

# Bhutan

Significant changes are afoot. The phased commissioning of the Tala hydropower project since July 2006 has more than tripled generation capacity, significantly boosting power exports to India as well as government revenues, and doubling GDP growth. Yet hydropower generates too few jobs for the growing number of young job seekers. More private sector activity is essential, both for jobs and economic diversification. Politically, the country is transforming itself from a monarchy to a multiparty democracy, a change that will likely be smooth. A continuation of prudent macroeconomic and development policies is foreseen.

## Economic performance

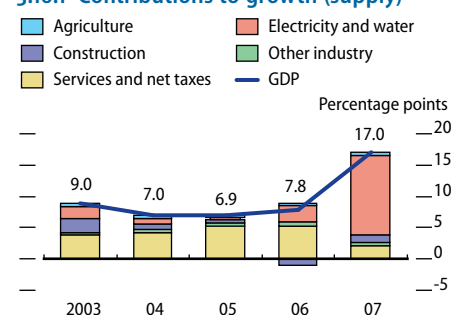
GDP growth in FY2007 (ended 30 June 2007) is estimated to have doubled to 17.0% (Figure 3.16.1). This was driven by the power sector (with a GDP share, including water, of 11.3% in FY2006) due to the commissioning of the 1,020 megawatt (MW) Tala hydropower station, which has been phased in since July 2006. Tala triples Bhutan's total power generation capacity to 1,480 MW from the combined 460 MW of three older power stations. As a result, sales from power project operations almost doubled in FY2007 (Figure 3.16.2); most power is exported to India. Although the completion of Tala and other major public projects had had a negative impact on construction in FY2006, the sector benefited from a boom in private housing in FY2007.

Broad money (M2) grew moderately by 8.6% in FY2007, down from 41.4% in the previous fiscal year. This was attributed to slower growth in net foreign assets. Growth in credit to the private sector, however, stayed rapid due to strong demand for housing loans (Figure 3.16.3).

The exchange rate peg of Bhutan's currency, the ngultrum, to the Indian rupee is working as an anchor to inflation. Since about two thirds of imports come from India, domestic inflation often reflects price changes there. The consumer price index nudged up to 5.2% in FY2007 from 4.9% the previous year. Although food prices jumped by 9.5% during April–June 2007 (the share of food is 31.7% in the consumer price index), the increase in overall inflation was limited by relative stability in the prices of nonfood items (Figure 3.16.4).

Preliminary estimates of the budget outcome for FY2007 show a 23.9% increase in total government revenues (including grants). Receipts from the Tala project were below budget due to a lower than expected power tariff setting. Government expenditures escalated by 33.0%, reflecting higher salaries for public servants, activities related to the national election, as well as capital spending such as land acquisition for a supreme court building and preconstruction work for the Punatsangchhu I

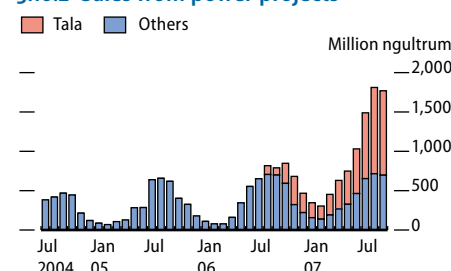
**3.16.1 Contributions to growth (supply)**



Sources: Royal Monetary Authority of Bhutan, *Annual Report 2006/07*; International Monetary Fund, *Country Report No. 07/350*; both downloaded 6 February 2008; staff estimates.

[Click here for figure data](#)

**3.16.2 Sales from power projects**



Source: Royal Monetary Authority of Bhutan, *Monthly Statistical Bulletin*, various issues, available: [www.rma.org.bt](http://www.rma.org.bt), downloaded 15 January 2008.

[Click here for figure data](#)

hydropower project. The budget deficit, which varies widely (reflecting financing for power projects), widened to 3.4% of GDP.

The balance of payments improved markedly, mainly because of Tala, but other items were favorable as well (Figure 3.16.5). The trade balance turned to surplus in FY2007 as both power and nonpower exports shot up by 76.9% and 63.7%, respectively. Tourism growth stayed strong, with visitors up by 21.6% and income by 24.2%. The current account moved from deficit to a large surplus at 10.5% of GDP.

With a positive balance in the capital and financial accounts, the overall balance-of-payments surplus amounted to \$117 million, lifting gross international reserves to \$599 million, or equal to about 13 months of merchandise imports. External debt outstanding as of end-FY2007 was estimated at around 75% of GDP. About 60% of debt is rupee-denominated borrowing from the Indian Government for hydropower projects. The overall debt service ratio was only 4.2% as almost all debt was contracted on concessional terms.

## Economic prospects

Prospects are good. Located in the Himalayas and close to India with its burgeoning demand for power, Bhutan is planning to capitalize on its huge untapped hydropower potential. Punatsangchhu I hydropower project (1,095 MW) is under construction, scheduled for completion in 2014. Mangdechhu (670 MW) and Punatsangchhu II (990 MW) projects will be built in 2009–2016. These three projects will eventually take total national generation capacity to 4,235 MW (Figure 3.16.6).

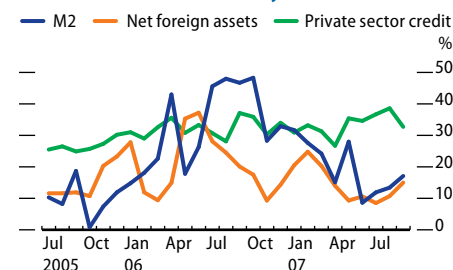
The economy follows a hydropower project cycle. After building began for Tala in 1997, construction led GDP growth until 2006 (the construction phase). With Tala now operating, additional power production is leading growth (the power production phase). In the medium term, the driver of growth will again be the construction of the three new hydropower stations. Assuming that Tala's full operation and the building of the new projects progresses on schedule, GDP growth should stay in double digits, at 14.4% in FY2008 but fall to 7.2% in FY2009.

The Tala project will have a huge impact on the fiscal figures in FY2008, in both revenue and expenditure terms. The budget for FY2008 anticipates an increase of about 17% in total receipts, mainly in the form of the corporate tax and dividends related to Tala. Expenditures are planned to rise by 12.4% and, though interest payments for Tala project borrowing will start, capital outlays will increase and account for about 52% of the total. As a whole, the fiscal deficit is expected to narrow to 1.8% of GDP in FY2008.

In FY2008, Tala's power exports to India will further push up exports, and offset imports and other payments mainly related to economic expansion outside the power sector. The current account surplus is seen remaining at 10.1% of GDP. The structure of the balance of payments in FY2009, however, will reflect a turn into the construction phase, and imports and other related payments will lower the current account surplus to a projected 2.4% of GDP.

Public sector debt is driven by the external borrowing for power

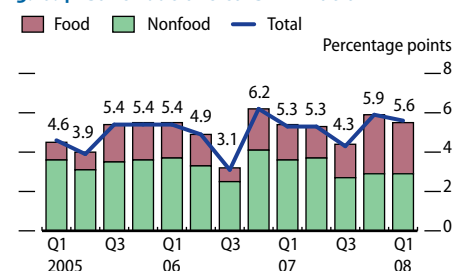
### 3.16.3 Growth of monetary indicators



Source: Royal Monetary Authority of Bhutan, *Monthly Statistical Bulletin*, various issues, available: [www.rma.org.bt](http://www.rma.org.bt), downloaded 5 March 2008.

[Click here for figure data](#)

### 3.16.4 Contributions to CPI inflation



Source: Royal Monetary Authority of Bhutan, *Monthly Statistical Bulletin*, various issues, available: [www.rma.org.bt](http://www.rma.org.bt), downloaded 5 March 2008.

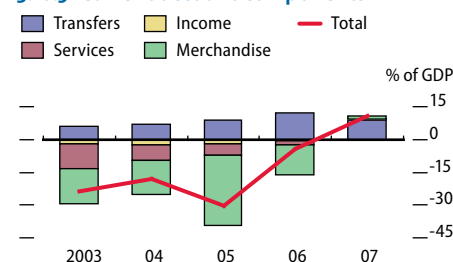
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### 3.16.1 Selected economic indicators

	2008	2009
GDP growth	14.4	7.2
Inflation	4.5	4.5
Current account balance (% of GDP)	10.1	2.4

Source: Staff estimates.

### 3.16.5 Current account components



Sources: Royal Monetary Authority of Bhutan, *Annual Report 2006/07*; International Monetary Fund, *Country Report No. 07/350*; both downloaded 6 February 2008.

[Click here for figure data](#)

projects. Based on a joint International Monetary Fund–World Bank debt-sustainability analysis in 2007, Bhutan’s debt dynamics are subject to only moderate risk of distress. Public sector debt is projected to stay at around 70% of GDP in the medium term, as repayment for Tala will be roughly balanced by loan disbursements for new hydropower projects. The analysis also assessed the power projects to be subject to low implementation risk because of Bhutan’s demonstrated experience in financing and running such projects. The relationship with India is maintained well, and therefore any commercial risk is virtually absent.

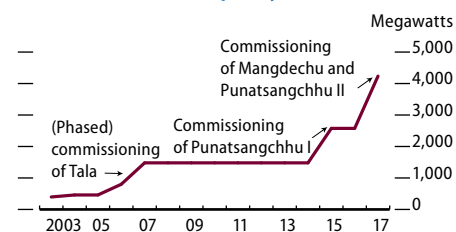
In the political sphere, Bhutan is scheduled to change from a monarchy to a two-party democratic system this year. An election for the National Council (the upper house) was held in December 2007, and the first National Assembly (lower house) election was held in March this year. The first written constitution will be discussed and passed by the new parliament.

## Development challenges

Because the hydropower sector employs few people, job generation elsewhere will remain crucial, especially with the growing number of young entrants to the labor force. The private sector will be the key focus, but needs to tackle a variety of bottlenecks, including cumbersome labor practices, difficult access to land, inadequate infrastructure, high cost of finance, and lack of skilled labor. Tourism is the obvious area where the private sector can expand.

In rural areas, the forthcoming 10th Five-Year Plan (2008–2013) calls for measures to encourage farm households to shift from subsistence to a commercial orientation; develop agroprocessing; and expand off-farm employment in cottage industries, local handicrafts, and textiles. These measures are to be underpinned by improvements to transport and communications to integrate the national economy, improve the private sector enabling environment, boost the efficiency of the financial sector, and develop human resources.

### 3.16.6 Generation capacity



Source: Gross National Happiness Commission, Royal Government of Bhutan, *Draft Tenth Five Year Plan (2008–2013)*.

[Click here for figure data](#)