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Lao People's Democratic Republic: 2009 Article IV Consultation—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2009 Article IV consultation with Lao People's Democratic Republic, the following documents have been released and are included in this package:

- The staff report for the 2009 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 27, 2009, with the officials of Lao People's Democratic Republic on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 24, 2009. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

- A staff supplement of on the joint World Bank/IMF debt sustainability analysis.

- A Public Information Notice (PIN) summarizing the views of the Executive Board as expressed during its July 10, 2009 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Lao P.D.R.: Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2009 Article IV Consultation

Prepared by the Staff Representatives for the 2009 Article IV Consultation
with the Lao People's Democratic Republic

Approved by Shogo Ishii and Dominique Desruelle

June 24, 2009

- **Discussions:** Held in Vientiane during May 13–27 with Bank of Lao P.D.R. Governor Khamphounvong, Deputy Minister of Finance Siphandone, Deputy Prime Minister and Standing Member of Government Lengsavat, other senior officials, and private sector and donor representatives.

- **Team:** Ms. Baker (Head), Mr. Ree, Ms. Bi (all APD), and Mr. Shin (FAD), and was assisted by Mr. Bingham (Senior Resident Representative) and Mr. Ngaosrivathana (Country Manager). Mr. Gil Sander and Ms. Vostroknutova (both World Bank) worked with the team on the debt sustainability analysis, in collaboration with Mr. Liu (AsDB). Ms. Vongpradhip and Mr. Nget (both OED) participated in policy meetings.

- **Context of past surveillance:** The conduct of fiscal policy has been broadly in line with past advice. Fiscal transparency would be improved by bringing rapidly increasing extra-budgetary expenditure on budget. Advice on monetary operations, including moving toward basic market-based instruments for domestic liquidity management, has had less traction. On the banking sector, the reform program has advanced broadly in line with past advice; however, the recent surge in credit growth risks unraveling gains.

- **Exchange arrangement:** Other floating, with no exchange restrictions under the transitional arrangements of Article XIV, section 2. Lao P.D.R. maintains restrictions for the preservation of national or international security notified pursuant to Decision No. 144-(52/51) and a restriction subject to IMF approval under Article VIII. Draft implementing instructions for the Decree on Foreign Exchange Management remove the tax certification requirement, paving the way for Article VIII acceptance—approval is expected in mid-2009.

- **Data:** Serious shortcomings that hamper surveillance, with the balance of payments and national accounts statistics most in need of strengthening.

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EXECUTIVE SUMMARY

Over the past five years, the Lao P.D.R. economy has performed well, but the impact of the global crisis is now being felt. The largest impact has been on the mining sector, but delays in hydropower projects are also evident—foreign currency inflows have slowed considerably. Growth is expected to moderate, but remain fairly robust, supported by large projects in train, strong mineral exports, and expansionary policies. Inflation is expected to remain low and stable, assuming no significant pick up in commodity prices. However, overly expansionary fiscal and credit policies pose a risk to macroeconomic stability. The external position is weakening, with international reserves steadily declining.

Provided that macroeconomic stability is maintained and structural reforms are accelerated, the medium-term outlook is positive. As the global crisis works itself out, investments in the mining and hydropower sectors would resume. Activity in the broader economy is also expected to pick up, assuming that reforms to strengthen the foundations of the economy are pushed forward. Although the external current account deficit is expected to widen again as investment-related imports rise, this would be more than offset by increased foreign direct investment and other capital inflows—the external position would strengthen, with international reserve coverage gradually returning to current levels.

Discussions focused on policies to safeguard macroeconomic stability while supporting growth. The authorities noted the temporary nature of the policy easing, and emphasized the importance of achieving their ambitious growth target. There was broad agreement on the medium-term structural reform agenda to strengthen the banking sector and improve the business climate.

Prompt tightening of policies is required in the near term to reduce pressure on the external position.

- Fiscal adjustment should aim to eliminate the sizeable domestic financing gap and halt the rise in quasi-fiscal liabilities. Off-budget operations and their financing should be brought on budget—in this context, the Bank of Lao P.D.R. advances and loans to lower levels of government should be curtailed. The 2009/10 budget should target a larger and more permanent adjustment.

- Strong signals should be sent to banks to rein in credit growth, including through a significant increase in the required reserve ratio. This would not only help take pressure off international reserves, but also avoid the building up future contingent liabilities of the state-owned commercial banks in light of continued weakness in risk management practices and slowing economic activity.

I. GLOBAL AND DOMESTIC CONTEXT

1. **Over the past five years, the Lao P.D.R. economy has performed well.** Aided by a booming global economy, large foreign direct investment (FDI) flows into the mining and hydropower sectors stoked robust growth, with trade and retail services, light manufacturing, and the nascent tourism industry also contributing. Stable macroeconomic conditions and reforms to further the transition toward a market-based economy helped improve the environment for economic development. Steady progress on poverty reduction has been made, although there are indications that greater efforts are required to meet a number of MDGs.[1]

2. **While Lao P.D.R. has been weathering the global crisis better than many countries in the region, the impact is being felt.** Project delays have led to a reduction in FDI, while the sharp drop in commodity prices has hit the mining and agricultural sectors hard. High-end tourism has been impacted by weaker external demand, and inward remittances and other capital flows appear to be on the decline. Growth is expected to moderate, but remain fairly robust, supported by large projects in train, strong mineral exports, and expansionary policies.

3. **Discussions focused on policies to safeguard macroeconomic stability while supporting growth.** In the near term reining in overly expansionary fiscal spending and credit growth is crucial, while over the longer term the priority is to strengthen the underpinnings of the economy through financial sector development, sound banking sector practices and supervision, and creating an economic environment conducive to broader based private sector-led growth.

II. RECENT MACROECONOMIC DEVELOPMENTS AND OUTLOOK

4. **Notwithstanding external and weather-related shocks, economic performance in 2008 was broadly positive.**

- Real GDP growth moderated only slightly despite severe flooding which negatively impacted agricultural production—construction and mining picked up the slack (Table 1 and Figure 1).
- Inflation came off its mid-year peak as food and fuel prices abated, aided by currency appreciation.
- The nonresource current account deficit widened, despite robust exports and tourism receipts, due to the impact of soaring commodity prices on the import bill in the first half of the year. However, international reserves increased by $100 million to

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[1] `Lao P.D.R.'s National Socio Economic Development Plan 2006-10 and Progress Report fulfill the main required criteria for a poverty reduction strategy.

$636 million (3.4 months of prospective imports) buoyed by strong FDI inflows (Table 2).

- Banking sector reform continued, through strengthening of the state-owned commercial banks' (SOCB) balance sheets and banking practices, and the opening of the sector to foreign banks. However, the system remains weak and financial depth, low.[2] Dollarization declined to about 50 percent (70 percent in 2003), supported by a significant appreciation of the kip.

5. **More recently, the impact of the deteriorating external environment has become increasingly evident.**

- Previously strong foreign currency inflows (into both the current and capital accounts) have slowed. The decline in copper prices has impacted the mining sector, lowering exports and depressing financial performance. In addition, tighter global financing conditions have delayed expansion plans and new hydropower investments.
- International reserves have fallen from their June 2008 highs, in defense of a strong kip (Figure 2).[3]
- Lower-than-budgeted profit tax collection from the mining sector is placing fiscal revenues under strain (Table 3 and Figure 3).[4]

6. **Policies have become increasingly expansionary in support of near-term growth and long-term development goals.**[5]

- On the fiscal front, domestically financed capital expenditure has increased rapidly—both on- and off-budget (Table 3).[6]

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[2] The market share of SOCBs is around 60 percent. SOCB capital is positive for the first time in many years as a result of recapitalization and improved profitability, but capital adequacy is still well below the statutory minimum (end-2008). Financial depth is low, with a ratio of broad money to GDP of less than 25 percent.

[3] Strong foreign currency inflows in the first half of 2008 led to currency appreciation and a significant accumulation ($165 million) of foreign reserves by end-June through unsterilized intervention. Once foreign currency flows abated, the continued pursuit of a strong currency to bring down inflation and further de-dollarization led reserves lower—down some $95 million from end-June 2008 through end-April 2009.

[4] Profit tax collection from the mining sector was budgeted at $120 million. This was subsequently marked down to $80 million, and a payment schedule was agreed. The $40 million loss represents 0.7 percent of GDP.

[5] Long-term development plans aim for graduation from low-income status by 2020 via sustained high growth.

[6] The 2008/09 budget contained a sizeable increase in domestically financed capital spending. Off-budget projects, which are generally carried out by lower levels of government, have surged.

- Credit growth accelerated to 85 percent in December 2008—with direct lending by the Bank of Lao P.D.R. (BoL) supplanting slowing credit to the private sector in the last quarter of the year—and has remained above 80 percent through March 2009 (Table 4 and Figure 2).[7]

7. **The near-term outlook is mixed.** Growth is expected to slow in 2009–10, but remain robust. Economic activity is projected to grow at around 4½ percent in 2009 supported by projects already in train and strong public investment, with modest drag from somewhat weaker tourism and declining rural incomes.[8] Inflation would remain low and stable, predicated on currency stability and relatively weak economic growth. With new large-scale investment projects taking off at the earliest in late-2010, growth is expected to only tick up in 2010 as the Nam Theun II hydroelectric dam comes fully on stream, with continued softness in other sectors. With expansionary policies, export softness, and lower FDI, the external position would continue to weaken.

8. **Risks to the near-term outlook are tilted to the downside.** On the external front, a weaker global economic recovery could further depress demand for tourism, garments, and other exports. FDI in the mining and hydropower sectors could also be adversely affected. On the domestic side, the main risk is that excessively expansionary economic policies may jeopardize macroeconomic stability—a precipitous decline in international reserves could put undue depreciation pressure on the kip and lead to a rapid return of high dollarization. Continued strong credit growth could fuel inflation down the road. The next 18 months appear particularly challenging.

9. **However, provided that macroeconomic stability is maintained and structural reforms are accelerated, the medium-term outlook is positive** (Table 5). As the global crisis works itself out, investments in the mining and hydropower sectors would resume. Activity in the broader economy is also expected to pick up, as reforms to strengthen the foundations of the economy push forward. Although the external current account deficit is expected to widen again as investment-related imports rise, this would be more than offset by increased FDI and other capital inflows, with international reserve coverage gradually returning to current levels. External debt is projected to remain high, but concessionality will

[7] As credit growth to the private sector began to wane in the last quarter of 2008, the BoL increased its quasi-fiscal operations including direct lending and advances to SOCBs and state-owned enterprises (SOEs), as well as to local governments, some of which were backed by issuance of BoL's own bonds.

[8] Rural incomes have been hit by lower agricultural commodity prices; a temporary closure of parts of the border to agricultural trade (now resolved); and the recent shift to cash crops, which left farmers indebted and unable to secure new credit.

keep public debt service manageable (Appendix 1).[9] However, in the absence of front-loaded fiscal adjustment, public domestic debt would increase significantly, albeit from a low base.[10]

10. **The medium-term outlook is also subject to risks.** Risks to external stability derive mostly from lower mineral prices. More broadly, improvements in the global economy—while key to improving external demand conditions—may not be sufficient to ensure sustainable growth and debt sustainability. Continued acceleration of domestically financed public investment would increase the nonresource current account deficit, placing sustained pressure on the external position. Postponement of necessary structural reforms, especially those related to strengthening the banking sector and creating an enabling environment for private-sector led growth, could reduce growth prospects and delay government withdrawal from economic activity, both of which would hinder a reduction in public debt ratios.

Lao P.D.R.: Medium-Term Macroeconomic Framework, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
			Est.			Proj.			
Real GDP growth	8.4	7.5	7.2	4.6	5.4	8.4	6.7	7.4	7.3
Real GDP growth excluding resource projects	5.4	6.5	4.1	3.1	3.0	5.4	5.7	6.3	6.5
Consumer prices (end-period)	4.7	5.6	3.2	3.3	3.3	3.5	3.2	3.1	3.0
Overall fiscal balance (percent of GDP)	-3.0	-2.9	-2.0	-7.8	-5.7	-5.4	-4.4	-3.5	-2.8
Current account balance (percent of GDP)	-10.3	-15.8	-16.5	-15.4	-8.1	-12.4	-13.1	-16.0	-20.1
Resource current account balance	-2.9	-10.0	-7.6	-5.4	1.5	-3.1	-3.4	-6.1	-9.2
Nonresource current account balance	-7.4	-5.8	-8.9	-10.1	-9.6	-9.3	-9.7	-10.0	-10.9
Gross official reserves									
In millions of U.S. dollars	336	536	636	536	512	595	736	939	1,184
In months of imports of goods and nonfactor services, excluding imports associated with large projects	3.2	3.9	3.4	3.0	2.2	2.3	2.5	2.6	3.3

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

III. Report on Discussions

A. Dealing with the Impact and Uncertainty of the Global Crisis through…

…Fiscal Adjustment

11. ***Background:*** In recent years, fiscal consolidation progressed on the back of rising budget revenue.[11] Now, the outlook for mining revenues has weakened, expenditure is slated

[9] Under all scenarios and stress tests, the net present value (NPV) of debt service—both to exports as well as revenue—remains below indicative thresholds (Appendix 1, Table 1b).

[10] Total external debt is around 100 percent of GDP, about half of which is public and publicly-guaranteed. Private debt is mostly associated with large hydropower projects. The debt sustainability analysis (Appendix 1) indicates that Lao P.D.R. remains at high risk of debt distress based on policy-contingent debt thresholds. Under the baseline, the high, albeit declining, fiscal deficit implies a sizeable accumulation of domestic debt over the medium term on the order of 8 percentage points of GDP. Domestic debt is estimated to be currently less than 2 percent of GDP.

to rise and quasi-fiscal liabilities have begun to increase. Identified extra-budgetary fiscal operations relate to the long-planned hosting of the Southeast Asian (SEA) Games in December 2009 and activities surrounding the 450-year anniversary of the capital city. The BoL has played an active role in financing the extra-budgetary operations of lower levels of government.[12] Contingent liabilities associated with SOCBs also appear set to rise as a result of rapid credit growth and slowing economic activity. On the positive side, modest measures to enhance revenue are beginning to be implemented.

12. ***Fiscal settings:*** In the absence of additional measures, the overall budget deficit (including off-budget operations) is projected to widen to 7.8 percent of GDP in FY2008/09 (October–September) (2 percent of GDP in 2007/08). Most of the increase is explained by a surge in expenditure of 5.2 percentage points of GDP in 2008/09, some 1.8 percentage points in the form of off-budget spending. A decline in revenue also contributes.[13, 14] In the absence of additional external financing, substantial bank financing on the order of 4 percent of GDP would be required to finance the deficit. This would be difficult to accommodate without putting downward pressure on international reserves and crowding out the private sector. The budget plan for 2009/10 is still under discussion; however, based on staff's projections fiscal year 2009/10 looks equally difficult. While a significant reduction in off-budget operations and some revenue measures would bring the deficit down to 5.7 percent of GDP, the domestic financing requirement would remain large—assuming no further run down in government deposits, domestic debt, and other unidentified financing of some 2.7 percent of GDP would be needed.

13. ***Staff views:*** While a modest easing (along the lines of the original budget) of fiscal policy in 2008/09 is warranted to support development objectives, the current fiscal stance poses risks to macroeconomic stability and fiscal sustainability in light of rapidly growing

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[11] The increase in revenue reflects mostly higher mining output and mineral prices, as well as recentralization efforts and administrative gains. During this period, expenditure was broadly stable.

[12] The BoL has supported off-budget outlays by local governments through monetized direct lending (0.6 percent of GDP) as well as on-lending of BoL's own bonds issued for this purpose (0.6 percent of GDP). In contrast, the extra-budgetary cost incurred in the building of the SEA Games stadium is reported to involve land exchanges (1.2 percent of GDP) between the Government of Lao P.D.R. and the construction company (equivalent to a non-debt creating asset sale).

[13] Total revenues (excluding grants) are projected to decline by 1.3 percentage points of GDP relative to 2007/08, while grants are expected to increase by 0.7 percentage point of GDP. The revenue target contained in the 2008/09 budget is ambitious due to lower mining revenues, and weaker profit tax receipts and customs collection, which are being dragged down by slowing economic activity. The estimated revenue shortfall (relative to budget) amounts to 2.1 percent of GDP, despite the recent introduction of specific excises on petroleum products in May.

[14] Revenue is vulnerable to a further decline in copper prices. For example, a decline of $500 per ton relative to the current WEO baseline would reduce revenue by about 0.2 percentage point of GDP.

quasi-fiscal liabilities, the sizeable domestic financing requirement, and the weakening external position. An adjustment of some 1–1½ percentage points of GDP through a combination of revenue and expenditure measures would be required over the remainder of 2008/09 to eliminate the financing gap, but would still imply a sizeable loss in international reserves. Short-term expenditure savings may be possible through deferred hiring of new staff and compression of non-priority current spending; rolling-back of fuel transfers; and reviewing and cutting back on nonessential domestically financed capital expenditure. The remainder of the adjustment might be secured by bringing forward revenue measures planned for 2009/10.[15] The 2009/10 budget should target a larger and more permanent reduction in the deficit—including through lowering domestically financed capital expenditure in line with realistic revenue estimates—to close the sizeable financing gap, limit the increase in public debt, and eliminate the nonresource current fiscal deficit. In light of the need for safeguarding social spending, additional revenue measures and donor support should continue to be sought.[16] All fiscal operations and associated financing should be placed on budget.

14. ***Authorities' views:*** Additional sources of revenue are being pursued to make up for the shortfall in mining revenues, including increased donor support. In May, the fuel tax structure was amended and other measures will be considered by the National Assembly in its June session. Efforts to strengthen customs collections on petroleum and automobile imports (70 percent of customs' revenue) are underway, with positive initial results. Development needs call for maintaining budgeted expenditure. However, in light of current difficulties a notification has been sent to ministries, spending units, and lower levels of government to carefully consider new spending, while safeguarding necessary expenditures. There is no scope to reduce wages and benefits, but postponement of non-essential spending, such as new office furniture, is under consideration. While there may be a slight increase in the debt stock over the near term due to exceptional circumstances, the government's policy of maintaining the debt on a downward path will continue over the medium term. Regarding the financing of off-budget operations by the BoL, these are currently being reviewed and will likely decline going forward. It is worth noting that while the expenditure is off-budget, debt service payments related to off-budget operations will be incorporated in future budgets.

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[15] Planned measures include adjustments to the reference prices applied to imported vehicles; imposition of additional alcohol and cigarette excises; and the restructuring of taxes and fees on luxury goods.

[16] Revenue is projected to rise modestly in 2009/10, as higher collection of income and turnover taxes as well as planned measures more than offset even lower profit taxes from the mining sector. Additional measures could include strengthening the monitoring of large tax payers and broadening the tax base through a review of deductions and exemptions. Moreover, preparations for a well-designed full roll-out of the VAT should continue.

…Tightening Monetary Conditions

15. ***Monetary developments and conditions:*** Strong signals from the BoL to increase lending resulted in a rapid expansion of credit.[17] Credit growth rose to 63 percent by June 2008, with the share of kip lending increasing to 40 percent (30 percent June 2007). When foreign exchange inflows weakened and commercial bank lending began to slow, credit growth was supported by continued easing and increasing BoL direct advances and lending operations.[18] Credit growth accelerated to 85 percent in December 2008 and has remained broadly stable through April 2009, with a rising share of new lending going to finance quasi-fiscal operations.[19] Broad money growth has been more muted, tempered by the decline in net foreign assets.

16. ***Staff views:*** While some quantitative easing may have been justified, credit growth has been excessive, posing risks to both macroeconomic stability and banking system soundness, not to mention fiscal sustainability. Credit growth should be reined in, including through curtailment of BoL quasi-fiscal operations and by sending a clear signal to banks, including through a sizeable increase in the required reserve ratio. BoL lending should be limited to temporary liquidity support for banks.

17. ***Authorities' views:*** Achieving the growth target requires greater bank lending. The emergence of new banks as well as market-based mechanisms to signal monetary easing led to the desired increase in credit growth. While credit growth has been high, it is from a small base—the loan-to-deposit ratio remains low at around 50 percent. Nonperforming loans (NPLs) have ticked up only slightly due to problems in one private bank. The BoL is keeping a close watch over NPLs and has instructed banks to follow prudential regulations. The economic slowdown has necessitated BoL direct lending and issuance of BoL bonds to finance capital expenditure. These operations should be viewed as temporary.

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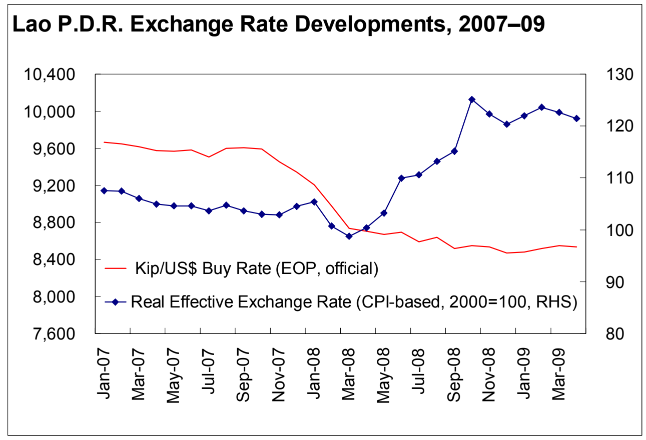
[17] While the effectiveness of market-based instruments is severely limited, in an effort to signal an easing of monetary conditions the BoL reduced the required reserve ratio on kip deposits and increased the portion which can be deposited in securities (both kip and forex); the policy rate was lowered 400 basis points to 8 percent. There was also a modest contribution to growth from the entry of new banks.

[18] Since mid-2008, the policy rate has been lowered on three occasions by an additional 300 basis points to 5 percent. The direct contribution of BoL advances and lending to credit growth is 24 percent (y/y, March).

[19] As of March 2009, credit growth to the public sector accelerated to 166 percent (y/y) while private sector growth slowed to 67 percent. The share of credit to the public sector rose to 23 percent (16 percent end-2007).

…Preserving Orderly Foreign Exchange Market Conditions

18. ***Exchange rate developments:*** Following a prolonged period of steady appreciation, since September 2008 the bilateral kip-U.S. dollar exchange rate has remained broadly stable despite slowing foreign exchange inflows. In real effective terms, the kip has appreciated by more than 20 percent over the past 12 months (April), reflecting a significant strengthening relative to the Thai baht. Increased flexibility has been introduced in the foreign exchange market, though the trading band around the daily reference rate remains narrow.[20]



19. ***Staff views:*** Maintaining foreign exchange market stability requires swift and determined tightening of fiscal and monetary policies. The strengthening of the kip served the Lao P.D.R. economy well in recent years, when the country was faced with large inflows and inflation pressures, but conditions have changed dramatically. The tightening of policies will protect the external position and provide scope for the exchange rate to continue to serve as a nominal anchor until market-based monetary policy instruments can be put in place. The staff share the authorities' view that any sizeable adjustment of the exchange rate in the current economic environment could trigger a reversal of recent gains in de-dollarization. Exchange rate stability is also consistent with current CGER-like estimates which continue to indicate that the exchange rate is broadly in line with its medium-term equilibrium level.[21]

20. ***Authorities' views:*** Strong capital flows led the kip to appreciate—this aided in bringing down inflation and fostered home-grown de-dollarization. In the current context, top priority is given to exchange rate stability. A flexible approach has been adopted, with the kip fluctuating within a "soft target" five percent band in either direction relative to major trading partners on an annual basis. Buying and selling are aimed at smoothing excess volatility. Vigilance will be maintained over both the exchange rate and reserves in view of

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[20] Private foreign exchange bureaus can conduct foreign exchange transactions with the public for up to 20 million kip ($2,300) per transaction without documentation, with multiple transactions permitted daily. The daily trading band is ± 0.25 percent around the daily reference rate for the U.S. dollar and ± 0.5 percent for the Thai baht and euro.

[21] Estimates should be interpreted with extreme caution in light of incomplete data, limited observations, structural changes to the economy over the estimation period, and the use of time series (not panel) data. The macroeconomic balance approach indicates an undervaluation of about 4 percent, but is not statistically significant. Results are broadly unchanged when the resource sector is excluded.

ongoing global instability. Little change in reserve coverage is expected over the course of the year.

B. Strengthening the Underpinnings of the Economy through…

…Strengthening Policy Frameworks

21. ***Staff views:*** The global crisis has put policy implementation capacity to the test. Stresses surrounding the delineation of responsibilities among institutions is clear from rising quasi-fiscal liabilities. Limited policy instruments and low financial market development pose challenges to the conduct of monetary policy, while fiscal policy is vulnerable to fluctuations in resource revenues. Capacity is in need of strengthening. As a first step, policy implementation should be aligned with institutional mandates. With the BoL's attention squarely focused on the conduct of monetary policy, steps toward developing indirect policy instruments, fostering a working interbank market, and strengthening domestic liquidity management should be taken. On the fiscal front, the progress to date in public financial management and the recentralization of tax, customs, and treasury operations (including the Treasury Single Account) is welcome. Going forward, these efforts will need to continue. In addition, steps should be taken to reduce vulnerability to resource revenues through a broadening of the tax base, and to move toward a medium-term budget framework.

22. ***Authorities' views:*** Progress on de-dollarization and the strengthening of the banking system support increased use of indirect instruments for the conduct of monetary policy in the future. In light of limited issuance of treasury securities, consideration is being given to floating BoL securities for the sole purpose of liquidity management. The BoL is encouraging banks to use the interbank market, by taking on the role of lender of last resort, but results have been very modest due to lack of quality collateral. Consideration is also being given to new facilities such as foreign exchange swaps. On fiscal policy, recentralization efforts are focusing on revenue sharing and budget allocation norms, and VAT roll-out is planned for January 2010. A new chart of accounts and budget nomenclature were incorporated into the 2008/09 budget process—work aimed at full implementation is ongoing in close collaboration with the World Bank.

…Sound Financial Sector Practices and Supervision

23. ***Banking sector reform program:*** Poor risk management, a legacy of directed lending, weak monetary discipline, and lax bank supervision contributed over time to a sharp deterioration in the banks' balance sheets—a donor-supported reform program aimed at strengthening banking oversight and restructuring SOCBs has been in place since 2003. Results are becoming increasingly evident. The two largest SOCBs have met financial targets set in the Governance Agreement which opened the door for bank recapitalization—capital

adequacy of the SOCBs has increased, and is positive for the first time in recent years, but remains well below the statutory minimum.[22] NPLs have been reduced through a series of work out and write-offs. Some progress has been on strengthening banking practices, but risk-management challenges remain. Profitability has recently improved.

24. ***Staff views:*** Despite progress, financial intermediation remains low and the banking sector weak. The legacy of directed lending is making it difficult to put in place banking sector practices in line with international best practice and may compromise the financial recovery of SOCBs, especially in view of increasing competition. In order for the banking system to support private sector development and sustained growth, the financial position of the SOCBs needs to be strengthened. Risk management and banking practices guided by international standards should be strived for. In view of the increasing number of private institutions, oversight capacity of the BoL needs to be strengthened, conflicts of interest related to SOCBs minimized, strict due-diligence in the granting of new licenses exercised, and cross-border supervisory collaboration increased.[23] Full implementation of the commercial banking law will provide a transparent and rules-based legal framework for banking activity. A key developmental challenge will be to create an environment in which banks can safely lend to small and medium enterprises on strictly commercial terms, an issue which might appropriately be addressed in the broader context of the Financial Sector Strategy which has been submitted to the Prime Minister.

25. ***Authorities' views:*** The BoL has stepped up onsite examinations and offsite supervision, although capacity-related challenges remain. Improvements in banking practices will be supported by the increased competition provided by the entrance of new banks, as well as investments by strategic partners—talks are progressing with a strategic foreign partner for the largest SOCB. Bank licensing is conducted in a two-phase framework of pre- and post-entry surveillance following proper screening, and consideration is being given to increasing the minimum required registered capital to 300 billion kip ($35 million, currently 100 billion). The necessary laws and regulations associated with the 2006 Banking Law have been issued; however, a draft implementing decree is needed to fill identified gaps in subordinate legislation.

…More Balanced Growth

26. ***Background:*** Broadening the sources of growth will reduce resource dependence and support sustained economic activity. Over the years, good progress has been made in opening

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[22] Bank recapitalization bonds have been issued for 588 billion kip (1.3 percent of GDP) since September 2005. As of end-2008 (latest available data), one SOCB had positive CAR of 2 percent, while the remaining two SOCBs had negative CAR of less than -4 percent.

[23] Conflicts of interest may arise due to the BoL acting as both owner and regulator of the SOCBs. Regarding new banking licenses, participation of the Financial Intelligence Unit should be required.

the economy to private sector activity. Recent legislative initiatives—such as the Enterprise Law, Mining Law, and draft Investment Law—are steps in the right direction toward reducing discretionary regulation, leveling the playing field, and codifying business practices. Ongoing efforts to reform SOEs are also welcome.

27. ***Staff views:*** Despite advances, the cost of doing business remains high. Private sector led-development requires economic openness, and transparent, rules-based regulation free from cumbersome administrative requirements. The government's role should increasingly be limited to providing an enabling environment. As transition proceeds, priority should be given to improving the business climate, including through establishing a transparent legal and regulatory environment, and furthering trade integration.[24] A strong commitment by government is key—this could be demonstrated by swift revision of local laws and regulations to be WTO compliant. Productivity gains would protect competitiveness and avoid potential Dutch disease associated with large resource-related flows.

28. ***Authorities' views:*** The government is committed to furthering the transition to a market-based economy. A legalistic approach is being taken—including the drafting of new, WTO-compliant laws and regulations—in order to reduce regulatory discretion and level the playing field. Efforts are ongoing, despite capacity constraints, through continued close cooperation with development partners. The Investment Law will be considered by the National Assembly in its June session, and implementation will proceed in line with WTO accession preparations. Trade integration is evolving on two levels: meeting regional trade commitments and actions toward WTO accession. However, the work program for WTO accession is becoming more challenging in light of increasingly stringent demands placed on Lao P.D.R. by member countries for granting accession.

C. Deepening Understanding of Economic Developments through…

…Improvements in Data

29. ***Staff views:*** Macroeconomic and financial data shortcomings hamper surveillance and impair the authorities' ability to assess economic developments in the context of policy formulation. Priority should be placed on strengthening balance of payments statistics in order to better manage inflows and to identify and address vulnerabilities. Greater use of direct surveys, improvements in collection and compilation methodologies, and increased comprehensiveness would enhance the reliability of national accounts statistics. Recent efforts to improve fiscal statistics should continue, especially broadening coverage to include off-budget activities and SOE debt. More broadly, enhanced coordination among statistical

[24] Specific actions relate to streamlining, simplifying, and clarifying existing regulations, especially in taxation, to reduce regulatory discretion; creating a level playing field between state and private sector enterprises, as well as domestic and foreign investors; and reducing red tape. The World Bank is taking the lead in this area.

agencies is required to ensure data quality and consistency. Data dissemination would be greatly enhanced by GDDS subscription.

30. ***Authorities' views:*** While there have been some data delays, progress continues to be made. The increased workload at ministries and agencies in the context of the global crisis has slowed compilation of 2008 GDP statistics, while a new chart of accounts has led to delays in the monetary accounts—both are expected to be resolved shortly. More broadly, national accounts statistics have recently been compiled on an expenditure basis for 2002–05. Continued work in this area will require increased funding to complete the required surveys. Past technical assistance and training courses have improved capacity—at this juncture, further gains to national accounts statistics require improvements in metadata.

IV. Staff Appraisal

31. **Over the past five years, the Lao P.D.R. economy has performed well.** Strong resource-related FDI, a booming global economy, and stable macroeconomic conditions supported growth, while reforms to further the transition toward a market-based economy helped improve the environment for economic development.

32. **The impact on growth from the global crisis will likely be somewhat less than in other countries of the region, but policies are straining the external position.** While some easing of policies was warranted, in the context of sharply lower foreign currency inflows, overly expansionary fiscal and credit policies are placing downward pressure on international reserves. Moreover, quasi-fiscal liabilities are mounting due to increasing off-budget operations financed in part by the BoL and to rising contingent liabilities in the banking sector fueled by rapid credit expansion.

33. **Macroeconomic stability should be protected through fiscal adjustment and the reining in of credit growth.** Revenue measures aimed at limiting the widening of the fiscal deficit are welcome, but most of the required adjustment will likely need to come from the expenditure side. Quasi-fiscal operations of the BoL should be curtailed and all fiscal operations placed on-budget. A strong signal needs to be sent to banks to tighten lending.

34. **Prompt and determined tightening of fiscal and monetary policies is crucial to foreign exchange market stability.** While the strengthening of the kip served the economy well when the economy was faced with large inflows and inflation pressures, changing conditions have resulted in downward pressure on international reserves. Policy adjustment will protect the external position and provide scope for the exchange rate to continue to serve as a nominal anchor until market-based monetary policy instruments can be put in place.

35. **The global crisis has brought to the fore the need for strengthening policy frameworks.** Policy implementation should be aligned with institutional mandates, and efforts to increase capacity should continue. The conduct of monetary policy would be enhanced by development of indirect instruments, fostering a working interbank market, and

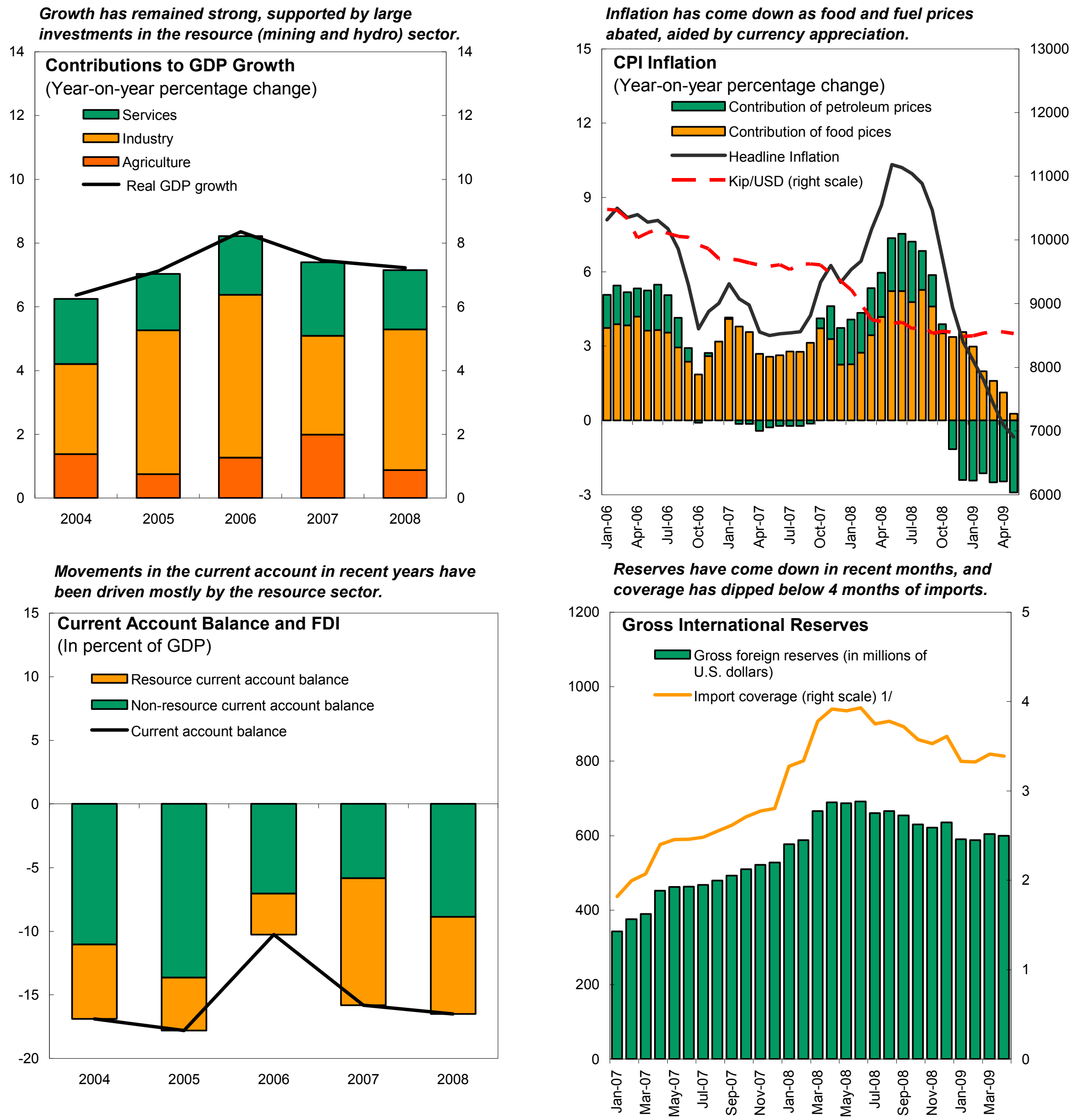
strengthening domestic liquidity management. On the fiscal front, ongoing recentralization and public financial management efforts are welcome. Going forward, vulnerability to resource revenues could be reduced through a broadening of the tax base, while budget planning would be strengthened by a move toward a medium-term expenditure framework.

36. **SOCB reform efforts are yielding results, but the banking sector remains weak.** The decline in nonperforming loans and the return to positive capital adequacy are welcome. Nonetheless, bolstering the ability of the banking sector to effectively support economic growth requires further strengthening of the financial position of SOCBs and improved risk management and banking practices. In light of the growing number of banks, BoL oversight capacity should be reinforced, and conflicts of interest mitigated. Full implementation of the banking law would provide a framework for sound commercial banking activity.

37. **Bold structural reforms are key to sustaining strong growth during the transition to a market economy.** Priority areas include improving the investment climate and advancing trade integration. Establishing a transparent and rules-based environment will reduce regulatory uncertainty, and furthering WTO compliance will promote a level playing field. Such reforms, when taken together, will provide an enabling environment for private sector participation and broaden the sources of growth, thereby reducing resource dependence.

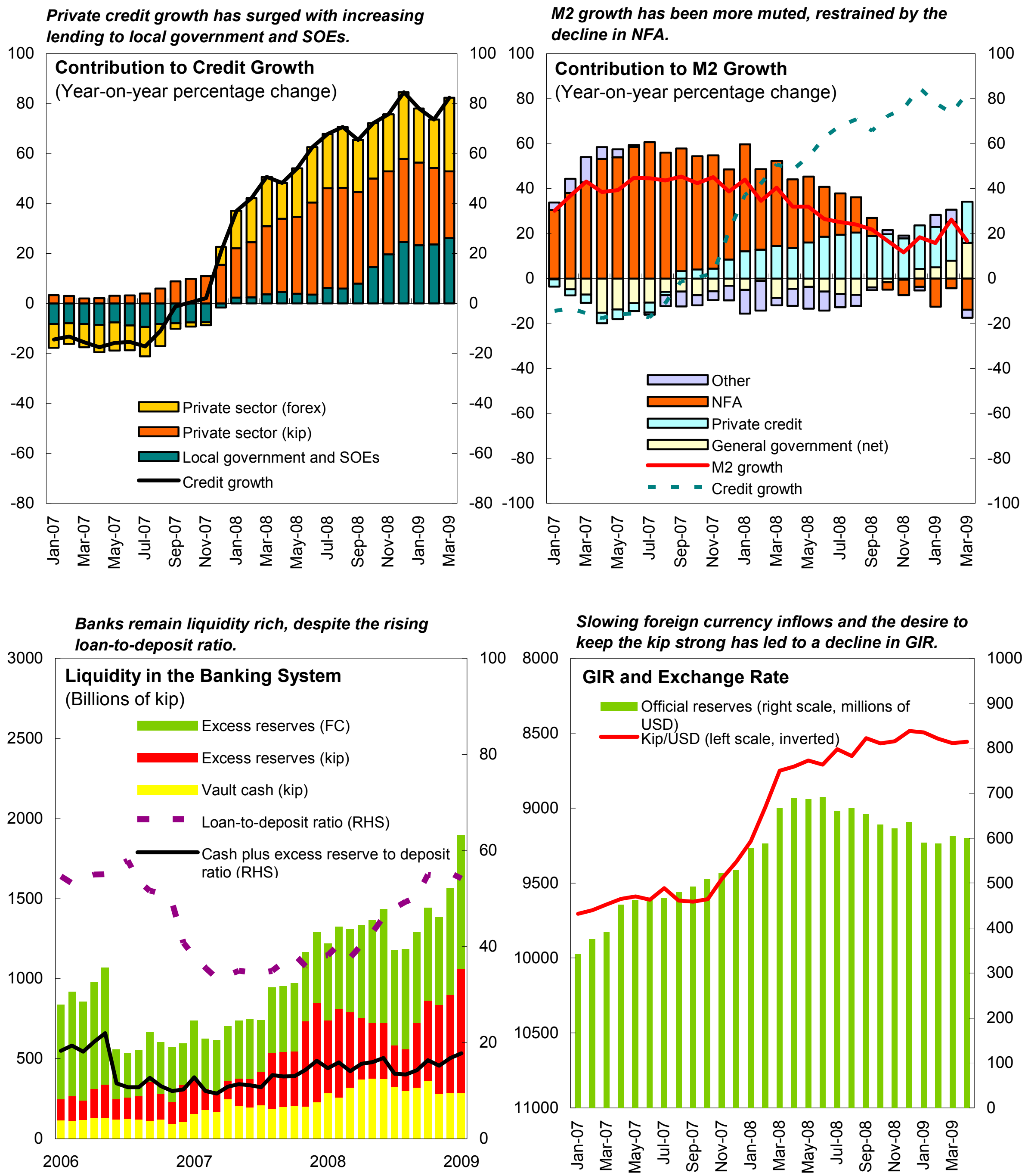
38. It is recommended that Lao P.D.R. remain on the 12-month consultation cycle.

Figure 1. Lao P.D.R.: Real and External Developments



Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ In months of prospective imports of goods and nonfactor services, excluding those associated with large projects.

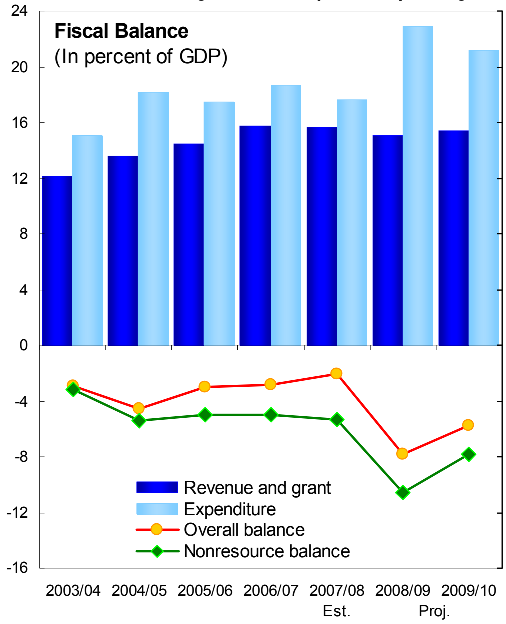
Figure 2. Lao P.D.R.: Monetary Developments



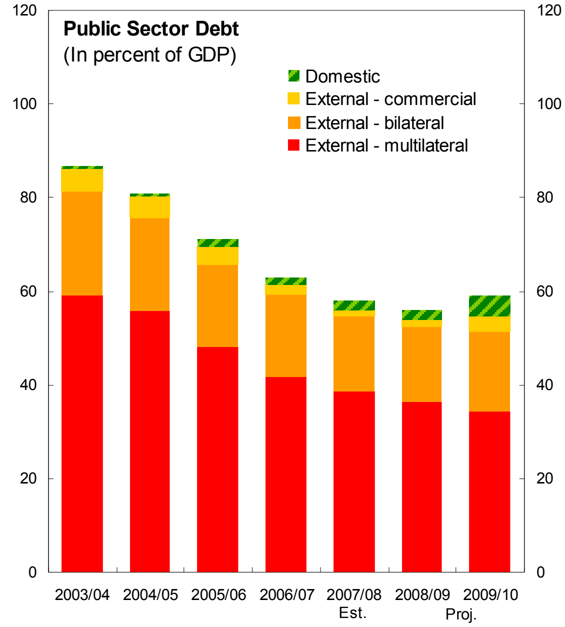
Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

Figure 3. Lao P.D.R.: Fiscal Developments

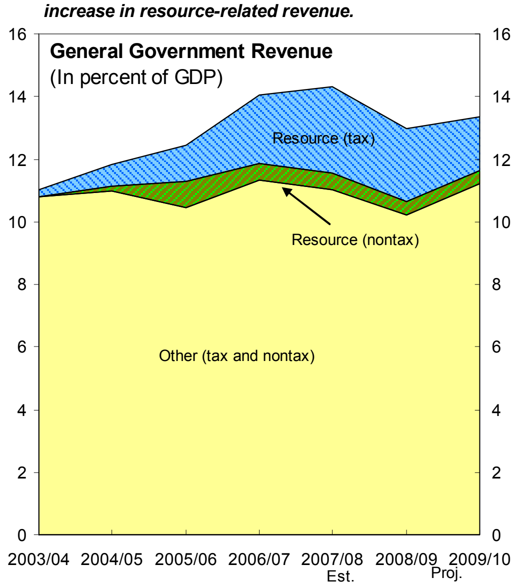
The fiscal deficit is projected to widen due to revenue shortfalls and a large increase in planned spending.



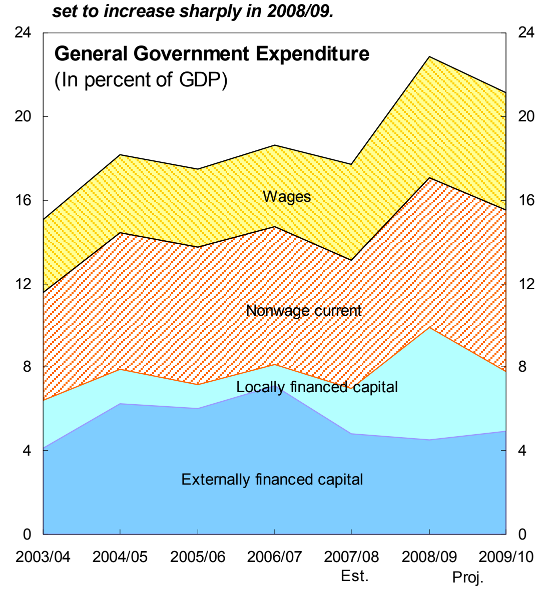
The sizeable public sector debt will tick up, with an increase in domestic debt.



Weaker copper prices are expected to halt the trend increase in resource-related revenue.



The wage bill and locally financed capital spending are set to increase sharply in 2008/09.



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

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2004–09

	2004	2005	2006	2007	2008 Est.	2009 Proj.
GDP and prices (percentage change)						
Real GDP growth	6.4	7.1	8.4	7.5	7.2	4.6
CPI (annual average)	10.5	7.2	6.8	4.5	7.6	0.2
CPI (end year)	8.6	8.8	4.7	5.6	3.2	3.3
Public finances (in percent of GDP) 1/						
Revenue	11.0	11.8	12.4	14.0	14.3	13.0
Of which: Resources 2/	0.3	0.8	2.0	2.7	3.3	2.8
Grants	1.1	1.7	2.0	1.7	1.3	2.1
Expenditure	15.1	18.2	17.4	18.6	17.7	22.9
Current (includes contingency and discrepancy)	8.6	10.3	10.3	10.5	10.7	12.9
Capital and net lending	6.4	7.9	7.2	8.1	7.0	9.9
Overall balance (including grants) 3/	-2.9	-4.6	-3.0	-2.9	-2.0	-7.8
Domestic financing	-0.7	0.2	-1.1	-0.9	-1.1	5.4
External financing	3.6	4.4	4.0	3.8	3.0	2.4
Money and credit (annual percent change) 4/						
Reserve money	12.9	18.0	37.2	58.8	20.2	32.0
Broad money	22.8	7.7	30.1	38.7	18.3	16.7
Bank credit to the economy 4/	9.0	7.6	-9.1	21.0	84.6	82.3
Interest rates (end-of-period)						
On three-month kip deposits	7.5	5.5	5.5	5.5	6.0	6.0
On short-term kip loans (1 year)	14.0	15.5	13.0	12.0	12.0	9.0
Balance of payments						
Exports (in millions of U.S. dollars)	535	697	1,133	1,321	1,639	1,293
In percent change	13.5	30.1	62.6	16.6	24.1	-21.1
Imports (in millions of U.S. dollars)	1,056	1,270	1,589	2,156	2,816	2,517
In percent change	34.3	20.3	25.1	35.7	30.6	-10.6
Current account balance (in millions of U.S. dollars)	-424	-492	-367	-660	-887	-884
In percent of GDP	-16.9	-17.8	-10.3	-15.8	-16.5	-15.4
Gross official reserves (in millions of U.S. dollars)	228	238	336	536	636	536
In months of prospective goods and services imports 5/	3.3	2.8	3.2	3.9	3.4	3.0
External public debt and debt service						
External public debt						
In millions of U.S. dollars	2,109	2,203	2,351	2,521	2,931	3,085
In percent of GDP	84.1	79.8	65.7	60.5	54.5	53.9
External public debt service						
In percent of exports	7.1	7.4	3.6	4.0	4.2	6.9
Exchange rate						
Official exchange rate (kip per U.S. dollar; end-of-period) 6/	10,357	10,767	9,655	9,341	8,466	8,519
Real effective exchange rate (2000=100)	95.9	103.1	105.5	104.3	123.5	…
Memorandum items:						
GDP at current market prices						
In billions of kip	26,549	29,369	35,983	39,874	46,700	48,955
In millions of U.S. dollars	2,509	2,761	3,577	4,170	5,374	5,721

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

1/ Fiscal year basis (October to September).
2/ Royalties and taxes from mining and hydropower (resource) projects.
3/ Includes off-budget investment expenditure of 0.6 and 2.6 percent of GDP in 2008 and 2009, respectively.
4/ At end-March 2009. Excludes debt write-offs. Includes Bank of Lao P.D.R. lending to state-owned enterprises and lower levels of government.
5/ Excludes imports associated with large resource projects.
6/ Figure for 2009 is as of June 24, 2009.

Table 2. Lao P.D.R.: Balance of Payments, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
			Est.			Proj.			
	(In millions of U.S. dollars, unless otherwise indicated)								
Current account	-367	-660	-887	-884	-493	-813	-925	-1,233	-1,686
Excluding official transfers	-452	-723	-975	-1,002	-619	-957	-1,087	-1,417	-1,894
Merchandise trade balance	-457	-835	-1,178	-1,224	-710	-1,042	-1,198	-1,497	-1,983
Exports, f.o.b.	1,133	1,321	1,639	1,293	1,671	1,935	2,199	2,414	2,684
Mining and hydropower	660	663	863	749	999	1,103	1,239	1,389	1,533
Other exports	472	658	776	544	673	832	960	1,025	1,151
Imports, c.i.f.	1,589	2,156	2,816	2,517	2,381	2,977	3,397	3,911	4,667
Mining and hydropower	529	875	977	897	668	1,049	1,236	1,560	2,011
Petroleum imports	209	311	422	202	252	312	374	440	519
Other imports	852	970	1,417	1,418	1,461	1,615	1,787	1,910	2,137
Services (net)	153	202	331	311	275	287	312	340	370
Of which: Tourism	149	189	276	249	213	223	246	270	297
Income (net)	-208	-141	-192	-141	-235	-256	-260	-325	-352
Interest payments	-74	-83	-79	-90	-159	-160	-159	-156	-152
Of which: Public	-17	-19	-26	-47	-52	-62	-67	-71	-74
Mining and hydropower	-28	-36	-35	-31	-93	-82	-74	-66	-57
Dividends and profit repatriation	-232	-216	-287	-182	-205	-249	-271	-369	-415
Of which: Mining and hydropower	-208	-169	-260	-128	-147	-175	-170	-231	-239
Other	99	159	173	132	130	153	170	201	215
Transfers (net)	144	114	152	170	177	197	220	248	279
Private	59	51	64	51	51	54	59	65	71
Official	85	63	88	119	126	144	162	183	208
Capital account	467	862	991	790	475	901	1,070	1,440	1,934
Public sector	130	140	112	150	234	228	175	171	183
Disbursements	162	186	173	223	310	309	269	277	300
Amortization	-32	-45	-61	-73	-76	-81	-94	-106	-117
Banking sector (net)	-93	-117	63	-15	0	-50	-50	-50	-100
Private sector	431	838	815	655	241	723	945	1,319	1,851
Foreign direct investment (net) 1/	335	779	906	681	291	773	970	1,344	1,961
Of which: Mining and hydropower projects	239	656	758	629	177	564	629	862	1,448
Other private flows and errors and omissions	95	60	-90	-26	-50	-50	-25	-25	-110
Overall balance	100	202	104	-94	-18	87	144	207	248
Financing	-100	-202	-104	94	18	-87	-144	-207	-248
Central bank net foreign assets	-100	-202	-104	94	18	-87	-144	-207	-248
Assets (increase -)	-98	-200	-100	100	23	-82	-141	-203	-245
Liabilities (reduction -)	-2	-2	-4	-6	-5	-5	-4	-4	-4
Memorandum items:									
Current account balance (in percent of GDP)	-10.3	-15.8	-16.5	-15.4	-8.1	-12.4	-13.1	-16.0	-20.1
Excluding official transfers	-12.6	-17.3	-18.1	-17.5	-10.2	-14.5	-15.4	-18.4	-22.6
Resource current account balance (in percent of GDP) 2/	-2.9	-10.0	-7.6	-5.4	1.5	-3.1	-3.4	-6.1	-9.2
Nonresource current account balance (in percent of GDP)	-7.4	-5.8	-8.9	-10.1	-9.6	-9.3	-9.7	-10.0	-10.9
Exports (annual percent change)	62.6	16.6	24.1	-21.1	29.2	15.8	13.7	9.8	11.2
Imports (annual percent change)	25.1	35.7	30.6	-10.6	-5.4	25.0	14.1	15.1	19.3
Gross official reserves (in millions of U.S. dollars)	336	536	636	536	512	595	736	939	1,184
In months of prospective imports of goods and non-factor services	2.4	2.9	2.6	2.6	2.0	2.0	2.2	2.3	3.0
(Excluding imports associated with large resource projects)	3.2	3.9	3.4	3.0	2.2	2.3	2.5	2.6	3.3

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

1/ Includes repayment of private debt. FDI in the balance of payments includes both equity and debt, whereas only the non-debt portion is included in the debt sustainability analysis.

2/ Pertains to large mining and hydropower (resource) projects.

Table 3. Lao P.D.R.: General Government Operations, 2004/05–2009/10

	2004/05	2005/06	2006/07	2007/08	2008/09		2009/10
				Outturn Est.	Budget	Proj.	Proj.
	(In percent of GDP)						
Revenue and grants	13.6	14.5	15.8	15.6	15.9	15.0	15.4
Revenue	11.8	12.4	14.0	14.3	14.5	13.0	13.3
Of which : Resource revenue 1/	0.8	2.0	2.7	3.3	3.4	2.8	2.1
Tax revenue	9.8	10.6	12.1	12.5	12.5	11.5	11.7
Of which: Resource revenue 1/	0.7	1.1	2.2	2.7	2.9	2.3	1.7
Income and profit taxes	1.8	2.0	3.0	3.7	3.6	3.1	2.4
Turnover tax	2.3	2.6	2.7	2.7	2.7	2.4	2.7
Excise duties	1.8	2.3	2.6	2.6	2.8	2.9	3.2
Import duties	1.5	1.5	1.5	1.5	1.6	1.3	1.4
Royalties	0.5	0.8	0.8	0.8	0.7	0.7	0.9
Other taxes	1.8	1.4	1.5	1.1	1.1	1.0	1.2
Nontax revenue	2.0	1.8	1.9	1.8	1.9	1.5	1.6
Of which : Resource revenue 1/	0.1	0.8	0.5	0.5	0.5	0.4	0.4
Grants	1.7	2.0	1.7	1.3	1.5	2.1	2.1
Expenditure	18.2	17.4	18.6	17.7	19.3	22.9	21.1
Current expenditure	8.8	9.1	8.9	10.3	11.3	11.9	12.1
Wages, salaries, and benefits	3.7	3.7	3.9	4.6	5.5	5.8	5.6
Transfers	1.8	2.0	2.1	2.3	2.6	3.0	3.2
Interest payments	1.1	0.8	0.7	0.8	0.8	0.8	0.9
Of which : External	0.9	0.7	0.6	0.6	0.7	0.7	0.8
Other recurrent	2.2	2.7	2.1	2.6	2.4	2.3	2.4
Capital expenditure and onlending	7.9	7.2	8.1	7.0	7.1	9.9	7.8
Domestically financed	1.6	1.2	2.1	2.2	2.9	5.4	2.9
Of which : Off-budget	…	…	…	0.6	…	2.4	0.4
Externally financed and on-lending 2/	6.3	6.0	6.0	4.8	4.1	4.5	4.9
Externally financed	4.4	6.4	5.8	4.6	4.1	4.6	5.1
Onlending (net)	1.9	-0.4	0.2	0.2	0.0	0.0	-0.1
Others and contingencies 3/	1.2	1.0	1.5	0.9	1.0	1.1	1.2
Discrepancy	0.3	0.2	0.2	-0.6	0.0	0.0	0.0
Overall balance	-4.6	-3.0	-2.9	-2.0	-3.4	-7.8	-5.7
Overall balance (excluding off-budget)	…	…	…	-1.5	…	-5.4	-5.4
Nonresource balance 4/	-5.4	-5.0	-5.6	-5.3	-6.8	-10.6	-7.9
Primary balance	-3.5	-2.2	-2.2	-1.2	-2.6	-7.0	-4.8
Financing	4.6	3.0	2.9	2.0	3.4	7.8	5.7
Domestic financing (net)	0.2	-1.1	-0.9	-1.0	1.1	5.4	3.1
Bank financing	0.2	-1.1	-0.9	-1.3	1.1	2.8	0.0
Of which: Off-budget (local government)	…	…	…	0.3	…	1.3	0.0
State Accumulation Fund	…	…	-0.1	-0.5	-0.1	-0.1	-0.1
Nonbank financing	0.0	0.0	0.0	0.3	0.0	1.5	0.4
Of which: Off-budget (SEA game related)	…	…	…	0.3	…	1.1	0.4
Other domestic (debt creating)	…	…	…	…	…	…	0.9
Financing gap	…	…	…	…	…	1.2	1.8
Foreign financing (net)	4.4	4.0	3.8	3.0	2.3	2.4	2.6
Disbursements	5.4	5.0	4.7	3.9	3.2	3.3	3.7
Amortization	-1.0	-0.9	-0.9	-0.9	-0.9	-0.9	-1.1
Memorandum items:							
Nonresource current balance	2.7	1.3	2.5	0.7	-0.2	-1.7	-0.9
GDP (in billions of kip)	28,664	34,330	38,901	44,993	50,591	48,391	52,106

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

1/ Resource revenue comprises royalties, taxes, and dividends from the mining and hydropower sectors.
2/ On-lending includes gross repayments of funds.
3/ Includes payments on liabilities carried over from the previous budget years and for arrears clearance.
4/ Overall balance net of resource revenue.

Table 4. Lao P.D.R.: Monetary Survey 2006–09

(In billions of kip, unless otherwise indicated)

	2006	2007		2008				2009
	Dec.	Mar.	Dec.	Mar.	Jun.	Sep.	Dec. Prel.	Mar. Prel.
				(In billions of kip)				
Bank of Lao P.D.R. (BoL)								
Net foreign assets	2,984	3,562	4,803	5,626	5,837	5,458	5,226	5,012
In millions of U.S. dollars	308	370	505	639	670	632	617	587
Net domestic assets	-482	-825	-829	-1,594	-1,539	-1,229	-449	312
Government (net)	-282	-643	-456	-1,418	-1,550	-1,396	-1,057	-636
SOEs	247	233	161	142	203	296	685	876
Banks	143	159	192	315	448	500	538	628
BoL securities	0	0	0	0	0	-151	-223	-301
Other items (net)	-590	-573	-726	-633	-641	-476	-392	-255
Reserve money	2,502	2,737	3,974	4,032	4,297	4,228	4,776	5,324
Currency in circulation	1,231	1,389	1,838	1,883	1,736	1,776	2,223	2,377
Bank reserves (kip)	421	384	964	885	820	828	993	1,174
Bank reserves (foreign currency)	851	964	1,172	1,265	1,741	1,624	1,560	1,771
Of which: Capital deposits	152	170	166	174	444	462	369	396
Monetary survey								
Net foreign assets	4,912	5,829	7,732	8,858	8,553	7,932	7,364	7,301
In millions of U.S. dollars	455	566	801	921	893	826	788	855
Of which: Commercial banks	147	196	296	283	223	194	171	268
Net domestic assets	2,134	2,131	2,042	2,321	1,748	2,856	4,201	5,744
Government (net)	-89	-316	-275	-1,091	-1,217	-990	-643	-274
Credit to the economy	2,617	2,420	3,166	3,647	4,158	4,842	5,845	6,650
In kip	709	702	1,115	1,376	1,713	2,024	2,208	2,512
In foreign currencies	1,908	1,717	2,052	2,271	2,444	2,818	3,637	4,138
Other items (net)	-394	27	-849	-235	-1,192	-996	-1,001	-631
Broad money	7,046	7,960	9,774	11,180	10,301	10,788	11,564	13,045
Currency outside banks	1,231	1,389	1,838	1,883	1,736	1,776	2,223	2,379
Kip deposits	1,712	1,870	2,612	2,899	2,968	3,272	3,517	4,103
Foreign currency deposits (FCDs)	4,103	4,702	5,324	6,398	5,597	5,740	5,824	6,563
				(Annual percent change)				
Reserve money	37.2	47.1	58.8	47.3	46.8	29.5	20.2	32.0
Broad money	30.1	43.1	38.7	40.4	26.5	21.7	18.3	16.7
Credit to the economy	-9.1	-15.6	21.0	50.7	62.6	65.5	84.6	82.3
In kip	27.0	11.0	57.2	95.9	120.7	113.3	98.0	82.5
In foreign currencies	-17.8	-23.1	7.5	32.2	37.3	42.6	77.3	82.2
Memorandum items:								
Money multiplier (at current exchange rates)	2.8	2.9	2.5	2.8	2.4	2.6	2.4	2.5
Velocity	5.8	5.8	4.5	4.8	4.6	4.3	4.2	4.1
Loan/deposit (percent)	40.8	33.3	37.9	37.7	46.2	50.4	55.2	54.1
In kip (percent)	41.4	37.6	42.7	47.5	57.7	61.8	62.8	61.2
Gross official reserves (in millions of U.S. dollars)	336	398	536	666	693	654	636	604
Net international reserves (in millions of U.S. dollars) 1/	220	270	380	495	470	444	433	379
Issue of debt clearance/bank recapitalization bonds 2/	446	446	446	694	694	694	704	704
Exchange rate, end-of-period (kip per U.S. dollar)	9,655	9,615	9,341	8,735	8,695	8,516	8,466	8,542
Dollarization rate (FCDs/broad money; in percent)	58.2	59.1	54.5	57.2	54.3	53.2	50.4	50.3

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

1/ Defined as gross official reserves minus BoL foreign liabilities and the foreign exchange component of reserve money.

2/ Cumulative since end-June 2003.

Table 5. Lao P.D.R.: Medium-Term Macroeconomic Framework, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
			Est.			Proj.			
Output and prices	(Percent change, unless otherwise indicated)								
Real GDP	8.4	7.5	7.2	4.6	5.4	8.4	6.7	7.4	7.3
Excluding resource projects	5.4	6.5	4.1	3.1	3.0	5.4	5.7	6.3	6.5
Consumer prices (end-period)	4.7	5.6	3.2	3.3	3.3	3.5	3.2	3.1	3.0
Annual average	6.8	4.5	7.6	0.2	3.0	3.5	3.2	3.1	3.0
GDP per capita (in U.S. dollars)	594	679	859	897	932	995	1,048	1,118	1,198
Public finances (in percent of GDP) 1/									
Revenue	12.4	14.0	14.3	13.0	13.3	13.4	14.1	14.5	14.9
Grants	2.0	1.7	1.3	2.1	2.1	2.2	2.3	2.4	2.5
Expenditure	17.4	18.6	17.7	22.9	21.1	21.0	20.8	20.4	20.1
Current (including contingency and discrepancy)	10.3	10.5	10.7	11.9	12.1	12.4	12.8	13.0	13.1
Capital and onlending	7.2	8.1	7.0	9.9	7.8	7.6	7.3	7.0	6.9
Of which : Off-budget capital expenditure	…	…	0.6	2.4	0.4	…	…	…	…
Overall balance	-3.0	-2.9	-2.0	-7.8	-5.7	-5.4	-4.4	-3.5	-2.8
Balance of payments	(In millions of U.S. dollars; unless otherwise indicated)								
Current account balance	-367	-660	-887	-884	-493	-813	-925	-1,233	-1,686
In percent of GDP	-10.3	-15.8	-16.5	-15.4	-8.1	-12.4	-13.1	-16.0	-20.1
Exports	1,133	1,321	1,639	1,293	1,671	1,935	2,199	2,414	2,684
Of which: Resources	660	663	863	749	999	1,103	1,239	1,389	1,533
Imports	1,589	2,156	2,816	2,517	2,381	2,977	3,397	3,911	4,667
Of which: Resources	529	875	977	897	668	1,049	1,236	1,560	2,011
Services and income (net)	-55	62	139	171	40	31	52	15	18
Transfers	144	114	152	170	177	197	220	248	279
Capital account balance	467	862	991	790	475	901	1,070	1,440	1,934
Of which : FDI	335	779	906	681	291	773	970	1,344	1,961
Overall balance	100	202	104	-94	-18	87	144	207	248
Trade (percent change)									
Exports	62.6	16.6	24.1	-21.1	29.2	15.8	13.7	9.8	11.2
Imports	25.1	35.7	30.6	-10.6	-5.4	25.0	14.1	15.1	19.3
External public debt and debt service									
External public debt (in percent of GDP)	65.7	60.5	54.5	53.9	54.9	53.9	52.9	51.1	49.3
External public debt service (in percent of exports)	3.6	4.0	4.2	6.9	6.2	6.1	5.7	5.4	5.5
Gross official reserves									
In millions of U.S. dollars	336	536	636	536	512	595	736	939	1,184
In months of imports of goods and non-factor services	2.4	2.9	2.6	2.6	2.0	2.0	2.2	2.3	3.0
In months of imports (excluding resource projects)	3.2	3.9	3.4	3.0	2.2	2.3	2.5	2.6	3.3
Memorandum items:									
Nominal GDP (in billions of kip)	35,983	39,874	46,700	48,955	53,156	59,617	65,616	72,685	80,400
Nominal GDP (in millions of U.S. dollars)	3,577	4,170	5,374	5,721	6,053	6,586	7,069	7,688	8,374

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

1/ Fiscal year basis (October to September).

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Joint IMF/World Bank Debt Sustainability Analysis 2009[1]

Prepared by the staffs of the International Monetary Fund and
the International Development Association

Approved by Shogo Ishii and Dominique Desruelle (IMF)
and Vikram Nehru and Carlos Alberto Primo Braga (IDA)

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This document presents the joint IMF-World Bank debt sustainability analysis (DSA) for Lao P.D.R. using the Debt Sustainability Framework for Low-Income Countries (LIC).[2] Lao P.D.R. is currently classified as a weak performer with regard to its policies and institutions.[3] This DSA assesses the impact of various exogenous shocks on the sustainability of external and public sector debt under the baseline scenario.

I. INTRODUCTION

1. **The LIC DSA for Lao P.D.R. indicates that the country continues to face a high risk of debt distress.** The high level of concessionality of official borrowing keeps debt service ratios relatively contained. However, public external debt stock indicators are expected to remain at or above policy-dependant indicative thresholds throughout half of the projection period under the baseline, and could increase further in the event of weaker

[1] This DSA was prepared jointly by the IMF and World Bank, in consultation with the Asian Development Bank (AsDB). The debt data underlying this exercise were provided by the Lao P.D.R. authorities.

[2] See "Debt Sustainability in Low-Income Countries: Proposal for an Operational Framework and Policy Implications" (http://www.imf.org/external/np/pdr/sustain/2004/020304.htm and IDA/SECM2004/0035, 2/3/04) and "Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework, Policy Implications" (http://www.imf.org/external/np/pdr/sustain/2004/091004.htm and IDA/SECM2004/0629, 9/10/04) and "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," (www.imf.org/external/np/pp/eng/2006/110606.pdf and IDA/SecM2006-0564, 8/11/06).

[3] 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 3.17 percent over the past three years, placing it in a "weak performer" category. The relevant indicative thresholds for this category are: 30 percent for the NPV of debt-to-GDP ratio, 100 percent for the NPV of debt-to-exports ratio, 200 percent for the NPV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 25 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly-guaranteed external debt.

macroeconomic performance or greater accumulation of nonconcessional debt. The global financial crisis has lowered growth prospects due to delays in investment projects and softer external demand, and the external position has weakened.[4] The fiscal position is under strain, as are international reserves.

II. Background and Assumptions

2. **Lao P.D.R.'s external public and publicly-guaranteed (PPG) debt stock remains elevated.** Strong economic growth, appreciation of the kip, and favorable external conditions contributed to a decline in the debt ratio over the past few years—the stock of external PPG debt in nominal terms was US$2.9 billion at end-2008, or 53 percent of GDP, down from 81 percent at end-2005. Nominal debt stocks also declined as share of exports of goods and nonfactor services, from an estimated 241 percent at end-2005 to around 143 percent currently. The corresponding net present value (NPV) of debt at end-2008 was 35 percent of GDP or 91 percent of exports. Despite these improvements, Lao P.D.R.'s debt stock indicators are generally above the policy-based indicative thresholds (Figure 1). Debt service ratios, however, are below the indicative thresholds, reflecting the high degree of concessionality of existing debt.

Lao P.D.R.: External Public Debt Indicators at End-2008

	Indicative Thresholds	End-2008
NPV of debt, as a percent of:		
GDP	30	35
Exports	100	91
Revenue	200	255
Debt service, as a percent of:		
Exports	15	4
Revenue	25	12

Source: IMF staff estimates.

3. **Around 69 percent of PPG debt in Lao P.D.R. is held by multilateral creditors**, mainly the Asian Development Bank (AsDB—39 percent) and International Development Association (IDA—23 percent). About 29 percent is held by bilateral creditors—mainly Russia, China, Thailand, and Japan.[5] The remaining 2 percent of PPG external debt comprises external debt incurred by public entities on nonconcessional terms and guaranteed by the government, mainly for hydropower development and electricity generation, including to finance equity stakes. As new emerging market creditors increase their presence in

[4] Compared to the 2008 DSA, growth projections for 2009–11 have been reduced by about 2 percentage points on average and the primary deficit in the near term is now projected to be nearly 3 percentage points of GDP larger. Long-term growth is also assumed to be lower (by 0.5 percentage points on average), although foreign direct investment (FDI) projections have been revised upward based on updated data on resource projects. Debt dynamics are comparable, but somewhat less benign: debt levels are higher in the near term and decline more slowly.

[5] The Soviet-era debt owed to the Russian Federation is currently under negotiation. The DSA makes no assumptions regarding the outcome of the negotiations, maintaining the present value of the debt at its nominal value throughout the projection period.

Lao P.D.R., the government should ensure appropriate concessionality from these lenders, given its current indebtedness. This further underlines the need for the authorities to strengthen the capacity in debt management and develop a borrowing strategy to ensure that new debt is contracted with a view to maintaining debt sustainability.

Lao P.D.R.: Stock of Public and Publicly-Guaranteed External Debt at End-2008

	In billions of U.S. Dollars	As a Share of Total External Debt	In percent of GDP
Total	2.93	100	53.1
Multilateral	2.04	69	36.9
Bilateral	0.83	29	15.1
Commercial 1/	0.06	2	1.2

Sources: Lao P.D.R. authorities; and IMF and World Bank staffs' estimates.
1/ Includes direct borrowing by state-owned enterprises on nonconcessional terms.

4. **The size of domestic public debt is currently small, and comprises mainly treasury bills and bank recapitalization bonds.** At end-2008, the stock of recorded domestic public debt amounted to 2.1 percent of GDP. Total public debt, including both domestic and external, stood at 55.2 percent of GDP. Increasing off-budget public investment by lower levels of government and quasi-fiscal operations will lead to a significant increase in the domestic debt this year. Over the medium term, in the absence of an increase in external donor assistance and/or fiscal adjustment, domestic debt is set to rise substantially. The baseline scenario assumes that sizeable budgetary deficits over the next few years will put an upward pressure on domestic debt, until fiscal adjustment leads to a stabilization of the domestic debt stock at around 8–9 percent of GDP in the medium and long term.

5. **The baseline scenario is based on current policies.** It incorporates the most recent outlook for global growth in the face of the ongoing global crisis. In 2009–11, growth would remain robust (averaging 6 percent), supported by large resource projects already under construction as well as the loose fiscal and credit conditions. Over the medium term, growth accelerates—some resource-related projects which had been placed on hold enter the construction phase, and structural reforms aimed at fostering greater private sector participation begin to take hold. As the transition to a market economy advances, private sector-led growth is enabled by a restructured and vibrant domestic financial sector and an improved business climate. External vulnerability is reduced as large resource sector projects start generating export receipts (Box 1).

III. External Debt Sustainability Analysis

6. **Under the baseline scenario, public external debt stock indicators remain at elevated levels over the medium term, declining to the indicative thresholds only toward the middle of the projection period** (Figure 1 and Table 1a). The net present value (NPV) of public external debt picks up slightly over the medium term before declining steadily to

20 percent of GDP over the longer term. Debt service ratios (both as a share of exports and government revenues) fall continually and remain below indicative thresholds throughout, despite falling concessionality.

7. **External debt sustainability is most vulnerable to a depreciation of the nominal exchange rate** (Table 1b).[6] In the same way that the sustained strong appreciation of the kip over the past couple of years served to bring the debt ratio down considerably, a 30 percent depreciation of the kip would lead to a sharp jump in the NPV of debt-to-GDP and debt-to-revenue ratios, which would remain above the respective debt stock thresholds through most or all of the projection period. Indicative thresholds (both related to GDP and revenue) would be reached only over the very long term. Lower export growth (by one standard deviation in 2010–11) would push the NPV of debt-to-exports up to double its baseline level over the first half of the projection period and in excess of indicative thresholds throughout.

8. **Debt dynamics are considerably worse under an alternative scenario in which key variables are at their historical averages.** This is largely driven by the fact that this scenario assumes that FDI remains at the historical average (2.7 percent of GDP), compared to the medium-term baseline assumption (8.1 percent of GDP between 2009–14), implying substantial additional debt financing. In case of a significant decline of FDI, all debt indicators would rise steadily over the projection period and remain more than 50 percentage points above indicative thresholds. However, the comparatively optimistic baseline scenario is justified by the positive structural changes to the economy and significant improvements in policy achieved over recent years.

9. **Lao P.D.R.'s external debt dynamics are highly sensitive to assumptions regarding investment and performance of the resource sector.** Large resource-related projects now account for some 10 percent of GDP, with this share expected to nearly double over the medium term. Under the baseline, the global crisis is assumed to delay the near-term investment pipeline by two years, but leave unaffected construction of future planned projects. In addition, profitability is expected to rebound in the medium term as global demand and prices strengthen. Under a less positive scenario, lower growth would lead to a deterioration in debt dynamics.

IV. PUBLIC SECTOR DEBT SUSTAINABILITY

10. **Under the baseline, PPG debt is expected to rise over the medium term reflecting a deterioration of the fiscal position and rising quasi-fiscal liabilities** (Figure 2 and Table 2a). In the absence of fiscal measures, revenue shortfalls—resulting from the global slowdown and the impact of the global crisis on mining profits—and higher expenditure (both on- and off-budget) lead to a large domestic financing requirement which cannot be met through a drawdown in government deposits. Domestic debt rises from 2 percent of GDP in 2008 to around 8–9 percent of GDP in the medium term and stabilizes at that level in the long

[6] The most extreme stress test is defined as the bound test resulting in the most extreme deterioration of the debt burden indicator after 10 years.

term. As fiscal adjustment is pursued over the longer term—in part by constraining domestically financed development expenditure in the face of rising domestic debt—PPG debt declines to around 35 percent of GDP.

11. **The NPV of the public debt-to-GDP ratio rises over the medium term before tapering off over the remainder of the projection period.** The impact of the global crisis on growth and fiscal revenues drives the near-term debt dynamics. The impact of expiring grace periods and falling concessionality are offset by assumed fiscal adjustment, leading the NPV of debt service-to-revenue lower over the projection period.

12. **Public debt ratios are particularly sensitive to a real kip depreciation over the medium term** (Figure 2 and Table 2b). The impact is somewhat less over the longer term. A one-time 30 percent real depreciation of the kip exchange rate would raise the NPV of public debt-to-GDP and public debt-to-revenue ratios to 58 and 370 percent, respectively. The impact on the debt service-to-revenue ratio is relatively mild, leading to an increase to around 22 percent; however, this impact is more sustained over the longer term.

13. **Alternative scenarios point to less positive debt dynamics, especially over the longer term.** With key variables at historical averages, the NPV of the public debt-to-GDP ratio remains elevated over the longer term. Assuming that the primary balance from 2009 is maintained throughout the projection period would lead to a severe increase in debt ratios—however, this alternative scenario is likely to overstate risks given the sharp deterioration of the primary balance in 2009.

V. Conclusion

14. **While Lao P.D.R. has made progress in reducing its external and public debt burden, it still faces a high risk of debt distress.** Near-term debt dynamics deteriorate as a result of the global crisis. Longer-term debt dynamics reflect current and planned large-scale investments in hydropower and mining projects that will only deliver returns over the medium term. The outlook is particularly sensitive to large swings of the exchange rate, highlighting the importance of maintaining macroeconomic stability and deepening structural reforms.

15. **External borrowing should be obtained on concessional terms and fiscal and quasi-fiscal liabilities should be carefully managed, to further guard against the vulnerabilities.** Continued prudent debt management as well as cautious assessment and monitoring of large-scale projects will be required to mitigate the risks posed to external and public debt sustainability. Fiscal risk could arise if these projects fail to generate the expected returns, including to the government's own equity stakes. Improving debt management capacity and developing a medium-term borrowing strategy for the government, including for resource sector activity, as well as greater disclosure of borrowing plans, would substantially enhance the assessment of debt sustainability.

Box 1: Baseline Scenario—Underlying Assumptions (2009–29)

- **Real GDP growth** is projected to average 6 percent during 2009–11 as the global crisis delays new resource sector-related projects, and falling rural incomes and weak external demand weigh on growth. Support is provided by large resource projects already under construction. Over the medium term, growth picks up (6½ percent average) as construction of new large projects resumes, rising incomes (domestic and foreign) boost consumption, and nonresource sector growth (mainly from agriculture, light manufactures, and tourism and other services) picks up. Overall growth is relatively volatile as resource sector output is subject to discrete changes as new projects come online or existing mines are exhausted. Over the longer term, assumed structural changes and reforms would create an enabling environment, broadening the sources of growth. Growth in the resource sector is expected to level off (about 6 percent), while nonresource sector growth would rise to a sustained level of about 7.5 percent over the second half of the projection period. Over time, the share of agriculture in GDP declines, as the transition to a market-based economy leads to an increasing share of industry and services. Graduation from low-income status could be achieved in the second half of the projection period.

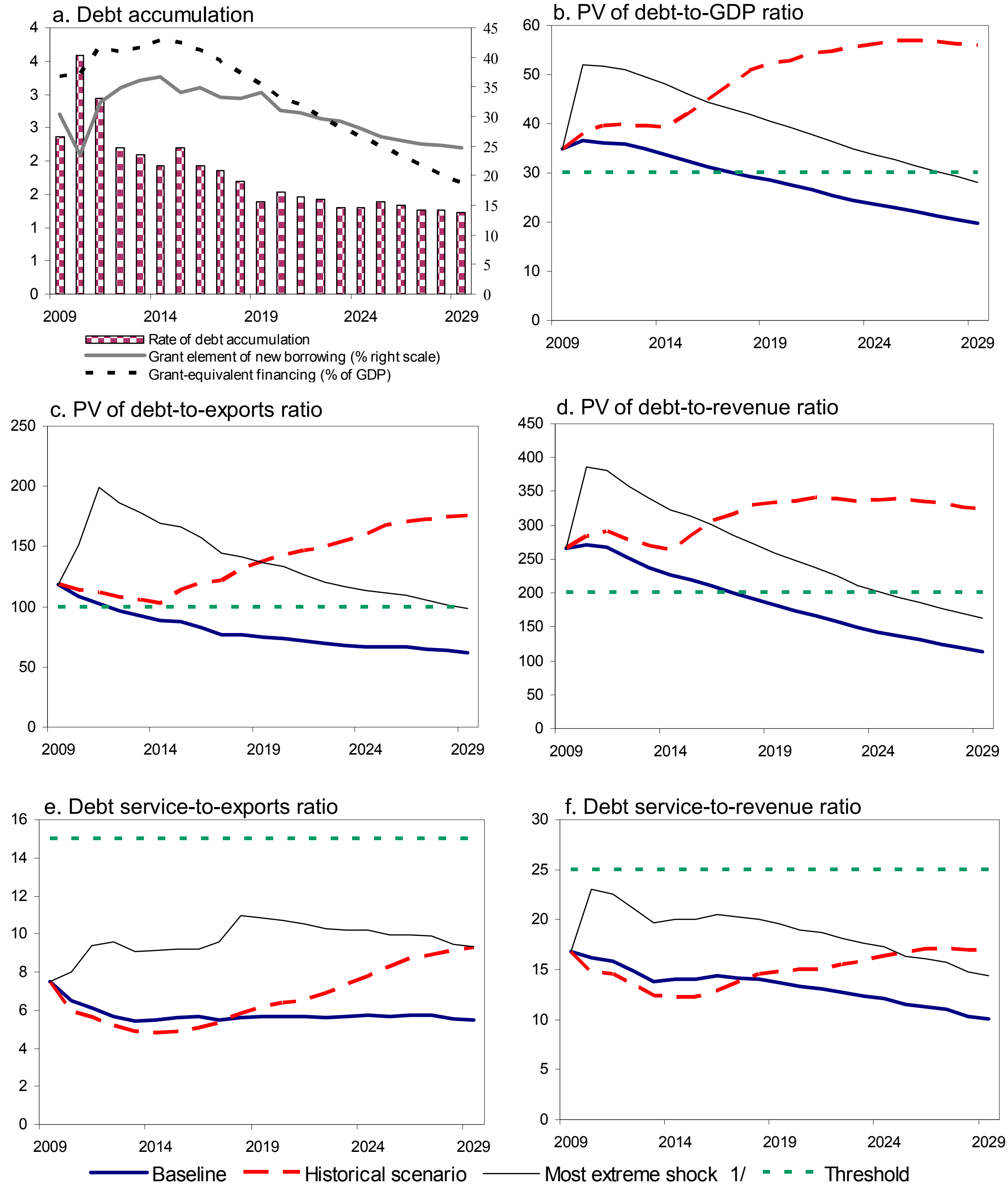
- **The external current account deficit** is projected to narrow considerably in the long run. The nonresource current account would deteriorate over the next decade reflecting the increasing cost of industrialization, before moderating over the longer term. This would increasingly be offset by a shift to surplus in the resource current account as large projects transition from construction to operation phase. The assumed pick up in nonresource export and services is driven by strengthened competitiveness and regional integration, supported by improvements in the investment climate, a streamlining of business regulations, and meeting trade commitments. Notwithstanding its recent weakening, the overall external position is expected to strengthen over time reflecting strong private capital and official inflows, and increasing international reserve accumulation in the outer years as the resource sector matures and industrialization takes hold. Exports are highly volatile due to the timing of production in the mining and electricity sectors, which respond for the majority of exports. For example, exports decline by 21 percent in 2009 mainly because of lower prices for copper before increasing by 29 percent in 2010 due to the coming online of Nam Theun II. Imports in the resource sector are closely linked to the development of new resource projects. In the near term, FDI is in line with the 2006–08 average as resource sector investments remain robust. Over the long term, resource FDI declines, while nonresource FDI is assumed to grow at the same rate as the nonresource economy.

- **External financing** is assumed to remain largely on concessional terms. Over the long term, grant financing decreases with economic development.
  - ***Multilateral creditors:*** Projected loan disbursements in the medium term are relatively low since IDA and the AsDB have a pipeline of operations financed on grant terms. Over the longer term, grant financing decreases with economic development, leading once again to a moderate increase in project loans.
  - ***Bilateral creditors:*** For 2009–10, projected loan disbursements increase as donors provide support to the government's development agenda. Over the medium and longer term, greater participation by new emerging market creditors leads bilateral finance to take on an increasing role, including for on-lending purposes to state-owned enterprises.
  - ***Commercial creditors:*** Over the medium term, commercial disbursements are relatively small, principally used to finance a portion of the government's equity stake participation in new hydropower projects. This includes the planned US$70 million bond issue backed by royalties from the Theun-Hinboun and Houay Ho projects. Over time, as development continues and market access increases, commercial borrowing takes on a larger role but disbursements remain below those of official creditors.

- **Fiscal policy** is expansionary in the near term—the public sector balance is expected to post a deficit of nearly 8 percent of GDP in 2008/09 (including off-budget operations), and remain elevated over the next few years. The nonresource current balance turns negative, implying that resource revenues are used to fund current expenditures. Under such a scenario, government deposits would quickly be depleted and domestic borrowing would increase. Financing constraints and the rising domestic debt stock provide an impetus for adjustment—in addition to a sizable revenue effort, a reduction in domestically financed capital expenditure leads to a lower deficit in the second half of the medium term. Over the longer term, vulnerability to resource-related revenue is decreased, as shown by a return of the nonresource current balance to positive territory.

- **Domestic debt** increases over the medium term. Domestic debt is initially assumed to be composed of mainly short-term debt (treasury bills) given the undeveloped nature of the domestic market for government debt. In the medium term, the role of medium- and long-term debt is assumed to increase, comprising about half of domestic debt.

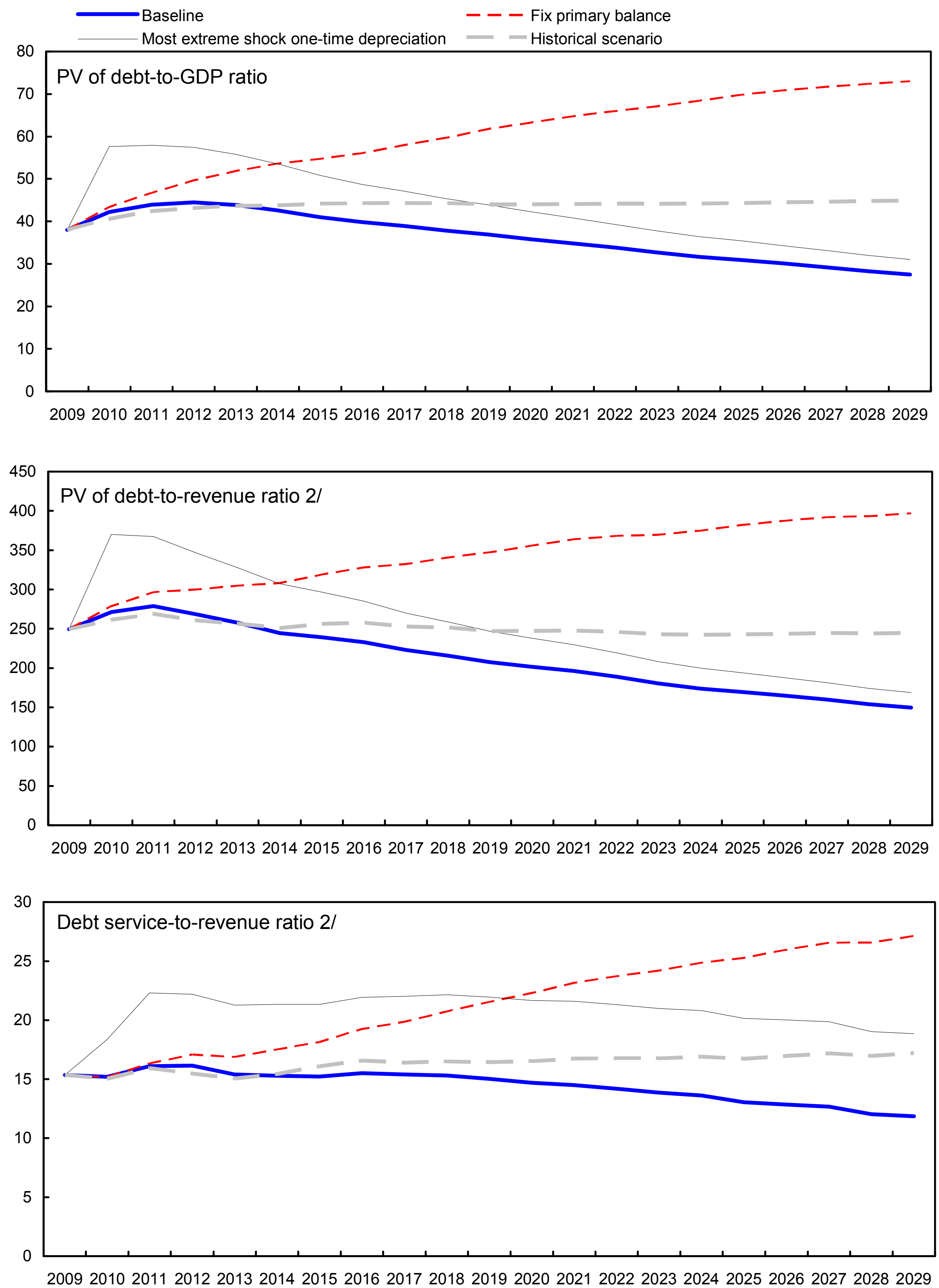
Figure 1. Lao P.D.R.: Indicators of Public and Publicly-Guaranteed External Debt under Alternatives Scenarios, 2009–29 1/



Source: Staffs' projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2019. In figure b. it corresponds to a one-time depreciation shock; in c. to an exports shock; in d. to a one-time depreciation shock; in e. to an exports shock and in picture f. to a one-time depreciation shock.

Figure 2. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios, 2009–29 1/



Sources: Lao P.D.R. authorities; and staffs' estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2019.
2/ Revenues are defined inclusive of grants.

Table 1a. Lao P.D.R.: External Debt Sustainability Framework, Baseline Scenario, 2006–29 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections									
	2006	2007	2008			2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
External debt (nominal) 1/	**93.1**	**101.7**	**94.3**			**97.6**	**96.6**	**96.6**	**98.6**	**101.8**	**106.6**		**88.7**	**53.6**	
Of which: Public and publicly-guaranteed (PPG)	63.1	59.1	53.1			54.5	55.7	54.8	53.4	51.6	49.7		40.9	26.9	
Change in external debt	-19.8	8.7	-7.4			3.2	-0.9	-0.1	2.1	3.2	4.8		-3.5	-2.3	
Identified net debt-creating flows	-18.2	0.8	-15.1			3.8	-1.4	-2.6	-0.3	0.5	0.8		-3.9	-2.6	
Noninterest current account deficit	**9.0**	**14.5**	**15.4**	**10.3**	**6.2**	**13.9**	**5.6**	**10.1**	**11.0**	**14.2**	**18.5**		**7.4**	**6.1**	7.0
Deficit in balance of goods and services	8.5	15.2	15.7			16.0	7.2	11.5	12.5	15.0	19.3		6.2	4.4	
Exports	37.7	38.3	38.2			29.5	33.7	35.3	37.1	37.5	38.2		38.1	31.8	
Imports	46.2	53.5	53.9			45.5	40.9	46.8	49.7	52.5	57.4		44.3	36.3	
Net current transfers (negative = inflow)	-4.0	-2.7	-2.8	-3.8	1.7	-3.0	-2.9	-3.0	-3.1	-3.2	-3.3		-3.0	-2.3	-2.8
Of which: Official	-2.4	-1.5	-1.6			-2.1	-2.1	-2.2	-2.3	-2.4	-2.5		-2.1	-1.0	
Other current account flows (negative = net inflow)	4.5	2.0	2.4			0.9	1.4	1.7	1.6	2.4	2.6		4.1	4.0	
Net FDI (negative = inflow)	**-2.7**	**-1.7**	**-8.8**	**-2.7**	**2.7**	**-7.5**	**-4.6**	**-7.5**	**-7.5**	**-8.8**	**-12.6**		**-8.8**	**-6.2**	-7.8
Endogenous debt dynamics 2/	**-24.4**	**-11.9**	**-21.7**			**-2.5**	**-2.5**	**-5.2**	**-3.9**	**-4.9**	**-5.2**		**-2.4**	**-2.5**	
Contribution from nominal interest rate	1.3	1.3	1.1			1.5	2.5	2.3	2.1	1.9	1.7		1.8	1.0	
Contribution from real GDP growth	-7.3	-6.0	-5.7			-4.1	-5.0	-7.4	-6.0	-6.7	-6.8		-4.3	-3.5	
Contribution from price and exchange rate changes	-18.4	-7.3	-17.1			...	...	...	...	...	...		...	...	
Residual (3–4) 3/	**-1.6**	**7.8**	**7.7**			**-0.6**	**0.5**	**2.5**	**2.4**	**2.7**	**4.1**		**0.4**	**0.4**	
Of which: Exceptional financing	2.7	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/	...	...	76.1			78.0	77.4	78.0	81.0	85.1	90.7		76.3	46.4	
In percent of exports	...	...	199.1			264.4	229.7	221.0	218.1	226.9	237.6		200.1	145.9	
PV of PPG external debt	...	...	**34.9**			**35.0**	**36.5**	**36.2**	**35.8**	**34.8**	**33.7**		**28.5**	**19.7**	
In percent of exports	...	...	**91.3**			**118.6**	**108.3**	**102.6**	**96.3**	**92.9**	**88.4**		**74.8**	**62.0**	
In percent of government revenues	...	...	**254.8**			**265.7**	**270.7**	**266.6**	**251.0**	**238.3**	**226.0**		**181.7**	**113.8**	
Debt service-to-exports ratio (in percent)	**5.7**	**12.5**	**10.3**			**11.1**	**19.5**	**17.4**	**15.1**	**16.4**	**14.8**		**19.3**	**14.9**	
PPG debt service-to-exports ratio (in percent)	**3.6**	**4.0**	**4.2**			**7.5**	**6.5**	**6.1**	**5.7**	**5.4**	**5.5**		**5.7**	**5.5**	
PPG debt service-to-revenue ratio (in percent)	**10.8**	**10.8**	**11.8**			**16.8**	**16.1**	**15.8**	**14.8**	**13.8**	**14.1**		**13.7**	**10.1**	
Total gross financing need (billions of U.S. dollars)	0.3	0.7	0.6			0.5	0.5	0.6	0.6	0.9	1.0		0.8	1.5	
Noninterest current account deficit that stabilizes debt ratio	28.8	5.8	22.8			10.7	6.5	10.2	9.0	11.0	13.6		10.8	8.3	
Key macroeconomic assumptions 5/															
Real GDP growth (in percent)	8.4	7.5	7.2	6.8	0.9	4.6	5.4	8.4	6.7	7.4	7.3	6.6	5.0	7.0	6.6
GDP deflator in U.S. dollar terms (change in percent)	19.5	8.5	20.2	8.2	9.0	1.8	0.4	0.4	0.6	1.2	1.5	1.0	2.8	2.9	2.7
Effective interest rate (percent) 6/	1.5	1.6	1.4	1.7	0.3	1.7	2.8	2.5	2.3	2.1	1.8	2.2	2.1	2.0	1.9
Growth of exports of G&S (U.S. dollar terms, in percent)	47.2	18.7	28.4	17.5	20.1	-17.7	20.7	14.0	12.9	9.7	10.9	8.4	6.9	8.5	8.2
Growth of imports of G&S (U.S. dollar terms, in percent)	24.2	35.2	29.9	17.6	13.6	-10.3	-4.9	24.5	14.0	15.0	19.1	9.6	4.0	8.4	6.2
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	30.4	23.5	32.4	34.8	36.1	36.7	32.3	34.0	24.7	29.7
Government revenues (excluding grants, in percent of GDP)	12.7	14.3	13.7			13.2	13.5	13.6	14.3	14.6	14.9		15.7	17.3	16.1
Aid flows (in billions of U.S. dollars) 7/	0.1	0.1	0.1			0.2	0.2	0.2	0.3	0.3	0.3		0.4	0.5	
Of which: Grants	0.1	0.1	0.1			0.1	0.1	0.1	0.2	0.2	0.2		0.3	0.3	
Of which: Concessional loans	0.0	0.0	0.0			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.3	3.3	3.7	3.6	3.7	3.8		3.2	1.7	2.7
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			54.6	45.7	53.9	59.3	61.6	62.6		60.3	46.3	54.7
Memorandum items:															
Nominal GDP (billions of U.S. dollars)	3.6	4.2	5.4			5.7	6.1	6.6	7.1	7.7	8.4		13.1	32.5	
Nominal dollar GDP growth	29.5	16.6	28.9			6.5	5.8	8.8	7.3	8.8	8.9	7.7	7.9	10.0	9.5
PV of PPG external debt (in billions of U.S. dollars)			1.9			2.0	2.2	2.4	2.5	2.7	2.8		3.7	6.4	
(PVt-PVt-1)/GDPt-1 (in percent)						2.4	3.6	2.9	2.2	2.1	1.9	2.5	1.4	1.2	1.5

Source: Staffs' simulations.

1/ Includes both public and private sector external debt, excluding contingent liabilities.
2/ Derived as [r - g - r(1+g)]/(1+g+r+gr) times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = 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/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.
6/ Current-year interest payments divided by previous period debt stock.
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 1b. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2009–29

(In percent)

		Projections																			
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**2019**	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
										PV of debt-to-GDP ratio											
Baseline	35	36	36	36	35	34	32	31	30	29	**29**	27	26	25	24	24	23	22	21	20	20
A. Alternative scenarios																					
A1. Key variables at their historical averages in 2009–29 1/	35	38	39	40	39	39	42	45	48	51	**52**	53	54	55	55	56	57	57	56	56	56
A2. New public sector loans on less favorable terms in 2009–29 2/	35	37	38	39	39	38	37	37	36	36	**36**	35	34	33	33	32	32	31	30	30	29
B. Bound tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	35	36	37	36	35	34	33	32	31	30	**29**	28	27	26	25	24	23	22	22	21	20
B2. Export value growth at historical average minus one standard deviation in 2010–11 3/	35	41	48	48	46	44	42	41	39	37	**36**	34	32	31	29	27	26	25	24	23	22
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	35	37	37	37	36	34	33	32	31	30	**29**	28	27	26	25	24	23	23	22	21	20
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010–11 4/	35	40	46	45	44	42	40	39	37	36	**34**	33	31	29	28	27	26	24	23	22	21
B5. Combination of B1–B4 using one-half standard deviation shocks	35	40	46	46	44	43	41	39	38	36	**34**	32	31	29	28	26	25	24	23	22	20
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	35	52	52	51	50	48	46	44	43	42	**41**	39	38	36	35	34	33	31	30	29	28
										PV of debt-to-exports ratio											
Baseline	119	108	103	96	93	88	87	83	77	76	**75**	74	72	69	68	67	67	66	65	64	62
A. Alternative scenarios																					
A1. Key variables at their historical averages in 2009–29 1/	119	113	112	107	105	103	113	120	122	132	**137**	142	146	149	154	160	167	170	172	174	175
A2. New public sector loans on less favorable terms in 2009–29 2/	119	110	109	104	103	100	100	98	92	93	**93**	94	93	91	91	91	93	93	93	92	91
B. Bound tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	119	108	103	96	93	88	87	83	77	76	**75**	74	72	69	68	67	67	66	65	63	62
B2. Export value growth at historical average minus one standard deviation in 2010–11 3/	119	151	199	186	179	169	166	157	145	141	**136**	133	127	121	117	114	112	109	105	102	98
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	119	108	103	96	93	88	87	83	77	76	**75**	74	72	69	68	67	67	66	65	63	62
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010–11 4/	119	120	130	121	117	111	109	103	95	93	**90**	88	84	80	78	76	75	73	71	69	66
B5. Combination of B1–B4 using one-half standard deviation shocks	119	138	166	155	149	141	138	131	120	117	**113**	110	105	100	97	94	93	90	87	84	81
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	119	108	103	96	93	88	87	83	77	76	**75**	74	72	69	68	67	67	66	65	63	62
										PV of debt-to-revenue ratio											
Baseline	266	271	267	251	238	226	220	212	200	192	**182**	174	166	158	148	141	136	130	125	119	114
A. Alternative scenarios																					
A1. Key variables at their historical averages in 2009–29 1/	266	283	290	279	270	263	286	306	316	330	**333**	334	340	338	335	337	339	336	331	325	322
A2. New public sector loans on less favorable terms in 2009–29 2/	266	276	282	272	264	255	253	249	240	234	**226**	220	215	207	198	192	188	183	178	172	168
B. Bound tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	266	269	271	255	242	230	224	215	204	195	**185**	177	169	160	151	144	139	133	127	121	116
B2. Export value growth at historical average minus one standard deviation in 2010–11 3/	266	305	356	333	315	298	289	276	259	244	**228**	215	203	189	175	165	156	148	140	131	124
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	266	274	273	257	244	231	225	216	204	196	**186**	178	170	161	152	144	139	133	128	121	116
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010–11 4/	266	299	337	316	299	283	274	263	247	233	**218**	206	195	182	170	160	152	144	136	128	122
B5. Combination of B1–B4 using one-half standard deviation shocks	266	294	342	320	302	286	277	265	248	233	**218**	206	194	181	167	157	149	141	133	125	118
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	266	386	380	358	339	322	314	301	285	273	**259**	248	237	225	211	201	194	186	178	169	162

Table 1b. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2009–29 (concluded)

(In percent)

	Projections																				
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	**2019**	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
	Debt service-to-exports ratio																				
Baseline	8	6	6	6	5	6	6	6	5	6	**6**	6	6	6	6	6	6	6	6	6	6
A. Alternative scenarios																					
A1. Key variables at their historical averages in 2009–29 1/	8	6	6	5	5	5	5	5	5	6	**6**	6	6	7	7	8	8	9	9	9	9
A2. New public sector loans on less favorable terms in 2009–29 2/	8	6	6	6	6	6	7	7	7	7	**7**	7	7	7	7	8	8	8	8	8	8
B. Bound tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	8	6	6	6	5	5	6	6	5	6	**6**	6	6	6	6	6	6	6	6	6	5
B2. Export value growth at historical average minus one standard deviation in 2010–11 3/	8	8	9	10	9	9	9	9	10	11	**11**	11	10	10	10	10	10	10	10	9	9
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	8	6	6	6	5	5	6	6	5	6	**6**	6	6	6	6	6	6	6	6	6	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010–11 4/	8	6	6	6	6	6	6	6	6	7	**7**	7	7	7	7	7	7	7	7	6	6
B5. Combination of B1–B4 using one-half standard deviation shocks	8	7	8	8	8	8	8	8	8	9	**9**	9	9	9	8	8	8	8	8	8	8
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	8	6	6	6	5	5	6	6	5	6	**6**	6	6	6	6	6	6	6	6	6	5
	Debt service-to-revenue ratio																				
Baseline	17	16	16	15	14	14	14	14	14	14	**14**	13	13	13	12	12	11	11	11	10	10
A. Alternative scenarios																					
A1. Key variables at their historical averages in 2009–29 1/	17	15	15	13	12	12	12	13	14	14	**15**	15	15	16	16	16	17	17	17	17	17
A2. New public sector loans on less favorable terms in 2009–29 2/	17	16	16	16	15	16	17	17	17	17	**17**	16	16	16	16	16	15	15	15	14	14
B. Bound tests																					
B1. Real GDP growth at historical average minus one standard deviation in 2010–11	17	16	16	15	14	14	14	15	14	14	**14**	14	13	13	13	12	12	11	11	11	10
B2. Export value growth at historical average minus one standard deviation in 2010–11 3/	17	16	17	17	16	16	16	16	17	19	**18**	17	17	16	15	15	14	14	13	12	12
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2010–11	17	16	16	15	14	14	14	15	15	14	**14**	14	13	13	13	12	12	12	11	11	10
B4. Net non-debt creating flows at historical average minus one standard deviation in 2010–11 4/	17	16	17	17	16	16	16	16	17	18	**17**	16	16	15	15	14	13	13	13	12	11
B5. Combination of B1–B4 using one-half standard deviation shocks	17	15	16	16	15	15	15	15	16	18	**17**	17	16	15	15	14	13	13	12	12	11
B6. One-time 30 percent nominal depreciation relative to the baseline in 2010 5/	17	23	23	21	20	20	20	21	20	20	**20**	19	19	18	18	17	16	16	16	15	14
Memorandum item:																					
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	30	30	30	30	30	30	30	30	30	30	**30**	30	30	30	30	30	30	30	30	30	30

Source: Staffs' projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in U.S. dollar terms), noninterest 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 assuming 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 2a. Lao P.D.R.: Public Sector Debt Sustainability Framework, Baseline Scenario, 2006–29

(In percent of GDP, unless otherwise indicated)

	Actual					Estimate	Projections								
	2006	2007	2008	Average	Standard Deviation	2009	2010	2011	2012	2013	2014	2009–14 Average	2019	2029	2015–29 Average
Public sector debt 1/	64.6	60.7	55.2			57.2	60.9	61.9	61.8	60.3	58.3		49.2	34.7	
Of which: Foreign-currency denominated	63.1	59.1	53.1			54.5	55.7	54.8	53.4	51.6	49.7		40.9	26.9	
Change in public sector debt	-16.9	-3.9	-5.6			2.0	3.8	1.0	-0.2	-1.5	-2.0		-1.4	-1.2	
Identified debt-creating flows	-18.9	-5.5	-10.3			5.6	2.7	0.1	-0.4	-1.8	-2.3		-1.8	-2.0	
Primary deficit	2.4	2.1	2.9	3.0	0.8	6.2	4.5	3.8	2.7	1.8	1.3	3.4	0.7	0.3	0.7
Revenue and grants	14.6	15.9	15.2			15.2	15.6	15.8	16.6	17.0	17.4		17.8	18.4	
Of which: Grants	1.9	1.6	1.5			2.1	2.1	2.2	2.3	2.4	2.5		2.1	1.0	
Primary (noninterest) expenditure	17.0	18.1	18.1			21.4	20.1	19.6	19.2	18.8	18.7		18.5	18.7	
Automatic debt dynamics	-21.3	-7.6	-13.0			-0.3	-1.8	-3.7	-3.1	-3.7	-3.7		-2.5	-2.3	
Contribution from interest rate/growth differential	-8.1	-5.5	-4.7			-1.8	-2.0	-3.8	-3.3	-3.9	-3.8		-1.9	-1.9	
Of which: Contribution from average real interest rate	-1.8	-1.0	-0.6			0.6	0.9	0.9	0.6	0.3	0.3		0.5	0.5	
Of which: Contribution from real GDP growth	-6.3	-4.5	-4.1			-2.4	-2.9	-4.7	-3.9	-4.3	-4.1		-2.4	-2.3	
Contribution from real exchange rate depreciation	-13.2	-2.1	-8.3			1.5	0.3	0.1	0.2	0.3	0.1		...	...	
Other identified debt-creating flows	0.0	0.0	-0.1			-0.3	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	-0.1			-0.3	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	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	2.0	1.6	4.7			-3.6	1.0	0.9	0.3	0.4	0.3		0.4	0.8	
Other sustainability indicators															
PV of public sector debt	1.6	1.7	36.0			38.0	42.2	44.0	44.5	43.8	42.6		36.9	27.5	
Of which: Foreign-currency denominated	0.0	0.0	34.0			35.4	37.0	36.8	36.1	35.1	34.0		28.5	19.8	
Of which: External	...	...	34.0			35.4	37.0	36.8	36.1	35.1	34.0		28.5	19.8	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 2/	4.3	4.5	5.2			9.5	8.2	10.0	10.8	10.3	9.6		7.2	6.0	
PV of public sector debt-to-revenue and grants ratio (in percent)	10.8	10.5	237.1			249.4	271.2	278.8	268.7	257.7	244.6		207.6	149.8	
PV of public sector debt-to-revenue ratio (in percent)	12.4	11.7	263.0			288.8	313.5	323.7	312.0	299.9	285.2		235.2	158.7	
Of which: External 3/	…	…	248.2			268.6	274.9	270.7	253.5	240.3	227.6		181.9	113.9	
Debt service-to-revenue and grants ratio (in percent) 4/	10.0	10.4	11.5			15.4	15.2	16.1	16.2	15.4	15.3		15.0	11.8	
Debt service-to-revenue ratio (in percent) 4/	11.5	11.6	12.8			17.8	17.6	18.7	18.8	17.9	17.8		17.0	12.6	
Primary deficit that stabilizes the debt-to-GDP ratio	19.2	6.0	8.4			4.2	0.8	2.8	2.9	3.3	3.3		2.1	1.5	
Key macroeconomic and fiscal assumptions 5/															
Real GDP growth (in percent)	8.4	7.5	7.2	6.8	0.9	4.6	5.4	8.4	6.7	7.4	7.3	6.6	5.0	7.0	6.6
Average nominal interest rate on forex debt (in percent)	0.8	0.8	1.0	0.8	0.3	2.0	1.9	1.9	1.9	1.9	1.9	1.9	1.9	2.3	2.0
Average real interest rate on domestic debt (in percent)	1.4	4.1	0.7	14.2	15.9	6.3	4.7	4.7	5.2	4.7	3.9	4.9	3.5	2.8	3.2
Real exchange rate depreciation (in percent, + indicates depreciati	-18.1	-3.7	-15.2	-5.2	9.9	2.9	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	13.1	3.1	9.2	9.3	4.4	0.2	3.0	3.5	3.2	3.1	3.1	2.7	3.1	3.1	3.1
Growth of real primary spending (deflated by GDP deflator, in perc	0.1	0.1	0.1	0.1	0.1	0.2	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	30.4	23.5	32.4	34.8	36.1	36.7	32.3	34.0	24.7	...

Sources: Lao P.D.R. authorities; and staffs' estimates and projections.
1/ Gross general government debt.
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 2b. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public Debt, 2009–29

	Projections							
	2009	2010	2011	2012	2013	2014	2019	2029
	PV of debt-to-GDP ratio							
Baseline	38	42	44	44	44	43	37	28
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	38	41	42	43	44	44	44	45
A2. Primary balance is unchanged from 2009	38	43	47	50	52	54	62	73
A3. Permanently lower GDP growth 1/	38	42	44	45	44	43	39	32
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010–11	38	42	45	46	45	44	39	31
B2. Primary balance is at historical average minus one standard deviations in 2010–11	38	42	43	44	43	42	37	27
B3. Combination of B1–B2 using one half standard deviation shocks	38	41	43	44	43	42	37	29
B4. One-time 30 percent real depreciation in 2010	38	58	58	57	56	54	44	31
B5. 10 percent of GDP increase in other debt-creating flows in 2010	38	49	51	51	50	48	41	30
	PV of debt-to-revenue ratio 2/							
Baseline	249	271	279	269	258	245	208	150
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	249	261	269	261	257	251	247	245
A2. Primary balance is unchanged from 2009	249	279	297	300	305	308	347	397
A3. Permanently lower GDP growth 1/	249	272	280	271	260	248	216	173
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010–11	249	270	284	275	265	252	219	166
B2. Primary balance is at historical average minus one standard deviations in 2010–11	249	268	275	265	255	242	206	149
B3. Combination of B1–B2 using one half standard deviation shocks	249	264	274	265	255	243	210	156
B4. One-time 30 percent real depreciation in 2010	249	370	368	347	328	307	247	169
B5. 10 percent of GDP increase in other debt-creating flows in 2010	249	317	322	308	294	278	232	162
	Debt service-to-revenue ratio 2/							
Baseline	15	15	16	16	15	15	15	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	15	15	16	15	15	15	16	17
A2. Primary balance is unchanged from 2009	15	15	16	17	17	18	22	27
A3. Permanently lower GDP growth 1/	15	15	16	16	16	15	15	13
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2010–11	15	15	16	16	16	16	16	13
B2. Primary balance is at historical average minus one standard deviations in 2010–11	15	15	16	16	15	15	15	12
B3. Combination of B1–B2 using one half standard deviation shocks	15	15	16	16	15	15	15	12
B4. One-time 30 percent real depreciation in 2010	15	18	22	22	21	21	22	19
B5. 10 percent of GDP increase in other debt-creating flows in 2010	15	15	18	20	16	16	17	13

Sources: Lao P.D.R. authorities; and staffs' 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 2009 Article IV Consultation—Informational Annex

Prepared by the Asia and Pacific Department
(In Consultation with Other Departments)

June 24, 2009

Contents Page

ANNEX I. LAO P.D.R.: FUND RELATIONS
(As of May 31, 2009)

I. **Membership Status:** Joined 7/05/61; Article XIV

II.	**General Resources Account:**	**SDR million**	**Percent Quota**
	Quota	52.90	100.00
	Fund holdings of currency	52.90	100.00

III.	**SDR Department:**	**SDR million**	**Percent Allocation**
	Net cumulative allocation	9.41	100.00
	Holdings	9.80	104.18

IV.	**Outstanding Purchases and Loans:**	**SDR million**	**Percent Quota**
	PRGF arrangements	11.78	22.26

V. **Latest Financial Arrangements:**

Type	**Approval Date**	**Expiration Date**	**Amount Approved (SDR million)**	**Amount Drawn (SDR million)**
PRGF	4/25/01	4/24/05	31.70	18.12
PRGF	6/04/93	5/07/97	35.19	35.19
SAF	9/18/89	9/17/92	20.51	20.51

VI. **Projected Obligations to Fund** (SDR million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	**2010**	**2011**	**2012**	**2013**
Principal	1.81	3.62	3.17	2.27	0.91
Charges/interest	0.06	0.04	0.02	0.01	0.00
Total	1.87	3.66	3.19	2.27	0.91

VII. **Implementation of Heavily Indebted Poor Countries Initiative (HIPC)**

Not applicable

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI):

Not applicable

IX. Safeguards Assessments

A safeguards assessment of the Bank of Lao P.D.R. (BoL) was completed in April 2003 with respect to the PRGF arrangement approved in 2001. The main findings, recommendations, and progress thereon were reported in Country Report Nos. 03/308 and 05/8. Progress on safeguards recommendations has been slow. The authorities indicated that they were not in a position to implement an earlier agreement to undertake a joint audit of the BoL's 2003 and 2004 accounts by the state auditor and an international audit firm. These audits have subsequently been completed by the state auditor, but the joint audit issue remains unresolved.

X. Exchange Rate Arrangement

In September 1995, Lao P.D.R. officially adopted a managed floating exchange rate system. The BoL sets a daily official reference rate, based on the weighted average of the previous day's commercial bank and interbank rates. Effective August 2007, banks 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 (previously ± 1.15 percent), and ±0.5 percent for the baht and euro. For all other currencies, commercial banks may not exceed a margin of 2 percent between the buying and selling rates. Within the prescribed limits, commercial banks are free to set their own rates. Under the IMF's current de-facto classification system, the exchange rate regime is now classified as an "other managed arrangement."

XI. Exchange and Payments System

Lao P.D.R. no longer maintains restrictions on the making of payments and transfers for current international transactions under the transitional arrangements of Article XIV, Section 2, but maintains restrictions imposed for the preservation of national or international security, which have been notified pursuant to Decision No. 144-(52/51), and a restriction subject to IMF approval under Article VIII (tax payment certificates are required for some transactions). A joint LEG/MCM mission in August 2004 conducted a review of the exchange system to establish the remaining measures that would facilitate Lao P.D.R.'s acceptance of the obligations under Article VIII, including the elimination of an exchange restriction on the making of payments and transfers for current international transactions.

XII. Last Article IV Consultation Discussions

The last Article IV consultation discussions were held in Vientiane during April 30–May 13, 2008. The Country Report No. 08/350 was discussed by the Executive Board on July 30, 2008 and was published on October 22, 2008.

XIII. Resident Representative

Mr. Benedict Bingham assumed the Senior Resident Representative post for Vietnam and Lao P.D.R., based in Hanoi, on October 17, 2007.

XIV. Technical Assistance (since 2004)

Department		Purpose	Date
STA	-	Government finance statistics	April–May 2004 April–May 2009
	-	Money and banking statistics	April–May 2004
	-	National accounts statistics	November–December 2006
FAD	-	Expert on customs administration	January and June 2004, February 2005, October and December 2008, January 2009
	-	Expert on tax administration	March–April and November 2004
	-	Mission on public expenditure management	June–July 2004 and October 2004
	-	Missions on tax policy and administration	October 2004
	-	Expert on public expenditure management	November 2004, March–April 2005
	-	Expert on customs law	January and March 2008
MCM	-	Expert on banking supervision	January–February, May–July, and September–October 2004; January–March, April–June, and September–December 2005
	-	Expert on foreign exchange regulations	July–August 2004
	-	Mission of Article VIII (jointly with LEG)	August 2004
	-	Mission on central bank audit	May 2005

ANNEX II. LAO P.D.R.: RELATIONS WITH THE WORLD BANK GROUP[1]

IMF-World Bank Collaboration

The IMF takes the lead in advising the government of Lao P.D.R. on macroeconomic policy. The support covers tax, fiscal, monetary, and exchange rate policies, and economic statistical issues. The World Bank takes the lead in supporting the government in formulating a growth and poverty reduction strategy and implementing structural reforms, such as in public finance management; state-owned enterprise (SOE) restructuring; private sector development; trade, legal, and judicial development; and natural resource management. The Bank and Fund coordinate their work on some structural issues that have important implications on macroeconomic performance, namely financial sector reform, public expenditure management, trade policy, and poverty reduction strategy.

IMF and Bank Joint Role in Policy Dialogue

Poverty Reduction Strategy. The Bank and the IMF, together with the United Nations Development Programme, have provided assistance to the government's process of formulating its medium-term poverty reduction strategy. In 2003, the government prepared the first full Poverty Reduction Strategy Paper, the *National Growth and Poverty Eradication Strategy* (NGPES). The Bank and the Fund's Joint Staff Advisory Note (JSAN) of the strategy was presented before IDA and IMF Boards in November 2004. In 2006, the government prepared the *Sixth National Socio Economic Development Plan (2006–2010)* (NSEDP) with a strong poverty focus and through wide consultations with key domestic stakeholders in Vientiane and provinces, as well as the Bank, IMF, and donors. The NSEDP was presented by the government to its development partners at the 9th Round Table Meeting in November 2006 and an annual progress reports were provided at a Round Table Implementation Meeting in November 2007 and 2008. The Bank and the Fund's Joint Staff Advisory Note (JSAN) of the PRS/NGPES and the annual progress report was presented before IDA and IMF Boards in June 2008.

The Bank is supporting the implementation of NGPES and NSEDP through the Poverty Reduction Support Operations (PRSOs). The focus of PRSOs includes public finance management reform, including in social sectors, and regional integration and private sector development. PRSO-1 ($10 million) was approved in March 2005, followed by PRSO-2 ($8 million) in April 2006, PRSO-3 ($10 million) in June 2007 and PRSO-4 ($10 million) in June 2008. The second programmatic series of PRSOs (PRSO4-7) was approved by the Bank Board in June 2008.

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[1] Prepared by the staff of the World Bank. Contact person: Ms. Ekaterina Vostroknutova, Senior Economist, Poverty Reduction and Economic Management Department, East Asia and Pacific Region, email: evostroknutova@worldbank.org.

Public Expenditure Management. The Bank has provided extensive technical assistance in developing and implementing the government's multi-year Public Expenditure Management Strengthening Program (PEMSP). The Bank completed a Public Expenditure Review 2006 jointly with the IMF, other donors, and government, a Public Expenditure Tracking Survey (PETS) for education and health sectors in 2007, and is currently undertaking a Public Expenditure Review 2009. The Bank is also assisting the government in the preparation and implementation of a *Government Finance Statistics Manual*-compatible Chart of Accounts and the new Budget Law, focusing on improving inter-governmental fiscal relations.

Financial Sector Reforms. The Bank and the IMF have worked closely to support the government in developing and implementing a banking reform program. The Bank has supported restructuring of state-owned commercial banks (SOCBs) and drafting of banking sector legislation, and is supporting the drafting of the Financial Sector Strategy.

Trade Policy. The Bank led preparation of the Diagnostic Trade Integration Study (DTIS), jointly with the government, and other Integrated Framework donors. A Multi-Donor Trust Fund (administered by the Bank) has been established to support the action matrix in the DTIS, and a Customs and Trade Facilitation Project , designed in close collaboration with the IMF to support customs modernization through implementation of an automated customs system, was approved in June 2008.

The Bank's Key Roles in Policy Dialogue

State-Owned Enterprises. The Bank has supported the government's SOE reform and restructuring program, aimed at improving transparency by institutionalizing the reporting and recording of annual performance of all SOEs and through international standard audits of large SOEs, restructuring them to reduce losses or raise profits for public utility SOEs and reforming their pricing policies in water, power, and telecoms.

Private Sector Development. The Bank supports the development of the private sector, both economy-wide and in the sectors, based on a joint AsDB-World Bank Investment Climate Assessment of manufacturing and tourism firms, a review of key regulatory procedures and business laws, and local government initiatives on private sector promotion. The Bank (the IFC through its Mekong Private Sector Development Facility) is also a lead coordinator of the public-private dialog through the semi-annual Lao Business Forum.

Forestry Development. The government is involved in a continuing process of reforming its forestry sector and improving the implementation of forestry programs and projects. The Bank is trying to ensure that the government's strategy and objectives for forestry are consistent with the NGPES, Rural Development Program, and Agriculture Development Strategy.

The Nam Theun 2 Hydropower Project. The Bank has supported the project through an International Development Association (IDA) partial risk guarantee, an IDA grant for environmental and social mitigation, and a Multilateral Investment Guarantee Agency (MIGA) guarantee, all done in March 2005. The World Bank decision to support the project was based on a "decision framework" with the following three pillars: (i) Lao P.D.R. establish and implement a viable development policy framework, characterized by concrete performance, and national programs for poverty reduction and social and environmental protection; (ii) the technical, financial, economic, and implementation aspects of the project, as well as the design and implementation of sound safeguards policies; and (iii) wider understanding and broader support from the international donor community, and global and local civil society for Lao P.D.R.'s development framework and the project. The Bank is supporting and monitoring the implementation of NT2, and its progress remains good; it is expected to be operational in early 2010.

Bank Strategy and Lending Operations

Country Assistance Strategy (CAS). The full CAS was presented to the Bank's Board in March 2005, and the CAS update (and extension through 2011) in May 2007. The CAS selectively targets key NGPES priorities, including: (i) sustaining growth through linking to and capitalizing on regional opportunities and better natural resource management; (ii) improving social outcomes through strengthening financial management and service delivery capacity; (iii) strengthening management capacities, partnerships, and monitoring for NGPES implementation; and (iv) implementing the NT2 program as a model for supporting sustainable growth, improving social outcomes, and building key development capacities. The updated CAS consists of a lending and non-lending program, with a notional amount of about US$200 million in new commitments (grants) during July 1, 2005 to June 30, 2011 (subject to the IDA Performance Based Allocation system).

Lending Operations

As of April 1, 2009, a total amount of US$871.9 million equivalent of IDA credits and grants had been approved. This included support for adjustment operations, rural development, forestry, transport, customs, energy, telecommunications, education, health, industry, capacity building, and risk guarantees. In the last three years, IDA support has focused on the CAS objectives, with an average disbursement of US$31 million per year.

IDA: Commitments and Disbursements to Lao P.D.R., 1977–2008
(In millions of U.S. dollars; as of January 1, 2009)

Fiscal Year (to June 30)	Committed	Disbursed	Repayments*
1977–93	335.2	180.7	1.5
1994	48.4	45.1	0.6
1995	19.2	31.4	0.6
1996	60.7	28.6	0.6
1997	48.0	65.2	0.6
1998	34.7	26.5	1.3
1999	29.8	27.8	1.5
2000	0.0	18.1	3.0
2001	41.7	29.9	3.6
2002	44.8	30.5	4.9
2003	24.7	41.2	6.1
2004	35.7	46.7	7.3
2005	76.0	36.0	8.4
2006	37.0	36.3	8.7
2007	28.0	53.4	9.6
2008	25.0	50.9	12.5
Total	888.9	748.3	70.8

*Note: repayments include principal repayments and do not include commitment or service charges.

The World Bank's Main Non-Lending Work

(Recently Completed and Ongoing)

Completed FY05–FY08	Ongoing and Proposed for FY09–FY11
Regional Integration/Private Sector Development	
Financial Sector Note	Economic Monitors (two issues each year)
Economic Monitors (two issues each year)	Financial Sector Strategy
Country Economic Memorandum (CEM) – Sources of Growth	Financial Sector Assessment
Investment Climate Assessment	Investment Climate Assessment 2
Diagnostic Trade Integration Study	Country Economic Memorandum on Natural Resource Management 2009
Integrated Public Expenditure Review and Integrated Fiduciary Assessment	Information and Communication Technologies Strategy
Poverty Reduction Strategy Paper – Joint Staff Assessment Note	
	Study on Trade in Services
Natural Resources Management, Environment and Rural Development	
Environment Monitor	Upland Livelihood Typology
Rural Sector Strategy	Country Economic Memorandum on Natural Resource Management 2009
Khammouane Provincial Development Study	Environment Monitor
Poverty Environment Nexus Study	Land Allocation, Planning and Management
Uplands Livelihood Typology	Forestry Sector Strategy Note
	Water Sector Review
Public Sector and Financial Management	
	NT2 Revenue Management
Peer Review of State Audit Organization	Intergovernmental Fiscal Relations and Decentralization
Contract Value Norms Study	Public Expenditure Tracking Survey
Civil Service Study	
Public Expenditure Tracking Survey	Integrated Public Expenditure Review/Integrated Fiduciary Assessment/Country Financial Accountability Assessment
	Strengthening Anti-corruption Measures
	Assessment of Government Strategic Plan for Governance
	PEMSP FY08
	Upland Livelihood Typology and Investment Climate Assessment
Service Delivery and Vulnerability	
Poverty Assessment	Teachers' Study
Decentralization Study	
Public Expenditure Tracking Survey	Public Expenditure Tracking Survey
Review of Poverty Reduction Fund	
	Health Sector Financing Strategy
	Poverty Assessment
Other/Infrastructure	
Mining Sector Review	Rural Water and Sanitation Strategy
	Cross-border Cooperation in Sustainable Hydropower Development
	Infrastructure Sector Study
	Dialog and Regulatory Reform

ANNEX III. LAO P.D.R.: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[2]

The Asian Development Bank (AsDB) has extended development assistance to Lao P.D.R. since 1968. In the 1970s and 1980s, AsDB assistance was focused mainly on economic growth projects involving infrastructure development in the transport and energy sectors, as well as agriculture. AsDB has been active in the development of the financial sector since the latter part of the 1980s, and broadened its assistance to Lao P.D.R. to include rural development, social development, and environment in the 1990s. AsDB has focused its activities on poverty reduction since the late 1990s.

In early 2008, AsDB endorsed its new Long-term Strategic Framework or Strategy 2020 for 2008-2020 which provides a framework for the gradual realignment of AsDB operations. To reduce poverty and improve living conditions and quality of life through inclusive growth, AsDB will scale up its operations in support of (i) private sector development and private sector operations; (ii) environmentally sustainable development, including reduction of carbon dioxide emissions and projects to address climate change; and (iii) regional and subregional integration. In terms of sector focus, infrastructure (including rural infrastructure), finance and education will receive priority. Good governance and capacity development, gender equity, knowledge solutions and partnerships will be drivers of change informing AsDB operations in the medium and long term. Strategy 2020 identifies five core areas of operations, namely (i) infrastructure, including rural infrastructure; (ii) environment, including climate change; (iii) regional cooperation and integration; (iv) financial sector development; and, (v) education.

AsDB's current Country Strategy and Program for Lao P.D.R. for 2007–11 (CSP) is aligned with the Lao P.D.R.'s *Sixth National Socio Economic Development Plan, 2006-2010* (NSEDP). A results-based strategy, the CSP focuses on (i) promoting pro-poor sustainable growth: nurturing employment opportunities through private sector development (small and medium-sized enterprise development, transition to commercial agriculture, and regional integration as the main engine of outward-oriented growth); (ii) fostering inclusive social development: accelerating progress in non-income MDGs (education, primary health care, water supply); and (iii) addressing priority governance issues: building capacity for good governance and Nam Theun 2 Hydropower project revenue management. The core of the strategy—a move to coordinated capacity development and program and/or sector-based approaches in priority sectors—is supported by the Vientiane Declaration on Aid Effectiveness and its associated country action plan.[3,4] The CSP is amplified by ADB's Greater Mekong Subregion (GMS) strategy and program initiatives aimed at fostering connectivity, promoting large-scale foreign direct investment, and creating regional public goods.

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[2] Prepared by the Asian Development Bank.

[3] Localized version of the Paris Declaration on Aid Effectiveness, endorsed by the Government and 22 partners at the Ninth Round Table Meeting in Vientiane in November 2006.

[4] The Government and development partners endorsed the country action plan on 31 May 2007.

These strategic foci are shaped by the country's specific requirements and capabilities after extensive stakeholder consultations. The CSP is designed to achieve high impact and sustainable development results, and to contribute to the government's MDGs and sector-specific commitments as set out in NSEDP, with specific goals, targets, and progress indicators for AsDB interventions.

Lao P.D.R. is a key actor in the Greater Mekong Sub-Region (GMS) program as a land-link among the other GMS member countries. The AsDB aims to explore various options to maximize the benefits to Lao P.D.R. from sub-regional cooperation. To enhance the development impact of projects and ensure their close monitoring, AsDB's interventions will focus primarily on the poor northern regional provinces and along the East-West economic corridor that links Thailand to Savannakhet in Lao P.D.R. and to Vietnam.

Since 1970, the AsDB has approved 76 loan and grant financed projects for a total of $1.27 billion—of which 25 projects were currently active—and 235 technical assistance projects for a total of $122.8 million (as of end December 2008).

In 2007, AsDB program operations shifted to 100% grant. Two grants were approved in 2008 comprising of JFPR for Alternative Livelihood for Upland Ethnic Group in Houaphan Province and GMS Sustainable Tourism Development amounting to 1.8 million and 10.0 million, respectively. In addition, 9 TA projects amounting to $3.5 million were approved. In 2009 AsDB approved 2 grants totaling $43 million and expects to approve another 3 totaling 45 million in the later half of 2009 (a total of $88 million) and 9 TAs amounting to $4.7 million. In addition AsDB proposes to approve $42 million ($22 million grants and $20 million concessional loan) for regional projects which Lao PDR is party to. Lao PDR's share would be $7.67 million.

Lao P.D.R.: Asian Development Bank Commitments and Disbursements, 2001–09

(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009 /1
Commitments	65.0	43.2	34.9	54.8	87.0	60.8	56.0	30.8	95.7 /2
Disbursements	44.7	48.6	54.7	48.5	78.7	78.5	76.6	49.0	59.1

Source: Data provided by the Asian Development Bank.

1/ Planned figures.

2/This includes $88 million from the national operations and another $7.67 million (Lao Share) for the Subregional projects involving Lao PDR

ANNEX IV. LAO P.D.R.: STATISTICAL ISSUES

As of June 24, 2009

I. Assessment of Data Adequacy for Surveillance
General: Macroeconomic and financial data provided to the Fund have serious shortcomings that significantly hamper surveillance. Priority should be placed on strengthening balance of payments statistics and national accounts, as well as external public debt and subnational fiscal accounts. Improvements in timeliness and accuracy are required. Greater coordination between the various agencies responsible for compiling macroeconomic statistics is also needed. While a General Data Dissemination System (GDDS) coordinator has been appointed, the authorities have yet to finalize the GDDS metadata and a strategy for statistical improvement. Macroeconomic and financial data are published in periodic reports by the National Statistical Center (NSC) and the Bank of Lao P.D.R. (BoL).
National Accounts: National accounts comprise annual estimates of GDP by activity at current and constant 2002 prices, broadly following the *System of National Accounts 1968*. The lack of regular surveys and use of inadequate methods to collect and compile comprehensive data on current economic activities limit the coverage and reliability of the GDP estimates. The estimates rely heavily on production and volume indicators collected by line ministries. With support from the Swedish International Development Agency, the Lao Expenditure and Consumption Survey 2002–03 (LECS) was finalized and released in 2005. In recent years, the NSC has made some progress in improving the quality of source data, including the implementation of annual enterprise and household surveys. In late 2006, a Statistics Department (STA) regional advisor identified data gaps in the source data and issues on data quality, which need to be addressed as well as in estimates of deflators and expenditures.
Price statistics: The NSC compiles a monthly CPI, with the latest basket introduced in January 2006 using the results of the 2002/03 LECS. Similar to earlier CPI series, the consumption basket only includes goods and services purchased in the market (i.e., excludes own consumption). Progress on compiling a producer price index has stalled.
Government finance statistics: The Ministry of Finance's (MOF) Budget Department produces monthly, quarterly, and annual revenue, expenditure, financing, and government debt statistics. Most data are recorded on a cash basis. Data on external and domestic debt are compiled by the MOF's External Financial Relations Department and Budget Departments. Debt data are comprehensive and available by type of debt holder and instrument. Efforts are ongoing to further improve debt data coverage, particularly relating to state-owned enterprises' debt. The 2009 GFS technical assistance mission made recommendations to bring the valuation of stock and flow foreign debt data in local currency in line with international standards. Overall, government finance statistics remain weak, with significant scope to improve their accuracy, transactions coverage, and timeliness. Greater decentralization in 2000/01 further complicated the timely reporting of fiscal data, as provincial monitoring systems are weak and skilled staff limited. Off-budget activities are also not included in fiscal data. Annual budget and outturn data formats do not follow international standards. Over the past few years, the Lao authorities have embarked on accounting and chart of accounts reforms, and established the Finance Statistics Division (FSD) in the Fiscal Policy Department of the Ministry of Finance, which is responsible for the compilation and dissemination of fiscal data according to international standards. In early 2008,

staff from the FSD attended a GFS Workshop in Bangkok, Thailand, where work was initiated on mapping monthly and annual fiscal source data (on an aggregated basis) to the *Government Finance Statistics Manual 2001* (*GFSM 2001*) framework. These data have been reported and published in the *GFS Yearbook* and *IFS*. Reporting of data for publication in IFS has been irregular. Except for the annual data disseminated in the *Official Gazette*, no fiscal data are disseminated in the country. The 2009 GFS technical assistance mission's recommendations were aimed at (1) enabling the authorities to compile more detailed quarterly and annual fiscal data in the *GFSM 2001* framework, and (2) the regular dissemination these data on the MOF's website and to the IMF.

Monetary statistics: The monetary and financial statistics mission in 2004 identified a number of problems in the compilation of monetary statistics and made further recommendations on sectorization, classification, and valuation. It also proposed improvement in the chart of accounts for BoL and commercial banks, and reconciliation of monetary and government finance statistics. Many of the recommendations of the mission have yet to be implemented, including those related to sectorization of the commercial bank balance sheet. In addition, the authorities have not submitted test data in the format of Standardized Report Forms that embody the methodology of the *Monetary and Financial Statistics Manual*. Financial soundness indicators should be compiled and published.

Balance of payments: Balance of payments (BOP) statistics are compiled on a quarterly and annual basis by the BoL, with inputs from the NSC, MOF, and Ministry of Planning and Investment, as well as commercial banks. Currently, certain major activities are unreported, with improvements needed in all major categories of the current account, as well as foreign direct investment and private capital flows. Data reconciliation as reported in the fiscal accounts and BOP on external loans and grants also needs to be strengthened.

New customs procedures adopted in 2000 by the MOF's Customs Department (with Fiscal Affairs Department technical assistance) have yet to produce more accurate trade data on a regular basis, due to technical reasons. More timely and accurate BOP estimates also require improved coordination among agencies involved in their compilation. The government of Japan is providing technical assistance to address some of these issues.

The BoL reports to the STA quarterly BOP data once a year in a highly aggregated format that makes difficult their re-dissemination through STA's publications (*International Financial Statistics* and *Balance of Payments Statistics Yearbook*). The last published data correspond to 2007.

II. Data Standards and Quality

Not a General Data Dissemination System participant.	No data ROSC is available.

III. Reporting to STA (Optional)

Quarterly and annual GFS statistics for Lao PDR appeared in the Fund's publications in the second half of 2008. However, subsequent reporting of quarterly data for publication in IFS has been irregular. Except for the fiscal data reported to APD and the annual data compiled by the Budget Department (disseminated in the *Official Gazette*), no fiscal data are disseminated.

No monetary data are currently reported to STA for publication in the *International Financial Statistics*.

Lao P.D.R.: Table of Common Indicators Required for Surveillance
(As of June 5, 2009)

	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Frequency of Publication[6]
Exchange Rates	06/05/09	06/05/09	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	April 2009	05/22/09	M	M	I
Reserve/Base Money	Mar 2009	05/12/09	M	M	M
Broad Money	Mar 2009	05/12/09	M	M	M
Central Bank Balance Sheet	Mar 2009	05/12/09	M	M	M
Consolidated Balance Sheet of the Banking System	Mar 2009	05/12/09	M	M	M
Interest Rates[2]	Mar 2009	04/29/09	M	M	I
Consumer Price Index	May 2009	06/02/09	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[3]—General Government[4]	Mar 2009	05/19/09	M	M	I
Stocks of Central Government and Central Government-Guaranteed Debt [5]	Dec 2008	03/25/09	Q	Q	I
External Current Account Balance	Q4 2008	03/25/09	Q	Q	I
Exports and Imports of Goods and Services	Q4 2008	03/25/09	Q	Q	I
GDP/GNP	2008	05/12/09	A	A	I
Gross External Debt	Dec 2008	03/25/09	Q	Q	I
International Investment Position[5]			NA	NA	NA

[1] Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.
[2] Both market-based and officially-determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.
[3] Foreign and domestic bank, nonbank financing.
[4] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[5] Includes external gross financial asset and liability positions vis-à-vis nonresidents.
[6] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).

ANNEX V. LAO P.D.R.: MILLENNIUM DEVELOPMENT GOALS INDICATORS, 1990–2015

	1990	1995	2001	2002	2005	2006	2007	Target 2015
Eradicate extreme poverty and hunger	(2015 target = halve 1990 $1 a day poverty and malnutrition rates)							
Population below $1.25 a day (%) 1/	55.7	…	…	44.0	…	…	…	[26.5]
Poverty gap at $1.25 a day (%)	16.2	…	…	12.1	…	…	…	
Percentage share of income or consumption held by poorest 20%	9.3	…	…	8.5	…	…	…	
Prevalence of child malnutrition (% of children under 5)	40.0	40.0	40.0	…	…	…	…	
Population below minimum level of dietary energy consumption (%)	29.0	28.0	…	21.0	…	…	…	[14.5]
Achieve universal primary education	(2015 target = net enrollment to 100)							
Net primary enrollment ratio (% of relevant age group)	61.4	70.0	76.9	78.5	82.7	83.7	…	[100]
Percentage of cohort reaching grade 5 (%)	53.3	55.4	62.3	64.1	62.0	…	…	[100]
Youth literacy rate (% ages 15–24)	70.1	71.1	78.5	…	…	…	82.5	[100]
Promote gender equality	(2005 target = education ratio to 100)							
Ratio of girls to boys in primary education (%)	79	…	86	86	88	89	…	[100]
Ratio of young literate females to males (% ages 15–24)	76	81	90	…	…	…	93	[100]
Share of women employed in the nonagricultural sector (%)	42	50	…	…	…	…	…	
Proportion of seats held by women in national parliament (%)	6	9	21	21	23	23	25	
Reduce child mortality	(2015 target = reduce 1990 under 5 mortality by two-thirds)							
Under 5 mortality rate (per 1,000)	163	131	105	100	79	75	…	[54.3]
Infant mortality rate (per 1,000 live births)	120	99	…	…	…	59	…	
Immunization, measles (% of children under 12 months)	32	68	50	55	41	48	…	
Improve maternal health	(2015 target = reduce 1990 maternal mortality by three-fourths)							
Maternal mortality ratio (modeled estimate, per 100,000 live births)	…	…	…	…	660	…	…	[162.5]
Births attended by skilled health staff (% of total)	…	…	19.4	…	…	…	…	
Combat HIV/AIDS, malaria and other diseases	(2015 target = halt, and begin to reverse, AIDS, etc.)							
Prevalence rate of HIV (% ages 15–24)	…	…	0.1	…	…	…	0.2	[0.0]
Contraceptive prevalence rate (% of women ages 15–49)	…	25.1	32.2	…	…	…	…	
Incidence of tuberculosis (per 100,000 people)	…	…	162	159	155	…	…	[0.0]
Tuberculosis cases detected under DOTS (%)	…	24	40	48	72	77	…	
Ensure environmental sustainability								
Forest area (% of total land area)	75.0	…	…	…	69.9	…	…	
Nationally protected areas (% of total land area)	…	…	16.0	16.0	16.0	…	…	
CO2 emissions (metric tons per capita)	0.1	0.1	0.2	0.2	0.2	…	…	
Access to an improved water source (% of population)	…	41.0	…	…	…	60.0	…	[74.0]
Access to improved sanitation (% of population)	…	13.0	22.0	…	…	48.0	…	[60.0]
Develop a global partnership for development								
Youth unemployment rate (% of total labor force ages 15–24)	…	5.0	…	…	…	…	…	
Fixed line and mobile telephones (per 1,000 people)	1.6	3.9	15.2	21.2	120.0	181.9	…	[Increase]
Internet (per 1,000 people)	0.0	0.0	1.9	2.7	8.4	11.6	…	
Personal computers (per 1,000 people)	…	1.1	3.0	3.3	4.0	16.9	…	[Increase]
General indicators								
Population (millions)	4.1	4.7	5.4	5.5	5.7	5.8	5.9	
Gross national income ($ billions)2/	0.8	1.7	1.7	1.8	2.7	2.9	3.4	
GNI per capita ($)	200	370	315	318	440	500	580	
Adult literacy rate (% of people ages 15 and over)	56.5	60.6	68.7	66.4	68.7	69.0	…	
Total fertility rate (births per woman)	6.0	5.2	…	3.6	3.4	3.3	3.2	
Life expectancy at birth (years)	54.7	58.1	…	61.9	63.4	63.9	64.4	
Aid (% of GNI)	17.2	17.5	14.4	15.8	10.8	11.1	10.0	
External debt (% of GNI)	204.3	123.2	146.7	167.0	98.4	84.4	74.1	
Investment (% of GDP) 2/	13.5	26.0	22.1	26.6	31.4	31.1	31.9	
Trade (% of GDP) 2/	35.8	60.6	67.5	65.3	78.0	87.0	83.4	

Sources: Millennium Development Goal Indicators (http://mdgs.un.org/unsd/mdg); World Development Indicators database and World Bank, 2007; World Resources Institute (http://earthtrends.wri.org).

1/ 2015 target based on previous poverty line ($1 a day).

2/ IMF staff estimates.

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IMF Executive Board Concludes 2009 Article IV Consultation with the Lao People's Democratic Republic

On July 10, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[1]

Background

Macroeconomic performance of the Lao P.D.R. economy was broadly positive in 2008, in spite of external and weather-related shocks. GDP growth moderated only slightly despite severe flooding which negatively impacted agricultural production, with construction and mining picking up the slack. Activity was further supported by a surge in credit growth. Inflation came off its mid-year peak as food and fuel prices abated, aided by continued currency appreciation. The nonresource current account deficit widened, despite robust exports and tourism receipts, due to the impact of soaring commodity prices on the import bill in the first half of the year, but this was more than offset by strong foreign direct investment (FDI) inflows.

More recently, the impact of the deteriorating external environment, which began to show in the second half of 2008, has become increasingly evident. The largest impact has been through the mining sector, but other sectors such as tourism, remittances and agriculture have also been affected. Previously strong foreign currency inflows (into both

[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. 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.

the current and capital accounts) have slowed. The decline in copper prices together with tighter global financing conditions has lowered export revenue, depressed financial performance, and delayed mining expansion plans. New hydropower investments have also been delayed. Lower-than-budgeted profit tax collection from the mining sector has placed fiscal revenues under strain.

The external position has weakened in the face of slowing foreign currency inflows and loose policies. International reserves have fallen from their June-2008 highs, as FDI flows and exports weakened, in the context of a strong and stable exchange rate.

Growth will likely hold up much better than in some other countries in the region, assuming no further negative shocks. Economic activity is projected to grow at around 4½ percent in 2009 supported by projects already in train, rapid past credit expansion, and strong public investment, with modest drag from somewhat weaker tourism and declining rural incomes. Inflation would remain low and stable, predicated on currency stability and flat commodity prices. With new large-scale investment projects taking off at the earliest in late-2010, growth is expected to only tick up in 2010 as Nam Theun II comes on stream, with continued softness in other sectors. The external position would continue to weaken, as expansionary policies, export softness, and lower FDI drive international reserves lower.

Risks to the near-term outlook are both external and domestic. On the external front, a weaker global economic recovery could further depress demand for tourism, garments, and other exports. Foreign direct investment in the mining and hydropower sectors could also be adversely affected. On the domestic side, the main risk is that excessively expansionary economic policies may jeopardize macroeconomic stability. The next 18 months appear particularly challenging.

However, provided macroeconomic stability is maintained and structural reforms are accelerated, the medium-term outlook is positive. As the global crisis works itself out, investments in the mining and hydropower sectors would resume, and activity in the broader economy would pick up, as reforms to strengthen the foundations of the economy push forward. Although the external current account deficit is expected to widen again as investment-related imports rise, this would be more than offset by increased FDI and other capital inflows—the external position would strengthen, with international reserve coverage gradually returning to current levels. External debt is projected to remain high, but concessionality should keep public debt service manageable. That said, improvements in the global economy, while key to improving external demand conditions, may not be sufficient to ensure sustainable growth. For this, strong policies and structural reforms are required.

Executive Board Assessment

Executive Directors commended the authorities for their economic management and structural reforms, which contributed to the recent robust economic growth, notwithstanding the severe flood and a deteriorating external environment. Directors noted that, while Lao P.D.R. has weathered the global crisis well relative to neighboring countries, expansionary policies have placed the external position under strain. An immediate priority is to safeguard macroeconomic stability, while supporting growth.

Directors supported the exchange rate as a nominal anchor, until market-based monetary policy instruments can be put in place. They stressed that prompt and determined tightening of fiscal and monetary policies would be necessary to support exchange rate stability. They noted the staff's assessment that the real effective exchange rate is broadly in line with its medium-term equilibrium.

Directors emphasized the need to reduce the fiscal deficit, to curtail quasi-fiscal operations, and to bring all fiscal operations on budget. They welcomed steps to boost revenue and the plan to bring forward revenue measures. Directors noted however that expenditure restraint, including postponement of non-priority spending, would need to bear most of the consolidation burden in order to create fiscal space to protect spending for social programs. Directors welcomed efforts to improve public financial management and to recentralize tax, customs, and treasury operations. They encouraged efforts to reduce vulnerability to resource revenues by broadening the tax base, and to strengthen budget planning by introducing a medium-term expenditure framework. Directors stressed the importance of prudent debt management, given the country's high risk of debt distress.

Directors encouraged the Bank of Lao P.D.R. to rein in bank credit growth, and to limit its lending to temporary liquidity support for banks. They recommended that steps be taken to improve the effectiveness of monetary policy, focusing on developing indirect instruments, fostering an interbank market, and strengthening domestic liquidity management.

Directors encouraged further efforts to deepen financial intermediation and address weaknesses in the banking sector, particularly the financial positions of state-owned commercial banks. This would require sound risk management and banking practices, improved supervisory oversight capacity, and full implementation of the banking law.

Directors noted that bold structural reforms are key to achieving sustained growth. Priorities in this area include improving the investment climate, reducing regulatory uncertainty, and advancing trade integration. These reforms will help expand private sector participation and diversify the sources of growth. Directors looked forward to furthering World Trade Organization compliance.

Noting shortcomings in data provision for surveillance, Directors called on the authorities to improve the quality and timeliness of various statistics, drawing upon technical assistance from the Fund. Enhanced coordination among statistical agencies would help ensure data consistency.

Lao People's Democratic Republic: Selected Economic Indicators

(Annual percent change, unless otherwise indicated)

	2004	2005	2006	2007	2008 Est.	2009 Proj.
GDP at constant prices	6.4	7.1	8.4	7.5	7.2	4.6
Inflation (CPI) (end year)	8.6	8.8	4.7	5.6	3.2	3.3
(Annual average)	10.5	7.2	6.8	4.5	7.6	0.2
Public finances (in percent of GDP) 1/						
Revenue and grants	12.1	13.6	14.5	15.8	15.6	15.0
Expenditure	15.1	18.2	17.4	18.6	17.7	22.9
Overall balance (- deficit)	-2.9	-4.6	-3.0	-2.9	-2.0	-7.8
Domestic financing (net)	-0.7	0.2	-1.1	-0.9	-1.0	5.4
External financing	3.6	4.4	4.0	3.8	3.0	2.4
Broad money	22.8	7.7	30.1	38.7	18.3	16.7
Credit to the economy 2/	9.0	7.6	-9.1	21.0	84.6	82.3
Balance of payments						
Exports (in millions of U.S. dollars)	535	697	1,133	1,321	1,639	1,293
Imports (in millions of U.S. dollars)	1,056	1,270	1,589	2,156	2,816	2,517
Current account balance (in percent of GDP)	-16.9	-17.8	-10.3	-15.8	-16.5	-15.4
Gross official reserves (in millions of U.S. dollars)	228	238	336	536	636	536
In months of prospective nonresource imports 3/	3.3	2.8	3.2	3.9	3.4	3.0
External public debt (in millions of U.S. dollars)	2,109	2,203	2,351	2,521	2,931	3,085
In percent of GDP	84.1	79.8	65.7	60.5	54.5	53.9
GDP at current market prices (in billions of kip)	26,549	29,369	35,983	39,874	46,700	48,955

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

1/ Fiscal year basis (October to September).
2/ For 2009, data as of end-March. Excludes debt write-offs. Includes Bank of Lao P.D.R. lending to state-owned enterprises and lower levels of government.
3/ Excludes imports associated with large resource projects.