BHUTAN

Table 1	2020
Population, million	0.8
GDP, current US$ billion	2.4
GDP per capita, current US$	3079.8
International poverty rate ($1.9)[a]	1.5
Lower middle-income poverty rate ($3.2)[a]	12.2
Upper middle-income poverty rate ($5.5)[a]	38.9
Gini index[a]	37.4
School enrollment, primary (% gross)[b]	105.8
Life expectancy at birth, years[b]	71.5

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) Most recent value (2017), 2011 PPPs.
(b) WDI for School enrollment (2020); Life expectancy (2018).

Output is projected to contract by 1.8 percent in FY20/21, reflecting the adverse impact of the COVID-19 crisis on tourism and non-hydropower industries. Poverty is expected to slightly increase due to high food price inflation and disruptions in agricultural activities. While the state-led hydropower sector cushioned the impact of the crisis on economic growth and fiscal accounts, accelerating reforms to promote private sector development is important to generate more and better jobs.

Key conditions and challenges

Annual real GDP growth has averaged 7.5 percent since the 1980s, mainly driven by public sector-led hydropower development and electricity sales to India. However, while hydropower has provided a reliable source of growth, it has resulted in high fiscal volatility (temporary one-off profits from the on-streaming of hydropower plants boosting revenues and driving up current spending). The capital-intensive hydropower sector has also failed to generate a large amount of jobs. Thus, over half of Bhutan's workforce remains employed in agriculture, primarily of subsistence nature, while one-third is employed in low value-added services. Nonetheless, poverty reduction was impressive, with a decline in the $3.20 poverty rate from 30.6 percent to 12.2 percent between 2007 and 2017, partly supported by a greater commercial orientation of farmers.

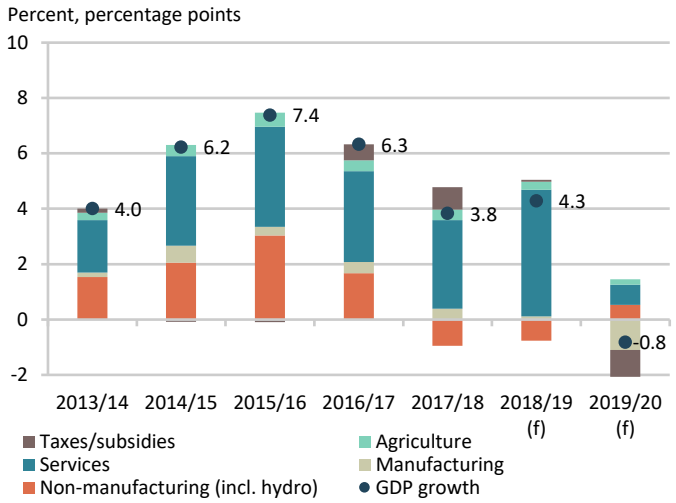
Bhutan has avoided a large-scale domestic COVID-19 outbreak thanks to stringent domestic containment measures, including two nationwide lockdowns in FY20/21. The closure of domestic borders since March 2020 brought the tourism industry to a standstill and disrupted trade with India, Bhutan's main trading partner. As a result, many workers in the services sector, especially in urban areas, experienced job and/or earning losses. The government launched a COVID-19 recovery package, with emphasis on agriculture, tourism, and construction.

The pace of economic recovery will depend on how fast COVID-19 vaccines can be deployed globally, and specifically in India (given significant tourism and trade linkages). Domestic risks include delays in hydro projects and lower-than-expected hydropower production (due to adverse weather patterns) as well as the materialization of financial sector contingent liabilities, which could strain government finances. The implementation of revenue measures, particularly the goods and services tax (GST), is critical to expanding domestic resource mobilization.

Recent developments

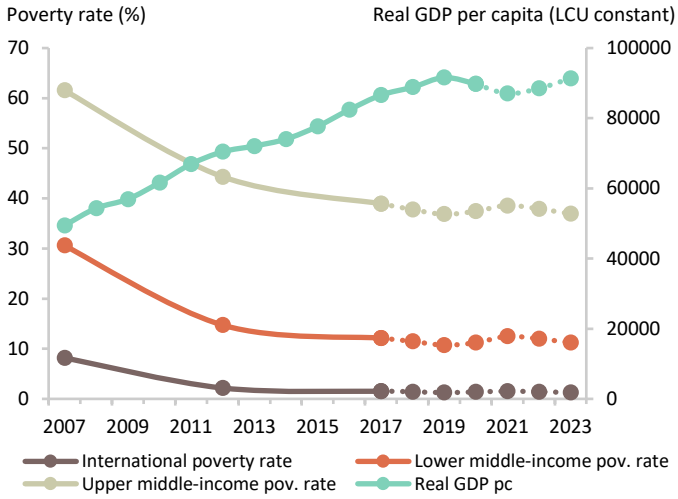
The economy contracted by 0.8 percent in FY19/20. Lower tourist arrivals y-o-y in the second half of FY19/20 (January to June 2020) dampened services sector growth. While the hydropower sector performed well thanks to the on-streaming of the Mangdechhu hydroelectric power plant, other industrial activities have been significantly affected by supply-chain disruptions (for critical inputs, including foreign labor), and depressed external demand (especially from India). On the demand side, public consumption and net exports supported growth. An increase in hydro exports more than offset the decline in non-hydro exports, and imports for infrastructure projects were subdued. However, there was a contraction in private consumption

FIGURE 1 Bhutan / Real GDP growth and sectoral contributions to real GDP growth



Sources: Government of Bhutan and World Bank staff calculations.

FIGURE 2 Bhutan / Actual and projected poverty rates and real GDP per capita



Sources: World Bank. Notes: see Table 2.

and investment due to domestic containment measures and disruptions in infrastructure projects.

Average inflation increased from 3.0 percent in FY19/20 to 7.7 percent in the first half of FY20/21. While non-food inflation remained modest, averaging 1.7 percent in the first half of FY20/21, food inflation averaged 15.3 percent–due to import restrictions on food and severe supply disruptions. High food inflation–along with disruptions in the production, transport, and sales of agricultural products–likely eroded the real incomes of many rural poor. This is expected to have led to a slight increase in the $3.20 poverty rate, from 10.7 in 2019 to 11.2 percent in 2020.

The current account deficit narrowed to 12.2 percent of GDP in FY19/20, mainly thanks to a smaller trade deficit. Hydropower exports doubled as a share of GDP, more than offsetting the decline in non-hydro exports, which have been severely impacted by the border closure and lower external demand during the last quarter of the fiscal year. Meanwhile, goods imports declined, as the pandemic depressed public investment–including hydro projects. Gross international reserves increased by 22 percent (y-o-y) to US$ 1.43 billion in November, equivalent to 16.1 months of FY19/20 goods and services imports.

The fiscal deficit widened to 3.2 percent of GDP in FY19/20 with spending growing faster than revenues. While the latter was boosted by one-off profits from hydropower, non-hydro revenues decreased with the discontinuation of excise duty refunds from India and lower-than-normal tourism receipts. The increase in spending was primarily driven by the increase in salaries and wages (40 percent, y-o-y) and an increase in capital expenditures. Public debt rose to 120.7 percent of GDP as of June 2020 (up from 106.6 percent in FY18/19). However, debt sustainability risks are moderate as the bulk of the debt is linked to hydropower project loans from India (to be paid off from future hydro revenues), which reduces re-financing and exchange rate risks.

Outlook

Under the baseline scenario, economic growth is projected to contract further by 1.8 percent in FY20/21 (July 2020 to June 2021). Services sector output is expected to fall by 3.7 percent, as tourism activity is not expected to reopen until mid-2021. Labor shortages, high input prices, and trade disruptions are expected to weigh on construction, manufacturing, and non-hydro exporting industries. Output is expected to return to pre-pandemic levels (in real terms) in FY21/22, when tourist inflows gradually resume and activities in the non-hydro industry pick up.

The current account deficit is expected to remain low relative to pre-COVID levels. Non-hydro exports are expected to recover gradually, supported by the global recovery and a resumption of tourism. Import growth is projected to increase gradually over the medium term, in line with increases in public investment.

The fiscal deficit is projected to increase sharply in FY21/22, with the discontinuation of profit transfers from Mangdechhu (4.0 percent of GDP in FY20/21), upward pressure on current expenditures (due to higher salaries and the COVID-19 recovery package), and downward pressures on non-hydro revenues from weak economic activity. Thereafter, the deficit should narrow to pre-COVID levels (in FY23/24) as profit transfers from Puna II begin. Public debt is expected to remain elevated as a share of GDP due to low economic growth, high financing needs, and an increase in hydropower debt (in FY22/23).

The $3.20 poverty rate is projected to rise further to 12.5 percent in 2021, given continued disruptions in economic activities.

A delay in the domestic rollout of vaccines could further impact economic activity. However, a faster-than-expected implementation of the COVID-19 recovery package, including employment programs and the national credit guarantee scheme to small and medium-sized enterprises, could support domestic job creation and growth.

TABLE 2 Bhutan / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017/18	2018/19	2019/20 e	2020/21 f	2021/22 f	2022/23 f
Real GDP growth, at constant market prices	3.8	4.3	-0.8	-1.8	2.9	4.5
Private Consumption	10.0	10.1	1.0	-4.0	3.0	0.2
Government Consumption	3.7	7.0	30.0	1.8	2.2	0.6
Gross Fixed Capital Investment	-3.6	-11.4	-29.2	-8.1	3.7	0.5
Exports, Goods and Services	5.5	9.6	12.5	-23.2	10.3	23.5
Imports, Goods and Services	3.6	0.5	-3.6	-22.0	8.6	6.7
Real GDP growth, at constant factor prices	3.2	4.5	0.4	-1.8	2.9	4.5
Agriculture	3.6	2.7	1.9	2.0	3.0	3.0
Industry	-1.3	-1.6	-1.5	-0.7	2.2	5.4
Services	7.8	10.8	1.6	-3.7	3.4	4.0
Inflation (Consumer Price Index)	3.7	2.8	3.0	7.2	3.7	3.7
Current Account Balance (% of GDP)	-19.1	-21.1	-12.2	-10.2	-10.9	-7.0
Fiscal Balance (% of GDP)	-1.6	-1.6	-3.2	-5.4	-7.4	-5.9
Debt (% of GDP)	110.5	106.6	120.7	121.5	120.5	133.9
Primary Balance (% of GDP)	-0.3	-0.7	-2.7	-4.3	-5.8	-4.3
International poverty rate ($1.9 in 2011 PPP)[a,b]	1.4	1.3	1.4	1.5	1.4	1.3
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]	11.5	10.7	11.2	12.5	12.0	11.2
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]	37.8	36.9	37.4	38.6	37.9	36.9

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations based on SAR-POV harmonization, using 2017-BLSS.Actual data: 2017. Nowcast: 2018-2020. Forecast are from 2021to 2023.

(b) Projection using neutral distribution (2017) with pass-through = 0.7 based on GDP per capita in constant LCU.