



Sovereign Bond Market Development in Bhutan: A Progress Review

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19 December 2019

Presentation Outline

- 1) Current Status of Bond Market in Bhutan
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Current Bond Market

Till now, only private and public corporations have issued bonds. Following are some pertinent information about listed bonds:

- Number of listed outstanding Bonds: 16
- Total Bond Outstanding (as on 31.12.2018): Nu. 8.76 billion
- Weighted average coupon rate of the Bond issued: 8.8%
- Debt securities transactions in 2018: 17,090 units (Nu. 18.51 million)
- Total coupon payments in 2018: Nu. 895.47 million

[Source: RSEBL Annual Report, 2018]

Benefits of Developing Sovereign Bond Market

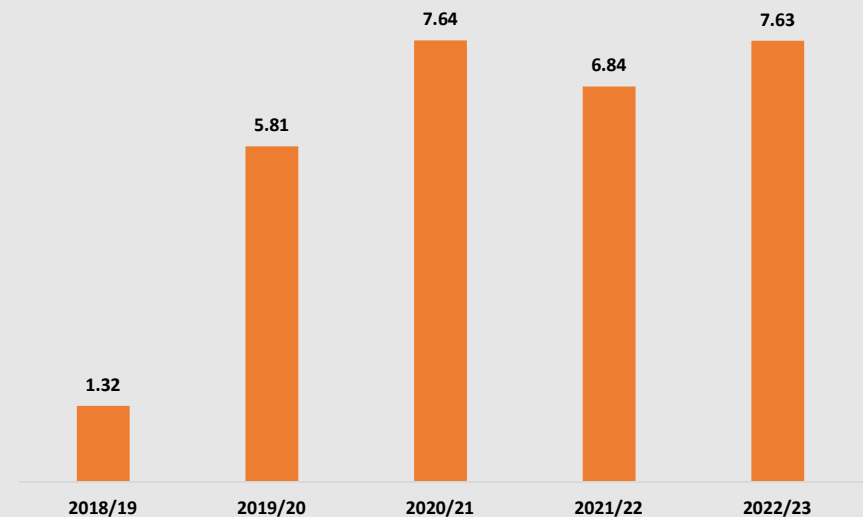
- Can help provide avenue for financing of budget deficit domestically.
- Help reduce exposure to exchange rate risks.
- Government bond yield curve can provide a reference point to other debt securities issuer in pricing their debt securities in the market.
- Can help the central bank strengthen transmission and implementation of monetary policy, such as through open market operation.
- Development of bond market entails creation of extensive infrastructure that benefits the entire financial system.
- Development of domestic debt market has shown to reduce borrowing cost for the government in the long-run.

Rationale for Developing Sovereign Bond Market in Bhutan: A Fiscal Perspective

1. Financing Government's Fiscal Deficit

- Total fiscal deficit project for 12th FYP: Nu. 29 billion
- Estimate net financing from external sources: Nu. 4 billion
- Net financing from domestic market: Nu. 25 billion.
- Development of domestic bond market will be critical for meeting the 12 FYP financing needs.

Projected Fiscal Deficit in 12 FYP
(in Billion Nu.)



Rationale for Developing Sovereign Bond Market in Bhutan (cont/-)

2. T-Bills Refinancing Risk due to low liquidity

During few auctions in 2019, the MoF was not able to raise required amount through T-Bills due to low liquidity in the market.

Example: T-Bills Auction on 7 Feb. 2019:

Bid invited: **Nu. 7 billion**

Bid received: **Nu. 2.7 billion**

Liquidity position: **Nu. 3.26 billion**

Main reason for large issuance of T-Bills: T-Bills proceeds are also used for financing budget deficits, apart from cash management.

Thus, bond market will be crucial in financing budget deficits, instead of entirely through Treasury Bills, thus mitigating Treasury Bills refinancing risk.

Rationale for Developing Sovereign Bond Market in Bhutan (cont/-)

3. LDC Graduation in 2023

- Bhutan is expected to graduate from LDCs in 2023.
- Graduation will mean reduced availability of concessional financing/withdrawal of grants by donors, or hardened borrowing terms for Bhutan.
- Development of alternative source of financing (innovative financing mechanism) is imperative.

The development of domestic bond market is one important way to augment and fill the gap.

Assessment of Conditions for Sovereign Bond Market Development in Bhutan

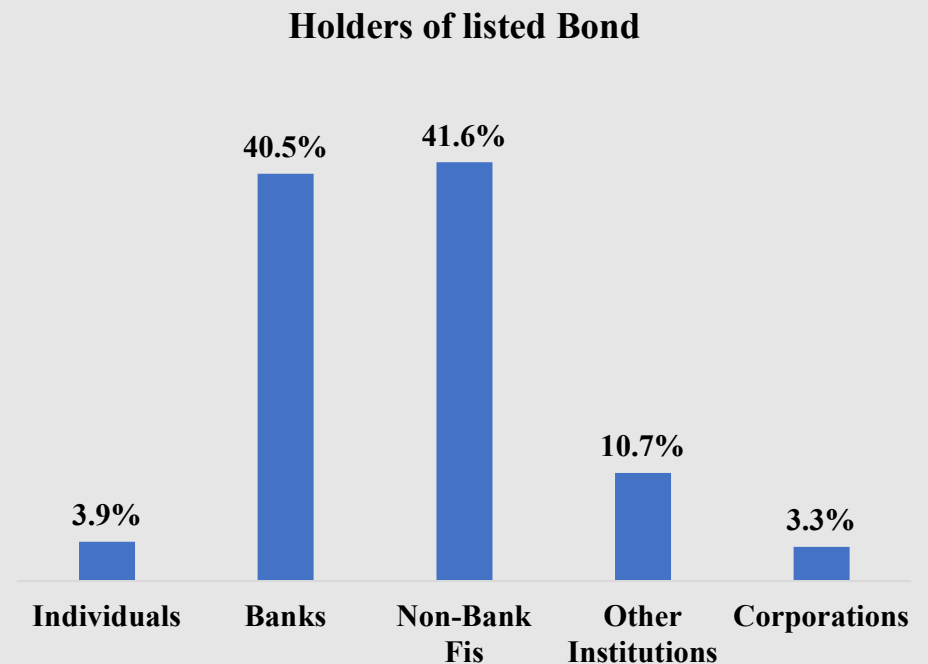
1. Legal & Regulatory Framework

- Public Finance Act 2007 (as amended in 2012) provides the Government the authority to borrow, including through issuance of debt securities.
- Public Debt Policy 2016.
- T-Bills Operational Guidelines in place since 2009.
- The Strategy and Rules on Government Bond issuance has been drafted.

Assessment of Conditions for Sovereign Bond Market Development (cont/-)

2. Investor base

- The investor base is narrow and concentrated.
- More than 80% of the outstanding bond that is listed with RSEBL is held by Financial Institutions
- Thus, the broadening investor base will be critical in developing a well-functioning domestic bond market



Assessment of Conditions for Sovereign Bond Market Development (cont/-)

3. Secondary market and intermediaries

- Currently there are 6 registered brokers (RICB Securities, BNB Securities, BoB Securities, BDB Securities, Lekpay Dolma Securities Broker Pvt Ltd, Drukyul Securities Broker Pvt. Ltd)
- Secondary market trading in debt securities is dormant with only Nu. 18.51 million worth of trading in 2018.

Assessment of Conditions for Sovereign Bond Market Development (cont/-)

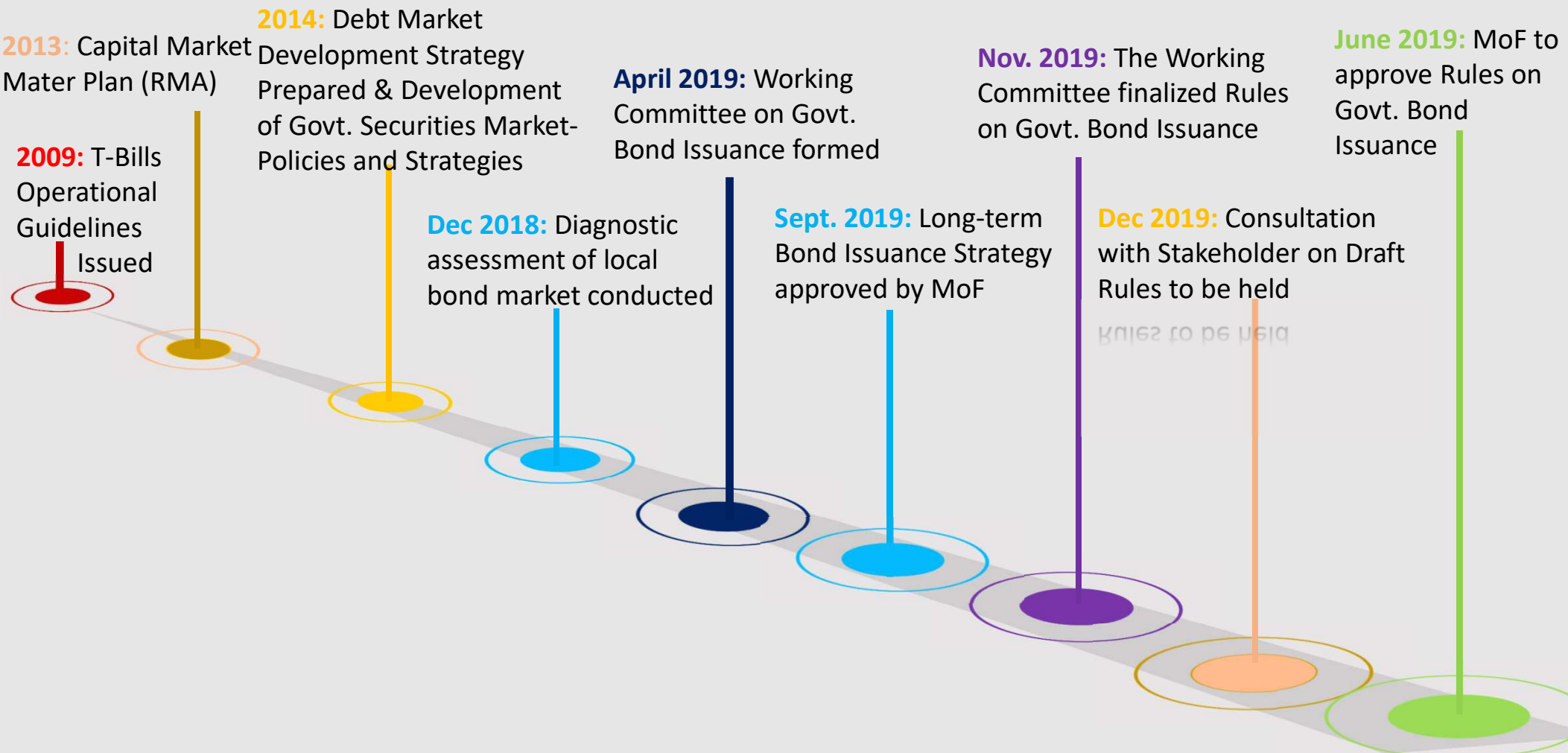
4. Market Infrastructure

There should be adequate depository, and clearing & settlement infrastructure for development of bond market

- RSEBL has electronic clearing & settlement system, and Depository system- license by RMA under Financial Services Act 2011.
- RSEBL also has automated trading system that facilitate online trading
- Broker's back office system is directly linked to RSEBL's electronic Depository System

Therefore, the market infrastructure is adequate and ready for domestic bond market development

Recent Initiatives to Develop Sovereign Bond Market in Bhutan



Issues and Challenges

1. Bank-dominated financial system
2. Narrow investor base; not many institutional investors
3. Inadequate regulatory framework: don't have sovereign bond issuance regulation yet
4. Low level of financial literacy and financial inclusion in the country

Way Forward

- All basic/minimum requirement for issuance of government bonds are adequate and ready.
- Adoption of relevant policies and strategies to overcome the challenges.
- MoF to issue long term Government Bond from FY 2020-21 (July 2020) to meet the financing needs of 12 FYP.
- Discussions on the big ticket items (not funded) of the 12 FYP- Flagship Programs (Nu. 15 billion)- Digital Drukyul, Waste flagship, Water flagship, Tourism flagship, Organic Bhutan... etc.
- A modest start- continuous improvement based on the feedback and experience.
- Working towards issuance of Green Bonds.

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