MONETARY POLICY STATEMENT

JULY 2022

ROYAL MONETARY AUTHORITY OF BHUTAN

Monetary Policy STATEMENT 2022

Monetary Policy Statement

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

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

Acronyms

BDBL	Bhutan Development Bank Ltd.
BIL	Bhutan Insurance Ltd.
CPI	Consumer Price Index
CRR	Cash Reserve Ratio
DGRK	Druk Gyalpo's Relief Kidu
FIs	Financial Institutions
FSP	Financial Services Provider
FY	Fiscal Year (July 1 – June 30)
FYP	Five Year Plan
GDP	Gross Domestic Product
IMF	International Monetary Fund
IPS	Interest Payment Support
M2	Broad Money
MFCC	Macroeconomic Framework Coordination Committee
MFCTC	Macroeconomic Framework Coordination Technical Committee
MLR	Minimum Lending Rate
NFA	Net Foreign Assets
NPL	Non-Performing Loan
NPPF	National Pension and Provident Fund
NRF	National Resilience Fund
RICBL	Royal Insurance Corporation of Bhutan Ltd.
RMA	Royal Monetary Authority of Bhutan
SDP	Skills Development Plan
USD	US Dollars
WADR	Weighted Average Deposit Rate
WALR	Weighted Average Lending Rate
WTO	World Trade Organization

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Executive Summary

Amidst considerable uncertainties in global growth and inflation, with the adoption of new economic normal beginning second quarter of 2022, the Bhutanese economy is positioning stronger than had been expected. Easing prolonged COVID-19 containment measures and achieving a nationwide booster shot vaccination drive has supported a revival of domestic demand conditions. However, notwithstanding the pick-up in economic activities from the last two years of suppressed demand, downside risk on the external imbalances continued to remain elevated. The rising imports and cost of external borrowing at the times of soaring prices and tightening financial conditions in the global market are risking small open economies particularly like Bhutan, which largely depend on imports and external grants and loans.

In addition to persistent challenges posed by the pandemic, the ongoing conflict and global supply-chain disruptions, the IMF has revised the global growth downward for 2022 at 3.6 percent from the initial estimate of 4.4 percent and the World Trade Organization (WTO) also slashed global trade growth by about two percentage points. Simultaneously, in the wake of rising inflation, most of the central banks, particularly, advanced economies, tightened monetary policy, leading to reversal of capital flights from emerging and developing economies putting financial conditions unstable.

On the domestic front, Bhutan experienced the worst economic growth of -10.1 percent in 2020 and is estimated to have expanded by 3.7 percent in 2021 and then projected to improve at 4.5 percent in 2022. Due to precipitous drop in 2020, economic output is expected to remain below the pre-pandemic level. With slight improvement in the unemployment scenario from 5.0 percent in 2020 to 4.8 percent in 2021, the overall unemployment is expected to remain higher than the historical trend. Dismayingly, limited prospects to generate adequate productive long-term employment opportunities for new entrants has resulted in rising youth unemployment rate.

Triggered by the pandemic, the escalation of ongoing geopolitical tensions and sanctions has resulted in unprecedented domestic inflationary pressure. The headline inflation rose to 7.4 percent in 2021 against 5.6 percent

in 2020, and is forecasted to remain above the implicit inflation target rate of 4.5 percent in 2022. This has impacted household consumption and investment demand, disrupting the government's demand acceleration policy interventions, thereby impacting economic efficacy of lifting the prolonged COVID-19 restriction measures.

Since the onset of the outbreak of the pandemic, under the benevolent leadership of His Majesty The Druk Gyalpo, numerous livelihood support measures were undertaken to maneuver the immediate impact of COVID-19 for individuals and businesses through Druk Gyalpo's Relief Kidu (DGRK). This was further supported by the phase-wise implementation of monetary and fiscal policy measures to sustain business activities and to support the domestic demand from unsustainable fallout. With the Phase III monetary policy measures coming to end by June 2022, the Royal Monetary Authority in collaboration with the Royal Government of Bhutan has formulated to roll-out Phase IV Monetary Measures to revitalize and reinforce the existing policy measures to support the economic recovery.

The re-opening of business activities in recent months combined with relaxation of labor imports have created room for economic recovery. Such implementation has been vied as timely to cushion not only the impact of the omicron variant, but reminiscently to minimize the spillover effects of conflict in Ukraine and sanctions. However, together with rising global inflationary and domestic demand boosting conditions, cannot rule out long term inflation expectations above the implicit target rate. Consequently, existing growth recovery policy measures are impacted and becoming costlier. Nevertheless, several central banks including the Reserve Bank of India have increased policy rates to contain inflationary pressure, which has a direct impact on domestic monetary policy settings.

While the latest GDP growth and employment outlook are expected to be firmer, driven by strengthening of domestic demand. The recent new economic normalization and the transition to endemicity has strengthened economic activity, with improved investment prospects underpinned by enhanced budget appropriation for investment projects. However, risk to growth and employment remains with the rising import prices, sudden escalation of import volume, weaker-than-expected growth and tightening of monetary policy in the region, and further escalation of geopolitical conflict.

In the medium term, inflation will remain elevated at 5-6 percent, hampering a smooth transition to economic recovery. The inflationary outlook is determined by global price dynamics, impacted by global shortages and imposition of export restriction on the selected items, such as edible oil and wheat. The soaring price of petroleum products posed a considerable risk to inflation through direct and indirect pass-through effects. Nevertheless, a quick monetary and other unconventional responses in the region as well as globally, followed by optimization of spare production capacity in the economy from the supply front, and maintaining credible interest rate policy throughout the pandemic period would partly contain price pressure.

Most importantly, a sign of rising inflation continues to outstrip a moderate level of growth and income expectations. Moreover, the heightening of global interest rate against rising inflation will further exert downward pressure on exchange rate, making import bills and debt service more expensive, impacting foreign exchange reserves.

Until the transition to the new economic normal, with subdued domestic demand, pressure on the external sector was limited. Now, with increasing dependency on imports, with increasing price of imports and depreciation of exchange rate, it will result in serious external imbalances.

Overall, liquidity in the banking system remains in surplus. As of March 2022, the liquidity surplus of Nu 39.89 billion is more than adequate to finance three times the net credit disbursed within the last one year. The relaxation of CRR from 10.0 percent to 7.0 percent, persistent build up in retail deposits with deposit rates maintained at pre-pandemic level, several liquidity provision facilities against pandemic and the drastic slowdown in credit demand resulted in a buildup of liquidity. Despite economic activities at abyss, Non-Performing Loans (NPL) has been maintained at a manageable level.

Nevertheless, with increasing economic activity, demand for domestic credit from both the government and private sector is expected to rise. The projected fiscal deficit in the budget estimates of FY 2022/23, recorded 7.6 percent of GDP, equivalent to Nu 22.88 billion deficit financing requirement. Despite improvement in the fiscal deficit, it may impose unexpected pressure on the domestic credit market given limited external financing. While the foreign exchange reserves is expected to finance 22 months of essential imports.

Accordingly, the RMA in consultation with the Royal Government of Bhutan has implemented Phase IV monetary policy measures to support economic recovery, while ensuring a sound financial system and sustainable external position. Moving forward, it must be understood that the existing monetary relief measures are temporary in nature which can only support borrowers to navigate through current economic circumstances. Given the past NPLs, a major impediment to a sound financial system, the NPL Resolution Framework remains one of the windows of Monetary Measures IV, and support for the targeted sectors.

Despite rising inflationary pressures induced by the supply-chain disruptions during the pandemic period, except for selected impacted sectors, provisioning of credit facilities and regulatory relaxations, RMA continued to operate accommodative monetary policy stance. In lieu of heightened uncertainty surrounding inflationary pressure and rapid rise in imports, posing formidable headwinds to vibrant growth recovery, RMA will continue with it's existing monetary policy stance in a more calibrated manner.

As RMA envisages gradual withdrawal of some of the stimulus implemented during the pandemic, such as interest support policy and providing loan deferments, the implementation of Phase IV Monetary Policy Measures will support towards achieving accommodative monetary policy by providing support to the targeted sectors.

1. Recent Economic Developments

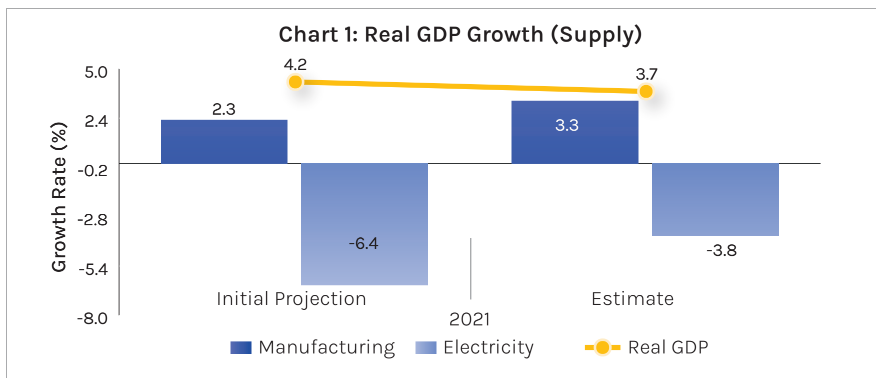
After the contraction in economic growth as a result of COVID-19 pandemic, there has been a sign of gradual global economic recovery in 2021. According to the World Economic Outlook Update (April 2022) of the International Monetary Fund (IMF), the global economy grew by 6.1 percent in 2021, against a growth of -3.1 percent in 2020. On the regional front, emerging and developing Asian economies recorded a growth of 7.3 percent in 2021 compared to -0.8 percent in 2020.

Similarly, the Indian economy significantly rebounded to a growth of 8.9 percent in 2021 from a low of -6.6 percent in the previous year. The upward trajectory in the growth was largely supported by availability of COVID-19 vaccines, the relaxation of travel restrictions and economic stimulus packages.

In 2021, the domestic economy is estimated to grow by 3.7 percent compared to -10.1 percent in 2020.

The estimated growth of 3.7 percent is a downward revision from an initial projection of 4.2 percent.

Chart 1: Real GDP Growth (Supply)

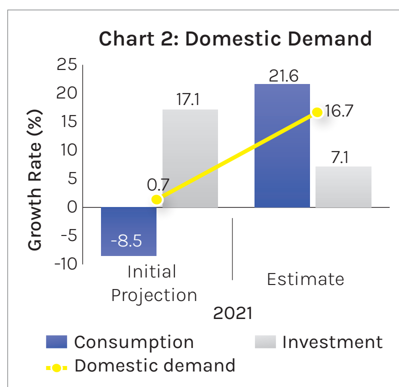


The downward revision is attributed to a lower performance in the construction and agriculture sectors. Initially the construction sector which

was projected to grow at 31.4 percent witnessed a growth of 20.7 percent in 2021. The disruptions in the supply of raw materials and restriction on mobility of foreign workers adversely impacted this sector. Similarly, the agriculture sector was downward revised to 3.3 percent from the earlier projection of 6.7 percent. This is largely driven by the decline in crop and livestock production. Declining farm productivity, labor shortages and market uncertainty are some of the factors that led to this decline.

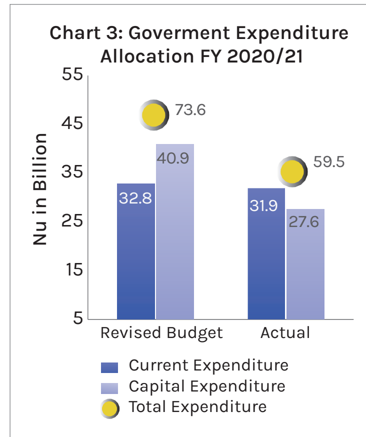
On the contrary, the service sector growth is estimated to improve by 3.1 percent in 2021, against the initial projection of 1.1 percent. As a part of a strategy to support the business enterprises and gradual relaxation in the business activities is expected to drive this sector.

The gross domestic demand in 2021 is estimated to grow by 16.7 percent compared to the initial projection of 0.7 percent. This has been driven by a substantial improvement in the growth of consumption demand owing to a significant increase in private consumption.



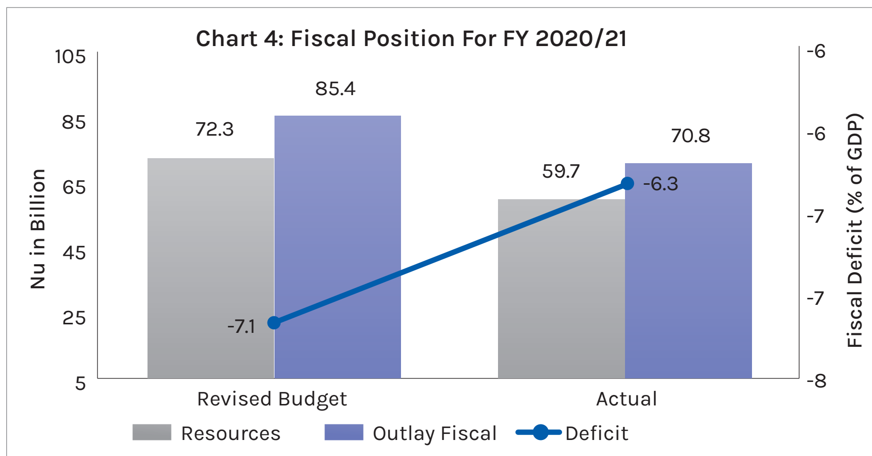
Total consumption is estimated to grow by 21.6 percent in 2021, against the initial projection of -8.5 percent. More than three-fourth of the total consumption comprises of private consumption, which grew by 28.9 percent against an earlier projection of -12.9 percent. However, the gross investment has decreased to 7.1 percent in recent estimate from earlier estimate of 17.1 percent in 2021. Substantial decrease in government capital expenditure followed by private construction activities led to a fall in the gross investment.

Contained economic activities amidst the pandemic have also resulted in the lowering of government expenditure to Nu 70.84[1] billion against an initial budget outlay of Nu 85.38 billion in FY 2020/21. Of the total expenditure of Nu 59.47 billion (excluding NRF), the current expenditure accounted for 53.6, while the capital expenditure accounted for 46.3 percent.



During the period, the variance between the revised budget and the budget outturn stood at 17.0 percent, equivalent to Nu 14.54 billion. This was mainly on account of under-utilization of capital budget by 32.5 percent. In terms of recurrent budget, more than 97 percent (Nu 31.89 billion) was utilized.

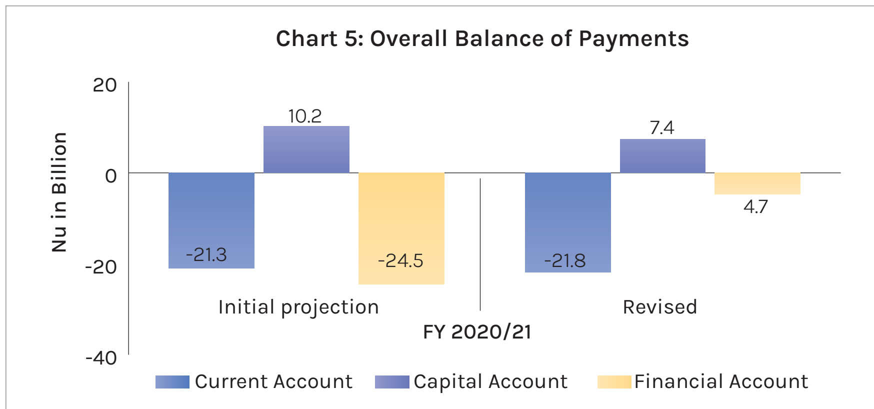
Despite the slow-down in economic activities, domestic revenue recorded a modest growth of 7.7 percent, compared to an earlier assessment of Nu 33.28 billion in 2020/21. This development was factored by an increase in non-tax revenue by 19.5 percent from the revised target. The additional collection of Nu 3.68 billion profit transfer from Mangdechhu Hydropower has largely contributed to the increase in non-tax revenue. However, external grant has decreased from an initial estimate of Nu 25.54 billion to Nu 14.42 billion.



[1] This also include National Resilience Fund (NRF) of Nu 11.6 billion during the FY 2020/21

Consequently, the total resources for FY 2020/21 decreased to Nu 59.70 billion, against a revised target of Nu 72.27 billion, recording a drop of 17.4 percent. Following a decrease in both the total expenditure outlay and the total resources, the fiscal stance slightly improved, with the deficit falling to 6.3 percent of GDP, down from a revised target of 7.1 percent of GDP in the FY 2020/21.

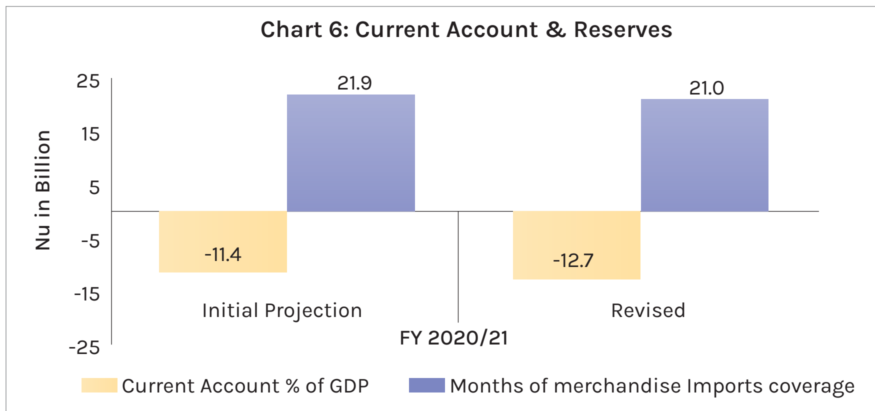
Unlike in the past, the overall balance of payments during the FY 2020/21 was recorded at negative Nu 6.27 billion compared to the initial projection of Nu 13.49 billion. The overall current account deficit widened by 2.5 percent from the initial projection of Nu 21.26 billion.



Moreover, the trade balance deteriorated by 11.5 percent due to higher imports. Net primary income payments recorded a significant decrease by 35.6 percent from the initial projection of 17.56 billion mainly on account of fall in hydropower loan interest payments. On the other hand, the net secondary income receipts decreased by 36.3 percent to Nu 10.38 billion.

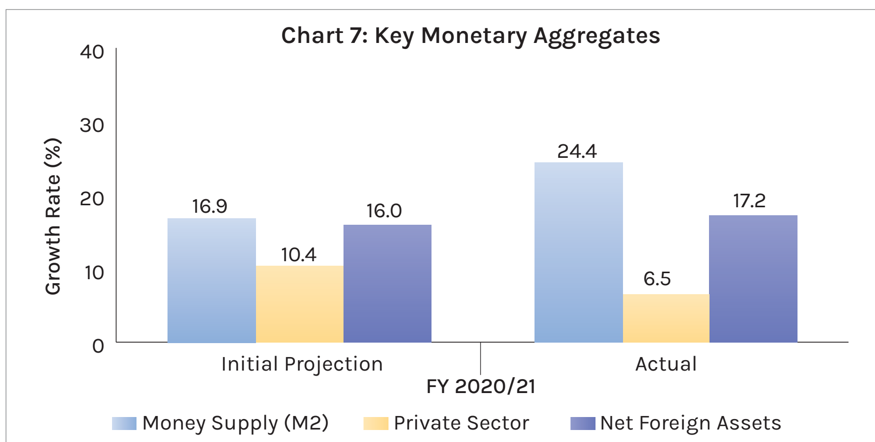
The capital account also witnessed a decline in the form of hydropower grants by 47.3 percent to Nu 1.27 billion against earlier projection of Nu 2.41 billion due to the impact of COVID-19 on work progress in hydropower projects. Similarly, non-hydro grants decreased by 21.5 percent amounting to Nu 6.15 billion.

Concurrently, the financial inflows deteriorated by 81.0 percent to Nu 4.66 billion against the initial projection of Nu 24.51 billion with a decline in external borrowings and foreign direct investment.



Consequently, the gross international reserve has also decreased to USD 1.56 billion in the FY 2020/21 from a preliminary projection of USD 1.57 billion in December 2020, which is sufficient to finance 21 months of merchandise imports and 28 months in terms of essential imports. Of the total reserve, USD 1.27 billion constituted convertible currency with the remaining in Indian Rupees.

The broad money supply (M2) growth which was initially projected at 16.9 percent for FY 2020/21 recorded at 24.4 percent. An increase in time deposits by 32.9 percent in FY 2020/21, compared to 19.2 percent in the previous period was the primary driver of the M2. The limited investment avenues, combined with favorable returns on term deposits resulted in

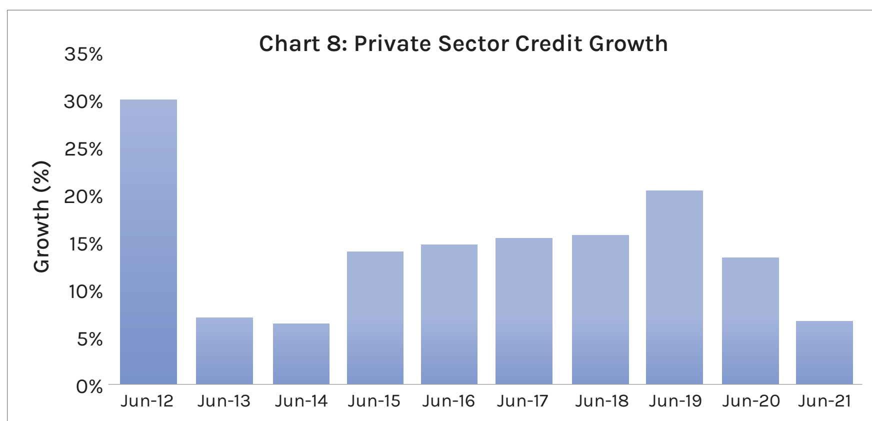


higher growth in long-term deposits.

On the sources of money supply, the increase was largely contributed by significant rise in the domestic credit to 17.0 percent against initial projection of 6.7 percent. As a measure to stimulate economic activities and support the livelihoods of the people affected by the pandemic, higher domestic borrowing by the Government through issuance of marketable securities in the banking sector led to an increase in the net bank credit to government, amounting to Nu 6.40 billion. On the other hand, the Net Foreign Assets (NFA) growth slowed down to 17.2 percent compared to initial projection of 31.6 percent in FY 2019/20. The decline in external loans and grants inflows, and returns from foreign investment abroad contracted the NFA holdings.

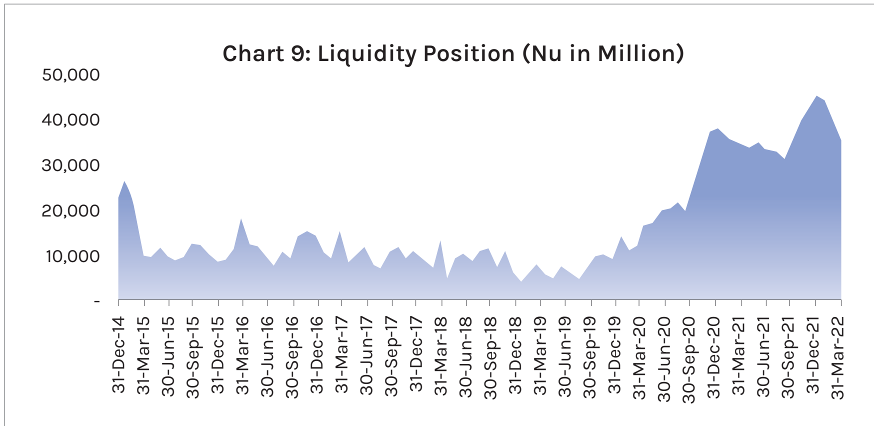
Of the total domestic credit, the private sector credit experienced a lower growth of 6.5 percent in the FY 2020/21 compared to an earlier projection of 10.4 percent, reflecting sluggish private investment demand in the economy. The severity of the impact on the growth was sustained due to a continued support provided in the form of concessional interest rates and working capital loans for the economic sectors affected by the pandemic. In terms of sectoral credit concentration, the building and construction sector accounted 27.4 percent, followed by service and tourism (26.9%), trade and

Chart 8: Private Sector Credit Growth



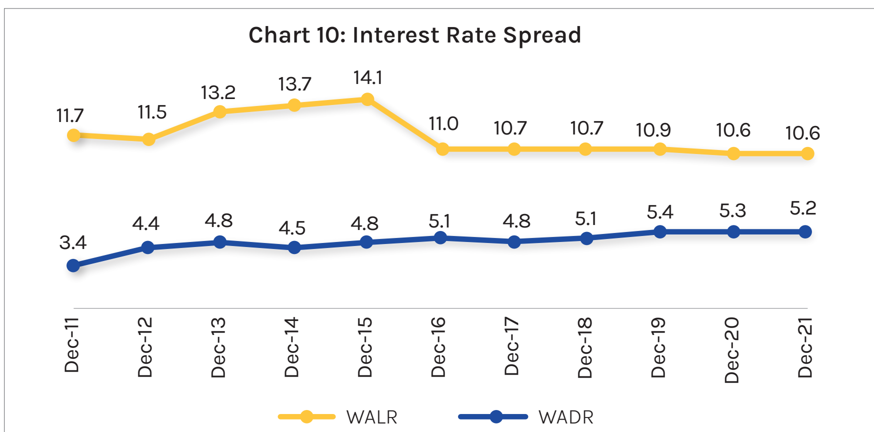
commerce (12.7%), and manufacturing sector (12.5%).

The overall liquidity position in the banking sector continued to remain favorable with the continuation of the DGRK in monetary and fiscal measures. The stable deposit base and limited investment avenues contributed to the



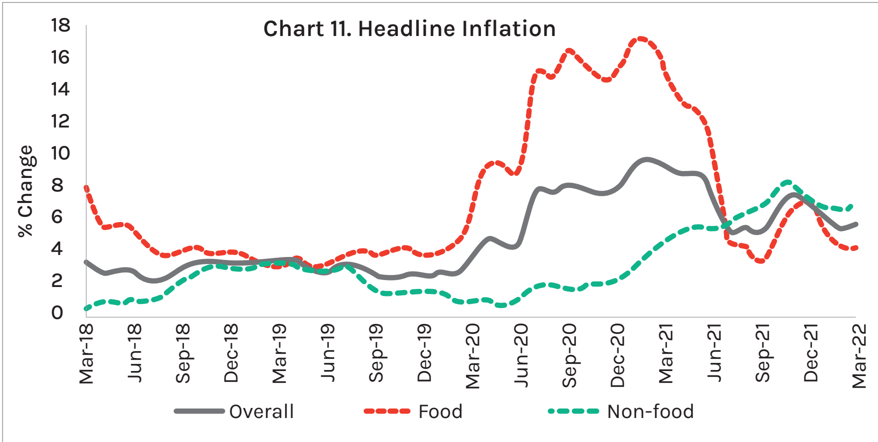
build-up in liquidity position in banking sector. As of April 2022, the liquidity surplus amounted to Nu 34.97 billion, which is adequate to meet the short-term liquidity demand for financing economic activities.

The implementation of the Minimum Lending Rate (MLR) since July 2016 has supported in moderating the final lending rate. The single MLR, which is an average rate of commercial banks stood at 7.2 percent in December 2021, compared to 6.9 percent in December 2020. The higher MLR was mainly contributed by the increase in the Marginal Cost of Fund (MC) from 5.1 percent to 5.4 percent in December 2021, attributed to higher inflow of time deposits. Despite stable Weighted Average Deposit Rate (WADR), a sizeable reduction in the Weighted Average Lending Rate (WALR) has reduced the interest rate spread over the period.

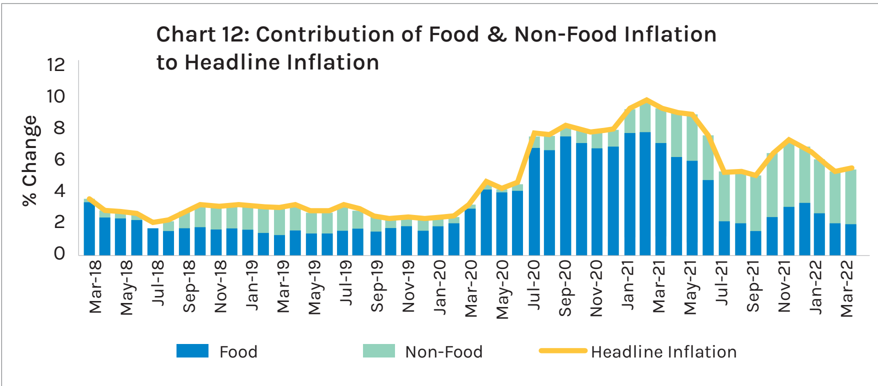


2. Inflation

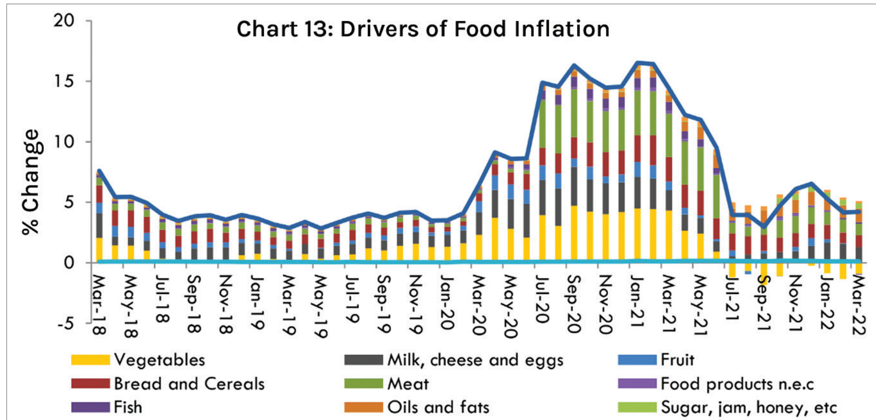
The overall CPI inflation remained elevated at 5.6 percent in March 2022, a fall in 3.5 percentage points from March 2021. This is largely attributed to the slowdown in the food prices driven by meat and vegetable prices. However, the headline inflation is expected to increase in the near term with the recent hike in fuel and commodity prices, global uncertainties and supply disruption.



The major contributor to headline inflation has shifted from food to non-food starting from the third quarter of 2021. The relative contribution of food to overall inflation has decreased to 35.9 percent in March 2022 from 76.3 percent of previous year. However, the contribution by non-food in same period has increased from 23.7 percent to 64.1 percent.

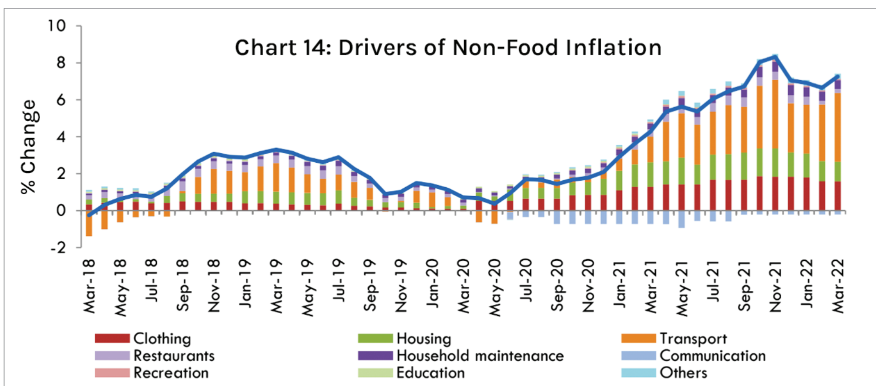


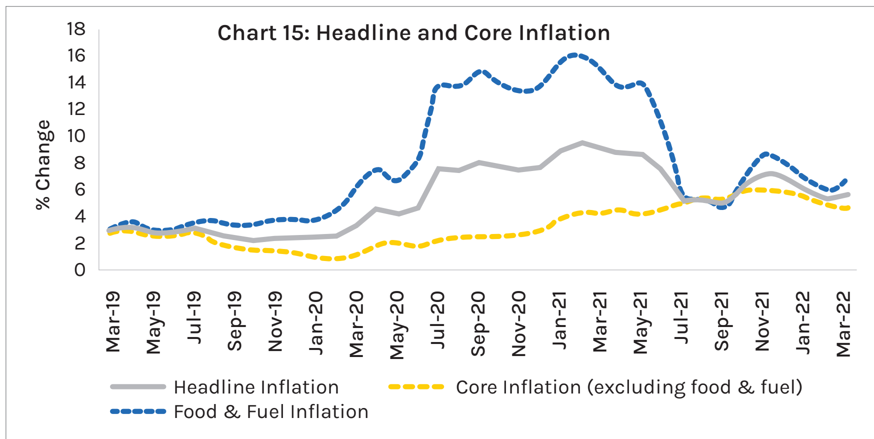
With the gradual relaxations of the COVID-19 protocol restrictions and given higher volatility in nature, food inflation has decreased to 4.0 percent in March 2022 from 15.3 percent last year. The decrease in food inflation was due to a significant drop in the vegetable prices to -4.2 percent followed by moderation of meat prices from 36.6 percent to 8.4 percent.

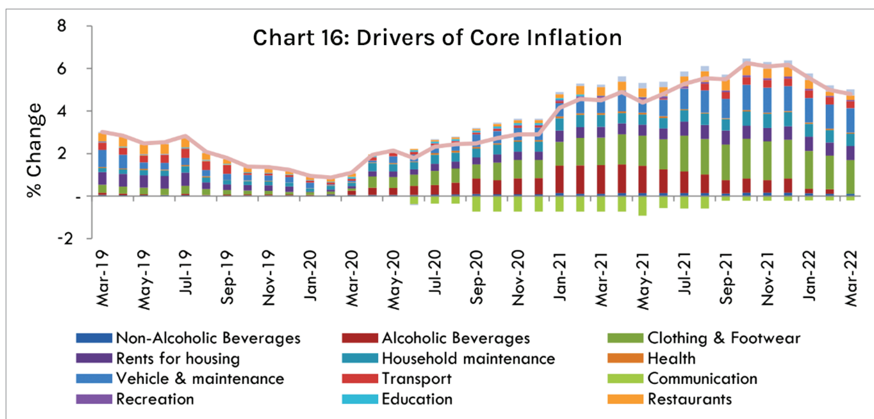


On the other hand, non-food inflation has increased to 7.3 percent in March 2022 from 4.3 percent in March 2021. The increase was mainly due to the rise in transportation prices from 4.6 percent in March 2021 to 12.2 percent in March 2022. Higher transportation cost was driven by a 35.9 percent hike in fuel price in the recent month.

Excluding volatile items such as food and fuel, there has been a gradual increase in the core inflation from January 2021, peaked to 6.0 percent in October 2021. The core inflation was mainly driven by clothing & footwear followed by alcoholic beverages.







In general, the purchasing power of Ngultrum measured by the CPI dropped by 5.3 percent in March 2022 compared to the previous year. In real term, Nu 100 in March 2022 is worth Nu 61 at December 2012 prices.

3. Medium Term Macroeconomic Outlook[2]

The global economy prospects are undergoing heightened uncertainty largely due to ongoing geopolitical tensions, sanctions and long-lived impact of the Omicron variant. The economic effects of the war are spreading through commodity markets, trade, and financial linkages. Against this backdrop, global output is expected to grow at 3.6 percent in 2022 and 2023, which is 0.8 percent and 0.2 percentage points lower than earlier projected *(World Economic Outlook, April 2022)*. The downward revision of global growth is largely because of disruption, shortages and escalating prices induced by the ongoing conflicts and sanctions, which have caused a global recovery set back, slowing growth and a rising humanitarian crisis.

The war related supply disruption is likely to further push the prices of food, metals and energy. As a result, inflation in advanced economies is projected to be at 5.7 percent in 2022 and 8.7 percent in emerging and developing economies and it is expected to remain elevated for much longer than anticipated in the medium-term. The persistent surge in inflation globally is expected to raise the cost of borrowings and interest rates, placing higher debt burden and contingent liabilities, particularly in emerging and developing economies. This has also compelled the central banks in advanced economies to tighten monetary policy in recent months, resulting in capital flight from emerging economies and tightening of external financial conditions for emerging market and developing economies.

On the regional front[3], economic growth is projected to grow at a slower rate of 5.6 percent in 2023 as compared to the pre-pandemic period. The lower growth is largely due to the spillover effect of the strict zero-COVID-19 strategy that led to repeated mobility restrictions and lockdowns in China. On the other hand, India's economic output growth is projected at 6.9 percent in 2023, driven by a rebound in domestic demand, widespread vaccine coverage, robust export growth, and huge investments in the private sector. However, the current geopolitical tensions in the region and the tightening of monetary policy pose challenges for the Indian economy.

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[2]MFCTC Updates, April 2022

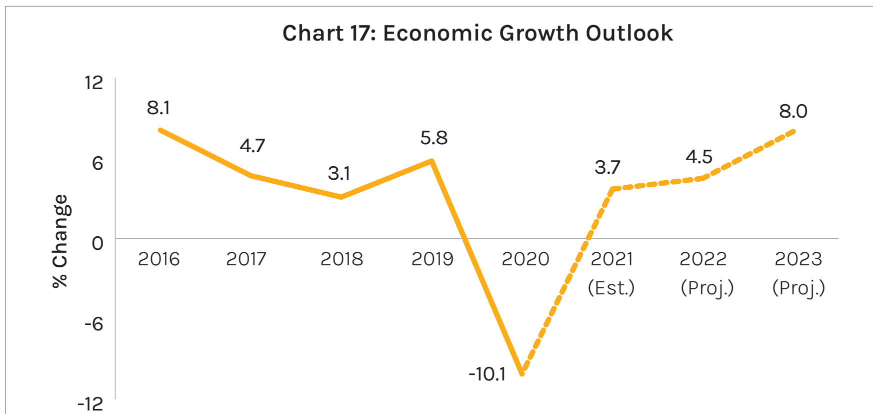
[3]World Economic Outlook, IMF April, 2022

Amidst ongoing conflict in the region, the domestic economy is projected to rebound, supported by sustained policy measures and easing of restrictions. After a deep contraction of growth at -10.1 in 2020, the domestic economy is estimated to grow at 3.7 percent in 2021 and then projected at 4.5 in 2022, which is still below its pre-pandemic level. Some of the underlying assumptions for the growth trajectory are the acceleration of government capital expenditure, absence of emergence of new variants, further relaxations of mobility restrictions and access to private credit.

On the driver of domestic economic growth, the industry and service sectors are expected to rebound faster and stronger in 2022 with a pick-up in domestic private consumption, investment demand and trade performance in the economy. The industry sector is projected to grow at 4.9 percent in 2021 and 4.1 percent in 2022, with favorable performance in the construction and manufacturing sector, which has witnessed negative growth during the pandemic. The construction sector, which contributed around 12 percent of GDP, is projected to grow by 17.1 percent in 2022, with the manufacturing sector at 4.1 percent in 2022 on the resumption of economic activities, a pick-up in trade performance and rise in domestic demand as the pandemic situation improves.

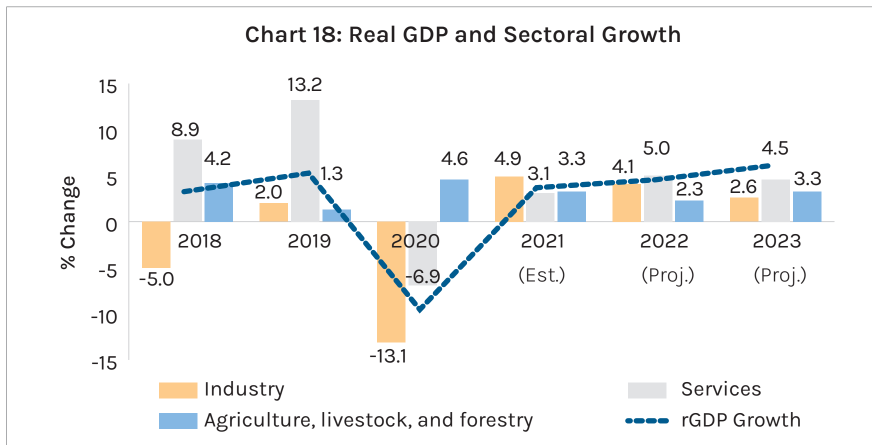
Similarly, the performance of the service sector which largely depends on the tourist arrivals is projected at 4.9 percent in 2022 from 3.1 percent in 2021. As a result of the gradual relaxation of international tourists, the hotel & restaurant sector is expected to perform better, while the transportation and communication sectors are expected to remain uncertain with surge in global fuel and energy prices.

Chart 17: Economic Growth Outlook



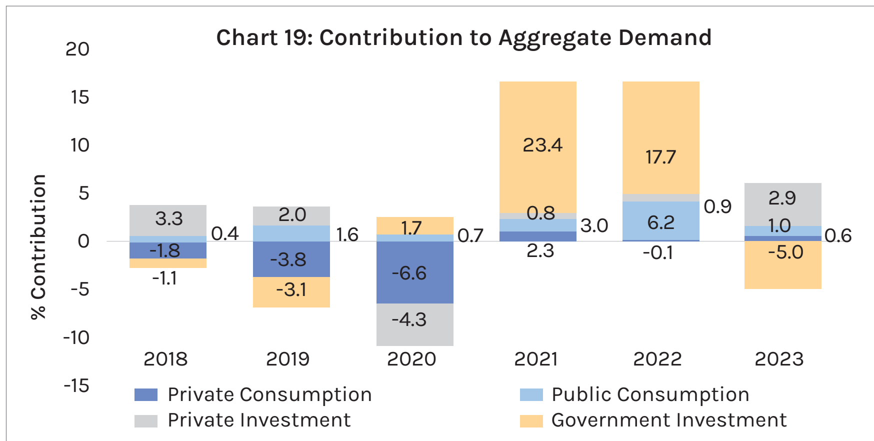
On the other hand, electricity production, which accounted for 17.8 percent of GDP in 2020 and remained resilient during the pandemic, is projected to contract by -4.5 percent in 2022. Falling hydropower exports earnings due to increasing domestic demand to meet upcoming power intensive projects is expected to reduce revenue earnings. Likewise, agriculture sector which experienced a robust growth during the pandemic, is also expected to grow slower at 2.3 percent in 2022 compared to 3.3 percent in 2021. Lower productivity, rising transportation cost, limited logistic network and unpredictable hydrological flows are some of broad-based factors affecting agricultural product output.

Chart 18: Real GDP and Sectoral Growth



On the demand side, after the sluggish domestic demand in 2020, aggregate demand is estimated at 16.7 percent in 2021 and 3.9 percent in 2022, propelled by acceleration in both government expenditure and private consumption growth. As of April 2022, only 43.0 percent of the total capital budget outlay of Nu 133.88 billion for the 12 FYP were utilized and acceleration of the remaining capital expenditure is expected to boost capital formation, which will have a positive spillover impact on the allied sectors. As a result, total investment is projected to grow by 9.9 percent in 2022 as compared to 7.1 percent in 2021.

Similarly, the final private consumption expenditure, which accounts for more than 50 percent of GDP, is also anticipated to experience positive growth as demand for essential commodities and contact- intensive service activities rise. The private consumption is projected to grow moderately at 2.3 percent

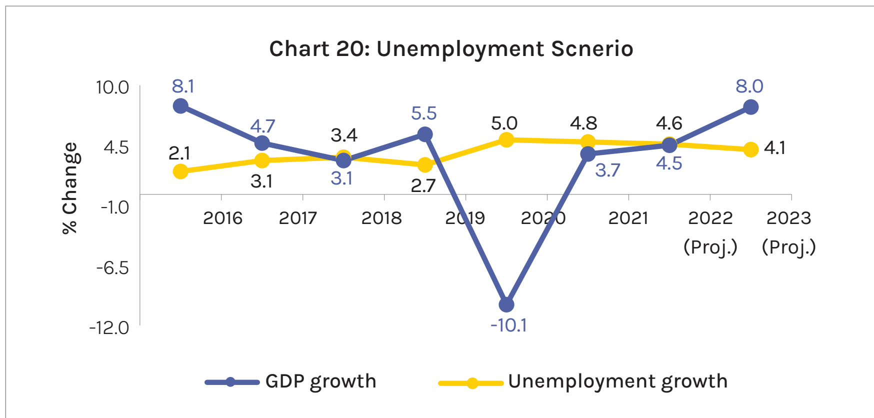


in 2022, while the consumer confidence in spending still remains subdued. The implementation of the Phase IV Monetary Measures even during the post-pandemic, focusing on resolving the past Non-Performing Loans (NPLs), targeted policy support to hardest-hit sectors and credit access to priority sectors, is expected to provide impetus to the economic recovery process in the medium term.

However, the intensification of geopolitical tensions, the surge in global oil and commodity prices and financial market volatility are expected to pose significant downside risks to global economic activity and could have spillovers on domestic growth prospects.

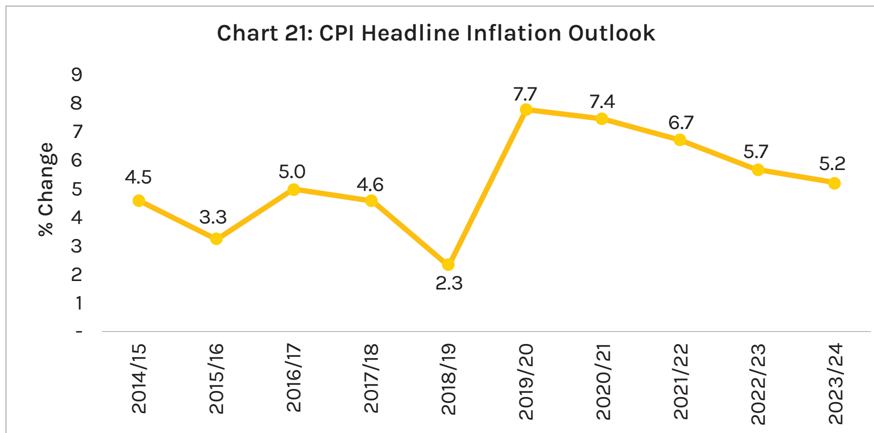
The labor condition is expected to improve in the medium-term with the gradual recovery of contact-intensive economic sector activities, supported by implementation of various skilling programs initiatives. The unemployment situation improved to 4.8 percent in 2021 from 5.0 percent in 2020, contributed by numerous employment schemes and program initiatives such as Skills Development Plan (SDP) and Entrepreneurship Courses provided for the youth cohort. This has also improved the youth unemployment rate to 20.9 percent in 2021 compared to 22.6 percent in 2020.

Labor market conditions are yet to fully recover from the unprecedented shock of the pandemic and are expected to remain lagged and below pre-pandemic level in the medium term. However, considering various intervention measures such as the economic stimulus package, Build



Bhutan Project and other employment engagement schemes, and taking stock of the existing labor force market, the overall unemployment rate is estimated to slightly decline to 4.4 percent in 2022 and 3.9 percent in 2023. However, labor market conditions are expected to stabilize and improve only after 2025, with potential output returning to pre-pandemic level.

Inflation in Bhutan is expected to remain elevated in the medium term, mainly due to surge in global fuel and commodity prices, triggered by geopolitical tension in Ukraine and sanctions. The CPI headline inflation peaked during the first half of 2021, where food prices increased significantly reaching high at 9.5 percent in February before moderating to 5.6 percent in March 2022. For the last two years, food prices were the main driver of inflation. However, starting from July 2021, increase in prices of non-food items dominated the inflation pressure, particularly the rising cost of transport. The price of transport, which mainly constitutes of fuel and energy, accounted for 15.6 percent of the overall CPI basket grew significantly to 12.2 percent in 2022 from 4.6 percent in March 2021. The trend is expected to remain elevated. The sharp rise in price of petrol and diesel, combined with the disruptions in the global supply chain in the form of logistic bottlenecks, increase in shipping costs, and longer delivery time resulted in higher input costs.

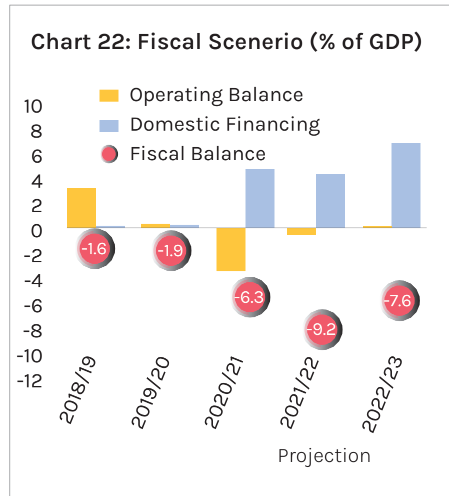


The rising global commodity, fuel and gas prices, combined with shortage of edible oil and wheat production and disruption in the supply chain are expected to have direct spill over effect on domestic food prices. With the recent restriction on the export of sugar by the Indian Government and the rising pass-through of input costs in the manufacturing and services sectors, the CPI headline inflation is projected to remain higher at 5.7 percent 2022-23. The persistent increase in inflation will deter savings, investment, competitiveness and output growth. It will adversely impact the poorer segments of the population by eroding their purchasing power.

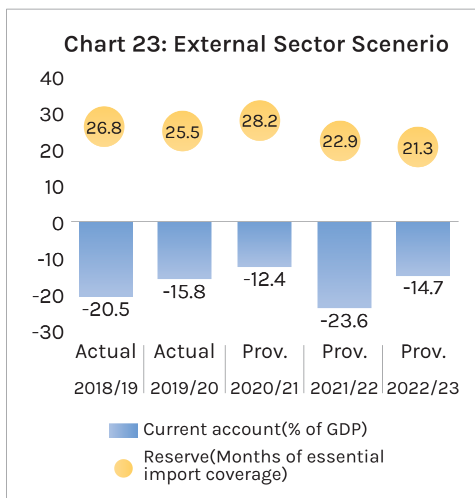
On the fiscal front, the fiscal deficit is expected to remain elevated at 9.3 percent of GDP during the FY 2021/22. This is mainly due to decline in domestic revenue by 4.2 percent and the total expenditure by 2.6 percent in FY 2020/21. In the medium term, the fiscal deficit balance is expected to improve at 5.3 percent of GDP on an average.

Domestic revenue is expected to fall to Nu 35.60 billion, mainly due to decline in net profit transfer from hydropower proceeds and financial institutions during the FY2021/22. While the tax revenue is expected to increase by 7.0 percent underpinned by a slight increase in the tax on business, personal, and goods and services during the period. With an improvement in the situation, economic activities are expected to pick up in the medium term. The domestic revenue for the FY 2022/23 is forecasted at Nu 36.36 billion against the current expenditure of Nu 36.34 billion, fulfilling the provision of the constitutional requirement on meeting recurrent expenditure from the internal sources of the country.

The total expenditure, on the other hand, is expected to decline by 2.6 percent during the review period, mainly on account of fall in current expenditure by 18.2 percent to Nu 35.60 billion from the previous year. The allocation of capital expenditure is expected to increase by 21.2 percent to Nu 33.43 billion as the economic conditions improve. Going forward, fiscal deficit is expected to improve to 7.6 percent of GDP during the FY 2022/23 as per the 3rd quarter of MFCTC updates as of April 2022 assessment.



The fiscal deficit is anticipated to be financed through domestic borrowings with the issuance of long-term government bonds and short-term 90-days treasury bills while the remaining is to be financed from external borrowings. With a higher expected fiscal deficit balance during the FY2021/22, the public debt to GDP ratio is projected to remain elevated at 126.4 percent of GDP during the review period, compared to 135.4 percent of GDP in the previous year.



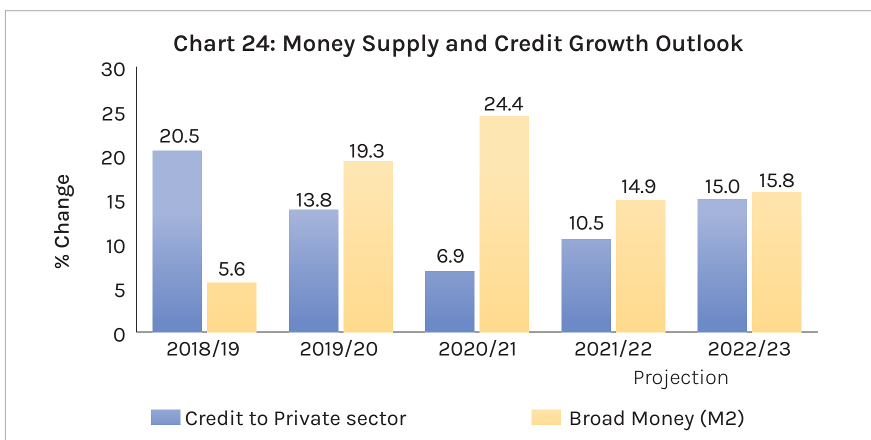
During the FY 2021/22, the current account deficit is estimated at Nu 44.47 billion (23.6% of GDP) against Nu 21.88 billion (12.4% of GDP) in the previous year. In contrast, inflows in the financial account in the form of hydropower project and government related borrowings are expected to be on the higher side during the period. Consequently, the change in reserves is expected to be negative Nu 12.92 billion.

However, the improvement in the macroeconomic outlook, the overall balance of payments is expected to improve from the FY2022/23 onwards. The grant inflows in the capital account are also anticipated to increase on an average, while inflows in financial accounts are expected to decline. With these, the overall balance is expected to improve.

As a result, the expected gross international reserve is adequate to finance 22 months of essential imports during the FY2021/22 and 21 months in the FY2022/23.

Despite the contraction of economic activities and build-up of inflationary pressures in 2020, monetary and liquidity conditions continued to remain favorable. The accommodative monetary policy stance remained supportive of economic growth and investment. With a surplus liquidity in the banking sector and the dispensation of regulatory policy measures, there has been a sustained easing of commercial banks final lending rates since the introduction of MLR in 2016 as indicated by the higher credit to deposit ratio, which remained above 90 percent. The WALR, which determines the cost of borrowing, fell from 14.0 percent in 2016 to 10.6 in 2022, resulting in higher growth in demand for household consumption and investment in the economy.

Money supply is estimated to grow at an average of 16.1 percent in the medium-term in tandem with nominal GDP growth and inflationary pressure. Credit to the private sector is projected to grow moderate at 15.0 percent in



FY 2022/23 to support rising aggregate demand for services, construction and manufacturing sectors. However, the recent temporary restriction of loan provisions by three financial institutions is expected to weigh uncertainty in the domestic credit outlook. If adequate safety measures for the financial sector are not put in place, the protracted period of loan restrictions is likely to put the financial sector under stress and risk. The NPL as of September 2021 improved to Nu 21.77 billion (15.0 percent), with the service & tourism sector recording the highest NPL (29.2 percent), followed by manufacturing at 19.0 percent.

As part of the comprehensive national response to the NPLs, the RMA has developed a comprehensive NPL resolution framework to provide relief to both financial institutions and borrowers for short to medium terms, while also creating an ecosystem for promoting a new credit culture and supporting the economic recovery process.

Banking liquidity conditions remained favorable and adequate to support credit growth. As of March 2022, the excess liquidity in banking sector stood at Nu 39.89 billion (22.1 % of GDP) contributed by the inflow of foreign currency, stable deposits and the impact of CRR lowering. With the implementation of Phase IV monetary measures, the liquidity position in the banking system is expected to remain adequate to meet the government's domestic borrowing to finance the required fiscal deficit without crowding out credit to the private sector as economic activities pick-up. The effective management of banking liquidity is important for promoting money market and stock exchange markets.

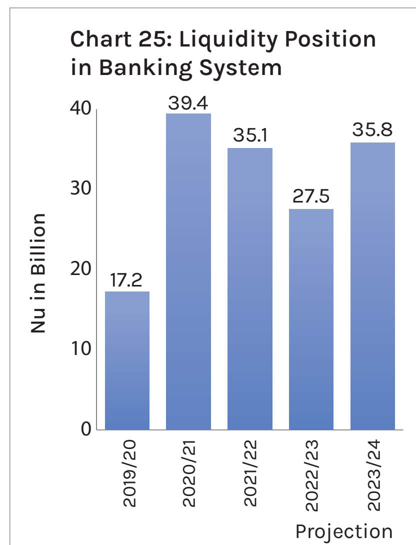


Table 1. Medium-term Macroeconomic Outlook

Items	2019	2020	2021	2022	2023
	Actual	Actual	Estimates	Projection	
Production (Supply)*					
Real GDP	5.5	-10.1	3.7	4.5	3.9
Agriculture	1.3	4.6	3.3	4.3	4.5
Industry	2.0	-13.1	4.9	4.1	2.6
Manufacturing	0.0	-20.8	3.3	4.1	3.3
Electricity & water	12.1	25.2	-3.8	-4.6	9.2
Construction	-14.7	-20.6	20.1	17.1	-5.2
Services	12.5	-6.9	3.1	5.0	4.5
Expenditure (Demand)*					
Gross domestic demand	-3.7	-8.8	16.6	3.9	1.1
Consumption	7.1	-5.6	21.5	1.2	8.1
Public	10.8	4.1	3.6	5.3	5.6
Private	4.5	-9.1	28.8	-0.2	0.0
Investment	-16.8	-14.5	7.1	9.9	-13.2
Public	-31.2	24.4	23.4	17.7	-34.4
Private	-12.3	-22.7	0.8	6.2	2.9
Output gap (% of potential)*	-2.9	-3.7	-6.0	-4.3	0.6
Unemployment rate (%)*	2.7	5.0	4.8	4.6	4.1
Financial Year (FY)	**2019/20**	**2020/21**	**2021/22**	**2022/23**	**2023/24**
Prices					
Headline inflation	2.7	7.7	6.7	5.7	5.2
Implicit Inflation target/ reference inflation rate	4.5	4.5	4.5	4.5	4.5
Fiscal (% of GDP)					
Operationg balance	0.4	-4.4	-0.7	0.1	4.8
Fiscal balance	-1.8	-6.0	-9.3	-11.3	-4.4
Domestic financing requirement	0.3	5.9	5.3	8.6	10.1

External (% of GDP)					
Current account balance	-12.2	-33.7	-24.6	-15.1	-10.9
Trade balance (goods)	-9.8	-19.2	-17.4	-8.3	-3.1
Gross reserves (Mill USD)	1,343.5	1556.2	1328.0	1298.3	1260.6
Reserves to Essential Import Coverage (Months)	20.0	28.7	22.4	20.7	20.4
External debt	121.9	125.7	121.8	117.9	129.1
Exchange rate (Nu/USD)	75.5	73.7	76.6	76.8	77.0
Monetary Sector Development					
Reserve requirement	6.5	11.1	12.2	15.8	15.7
Broad Money (M2)	19.3	24.4	15.0	16.1	15.9
Net Foreign Assets (NFA)	32.6	17.2	8.3	21.5	13.8
Net Domestic Asset	5.7	34.5	23.1	10.3	18.3
o.w credit to private sector	20.5	6.5	10.5	12.3	13.6
Credit to deposit ratio	97.3	97.3	91.4	88.5	86.7
External Environment					
Global GDP*	2.9	-3.3	6.1	3.6	3.6
GDP growth, India*	6.1	-8.0	8.9	8.2	6.9
Inflation, India*	3.7	6.2	5.5	6.1	4.8
LIBOR*	2.3	1.9	1.9	1.9	1.9
Key policy rate, India*	5.7	4.3	4.9	-	-
Exchange rate (INR/USD)	75.0	73.0	73.6	75.0	75.8
Memo:					
Nominal GDP at market prices (Mn. of Nu)-FY	179,568.0	171,572.9	181,218.5	196,543.9	220,760.5

Data are as of FY ending June unless marked with (*) are in calendar year basis. Source: Macroeconomic Framework Coordination Committee (MFCC), Ministry of Finance, April 2022 updates, World Economic Outlook, IMF, April 2022 updates, and Monetary Policy Statement, April 2022, Reserve Bank of India (RBI).

4. Review of Monetary Measures

Overview of Monetary Measures Phase I, II & III

Under the visionary leadership of His Majesty the Druk Gyalpo, the National Resilience Fund (NRF) was instituted in April 2020 to provide economic relief to support the affected individuals and businesses and cushion the risks of the pandemic on the economy and the financial sector, through the provision of income support and Interest Payment Support (IPS) measures. Complementing the DGRK, the RMA also implemented monetary measures and ease prudential requirements as well. These inclusive and broad-based measures have not only provided immediate economic relief to individuals but also helped in mitigating the immediate liquidity requirements to the affected sectors/businesses and helped the financial sector to avert the risk, particularly the build-up of non-performing loans.

The RMA remained steadfast working closely with the Government during the pandemic period. Monetary Measures were implemented in phase wise, Phase I (April to June 2020), Phase II (July 2020 to June 2021) and Phase III (June 2021 to June 2022). The key elements of the three phases of Monetary Measures implemented are summarized below:

Phase I

- Concessional Term Based Working Capital for Wholesale Distribution, Tourism and Related Business and Industries.
- Deferent of loan Repayment
- Extension of Gestation Period for Projects under Construction
- Loans to Cottage and Small Industries

Phase II

- Conversion of Term Based Working Capital Facility
- Deferent of loan repayment
- Concessional Short-Term Loans to Micro Business and CSIs
- Concessional Term Loans to Businesses (Bridging Loans)

Phase III

- Deferment of loan repayments
- Incitive for regular repayments during the deferment period
- Non-capitalization of interest accrued during the deferment period
- Treatment of soft term loans (Bridging Loans) sanctioned under Monetary Phase I
- Revision of Loan to Value Limit and adoption of Land valuation

Monetary Measures Phase IV

The past two phases and the ongoing phase III Monetary Measures have helped individuals and businesses to remain resilient during the pandemic. As the Monetary Measures III will come to end by the end of June 2022, MM IV is formulated to provide continued support in targeted sectors, based on the magnitude of disruption by pandemic. Unlike the past three phases of Monetary Measures, the Phase IV Monetary Measures will adopt targeted support measures and strategies to achieve the following three key objectives:

- ✔ Support Economic Recovery process with improved End-to-End Credit Ecosystem
- ✔ Address the impact of the COVID-19 pandemic on the affected borrowers; and
- ✔ Maintain continued stability and resilience of the financial system.

The Phase IV Monetary Measures shall be implemented through the following three windows covering past NPL, present credit portfolio and future credit outlook:

4.1 Window I: Resolution of Past Non-Performing Loans

As of March 31, 2020, the total NPL stood at Nu. 28.16 billion which accounted to 18.0 percent gross NPL. The NPL reduced to Nu. 17.05 billion (Gross NPL of 9.5%) as of 31 st December 2021 mainly due to the implementation of NPL Resolution Framework and the recovery efforts by FSPs. Of the remaining NPL of Nu. 17.05 billion, Nu. 4.37 billion (1,305 NPL accounts) are already being pursued for legal foreclosure. The remaining NPL of Nu. 12.68 billion (6,594 accounts) needs to be resolved either through rehabilitation (debt restructuring) or foreclosure within the next 365 days (moving from past legacy of accumulating NPLs over years).

It is important to understand that the relief measures are temporary in nature and are only aimed at helping the borrowers to navigate through the current circumstances with the expectations to resume servicing of debt obligations once the pandemic is over. While extending such relief measures, it is important to ensure that individuals and businesses are not burdened with high indebtedness through extended periods of loan deferment. To address such risks, the RMA issued two new Regulations and one new Guideline (highlighted below) for the continued resolution of NPLs. The following figure is the framework for NPL resolution.

NPL Resolution Framework

The RMA issued following regulations and guidelines for the resolution of Non-performing Loans:

1. Rules and regulations for Loan Restructuring 2022;
2. Rules and Regulations on Foreclosure and Write-off Non-Performing Loans 2022;
3. Guidelines on the Reclassification of Old Non-Performing Loans 2022.

1. Rehabilitation of Viable NPLs Eligibility:

- Loans deemed as Viable and non-willful as per Rules and Regulations for Loan Restructuring 2022;
- NPLs overdue by less than or equal to 270 days shall be eligible for loan restructuring;
- Meets the affordability assessment of the borrowers.

2. Measures for closure of NPLs

- Out-of-court settlement schemes;
- Establishment of work-out units by FSPs (negotiate for takeover of mortgaged properties);
- Establishment of credit counseling for micro and small borrowers to help manage credit obligations and arrange work-outs;
- In-addition, FSPs may provide any additional measures as approved by their Board of Directors;

* If all above measures fail, the FSPs may proceed to initiate foreclosure through legal measures.

4.2 Window II: Targeted Support Measures for Existing Loans

Phase I to III Monetary Measures provided deferment of loan repayment on all eligible loan accounts from April 2020 to June 2022. The continuation of such deferment on all loan accounts is not seen as a prudent practice as it will lead to building up of credit risk due to growing indebtedness and postponement of debt recovery over a protracted period. Furthermore, it will create critical mismatches in the asset-liabilities of the FSPs. Therefore, while providing continuous support, Monetary Measures IV shall focus on the targeted sectors and sub-sectors that require support measures and contributes to the economic recovery.

4.2.1 Eligibility for Targeted Support Measures

As per the risk and impact assessment, the sectors and subsectors are classified into three different risk categories viz High, Moderate and Low. The targeted sectors and sub-sectors listed under this monetary measure

shall be eligible for the Qualitative Support Measures (QSM) as per their risk classification.

i. For Individual Loan Accounts Holders, the eligibility for the QSM shall be based on the targeted sector/subsectors and the financial vulnerabilities of the borrowers as per their risk classification.

ii. For Corporate Group that is a group of companies operating as a parent and subsidiary companies, it shall be assessed in a consolidated manner to determine the need for the QSM. The FSPs shall at least review the latest audited financial statements, including income statements and cash-flow statements to determine the need for appropriate support measures.

iii. The Monetary Measures include a broad list of 'Loan Restructuring' measures which involves modification of existing loan terms to help borrowers with financial difficulties. There are 8 forms of Loan Restructuring measures under Monetary Measures IV. The FSPs may apply one or more of these measures as per the Targeted Sector/ Subsector list.

iv. The following loans shall Not be eligible for QSM:

    a. Loans to Government, Loans to Financial Institutions, Staff Incentive Loans & Credit Cards
    b. Soft Working Capital/Bridging Loans granted under the previous Monetary Measures
    c. Fixed Equated Instalment Facility (FEIF) accounts;
    d. Loans suspended, under litigation or Assets Pending Foreclosure (APF).

v. The Non-Performing Loans shall be treated as per the 'NPL Resolution Framework'

vi. Within the Targeted Sector/ Subsectors, the FSPs shall exercise due diligence and provide one or more loan restructuring measures (QSM) to the borrowers, as per the need and the affordability of the borrowers.

vii. The QSM shall be available for a period of six months (July 2022 to December 2022), within which the FSPs and the borrowers must complete working on the application of relevant Loan Restructuring measures.

Represents targeted support measures along with the eight forms of **Loan Restructuring measures under this Monetary Measures IV**

SL. #	Sector/Sub-sector	Overall Risk Level	8 Forms of Loan Restructuring Measures	
1	Hotels & Restaurants (Tourist Standard/ Budget)	High	1. Deferment of Loan Repayment up to 2 years 2. Partial Repayment (50% of instalment) up to 2 Years	3. Extension of Maturity Period up to 3 Years (in addition to deferment period) 4. Change in repayment frequency (Monthly, Quarterly or Half Yearly Repayment) 5. Conversion of overdraft facility to term-loan 6. Splitting of loans into multiple accounts 7. Transfer of loans to third party 8. Extension of gestation period up to 2 years depending on the progress of the project
2	Tourism (Airlines/Tour Operators/Ticketing & Travel Agents)			
3	Construction (Contract-Based)	Moderate	1. Deferment of Loan Repayment up to 1 year 2. Partial Repayment (50% of instalment) up to 1 Year	
4	Hospitality, Entertainment & Recreational Services			
5	Mining & Quarrying			
6	Manufacturing Enterprises			
7	Handicrafts & Textile Production			
8	Trade (Retail)			
9	Housing (Commercial)			
10	Home Loans			
11	Personal (Consumer loan)			
12	Personal (Mortgage loan)			
13	Transport (Commercial)			
14	Transport (Non-Commercial)			
15	Education Loan			

16	Institutional/Educational Services	Low	Extension of gestation period up to 2 years depending on the progress of the project
17	ICT		
18	Contract (non-construction)		
19	Consultancy Services		
20	Health Services & Traditional Medicines		
21	Wood Based Products		
22	Renewable Energy		
23	Hydro Power		
24	Traditional and Herbal Medicines		
25	Trade (Wholesale)		
26	Crop Cultivation		
27	Livestock Farming		
28	Argo-Processing		
29	Forestry		
30	Personal (Credit Card)		
31	Staff Incentive Loans		
32	Loan Against Fixed Deposits		
33	Loan to Financial Institutions		
34	Others		

5. Financial Sector **Overview**

The COVID-19 pandemic has put the domestic economy to a massive resilient test, since the episode of the Indian Rupee Crunch (2012-13). Although the nation was able to move swiftly to prevent the spread of infection and human mortality from the COVID-19, it witnessed an unprecedented fall in economic activity. Contraction in the economic activities normally translates to bank loses and subdued credit growth.

Despite the fall in economic activity, the pandemic has been unusual for the financial system in the country with a modest growth in income and credit to private sectors. This has largely been possible with the extraordinary measures deployed by the RMA under the guidance of His Majesty The Druk Gyalpo, to support households, businesses, and the financial sector.

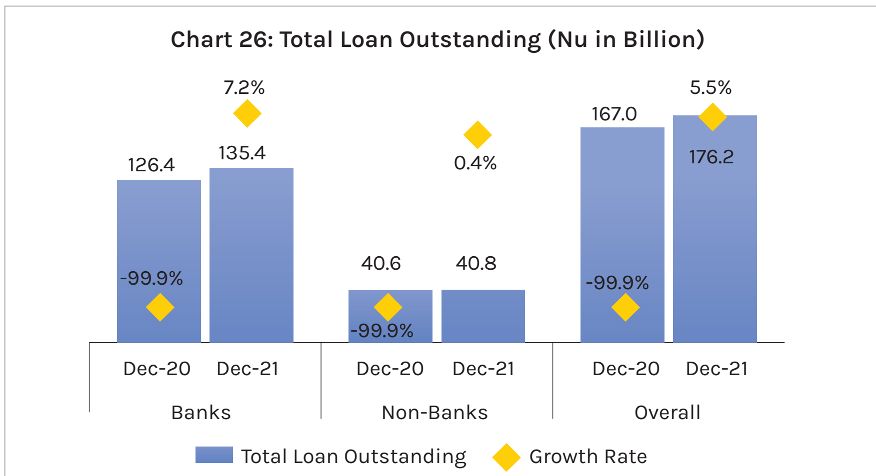
The financial sector's ability to provide credit and bring down the quality of bad assets has been a distinguishing feature of the COVID-19 pandemic. Additionally, the deposits with the commercial banks grew by more than 12 percent, which expanded the banks' reserve position and widened its capacity to lend.

As the global economy sets to navigate away from the COVID-19 pandemic, the financial system's effort to post pandemic recovery is further challenged by the current intensifying geopolitical war (Russia & Ukraine). Given the global-interdependence and interconnectedness of the financial system, it advocates the central banks to adopt prudent financial and monetary policies to withstand abrupt macroeconomic and financial shocks.

Against this background, this section provides an overview of the financial sector development by drawing a brief comparison to the financial sector performance of December 2020.

5.1 Credit Portfolio

The financial institution in the country consists of five commercial banks and three non-banks. Banks in particular have been playing an important role in promoting private demand in the economy. As of December 2021, almost 77.0 percent of the total loans and advances amounting to Nu 135.42



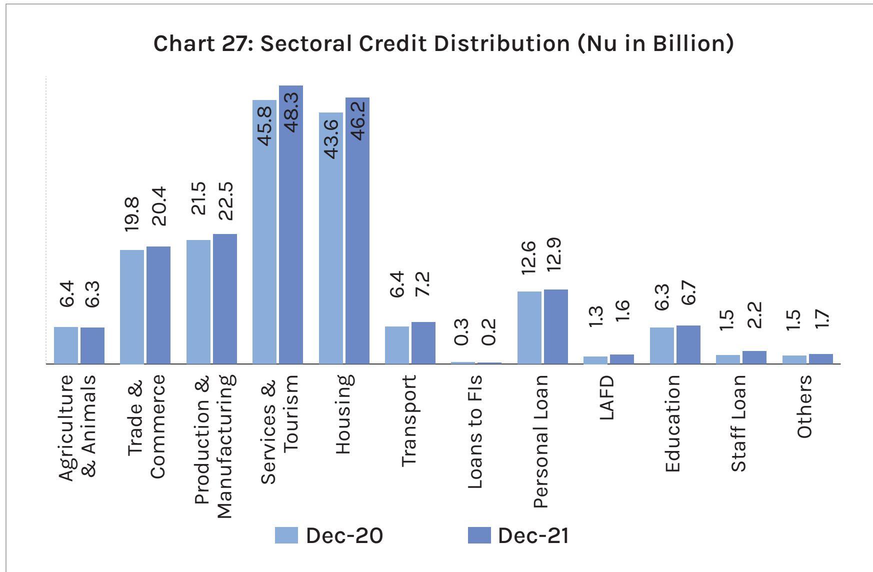
billion have been provided by the commercial banks. From the total credit portfolio of Nu 176.21 billion, slightly higher than 23.0 percent is financed by the non-banks consisting of RICBL, BIL and NPPF.

The domestic credit growth declined from 8.2 percent in 2020 to 5.5 percent in 2021, despite recording an absolute expansion of Nu 9.22 billion. While the banks witnessed a marginal decline in credit growth, non-banks experienced a substantial dip in the growth to 0.4 percent from 7.5 percent in 2020. As part of a monetary measure, the RMA reduced the CRR requirement to 7 percent amidst the pandemic. Since the CRR requirement is applicable only to the banks, most of the loans sanctioned under the monetary measures has been limited to the commercial banks.

Prior to the onset of the COVID-19 pandemic, the booming construction industry and tourism sector was a major investment avenue for many enterprises. Although these sectors have been severely impacted by the pandemic, they continue to hold the largest share of credit flow. As of

December 2021, loans to the service and tourism sectors accounted for 27.4 percent of the total loan outstanding of Nu 176.21 billion, followed by housing and production with 26.2 percent and 12.8 percent respectively.

Chart 27: Sectoral Credit Distribution (Nu in Billion)

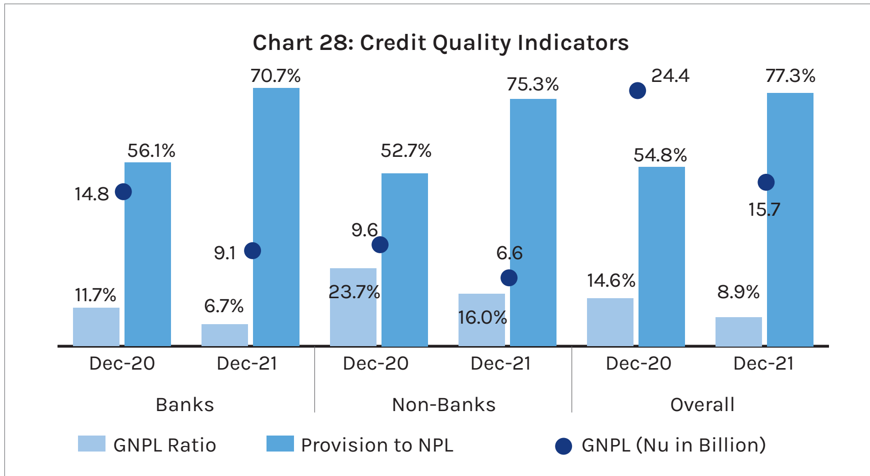


Except for agriculture and loans to FIs, other sectors recorded a growth from marginal to exponential. Due to travel restrictions amidst the pandemic, activities related to agriculture could not pick up during the review period. The increase in the portfolio of trade, manufacturing and services sector were largely fueled by the loans granted under the monetary measures.

In June 2021, the RMA permitted the FIs to extend credit facilities to their employees, with an objective to instill desired discipline and promote professionalism. The incentive loans spread across sectors such as housing, vehicle, education, and personal loans. Evidently, staff loans in December 2021 recorded the highest growth of 45.0 percent amounting to Nu 0.67 billion.

5.2 Asset Quality

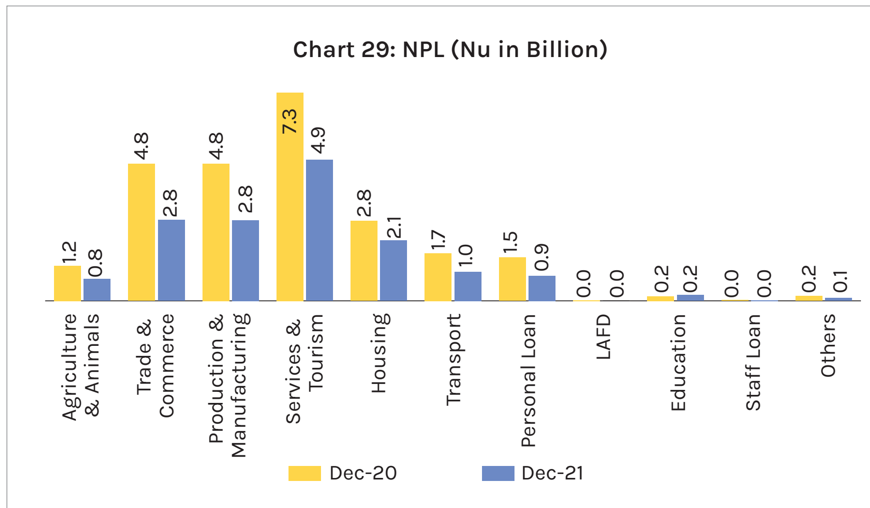
Unlike in the past, the financial sector in the economy witnessed a marked improvement in the quality of assets despite encountering numerous challenges imposed by the pandemic. This was realized through two different channels. Firstly, it was supported by the monetary measures such as IPS



and loan deferment facility. Secondly, the RMA undertook a rigorous as well as prudent management of the NPLs.

By far, the banks comparatively have a low NPL ratio to non-banks, although the absolute figure remains high with the banks. Despite low GNPL ratio, the provisioning requirement has increased substantially for banks as well as non-banks during the review period. The BDBL has the highest share of NPL amongst the banks and RICBL has the highest from the non-banks.

Past trends show that the asset quality in the financial sector normally tend to improve towards the end of calendar year. As the financial sector close



their books of accounts towards the year end, all efforts are made to recover the bad debts and improve the quality of the balance sheet. This effort from financial institutions complemented well with the monetary measures and prudential management.

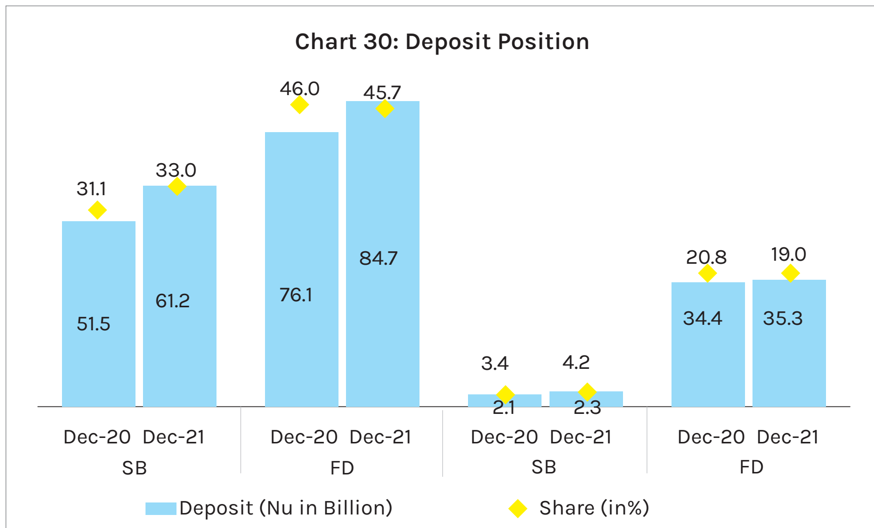
The sectors most severely impacted by the COVID-19 pandemic are tourism and transport. However, due to implementation of timely measures, the financial institutions in the country were able to curb the highest NPL in these sectors. The NPL in all other sectors declined during the review period except for the education loan, which has largely originated from NPPF.

5.3 Deposit Portfolio

The subdued investment opportunities have led to a surge in the bank deposits. The deposits with the banks expanded nearly by the tune of Nu 20 billion. The deposits increased from Nu 165.45 billion in December 2020 to Nu 185.44 billion in December 2021.

An exceptional increase in Savings Deposit (SB) and Fixed Deposits (FD) steered the deposit growth. While SB grew by Nu 9.76 billion, FD expanded by Nu 8.62 billion. Despite having a marginal deposit share of 2.3 percent, RD grew at an exponential rate of 23.5 percent.

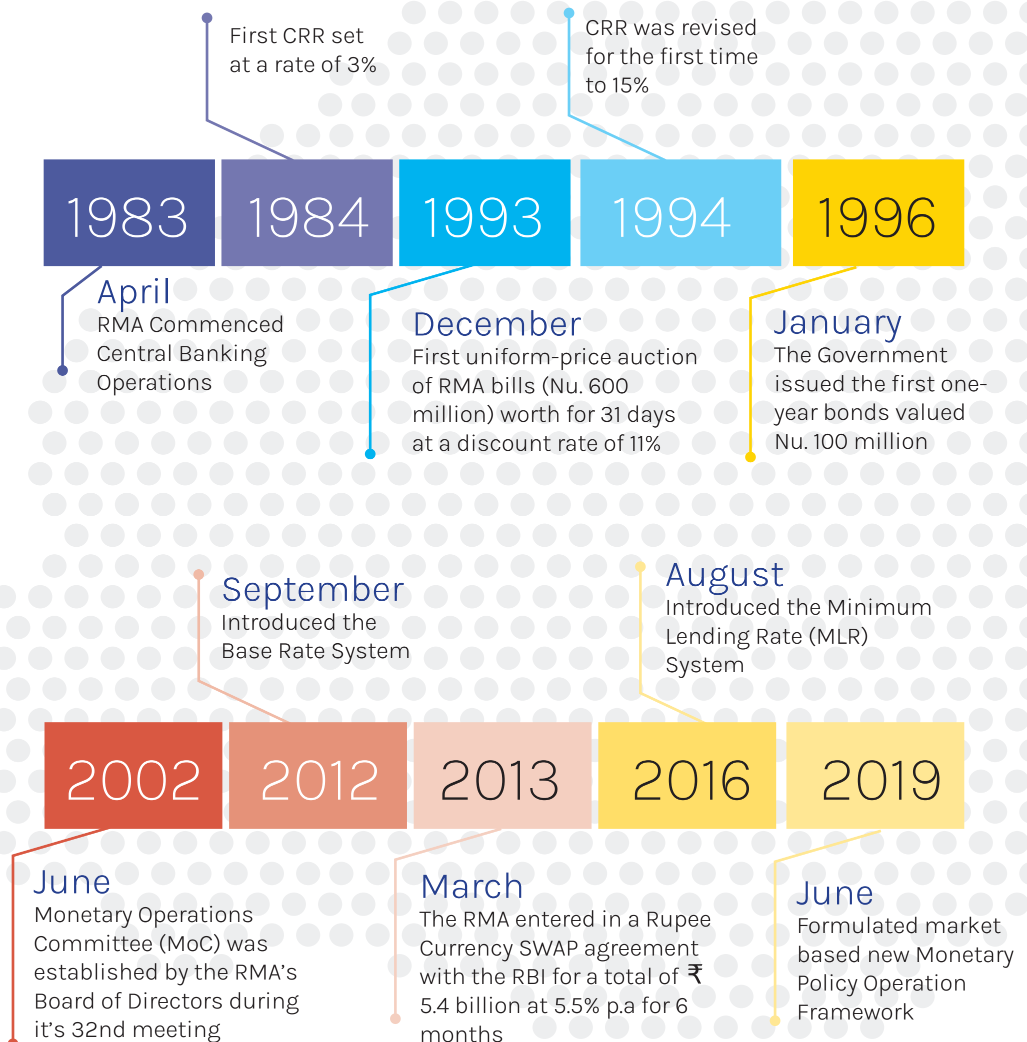
Chart 30: Deposit Position



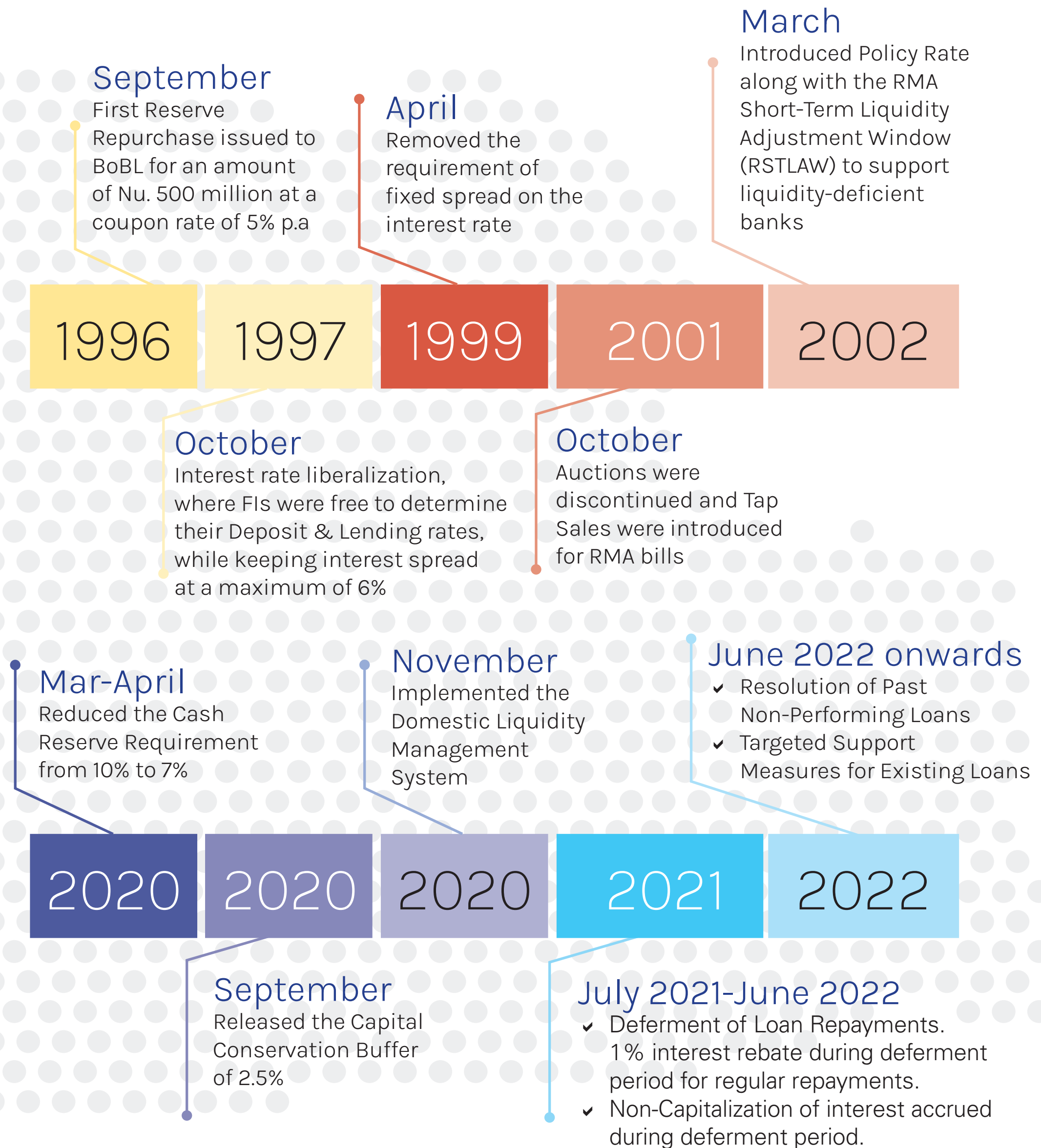
There are various reasons which have propelled the growth of deposits amidst the pandemic. Firstly, the IPS and loan deferment encouraged customers to save, as it eased the loan repayment burden. Secondly, the banks in the country continue to offer attractive deposit rates, particularly on time deposits. Interest rate on time deposits range from 5.0 percent to 9.5 percent per annum depending on the tenure. Thirdly, the prominence of greater digitalization in the financial sector has ensured the funds remain within the banking domain rather than in cash. Lastly, the financial inclusion and literacy drive initiated by the RMA has reached the far-flung areas, benefitting the unbanked and financially illiterate.

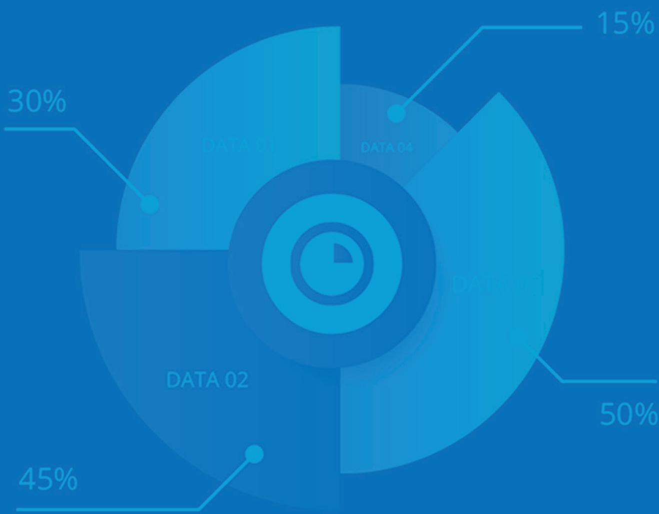
In summary, the financial sector witnessed a sound indicator, stipulating resilience and stability. However, concerns still remain when the monetary measures and IPS will formally end in June 2022. To ensure smooth transition and support new developments, the RMA has already initiated new measures to support post-pandemic economic growth.

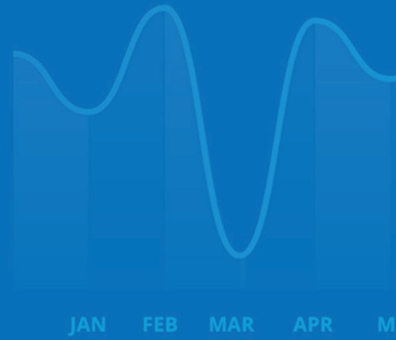
Chronology of **Key Monetary**

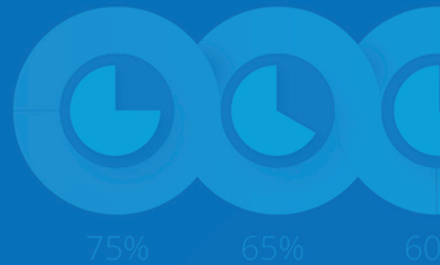


Policy Interventions since 1983









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