MONETARY POLICY STATEMENT JULY 2021

ROYAL MONETARY AUTHORITY OF BHUTAN

Monetary Policy Statement July 2021

Our Aspiration

A Progressive, Agile, and Resilient Central Bank that supports a 21st century economy

Mission

Reinforce an inclusive, sustainable, and dynamic economy

Maintain stability and resilience of the financial system

Advance innovation and technology in the financial services

Core qualities

CREDIBILITY
A reliable, trustworthy national institution and partner in promoting Bhutan's economic progress

LEADERSHIP
Leader of change and innovation in the financial sector, taking bold steps to leverage opportunities and address challenges

KNOWLEDGE
Source of informed discourse and policy on the financial sector and economy

Values

UPHOLDING THA-DAMTSHI (INTEGRITY)
We will mindfully shoulder our responsibilities with full dedication, integrity and sincerity

BEING NYAMCHUNG (HUMILITY)
We will conduct ourselves with humility and treat everyone with respect and diginity. Our motivation to succeed will be driven by the need to improve conditions for others.

EXHIBITING DREMBA (SENSIBILITY)
We will be alert and practical when discharging our duty, acknowledging and addressing challenges in an astute manner, perceptive to immediate exigencies and long-term sustainability.

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 part of special analysis, the statement also highlights on key financial sector issues.

The statistics presented in this statement are based on Multi-sector Macroeconomic Framework Coordination Technical Committee projections, endorsed by the policy-level Macroeconomic Framework Coordination Committee.

ACRONYMS

CPI	Consumer Price Index
CSI	Cottage and Small Industry
DGRK	Druk Gyalpo's Relief Kidu
FIs	Financial Institutions
FSPs	Financial Source Providers
FY	Fiscal Year (July 1 – June 30)
FYP	Five Year Plan
GDP	Gross Domestic Product
GST	Goods and Services Tax
IMF	International Monetary Fund
₹/INR	Indian Rupees
LIPSK	Loan Interest Payment Support Kidu
M2	Broad Money
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MFIs	Microfinance Institutions
MoF	Ministry of Finance
MLR	Minimum Lending Rate
NFA	Net Foreign Assets
RBI	Reserve Bank of India
RMA	Royal Monetary Authority of Bhutan
USD	US Dollars

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Executive Summary

The outbreak of new variant of COVID-19 virus has created a new wave of distress and uncertainty in the country and within the region, amidst the ongoing vaccination drive. Balancing the interventions to safeguard the lives and livelihoods of the people continues to remain a challenge over the medium term.

Blessed with the selfless leadership of His Majesty The Druk Gyalpo, the country has been cautiously battling the spread of the virus since March 2020. During unprecedented times like the present, under the guidance of His Majesty, ensuring health safety and providing inclusive and broad-based livelihood support measures for citizens has become a national priority. As of now, the ongoing economic activities, following strict COVID-19 protocols have been manageable. However, the impact of the pandemic on the overall economic performance persists and remains distressful.

With the ongoing pandemic, the real GDP growth for 2020 is estimated (April 2021) to contract to a record low of -6.3 percent, against an initial estimate (May 2020) of 1 percent. The impact of the pandemic has been significant in sectors including tourism and allied sectors, manufacturing and construction sectors. The hydropower sector, which accounted for 18 percent of GDP, recorded a sustained growth at 18.9 percent, complemented by favorable credit conditions that continued to cushion the economy from a severe fallout. The unemployment challenges have also intensified during the pandemic. In 2020, the unemployment rate stood at 5.0 percent and continues to remain as one of the grave challenges over the medium and longer term. In order to ease the pressure, the timely interventions of His Majesty The Druk Gyalpo and the Government through interventions such as the Druk Gyalpo's Relief Kidu (DGRK), accelerated De-suung

Training Programs, and Economic Contingency Plan, have helped to support the affected individuals and businesses and also mitigate the rising issues of unemployment. Driven by supply front dynamics, the inflation rate is at 7.7 percent in 2020 compared to 2.7 percent in 2019, mainly contributed by food inflation. The ongoing renewed focus of the Government in strengthening agricultural productivity and promoting cottage and small-scale industries will play a critical role in moderating the general prices and creating more employment opportunities.

With an expected fall in domestic revenue collection and increased proposals for the capital budget to accelerate economic activities, the estimated fiscal deficit is 7.3 percent of GDP in FY 2020/21, against 1.9 percent of GDP in FY 2019/20. Despite the higher allocation of capital budget, the pandemic has limited full-swing execution of capital works, affecting overall economic activities and limiting domestic credit demand. Although there was an adequate supply of liquidity, credit growth in 2020 dropped to almost half of the pre-COVID level in 2019 due to demand constraints. On the external front, current account deficit is expected to improve from 12.1 percent of GDP in FY 2019/20 to 11.4 percent of GDP in 2020/21. The increase in hydro export supported by decreasing imports resulted in improvement of the current account deficit. Concurrently, constant capital and financial inflows helped maintain a comfortable level of international reserve, adequate to finance more than 15 months of merchandise imports.

In response to the pandemic, the RMA initiated and implemented several policy measures starting from immediate relief measures to long-term policy support. For ensuring adequate liquidity, the RMA immediately reduced the CRR from 10 percent to 7 percent. Loan deferment and several concessional loans were also granted for business units. Further, to tide over immediate impact of COVID-19 on

households and business units, 50 percent loan interest payment support kidu (LIPSK) was granted as the DGRK and the remaining 50 percent was borne by the Financial Service Providers, thereby providing 100 percent interest relief to the borrowers in Phase I (April-June 2020). Under Phase II (July 2020 - March 2021), 100 percent LIPSK was granted through the DGRK from July 2020 to September 2020, followed by 50 percent LIPSK support from October 2020-March 2021. Given the continued uncertainties posed by the COVID-19 pandemic, the DGRK and other monetary measures will be continued for another fifteen months (i.e., until June 2022) for all eligible borrowers.

Moving forward, with the pandemic situation worsening in the region, India in particular, the domestic economy anticipates adverse spillover impact arising from access to raw materials, labor mobility restrictions, and slackening demand. Through proper risk assessment, if existing measures are fully implemented by 2021, the domestic economy is projected to rebound close to the pre-COVID level in 2022.

The lessons learnt from the economic damages and disruptions caused by the pandemic must be redressed appropriately through medium to longer term interventions. While moving towards the recovery and new normal, focus must be made in boosting productive investment, strengthening human capital, boosting overall efficiency of the factors of production, making appropriate choice and use of technology that support post pandemic growth. Realizing high productivity and efficiency gain in the use of capital and human resource through the use of modern technology will help in promoting capital formation and exports. To harness the benefits of evolving technology, the RMA is considering development of Central Bank Digital Currency (CBDC) on a pilot basis. This initiative would complement the RMA's efforts in moving towards a digital economy.

The adoption of CBDC would have far-reaching positive impacts on the general public, financial service providers, and other stakeholders in the financial sector. Some of the other ongoing activities include initiatives on cross-border QR code payment integration, promoting interconnectivity with international cards payment such as the JCB, setting up of easy remittance corridor through innovative digital platform such as Visa Direct and implementation of data warehousing project. These initiatives are aimed towards promoting digitization in the financial sector and ensuring a resilient cyber security system that is essential for the RMA as a key enabler to support the 21st century economic development agenda of the Government. Along these initiatives, adopting to a new behavioral change in promoting national savings to address future contingencies is also critical. Natural catastrophes are unpredictable and call for preparedness and mitigation strategies. Accumulating strategic resources and strengthening internal capabilities to deal with future contingencies requires the creation of an adequate buffer. Promoting saving habits and financial inclusion initiatives will be important to build resilience among individuals, businesses and households.

The RMA will continue to support the Government in mitigating the pandemic turbulence and maintaining the smooth and effective recovery process to enhance growth and employment generation.

While moving forward, the RMA will also continue to ensure the stability of the financial sector through series of risk assessment and stress testing based on scenario analysis. At the same time, the RMA will strengthen the existing credit ecosystem and management of non-performing loans of the financial sector, improve the overall risk management framework and practices, and promote adoption of appropriate technologies for effective delivery of financial services while supporting the overall macroeconomic stability.

1. Recent Economic Developments

The recession resulting from the COVID-19 outbreak has impaired the health of the economy across the globe. According to the IMF (World Economic Outlook, April 2021), global economy is estimated to contract by -3.3 percent in 2020 and projected to grow at 6 percent in 2021 on the assumption that the vaccines would be available and rolled out effectively across all the countries. Emerging markets and low-income developing countries were hit hard by the pandemic and might be affected more due to the resurgence of new variants of COVID-19.

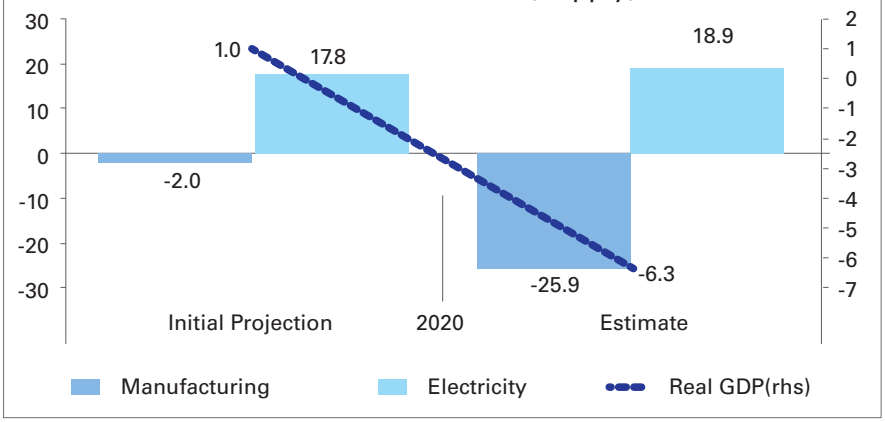
The impact of the pandemic differs across the globe, depending on the pre-existing state of health care and its accessibilities to public; a country's preparedness and the resiliency of the economy; the quality of public response and citizens' trust in service delivery. China has managed to return to pre-COVID GDP growth level in 2020, while other countries are expected to attain pre-COVID level only towards the end of 2023. The global economic growth outlook remains bumpy and uncertain with higher downside risks. The United States is currently recovering after a sharp fall in GDP and significant increase in unemployment during the first half of 2020. Its real GDP is estimated to contract by 3.7 percent in 2020 and to rise gradually by 3.2 percent in 2021. As a result, the unemployment rate is also expected to remain elevated with a gradual fall during the post pandemic period.

With emergence of new COVID-19 variants in the South Asia, most of the economies were severely impacted in 2020. India in particular, though it grew at 4.0 percent in FY2019/20, witnessed unprecedented economic decline, with fall in output by -8.0 percent in FY2020/21. Despite undertaking drastic fiscal and monetary measures during the pandemic, domestic consumption remains subdued. Further, the optimism of recovery, followed by the vaccination, has been unresponsive,

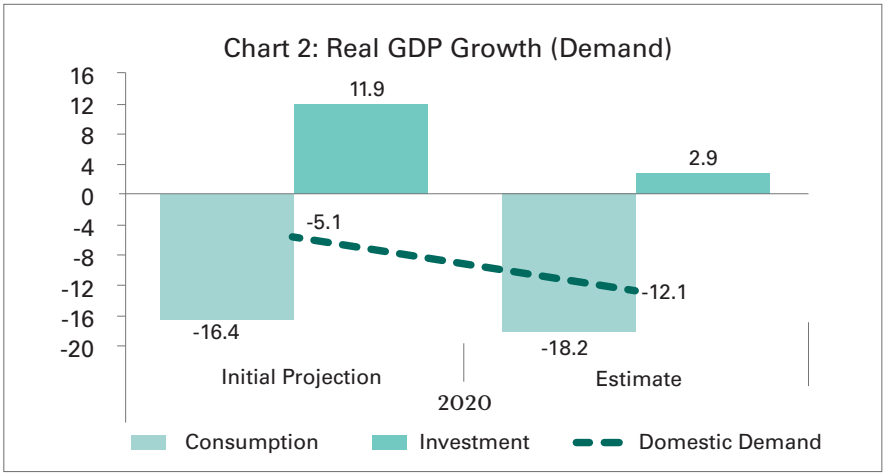
with the recent surge in new variants of the virus. These factors have added uncertainties to the economic outlook that may delay the economic revival process as perceived earlier. With accommodative monetary policy conditions in India, the headline inflation continuously breached the upper tolerance threshold (6%) from June to November 2020. However, the inflation eased to 5 percent in February 2021, which later edged up to 5.5 percent in March 2021.

On the domestic front, the economic growth is estimated to contract in 2020. As per estimates as of April 2021, the economic growth is expected to decline to -6.3 percent in 2020. The deceleration of growth rate, from an initial projection of 1.0 percent, is attributed to the adverse effects of the pandemic on the economic activities. The industry and service were the hardest hit sectors due to continued travel restrictions and border closures. The industry sector which was initially projected to grow at 11.5 percent, witnessed a downward trend of -4.5 percent. With disruptions of supply of raw materials and restriction on mobility of foreign workers, most of the construction activities and businesses were impacted adversely. Similarly, the service sector growth is estimated to contract by -7.9 percent in 2020, against the initial projection of -6.5 percent.

Chart 1: Real GDP Growth (Supply)

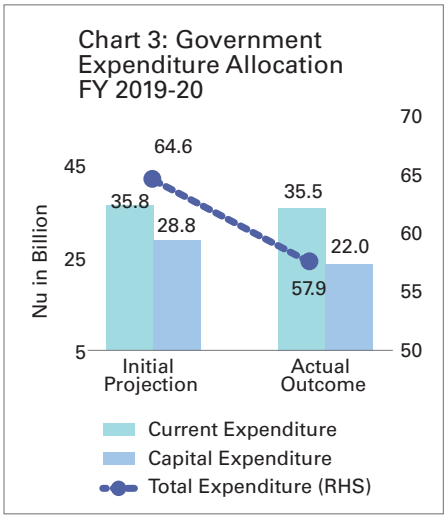


The gross domestic demand in 2020 is estimated to contract by -12.1 percent, compared to earlier projection of -5.1 percent. The total consumption, for both public and private sectors, is estimated to decline by 18.3 percent in 2020, against the initial projection of -16.4 percent. Negative growth in total consumption was mainly on account of a fall in disposable income during the pandemic. The import of goods and services which was initially projected to grow at -15.7 percent has been revised downward at -17.3 percent, mainly on account of current developments and continued closure of borders. However, the gross capital formation, which was initially projected to increase by Nu 3,915.5 million in 2020, has only increased by Nu 745.6 million, leading to decline in overall investment growth at 2.9 percent against the initial projection of 11.9 percent.

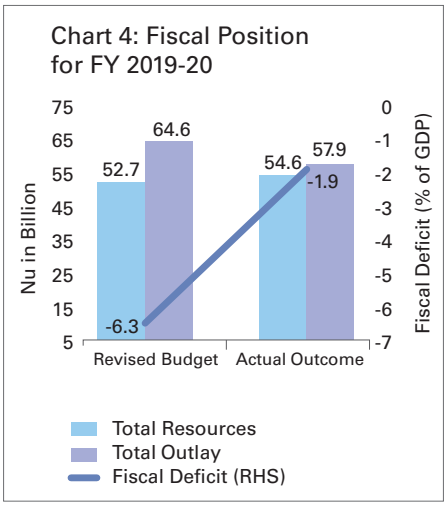


On the fiscal front, the actual budget outlay for FY2019/20 was Nu 57.57 billion against a projected outlay of Nu 64.62 billion for the same year. The total outlay to GDP accounted for 32.1 percent as compared to previous projection of 34.1 percent. The capital budget utilization has been affected by the pandemic, recording at Nu 22.05 billion as against the initial projection of Nu 28.79 billion. On the resource front, a total

resource amounting to Nu 54.60 billion was mobilized, as compared to the initial estimate of Nu 52.73 billion. Despite a continuous expense on pandemic containment and fiscal relief measures provided by the Government, the total resources increased by 29.9 percent during the FY2019/20. Consequently, the fiscal deficit improved to 1.9 percent of GDP from 6.3 percent as estimated earlier.

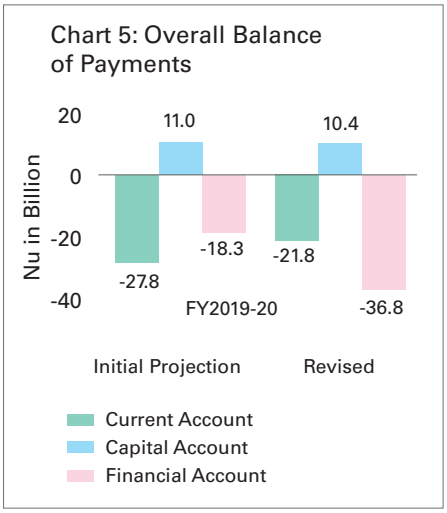


Of the total resources, 66.3 percent constitutes domestic revenue and the remaining was external grants. Total domestic revenue realized during the FY2019/20 was Nu 36.22 billion (20.2% of GDP), an increase of Nu 1.51 billion. The increase was mainly attributed to the commissioning of Mangdechu hydropower project, which contributed in a form of net profit transfer, amounting to Nu 3.90 billion. In addition, the net profit transfer from the Royal Monetary Authority has also increased significantly by 94.3 percent (Nu 3.01 billion) as compared to the previous year (Nu 1.55 billion).

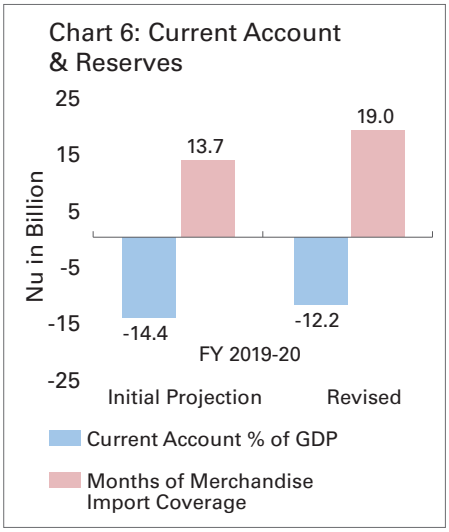


In terms of external grant inflows during the FY2019/20, the government received Nu 16.43 billion, which is an increase of 60.7 percent from the previous year.

During the FY2019/20, the overall balance of payments improved significantly to Nu 21.32 billion, compared to the initial projection of Nu 1.53 billion. The improvement during the review period is largely due to improvement in current account deficit and financial account inflows. The current account deficit improved by 22 percent from the initial projection of Nu 27.79 billion. This development was mainly due to improvement in trade deficit to Nu 17.53 billion from initial projection of Nu 20.30 billion. Similarly, net primary payments decreased marginally to Nu 11.51 billion from the initial projection of Nu 13.07 billion, on account of fall in interest payments by 10.8 percent during the review period. Further, net secondary income receipts also witnessed improvement to Nu 12.36 billion from the initial projection of Nu 9.12 billion.



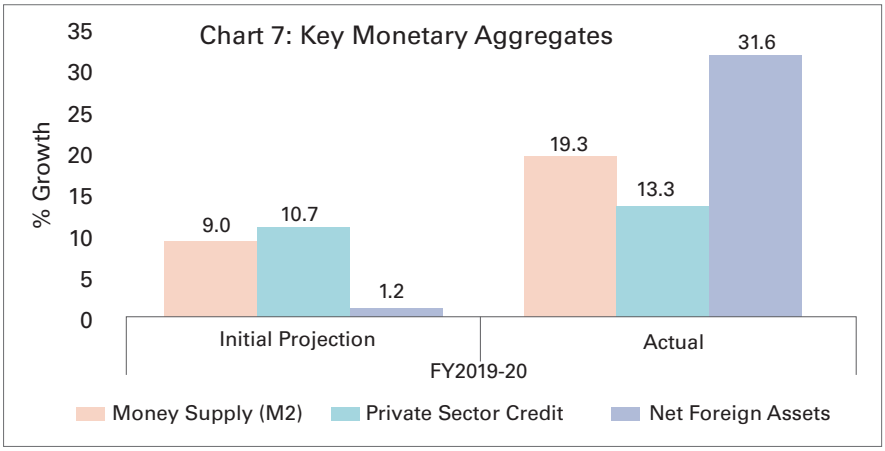
On the other hand, the capital inflows in the form of budgetary grants slightly decreased to Nu 10.37 billion from the initial projection of Nu 11.01 billion due to decline in non-hydropower grants. However, the net financial inflows, which largely constitutes the FDI, currency and deposits, and external loans increased significantly to Nu 36.83 billion during the review period, from the initial projection of Nu 18.31 billion.



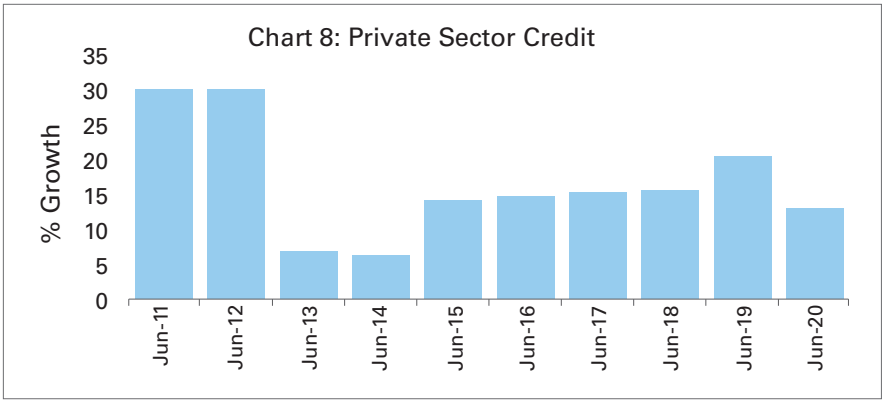
As in the past, the net inflows in capital and financial accounts were adequate to finance the current account deficit.

Consequently, the gross international reserves increased to USD 1,343.53 million during the FY2019/20, compared to the initial projection of USD 1,049.90 million, which is adequate to cover 19 months of merchandise imports. Of the total reserves, USD 1.03 billion was in the form of convertible currency and the remaining ₹ 23.71 billion equivalent were in the form of Indian Rupees.

On the monetary front, the broad money supply (M2) which was initially projected at 9.0 percent in FY2019/20, improved to 19.3 percent and further to 27.7 percent in December 2020. A significant growth in M2 is largely contributed by increase in demand deposits which grew by 24.1 percent from the previous year. With the onset of the pandemic and with constrained investment and spending environment, the deposits in the banking sector witnessed a steady growth during the review period. On the counterpart side, the increase was largely contributed by substantial rise in the Net Foreign Assets (NFA) to 31.6 percent from the initial projection of 1.2 percent. The growth in NFA was contributed by inflows of foreign grants, hydropower receipts and decline in import payments due to pandemic related interventions.

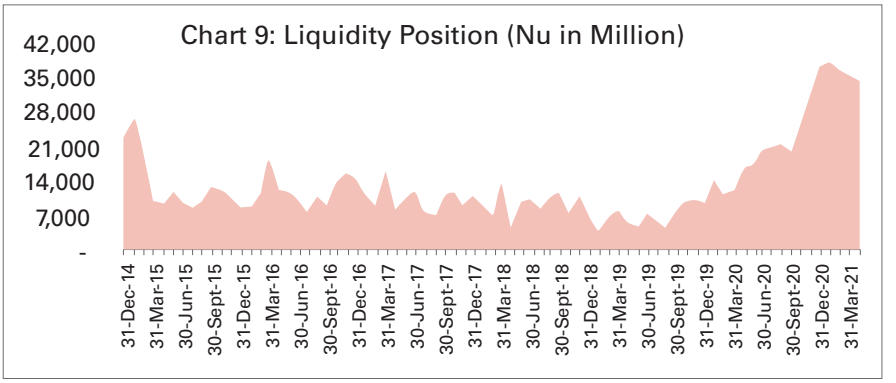


Despite the pandemic, credit to the private sector grew by 13.3 percent in FY2019/20, compared to the initial projection of 10.7 percent, though it was recorded one of the lowest during the review period, since last five years. As in the past, credit growth continues to concentrate in selected sectors such as the service and tourism, building and construction, trade and commerce and manufacturing sectors. None-the-less, in terms of financial sector soundness, the overall asset quality of the financial institutions deteriorated with an NPL of 16.3 percent in FY2019/20.

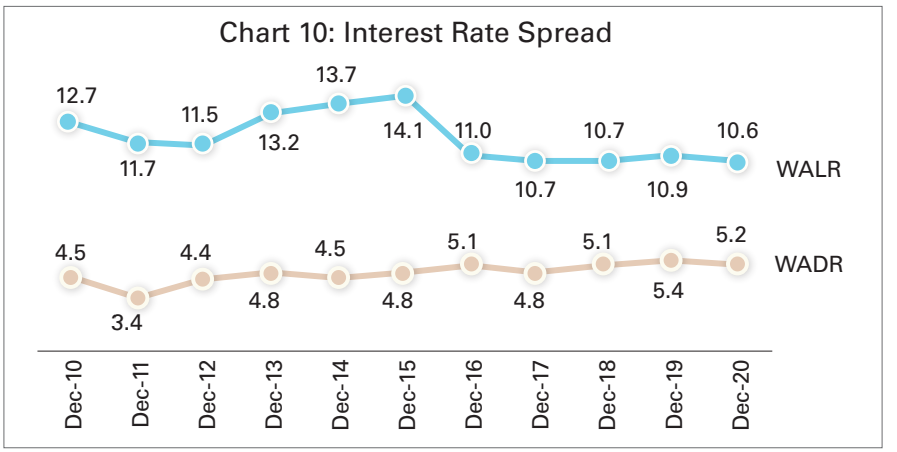


The banking sector liquidity improved significantly in recent months as the domestic financial conditions continue to remain accommodative, supported by the DGRK and monetary measures. With stable deposit base and lower investment demand, the overall liquidity situation is expected to remain comfortable in the near term. As on April 2021, the total liquidity surplus in the banking system increased by 105.7 percent from the previous period, amounting to Nu 34.3 billion. The increase in liquidity is mainly attributed to increase in net foreign asset inflows (in the form of loans, grants and hydropower receipts).

Following the developments in the domestic credit market, the implementation of the Minimum Lending Rate (MLR) since July 2016 continued to support in softening the interest rates



due to decrease in the single MLR over the period. The single MLR as of December 2020 was recorded at 6.9 percent, lower by 0.1 percentage points from 7.0 percent in December 2019. The lowering of Cash Reserve Ratio (CRR) by 300 basis points from 10 percent to 7 percent during March to April of 2020, has contributed to moderate the CRR cost by 20 basis points for the banks. Similarly, the operational cost of banks also decreased from 1.4 percent in December 2019 to 1.3 percent in December 2020. Although there has not been much variations in the MLR (6.7% on average) within the financial institutions, the changes in the Weighted Average Lending Rate (WALR) witnessed a notable reduction from 14.1 percent in December 2015 to 10.6 percent in December 2020, while the deposit rates continue to remain stable.

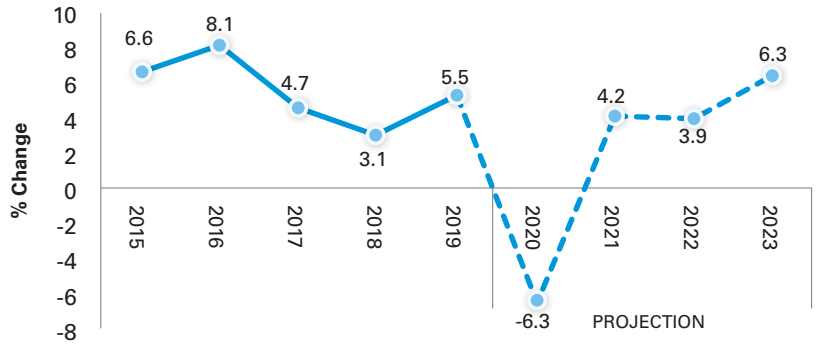


2. Medium Term Macroeconomic Outlook

The widespread pandemic and emergence of new strains of the virus in the region have constrained the recovery of the economy. With increasing cases of infection in India, and continued enforcement of containment measures, domestic economic condition is expected to remain subdued in the near term. The growth in domestic economy is estimated at -6.3 percent in 2020, the lowest growth until now. A sharp fall in the growth of private consumption and government investment in 2020 resulted into a significant decline in aggregate demand to -12.1 percent from -3.7 percent in 2019. The service sector which is one of the main drivers of economic growth during the pre-COVID-19, recorded a sharp decline of -7.9 percent in 2020. Similarly, due to disruption in trade, transport and access to market, the construction (-9.5%), manufacturing (-25.9%), and non-hydro exporting industries have also experienced a negative growth.

However, the higher domestic demand for agricultural products (2.6%) and favourable output in the electricity sector (18.9%) have prevented the economy from a deep economic loss in 2020. Additionally, a timely response to the emerging issues with the provision of safety nets through the DGRK

Chart 11: Economic Growth Outlook

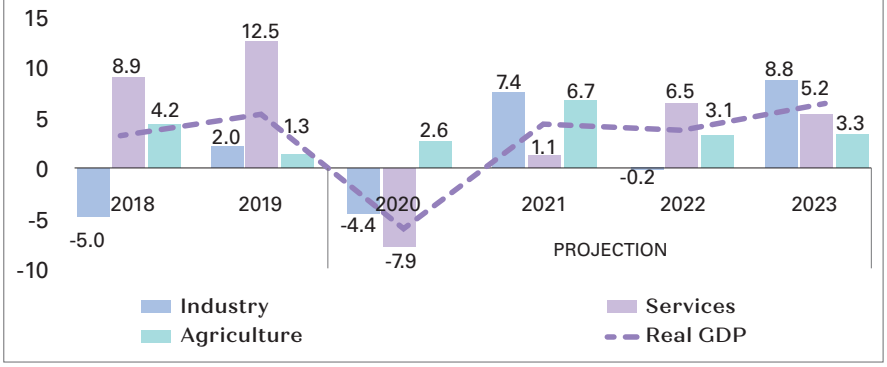


along with fiscal and monetary measures, have helped to shield the economy from a sharp contraction in the economic growth in 2020.

With wider coverage of vaccine rollout across the world and continuation of relief and recovery packages by the Government, the economic prospects remain positive over the medium term. The real GDP growth is projected to rebound to 4.2 percent in 2021, while it is estimated to be at the pre-COVID level by 2023.

A recovery of economy in 2021 is attributed to improvement in agriculture, industry and service sectors. The agriculture sector is projected to grow at 6.7 percent during 2021 from 2.6 percent in 2020 while industry sector is projected to grow at 7.4 percent from -4.4 percent in 2020. The growth in industry sector is mainly to be driven by construction and manufacturing sectors. The construction sector, which accounted for more than 15 percent of GDP, is projected to grow by 31.4 percent in 2021 and the manufacturing sector is expected to experience a positive growth of 2.3 percent in 2021, as the pandemic situation improves. The service sector is anticipated to grow at 1.1 percent in 2021 from -7.9 percent in 2020, on the assumption that the vaccines are made widely

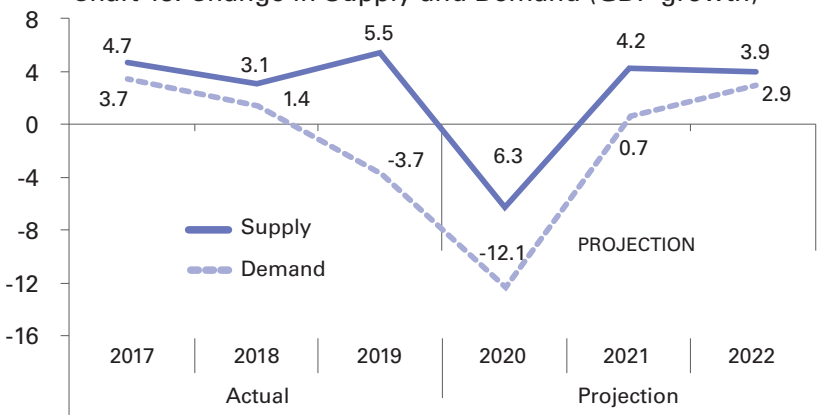
Chart 12: Real GDP and Sectoral Growth



accessible both within and outside of the region. The base effect of 2020 is another reason for illustrating the higher sectoral growth projection in 2021.

The hydropower sector is expected to continue to perform well during the post pandemic period, with a growth averaging at 11.9 percent over the medium term. Similarly, the agriculture sector under the Economic Contingency Plan (ECP) which received a special focus to enhance and ensure uninterrupted food supply during the pandemic, will continue to remain buoyant. Various initiatives such as buy-back program and large-scale commercial farming, among others are expected to contribute in achieving food self-sufficiency. Consequently, the agriculture sector is anticipated to contribute 0.8 percent to GDP in 2021 as compared to 0.3 percent in 2020.

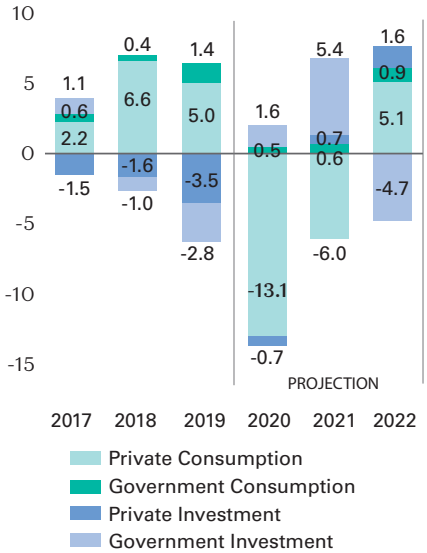
Chart 13: Change in Supply and Demand (GDP growth)



On the demand front, the aggregate demand is projected to revive to 0.7 percent in 2021 as compared to -12.1 percent in 2020, with an increase in both government and private investment growth. The allocation of higher share of capital budget (33% of the capital plan outlay for FY2021/22) is expected to boost capital formations, which will have a positive spillover impact on other allied sectors.

The public and private demand is expected to rise over the medium term, as the economic activities pick momentum. As such, both export and import of goods and services are expected to increase. Furthermore, the implementation of projects under the National Credit Guarantee Scheme (NCGS) will continue to support and sustain the economic recovery process over the medium term. As a result of timely and unprecedented policy measures, the economic gain in 2021 is estimated at Nu 2.70 billion.

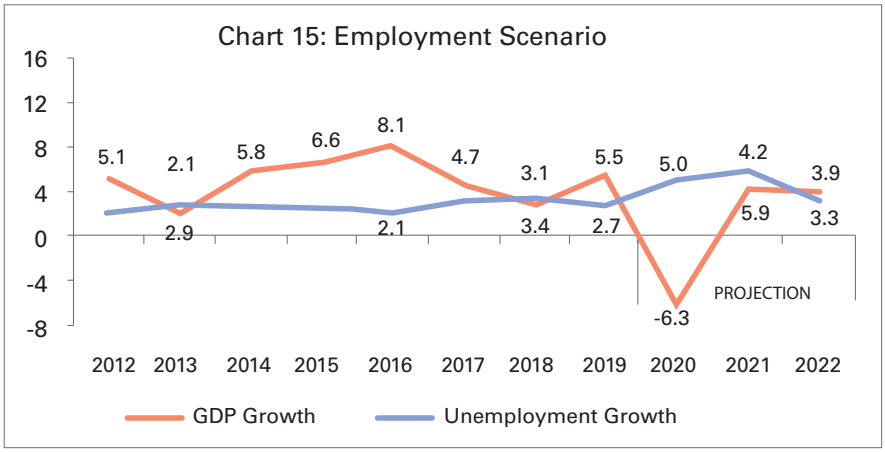
Chart 14: Contribution to Aggregate Demand (%)



In terms of contribution to aggregate demand in 2021, Government investment is expected to increase by contributing 5.4 percentage points, followed by private investment and Government consumption with 0.7 percentage points and 0.6 percentage points respectively while private consumption to record at -6.0 percentage points. In 2022, the private and Government consumption, and private investment are expected to contribute more to aggregate demand, with exception to Government investment. However, the downside risk persists as the surge in the transmission of new variants of the virus continues in neighboring countries.

The labor market is expected to continue to face challenges over the medium term. The pandemic has disproportionately impacted different segments of workers. The time lag or the adjustment time required for full implementation of employment generating projects will also determine the

pace of creating new employment opportunities as per the expectation of the job seekers. In particular, youth and the low-skilled, who are working in the tourism and other non-formal activities have been hit hardest, leading to low labor force participation. According to the Labour Force Survey Report (2020), the unemployment rate peaked at 5.0 percent in 2020 from 2.7 percent in 2019. Similarly, the overall youth unemployment rate increased significantly from 11.9 percent in 2019 to 22.6 percent in 2020.

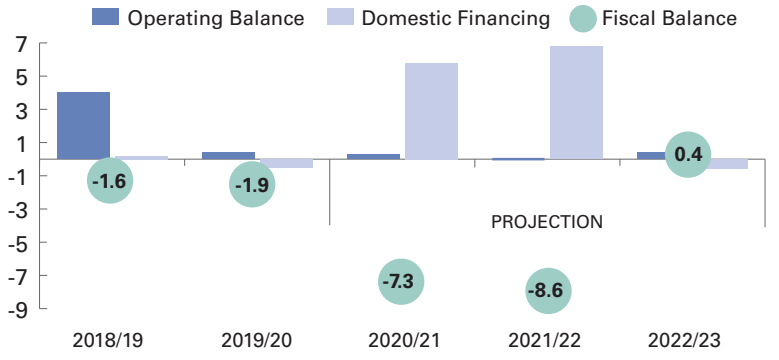


Since the onset of the pandemic, the DGRK and the accelerated De-suung Integrated Training Program initiatives have significantly prevented unemployment rate going spiral to a double digit. Further, several timely policy initiatives were introduced by the Government under Economic Contingency Plan (ECP) to provide employment opportunities for unemployed youth and displaced individuals; focusing on re-skilling and up-skilling in the areas of tourism, agriculture and construction sectors. With more than 50 percent of total population still engaged in the agriculture sector, the pandemic has provided added opportunities to enhance productivity and production not only to meet the domestic demand but also for export. Higher growth in agriculture

sector and related activities, supported by easy access to credit, are expected to increase the labor force participation, particularly amongst the youth segment. The unemployment rate is expected to stabilize at 4.2 percent in 2021 and 3.3 percent in 2022. A continuous policy intervention such as monetary and fiscal incentives to boost aggregate demand would aid the economic recovery process, supported by conducive labor market conditions as the pandemic gradually subsides.

Despite weak domestic demand and softening of global commodity price, inflation in Bhutan is expected to remain elevated in the short term, mainly due to food price inflation, before moderating in the medium term. Headline inflation was recorded at 7.7 percent in December 2020. Build up of inflationary pressure in the recent months are largely on account of increase in prices of domestic and imported food items, which have increased due to high transport and logistic costs and a shortfall in supply of goods and services. Supply chain disruptions in food production and the recent surge in new variants of the virus and community transmission in India are expected to continue pushing up the food prices and wages over the short term. As a result, the overall price level

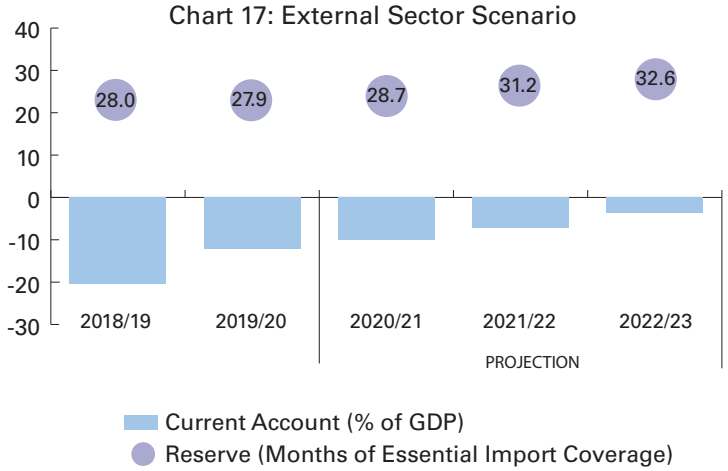
Chart 16: Fiscal Scenario (% of GDP)



is expected to remain elevated at a range of 5-6 percent in the short term, before moderating to 3-5 percent in the medium term. A sizeable drop in aggregate demand and fall in non-food prices, particularly the global price, will offset potential cost-push inflation in the medium term.

To stimulate economic growth, the government has fast tracked the prioritized economic activities during the pandemic. The overall investment demand is therefore expected to improve with anticipated increase in capital expenditure by 71.3 percent in FY2020/21 from Nu 22.05 billion in FY2019/20, and further increase by 1.5 percent in FY2021/22. Although the average fiscal deficit has to be maintained within 3 percent of GDP during the plan period, the fiscal target has been adjusted within 5 percent of GDP to support the economic growth. The capital outlay has been increased and spending has been enhanced to cover up the activities of the economic contingency plan. Accordingly, the fiscal deficit is projected at 7.3 percent and 8.6 percent of GDP for the FY2020/21 and the FY2021/22 respectively. The government as a dominant player during the pandemic, it's spending for various activities aims to keep the economy afloat amidst the pandemic and post-recovery period.

Chart 17: External Sector Scenario

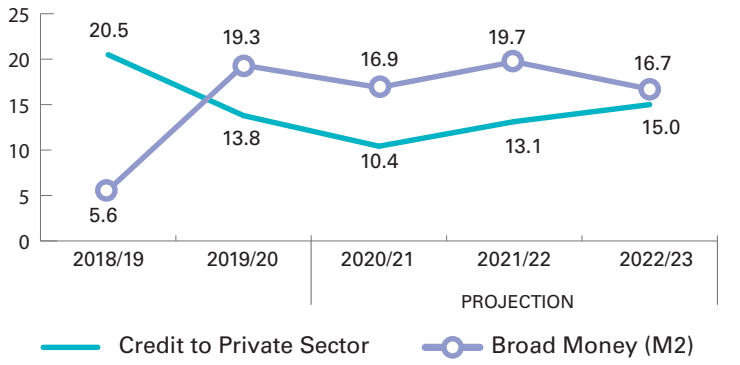


In the medium-term, the trade imbalance is expected to improve with a lower domestic demand for imports and subdued export under the stringent containment measures in the region and abroad. Notably, the electricity export to India is expected to increase in the coming years. In contrast, with the emerging second wave of COVID-19 in India as well as unfavorable situation around the globe, regaining of external demand for exports of goods and revitalization of tourism business remains uncertain for the following 1 to 2 years.

Against this backdrop, the RMA's forecast for the balance of payments is shown until FY2022/23 in Table 1. During the period, the current account deficit is expected to improve mainly due to improvement in trade balance, though the current account balance continued to remain in deficit. Although financial account is forecasted with declining net inflows on account of reduced investment demand, increase in capital inflows in the form of grants will help to accumulate external reserves.

The external debt stock as of March 2021 stood at USD 3.16 billion (Nu 232.3 billion), equivalent to 130.4 percent of GDP. In terms of external debt by currency, about 72.1 percent (₹ 167.50 billion) of total external debt is Indian Rupee debt, of which 87.1 percent of INR debt are related to hydropower sector.

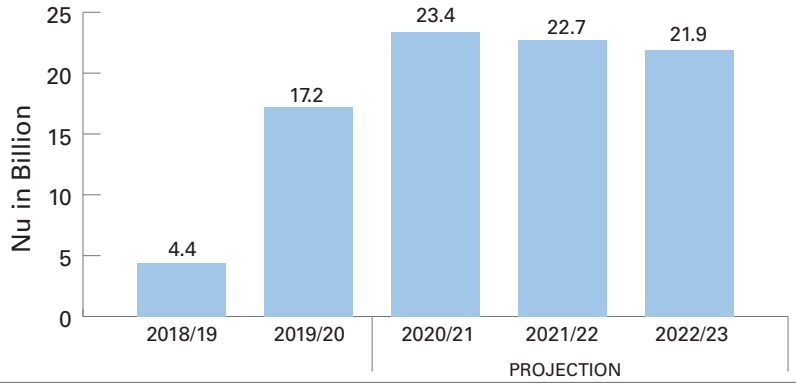
Chart 18: Money Supply and Credit Growth Projection (%)



On the monetary front, amidst economic uncertainty and rising inflation, the domestic financial conditions continued to improve with a surplus liquidity in the banking system. The monetary and credit conditions supported by monetary measures continued to experience a favorable growth in 2020. The broad money (M2) is expected to grow at 16.9 percent in the FY2020/21, in tandem with the nominal GDP growth. The growth in money supply is largely driven by Net Foreign Assets during the review period.

Despite adequate liquidity in the banking sector in FY 2020/21, the credit to private sector is projected to slow down to 10.4 percent from 13.3 percent in the previous year. The slowdown in credit supply is attributed to lower demand for private investment and consumption. The credit to tourism and construction sector, which accounted for more than 50 percent in 2020, decreased significantly, owing to disruptions in the economic activities. In the medium term, domestic credit is expected to grow on an average of 14 percent in line with pace of the economic growth.

Chart 19: Liquidity Position in the Banking Sector



The liquidity condition in the financial sector continues to remain favorable due to stable deposit base, aided by sustained increase in foreign asset inflows through hydropower receipts and reduction in CRR. The liquidity in banking sector is projected at a surplus of Nu 23.36 billion during FY2020/21, which is adequate to meet the financing requirements of the Government without crowding out of credit to the private sector. Given the uncertainties, the increasing trend in new loan disbursement and rising non-performing loans is anticipated to pose new challenges and risks for the financial sector during the post pandemic period.

As on December 2020, the non-performing loans increased by 45.6 percent from Nu 16.75 billion in 2019. In absence of relief measures, the NPLs are projected to grow over 50 percent, largely contributed by the affected sectors.

As part of the comprehensive national response against the rising NPLs, the RMA conducted an in-depth assessment of NPLs from July 2020 to facilitate rehabilitation and/or foreclosures of NPLs. A comprehensive NPL resolution framework has been developed to provide relief to both financial institutions and borrowers for short to medium terms, while also creating ecosystem for promoting new credit culture that support the economic recovery process.

Table 1. Medium-term Macroeconomic Outlook

Financial Year (FY)	2018/19	2019/20	2020/21	2021/22	2022/23
Calendar Year (CY)	**2018**	**2019**	**2020**	**2021**	**2022**
	Actual	**Actual**	**Actual/ Prov.**	**Projection**	
Production* (Supply % change)					
Real GDP	3.1	5.5	-6.3	4.2	3.9
Agriculture	4.2	1.3	2.6	6.7	3.1
Industry	-5.0	2.0	-4.4	7.4	-0.2
Manufacturing	2.6	0.0	-25.9	2.3	3.9
Electricity & water	-14.9	12.1	18.9	-6.4	4.0
Construction	-8.0	-14.7	-9.5	31.4	-9.4
Services	8.9	12.5	-7.9	1.1	6.5
Expenditure (Demand % change)					
Gross Domestic Demand	1.4	-3.7	-12.1	0.7	2.9
Consumption	6.8	7.1	-18.3	-8.5	10.4
Public	3.0	10.8	3.1	3.6	5.3
Private	8.1	4.5	-12.3	-12.9	12.7
Investment	-5.3	-16.8	2.9	17.1	-7.4
Public	-9.7	-31.2	26.2	63.0	-33.8
Private	-5.2	-12.3	-2.8	2.7	5.8
Output gap (% of potential) *	-2.2	-2.9	-3.7	-3.0	-2.0
Unemployment rate (%)	3.4	2.7	5.0	4.5	3.3
Prices					
Headline inflation	2.7	2.7	7.7	5.5	4.0
Implicit Inflation target/ reference inflation rate	4.5	4.5	4.5	4.5	4.5
Fiscal (% of GDP)					
Operating balance	4.0	0.4	0.3	0.0	0.4
Fiscal balance	-1.6	-1.9	-7.3	-8.6	0.4
Domestic financing requirement	0.2	-0.5	5.8	6.8	-0.6

External (% of GDP)					
Current account balance	-21.2	-12.2	-11.4	-7.3	-3.7
Trade balance (Goods)	-16.4	-9.8	-6.0	-5.4	-1.0
Gross reserves (Mill USD)	1,064.8	1,343.5	1574.8	1883.9	2162.8
External debt	112.4	121.8	122.6	120.9	127.2
Reserves to Essential Import Coverage (Months)	28.0	20.0	28.7	31.2	32.6
Exchange rate (Nu/USD)-FY	70.5	72.5	73.8	73.1	73.0
Monetary Sector Development (% change)					
Reserve Money (M0)	-4.5	40.9	14.7	19.7	16.7
Broad Money (M2)	5.6	19.3	16.9	19.7	16.7
Net Foreign Assets (NFA)	-3.2	31.6	16.0	8.7	13.3
Net Domestic Asset	17.4	5.6	8.3	35.4	20.4
o.w credit to private sector	20.5	13.3	10.4	13.1	15.0
Credit to deposit ratio	102.3	97.3	97.3	98.5	98.3
External Environment					
Global GDP*	3.6	2.9	-3.3	6.0	4.4
GDP growth, India*	6.8	6.1	-8.0	12.5	6.9
Inflation, India*	4.0	3.7	6.2	4.9	4.1
LIBOR*	2.5	2.3	1.9	1.9	1.9
Key policy rate, India*	6.3	5.7	4.3	4.0	4.0
Exchange rate (INR/USD)	69.9	70.9	73.0	72.9	73
Memo:					
Nominal GDP at market prices (Mn. of Nu)-FY	172,758.8	179,568.0	186,653.0	199,654.7	220,162.2

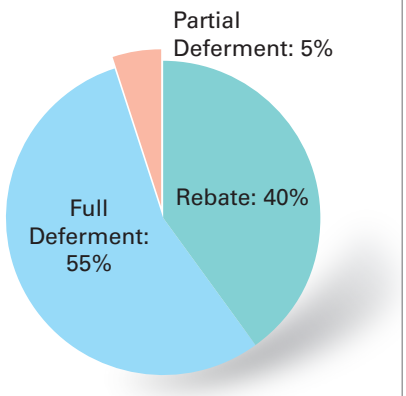
Data are as of FY ending June unless marked with (*) are in calendar year basis. Source: Macroeconomic Framework Coordination Committee (MFCC), Ministry of Finance, April 2020 updates, World Economic Outlook, IMF, April 2020 update, and Reserve Bank of India (RBI).

3. Summary on Monetary Measures Phase I and II

In response to the COVID-19 pandemic, the RMA intervened through phase I and phase II monetary measures, complementing both fiscal measures and DGRK, aimed at providing relief to individuals and businesses, affected by the pandemic. These relief measures were broad based and inclusive that not only provided immediate economic relief to the people while maintaining their psychological well-being during the pandemic but also helped the financial sector to avert the risk of build-up of non-performing loans and their performance.

As an immediate response to curtail the impact of the pandemic, His Majesty The Druk Gyalpo granted 100 percent interest payment support to all the borrowers for a period of six months (April to September 2020) followed by 50 percent interest payment support for the next six months (October 2020 to March 2021). Of the 100 percent interest payment support provided during the first three months, 50 percent was borne by five commercial banks, National Pension and Provident Fund, two insurance companies, five microfinance institutions and the National CSI Development Bank. As of December 2020, the total interest payment support provided amounted to Nu 9.32 billion, out of which Nu 7.44 billion was granted as DGRK and Nu 1.88 billion was borne by the Financial Service Providers.

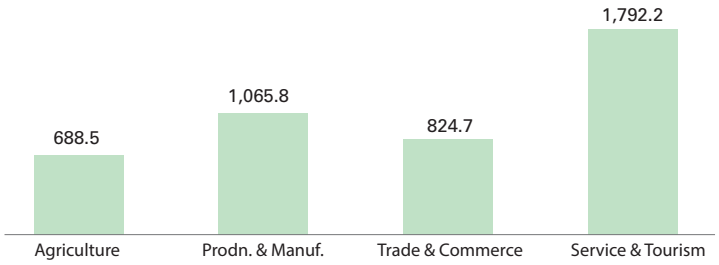
Chart 20: Loan Deferment and Rebate



Complementing the interest payment support measures, the financial institutions have provided deferment of loan

repayments, starting from 30th June 2020, with 1 percent rebate for regular repayment Equated Monthly Installment (EMI) for 1 year to all borrowers. This measure has provided incentive for account holders who have the ability to repay regular EMI in the form of 1 percent interest rate reduction on the principal outstanding during the deferment period. As of December 2020, a total of 83,464 account holders have availed deferment facility amounting to Nu 125.70 billion. Likewise, 56,696 account holders who made full regular payment of EMIs during the deferred period benefited through provision of 1 percent reduced interest rate.

Chart 21: Loans under Monetary Measures (Nu in Million)



To provide immediate liquidity relief in the financial sector, the RMA reduced the Cash Reserve Ratio from 10 percent to 7 percent, releasing an additional liquidity of Nu 4.22 billion to finance term-based working capital and bridging loans to wholesale distributors of essential items, tourism and related businesses and manufacturing industries at a concessional interest rate. As on December 2020, eight financial institutions sanctioned Nu 4.37 billion under the phase I and II monetary measures to 2,744 beneficiaries[1]. The service and tourism sector being the most affected by the pandemic, has received the highest share of loans amounting to Nu 1.79 billion, followed by the production and manufacturing sectors with Nu 1.06 billion.

[1]The sanction amount excludes Inter-institutional lending of Nu 22 million between BNBL and BIL.

Box 1. Monetary Measures Phase III

As the pandemic continues to intensify risks and vulnerabilities in the real economy, His Majesty The Druk Gyalpo continued to provide Income Support and Loan Interest Payment Support Kidu for another fifteen months until June 2022. While the DGRK has been the most effective form of intervention, other conventional monetary measures have also been a complementary policy during the pandemic. The phase II monetary and fiscal measures have been in force from 1st July, 2020 until 30th June, 2021.

Amid these uncertain and challenging times, the following monetary measures under phase III will be continued to provide crucial relief to household and business entities from July 2021 until June 2022.

(a) Deferment of loan repayments.

All loans sanctioned as of 30th June 2020 shall be eligible for the deferment of loan repayment for another one year until June, 2022.

Notwithstanding the above provision, the Financial Service Providers (FSPs) may negotiate with the borrowers for revival/ rehabilitation/ out-of-court settlement or initiate foreclosure of non-performing loans.

In order to ease the burden of loan repayment on the borrowers, the FSPs may extend the loan tenure by the deferred period or by up to 5 years depending on the repayment capacity of the borrowers.

(b) Incentive for regular repayments during the deferment period

As the provision of interest rate rebate proved effective in motivating borrowers to make regular repayment during the

Phase I and II measures, the incentive of interest rate rebate for loans during the deferment period shall be continued by the FSPs to provide one percent interest rate reduction (rebate) on term loans for another one year from July 2021 to June 2022 to the borrowers who service their loan installments regularly and fully as per the agreed repayment schedule (after adjustment of 50 percent interest payment support) during the deferment period.

(c) Non-capitalization of interest accrued during the deferment period

The FSPs shall not capitalize the interest accrued during the deferment period. The total accumulated interest from April 2020 to June 2022 shall be payable in equal installments after the end of the deferment period.

(d) Treatment of Soft Term Loans (Bridging Loans) sanctioned under Monetary Measures Phase II

The FSPs shall provide gestation for another one year until June 2022 for the Soft Term Loans granted to the business entities under the Monetary Measures Phase II.

The FSPs shall not capitalize the interest accrued during the gestation period. The total accumulated interest from April 2020 to June 2022 shall be payable in equal installments after the end of the gestation period.

(e) Loan-to-Value (LTV) limit and Land valuation

In case of project financing/ business loans, the FSPs may provide loans up to the LTV limit of 100 percent of the collateral value. However, the maximum debt-to-equity financing limit shall continue to apply. The LTV limits for housing loans and vehicle loans shall remain unchanged.

As proposed by Financial Institutions Association of Bhutan (FIAB), the FSPs may adopt uniform land rates for the valuation purposes as per the agreed modality among the FSPs.

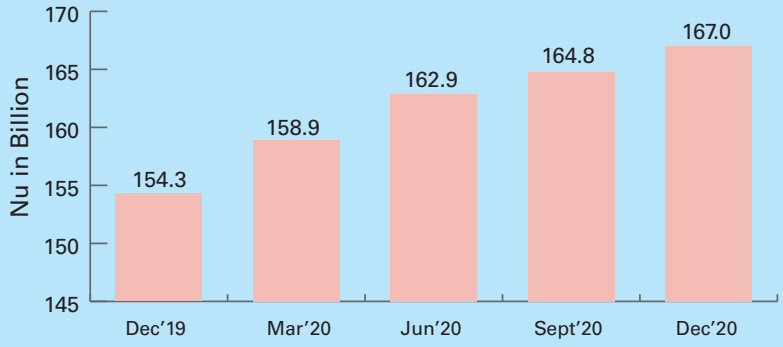
Box 2: Key Highlights of Financial Sector Performance

1. Deposit base of the banks remained stable during 2020.
2. SLR position also remained above the minimum requirement (20% for banks and 10% for non-banks) in 2020.
3. The financial sector witnessed a credit growth of more than 8% (y-o-y) in 2020.
4. CAR (%) improved in Q4 2020 compared to previous quarters of 2020.
5. Capital risk level remained high and FIs relatively have low capital and were exposed to riskier assets.
6. Despite the pandemic, the overall NPLs remained manageable in 2020.
7. Support measures like loan deferment facility and Interest Payment Support (IPS) have helped to safeguard the rising NPLs.
8. Ensuring credit quality will be the key challenge during the post pandemic period.
9. The FIs profitability in 2020 was severely impacted, although the provisioning requirements and NPLs were lower with monetary measures.
10. Provision of LIPSK along with exemptions provided by the RMA helped the FIs to maintain a reasonable level of profit in 2020.

1. Credit Exposure

Total loans and advances have increased by 8.3 percent in 2020 from Nu 154.32 billion in 2019. The primary driver of credit growth were tourism and service sector, and its allied sectors, that witnessed a significant growth of 25.5 percent, followed by production and manufacturing sector with 23.7 percent. Besides, personal loan also grew by 18.7 percent during the review period. Even during the pandemic, the flow of credit to private sector is ensured without disruptions, mainly supported by monetary measures and the DGRK.

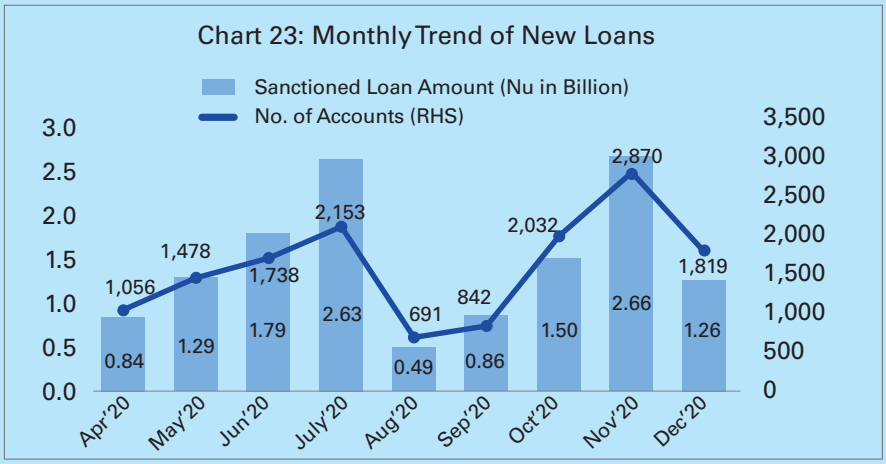
Chart 22: Total Loan Outstanding



1.1. New Loans during COVID-19 Pandemic

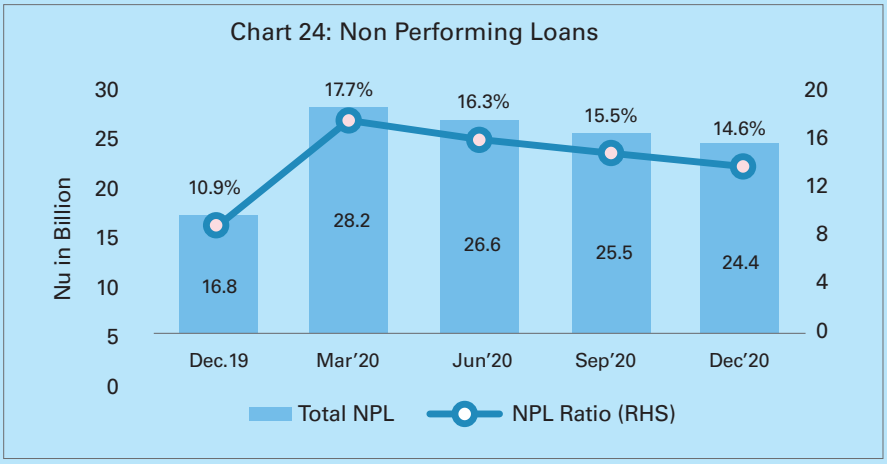
As a part of the monetary measure and ensuring seamless credit flow in the economy, the total new loans sanctioned by financial sector from 11th April 2020 to 31st December 2020 amounted to Nu 17 billion. From the new loans, Nu 3.70 billion was sanctioned under the monetary measures and Nu 13.30 billion were regular loan that do not fall under the monetary measures. The total new loan outstanding under monetary measures and regular loans as of 31st December 2020 stood at Nu 2.80 billion and Nu 10.20 billion, respectively.

Excluding the loans under monetary measures, personal loans recorded the highest loan outstanding of Nu 2.36 billion with 7,141 loan accounts.



1.2. Asset Quality

Despite the pandemic, the NPLs in the financial sector remained manageable in 2020, as a result of monetary measures supported by the DGRK and constant follow-ups on loans and recovery initiatives undertaken by the financial



institutions. As a result, the NPLs in the financial sector decreased from Nu 25.5 billion in September 2020 to Nu 24.4 billion in December 2020. A broad based and inclusive monetary measures supported by the DGRK have helped the financial sector to absorb the economic shock of the pandemic. In absence of such interventions, the NPLs would have risen significantly during the period. In terms of NPL buckets, the financial sector witnessed a substantial decrease in NPLs in doubtful and loss categories, with a marginal increase in the substandard category. With such development, if the economic effect of the pandemic turns out to be acute and persistent in the medium to long term, it would be challenging for the financial sector to manage them.

Table 2. Asset Classification (Nu in Billion)

Loan Category	Dec'19	Mar'20	Jun'20	Sep'20	Dec'20
Performing Loan					
Standard (0 to 30 days)	122.9	113.8	120.4	126.7	128.2
Watch (31 to 90 days)	14.7	16.9	15.9	12.6	14.4
Non-performing loans					
Substandard (91 to 180 days)	2.5	11.8	10.6	8.1	8.9
Doubtful (181 to 365 days)	2.8	2.1	2.1	3.4	1.9
Loss (366 days & above)	11.4	14.2	14.0	14.1	13.6

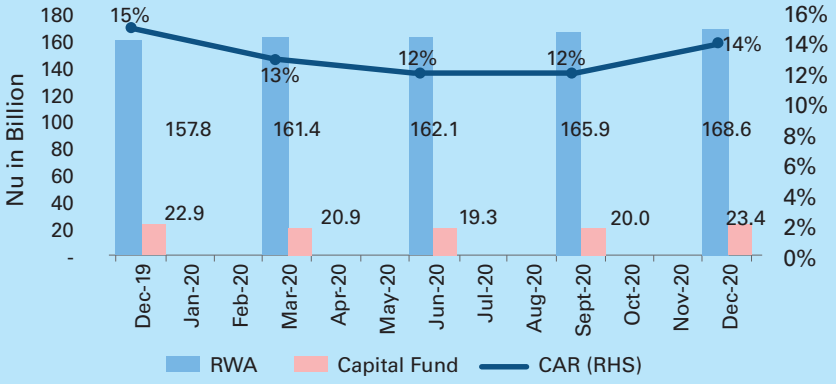
2. Risk Assessment

Based on the lesson learnt during the pandemic, the RMA carried out the following risk assessment of the financial sector to measure the impact of pandemic, and to prepare for the future uncertainties.

2.1. Capital Risk

The Financial sector entered the pandemic phase with capital adequacy ratio (CAR) of 15 percent as of December 2019, which includes the requirement of capital conservation buffer of 2.5 percent. The CAR as of December 2020 reached 14 percent (against the minimum requirement of 10 percent) as compared to 12 percent in September 2020. The decrease in overall NPLs from September to December 2020 has resulted in the improvement of the position of CAR in the financial sector.

Chart 25: CAR Position of the Financial Sector

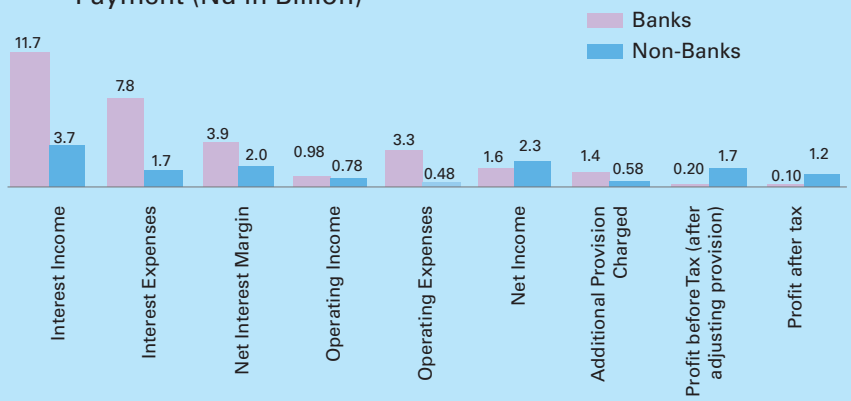


The capital buffers accumulated prior to the pandemic and the regulatory relief provided by the RMA have allowed financial institutions to increase their lending to the economy, helping the sector to withstand the impact of forthcoming expected credit risk losses stemming from the crisis.

2.2. Profitability

More importantly, the DGRK, fiscal measures and loan deferment facility have helped the financial institutions to prevent further build-up of NPLs and huge negative net interest income (difference between interest income and interest expenses). Without these stimulus packages, the pandemic would have caused a significant decline in financial institutions' interest income, and potentially impacted the capital and earning of financial institutions, leading to financing instability. Moving ahead with the pandemic, ensuring an undisrupted flow of liquidity in the economy at all times is of utmost importance to revitalize the economy and promote lending to productive investment. As the pandemic persists, continued relief support granted by His Majesty The Druk Gyalpo through the DGRK until June 2022 would provide adequate cushion for both borrowers and the financial sector to adjust to the persistent shocks of the pandemic.

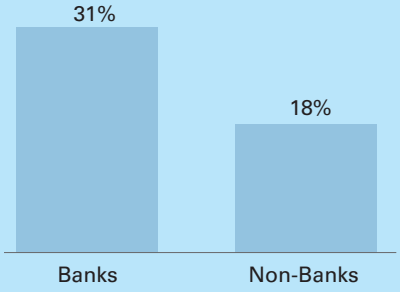
Chart 26: Profit as of December 2020 with Interest Waiver Payment (Nu in Billion)



2.3. Liquidity and Funding Risk

Since the outbreak of the pandemic, funding structure in terms of deposits has been stable and unaffected, supporting the banks to meet the demand for new loans. The total deposits in the banking sector have increased from Nu 138.74 billion in 2019 to Nu 165.45 billion in 2020. The financial institution's statutory liquidity ratio (SLR) as of December 2020 are above the minimum regulatory requirement of 20 percent for banks and 10 percent for non-banks. As of December 2020, the SLR position stands at 31 percent for banks and 18 percent for the non-banks.

Chart 27: Average SLR Position as of December 2020



Box 3: Analysis on Banks' Deposit

The five commercial banks and two Deposit-Taking MFIs mobilized a total deposit of Nu 165.70 billion with 970,769 deposit accounts as of December 2020. In-terms of the deposit's distribution, there is a considerable heterogeneity.

Table 3. Types of deposit holdings by Dzongkhag (Nu in million)

Dzongkhags	Current Deposit	Fixed Deposit	Recurring Deposit	Saving Deposit	Total
Bumthang	108.9	600.4	52.5	1,244.9	2,006.7
Chhukha	4,137.2	3,362.3	373.5	5,068.0	12,941.0
Dagana	34.3	145.5	31.4	485.8	697.0
Gasa	4.3	104.6	9.4	111.3	229.7
Haa	175.0	254.2	43.0	511.1	983.3
Lhuentse	25.1	285.8	43.5	416.0	770.4
Mongar	84.3	470.9	89.8	1,302.6	1,947.5
P/Gatshel	59.7	625.8	43.7	736.3	1,465.4
Paro	762.9	2,064.9	189.1	3,513.9	6,530.8
Punakha	67.4	418.0	43.6	867.0	1,395.9
S/Jongkhar	450.2	801.7	125.1	1,373.2	2,750.3
Samtse	2,071.1	810.2	137.7	1,840.1	4,859.1
Sarpang	453.4	589.9	132.3	2,274.6	3,450.2
T/Yangtse	22.1	159.2	44.0	531.2	756.5
Thimphu	25,070.2	63,265.2	1,604.9	25,308.0	115,248.4
Trashigang	165.7	495.6	103.0	1,693.6	2,457.9
Trongsa	137.7	238.4	44.8	682.0	1,102.9
Tsirang	52.8	217.9	39.9	883.5	1,194.1
W/Phodrang	533.3	1,152.7	242.4	2,470.6	4,399.0
Zhemgang	19.4	84.1	27.8	377.6	509.0
Total	**34,434.8**	**76,147.3**	**3,421.6**	**51,691.5**	**165,695.1**

The Bank of Bhutan has the highest share amongst the financial institutions and Thimphu has the highest concentration, compared to other Dzongkhags. Thimphu alone accounts for 30.6 percent of the total deposit accounts and 69.6 percent of the total deposit amount. The concentration of different deposits across Dzongkhags is presented in Table 3.

Going by the types of deposits, the Retail deposits continue to influence the deposit base of the commercial banks. In terms of shares in both volume and value, the Retail deposits constitute 98.5 percent in total deposit accounts and 55.8 percent in total deposit amount. Besides the Government deposits, the non-Banks deposit also secured a commendable share amounting to Nu 22.67 billion.

The marginal share of the Banks' deposit can be attributed to the adjustment of short-term liquidity, in the form of interbank borrowings. The retail deposits persist to remain a major source of fund for the commercial banks and Deposit-Taking MFIs, concentrated largely in both savings and fixed deposits. Base on the experience gained from the pandemic, the dependency of banks on deposits for lending, calls for an attention on the following important issues;

i) Ensuring public confidence on banking sector as a custodian of public deposits and the source of funding for investment

ii) Exploring cheaper alternative financing options for long term investment through financial deepening and innovative financing models

iii) Introducing technology driven financial services to bring greater efficiency and cost effectiveness in financial intermediation process and operations

iv) Harnessing green and sustainable financing sources to promote investment for attaining a sustainable and resilient economic growth.

4. Chronology of Key Monetary Policy Interventions since 1983

April 1983
RMA Commenced Central Banking Operations

1984
First CRR set at a rate of 3%

1994
CRR was revised for the first time to 15%

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

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%

October 1997

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

October 2001

Auctions were discontinued and Tap Sales were introduced for RMA bills

June 2002

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

April 1999

Removed the requirement of fixed spread on the interest rate

March 2002

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

November 2020

Implemented the Domestic Liquidity Management System

September 2020

Released the Capital Conservation Buffer of 2.5%

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.

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