

BHUTAN

Table 1	2021
Population, million	0.8
GDP, current US\$ billion	2.4
GDP per capita, current US\$	3069.5
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	71.8
Total GHG Emissions (mtCO2e)	-5.5

Source: WDI, Macro Poverty Outlook, and official data.
 a/ Most recent value (2017), 2011 PPPs.
 b/ WDI for School enrollment (2020); Life expectancy (2019).

Output is estimated to have contracted by 3.7 percent in FY20/21, with broad based contractions in the non-hydro industrial and services sector, reflecting COVID-19-related disruptions. The fiscal deficit has increased to 6.3 percent in FY20/21 due to fiscal measures to support livelihoods and the recovery of the economy, amid subdued revenue performance. Poverty is expected to have increased with the economic contraction translating into lower household incomes.

Key conditions and challenges

Economic growth had been strong prior to the COVID-19 pandemic, fueled by the public sector-led hydropower sector and strong performance in the services sector, including tourism. Annual real GDP growth averaged 7.5 percent since the 1980s, and the poverty rate dropped from 36 percent to 12 percent from 2007 to 2017, based on the \$3.20/day poverty line. While the hydro sector has provided a reliable source of growth, it did not create many jobs, which remain concentrated in agriculture and the public sector. Growth constraints related to the country's unique geographic and economic characteristics, including high trade costs and a small domestic market, have limited competitiveness of non-hydro sectors.

Bhutan has achieved mass vaccination (almost 90 percent of its adult total population has received a booster dose by early March 2022), and managed to contain the virus, despite a recent surge in cases due to the Omicron variant. However, the government's strict zero-COVID policy has significantly constrained livelihoods and economic activity in the non-hydro industrial and services sectors, as stringent social and mobility restrictions – including for inbound tourism and foreign workers – remained in place. This has had a direct impact on worker earnings and contributed to an increase in the estimated

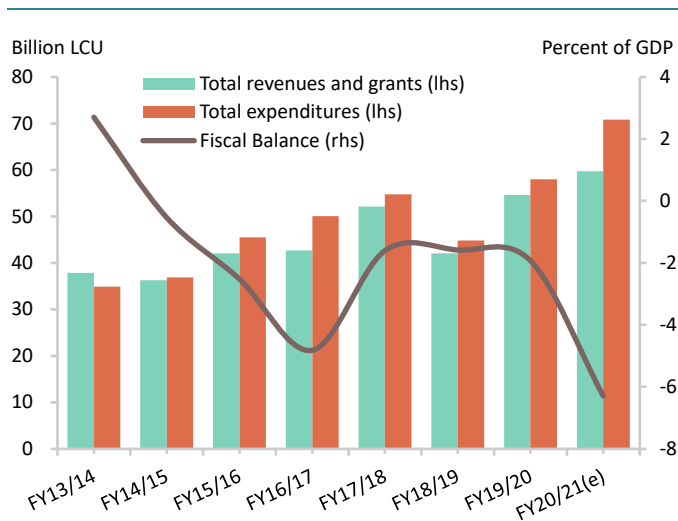
\$3.20 poverty rate from 11.0 percent in 2019 to 12.6 percent in 2021.

The short term outlook is largely dependent on the speed of return to economic normalcy, and the efficacy of fiscal support, both through COVID-19 relief measures (which includes a partial interest waiver on loans and temporary income support to individuals directly affected by the pandemic) and the scale up of capital expenditures. Addressing vulnerabilities in the financial sector is crucial, as pressures on asset quality are likely to increase once the forbearance measures are phased out. Other risks include delays in hydro projects (the generation capacity is expected to double in the medium term with the completion of four projects), which would have significant impacts on growth, fiscal revenues, and exports. The economic impact from the war in Ukraine on Bhutan will likely be felt through higher energy and food prices, as direct trade with Russia and Ukraine is negligible.

Recent developments

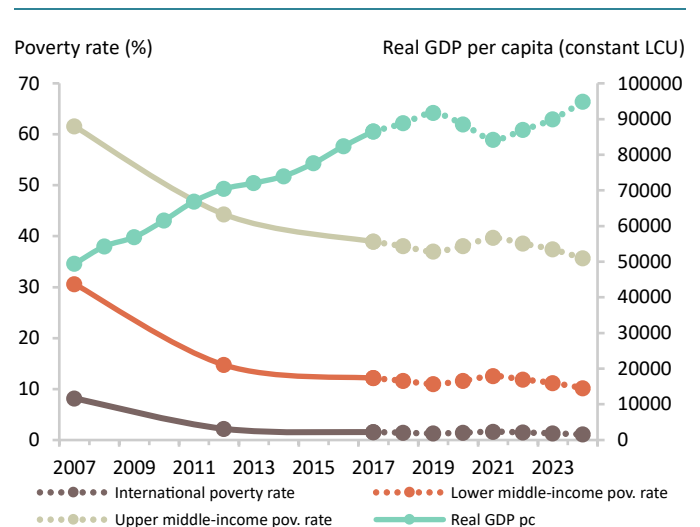
The economy has further contracted by 3.7 percent in FY20/21 (July 2020 to July 2021), after a negative growth of 2.4 percent in FY19/20. The industry sector contracted by 5.5 percent, despite positive growth in the hydro sector. Construction, manufacturing, and mining sectors were adversely affected by foreign labor shortages and high input prices. Services sector output fell by 2.2 percent, as the

FIGURE 1 Bhutan / Fiscal indicators



Source: Ministry of Finance and World Bank staff estimates.

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



Source: World Bank. Notes: see Table 2.

tourism industry remained largely inactive in FY20/21. On the demand side, private investment and consumption contracted sharply due to domestic COVID-19 containment measures and lower incomes.

Average inflation moderated from 8.2 percent in FY20/21 to 6.0 percent in the first half of FY21/22, driven by a slowdown in food inflation. However, non-food inflation remains high, reflecting higher fuel and transport prices, and food inflation has picked up in line with price developments in India.

The current account deficit (CAD) has further narrowed to 11.8 percent of GDP in FY20/21, driven by a smaller trade deficit than in FY19/20. Goods exports (as a share of GDP) increased, supported by an increase in hydro exports and trade facilitation measures for non-hydro goods, mainly mineral products and base metals. Goods imports also increased compared to FY19/20, but to a lesser extent, as private investment projects, including hydro construction, remained subdued. The services deficit deteriorated further, reflecting the standstill in tourism-related services in FY20/21. Gross international reserves stood at US\$1.6 billion in November 2021, equivalent to 19.5 months of goods and services imports.

The fiscal deficit widened to 6.3 percent in FY20/21, reflecting fiscal support and subdued revenue performance. The increase

in spending was driven by COVID-19 relief measures (6.6 percent of GDP), as well as an increase in capital expenditures. Revenues also increased, but to a lesser extent, driven by hydro profit transfers from the on-streaming of Mangdechhu (4.2 percent of GDP). Tax revenues declined in FY20/21, reflecting the slowdown in the non-hydro economy. Public debt increased to 134.9 percent of GDP in FY20/21 (up from 123 percent in FY19/20). However, risks to debt sustainability remain moderate as the bulk of the debt is linked to hydro project loans from India (to be paid off from future hydro revenues) with low refinancing and exchange rate risks.

Outlook

The economy is expected to grow by 4.4 percent in FY21/22, supported by Bhutan's rapid vaccination campaign, the easing of mobility restrictions, and ongoing fiscal support. On the demand side, public investment and a recovery in domestic and external demand (in particular from India) underpin growth. Output is expected to return to pre-pandemic levels in FY22/23 with a gradual recovery in tourism and a pick up in services sector growth. In the medium term, growth will be driven by the new hydro plants coming on stream

and the resulting increase in exports, as well as a recovery in non-hydro industries and the services sector. Inflation is projected to remain elevated in the short and medium term, owing to continued supply disruptions and higher energy and commodity prices.

The CAD is expected to remain low relative to pre-COVID levels, and to moderate further in the medium term due to a sharp increase in electricity exports and a gradual decline in hydro-related imports after the completion of projects.

The fiscal deficit is expected to increase to 10.1 percent of GDP in FY21/22 due to the scale up in capital expenditures and subdued revenue performance, including a decline in hydro profit transfers, and would then decline to 7.4 percent of GDP in FY22/23 as pandemic-related fiscal measures are gradually phased out. Domestic revenues are expected to increase over the medium term, supported by hydro revenues and policies aimed at mobilizing non-hydro revenues, including the introduction of the Goods and Services Tax (GST) in FY22/23. Public debt is projected to remain elevated as a share of GDP in the short term due to high fiscal deficits.

The \$3.20 poverty rate is expected to decline from 2021 onwards, although a full recovery to poverty headcount rates estimated before the pandemic is not likely to be achieved until 2023.

TABLE 2 Bhutan / Macro poverty outlook indicators

(annual percent change unless indicated otherwise)

	2018/19	2019/20	2020/21	2021/22e	2022/23f	2023/24f
Real GDP growth, at constant market prices	4.4	-2.4	-3.7	4.4	4.7	6.7
Private Consumption	10.3	-0.5	-3.5	4.0	2.5	2.0
Government Consumption	7.0	7.3	24.0	-5.6	-11.4	2.8
Gross Fixed Capital Investment	-11.2	-15.2	-18.6	19.1	3.0	2.1
Exports, Goods and Services	9.6	-4.1	-1.2	5.2	20.7	20.8
Imports, Goods and Services	0.0	-9.2	-2.1	8.9	3.8	6.7
Real GDP growth, at constant factor prices	4.6	-0.8	-2.6	4.4	4.7	6.7
Agriculture	2.7	2.9	5.7	3.5	3.5	3.5
Industry	-1.6	-5.6	-5.5	7.5	5.4	11.9
Services	11.1	2.6	-2.2	2.3	4.3	3.2
Inflation (Consumer Price Index)	2.8	3.0	8.2	7.3	5.5	3.9
Current Account Balance (% of GDP)	-20.5	-12.4	-11.8	-11.4	-9.5	-5.2
Fiscal Balance (% of GDP)	-1.6	-1.9	-6.3	-10.1	-7.4	-4.5
Debt (% of GDP)	106.5	123.0	134.9	134.6	131.4	128.1
Primary Balance (% of GDP)	-0.7	-1.5	-5.3	-8.3	-5.8	-2.2
International poverty rate (\$1.9 in 2011 PPP)^{a,b}	1.3	1.4	1.6	1.5	1.3	1.1
Lower middle-income poverty rate (\$3.2 in 2011 PPP)^{a,b}	11.0	11.6	12.6	11.9	11.2	10.2
Upper middle-income poverty rate (\$5.5 in 2011 PPP)^{a,b}	37.0	38.1	39.7	38.6	37.4	35.7
GHG emissions growth (mtCO₂e)	-0.2	1.6	1.5	-2.0	-1.8	-3.8
Energy related GHG emissions (% of total)	-15.6	-15.1	-14.4	-15.2	-16.0	-17.5

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.

a/ Calculations based on SAR-POV harmonization, using 2007-BLSS, 2019-, and 2017-BLSS. Actual data: 2017. Nowcast: 2018-2021. Forecasts are from 2022 to 2024.

b/ Projection using average elasticity (2007-2019) with pass-through = 1 based on GDP per capita in constant LCU.