

# BHUTAN

## Recent developments

**Table 1** 2019

Population, million	0.8
GDP, current US\$ billion	2.5
GDP per capita, current US\$	3288.6
International poverty rate (\$ 19) <sup>a</sup>	1.5
Lower middle-income poverty rate (\$3.2) <sup>a</sup>	12.2
Upper middle-income poverty rate (\$5.5) <sup>a</sup>	38.9
Gini index <sup>a</sup>	37.4
School enrollment, primary (% gross) <sup>b</sup>	100.1
Life expectancy at birth, years <sup>b</sup>	71.5

Source: WDI, Macro Poverty Outlook, and official data.

Notes:

(a) Most recent value (2017), 2011 PPPs.

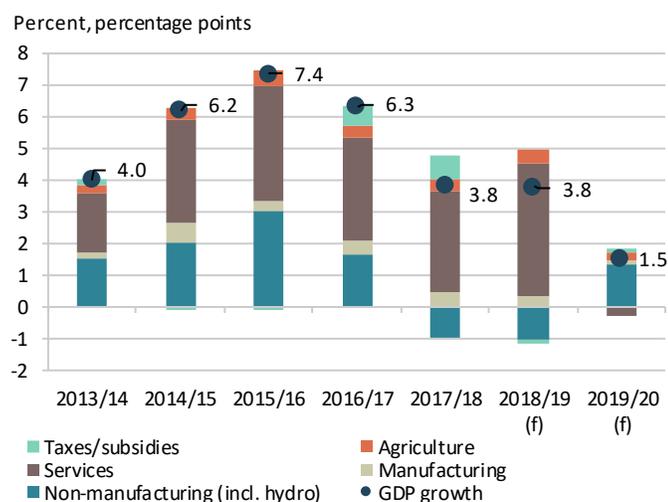
(b) Most recent WDI value (2018).

Real GDP growth is estimated at 1.5 percent in FY20 reflecting COVID-19 related disruptions, including in the tourism sector and industrial production. The fiscal balance deteriorated due to salary increases and higher government spending. Medium-term growth prospects are subdued and risks are tilted to the downside, particularly in the event of a large scale domestic outbreak of COVID-19. The poverty rate is expected to remain unchanged at 11 percent in 2020, reflecting lack of progress due to the pandemic.

Bhutan's economy has been affected significantly by the COVID-19 crisis, with real GDP growth decelerating to 1.5 percent in FY20 (from 3.8 percent in FY19). Even though Bhutan managed to contain the number of domestic COVID-19 cases, the economy was affected through two main channels: a decline in the services sector as tourist arrivals dried-up, and disruptions in industrial activities, reflecting reduced foreign demand, shortages in critical inputs (including foreign labor), and temporary export restrictions. However, hydropower production and exports increased in FY20 due to the on-streaming of the Mangdechhu project. On the demand side, consumption, public investment, and net exports declined due to domestic containment measures, disruptions in public sector infrastructure projects, and the lockdown in India -Bhutan's largest trading partner-, which affected supply chains. In spite of relatively low growth, headline inflation accelerated to 7.6 percent in July 2020, driven by food prices and reflective of similar trends in India. Asset quality in the financial sector deteriorated further. The Non-Performing Loan (NPL) ratio rose to 17.7 percent in March 2020, up from 10.9 percent in December 2019. While this partly reflects seasonal fluctuations in NPL cycles, the sector has been adversely impacted by weak underwriting standards and supervision, and the effect of COVID-19 on businesses and households.

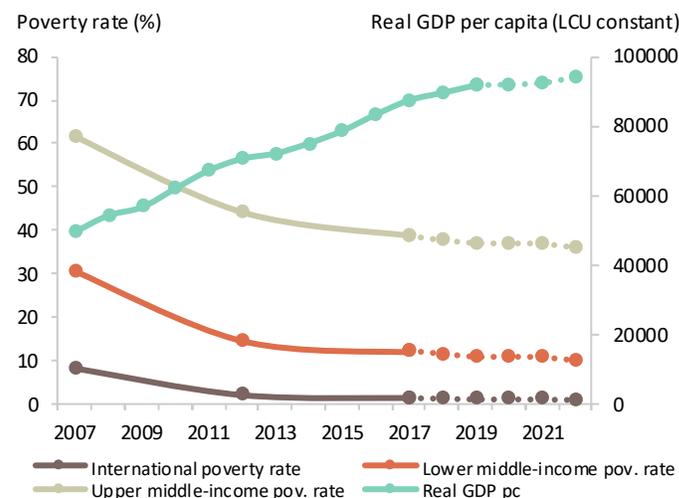
The growth deceleration drove a reduction in trade activity and a narrowing of the current account deficit. Both exports and imports decreased, in line with weak foreign and domestic demand, and disruptions to trade. Given that imports declined significantly more than exports the current account deficit narrowed to 14 percent of GDP in FY20 (down from 22.5 in FY19). The fiscal balance, however, deteriorated, with salary increases and additional COVID-19 related expenditures driving the deficit to 3.1 percent of GDP in FY20. Total spending is estimated to have increased by 27.4 percent in FY20. Total revenues also increased, but to a lesser extent, and were driven by a one-off profit transfer from the commissioning of the Mangdechhu hydropower plant. Non-hydro revenues declined with the discontinuation of excise duty refunds from India and lower tourism receipts. With a higher deficit, public debt is projected to have increased, albeit modestly (to 109.1 percent of GDP from 104.4 at end FY19). The poverty headcount, measured at \$3.20 per day per person (in 2011 PPP terms), is estimated to have decreased slightly, from 11.5 percent in 2018 to 11 percent in 2019. Services sector workers in urban areas, including many that directly or indirectly depend on tourism, experienced jobs and earnings losses since the COVID-19 outbreak. However, tourism is highly concentrated in just a few districts with very low poverty while almost all of the poor live in rural areas, primarily engaged in subsistence agriculture, and are thus relatively shielded from the economic fallout of the pandemic.

**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.

## Outlook

Economic growth is projected to slow markedly, averaging 2.5 percent a year over the medium term, well below the pre-COVID-19 five-year average of 5.5 percent. Tourism is expected to recover only gradually, given that travel restrictions in Bhutan will likely continue until at least early 2021, delaying a rebound in overall services sector growth. The slowdown in India is expected to depress manufacturing and exporting industries, and the construction sector is also likely to experience a protracted slowdown due to a limited pipeline of public sector infrastructure projects. Finally, hydropower production is expected to pick up marginally in FY21, providing limited support to industry sector growth. Inflation will likely remain elevated in the short term because of localized food shortages resulting in higher prices, but a moderation in prices is expected in the medium term. Relative to previous years, the current account deficit is expected to remain lower in

the medium term mostly on account of subdued imports for public investment and hydropower projects. However, the fiscal deficit is projected to increase to 6.7 percent of GDP in FY21 before gradually decreasing over the medium term. This trend reflects upward pressure on expenditures to implement the COVID-19 recovery package and downward pressures on non-hydro revenues from weak economic activity.

The pandemic is expected to significantly slow down the pace of poverty reduction. The poverty headcount rate (at \$3.20 per day) is projected to remain unchanged at 11 percent in 2020. Unemployment will likely remain high, particularly in tourism related activities, though temporary cash support through the Druk Gyalpo's Relief Kidu should help mitigate the impact of earnings losses. Reduced demand for agricultural products could lower exports and hurt agribusinesses. Elevated food prices could disproportionately impact poor households since not all of their food requirements are met by own production. This could exacerbate high levels of pre-existing malnutrition and should be closely monitored.

## Risks and challenges

Given the unpredictability of the pandemic's course, there is a high degree of uncertainty over the ultimate growth and poverty trajectory. The most acute risk to the outlook is a large-scale domestic outbreak of the virus leading to prolonged mobility restrictions. The materialization of financial sector contingent liabilities is another potential risk, which could strain government finances. Other domestic risks include lower-than-expected hydropower production and delays in the implementation of revenue measures, particularly the goods and services tax, which are critical to offset the decline in excise duties and grant financing in the medium term.

The immediate opportunities are to prevent a large-scale community transmission of the virus and to ensure that the national response to COVID-19 is well coordinated across sectors. There is also an opportunity to accelerate the policy reforms required to boost private sector job creation and economic diversification.

**TABLE 2 Bhutan / Macro poverty outlook indicators**

(annual percent change unless indicated otherwise)

	2016/17	2017/18	2018/19	2019/20 e	2020/21 f	2021/22 f
<b>Real GDP growth, at constant market prices</b>	6.3	3.8	3.8	1.5	1.8	2.0
Private Consumption	0.0	10.1	6.0	1.5	2.0	3.5
Government Consumption	4.3	3.7	4.5	6.0	5.0	4.0
Gross Fixed Capital Investment	4.4	-3.6	7.2	-19.5	-10.4	-5.6
Exports, Goods and Services	0.4	5.5	-5.7	-3.9	-9.6	3.1
Imports, Goods and Services	-5.3	3.6	4.4	-20.2	-15.4	-1.6
<b>Real GDP growth, at constant factor prices</b>	6.0	3.3	4.2	1.5	1.8	2.0
Agriculture	3.6	3.7	3.8	2.5	3.1	3.5
Industry	4.7	-1.2	-1.6	3.7	2.0	1.5
Services	8.2	7.9	9.9	-0.6	1.3	2.2
<b>Inflation (Consumer Price Index)</b>	4.3	3.7	2.8	3.2	5.0	2.8
<b>Current Account Balance (% of GDP)</b>	-23.9	-19.1	-22.5	-14.0	-13.8	-12.3
<b>Fiscal Balance (% of GDP)</b>	-4.8	-2.8	0.7	-3.1	-6.7	-5.3
<b>Debt (% of GDP)</b>	111.8	110.5	104.4	109.1	108.8	109.1
<b>Primary Balance (% of GDP)</b>	-3.5	-1.5	1.6	-2.1	-5.6	-3.7
<b>International poverty rate (\$1.9 in 2011 PPP)<sup>a,b</sup></b>	1.5	1.4	1.3	1.3	1.3	1.2
<b>Lower middle-income poverty rate (\$3.2 in 2011 PPP)<sup>a,b</sup></b>	12.2	11.5	11.0	11.0	10.8	10.2
<b>Upper middle-income poverty rate (\$5.5 in 2011 PPP)<sup>a,b</sup></b>	38.9	37.8	37.1	37.0	36.9	36.0

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 and fiscal year growth rates. Actual data: 2017. Nowcast: 2018-2019. Forecast are from 2020 to 2022.

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