Royal Government of Bhutan

Medium-Term Debt Management Strategy

(FY2025/26 to FY2027/28)

Department of Macro-fiscal and Development Finance

Ministry of Finance

30 June 2025

TABLE OF CONTENTS

LIST OF ACRONYMS

ADB	Asian Development Bank
ATR	Average Time to Re-fixing
ATM	Average Time to Maturity
CAD	Current Account Deficit
EIB	European Investment Bank
GFN	Gross Financing Need
GDP	Gross Domestic Product
IBRD	International Bank for Reconstruction and Development
IDA	International Development Association
IFAD	International Fund for Agricultural Development
IFC	International Finance Corporation
INR	Indian Rupee
JICA	Japan International Cooperation Agency
MEF	Macroeconomic and Fiscal Framework
MFCTC	Macroeconomic Framework Coordination Technical Committee
MTDS	Medium-Term Debt Management Strategy
OPEC	Organization of the Petroleum Exporting Countries
PDMP	Public Debt Management Policy
PPG	Public and Publicly Guaranteed (debt)
RMA	Royal Monetary Authority
T-Bill	Treasury Bill
T-Bond	Treasury Bond

FORWARD

The Department of Macro-Fiscal and Development Finance (DMDF) of the Ministry of Finance presents the Medium-Term Debt Management Strategy (MTDS) for the fiscal years 2025/26 to 2027/28. This strategy has been developed in accordance with the Public Debt Management Policy (PDMP) 2023 and serves as a key instrument in guiding Bhutan's prudent and forward-looking approach to public debt management.

Bhutan's evolving economic landscape, shaped by structural transformations and development priorities, necessitates a strategic framework that balances the financing needs of the government with the imperative to maintain debt sustainability. The MTDS lays out a carefully considered roadmap to achieve these objectives, incorporating a comprehensive analysis of the current debt portfolio, macro-fiscal outlook, and funding options, both external and domestic.

At its core, the strategy aims to minimize the cost of debt over the medium term, within an acceptable level of risk. It prioritizes concessional external financing as a primary source of funding, complemented by selective commercial external borrowing for investment projects and domestic borrowing to support the development of a resilient capital market. The analysis and simulations conducted under this strategy underscore the selection of an optimal strategy, which presents the most cost-effective and sustainable path forward for Bhutan's public debt profile.

The successful implementation of this strategy requires coordinated action across various stakeholders. DMDF encourages continued collaboration and commitment to ensure that debt remains a viable instrument for development without compromising long-term fiscal sustainability. In doing so, we reaffirm our commitment to transparency, good governance, and sound economic management principles that are vital to our national vision and prosperity.

Let us collectively ensure that Bhutan's debt management strategy not only safeguards macroeconomic stability but also supports inclusive and resilient economic growth in the years ahead.

Department of Macro-fiscal and Development Finance

1. INTRODUCTION

The MTDS is an essential component of the Monitoring and Reporting framework established by the PDMP 2023. Its purpose is to support the government's debt management objectives and financing strategies, aligned with the annual National Budget. The strategy reflects our preferences for balancing costs and risks, especially in managing the inherent vulnerabilities associated with the debt portfolio.

The primary objectives of the MTDS are to:

- Minimize debt servicing and issuance costs within prudent risk levels
- Reduce refinancing and market risks through appropriate currency, interest rate, and maturity structures
- Maintain access to concessional and cost-effective borrowing sources
- Pursue commercial borrowings only for self-liquidating projects
- Ensure full and timely debt service obligations
- Support the development of a reliable and robust domestic capital market
- Promote transparency through comprehensive financial disclosure
- Diversify external financing sources, including exploring green and climate-related financing options

During FY 2025/26 to FY 2027/28, Bhutan will prioritize external concessional borrowing to meet the GFN, supplemented by domestic issuance of Treasury bills and bonds. This approach aims to lower overall financing costs, given the concessional terms, while also fostering the growth of our domestic capital markets.

The MTDS includes an analysis of our existing debt portfolio, updates on debt management developments, potential funding sources with their benefits and risks, and a macroeconomic outlook. Based on this, an optimal financing strategy has been selected, with additional activities planned to support domestic debt market development.

Scope: This MTDS covers PPG debt over the three-year period from FY 2025/26 to FY 2027/28. PPG debt includes obligations of the Royal Government, the RMA, and public corporations. Debt servicing for corporate debt and RMA obligations is excluded from gross financing needs, as these are settled directly by the respective entities.

2. DEBT PORTFOLIO ANALYSIS

2.1 Total PPG Debt Summary

The summary of PPG's debt stock as of 31 March 2025 is presented in the table below:

Table 1: Summary of PPG Debt

Category	**31-March-2025**
Total Public Debt	298,183.293
Percent of GDP	99.1%
External Debt	277,085.241
Percent of GDP	92.1%
Percent of Total Public Debt	92.9%
Domestic Debt	21,098.052
Percent of GDP	7.0%
Percent of Total Public Debt	7.1%
Hydropower External Debt	170,041.964
Percent of GDP	56.5%
Percent of Total External Debt	61.4%
Non-Hydro External Debt	107,043.276
Percent of GDP	35.6%
Percent of Total External Debt	38.6%

As of March 31, 2025, Bhutan's PPG debt stock stood at Nu 298.18 billion, representing approximately 99.1% of GDP. External debt accounted for Nu 277.09 billion (92.1% of GDP), constituting 92.9% of total public debt, while domestic debt was Nu 21.10 billion (7.0% of GDP). External debt is further divided into hydropower-related debt from India and non-hydropower debt from multilateral and bilateral partners. Hydropower debt from India totals Nu 170.04 billion (56.5% of GDP), with non-hydropower external debt at Nu 107.04 billion (35.6% of GDP).

2.2 External Debt Composition

Figure 1 presents external debt by currency composition:

Figure 1: External Debt by currency composition

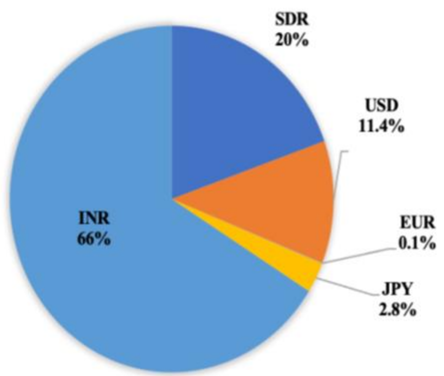
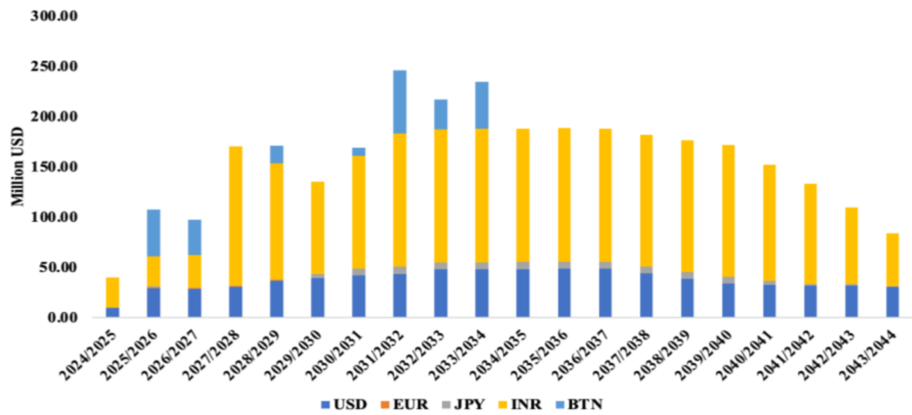


Figure 2: Repayment Profile of existing Debt



The majority of external debt is denominated in Indian Rupees (INR), followed by Special Drawing Rights (SDR) and US Dollars (USD). This currency composition reduces foreign exchange risk, given Bhutan's currency peg to INR.

2.3 Repayment Profile of the Existing Debt

Figure 2 presents the projection of principal repayment of the existing debt, disaggregated by the currencies of the denomination. Principal repayments are predominantly scheduled in INR for hydropower loans from India, with significant repayments in FY 2027/28 for standby credit facilities. Post-project repayment milestones are projected until FY 2037/38, after which debt levels are expected to decline.

2.4 Cost and Risk of Existing Debt

Table 2 summarizes the cost and risk indicators of the existing debt portfolio as of 31 March 2025.

Table 2: Cost and Risk Indicator of the existing Public Debt

<table>
<tr><th colspan="2">Cost & Risk Indicators</th><th>External Debt</th><th>Domestic Debt</th><th>Total Public Debt</th></tr>
<tr><td colspan="2">Nominal Debt (Million Nu.)</td><td>277,085.241</td><td>21,098.052</td><td>298,183.293</td></tr>
<tr><td colspan="2">Nominal Debt as a percent of GDP</td><td>92.1%</td><td>7.0%</td><td>99.1%</td></tr>
<tr><td colspan="2">Weighted Average Interest Rate</td><td>6.5%</td><td>5.9%</td><td>6.5%</td></tr>
<tr><td rowspan="4">Refinancing Risks</td><td>Average Time to Maturity (Years)</td><td>11.9</td><td>5.7</td><td>11.4</td></tr>
<tr><td>Debt Maturing in 1 Year (% of Total)</td><td>1.2%</td><td>0.0%</td><td>1.2%</td></tr>
<tr><td>Debt Maturing in 2-5 Years (% of Total)</td><td>12.9%</td><td>2.8%</td><td>15.7%</td></tr>
<tr><td>Debt Maturing in 5-10 Years (% of Total)</td><td>24.6%</td><td>4.2%</td><td>28.9%</td></tr>
<tr><td rowspan="3">Interest Rate Risks</td><td>Average Time to Re-fixing (Years)</td><td>11.4</td><td>5.7</td><td>11.0</td></tr>
<tr><td>Debt Re-fixing in 1 Year (% of Total)</td><td>6.3%</td><td>0.0%</td><td>5.9%</td></tr>
<tr><td>Fixed Rate Debt (% of Total)</td><td>94.8%</td><td>100.0%</td><td>95.2%</td></tr>
<tr><td>Forex Risk</td><td colspan="3">CC Debt (% of Total Public Debt)</td><td>31.5%</td></tr>
<tr><td rowspan="3">Debt Stress</td><td colspan="3">Hydro Debt to GDP (%)</td><td>56.5%</td></tr>
<tr><td colspan="3">Non-Hydro Debt to GDP (%)</td><td>35.6%</td></tr>
<tr><td colspan="3">Central Government Debt to GDP (%)</td><td>35.6%</td></tr>
</table>

As of 31 March 2025, the external debt's weighted average interest rate was 6.5%, with an average maturity of approximately 11.9 years. Refinancing risk remains low, with minimal short-term maturities. The fixed-rate component dominates external debt, further reducing interest rate risk. Exchange rate risk is limited, as most foreign debt is INR-denominated, and hydropower revenue streams offset debt servicing obligations.

The weighted average interest rate of total public debt stands at 6.5%, primarily driven by domestic bond coupon rates and hydropower-related debt. Hydropower debt accounts for 61.4% of total external debt and is considered low risk due to its favourable repayment structure. Debt servicing for hydropower loans from the Government of India (GoI) begins only one year after project commissioning, allowing revenue inflows to commence prior to repayment obligations. Additionally, electricity export tariffs are calculated based on the total project cost, including projected debt servicing, ensuring sufficient revenue to cover repayment obligations. As a result, hydropower debt is deemed commercially viable, with most financing obtained on commercial terms—contributing to the higher average interest rate.

The remaining 31.5% of external debt is denominated in convertible currency (CC) and consists of concessional loans. These loans carry low nominal interest rates (ranging from 0% to 2%), extended grace periods (typically 5 to 10 years), and long repayment terms of up to 40 years. The concessional nature of this debt helps spread debt servicing obligations over an extended period, thereby reducing the impact on government cash flows and foreign exchange reserves and mitigating liquidity risks.

2.5 Evaluation of the Previous MTDS for FY2020/21 – FY2022/23

The MTDS for FY2020/21–FY2022/23 was designed to meet the government's financing needs at minimal cost and risk while fostering the development of the domestic debt market. The evaluation reveals that the strategy effectively achieved its primary objectives.

Key strategic goals - including maximizing concessional borrowing, promoting domestic market participation through T-Bills and bonds, and maintaining external debt within the 35% GDP threshold set by the Public Debt Policy 2016 - were all fulfilled. Quantitative targets were also met: 60%-80% of GFN was sourced from concessional external financing, and 20%-40% from domestic sources. Fixed-rate debt was maintained above 95%, and T-Bills were mainly used for short-term cash flow management. Bond auctions became the main issuance method, and some retail investor participation was observed.

However, progress on several planned domestic market development initiatives was limited. Efforts to establish a Government Securities Issuance System, hold investor consultations, and introduce a bond issuance calendar were not implemented due to structural constraints. These activities have been deferred to the next MTDS period.

Therefore, while the MTDS achieved strong results in financing and risk management, greater attention is needed on structural reforms to deepen the domestic debt market and broaden the investor base in the coming years.

3 MACRO-FISCAL DEVELOPMENTS AND OUTLOOK

3.1 GDP outlook

Bhutan's economy is projected to grow by approximately 8.3% in FY2025, 6.8% in FY2026, and 6.4% in FY2027, resulting in an average growth rate of 7.2% over the next three fiscal years. This growth is primarily driven by higher tax revenues and increased infrastructure activity, particularly in the hydropower sector.

In the primary sector, forestry and logging are expected to remain key growth contributors, supported by increased timber production. The subsector recorded a provisional growth rate of 15.5% in 2024 and is projected to continue its strong performance.

The secondary sector is forecast to expand by 16.4% in 2025, led by electricity and construction. While both subsectors remain significant growth drivers, their growth are expected to moderate, with electricity projected to grow by 15.0% and construction by 25.1%.

The services sector is also expected to play a critical role, with a projected growth rate of 4.8% in 2025. Within the sector, transportation and storage, as well as hotels and restaurants, are anticipated to contribute 0.7% and 0.5%, respectively, reflecting a continued recovery in tourism and related industries. However, growth in key subsectors such as wholesale and retail trade, and communications will be slower.

3.2 Current Account

The CAD is projected around 11.9% of GDP in FY 2025–26. This projected CAD reflects an improvement relative to FY 2024–25, supported by anticipated growth in non-hydropower exports. The CAD for FY 2024–25 is estimated at 17.9% of GDP. This widening deficit is primarily attributed to a significant increase in the trade deficit for goods. Looking ahead, the CAD is expected to deteriorate further, reaching 13.4% of GDP in FY 2026–27, largely due to increased imports of goods and services associated with the accelerated development of major hydropower projects, including the Dorjilung project.

3.3 Reserve Position

Foreign reserves stood at USD 991.14 million, providing 26 months of essential imports cover. It is projected to improve to USD 1,236.90 million in FY 2025-26, providing sufficient coverage for approximately 32 months of essential imports. This figure is expected to increase further to USD 1,511.52 million in FY2026-27, extending coverage to around 39 months.

3.4 Fiscal Framework

The fiscal policy aims to foster robust and inclusive economic growth while maintaining fiscal discipline and macroeconomic stability. Based on the medium-term economic outlook, the government will pursue the following fiscal targets[1]:

- Keep the fiscal deficit at an average of 3% of GDP during the plan period.
- Maintain the tax-to-GDP ratio above 15%.
- Ensure total central government debt (external and domestic) does not exceed 55% of GDP in any year.
- Keep inflation below 5% annually on average.

3.5 Key assumptions for MTDS

This outlines the fundamental macro-fiscal assumptions underpinning the simulation of various debt management strategies. The assumptions are based on the recent MEF, as of March 2025. These assumptions serve as the baseline parameters for modeling future fiscal and debt trajectories.

Table 3: Key macro-fiscal assumptions

In millions of Nu.

Indicators	FY2025-26	FY2026-27	Fy2027-28
Revenue & Grant	97,773	105,984	107,329
Primary Expenditure	108,303	104,100	98,415
Budgeted Interest Payment	10,908	10,649	11,654
International Reserve (Million US$ $)	1,237	1,512	1,398
GDP	344,554	385,500	425,814

Source: MEF, MFCTC, March 2025

Based on these assumptions, the estimated GFN as a percentage of GDP is approximately 10.6% for FY2025/26, 8.0% in FY2026/27, and further decreasing to around 7.2% in FY2027/28. Correspondingly, the gross financing requirements are projected to decline over the medium term, reflecting anticipated fiscal consolidation and growth trajectories.

---

[1] *Thirteenth Five Year Plan (2024-2029) of the Royal Government of Bhutan, P. 92.*

4 FINANCIAL SOURCES

This section provides a brief overview of the government's potential funding sources and the costs and risks associated with various financing sources.

4.1 External sources

The government currently secures concessional financing from multilateral development partners such as the IDA, ADB, IFAD and JICA to fund budgetary programs and projects. In contrast, large capital investments, particularly in hydropower development, are primarily financed by the Government of India (GoI). Concessional financing from institutions such as ADB, IDA, and IFAD is expected to remain the government's preferred source due to its cost-effectiveness and long-term repayment structure. These loans typically offer favorable terms, including lower interest rates, extended grace periods, and long repayment tenures, which help mitigate refinancing and interest rate risks. To further diversify its financing sources, the government started engaging with institutions such as the IFC, IBRD, Kuwait Fund, OPEC Fund, and the EIB to support energy and other commercially viable projects.

Table 4: Potential Financing Sources

Funding Source	Financing Terms
1. External concessional sources	
ADB (COL/ADF)	Has a maturity period of 24 years for program loans and 32 years for project loans, a grace period of 8 years, and an interest rate of 1% during the grace period and 1.5% after the grace period.
IFAD - regular	Has a maturity period of 40 years, a grace period of 10 years, and an interest rate/service charge of 0.75%.
JICA	**Before graduation from the LDC category:** Has a maturity period of 40 years, a grace period of 10 years, an interest rate of 0.01% and a front-end fee of 0.2%. **After graduation:** Has a maturity period of 32 years, a grace period of 7 years, and an interest rate of 2.05% for loans other than consulting services and 0.55% for loans on consulting services.

Kuwait Fund	Has a maturity period of 28 years, a grace period of 4 years, and an interest rate of 2.5%.
OPEC Fund	Has a maturity period of 20 years, a grace period of 5 years, and an interest rate of 2%.
World Bank (IDA-regular)	Has a maturity period of 40 years, a grace period of 10 years, interest rate/service charge of 0.75%.
2. External other sources	
ADB (OCR & AFD), WB (IBRD & IFC), EIB and Bilateral Partners	Loans from these sources have different maturity and grace periods and interest rate of more than 3%.
3. Domestic sources	
T-bills and T-bonds	Short-term instruments (e.g., T-Bills) have maturities up to 1 year with low discount rates; longer-term bonds (3-10 years) offer fixed or variable coupon rates.

External commercial sources are cost-effective, highly concessional, reduces financing costs, and often includes grant support. However, there are exchange rate risks due to foreign currency-denominated financing.

4.2 Domestic sources

Domestic financing, mainly through T-Bills and bonds, will be utilized to supplement external funds, especially when external concessional financing is insufficient. These domestic sources are cost efficient compared to other domestic options, helps diversify funding sources and develop the domestic capital market while such short-term instruments face higher refinancing risks, bonds may have limited availability and higher interest costs. The domestic bond market remains nascent, requiring development efforts such as establishing benchmark bonds, improving liquidity, and expanding investor participation.

5 MODELLING THE MEDIUM-TERM DEBT PORTFOLIO

5.1 Hypothetical borrowing strategies and the caveats

The government's strategy to meet its Gross Financing Needs (GFN) relies on a mix of external and domestic sources, guided by key considerations of cost, risk, and market development. As part of this Medium-Term Debt Management Strategy (MTDS), four alternative financing strategies have been modeled to evaluate their relative cost-effectiveness and risk profiles. The preferred strategy is the one that achieves an optimal balance between minimizing borrowing costs and managing associated risks.

For analytical simplicity, these strategies are based on aggregated debt instruments. While specific bond tenors are mentioned, they broadly represent short-, medium-, and long-term bond issuances. The MTDS will be reviewed annually to reflect evolving macroeconomic conditions and ensure continued alignment with the government's debt management objectives.

A summary of the four strategies is provided below:

Strategy 1 (S1): Baseline / Business As Usual (BAU)

This strategy reflects a continuation of the current financing approach, where external resources are sourced primarily from multilateral and bilateral development partners, and any remaining financing needs are met through domestic borrowing.

Given that support from development partners is expected to remain unchanged—or potentially decline—while the government pursues an ambitious development agenda under the 13th Five-Year Plan (FYP), domestic resource mobilization is anticipated to increase over time. As such, this strategy represents the status quo.

The external financing component is based on an indicative concessional loan mix, with 80% sourced from multilateral institutions at fixed interest rates and 20% from bilateral partners, also at fixed rates. Domestic borrowing includes a combination of Treasury bills and long-term bonds, with the share of domestic instruments gradually declining as external concessional financing increases.

The indicative proportions of external and domestic financing under this strategy are outlined in the table below:

Table 3: Strategy 1(BAU)

S1	FY2025-26	FY2026-27	FY2027-28
External Financing (% of GFN)	**80%**	**70%**	**50%**
Multilateral Fixed	80%	80%	80%
Bilateral Fixed	20%	20%	20%
Domestic financing (% of GFN)	**20%**	**30%**	**50%**
T-Bill fixed	10%	10%	10%
T-Bond 5-year fixed	50%	50%	50%
T-Bond 7-year fixed	40%	40%	40%

Strategy 2 (S2): Issuance of International Green Bond

Building upon the baseline, this strategy incorporates the issuance of international bonds, specifically green bonds, to finance 20% of the external borrowing requirement. As a result, the share of concessional multilateral financing is reduced from 80% to 60%, while the proportions of bilateral and domestic financing remain consistent with Strategy 1.

The introduction of international bond issuance is aimed at diversifying the government's financing sources and investor base, enhancing Bhutan's visibility in global capital markets, and supporting the development of market-based financing capabilities. Issuing a green bond aligns with Bhutan's strong commitment to environmental sustainability and builds on the country's recent progress in green finance frameworks and readiness assessments. Given the advanced preparatory work already undertaken, Bhutan is well-positioned to access green capital markets in the near term.

From a financing perspective, green bonds are functionally similar to regular bonds in terms of cost and risk. However, the decision to pursue a green bond issuance reflects Bhutan's policy alignment with climate-resilient development and its ambition to attract ESG-focused investors. This approach could also help position Bhutan as a credible and transparent green issuer, potentially unlocking preferential access to green capital over time.

Nonetheless, international bond issuance, green or otherwise, introduces certain risks and challenges. These include higher foreign exchange (FX) risk, potential maturity concentration, and the absence of concessional features such as grace periods and low fixed interest rates typically associated with multilateral commercial financing. These factors must be carefully managed through prudent debt and risk management practices.

Therefore, this strategy attempt to simulate a balanced approach by partially tapping international markets while maintaining a strong conventional financing base, enabling Bhutan to begin integrating market-based instruments into its broader debt management framework.

Table 4: Strategy 2: International Green Bond

S2	**FY2025-26**	**FY2026-27**	**FY2027-28**
External Financing (% of GFN)	**80%**	**70%**	**50%**
Multilateral Fixed	60%	60%	60%
Bilateral Fixed	20%	20%	20%
7-year International Green Bond	20%	20%	20%
Domestic financing (% of GFN)	**20%**	**30%**	**50%**
T-Bill fixed	10%	10%	10%
T-Bond 5-year fixed	50%	50%	50%
T-Bond 7-year fixed	40%	40%	40%

Strategy 3(S3): External concessional borrowings to meet 80% of GFN

Under this strategy, 80% of the GFN is consistently met through external concessional borrowing over the MTDS period, while the remaining 20% is financed through domestic sources each year. The external financing is fully sourced from multilateral and bilateral institutions on fixed rate terms. Domestic financing consists of a mix of Treasury bills and government bonds.

This strategy highlights the limited capacity of the domestic capital market, which remains relatively narrow and underdeveloped. As a result, the majority of development financing continues to rely on concessional external borrowing, underscoring the importance of sustained engagement with development partners to meet Bhutan's financing needs.

Table 5: Strategy 3: External concessional borrowings

S3	**FY2025-26**	**FY2026-27**	**FY2027-28**
External Financing (% of GFN)	**80%**	**80%**	**80%**
Multilateral Fixed	80%	80%	80%
Bilateral Fixed	20%	20%	20%
Domestic financing (% of GFN)	**20%**	**20%**	**20%**
T-Bill fixed	10%	10%	10%
T-Bond 5-year fixed	50%	50%	50%
T-Bond 7-year fixed	40%	40%	40%

Strategy 4(S4): External concessional borrowings and domestic borrowing each to meet 50% of the GFN

This strategy proposes an equal allocation of financing sources, with 50% of the GFN met through external borrowing and the remaining 50% through domestic borrowing. External financing is assumed to be fully concessional, sourced from multilateral and bilateral partners on fixed-rate terms. Domestic borrowing consists of a mix of Treasury bills and government bonds with various maturities.

While this approach provides a balanced mix of financing and promotes the development of the domestic capital market, its practical implementation over the next three years may face significant challenges. Given the current limitations of Bhutan's domestic capital market, including its relatively shallow and limited investor base, achieving a 50% domestic financing share may not be feasible in the medium term.

Therefore, this strategy is presented primarily for analytical purposes to assess the potential cost and risk implications of a more balanced financing mix. It serves as a benchmark for exploring the long-term benefits and trade-offs of reducing reliance on external borrowing and gradually increasing domestic market participation.

Table 6: Strategy 4: Domestic market development

S4	**FY2025-26**	**FY2026-27**	**FY2027-28**
External Financing (% of GFN)	**50%**	**50%**	**50%**
Multilateral Fixed	80%	80%	80%
Bilateral Fixed	20%	20%	20%
Domestic financing (% of GFN)	**50%**	**50%**	**50%**
T-Bill fixed	10%	10%	10%
T-Bond 3-year fixed	20%	20%	20%
T-Bond 5-year fixed	40%	40%	40%
T-Bond 7-year fixed	30%	30%	30%

5.2 Cost and Risk Indicators

The cost-risk indicators of the four strategies are summarized in the table below:

Table 7: The Cost and Risk Indicators of the four strategies

Risk Indicators		2024	As at end 2027			
		Current	S1	S2	S3	S4
Nominal debt as percent of GDP		101.9	86.6	86.9	86.6	86.7
Present value debt as percent of GDP		104.6	82.9	84.7	81.7	84.4
Interest payment as percent of GDP		5.3	4.1	4.3	4.1	4.2
Implied interest rate (percent)		5.2	4.7	4.9	4.6	4.8
Refinancing risk	Debt maturing in 1yr (percent of total)	3.2	5.0	5.0	4.7	6.0
	Debt maturing in 1yr (% of GDP)	3.5	4.3	4.3	4.1	5.2
	ATM External Portfolio (years)	9.9	11.1	10.4	11.5	10.5
	ATM Domestic Portfolio (years)	5.6	4.6	4.6	4.5	3.9
	ATM Total Portfolio (years)	9.6	10.2	9.6	10.8	9.4
Interest rate risk	ATR (years)	9.3	10.1	9.5	10.7	9.2
	Debt refixing in 1yr (percent of total)	7.2	7.7	7.7	7.4	8.7
	Fixed rate debt including T-bills (percent of total)	95.9	97.0	97.1	97.0	97.0
	T-bills (percent of total)	0.0	0.5	0.5	0.2	0.5
FX risk	FX debt as % of total	92.8	87.3	87.3	90.9	82.8
	ST FX debt as % of reserves	7.1	13.2	13.2	13.2	13.2

The analysis confirms that Strategy 3 strikes the optimal balance between cost efficiency and risk mitigation, primarily due to its reliance on concessional external debt and manageable exchange rate exposure.

5.3 Stress tests

To evaluate the resilience of each financing strategy, stress testing is conducted against exchange rate and interest rate shocks:

- Shock 1: A one-time depreciation of the Ngultrum by 7.7% in FY2025/26 in combination with moderate interest rate shock. In the same year, a standalone depreciation of 15.4% was also introduced. Ngultrum depreciation refers to a decrease in the value of Ngultrum relative to the USD in floating exchange rate system.
- Shock 2: A depreciation is introduced starting FY2025/26 in combination with interest rate shocks. A moderate shock (combined with 7.7% depreciation shock) of 1% on external borrowing and T-bills fixed, and 2% for domestic bond fixed was introduced. And extreme shock (standalone) of 2% on external borrowing and T-bills fixed and 4% on T-bonds fixed was introduced. Interest rate shocks refers to sudden and unexpected shifts in interest rates, used in assessing the potential impact on debt portfolio in this context.

These tests are critical for understanding the potential variability of debt servicing costs and assessing the strategies' robustness under adverse macroeconomic conditions.

5.4 The outcome of the strategy simulation

The simulation outcomes (as at end of FY2027/28) are assessed using key cost and risk indicators, with the results summarized in the following figures:

Figure 3: Debt to GDP

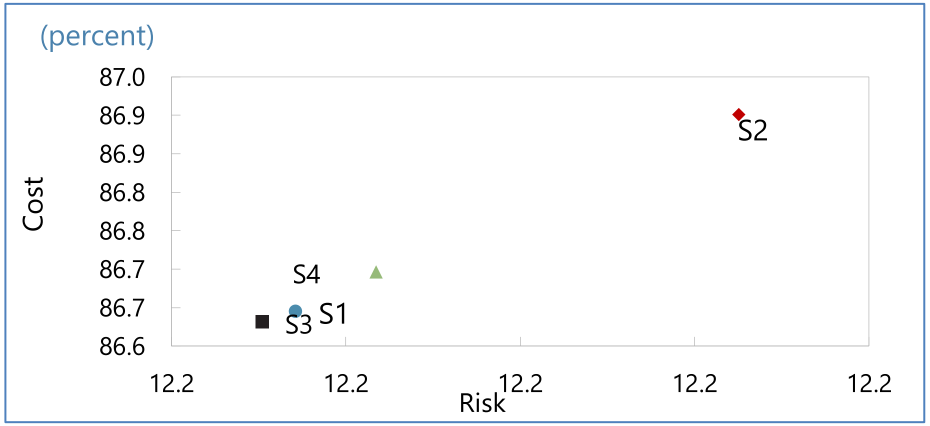


Figure 4: Interest to GDP

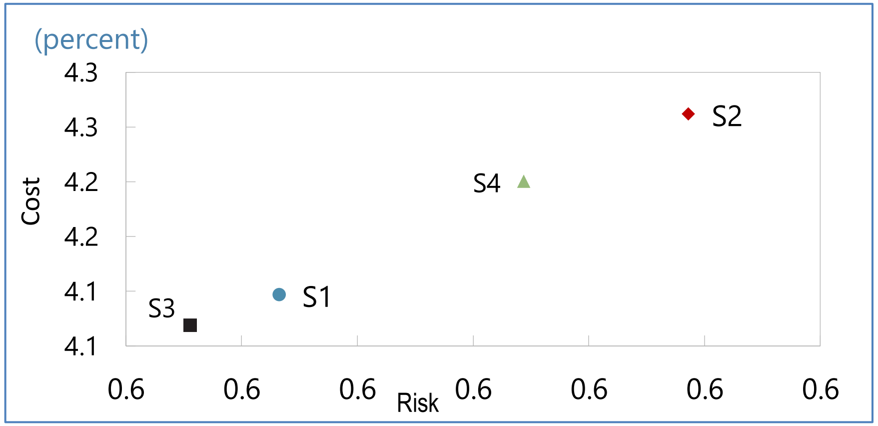


Figure 5: Debt Service to GDP

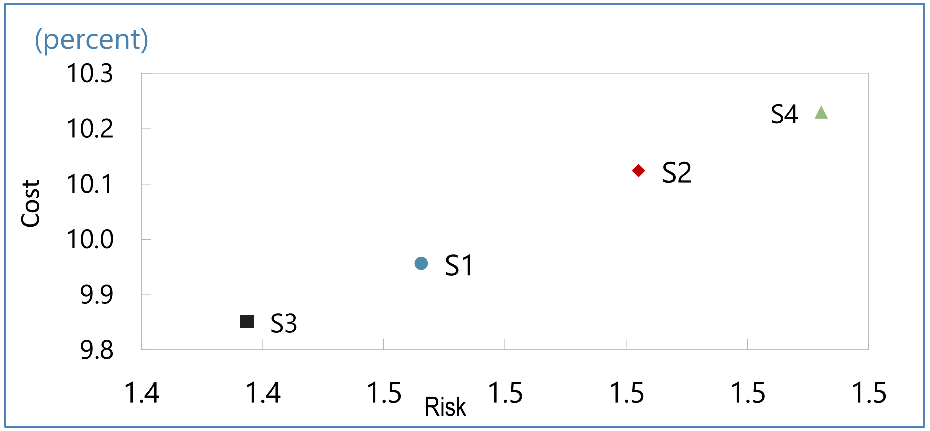
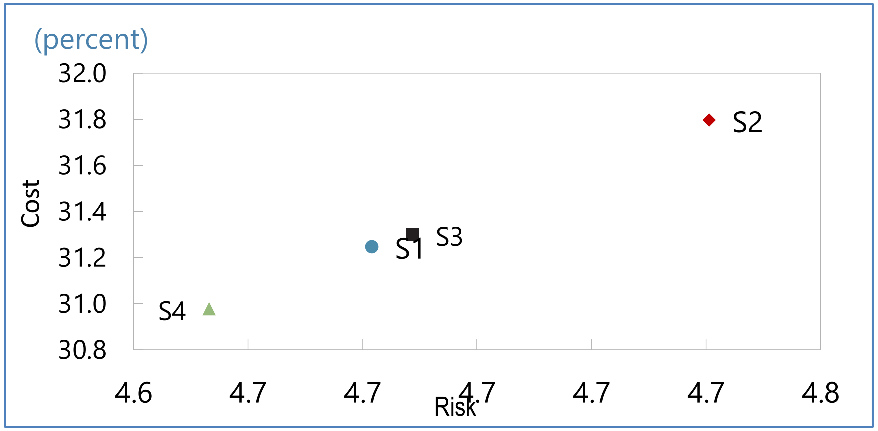


Figure 6: External Debt Service to International Reserves



The debt servicing cost is the main criterion for selecting the financing strategy that will be implemented in this MTDS, in line with the debt management objective of lowering the financing cost.

Analysis indicates that S3 consistently exhibits the lowest debt service costs and risk levels. While it involves increased foreign currency debt, exchange rate risks remain manageable. The S3 also demonstrate lower refinancing and interest rate risks.

6 STRATEGIC FRAMEWORK

6.1 Broad description of selected strategy and rationalization

The preferred debt management strategy identified in this MTDS is S3, which emphasizes external borrowings, mostly available in concessional terms, to meet 80% of the GFN, complemented by domestic borrowing to finance the remaining 20%. This approach is justified by its potential to minimize overall financing costs, leverage highly concessional external funds, and promote domestic capital market development. By predominantly relying on concessional external sources, the government can reduce debt servicing costs and interest rate risks. Simultaneously, maintaining a smaller but development-focused domestic debt component encourages the growth of a resilient and liquid bond market, which aligns with the strategic objective of fostering a robust domestic financial sector.

6.2 Strategy Guidelines and Operational Targets

The implementation of Strategy 3 will be guided by existing policy thresholds and operational targets, ensuring timely debt servicing, effective refinancing risk management, and alignment with Bhutan's debt sustainability objectives. Specific operational targets under this strategy include:

1. Financing, on average, more than 70% of GFN through external sources, with the majority sourced from concessional loans to support budgetary programs.
2. Maintaining fixed-rate debt at above 95% of the total debt portfolio to reduce exposure to interest rate fluctuations.
3. Maintaining an average maturity of external loans at a minimum of 11 years.
4. Limiting short-term debt (maturing within one year) to below 5% of the total debt stock.
5. Introducing a government bond issuance calendar by 2027 to support domestic market development and enhance transparency.
6. Closely monitoring exchange rate movements and employing hedging instruments, where appropriate, to mitigate foreign exchange (FX) risks.
7. Conducting regular reviews of the debt portfolio composition and associated risk indicators to ensure compliance with the thresholds outlined in the Public Debt Management Policy 2023.

These measures collectively support the goals of maintaining debt sustainability, strengthening domestic market capacity, and managing exposure to key risks in line with Bhutan's medium-term fiscal and economic priorities.

6.3 Risks, Challenges, and Mitigation Measures

While Strategy 3 offers significant benefits, several risks and challenges could impact its successful implementation:

External Financing Environment: Changes in global interest rates, lending conditions, or a shift in donor priorities could limit access to concessional loans or increase borrowing costs. To mitigate this, the government will diversify its external financing sources, including exploring new bilateral and multilateral partners and maintaining good relations with existing donors.

Exchange Rate and Currency Risks: Although the majority of external debt is denominated in INR, fluctuations in foreign exchange rates could impact debt sustainability. The government will monitor currency movements and consider employing hedging instruments or currency swaps as appropriate.

Domestic Market Development Challenges: Developing a deep and liquid domestic bond market remains a long-term endeavor, with risks related to a limited investor base and low secondary market activity. To address this, the government will implement targeted market development activities, including investor education, establishing benchmark bonds, and improving market infrastructure.

Policy and Implementation Risks: Changes in government policy priorities or delays in project implementation could affect debt issuance plans. Continuous stakeholder engagement, transparent reporting, and adherence to established debt management policies will be essential to mitigate these risks.

6.4 Comparison to Previous Strategies

Compared to the previous strategies that focused predominantly on external concessional borrowing, Strategy 3 places greater emphasis on balancing financing sources and proactively developing the domestic debt market. It also incorporates commercial borrowing to support commercially viable projects, reflecting a more diversified and market-oriented approach.

While the inclusion of international green bonds under Strategy 2 aligns well with Bhutan’s environmental and ESG commitments, it was assessed to be less cost-effective and more vulnerable to external market volatility.

Nonetheless, this MTDS continues to prioritize a sustainable debt structure, effective risk management, and the development of both domestic and external financing markets, ensuring consistency with the previous MTDS and Bhutan’s broader macroeconomic and fiscal policy objectives.

7 CONCLUSION

The MTDS for FY2025/26 to FY2027/28 lays a clear and disciplined roadmap for managing Bhutan's public debt in a manner that ensures fiscal sustainability while supporting inclusive economic growth. By selecting Strategy 3, prioritizing concessional external borrowing for 80% of the GFN and supplementing with 20% domestic issuance, the Royal Government of Bhutan has adopted a prudent approach that balances cost-effectiveness with risk mitigation. This strategy will leverage Bhutan's strong relationships with development partners and maintains manageable exchange rate exposure. It also facilitates the gradual development of the domestic debt market, which is essential for long-term financial resilience.

The simulations and stress testing conducted as part of the MTDS suggest that this approach offers the lowest debt service burden and minimal refinancing and interest rate risks, while remaining aligned with key fiscal targets. Effective implementation will require ongoing coordination among government agencies, active engagement with stakeholders, and consistent monitoring of macroeconomic developments. By adhering to the strategic guidelines and operational targets outlined in the MTDS, Bhutan reinforces its commitment to sound public financial management, macroeconomic stability, and responsible borrowing practices. This strategy is not only a financing tool but a cornerstone of the nation's broader development agenda.