Royal Government of Bhutan
Ministry of Finance

MACROECONOMIC SITUATION REPORT

3rd QUARTER UPDATE : FY 2024-25

DEPARTMENT OF MACRO-FISCAL
&
DEVELOPMENT FINANCE

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The macroeconomic situation report, quarterly update is prepared by Macro-Fiscal Policy Division under Department of Macro-Fiscal and Development Finance. This is as per the information compiled during the quarterly Macroeconomic Framework Coordinating Technical Committee (MFCTC) meetings and presented to the Macroeconomic Framework Coordinating Committee (MFCC).

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Executive Summary

Bhutan’s macroeconomic landscape in Q3 FY 2024–25 signals a gradual but steady recovery, underpinned by domestic sectoral resilience, yet challenged by persistent external and structural vulnerabilities. Real GDP is projected to grow at 6.06 percent, supported by robust performance in construction, hydropower, forestry, and manufacturing. Inflation remains moderate at 3.52 percent, driven by food price pressures, while the labour market exhibits signs of resilience despite persistent youth unemployment.

Globally, growth is moderating, and inflation is easing, although geopolitical tensions continue to cast uncertainty. Regionally, South Asia's outlook remains cautious. Bhutan's economic prospects are closely tied to India's macroeconomic trends due to the INR peg, with implications for inflation, trade, and monetary policy.

On the supply side, the industrial sector outperformed expectations due to hydropower and construction momentum, while the services sector witnessed a relative slowdown from the previous year. Agricultural growth was led by strong forestry output. On the demand side, private consumption surged following policy relaxations, though public investment remains constrained due to underutilization of capital expenditure.

Labor market conditions remained stable, with an overall unemployment rate of 3.5 percent. However, youth unemployment averaged 19.1 percent in 2024, highlighting the need for targeted interventions. Labor force participation peaked mid-year but slightly declined in early 2025, reflecting structural gaps.

Fiscal performance improved with domestic revenues rising by 13.7 percent year-on-year, supported by corporate income tax, hydropower transfers, and tourism royalties. External grants contributed 29.2 percent of total resources, mainly through the support from Government of India. The fiscal deficit narrowed to 2.37 percent of GDP, but capital budget execution remains low at 44.9 percent, limiting development impact.

Monetary indicators show stable liquidity at Nu. 16,947.374 million, supported by foreign assets. Credit expanded by 13.8 percent, driven by housing and tourism sectors, even though agriculture remained underfinanced. Non-performing loans persisted in trade and housing sectors, while deposit and lending rates showed minimal fluctuation. Inflationary pressures were mainly food-driven, with overall inflation at 3.52 percent as of March 2025.

The external sector faces rising pressures. The current account deficit widened to 17.94 percent of GDP due to increased imports and a higher merchandise trade deficit, though tourism earnings improved. Foreign reserves stood at USD 991.142 million, providing 26 months of essential imports cover. Special studies deploying the IS-LM-BP and AD-AS simulations reveal the economy's sensitivity to tariff shocks, particularly from import price surges.

Risks remain elevated. Scenario modelling suggests monthly GDP losses of up to 3 percent under severe shocks, with industry and services being most vulnerable. A prolonged shock could result in an 18 percent decline in annual output. These insights underscore the urgency of enhancing structural resilience, improving capital execution, and diversifying the export base.

Key Macroeconomic Highlights FY 2024–25

Strengths

- **Resilient Growth**: Real GDP growth is projected at 6.06 percent**,** led by robust performance in construction, hydropower, and forestry.
- **Improved Fiscal Position**: The fiscal deficit narrowed to 2.37 percent of GDP, supported by higher tax and non-tax revenues.
- **Public Debt Discipline**: Domestic debt declined, contributing to overall debt moderation despite total debt remaining high.

Risks

- **External Vulnerability**: The current account deficit widened to 17.94 percent of GDP, reflecting rising imports and subdued exports.
- **Debt Sustainability**: Public debt remains above 100 percent of GDP, requiring careful fiscal management.
- **Inflation Sensitivity**: Inflation is stable but vulnerable to commodity price shocks and external supply disruptions.

Policy Priorities

- Leverage growth momentum to drive structural transformation and diversification.
- Address trade imbalances by enhancing export competitiveness and reducing import dependency.
- Sustain fiscal gains through revenue reform and expenditure efficiency.
- Manage public debt prudently to preserve fiscal space.
- Maintain vigilance on inflation with buffer mechanisms and forward-looking policy tools.

LEADING ECONOMIC INDICATORS

Indicators	Units	2022/23	2023/24	2024/25	2025/26	2026/27
		2022	2023	2024	2025	2026
		Actual		Estimates	Projection	
Real Sector						
Real GDP growth	% (CY)	5.2	4.9	6.1	8.3	6.8
Nominal GDP	Million Nu. (CY)	227,814	249,388	267,120	324,338	364,769
Agriculture Sector Growth	% (CY)	-1.1	1.4	3.6	2	1.7
Industry Sector Growth	%(CY)	5.6	-0.03	8.7	16.3	12.5
Services Sector Growth	%(CY)	6.8	7.9	4.8	4.7	4.1
GDP per Capita	US$ (CY)	3,956	4,010	4,147	4,985	5,516
Fiscal Sector						
Domestic Revenue	Million Nu. (FY)	44,875	56,014	63,695	70,462	74,893
Tax Revenue, percent of GDP	*% (FY)*	13.2	13.6	13.7	13.6	12.9
Grants & Other Receipts	Million Nu. (FY)	15,594	14,181	19,740	27,310	31,091
Current Expenditure	Million Nu. (FY)	35,428	43,425	50,755	58,481	59,425
Capital Expenditure	Million Nu. (FY)	33,798	26,798	39,690	60,730	55,324
Fiscal deficit, percent of GDP	*% (FY)*	-4.7	-0.2	-2.4	-6.2	-2.3
Total Public Debt	Million Nu. (FY)	276,977	287,397	306,171	387,217	396,140
o.w Domestic Debt	Million Nu. (FY)	32,791	21,477	21,098	27,098	24,101
o.w External Debt	Million Nu. (FY)	244,186	265,920	285,073	360,119	372,039
External Sector						
Current Account balance (CAB)	Million Nu. (FY)	-81,198	-55,321	-53,047	-40,937	-51,591
o.w Trade balance (Goods)	Million Nu. (FY)	-60,358	-51,933	-66,654	-57,446	-73,360
CAB, percent of GDP	*% (FY)*	*-33.5*	-21.4	-17.9	-11.9	-13.4
Total International Reserves	Million US$ (FY)	574	625	991	1237	1512
Monetary Sector						
Inflation (average)	% (CY)	5.6	4.2	3.52		
Money Supply	Million Nu. (FY)	216,699	220,405	253,868	287,063	324,068
Credit growth	% (FY)	*25.1*	*5.1*	*13.8*	*3.86*	*35.8*
Pure Excess Liquidity	Million Nu. (FY)	10,139	10,899	11,247	7,224	22,908
Labor and Household Sector						
Unemployment	%(CY)	5.9	3.5	3.5	3.6	3.4
Youth Unemployment Rate	%(CY)	28.6	15.9	19.1	17.1	20.8

1. Global & Regional Context

Bhutan's economic outlook for FY 2024–25 is unfolding amidst a complex global and regional landscape characterized by moderating growth, easing inflation, and persistent geopolitical uncertainties. These external dynamics are particularly consequential for Bhutan, given its economic structure and the currency peg to the Indian Rupee (INR).

1.1 Global Economic Trends

The global economy is experiencing a synchronized slowdown. Growth is projected to decelerate to 3.9 percent in 2025, down from 4.6 percent in the previous year, influenced by restrictive financial conditions, subdued trade, and heightened geopolitical tensions.

Inflationary pressures are gradually easing, yet remain above pre-pandemic levels, with food and energy prices being notably volatile.[1] Central banks worldwide are maintaining cautious monetary stances to balance growth and inflation objectives.

1.2 Regional Developments in South Asia

South Asia's growth prospects are also moderating. The region's GDP growth is projected to slow to 5.8 percent in 2025, a downward revision of 0.4 percentage points from earlier forecasts.

This deceleration is attributed to limited fiscal buffers, reduced external demand, and domestic structural challenges. Inflation across the region is expected to decline below its 10-year average of 5.7 percent, aided by easing oil and food prices.[2]

1.3 India's Economic Outlook and Implications for Bhutan

India, Bhutan's largest trading partner and the anchor for its currency peg, is projected to grow at 6.2 percent in 2025, a slight downward revision from earlier estimates due to global trade uncertainties and geopolitical risks. Inflation in India has moderated, with the Consumer Price Index (CPI) registering at 3.34 percent in March 2025.[3]

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[1] *International Monetary Fund (IMF). World Economic Outlook: Navigating Global Crosscurrents. April 2025. https://www.imf.org*

[2] *World Bank. (2024). South Asia Economic Focus, Spring 2024: Jobs for Resilience. Washington, DC: World Bank Group. Retrieved from https://www.worldbank.org/en/region/sar/publication/south-asia-economic-focus*

[3] *Reserve Bank of India (2025). Monetary Policy Statement, April 2025. RBI Bulletin. Retrieved from https://www.rbi.org.in.*

The Reserve Bank of India (RBI) has adopted an accommodative monetary policy stance, recently reducing the key repo rate by 25 basis points to 6 percent, to support economic activity.

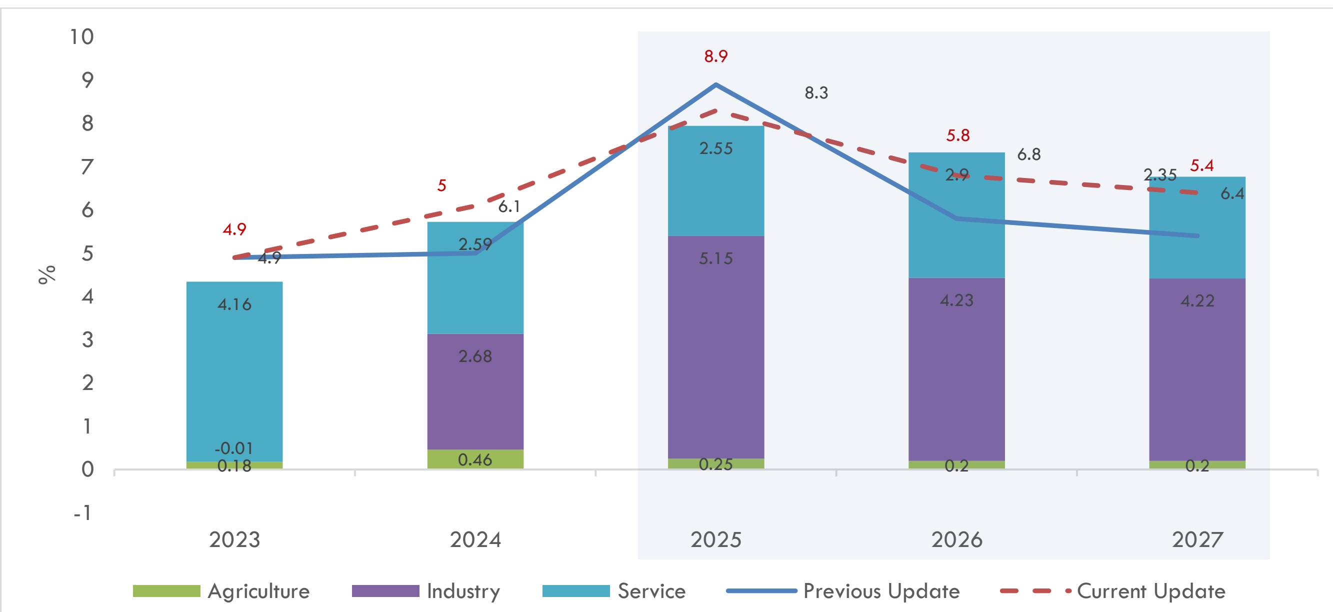
Given the currency peg, India's macroeconomic conditions directly influence Bhutan's economic environment. Exchange rate stability, inflation trends, and monetary policy decisions in India have immediate implications for Bhutan's price levels, interest rates, and external balances.

2. Domestic Macroeconomic Developments

2.1 Real Sector Trends

Bhutan's economy is expected to grow by 8.31 percent in 2025, continuing its post-pandemic recovery, at a faster pace than observed in the previous years. While the current estimate marks a downward revision by 0.62 percentage points from the Q2 estimate, the economy shows growth rooted in steady resilience and a strong economic rebound in 2024. The provisional growth estimate for 2024 has been revised upwards to 6.06 percent, an increase of 1.06 percentage points from the previous quarter estimate. This stronger-than-expected performance is largely attributed to higher tax revenues and increased infrastructure activity, particularly in the hydropower sector. Figure 1 illustrates the peak in GDP growth in 2025, driven in part by base effects, which are expected to taper off with the economy returning to a more moderate growth trajectory from 2026, hovering around 6.83 percent.

Figure 1: GDP Growth



2.2 Sectoral Highlights

2.2.1 Agriculture and Livestock

The 2025 growth prospects for the agriculture and livestock sector are optimistic as this sector is expected to outperform previous expectations with its contribution to GDP estimated at 0.14 percent in comparison to Q2 estimate of 0.07 percent. This is mainly attributed to the sustained growth in forestry and logging, with the subsector expected to grow at 5.80 percent compared with the Q2 estimate of 3.08 percent. This is expected to be observed on account of the accelerated growth in the subsector because of increased timber production, leading the subsector to see a provisional growth of 15.53 percent in 2024 in contrast to the growth of 1.90 percent forecasted in Q2. This also marks the highest growth observed by the sub-sector since 2018.

The extraordinary growth observed in 2024 normalizes in 2025 and is expected to be sustained, growing at 6.49 percent in 2026. Looking ahead, forestry and logging is anticipated to remain a key driver of growth in the primary sector, supported by sustainable forest management initiatives amid growing demand for timber products and export opportunities. However, climate related challenges, forest fire risks, and regulatory changes in logging practices may influence performance.

2.2.2 Industry

The secondary sector is forecasted to grow by 16.38 percent in 2025, albeit at a lower rate than the previous projection of 19.48 percent. Electricity and construction will continue to be the main drivers of growth, though growth in both subsectors is projected to moderate, with electricity growing at 15.03 percent and construction at 25.05 percent. These growth estimates are lower than the previous quarter where the subsectors had been expected to grow at 20.67 percent and 30.04 percent, respectively. This is partially attributed to the base effect, as the provisional growth estimates for electricity and construction subsectors outperformed expectations in 2024 at 9.55 percent and 15.82 percent, respectively.

Electricity had previously been projected to grow at 3.53 percent and construction at 10.68 percent, upward revisions are driven by the near-completion and commissioning of major hydropower projects. On the other hand, mining and quarrying contracted by 10.92 percent due to a general decline in production levels, thereby prompting a downward revision from the previous quarter's growth projection of 7.04 percent. Looking forward to 2026, industrial growth is expected to remain a key pillar of economic expansion, with the sector being the largest contributor to growth at 4.23 percent, and construction being the driving factor.

2.2.3 Service

A key driver of growth, the services sector is projected to grow at a rate of 4.77 percent in 2025, driven mainly by transportation and storage, and the hotel and restaurants subsectors contributing 0.66 percent and 0.46 percent, respectively. This reflects a sustained recovery in tourism and related industries, although key subsectors such as wholesale and retail trade and communication are expected to expand at a slower pace, compared to previous projections.[4]

In 2024, the services sector underperformed relative to initial expectations, growing at a provisional rate of 4.79 percent, down from 7.92 percent in 2023. This deceleration was expected as the economy has transitioned from a sharp post-pandemic rebound to a more stable growth phase. Key subsectors like communication and wholesale and retail trade fell short of expectations, performing at 2.98 percent and 2.25 percent, respectively. However, hotels and restaurants significantly outperformed, with 25.67 percent growth, sounding a revival in tourism. Looking forward, the sector is expected to stabilize further, with growth in 2026 projected at 4.17 percent. Though the sector is expected to grow at a slower pace, prospects appear optimistic as policy efforts and targeted marketing are likely to enhance the performance of tourism and hospitality.

[4] *The observed slowdown in the service sector partly reflects a methodological shift in the projection of tourist arrivals. The revised forecasting approach incorporates more conservative assumptions, leading to lower projected tourist numbers compared to previous estimates.*

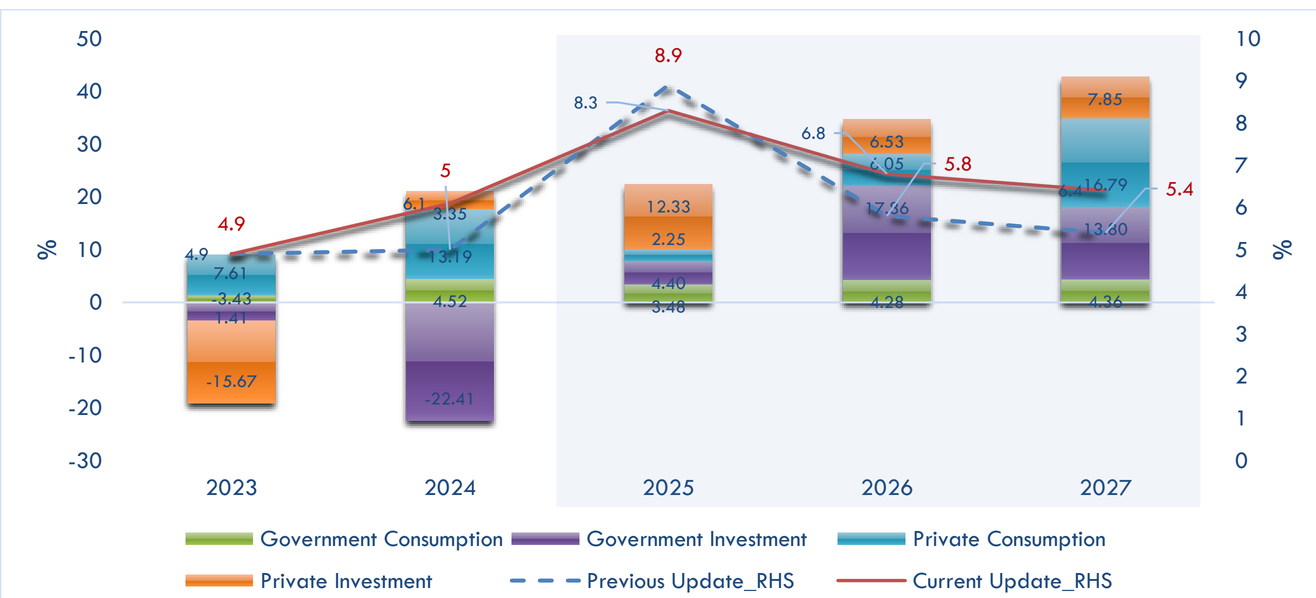
2.3 Demand Side Dynamics

In 2025, aggregate demand is expected to grow more moderately. Private consumption is projected to increase by 2.25 percent, marking a deceleration from the rapid expansion seen in 2024. However, this still marks an upward revision from the Q2 estimate of -2.36 percent, reflecting strong private consumption.

Public investment is expected to grow at 4.40 percent, at a much lower rate than the previous estimate of 25.46 percent. This is on account of the downward revision in capital expenditure for FY 2024-25 from Nu. 40,546.022 million in Q2 to Nu. 39,689.588 million in this quarter's estimates. Looking back at 2024, private consumption exceeded expectations with a provisional growth of 13.19 percent, much larger than the Q2 forecast of 2.60 percent, fueled in part by the lifting of moratoriums.

Similarly, the provisional growth rate for public investment in 2024 stands at -22.41 percent, showing marginal improvement from the previous quarter estimate of -23.69 percent. Looking ahead, both consumption and investment are expected to accelerate, as illustrated in Figure 2, reflecting increased expenditure towards the middle of the Five-Year Plan (FYP) in congruence with expectations.

Figure 2: GDP by Expenditure



Bhutan's economy is projected to experience accelerated growth in the near term, with GDP peaking at 8.31 percent in 2025, before moderating to 6.83 percent in 2026. The upwards revision of the 2024 GDP estimate to 6.06 percent signals a stronger-than-anticipated recovery, underpinned by infrastructure development and energy generation.

This highlights the effectiveness of ongoing public investment in hydropower and its continued role in the economy's growth. Robust performance in forestry and logging also signals the government's shift from conservation to sustainable use through initiatives like the Forest Thinning Pilot Project.[5] The alignment of policy and interventions towards the sustainable and efficient use of resources will be critical to strengthening economic resilience through diversification, particularly considering the persistent weak performance of sectors such as mining and quarrying.

2.4 Labor Market Developments

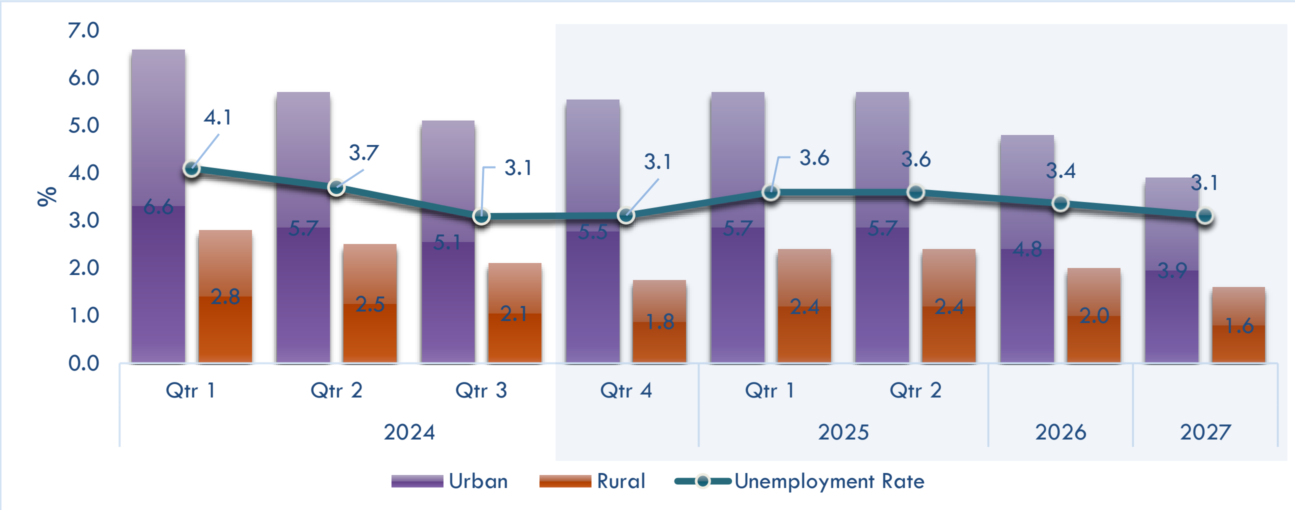
2.4.1 General Unemployment

The average unemployment rate in 2024 stood at 3.52 percent, translating to an employment rate of 96.48 percent, reflecting a relatively stable labor market. However, the unemployment rate is estimated to increase slightly to 3.60 percent in the first quarter of 2025, before gradually declining to 3.40 percent and 3.10 percent in 2026 and further to 3.10 percent in 2027. These projected improvements are supported by anticipated economic growth driven by the accelerated implementation of the 13th FYP. The expected increase in economic activities and investments under the 13th FYP is likely to create more job opportunities thereby contributing to a steady decline in the unemployment rate over the medium term.

Despite the overall positive outlook, urban unemployment remains higher than rural unemployment, primarily due to rural to urban migration. Many individuals move to urban centers in search of better paying and higher quality jobs, resulting in a greater concentration of job seekers in towns and cities. The prevalence of this internal labor mobility underscores aspirations among the working age population for improved livelihoods but also creates pressures on the urban job market.

[5] *https://www.bbs.bt/200115/*

Figure 3: Unemployment Rate



The unemployment rate is estimated to increase slightly to 3.60 percent in the first quarter of 2025, up by 0.49 percentage point from the previous quarter. However, it reflects a 0.50 percentage point improvement from 4.10 percent in the first quarter of 2024, indicating a gradual recovery supported by improving macroeconomic conditions.

While there is no universal benchmark for an ideal unemployment rate, economists generally consider a rate between 3.50 percent and 4.50 percent to reflect a healthy labor market. Rates lower than this range may lead to labor shortages and upward wage pressures which will contribute to inflationary pressures, while higher rates may signal underlying weaknesses in the economy. Based on this standard, Bhutan's current unemployment rate is broadly acceptable and indicative of a stable labor market.

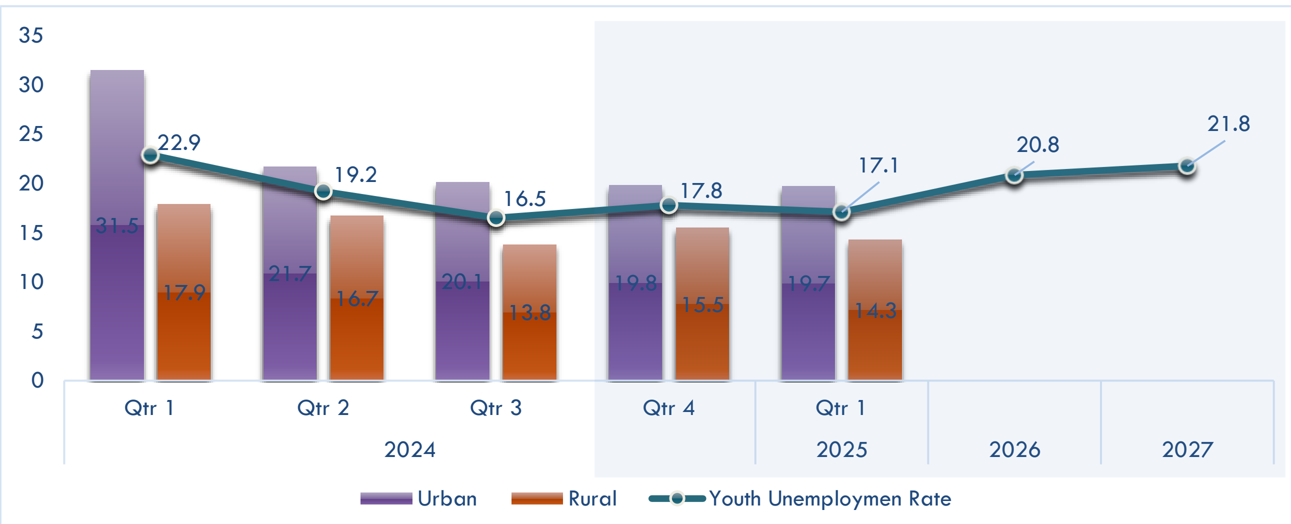
2.4.2 Youth Unemployment

In the first quarter of 2025, the youth unemployment rate is estimated to fall to 17.10 percent, down by 0.70 percent from the previous quarter and a notable decline from 22.9 percent in the first quarter of 2024. This substantial improvement could be attributed to increased absorption of young people into the labor market potentially due to targeted government initiatives and improved private sector hiring.

However, looking ahead, youth unemployment is projected to rise again to 20.85 percent in 2026 and 21.77 percent in 2027. This anticipated reversal could be attributed to a growing number of youths entering the job market, outpacing job creation. The situation reflects structural constraints such as limited high-skilled job opportunities and a mismatch between education and labor market needs.

Youth unemployment is particularly prevalent in urban areas, reflecting the concentration of young job seekers seeking formal employment in public and private sectors. Many young people are reluctant to take up jobs in agriculture or the informal sector, further intensifying the urban employment challenge.

Figure 4: Youth Unemployment Rate



The persistent high youth unemployment highlights structural challenges in the labor market. It suggests a mismatch between available skills and market demand, as well as insufficient job creation to absorb new entrants into the workforce. This situation could weaken long-term human capital accumulation, limit future income potential, and contribute to social discontent if not addressed effectively. Therefore, youth unemployment remains a pressing concern as it exceeds the national average. Policy interventions, including vocational training, targeted subsidies, and private sector engagement, are critical to improve youth employment outcomes.

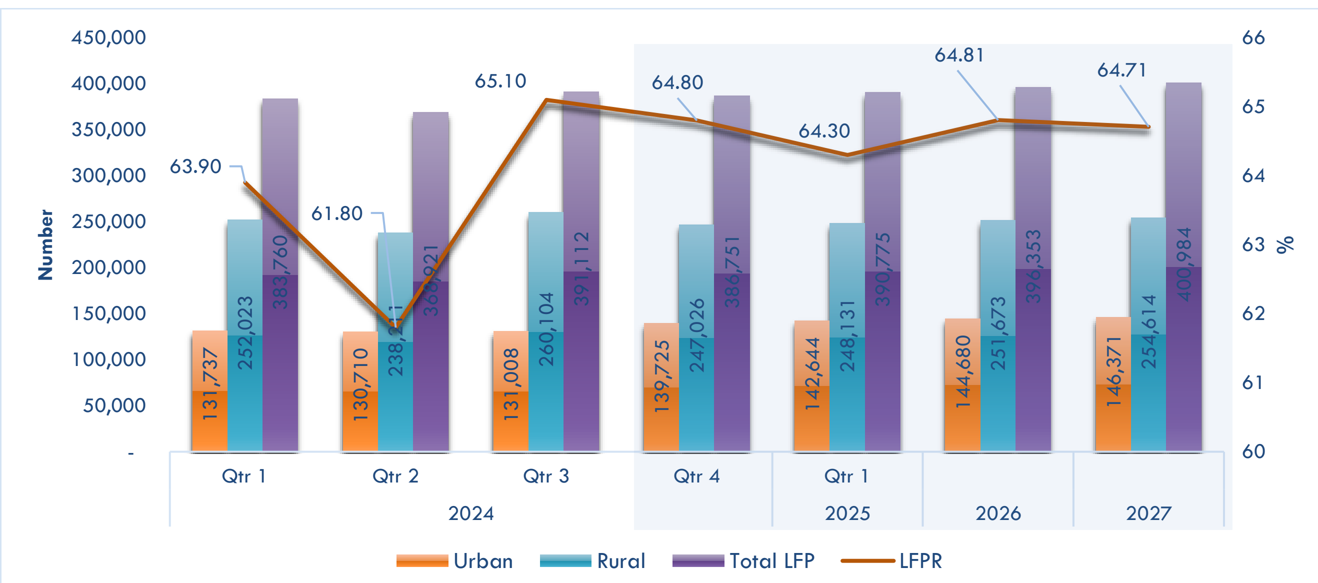
2.4.3 Labor Force Participation

The labor force participation is a critical indicator reflecting the active supply of labor in the economy. In 2024, the average total labor force was around 383,636 with the highest participation of 391,112 recorded in the third quarter. In terms of area, rural areas continue to dominate labor force size, indicating that a larger share of the population remains engaged in agriculture and livestock related activities.

As of the first quarter of 2025, total labor force participation is estimated to increase to 390,775, a gain of 4,024 from the previous quarter, and an increase of 7,015 compared to the first quarter of 2024. This growth reflects the expanding working-age population and renewed labor market optimism.

The Labor Force Participation Rate (LFPR) in the first quarter of 2025 is estimated at 64.30 percent, marking a 0.50 percentage point decline from the fourth quarter of 2024, but a 0.40 percentage point increase compared to the first quarter of 2024. This modest year on year improvement suggests that more individuals have re-entered the labor force, likely driven by better job prospects and improved confidence in the economy.

Figure 5: Labor Force Participation and LFPR



Projections indicate that the labor force will continue to expand to 396,353 in 2026 and to 400,984 in 2027, supported by demographic trends and broader economic participation. The LFPR is also expected to rise slightly to 64.81 percent in 2026 before settling at 64.71 percent in 2027, implying a stable by slowly increasing labor supply.

While general unemployment remains low and stable, the persistent challenge of youth unemployment and marginal labor force participation changes signal the need for targeted and sustained policy responses. It is crucial to strengthen the labor market matching mechanisms through improved career counselling and job portals, promoting entrepreneurship and small and medium enterprises, and encouraging private sector growth.

3. Fiscal Developments

3.1 Domestic revenue

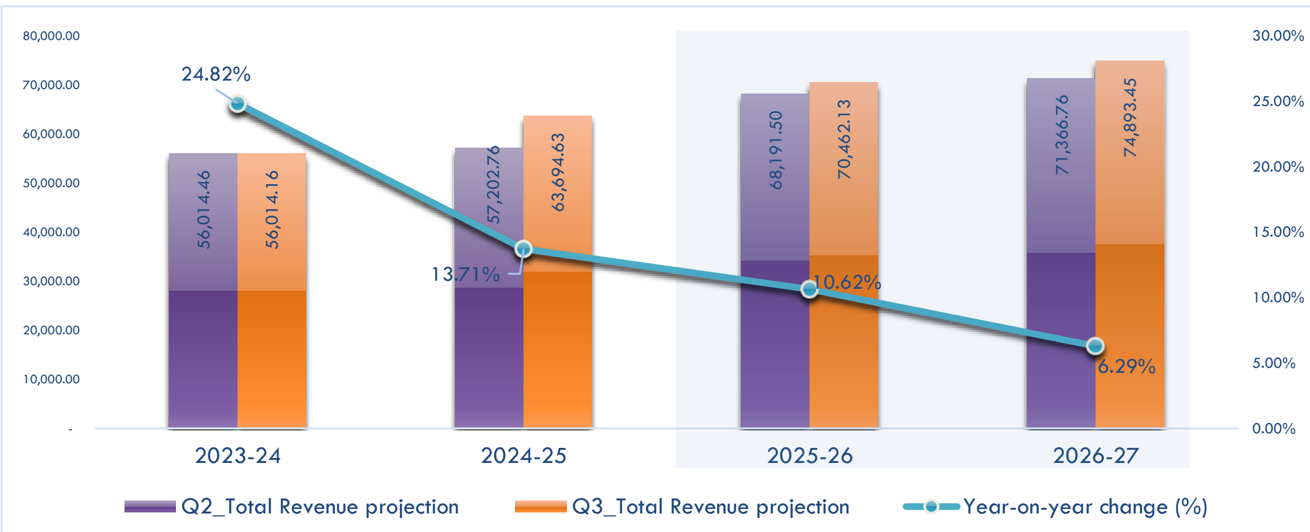
The domestic revenue for FY 2024–25, based on the current quarter update, is estimated at Nu. 63,694.630 million. The major share of this revenue comes from taxes, particularly Corporate Income Tax from Druk Green Power Corporation and Druk Holding and Investments, followed by Business Income Tax and Personal Income Tax. In addition, significant contributions are recorded from tourism-related receipts and hydropower royalty. Non-tax revenue is also substantial, amounting to Nu. 20,409.603 million, primarily driven by net profit transfers from hydropower projects and the Royal Monetary Authority.

Table 1: Summary of Domestic Revenue

Sl. No	Particulars	2023-24 Actual	2024-25		2025-26 Projection	2026-27 Projection
			Approved Budget	Revised estimates		
	Revenue	**56,014.163**	**54,749.940**	**63,694.630**	**70,462.134**	**74,893.450**
A	**Taxes**	**35,037.435**	**39,246.340**	**40,373.566**	**46,939.248**	**49,908.986**
1	Taxes on Income, Profits and Capital Gains	17,067.210	16,776.300	19,222.189	20,851.380	21,763.158
2	Taxes on Property	709.236	708.390	922.027	936.135	948.633
3	Taxes on Goods and Services	9,700.269	10,743.060	11,015.297	13,815.412	14,648.095
5	Taxes on International Trade and Transactions	640.275	985.880	752.810	865.963	979.090
6	Other Taxes	6,920.445	10,032.710	8,461.243	10,470.357	11,570.012
B	**Other Revenue**	**18,335.779**	**13,381.420**	**20,409.603**	**20,314.226**	**21,510.863**
1	Property Income	18,335.779	13,381.420	20,409.603	20,314.226	21,510.863
C	**Current Revenue from Government Agencies**	**1,813.258**	**1,465.860**	**2,006.835**	**2,211.691**	**2,394.311**
D	**Capital Revenue from Government Agencies**	**827.691**	**656.320**	**904.626**	**996.970**	**1,079.290**

Compared to the previous quarter, domestic revenue is estimated to increase by 11.35 percent. This increase is largely attributed to the profit transfer of Nu. 3,631 million from the Punatsangchu-II Hydroelectric Project, higher CIT collections, particularly from DGPC and increased royalty revenues. When compared to FY 2023-24, domestic revenue is projected to grow by 13.71 percent, reflecting the cumulative impact of these factors along with the anticipated introduction of the Goods and Services Tax (GST). Going forward, revenue is projected to maintain a positive trajectory, reaching Nu. 70,462.134 million in FY 2025–26 and Nu. 74,893.450 million in FY 2026–27. This growth is expected to be driven by improved corporate tax performance, the successful implementation of GST, and higher inflows from hydropower and tourism-related royalties.

Figure 6: Year-on-Year Revenue Growth

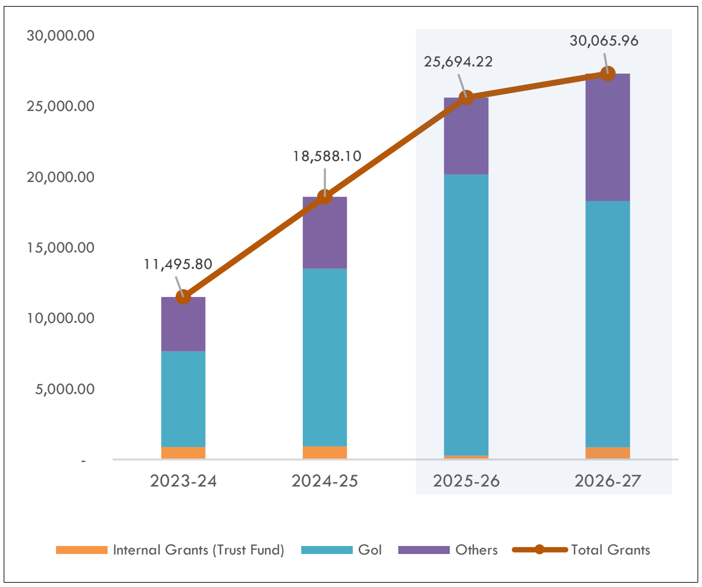


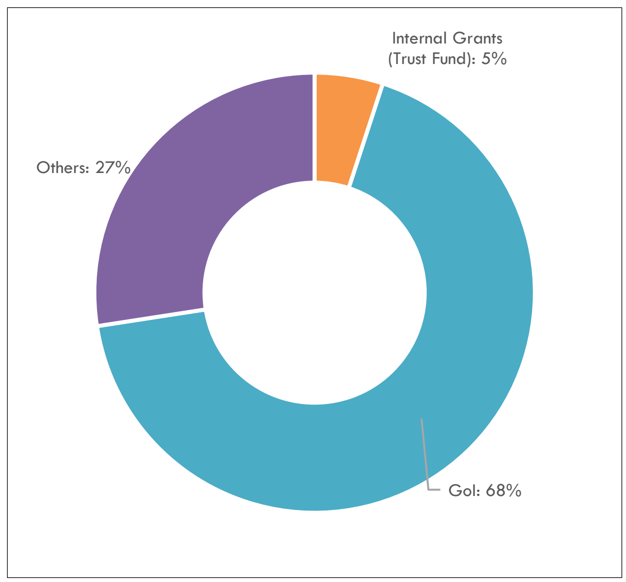
The upward trend in domestic revenue signals a positive fiscal outlook, as it strengthens fiscal space and reduces dependency on public debt. To sustain this momentum, it is essential to strengthen tax compliance and audit systems to ensure consistent corporate tax performance. The well-designed law, along with the successful and timely implementation of the GST, supported by robust digital infrastructure, will be critical to broadening the tax base. Additionally, accelerating the completion and commissioning of hydropower projects and investing strategically in tourism marketing and infrastructure will be key to boosting sectoral recovery and securing long-term revenue growth.

3.2 Grants

Grants, comprising both foreign and domestic aid, continue to be a significant source of fiscal support, accounting for approximately 22.28 percent of total resources in FY 2024–25. As per the third quarter update, the external grant estimate has been slightly revised downward to Nu. 17,654.807 million from the earlier projection of Nu. 18,172.990 million, primarily due to delays in the incorporation of certain project-tied assistance. Among development partners, India continues to be Bhutan's largest contributor, accounting for 68 percent of total grant inflows, reinforcing its role as a key bilateral partner. Going forward, total grant is projected to increase to Nu. 25,694.222 million in FY 2025–26 and Nu. 30,065.972 million in FY 2026–27. This growth is primarily driven by higher external grants, particularly project-tied and program grants from the Government of India (GoI).

Figure 7: Total Grants and their Share





The increasing reliance on external grants, particularly from a single partner presents both opportunities and risks. While such inflows ease fiscal constraints and enable investment in capital infrastructure, they also expose the budget to external uncertainties. From a policy perspective, this underscores the importance of maintaining strong strategic partnerships, improving the efficiency of grant utilization, and enhancing domestic resource mobilization. Over the long term, reducing dependency through broader funding diversification and strengthening internal revenue generation will be critical to ensure sustainable fiscal resilience.

3.3 Expenditure

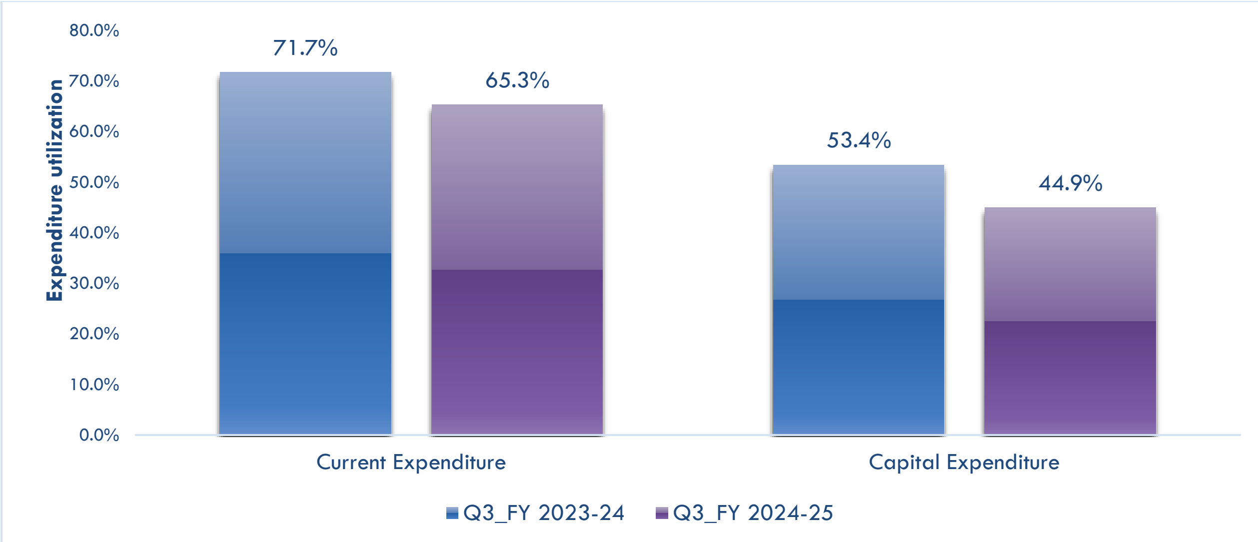
The total government expenditure for FY 2024–25 has been revised upwards to Nu. 90,444.482 million from the approved budget of Nu. 89,154.218 million. This includes Nu. 50,754.894 million allocated for current expenditure and Nu. 39,689.588 million for capital expenditure. The upward revision reflects additional budget incorporations from implementing agencies during the quarter. The total expenditure is projected to rise further to Nu. 119,211.302 million in FY 2025–26, before slightly declining to Nu. 114,748.825 million in FY 2026–27. This pattern reflects the typical cyclical nature of Bhutan's public spending around the FYP cycle, with significant increases at the beginning and moderate contractions during transition periods.

Table 2: Expenditure Estimates (Nu. In million)

Sl. No.	Particulars	2023-24 Actual	2024-25		2025-26 Projection	2026-27 Projection
			Approved Budget	Revised estimates		
A	**Total Expenditure**	**27,200.153**	**89,154.218**	**90,444.482**	**119,211.302**	**114,748.825**
1	***Current Expenditure***	***43,424.604***	***50,809.905***	***50,754.894***	***58,481.217***	***59,425.128***
1.1	Primary Current	38,301.726	43,662.554	43,604.217	47,573.285	48,775.808
1.2	Interest Payment	5,122.879	7,147.351	7,150.677	10,907.932	10,649.320
2	***Capital Expenditure***	***26,798.396***	***38,344.313***	***39,689.588***	***60,730.085***	***55,323.797***

As of the third quarter, FY 2024–25, overall budget utilization remains moderate. Current expenditure utilization stands at 65.3 percent, a decline from 71.7 percent during the same period in FY 2023–24. Capital expenditure utilization is even lower at 44.9 percent, down from 53.4 percent last year. Although the nominal expenditure has increased, the slower pace of spending in capital outlays raises concerns about potential underutilization. This may be attributed to delays in procurement, planning inefficiencies, and administrative bottlenecks, as noted in previous fiscal updates.

Figure 8: Expenditure Utilization



The expenditure utilization trend is concerning because inefficient and delayed spending undermines the effectiveness of an expansionary fiscal policy and reduces the intended impact on economic growth. Low capital budget execution weakens infrastructure development and impairs long-term productivity. From a policy perspective, this highlights the urgent need to strengthen expenditure planning and execution capacity, enhance procurement systems, and institutionalize robust mid-year expenditure reviews. Moreover, adopting an expenditure smoothing strategy across FYP cycles would help mitigate volatility, ensure more consistent public investment, and support long-term macroeconomic stability and development outcomes.

3.4 Medium-Term Fiscal Framework (MTFF)

The fiscal balance remains a key anchor of the Medium-Term Fiscal Framework (MTFF), reflecting the government's commitment to prudent fiscal management under the 13th FYP. For FY 2024–25, the fiscal deficit is estimated at Nu. 7,009.691 million, or 2.37 percent of GDP, widening from the previous year as rising recurrent and capital expenditures surpass revenue growth. Despite improved domestic revenue and external grants, spending pressures have kept the deficit elevated.

Table 3: Medium-Term Fiscal Framework (Nu. in millions)

Sl. No	Particulars	2023/24	2024/25		2025/26	2026/27
		Actual	*Approved Budget*	*Revised Estimate*	*Projections*	
A	**Total Resources**	**70,195.195**	**73,182.049**	**83,434.791**	**97,772.618**	**105,984.422**
1	**Internal Resources**	**59,579.628**	**56,660.43**	**65,779.981**	**72,357.400**	**76,770.640**
1.1	**Domestic Revenue**	**56,014.461**	**54,749.94**	**63,694.63**	**70,462.13**	**74,893.45**
	Tax	35,037.732	39,246.347	40,373.566	46,939.248	49,908.986
	Non-tax	20,976.728	15,503.597	23,321.064	23,522.886	24,984.464
1.2	***Other receipts (including internal grants)***	***3,565.167***	***1,910.482***	***2,085.351***	***1,895.266***	***1,877.190***
	Internal Grants (trust funds)	**880.232**	**916.615**	**933.294**	**279.004**	**852.190**
	Other receipts	**2,684.935**	**993.867**	**1,152.057**	**1,616.262**	**1,025.000**
2	**External Grants**	**10,615.567**	**16,521.623**	**17,654.810**	**25,415.218**	**29,213.782**
2.1	GoI	6,773.255	12,206.203	12,555.520	19,885.874	18,453.782
2.2	Others	3,842.312	4,315.420	5,099.290	5,529.344	10,760.000
B	**Total Expenditure**	**70,626.395**	**89,154.218**	**90,444.482**	**119,211.302**	**114,748.825**
1	Current	43,424.604	50,809.905	50,754.894	58,481.217	59,425.128
1.1	Primary Current	38,301.726	43,662.554	43,604.217	47,573.285	48,775.808
1.2	Interest payments	5,122.879	7,147.351	7,150.677	10,907.932	10,649.320
2	**Capital**	**26,798.396**	**38,344.313**	**39,689.588**	**60,730.085**	**55,323.697**
C	**Fiscal Balance**	**(431.200)**	**(15,972.169)**	**(7,009.691)**	**(21,438.684)**	**(8,764.403)**
	In percent of GDP	*(0.16)*	*(5.24)*	*(2.37)*	*(6.22)*	*(2.27)*

The fiscal situation is expected to deteriorate further in FY 2025–26, with the deficit projected to peak at Nu. 21,438.684 million, equivalent to 6.22 percent of GDP driven by a substantial rise in capital outlay and interest payments.

Nonetheless, the fiscal outlook improves in the later years of the plan period. The deficit is forecast to narrow to 2.27 percent of GDP in FY 2026–27, supported by anticipated revenue growth, enhanced fiscal discipline, and gradual reduction in capital expenditures. The projected improvement in the fiscal position signals a return to sustainable financing and reduced reliance on debt. Maintaining this path will require strengthened public financial management, credible budget execution, and ongoing fiscal reforms aimed at optimizing expenditure and mobilizing adequate resources. Anchoring fiscal policy within a realistic deficit target is essential to preserve macroeconomic stability and safeguard development priorities.

3.5 Quarterly Fiscal Framework for FY 2024-25

The Quarterly Fiscal Framework for FY 2024–25 highlights notable seasonal patterns in revenue collection and expenditure execution. The fiscal year began with a surplus of Nu. 1,137.040 million (0.38 percent of GDP) in Q1, but this quickly shifted to rising deficits in Q2 (Nu. 2,830.149 million) and Q3 (Nu. 4,358.078 million), before slightly narrowing to Nu. 957.859 million in Q4. This trend reflects the mismatch between revenue inflows and back-loaded expenditure patterns. The cumulative fiscal deficit for the year is estimated at Nu. 7,009.691 million, accounting for 2.37 percent of GDP.

Revenue collections were strongest in Q4, largely due to peak tax receipts and disbursement of external grants, while internal resources totalled Nu. 65,779.981 million for the year. Capital expenditure shows significant seasonality, with over 80 percent incurred in Q3 and Q4, indicating delays in project execution and fund release. For FY 2025–26, the fiscal deficit is projected at 0.16 percent of GDP in Q1, rising sharply to 1.6 percent in Q2. This heavy concentration of spending toward year-end reinforces the need for improved budget planning and timely implementation.

Table 4: Quarterly Fiscal Framework FY 2024-25

Sl. No	Particulars	FY 2024-25					FY 2025-26	
		Q1	Q2	Q3	Q4	Total	Q1	Q2
		Provisional		*Estimate*			*Projection*	
A	**Total Resources**	**13,975.804**	**11,980.679**	**21,655.320**	**35,823.827**	**83,435.630**	**16,377.308**	**14,039.354**
1	**Internal Resources**	**12,696.426**	**10,345.418**	**16,101.876**	**26,636.911**	**65,779.981**	**13,965.819**	**11,379.756**
i	**Domestic Revenue**	**12,203.579**	**9,972.462**	**15,642.165**	**25,876.423**	**63,694.630**	**13,500.200**	**11,032.029**
a	Tax	8,831.874	8,257.171	8,772.464	14,512.056	40,373.566	10,268.143	9,599.980
b	Non-tax	3,371.705	1,715.291	6,869.701	11,364.367	23,321.064	3,400.884	1,730.135
	o/w interest receipts	*146.510*	*674.357*	*818.160*	*1,353.460*	2,992.488	393.704	1,812.142
ii	***Other receipts** (including internal grants)*	***492.847***	***372.955***	***459.711***	***760.487***	**2,086.000**	**447.783**	**338.854**
2	**External Grants**	**1,279.378**	**1,635.261**	**5,553.444**	**9,186.917**	**17,655.000**	**1,841.726**	**2,354.037**
i	GoI	333.692	546.777	4,398.767	7,276.764	12,556.000	528.494	865.971
ii	Others	945.686	1,088.485	1,154.677	1,910.152	5,099.000	1,025.499	1,180.350
B	**Total Expenditure**	**12,838.765**	**14,810.828**	**26,013.398**	**36,781.686**	**90,444.677**	**16,922.233**	**19,521.526**
1	Current	10,110.862	10,749.145	14,285.801	15,608.869	50,754.677	11,650.070	12,385.520
i	Primary Current (Regular)	8,553.757	9,594.815	12,031.194	13,424.234	43,604.000	9,332.408	10,468.234
ii	Interest payments	1,557.106	1,154.330	2,254.607	2,184.634	7,150.677	2,375.272	1,760.862
2	Capital	2,727.902	4,061.683	11,727.597	21,172.818	39,690.000	4,173.992	6,214.824
C	**Fiscal Balance**	**1,137.040**	**(2,830.149)**	**(4,358.078)**	**(957.859)**	**(7,009.047)**	**(544.925)**	**(5,482.172)**
	In percent of GDP (%)	*0.38*	*(0.95)*	*(1.47)*	*(0.32)*	*(2.37)*	*(0.15)*	*(1.59)*

3.6 Public Debt

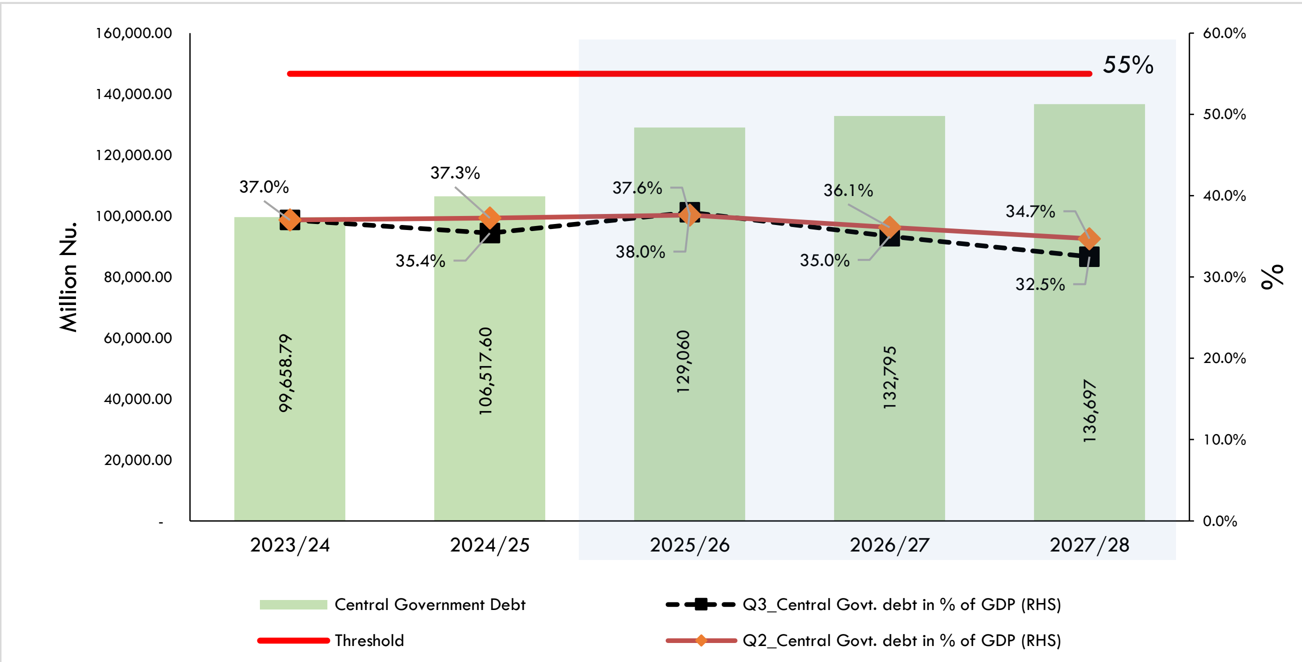
As of FY 2024-25, Bhutan's total public debt is estimated at Nu. 306,171.346 million which is 101.74 percent of GDP and is projected to rise sharply to Nu. 387,217.246 million in FY 2025-26. This rise in public debt is primarily driven by external borrowings, particularly for hydropower loans, with external debt consistently accounting for over 93.11 percent of total public debt. For FY 2025-26, projected external borrowings amount to Nu. 360,119.194 million, comprising of both program and project-tied loans. At the same time, domestic borrowings are estimated to be Nu. 27,098.052 million, about 7 percent of total public debt.

Table 5: Total Public Debt (Nu. in millions)

Sl. No	Particulars	2023/24	2024/25	2025/26	2026/27	2027/28
		Actual	Estimate	Projection		
	Total Public Debt	**287,397.047**	**306,171.346**	**387,217.246**	**396,140.336**	**419,222.835**
	% of GDP	108.3%	101.7%	113.9%	104.4%	99.7%
1	**Domestic Debt**	**21,477.361**	**21,098.052**	**27,098.052**	**24,101.122**	**24,101.120**
	% of GDP	8.1%	7.0%	8.0%	6.4%	5.7%
	% of Total Public Debt	7.5%	6.9%	7.0%	6.1%	5.7%
2	**External Debt**	**265,919.686**	**285,073.294**	**360,119.194**	**372,039.214**	**395,121.715**
	% of GDP	100.2%	94.7%	105.9%	98.1%	93.9%
	% of Total Public Debt	92.5%	93.1%	93.0%	93.9%	94.3%
2.1	**Hydro Debt**	169,412.258	178,237.534	235,922.395	247,582.599	266,886.258
	% of GDP	63.8%	59.2%	69.4%	65.3%	63.4%
	% of Total Public Debt	58.9%	58.2%	60.9%	62.5%	63.7%
2.2	**Non-Hydro Debt (external)**	96,507.428	106,835.759	124,196.799	124,456.615	128,235.457
	% of GDP	36.4%	35.5%	36.5%	32.8%	30.5%
	% of Total Public Debt	33.6%	34.9%	32.1%	31.4%	30.6%

Meanwhile, central government debt is also on an upward trend, increasing to Nu. 106,517.597 million in FY 2024-25 from Nu. 99,658.790 million in FY 2023-24, accounting for 35.4 percent of GDP. The central government debt is further projected to increase to Nu. 129,059.642 million in FY 2025-26 and Nu, 136,696.954 million in FY 2026-27. Although the debt stock is rising in absolute terms, its share of GDP is projected to gradually decline, staying well below the 55 percent threshold. In the current quarter update, central government debt for the fiscal year is projected to decline compared to the previous quarter, contributing to a reduction in total public debt. This improvement is primarily driven by a notable decrease in domestic borrowing.

Figure 9: Central Government Debt



The upward trend in total public and central government debt, mainly driven by concessional external borrowings for hydropower and budgetary needs, underscores both its strategic importance and associated fiscal risks. While the favourable terms of these loans ease immediate pressures, the rising debt-to-GDP ratio highlights the need for sound macroeconomic management. This calls for policies that promote the productive use of debt, enhance domestic revenue, improve expenditure efficiency, and diversify financing sources.

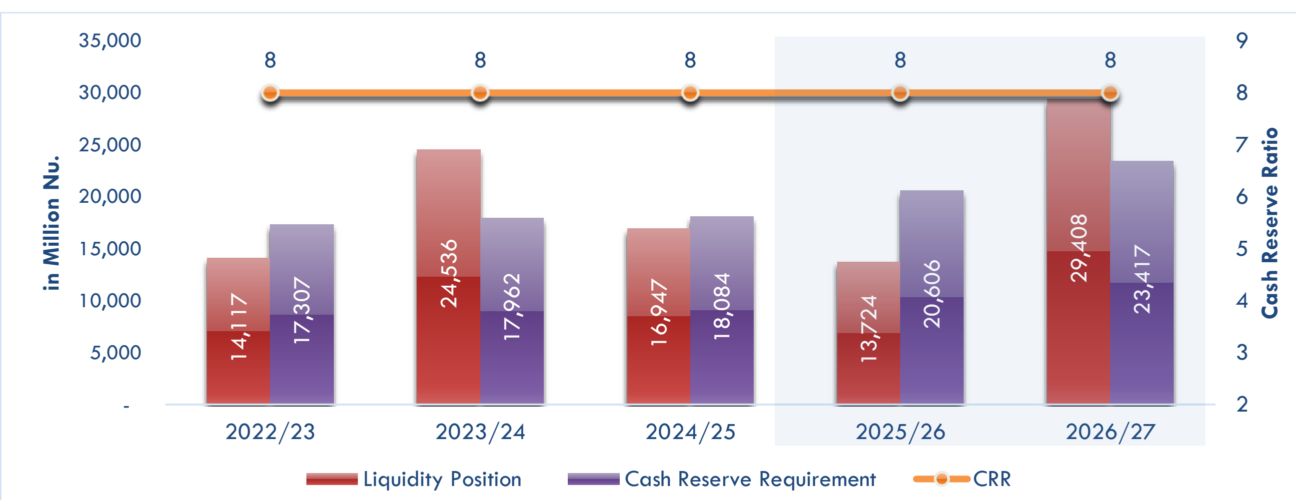
4. Monetary & Financial Sector Overview

4.1 Liquidity

The banking sector is expected to maintain adequate liquidity during this FY 2024-25, with total liquidity projected at Nu. 16,947.374 million, marking an increase from the previous quarter's projection of Nu. 16,363.009 million. This improvement is primarily attributed to an increase in the net foreign assets by Nu. 1,550.417 million and currency in circulation by Nu. 185.455 million. The liquidity position is projected to decline to Nu. 13,724.407 million in FY 2025-26, primarily due to an increase in net domestic assets and the expected reinstatement of the sweeping account. However, a significant rebound is anticipated in FY 2026-27, largely driven by a substantial increase in net foreign assets which is expected to bolster the overall liquidity in the banking system.

To manage liquidity in the banking sector, the central bank relies primarily on Cash Reserve Ratio (CRR) which is still maintained at 8 percent. The cash reserve requirement for FY 2024-25 stands at Nu. 18,084.762 million, reflecting a slight increase from the previous quarter projection of Nu. 17,982.608 million. It is further projected to rise to Nu. 20,606.417 million in FY 2025-26 and expected to reach Nu. 23,417.447 million in FY 2026-27. This upward trend is driven by the projected expansion in the deposits base, underpinned by an increase in the expected money supply.

Figure 10: Liquidity and CRR



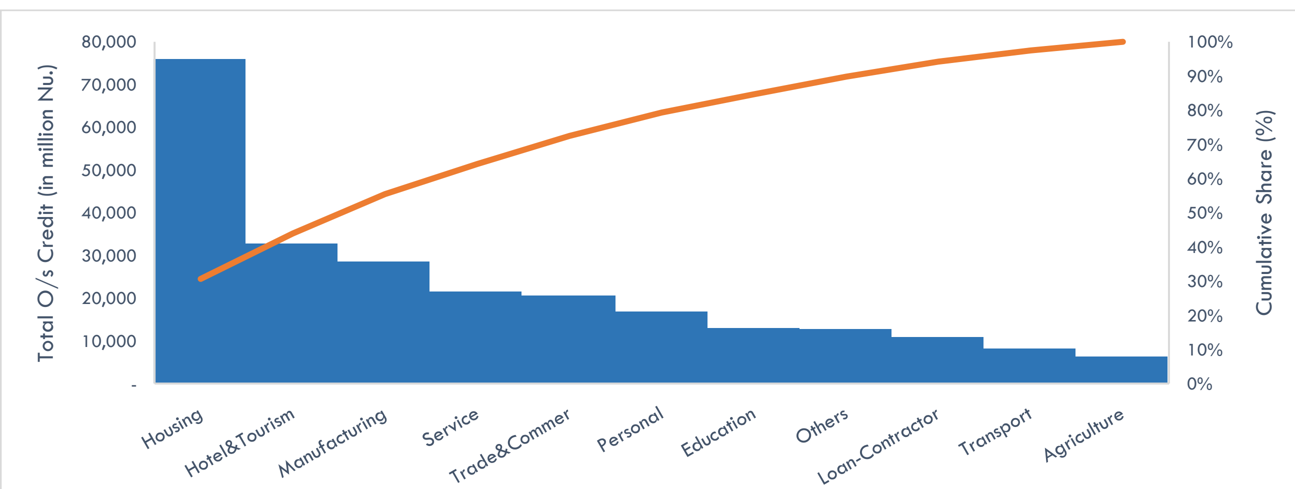
4.2 Credit Allocation

The total outstanding credit is projected to reach Nu. 250,913.961 million in FY 2024-25 compared to previous quarter projection of Nu. 236,409.152 million. This growth is primarily driven by heightened credit disbursements in the hotel and tourism sector, trade and commerce sector, and the other loans category which includes loans against shares and staff loans.

The housing sector continues to dominate the credit portfolio, with outstanding loans amounting for Nu. 75,982.905 million, accounting for approximately 30 percent of the total. It is followed by the hotel and tourism sector at Nu. 32,806.199 million (13 percent) and the manufacturing sector at Nu. 28,617.576 million (11 percent). On the other hand, the agriculture sector remains the least financed, representing only 2.55 percent of the total outstanding credit, followed by the transport sector at 3.27 percent.

This distribution reveals persistent structural disparities in credit allocation emphasizing the need for financial interventions to strengthen vital sectors like agriculture. In the FY 2025-26, total outstanding credit is projected to increase by Nu. 9,693.729 million, primarily driven by growth in credit to the hotel and tourism sector, manufacturing sector and housing sector. This upward trend is expected to continue into FY 2026-27, with outstanding credit anticipated to rise further, largely on account of a significant increase in housing loans and loans classified under the 'other loans' category.

Figure 11: Sectoral Credit

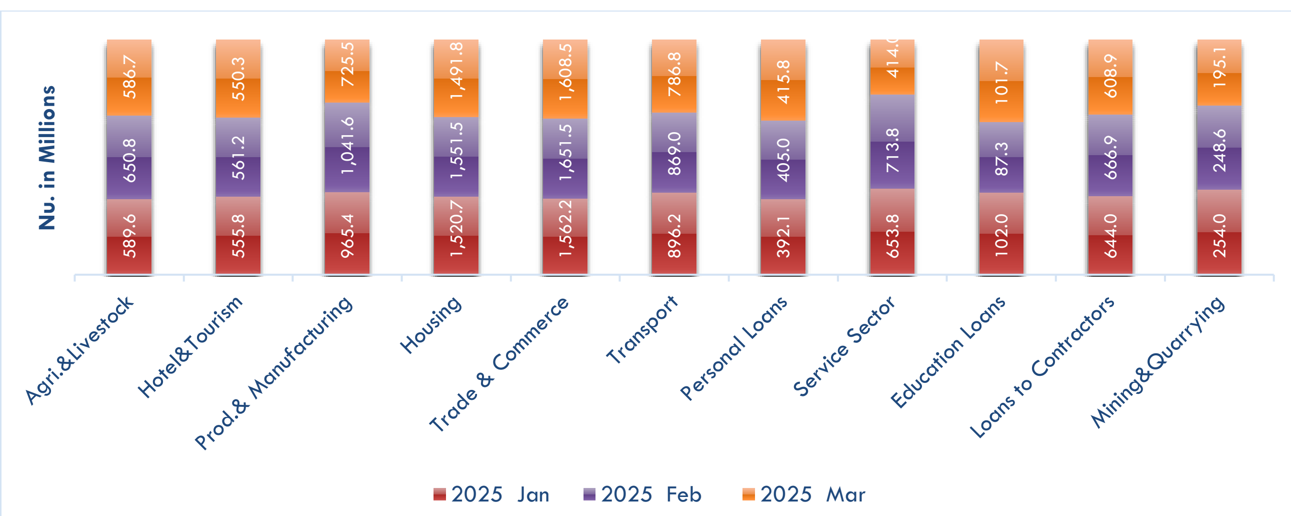


4.3 NPL levels

Non-Performing Loans (NPL) are critical indicators of financial soundness and credit risk. The data for the first quarter of 2025 reveals the level of NPLs across several sectors. As of March 2025, the trade and commerce sector recorded the highest NPL at Nu. 1,608.540 million, followed by the housing sector at Nu. 1,491.762 million and the transport sector at Nu.786.833 million. The loan deferment scheme is scheduled to conclude by June 2025. Among all sectors, the tourism and hotel industry hold the highest share of total outstanding loans, followed by the production and manufacturing sector. A potential increase in NPL is anticipated across sectors with high loan exposure which highlights the need for targeted interventions and well-defined exit strategies to support borrowers transitioning out of the deferment period.

The consistently high NPL levels in the trade and commerce and housing sectors points to significant credit exposure and repayment challenges which require closer monitoring and targeted recovery strategies. In contrast, the production and manufacturing sector and service sector experienced a notable decline in NPL in March which reflects effective recovery efforts and improved repayment behavior within the sector. Overall, the sectoral distribution of NPLs highlights the urgent need to strengthen credit risk management particularly in high exposure sectors while also acknowledging encouraging signs of improvement in sectors where NPLs are on a declining trend.

Figure 12: Sectoral NPL

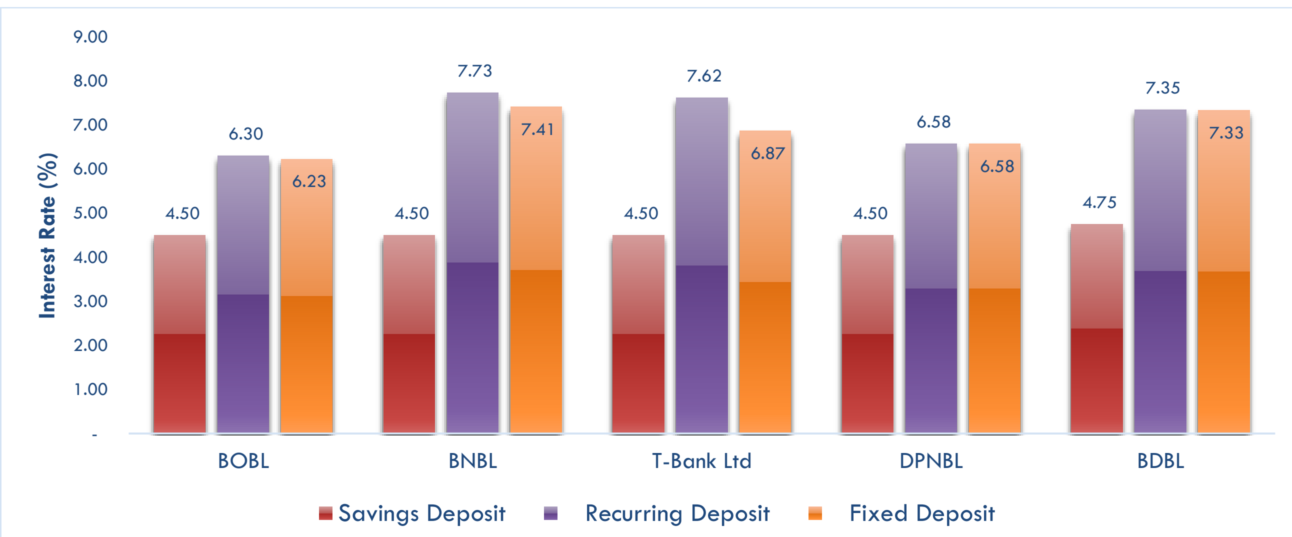


4.4 Interest Rates[6]

4.4.1 Deposit rates

The chart presents the interest rates offered by five major banks in Bhutan; BOBL, BNBL, T-Bank Ltd, DPNBL, and BDBL across three deposit categories: Savings, Recurring and Fixed Deposits. Savings deposit rates remain largely uniform at 4.50 percent for most banks, except for BDBL, which offers a marginally higher rate of 4.75 percent. For recurring deposits, BNBL offers the most competitive rate at 7.73 percent, while BOBL provides the lowest at 6.30 percent. Similarly, BNBL leads in fixed deposit rates at 7.41 percent, followed closely by BDBL at 7.30 percent. Overall, BNBL and BDBL stand out as the most competitive institutions in terms of deposit interest rates. These variations highlight how financial institutions differentiate their savings products to attract clients, emphasizing the importance for depositors to compare rates across banks to optimize their returns.

Figure 13: Interest Rates

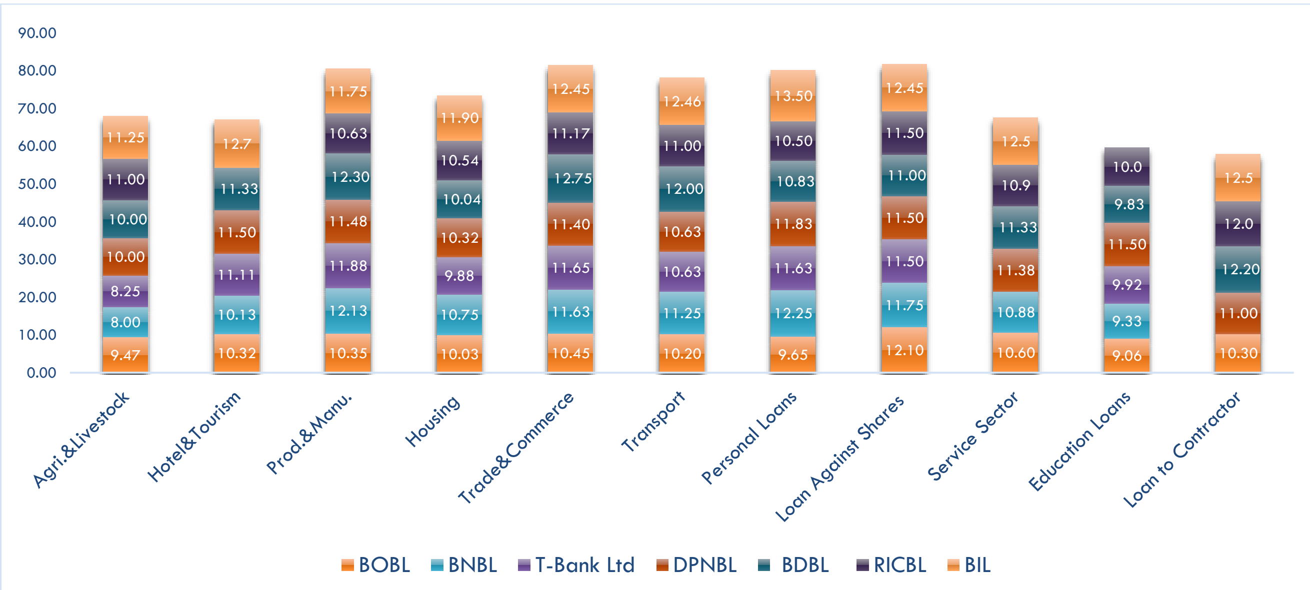


[6] *The average lending and deposit rates were calculated by taking a simple arithmetic mean of the respective rates published by individual banks and financial institutions.*

4.4.2 Lending rates

Personal loans continue to carry the highest lending rates across various financial institutions, with rates reaching up to 13.5 percent. This reflects the unsecured nature and higher risk profile typically associated with it. Following closely, loans extended to the production and manufacturing sector, as well as the services sector, also face relatively high lending rates, ranging up to 12.5 percent**.**

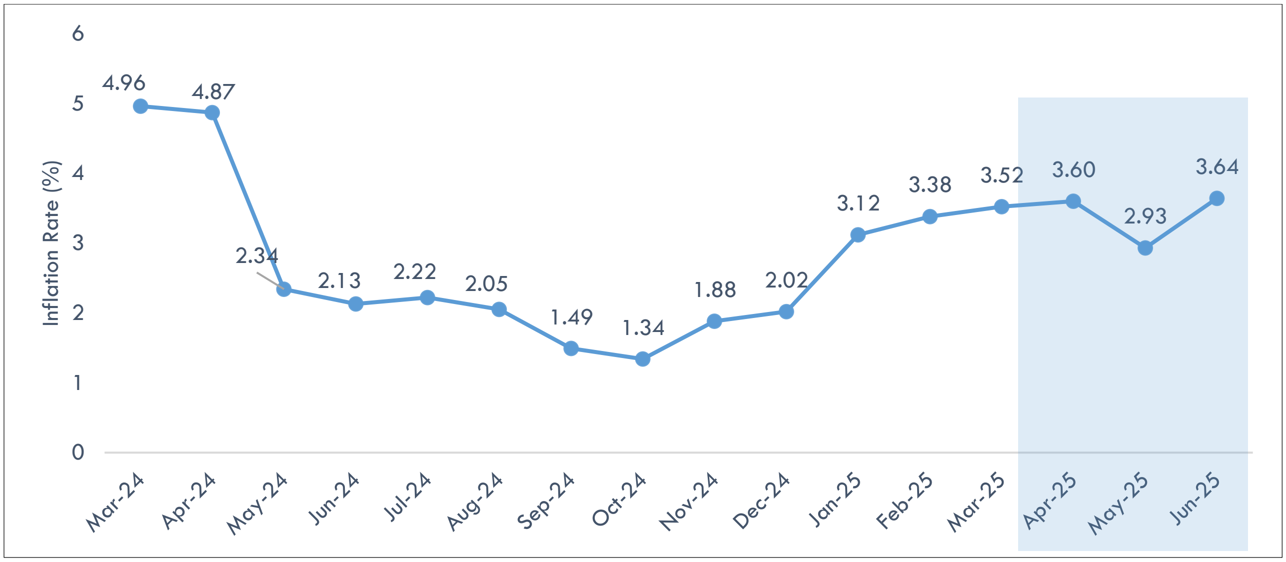
Figure 14: Lending rates



4.5 Inflation

Inflation has shown a modest upward trend in recent months, rising to 3.52 percent in March 2025 from 3.38 percent in February. The increase was mainly driven by an increase in food inflation, which rose to 5.81 percent of which the food & non-alcoholic beverages index surged by 6.43 percent, reflecting stronger demand. On the other hand, non-food inflation remained modest at 1.01 percent as the transport index dropped by 4.24 percent and the housing and utilities index contracted slightly by 0.13 percent, helping to contain overall inflation. Inflation is projected to rise to 3.60 percent in the upcoming month, indicating a slight upward movement in the consumer prices.

Figure 15: Inflation



5. External Sector & Balance of Payments

5.1 Balance of Payment

The overall balance of payment is projected to reach Nu. 23,900.561 million in FY 2025-26, reflecting a marginal increase of 2.88 percent from the previous quarter update. This is attributed to a projected increase in financial account inflows which is partially offset by an increased current account deficit. In FY 2024-25, the overall balance is forecasted at Nu. 33,047. 841 million, up by 17.56 percent from the previous quarter, primarily driven by increased projections in capital and financial accounts.

5.1.1 Current Account Balance

The Current Account Deficit (CAD) is projected to increase to 11.88 percent of GDP in FY 2025-26, up by 3.26 percentage points from the previous quarter update. This, however, is an improvement from FY 2024-25 as an increase in non-hydropower exports is anticipated. The revised CAD in FY 2024-25 is projected at 17.94 percent of GDP, up by 6.12 percentage points from the previous quarter forecast. The worsening CAD is attributed to the increasing trade deficit in goods to Nu. 66,654.140 million, up from Nu. 48,507.390 million in the previous quarter's projection. In the medium term, CAD is expected to deteriorate to a deficit of 13.38 percent of GDP in FY 2026-27, with increase in imports of goods and services as development of major hydropower projects such as Dorjilung accelerates.

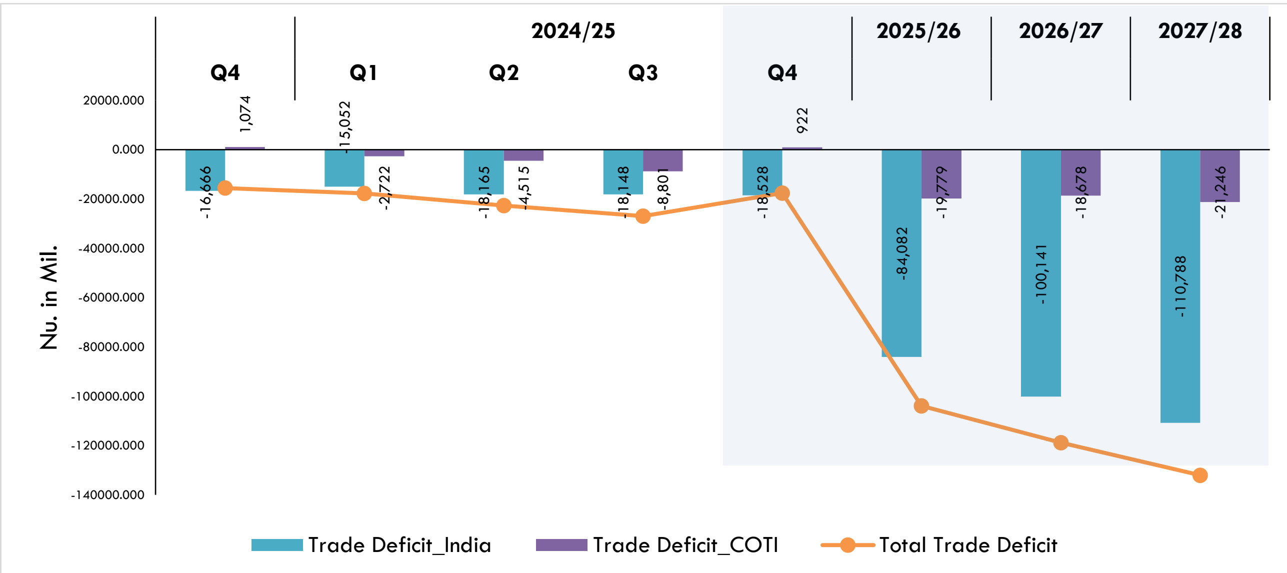
5.1.1.1 Merchandise Trade Deficit [7]

The merchandise trade deficit (excluding electricity) in FY 2025-26 is projected to reach Nu. 103,861.284 million, an upward revision of 41.22 percent from the previous quarter forecast. This is partly attributed to the baseline effect given the increase in 2024 baseline following the reconciliation of the provisional data for 2023 and 2024. Further, the provisional data show an increase in merchandise trade deficit from Nu. 22,680.208 million in the second quarter to Nu. 26,949.296 million in the third quarter of FY 2024-25. This increase in quarterly trade deficit is largely on account of increased imports of electrical machinery and equipment and vehicles from countries other than India with the expansion of data centers and lifting of moratorium on vehicle imports. On the other hand, exports to COTI also decreased while exports to India improved marginally from second to third quarter. As such, the merchandise trade deficit in FY

[7] *This is based on trade statistics update which do not take into account any adjustment undertaken in the BoP file.*

2024-25 is projected to reach Nu. 85,009.725 million, up from the second quarter's projection of 68,446.966 million. The merchandise trade deficit is projected to worsen further in 2026-27 and 2027-28 as imports are expected to increase with the construction of mega hydropower projects taking off.

Figure 16: Quarterly Trade Statistics Update[8]



5.1.1.2 Services & Transfers

A surplus in the balance of trade in services of Nu. 8,976.720 million is projected for FY 2025-26, higher than the previous quarter forecast by 50.65 percent, mainly driven by the upward revision in business related travel services. However, the surplus is declining compared to the projected surplus of Nu. 12,744.490 million for FY 2024-25 as increase in travel outside the country is expected. The remittances from the rest of the world and the inflow of budgetary grants not for investment is projected to improve slightly compared to the last quarter projection; however, the outflow of remittances to India is forecasted to increase, therefore on net, the secondary income show a slight decline compared to the previous quarter projection in FY 2024-25. The secondary income is expected to increase in FY 2026-27, driven by inflow of grants and remittances.

[8] *The provisional data were reconciled with the 2023 and 2024 Bhutan Trade Statistics data.*

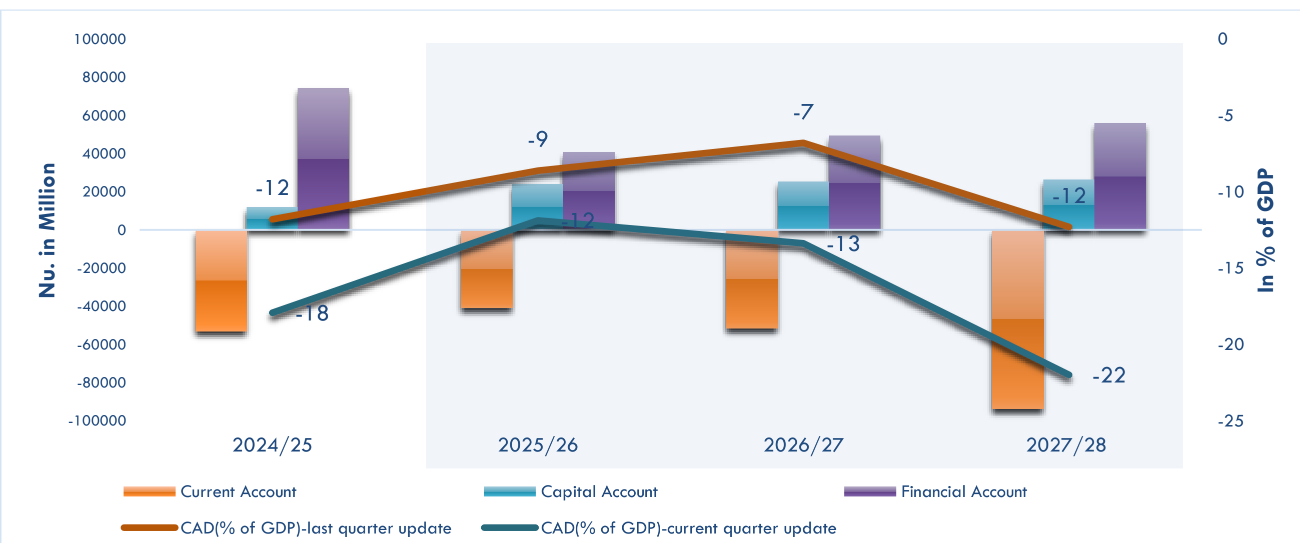
5.1.2 Capital Account

The capital account for FY 2025-26 is projected at Nu. 24,040.960 million, an upward revision of 18.50 percent from the previous quarter's forecast, driven by anticipated increases in grants inflows. Similarly, the projection for FY 2024-25 has been revised upward from Nu. 9,949.878 million in Q2 to Nu. 11,807.973 million in the current quarter. These inflows are primarily attributed to grants for the 13th FYP and hydropower development. Looking ahead, the capital account is projected to improve further in the medium term, reaching Nu. 26,187.799 million in FY 2027-28, as the implementation of the 13th FYP progresses and hydropower development accelerates in line with the Renewable Energy Roadmap.

5.1.3 Financial Account

The net financial inflow for FY 2025-26 is expected to reach 40,796.215 million, reflecting a decline from FY 2024-25. For FY 2024-25, the net financial inflows are projected at Nu. 74,286.839 million, which is 38.58 percent higher than last quarter's projection. The upward revision is primarily on account of projected net decrease in other investment assets particularly with India. On the other hand, projected direct investment inflows remain relatively stable at Nu. 4,829.170 million. This implies the net financial inflows to finance CAD is on account of external borrowings without much improvement in direct investment.

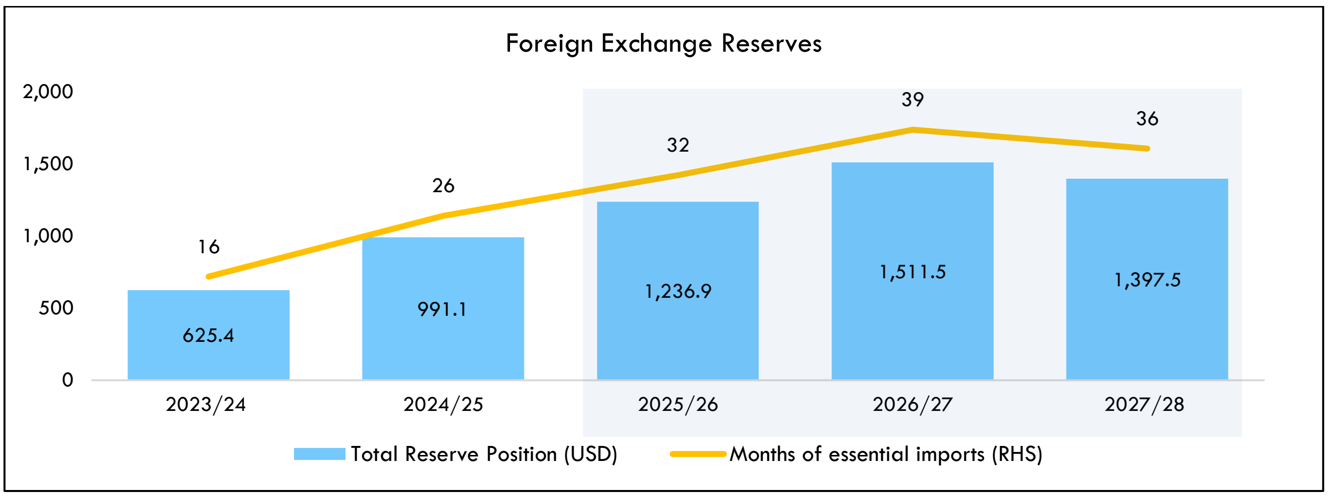
Figure 17: Balance of Payment



5.2 Foreign Reserves

Bhutan's foreign reserve position is projected to improve to USD 1,236.898 million in FY 2025-26, sufficient for 32 months of essential import coverage. This is expected to increase further to USD 1,511.524 million, extending coverage to 39 months. At the end of FY 2024-25, the reserves are forecasted at USD 991.142 million, up marginally by 2.02 percent from previous quarter projections, on account of projected improvement in capital and financial account inflows. This is enough to finance 26 months of essential imports during a critical period. As of March 2025, the external reserves stood at USD 886.881 million.

Figure 18: Foreign Exchange Reserves



6. Special Topics

6.1 Understanding Tariff Shocks in Bhutan: A Macroeconomic Analysis using ISLMBP and AD-AS model

Bhutan's small and highly trade dependent economy, operating under a fixed exchange rate regime pegged to the INR, is inherently exposed to external shocks, particularly those originating from global trade disruptions such as tariff increases. The country's imperfect capital mobility further limits the efficacy of monetary policy as an adjustment tool, making fiscal policy and structural preparedness central to macroeconomic stability.

Given Bhutan's reliance on imports for both consumption and production, even marginal shifts in global trade conditions such as tariff escalations can significantly affect the country's output, liquidity, and price dynamics. This study simulates the macroeconomic consequences of such tariff induced shocks using a theoretically grounded yet empirically estimated ISLMBP and AD-AS model.

6.1.1 Shock Scenarios and Simulation Design

Two plausible tariff related exogenous shocks were simulated:

a. **Export Shock**: A 30 percent decline in exports to simulate reduced foreign demand.
b. **Import Cost Shock**: A 20 percent increase in import prices to simulate rising trade costs.

These shocks were introduced into the IS and LM models to evaluate their effects on output, money supply, and trade balance. The inflationary impact was assessed through the SRAS specification, reflecting both cost push inflation and second round effects.

6.1.2 Key Findings

i. Output Response to Export Decline:

The export shock leads to a contraction in output as external demand weakens. However, domestic demand components particularly government expenditure and gross capital formation partially cushion the decline. The IS curve shifts towards the left, reflecting lower aggregate demand. Nevertheless, the overall decline in output remains moderate due to the robustness of internal demand.

ii. Liquidity Effects of Import Shock:

The import price shock generates a more pronounced macroeconomic impact. The LM equation indicates that for every 1 percent decline in output, broad money (M2) contracts by 2.2 percent. This points to a strong liquidity tightening effect under conditions of demand contraction. The sharper response compared to the export shock suggests higher sensitivity of the financial system to supply-side inflationary pressures.

iii. External Sector Adjustment:

The BP model reveals a deterioration in the trade balance following both shocks, with the import shock worsening net exports more substantially due to elevated costs. Limited capital inflows and constrained reserve flexibility mean that Bhutan's external sector is not well positioned to absorb such shocks without policy intervention.

iv. Inflation Sensitivity and Price Pressures

The SRAS simulation confirms that the Bhutanese economy becomes significantly more inflation sensitive under import driven cost pressures. The results suggest that inflation is not only influenced by current shocks but also exhibits inertia driven by past inflation and investment activity. A 1 percent increase in import prices results in a substantial and persistent rise in headline inflation, highlighting Bhutan's vulnerability to external price shocks.

6.1.3 Policy Implications

Given the structural features of Bhutan's macroeconomic environment, the following implications emerge:

Box 1: External Risk Transmission to Bhutan

Transmission Channel	Potential Impact on Bhutan
Monetary Policy	Tightening in India or globally may lead to higher domestic interest rates in Bhutan, constraining credit availability.
Trade and Energy Prices	Volatility in global and Indian fuel prices can directly affect Bhutan's inflation and import costs.
Exchange Rate Dynamics	Fluctuations in the INR can impact Bhutan's external balance and foreign reserve adequacy.
Capital Flows	Global financial tightening may restrict concessional financing and donor flows to Bhutan.

Policy Priority: Bhutan must strengthen external sector buffers, deepen regional trade diversification, and align macro-fiscal planning with regional developments to mitigate exposure to exogenous shocks.

The above study demonstrates that Bhutan's macroeconomic stability is sensitive to tariff related external shocks, particularly through the trade, money, and price channels. By integrating the IS-LM-BP and AD-AS frameworks with empirical simulations, the study provides a rigorous understanding of how such shocks propagate through the economy and informs the design of appropriate policy responses. Fiscal preparedness, inflation containment, and trade resilience must remain central to Bhutan's economic strategy in an increasingly uncertain global environment.

7. Risks & Outlook

Bhutan's near-term economic outlook remains vulnerable to a range of exogenous shocks, with the potential for significant sectoral and aggregate output losses. Recent scenario-based modeling reveals significant downside risks to output, with sector-specific sensitivities shaping the depth and breadth of overall economic losses. These include external shocks, domestic implementation delays, and persistent structural vulnerabilities.

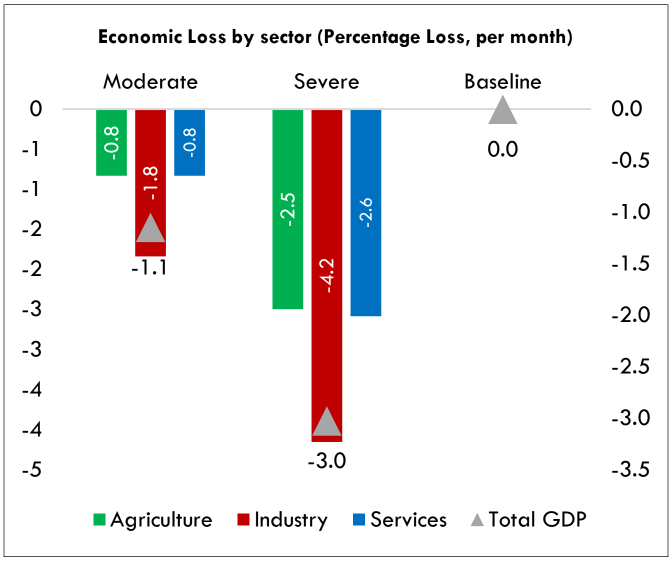
7.1 Sectoral Exposure and Shock Sensitivity

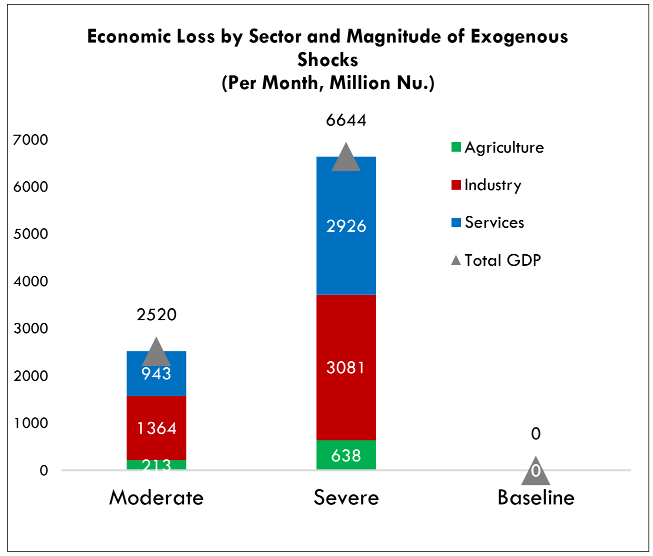
The sector-wise decomposition of economic loss under moderate and severe shocks demonstrates asymmetric vulnerabilities across Bhutan's economic structure. The analysis assumes output reductions in agriculture and services sectors under both scenarios, while the industry sector's losses are primarily driven by disruptions to hydropower construction and electricity generation.

- **Agriculture** is projected to decline by 0.8 percent and 2.5 percent per month under moderate and severe shocks, largely reflecting adverse weather-related disruptions, supply chain constraints and productivity.
- **Services**, including tourism and the wholesale/retail sector, contracted by 0.8 percent and 2.6 percent, reflecting demand-side weaknesses and a slower-than-expected tourism recovery.
- **Industry**, the most impacted sector due to its composition (construction, hydropower, and electricity), exhibits monthly losses of 1.8 percent in moderate and 4.2 percent in severe scenarios. These stem from potential delays in the Puna I hydropower project and lower electricity exports due to hydrological and other exogenous conditions.

The cumulative monthly GDP loss under moderate shock is estimated at 1.1 percent (Nu. 2.5 billion), increasing to 3.0 percent (Nu. 6.6 billion) under a severe scenario. In absolute terms, the industrial sector contributes the largest share of total losses i.e., 54 percent under moderate and 46 percent under severe conditions.

Figure 19: Economic Loss by Sector





7.2 Implications and Forward Risk Assessment

These findings highlight Bhutan's structural exposure to sector-specific and project-dependent risks:

- **Hydropower and construction concentration** intensifies growth volatility, particularly when flagship projects are delayed.
- **Tourism and services**, although recovering, remain highly sensitive to external conditions including geopolitical stability, economic conditions, and regional health risks.
- **Agriculture**, while smaller in GDP share, is susceptible to climate variability, with implications for rural livelihoods and inflation.

Therefore, if severe shocks persist over a six-month horizon, cumulative GDP loss could reach **18 percent of annual GDP**, potentially derailing medium-term fiscal and external balance objectives. This underscores the need for proactive contingency planning.

8. Conclusion

Bhutan's macroeconomic performance in the third quarter of FY 2024–25 presents a cautiously optimistic outlook. The upward revision of GDP growth to 6.06 percent underscores the resilience of key productive sectors, particularly construction, hydropower, manufacturing, and forestry. At the same time, the moderation in inflation, stable liquidity conditions, and a narrowing fiscal deficit reflect improving macroeconomic management and fiscal prudence.

Nevertheless, the economy remains structurally exposed to external shocks, particularly through the trade and current account channels. The widening CAD at 17.94 percent of GDP, and continued reliance on concessional external financing for capital investment intensify Bhutan's vulnerability to global price volatility and policy shifts in partner economies. Moreover, while domestic debt has declined, overall public debt remains elevated, calling for sustained fiscal consolidation and revenue diversification strategies.

The labor market exhibits signs of broad-based recovery, yet persistent youth unemployment and fluctuations in labor force participation suggest the need for targeted skills development and employment generation policies, especially in urban areas. Likewise, the underperformance in mining and services highlights areas requiring strategic reform and private sector engagement.

The study on tariff shocks reinforces Bhutan's macro-financial sensitivity to global trade dynamics, and the findings call for a more coordinated policy mix blending structural reforms, better public investment execution, and enhanced external sector resilience. Going forward, Bhutan must leverage the current growth momentum to transition toward a more diversified and shock-resilient economic structure. Anchoring fiscal policy within sustainable parameters, deepening the financial sector, and strategically positioning tourism and hydropower exports will be essential for long-term stability and inclusive development.

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10. Annexure

ASSUMPTIONS

STEP 1				STEP 2					
Value Added (VA) by Sector, 2025 Baseline *(in constant prices, million Nu)*				**Assumptions on VA by Type of Exogenous Shocks** *(1 means operating at 100% capacity)*			**Sectoral Loss** *(in constant prices, million Nu)*		
Sector	Description	Value	Share (%)	Moderate	Severe	Baseline	Moderate	Severe	Baseline
Agriculture		**25515**	**11.6**				**2551**	**7654**	**0**
	Crops	10817	4.9	0.90	0.70	1.00	1082	3245	0
	Livestock Production	9561	4.4	0.90	0.70	1.00	956	2868	0
	Forestry & Logging	5137	2.3	0.90	0.70	1.00	514	1541	0
			-						
Industry		**74130**	**33.8**				**16373**	**36967**	**0**
	Mining & Quarrying	5464	2.5	0.90	0.70	1.00	546	1639	0
	Manufacturing	11334	5.2	0.90	0.70	1.00	1133	3400	0
	Electricity & Water	29866	13.6	0.60	0.30	1.00	11946	20906	0
	Construction	27465	12.5				**2747**	**11021**	**0**
	o/w Hydro	9273	4.2	0.90	0.40	1.00	927	5564	0
	o/w Govt.	14964	6.8	0.90	0.70	1.00	1496	4489	0
	o/w Pvt. Sector	3228	1.5	0.90	0.70	1.00	323	969	0
Services		**113179**	**51.6**				**11318**	**35108**	**0**
	Wholesale and retail trade	22754	10.4	0.90	0.70	1.00	2275	6826	0
	Transport, Storage	15776	7.2	0.90	0.70	1.00	1578	4733	0
	Hotel and restaurant	4558	2.1	0.90	0.60	1.00	456	1823	0
	Communications	6987	3.2	0.90	0.60	1.00	699	2795	0
	Financing and Insurance	10459	4.8	0.90	0.70	1.00	1046	3138	0
	Real Estate & Dwellings	12869	5.9	0.90	0.70	1.00	1287	3861	0
	Professional, Administrative and Support Services	3793	1.7	0.90	0.70	1.00	379	1138	0
	Public Administration and defense	22419	10.2	0.90	0.70	1.00	2242	6726	0
	Education	9562	4.4	0.90	0.70	1.00	956	2869	0
	Human Health and social work Health	3436	1.6	0.90	0.70	1.00	344	1031	0
	Entertainment, recreation, and other services	565	0.3	0.90	0.70	1.00	57	170	0
Net Taxes		6506	3.0						
	Total VA	**219,330**	**100**				**30,242**	**79,730**	**-**