Macroeconomic Performance and Outlook

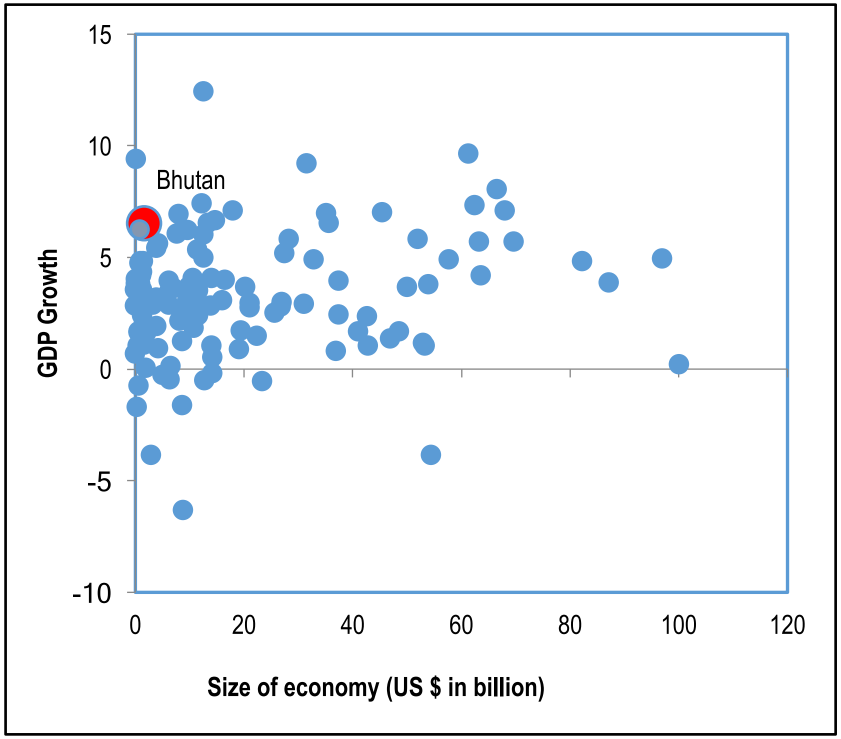
13th Round Table Meeting

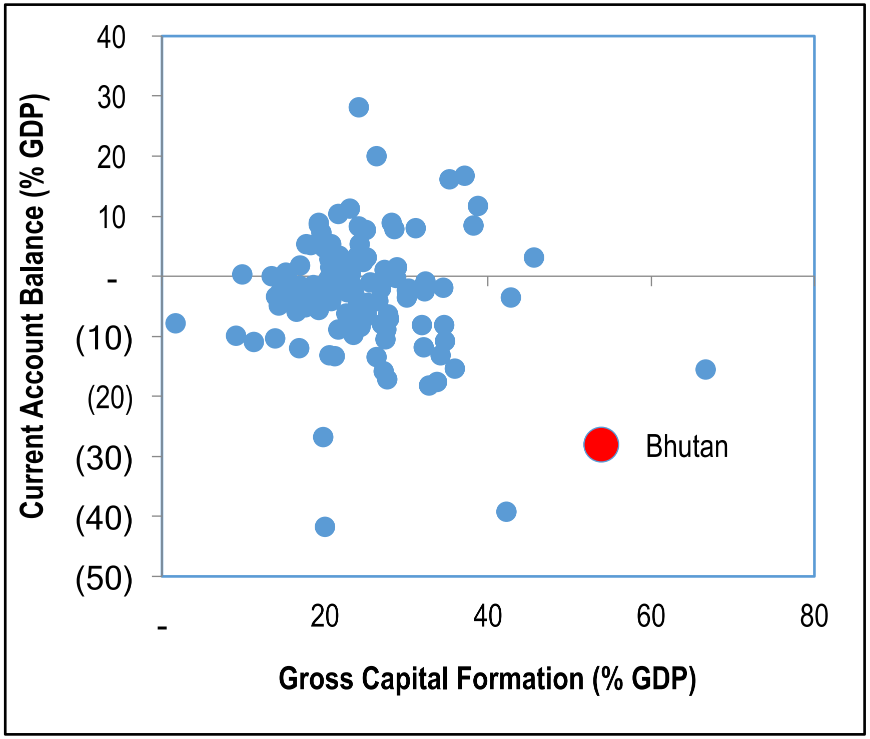
Ministry of Finance
Royal Government of Bhutan

Outline of Presentation

1. Bhutan in global and regional context;
2. Macro economic Performance;
3. Fiscal Position;
4. Policy Initiatives;
5. Economic Outlook;
6. Way Forward.

Bhutan in global and regional contexts (2015)



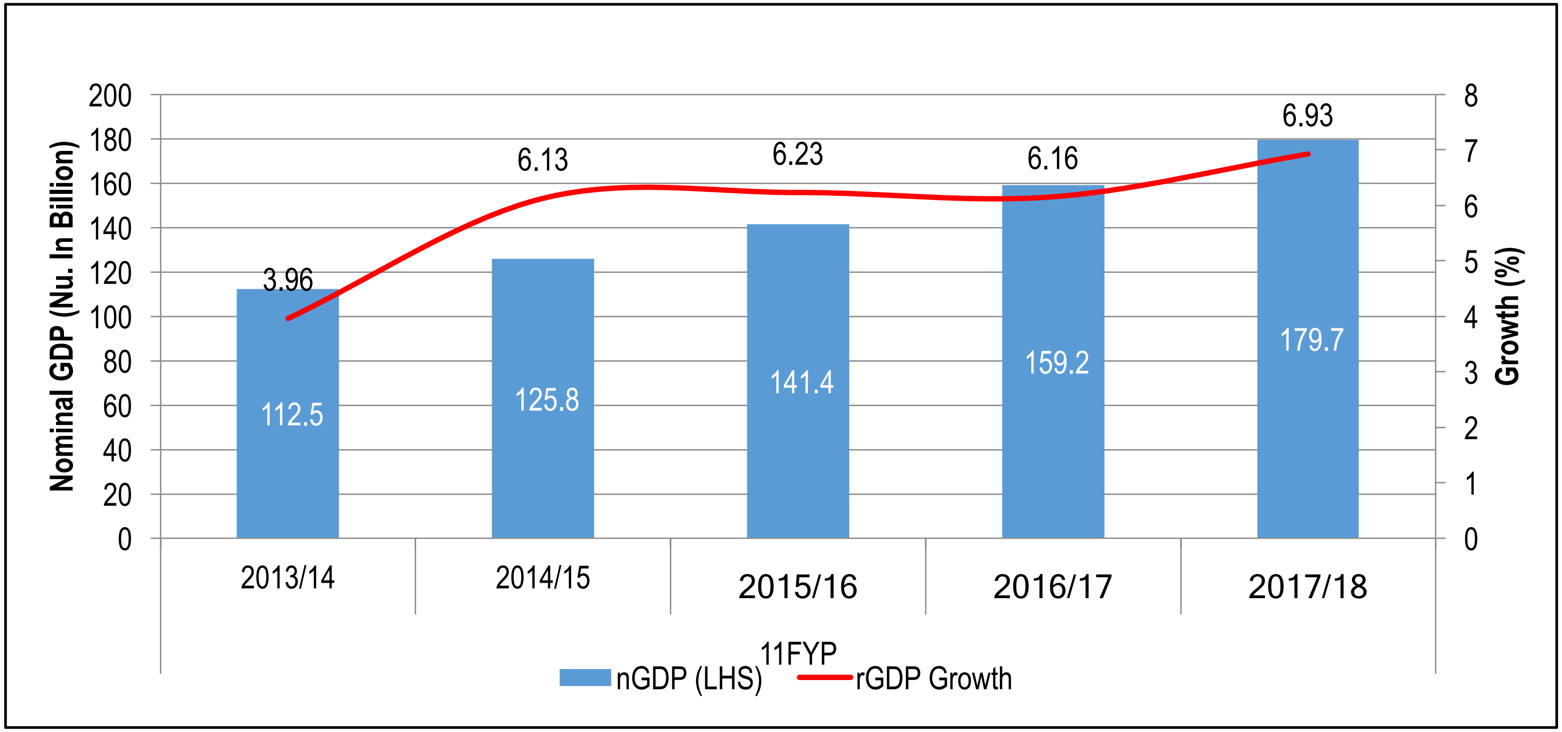


- Smallest economy in terms of GDP ($ 2 billion) but one of the fast-growing economy in the world.
- Investment in hydropower & 11FYP as the main driver of growth.
- High investment associated with Current Account Deficit of 29% of GDP in FY 2015-16, one of the highest in the world.

1. Real Sector Performance:

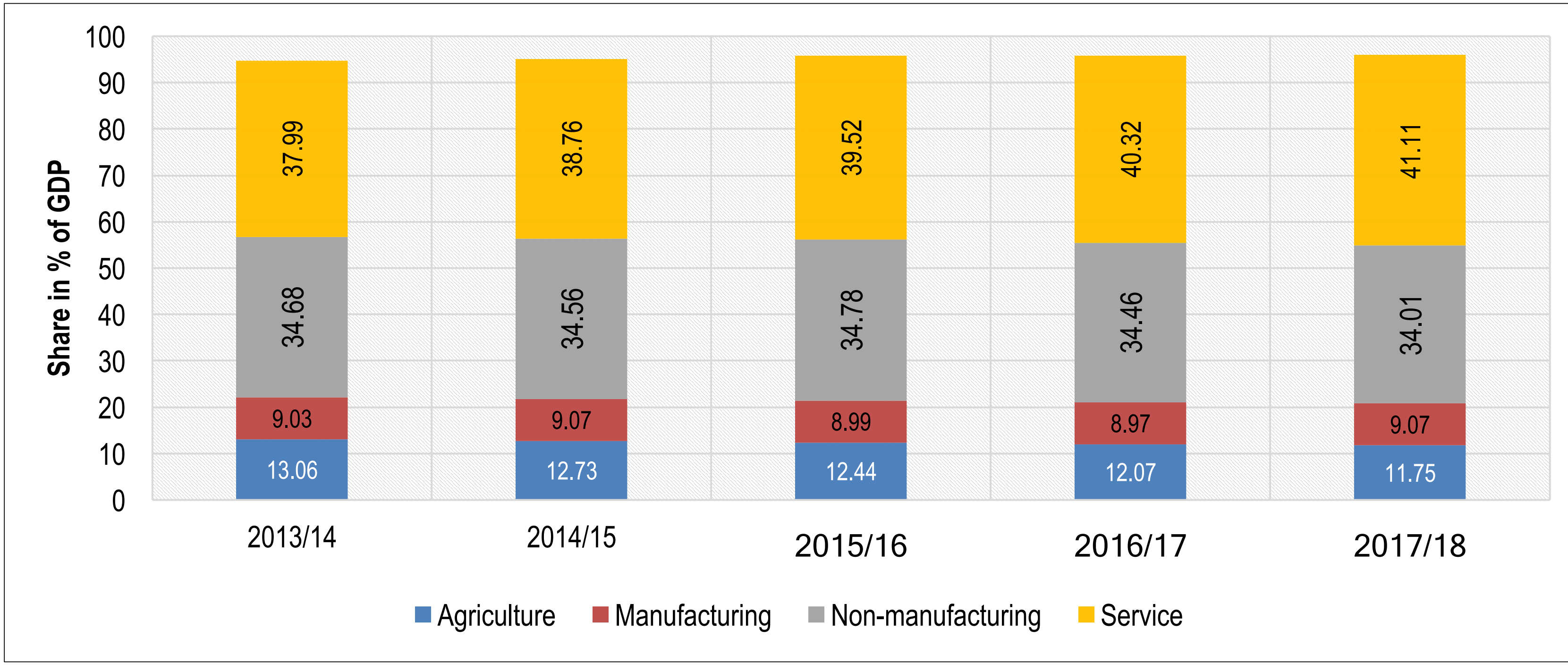
- Growth;
- Structure;
- Income;
- Employment

Medium-Term Growth Path – Economy by size & Growth



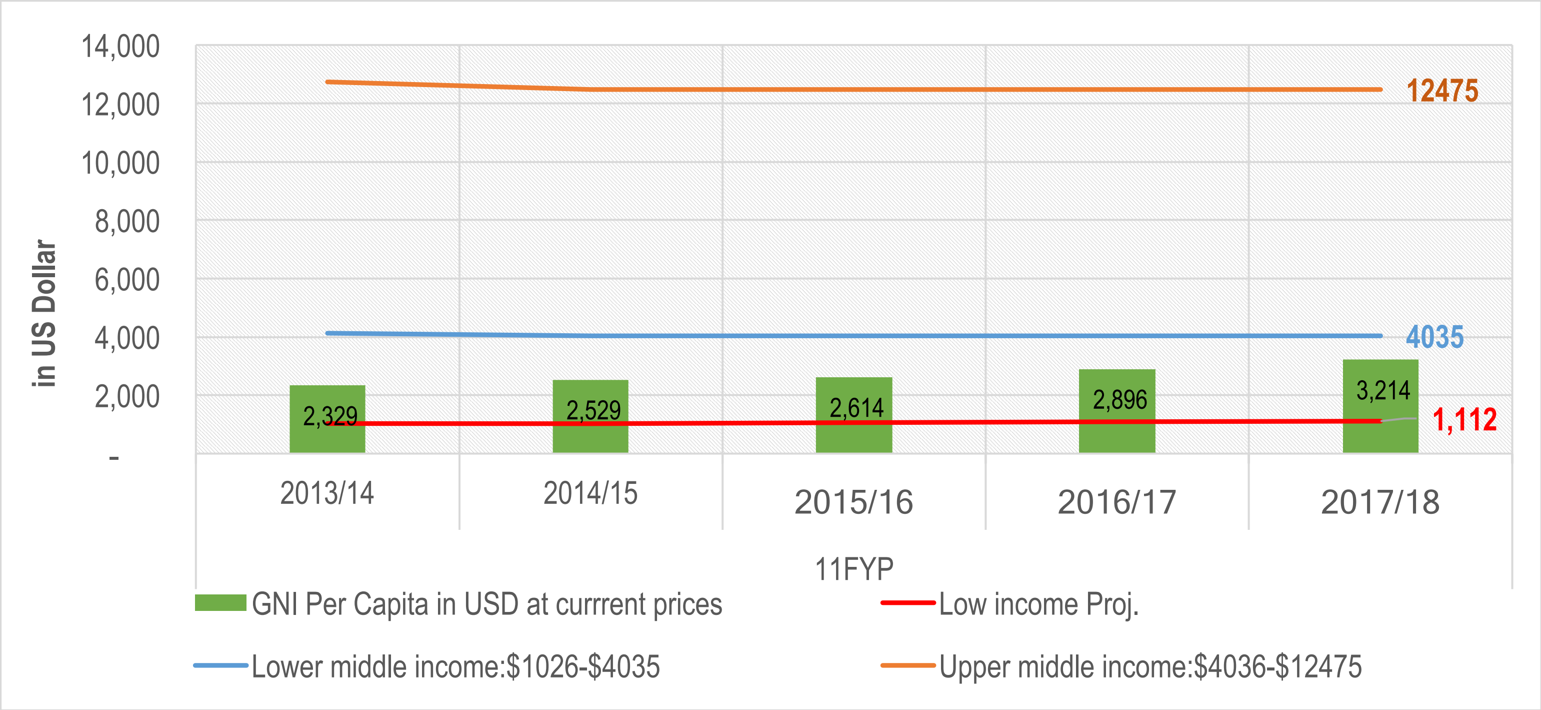
- In the last 3 years of 11FYP, average growth was 5.4%.
- Growth plummeted to 3.9% in FY 2013/14 due to measures to correct imbalances in external sector.
- With accommodative fiscal measures and monetary policies, growth has recovered to 6.13% in FY 2014/15.
- In the last two years of 11FYP, the growth is projected at an average of 6.5% with sound macro-fiscal policies.

Structural Composition of economy



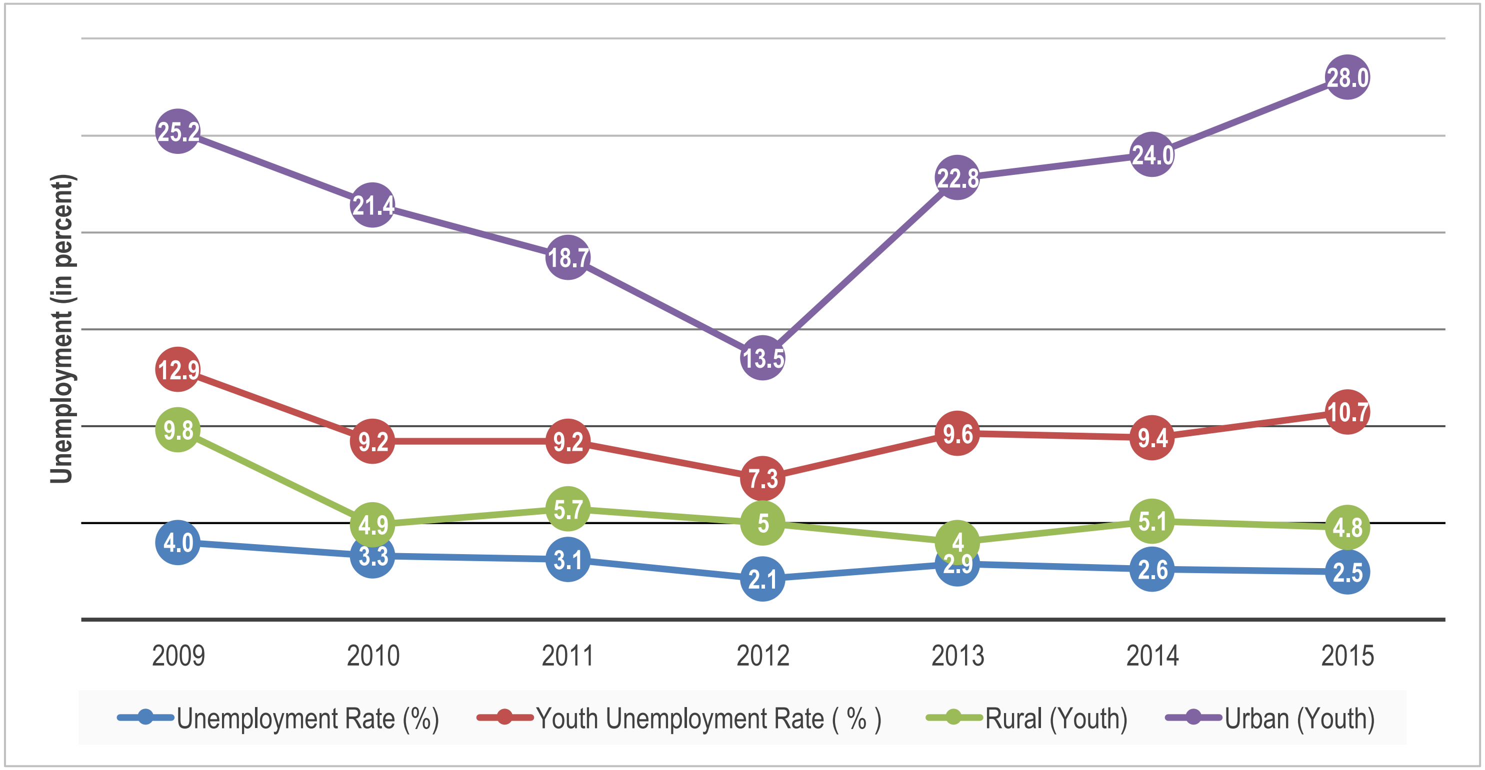
- Structural change in the economy shifting from primary to secondary & tertiary sector.
- Industry & service sectors are the main driver accounting for 40% & 38% respectively.
- Contribution of agriculture sector to GDP is declining as it was 13% in FY 2013-14 and projected to be 11% at the end of 11FYP.
- Agriculture provides 56% of employment and 70% of population is dependent on agriculture for their livelihood.
- As such, more focus on agriculture sector is required for rural development & ensuring food security.

GNI Per Capita Income



- GNI per capita increased from US$ 2,329 in FY 2013/14 to US$ 2,529 in FY 2014/15 and projected at about US$ 3,000 at the end of the plan.
- Although, Bhutan is eligible to graduate from LDC status in terms of income & Human Assets Index threshold (67.9%), there is risk of being trapped in the lower middle income threshold in the medium to long term.
- In terms of Economic Vulnerability Index, we are below the threshold and support necessary to improve EVI.

Employment

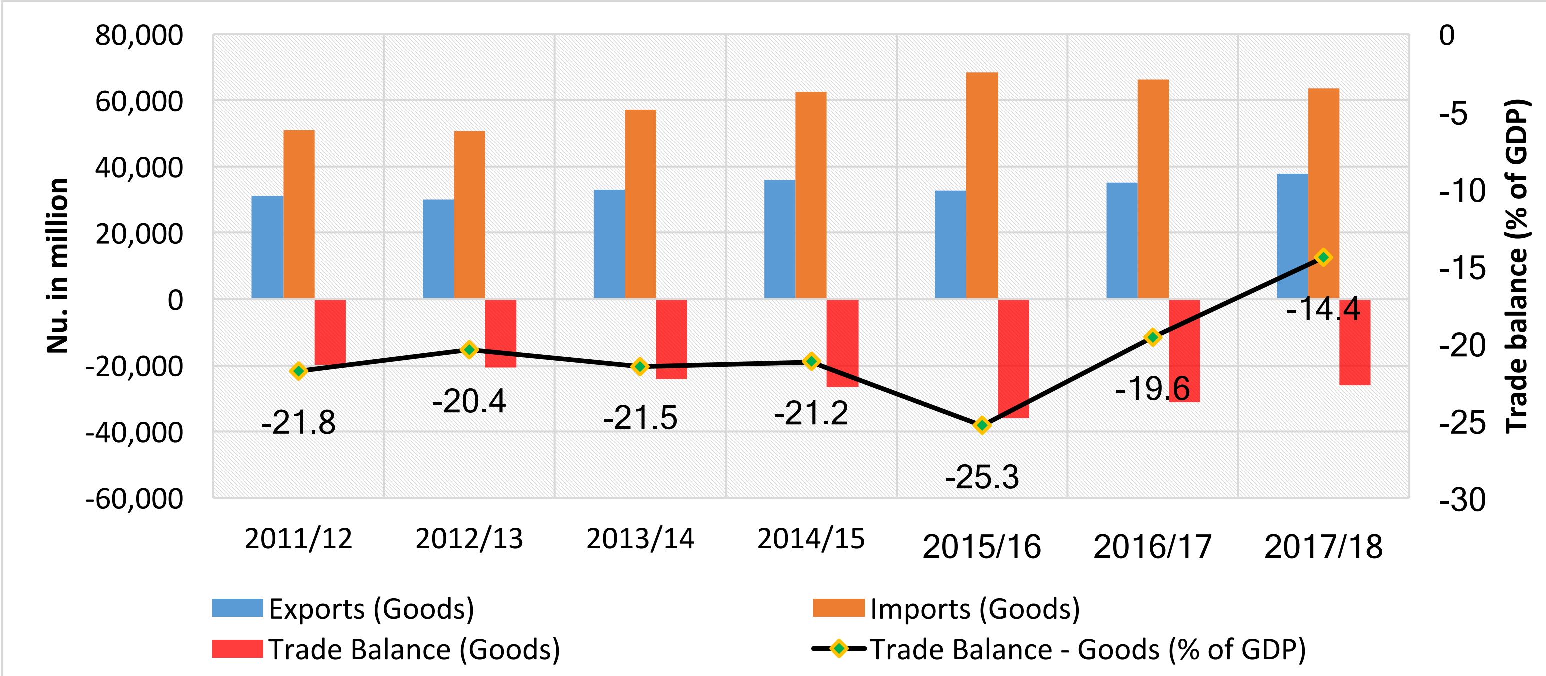


- Sustaining full employment is a priority.
- Presently, overall unemployment rate is at 2.5% in 2015, however youth unemployment has increased to 10.7% in 2015 from 9.4% in 2014.
- Since most of the unemployed youths are residing in urban area, youth unemployment in urban areas has increased from 13.5% in 2012 to 28% in 2015.
- Major programs under implementation to address youth unemployment.

2. External Sector Performance

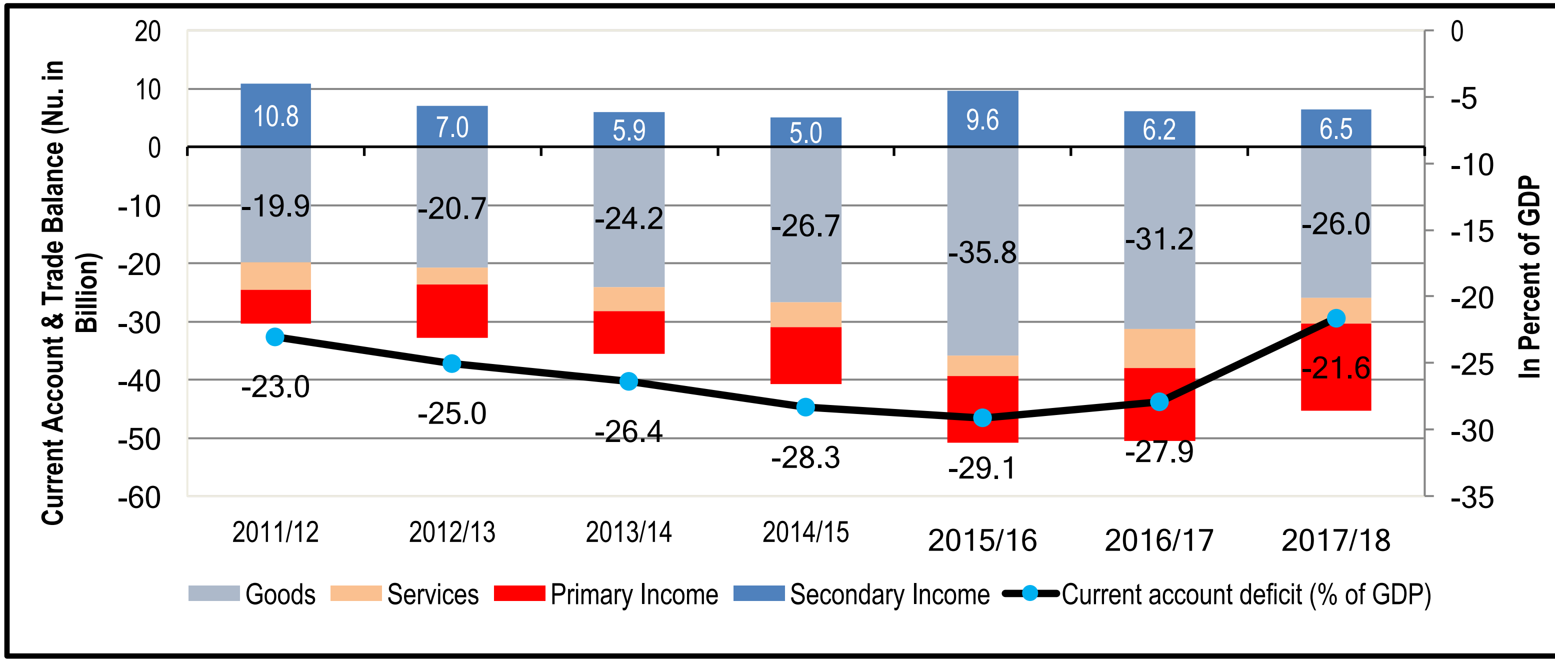
- Trade Balance
- Current account balance
- Overall Balance;
- Reserves

Trade Balance



- Managing the balance of trade has been a challenge for a import driven economy, however most of imports are capital goods for investments.
- Import of goods increased from Nu.50.8 billion in FY 2011-12 to Nu.62.6 billion in FY 2014-15 while exports increased from Nu.30.9 billion to 35.9 billion for the same period.
- In terms of GDP, trade deficit was 21.8% in FY 2011/12 which deteriorated to 25% in 2015/16. It is projected to improve in the last two years of 11FYP as most of the hydropower projects are on completion stage.
- Implemented Economic Stimulus Plan to increase domestic productive capacity for import substitution.

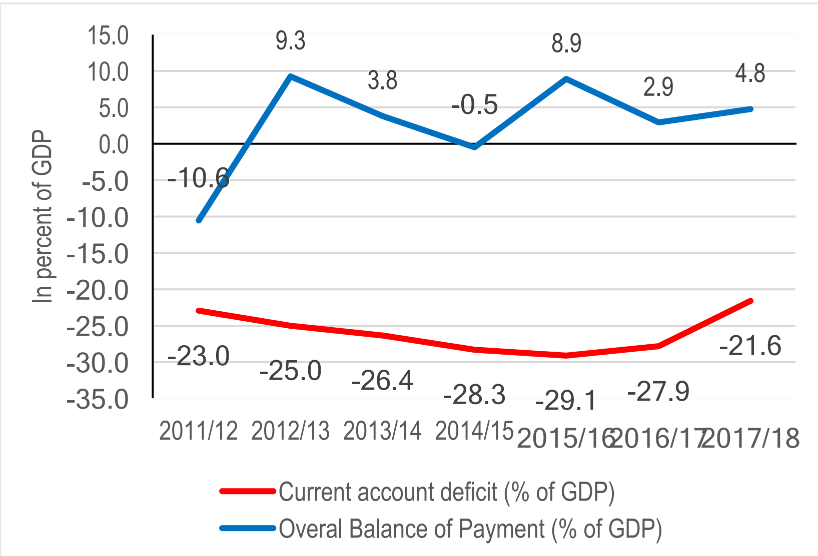
Current Account and its Composition



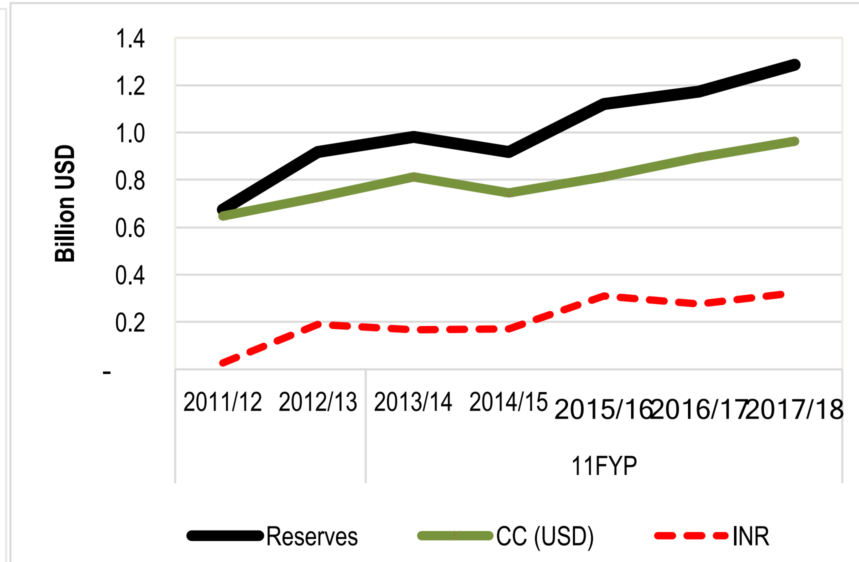
- Current account deficit widening from 23% of GDP in FY 2011/12 to 29% in FY 2015/16.
- The deficit is mainly contributed by balance of trade followed by services and payment for debt services.
- Mainly financed by capital and financial account which constitutes loans and grants.
- Expected to improve to 21.6% of GDP at the end of the plan due to completion of three hydropower projects.

Overall Balance of Payments and Reserves

Positive Overall balance of payments



Increasing international reserves



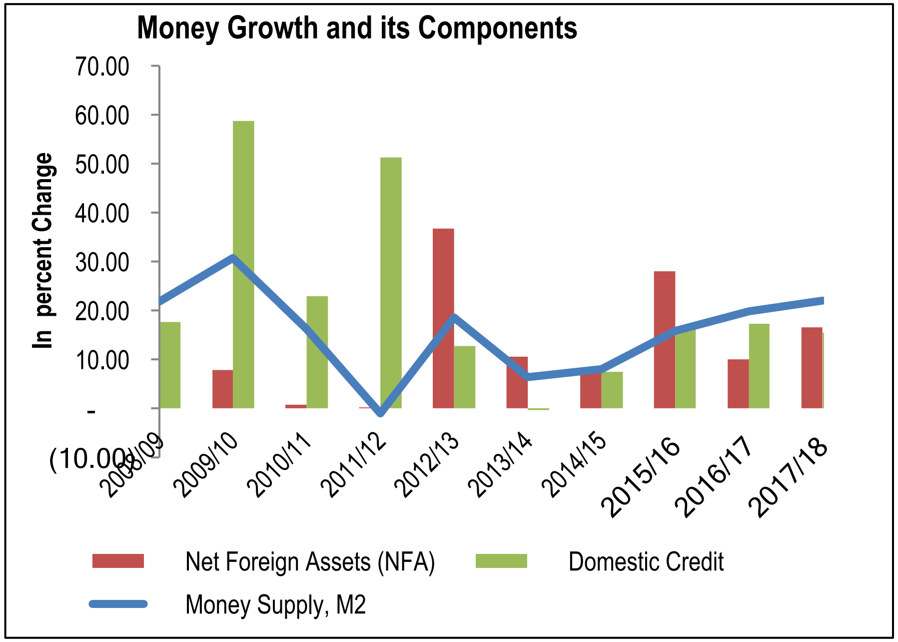
- Despite large current account deficits, the overall balance is positive due to capital and financial accounts inflows mainly in the form of loans and grants.
- Overall balance was negative in FY 2011/12 during the Indian Rupee shortage in the economy and in FY 2014/15 when the govt. paid short term borrowings.

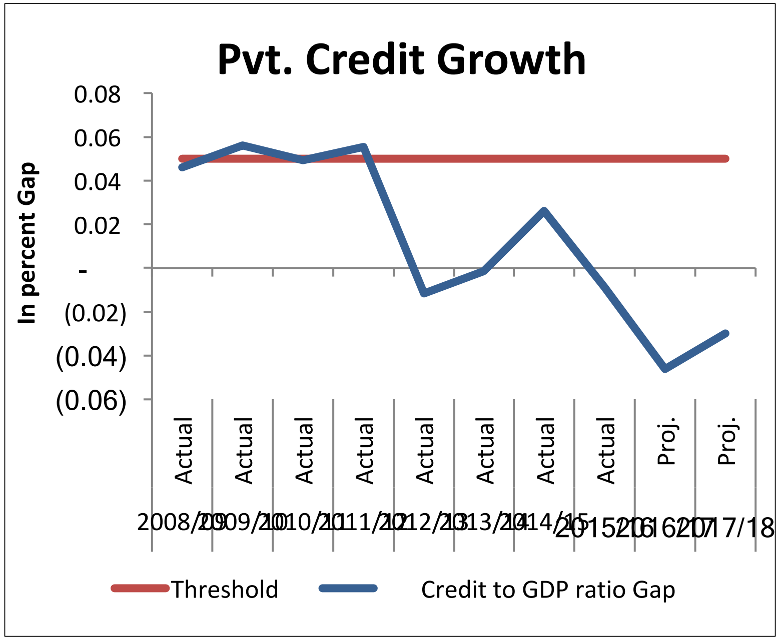
- International Reserves increased from US$ 916 million in FY 2012-13 to US$ 1,118 million in FY 2015-16, sufficient to cover 12 months of merchandise imports.
- Built up in reserves is mainly through receipts of loans and grants besides export performance.
- Reserves adequate from the risk-based perspective (i.e. 100% of debt service + 10% of M2 + 10% of imports).

3. Monetary & Financial Sector

- Money Supply
- Credit growth
- Inflation.

Credit Growth

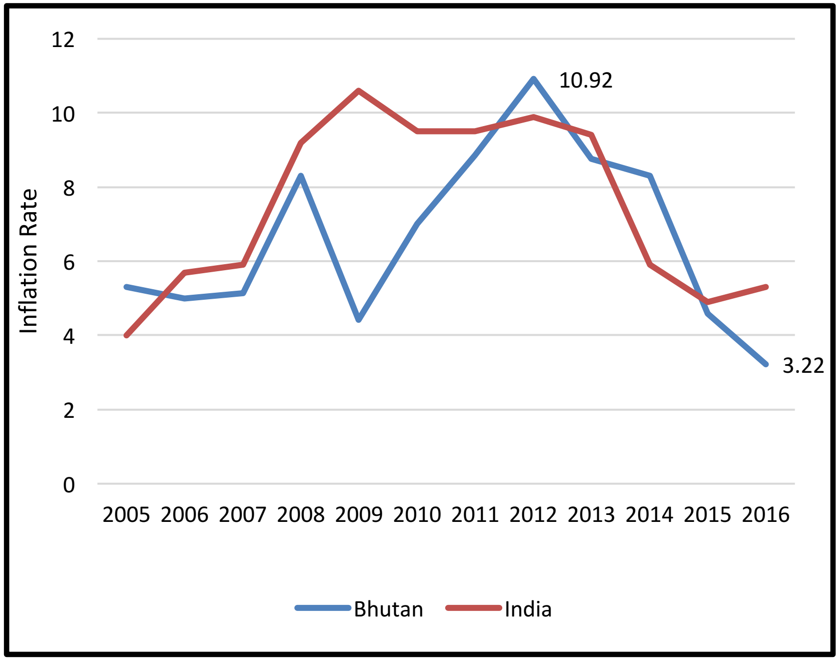


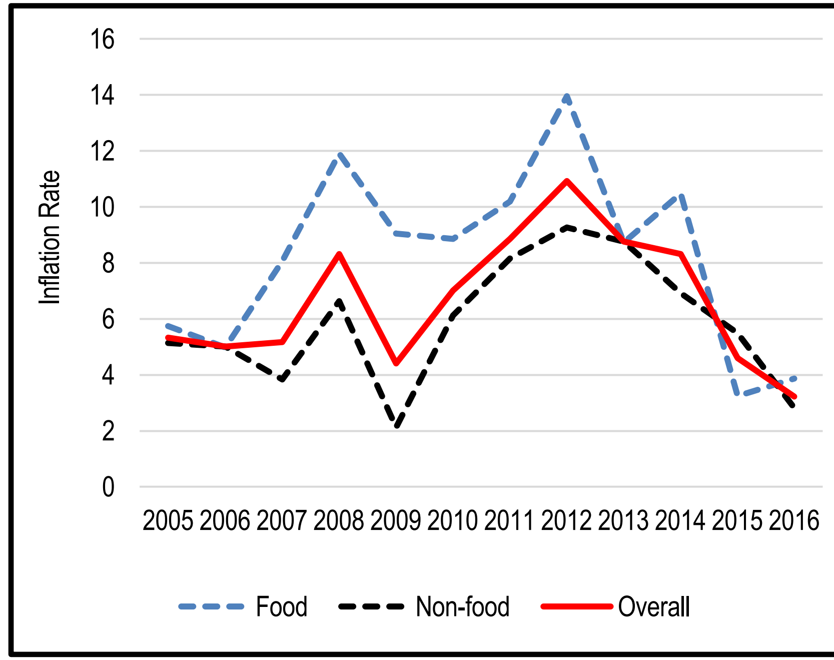


- Money supply (M2) growth in the economy is driven by domestic credit & Net Foreign Assets.
- Increase in M2 was driven by domestic credit till FY 2011/12.
- With the moderation of domestic credit through monetary policy, NFA is driving the M2 growth since FY 2013/14.
- M2 is expected to be driven by domestic credit as NFA is anticipated to decline with the phasing out of ODA grants by some of the development partners.

- Access to credit is crucial for pvt. sector dev.
- As per Basal-III conditions, if the private credit to GDP Ratio Gap is above the threshold of 5%, the economy would experience overheating.
- During FY 2011/12, private sector credit growth breached this threshold, resulting in INR crunch. Policy intervention has contained credit growth contained below threshold since 2012.
- Expected to rise in the medium term with the introduction of MLR.

Inflation





- Bhutan tracks Indian inflation as more than 80% of imports are from India.
- Inflation rate moderated from 10.9% in 2012 to 3.22% in 2016.
- Inflation rates have fallen in both food *(13.95% in 2012 to 3.2% in 2015)* and non-food items *(9.26% in 2012 to 5.48% in 2015).*
- In the medium term, inflation is anticipated to remain low with the inflation targeting policy adopted by India.

4. Fiscal Position:

- Key Fiscal Policies
- Fiscal Framework for 11FYP
- Public Debt

Key Fiscal Policies

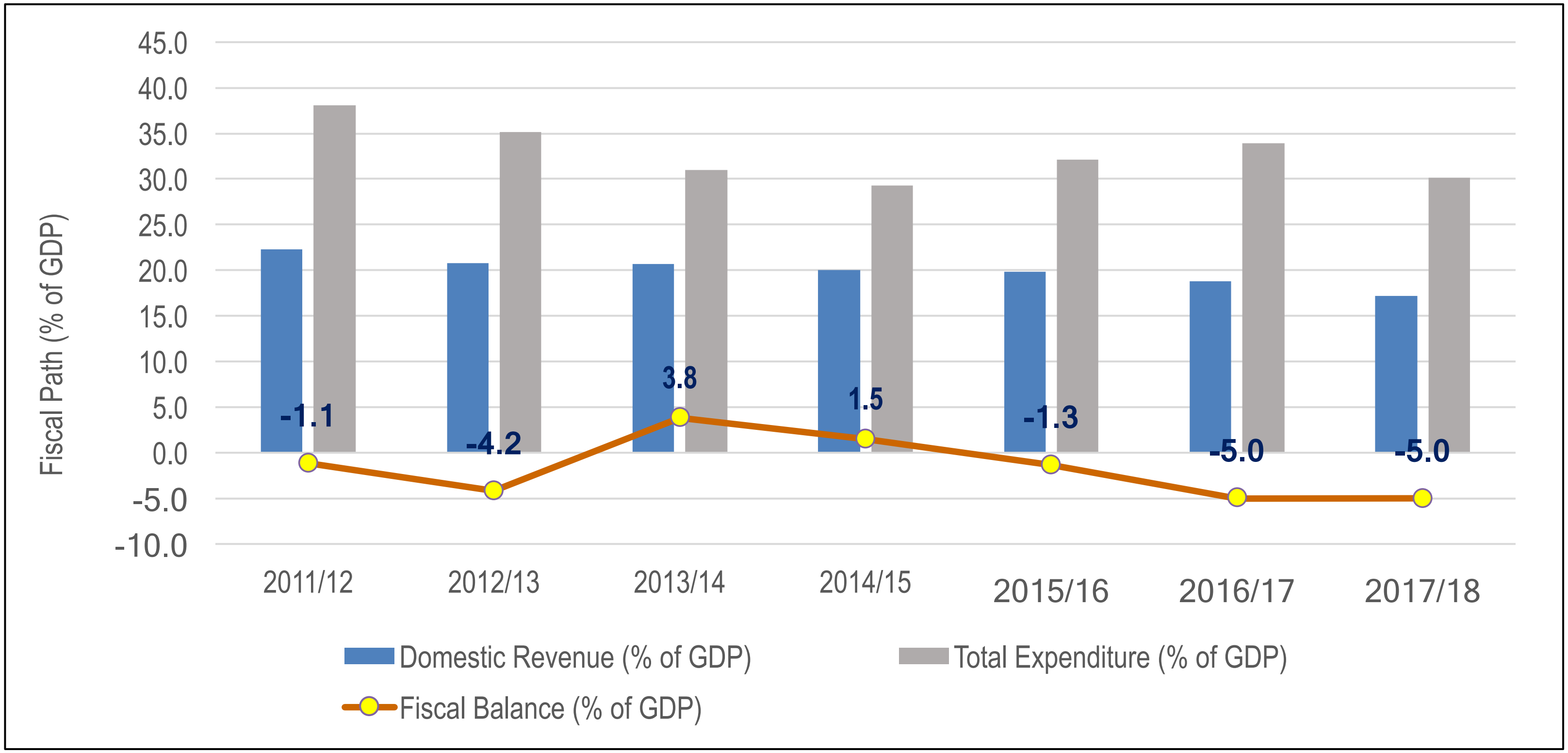
- To contain fiscal deficit at 3% of GDP;
- Recurrent expenditure to be covered by domestic revenue;
- Domestic revenue to cover 85% of total expenditure by the end of plan period;
- Non-hydro debt stock shall not exceed 35% of GDP;
- Ratio of hydropower debt service to hydropower export revenue shall be maintained within 40%.

Fiscal Framework for 11th FYP

Particulars	11FYP Projection (Nu. in million)		% Change
	Original	Revised Estimates	
Revenue & Grants	**198,455.038**	**196,131.907**	**(1.17)**
Domestic Revenue	139,816.338	127,024.528	**(9.15)**
Grants	58,638.700	68,469.727	**16.77**
Outlay	**213,966.690**	**218,158.186**	**1.96**
Total Expenditure	**213,291.490**	**215,793.239**	**1.17**
Current	121,291.490	105,927.086	**(12.67)**
Capital	92,000.000	109,866.153	**19.42**
Net Lending (excl. hydro principal recovery)	675.200	912.155	
Fiscal Balance	**(15,511.652)**	**(22,026.279)**	**42.00**
Net Borrowing	16,672.816	7,037.946	**(57.79)**
Borrowings	21,493.147	11,423.345	**(46.85)**
Repayments (excl. hydro repayments)	4,820.331	4,385.399	**(9.02)**
Resource Gap	**1,161.164**	**(14,988.333)**	
In percent of GDP	**-**		
Fiscal Balance	(2.3)	*(2.6)*	
Resource Balance	0.1	*(1.7)*	
Coverage by Domestic Revenue			
Total Expenditure	64.4	*59.8*	

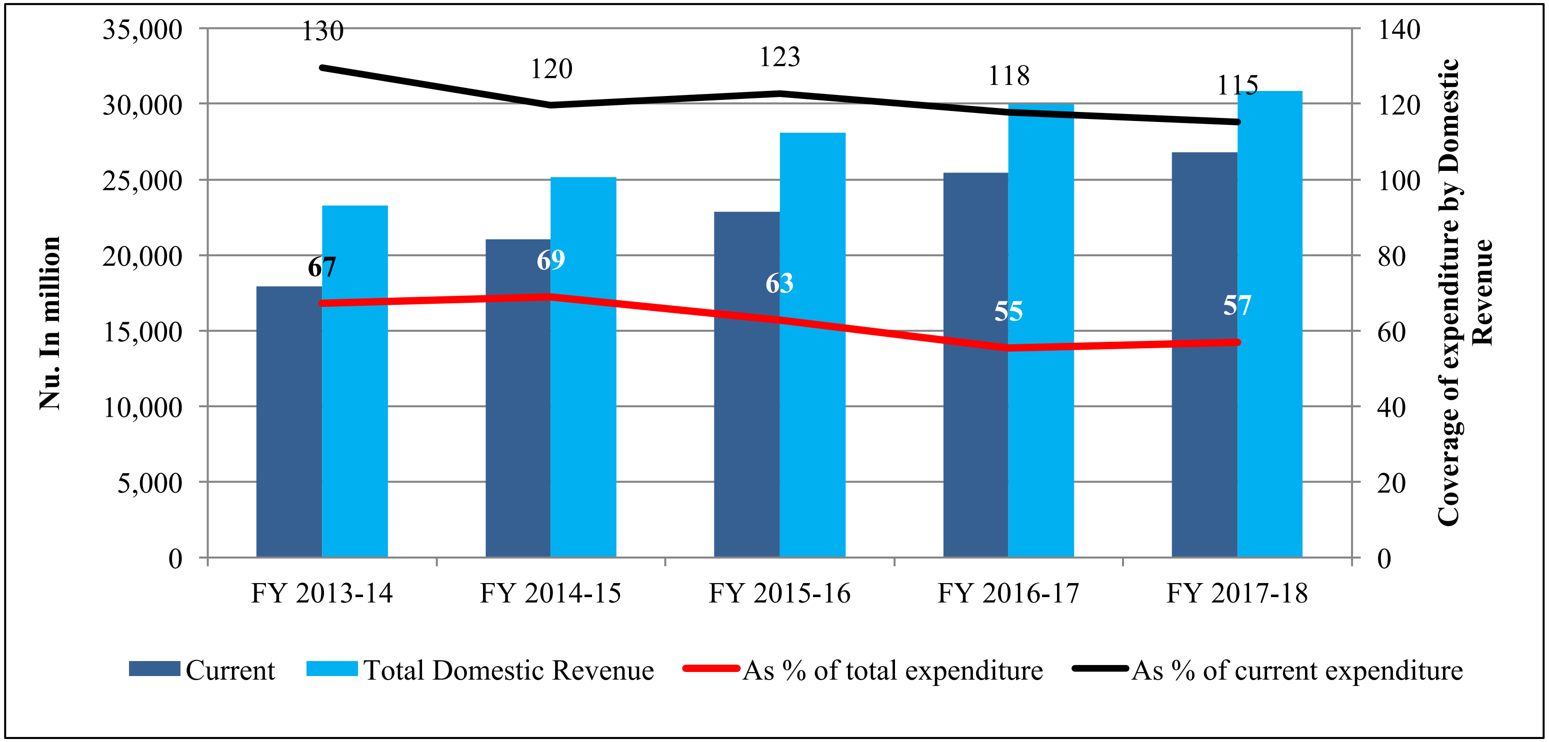
- ✓ Domestic revenue was revised downward from Nu. 139.8 billion to Nu. 127.02 billion, a decrease of 9% due to delay in commissioning of hydropower projects.
- ✓ Grants increased by 16.7% after the 12 RTM due to higher ODA commitments.
- ✓ Current expenditure reduced by 12.7% while capital expenditure increased by 19%, leading to a fiscal deficit of Nu. 22 billion (2.6% of GDP within 3% target).
- ✓ Coverage of total expenditure by domestic revenue about 59.6% against the target of 85%.

Fiscal Path



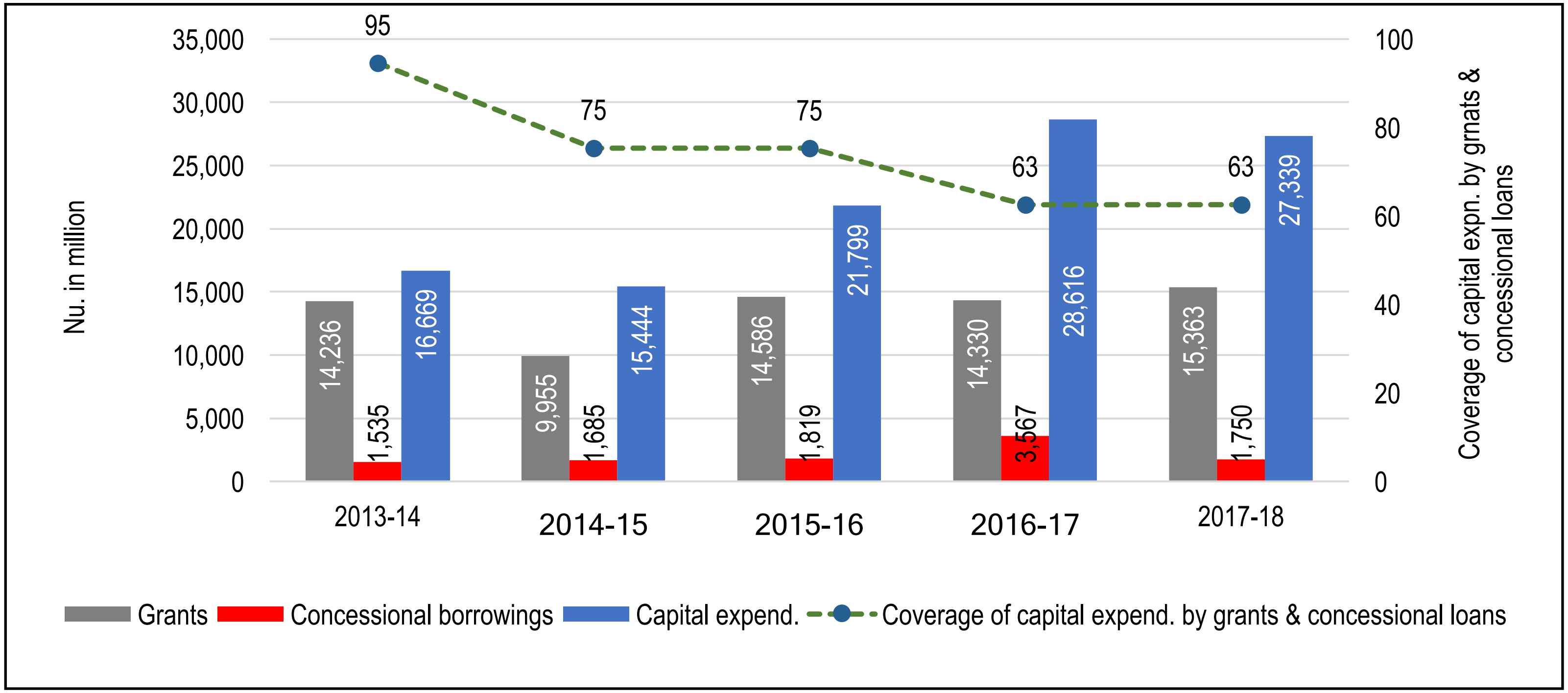
- Domestic revenue as a share of GDP declining trend while public spending is increasing;
- Tax to GDP ratio is also declining from 15% in FY 2013/14 to 13% in FY 2017/18 mainly on account of fiscal incentives.
- Fiscal balance was positive in first two FYs and it is projected at deficit of 5% of GDP during the last two FYs of the 11FYP and will averaged at 2.6%..

Coverage of Expenditure by Domestic Revenue



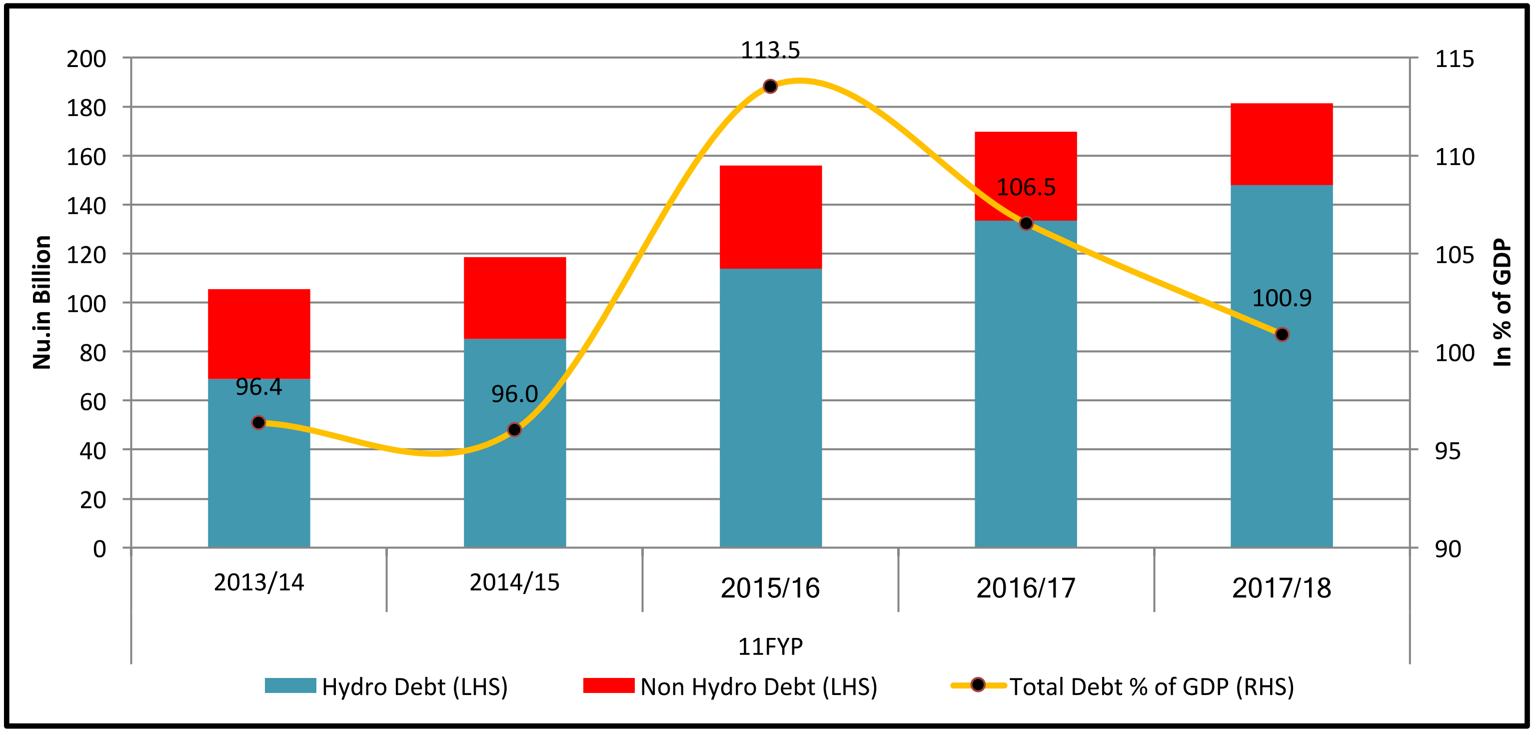
- Coverage of current expenditure by domestic revenue was 130% in FY 2013/14 and reduced to 120% in FY 2015/16. It is projected to fall in the last two years of 11FYP.
- Coverage of total expenditure by domestic revenue is also projected to be about 57% in 2017/18 against the target of 85%.

Coverage of Capital Expenditure by Grants & loans



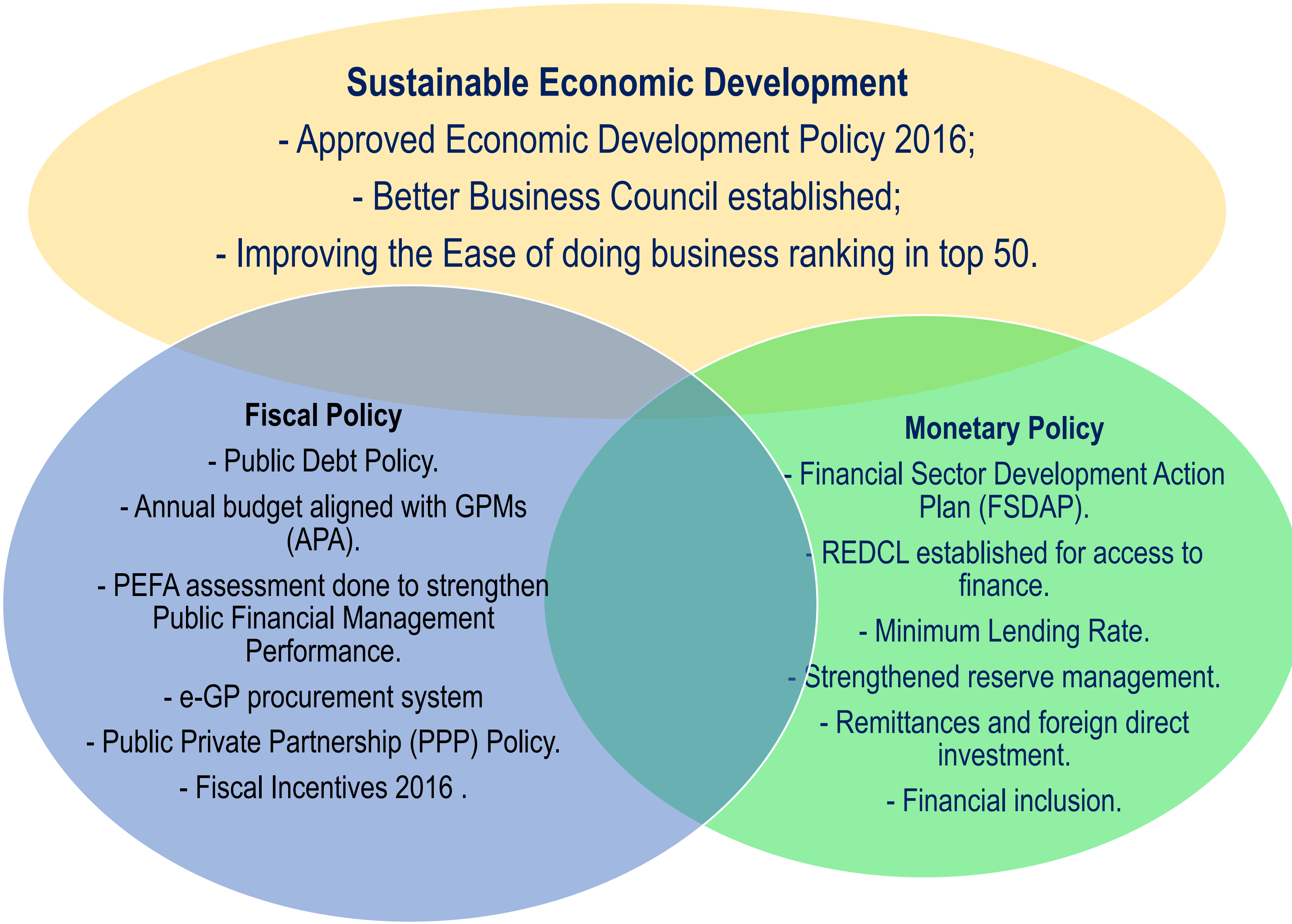
- Capital expenditure mainly finance by ODA grants and loans as revenue surplus is not sufficient.
- However, financing of capital expenditure is expected to decline from 95% in 2013/14 to 63% in FY 2017/18 due to phasing out by some of the development partners.

Public Debt



- Rising public debt level is a major development challenge
- Debt to GDP increase from 96% in FY 2013/14 to 113% in FY 2015/16 and it is expected to decline below 100% by end of the plan period.
- Hydro Loan accounts more than 70% of the debt stock.
- The Joint IMF/WB DSA 2016, confirmed that debt dynamics are subject to a moderate risk of distress.

Macroeconomic Policy Initiatives



Macroeconomic Outlook

	UNIT	2018/19	2019/20	2020/21	2021/22	2022/23
Real Sector						
Real GDP Growth	**% yoy change**	**9.4**	**9.4**	**10.7**	**9.6**	**5.8**
Consumption	In percent of GDP	69.3	72.8	75.1	73.9	70.9
Gross Investment	In percent of GDP	40.7	35.6	30.0	26.2	24.6
External Sector						
Trade Balance	Nu. in Billion	22.4	19.0	14.0	26.2	29.0
Trade Balance	In percent of GDP	(12)	(9)	5.3	9	9.5
Current account balance	**Nu. in Billion**	**-34.1**	**-29.9**	**3.9**	**19.6**	**25.6**
CAB % of GDP	In percent of GDP	-16.5	-12.7	1.4	6.2	7.3
Gross Official reserves	Months of Imports (GNFS)	10.4	10.0	7.4	6.4	5.8
External debt	**In percent of GDP**	**93.2**	**85.6**	**74.4**	**60.9**	**50.6**
Debt service ratio	External debt service to export	14.2	9.5	8.5	23.9	25.1
Fiscal Sector						
Tax Revenue	In percent of GDP	10.3	9.4	9.0	8.3	9.5
Total expenditure	In percent of GDP	27.4	25.2	23.9	24.6	19.3
Current Balance	Ratio of DR to RE	91.6	93.7	138.5	157.9	128.8
Fiscal Deficit (% of GDP)	**In percent of GDP**	***(11.0)***	***(10.5)***	***(6.6)***	***(0.1)***	***(3.4)***
Total Debt (% of GDP)	In percent of GDP	93.2	85.6	74.4	60.9	50.6
Monetary Sector						
Broad money	% yoy change	22.0	14.4	27.3	26.0	22.5
Domestic credit	% yoy change	15.52	11.33	11.20	13.70	14.92
Inflation	% yoy change	5.66	7.24	7.53	7.28	6.81

Fiscal Projection for 12th Plan

Particulars	11 FYP Estimate	12FYP Projection
	Nu. in million	
Revenue & Grants	**196,131.907**	**214,563.490**
Domestic Revenue	**127,024.528**	**214,563.490**
Grants	68,469.727	-
Outlay	**218,158.186**	**292,424.571**
Total Expenditure	215,793.239	**292,424.571**
Current	105,927.086	177,100.268
Capital	109,866.153	115,324.303
Net Lending	912.155	-
Advances & Suspenses (Net)	1,452.793	-
Fiscal Balance	**(22,026.279)**	**-**
Fiscal Balance without Grants	(91,133.658)	**(77,861.082)**
In percent of GDP		
Fiscal balance	(2.631)	-
Fiscal balance without Grants	(12.439)	**(6.317)**
Coverage by Domestic Revenue		
Total Expenditure	59.775	**71.235**

Way Forward

- Ensuring growth and macroeconomic stability through economic diversification and financial inclusion;
- Broadening the revenue base to contain fiscal deficit at sustainable level;
- Innovative financing for integration and localization of the Sustainable Development Goals (SDGs);
- Strengthening and deepening fiscal decentralization;
- Continued support of the development partners will be critical to achieving the SDGs and realizing GNH.

THANK YOU