PRESS RELEASE

Monetary Policy Statement 2020
July 23, 2020

2020 is a year of unprecedented challenge as the COVID-19 pandemic continues to brutally exacerbate the livelihood of millions of people across the globe. Detrimental impact of the pandemic on human lives, our economies and societies posed a serious threat to overall socioeconomic development progress. As a result of the COVID-19 pandemic, the global economic conditions continued to deteriorate sharply since the end of the first quarter 2020. The pandemic has brought high uncertainty and changed the global economic prospect from short-term to longer-term. By the pandemic itself and through the containment measures such as isolation, social distancing, lock downs and increased cross border controls by individual countries, there has been a substantial reduction in both global demand and supply. As per the April 2020 WEO, IMF, the global growth is estimated to contract sharply by - 3 percent in 2020- much worse than the global financial crisis of 2009 (-0.07 %). With the declining market confidence and slow progress in the development of a vaccine, global growth is forecasted to rebound to pre-COVID level only by mid-2021.

Similarly, the South Asian region is also equally impacted by the pandemic and projected to experience the worst economic performance in 40 years. Amidst experiencing slower economic growth in 2019, India, the most dominant economic player in the region is forecasted to face further economic slowdown with the onset of the pandemic at 5.0 percent (RBI), 1.9 percent (WEO, IMF) from the initial projection of 7.0 percent in 2020 (FY 2019-2020). With the unfavorable base effect coupled by supply disruptions from the pandemic and rapid depreciation of INR, inflationary pressure in FY 2020 is most likely to rise. On the positive side, the timely monetary easing measures such as reduction of key policy rate five times from high of 6.5 percent in 2018 to 5.2 percent in October 2019 and further by 75 basis points

in March 2020 (4.4%) and sizeable fiscal stimulus (of about 10% of GDP) are anticipated to reposition the economy once the pandemic subsides.

Bhutan being a small open economy, is not an exception. Since the beginning of March 2020, gradual internal containment measures were implemented to curb the possible spread of virus and to protect human lives. These concerted efforts for the last four months aided to achieving zero community transmission cases, despite rise in the imported cases in the recent months. On the other hand, these measures have inflicted a significant economic fallout such as lowering potential supply, increasing employment displacement and cuts in the monthly wages in the private sector, thereby depressing the aggregate demand. As a result, both supply (GDP growth) and domestic demand was initially estimated to slump to a historic low at -1.0 percent and -6.9 percent, respectively. However, under the national economic response plan, the estimated fiscal stimulus and monetary measures are likely to boost domestic demand and reverse economic growth at 1.0 percent (200 bps higher than worst case scenario). The key highlights on the impact of COVID-19 pandemic in our domestic economy are as follows;

1. Drop in production potential: The service sector which is the highest contributor to economic output, largely dependent on tourist arrival is badly impacted. Compared to initial projection of -5.5 percent, due to policy measures, the contraction is likely to drop below -5 percent in 2020. The economic loss in transportation, particularly airline services and high-end hotels and restaurants is projected to continue at an initial forecast since the possibility of reopening in the regional and international travel services remains very dim. With a gradual lift in the containment measures in a phase wise manner, activities in hotels and restaurants, entertainment services and local transport services are anticipated to gradually improve over the near term.

The construction activity was initially projected to decline by -7.0 percent on account of restrictions imposed on cross-border labor mobility. However, with the enhanced government budget (with a fiscal deficit of 7 percent of GDP) and continued

hydropower investment, followed by re-orientation of domestic labor force, the construction sector is expected to revive the construction output. Similarly, with the anticipated rise in the domestic demand for the finished products, the industrial production is also projected to regain. On the upside, the hydro electricity production remains unaffected and would help to cushion the economy from deterioration.

On the positive side of the pandemic, with limited external market access and internal restriction, the enhanced demand for domestic agriculture produce is expected to boost the agricultural related production.

2. Aggregate demand is severely impacted: Unlike in the production side, policy measure offsets contraction in domestic demand partially, leading to -1.0 percent drop in 2020 from the initial forecast of -3.7 percent. Consumption growth, in particular has also been downgraded from the initial forecast, reflecting a cut in the government current expenditure in lieu of consolidation of government expenditure. Although, the policy support is expected to reinvigorate the private consumption, a large slash in government consumption budget is projected to drop consumption growth by about -4.0 percent, compared to earlier forecast of -2.0 percent. In real term, the government current expenditure budget in FY 2020-21 is reduced by about -15.0 percent (3% of GDP) mainly to ensure that the recurrent expenditure is maintained within the threshold of domestic revenue (Constitutional Requirement) and to create a fiscal space for the capital expenditure. On the other side, as a counter measure to revive the aggregate demand in the short run and to boost the supply side factors over the medium term, the overall investment expenditure is projected to increase by 2.8 percent, against the initial forecast of -6.3 percent in 2020. This is induced by enhanced government capital expenditure of 4 percent of GDP and operation of the National Resilience Fund (15% of GDP), including the monetary easing measures of the RMA. If policy measure is to offset the negative impact of the pandemic on aggregate demand fully, additional capital budget, equivalent to one percent of GDP is further required.

3. Employment becomes more vulnerable: Prolongation and extension of internal containment measures to combat the pandemic has adversely impacted the labor demand in the market. Further, combining existing unemployment and increasing returnees from overseas employment will further aggravate the level of unemployment, especially the youth unemployment. In 2019, level of unemployment is estimated at 8,698 persons (2.7%). Carrying forward 2019 unemployed persons, additional new entrants in job market, returnees from abroad plus more than 23,000 displaced employees, the unemployment rate in 2020 is estimated to remain at a double digit-*with a record high*[1]. Therefore, given the rate of employment displacement with higher uncertainty in the job market, unemployment is projected to remain in the forefront of macroeconomic challenges over the medium term.

4. Downward price pressure: Driven by weaker domestic demand in tandem to declining price pressure in India, inflation is expected to remain at a modest level. In addition, with lower global fuel price, inflation is expected to persist within a range of 2.5-3.0 percent until 2021. However, continuing exchange rate depreciation is expected to partially offset the likely downward price pressure through imports.

5. Fiscal deficit widens to accommodate policy counter measures: Given the prominence of fiscal policy to impact supply side dynamics, both taxation and spending measures were implemented. On taxation front, business and corporate tax have been deferred to provide an immediate relief for business units. Importantly, a swift and sizeable fiscal stimulus (15% of GDP) under the National Resilience Fund has been implemented to contain the economic fallout and to facilitate quick recovery during the post crisis. In addition, various fiscal consolidation measures such as reallocation of expenditure in the annual budget and re-prioritization of Five Year Plan resources were undertaken. Unlike during

[1] As per the Druk Gyalpo's Relief Kidu update, within the first three months (April-June) of 2020, over 23,000 individuals who had lost their livelihoods largely through the loss of jobs due to pandemic were granted an immediate income support.

normal budget period, fiscal deficit is largely on account of investment expenditure, where capital expenditure budget was up ticked by 4 percent of GDP and current expenditure budget was reduced by 3 percent of GDP.

6. Imports to fall: Due to reduced domestic demand, import is projected to drop more than the export. As a result, the trade deficit is forecasted to improve slightly in 2020. The import of construction related goods and services and non-essential items are expected to fall drastically. Further, with the depressed cross-border labor mobility, the outward remittances, especially to India is to drop by manifold. Consequently, draw down in external reserves is to be contained with the declining import demand, as external grants and loans are to realize as per the projection. With narrowing current account deficit (-15% of GDP) and about 90 percent of fiscal deficit financing to be sourced domestically, external debt to GDP is forecasted to improve from 115 percent GDP in June 2020 to 114 percent of GDP by June 2021. On the contrary, if the pandemic prolongs than as anticipated, a weaker external demand for goods and tourism export would pose a new challenge to sustain the current account deficit over the medium term.

To combat the impact of COVID-19 pandemic in the economy, under the close guidance of His Majesty The Druk Gyalpo and in collaboration with the Government, the RMA implemented the monetary policy measures in a two phased manner as discussed below.

Phase I Monetary policy measures: As containment measures are necessary on the health front, given the high uncertainty of the pandemic without much progress in development of a vaccine so far, timely and impactful counter policy measures are equally important to support the livelihoods of the people and stride for a speedier economic recovery during the post-crisis period. Accordingly, sizeable and well timed monetary and fiscal measures are expected to avert from

a likely economic depression in 2020 as the GDP growth is to regain at 1.0 percent. This is mainly attributable to deployment of Nu 30 billion (15% of GDP) of the National Resilience Fund for economic recovery projects, as a comprehensive national response to the COVID-19 pandemic, under a close guidance of His Majesty the Druk Gyalpo in April 2020. The complementing monetary and fiscal measures targeted to affected sectors, businesses and households has helped to prevent the worst anticipated shock of COVID-19 pandemic. For instance, about 20 percent of impacted households are provided monthly cash transfers through The Grant of Druk Gyalpo's Relief Kidu operated through the National Resilience Fund. Monetary measures like injection of liquidity of more than Nu 4.2 billion by lowering the CRR, provision of interest rate concession for the targeted sectors, provision of three months' loan deferment and interest waiver on loan across sectors, and tax break have salvaged the domestic economy from deep economic downturn in 2020. Both conventional and unconventional monetary policies are implemented to maneuver the economic shocks from the pandemic. Several measures were implemented in a phase wise manner. As an immediate measure, the CRR was reduced to ensure adequate liquidity in the banking sector-thereby providing immediate financial relief to COVID-19 impacted sector. As a part of the comprehensive national response plan against the COVID-19, in the first phase, three months of loan deferment was provided for all loans. Further, an unconventional approach to avert economic downturn as well to support the household segment from the unpredictable pandemic, three months of interest waiver has been granted under The Druk Gyalpo Relief Kidu, operated through the National Resilience Fund. The Kidu was granted mainly to help the impacted individuals to sustain livelihoods and to boost household demand for consumption and investment. For the month of April 2020, a total of Nu 1.25 billiion was granted as interest waivers to 139,096 loan account holders, shared equally by the Government and the financial institutions.

Phase II Monetary policy measures: Keeping in view the emerging and medium-term macroeconomic conditions, the monetary policy stance for medium term is targeted to support the domestic demand based on priority and need of the economy to revive the COVID-19 affected sectors and support economic and employment growth. Accordingly, the policy stance is programed based on macroeconomic outlook and challenges - duration of the COVID-19 fallout and impact assessment of Phase I monetary policy measures. Along with fiscal measures and The Grant of Druk Gyalpo's Relief Kidu, the RMA introduced Phase II monetary measures to help the economy to recover from the COVID-19 pandemic starting July 2020, while keeping vigilance and maintaining overall financial stability in the financial sector. The RMA will continue to provide adequate liquidity in the market to build confidence and to support the implementation of fiscal stimulus. Currently, the supply of liquidity is in surpass of demand and is projected to continue until the domestic demand fully recovers in the near-term.

For details, please visit https://www.rma.org.bt/publication.jsp?id=6

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