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May 11, 2022

**Statement by Mr. Alhosani and Mr. Al-Kohlany on Bhutan
(Preliminary)
Executive Board Meeting
May 13, 2022**

We thank the staff for the comprehensive report and by Mr. Bhalla and Mr. Natarajan for their Buff statements. We are in broad agreement with the staff's appraisal and policy recommendations and would like to limit our comments to the following:

- 1- Fiscal support should gradually turn more targeted, while fiscal policy should be geared to mitigate the longer-term impact of the pandemic to support vulnerable households.** We agree that medium-term fiscal consolidation is warranted, underpinned by revenue mobilization and improved spending efficiency in order to support macroeconomic stability and create fiscal space needed to finance Bhutan's development goals. We positively note the authorities' efforts to introduce the Goods and Services Tax with expected revenue gains of about 2 percent of GDP over the medium term. Here we highlight the need to further broaden the tax base, rationalize tax exemptions, and reduce compliance costs. We note staff assessment that risk of debt distress remains moderate. However, given the high levels of public and public guaranteed debt, we encourage the authorities to further reduce debt vulnerabilities by strengthening the debt management framework and developing the domestic debt market, in line with the medium-term debt management strategy.
- 2- Monetary policy should gradually tighten as recovery takes hold, unemployment declines, and credit growth picks up.** Considering the growing inflationary pressures, we agree on the need for a well-communicated, phased withdrawal of monetary policy support, accompanied by close monitoring of excess liquidity and inflation dynamics. We welcome the authorities' efforts in modernizing the monetary policy framework, and we

encourage further work in this regard. We note the authorities and staff agreement on the need to address excess liquidity. Here, we encourage the authorities to prioritize operationalizing the new liquidity management framework, and the overnight marginal lending facility, which will help improve monetary policy transmission.

- 3- On the financial sector, strengthening bank resilience and addressing financial sector risks are necessary to safeguard financial stability.** While the broad-based pandemic support measures have been helpful, credit quality indicators are expected to worsen when policy support expires. Here we encourage the authorities to closely monitor and address vulnerabilities stemming from the elevated levels of non-performing loans (NPLs), concertation risks, and low profitability. The authorities' plans to gradually rollout the risk-based supervisory framework will further strengthen financial supervision, and we welcome their committed to implementation of the NPL resolution framework. We note that private sector credit growth remains subdued -at an eight-year low- amid abundant liquidity. *Could staff elaborate on the bottlenecks facing credit to the private sector, and the measures necessary to stimulate its growth? We would also appreciate staff assessment of the impact of monetary policy normalization on private sector credit.*
- 4- We take positive note on the authorities' commitment to diversifying the economy and boosting long-term growth.** We also welcome their plans to enhance the physical and digital infrastructure with a focus on productivity. Further efforts to reducing the high levels of youth unemployment will be important, and here we welcome the authorities plans to continue with their programs to address skill mismatches and unemployment during the pandemic. At the same time, efforts to expand digital payments and access to finance, particularly in rural areas, should continue.