INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS[1]

December 15, 2014

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The risk of Lao P.D.R. facing external debt distress remains moderate, but it is on the cusp of a transition to high risk, with heightened vulnerabilities for public debt.[2] External debt distress indicators are more elevated than in last year's DSA, owing to the higher initial external PPG debt stock and projected debt flows to support public investment, and less concessional borrowing terms over time. Buffers are very limited in the case of adverse shocks. Given the considerable share of foreign currency denominated debt, large and sudden exchange rate depreciation could significantly raise the debt-to-GDP and the debt service-to-revenue trajectories for external and public debt; though revenues from large resource projects are expected to mitigate risks over the long term. While the change in external risk rating is not warranted at this time because baseline breaches of the thresholds under both the traditional and probability approaches are minor and temporary, the breaches do suggest heightened vulnerabilities, which should be addressed through fiscal consolidation, as recommended by staff, and by strengthening public investment management capacity.

[1] This DSA has been prepared by IMF and World Bank staffs, in consultation with the Lao P.D.R. authorities.

[2] The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels for debt indicators are policy-dependent. In the LIC-DSF, the quality of a country's policies and institutions is measured by the World Bank's Country Policy and Institutional Assessment (CPIA) index and classified into three categories: strong, medium, and weak. Lao P.D.R.'s policies and institutions, as measured by the CPIA, averaged 3.37 over the past three years. Since its average CPIA index has been above 3.25 for three years in a row, Lao P.D.R.'s policy performance remains classified as medium according to the "Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-income Countries" (www.imf.org/external/np/pp/eng/2010/012210.pdf). Therefore, the relevant indicative thresholds for this category are: 40 percent for the PV of debt-to-GDP ratio, 150 percent for the PV of debt-to-exports ratio, 250 percent for the PV of debt-to-revenue ratio, 20 percent for the debt service-to-exports ratio, and 20 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

BACKGROUND

1. The 2013 Debt Sustainability Analysis (DSA) classified Lao P.D.R.'s risk of debt distress as moderate. The classification continues to depend on the favorable Country Policy and Institutional Assessment (CPIA) index.[3]

Lao P.D.R.: External PPG Debt Indicators

	Indicative thresholds	End-2013
Present value of debt, in percent of:		
GDP	40	40
Exports	150	92
Revenue	250	221
Debt service, in percent of:		
Exports	20	5
Revenue	20	12

Sources: Lao P.D.R. authorities; IMF and World Bank estimates.

2. This DSA continues to classify the risk of debt distress as moderate, but Lao P.D.R. is on the verge of a transition to high risk, with heightened vulnerabilities for public debt. The indicative debt distress thresholds remain unchanged from the 2013 Article IV DSA. Under the baseline scenario of the current DSA, some of the external and public debt distress indicators breach the policy-dependent indicative thresholds for some years, the PV of external debt follows a downward trend and returns to levels below the respective thresholds in the medium term. Given the traditional approach classifies the debt distress risk as borderline high/moderate, a probability approach is adopted. The results of the probability approach suggest moderate debt distress risks, since all the indicators remain under their corresponding thresholds, with the exception of debt-to-GDP ratio, which breaches the threshold for a brief period.

3. Lao P.D.R.'s external public and publicly guaranteed (PPG) debt remains elevated and has risen since 2012. The nominal stock of PPG external debt increased from US$4.5 billion in 2012 to about US$5.1 billion at end-2013, mainly the result of higher borrowing from Thailand and China. The rise in debt was in part driven by heavy investment in power generation projects. Thus, the PPG external debt rose from 47.7 percent of GDP in 2012 to 48.3 percent of GDP at end-2013. The corresponding net present value (PV) of PPG external debt was 39.8 percent of GDP, a significant increase from 32.5 percent of GDP at end-2012, primarily because the amortization schedule of existing debt puts the larger part of principal repayments on more recent years compared to the last DSA.

Lao P.D.R.: External PPG Debt Indicators

	U.S. dollar (billion)	Share of total PPG external debt (percent)	In percent of GDP
Total	5.1	100	48
Multilateral	1.8	36	17
Bilateral	3.3	64	31
Commercial[1]	0.1	3	1

Sources: Lao P.D.R. authorities; and IMF and World Bank estimates.

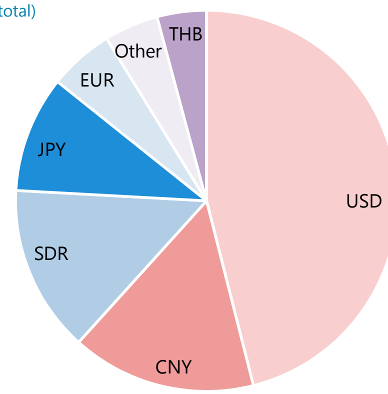
[1] Commercial debt includes Thai bond issuance.

4. Bilateral creditors have taken a larger share than multilateral creditors in 2013, and this trend is expected to continue in the projection period. Bilateral creditors—mainly China, Russia, Thailand, Japan, and Korea—account for 64 percent of total external PPG debt at end-2013. Multilateral

[3] Lao P.D.R.'s CPIA index declined marginally in 2013, not sufficient to change the classification of its policy performance, which remains moderate.

creditors consist mainly of the Asian Development Bank (AsDB—20 percent of total external PPG debt), and the International Development Association (IDA—12 percent of total external PPG debt).

Currency Composition of External PPG Debt
(In percent of total)



Sources: Lao P.D.R. authorities; and IMF and World Bank estimates.

5. **About three-quarters of total external PPG outstanding debt was contracted in U.S. dollars, renminbi, and SDR.** The rest consists of yen, euro, Thai baht and others.

6. **The high level of concessionality of official borrowing helps to keep the external debt service ratios at manageable levels.** PPG external debt service indicators are expected to remain below the policy-dependent indicative thresholds throughout the projection period in the baseline. However, given almost half of total external PPG debt is contracted in U.S. dollars and declining concessionality of new borrowing under the current DSA assumptions, the debt to GDP and debt service ratios of external PPG debt are most sensitive to large sudden currency depreciation shocks. Given very thin buffers, other adverse shocks, including delayed fiscal consolidation, could push the stock of external PPG debt beyond sustainable levels, with some debt distress indicators breaching their respective thresholds.

7. **The rising external debt-to-GDP ratio and near-term threshold breaches underscore the need to strengthen debt management capacity.** This includes ensuring that debt sustainability considerations are taken into account when contracting new debt, particularly because the country is expected to shift from concessional to more market-based terms as it graduates from Least Developed Country (LDC) status. Additional near-term external borrowing, for example to finance mega-projects, could push the debt-to-GDP ratio over the indicative thresholds for a protracted period, potentially jeopardizing debt sustainability. A mitigating factor for Lao P.D.R.'s external debt burden lies in the prospective returns on the hydropower and mining projects that have been financed in part by the external PPG debt. The long-term power purchase agreements that are singed for these projects and the resulting government revenues in the form of royalties, dividends, and profit tax payments help reduce the risk of debt distress in the long run.

8. **Recorded domestic PPG debt (excluding arrears) declined marginally from 12 percent of GDP in 2012 to about 11 percent of GDP at end-2013.**[4] Domestic debt consists of commercial bank lending and bond holdings as well as Bank of the Lao P.D.R.'s direct lending to local government's off-budget infrastructure projects. Given higher costs of domestic borrowing, the share of domestic PPG debt remains relatively small. Going forward, however, as domestic financial markets deepen, the share of domestic public debt is likely to increase. Financing through arrears accumulation allows total domestic and external PPG debt to remain at about 59 percent of GDP at end-2013, similar to the year before.

[4] Recorded domestic PPG debt (excluding arrears) declined marginally in 2013 as due to accumulation of arrears.

ASSUMPTIONS UNDERLYING THE DEBT SUSTAINABILITY ANALYSIS

Lao P.D.R.: Macroeconomic Assumptions Comparison with 2013
(Average over the 20 years projection period)

	2013 DSA	2014 DSA
GDP growth	6.9	6.6
GDP deflator in U.S. dollar terms (percent)	2.2	1.5
Non-interest current account deficit	12.3	10.6
Primary deficit	1.6	1.9

Sources: Lao P.D.R. authorities; IMF and World Bank estimates.

9. The medium-term macroeconomic assumptions underlying the DSA are summarized in Box 1. The baseline scenario--which is based on current policies and consistent with the macroeconomic framework presented in the staff report—projects annual GDP growth to moderate to 7.4 and 7.2 percent in 2014 and 2015, respectively, before reverting toward 7.5 percent in the medium term. Average real GDP growth over the projected period is expected to be lower than in 2013 DSA, in large part due to lower projected mining sector growth. GDP deflator growth (in USD terms) is projected to be about 1 percent, lower than in 2013 DSA, on account of the subdued global commodity and import price outlook and moderately lower real GDP growth. The bilateral exchange rate vis-à-vis USD is expected to depreciate by about 3.5 percent year-on-year starting in 2016 and thereafter, consistent with the authorities' exchange rate band of +/-5 percent.

10. Compared to the 2013 DSA, the baseline projects slight improvement in the external position, but deterioration in the fiscal position. The current account deficit is projected to improve over the forecast period and also compared to the 2013 DSA. On the fiscal side, the primary deficit is expected to deteriorate in the medium term, worse than 2013 DSA.

11. As a result, a higher level of financing than last year is assumed. To meet the country's financing needs, a higher level of new borrowing is projected to finance investment that would support the country's ambition to graduate from the LDC status by 2020. External financing is assumed to remain largely on concessional terms in the near future. Going forward, however, the new disbursement schedule is assumed to rely less on multilateral creditors, and more on bilateral and commercial creditors. In this vein, the share of commercial borrowing is projected to reach about 10 percent of total new disbursements in the long term. Multilateral assistance will slowly shift from grant- to credit-based conditions, and AsDB and the World Bank Group are expected to remain the principal suppliers of multilateral credit, with IDA loans slowly phasing out and replaced by IBRD loans with less concessional terms. The level of grant financing is projected to decline from 5.6 percent of GDP in 2013 to about 3.5 percent of GDP in the medium term, adding to the higher projected borrowing needs, which are estimated to be higher than the authorities' disbursement projections. Interest rates on bilateral and commercial loans are expected to increase with libor, in line with the assumptions from the IMF's World Economic Outlook, and stabilize at a higher level in the medium term. As the domestic financial market deepens, the private sector is assumed to rely more on domestic sources of financing, lowering the need for foreign borrowing in the long term.

Box 1. Baseline Scenario – Underlying Assumptions (2014–34)

The baseline macroeconomic framework assumes neutral fiscal stance in the medium-term, followed by some consolidation, and accommodative monetary conditions. Although long-term growth is still anchored by the vigorous energy production sector, vulnerabilities remain heightened.

Real GDP growth is projected to average 7.5 percent during 2014–19. Growth has slowed in FY2014, partly due to fiscal tightening and lower mining production. In the medium term, some fiscal easing and higher growth in the resource sector, driven by the commencing of operation of some power projects, will return growth to about 7½ percent. This outlook also relies on continued accommodative monetary policy, vigorous resource-related FDI inflows, rising electricity demand from neighboring countries, and a gradual pickup of investment inflows into nonresource sectors following Lao P.D.R.'s recent WTO accession. Over the longer term, successful structural reforms would create a better environment for private investment, broadening the sources of growth. Real GDP is expected to moderate to 6.3 percent on average during 2020–34, as production in the resource sector reaches maturity. Graduation from Least Developed Country status is projected around early-2020s.

Inflation (measured by GDP deflator in USD terms) is projected to average about 1.5 percent in 2014–34. Price growth is expected to remain subdued, owing to weaker food and fuel price growth outlook and declining domestic pressures.

The balance of payments continues to be driven by developments in the resource sector, which has an important bearing both the current account and the capital and financial account. The current account deficit is estimated to have narrowed slightly to about 28.9 percent of GDP in 2013 and is expected to decline to 25 percent of GDP in 2014, as the nonresource deficit remains elevated and the resource deficit temporarily increases before large-scale power projects come on stream in 2015–16. FDI inflows are assumed to be vigorous, driven by growing investment inflows into both resource and nonresource sectors following Lao P.D.R.'s recent WTO accession. The current account is projected to improve over medium and long term, assuming that nonresource exports and services will gradually pickup driven by solid recovery in advanced economies, strengthened regional integration, supported by improvements in the investment climate, streamlining of business regulations, and the prevalence of trade commitments.

External financing is assumed to remain largely on concessional terms in the near term. In the longer-run, however, the degree of concessional financing decreases with economic development, while new disbursement schedule will shift from multilateral to commercial and bilateral creditors.
Multilateral creditors: Projected loan disbursements in the medium term are relatively low, since IDA and AsDB have a pipeline of operations financed on grant terms, which are forecast to roll over into loans with decreasing levels of concessionality going forward. Over the longer term, project loans are assumed to increase moderately, but the share of multilateral loans in total disbursements are expected to decline over the long run.

- Under the IDA pipeline, half of new disbursements starting in FY 2014 are expected to be financed through grants and half through loans on concessional terms. Given the expected graduation of Lao P.D.R. from the LDC status, beginning in FY 2021 half of the disbursements are expected to be financed under IDA terms and half under IBRD terms, and starting in FY 2024 all financing by the World Bank Group is expected to shift to IBRD terms with less concessional conditions.

- AsDB loans are expected to remain on concessional terms. New projects for 2015 to 2035 are assumed at US$85 million per year, which is the average of Lao P.D.R.'s indicative lending allocations as set out in the Work Program and Budget Framework for 2015–17, with the addition of US$27 million per year for additional allocation for subregional project, based on the annual average of 2013–14 subregional allocations.

Bilateral and Commercial Creditors: For 2014–19, project loan disbursements also increase, as donors provide support to the government's development agenda. Over the medium and longer term, greater participation by new emerging market creditors results in an increased role for bilateral finance, including on-lending to state-owned enterprises. As Lao P.D.R. exits from low income country status, larger share of external borrowing is expected to shift from multilateral to bilateral and commercial creditors, with lower degree of concessionality on market-based terms. The share of commercial creditors is expected to increase over the projection period to about 10 percent of total new borrowing. Given the anticipated increase in global interest rates due to the exit from unconventional monetary policy in the US, interest rates for bilateral and commercial borrowing are expected to start rising in 2015 in line with the World economic Outlook's libor forecasts. DSA assumptions also incorporate historical and projected bond issuance initiative in the Thai market. So far, a 50-million USD bond has been issued in May 2013, two bonds totaling US$100 million have been issued in December 2013, and a 170 million USD bond has been issued in October 2014.

Fiscal policy is projected to be neutral in the medium-term. The primary deficit is projected to peak at 3.6 percent of GDP in 2016 and remain at about 3.4 percent of GDP on average over the medium term, then decline gradually to around 1.4 percent of GDP on average. Over the long-term the primary deficit is expected to stabilize at around 0.7 percent as improvements in non-mining revenue collection are counteracted by declines in mining and resource related revenue, while capital expenditure is expected to decline and other expenditure categories are expected to remain constant as a percent of GDP.

Domestic debt is expected to increase over the long-term as the country relies more on domestic funding. Going forward, as global interest rates are projected to rise and domestic financial markets deepen a larger share of financing needs is likely to be satisfied by domestic creditors.

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

12. Under the baseline scenario, the PV of external debt to GDP ratio is projected to be above the policy dependent indicative threshold and decline in the medium term (Figure 1), indicating that the debt distress risk is more elevated than the 2013 DSA. The change is driven primarily by the higher debt stock at the end of 2013, and higher projected new borrowing, with less concessional terms going forward as Lao P.D.R. graduates from the LDC status. As a result, the current DSA forecasts a breach in the PV of external PPG debt-to-GDP ratio until 2018. Other debt and debt service indicators remain below the policy-dependent indicative threshold during the entire forecast period under the baseline scenario.

13. Under the historical scenario, in which key variables are set at their historical averages, debt dynamics become unsustainable for all debt stock indicators. The historical scenario is based on 10-year averages of higher current account deficit, real GDP growth, and growth of exports of goods and services than assumed under the baseline, requiring higher debt accumulation rates and putting debt dynamics on an unsustainable path.

14. Debt dynamics continue to be markedly worse under the alternative scenarios, with the exchange rate depreciation risk having the largest impact. Abrupt exchange rate depreciation remains the most important risk to sustainability, given a large share of foreign currency debt and a very thin international reserves cushion. A potential trigger is an increase in global interest rates, as advanced economies exit from unconventional monetary policies. As shown in Figure 1, a one-off 30 percent depreciation shock would cause the breach of the indicative threshold of the PV of debt-to-GDP, debt-to-revenue, and debt service-to-revenue ratios over a prolonged period. While the PV of external PPG debt declines over the projection period, liquidity indicators worsen, as indicated by the increasing debt service ratios. This raises concerns about possible foreign-currency liquidity crunch. However, given the expected increase in revenues from hydropower production, which are not fully captured by fiscal revenues, debt service-to-exports ratio, rather than debt service-to-revenue ratio, is a more appropriate indicator. A somewhat worse debt trajectory emerges as a result of an assumed negative shock to FDI inflows—a scenario with net official transfers and net FDI falling in 2014-15 below their historical averages—in which case Lao P.D.R. would be forced to reduce its current account deficit in order to avoid worsening the external debt position.

15. The borderline high/moderate case issue was addressed with the probability approach, which suggests moderate risk of debt distress, but verging on a transition to high risk. Given the small breach under the baseline and multiple breaches of thresholds under the alternative scenarios, the debt distress risk is classified as high/moderate. To address the borderline issue, a so-called probability approach was adopted. The key difference is that the probability approach incorporates a country's individual CPIA score and average GDP growth rate, whereas the traditional approach uses one of three discrete CPIA values (for weak, medium, and strong performers) and an average growth rate across LICs. Under the baseline scenario, the probability of debt distress is lower than the threshold for all indicators, with the PV of debt-to-GDP ratio breaching its threshold only briefly. The risk of debt distress is sensitive to significant exchange rate depreciation and under a historical scenario, in which case the stress tests result in multiple breaches of thresholds. This is consistent with moderate risk of debt distress.

B. Public Debt Sustainability Analysis

16. The PV of total PPG debt in percent of GDP and in percent of revenue are both projected to remain elevated over the long run under the baseline scenario. Current public sector debt dynamics show a worsening situation than in 2013 DSA. The PV of public sector debt was estimated at 50.5 percent of GDP in 2013 and is expected to remain high and above the threshold until the end of the projection period in the baseline scenario. The breach is primarily driven by faster amortization schedule on existing 2013 debt and higher projected disbursement schedule necessary to support growth in the conditions of fiscal easing and limited public investment management and implementation capacity. Given the underlying assumptions of the eventual shift from concessional to market-based borrowing terms and higher borrowing interest rates over time, Lao P.D.R.'s PPG debt-to-GDP, debt-to-revenue, and debt service-to-revenue ratios are expected to increase over the projection period.

17. The worsened baseline and the alternative scenarios from last year's DSA highlight the growing risk of debt distress and point to the importance of fiscal consolidation over the medium term. As shown by the fixed primary balance scenario, which assumes unchanged primary balance from 2014 for the entire projection period, the PV of the debt-to-GDP and debt-to-revenue ratios would be higher than the baseline in the second half of the projection period.

18. Owing to significant reliance on external borrowing, the PV of public debt remains sensitive to large, abrupt exchange rate depreciation. A sudden 30-percent depreciation of the kip against the U.S. dollar would immediately raise the PV of public debt-to-GDP in the medium-term, with unfavorable implications for debt sustainability.

AUTHORITIES' VIEWS

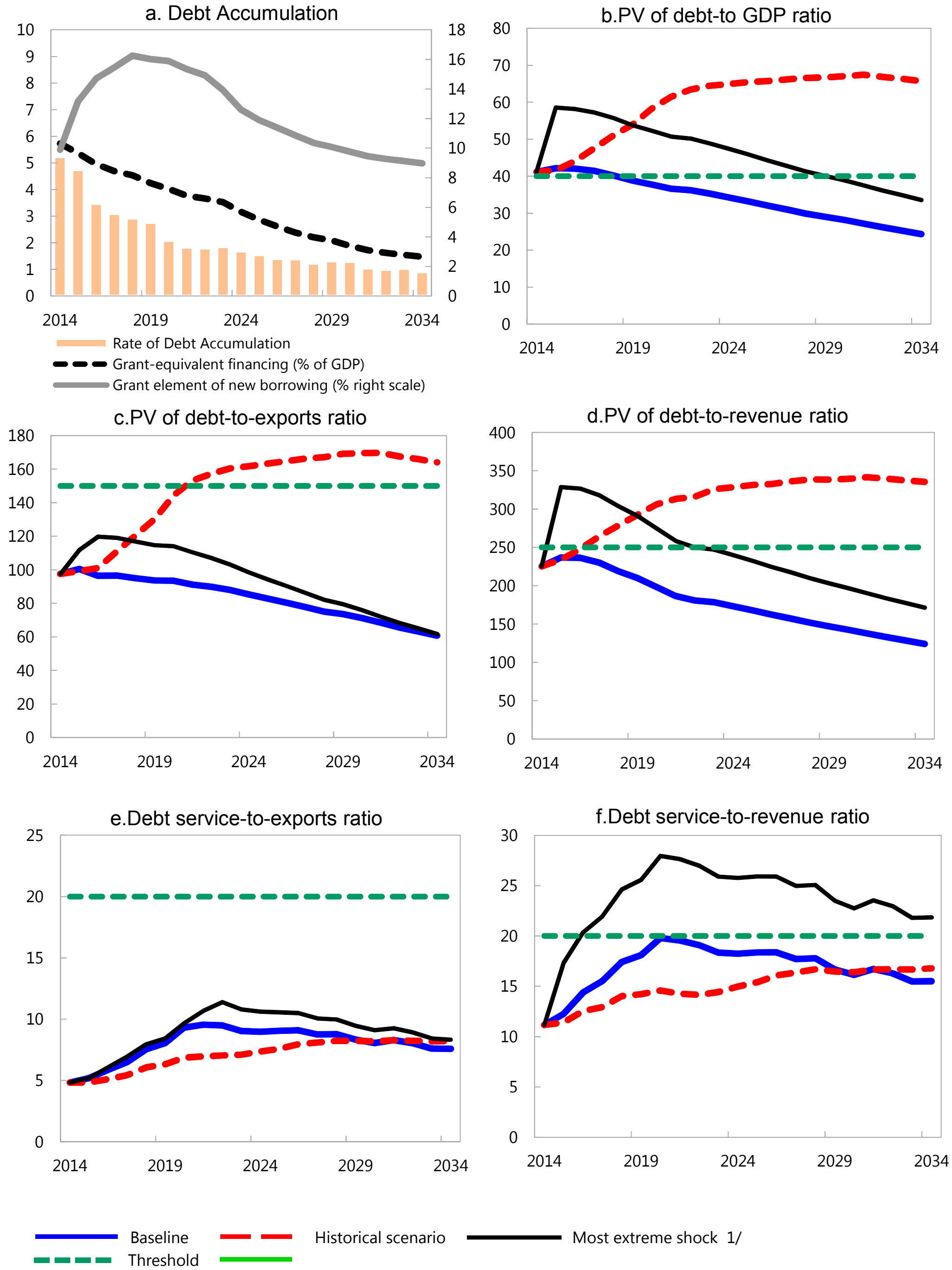
19. The authorities broadly agreed with the overall assessment, emphasizing that the government does not foresee difficulties in servicing debt, and expect lower new borrowing than the DSA assumes. Given the expected strong royalty, dividends, and profits, the authorities do not anticipate any difficulty finding creditors and servicing outstanding loans. A relatively long maturity profile of loans, as well as U.S. dollar returns of the exporting sectors, would help mitigate the risks of debt distress. The authorities anticipate an increase in disbursements of new funds from some bilateral donors between 2014 and 2019, and that borrowing would not expand at the rate assumed in the DSA given a number of current regulations restricting new external commercial borrowing to no more than 25 percent of government revenue. Restrictions on borrowing for infrastructure and social development purposes also allow financing only on concessional terms with interest rates below 3 percent and long-term maturity. Nevertheless, the authorities indicated that these guidelines could be modified should financing needs and financial conditions change. Borrowing is expected to shift from external to domestic sources over time, as domestic financing becomes cheaper. Better access to nonconcessional loans is also expected in the future.

20. The authorities highlighted that a significant part of the external debt is related to viable, large resource projects. They believe that energy sector projects will generate high and stable economic returns upon completion. While going forward, the authorities felt that external borrowing from China will decline, as lending will focus on the energy sector and on guaranteed terms only.

CONCLUSION

21. Although Lao P.D.R.'s risk of external debt distress remains moderate, it is on the cusp of a transition to high risk, with heightened vulnerabilities for public debt. While debt service ratios remain within the policy-dependent indicative thresholds in the baseline, primarily because of the still high concessionality of official borrowing, the PV of external debt to GDP ratio breaches the indicative threshold for some years, leaving almost no buffers in the case of adverse shocks. Given that the traditional approach identifies the risk of debt distress as borderline between moderate and high, a probability approach is adopted, using Laos-specific indicators. The results show that the debt distress probability remains below the threshold in the baseline for all indicators, except the external debt to GDP ratio, which breaches the threshold for a brief period. Also, given the considerable share of foreign currency denominated debt, a large sudden exchange rate depreciation could significantly raise the debt-to-GDP and the debt service-to-revenue trajectories for external and public debt. In that event, the elevated private external debt would also raise concern. Large sudden exchange rate depreciation would put public debt dynamics on an unsustainable path well above the baseline. While the external risk rating does not warrant a change at this time because baseline breaches of the thresholds under both the traditional and probability approaches are minor and temporary, the breaches do suggest heightened vulnerabilities, which should be addressed through fiscal consolidation, as recommended by staff, and by strengthening public investment management capacity.

Figure 1. Lao P.D.R.: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2014–34 1/

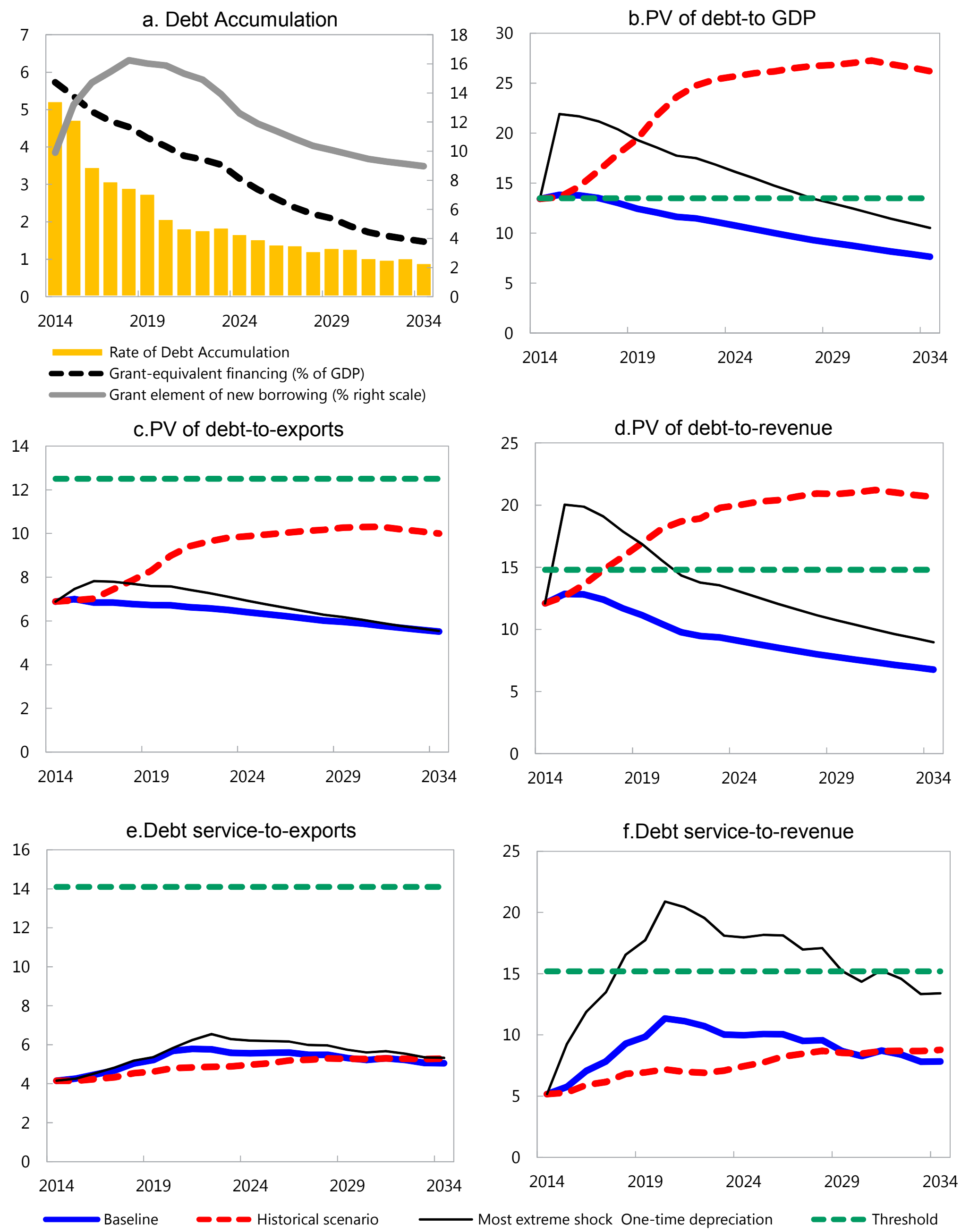


Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio on or before 2024. In figure b. it corresponds to a One-time depreciation shock; in c. to a Non-debt flows shock; in d. to a One-time depreciation shock; in e. to a Non-debt flows shock and in figure f. to a One-time depreciation shock

Figure 2. Lao P.D.R.: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2014–34 1/

(Probability Approach)



Sources: Country authorities; and staff estimates and projections.

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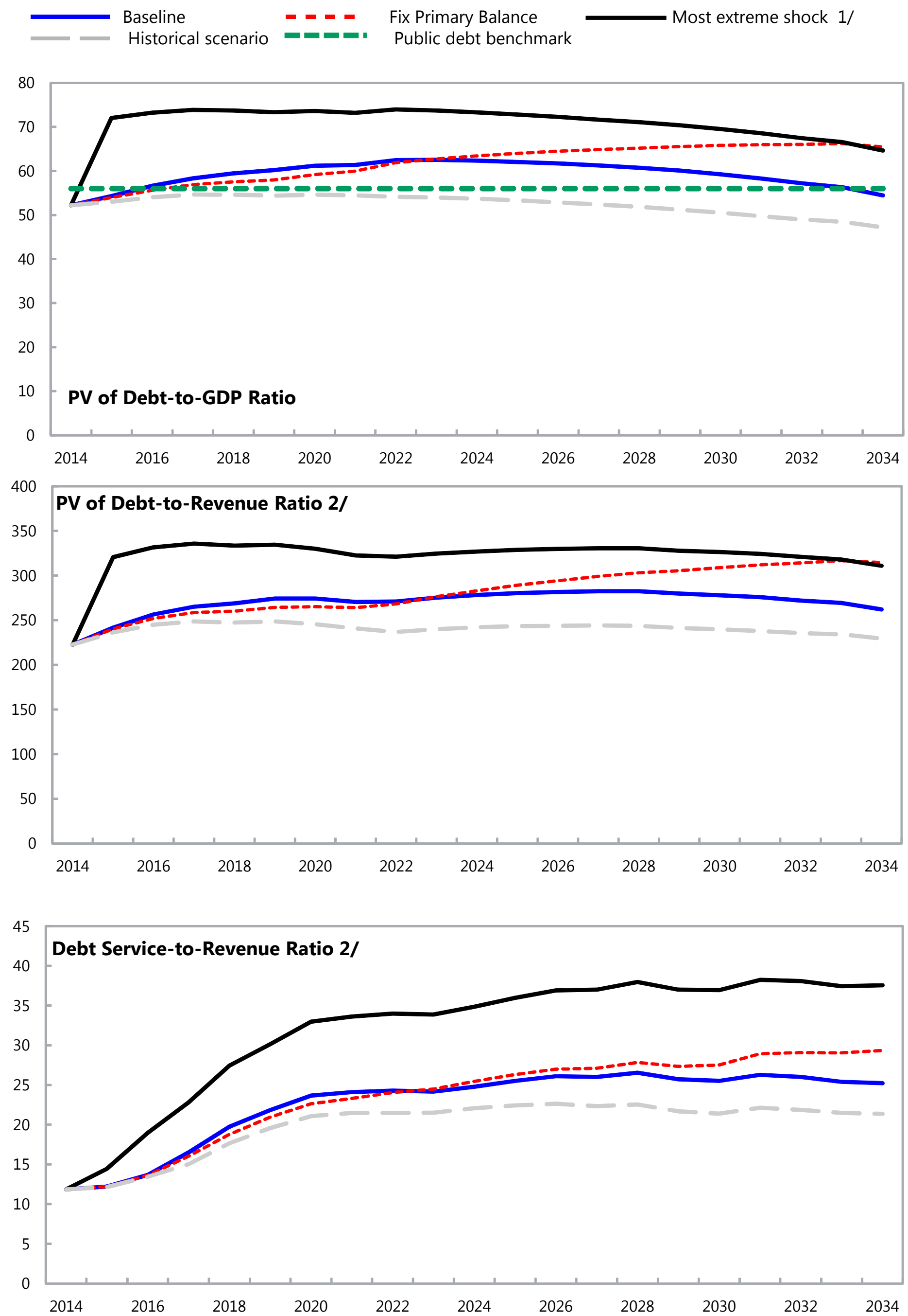
Figure 3. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios 2014–34 1/



Sources: Country authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio on or before 2024.
2/ Revenues are defined inclusive of grants.

Table 1. Lao P.D.R.: External Debt Sustainability Framework, Baseline Scenario, 2011–34 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical 6/ Average	Standard 6/ Deviation	Projections									
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-2019 Average	2024	2034	2020-2034 Average
External debt (nominal) 1/	**76.5**	**79.8**	**84.4**			**90.8**	**91.2**	**87.8**	**83.7**	**78.3**	**73.4**		**60.3**	**47.6**	
of which: public and publicly guaranteed (PPG)	46.7	47.7	48.3			48.5	48.7	47.9	46.9	45.5	44.1		40.5	30.8	
Change in external debt	0.4	3.3	4.6			6.5	0.4	-3.4	-4.1	-5.4	-4.9		-1.9	-1.4	
Identified net debt-creating flows	-1.4	13.3	12.4			13.5	5.3	0.6	-2.2	-3.0	-2.2		-1.6	-1.7	
Non-interest current account deficit	**16.3**	**29.0**	**27.6**	**18.7**	**5.9**	**23.8**	**20.1**	**15.0**	**14.9**	**14.8**	**14.0**		**9.8**	**5.0**	8.1
Deficit in balance of goods and services	16.0	29.6	29.2			26.6	22.1	17.0	17.8	17.7	16.1		11.6	8.5	
Exports	45.5	41.5	43.2			42.2	42.0	43.6	42.9	42.4	41.4		40.2	40.1	
Imports	61.5	71.1	72.5			68.8	64.1	60.6	60.7	60.1	57.5		51.8	48.6	
Net current transfers (negative = inflow)	-2.8	-2.7	-2.2	-2.7	0.4	-3.1	-3.1	-3.1	-3.9	-3.8	-3.3		-3.2	-5.0	-3.6
of which: official	-1.9	-1.8	-1.4			-1.6	-1.6	-1.6	-2.3	-2.2	-1.6		-1.0	-0.3	
Other current account flows (negative = net inflow)	3.1	2.1	0.6			0.3	1.1	1.1	1.0	1.0	1.2		1.3	1.5	
Net FDI (negative = inflow)	**-7.2**	**-6.0**	**-6.3**	**-5.5**	**3.2**	**-5.8**	**-10.1**	**-10.5**	**-13.4**	**-14.7**	**-13.3**		**-9.5**	**-5.3**	-8.9
Endogenous debt dynamics 2/	**-10.5**	**-9.7**	**-9.0**			**-4.5**	**-4.7**	**-3.8**	**-3.7**	**-3.2**	**-2.9**		**-1.8**	**-1.5**	
Contribution from nominal interest rate	1.0	1.2	1.3			1.3	1.2	2.6	2.5	2.4	2.4		2.0	1.4	
Contribution from real GDP growth	-5.2	-5.2	-5.5			-5.8	-6.0	-6.4	-6.2	-5.6	-5.3		-3.8	-2.9	
Contribution from price and exchange rate changes	-6.3	-5.7	-4.7			...	...	...	...	...	...		...	...	
Residual (3-4) 3/	**1.8**	**-10.0**	**-7.9**			**-7.0**	**-4.9**	**-4.1**	**-1.9**	**-2.3**	**-2.7**		**-0.4**	**0.4**	
of which: exceptional financing	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of external debt 4/	...	...	75.8			83.5	84.7	81.9	78.2	73.0	68.1		54.0	41.1	
In percent of exports	...	...	175.3			197.7	201.7	187.7	182.3	172.3	164.4		134.6	102.6	
PV of PPG external debt	**...**	**...**	**39.8**			**41.2**	**42.2**	**42.1**	**41.4**	**40.2**	**38.8**		**34.3**	**24.3**	
In percent of exports	**...**	**...**	**92.0**			**97.6**	**100.5**	**96.4**	**96.5**	**94.9**	**93.6**		**85.3**	**60.7**	
In percent of government revenues	**...**	**...**	**221.3**			**225.4**	**237.0**	**236.5**	**230.2**	**219.2**	**210.2**		**173.3**	**124.1**	
Debt service-to-exports ratio (in percent)	**8.2**	**9.3**	**10.7**			**10.2**	**9.7**	**15.6**	**16.2**	**16.8**	**17.0**		**14.8**	**10.6**	
PPG debt service-to-exports ratio (in percent)	**2.7**	**4.1**	**5.1**			**4.8**	**5.2**	**5.9**	**6.5**	**7.5**	**8.1**		**9.0**	**7.6**	
PPG debt service-to-revenue ratio (in percent)	**7.4**	**9.8**	**12.4**			**11.2**	**12.3**	**14.4**	**15.5**	**17.4**	**18.1**		**18.3**	**15.5**	
Total gross financing need (Billions of U.S. dollars)	1.0	2.5	2.8			2.6	1.8	1.6	1.3	1.2	1.4		1.7	2.3	
Non-interest current account deficit that stabilizes debt ratio	15.9	25.7	23.1			17.3	19.7	18.4	19.0	20.2	18.9		11.7	6.4	
Key macroeconomic assumptions															
Real GDP growth (in percent)	8.0	7.9	8.0	7.8	0.5	7.4	7.2	7.7	7.7	7.4	7.5	7.5	6.6	6.3	6.3
GDP deflator in US dollar terms (change in percent)	9.1	8.1	6.3	9.8	6.0	0.5	2.6	1.3	1.4	2.4	3.2	1.9	1.4	1.3	1.4
Effective interest rate (percent) 5/	1.5	1.8	1.9	1.7	0.3	1.6	1.5	3.1	3.1	3.2	3.4	2.6	3.5	3.1	3.4
Growth of exports of G&S (US dollar terms, in percent)	35.6	6.3	19.6	23.3	17.5	5.4	9.4	13.3	7.4	8.6	8.5	8.8	8.1	8.0	7.5
Growth of imports of G&S (US dollar terms, in percent)	29.2	34.8	17.0	25.4	9.6	2.5	2.4	3.2	9.4	8.8	6.2	5.4	6.9	7.1	6.6
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	9.9	13.2	14.7	15.5	16.2	16.0	14.3	12.6	9.0	11.6
Government revenues (excluding grants, in percent of GDP)	16.6	17.2	18.0			18.3	17.8	17.8	18.0	18.3	18.4		19.8	19.6	19.7
Aid flows (in Billions of US dollars) 7/	0.5	0.6	0.6			0.7	0.7	0.7	0.8	0.8	0.9		0.9	0.8	
of which: Grants	0.5	0.6	0.6			0.6	0.6	0.6	0.6	0.6	0.6		0.7	0.7	
of which: Concessional loans	0.0	0.0	0.0			0.1	0.1	0.1	0.2	0.2	0.2		0.2	0.1	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			5.7	5.4	4.9	4.7	4.5	4.2		3.2	1.5	2.6
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			53.1	53.7	56.3	55.7	53.1	51.2		47.0	35.1	42.5
Memorandum items:															
Nominal GDP (Billions of US dollars)	8.1	9.4	10.8			11.6	12.8	14.0	15.2	16.8	18.6		27.0	57.1	
Nominal dollar GDP growth	17.8	16.6	14.8			7.9	10.0	9.1	9.2	10.0	10.9	9.5	8.1	7.8	7.8
PV of PPG external debt (in Billions of US dollars)			4.2			4.8	5.3	5.7	6.2	6.6	7.1		9.1	13.6	
(PVt-PVt-1)/GDPt-1 (in percent)						5.2	4.7	3.5	3.1	2.9	2.8	3.7	1.7	0.9	1.4
Gross workers' remittances (Billions of US dollars)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
PV of PPG external debt (in percent of GDP + remittances)	...	...	39.8			41.2	42.2	42.1	41.4	40.2	38.8		34.3	24.3	
PV of PPG external debt (in percent of exports + remittances)	...	...	92.0			97.6	100.5	96.4	96.5	94.9	93.6		85.3	60.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	5.1			4.8	5.2	5.9	6.5	7.5	8.1		9.0	7.6	

Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as [r - g - ρ(1+g)]/(1+g+ρ+gρ) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and ρ = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 2. Lao P.D.R.: Public Sector Debt Sustainability Framework, Baseline Scenario, 2011–34

(In percent of GDP, unless otherwise indicated)

	Actual			Average 5/	Standard Deviation 5/	Estimate	Projections								
	2011	2012	2013			2014	2015	2016	2017	2018	2019	2014-19 Average	2024	2034	2020-34 Average
Public sector debt 1/	58.0	59.4	59.1			59.6	60.8	62.5	63.8	64.8	65.5		68.6	61.0	
of which: foreign-currency denominated	46.7	47.7	48.3			48.5	48.7	47.9	46.9	45.5	44.1		40.5	30.8	
Change in public sector debt	-0.3	1.5	-0.3			0.5	1.2	1.8	1.3	1.0	0.7		-0.1	-1.9	
Identified debt-creating flows	-6.2	-6.4	-1.1			-1.0	-0.6	0.1	-0.2	-0.3	-0.5		-1.0	-1.5	
Primary deficit	1.1	1.1	3.9	1.8	1.1	2.8	3.2	3.8	3.5	3.6	3.4	3.4	1.5	0.5	1.3
Revenue and grants	22.6	23.3	23.4			23.4	22.5	22.1	22.0	22.1	21.9		22.4	20.8	
of which: grants	6.0	6.0	5.5			5.2	4.7	4.3	4.0	3.8	3.5		2.6	1.2	
Primary (noninterest) expenditure	23.7	24.4	27.3			26.2	25.7	25.9	25.5	25.7	25.4		23.9	21.3	
Automatic debt dynamics	-7.3	-7.6	-5.0			-3.8	-3.8	-3.7	-3.7	-3.9	-4.0		-2.5	-2.0	
Contribution from interest rate/growth differential	-5.4	-5.0	-4.2			-3.6	-3.9	-4.1	-4.0	-3.6	-3.5		-2.7	-2.2	
of which: contribution from average real interest rate	-1.1	-0.7	0.2			0.4	0.1	0.2	0.5	0.8	1.0		1.6	1.5	
of which: contribution from real GDP growth	-4.3	-4.2	-4.4			-4.1	-4.0	-4.3	-4.5	-4.4	-4.5		-4.3	-3.7	
Contribution from real exchange rate depreciation	-1.9	-2.6	-0.8			-0.2	0.1	0.4	0.3	-0.3	-0.5		...	...	
Other identified debt-creating flows	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	6.0	7.9	0.8			1.5	1.8	1.7	1.4	1.3	1.3		0.8	-0.4	
Other Sustainability Indicators															
PV of public sector debt	...	...	50.5			52.2	54.3	56.6	58.3	59.4	60.2		62.3	54.5	
of which: foreign-currency denominated	...	...	39.8			41.2	42.2	42.1	41.4	40.2	38.8		34.3	24.3	
of which: external	...	...	39.8			41.2	42.2	42.1	41.4	40.2	38.8		34.3	24.3	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	3.8	6.0	12.8			9.0	9.4	10.4	11.4	12.7	13.5		14.5	14.2	
PV of public sector debt-to-revenue and grants ratio (in percent)	...	...	215.6			222.7	241.7	256.6	265.2	268.9	274.4		278.2	262.0	
PV of public sector debt-to-revenue ratio (in percent)	...	...	281.3			285.8	304.9	318.4	324.3	323.9	326.1		315.5	278.1	
of which: external 3/	...	...	221.3			225.4	237.0	236.5	230.2	219.2	210.2		173.3	124.1	
Debt service-to-revenue and grants ratio (in percent) 4/	5.9	8.3	11.7			11.8	12.2	13.7	16.5	19.7	21.8		24.8	25.2	
Debt service-to-revenue ratio (in percent) 4/	8.1	11.2	15.3			15.2	15.4	17.0	20.2	23.8	26.0		28.1	26.8	
Primary deficit that stabilizes the debt-to-GDP ratio	1.3	-0.3	4.2			2.3	2.0	2.0	2.3	2.6	2.7		1.6	2.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	8.0	7.9	8.0	7.8	0.5	7.4	7.2	7.7	7.7	7.4	7.5	7.5	6.6	6.3	6.3
Average nominal interest rate on forex debt (in percent)	0.5	1.3	1.8	1.1	0.4	1.8	2.0	2.6	2.9	3.5	3.8	2.8	4.3	4.5	4.4
Average real interest rate on domestic debt (in percent)	-4.5	-5.0	0.9	-3.0	4.6	3.6	0.3	-1.1	0.7	1.2	1.6	1.1	2.8	2.8	2.8
Real exchange rate depreciation (in percent, + indicates depreciation)	-4.4	-6.0	-1.9	-6.4	7.1	-0.3	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.0	7.7	4.1	6.6	4.9	3.9	5.5	5.5	5.9	6.6	7.0	5.7	5.1	5.1	5.1
Growth of real primary spending (deflated by GDP deflator, in percent)	5.3	11.0	20.9	3.8	7.0	3.1	5.0	8.5	6.3	8.2	6.1	6.2	5.0	5.6	5.1
Grant element of new external borrowing (in percent)	...	...	...	...	...	9.9	13.2	14.7	15.5	16.2	16.0	14.3	12.6	9.0	...

Sources: Country authorities; and staff estimates and projections.

1/ [Indicate coverage of public sector, e.g., general government or nonfinancial public sector. Also whether net or gross debt is used.]

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34

(In percent)

	Projections							
	2014	2015	2016	2017	2018	2019	**2024**	2034
PV of debt-to GDP ratio								
Baseline	41	42	42	41	40	39	**34**	24
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	41	42	44	48	51	54	**65**	66
A2. New public sector loans on less favorable terms in 2014-2034 2	41	41	41	40	39	38	**33**	23
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	41	41	41	41	40	38	**34**	24
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	41	42	45	44	43	41	**35**	24
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	41	41	40	39	38	37	**32**	23
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	41	47	52	51	49	47	**40**	25
B5. Combination of B1-B4 using one-half standard deviation shocks	41	42	42	42	40	39	**33**	22
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	41	59	58	57	56	54	**47**	34
PV of debt-to-exports ratio								
Baseline	98	100	96	96	95	94	**85**	61
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	98	99	101	111	121	130	**162**	164
A2. New public sector loans on less favorable terms in 2014-2034 2	98	98	94	94	93	91	**83**	58
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	98	99	94	94	93	92	**83**	59
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	98	104	113	113	111	110	**98**	66
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	98	99	94	94	93	92	**83**	59
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	98	112	120	119	117	115	**99**	62
B5. Combination of B1-B4 using one-half standard deviation shocks	98	101	101	100	99	97	**86**	57
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	98	99	94	94	93	92	**83**	59
PV of debt-to-revenue ratio								
Baseline	225	237	236	230	219	210	**173**	124
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	225	234	248	265	279	293	**329**	336
A2. New public sector loans on less favorable terms in 2014-2034 2	225	232	230	223	214	205	**169**	119
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	225	233	232	226	216	207	**170**	122
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	225	238	251	244	232	222	**180**	123
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	225	230	223	217	207	199	**164**	117
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	225	264	294	284	270	257	**200**	126
B5. Combination of B1-B4 using one-half standard deviation shocks	225	238	238	231	220	210	**168**	113
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	225	329	327	318	304	291	**240**	171

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2014–34 (concluded)

(In percent)

Debt service-to-exports ratio								
Baseline	5	5	6	7	8	8	**9**	8
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	5	5	5	5	6	6	**7**	8
A2. New public sector loans on less favorable terms in 2014-2034 2	5	5	5	6	7	7	**7**	5
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	5	5	6	7	8	8	**9**	8
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	5	5	7	7	8	9	**11**	9
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	5	5	6	7	8	8	**9**	8
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	5	5	6	7	8	8	**11**	8
B5. Combination of B1-B4 using one-half standard deviation shocks	5	5	6	6	7	8	**9**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	5	5	6	7	8	8	**9**	8
Debt service-to-revenue ratio								
Baseline	11	12	14	16	17	18	**18**	16
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2014-2034 1/	11	11	13	13	14	14	**15**	17
A2. New public sector loans on less favorable terms in 2014-2034 2	11	12	13	14	15	15	**15**	11
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2015-2016	11	12	14	16	18	18	**18**	16
B2. Export value growth at historical average minus one standard deviation in 2015-2016 3/	11	12	14	16	18	18	**19**	16
B3. US dollar GDP deflator at historical average minus one standard deviation in 2015-2016	11	12	14	15	17	17	**18**	15
B4. Net non-debt creating flows at historical average minus one standard deviation in 2015-2016 4/	11	12	15	17	18	19	**22**	17
B5. Combination of B1-B4 using one-half standard deviation shocks	11	12	13	15	16	17	**18**	15
B6. One-time 30 percent nominal depreciation relative to the baseline in 2015 5/	11	17	20	22	25	26	**26**	22
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	36	36	36	36	36	36	**36**	36

Sources: Country authorities; and staff estimates and projections.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline., while grace and maturity periods are the same as in the baseline.
3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly a an offsetting adjustment in import levels).
4/ Includes official and private transfers and FDI.
5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.
6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 4. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public Debt 2014–34

	Projections							
	2014	2015	2016	2017	2018	2019	2024	2034
PV of Debt-to-GDP Ratio								
Baseline	52	54	57	58	59	60	62	54
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	52	53	54	55	55	54	54	47
A2. Primary balance is unchanged from 2014	52	54	56	57	58	58	63	65
A3. Permanently lower GDP growth 1/	52	54	57	59	60	61	64	58
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	52	54	57	59	60	61	63	55
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	52	54	56	58	59	59	62	54
B3. Combination of B1-B2 using one half standard deviation shocks	52	54	55	57	58	59	61	54
B4. One-time 30 percent real depreciation in 2015	52	72	73	74	74	73	73	65
B5. 10 percent of GDP increase in other debt-creating flows in 2015	52	61	63	64	65	65	66	57
PV of Debt-to-Revenue Ratio 2/								
Baseline	223	242	257	265	269	274	278	262
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	223	236	245	249	247	249	242	229
A2. Primary balance is unchanged from 2014	223	240	252	259	260	264	283	315
A3. Permanently lower GDP growth 1/	223	242	257	266	270	277	284	279
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	223	242	258	267	271	276	281	267
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	223	241	253	261	266	271	276	261
B3. Combination of B1-B2 using one half standard deviation shocks	223	238	249	258	263	268	273	259
B4. One-time 30 percent real depreciation in 2015	223	321	332	336	334	334	327	311
B5. 10 percent of GDP increase in other debt-creating flows in 2015	223	272	287	292	294	298	297	273
Debt Service-to-Revenue Ratio 2/								
Baseline	12	12	14	17	20	22	25	25
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	12	12	13	15	18	20	22	21
A2. Primary balance is unchanged from 2014	12	12	14	16	19	21	25	29
A3. Permanently lower GDP growth 1/	12	12	14	17	20	22	25	27
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2015-2016	12	12	14	17	20	22	25	26
B2. Primary balance is at historical average minus one standard deviations in 2015-2016	12	12	14	16	19	22	25	25
B3. Combination of B1-B2 using one half standard deviation shocks	12	12	14	16	18	22	24	25
B4. One-time 30 percent real depreciation in 2015	12	14	19	23	27	30	35	38
B5. 10 percent of GDP increase in other debt-creating flows in 2015	12	12	15	25	21	24	27	27

Sources: Country authorities; and staff estimates and projections.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the square root of the length of the projection period.

2/ Revenues are defined inclusive of grants.

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

STAFF REPORT FOR THE 2014 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

December 15, 2014

Prepared By	Asia and Pacific Department (In consultation with other departments)

CONTENTS

FUND RELATIONS 2

WORLD BANK-IMF COLLABORATION 4

RELATIONS WITH THE ASIAN DEVELOPMENT BANK 6

STATISTICAL ISSUES 7

FUND RELATIONS

(As of October 31, 2014)

Membership Status: Joined on July 5, 1961.

General Resources Account:

	SDR Million	Percent Quota
Quota	52.9	100.0
Fund holdings of currency (Exchange Rate)	52.9	100.0
Reserve Tranche Position	0.0	0.0

SDR Department:

	SDR Million	% Allocation
Net cumulative allocation	50.68	100.00
Holdings	51.07	100.78

Outstanding Purchases and Loans: None

Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved	Amount Drawn
ECF[1]	04/25/2001	04/24/2005	31.70	18.12
ECF[1]	06/04/1993	05/07/1997	35.19	35.19
SAF	09/18/1989	09/17/1992	20.51	20.51

Projected Payments to the Fund[2]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2014	2015	2016	2017	2018
Principal					
Charges/Interest		0.00	0.00	0.00	0.00
Total		0.00	0.00	0.00	0.00

[1] Extended Credit Facility (ECF), formerly PRGF.

[2] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

Exchange Rate Arrangement

The de jure arrangement is floating. The kip slightly depreciated against the U.S. dollar within a 1 percent band from November 2013 to November 2014. Therefore, the de facto arrangement is reclassified retroactively as crawl-like from its previous classification as stabilized. The authorities' objective is to limit currency fluctuations vis-à-vis major currencies, including the U.S. dollar and Thai baht, within ±5 percent per annum. The Bank of the Lao P.D.R. (BOL) sets a daily official reference rate, which is calculated as a weighted average of the previous day's interbank rates. Commercial banks and foreign exchange bureaus are required to maintain their buying and selling rates within ±0.25 percent of the BOL's daily reference rate for the U.S. dollar. For the euro and baht, the buying and selling rates may not exceed a margin of 0.5 percent. For other currencies, a margin of 2 percent applies.

On May 28, 2010, Lao P.D.R. accepted the obligations under Article VIII, Section 2, 3, and 4, following the elimination of one restriction subject to Fund jurisdiction under Article VIII arising from a requirement to obtain tax payment certificates for some transactions. Lao P.D.R. now maintains an exchange system free of restrictions on the making of payments and transfers for current international transactions, except for restrictions imposed solely for the preservation of national or international security notified to the Fund pursuant to Decision No. 144-(52/51).

Article IV Consultation

The last Article IV consultation discussions were held in Vientiane during August 28–September 12, 2013 and were concluded by the Executive Board on November 15, 2013. The staff report (Country Report No. 13/369) was published on December 20, 2013.

Technical Assistance

Over the past three years, Lao P.D.R. has received technical assistance in the areas of customs and tax revenue administration; price statistics; external sector statistics; and the national accounts. A Bangkok-based IMF office was set up in September 2012 to facilitate technical assistance to Lao P.D.R. as well as Myanmar.

Resident Representative

Mr. Sanjay Kalra assumed the Resident Representative post for Vietnam and Lao P.D.R., based in Hanoi, on October 16, 2011.

IMF-WORLD BANK COLLABORATION

The World Bank and the IMF country teams for Lao P.D.R. met on October 21, 2014 to discuss economic issues and outlook and to coordinate the two teams' work for FY2015. The teams were led by Mr. Alain W. D'Hoore (Senior Country Economist, Macro and Fiscal Management Global Practice, World Bank), and Mr. Ashvin Ahuja (IMF Mission Chief for Lao P.D.R.).

The teams agreed that although Lao P.D.R. had made progress on macroeconomic stabilization, significant vulnerabilities remain. While fiscal consolidation has been initiated, more efforts could be made to reduce external vulnerabilities and restore fiscal sustainability. Tighter fiscal and monetary policies, a more flexible exchange rate and strengthened banking supervision will be needed to build international reserves and ensure macro-financial stability. In the longer run, a key challenge is to promote inclusive growth and poverty reduction through more diversification into nonresource sectors and sustainable development of natural resources. Much progress has been made in recent years on product and labor market openness and poverty reduction. Further trade integration will improve the business climate, and promote private investment and institutional reform. Upgrading health and education infrastructure will raise the growth potential and help reduce inequality.

Lao P.D.R.: Bank and Fund Planned Activities in Macro-Critical Structural Reform Areas, October 2013–April 2015

Title	Products	Provisional Timing of Missions	Delivery Date
1.World Bank Program	Poverty Reduction Support Operations (PRSOs)	Third series (10th Operation is under preparation with Identification mission in September 2014)	Implementation throughout fiscal year. PRSO 10 Board discussion expected in FY16
	Customs and Trade Facilitation Project (CTFP) and Lao PDR second Trade Development Facility project (TDF II)	November 2014	Implementation throughout fiscal year TDF2 effective in May 2013
	Hydro-Mining Technical Assistance Project	Ongoing	Additional Financing approved in June 2014. Implementation throughout FY15
	Technical Assistance on improving financial soundness indicators	Ongoing	Implementation throughout FY15
	Lao Statistical Capacity Building Project (LAOSTAT) (focus on economic statistics and macro framework in coordination with IMF TA below)	Ongoing	Implementation throughout FY15
	Analytical work: macroeconomic monitoring (Lao economic monitors), investment climate	Ongoing	Implementation throughout FY15
	Lao Development Report (on human resource development and skills)	Completed	October 2014

Title	Products	Provisional Timing of Missions	Delivery Date
2. IMF Work Program	Periodic staff visits by IMF HQ team and resident representative based in Hanoi	July 2014	June 2015
	Technical Assistance mission on natural resource revenue administration	Completed	December 2013
	Technical Assistance mission on tax administration	Completed	January 2014
	Technical Assistance on bank-supervision and regulations	Completed	December 2013; November, 2014
	Technical Assistance on consumer prices/producer prices	Completed	February 2014
	Technical Assistance on national accounts statistics	Completed	March 2014
	Technical Assistance on monetary policy implementation	Ongoing	Implementation throughout FY15
	Technical Assistance on crisis management	Completed	June 2014
	Article IV Consultation	October 2014	Board discussion January 2015
	TAOLAM assistance on external sector statistics compilation	Regular staff visits	Implementation throughout FY15
	TAOLAM assistance on strengthening fiscal reporting, Government Finance Statistics (GFS)	Regular staff visits	Implementation throughout FY15
	TAOLAM on public financial management - implementation of the cash-based IPSAS	Regular staff visits	Implementation throughout FY15
	TAOLAM on macroeconomic framework	Regular staff visits which started in October 2013.	Implementation throughout FY15
3. Joint Work Program	External Debt Sustainability Analysis	October 2014	November 2014

RELATIONS WITH THE ASIAN DEVELOPMENT BANK

The Asian Development Bank's (AsDB) current Country Partnership Strategy (CPS) 2012-2016 is aligned with the government's Seventh Five-Year National Socio-Economic Development Plan, 2011–2015. It promotes inclusive and sustainable growth and poverty reduction through (i) engagement in four priority sectors (agriculture, natural resources and rural development; education; energy; and water and other urban infrastructure and services); and (ii) more effective private sector development, gender equity, public sector management and regional cooperation and integration as crosscutting concerns. The CPS aims to maximize efficiency and sustainability through larger operations implemented over a longer period; maximize synergies with the implementation of Greater Mekong Subregion (GMS) strategic framework 2012–22; and also increase responsiveness to emerging issues in a rapidly changing economy. The performance-based allocation of the Asian Development Fund (ADF), based on the country performance assessment (CPA) finalized in 2012, provided Lao P.D.R. with an ADF allocation in the amount of US$156.01 million for the biennial period 2013–14. The CPA for the next allocation period (2015–16) will be finalized by the end of 2014.

As of end-2013, outstanding loans/grants approved stood at US$715.0 million, of which amount of US$368.3 million was awarded for contracts. During 2013, US$76.4 million was disbursed and US$102.6 million of contracts were awarded. ADB approved three new loan projects and four new technical assistance (TA) projects for a total of US$115 million and US$2.5 million in 2013 respectively, including water supply and sanitation, GMS rural infrastructure development and private sector development program; TA projects related to health and road sector governance, smallholder, and support for improved aid effectiveness.

Lao P.D.R.: Asian Development Bank Commitments and Disbursements, 2003–13 1/
(In millions of U.S. dollars)

	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013 2/
Commitments	34.9	54.8	87	60.7	47.4	46.6	81.2	55.3	53.2	73.65	102.6
Disbursements	54.7	48.5	78.7	76.8	74.8	56.9	75.9	61.5	73.2	68.6	76.4

Source: Data provided by the Asian Development Bank.

1/ Starting from 2006, the commitments and disbursements included both loans and grants.
2/ The commitments and disbursements were estimated for 2013.

STATISTICAL ISSUES

LAO PEOPLE'S DEMOCRATIC REPUBLIC—STATISTICAL ISSUES APPENDIX As of December 3, 2014
I. Assessment of Data Adequacy for Surveillance
General: Data provision has serious shortcomings that significantly hamper surveillance, especially regarding national accounts, government finance, monetary and financial and external sector statistics. These shortcomings are mostly due to lack of capacity, which could be addressed through further efforts on the part of the agencies involved. The IMF is conducting technical assistance (TA) and training programs to address the specific needs with a focus to mitigate near-term risks, covering the areas of national accounts, prices, government finance statistics, monetary and financial statistics, and external sector statistics.
National Accounts: National accounts (NA) comprise annual estimates of GDP by activity at current and constant prices (base year=2002), broadly following the *System of National Accounts (SNA) 1993*. Lao P.D.R. participated in the IMF's Statistics Department (STA) project to implement the SNA and International Comparison Project (ICP), funded by the government of Japan through the Japan Administered Account for Selected Activities (JSA), and has received technical assistance (TA) to improve annual national accounts and develop quarterly national accounts (QNA). Under this project, Lao PDR made some methodology improvements in the annual GDP by activity estimates, including good progress in updating the base year from 2002 to 2010, and has moved closer to completing a new annual expenditure measure of GDP and a preliminary GNI series, Some progress had also been made toward the development of a new quarterly GDP series. Under a new JSA funding Project, a Real Sector Statistics Advisor for Lao P.D.R. and Bangladesh, stationed in the latter country, was appointed in January 2014 to assist with the improvement of national accounts.
Price Statistics: Lao P.D.R. compiles a monthly CPI (December 2010=100) using weights based on the 2007/08 Lao Expenditure and Consumption Survey. An update on the weights is expected for this year to be implemented in 2016 CPI collection. A producer price index (PPI) is under development and is planned for availability in March 2015. Data from the 2012 economic census will be used to develop its weights and as the basis for selecting a sample of establishments. The PPI coverage is currently restricted to mining and quarrying, manufacturing, and electricity and will be progressively expanded to cover tourism, construction activities, agriculture, services and other activities.
Government Finance Statistics: Government finance statistics remain weak. The timeliness of fiscal reporting needs significant improvement. Off-budget activities are not included in the fiscal data, although they have expanded rapidly in recent years. Annual budget and outturn data formats do not follow international standards for government finance statistics. Except for the annual data disseminated in the Official Gazette, no fiscal data are disseminated in the country. A mission took place during March 2014 funded by the Government of Japan through the Japan Administered Account for Selected IMF activities (JSA) to further assist the Fiscal Policy Department (FPD) of the Ministry of Finance (MoF) in upgrading the compilation and dissemination procedures of GFS data for Lao P.D.R. in line with the ongoing migration to the GFSM 2001. The JSA has also financed a resident advisor to assist and guide the updating and implementing of the GFSM 2001 (GFSM 2014) migration action plans by providing training on GFS, by promoting interaction of government

agencies in the development of GFS, and by coordinating the GFS reporting with other fiscal reporting activities. The authorities will be assisted in disseminating GFS data on their websites and reporting the data for publication.
Monetary and Financial Statistics: The classification of monetary data by institutional sector and by financial instrument as well as valuation principles need to be strengthened. The latest monetary data reported to STA refer to December 2010. The Standardized Report Forms (SRFs), which embody the IMF-recommended framework for compiling monetary statistics, have yet to be introduced. STA conducted a one-week training course for the Bank of Lao in February 2014, to build the capacity of the monetary compilers. **Financial sector surveillance:** Financial sector surveillance: Lao P.D.R. does not produce Financial Soundness Indicators (FSIs) yet.
External sector statistics: STA appointed an External Sector Statistics (ESS) Advisor to the Technical Assistance Office for Lao P.D.R. and Myanmar (TAOLAM) in February 2014. Since then, the Advisor has conducted three missions, which focused mainly on trade. The missions assisted in reconciling the discrepancy between imports data published by the Bank of Lao and imports derived from partner countries' data in the Direction of Trade Statistics and found that the use of minimum prices to value vehicles and petroleum imports might explain some of the differences. In addition, several balance of payments components are missing due to the lack of source data. The BOL balance of payments compilers have designed an FDI survey questionnaire in the context of the World Bank's LAOSTAT-Strengthening the National Statistical System Project. Coordination on FDI is needed as the European Union has also appointed an expert to assist on FDI statistics. Implementation of the new international transactions reporting system (ITRS) is ongoing and testing of the new ITRS is expected by June 2015. The BOL does not yet compile an international investment position statement.

II. Data Standards and Quality	
Lao P.D.R. is currently not a General Data Dissemination System (GDDS) participant. The government has expressed its intention to collaborate with the IMF in moving Lao's macroeconomic statistics closer to the international standards, including to join the IMF's GDDS, and use it as a framework for development of the national data compilation and dissemination practices. No Data ROSC mission has been conducted.	

Table of Common Indicators Required for Surveillance

As of November 26, 2014

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	11/25/14	11/25/14	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	August 2014	10/21/14	M	I	Q
Reserve/Base Money	August 2014	10/21/14	M	I	Q
Broad Money	August 2014	10/21/14	M	I	Q
Central Bank Balance Sheet	August 2013	10/21/14	M	I	Q
Consolidated Balance Sheet of the Banking System	August 2013	10/21/14	M	I	Q
Interest Rates[3]	September 2014	10/21/14	M	M	M
Consumer Price Index	October 2014	11/02/14	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	September 2014	10/21/14	I	I	I
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government	September 2014	10/21/14	Q	I	M
Stocks of Central Government and Central Government-Guaranteed Debt[6]	December 2013	10/21/14	NA	NA	NA
External Current Account Balance	Q2 2014	10/21/14	Q	I	I
Exports and Imports of Goods and Services	Q2 2014	10/21/14	Q	I	I
GDP/GNP	2012/13	10/21/14	A	A	A
Gross External Debt	Dec 2013	10/21/14	A	A	I
International Investment Position[7]			NA	NA	NA

1 Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

2 Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency, but settled by other means.

3 Both market-based and officially determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.

4 Foreign and domestic bank, nonbank financing.

5 The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

6 Including currency and maturity composition.

7 Includes external gross financial asset and liability positions vis-à-vis nonresidents.

Statement by the Staff Representative on Lao People's Democratic Republic
January 14, 2015

1. This statement provides information that has become available since the staff report was circulated to the Executive Board on December 17, 2014. This information does not alter the thrust of the staff appraisal.

2. Real GDP growth was 7.8 percent (y/y) in fiscal year 2014 (October 2013–September 2014). For calendar year 2014, growth is estimated at around 7½ percent, broadly in line with staff's forecast.

3. Inflation edged down slightly on a year-on-year basis to 2.8 percent in November (3.0 percent in October), reflecting slowing nonfood price increases and lower energy prices. Inflation in 2014 is likely to be slightly lower than staff's forecast.

Press Release No. 15/78
FOR IMMEDIATE RELEASE
February 26, 2015

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes Article IV Consultation with Lao People's Democratic Republic

On January 14, 2015, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Lao People's Democratic Republic.

Real GDP growth is expected to moderate from 8 percent in 2013 to 7½ percent in 2014. Domestic activity has slowed, and credit growth has declined from excessive levels. Inflation has declined to 3 percent from 6½ percent at end-2013, largely due to weaker food and fuel price momentum. However, the current account deficit is expected to remain large at 25 percent of GDP in 2014; and, at 1 month of prospective imports of goods and services, international reserves (US$0.7 billion, August 2014) do not offer adequate protection against external shocks. Bank balance sheets are showing signs of weakness, with rising nonperforming loans (NPL) and weaker capital and profitability. Public and publicly guaranteed debt (excluding arrears) is projected at 60 percent of GDP in nominal terms (52 percent of GDP in present value terms) in 2014.

As growth continues to moderate in the near term, inflation is projected to remain in the mid-single digits. The current account deficit is projected to improve to about 21 percent of GDP in 2015, but with lower capital inflows, reserves would rise only slightly to 1¼ months of imports. Risks are on the downside. A more expansionary fiscal stance would worsen the external position. The economy is also exposed to external shocks, notably a regional growth slowdown and a deterioration in terms-of-trade and capital inflows. With a thin reserves cushion, these shocks could force large movements in the exchange rate, leading to debt defaults, and undermining growth, financial stability, and fiscal sustainability.

Following a sharply expansionary and procyclical stance in 2013, the authorities started to tighten fiscal policy in 2014, mainly through curbs on civil service compensation and capital spending cuts. Public investment cuts have helped limit the Bank of Lao P.D.R.'s quasi-fiscal lending and lower private credit growth. Strict enforcement of regulation on banks' net open foreign exchange positions and the limits on foreign-currency lending has helped reduce foreign-

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

currency liquidity risk at banks. However, excess kip liquidity in the banking system has risen, and greater exchange rate flexibility, observed in the second half of 2013, has not resumed.

After years of rapid credit growth, financial stability concerns are coming to the fore. Accumulation of public investment arrears has led to losses in the business sector, with impact on banks. The system's nonperforming loan ratio (NPL) is estimated to have doubled during the first half of 2014. In the same period, state-owned banks' average NPL is reported to have increased from 2 percent to about 8 percent, with average capital-to-asset ratio declining to 3 percent. Direct exposure to foreign currency through lending and deposits remain high, with the foreign-currency shares in total lending and deposits standing at 48 percent, down from 50 percent in 2013.

Executive Board Assessment[2]

The Executive Directors welcomed policy corrections initiated by the Lao P.D.R. authorities and the progress made in macroeconomic stabilization in the past year. Directors nevertheless noted that the economic outlook remains clouded by significant vulnerabilities in the external, fiscal, and financial sectors. A regional growth slowdown, deterioration in global metal prices, and capital flow volatility continue to pose external risks. To address these vulnerabilities, Directors emphasized the need for continued fiscal consolidation, greater exchange rate flexibility, tighter monetary conditions, strengthened financial supervision, and improved bank resolution and crisis prevention frameworks.

Directors considered that a more ambitious medium-term fiscal consolidation anchored around a nonmining deficit target of no more than 5 percent of GDP would help strengthen the external position and reduce public debt. While welcoming recent progress in fiscal consolidation, Directors stressed the need to ensure steady consolidation into the medium term and create space for well-targeted social and capital spending and possible banking sector contingent liabilities. In this regard, they recommended further revenue mobilization, the rationalization of current and off-budget capital expenditures, and containing public sector employee compensation, including by accelerating civil service reform. Directors also encouraged enhanced fiscal transparency and strengthened public financial management, including the elimination of fiscal arrears.

Directors recommended letting the exchange rate move more flexibly within the official band, supported by the tightening of kip liquidity, with interventions limited to preventing excessive exchange rate volatility. They noted that this approach would avoid a potentially destabilizing devaluation, given the risk from currency mismatches; help contain inflation; and support interbank market functioning.

[2] At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Directors welcomed measures to improve foreign currency liquidity at banks, but noted increasing financial stability concerns from growing credit impairment and undercapitalization at state-owned banks. They recommended prompt recognition of nonperforming loans, the phasing out of regulatory forbearance, strengthening supervisory and lending practices, and recapitalizing state-owned banks to help safeguard macro-financial stability. Technical and capacity-building assistance from the Fund would be helpful in this regard. Directors welcomed the passage of the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) law, and advised full implementation of the action plan agreed with the Financial Action Task Force.

Directors emphasized the need for more resources to enhance the quality, availability, coverage, and publication of economic and financial data, and encouraged the authorities to request further Fund technical assistance in this regard.

Directors welcomed progress on product and labor market openness and gains in poverty reduction. To support more inclusive and broad-based growth, they recommended further trade integration and improvements in education and health infrastructure. Directors noted that the benefits of financial deepening and financial access by small and medium-sized enterprises could be enhanced through the adoption of a clear and unified accounting framework; strengthened creditors' rights, credit analysis, and financial transparency; and implementation of an effective debt resolution process.

Lao P.D.R.: Selected Economic and Financial Indicators, 2010–15[1/]

	2010	2011	2012	2013	2014	2015
				Est.	Proj.	
GDP and prices (percentage change)						
Real GDP growth	8.1	8.0	7.9	8.0	7.4	7.2
CPI (annual average)	6.0	7.6	4.3	6.4	4.3	5.0
CPI (end year)	5.8	7.7	4.7	6.6	3.6	5.6
Public finances (in percent of GDP)						
Revenue and Grants	22.6	22.4	24.1	23.9	23.6	22.5
Of which: Resources	2.6	3.4	3.9	3.0	2.8	2.3
Of which: Mining	1.8	2.5	3.2	2.2	2.0	1.6
Of which: Hydro power	0.8	0.9	0.7	0.8	0.7	0.8
Of which: Grant	6.7	6.0	6.4	5.7	5.3	4.8
Expenditure	25.9	24.1	24.6	29.6	27.9	27.2
Expense	11.2	11.3	12.0	17.3	15.5	16.2
Net acquisition of nonfinancial assets 2/	14.6	12.9	12.6	12.3	12.3	10.9
Overall balance	-3.2	-1.7	-0.5	-5.6	-4.2	-4.7
Nonmining balance 3/	-5.0	-4.3	-3.7	-7.8	-6.3	-6.2
Money and credit (annual percent change)						
Reserve money	48.6	16.2	27.2	7.7	22.6	20.8
Broad money	39.5	28.7	31.0	17.0	16.6	23.7
Bank credit to the economy 4/	48.4	45.8	26.6	34.5	15.7	23.8
Bank credit to the private sector	48.4	39.3	35.1	36.3	14.0	24.0
Balance of payments						
Exports (in millions of U.S. dollars)	2,196	3,120	3,323	3,882	4,119	4,498
In percent change	44.4	42.1	6.5	16.8	6.1	9.2
Imports (in millions of U.S. dollars)	3,574	4,635	6,340	7,283	7,604	7,756
In percent change	23.6	29.7	36.8	14.9	4.4	2.0
Current account balance (in millions of U.S. dollars)	-1,369	-1,393	-2,838	-3,123	-2,913	-2,726
In percent of GDP	-20.0	-17.3	-30.2	-28.9	-25.0	-21.3
Gross official reserves (in millions of U.S. dollars)	728	677	740	662	750	870
In months of prospective goods and services imports	1.8	1.2	1.1	1.0	1.1	1.2
External public debt and debt service						
External PPG debt						
In millions of U.S. dollars	3,348	3,769	4,500	5,092	5,601	6,118
In percent of GDP	48.1	46.7	47.7	48.3	48.5	48.7
External PPG debt service						
In percent of exports	4.3	2.6	4.0	5.1	4.8	5.2
Exchange rate						
Official exchange rate (kip per U.S. dollar; end-of-period)	8,066	8,019	7,982	8,030	…	…
Real effective exchange rate (2005=100)	125.4	128.3	133.8	141.7	…	…
Nominal GDP						
In billions of kip	56,523	64,727	75,251	84,572	94,340	106,655
In millions of U.S. dollars	6,842	8,062	9,400	10,788	11,642	12,801

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Public finances are on a fiscal year (October to September) while other data are on a calendar year.
2/ Includes off-budget investment expenditures.
3/ Net lending/borrowing excluding mining revenue.
4/ Includes Bank of Lao P.D.R. lending to state-owned enterprises and subnational levels of government.

Statement by Mr. Wimboh Santoso, Executive Director for Lao P.D.R. and Mr. Ram Kharel, Advisor to Executive Director

January 14, 2015

Background

1. On behalf of the Lao authorities, we would like to thank the mission team for the constructive policy discussions and invaluable advices provided during the 2014 Article IV consultation. As the country's seventh five-year National Social and Economic Development Plan (7th NSEDP, 2011-15) will end this year, the policy discussion remains extremely useful not only to strengthen macroeconomic stability, but also to frame a new plan so as to overcome remaining obstacles to achieve the 2015 MDG targets and graduate the country from the LDC status by 2020 (Vision 2020).

2. The staff appreciates the authorities' effort of maintaining strong growth over the years while preserving macroeconomic stability. They also outline economic challenges and risks facing the country and the appropriate policy measures to be considered in the report. Our authorities broadly agree with the major thrust of the staff's appraisal contained in the report and will thoughtfully consider the recommendations therein. In general, they remain committed to pursue structural reforms and enhance business environment so as to foster private and foreign investments. They are also mindful that the broad-based and inclusive growth underpinned by domestic and external macroeconomic stability play important roles in raising general living standards, achieving further progress in poverty reduction and meeting the MDG goals.

Recent Economic Development and Outlook

3. Despite the weaker global growth and external uncertainties, Lao PDR has been able to maintain strong growth since a decade on the back of flourishing mining sector and hydropower projects, attracting large foreign investment inflows. Economic growth, however, has slightly moderated to 7.8 percent in FY 2014, from 8.0 percent in 2013 and 7.9 percent in 2012 on the account of weakening mining sector due mainly to moratorium of new mining projects coupled with declining global metal prices. Fiscal consolidation policies, together with tightening credit expansion, have played important roles to moderate growth in 2014.

4. The economic growth in 2015 is projected at 7.5 percent on the account of increasing industrial and service sector by 9.0 percent and agriculture by 3.0 percent, closed to the staff's projection of 7.2 percent. On the other hand, the CPI inflation had been under control at 2.8 percent in November 2014 from 6.6 percent a year ago, largely due to weaker food and fuel prices momentum. It is expected to moderate at 5.6 percent in 2015.

5. Fiscal consolidation remained a priority in 2014 given stress in foreign exchange reserves and rising public debts. As such, budget deficit declined to 4.2 percent of GDP in 2014 from 5.6 percent of GDP a year ago given the authorities effort of maintain public

spending close to the target and strengthening public revenue. They plan to maintain the budget deficit around at 4.7 percent of GDP in 2015 by mainly containing recurrent expenditure, stepping up efforts in improving tax administration and strengthening public financial management system.

6. Given the BOL's prudent monetary policy with foreign exchange market intervention when necessary, the exchange rate has remained broadly stable in recent years. As such, the Kip has appreciated only by 3.5 percent in nominal effective term and 5.0 percent in real term in 2014 compared to that a year ago. The authorities confirm that the appreciation is broadly in line with the movement of regional currencies and remains flexible within the target band. They have also carefully monitored and observed the phenomenon in the parallel exchange market, which has been traded at a premium over the Bank of the Lao PDR's reference rate since August 2013.

7. Because of authorities' focus on strengthening export together with moderating import growth due to slow down in bank credits, the current account deficit has been gradually decreased from 30.2 percent since 2012. It is expected to come down to 25 percent of GDP in 2014 and further to 21.3 percent of GDP in 2015 respectively. It will help to strengthen the foreign exchange reserve to a more comfortable level in the medium term.

8. The authorities reiterate their commitment to pursue structural reform and attract quality foreign investments in order to drive sustainable development and more diversified economy. In conjunction with this effort, the government has suspended temporarily new land concessions for gold and copper mining projects until the review and evaluation of the existing projects are completed. Such assessment will ensure compliance with regulations and maximize its benefit to meet socio-economic development objectives.

9. The authorities share staff's views that several emerging challenges could pose downside risks to the economic outlook, and put macroeconomic and financial stability in the high priority agenda going forward. They generally agree that policy tightening may be warranted to address potential pressures on the external position. To this end, the authorities will stay vigilant on any possible external shocks and stand ready to respond as appropriate.

Fiscal Policy

10. The Lao authorities recognize the importance of fiscal prudence and concur that fiscal consolidation is crucial for preserving macroeconomic stability and public debt sustainability. They are mindful that steps to rebuild fiscal buffers are needed to ensure fiscal sustainability. In this regard, they have adopted expenditure rationalizing measures together with introducing a series of other fiscal measures to address fiscal challenges, initiated by amending value-added tax and accounting laws, revising customs and budget laws, and related rules and regulations.

11. On the expenditure side, curtaining the recurrent expenditure and fostering capital and social expenditure remain key priorities of the authorities. In this regard and given higher rise in wages and salaries than expected in late 2013, they have suspended wage rise in civil services that was initiated earlier and also set quota for new recruitment in public services. They have constituted a high level committee to quantify and resolve arrears and debts related to public infrastructure projects so as to streamlining expenses.

12. On the public investments, the government has streamlined expenditures by avoiding low-priority current expenditures and restrained state infrastructure development projects that are commissioned by local governments, financed by private contractors and repaid by the government upon completion of the projects. The authorities are in the process of reviewing procurement procedures and strengthen project management regulations according to the State Investment Law.

13. On revenue front, the authorities are in the process of mapping out strategies to intensify its revenue collection and widen tax base. Revenue collection has been strengthened by enforcing compliance with investment promotion law regarding tax and duty exemption and VAT deductibles, as well as focusing on large taxpayers and taxes on vehicles, petrol and luxury goods.

14. Over the medium-term, the authorities recognize that challenges remain in securing a more sustainable revenue stream especially from non-resource sectors and enhancing the capacity on public financial management. In this regard, they have undertaken sizable investments to upgrade technology in the tax offices and enhance staff's capabilities so as to strengthen revenue mobilization. They have also recently changed valuation method for automobile, fuel imports and luxury goods from reference price system to an actual transaction price system which, together with effective tax surveillance, is expected to enhance revenue mobilization going forward.

15. The authorities are committed to keep public debt on a sustainable path and target to reduce level of external debts to be less vulnerable to external shocks. The Debt Management and Financial Analysis System (DMFAS) have been rolled out to enhance public debt data recording and strengthen debt management capacity. The Presidential Decree Law on Public Debt Management is also expected to be approved by the Lao National Assembly.

Monetary and Exchange Rate Policies

16. The BOL aims to attain the price and exchange rate stability with setting annual target band for the exchange rates and the reference rates for commercial banks. In doing so, the BOL aims to limit currency fluctuations vis-à-vis major currencies within ±5.0 percent per annum. Commercial banks and foreign exchange bureaus are required to maintain their buying and selling rates within ±0.25 percent of the BOL's daily reference rates for US dollar, within ±0.5 percent for Euro and Thai Baht and within ±2.0 percent for other currencies.

17. The authorities welcome staff's assessment that the BOL's commitment to keep the exchange rates within a reasonably wide and adjustable band has provided an anchor for macro-financial stability. However, they are cautious with the staff's recommendation to tighten monetary conditions given slowdown in credit growth from 34.5 percent of GDP in 2013 to 15.7 percent in 2014 with having relatively low level of inflation.

18. Realizing the importance of safeguards against external uncertainties, the BOL has continued stepping up their efforts to strengthen international reserves. Measures that have been implemented include suspension of foreign currency lending to local governments and state-owned enterprises since last few years, collecting outstanding loans, and intensifying enforcement of foreign currency related regulations. In addition, the authorities are taking steps to enhance the mechanism for regulating foreign exchange transactions to be able to monitor daily trading activities in a more real-time basis.

19. As the current account deficit has been reducing gradually since 2012, the authorities are optimistic in maintaining adequate foreign exchange reserves to cover imports at least for 5 months by the end of 2015. While actual data is not comprehensive, the authorities urge staff to be cautious in using trading partners' export data as proxy for Laos' import, as a significant part of the unrecorded import content is re-exported to other countries. That said, the authorities agreed that there could be scope for exploring the discrepancy in the measurement of imports and enhancing the authorities' data collection system.

Financial Sector

20. Banking sector in Lao PDR remains sound with strong capital base, ample liquidity, andlow level of NPLs. While the credit growth has significantly slowed down in 2014, the BOL is aware of potential risks from rapid credit growth in the past, thus has tightened prudential regulation for banks to closely monitor credit quality and to ensure good quality underwriting standard, especially for banks with NPL ratio of more than 3%. Regulations to control single lending limits to mitigate concentration risk and prohibit connected lending to shareholders, directors and subsidiaries have also been issued.

21. The authorities are in the process of adopting Basel II capital standard with technicalsupport from the WB and the Bank of Thailand. In this context, supervisory capacity and regulatory framework are being strengthened to preserve a safe and sound banking system. These efforts along with ongoing enhancement of the regulatory framework under the ASEAN Banking Integration Framework will help to improve banking capacity and enhance financial stability. More importantly, the AML/CFT law has recently been approved by the National Assembly, which has helped to enable business environment and strengthened public confidence in the banking system.

22. Improving money and capital market remain priority to strengthen transmission mechanism of monetary policy. In this context, our authorities are in the process of creating FX trading monitoring system, promoting active interbank market, and strengthening financial market. They have introduced *End of Day Liquidity Management*

Program (EoDLMP) since May 2014 so as to ensure adequate liquidity in the banking system. Introducing regulations related to the derivative markets are underway.

23. Taking into account of the growing numbers of banking institutions with limited regulatory and supervisory capacity at the BOL, the authorities have temporarily suspended new licenses to private banks until 2016, when the overall performance assessments of the banking sector and craft new licensing policy are completed.

Structural Reform

24. The authorities have made significant progress on structural reforms in recent years where several laws and regulations including those related to AML/CFT, import licensing, custom valuation, investment, technical barriers to trade, as well as intellectual property right have been enacted. The authorities also continue their efforts in simplifying business start-up procedures, notably with the establishment of a one-stop shop to coordinate the application for foreign investment in the country. Electronic data interchange system has been modernized to better facilitate cross-border trades. Our authorities believe that these initiatives will create conducive business climate to more broad-based and inclusive growth.

25. Lao authorities are paying attention to strengthen macroeconomic and financial sector statistics for conducting economic surveillance to formulating appropriate and timely policy responses. Efforts have been made to improve the compliance with international guidelines in official statistics and the reporting system. In this regard, the authorities welcome the Fund's technical assistance to enhance statistical capacity going forward.

Conclusion

26. With the most successful implementation of the 7th national socio-economic plan, our authorities are in the process of crafting new plan to address the remaining bottlenecks in achieving LDC graduation by 2020. The authorities are, however, aware of many challenges ahead and intend to gear up the efforts to embark from the LDC by enhancing business environment, improving efficiency of public services, and reforming public financial management. They also intend to build up necessary fiscal and monetary policy space as well as strengthen banking regulatory and supervisory framework together with enhancing access to financial services.

27. Finally, our authorities welcome constructive policy dialogue with the mission team and wish to thank the Mission Chief, Mr. Ahuja, and his team for the comprehensive reports and useful policy suggestions. On behalf of the authorities, let me also express high appreciation to the Fund for their continuing support to the authorities.