

# **Royal Government of Bhutan**

## **Ministry of Finance**



### **Macroeconomic Situation Report**

**4<sup>th</sup> Quarter Update: FY 2024-25**

**September, 2025**

**Department of Macro-Fiscal and Development Finance**

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## Executive Summary

This report provides an update on the macroeconomic situation of Bhutan in the fourth quarter of the Fiscal Year (FY) 2024-25.

Bhutan's economy is anticipated to grow by 8.55 percent, primarily driven by the increased contribution from the service sector, particularly wholesale and retail trade, hotels and restaurants, transport, finance and insurance. Agriculture, livestock, and forestry slowed, though there are cautiously optimistic projections given the upcoming investments in the sector. The industry sector is projected to grow at 15.80 percent. Electricity outperformed, however, delays in hydropower projects constrained the momentum of the sector. Looking ahead, the growth remains primarily driven by the construction activities in the hydropower sector.

The overall unemployment is projected to average 2.9 percent in 2025, with the 13<sup>th</sup> Five Year Plan (FYP) to support employment generation. However, youth unemployment and structural mismatches persist. Moreover, while migration offers temporary relief to this situation, it raises brain drain concerns.

Domestic revenue fell due to delayed dividends and profit transfers, alongside the ongoing tax reforms. While grants are projected to rise, creating fiscal space in the short run, the reliance on external assistance underscores risks given Bhutan's graduation from Least Developed Country (LDC) status in 2023 and financing begins to decrease.

Expenditure is expected to increase; this rise in expenditure is caused by higher debt servicing obligations, increased current grants to local governments on the current expenditure side, larger allocation for capital grants and higher capital outlays for infrastructure and human resource development on the capital expenditure side. Additionally, public debt is projected to rise due to hydropower related borrowings and fiscal deficits.

Money supply saw downward revisions caused by decline in reserves assets and foreign currencies, along with decline in private sector credit. The liquidity position after the Cash Reserve Requirement stands at Nu. 29,058.05 million is adequate by projected to decline on the account of net foreign assets.

Non-Performing Loans (NPL) stood at Nu. 8,375 million as of May, 2025. NPL's were highly concentrated in housing, trade, and commerce placing an emphasis on the need for stronger credit management.

As of June, 2025, headline inflation moderated to 3.65 percent driven by a fall in food index. However, the year-on-year increase shows that inflationary pressures still remain elevated.

The balance of payment is expected to improve by 4.7 percent driven by inflows in the financial account. Meanwhile, the Current Account Deficit worsened due to weaker service exports. Merchandise trade deficit with the exclusion of electricity is projected to improve slightly with anticipated improvement in the export performance of ferrosilicon plants from 2026.

Foreign reserves are projected to reach USD 1,112.880 million at the end of FY 2025-26, sufficient to cover 29 months of essential imports. However, their sustainability depends on export performance and careful external borrowing.

## Key Macroeconomic Highlights

### Strengths

- **Robust Growth Outlook:** Driven by hydropower, GDP is expected to grow at 8.55 percent in 2025 and is projected to remain above 8 percent for three consecutive years, highlighting a return to long-term economic growth rates, with the employment rate closer to the natural rate of unemployment.
- **Fiscal Transition:** The government has made a concerted effort to move away from a reliance on distortionary income tax to a non-distortionary consumption tax, thereby creating an enabling business ecosystem. Gains from such a transition will result through base broadening under the GST regime and a reduction in income tax.
- **Improved External Position:** Foreign reserves projected to reach USD 1,112.880 million at the end of FY 2025-26 are sufficient to provide 29 months of essential import coverage, providing a cushion against external shocks.

### Risks

- **Hydropower-driven growth:** Despite ongoing efforts, the economy remains heavily reliant on hydropower for its growth, which is subject to volatility due to various exogenous factors. Delays in Dorjilung and Khorlochu financing and construction pose a downside risk to the economy.
- **Fiscal Pressure:** As a result of continued expansionary fiscal policy, the fiscal deficit is projected to widen to 5.21 percent and 5.60 percent for FY 2025-26 and 2026-27, respectively. As expenditure growth outpaces revenues, public debt is likely to increase, creating a tight fiscal space should any extreme events, such as a pandemic or natural calamities, occur.
- **External vulnerabilities:** The Current Account Deficit (CAD) remains elevated at a double-digit level with a widening trade deficit. Persistent high levels of CAD, combined with a persistent fiscal deficit (twin deficit), could lead to macroeconomic instability in the coming years, particularly if the money supply and liquidity rise beyond a controllable level. Low domestic productivity and inefficient government spending, combined with a volatile financial sector, can further exacerbate external sector vulnerabilities.

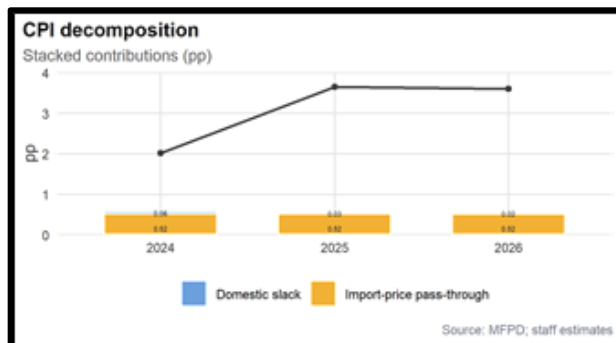
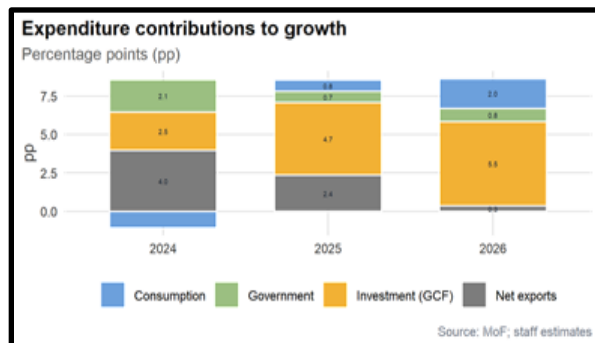
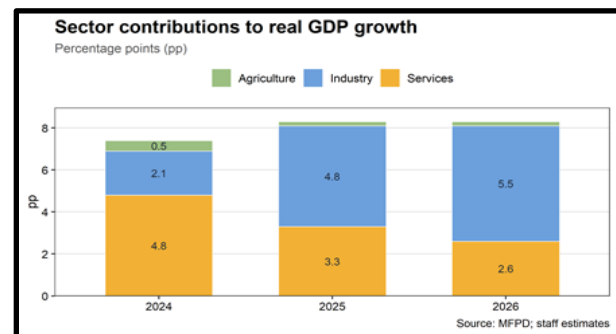
### Policy Priorities

- **Diversify Growth Drivers:** Accelerate the recovery and development of the tourism sector, combined with the development of niche manufacturing industries, led by the private sector, to reduce dependence on hydropower and promote sustainable growth.
- **Enhance Fiscal Multiplier:** The expenditure multiplier should be increased to have a higher impact on growth through efficient planning and implementation of plans. Every

government investment should be able to either generate economic or social returns. Similarly, the tax multiplier should be as low as possible to remove the distorting effects.

- **External Sector Management:** Between 2012 and 2025, Bhutan undertook administrative measures three times to manage the external imbalance, resulting in a contraction of economic growth that reversed the expansionary fiscal policy implemented in its preceding periods. Promoting non-hydro exports, boosting tourism, prudent liquidity management, financial sector reforms, and fiscal consolidation are necessary to resolve this structural issue.

Year	GDP Growth_Q3	GDP Growth_Q4	Change
2023	4.63	4.63	▬
2024	6.06	7.50	▲
2025	8.31	8.55	▲
2026	6.83	8.63	▲
2027	6.35	8.38	▲
2028	4.36	8.78	▲





## Leading Economic Indicators

Indicators	Units	2022/23	2023/24	2024/25	2025/26	2026/27
		2022	2023	2024	2025	2026
		Actual		Projection		
Real Sector						
Real GDP growth	% (CY)	5.21	4.63	7.50	8.55	8.63
Nominal GDP	Million Nu. (CY)	227,814	248,863	280,008	325,149	371,447
Agriculture Sector Growth	% (CY)	-1.15	1.37	3.73	1.94	1.56
Industry Sector Growth	%(CY)	5.60	-0.79	6.96	15.80	16.88
Services Sector Growth	%(CY)	6.82	7.92	8.80	6.03	4.87
GDP per Capita	US\$ (CY)	3,833	3,911	4,246	4,875	5,483
Fiscal Sector						
Domestic Revenue	Million Nu. (FY)	44,875	56,014	62,208	73,219	70,467
Tax Revenue, % of GDP	%(FY)	13.8	13.6	14.5	13.5	10.8
Grants &Other Receipts	Million Nu. (FY)	15,594	14,181	19,517	27,806	31,091
Current Expenditure	Million Nu. (FY)	35,428	43,425	45,874	58,432	59,373
Capital Expenditure	Million Nu. (FY)	33,798	26,798	43,435	60,730	64,357
Fiscal deficit, % of GDP	%(FY)	-4.7	-0.2	-2.5	-5.2	-5.6
Total Public Debt, % of GDP	%(FY)	116.2	108.7	100.5	108.0	101.1
Domestic Debt, % of total public debt	%(FY)	11.7	7.5	8.1	6.3	10.3
External Debt, % of total public debt	%(FY)	88.5	92.5	91.9	93.7	89.7
External Sector						
Current Account Balance	Million Nu. (FY)	-81,198	-55,321	-43,834	-44,076	-48,338
o.w Trade balance (Goods)	Million Nu. (FY)	-60,358	-51,933	-58,953	-57,742	-66,583
CAB,% of GDP	%(FY)	-34.0	-20.9	-14.5	-12.7	-12.2
Total International Reserves	Million US \$ (FY)	574	624	816	1,113	1,396
Monetary Sector						
Inflation (average)*	% (CY)	5.6	4.2	2.8		
Money Supply	Million Nu. (FY)	216,699	220,405	247,197	285,894	297,030
Credit growth	%(FY)	25.1	5.1	14	7	5.1
Pure Excess Liquidity	Million Nu. (FY)	10,139	10,899	12,734	13,973	12,113
Labor Market						
Unemployment**	% (CY)	5.9	3.5	3.5	2.9	2.7
Youth Unemployment**	% (CY)	28.6	15.9	19.1	17.9	20
*Average inflation from Jan - December						
** Quarterly LFS for 2023, 2024 and 2025						

## 1. Global and Regional Outlook

### 1.1 Global Economic Situation

The uncertainty surrounding the trade policies is projected to slow the global growth in the coming years. The July update of the World Economic Outlook forecasts a global growth of 3.0 percent in 2025 and 3.1 percent in 2026, representing a modest upward revision from the April forecasts (International Monetary Fund, 2025). This improvement is primarily a reflection of the stronger-than-expected loading of trade ahead of the anticipated tariffs, improved financial conditions due to a weaker US dollar, and fiscal expansion in some major economies.

However, the June update of the Organisation of Economic Co-operation and Development (OECD) Economic Outlook projected a sharper slowdown to 2.9 percent in 2025 (OECD, 2025). More critically, the OECD's quarterly projection reveals that global growth momentum is expected to deteriorate sharply to 2.6 percent by the end of 2025 before a tentative recovery to 3.0 percent in 2026. This forecast of fading momentum is based on the technical assumption that prevailing tariffs persist, and it reflects their expected impact of higher trade costs and heightened uncertainty that will subdue business investment and weaken consumer spending as prices rise.

Global inflation exhibits mixed signals. The IMF projects the headline inflation to decrease to 4.2 percent in 2025 and 3.6 percent in 2026, and core inflation to ease to below 2 percent. Inflation dynamics vary widely across the world. The OECD forecasts that inflation will come down to central bank targets by 2026 in most countries. The U.S. is likely to remain above the 2 percent target through 2026, driven by higher import prices, with monetary policy easing to remain throughout 2025. Inflation dynamics in the Eurozone are more subdued, aided by currency appreciation and temporary fiscal support.

OECD emphasizes that sticky services inflation and rising food prices continue to pressure households. Furthermore, protectionist trade policies act as a new inflationary supply shock, particularly in China and the U.S. Moreover, the anticipated higher import duties will cause a rise in price levels of the levying nation. The persistence of this inflationary impact will depend on whether it triggers nominal wage demand and increases in mark-ups in firms. Thus, the rise in inflation expectations increases the risk of these second-round effects. However, the magnitude of such effects is likely to be modest in economies with well-anchored inflation expectations, though this remains a key risk to the forecast.

## 1.2 Regional Economic Situation

South Asia is projected to remain the fastest-growing emerging market region, with growth moderating to 5.8 percent in 2025 before averaging 6.2 percent in 2026. Despite this resilience, growth remains below pre-pandemic levels, limiting the prospect of employment creation. Moreover, trade barriers and increased uncertainty have declined regional prospects.

While the per capita income of the region is expected to average 5 percent, this pace is largely driven by India. Growth in other economies in the region is far more tepid, suggesting only modest improvements in poverty reduction and living standards. Bangladesh in particular has been facing major challenges over the last couple of years that has weakened macroeconomic stability. The economic growth slowed down from 5.8 percent in 2023 to 4.2 percent in 2024, which is further expected to decelerate to 3.9 percent in 2025 (Asian Development Bank, 2025)

Risks are tilted to the downside, with escalating trade protectionism, tighter global financial conditions, financial sector vulnerabilities, and climate-related shocks representing the most pressing threats. While India will continue to anchor regional growth, South Asia's medium-term expansion is unlikely to be sufficient to address the region's employment challenge, underscoring the need for policies that enhance productivity, resilience, and labour market opportunities.

## 1.3 India's Economic Situation and the Implications on Bhutan

India's economy is expected to remain the fastest-growing in the world, fueled by strong domestic demand, rising real incomes, and an accommodating financial policy. Growth is forecasted at 6.3 percent for FY 2025-26 and 6.4 percent for FY 2026-27. However, with ongoing trade talks involving its major trading partner and the potential implementation of a 50 percent tariff by the US, it is projected to reduce GDP growth by 1.2 percentage points (Times of India, 2025). The bilateral merchandise trade between India and the US grew approximately 10 percent in fiscal year 2024-25, reaching US\$131.84 billion, with a trade surplus of US\$41.18 billion (FactoData, 2025). Including services, India has a trade deficit of US\$94.26 billion. Overall, trade with the US accounts for about 3 to 4 percent of GDP. In the short term, the Indian economy will experience shocks due to excess capacity adjustments and the reallocation of supply chains and factors of production. However, in the medium to long term, it is expected to stabilize. Furthermore, the forward-looking reforms undertaken by the Indian government in industrial development, investments in emerging technologies, deregulation, and privatization are expected to keep the growth momentum.

On the monetary policy front, the Reserve Bank of India (RBI) is cautiously easing after rate cuts in February and April. Headline inflation eased to 3.2 percent in April 2025, which remains firmly within the RBI's target range. With inflation expectations well-anchored, further monetary easing is anticipated. On the fiscal policy front, India is pursuing a path of consolidation, aiming to reduce

the central budget deficit from 4.8 to 4.4 percent of GDP in FY 2025-26. This is being achieved through higher revenues aided by digitization and reduced subsidies. Additionally, the government has announced its plans for GST reforms and simplification. This is anticipated to enhance the business ecosystem in India.

Such reforms and development provide an optimistic outlook for India. However, as discussed before, the geopolitical issues surrounding the tariff will have a significant impact in India within the short term.

## 2. Domestic Macroeconomic Developments<sup>1</sup>

### 2.1. Real Sector Trends

The economy is expected to grow at 8.55 percent, up by 0.24 percentage points from the previous quarter's estimates. The upward revision is driven by a 3.30 percentage point increase in growth contribution from the service sector, compared to the previous quarter's contribution estimate of 2.55 percentage points. The upward revision in the service sector is attributed to the wholesale and retail trade subsector's increased contribution, with the subsector projected to grow at 5.27 percent compared to 1.44 percent in the previous quarter update. The economy in 2024 grew at 7.50 percent, up 1.44 percentage points from the provisional data estimates in the previous quarter, underpinned by a better-than-anticipated performance in wholesale and retail trade, public administration, and finance and insurance in the services sector. This could be attributed to the increase in disposable income, given the pay hike revision for the public sector in late 2023.

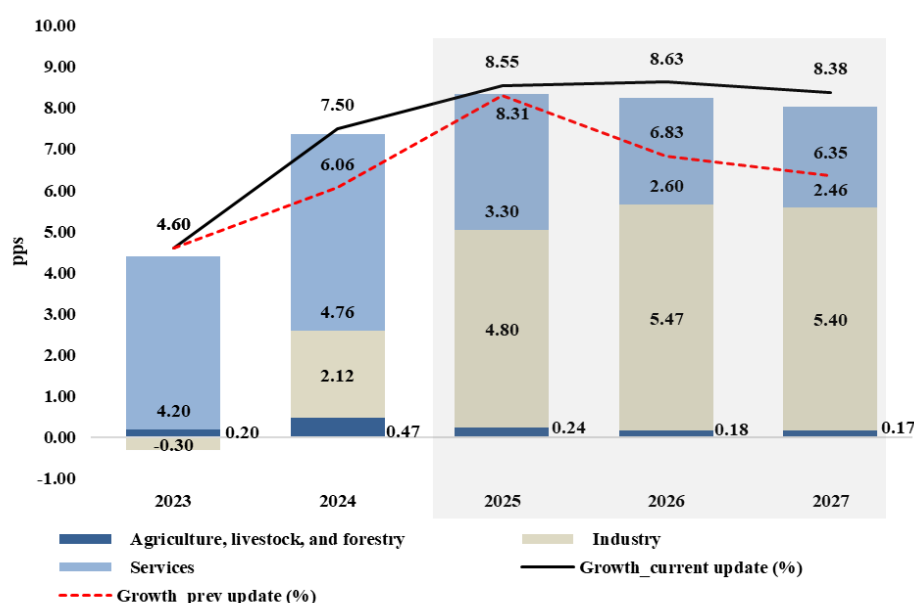


Figure 1: GDP growth and its drivers

<sup>1</sup>The estimates and projections in the report do not take into account the developments in GMC in totality

The growth is expected to accelerate further to 8.63 percent in 2026, driven by the construction sector as major hydropower projects, Dorjilung and Khorlochu, take effect, coupled with an acceleration in the implementation of the 13<sup>th</sup> FYP and continued recovery in the tourism sector. Moreover, with the implementation of the Goods and Services Tax (GST) in 2026, given the broad-based nature of the tax, indirect taxes are projected to contribute 0.38 percentage points to growth.

In the medium term, the economy is expected to hold its growth trajectory with a growth rate of 8.38 percent in 2027, mainly driven by hydropower construction activities, particularly with the construction activities for Punatsangchu-I (PHPA-I) picking up in 2027 with anticipated positive developments to address its geological issues, while the construction of small hydropower plants winds down. While the medium-term growth path has returned to the long-term growth trajectory, Bhutan's economy remains driven and highly susceptible to developments in the hydropower sector.

## **2.2. Sectoral Highlights**

### **2.2.1 Agriculture and Livestock**

Agriculture, livestock, and forestry are expected to show minor gains with the sector growing at 1.94 percent in 2025, a downward revision of 0.07 percentage points from the previous quarter estimate. This is also much slower than the 3.73 percent growth recorded in 2024. The slowdown is a result of weaker performance in the forestry and logging subsector, which was expected to grow at a rate of 5.80 percent but has now been revised downward to 3.93 percent, following lower-than-anticipated performance in 2024. In contrast, livestock is expected to drive growth for the sector, with the highest growth contributions, which are expected to be sustained over the medium term at around 0.98 percentage points of agriculture sector growth. Livestock, forestry, and logging are expected to grow steadily in the near term, while crops face uncertainties, despite the subsector's higher-than-anticipated performance in 2024.

In the medium term, growth in agriculture, livestock, and forestry is expected to slow slightly, with its contribution to growth declining from 0.24 percentage points in 2025 to 0.17 percentage points in 2027. The cautiously optimistic growth trajectory in the agriculture sector is driven by the livestock subsector, reflecting the government's priorities towards the sector through the implementation of Price Guaranteed Schemes (PGS) as part of the Economic Stimulus Plans and other 13<sup>th</sup> FYP priorities. Nonetheless, the downside risk for such projections is significant, as the implementation of PGS has not lived up to the expectations.

### **2.2.2 Industry**

The industry sector is projected to grow at 15.80 percent in 2025, down from the 16.38 percent growth projected in the previous quarter's estimates. Industry performance is marked by better-than-expected performance of the electricity subsector; however, it is overall dampened due to

delays in the construction of major hydropower projects, primarily due to progress and financing issues. Specifically, the projected spending for the Dorjilung hydropower project has been significantly reduced, with the financing agreement now expected to be finalized towards the end of 2025 or early 2026. Similarly, given the progress on the ground, the project estimates for the Khorlochu hydropower plant have also been revised downwards. These have contributed to a downward revision in the construction sector's growth outlook.

However, the industry's growth is expected to pick up in 2026, with its contribution increasing to 5.47 percentage points, up from 4.80 percentage points in 2025. The growth in the industry sector is mainly stemming from the anticipated construction activities in the hydropower sector, coupled with increased government spending as the 13<sup>th</sup> FYP implementation accelerates. The industry sector is also expected to see a higher-than-anticipated performance in the mining and quarrying sector, which experienced a contraction in growth in 2024. Activities such as allocation of dredging sites in Samtse are expected to stimulate activity in the mining and quarrying sector (Ministry of Energy and Natural Resources, 2025). Therefore, it will be critical for the Department of Geology and Mines to ensure effective administrative follow-through and regulatory oversight to facilitate a rebound in the growth of this subsector.

In the medium term, the industry sector's growth is expected to hover around 15 to 17 percent, primarily driven by the construction and electricity sectors, indicating the sector's reliance on hydropower. On the other hand, the manufacturing subsector's growth is projected to remain modest, growing at an average of 2.99 percent over the projected period.

### **2.2.3 Services**

For the year 2025, the service sector is expected to grow at 6.03 percent, up 1.26 percentage points from the previous quarter's estimates. The growth in the service sector is projected to be mainly driven by wholesale and retail trade, transport and storage, and the hotels and restaurants subsector. Growth for wholesale and retail trade has been revised upwards to 5.27 percent, the sub-sector's momentum was built by higher-than-expected performance by the sector in 2024. This reflects a sustained recovery in tourism and related industries. However, key subsectors such as wholesale and retail trade and communication are expected to expand at a slower pace in the upcoming years, compared to previous projections.

Overall, the services sector has outperformed previous estimates in 2024, led by growth in wholesale and retail trade, transport and storage, communications, and finance and industry subsectors. Public administration is another major contributor to growth, reflecting the impact of pay revisions. The ongoing tourism rebound is expected to strengthen further the growth of the transportation, hotel, and restaurant subsectors. Looking forward, the service sector is expected to remain the largest by share, although its growth contributions are anticipated to moderate, indicating slower relative growth.

The current update signals a favorable recovery for many subsectors, particularly in mining, electricity, and tourism-related sectors. Forecasts based on the current quarter update indicate a transition from a heavy service sector dependency to industry, with the industry's share of GDP rising from 30.36 percent in 2024 to 41.28 percent in 2030, and the sector's contribution to GDP expected to peak in 2029. Hydropower construction and commission will power the growth in the 13<sup>th</sup> FYP, however, to sustain and smooth growth, the economy must strengthen manufacturing and other employment-generating sectors, including investments in emerging technologies.

### **2.3. Demand-Side Dynamics**

On the demand side, private consumption is projected to grow at 1.64 percent in 2025, a downward revision from the 2.64 percent growth projected in the previous quarter. This is partly attributed to the base effects of growth in 2024. Public consumption remains largely unchanged, maintaining steady growth contributions, growing at a rate of 3.48 percent in 2025.

In 2025, Gross Capital Formation (GCF) is projected to grow at 10.22 percent, compared to the 10.70 percent growth projected in the previous estimate. The downward revision is attributed to base effects as well as downward revision in construction activities stemming from lower-than-expected spending of hydropower projects. GCF recorded a growth of 5.33 percent in 2024, capital formation expanding at a higher rate than the previously projected contraction of 3.50 percent. This upward revision is primarily driven by increased private sector investment in construction and investments in hydropower machinery and equipment post lifting of moratoriums. This indicates a stronger rebound in capital formation, with notable upward revisions in private construction and machinery and equipment, signaling renewed business confidence and a recovery in the momentum of fixed asset investment. This momentum is expected to moderate post-2025, as illustrated in Figure 2.



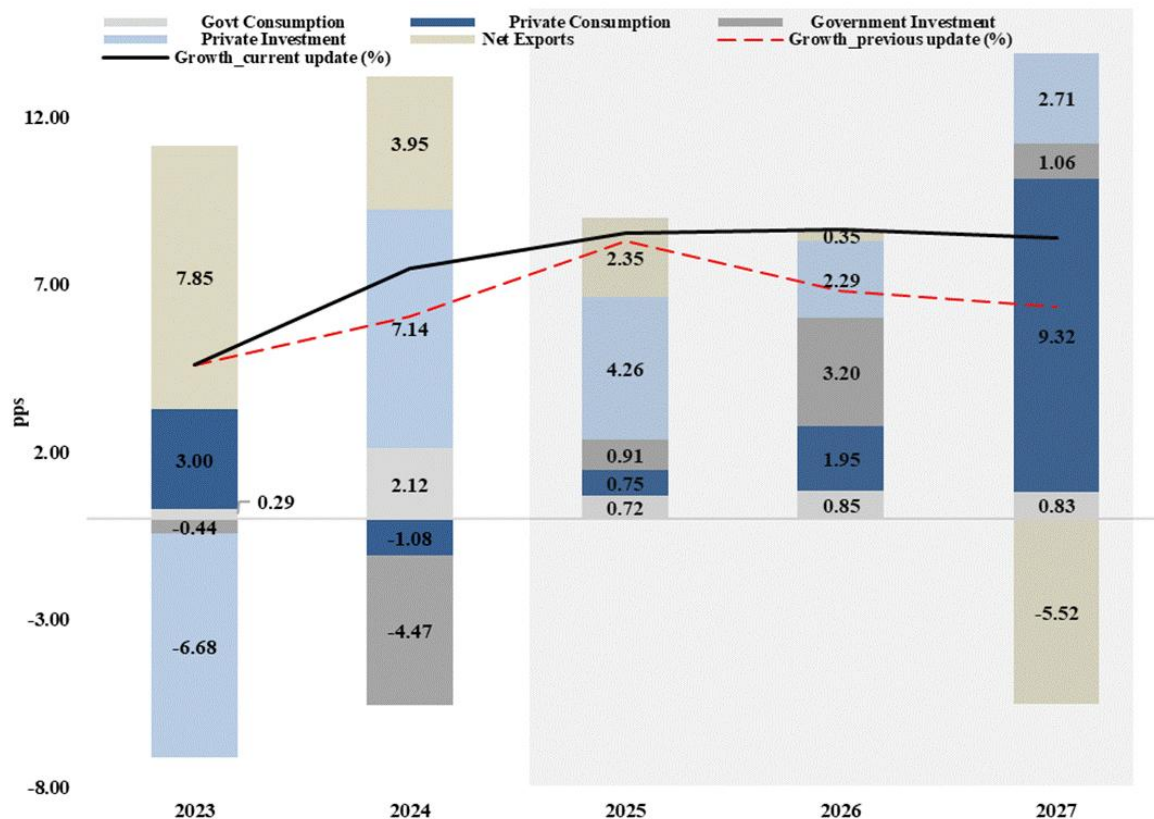


Figure 2: GDP growth and contribution of expenditure components

Looking ahead, public consumption is expected to grow steadily at an average of 4.04 percent, but its contribution to overall growth is only about 0.80 percentage points, likely due to a weak fiscal multiplier. Meanwhile, private consumption is projected to contribute 0.75, 1.95, and 9.32 percent in 2025, 2026, and 2027, respectively. These projections reflect model limitations rather than an anticipated rise in events that would boost disposable income and, in turn, consumption. Nonetheless, reforms lowering net effective taxes are expected to boost disposable income. Additionally, although public investment is forecasted to grow at an average of 23.35 percent annually over the next three years, it will only contribute about 1.72 percentage points to the growth. This suggests persistent structural issues within the economy, despite the growth rate returning to its long-term trend, remain unaddressed. Highly dependent on imports, with significant twin deficits, strong consumption poses notable risks to macroeconomic stability.



## 2.4 Labor Market Developments

### 2.4.1 General Unemployment

The overall unemployment rate in the second quarter of 2025 declined to 2.9 percent, down from 3.6 percent in the first quarter, marking a 0.7 percentage point reduction. The current update projections suggest further improvements, with unemployment expected to fall to 2.7 percent in the third quarter and 2.3 percent in the fourth quarter. This would translate into an anticipated annual average unemployment rate of 2.9 percent for 2025, implying an employment rate of 97.1 percent. Looking ahead, unemployment is projected to continue its gradual decline, reaching 2.7 percent in 2026 and 2.6 percent in 2027.

Compared to the previous quarter's forecast, the current update reflects stronger-than-anticipated improvements, supported by robust economic growth and strengthening labor market conditions. This trend aligns with the ongoing implementation of the 13<sup>th</sup> FYP, where increased investment and expansion of economic activities are expected to generate employment opportunities, particularly in mining & quarrying, electricity, construction, and hospitality (hotels & restaurants) sectors. Growth in other services and industrial sectors is also expected to support employment creation over the medium term.

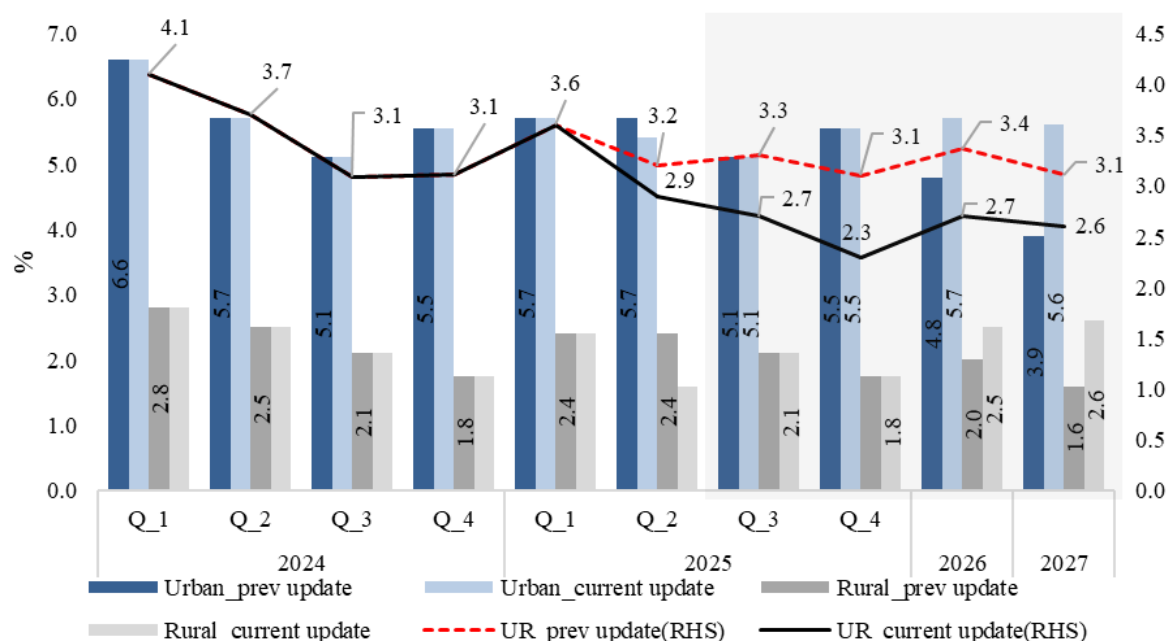


Figure 3: Unemployment Rate (percent)

On a year-on-year basis, unemployment in the second quarter of 2025 stood at 2.9 percent, which was lower than the 3.7 percent recorded in the same quarter of 2024, reflecting a 0.8 percentage point improvement. Compared to the third and fourth quarter levels of 3.1 percent in 2024, the

projected unemployment rates of 2.7 percent and 2.3 percent, respectively, in the same quarters of 2025, underscore a steady improvement in labor absorption. The quarterly trend also highlights seasonal patterns as unemployment tends to peak in the first quarter before declining in subsequent quarters.

Despite these gains, urban unemployment rates remain higher than those in rural areas. This divergence is largely explained by rural-to-urban migration and internal labor mobility, as workers seek better opportunities in urban centers. Though the unemployment rate remains low, many in the agricultural sector work low-productivity jobs, such as small-scale farming, which does not contribute significantly to the overall economic growth.

### 2.4.2 Youth Unemployment

While overall unemployment has decreased to full-employment levels, youth unemployment remains a persistent issue. In the second quarter of 2025, the youth unemployment rate increased slightly to 17.3 percent, a 0.20 percentage point rise from the first quarter. This small increase reflects seasonal inflows of new job seekers. However, it is a significant improvement from 19.2 percent in the second quarter of 2024. The year-over-year decline indicates stronger job creation and economic growth, while the slight quarter-over-quarter rise reflects seasonal inflows and mismatches. The current estimate suggests that the youth unemployment rate for 2025 will reach approximately 17.9 percent, down from 18.5 percent in the previous quarter's projections, aligning with the medium-term economic recovery.

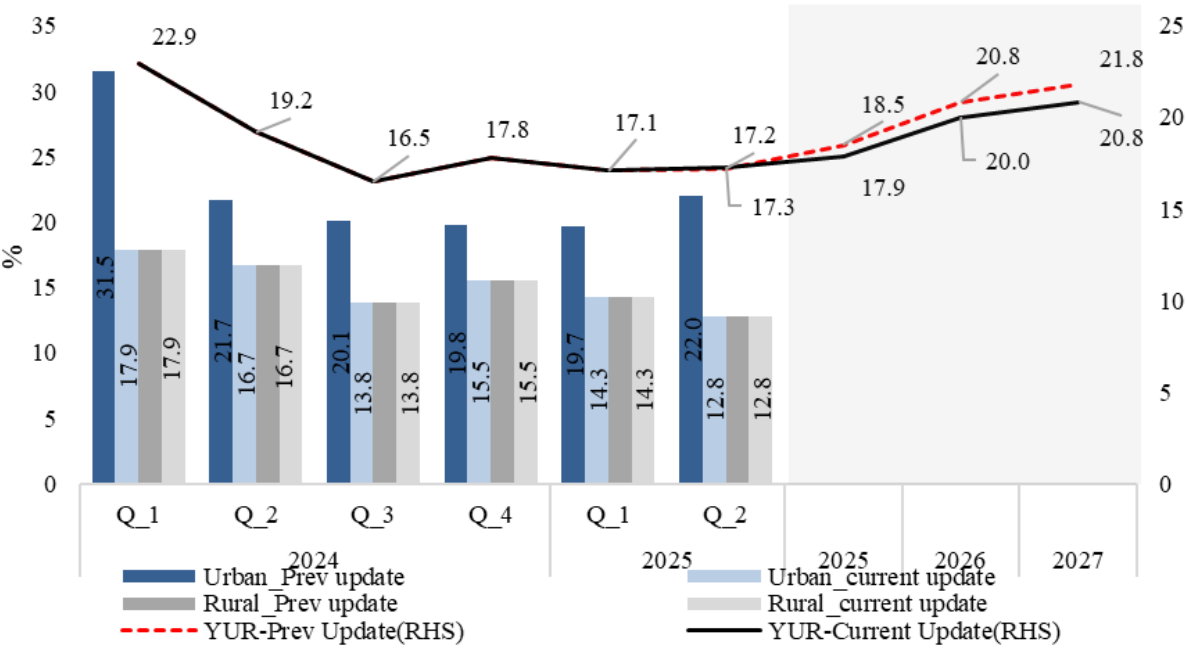


Figure 4: Youth Unemployment Rate (percent)

Going forward, the youth unemployment is projected to hover around 20 percent in 2026 and 20.8 percent in 2027. While this represents a marginal improvement compared to earlier forecasts, it still points to significant structural challenges. The sticky high youth unemployment rate is a reflection of the mismatch between the qualifications acquired by youths and jobs produced by the nascent, yet crowded market economy. This is further evident from the concentration of youth unemployment in urban areas, where young job seekers predominantly pursue formal-sector jobs in government and private firms. If not addressed, persistently high youth unemployment could erode human capital development, as young people miss out on essential skills and experience, depress their future earnings potential, and increase the risk of social dissatisfaction and emigration. This dynamic could weaken Bhutan’s long-term growth potential and reduce the pool of young talent needed to drive future economic transformation.

### 2.4.3 Labor Force Participation

The labor force expanded to 394,759 persons in the second quarter of 2025, an increase of 3,984 from the first quarter and 25,838 compared to the second quarter of 2024. Projections suggest that the labor force will continue to expand, reaching 396,370 in 2026 and 401,002 in 2027, supported by favorable demographic trends and improvements in labor market engagement, driven by anticipated improvements in macroeconomic conditions.

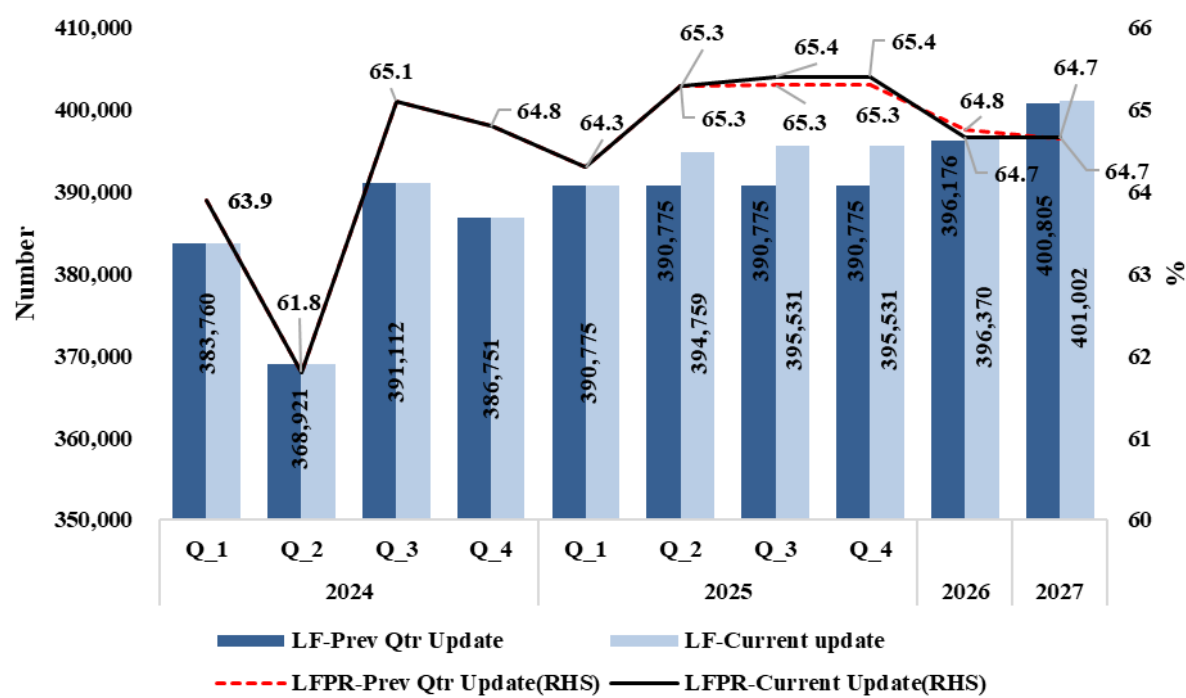


Figure 5: Labor Force Participation and Participation Rate

The Labor Force Participation Rate (LFPR) in the second quarter of 2025 is recorded at 65.30 percent, marking a 1.0 percentage point increase from the first quarter, and a 3.5 percentage point

increase compared to the same quarter of 2024. This steady increase reflects improved confidence in the economy and better job prospects, which encouraged more individuals to enter or re-enter the labor force. Looking ahead, LFPR is expected to increase slightly to 65.4 percent over the next two quarters of 2025, before declining marginally to 64.8 percent in 2026 and 64.7 percent in 2027, indicating a stable but gradually tapering labor supply.

### 3. Fiscal Development

#### 3.1. Domestic Revenue

Domestic revenue for FY 2024–25 is estimated at Nu. 62,208.397 million, reflecting a modest decline compared to the previous quarter’s projection. The shortfall is primarily attributed to the delay in receiving dividends and the postponement of profit transfer from the Punatsangchhu-II (PHPA-II). These deferred inflows are expected to materialize in FY 2025–26, leading to an upward revision of revenue projections for that year. Furthermore, the reduction in PHPA-II profit transfers relative to the previous quarter’s projection is driven by changes in the tariff assumptions and a recalibration of export due to delays in finalizing the power purchase agreement for the plant.

Table 1: Summary of revenue collection and projections (Nu. in millions)

Sl. No.	Particular	2023-24	2024-25	2025-26		2026-27	2027-28
		Actual	Actual	Approved Budget	Revised Estimate	Proj.	Proj.
	<b>Domestic Revenue</b>	<b>56,014.461</b>	<b>62,208.397</b>	<b>70,462.134</b>	<b>73,218.611</b>	<b>70,466.856</b>	<b>74,504.090</b>
<b>A</b>	<b>Taxes</b>	<b>35,037.732</b>	<b>44,008.072</b>	<b>46,939.248</b>	<b>46,905.191</b>	<b>42,253.083</b>	<b>45,261.046</b>
<b>1</b>	<b>Taxes on Income, Profits and Capital Gains</b>	<b>17,067.210</b>	<b>20,682.422</b>	<b>20,851.380</b>	<b>21,542.273</b>	<b>11,295.246</b>	<b>11,942.006</b>
	<i>o.w. Corporate Tax</i>	<i>11,966.938</i>	<i>14,757.822</i>	<i>15,425.450</i>	<i>15,425.450</i>	<i>8,597.823</i>	<i>9,185.350</i>
	<i>Business Income Tax</i>	<i>1,712.936</i>	<i>1,991.040</i>	<i>1,975.688</i>	<i>2,145.203</i>	-	-
	<i>Personal Income Tax</i>	<i>3,387.335</i>	<i>3,933.560</i>	<i>3,450.243</i>	<i>3,971.620</i>	<i>2,670.499</i>	<i>2,723.909</i>
<b>2</b>	<b>Taxes on Property</b>	<b>709.236</b>	<b>833.040</b>	<b>936.135</b>	<b>936.135</b>	<b>948.633</b>	<b>961.554</b>
<b>3</b>	<b>Taxes on Goods and Services</b>	<b>9,700.567</b>	<b>12,044.780</b>	<b>13,815.412</b>	<b>13,090.463</b>	<b>17,460.104</b>	<b>18,525.635</b>
	<i>o.w. GST &amp; Excise tax</i>	-	-	<i>10,880.00</i>	<i>8,044.190</i>	<i>16,880.680</i>	<i>17,901.133</i>
<b>4</b>	<b>Taxes on International Trade and Transactions</b>	<b>640.275</b>	<b>929.260</b>	<b>865.963</b>	<b>865.963</b>	<b>979.090</b>	<b>1,093.273</b>
<b>5</b>	<b>Other Taxes</b>	<b>6,920.445</b>	<b>9,518.570</b>	<b>10,470.357</b>	<b>10,470.357</b>	<b>11,570.012</b>	<b>12,738.578</b>
	<i>o.w. Royalty</i>	<i>6,808.675</i>	<i>8,912.630</i>	<i>10,326.307</i>	<i>10,326.307</i>	<i>11,418.640</i>	<i>12,582.072</i>
<b>B</b>	<b>Other Revenue</b>	<b>18,335.779</b>	<b>15,411.510</b>	<b>20,314.226</b>	<b>23,104.758</b>	<b>24,740.172</b>	<b>25,491.650</b>
	<i>o.w. Interest receipt from corporation</i>	<i>2,999.504</i>	<i>2,979.970</i>	<i>8,041.449</i>	<i>7,725.488</i>	<i>7,930.577</i>	<i>8,204.029</i>
	<i>DHI Dividend</i>	<i>5,058.291</i>	<i>3,500.000</i>	<i>6,481.940</i>	<i>8,630.940</i>	<i>12,568.000</i>	<i>13,429.000</i>
	<i>Profit transfer, RMA</i>	<i>5,269.214</i>	<i>2,181.050</i>	<i>2,256.000</i>	<i>2,256.000</i>	<i>1,941.040</i>	<i>2,933.870</i>
	<i>Profit transfer, Puna II</i>	-	<i>694.980</i>	<i>3,281.838</i>	<i>4,239.333</i>	<i>2,031.231</i>	<i>638.331</i>
<b>C</b>	<b>Current Revenue from Government Agencies</b>	<b>1,813.258</b>	<b>2,686.914</b>	<b>2,211.691</b>	<b>2,211.691</b>	<b>2,394.311</b>	<b>2,585.791</b>
<b>D</b>	<b>Capital Revenue from Government Agencies</b>	<b>827.691</b>	<b>101.900</b>	<b>996.970</b>	<b>996.970</b>	<b>1,079.290</b>	<b>1,165.603</b>

Looking ahead, revenue collections are expected to increase gradually over the medium term, although projections remain slightly lower than those in the previous quarter’s outlook. This downward revision reflects the implementation of ongoing tax reforms, particularly the introduction of the Business Income Tax (BIT) and Personal Income Tax (PIT) merger, reduction of Corporate Income Tax (CIT) to a uniform 22 percent, and exemption of intercorporate dividend

tax. Nevertheless, the implementation of the GST is expected to increase revenue compared to the sales tax regime it will replace.

The GST will come into effect from 2026, with partial impact in FY 2025-26. Revenue collection in the first year is projected at around Nu. 14,000 million, although a conservative estimate has been applied to account for potential implementation challenges. Over time, efficiency gains are expected to strengthen GST collections, making it a more robust revenue source.

Beginning FY 2026-27, revenue composition will undergo a significant shift. While direct tax revenues are projected to decline, indirect tax as well as non-tax revenues are expected to rise, largely due to the exemption of inter-corporate dividend tax. DHI's contribution under this reform will drop to about Nu. 100 million, compared to the approximate amount of Nu. 3,200 million, which was previously projected, as the reform is designed to reduce double taxation and encourage reinvestment. To cushion the short-term revenue impact, higher DHI dividend payouts have been projected as a temporary offset until GST revenues stabilize. In addition, the merging of BIT and PIT will result in the elimination of BIT collections from 2026-27, leading to an estimated Nu. 2,000 million in losses. Furthermore, the reduction of CIT rates from 30 percent for SOEs and 25 percent for private companies to a uniform 22 percent will further moderate tax revenue growth.

In the short term, delays in dividend inflows and profit transfers constrain the fiscal space, limiting resources for public investment and expenditure. However, over the medium term, the introduction of GST and the restructuring of the tax system are expected to broaden the tax base, improve efficiency, and align Bhutan's tax regime with international practices. The temporary reliance on higher DHI dividends underscores the importance of careful fiscal management during the transition phase.

Overall, although domestic revenue growth may face initial challenges during reform, these measures are expected to enhance revenue sustainability, reduce distortions like double taxation, and make the investment environment more appealing. The shift from income to consumption taxes in government policy aims to increase productivity and promote a less distortionary consumption tax as an alternative to traditional income taxes. Historically, reliance on income tax has caused market distortions and has not been considered Pareto optimal due to its discretionary principles. The new tax strategy is expected to improve the business climate and potentially raise future tax revenues. This structural change, along with efficiency gains from GST, will strengthen Bhutan's fiscal resilience over time.

### **3.2. Grants**

For FY 2024–25, total grants amount to Nu. 18,026.318 million, from both external and internal sources. This represents a slight decline from the previous quarter's projection, primarily due to lower receipts of project-tied grants from other development partners resulting from delays in

project implementation. As shown in Figure 6, the Government of India (GoI) remains the primary donor, contributing 72.17 percent of the total grants. Over the medium term, total grant inflows are expected to increase by 45 percent and 15 percent in FY 2025-26 and 2026-27, respectively, supported by higher disbursements from both the GoI and other development partners.

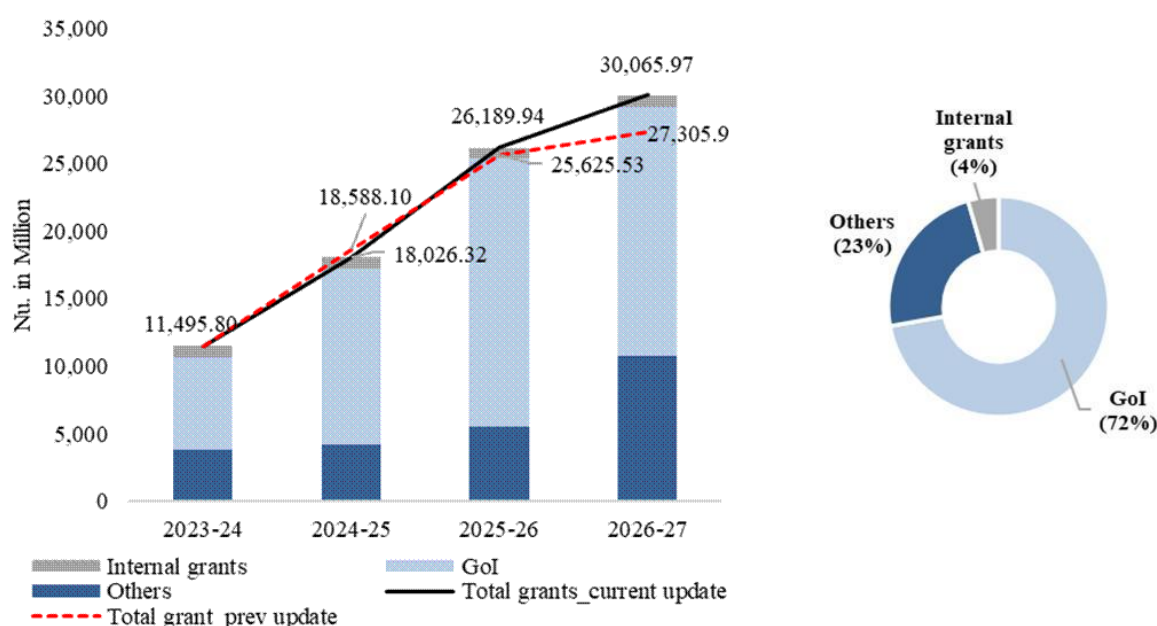


Figure 6: Total grants (excluding other internal receipts) and their share

The share of grants in overall government resources was 22.06 percent in FY 2024-25 and is expected to rise gradually in the coming years, indicating an over-reliance on external aid. In the short term, increased grant inflows expand fiscal space, reduce the need for domestic borrowing, and enable capital investments without additional debt. However, over the medium term, reliance on external grants can weaken fiscal autonomy and heighten risks to external reserve management. Therefore, it is vital to strategically assign grants to high-impact and growth-promoting investments such as hydropower, human capital development, and infrastructure, while also tightening expenditure and boosting private sector investments. These steps will help decrease dependence on external aid, protect fiscal autonomy, and promote long-term fiscal sustainability.

### 3.3. Expenditure

The total expenditure for FY 2024-25 stood at Nu. 89,308.431 million, reflecting only a marginal change from the previous quarter's update. As illustrated in Figure 7, the revised estimate for the upcoming fiscal year remains largely unchanged. However, total expenditure is projected to increase substantially, with a notable jump of 33.43 percent between FY 2024-25 and FY 2025-26. This surge is driven by significant increases in both current and capital expenditure. The rise in current expenditure is largely attributed to higher debt servicing obligations and increased

current grants to local governments. On the capital side, the expansion is mainly explained by larger allocations for capital grants as well as higher outlays on structures, plant and equipment, and human resource development initiatives such as training programs as the implementation of 13<sup>th</sup> FYP is anticipated to pick up.

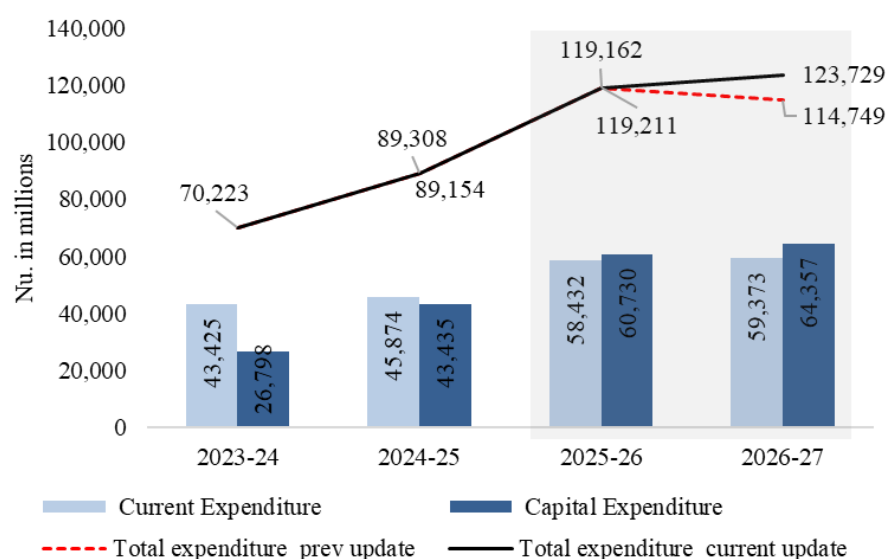


Figure 7: Expenditure estimates

Figure 7 clearly shows a significant change in the composition of current and capital expenditures in the later years. Starting in FY 2025-26 and continuing into FY 2026-27, capital expenditure surpasses current spending. Although recurrent expenses have traditionally comprised the largest portion, this shift indicates a strategic move toward growth-oriented investments in infrastructure and human capital, aligning with the goals of the 13<sup>th</sup> FYP. An increased focus on capital spending is expected to boost Bhutan's long-term productive capacity, stimulate private sector growth, and improve fiscal policy by shifting resources from consumption to asset development. Overall, this change in expenditure highlights a shift toward an expansionary fiscal policy focused on investment-driven growth, but it requires careful fiscal management and a robust implementation strategy. However, the risk of such a policy is the creation of a high baseline for government spending. This practice could spill over to future plans, exacerbating the fiscal pressure and excessive intervention in the market economy.



Particulars	2023-24	2024-25	2025-26		2026-27
	Actual	Actual	Approved Budget	Revised estimates	Projection
<b>Q4_ Total Expenditure</b>	<b>70,223.000</b>	<b>89,308.431</b>	<b>119,211.302</b>	<b>119,161.802</b>	<b>123,729.257</b>
<i>Current Expenditure</i>	<i>43,424.604</i>	<i>45,873.898</i>	<i>58,481.217</i>	<i>58,431.717</i>	<i>59,372.658</i>
Primary Current	38,301.726	40,309.167	47,573.285	47,523.785	48,723.338
Interest Payment	5,122.879	5,564.731	10,907.932	10,907.932	10,649.320
<b>Capital Expenditure</b>	<b>26,798.396</b>	<b>43,434.533</b>	<b>60,730.085</b>	<b>60,730.085</b>	<b>64,356.599</b>

### 3.4. Public Debt

The total public debt stood at Nu. 303,965.228 million in FY 2024-25, equivalent to 100.46 percent of GDP, moderating from 108.72 percent in the previous FY. The debt stock is projected to rise to Nu. 376,084.765 million in FY 2025-26 and Nu. 400,088.317 million in FY 2026-27, reflecting hydropower-related borrowings, fiscal deficits, and projected economic growth. External debt dominates the debt profile, accounting for 91.89 percent of total debt in FY 2024-25, while domestic debt remains modest at Nu. 24,646.912 million (8.11 percent of total debt) for budgetary shortfalls and liquidity management. Among hydro and non-hydro debt, hydropower loans constitute the largest share of external debt at Nu. 170,087.648 million (55.96 percent of total debt), which is projected to increase further in FY 2026-27, whereas non-hydro external debt is projected to grow modestly.

Table 3: Total public debt (Nu. in millions)

Particular	2023-24 Actual	2024-25 Actual	2025-26 Projection	2026-27 Projection
<b>Total Public Debt</b>	<b>287,487.39</b>	<b>303,965.23</b>	<b>376,084.77</b>	<b>400,088.32</b>
<i>% of GDP</i>	<i>108.72%</i>	<i>100.46%</i>	<i>107.98%</i>	<i>101.05%</i>
<b>Domestic Debt</b>	<b>21,477.36</b>	<b>24,646.91</b>	<b>23,667.80</b>	<b>41,186.11</b>
<i>% of Total public debt</i>	<i>7.47%</i>	<i>8.11%</i>	<i>6.29%</i>	<i>10.29%</i>
<b>External Debt</b>	<b>266,010.03</b>	<b>279,318.32</b>	<b>352,416.96</b>	<b>358,902.21</b>
<i>% of Total public debt</i>	<i>92.53%</i>	<i>91.89%</i>	<i>93.71%</i>	<i>89.71%</i>
<b>Hydro Debt</b>	<b>167,194.63</b>	<b>170,087.65</b>	<b>230,266.23</b>	<b>236,641.54</b>
<i>% of total public debt</i>	<i>58.16%</i>	<i>55.96%</i>	<i>61.23%</i>	<i>59.15%</i>
<i>% of GDP</i>	<i>63.23%</i>	<i>56.21%</i>	<i>66.11%</i>	<i>59.77%</i>
<b>Non-hydro Debt (external)</b>	<b>98,815.40</b>	<b>109,230.67</b>	<b>122,150.73</b>	<b>122,260.66</b>
<i>% of total public debt</i>	<i>34.37%</i>	<i>35.94%</i>	<i>32.48%</i>	<i>30.56%</i>
<i>% of GDP</i>	<i>37.37%</i>	<i>36.10%</i>	<i>35.07%</i>	<i>30.88%</i>
<b>Central government Debt</b>	<b>99,658.79</b>	<b>111,984.60</b>	<b>123,083.38</b>	<b>146,737.65</b>
<i>% of GDP</i>	<i>37.69%</i>	<i>37.01%</i>	<i>35.34%</i>	<i>37.06%</i>

Central government debt stood at Nu. 111,984.601 million in FY 2024-25. It is projected to increase to Nu. 123,083.375 million in FY 2025-26 and Nu. 146,737.654 million in FY 2026-27, primarily reflecting the government's fiscal deficit financing requirements. Despite this increase, the central government debt-to-GDP ratio remains at 37.01 percent in FY 2024-25, well below the 55 percent threshold, and is expected to stay comfortably below this limit over the medium term.

Looking ahead, total public debt is likely to remain high, driven mainly by external and hydropower-related obligations. The concentration of debt in this sector presents both opportunities and risks: hydropower debt is largely self-liquidating, supported by export revenues to India, yet delays in project completion could significantly increase debt obligations. Persistent fiscal deficits and reliance on external financing underscore the need for prudent debt management, effective project execution, and stronger domestic resource mobilization to ensure long-term debt sustainability.

### **3.5. Medium-Term Fiscal Framework (MTFF)**

The fiscal position over the medium term is characterized by persistent deficits, with the fiscal deficit recorded at 2.51 percent of GDP in FY 2024-25, and projected to widen to 5.21 percent in FY 2025-26 and 5.60 percent in FY 2026-27. This rising deficit trajectory reflects ambitious expenditure commitments outpacing resource mobilization, thereby heightening financing pressures and underscoring the need for prudent debt management and strengthened fiscal discipline.

Relative to the previous quarter's update, the actual fiscal deficit for FY 2024–25 was marginally higher, primarily due to the deferment of DHI dividends and profit transfers from PHPA-II. While these delays adversely affected revenues in the current year, the associated inflows are expected in the next fiscal year, resulting in higher domestic revenue than earlier projected and a temporary improvement in the deficit outlook for FY 2025-26.

Table 4: Medium Term Fiscal Framework (Nu. in millions)

Sl. No.	Particular	2023-24 Actual	2024-25 Actual	2025-26		2026-27 Proj.
				Approved Budget	Revised Estimate	
<b>A</b>	<b>Total Resources</b>	<b>70,195.195</b>	<b>81,725.664</b>	<b>97,772.614</b>	<b>101,024.809</b>	<b>101,557.828</b>
<b>1</b>	<b>Internal Resources</b>	<b>59,579.628</b>	<b>64,509.528</b>	<b>72,357.400</b>	<b>75,609.591</b>	<b>72,344.046</b>
1.1	Domestic Revenue	56,014.461	62,208.397	70,462.130	73,218.611	70,466.856
a	Tax	35,037.732	44,008.072	46,939.250	46,905.191	42,253.083
b	Non-tax	20,976.728	18,200.324	23,522.890	26,313.419	28,213.773
1.2	Other receipts (including internal grants)	3,565.167	2,301.131	1,895.266	2,390.980	1,877.190
a	Internal Receipts (trust funds)	880.232	810.181	279.004	774.718	852.190
b	Other receipts	2,684.935	1,490.950	1,616.262	1,616.262	1,025.000
<b>2</b>	<b>External Grants</b>	<b>10,615.567</b>	<b>17,216.136</b>	<b>25,415.220</b>	<b>25,415.218</b>	<b>29,213.782</b>
2.1	Gol	6,773.255	13,008.711	19,885.870	19,885.874	18,453.782
2.2	Others	3,842.312	4,207.425	5,529.340	5,529.344	10,760.000
<b>B</b>	<b>Total Expenditure/ Outlay</b>	<b>70,626.395</b>	<b>89,308.431</b>	<b>119,211.302</b>	<b>119,161.802</b>	<b>123,729.257</b>
<b>1</b>	<b>Current</b>	<b>43,424.604</b>	<b>45,873.898</b>	<b>58,481.217</b>	<b>58,431.717</b>	<b>59,372.658</b>
1.1	Primary Current (Regular)	38,301.726	40,309.167	47,573.285	47,523.785	48,723.338
1.2	Interest payments	5,122.879	5,564.731	10,907.932	10,907.932	10,649.320
<b>2</b>	<b>Capital</b>	<b>26,798.396</b>	<b>43,434.533</b>	<b>60,730.085</b>	<b>60,730.085</b>	<b>64,356.599</b>
<b>C</b>	<b>Fiscal Balance</b>	<b>(431.200)</b>	<b>(7,582.767)</b>	<b>(21,438.688)</b>	<b>(18,136.993)</b>	<b>(22,171.428)</b>
	<i>In percent of GDP</i>	<i>(0.163)</i>	<i>(2.506)</i>	<i>(6.210)</i>	<i>(5.207)</i>	<i>(5.600)</i>

Over the medium term, expenditure growth is expected to continue outpacing revenue mobilization. For the next five years, total resources are projected to grow at 7 percent, while expenditures are projected to grow at 9.4 percent. Consequently, greater reliance on borrowing is anticipated, making fiscal sustainability increasingly dependent on effective project execution, expenditure consolidation and efficacy improvement, enhanced domestic resource mobilization, and sound debt management.

### 3.6. Quarterly Fiscal Framework

The quarterly fiscal performance reveals pronounced intra-year fluctuations, primarily driven by the uneven timing of revenue mobilization and expenditure outlays. In FY 2024-25, the fiscal balance recorded a surplus of 0.35 percent of GDP in Q4, as both revenue collection and spending peaked toward the end of the fiscal year. This highlights a clear seasonality in fiscal operations, with activity concentrated heavily in the third and fourth quarters, as shown in Figure 8.

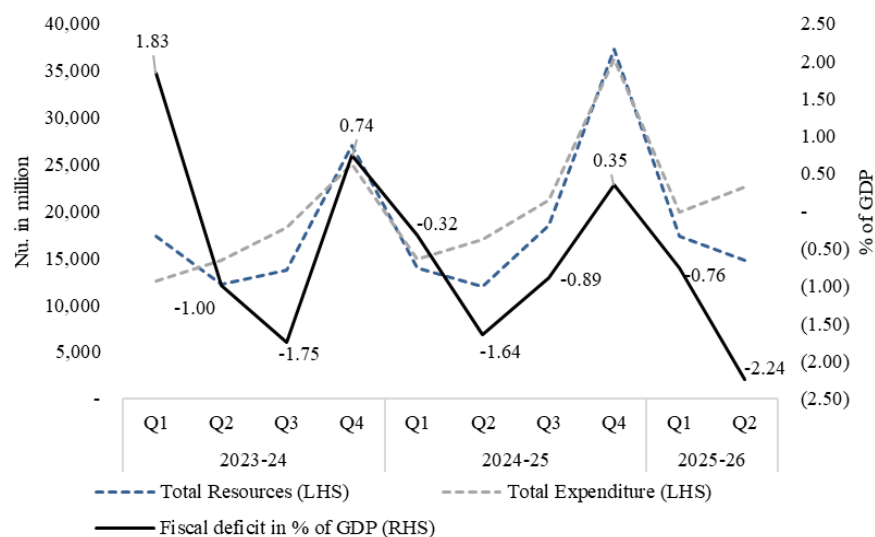


Figure 8: Quarterly fiscal activity trends

Back-loaded spending and revenue collection patterns can compromise project execution efficiency, lead to cash-flow mismatches, and exacerbate short-term financing challenges. Additionally, depending on year-end inflows, such as tax revenues, dividends, and external grants, raises fiscal vulnerability. To address these issues over the medium term, it will be essential to distribute expenditures more evenly and strengthen cash management to enhance fiscal discipline, stability, and predictability in budget implementation.

Table 5: Quarterly Fiscal Framework

Particular	2024-25 (Actual)				Total	2025-26	
	Q1	Q2	Q3	Q4	Actual	Q1	Q2
<b>Total Resources</b>	<b>13,975.804</b>	<b>11,980.678</b>	<b>18,491.111</b>	<b>37,278.071</b>	<b>81,725.664</b>	<b>17,276.127</b>	<b>14,809.861</b>
<b>Internal Resources</b>	<b>12,696.426</b>	<b>10,345.417</b>	<b>12,937.667</b>	<b>28,530.018</b>	<b>64,509.528</b>	<b>14,881.082</b>	<b>12,125.538</b>
<b>Domestic Revenue</b>	<b>12,203.579</b>	<b>9,972.462</b>	<b>12,477.956</b>	<b>27,554.400</b>	<b>62,208.397</b>	<b>14,363.481</b>	<b>11,737.480</b>
Tax	8,831.874	8,257.171	8,810.028	18,108.999	44,008.072	9,413.290	8,800.754
Non-tax	3,371.705	1,715.290	3,667.928	9,445.401	18,200.324	4,874.698	2,479.910
Other receipts (including internal grants)	492.847	372.955	459.711	975.618	2,301.131	512.090	387.517
<b>External Grants</b>	<b>1,279.378</b>	<b>1,635.261</b>	<b>5,553.444</b>	<b>8,748.053</b>	<b>17,216.136</b>	<b>1,888.674</b>	<b>2,414.044</b>
GoI	333.692	546.777	4,398.767	7,729.475	13,008.711	510.101	835.835
Others	945.686	1,088.485	1,154.677	1,018.577	4,207.425	1,242.808	1,430.473
<b>Total Expenditure/ Outlay</b>	<b>14,938.444</b>	<b>16,952.943</b>	<b>21,189.481</b>	<b>36,227.567</b>	<b>89,308.435</b>	<b>19,931.957</b>	<b>22,619.847</b>
<b>Current</b>	<b>10,110.862</b>	<b>10,749.145</b>	<b>12,135.920</b>	<b>12,877.971</b>	<b>45,873.899</b>	<b>12,878.675</b>	<b>13,691.685</b>
Primary Current (Regular)	8,560.789	9,594.876	10,542.669	11,610.834	40,309.168	10,093.017	11,312.187
Interest payments	1,557.106	1,154.330	1,594.831	1,258.464	5,564.731	3,052.223	2,262.707
<b>Capital</b>	<b>4,827.582</b>	<b>6,203.798</b>	<b>9,053.561</b>	<b>23,349.596</b>	<b>43,434.536</b>	<b>6,749.915</b>	<b>8,674.138</b>
<b>Fiscal Balance</b>	<b>(962.640)</b>	<b>(4,972.265)</b>	<b>(2,698.370)</b>	<b>1,050.504</b>	<b>1,797.501</b>	<b>(2,655.830)</b>	<b>(7,809.987)</b>
<i>In percent of GDP</i>	<b>(0.318)</b>	<b>(1.643)</b>	<b>(0.892)</b>	<b>0.347</b>	<b>(2.506)</b>	<b>(0.763)</b>	<b>(2.242)</b>

## 4. Monetary and Financial Sector Overview

### 4.1. Money Supply

The total money supply (Broad money: M2)<sup>2</sup> in the economy for FY 2024-25 was recorded at Nu. 247,197.243 million, reflecting a contraction of 2.63 percent compared to the previous update of Nu. 253,878.519 million. This contraction in the total money supply was primarily due to a reduction in net foreign assets which resulted from a decline in reserve assets denominated in Indian Rupees (INR) and foreign currencies, as well as a decrease in credit extended to the private sector.

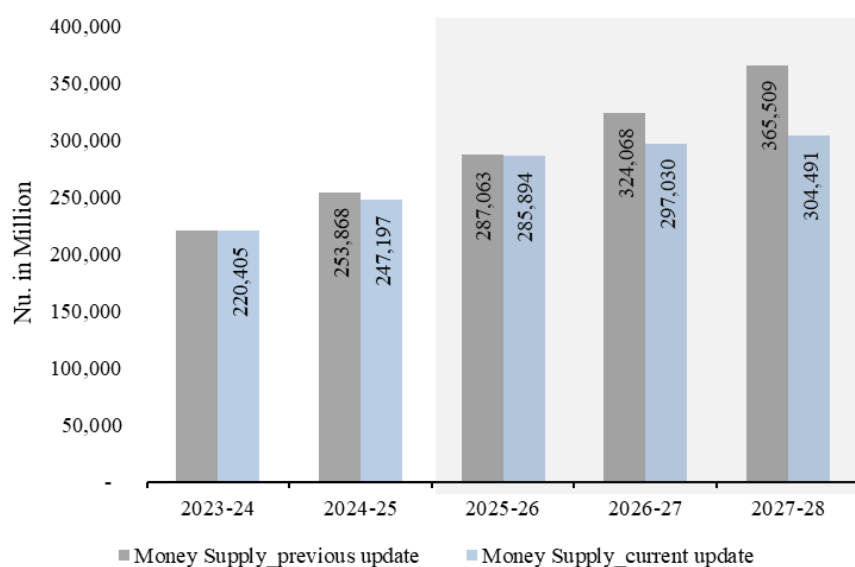


Figure 9: Money Supply

Although the money supply contracted on a quarter-on-quarter basis, an expansion in credit to the private sector combined with higher foreign currency holdings contributed positively to the overall increase in net foreign assets, which led to a growth of money supply by 12.29 percent in FY 2024-25, reaching Nu. 247,197.243 million, up from Nu. 220,405.491 million in FY 2023-24. On an annual basis, both net foreign assets and domestic assets are projected to rise, indicating a gradual expansion of the monetary base. In turn, this expansion, together with strong GDP growth, higher government spending and continued grant inflows, is expected to drive a steady increase in money supply over the medium term.

<sup>2</sup> Broad Money (M2) is a measure of the total money available in the economy. It comprises the narrow money, which includes the currency outside banks and demand deposits, time deposits and foreign currency deposits.

## 4.2. Liquidity

The Cash Reserve Ratio (CRR) of 8.00 percent is utilized as a key monetary policy tool to monitor and regulate credit growth and liquidity, with the scope of revision based on the prevailing liquidity conditions and overall macroeconomic conditions. For FY 2024-25, the cash reserve requirement stands at Nu. 19,841.576 million, up from Nu. 18,084.762 million in the previous quarter, which reflects that banks have more deposits, resulting in the subsequent increase in the reserves kept by banks despite the CRR ratio remaining constant.

This brings the overall liquidity position after the CRR at Nu. 29,058.055 million. Compared to FY 2023-24, all the components under liquidity management increased in FY 2024-25, primarily driven by a rise in the net foreign assets and an improvement in the liquidity position after the cash reserve requirement.

In the FY 2025-26, the liquidity position is projected to decline by 32.28 percent and further decline by 5.06 percent in FY 2026-27; this is mainly on account of an increase in net domestic assets, meaning the central bank is expected to absorb more liquidity, leaving less money available in circulation for banks and the economy. Further, to enhance liquidity management, the central bank plans to reinstate the sweeping of project accounts starting from FY 2025-26 and further refine the Precautionary Liquidity Buffer adjustments to Nu. 6500 million in FY 2026-27, in line with changing liquidity conditions in the banking sector.

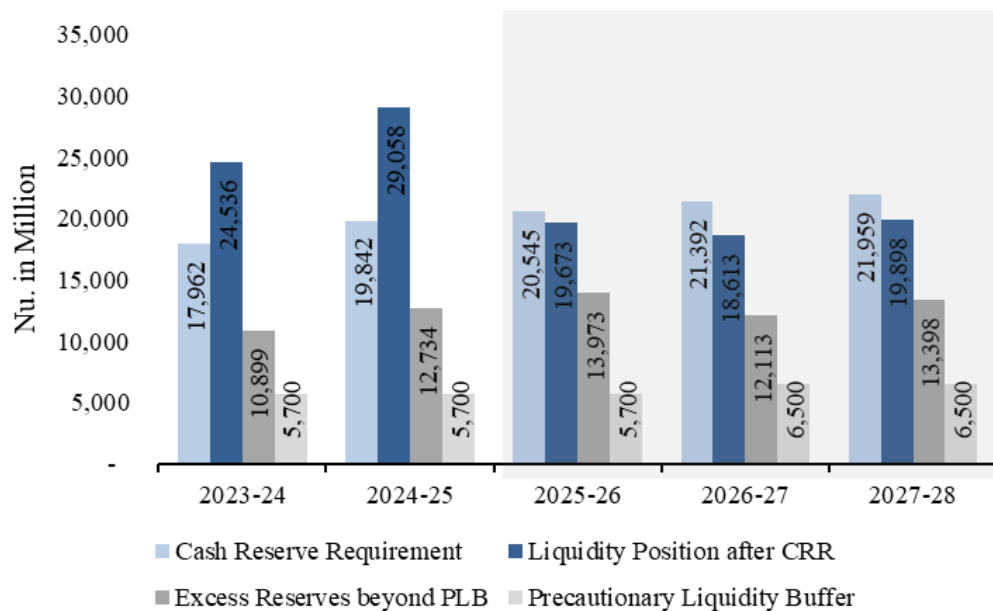


Figure 10: Liquidity Position

### 4.3 Credit Allocation

During FY 2024-25, sectoral credit by financial institutions increased to Nu. 251,266.357 million from Nu. 220,416.019 million in FY 2023-24, reflecting a 14.00 percent rise. Significant credit expansions in the hotel and tourism, manufacturing, and housing sectors mainly drove the growth. Increasing growth contribution of the manufacturing subsector to credit reflects the bounce-back in economic growth experienced by the manufacturing sector in 2024-25 as the subsector had contracted in 2023. The rise in the housing sector credit, which accounts for 29.03 percent of the total credit, can be specifically linked to the lifting of the moratorium on housing construction loans. In the last quarterly update, higher estimates were anticipated owing to the expected increase resulting from the removal of the moratorium on housing and vehicle loans. Similarly, the agriculture sector was projected to experience growth owing to ESP loans. However, in this quarter's update, there has been a decline in credit across all these sectors, notwithstanding a marginal increase in the total credit extended.

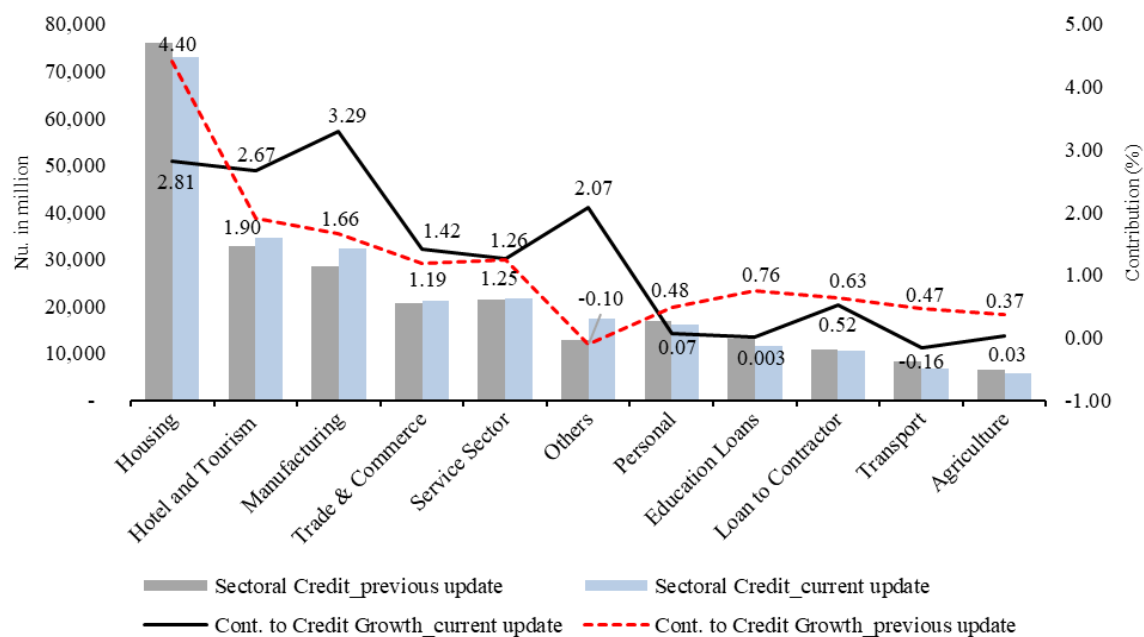


Figure 11: Sectoral Credit, FY 2024-25

## Box A. Monetary Conditions Index (MCI): Stance, Drivers, and Policy Cues

**What it is.** The MCI is a single indicator of monetary conditions that combines two channels: a Money leg (growth of broad money,  $\Delta \log M2$ ) and an External leg (inflation differential, Bhutan minus India). Each leg is standardized (z-scores) and combined with equal weights so the index is transparent and comparable over time; higher MCI = tighter, lower MCI = looser. A neutral band is defined by the historical mean  $\pm 1\sigma$ .

**Why an MCI for Bhutan.** Bhutan is a small, open economy with tight price linkages to India and episodic liquidity constraints. Policymakers need a single, comprehensible indicator to synthesize multiple moving parts, money growth, external price pressures into a clear stance indicator. An MCI provides discipline and a common language to coordinate: liquidity management, the phasing of capital spending, macro-prudential settings, and external buffer policy.

### Variables Chosen and Rationale

Component	Economic rationale & sign in MCI
<b>Money leg</b>	$\Delta \log M2$ (money supply growth). Meaning: faster M2 growth eases domestic financial conditions. Index sign: negative (more money $\rightarrow$ looser).
<b>External leg</b>	Inflation differential (Bhutan – India), a practical stand-in for REER. Meaning: domestic prices rising faster than India’s imply competitiveness loss/imported pressure. Index sign: positive (bigger gap $\rightarrow$ tighter).
<b>Standardization</b>	Each leg is z-scored to ensure comparability. v1 combines legs with equal weights (0.5, 0.5) for transparency in a small sample.

The MCI’s rule dials—band\_sigma (neutral band), level\_sigma (strong level), change\_sigma (large step), and the persistence rule—are designed to balance early warning against false alarms in a short annual sample, as shown in Figure A1. To translate the annual MCI into operational guidance, we use three complementary rules:

1. Level rule: Trigger when (an unusually tight or loose year).
2. Two-of-three rule: Trigger when at least two of the last three years share the same non-neutral state (Tight or Loose).
3. Level-and-change rule: Trigger when and the current year is non-neutral (a large step into/further within Tight/Loose).

The shaded band shows  $\pm 1\sigma$  around the long-run mean. Upward spikes indicate tight conditions; downward dips indicate loose conditions. **Orange dots** mark “Prepare” and **red dots** mark “Act” where rules trigger.



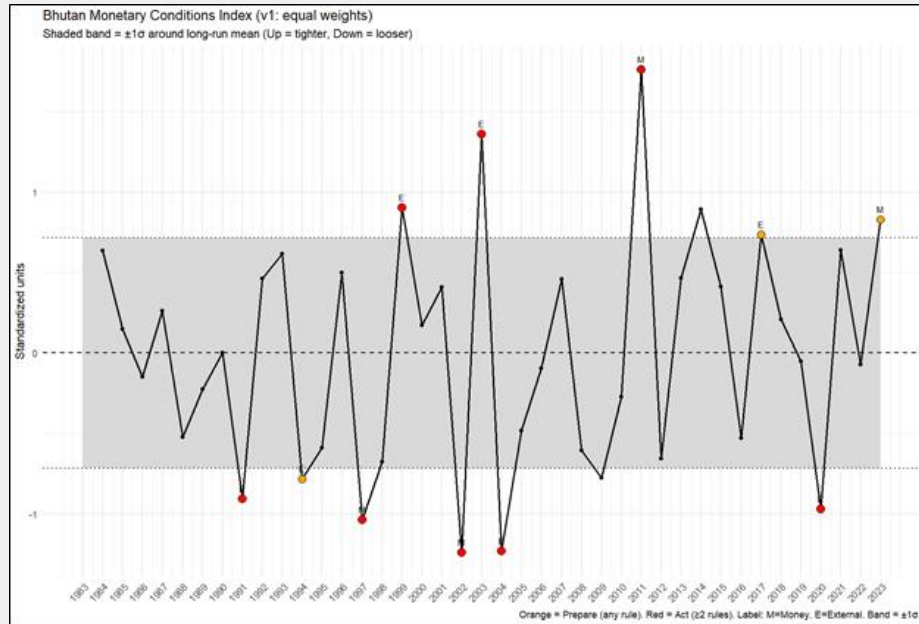


Figure A1: Headline MCI with neutral band and rule-based signals.

### Driver Decomposition (Money vs External)

The total MCI is decomposed into standardized contributions from the Money leg and the External leg. Dominant Money contributions imply domestic-liquidity instruments; dominant External contributions imply FX/input-cost/logistics measures.

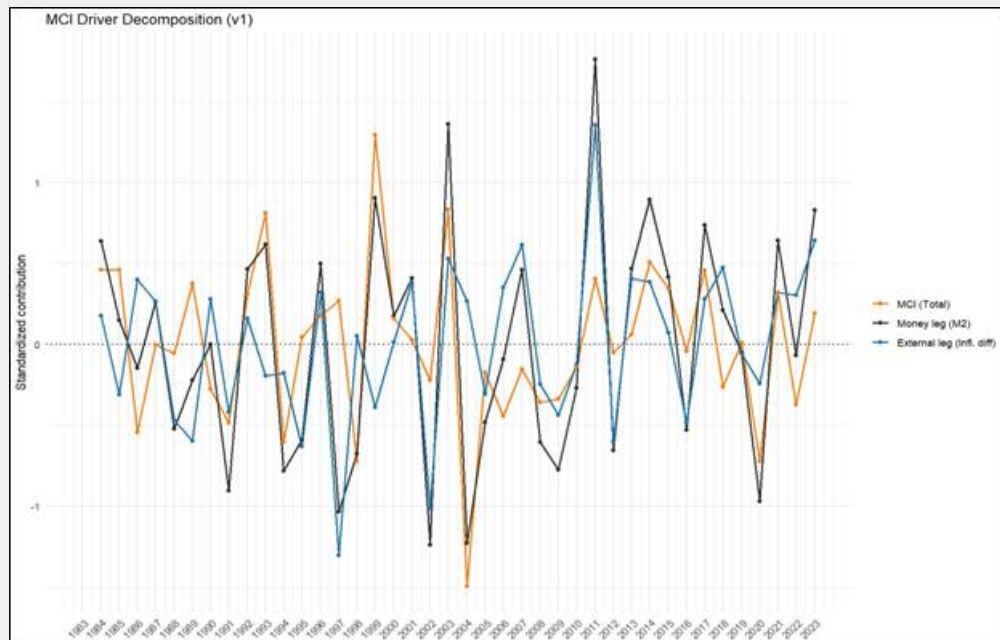


Figure A2. Standardized contributions of Money and External legs.

## Decision Rules (annual data) and Policy Mapping

Rule	Definition / Use
<b>Level rule</b>	Trigger if $ MCI_t - \mu  \geq 1.25\sigma$ in a given year (unusually tight/loose).
<b>Two-of-three rule</b>	Trigger if at least two of the last three years are in the same non-neutral state (Tight or Loose).
<b>Level-and-change rule</b>	Trigger if $ \Delta MCI_t  \geq 0.8\sigma$ and the current year is non-neutral (large step into/further within Tight/Loose).
<b>Signal mapping</b>	Prepare if any one rule fires; Act if two or more rules fire; otherwise Monitor. Dots in the figure are labeled by driver (M or E).

## Policy Mapping (state $\times$ driver)

State – Driver	Policy cues
<b>Tight – Money</b>	Targeted liquidity to productive sectors; accelerate arrears & productive capex; remove non-price frictions.
<b>Tight – External</b>	Prioritize FX for essentials; temporary duty relief on key inputs; time-bound transfers.
<b>Loose – Money</b>	Tighten macro-prudential (LTV/DTI, risk weights); rephase non-urgent spending.
<b>Loose – External</b>	Rebuild buffers; export/productivity support; Rebuild reserves.

## Outer- Year Application: Baseline & Scenarios, Fan Chart, and Tables

We forecast each leg ( $\Delta \log M2$  and the external proxy) with AR(1) dynamics, add deterministic scenario shocks, standardize with fixed historical  $\mu/\sigma$ , and recombine into a forward MCI. Residual resampling yields a fan chart (median, 50% and 90% bands). The same rules produce **Prepare/Act/Monitor** signals by scenario and year. An MCI-neutral money-growth path shows the  $\Delta \log M2$  that would keep conditions near neutral given the external outlook.

## Forecast Fan Chart

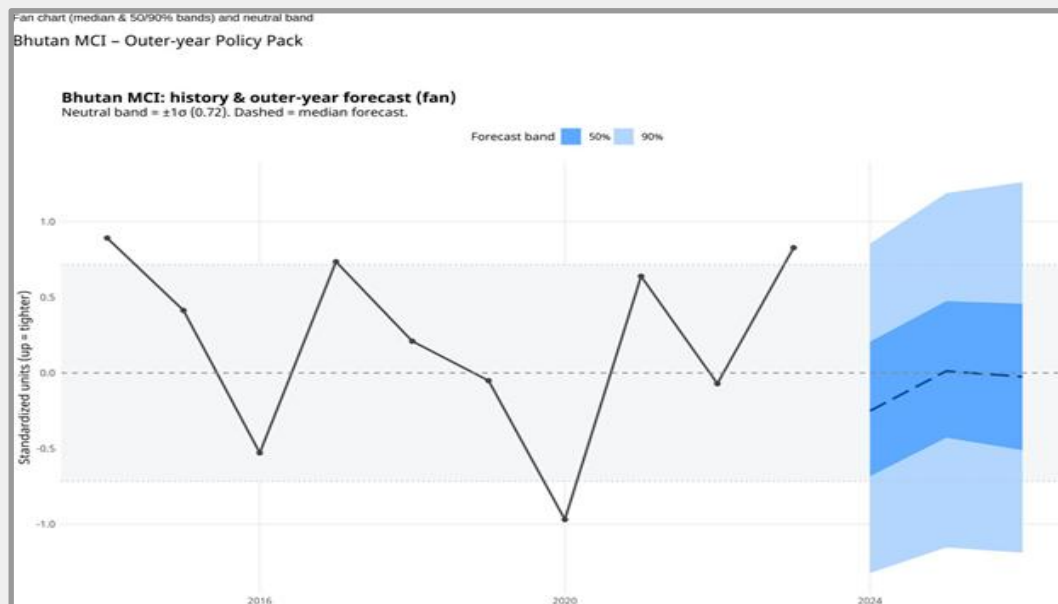


Figure A3. Forecast fan chart with 50%/90% bands and neutral band overlay.

## Scenario Signals and MCI-Neutral Money-Growth Path

Scenario signals & policy cues								
Scenario	Year	MCI_fc	State	Driver	Signal	Flags(#)	Policy cue	
Baseline	2024	-0.24	Neutral	Money	Monitor	0	Monitor: no action trigger	
Baseline	2025	0.04	Neutral	Money	Monitor	0	Monitor: no action trigger	
Baseline	2026	-0.03	Neutral	Money	Monitor	0	Monitor: no action trigger	
External_Shock	2024	-0.20	Neutral	Money	Monitor	0	Monitor: no action trigger	
External_Shock	2025	0.08	Neutral	External	Monitor	0	Monitor: no action trigger	
External_Shock	2026	0.00	Neutral	External	Monitor	0	Monitor: no action trigger	
Liquidity_Squeeze	2024	-0.20	Neutral	Money	Monitor	0	Monitor: no action trigger	
Liquidity_Squeeze	2025	0.09	Neutral	Money	Monitor	0	Monitor: no action trigger	
Liquidity_Squeeze	2026	0.01	Neutral	Money	Monitor	0	Monitor: no action trigger	

MCI-neutral M2 growth path					
Scenario	Year	ext_fc (pp)	zext_fc	M2 target (pp)	
Baseline	2024	0.02095443	-0.126412668	14.86	
Baseline	2025	0.07350467	0.007327714	16.39	
Baseline	2026	0.05956475	-0.028149386	15.98	
External_Shock	2024	0.05095443	-0.050062650	15.73	
External_Shock	2025	0.10350467	0.083677733	17.26	
External_Shock	2026	0.08956475	0.048200632	16.85	
Liquidity_Squeeze	2024	0.02095443	-0.126412668	14.86	
Liquidity_Squeeze	2025	0.07350467	0.007327714	16.39	
Liquidity_Squeeze	2026	0.05956475	-0.028149386	15.98	

Figure A4. Scenario results (state/driver/signal & policy cue) and neutral money-growth path.

### 4.3.1. Non-Performing Loans

As of May 2025, NPLs stood at 3.33 percent, equivalent to approximately Nu. 8,374.993 million. The housing sector, along with the trade and commerce sectors, accounted for around 41.40 percent of the total, reflecting the largest share of NPLs. Along with the manufacturing sector, these sectors also hold the highest share of credit in the portfolio, indicating potential systemic vulnerabilities. The NPLs increased by 7.23 percent compared to May 2024, driven by higher NPLs across most sectors, except in production and manufacturing, loans against shares and securities, and loans to contractors. Credit remains heavily concentrated in these sectors, which also record the highest NPL volumes, potentially weakening banks' stability and spreading risks to the overall economy. This highlights the need for stronger credit risk management to mitigate potential financial stability risks. To address the rising NPLs, RMA has implemented targeted loan restructuring measures starting in July 2025, moving away from unsustainable blanket deferments to a new approach that emphasizes borrower-specific solutions, such as interest-only payments, payment moratoriums, capitalization, maturity extensions, enhancements of credit facilities, loan splitting, and conversion of term loans. All of these measures are designed to ease repayment pressures while maintaining financial stability. However, such policies can result in perverse incentives that could be detrimental to financial stability.

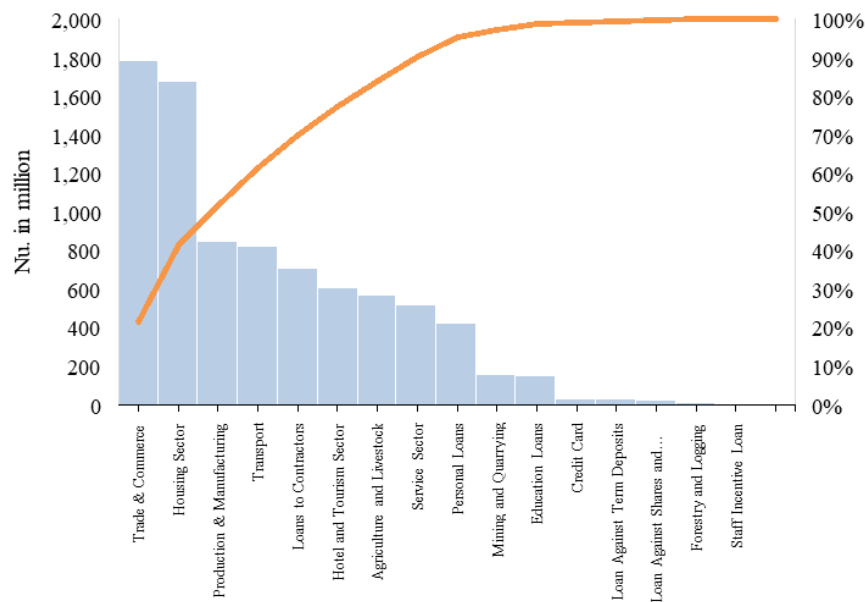


Figure 12: Sectoral Non-Performing Loans

## 4.4. Inflation

The headline inflation for June was 3.65 percent, down from 3.85 percent in the previous month. However, it increased compared to the same month last year, when inflation was 2.13 percent. The drop in inflation for June was mainly driven by a decrease in the food index, which fell from 6.42 percent in May to 5.27 percent. Additionally, the communication index saw a sharp decline, dropping from 7.77 percent in May to -3 percent in June, indicating a significant reduction in prices within this sector. While overall inflation has slowed compared to the previous month, the year-over-year increase shows that inflationary pressures are still higher than last year.

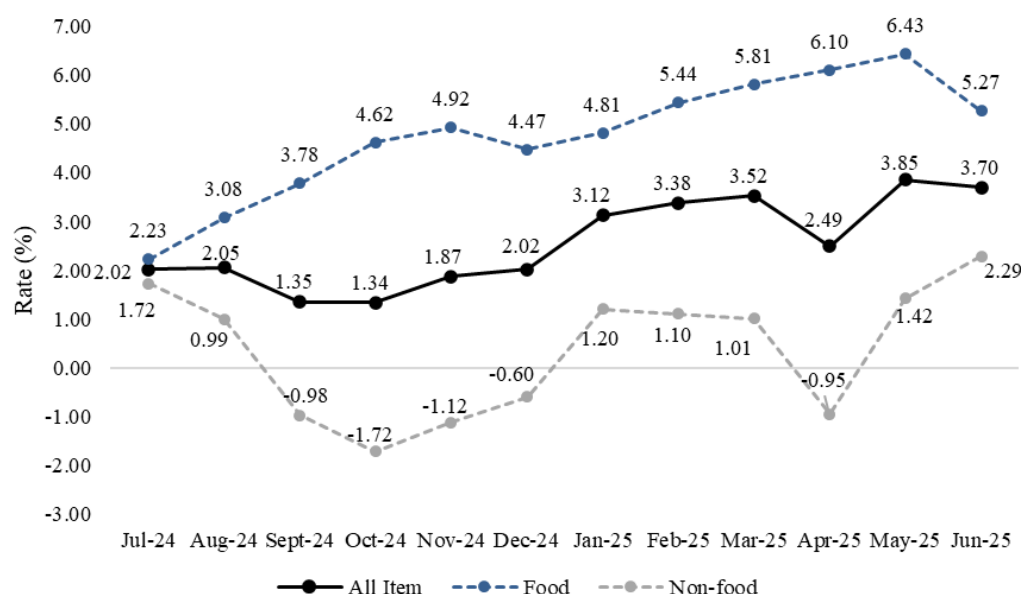


Figure 13: Inflation (year-on-year)

Looking ahead, inflation is expected to increase slightly, driven by ongoing food price rises, with overall inflationary pressures influenced by both domestic and global factors. The rise in global trade tensions could indirectly impact Bhutan by boosting global commodity prices and causing supply chain disruptions, which would lead to higher import costs. Additionally, the easing of the vehicle and housing construction moratorium in July and August 2024 is likely to put upward pressure on transportation and housing prices. Overall, inflationary pressures will continue to depend on domestic conditions and shifts in global trade policies.

## 5. External Sector & Balance of Payments

### 5.1. Balance of Payments

The overall balance of payments is anticipated to attain a surplus of Nu. 25,031.285 million in FY 2025-26, representing a 4.73 percent increase from the preceding quarterly update. This positive development is attributed to an expected rise in inflows within the financial account. In the medium term, the overall balance of payments is projected to experience a modest improvement in FY 2026-27, followed by a decline in FY 2027-28.

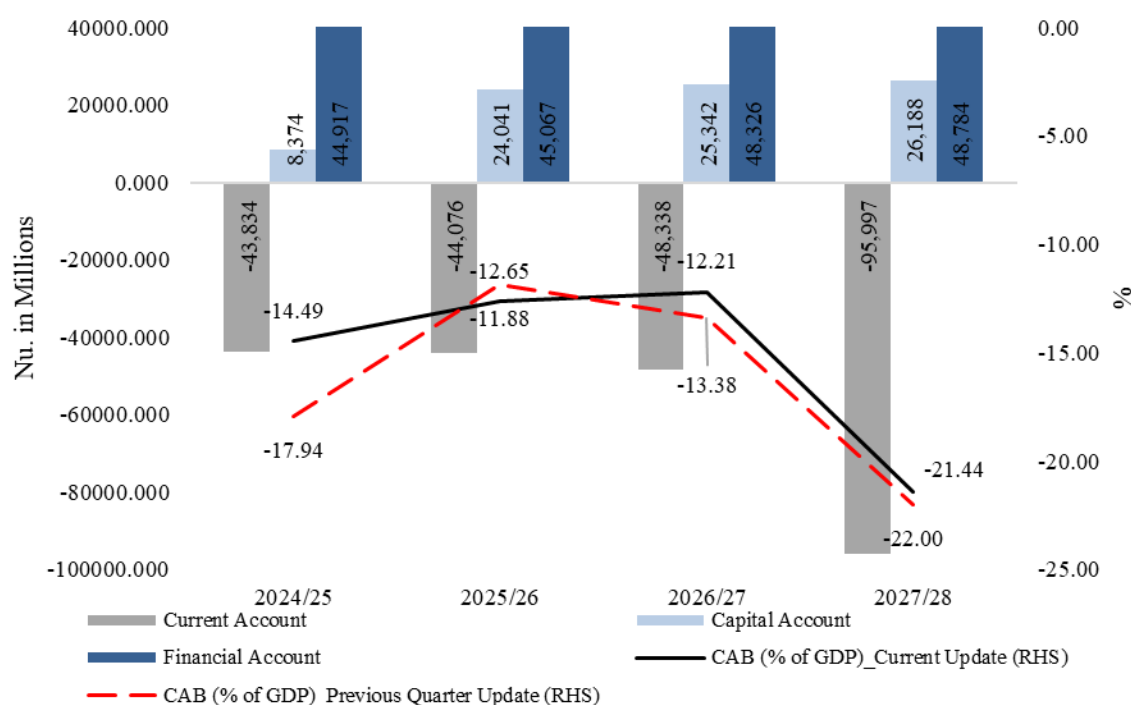


Figure 14: Balance of Payments

#### 5.1.1. Current Account Balance

The CAD is expected to rise to 12.65 percent of GDP in FY 2025-26, marking a 0.77 percentage point increase from the previous update. This decline in the current account balance is mainly due to lower service export estimates, as tourist arrivals have been revised to acknowledge the slow but ongoing recovery. In FY 2024-25, the CAD is projected at 14.49 percent of GDP, improving by 3.45 percentage points from the previous quarter estimates. Over the medium term, the CAD is expected to improve slightly to 12.21 percent in FY 2026-27, but then deteriorate significantly to 21.44 percent of GDP in FY 2027-28. This rise is driven by higher imports of goods, especially raw materials and machinery, expected for the development of the Dorjilung, Khorlochu, and PHPA-I hydropower projects.

### 5.1.1.1. Merchandise Trade Deficit

The merchandise trade deficit (excluding electricity) in FY 2025-26 is projected to reach Nu. 100,911.055 million, a 2.64 percent improvement from the previous quarter's estimates. This is due to anticipated improvements in export performance with the upcoming ferrosilicon plants from 2026, located at the Norbugang industrial estate.

Compared to the previous quarter estimates, the merchandise trade deficit (excluding electricity) for FY 2024-25 reached Nu. 92,815.564 million, a deterioration of 9.18 percent. This is attributed to increased imports of vehicles, machineries and equipment, construction items and raw materials such as iron and steel. With major construction projects for hydropower plants such as Dorjilung and Khorlochhu expected to commence in full swing from 2026 onwards, the trade deficit is expected to continue widening in the medium term.

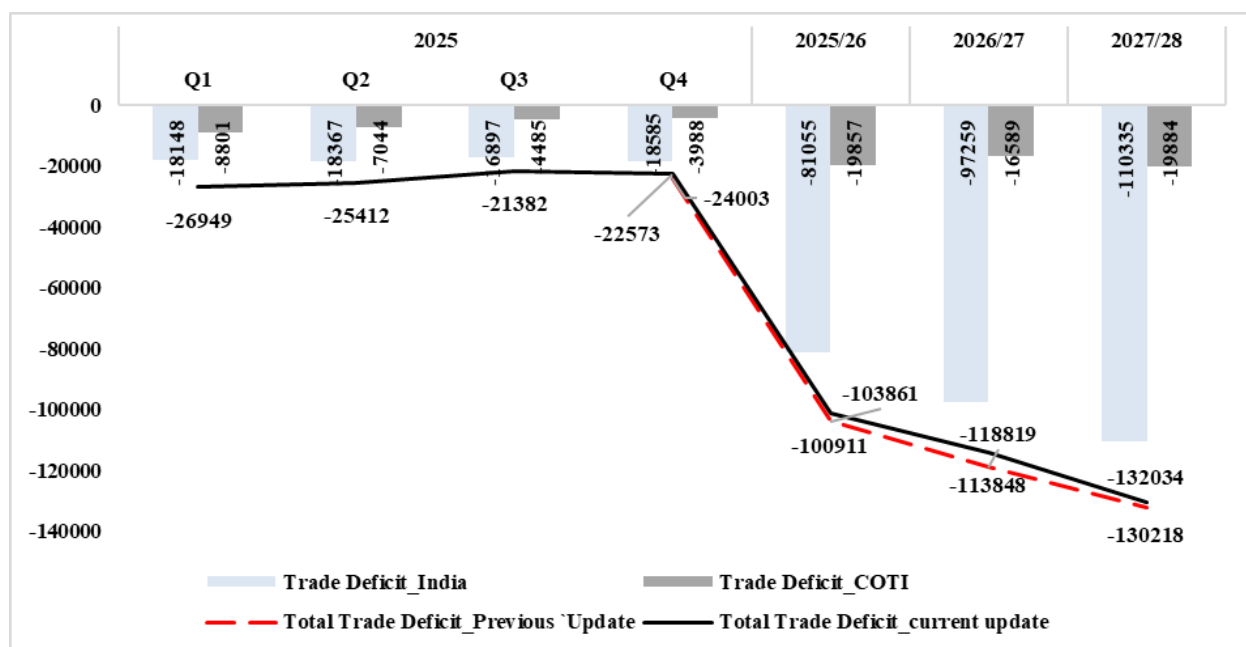


Figure 15: Merchandise Trade Deficit

### 5.1.1.2 Services & Transfers

A surplus in the balance of trade in services of Nu. 4,312.44 million is projected for FY 2025-26, down by 51.94 percent compared to the previous quarter estimate. This is mainly on account of downward revision in service exports and an increase in personal and business-related travels. On the other hand, an improvement in the primary income balance is expected, with the primary income deficit reaching Nu. 17,528.724 million in FY 2025-26 compared to the previous quarter estimate of Nu. 18,339.603 million. An anticipated increase in interest income drives the improvement. However, in the medium term, the primary income balance is expected to worsen as interest payments on external debt increase. The secondary income surplus saw an upward revision in its surplus by 3.90 percent compared to the previous quarter estimates, with the remittances and grants inflows expected to improve.

In the medium term, the service exports are expected to improve with the anticipated growth in the tourism sector. On the other hand, the secondary income surplus is expected to improve in FY 2026-27 and then decline as the inflow of budgetary grants decreases with the approach of the 13<sup>th</sup> FYP's end.

### **5.1.2. Capital Account**

The capital account for FY 2025-26 remains the same as the previous quarter estimate, projected at Nu. 24,040.960 million. On the other hand, the projection for FY 2024-25 has been revised downwards from Nu. 11,807.973 in the third quarter to 8,374.324 million in the current quarter. This is mainly due to the downward revision in grant inflows for investment and hydropower development, especially as construction development for major projects did not materialize as expected.

In the medium term, the capital account is expected to improve with the increased inflows of budgetary grants for investment related to the 13<sup>th</sup> FYP as it accelerates its implementation.

### **5.1.3 Financial Account**

The net financial account inflows in FY 2025-26 is projected to reach Nu. 45,066.538 million, an increase by 10.5 percent compared to the previous quarter's estimates. The upward revision is primarily due to increased inflows of loans for hydropower development. On the other hand, the projected direct investment inflows have remained stable at 4,829.170 million. Therefore, reflecting financial accounts is predominantly composed of external borrowings to finance the current account deficit. In the medium term, the net financial inflows are expected to increase marginally.

## **5.2. Foreign Reserves**

With the projected increase in the CAD, the foreign reserve is projected to reach USD 1,112.880 million at the end of FY 2025-26, down by 10.03 percent from the last quarter estimate. This is sufficient for 29 months of essential import coverage. At the end of FY 2024-25, the reserves stood at 816.451 million USD, slightly lower than the projection made in the same quarter of FY 2023-24 by 3.57 percent. In the medium term, the foreign reserves are projected to improve in 2026-27 with improvements expected in non-hydropower exports before declining.



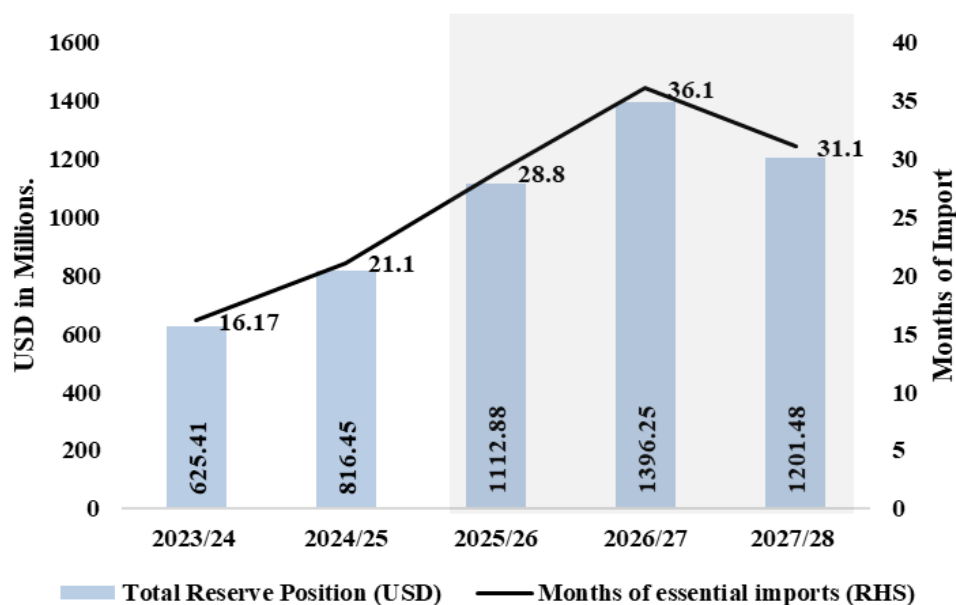


Figure 16: Foreign Reserves

Bhutan's external position shows that it is manageable but reliant on external sources of funds. The BoP surplus is primarily driven by financial account inflows, of which hydropower-related funds are a significant source. Similarly, as an import-dependent economy, the CAD is expected to remain at around 12.70 for the FY 2025-26, but could widen with imports increasing as economic growth accelerates without changes in domestic production capabilities. Reserves are adequate and improving, but their near-term improvement is shallower than previously projected. The persistent reliance on grants and loan inflows to boost or maintain the reserves is one of the core challenges and vulnerabilities that the economy faces.

## 6. Conclusion

Bhutan's fourth-quarter update anticipates a positive growth outlook, with the economy expected to grow at 8.55 percent in 2025. In the medium term, growth is expected to hover around the long-term growth rate. The upgrade is anchored in a stronger-than-expected services outturn, especially in tourism-linked activities and sectors, supported by higher disposable incomes following the last pay revision. Going forward, as is usually the case, growth is driven by major hydropower constructions and the commissioning of these projects.

Sectorally, the agriculture sector slows down from its 2024 performance, as forestry is revised downward, while livestock remains a steady driver amid the mixed implementation of the price guarantee scheme. The industry remains driven by hydropower, with a 2025 growth projection trimmed due to financing delays. Nevertheless, it is expected to rebound in 2026, bolstered and dependent on the recovery of the mining sector. The services sector takes the crown as the largest

share of GDP, but with a modest growth projection underpinned by the slow recovery of the tourism industry. Against the backdrop of persistent structural challenges, the economy hovers between services and industry, with services as the largest contributor, underscoring the need to deepen value and supply chains by developing niche manufacturing capabilities (such as biotech and foodtech) and other job-rich sectors that complement the tourism sector.

The fiscal stance remains expansionary, and capital outlays are projected to surpass current spending from FY 2025/26, aimed at fostering economic growth, provided adequate implementation strategies are in place. As a result, the deficit is expected to widen as expenditure growth outpaces resources. The recent tax reforms further worsen this position, but are not the cause of the widening deficit. Nevertheless, the impact of tax reform on the deficit is only during the transition and is expected to normalize after 2027. Public debt remains elevated but largely linked to hydropower and, over the long run, self-liquidating, contingent on timely delivery and export realization. A rise in the Central government debt is something to be cautious about.

The balance of payments positions are supported by inflows into the financial account, particularly hydropower-related financing, which has contributed to the widening current account deficit and reliance on external assistance. This highlights vulnerabilities after Bhutan's graduation from LDC status. While foreign reserves remain sufficient, their sustainability will depend on maintaining a strong export performance and exercising caution in external borrowing. However, recent experience suggests that stronger domestic demand, combined with inadequate liquidity management and a history of twin deficits and import dependence, can cause an immediate macroeconomic shock, leading to the implementation of strict administrative measures, such as a moratorium on credits and imports. As a result, such policies reverse the expansionary fiscal efforts made so far. Therefore, it is crucial that external sector management be closely linked with efficient liquidity management, an effective export earnings strategy, and fiscal consolidation.

Looking ahead, the successful implementation of the 13<sup>th</sup> FYP, diversification of the economic base, and effective policy reforms will be critical to translating short-term gains into long-term inclusive growth. Strengthening domestic revenue mobilization, managing debt prudently, addressing labor market mismatches, and reducing external dependence remain essential to ensuring macroeconomic stability and resilience.

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