MONETARY POLICY Statement

RMA June 2014

Royal Monetary Authority of Bhutan

This Report has been prepared by the Royal Monetary Authority of Bhutan in accordance with Chapter II Section 10 of the RMA Act of Bhutan 2010.

Unless specified, the source of data presented in tables and charts is the Royal Monetary Authority of Bhutan or the National Statistics Bureau. Macroeconomic projections presented in the Outlook Section of this Report have been prepared by the Multi-Sectoral Macroeconomic Framework Coordination Technical Committee composed of various government and statistical agency representatives, and led by the Ministry of Finance, Royal Government of Bhutan. Projections and assumptions adopted thereof are a representation of collective judgment.

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ACRONYMS

BOP	Balance of Payments
CAD	BOP Current Account Deficit
CC	Convertible Currency
COTI	Countries other than India
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
CY	Calendar Year (January 1 – December 31)
DACL	Druk Air Corporation Limited
FY	Fiscal Year (July 1 – June 30)
FYP	Five Year Plan
FXD	Foreign Exchange & Reserve Management Department, RMA
GDP	Gross Domestic Product
GoI	Government of India
IMF	International Monetary Fund
M0	Reserve Money
M1	Narrow Money
M2	Broad Money
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MoF	Ministry of Finance
MoLHR	Ministry of Labour & Human Resources
NBFI	Non-Bank Financial Institution
NFA	Net Foreign Assets
NPL	Non Performing Loan
NPPF	National Pension and Provident Fund
NSB	National Statistics Bureau
ODA	Official Development Assistance
ODF	Overdraft Facility
OIN	Other Items Net
PNB	Punjab National Bank, India
PPI	Producer Price Index
RBI	Reserve Bank of India
RGOB	Royal Government of Bhutan

RMA	Royal Monetary Authority of Bhutan
RSEBL	Royal Securities Exchange of Bhutan Limited
RSTLAW	RMA Short Term Liquidity Adjustment Window
SBI	State Bank of India
SCF	Standby Credit Facility (also referred to as Line of Credit, LoC)
SLR	Statutory Liquidity Requirement
T-Bill	Treasury Bill
QM	Quasi Money
WPI	Wholesale Price Index
y-o-y	Year-On-Year

GOVERNOR'S STATEMENT

Two years ago the RMA rolled out multiple monetary policy measures and financial sector reforms to moderate aggregate demand, reduce pressures on Bhutan's external account and international reserves as well as to tighten domestic banking liquidity. Throughout, the RMA has closely monitored the health of the financial sector against potential risks and vulnerabilities. The time for unconventional measures is now over and this year, the RMA will be systematically phasing out its temporary credit restrictions imposed on housing and transport portfolios in tandem with the easing of foreign exchange controls on access to the INR for these related imports. I thank all our stakeholders in the Royal Government, financial and private sectors for their cooperation and patience the past year.

When these measures were first implemented, the objective was to provide short-term relief from external imbalances by stemming domestic demand and non-essential imports until long-term fiscal and other structural policies were introduced. I have consistently maintained that such stand-alone measures are ineffective to tackle Bhutan's underlying macroeconomic structural weaknesses, the long-term continuation of which would only distort markets. Market forces must be permitted to intervene and policies today have to be more symmetrical over financial and business cycles – leaning deliberately against booms and easing up during downturns with the priority on repair and reform. I reiterate that the current development imperative is to crystallize structural policies (labor, taxation, private sector development) to raise growth potential beyond that of hydropower. There are no short-cuts while delays will only escalate costs to the Bhutanese economy and country at large. Positive developments are on the horizon with the government having proposed numerous fiscal measures to deal with growing external imbalances during the recently concluded summer session of Parliament and we look forward to these initiatives and outcomes in this Plan period.

Notably, mainstream monetary policy measures seek to impact real sector economic activities primarily by influencing financing costs and liquidity volumes. However, mainstream monetary policy has proven to be sub-optimal as indicated by global waves of financial instability and financial exclusion. For low income developing economies such as Bhutan's, we now need to shift from mainstream monetary policies towards supporting inclusive sustainable growth. Over the past 24 months, the Bhutanese financial sector has learned valuable lessons from the buildup of sectoral exposure pressures, and moving forward, we hope the financial institutions will exercise prudence in their credit policies while assisting the RMA and RGOB to direct finance towards more productive sectors of the economy.

Overall, Bhutan's medium-term economic growth outlook is forecast to pick up in the medium term. Growth performance during 2012 had slowed to 4.6% and is expected to drop further to 4% for 2013 (April 2014 forecast) due to the moderation in credit growth. However, over the 11th FYP period, growth is projected to pick up and average 6% per annum on the back of the construction of new hydropower projects and the commissioning of the Puna I, II and Mangdechhu projects during the final year of the Plan period. Meanwhile, rising inflationary pressures continue to reflect developments in India – in the first quarter of 2014, although inflation reduced to 9.5% from 11.3% in the quarter ending December 2013, it has increased from 8.4% in the first quarter of 2013 and remains elevated, largely on account of food prices. Similarly, it is expected that Bhutan's current account deficit will worsen further from 25% of GDP this FY to 30% during FY 2014/15 driven by both consumption in the hydro and non-hydro sector, remaining elevated for the remainder of the 11th FYP. Consequently, all of this will raise the demand for INR with implications for reserve management.

RMA's recent efforts have focused on managing recurrent pressures on INR reserves. With assistance from the International Monetary Fund, the RMA reviewed Bhutan's reserve management policy, revising and streamlining operational guidelines to ensure prudent management of reserves and advance current positioning for international transactions. Notably, in addition to the Constitutional provisions on maintenance of reserves to meet essential imports, the RMA has also adopted an operational threshold for reserves that reflects other key parameters. Having this threshold will enable the RMA to adjust reserve composition without impacting the Constitutional requirement and position for necessary INR in advance. Since June 2013, the RMA has not availed any short-term ODF from India while the SWAP has not been renewed after its term ended in September 2013.

In line with Bhutan's economic outlook, monetary policy shall remain tight to counter prospective overheating and pressures on INR reserves. There is room for further maneuvering and further enhancements to the monetary policy transmission especially with regard to adjustments in reserve requirements, interest rates and working closely with the government to promote a more active government securities market. The RMA is currently working in collaboration with the RSEBL on the preparation of a Capital Markets Development Master Plan (approved by the Board in May 2014), while drafting the Credit Rating Agency Regulations with technical assistance from the Asian Development Bank, formulating regulatory and supervisory frameworks for fund management entities, and assisting the RSEBL on the development of an Agricultural Commodity Exchange.

Generally, financial soundness indicators for Bhutan have been sound, and since the end of 2013, tight liquidity conditions faced by the banking sector have eased following the implementation of monetary policy measures. Banks are well capitalized with their CAR holding well above prudential requirements at 18.2% at the end of the first quarter of 2014. Credit to deposit ratios have improved from 88.5% in 2012 to 88.2% in 2013 and 84.3% as of March 2014. There are still some concerns regarding the higher level of NPLs among the financial institutions since gross NPL across sectoral lending in all institutions grew to 11.8% for the quarter ending March 2014 from 10.9% in 2013. Sectors experiencing higher NPLs during the quarter (year-on-year) include that of transport, service and tourism, personal loans, and other loans.

I am pleased to report that in lieu of these developments and in tandem with the lifting of temporary credit and exchange restrictions, the RMA will be introducing and implementing a series of new macro-prudential reforms. Under a two-year ADB TA for Supporting Financial Stability (2013-2015), the RMA in collaboration with the financial institutions will be issuing several Macro-Prudential Regulations to improve the timely recognition of financial vulnerabilities and deal with asset-liability mismatches (framework and regulation on liquidity management), to mitigate against growing systemic risks. These include rules and provisions outlining countercyclical buffer for banks, loan-to-value and loan-to-income ratios, sectoral capital requirements, time-varying capital provisioning, debt-to-equity and minimum ceiling on leverage ratio.

While micro prudential policies are aimed at ensuring the safety and soundness of individual financial institutions, macro prudential policies help to limit system-wide financial risks, although they may overlap. A key aspect of doing so is mitigating the extremes of the financial cycle that result from the interplay of value and risk perceptions feeding into the build-ups and declines in credit and asset valuations, and leveraging within sectors. Evidence has indicated that macro-prudential policies are much more effective at strengthening the resilience of financial institutions against busts than in restraining booms. However, they do work best when reinforced by monetary and fiscal policies; even though macro-prudential measures may affect investment and consumption through the supply of credit, they cannot efficiently control aggregate demand.

The IMF during its recent Article IV Consultation Mission carried out a comprehensive assessment of macro-economic developments, challenges and policy priorities for Bhutan. As they have pointed out, while Bhutan has enjoyed a higher growth trajectory on the back of hydropower, growth has become more volatile and a more stabilizing role has been played by the non-hydro sectors. Growth has also been unable to generate adequate employment in the manufacturing and services sectors. Going forward, while hydropower exports will continue to remain a key source of revenue, it is vital that we boost domestic economic productivity and the role of the private sector for greater macroeconomic stability and growth.

I cannot emphasize enough how critical it is for all stakeholders to coordinate and implement appropriate structural policies to facilitate sectoral reallocation of resources to boost Bhutan's domestic productive capacities, especially in the non-hydropower growth areas. These include niche areas such as agriculture, tourism and small and medium scale enterprises generating employment, import-substitution, revenues, while addressing national issues of inclusive and sustainable development.

We thank all our partners in development and the Bhutanese public for their understanding and look forward to another year of fruitful collaboration.

Daw Tenzin
Governor
June 2014

I. The State of the Bhutanese Economy: Recent Developments[1]

1. **Real GDP growth** for Bhutan halved to 4.6% during 2012 as compared to 8.6% in 2011. While all components of the GDP recorded positive growth, the mining and quarrying, and the finance, insurance, real estates and business services sector recorded a significant decline to negative growth of 2.2% and 2.9% respectively followed by the community, social, and personnel services sector at negative 6.4%. The electricity and water sector recorded a slight improvement; from negative 5.5% growth in 2011 to negative 0.6% during 2012. Following an average growth of 14.3% for the last three years, the tertiary sector still remained highest at 6.6% during 2012 with a 2.9% contribution to real GDP growth. At the sectoral level, the tertiary sector constituted 43.7% of GDP followed by the secondary and primary sectors with 39.3% and 17%, respectively.

2. **Inflationary conditions** remained consistently high during the year, largely carried over from across the border in India. As of the first quarter of 2014, food commodities now constitute 39.9% of Bhutan's CPI's basket weights, and over 90% of all food and processed foods and beverages imports are derived from India[2]. Price levels in India as featured by their WPI (RBI) grew by 5.2% during the first quarter of 2014 compared to 6.8% during the same quarter of 2013. Annual inflation in Bhutan increased to 9.5% during the first quarter of 2014 from 8.4% during the first quarter of 2013.As of March 2014, food inflation increased to 13.3% from 7.9% as of the first quarter of 2013.

3. As of March 2014, **broad money supply (M2)**[3] grew by 5.9% up from 4.6% (*year-on-year growth*) during the same period last year. Growth in M2 was contributed mainly by higher growth of net foreign assets (21.4%), followed by time and foreign currency deposits (8.9%), and transferable deposits (4.4%) during March 2014. Although the net foreign assets continued to influence major monetary aggregates as in the past, its spillover impact has not been transmitted directly in the banking sector's credit growth in the recent years due to tight monetary conditions. As a result, the growth of domestic credit remained relatively lower at negative 3.1% during March 2014 as compared to 12.4% in March 2013.

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1 Please see Annex 1 for a summary of Bhutan's latest Key Economic Indicators and charts. Data featured is as of March 2014.

2 As of the second quarter of 2013, the NSB has revised the weight of food in the CPI index from 31.67% to 39.92%; and that of non-food from 68.33% to 60.08%.

3 For monetary analysis, the balance sheet data of financial corporations are classified within the framework of the Monetary and Financial Statistics Manual (MFSM 2000) of the IMF. Please note that the data classification done here by the Research and Statistics Department are not directly comparable to those compiled and published by the Financial Regulation and Supervision Department of the RMA.

4. As of the first quarter of 2014, the growth of **combined assets of the financial sector**[4] increased to 8.6% (Nu.84.3 billion). Of the total assets, 88.7% belonged to the commercial banks and the residual to the NBFIs. During the same period, banking sector assets alone grew by 7.4% to Nu.74.8 billion while that of the NBFIs grew by 19.3% to Nu.9.6 billion. **NPLs** increased from Nu.5.9 billion to Nu.6.9 billion recording a growth of 11.8% at the end of March 2014 against 10.9% in the same period last year. In particular, high NPLs were observed under the trade and commerce, manufacturing and industry, housing, and personal loans sectors. Apart from seasonal factors in loan recovery, lack of access for ever-greening of loans due to tighter credit conditions may also have contributed to the increase in NPLs; although normally, NPLs during the early part of the year are relatively higher than that of the end of the financial year due to more rigorous recovery efforts by the financial institutions.

5. In Bhutan's **balance of payments**, Bhutan's current account deficit continues to remain elevated, widening to an estimated 25% of GDP in FY 2012/13. Reflecting the slowdown in credit and temporary restrictions on selected imports following the Indian Rupee shortages in 2012, the deficit in goods and services moderated from 28.7% of GDP in FY 2011/12 to 22.9% in FY 2012/13 albeit still remaining at high levels. Despite improvements in the goods and services account, the current account deficit increased in FY 2012/13 because of much reduced inflows of budgetary grants (47.7% decrease over the previous fiscal year) and much increased primary income debits.

6. The net inflows in the **capital and financial account** were more than sufficient to finance the current account deficit. In particular, inflows of Indian Rupee grants for hydropower development increased from ₹ 1.3 billion in the previous fiscal year to ₹ 9.8 billion, while there was also a concomitant increase in the Indian Rupee denominated loans of the hydropower projects from ₹ 9.9 billion to ₹ 14.8 billion. After accounting for other flows in the capital and financial account and the net errors and omissions, against a current account deficit of Nu.24.9 billion, the capital and financial account surplus stood at Nu.31.7 billion, with a subsequent increase in reserves by an equivalent of Nu.9.2 billion. As of March 2014, Bhutan's International Reserves stood at USD 965.4 million sufficient to cover 21.9 months of total merchandise imports and 16.8 months of both merchandise and services imports. Of the total reserves, USD 873.4 million were convertible currency reserves and ₹ 5.5 billion Indian Rupee reserves. (*Table 1*).

4 This excludes the NPPF.

7. Bhutan's **external debt obligations** as of March 2014 totaled USD 1.7 billion, increasing by 7.3% from December 2013. Of the total, 37.6% were outstanding convertible currency loans and the remaining 62.4%, Indian Rupee denominated debt (mostly for hydropower development). Overall debt servicing for the quarter ending March 2014 amounted to USD 16.8 million on convertible currency debt and ₹ 7.9 billion on Rupee denominated debt. Consequently, as of March 2014, Bhutan's total debt outstanding stood at 100.2% of GDP and the debt service ratio at 30.3%.

8. On the fiscal front[5], according to the Ministry of Finance's latest updates, total revenue including grants decreased marginally from 38% of GDP in 2011/12 to 37.9% of GDP in FY 2012/13. Similarly, total expenditure also decreased from 39.2% of GDP in 2011/12 to 38.8% of GDP during 2012/13 driven by a decrease in current expenditure to 18.7 % of GDP compared to 19.4% of GDP in the previous year. On the other hand capital expenditure witnessed an increase from 19.8% of GDP to 20.1% of GDP in the previous year. During the FY 2012/13, of the total revenue (including grants), domestic revenue collection totaled Nu.21.9 billion (an increase of Nu.1.7 billion from the previous year's collection) and was more than sufficient to finance current expenditures (Nu.18.6 billion). Grants financed over 40.9% of total expenditure during the FY 2012/13. As a result, during the FY 2012/13, the **national budget deficit** improved to 0.9% of GDP from 1.2% of GDP in the previous year.

5 Source: Ministry of Finance, National Budget Report 2013-2014.

II. Bhutan's International Reserve Status at a Glance[6]

Table 1. Bhutan's CC and INR Reserves Indicators, 2013-2014

Particulars	*(USD/INR millions)*				
	Q1 (Mar'13)	*Q2 (Jun'13)*	*Q3 (Sept'13)*	*Q4 (Dec'13)*	*Q1 (Mar'14)*
1. **Total Reserves**	**957.3**	**938.4**	**831.0**	**933.1**	**965.4**
Gross CC reserves	916.3	743.8	762.5	833.8	873.4
Gross INR reserves	2,233.4	11,352.2	4,300.4	6,160.2	5,532.2
2. **Net INR position**	**(1,250.2)**	**6,000.4**	**4,300.4**	**6,160.2**	**5,532.2**
3. Gross Reserves coverage (months) of total imports (goods)	11.6	20.7	19.7	21.9	21.9
4. Gross reserves coverage of total imports(goods & services)	10.3	15.8	15.1	16.7	16.8
5. Gross reserves coverage of essential imports		24.5	20.2	22.7	23.5

1) Gross reserve figures are sourced from the RMA Monthly Bulletin. Net INR reserve position figures are equal to Gross reserve position as the ODF was fully liquidated since Q3(September 2013).
2) Reserve import coverage (goods and including services) in months, source: RMA Monthly Bulletin.
3) The essential imports figure of USD 448.9 million was applied with incremental growth of 10% during FY 2013/14 as defined by the March 2012 Indian Rupee Taskforce.

Table 2. Bhutan Reserve Position: May 31, 2014

Particulars	
1. **Total Reserves (USD millions)**	**1,071.2**
2. **CC Reserve Position (USD millions)**	**836.4**
Royal Monetary Authority	*780.0*
Commercial Banks	*56.5*
3. **Net Rupee Position (INR millions)**	**13,858.5**
Of which, Commercial Banks' Holdings	*893.4*

6 Source: FXD, RMA.

Table 3. Timeline: GoI SCF and ODF

1993	GoI SCF – INR 100 million
1994	GoI SCF enhanced to INR 250 million
1998	SBI ODF – INR 800 million
1999	GoI SCF of INR 250 million liquidated
2003	SBI ODF enhanced to INR 2 billion
2007	SBI ODF enhanced to INR 4 billion (sold USD 25 million)
2009 (Mar)	GoI SCF – INR 3 billion – fully utilized
2010 (Jul)	SBI ODF enhanced to INR 5 billion
2011 (Jun)	SBI ODF enhanced to INR 6 billion
2011 (Jul)	SBI ODF enhanced to INR 7 billion
2011 (Aug)	SBI ODF enhanced to INR 8 billion
2011 (Dec)	Sold USD 200 million to liquidate SBI ODF – INR 8 billion
2012 (Mar)	SBI ODF enhanced to INR 10 billion
2012 (May)	PNB ODF limit of INR 2 billion
2012 (Jun)	PNB ODF enhanced to INR 5 billion
	Additional GoI SCF of INR 3 billion; fully utilized
2013 (Jan)	Sold USD 36.84 million (*World Bank Development Policy Credit II received as budgetary support to RGOB*); fully utilized
2013 (Mar)	INR SWAP with RBI – INR 5.4 billion; fully utilized
	Additional GoI SCF – INR 4 billion; fully utilized
2013 (Jun)	Sold USD 200 million

Table 4. Summary of Major INR Inflows/Outflows: June 2013 to March 2014 (INR Millions)

Particulars	Apr-Jun'13	Jul-Sept'13	Oct-Dec'13	Jan-Mar'14
Inflows	**20,845.4**	**14,370.3**	**19,147.1**	**23,785.6**
Commercial Banks	4,082.1	5,531.9	11,792.3	14,448.4
GoI Grants	16,230.7	425.0	1,870.0	8,713.8
Interest Income	0.0	110.5	78.4	75.3
Hydro-Project Export Proceeds	532.6	4,477.88	5,406.37	548.1
Outflows	**18,493.0**	**13,999.7**	**13,652.1**	**16,816.5**
Industry	3,385.7	2,265.0	2,618.0	3,059.3
Hydro Projects	5,916.9	4,254.2	2,946.8	3,906.9
Govt & Corporations	1,241.1	921.3	1,054.8	1,010.7
Remittances	575.6	447.4	476.6	398.0
Card Payments	632.3	640.6	1,093.1	1,328.2
Fuel	2,015.9	1,854.0	2,000.4	2,193.0
Interest Expenses	330.7	126.0	124.7	123.3
ODF	*131.9*	*0.0*	*0.0*	*0.0*
GoI LoC & SWAP	*198.8*	*126.0*	*124.7*	*123.3*
Other Imports	4,394.8	3,491.3	3,337.8	4,797.1
Net Rupee Flows (+/-)	**2,352.4**	**370.6**	**5,495.0**	**6,969.1**

Notes:
1) *Quarterly data flows sourced from the FXD, RMA.*
2)*All flows pertain to transactions only carried out through the banking system (RTGS), and therefore exclude all INR transactions in cash issued over the banking counters.*
3)*Other Imports include meat, footwear, vegetables, garments,vehicle spare parts, groceries, and ticketing etc. and EMFC includes education,medical, fees and commission.*

III. RMA Monetary Policy Operations: FY 2012/13-FY2013/14[7]

Review of Key Financial Sector Developments and Reforms

9. The RMA undertook numerous financial sector reforms during the year aimed at supporting and strengthening financial sector stability and growth. These included the establishment of the Central Registry for movable properties in September 2013 to facilitate secured credit transactions and secured creditors' rights as provided under the Movable and Immovable Property Act, 1999. Besides enabling creditors to register movable assets, which will facilitate smooth credit appraisal process to the foreclosure of bad loans, it will also enable the public and entities to enquire any lien by any creditor on all kinds of movable assets with which they intend to transact.

10. During the year, several key financial sector regulations were issued by the RMA, including the Anti-Money Laundering and Combating the Financing of Terrorism (AMT/CFT) Regulations, Credit Information Bureau Regulations, Loss Adjuster Regulations, and Fund Management Regulations.

11. Meanwhile, the RMA continues to play a vital role in the development of Bhutan's capital market as the Securities Commission and supporting the Royal Securities Exchange of Bhutan Ltd (RSEBL) through financial and infrastructure assistance. Capital market reforms are crucial to strengthening the potential and scope of the private sector. This assumes added significance in light of the current challenges facing the Bhutanese economy as we strive to diversify and boost domestic capacity to meet aggregate demand. The RMA in collaboration with the RSEBL and with technical assistance from the Asian Development Bank (ADB) is currently working on the preparation of a Capital Markets Development Master Plan and is drafting Credit Rating Agency Regulations. Similarly, a regulatory and supervisory framework for the fund management industry is under review while the RSEBL works on the development of an Agricultural Commodity Exchange.

12. Following the global financial crisis of 2008-2009, financial stability has been the main focus of policy reforms across the globe. The RMA with assistance from the ADB is in the process of strengthening and enhancing the foundations for financial sector monitoring, surveillance and mitigation of risks to financial stability in Bhutan. Under a two-year ADB TA for Supporting Financial Stability (2013-2015), the RMA in collaboration with the financial institutions will be issuing several Macro-Prudential Regulations (covering areas such as countercyclical buffers for banks, sectoral capital requirements and time-varying capital provisioning etc.) during 2014 to improve timely recognition of financial vulnerabilities across the financial system, deal with asset-liability mismatches and insulate against growing systemic risks.

7 Please see Annex 2 for supplementary data.

13. Besides Macro-Prudential Regulations, the RMA has plans to introduce Deposit-Taking Micro Finance Regulations and Non-Deposit Taking Micro Finance Regulations. The drafts of these Regulations, currently in the public domain for comments, shall be submitted to the RMA Board for final approval during 2014. Once endorsed and implemented, these regulations will help streamline and promote access to finance for cottage, small and medium scale industries (CSMI) in Bhutan. Improving and facilitating micro finance under the national Financial Inclusion Policy is a key priority for the RMA and RGOB; access to finance was identified as one of major constraints for CSMIs as per the Enterprise Survey, 2011.

14. Ongoing financial literacy initiatives and programs conducted by the RMA have recently targeted Bhutan's youth to increase awareness on the importance of financial inclusion and education. During March 2014, the RMA organized Global Money Week in partnership with the financial institutions in Paro and conducted interactive sessions with selected schools on the importance of money, savings, the difference between "wants" and "needs", insurance, social security, rights of the customers while dealing with financial institutions, creating livelihoods, gaining employment, and entrepreneurship. Financial literacy materials were distributed and fast track services were provided by the BNBL in opening saving and piggy bank accounts for children.

Role, Functions and Instruments of the Royal Monetary Authority

As stipulated in the RMA Act 2010, the primary function and objective of the RMA is to formulate and implement monetary policy with a view to achieving and maintaining price and financial stability (Chapter II, Section 7). Other secondary objectives that evolve around the primary objectives are to: a) formulate and apply financial regulations and prudential guidelines to ensure the stability and integrity of the financial system as empowered by the Act; b) promote an efficient financial system comparable to international best practices; c) promote, supervise and, if necessary, operate national and international payment and settlement systems including the electronic transfer of funds by financial institutions, other entities and individuals; d) promote sound practices and good governance in the financial services industry to protect it against systematic risks; and e) promote macro-economic stability and economic growth in Bhutan.

It is important to note that the RMA's monetary policy works largely via its influence on aggregate demand in the economy and has a limited role in explaining the dynamics of domestic supply and structural bottlenecks. The RMA pursues a multi-faceted monetary policy strategy aimed at stability in the credit and financial markets, domestic inflation and growth. This requires the monitoring and analysis of movements of a number of macro indicators including broad money supply, interest rates, credit growth, inflation, trade, capital flows and the fiscal position, along with trends in output. Moreover, the RMA also places large emphasis on financial inclusion and financial literacy programs in collaboration with the government and international development partners including the World Bank.

In the pursuit of monetary policy, the RMA uses the following tools to manage and influence key macroeconomic variables that impact macroeconomic trends and development in the country.

- ***The CRR and SLR:*** *Changes in the CRR and SLR addresses non-autonomous, structural mismatches in the liquidity conditions of the economy (such as large mismatches in the growth of domestic deposits, domestic credit and domestic investment).*

- ***Base Rate:*** *The base rate provides a broad framework for assessing the cost of funds for commercial banks. Changes in the monetary policy stance signaling through base rates of the commercial banks influence lending and the deposit rates of the financial sector, thereby having some impact on savings and investment levels in the economy.*

- ***RMA Short-term Liquidity Adjustment Window Facility (RSTLAW):****The RSTLAW provides short-term funds to liquidity-deficient banks to meet daily operational requirements and short term outstanding liabilities; and not for long term lending activities; this is to ensure that liquidity injected through the RSTLAW are prudently utilized and not directed towards further credit creation.*

- ***Policy Rate:*** *Unlike the two facility window corridor on deposits and lending as in neighboring India, the RMA operates a single lending facility currently through the RSTLAW. This facility is normally used to address autonomous frictional liquidity mismatches that occur due to (i) liquidity pressures originating from currency demand which is periodic and seasonal in nature; (ii) changes in commercial banks reserve levels and cash balances maintained with the RMA and, (iii) changes in the government cash balances at the RMA.*

- ***Open Market Operations (OMOs):*** *OMOs are conducted through periodic auctioning of government Treasury Bills. Treasury Bills are issued (i) to help finance the short term fiscal deficit of the government and (ii) towards liquidity sterilization for monetary policy purposes. Similar to the policy rate, OMOs are more often used to meet shorter-term structural liquidity mismatches than the CRR.*

- ***Macro-Prudential Measures:*** *Other instruments at the discretion of the RMA include the enforcement of macro-prudential measures and guidelines as embodied in the RMA's Prudential Regulations 2002, to influence the operations of depository institutions, as well as the prudent management of country's foreign exchange balances. Additionally, through moral suasion, the RMA appeals to financial institutions to collectively shoulder social responsibility and operate in a manner that supports the overarching economic policies of the government aimed at poverty reduction and sustainable socio-economic growth.*

Monetary Policy Operations: Addressing External Sector Imbalances and Enhancing Reserve Management Operations

15. In light of continued demand-side external account pressures warranting continued aggregate-demand policy intervention to keep prospective credit growth in check, the RMA's monetary policy stance continued to remain tight during first half of 2012/13. The RMA continued to maintain its vigil on developments in money and credit markets, with focus on effective management of demand and supply of market funds geared towards building productive capacity in the economy. Meanwhile, maintaining a sustainable level of growth and minimizing external sector imbalances through prudent management of international reserves and short term Rupee debt are viewed equally critical for sustainable economic development in the medium to long-term.

16. During the year, the RMA faced limited options when dealing with acute banking sector liquidity constraints and mounting Rupee outflow pressures. As remedial action, the RMA implemented several corrective policy measures to slow aggregate demand while safeguarding the financial sector from unwarranted risks and vulnerabilities. Dealing with the twin problem of huge Rupee outflows and tight domestic financial sector liquidity, the RMA lowered the CRR twice during 2012 while at the same time restraining credit flows channeled through import-oriented sectors including the transport and housing sectors which contribute to large Rupee outflows and external sector imbalances with India. These measures were necessary at the time due to the substantial, costly and growing short-term Rupee borrowings by the central bank. Despite these measures, however, large interest payments associated with the short-term Rupee borrowing from Indian commercial banks continued to burden the RMA during the second half of 2012.

17. Demand-side management implemented by the RMA, has produced a gradual albeit marginal slow-down in the growth of key monetary aggregates along with movements of key policy variables and economic variables (see Table on page 19). In summary, changes in policy variables and monetary as well as foreign exchange measures taken by the RMA have resulted in the following outcomes:

(i) *Lowering of the CRR helped ease financial sector liquidity constraints without resulting in an automatic pick-up in growth of credit to the private sector during FY 2013/14;*

(ii) *The sweeping of bulky hydropower-related current accounts deposits held by banks helped prevent and minimize major distortions in monetary aggregates.*

18. Unlike the past trends in sectoral credit concentration, the composition of lending of the financial institutions to the transport sector as a percentage of overall credit also declined from 7.7% in March 2013 to 5.1% as of March 2014. During the first half of 2012/13, liquidity constraints faced by the banking sector gradually eased due to improvements in the flow of funds in the banking sector. Banking sector structural liquidity remained steady at over Nu.9 billion during March, 2014 (*Annex 2*). Strong liquidity position of the banking sector was also attributed to an injection of additional liquidity through the Economic Stimulus Plan.

19. Meanwhile, the implementation of the Base Rate System since 2012 by the financial sector has revealed some signaling effects in RMA's monetary policy transmission. Gradual movements in the lending interest rates of the financial institutions were witnessed within the span of the last two to three quarters of the year 2012/13. As of March 2014, the average retail lending rate range of the financial institutions declined to 14% from 14.6% as of March 2013, while, the average deposit rate (all deposits with varying maturities) of the commercial banks witnessed an increase from 7.65% as of March 2013 to 7.73 % as of March 2014.

20. The RMA conducted the first Bilateral Base Rate Review with the financial institutions during April 2013. Operational concerns of the banks were accommodated in the revised Base Rate Guidelines re-issued in July 2013; meanwhile, reflective of tight liquidity conditions, overall base rates for the financial system were re-calculated upwards to the range of 10.8% to 11.3%; while set at 13.2% for NBFIs. Besides providing a benchmark rate for lending to the financial institutions, the base rate system has helped financial institutions appropriately price their loan products while at the same time protecting against financing risky investment projects.

21. During May 12-14, 2014, in line with the Base Rate Operational Guidelines, the RMA conducted the Second Base Rate Review Meeting with the commercial banks. For the FY 2014, the Base Rate for the commercial banks ranged between 10.32% to 11.43% and 12% for the NBFIs. Compared to 2013, the lower limit on the base rate has fallen marginally from 10.81% to 10.32% this year mainly due to (i) the fall in CASA adjustments on account of the decline in the share of current account balances of the bank through the RMA's sweeping facility; (ii) improvements in banks' profit levels; iii) growth in the capital base of the banks; and (iv) improvements in the levels of deployable deposits of the banks.

22. And to promote the flow of credit towards priority sectors, the RMA has provided the following exemptions on the base rate framework to the financial institutions:

(i) *Loans for the agricultural sector;*
(ii) *Loans for small businesses and artisan schemes;*
(iii) *Entrepreneurship Development Program (EDP) loans;*
(iv) *Staff incentive loans;*
(v) *Loans against fixed deposits;*
(vi) *Loans which call for renewal, restructuring, enhancement and rescheduling;*
(vii) *Pension membership loans of the NPPF.*

23. As mentioned above, in an attempt to ease the current liquidity shortage and to restart lending to productive and priority economic sectors, the RMA was selected to participate in the Government-constituted Economic Stimulus Plan (ESP) Taskforce from August 2013 to draw up the ESP Strategy and Implementation Plan. INR 5 billion secured by the newly elected Government as grant support outside of the 11th FYP from the GoI, is being distributed to inject financial resources through the financial institutions towards improving financial sector liquidity levels and lending; creation of revolving funds for collateral-free lending towards cottage and small industries and non-formal rural activities (agri-based); as well as other Special Support Schemes targeting youth education and employment and senior citizen support.

24. Similarly, the RMA was also involved in the Taskforce to review selected import restrictions placed in May 2012 (on non-essential furniture, alcohol and vehicle imports). Following from the recommendations made by the Taskforce, all import and foreign exchange restrictions imposed on the import of furniture and alcohol from India and third countries were lifted by the government from February 2014.

25. The following table provides an overview of key monetary and financial policy measures taken by the RMA during the FY 2013/14:

Date	Measures Taken
With effect from December 1, 2013	In August 2013, the RMA made further amendments to the **RMA Prudential Regulations on Risk Weights.** With effect from December 1, 2013, revised risk weights shall be assigned with the new Sectoral Classification for loan portfolios designed collaboratively with the financial institutions as follows; (i) *Agriculture - 50%* (ii) *Manufacturing/Industry – 100%* (iii) *Services – 150%* (iv) *Trade/Commerce – 100%* (v) *Housing – 150%* (vi) *Transport – 150%* (vii) *Loan to Purchase Securities – 100%* (viii) *Personal Loan – 300%* (ix) *Education Loan – 100%* (x) *Loan against Term Deposits – 0%* (xi) *Loans to FIs – 100%* (xii) *Infrastructure Loan – 100%* (xiii) *Staff Loan – 50%* (xiv) *Loan to Government Owned Corporations – 20%* (xv) *Consumer Loans (GE) – 50%* These risk weights shall be assigned to each sector and reviewed after 6 months from the date of compliance. Furthermore, for sector exposures above 20%, further 50% risk weight shall apply for additional exposure.
March 2014	Ongoing **financial literacy initiatives** and programs conducted by the RMA have recently targeted Bhutan's youth to increase awareness on the importance of financial inclusion and education. During March 2014, the RMA organized Global Money Week in partnership with the financial institutions in Paro and conducted interactive sessions with selected schools on the importance of money, savings, the difference between "wants" and "needs", with financial institutions, creating livelihoods, gaining insurance, social security, rights of the customers while dealing employment and entrepreneurship. Financial literacy materials were distributed and fast track services were provided by the BNB in opening saving and piggy bank accounts for children.

Date	Measures Taken
April 2014	ADB TA 8284 **Supporting Financial Stability in Bhutan**, a two-year programme, was launched in March 2013. Key activities under the TA include (i) development of **macro-prudential policies**, tools and a monitoring framework; (ii) improving liquidity management plan and strategies; and (iii) enhancing capacity building and training for central bank staff performing financial stability functions. Price Waterhouse Coopers Pvt. Ltd (PWC) Consultants have been recruited by the ADB to draft macro-prudential regulations and guidelines with the RMA. Under this TA, a Stakeholders Meeting and Workshop between the RMA and all financial institutions was conducted on April 4, 2014 in Paro to discuss the draft macro-prudential regulations including (i) Countercyclical buffer for banks; (ii) Loan-to-value and loan-to-income rules; (iii) Sectoral capital requirements; (iv) Time-varying capital provisioning; (v) Debt-to-equity ratio; (vi) Restriction on distribution of profits; and (vii) Minimum ceiling on leverage ratios. These regulations are scheduled for implementation commencing end of 2014. *Please see the RMA website for more information as presented in the **Policy Paper on Macro-Prudential Rules and Regulations.***

Key Policy Variables, Q1, 2013-Q1, 2014

Policy variable	Q1, 2013	Q1, 2014
Policy Rate	6.00	**6.00**
RSTLAW Rate	7.00	**7.00**
CRR	5.00	**5.00**
SLR	20.00	**20.00**
Term Deposit Rates	5.00-8.75	**5.00-8.75**
Base Rate*	10.81-11.25	**10.32-11.43**
Government T-Bill Rate(91 days)	3.00	**2.28**
Economic variables		
Consumer Price Index (CPI) (y-o-y)	8.37	**11.31**
Broad Money (M2, growth %)	4.58	**5.94**
Domestic Credit (growth %)[2]	12.44	**-3.10**
Of which: Credit to the Private Sector (growth %)	7.17	**6.01**
Money Multiplier (M2/Reserve Money)	3.26	**2.38**
Income Velocity (GDP/M2)	1.79	**1.69**

**/ The Base Rate for commercial banks is as of May 2014.*

26. During the first half of 2013/14, the RMA continued its efforts to improve and enhance reserve management operations by conducting an in-depth needs assessment with the IMF and the World Bank during July and September 2013. Subsequently, the RMA recently issued the newly revised Reserve Management Policy and Operational Guidelines to be submitted for review and endorsement by the RMA Board of Directors; implementation is scheduled sometime in 2014.

27. Furthermore, to strengthen international reserves management practices, the RMA has estimated an operational reserve threshold based on 11 FYP forecasts of Convertible Currency (CC) reserves and provisioning adequate CC reserves to cover the Constitutional requirement, future external debt service obligations and other essential CC denominated expenditure over the plan period. The main objectives of identifying a minimum operational reserve threshold is to (i) ensure effective management of available foreign exchange reserves without frequently resorting to expensive ODF; (ii) establishing an operational window facility for the RMA's INR management; and (iii) harnessing better returns and minimizing the opportunity cost of holding excess reserves especially during favorable times. This operational reserve threshold has been endorsed by the RMA Board of Directors in December 2013.

28. As of May 31, 2014, Bhutan's International Reserves stood at USD 1.1 billion sufficient to cover 14.6 months of total merchandise imports of goods and 26 months of essential imports[8]. Of the total reserves, USD 836.4 million was CC reserves and ₹ 13.9 billion Indian Rupee reserves. Notably, the RMA, in its exercise of prudent reserve management of Bhutan's limited international reserves shall evaluate its reserve component and sell CC reserves for Indian Rupees as and when necessary and when market conditions are deemed favorable. This will also reduce dependence on costly short-term Rupee borrowings through the overdraft facilities.

29. It has been two years since the introduction of Rupee measures in 2012 by the RMA and as constantly iterated, the policy imperative today remains on ensuring that long-term supply-side policy measures take center stage. Bhutan still faces numerous structural weaknesses and challenges that needs close attention to ensure long term sustainability. The economy can no longer be sustained on the back of a single economic sector although hydropower development remains a vital catalyst for socio-economic development. In light of our vulnerabilities and exposure to potential external shocks, longer term strategies are needed for structural transformation of our economy, by strengthening agricultural

8 This is calculated based on the value of essential imports of USD 448.9 million with incremental growth of 10% during FY 2013/14 as defined by the March 2012 Indian Rupee Taskforce.

productivity and marketing, as well as boosting the contribution of value added production and services.

30. Therefore, moving forward, in the interest of supporting sustainable macroeconomic growth and financial system soundness, the RMA is hopeful, especially after recent discussion and dialogue between the RMA and the Ministry of Finance earlier this year regarding the phasing out and replacement of RMA temporary credit and Rupee measures mid-2014, and the recent introduction of fiscal measures to discourage non-essential imports.

IV. Medium Term Outlook for Bhutan: FY 2013/14 - 2015/16[9]: *Risks and Challenges*

Macroeconomic forecasts for Bhutan's medium-term are prepared by the multi-sectoral Macroeconomic Framework Coordination Technical Committee (MFCTC) taskforce and endorsed by the high-level Macroeconomic Framework Coordination Committee (MFCC), chaired by the Finance Secretary, and comprising executives from various government departments and the RMA. The compilation of macroeconomic and fiscal projections involves estimating revenues, issuing a statement of strategic fiscal policy, and establishing a budget envelope for the medium-term period. Careful monitoring of possible policy changes is vital to prepare and address emerging issues in the Bhutanese context, where a few variables can have a dramatic effect on the overall macroeconomic and fiscal picture.

31. With some improvement in the momentum of activities in industry and services sector the GDP **growth** forecast for FY 2013/14 is expected to slightly improve to 6% from 4.2% in the previous year. However with activities in construction still expected to be very sluggish, partly because of the credit measures that were taken and also because of the postponement of the construction of five new hydropower projects, real GDP growth is expected to remain at around 6% during the medium term.

32. Globally, **inflationary** pressures are expected to remain contained although much more elevated than in the recent past. A decline in the prices of commodities especially that of fuel and food have been a major force behind disinflationary trends across the globe (IMF World Economic Outlook, April 2014). Similarly in India, the CPI inflation declined to a 25-month low of 8.1% in February 2014 driven mainly by the sharp disinflation in food prices. However, the prices of some of the food items have started to firm up recently (RBI Monetary Policy Statement 2014-15, April 2014). With inflation in Bhutan closely tied to inflation in India, Bhutan's CPI inflation moderated from 11.3% in the last quarter of 2013 to 9.5% in the first quarter of 2014, and is further expected to remain between 7% and 8% in the medium term.

33. Over the medium term, the **current account deficit** will continue to rise as imports continue to grow at a faster pace than exports. Although a slowdown in hydro-related imports is expected towards the end of the medium term, Bhutan's trade deficit is expected to persist due to the large and sustained growth of non-hydro imports that are not offset by the increase in hydro exports. While hydro imports are expected to slow down with a medium-term average of Nu.20 billion per annum, non-hydro imports are expected to

9 Please see Annex 3 for a summary of Bhutan's macroeconomic projections from FY 2011/12. Please note that macroeconomic projections are subject to sector-wise revisions as and when new data is available, thereby potentially generating variations in different forecasts published.

grow and average around Nu.34 billion per annum over the medium term. Hydro exports are expected to improve slightly averaging at around Nu.12 billion per annum. Meanwhile, Bhutan's current account deficit is expected to worsen during the medium term reaching 30.6% of GDP by 2015/16.

34. Official inflows in the form of **capital transfers** (grants for hydropower development) and external loans of the RGOB are expected to continue to finance the current account deficit. Consequently, with anticipated surpluses in the capital and financial account, Bhutan's **overall balance** is forecast to be positive in the medium term implying growth in the nation's **gross international reserves** (USD 1,312.9 million by the end of 2015/16).

35. On the domestic front, the **fiscal deficit** is expected to decrease to 2.7% of GDP by FY 2014/15 from 4% of GDP in FY 2013/14. A positive fiscal balance of 0.1% of GDP is expected in 2015/16. **Domestic revenue receipts** are expected to average 18.5% of GDP over the medium term while **capital expenditure** is expected to average 14.4% of GDP.

36. Launched for the first time in 2012/13, Bhutan's BOP statistics have been revised in line with IMF BPM6 methodology (from reference FY 2006/07 onwards), replacing BPM5 methodology. Revisions were made under the 3-year IMF project funded by the Government of Japan Sub-Account to improve external sector statistics (IMF-JSA Project). The IMF-JSA Project is aimed at improving the quality of external sector statistics in the Asia Pacific region and also includes other improvements in data coverage and classifications that were carried out in 2013. Bhutan is currently being regarded as one of the success stories in the implementation of the IMF-JSA project. The following box highlights the major changes made to Bhutan's new data series.

Summary of Changes in Bhutan's New BOP Data Series

Featured first in the RMA Annual Report for FY 2012/13 (January 2014)

- ***Imports from countries other than India*** *have been converted from c.i.f. to* ***f.o.b. basis****. In consultation with the DRC, 20% of imports have been reclassified to freight (transportation services) and 1.125% to insurance services.*
- *Grants received by the RGOB as budget support were previously classified entirely as current transfers (secondary income in BPM6). Such* ***budgetary grants*** *have now been segregated based on purpose with all grants for* ***investment purposes to finance gross fixed capital formation*** *reclassified from the secondary income account into the Capital account as* ***capital transfers****.*
- *In line with the principle of accrual accounting of the BOP,* ***accrued interest*** *on existing* ***Indian Rupee denominated hydropower loans*** *have been recorded in the primary income account (debit) as well as to loan liabilities in the financial account. (Data will therefore, not be comparable to the ones published by the Ministry of Finance).*

- *Revisions have been made in the methodology to calculate the debit items for **compensation of employees** and **workers' remittances** affecting data for FY 2012/13. Until last year, old estimates were either being inflated annually or ratios applied to total external aid. From this year however, information on numbers and salaries of foreign workers from the Department of Immigration and the MoLHR have been used to estimate the debit items for compensation and remittances as well as to estimate **business travel credits** (acquisition of goods and services by short term workers).*

- ***Trade credits**, which represented an important data gap in the past, are now being included for all sources that report transactions in trade credits.*

- *Reserve assets **exclude US Dollar deposits that were pledged on the Indian Rupee overdraft facility** from the SBI and PNB by the amount of outstanding overdraft during the relevant reference period. The equivalent US Dollars of the outstanding overdraft was considered to be encumbered assets and reclassified under other investments.*

- *BPM6 **sign convention** has been adopted for **all** the components of the BOP from FY 2006/07; the table below shows the changes in sign convention between BPM5 and BPM6:*

Item	*BPM6*	*BPM5*
Current and capital accounts	*Both credits and debits are recorded with **positive** signs*	*Credits "+" and debits "-"*
Financial account	***Increases** in assets & liabilities "**+**" and **decreases** in assets & liabilities "**-**"*	*Increases in assets & decreases in liabilities "-" and decreases in assets & increases in liabilities "+"*
Financial account balance (net lending (+) / net borrowing (-) in BPM6)	*Calculated as change in assets **minus** liabilities*	*Calculated as change in assets plus liabilities*

- *Reclassifications that were required in line with BPM6 have been made although the resulting changes have not been significant because of minimal transactions in the reclassified items.*

Outlook and Risks for India
(FY 2014/15)

The Reserve bank of India anticipates a modest recovery in 2014-15 with a pickup in GDP growth from a little below 5% in 2012/13 to a range of 5-6%, contingent upon the desired downward trajectory of inflation. Economic activity is expected to improve over the previous year with the easing of domestic supply bottlenecks, progress on the implementation of stalled projects that have been cleared, and stronger anticipated export growth when the world economy improves, in addition to improved business and consumer confidence.

Downside risks to growth continue to be tight global financial and monetary conditions, fiscal adjustments in some countries and the challenges of maintaining a disinflationary momentum. Since April 2014, given the subdued consumption and investment demand reflected by the fall in output of consumer durables and capital goods, industrial activity remains stagnant with sluggish exports and other services. Largely, growth prospects remain contingent on improvements in the domestic investment climate.

Headline CPI inflation had moderated in recent months, mainly driven by seasonal correction in vegetable prices. In March and April 2014, CPI headline inflation grew on the back of a sharp increase in food prices, especially that of fruits, vegetables, sugar, pulses and milk. It is expected that some of these pressures shall continue into May but shall be seasonal. CPI inflation excluding food and fuel has moderated gradually since September 2013 although remains elevated. A sub-normal or delayed south-west monsoon and its spread could give rise to upside inflationary risks as could geo-political tensions and its impact on fuel prices.

India's external sector risks have lowered, allowing monetary policy to focus on the core objective of lowering inflation and supporting growth. During FY 2013-14, India's current account deficit narrowed sharply to 1.7% of GDP after a historical high during the previous year. This was primarily on account of higher exports helped with the depreciation of the Indian Rupee and a moderation in imports, largely the decline in gold imports since July 2013 and stable international crude oil prices resulting in a contained POL import bill. Robust inflows of portfolio investment supported by FDI and ECB helped add to reserves. It is projected that the current account deficit for the year as a whole shall be about 2%, although it remains to be seen whether the current gain in global trade and India's prospects for exports shall improve further.

The RBI is committed to keeping India's economy on a disinflationary course taking CPI inflation to 8% by January 2015 and 6% by January 2016. For now, the central bank shall maintain its monetary policy stance (policy rate at 8%), monitoring liquidity conditions to ensure adequate flow of credit to productive sectors, unless disinflation is faster than anticipated which would then provide more headroom for further policy easing. As of April 2014, the RBI has introduced reductions in the SLR, opened India's domestic exchange traded currency derivatives market to foreign portfolio investors and raised limits on foreign exchange remittances.

Forecast of Selected Economic Indicators

	2013-14	2013-14	2014-15			
	Annual	**Q4**	**Q1**	**Q2**	**Q3**	**Q4**
Real GDP growth rate (%)	4.7	4.9	5	5.3	5.7	5.9
Inflation, WPI (avg %)	6	5.2	5.8	4.6	4.9	6.0
Exchange Rate (INR/USD) end of period	-	-	61.0	61.0	61.0	59.8

1. Forecast are based on the latest round of projects
2. India's fiscal year runs from April to March

Source: RBI Macroeconomic and Monetary Developments 2014-15, April 2014, and RBI Monetary Policy Statement 2014-15, April, 2014

ANNEX 1

BHUTAN: KEY ECONOMIC INDICATORS

Indicator	2009/10	2010/11	2011/12	2012/13	Mar'14
GDP Growth and Prices (% change)					
GDP at Constant (2000) Price (a), (b)	6.7	11.7	8.6	4.6	n/a
Consumer Prices (c)	6.1	8.3	13.5	5.5	9.5
Producer Price Index (d)				(0.2)	n/a
Wholesale Prices (India) (e)	10.6	9.9	7.4	4.9	5.2
Government Budget (in millions of Nu.) (f)					
Total Revenue and Grants	30,990.7	28,171.8	32,646.4	37,648.2	n/a
Of which: Foreign Grants	11,118.9	10,497.7	12,501.5	15,798.6	n/a
Total Expenditure and Net Lending	29,888.9	29,842.4	33,688.0	38,604.4	n/a
Current Balance	6,969.1	2,938.9	3,439.2	2,636.0	n/a
Overall Balance	1,101.8	(1,670.7)	(1,041.7)	(956.2)	n/a
(In % of GDP)	1.8	(2.3)	(1.2)	(0.9)	n/a
Money and Credit (% change, end of period)					
Broad Money, M2	30.1	21.2	(1.0)	18.6	5.9
Credit to Private Sector	40.7	29.4	30.1	7.1	6.0
Interest Rates (%, end of period)					
One Year Deposits	4.8	5.3	5.0-6.0	5.0-6.5	5.0-6.5
Lending Rate (*)	10.00-16.00	10-16.0	10.4-16.0	11.5-16.0	11.7-16.0
91-day RMA Bills/ Treasury Bills	2.0	2.0	4.1	3.0	2.3
Balance of Payments (in millions of Nu.) **					
Trade Balance	(12,568.3)	(20,835.3)	(19,880.6)	(19,441.6)	n/a
(In % of GDP)	(20.5)	(28.7)	(23.1)	(19.5)	n/a
With India	(5,855.3)	(15,160.0)	(12,795.1)	(17,265.4)	n/a
Current Account Balance	(14,863.5)	(23,621.4)	(19,774.3)	(24,892.2)	n/a
(In % of GDP)	(24.3)	(32.6)	(23.0)	(25.0)	n/a
With India	(9,211.2)	(18,171.5)	(15,685.8)	(26,504.9)	n/a
(In % of GDP)	(15.0)	(25.1)	(18.3)	(26.7)	n/a
RGOB Loans, net (including hydropower)	4,359.0	11,974.7	11,435.1	18,454.7	n/a
Of which: India	1,293.2	7,376.8	9,878.4	14,798.4	n/a
Errors and Omissions	3,354.0	(1,823.4)	(9,271.4)	2,395.9	n/a
Overall Balance	4,410.0	797.5	(9,068.4)	9,212.2	n/a
(In % of GDP)	7.2	1.1	(10.6)	9.3	n/a
External Indicators (end of period)					
Gross Official Reserves (in millions of USD)	-	-	-	916.9	965.4
(In months of merchandise imports)	0.6	0.2	0.5	12.6	21.9
(In % of external debt)	-	-	-	57.1	58.3
External Debt (% of GDP)	66.6	79.5	87.4	96.5	100.2
Debt-Service Ratio (including overdraft) (g)	29.7	51.7	127.1	213.8	30.3

Indicator	2009/10	2010/11	2011/12	2012/13	Mar'14
Memorandum Items:					
Nominal GDP (in millions of Nu.) (a), (b)	61,223.5	72,496.6	85,913.0	99,455.0	n/a
Ngultrum per USD (period average)	46.7	45.3	50.3	54.9	
Money Supply, M2 (end of period)	41,778.7	50,639.8	50,122.9	59,451.2	58,876.3
Money Supply, M1 (end of period)	22,537.7	30,270.3	31,960.2	37,794.1	34,175.2
Counterparts (in millions of Nu)					
Foreign Assets (Net)	34,918.5	35,144.5	35,168.6	48,566.4	51,837.5
Domestic Credit	23,136.5	30,705.7	46,466.1	52,432.3	51,202.9
Claims on Private Sector	25,994.0	33,625.2	43,734.6	46,824.6	48,817.4
Components (in millions of Nu)					
Currency Outside Banks	5,386.5	6,893.7	6,390.7	5,681.2	5,246.6
Demand Deposits	17,151.2	23,376.6	25,569.5	32,112.9	28,928.5
Quasi-Money	19,241.0	20,369.5	18,162.7	21,657.1	24,701.1
Reserve Money , M0, of which	20,574.7	19,727.6	16,743.1	23,997.4	24,727.9
Banks' Deposits	14,683.9	11,927.4	9,397.7	16,607.6	17,305.3
Money Multiplier (M2/M0)	2.0	2.6	3.0	2.5	2.4
Income Velocity (GDP/M2)	1.5	1.4	1.7	1.7	1.7
Population Growth Rate (a), (h), (i)	1.3	1.8	1.8	1.9	n/a
Unemployment Rate (a), (i)	4.0	3.3	3.1	2.1	n/a

a) On a calendar year basis, e.g., the entry under 2012/13 is for 2012. b) Source: National Accounts Statistics 2013, NSB. c) The CPI reflected in this table is for the last quarter of each fiscal year. As of the second quarter of 2013, the NSB has increased the weight of food in the CPI from 31.67% to 39.92%, and correspondingly decreased the weight for non-food from 68.33% to 60.08%. d) The first PPI bulletin for Bhutan was released by NSB during Q2, 2012 and the data available are year-on-year inflation. e) Source: Reserve Bank of India. Wholesale Price Index of All Commodities, Base = 2004-05. Effective August 2010, the RBI revised the base year from 1993-04 to 2004-05, creating a break in the continuity and comparison of data. The newly-recalculated WPI commences from April 2004; reference period same as for Bhutan CPI. f) Fiscal data 2012/13 are updates from the MoF. g) Debt service payments in percent of exports of goods and services. h) Data on calendar year basis; sourced from NSB. i) Updates sourced from Labour Market Information System, MOLHR. (*) With effect from September 2012, the RMA introduced the base rate system. (**) Bhutan's BOP Statisics has been revised in line with BPM6 methodology(from 2006/07 onwards), replacing BPM5 methodology. Also included other improvements and data coverage and classifications that were carried out in 2013.

Chart 1: Sectoral Growth of GDP

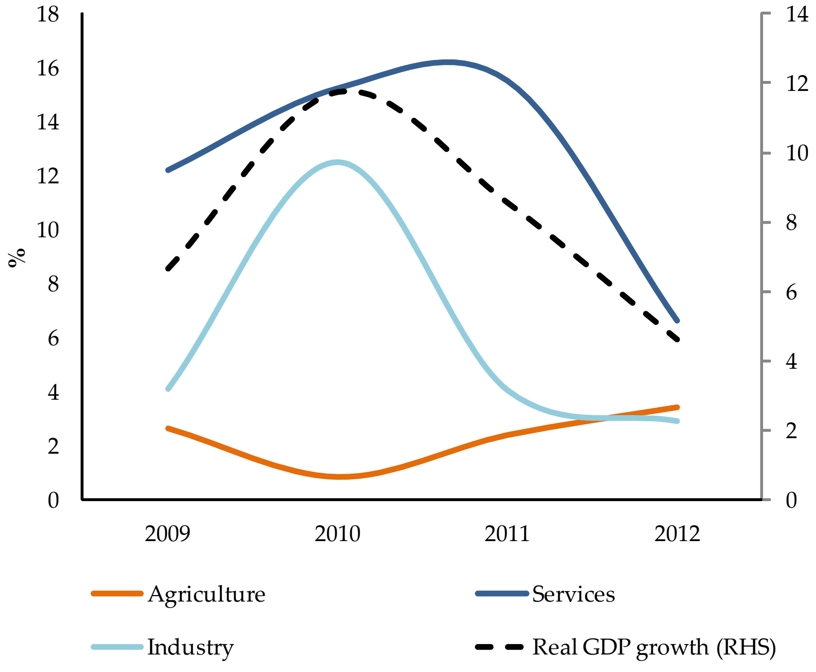


Chart 2: CPI Inflation (y-o-y)

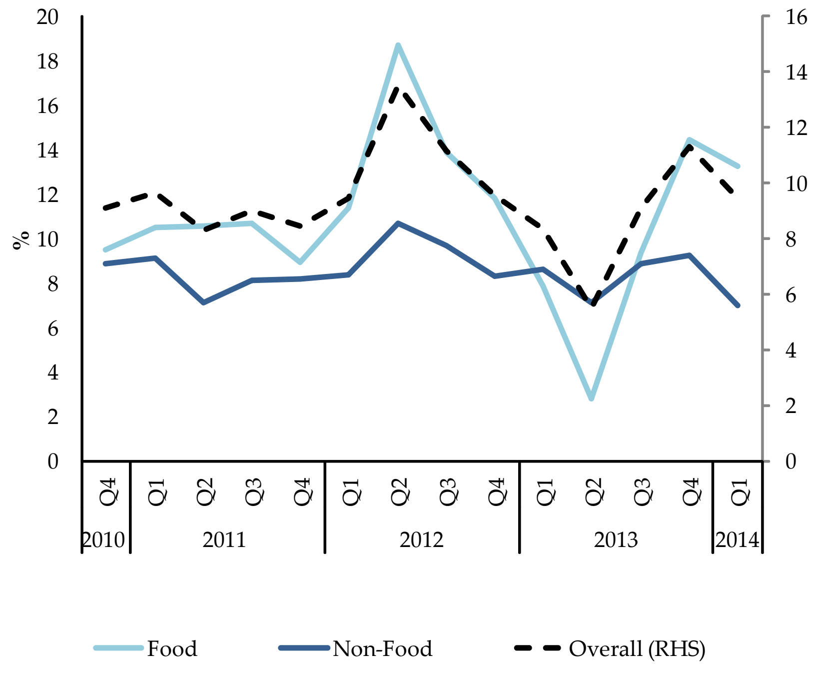


Chart 3: CPI Inflation (quarter average)

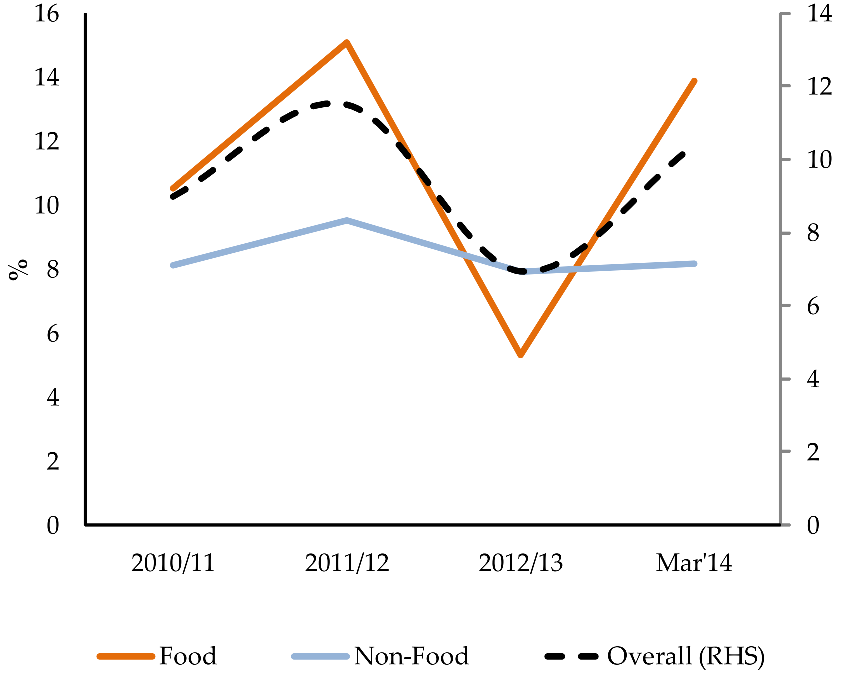
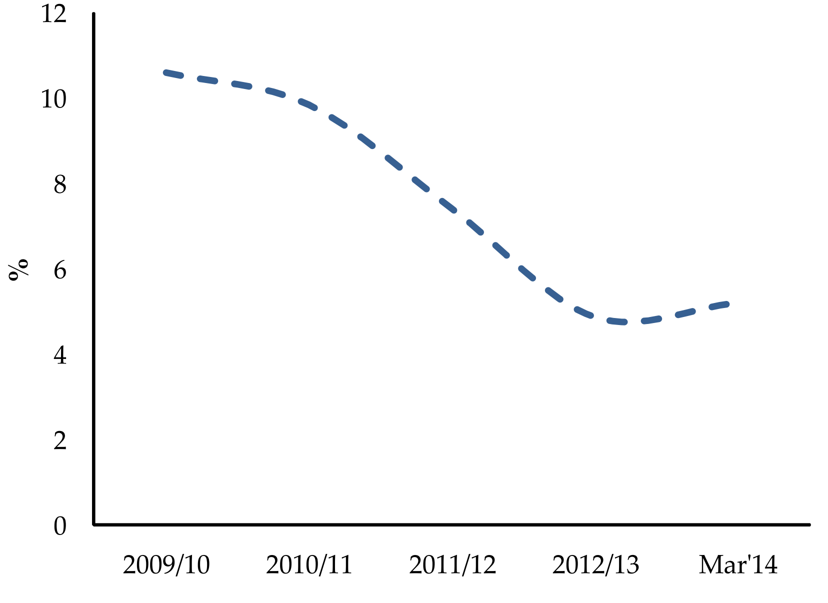


Chart 4: India WPI (quarter average)



MONETARY AGGREGATES (y-o-y Growth in %)

	2009/10	2010/11	2011/12	2012/13	Mar'14
M2	30.1	21.2	(1.0)	18.6	5.9
Reserve Money	40.0	(4.1)	(15.1)	43.3	3.0
Net Foreign Assets (% growth)	7.8	0.8	0.0	36.7	21.4
Net Domestic Assets	1,175.5	131.9	(3.4)	(25.4)	(45.3)
Domestic Credit	42.3	32.7	51.3	12.8	(3.1)
Credit to the private sector (% growth)	*40.7*	*29.4*	*30.1*	*7.1*	*6.0*
Credit to the public sector (% growth)	*(85.5)*	*662.7*	*43.4*	*53.8*	*56.0*

Source: RMA.

*) Includes only banking sector credit.

MONETARY AGGREGATES (% Share of M2)

End of the period

	2010	2011	2012	2013	Mar'14
Nu. in Millions					
M2	51,112.1	53,228.6	56,289.7	58,209.9	58,876.3
Domestic Credit	29,162.5	40,310.2	50,971.5	48,009.6	51,202.9
Credit to the Private Sector	30,808.4	40,262.5	45,158.8	48,751.8	48,817.4
% growth rates					
M2	16.5	4.1	5.8	3.4	1.1
Domestic Credit	58.9	38.2	26.4	(5.8)	6.7
Credit to the Private Sector	51.4	30.7	12.2	8.0	0.1
% share of M2					
Domestic Credit	57.1	75.7	90.6	82.5	87.0
Credit to the Private Sector	60.3	75.6	80.2	83.8	82.9
CD ratio (%)*	70.9	91.9	102.8	95.3	101.6
CA ratio (%)**	55.0	71.2	75.0	71.6	72.8

**/ CD ratio refers to credit to deposit ratio of commercial banks. This ratio is not comparable with the ratio published by the Financial Regulation and Supervision Department of the RMA, as the balance sheet data of financial corporations are classified within the framework of the Monetary and Financial Statistics Manual (MFSM 2000) of the IMF.*

***/ CA ratio refers to credit to asset ratio of commercial banks.*

Chart 5: Broad Money

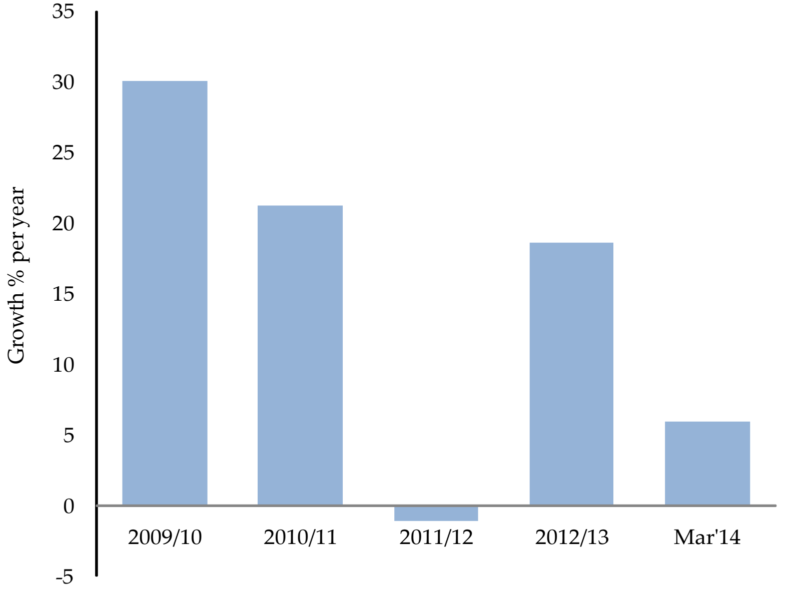


Chart 6: Domestic and Private Sector Credit

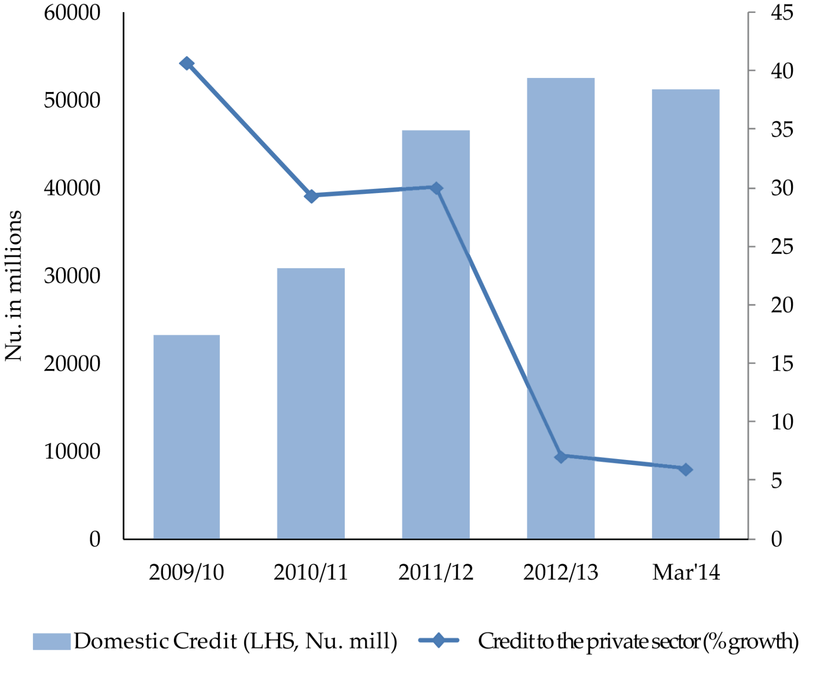


Chart 7: Net Foreign Assets

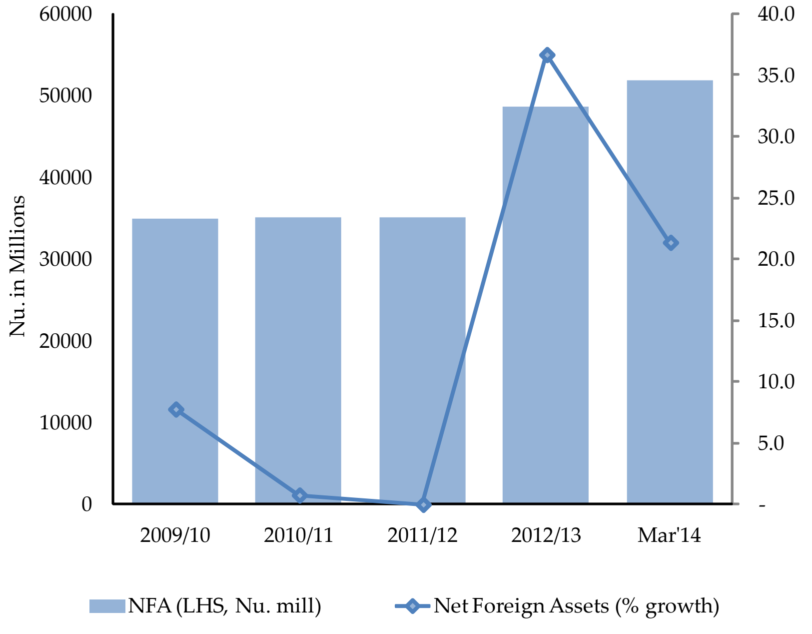
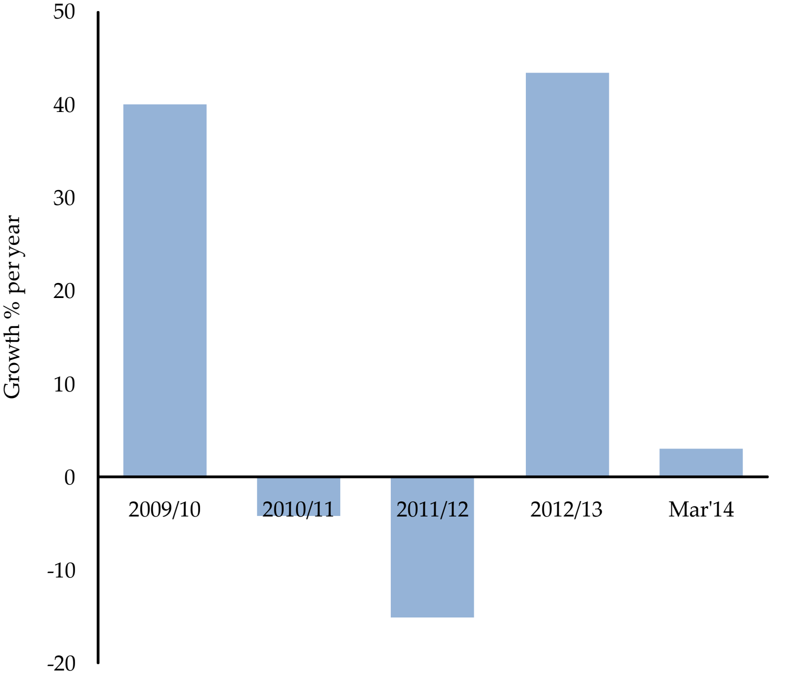


Chart 8: Reserve Money



SECTORAL CREDIT OF FINANCIAL INSTITUTIONS

June end; Millions of Ngultrums

	2010	2011	2012	2013	Mar'14	% of Total
Agriculture	492.2	657.5	1,116.1	1,514.0	2,024.5	3.4
Service and Tourism	4,352.8	4,889.8	6,164.1	6,667.7	7,215.2	12.2
Manufacturing	5,085.8	7,093.3	7,827.3	10,167.9	9,990.7	16.9
Building & Construction	7,615.8	10,287.5	13,578.1	14,906.1	15,693.3	26.6
Trade & Commerce	4,761.7	5,806.6	4,262.8	6,751.5	8,253.3	14.0
Transport	2,298.7	4,042.9	4,881.9	3,739.1	3,010.2	5.1
Personal Loans	4,552.5	6,516.0	8,334.7	10,013.2	10,860.4	18.4
Loan Against Shares	201.9	255.6	522.0	557.3	631.0	1.1
Government (Short term loans)	-	-	-	1,356.7	-	-
Credit Card	-	6.6	7.1	7.7	7.7	0.0
Others*	414.4	1,089.9	4,611.1	1,096.9	1,272.4	2.2
Total Loans of FIs	**29,775.9**	**40,645.6**	**51,305.2**	**56,778.3**	**58,958.7**	**100.0**

Source: Financial Institutions (excluding NPPF)

**) Others includes Staff Loans, Entrepreneur Development Program and Small Business and Artisan Schemes.*

NON-PERFORMING LOANS OF FINANCIAL INSTITUTIONS

June end; Millions of Ngultrums

Sector	2010	2011	2012	2013	Mar'14	% of Total
Agriculture/Animal Husbandry	110.0	131.2	166.3	218.2	329.5	3.9
Trade & Commerce	216.0	625.2	434.5	1,812.9	2,005.5	32.8
Manufacturing/Industry	244.5	546.1	542.3	843.1	736.2	15.2
Service & Tourism	424.4	255.1	455.2	476.4	819.9	8.6
Housing	726.0	436.6	503.5	841.9	877.9	15.2
Transport	178.4	300.8	450.1	492.5	716.9	8.9
Loan Against Shares	1.2	7.6	1.5	8.0	35.5	0.1
Personal Loan	303.9	416.8	483.7	779.6	1,055.7	14.1
Credit Card		2.2	5.0	6.1	3.4	0.1
Others	15.3	738.0	971.8	51.0	367.2	0.9
Overdraft/Working Capital*	799.3	-	-	-	-	-
Total NPL	**3,018.9**	**3,459.5**	**4,014.1**	**5,529.7**	**6,947.6**	**100.0**
Total Loans of FI	**29,775.8**	**40,645.6**	**51,305.2**	**56,778.3**	**58,958.7**	
Total NPL Ratio	**10.1**	**8.5**	**7.8**	**9.7**	**11.8**	

**) From 2011, the figures under Overdraft/Working Capital have been allocated to the various sectors for each bank.*

Source: Financial Institutions (excluding NPPF).

SELECTED DEBT INDICATORS

	2010/11	2011/12	2012/13	Mar '14
Total External Debt Outstanding (in USD millions)	1,289.3	1,333.7	1,606.8	1,657.3
(Growth in %)	*47.6*	*3.4*	*20.5*	*3.1*
*In % of GDP **	*79.5*	*87.4*	*96.5*	*100.2*
Rupee Debt Outstanding (in INR millions)	34,062.3	45,550.9	61,341.7	62,130.3
o.w. Hydropower Debt	*24,647.5*	*32,546.3*	*44,369.0*	*50,784.6*
o.w. Overdraft	*4,914.8*	*5,156.0*	-	-
o.w. GOI Line of Credit	*3,000.0*	*6,000.0*	*10,000.0*	*10,000.0*
CC Debt Outstanding (in USD millions)	527.6	524.7	579.3	623.5
Hydropower debt (millions of Nu)**	31,376.8	41,471.7	54,561.5	61,322.8
Rupee Debt Service (in INR millions)	16,522.5	44,804.3	82,897.9	7,903.0
Interest	*1,825.6*	*2,391.0*	*3,408.8*	*1,417.9*
Principal	*14,696.9*	*42,413.4*	*79,489.1*	*6,485.0*
CC Debt Service (in USD millions)	21.4	22.8	22.1	16.8
Interest	*6.5*	*8.0*	*7.2*	*6.0*
Principal	*14.9*	*14.8*	*14.8*	*10.8*
Debt Service Ratio (excluding OD)	12.5	12.9	16.3	30.3
Debt Service Ratio (including OD)	51.7	127.1	213.8	30.3

Source: Department of Public Accounts, Ministry of Finance and Private Enterprises for Commercial Debt data.

* Calendar year GDP; 2012/13 value in % of 2011 calendar year GDP.

** Includes Rupee hydropower debt and convertible currency debt on the Dagachhu and Basochhu hydropower projects.

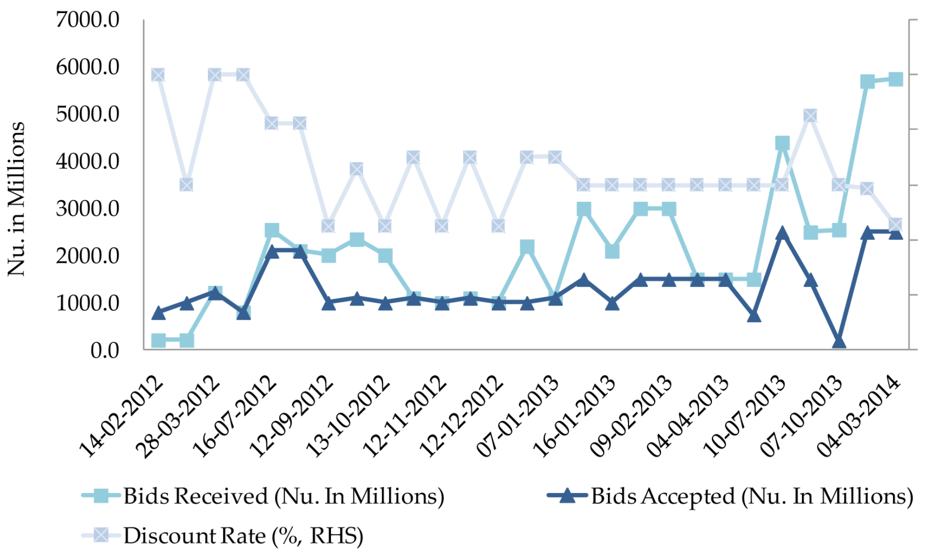
ANNEX 2

LIQUIDITY STATUS AND STERILIZATION

Items *(Nu. In millions)*	Jun'10	Jun'11	Jun'12	Jun'13	Mar'14
1. Quick Assets of Commercial Banks	13,257.2	10,131.4	14,445.3	22,826.5	22,216.2
2. Capital Fund (Tier 1+Tier 2)	5,707.0	6,382.3	10,263.0	12,441.4	13,335.0
Tier 1 Capital (Core Capital)	*4,632.3*	*5,179.0*	*7,954.6*	*10,704.5*	*11,600.9*
Tier 2 Capital (Secondary Capital)	*1,074.7*	*1,203.3*	*2,308.4*	*1,736.9*	*1,734.1*
3. Total Liabilities of Commercial Banks	50,096.4	62,694.4	62,829.2	79,337.3	79,189.7
4. SLR Position *[20% of (3-2)]*	8,877.9	11,262.4	10,513.2	13,379.2	13,170.9
Structural Liquidity *(1-4)*	**4,379.4**	**(1,131.0)**	**3,932.0**	**9,447.3**	**9,045.3**
Amount of Sterilization	**6,846.9**	**8,286.8**	**2,363.3**	**2,654.7**	**4,960.1**
CRR	*6,846.9*	*8,286.8*	*2,363.3*	*2,654.7*	*2,972.5*
RGoB T- Bills	-	-	-	-	*1,987.6*

Source: FRSD, RMA.

Chart 9: Operations of Treasury Bills



ANNEX 3

MACROECONOMIC FORECAST: FY 2012/13 – 2015/16

	2012/13	2013/14	2014/15	2015/16
	prov		*proj*	
Output and Prices				
Nominal GDP at market prices (mn. of Nu, fiscal year)	99455.0	116283.4	129831.4	143039.9
Real GDP (annual % change)	4.2	6.0	6.8	5.2
Agriculture & Allied	2.6	1.8	1.8	1.8
Industry	**4.4**	**9.2**	**8.8**	**4.2**
Manufacturing	*5.1*	*2.8*	*7.0*	*9.9*
Electricity & water	*2.7*	*8.8*	*5.4*	*1.2*
Construction	*6.9*	*15.0*	*14.0*	*3.4*
Services	**2.3**	**3.9**	**5.9**	**6.7**
CPI (annual % change)	7.6	7.6	7.6	7.6
Balance of Payments and Reserves (mn. of Nu)				
Current account balance	-24892.2	-28864.5	-38796.8	-43735.1
(in % of FY GDP)	*-25.0*	*-24.8*	*-29.9*	*-30.6*
Merchandise exports	32498.3	34743.7	39581.4	43383.2
(growth in %)	*4.8*	*6.9*	*13.9*	*9.6*
Merchandise imports (c.i.f.)	51939.9	56206.7	65944.7	75246.9
(growth in %)	*2.1*	*8.2*	*17.3*	*14.1*
Trade balance (% of FY GDP)	-19.5	-18.5	-20.3	-22.3
Current and capital grants	*22876.7*	*22640.3*	*34574.9*	*31602.2*
o.w. Budgetary Grants	*9414.8*	*8337.8*	*16712.9*	*14481.5*
Financial account balance	-17249.4	-11031.5	-29537.1	-29199.3
Overall balance (mn. of Nu)	9212.2	856.7	20884.8	12702.7
International Reserves (mn. of USD)	916.9	895.6	1177.8	1312.9
(months of merchandise imports)	*12.6*	*11.9*	*13.9*	*14.2*
National Budget (mn. of Nu)	*Actual*	*Revised*	*Proj*	
Total Resources	30656.1	33171.8	31959.3	41304.0
(in % of FY GDP)	*30.8*	*28.5*	*24.6*	*28.9*
Domestic revenue	*21101.7*	*21860.9*	*24599.0*	*25388.7*
(in % of FY GDP)	*21.2*	*18.8*	*18.9*	*17.7*
Grants	*9562.6*	*11179.8*	*7360.2*	*15915.2*
Total expenditure and Net Lending	34900.8	37773.3	35406.3	41122.1
Current	*18096.6*	*19261.3*	*21895.7*	*23403.3*
Capital	*16804.3*	*18512.0*	*13510.6*	*17718.8*
Fiscal balance	-4244.7	-4601.6	-3447.1	181.9
(in % of FY GDP)	*-4.3*	*-4.0*	*-2.7*	*0.1*

Data as of the FY ending June, including GDP which is also on FY basis. Source: MFCTC, Ministry of Finance. 1) Fiscal data for FY 2011/12: Actual figures as of date by the Ministry of Finance (MFCTC). Fiscal projection source: Ministry of Finance. Capital expenditure is inclusive of net lending. 2) BOP data source: RMA. 3) GDP and CPI data source: NSB. Note: Any data for 2011/12 in this table as a percent of GDP uses FY GDP and are not comparable with the table in Annex I which uses CY GDP. 4) Projections as of April 2014.

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