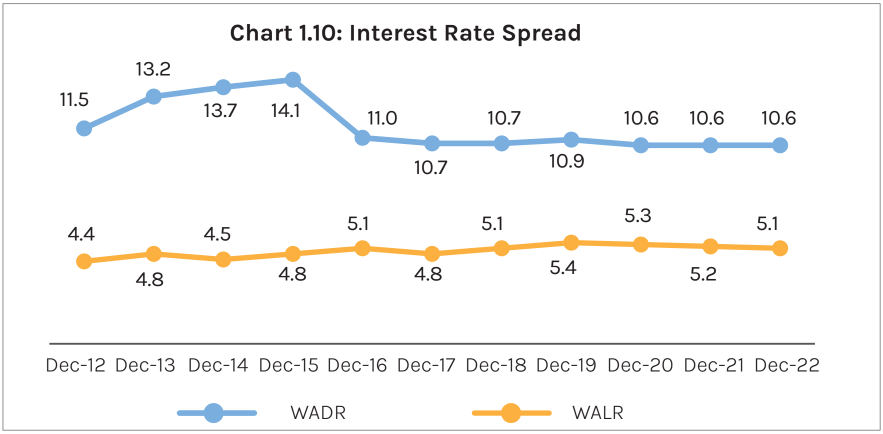
The liquidity conditions of the commercial banks recorded a significant growth in FY 2021/22 and thereafter started to decrease due to moderated growth in total deposits. As of April 2023, the total excess liquidity in the commercial banks amounted to Nu 12,986.5 million, comfortable to meet the short-term liquidity demand in the economy. However, the excess liquidity remains volatile as it is driven by short-term deposits.

Chart 1.9: Liquidity Position (Nu in Million)



The interest rate in Bhutan underwent a notable revision from the 1980s, with complete liberalization in October 1999 to promote competition and flexibility, enabling banks to determine their interest rates; however, this approach posed challenges such as rigid rates with high spreads. To address the issue, the RMA introduced Base Rate System in 2012. The base rate is the minimum rate below which it is not viable for the credit lending institutions to lend in the domestic market. It helped the financial sector promote transparency, fair competition, and safeguard the interest of borrowers, while facilitating monetary policy transmission and encouraging domestic savings.

The review of the Base Rate system revealed various limitations such as backward-looking computation, double accounting of margins, lack



of competition, and multiple objectives. Therefore, Minimum Lending Rate (MLR) was introduced in 2016 to address the rigidities and aimed at encouraging competition and professionalism in financial institutions. The MLR has helped in improving the transparency and deriving the real cost of the banks. On average, over the years, the MLR reduced the cost of borrowing by 200 basis points across all the sectors.

Since the launch of MLR, the Weighted Average Lending Rate (WALR) witnessed a notable reduction from 14.1 percent in December 2015 to 10.6 percent in December 2022, despite the marginal variations in the MLR (6.8% on average since 2016) within the financial institutions. On the Weighted Average Deposit Rate (WADR), the WADR continues to remain more or less stable over the period.

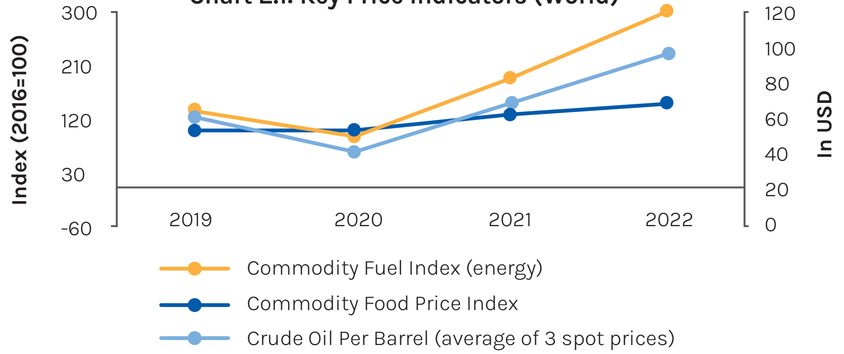
The single MLR based on five commercial banks' returns as of December 2022 stood at 6.9 percent, a decrease of 0.3 percentage points from 7.2 percent in December 2021. The decline in the Marginal Cost of Fund (MCF) of the banks from 5.4 percent in December 2021 to 5.3 percent in December 2022, contributed to the overall fall in the single MLR in December 2022. On the other hand, an increase in the Cash Reserve Ratio (CRR) by 1 percentage point from 7 percent to 8 percent with effect from 31st October 2022 has slightly increased the CRR cost to 0.5 percent in December 2022 from 0.4 percent in December 2022.

2.Inflation

Amidst the global economic uncertainty and rising inflationary pressures, the domestic consumer prices remained low due to fall in the prices of food items.

The global economy experienced a heightened uncertainty in the last three years due to a recurring economic shock emanating from the COVID-19 pandemic and Russia's invasion of the Ukraine since February 2022. The adverse shocks have embroiled the global economy with lower growth

Chart 2.1: Key Price Indicators (World)



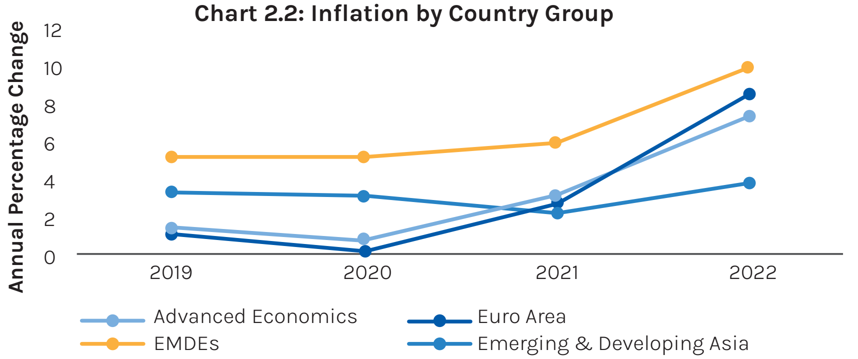
Source: IMF World Economic Outlook Database (April '23)

prospect and rising inflationary pressures. The spike in commodity prices and incessant disruptions in supply chain in particular pushed the inflation to a decade high in many economies last year, prompting many central banks to tighten its monetary policy.

The geo-economic fragmentation, dislocation of the global supply chain and trade spillovers severely impacted the global energy prices in 2022. The commodity fuel index which includes crude oil, natural gas and coal price increased by 226.6 percent between 2020 and 2022. The crude oil prices (petroleum) alone increased from USD 41.8 per barrel to USD 96.4 per barrel during the same period. Besides the ban imposed on the import of Russian crude oil, a decision by OPEC+ to cut down the oil production further fueled the rise in petroleum prices.

Since the fluctuation in oil prices exert a greater influence on the cost of inputs and producer prices, the energy price shocks have translated into higher inflation in Emerging Markets and Developing Economies (EMDEs) in 2022. The EMDEs have been affected the most as these economies are highly dependent on the imports of energy and are more vulnerable to economic shocks.

Chart 2.2: Inflation by Country Group



Source: IMF World Economic Outlook Database (April '23)

During the COVID-19 pandemic, inflation in EMDEs hovered around 5 percent and increased sharply to 9.8 percent in 2022. Due to supply chain disruptions and exchange rate depreciations, the exports of goods in EMDEs nosedived from 11.8 percent in 2021 to 1.5 percent in 2022, while imports during the same period plunged from 12.3 percent to 2.2 percent (WEO).

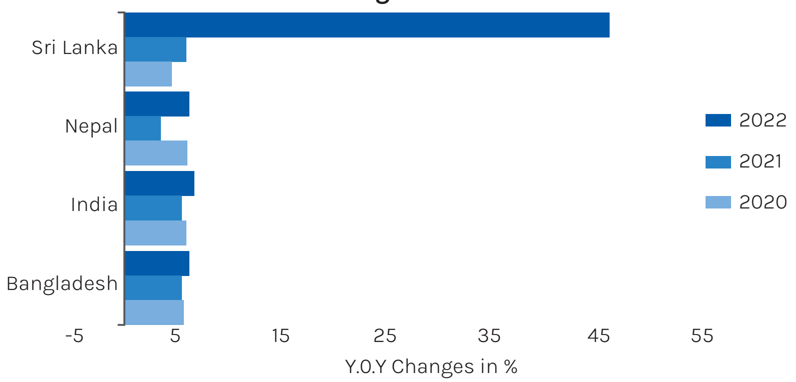
Inflation in the advanced economies such as United States of America (USA), United Kingdom (UK) and Canada remained elevated at 8 percent, 9.1 percent and 6.8 percent respectively in 2022.The Japanese economy with zero inflation in 2020, endured an inflation of 2.5 percent in 2022 from a -0.2 percent in 2021. Over the period, the Bank of Japan subscribed public bonds to increase the money supply and enhance the aggregate demand in the economy to maintain inflation at desired level.

The Emerging and Developing Asia recorded the annual inflation at 3.8 percent in 2022, which is considered to be one of the highest in the last nine years. Inflation in China and India, which is the two largest emerging economies recorded at 1.9 percent and 6.7 percent respectively. Lower inflation in China was largely due to a decline in mobility and economic activities towards the fourth quarter of 2022 as COVID-19 outbreak re-emerged, contraction in real estate sector and moderation in demand.

The higher inflation in India was driven by higher crude oil prices as it accounts for more than 40 percent of the Indian Consumer Price Index (CPI). India imports 80 percent of its energy needs, and such increase has led to rise in the prices of raw materials, production and transportations sector. The persistent rise in the inflation steered the Indian government to cut central excise duty on petrol & diesel, reduction of custom duties on plastic products and steel, and restriction of export on wheat was imposed in June 2022 to discourage market speculation and protect the native farmers.

Further, the Reserve Bank of India (RBI) revised the policy repo rate six times in 2022 taking the rate from 4 percent in April 2022 to 6.25 percent towards December 2022. The repo rate was revised upward by 25 basis points in February 2023 to 6.5 percent to curtail inflationary pressure.

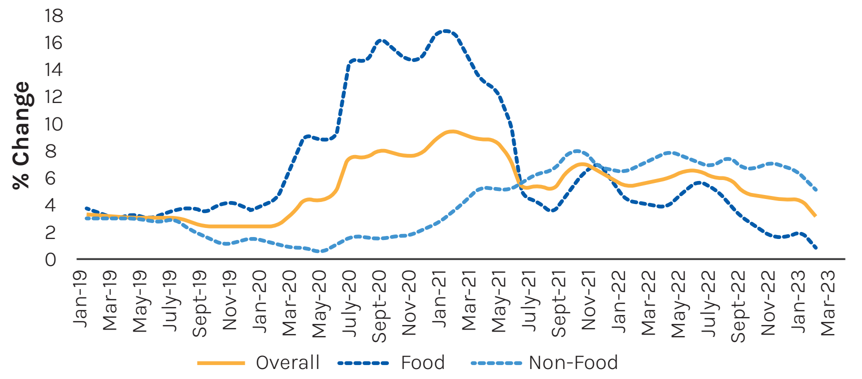
Chart 2.3: Regional Price Outlook



Source: IMF World Economic Outlook Database (April '23)

Except for Sri Lanka (46.4 percent), the annual inflation in the region remained within the range of 6 to 7 percent in 2022. The energy price fluctuations and supply chain disruptions are primarily an underlying cause for higher prices in these countries except for Sri Lanka, which has been grappling with worst economic crisis in its history. The shortages of basic essentials such as goods and fuel, growing international debts and depleting foreign currency reserves led to a surge in inflation in Sri Lanka. Further, it has also been argued that banning imports of chemical fertilizers by the Lankan government to tackle foreign currency shortages in 2021 caused a widespread crop failure, which further compounded into the already challenging food prices.

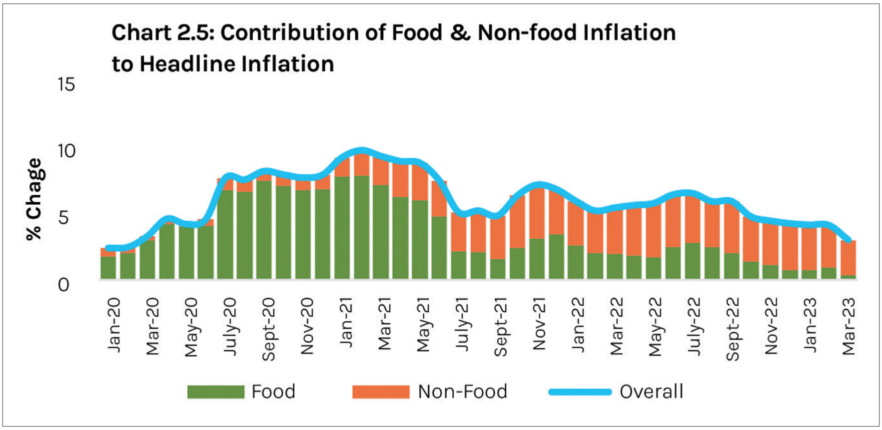
Chart 2.4 Headline Inflation



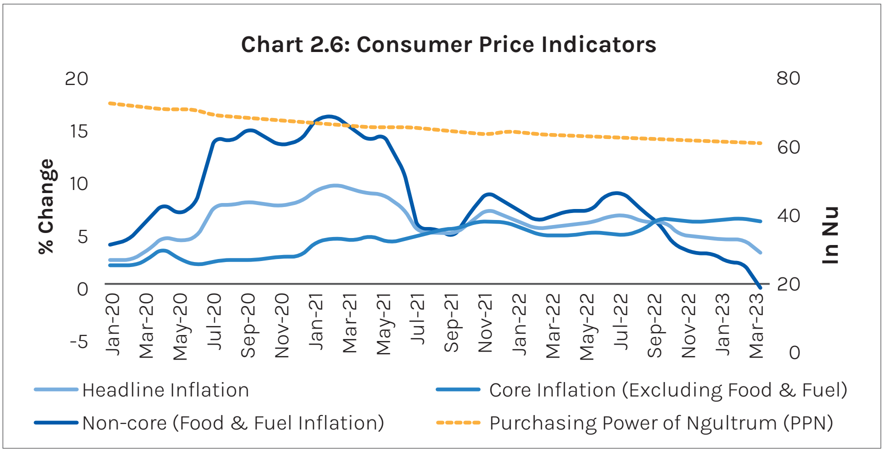
On the domestic front, the Bhutanese economy has experienced a fluctuation in price level in the last three years, due to COVID-19 pandemic in 2020, recovery efforts from the pandemic in 2021 and the global geopolitical tensions in 2022. Given that 80 percent of Bhutan's imports are from India, inflation in Bhutan closely follows Indian Inflation trends.

During the review period, starting from July 2021, the non-food inflation was higher than the food inflation due to unprecedented increase in global fuel price and supply chain disruptions.

The price of consumer goods and services increased by 3.2 percent in March 2023 as compared to 5.6 percent in the previous year of the same month. The increase in CPI inflation was driven by non-food price (weight of 54.1 percent). The non-food prices increased by 5.2 percent in March 2023 compared to the same period last year and the food prices increased by 0.8 percent compared to 4 percent in the previous year. The volatility in the non-food prices is due to increase in crude oil prices in the first half of 2022 and decrease in broad-based prices in the remaining months.



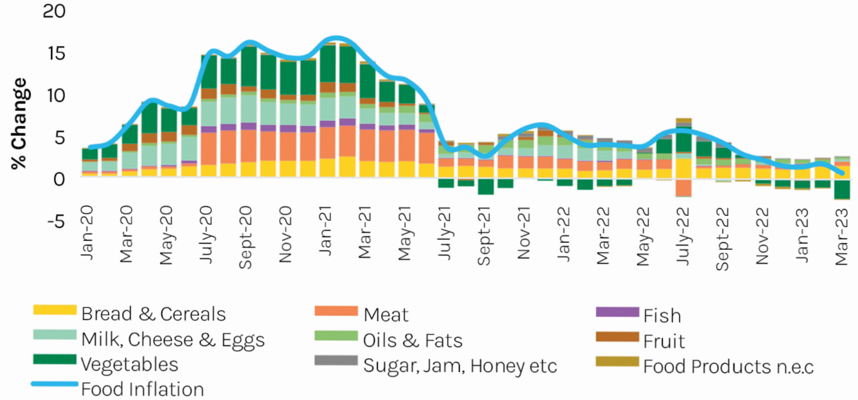
Furthermore, the relative contribution of non-food to overall inflation in the economy increased to 87.8 percent in March 2023 from 63.5 percent in the previous year, while the relative food contribution declined to 12.2 percent from 36.5 percent during the review period. In July 2022, there was an increase in both the food and non-food inflation as the geopolitical tension and trade disruptions continued to dampen the global economy. While there was a gradual decrease in food inflation following July 2022, the non-food inflation continued to remain volatile.



Against the backdrop of rising inflation and uncertainties, the Purchasing Power of Ngultrum (PPN) has been gradually falling over the years. The PPN measured by the CPI is Nu 59 as of March 2023 compared to December 2012(base line), which is a decline by 41 percent from 2012.

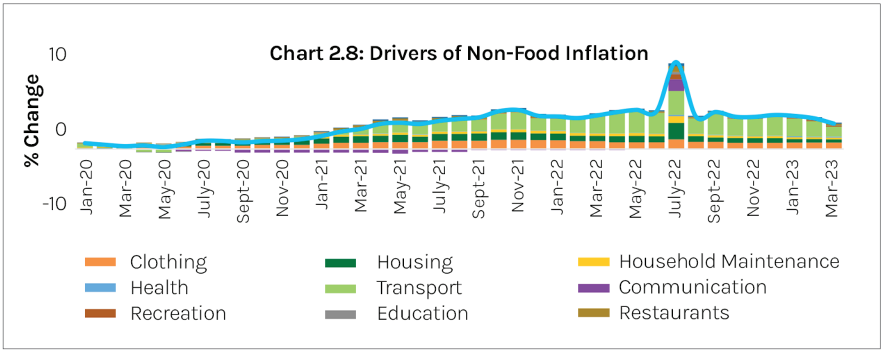
The food price which constitutes 45.9 percent of the total CPI basket grew by 0.75 percent in March 2023 compared to 4.0 percent in March, 2022. Among the major drivers of the food inflation, the price of meat item (20.4 % in CPI food basket) recorded a slower growth at 8.9 percent in June 2022 compared to 37.2 percent in the June 2021.The increase in domestic supply

Chart 2.7: Drivers of Food Inflation



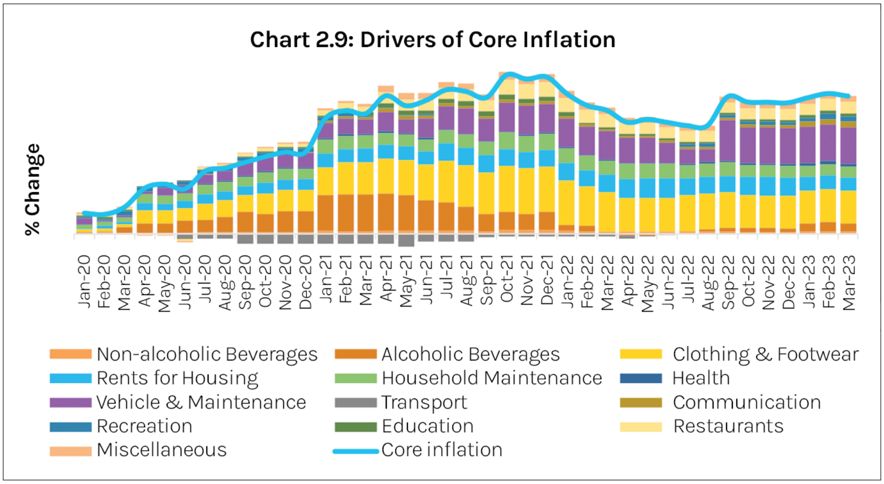
and restrictions on meat imports contributed to lower growth in food prices. Similarly, the inflation in fish and oils & fats dropped to 2 percent and 13.6 percent in June 2022 compared to 14.8 percent and 21.6 percent in the previous year.

Non-Food prices continued to be the primary driver of overall headline CPI inflation since July 2021, contributing more than 85 percent to the inflation. The inflation in the cost of the transportation (55.4 % in non-food basket) has doubled to 14.7 percent in June 2022 resulting from rise in fuel and commodity prices, followed by price of household maintenance at 6.41 percent in June 2022 compared to 4.9 percent in June 2021.



The core inflation which excludes highly volatile items such as food and fuel, experienced minimal rise over the period to 4.9 percent in June 2022 from 4.6 percent in the previous year. The price of housing (0.08 percent inflation) and household maintenance (0.6 percent inflation) recorded a marginal increase during the period contributing to rise in the core inflation.

The headline CPI inflation continued to experience a slower growth recording at 3.2 percent as of March 2023 as global supply chain stabilizes and economy recovery posits to continue.



3. Medium Term Macroeconomic Outlook

The pandemic, Russia-Ukraine war and recent financial sector turmoil have created a deep scar on the global economy. The major forces that shaped the world economy in 2022 is presumed to continue this year such as higher debt level, high geopolitical tensions with war still ongoing. The economies that were hit hard by the last pandemic are still in recovering stage. Although there is an improvement in food and energy prices with supply chain restoration, the uncertainty from the recent financial sector turmoil in USA and Europe possess challenges. If the financial turmoil is contained, the global growth is projected at 2.8 percent in 2023 compared to 3.4 percent in 2022, and if it continues, the growth is projected to decline to about 2.5 percent in 2023, the weakest growth since the global downturn of 2001, with the exception of COVID-19 crisis in 2020 and during the global financial crisis in 2009 (WEO, 2023 April).

The advanced economies are expected to experience a growth slowdown from 2.7 percent in 2022 to 1.3 percent in 2023. The emerging and developing economies are anticipated to perform better than advanced economies though performances may vary across the regions. These economies are estimated to grow on an average at 3.9 percent in 2023 and rise to 4.2 percent in 2024. On the other, the economic growth on an average is estimated at 5.1 percent over 2023/24 in low income developing countries.

Global headline inflation is set to fall from 8.7 percent in 2022 to 7.0 percent in 2023 on account of fall in fuel and energy commodity prices, particularly for the United States, euro area, and Latin America. Nonetheless, underlying (core) inflation is likely to decline more slowly. Inflation's return to target is unlikely before 2025 in most cases despite financial tightening by central banks globally. However, depending on the varying exposure, regions are expected to experience different price effects. The risk foreseen to the outlook are in the form of financial sector stress, sovereign debt distress and high food and energy prices due to war in Ukraine.

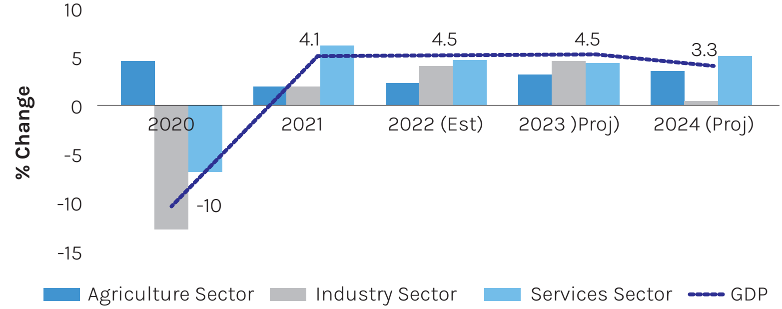
Against these global developments, the Asia-Pacific region remains dynamic with recovery in China and resilient growth in India. The regional growth is expected to reach 4.6 percent in 2023, up from 3.8 percent in 2022. The growth in other Asian countries is also expected to bottom up in 2023.

The core or headline inflation in the region is anticipated to remain within central bank targets, although output of China and Japan remains below the potential output due to delayed re-opening and softening external demand.

On the domestic economy front, the economy is estimated to grow at 4.2 percent in 2023 and then projected at 5.2 percent in 2024, which are still below the pre-pandemic economic performance.

The industry (35.2 % of GDP) and services (50.4 % of GDP) sectors in 2023 are expected to improve, with an increase in domestic private consumption

Chart 3.1: Real GDP & Sectoral Growth



and private capital spending, though government investment is estimated to remain almost constant in the medium term. The industry sector which is estimated to contribute 0.6 percentage points to the GDP, is expected to grow by 1.6 percent in 2023 from the previous year and projected at 3.7 percent in 2024. The electricity and water; and mining and quarrying sectors are anticipated to witness a growth of 5.5 percent and 5.3 percent respectively followed by 3.2 percent growth in manufacturing sector in 2023. However, the construction sector is estimated to witness a negative growth of 5.9 percent.

While, the services sector with expected contribution to GDP at 2.9 percentage points in 2023 is expected to grow at 5.9 percent, and projected at 6.4 percent in 2024. The improvement in services sector is attributable to inflow of tourists, and hotel and restaurant sector that further expected to translate into growth of transport, storage and communications. The services sector in 2023 is driven by 48.0 percent growth in hotel and restaurant followed by

8.5 percent in wholesale and retail, and 8.1 percent in transport, storage and communications sectors.

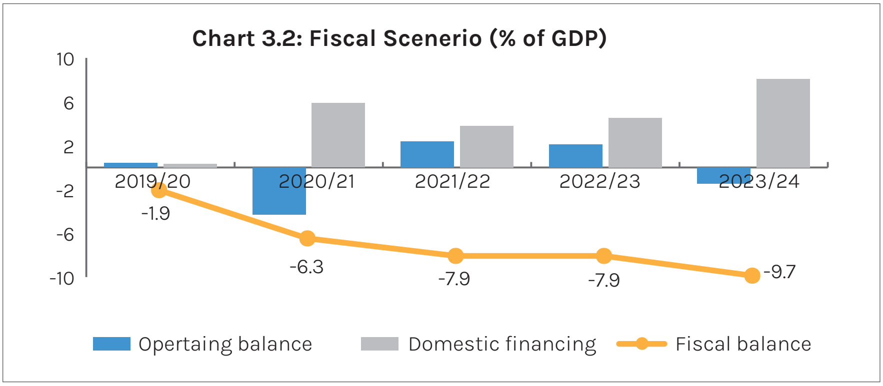
Similarly, agriculture sector (11.3 % of GDP) is also expected to grow by 3.9 percent in 2023 as the government continues to invest in agricultural infrastructure, value chain creation, and contingency measures to address the rising issue of human-wildlife conflict.

On the demand side, the total consumption is estimated to grow by 3.9 percent in 2023 and projected at 2.5 percent in 2024. The increase of consumption in 2023 is expected to be driven by public consumption with 5.6 percent growth. In contrast, the total investment is estimated to decline by 10.2 percent in 2023, mainly due to a huge fall in government investment by 32.6 percent. Of the estimated total outlay for the FY 2023/24, 39.1 percent is capital expenditure and remaining is current expenditure.

On account of various skilling program initiatives under the Desuung skilling program (DSP) and tourists' inflow, the labor market is expected to pick up in the medium term. As such, the unemployment rate is estimated to improve marginally from 5.9 percent in 2022 to 5.8 percent in 2023. In line with higher anticipation of working age population in 2023, the person employed is also expected to increase by 5.5 percent to 303,694.

The headline inflation is expected to subside at 5.3 percent in the FY 2022/23 and further to 5.2 percent in the succeeding year.

To support the economy development, the government has intervened with various policy applications during the pandemic. Consequently, the fiscal deficit for the FY 2022/23 is estimated at Nu 15,922.1 million, which still remains elevated at 7.9 percent of GDP during the fiscal year, which grew by 5.9 percent from the previous year. This development is mainly on account of total expenditure outpacing the total revenue, where the total expenditure is estimated at Nu 76,990 million vis-à-vis a total revenue of Nu 61,068 million during the fiscal year. Under the total revenue, the domestic revenue is estimated to grow by 4.6 percent to Nu 40,829 million during the FY2022/23 and external grants by 40.6 percent to Nu 19,098 million. During the review year, the capital expenditure is estimated to exceed recurrent expenditure, where capital expenditure is estimated to grow by 16.8 percent and recurrent



expenditure by 5.8 percent from the previous year. These developments are expected to unleash income multiplier effect and hasten the recovery process.

Further on the operating balance front, the domestic revenue is estimated to exceed recurrent expenditure during the FY 2022/23, where domestic revenue is estimated to grow by 4.6 percent from the previous year at Nu 40,829.2 million and recurrent expenditure at Nu 36,447 million. The projection is anticipated to continue during the FY 2023/24 with positive balance of Nu 700 million. As such, the provision of the constitutional requirement on meeting recurrent expenditure from the internal sources of the country will be met.

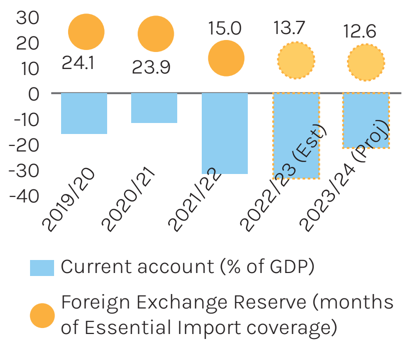
During the FY 2023/24 which coincides with the conclusion of the 12th Five-Year Plan (FYP), the fiscal deficit is projected to widen to Nu 21,348.0 million due to decrease in grants and other receipts while the total expenditure is projected to remain elevated, despite a decline in capital expenditure by 27.7 percent. The fiscal balance is projected to record a significant improvement in the FY 2024/25.

The fiscal deficit is anticipated to be financed through domestic borrowings with the issuance of long-term government bonds and short-term 90-days treasury bills and remaining is to be sourced from external borrowings. The average non-hydro power debt ratio to GDP for the last four years (as of 31st March 2023) of the 12th FYP is 31.5 percent, which fulfills 35 percent of GDP threshold requirement during the FYP period as stated in the Public Debt Policy 2016.

During the FY 2022/23, the internal borrowings is estimated at Nu 8,110 million against external borrowings of Nu 4,138 million. However, the domestic borrowings are projected to outpaced external borrowings in the medium term.

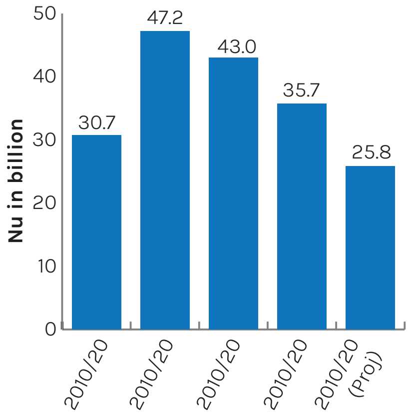
The overall balance of payments is estimated at negativsse Nu 9,597.38 million during the FY 2022/23, mainly driven by widening of the current account deficit which has deteriorated to Nu 69,877.08 million from Nu 63,883.63 million in the FY 2021/22. The project tied grants under capital account is estimated to increase by 9.1 percent during the fiscal year to Nu 11,320.8 million from the previous year, on account of increase in budgetary grants inflow for hydropower development. On the other, the budgetary grants inflow for non-hydropower investment is expected to decline marginally during the period. Similarly, inflows in the financial account are expected to record a 15.7 percent increase, primarily due to public debt related inflows in terms of hydropower, and concessional government borrowings. Consequently, the foreign exchange reserve is estimated to cover only 13 months of essential imports.

Chart 3.3: External Sector Scenerio



The money supply is estimated to increase to Nu 216,381.6 million in the FY 2022/23 from Nu 197,302.4 million in the previous year and is expected to increase by 11.8 percent in the medium-term. Credit to private sector which constitute 58.6 percent of broad money is estimated to slow down by 9.2 percent from previous year to Nu 126,708.7 million in the FY 2022/23, on account of decline in credit supply for other sectors (loan against shares, staff loan, education etc.) and a marginal decline in transport, manufacturing and personal loan. In contrast, agriculture; service and tourism; and trade and commerce sectors are expected to receive higher credit supply in the FY 2022/23 compared to the previous fiscal year.

Chart 3.4: Liquidity Position In banking System



Banking liquidity conditions remained adequate to finance the economic activities where the excess liquidity in banking sector is also estimated at Nu 19,307.1 million (9.5% of GDP). With this, liquidity position in the market is adequate to meet the government needs for financing the fiscal deficit through domestic borrowings without crowding out effect on the credit supply to the private sector. With expected economic activities to pick up in the medium term, the credit supply to private sector is estimated to grow to Nu 134,990 million on an average.

Table 1. Medium-Term Macroeconomic Outlook

Items	2020	2021	2022	2023	2024
	Actual	Actual	Estimates	Projection	
Production (Supply)*- Growth					
Real GDP	-10.0	4.1	4.7	4.2	5.2
Agriculture	4.6	2.1	1.1	3.9	3.9
Industry	-13.1	2.3	3.4	1.6	3.7
Manufacturing	-20.8	2.7	4.0	3.2	3.1
Electricity & water	25.4	-3.7	0.7	5.5	1.5
Construction	-20.6	8.8	14.8	-10.9	-22.3
Services	-6.9	6.2	5.6	5.9	6.4
Expenditure (Demand)*					
Gross domestic demand	-9.1	23.4	13.9	0.0	-0.3
Consumption	-5.0	32.0	14.7	3.9	2.5
Public	4.1	3.6	5.3	5.6	5.0
Private	-8.2	43.5	17.4	3.5	1.8
Investment	-16.3	6.2	11.9	-10.2	-8.6
Public	24.4	25.1	23.3	-32.6	-37.5
Private	-26.3	0.6	6.2	3.0	2.5
Unemployment rate (%)*	5.0	4.8	5.9	5.8	5.6
Financial Year (FY)	**2020/21**	**2021/22**	**2022/23**	**2023/24**	**2024/25**
Prices					
Headline inflation	7.4	6.5	5.3	5.2	5.7
Implicit Inflation target/ reference inflation rate	4.5	4.5	4.5	4.5	4.5
Fiscal (% of GDP)					
Operating balance	-4.2	2.4	2.1	0.3	2.0
Fiscal balance	-6.1	-7.7	-7.9	-9.7	-0.6
Domestic financing requirement	6.0	4.0	4.2	7.9	0.6

External (% of GDP)					
Current account balance	-12.1	-33.9	-34.5	-23.7	-20.9
Trade balance (goods)	-7.0	-24.5	-26.8	-15.9	-14.9
Gross reserves (Mill USD)	1,342.6	871.5	690.0	628.6	633.1
Reserves to Essential Import Coverage (Months)	23.9	15.0	13.7	12.5	12.3
External debt	124.7	120.5	118.68	115.42	106.27
Exchange rate (Nu/USD)	73.8	75.5	81.4	80.0	81.3
Monetary Sector Development					
Reserve requirement	7.0	7.0	8.0	8.0	9.0
Broad Money (M2)	24.4	9.4	9.7	12.2	12.7
Net Foreign Assets (NFA)	17.2	(1.0)	37.4	19.3	23.5
Net Domestic Asset	30.8	22.2	(16.9)	0.5	(8.0)
o.w credit to private sector	6.9	10.6	(9.2)	(1.8)	5.0
Credit to deposit ratio	91.7	89.8	90.2	88.4	82.4
External Environment					
Global GDP*	2.9	-3.3	3.4	2.8	3
GDP growth, India*	-5.8	9.1	6.8	5.9	6.3
Inflation, India*	6.2	5.5	5.5	6.1	4.8
Key policy rate, India*	5.7	4.0	4.9	-	-
Memo:					
Nominal GDP at market prices (Mn. of Nu)-FY	177,494.6	188,659.6	202,431.9	219,505.1	242,298.3

Data are as of FY ending June unless marked with (*) are in calendar year basis. Source: Macroeconomic Framework Coordinaion Committee (MFCC), Ministry of Finance, April 2023 updates, World Economic Outlook, IMF, April 2023 update, and Reserve Bank of India (RBI).

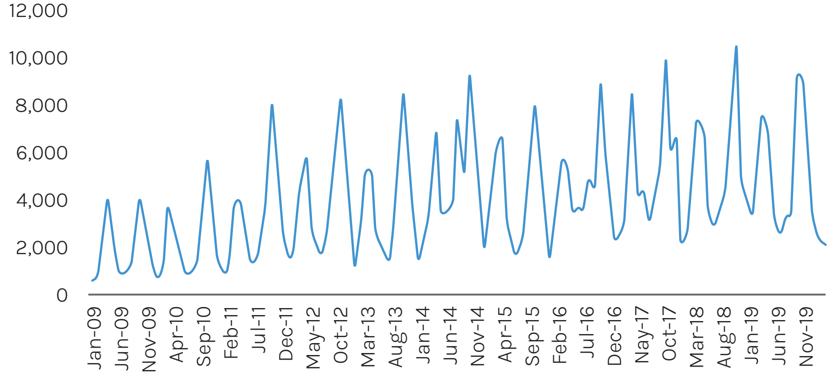
BOX I:

Impact of Tourist Arrival on Economic and Financial Development

Tourism sector is now one of the world's largest industries and one of its fastest-growing economic sectors. For many countries, tourism is seen as a main instrument for regional development, as it stimulates new economic activities. It also has a positive economic impact on the balance of payment, employment, gross income and production. However, unplanned and uncontrolled tourism growth can impose adverse impact on the culture and environment.

The tourism industry in Bhutan started in 1974. Since then, the industry has immensely contributed to revenue generations, especially foreign exchange reserves. The Royal Government of Bhutan has always been cautious that an unrestricted flow of tourists can have negative impact on Bhutan's pristine environment and its rich and unique culture. Considering its negative impact, the government adopted "high value-low volume" policy to ensure environmentally and ecologically friendly, socially and culturally acceptable and economically viable.

Chart 1: Number of Visitors



In October 1991 to encourage private sector participations, the government privatized the tourism industry. Over the years, the numbers and revenue generated from tourism have been increasing, thereby contributing significantly to the socio-economic development of the country. According to the Tourism Establishment Census of Bhutan 2021, there were 3,818 tour operators engaged in travel and transportation services in 2019. Likewise, employment generated by tourism is estimated at 52,174 individuals. Given the importance of the sector to the economy, this study aims to explore the contribution of tourism on the economic and financial development.

The data used in the study are annual figures for the period from 1995 to 2001, consisting of GDP per capita, a proxy for economic growth, international tourism arrival and financial development respectively. The outcome variable is the gross international reserves in USD. The variables are transformed into log-transformation to reduce the skewness of a measurement variable. The general functional form of the model for estimating the influence of tourism on economic growth is represented in the following equation.

$$Log\ Reserves_t = LogGDP_t + LogA_t + LogF_t + \varepsilon_t$$

Where *Reserves* is the gross international reserves in US Dollar, GDP is the GDP per capita in US dollar, A is the number of tourist arrival, F is the financial development where it is defined as money supply divided by nominal GDP and ε is error term.

The study examined the integrating properties of the series by applying Augmented Dicky-Fuller (ADF) and Philip Perron (PP) unit root tests. It is found that all variables are non-stationary at the level. However, in the first difference form, all the variables become stationary. This empirical result indicates that international reserves, GDP per capita, international tourism arrival and financial development series are integrated of order one I (1).

ARDL model selected based on AIC illustrates that the estimated value of the F-statistic is above the lower and upper limit of the bound indicating no existence of the long-run relationship. Hence, we reject the null hypothesis of no long-run relationship. Therefore, we are able to conclude that Ln reserve, Ln GDP per capita, Ln tourist arrival and Ln financial development are significantly cointegrated.

Table 1: Long-run estimates from the ARDL model.

Variables	Coefficient	Standard Error
GDP per capita	0.326**	0.445
Tourist arrival	0.024***	0.083
Financial development	0.283***	0.328
Constant	8.677***	2.411

**** indicates significant at 1% and ** indicates significant at 5%*

Thus, the empirical result implies that all the variables are positively correlated with gross international reserve. In other words, the increase in the GDP per capita, number of tourist arrival and financial development will result in an increase in gross international reserves. First, rising international tourism arrivals have a long-run significant influence on gross international reserves, specifically, a 10 percent increase in tourism arrival will lead to 0.12 percent growth in gross international reserves. Likewise, financial development as expected is found to be positively and strongly associated with economic growth. To be precise, a 10 percent advancement in financial development could be linked with a 2.8 percent rise in international reserves in the long run, all else remaining the same. Finally, GDP per capita is also found to be positively related at a 10 percent significance level to the international reserves.

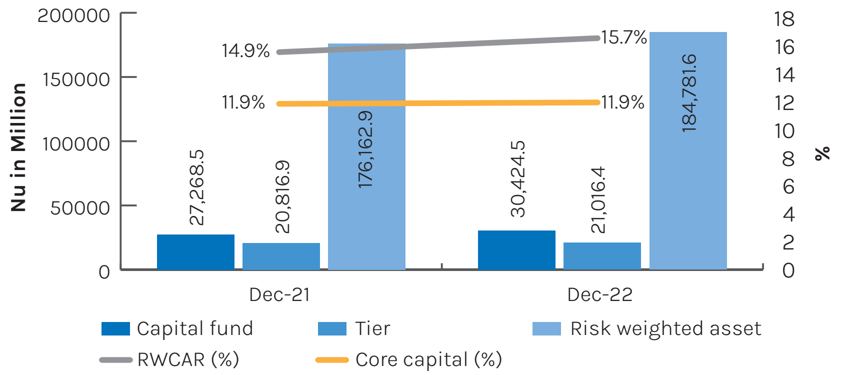
In the policy context, the findings offer justification for the Government of investing in the tourism industry as a means of invigorating economic growth over the long run. Tourism can be depended upon to stimulate Bhutan's economic prosperity and, for this reason, policy makers ought to give careful consideration toward encouraging tourism in the country.

4. Financial Sector Performance Overview

Despite the tightening of global financial conditions, the financial sectors in Bhutan continued to remain resilient and stable as per Financial Soundness Indicators of December 2022. The financial sector acts as an intermediary by mobilizing savings and channeling credit for investments and sustainable economic growth. 2022 was a challenging year for the financial sector. While the global economy was recovering from the pandemic-induced disruptions and geopolitical tension, new challenges such as inflationary pressure, coupled with the looming risk of recessions further escalated volatility in the financial market.

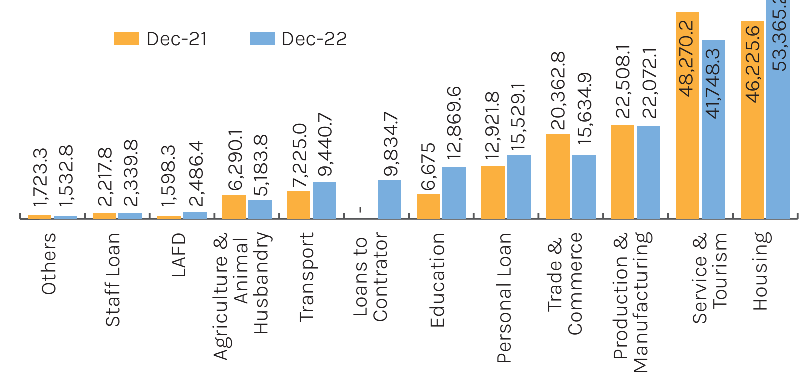
On the domestic front, the RMA in 2022 took a closer surveillance and rigorous monitoring of capital, assets, earnings and liquidity of the financial sectors. The capital fund stood at Nu 30,424.5 million in December 2022 as compared to Nu 27,268.5 million in December 2021. The core capital ratio stood at 11.9 percent which is above the minimum regulatory requirement of 7.5 percent. The capital adequacy ratio (CAR) increased marginally to 16.5 percent in December 2022 (against the minimum requirement of 12.5 percent) as compared to 15.5 percent in December 2021 as a result of an increase in capital fund by 11.6 percent (Nu 3,156.0 million) which has outweighed the growth of Risk Weighted Assets of 4.9 percent (Nu 8,618.8 million).

Chart 4.1: Capital Adequacy



Total FIs' loan exposures increased by Nu 15,896.4 million from Nu 176,209.3 million in December 2021 to Nu 192,105.7 million as of December 2022. The highest exposure of loans continued to remain in sectors such as Housing with Nu 53,365.3 million, Service & Tourism with Nu 41,748.3 million, and Production & Manufacturing with Nu 22,072.1 million. These three sectors collectively account for 61 percent of the total loans and advances during the review period.

Chart 4.2: Sectoral Credit Distribution (Nu in Million)



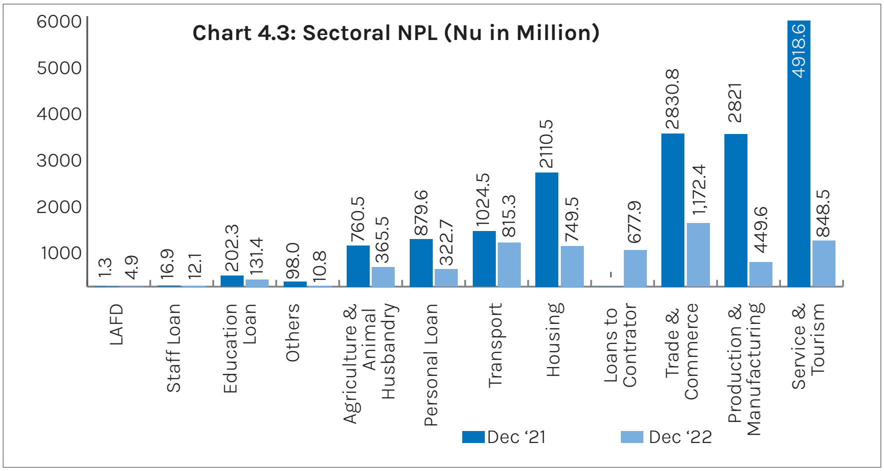
Notwithstanding the various policy measures and intervention undertaken in 2022, the RMA continued to focus on monitoring and resolving Non-Performing Loans (NPLs) in the financial sector. In addition to the existing regulatory enforcement and restructuring, the RMA set up High-Level NPL resolution committee, reclassifications of old NPLs and extension of loan tenure.

The RMA issued the Rules and Regulations on Loan Restructuring 2022, Rules and Regulations on Foreclosure and Write-off 2022 and Guidelines on Reclassification of old NPLs 2022 in efforts to resolve NPLs. Additionally, in order to help financial institutions to decongest their books and manage chronic NPLs, a Framework for Charge-off and Transfer of NPLs to Off-Balance sheet was issued in June 2022. The RMA introduced the Prompt Corrective Action Framework to enable early supervisory interventions to mitigate any risk that could threaten viability of financial service providers and financial system as a whole. Under this Framework, financial institutions with NPL ratio above the regulatory limits were put under a credit moratorium during which they implement remedial measure and clean their system to rebuilt their financial strength.

RMA also issued Rules and Regulations on Loan origination and monitoring with objective to guide FSPs on the basic prudent requirements for credit originations and sanctioning procedures, and Framework for monitoring credit risk and NPL management with effect from 1st November 2022.

On the backdrop of these policy initiatives, the NPL to total loan ratio in December 2022 stood at 7.9 percent, reflecting a marginal improvement from 8.9 percent in December 2021. In particular, the highly exposed sectors such as Service and Tourism, Production & Manufacturing, and Housing sector saw a substantial decrease in NPL by 4,070.1million, Nu. 2,371.4 million, and 1,361.0 million from Nu 4,918.6 million, Nu 2,821.0 million and Nu 2,110.5 million respectively in 2021.

Chart 4.3: Sectoral NPL (Nu in Million)



The profitability of FIs increased marginally to Nu 4,091.6 million in December 2022 as compared to Nu 3,988.0 million in the previous year. This increased in profit of Nu 103.5 million was on account of increased interest income and reduced loan loss provisioning on account of improved NPL during the year 2022.

In terms of banking sector liquidity, the banks and non-banks were required to maintain a minimum Statutory Liquidity Ratio (SLR) of 20 percent and 10 percent respectively. The overall liquidity position of the financial sector remained comfortable to meet the demand of depositors and ensure financial stability. The quick assets of the FIs stood at Nu 70,790 million as of December 2022, marking the overall SLR at 29.2 percent. The loan-to-deposit ratio of the commercial banks which measures the adequacy of liquidity, stood at 75.4 percent as of December 2022.

Box II:

Monetary Measures During the Pandemic

The RMA implemented phase-wise monetary measures amidst the COVID-19 pandemic- Phase I (April-June 2020), Phase II (July 2020-June 2021), Phase III (July 2021–June 2022) and Phase IV (July 2022-June 2024). The measures included interest payment supports, loan deferments, term-based soft working capital for affected sectors as well as loans to cottage and small industries. The incentives of rebate on the interest rates for regular repayments, extensions of loan tenures and creation of FEIF account was also implemented as part of the monetary measures during the pandemic.
The following tables summarizes the interest payment supports given in phase I – Phase III of the pandemic: -

Interest Payment Supports (NU IN MILLION)				
Phase-Wise	No. of Account	DGRK	FSPs	Total Interest
Phase I	409,823	1,882.38	1,883.31	3,765.68
Phase II	1,127,682.00	7,299.70	-	7,299.70
Phase III	953594	5,044.00	-	5,044.00
Total	**2,491,099.00**	**14,226.08**	**1,883.31**	**16,109.38**

Box III:

Key RMA policy Initiatives and lessons learned from the COVID -19 Pandemic

Since the first outbreak of the COVID-19 pandemic in March 2020 in Bhutan, several policy measures and reforms were initiated at the national as well as institutional level under the benevolent guidance of His Majesty The Druk Gyalpo. The initiatives were mainly aimed at reverting the adverse impact of the pandemic on the economy, protecting livelihood and health sectors, and also to promote accountability and transparency in the Government and corporate agencies. The Royal Monetary Authority of Bhutan (RMA) as the central bank responsible to safeguard economic and financial stability in the country has also implemented both conventional and unconventional policy measures during the unprecedented period.

In the process of outlining appropriate policy measures, the RMA consulted and closely worked with the Government, Financial Institutions (FIs), Private entities and carried out a periodic review of the financial sector by the expert panels at the RMA as part of transformation reforms with an objective to improve efficiency and effectiveness. The key policy measures and reforms were undertaken through three broad channels.

Firstly, a series of monetary measures were introduced primarily targeted to support the livelihoods and severely impacted economic sectors. Beginning April 2020 to date, four phases of monetary measures have been undertaken by the RMA. Guided by His Majesty The Druk Gyalpo's wisdom and farsightedness, the deferment of loan repayment and Interest Payment Support (IPS) were provided to all the citizens in the country. The measures not only supported the livelihood of the vulnerable individuals in the society, but it immensely helped in preventing the build-up of NPLs, which would otherwise pose threat to the financial sector stability. All the loan repayments were deferred till June 2022, and loans for high-risk sectors (tourism related sector) were further extended till June 2023. On the IPS, a total of Nu 16.12 billion in the form of IPS have been provided. Other key interventions include extension of gestation period for projects, term based soft working capital facility for tourism related business and loans to small and cottage industries at concessional interest rates.

Secondly, in view of ensuring uninterrupted flow of credit for financing business continuity, the RMA provided liquidity support to the banking sector by reducing the Cash Reserve Ratio (CRR) from 10 percent to 7 percent, injecting a total liquidity amount of Nu 4.2 billion in the banking sector. Similarly, a periodic evaluation of the financial sector through Stress Test was carried out on the overall capital adequacy and its requirement. A regulatory requirement of 12.5 percent of CAR was reduced to 10 percent in 2022. The reduction of CRR and relaxation of CAR enabled the financial institutions to maintain liquidity buffers and continue lending activities.

Thirdly, as part of transformation initiatives carried out across all sectors, a periodic review of the financial sector by the expert panel in the last two years has immensely helped the RMA in becoming a more effective and efficient institution as a role of supervisory, monitoring and implementation of policies in the financial sector. Through reform exercises, the RMA has implemented a resolution framework aimed at improving the Non-Performing Loans (NPLs) in terms of loan restructuring, asset foreclosures and NPL classification in the FIs. With these initiatives, the overall gross NPL of FIs has been brought down to 5.1 percent as of March 2023. Additionally, the initiatives also guided the RMA and FIs for

seamless implementation of Interest IPS under the Relief Kidu for all those borrowers who faced difficulties to repay the loans.
At the same time, the foreign exchange rules, regulations and operational guidelines were revised to facilitate the foreign exchange transactions and boost inward remittance. One major achievement is that the quality of economic and financial data also improved tremendously in terms of collection, compilation, analysis and dissemination, which support in making evidence-based decisions.

Although the RMA has been able to navigate through stage of different challenges and difficulties staring away from adverse impact of the COVID- 19 pandemic, facing with public scrutiny and periodic review, the RMA has become more resilient, stronger and steadfast institution as a role of central bank in promoting the economic growth and financial stability. Moving forward, the RMA remains committed to collaborate with relevant stakeholders and renew its policy focus in making conducive environments towards achieving resilient, sustainable and inclusive economic growth in the long-term.

5. CHRONOLOGY OF KEY MONETARY POLICY

April 1983
RMA Commenced Central Banking Operations

1984
First CRR set at a rate of 3%

December 1993
First uniform-price auction of RMA bills (Nu. 600 million) worth for 31 days at a discount rate of 11%

1994
CRR was revised for the first time to 15%

January 1996
The Government issued the first one-year bonds valued Nu. 100 million

September 1996
First Reserve Repurchase issued to BoB for an amount of Nu. 500 million at a coupon rate of 5% p.a

December 2009
Bhutan's first issue of RGoB Treasury Bills (T Bills) was auctioned upon the discontinuation of RMA bills

September 2012
Introduced the Base Rate System

March 2013
The RMA entered in a Rupee Currency SWAP agreement with the RBI for a total of ₹ 5.4 billion at 5.5% p.a for 6 months

August 2016
Introduced the Minimum Lending Rate (MLR) System

June 2019
Formulated market based new Monetary Policy Operation Framework

Mar-Apr 2020
Reduced the Cash Reserve Requirement from 10% to 7%

INTERVENTIONS SINCE 1983

October 1997

Interest rate liberalization, where FIs were free to determine their Deposit & Lending rates, while keeping interest spread at a maximum of 6%

April 1999

Removed the requirement of fixed spread on the interest rate

October 2001

Auctions were discontinued and Tap Sales were introduced for RMA bills

March 2002

Introduced Policy Rate along with the RMA Short-Term Liquidity Adjustment Window (RSTLAW) to support liquidity-deficient banks

June 2002

Monetary Operations Committee (MoC) was established by the RMA's Board of Directors during it's 32nd meeting

September 2020

Released the Capital Conservation Buffer of 2.5%

November 2020

Implemented the Domestic Liquidity Management System

July 2021-June 2022

- Deferment of Loan Repayments.
- 1% interest rebate during deferment period for regular repayments.
- Non-Capitalization of interest accrued during deferment period.

31st October 2022

Revision of Cash Reserve Requirement from 7 percent to 8 percent.

June 14, 2023

Incentive was increased from 2 percent to 10 percent to boost remittance inflow.

June 22, 2023

Temporarily discontinued the Sweeping account arrangement to address the immediate liquidity shortage.

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