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LAO PEOPLE'S DEMOCRATIC REPUBLIC

November 2024

2024 ARTICLE IV CONSULTATION—PRESS RELEASE; STAFF REPORT; AND STATEMENT BY THE EXECUTIVE DIRECTOR FOR LAO PEOPLE'S DEMOCRATIC REPUBLIC

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 2024 Article IV consultation with the Lao People's Democratic Republic, the following documents have been released and are included in this package:

- A **Press Release** summarizing the views of the Executive Board as expressed during its November 4, 2024 consideration of the staff report that concluded the Article IV consultation with the Lao People's Democratic Republic.
- **The Staff Report** prepared by a staff team of the IMF for the Executive Board's consideration on November 4, 2024, following discussions that ended on July 9, 2024, with the officials of the 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 October 15, 2024.
- An **Informational Annex** prepared by the IMF staff.
- A **Debt Sustainability Analysis** prepared by the staffs of the IMF and the World Bank.
- A **Statement by the Executive Director** for Lao People's Democratic Republic.

The IMF's transparency policy allows for the deletion of market-sensitive information and premature disclosure of the authorities' policy intentions in published staff reports and other documents.

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International Monetary Fund
Washington, D.C.

IMF Executive Board Concludes 2024 Article IV Consultation with Lao People's Democratic Republic

FOR IMMEDIATE RELEASE

Washington, DC – November 8, 2024: The Executive Board of the International Monetary Fund (IMF) concluded the 2024 Article IV Consultation[1] with Lao People's Democratic Republic.

Notwithstanding solid growth this year, supported by the tourism and resources sectors, the economic situation remains very challenging. Despite fiscal consolidation, public debt remains elevated and government financing needs are expected to increase. Exchange rate depreciation continues and high inflation persists.

The government has continued reforms to improve the public finances and to ease foreign exchange pressures. These include ongoing fiscal consolidation through revenue mobilization and expenditure constraints. The central bank has further tightened monetary conditions by increasing the policy rate and reserve requirements, and has also tightened exchange controls and prioritized access to foreign exchange.

Growth is projected to accelerate to 4.1 percent in 2024 on the back of recovering tourism, while inflation is expected to only decline moderately and remain elevated. However, the large financing needs arising from the significant level of public debt poses challenges to the medium-term economic outlook. Based on current conditions and policy settings, inflation and debt revaluation would likely intensify, implying a significant drag on growth over time. Substantial uncertainties also cloud the outlook, with risks of an intensification of labor emigration and a decline in investment should exchange rate pressures exacerbate, increased pressures on the banking sector from deteriorating asset quality and continuing currency mismatch, and potentially more frequent and more damaging natural disasters. The external economic environment could also turn out to be less favorable, if growth in major trading partners were weaker than expected or commodity prices more volatile.

Executive Board Assessment[2]

[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.

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

Executive Directors noted that growth gathered momentum in 2023 on the back of recovering external demand. Important progress has been made on many fronts: a primary fiscal surplus has been sustained, the current account balance has improved substantially, and inflation has fallen from its peak in 2023. Nonetheless, the economy continues to face challenges: pressures on the exchange rate remain, inflation is still high, public debt is assessed to be unsustainable, and FX reserves remain low. Growth is expected to be substantially below pre pandemic levels over the medium term. Against this difficult background, Directors urged the authorities to press ahead with coordinated, ambitious, and comprehensive policies to stabilize the economy and boost potential growth while avoiding scarring effects. Continued Fund capacity development will be critical to support these efforts.

Directors welcomed the authorities' recent progress in achieving primary surpluses, while emphasizing the need for a balanced and credible medium term fiscal consolidation and financing plan to restore debt sustainability and regain international market access. They called for rebalancing fiscal adjustment via revenue mobilization–focused on removing tax exemptions and improving tax administration and compliance–to create more fiscal space for growth enhancing spending on education, health, and critical infrastructure, that has been cut to very low levels. A credible and clearly communicated multi year financing and debt management strategy will also be key. Alternative options to bring debt toward a sustainable level could also be considered.

Directors stressed that monetary policy should prioritize reducing inflation. They welcomed the authorities' recent measures to modernize monetary tools and tighten monetary policy, but noted further efforts are needed to help stabilize the exchange rate, including more significantly raising the policy rate to slow the expansion of broad money and achieve positive real interest rates, stopping monetary financing, and issuing Bank of the Lao P.D.R. (BoL) bonds to soak up excessive liquidity. They welcomed greater exchange rate flexibility and encouraged phasing out distortionary exchange restrictions and capital flow measures.

Directors called for proactive, risk based financial supervision, given vulnerabilities in the banking sector. They recommended that the authorities implement new capital and liquidity requirements, and end loan forbearance decisively to safeguard the financial system.

Directors agreed that structural reforms are crucial to improve the business climate and support growth and employment. They called for measures to strengthen institutions, legal and regulatory frameworks, and invest in human capital. Directors emphasized the need to improve governance and transparency, implement anti corruption measures, and address remaining gaps in the AML/CFT framework, including swift implementation of the Financial Action Task Force's mutual evaluation recommendations. They also urged progress on addressing data gaps.

Lao P.D.R.: Selected Economic Indicators, 2020–25

	2020	2021	2022	2023	2024	2025
				Est.	Proj.	Proj.
Output and prices (percentage change)						
Real GDP growth 1/	-0.4	2.1	2.3	3.7	4.1	3.5
Consumer prices (annual average)	5.1	3.8	23.0	31.2	22.0	23.7
Consumer prices (end-period)	3.2	5.3	39.3	24.4	16.2	37.7
GDP deflator	4.6	5.6	25.6	24.1	14.6	13.5
Public finances (in percent of GDP)						
Revenue and Grants	13.0	15.0	14.8	16.4	16.5	16.5
Expenditure	18.4	15.7	14.7	15.7	17.0	16.6
Current Expenditure	11.8	11.0	10.4	10.4	10.9	11.1
Net acquisition of nonfinancial assets	6.6	4.7	4.3	5.3	6.1	5.6
Overall balance	-5.4	-0.7	0.1	0.7	-0.5	-0.1
Primary balance	-3.8	0.5	1.8	2.7	2.7	3.1
Public and public guaranteed debt 2/	76.0	92.9	130.7	115.9	108.3	118.3
Domestic	5.0	13.3	26.8	20.2	18.8	20.3
External	70.9	79.6	103.9	95.6	89.6	98.0
Money and credit (percentage change)						
Broad money	16.3	24.0	36.9	33.3	30.7	22.6
Credit to the economy	4.3	11.5	45.6	27.8	27.4	14.2
Balance of payments (in millions of U.S. dollars)						
Current account balance	-304	432	-459	405	351	314
In percent of GDP	-1.6	2.3	-3.0	2.7	2.4	2.2
Capital and Financial account balance	1,355	-158	717	385	-86	-524
Gross official reserves 3/	1325.0	1245.0	990.5	1182.5	1462.9	1273.9
In months of prospective imports of goods and services	2.4	1.9	1.4	1.7	2.1	2.0
Memorandum items:						
Nominal GDP (in billions of kip)	167,669	180,751	217,350	279,576	333,607	391,737
GDP per capita (in billions of kip)	22.9	24.3	29.1	36.9	43.4	50.3
Real GDP growth (published by authorities) 4/	3.3	3.5	4.4	4.2	…	…

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

1/ Staff estimate 2019–23 numbers using leading indicators such as electricity and mining productions, harvest volumes in major crops, export of goods and services, and tourism revenues (due to concerns over data quality and availably).

2/ Includes publicly-guaranteed debt in the stock of external debt for which data was missing prior to 2020, and Swap drawings with the People's Bank of China (PBoC).

3/ Includes Swap drawings with the People's Bank of China (PBoC), and the Special Drawing Right (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.

4/ Lao Statistics Bureau (LSB) data.

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

October 15, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION

KEY ISSUES

Context. Growth gathered momentum in 2023 on the back of recovering external demand, but exchange rate depreciation continues and inflation remains persistently high. Labor and FX shortages are intensifying. Public debt is assessed to be unsustainable, despite a tight fiscal stance. FX reserves remain low.

Outlook for growth and inflation under the baseline: The coming increase in the government's financing needs—especially those FX-denominated—poses severe challenges. Without active measures to ease pressures on the exchange rate, inflation and debt revaluation are likely to intensify, with a significant drag on growth over time.

Recommendations. Coordinated and comprehensive policies are needed to stabilize the economy while avoiding scarring effects.

- **Fiscal and debt policy.** Rebalancing fiscal adjustment via revenue mobilization to create more fiscal space for growth-enhancing spending would reduce drag on potential growth. A credible and clearly-communicated multi-year financing and debt management strategy should be established to bring debt back to a sustainable trajectory and help regain international market access.

- **Monetary policy.** The central bank should concentrate on containing inflation, through raising policy rates and slowing money growth.

- **Financial sector.** New capital and liquidity requirements should be implemented immediately to improve financial sector health. Loan forbearance should be ended decisively. The supervisor should pay close attention to balance sheet imbalances.

- **Structural policies, governance, and statistics.** Broader reforms are needed to improve the business environment, enhance transparency, and improve data. Governance should be improved including with greater transparency and consistent implementation of regulations; and tackling corruption concerns remains crucial. Strengthening institutions, legal and regulatory frameworks, and investing in human capital would help investment and growth.

Approved By
Rupa Duttagupta (APD) and Peter Dohlman (SPR)

Discussions took place in Vientiane, Lao P.D.R., from May 16 to 29, 2024 and virtually on July 9, 2024. The staff team was comprised of Narayanan Raman, Alasdair Scott (head), Shogo Takahashi, Weining Xin (all APD), and Jochen Schmittmann (IMF Resident Representative). In addition, Chanda DeLong and Qingxiang Li (both LEG) and Pornpinun Chantapacdepong (MCM) conducted assessments of Article VIII issues during the mission. Anousa Kounnavong, Vimaly Savannarideth, and Lamngern Pharakhone supported the mission from the IMF's Resident Representative's Office in Vientiane, while Mariam Souleyman and Chao Wang supported from HQ. Meetings were attended, variously, by Raja Anwar and Bounchantaphone Philavong (OEDST).

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CONTEXT

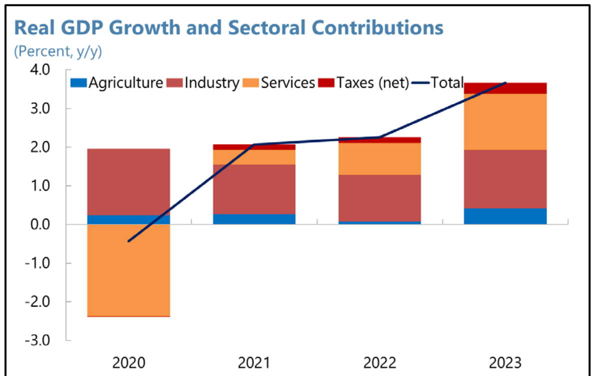
1. The economy has been beset by escalating debt, currency depreciation, and high inflation. Public investment drove high growth before 2018, but at the cost of high public debt. The pandemic-induced downturn accentuated debt sustainability concerns. The exchange rate depreciated by 140 percent from January 2021 to September 2024, fueling inflation and inflating the domestic currency value of public debt.

RECENT DEVELOPMENTS

2. The post-pandemic recovery gathered momentum in 2023, but firms report increasing labor and FX shortages.

- Growth in 2023 is estimated at 3.7 percent, mainly driven by industries and services. Tourism and the natural resource sector continue to perform well in 2024. However, agriculture and electricity generation have been affected by drought.

- Outward migration has reportedly intensified, implying a shrinking labor force despite strong working age population growth. The parallel exchange rate premium persists and firms report difficulties obtaining FX at official rates.



Sources: National authorities and IMF staff estimates.
Notes: 2020–23 numbers are staff estimates using leading indicators .

3. Inflation has been high and persistent. Headline inflation peaked at 41 percent y/y in February 2023; a deceleration in exchange rate depreciation and slowdown in money growth saw inflation decline, but subsequently plateau at around 25 percent y/y.

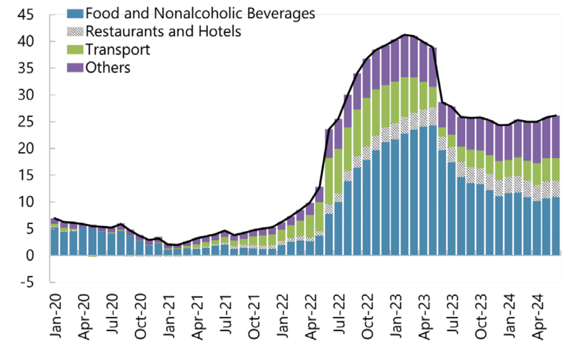
- The persistence of inflation points to domestic factors: inflation increased in 2021 and 2022 as in other countries, but by much more; it has persisted while falling in neighboring countries.

- Inflation was fueled by exchange rate depreciation—largely reflected in the imported inflation of food and fuel, accounting for more than half of the headline inflation—and monetary expansion (Annex I),[1] including monetary financing of the government.[2] Parallel rate premia fluctuates but remains positive, indicating more depreciation to yet come.

[1] Modeling work by conducted by ICD in the context of engagement for technical assistance finds the same result: exchange rate depreciations account for most of the inflation, whereas contributions from external factors are small. M2 growth and, separately, the central bank's gross claims on government are also significant factors.

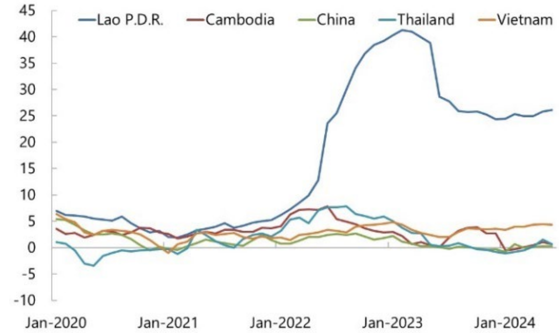
[2] The full extent of monetary financing not only includes direct lending—which remains within the statutory limit of 20 percent of the total annual budget revenue—but also the central bank's purchases of government bonds from commercial banks.

Headline CPI Inflation and Contributions
(Percent, yoy)



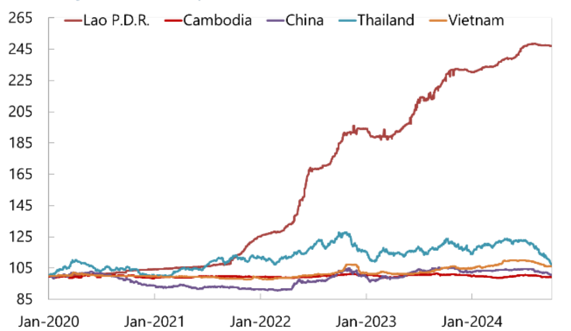
Sources: National authorities and IMF staff calculations.

Headline CPI Inflation Rates Compared
(Percent, y/y)



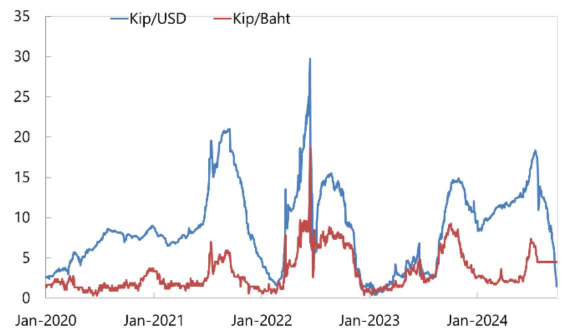
Sources: National authorities and IMF staff calculations.

Exchange Rates Compared
(Index, against US$, January 1, 2021 = 100)



Sources: Bloomberg and IMF staff calculations.
Notes: Commercial banks' exchange rates are used.

Parallel Exchange Rate Premiums
(Percent)

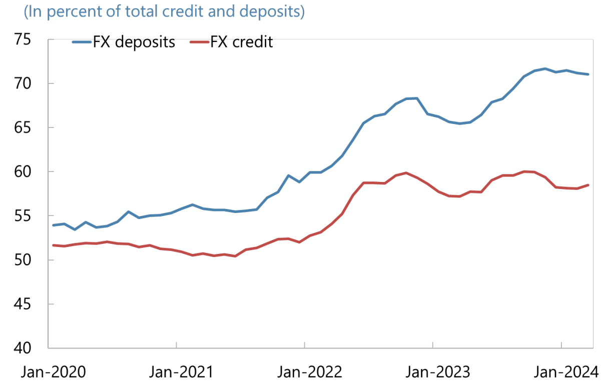


Sources: National authorities and IMF staff calculations.
Notes: Parallel premium is calculated against commercial banks' exchange rates.

- Firms report that prices have not yet caught up with increases in import costs and that labor costs are increasing for qualified workers. In addition, anecdotal reports indicate that inflation expectations are becoming entrenched, adding to inflation pressures.

- There are signs of increasing dollarization, consistent with other countries' experiences of high inflation and persistent exchange rate depreciations. Invoicing and settlement are increasingly in foreign currency. The share of FX-denominated bank credit and deposits have notably increased since 2022.

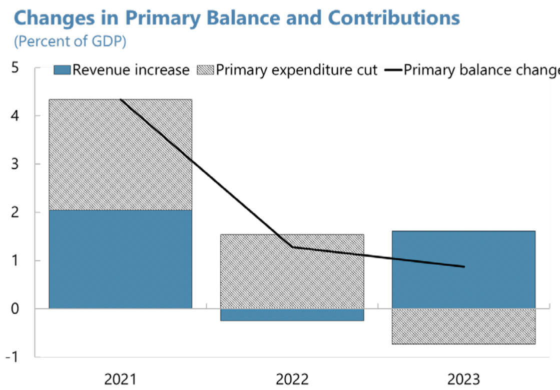
FX Credit and Deposits
(In percent of total credit and deposits)



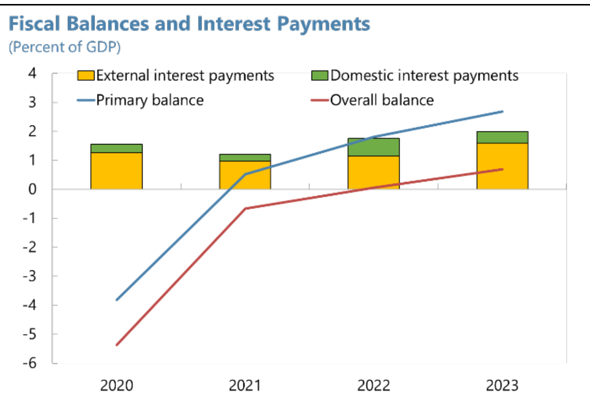
Sources: National authorities and IMF staff calculations.

4. **The government has maintained a tight fiscal stance.** The primary fiscal balance has been in surplus since 2021, reaching 2.7 percent of GDP in 2023. The balance was achieved largely through low primary spending (14 percent of GDP, compared with an average of 21 percent during 2010-19). Excise tax rates were increased in October 2023 and the VAT rate restored to 10 percent in March 2024. However, interest payments (2 percent of GDP) largely offset the primary surplus.

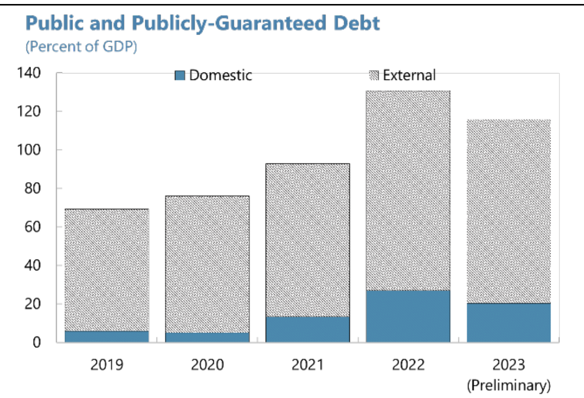
5. Public and publicly-guaranteed (PPG) debt remains high, despite ongoing fiscal adjustment. After reaching a record high at 131 percent of GDP in 2022,[3] the PPG debt decreased to 116 percent in 2023, mainly reflecting rapid expansion of nominal GDP due to high domestic inflation. More than 80 percent of debt is external and denominated in foreign currency. Contingent liabilities (not included in the PPG debt) have also likely increased following exchange rate depreciation[4] and the deteriorating financial health of state-owned banks.



Sources: National authorities and staff calculations.



Sources: National authorities and staff estimates.



Sources: National authorities and staff estimates.

6. The government has used debt servicing deferrals to help meet financing needs:

- China has granted debt servicing deferrals since 2020; in 2023, they amounted to US$770 million (about 5 percent of GDP). The authorities have indicated that they are in discussions with development partners and creditors on future financing and debt servicing deferrals, but wider debt restructuring has not been announced (Annex II).[5]

- The authorities continued to receive disbursements from bilateral and multilateral development partners, and net issuance of domestic debt amounting to LAK 5.8 trillion (2.1 percent of GDP).

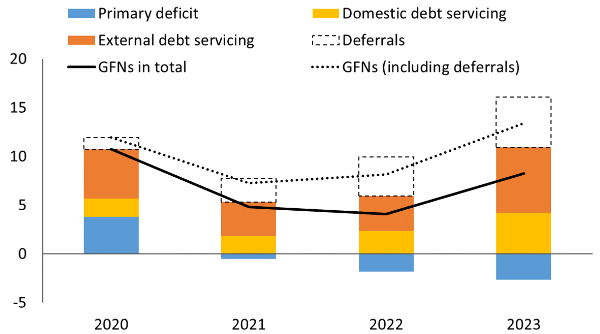
[3] Staff's debt stock estimate includes additional domestic expenditure arrears (about LAK 8.3 trillion, or 4 percent of GDP) and drawdowns on the swap line with the People's Bank of China (US$ 300 million, or 1.7 percent of GDP). In 2023, the authorities cleared LAK 6.3 trillion (2.6 percent of GDP) in expenditure arrears and repaid US$ 50 million drawn under the swap.

[4] The depreciation affected state-owned Électricité du Laos (EdL) severely due to the currency mismatch between revenues (largely in kip) and electricity purchases and debt payments (largely in FX).

[5] Debt owed to a foreign commercial bank (about US$ 50 million) was restructured in 2023.

Gross Financing Needs

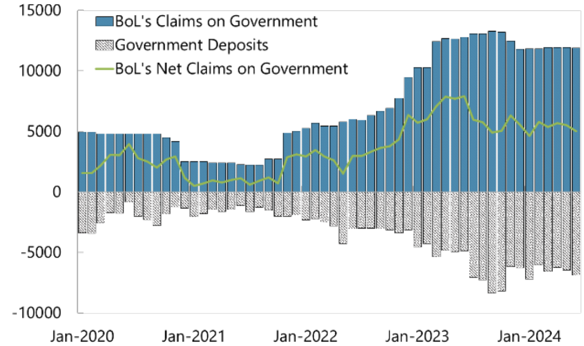
(In percent of GDP)



Sources: National authorities and staff estimates.

BoL's Net Claims on the Government

(Billions of Kip)



Sources: National authorities and IMF staff calculations.

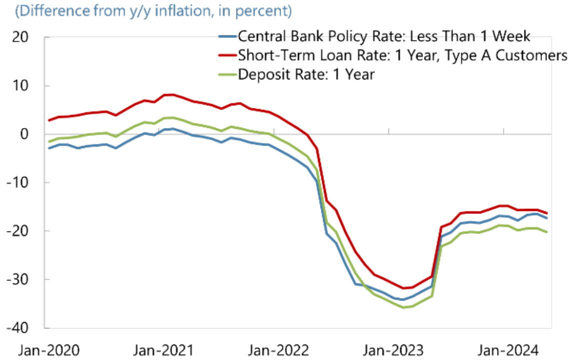
- Net borrowing of the government from the central bank reversed its upward trend since second half of 2023, declining to around 60 percent of its peak.

7. Monetary conditions remain extremely loose, despite steps to tighten monetary policy and control the exchange rate:

- Real interest rates are well below zero. Reserve money growth hit 40 percent y/y in the middle of 2023, driven substantially by an increase in gross claims on the government that exceeded the net issuance of the Bank of the Lao P.D.R. (BoL) bonds, suggesting monetary financing of the budget was significant. With ample domestic currency liquidity, larger banks (notably Banque Pour Le Commerce Exterieur Lao Public (BCEL)) lent in the interbank market at lower rates than the policy rate. Private sector credit growth averaged nearly 30 percent in 2023, reflecting both high demand for kip-denominated borrowing given negative real interest rates and increased supply of credit by banks in kip to match the increasing kip value of the FX liabilities on their balance sheets (¶31).

Real Interest Rates

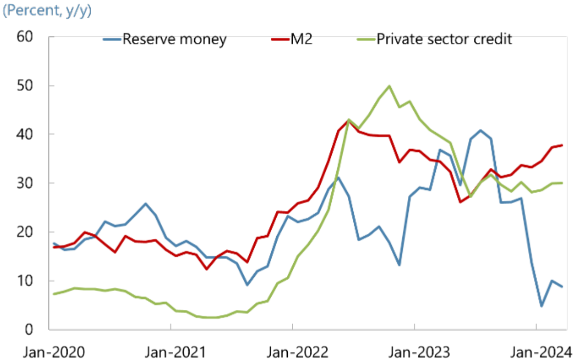
(Difference from y/y inflation, in percent)



Sources: National authorities and IMF staff calculations.

Money and Credit Growth

(Percent, y/y)

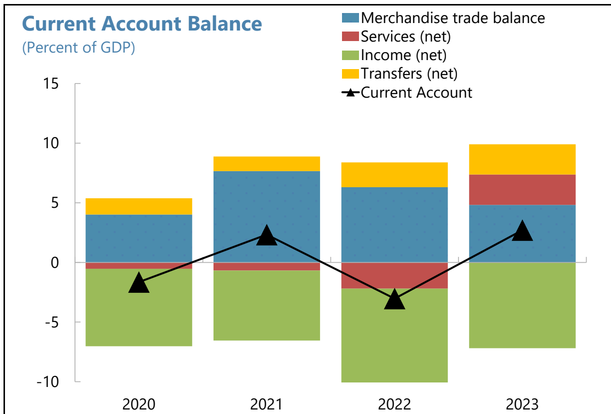


Sources: National authorities and staff calculations.

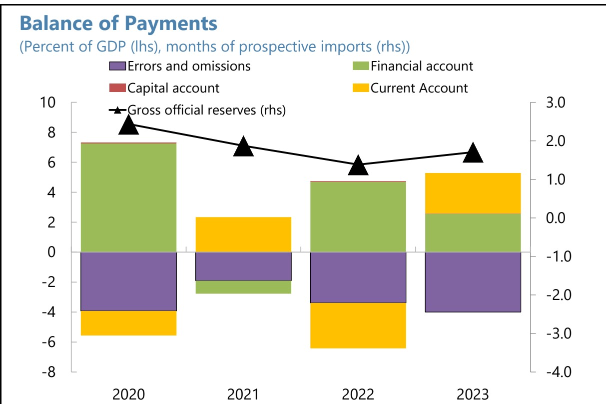
- The BoL has raised the policy rate, in stages, to 10.5 percent as of August 2024. Reserve requirements on Lao kip and FX deposits have been raised, to 8 percent and 11 percent, respectively. BoL bonds have been issued to mop up liquidity, and BoL's claims on the government have declined. In June 2024, the 7-day bill rate was brought to the same level as the policy rate. Reserve money growth has receded, to about 9 percent as of the latest data (March 2024). But real interest rates are well below zero and M2 and private sector credit growth rates remain high (37 and 30 percent y/y, respectively), above the inflation rate.

- The BoL had previously closed exchange rate bureaus and restricted trading to commercial banks. In addition, the BoL has recently added mandatory conversion requirements to the existing repatriation requirement,[6] which constitutes a capital flow measure (¶27).

8. The current account balance has improved, but financial outflows remain large. Surpluses in merchandise and services accounts have improved the current account balance from the pre-pandemic deficits to a surplus of 2.7 percent of GDP in 2023. Imports of some categories of vehicles have recently been halted, to improve the trade balance. FDI increased to 12 percent of GDP, but largely from a one-off inflow,[7] while errors and omissions indicate outflows of 4 percent of GDP, suggesting capital flight and/or mis-invoicing of trade flows. Staff assesses Lao P.D.R.'s external position to be weaker than the level implied by fundamentals and desirable policies (Annex III), reflecting high debt, thin reserves (estimated by staff to cover 1.7 months of imports), and a weak net international investment position (estimated at around -195 percent of GDP in 2022).



Sources: National authorities and staff estimates.



Sources: National authorities and staff estimates.

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[6] Currently, exporters are required to repatriate their FX proceeds through import-export deposit accounts at commercial banks. The amount to be repatriated depends on the economic sector. In addition, the exporters are subject to mandatory conversion requirements, under which they have to sell a portion of the repatriated FX to commercial banks, with the amount to be sold depending on the specific sector the exporters are in. Lastly, commercial banks will have to sell 30 percent of the foreign currency they receive from exporters to the BoL.

[7] Investment from China to pay for leases provided by the state-owned power company, EdL, of around 2 percent of GDP was made in 2023Q3.

Authorities' Views

9. The authorities agreed that Lao P.D.R. is facing significant challenges. They agreed that the high and persistent inflation resulted from the significant exchange rate depreciation. However, they explained that exchange rate depreciation was caused by an adverse external environment, including high global interest rates, and structural issues including low exports and FX inflows. They attributed the rapid broad money growth to exchange rate revaluation of FX deposits. They assessed FX reserve coverage to be higher, based on their methodology (which includes the full value of the swap line with the PBoC, rather than disbursed amounts).[8] While recognizing that assessing the equilibrium real exchange rate is challenging under the current circumstances, they believe that with the current policies, the real exchange rate will return to its equilibrium in the medium term.

OUTLOOK AND RISKS

10. Government financing and the exchange rate play central roles in the projections. Substantial FX demands to service external debt and rapid expansion in broad money and credit fuel depreciation pressures. Exchange rate depreciation raises the kip value of debt and leads to domestic inflation, reducing real incomes, intensifying outward migration and creating labor shortages, and increasing uncertainty about investment returns.

11. The baseline's assumptions for financing plans, policy settings, and the external environment are subject to considerable uncertainty:

- *Financing and debt management* (Annex II): The projections assume (i) in 2024, the government makes interest payments to China, but not principal payments, while fulfilling its debt servicing obligations to other creditors; and (ii) from 2025 onward, no deferrals on debt servicing of the government or SOEs, nor debt restructuring. With international market access assumed to remain limited, financing needs are partially met by primary surpluses and external disbursements from ongoing loans. Residual financing needs are met by issuance of domestic debt, split equally between the central bank and commercial banks. Staff does not assume proceeds from a planned asset sale, as there are open questions as to its financing by the foreign investor.[9]

- *Policies:* Consistent with the authorities' plans, fiscal consolidation (including continued restraint on spending) leads to ongoing primary surpluses. Tax revenues are assumed to increase, but not as much as assumed by the authorities, owing to implementation concerns (¶18). Monetary policy is assumed to tighten gradually such that M2 growth converges to GDP deflator growth

[8] Revised BoP data published in December 2023 show a substantial upward revision in gross reserves at the BoL, as the BoL now includes the full value—not only the disbursed amount—of the swap line with the PBoC. Staff excludes the amount that has not been disbursed in its calculations, per IMF guidelines that lines of credit that *could* be drawn are not *existing* claims. (See BPM6, clause 6.105.)

[9] See discussion in Annex II.

over the medium term. Monetary financing is partially sterilized (i.e., the BoL issues bonds amounting 50 percent of its new purchase of government bonds).[10]

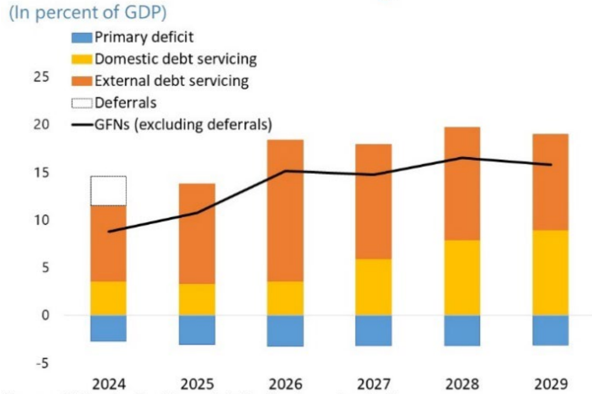
- *External environment:* External demand is assumed to remain steady, with no major fluctuations in commodity prices, consistent with the latest *World Economic Outlook* projections.

12. Given these assumptions, the baseline projections imply intensifying macroeconomic pressures that would reduce growth over time.

- Recovering tourism accelerates growth to 4.1 percent in 2024. Inflation, however, declines only moderately, reaching 16 percent y/y by year-end and 22 percent y/y on average.

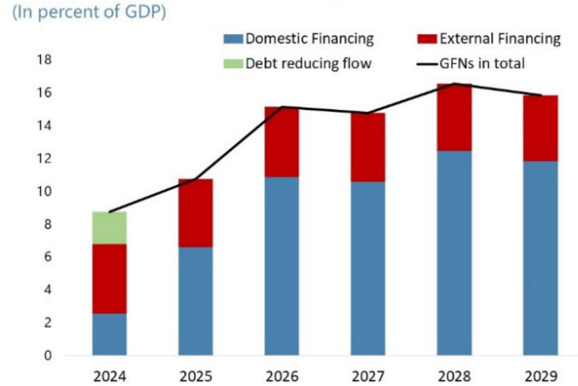
- Gross financing needs are projected to surge during 2025-26 due to scheduled external debt repayments and stay elevated afterwards due to increasing domestic debt servicing. Substantial reliance on domestic financing sources would renew pressures on the exchange rate; recent monetary tightening mitigates depreciation somewhat, but is outweighed by the effects of not-fully-sterilized central bank financing. Government borrowing from commercial banks crowds out private sector credit.[11]

Contributions to Gross Financing Needs
(In percent of GDP)



Sources: National authorities and staff estimates and projections.

Financing of Gross Financing Needs
(In percent of GDP)



Sources: National authorities and staff estimates and projections.

- Inflation would increase during 2025-26 and remain elevated. The GDP deflator is also projected to increase, though more slowly, reflecting the potential substitution effect of the high inflation while CPI basket's weights have not been updated since 2015 and the more stable exports and imports prices.

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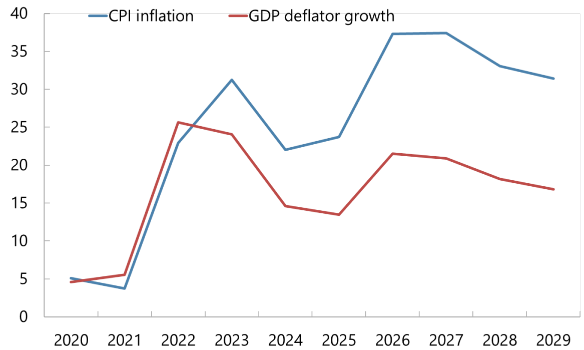
[10] No changes from current prudential settings are assumed, except the announced gradual increase in liquidity coverage ratio.

[11] Banks are assumed to be able to withstand the implied crowding out of private sector credit from government borrowing and manage currency mismatches—see risks (¶13).

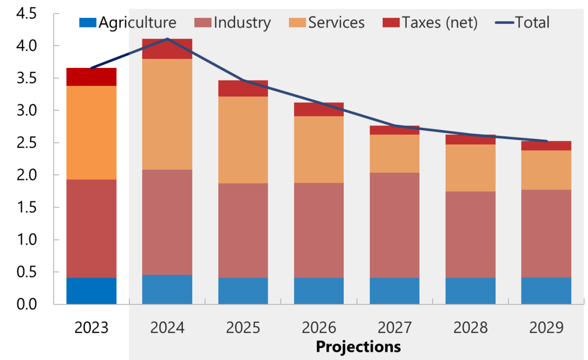
- Growth would decline over the medium term to around 2½ percent—sharply below the average of 7.2 percent during 2010-19—reflecting deteriorating real wages and purchasing power, prolonged fiscal tightness, outward migration, and declining non-resource sector investment (Annex IV). Resource sectors would be largely unaffected by exchange rate depreciation and FX and labor shortages and continue to receive FDI. FX reserves would fall to very low levels.

CPI and GDP Deflator Paths
(Percent, y/y)



Sources: National authorities and IMF staff estimates and projections.

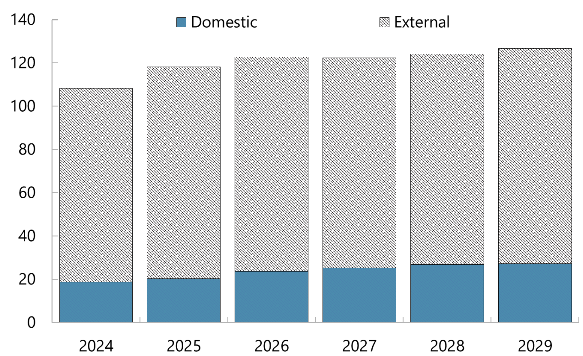
Real GDP Growth and Sectoral Contributions
(Percent, y/y)



Sources: National authorities and IMF staff estimates and projections.

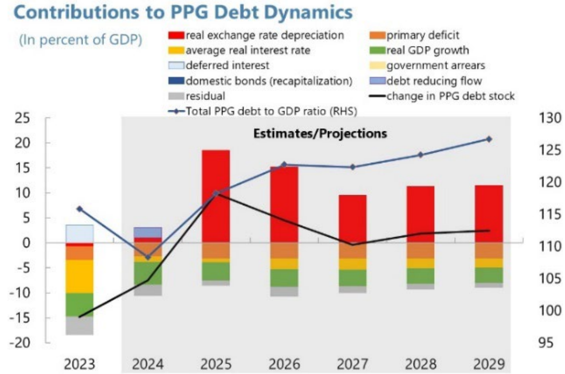
- The PPG debt-to-GDP ratio would increase, despite primary surpluses and high inflation, mainly due to currency depreciation. Most debt indicators would remain far above their sustainability thresholds (Debt Sustainability Analysis). Adjustment options are limited—the primary surpluses required to reduce debt indicators below risk thresholds within the medium term are neither feasible or desirable. As a result, Lao P.D.R. remains in debt distress.

Public and Publicly-Guaranteed Debt Projections
(Percent of GDP)



Sources: Staff projections.

Contributions to PPG Debt Dynamics
(In percent of GDP)



Sources: National authorities; and IMF staff calculations and projections.

13. **Risks around this baseline are mostly to the downside and are mostly domestic** (Annex V).

- *Potential growth:* The baseline projections assume positive workforce growth, even though estimates indicate negative growth currently. Capital accumulation could be lower as exchange rate pressures accumulate (Annex IV).

- *Climate:* Agriculture and hydropower generation are vulnerable to floods and droughts.

- *Banks* face risks of asset quality deterioration from loose credit and weakening potential growth, funding pressures from renewed inflation and exchange rate weaknesses, and currency mismatches. The weakness of BCEL creates systemic risks. Potential bank recapitalizations would exacerbate the government's financing challenges.

- *Dollarization:* Persistently high inflation could lead to abandonment of domestic currency, removing monetary policy as a tool.

- *External shocks* arise amid geoeconomic fragmentation, potentially weaker-than-expected growth in major trading partners, and commodity price volatility. An increase in fuel and fertilizer prices would set back all sectors.

14. Planned asset sales would only temporarily ease difficulties and increase later financing needs (Annex II). Proceeds from selling shares of hydro production would exceed public FX-denominated financing needs in 2024 and partly meet needs in 2025. FX reserves would increase and pressure on the exchange rate—and hence inflation and domestic-currency value of debt—would decrease in the near term. However, financing pressures would resume later in 2025. Moreover, the sale of profitable assets would reduce government revenues in later years.[12]

15. More policy adjustment could contain exchange rate pressures and damage to medium-term growth (Annex VI). If monetary policy were tightened more than indicated by the authorities—through (i) raising policy rates more quickly, to positive real levels, and increasing reserve requirement rates, such the broad money growth slows substantially; (ii) fully sterilizing monetary financing; and (iii) ceasing central bank lending to SOEs—and fiscal policy rebalanced (¶18), the macroeconomy would improve over the medium term compared to the baseline. However, public debt would remain unsustainable.

- Exchange rate depreciation would continue (especially in the near term, given large FX-denominated debt repayments during 2025-26 and because of monetary transmission lags), but by much less than in the baseline. Depreciation in this scenario would slow to pre-pandemic trend rates over the medium term.

- Inflation would fall following monetary tightening and exchange rate stabilization. (Exchange rate passthrough is significant—Annex I). With gradual stabilization of the exchange rate, it would return to pre-pandemic levels by end-2029.

- Tighter monetary policy would imply slower growth in the near term. However, domestic demand and growth would be higher over the medium term due to the improved economic climate and restoration of some critical social and capital spending by the government.

[12] For example, the value of shares to be sold assumed by the government of US$1 billion implies a loss of revenues of US$150 million per year (about 1.2 percent of GDP on average) assuming a commercial discount rate of 15 percent.

- However, financing needs would remain large and PPG debt unsustainable, despite an improved debt trajectory due to less exchange rate depreciation.

Text Table 1. Selected Economic and Financial Indicators in the Baseline versus the Active Scenario

	2024	2025		2026		2027		2028		2029	
	Proj.	Baseline	Scenario	Baseline	Scenario	Baseline	Scenario	Baseline	Scenario	Baseline	Scenario
Output and prices	(percentage change, unless otherwise indicated)										
Real GDP growth 1/	4.1	3.5	2.7	3.1	2.3	2.8	3.4	2.6	3.6	2.5	4.1
Consumer prices (annual average)	22.0	23.7	17.5	37.3	16.8	37.4	16.4	33.1	11.5	31.4	9.7
Consumer prices (end-period)	16.2	37.7	25.0	41.1	14.9	33.1	14.3	32.4	12.6	31.2	3.0
GDP deflator	14.6	13.5	10.7	21.5	10.9	20.9	10.4	18.1	5.6	16.8	4.6
Public finances	(in percent of GDP, unless otherwise indicated)										
Revenue and Grants	16.5	16.5	17.5	16.5	18.1	16.5	18.1	16.5	18.1	16.5	18.1
Expenditure	17.0	16.6	17.6	16.8	18.2	17.1	18.4	17.2	18.5	17.3	18.5
Overall balance	-0.5	-0.1	-0.1	-0.3	-0.1	-0.6	-0.3	-0.7	-0.5	-0.8	-0.4
Primary balance	2.7	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1	3.1
Public and public guaranteed debt 2/	108.3	118.3	112.5	122.7	108.8	122.3	104.0	124.2	102.4	126.7	95.1
Domestic	18.8	20.3	20.7	23.8	24.9	25.2	26.4	26.9	28.2	27.2	28.5
External	89.6	98.0	91.9	99.0	83.9	97.1	77.6	97.3	74.2	99.5	66.5
Money and credit	(percentage change, unless otherwise indicated)										
Broad money	30.7	22.6	10.0	21.1	10.0	18.9	10.0	16.9	10.0	16.6	10.0
Credit to the economy	27.4	14.2	1.5	8.8	1.7	10.8	6.0	7.0	7.4	9.9	10.0
Balance of payments	(in millions of U.S. dollars, unless otherwise indicated)										
Current account balance	351.5	314.3	-89.6	255.9	-81.3	229.0	-113.0	199.6	-250.4	175.8	-268.7
In percent of GDP	2.4	2.2	-0.6	1.9	-0.6	1.8	-0.8	1.7	-1.7	1.6	-1.8
Capital and Financial account balance	-86.5	-524.3	113.8	-568.4	118.2	-466.5	257.1	-379.6	394.6	-304.4	475.1
FDI	680.2	677.2	691.0	644.0	728.6	606.9	765.6	576.2	803.8	536.4	829.1
Gross official reserves 3/	1462.9	1273.9	1019.2	990.4	1077.4	790.5	1245.4	659.3	1416.1	593.5	1649.1
In months of prospective imports of goods and services	2.1	2.0	1.5	1.7	1.6	1.5	1.9	1.4	2.2	1.3	2.3

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Staff estimate 2019–23 numbers using leading indicators such as electricity and mining productions, harvest volumes in major crops, export of goods and services, and tourism revenues (due to concerns over data quality and availably).
2/ Includes publicly-guaranteed debt in the stock of external debt for which data was missing prior to 2020, and Swap drawings with the People's Bank of China (PBoC).
3/ Includes Swap drawings with the People's Bank of China (PBoC), and the Special Drawing Right (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.

Authorities' Views

16. **The authorities emphasized the economy's positive growth potential and were confident of meeting financing needs.** They were more optimistic about growth. While acknowledging that inflation was not likely to fall quickly, they did not forecast a surge in inflation, expecting exchange rates to stabilize. They were confident about revenue gains, the planned asset sales, and rolling over external financing, which would avoid substantial domestic financing and monetary financing of the government.

POLICY DISCUSSIONS

Discussions focused on the need for coordinated policies to stabilize the economy, including: a clear, credible, multi-year financing strategy to address large external debt repayments; tighter monetary policy to stabilize the exchange rate and contain inflation; closer financial supervision to reduce financial imbalances; and rebalancing to more growth-friendly fiscal policy, supported by growth-enhancing structural and governance reforms.

A. Fiscal Policy

17. **The tight fiscal stance contributes to restoring debt sustainability, but is not sufficient by itself.** The primary surplus is expected to remain stable in 2024, around 2.7 percent of GDP, and increase to 3.1 percent from 2025 onward. But larger surpluses would not restore debt sustainability:

staff estimates that a primary surplus averaging around 17 percent of GDP would be needed *each year* to bring the present value of PPG debt-to-GDP ratio to the DSA debt sustainability threshold (35 percent) by 2029—and without lowering baseline growth rates.

18. The balance of fiscal policy should be shifted to greater social spending and more revenue mobilization. Fiscal consolidations have relied mainly on social spending (education, health) and capital expenditure (suspension of new public investment projects) restraint, which would scar potential growth if sustained. A more growth-friendly fiscal stance would raise more revenue to restore crucial spending, while maintaining a steady primary surplus of around 3 percent of GDP. This would strike the right balance between feasibility and setting the right signal of commitment to restoring the sustainability of public finances, if part of a credible, comprehensive, and actionable multiyear financing and debt management plan to restore debt sustainability.

- Revenue mobilization yielding an additional 1.5 percent of GDP (Annex VI) would allow increasing education and health spending by around 1 percent of GDP in total while restoring social benefits to pre-pandemic levels (an increase of 0.5 percent of GDP). Any additional fiscal overperformance should be directed to growth-enhancing expenditures (e.g., modernization of key export-oriented infrastructure), with careful administration.

- Such improvement is feasible: the reinstatement of the VAT rate and increases in excise taxes are welcome, and further acceleration of revenue reforms is needed, starting with a Tax Administration Diagnostic Assessment that is critical in establishing baselines essential for future reform planning and prioritization. To promote private investment, the current profit-based incentive system with reduced rates for selected activities should be replaced by a cost-based system based on depreciation and other allowable deductions. A property tax would widen the tax base.[13]

- A key area for tax administration reform remains improving large taxpayers' compliance.[14] Stronger coordination of the tax and custom administrations, risk-based controls, and audits of large taxpayers could yield substantial gains.[15] AML/CFT tools can also be leveraged to further these objectives.

19. Expenditure and public financial management (PFM) would benefit from strengthening budget processes and improving transparency and SOE oversight.

- Greater transparency around PFM and budget processes would strengthen the credibility of fiscal policy while lowering corruption risks through promoting accountability and preventing the

[13] For more details, see Staff Report for the 2023 Article IV Consultation.

[14] Large Taxpayers compliance has been delegated to the provinces which is contrary to past advice. To increase revenue, close monitoring of large taxpayers driven by a central function is recommended.

[15] A significant gap exists between goals for tax and customs revenue administration reform and progress. A comprehensive workplan to enhance data exchange with customs administration, refine debt management practices, and bolster risk assessment has been developed with IMF technical assistance. However, implementation has been slow. Staff recommends a Tax Administration Diagnostic Assessment and full implementation of recommendations.

accumulation of domestic payment arrears (¶36). Comprehensive public procurement contracts should be published regularly. Governance of SOEs should be strengthened, through including regular and rigorous monitoring and assessing of their operational performance and financial health, and enhancing legal and regulation frameworks to promote transparency and enforce compliance.

- The Ministry of Finance has received ongoing TA (Annex VI). Urgent progress is needed to improve government financial statistics, starting with the chart of accounts that has been delayed for several years. Government arrears to the private sector should be included in official public debt, in line with international standards. Exchange of information between the various departments inside of the ministry and other public entities is essential to improve fiscal reporting.[16]

Authorities' Views

20. The authorities emphasized their commitment to a tight fiscal stance. They noted that recent efforts and planned measures to enhance revenue mobilization would significantly increase revenues and help meet the government's financing needs. They aim to diversify sources of income, to limit tax exemptions to those specified by law, and to focus on collecting taxes from property, natural resources, and environmental protection efforts, with a goal of increasing revenue to 20 percent of GDP. They aim to allocate a higher proportion of funds to investments and reduce current expenditures, and to promote transformation of state-owned enterprises into partnerships and expand the state's shares in activities, projects, and business units that are crucial for important national income or strategy.

B. Debt Management and Financing Policy

21. A more realistic financing and debt management plan is needed. The authorities' medium-term financing plan assumes rapidly increasing primary surpluses, substantial proceeds from asset sales in 2024 and 2025, strengthened debt collection from the private sector (¶36), repayment of on-lending to SOEs, a sharp reduction in exchange rate depreciation, and a return to international markets by 2027. A more feasible and credible financing strategy with contingencies to shocks is needed. In this context, the authorities should consider appointing professional legal and financial advisors to help formulate a comprehensive debt management strategy, in addition to technical assistance to strengthen debt management capacity. In addition, further developing the domestic market for domestic currency-denominated bonds is needed.

Authorities' Views

22. The authorities remain committed to fulfilling their obligations and reiterated that their capacity to repay remains adequate including under a downside scenario. They maintained their financing plans were feasible, while acknowledging the difficulty in projecting exchange rates,

[16] Code of Good Practices on Fiscal Transparency, April 2008 (imf.org)

which remain a key element of the government's financing needs. To enhance management and address public debt challenges, the authorities are undertaking a series of strategic measures, including enhancing debt management tools and mechanisms by developing a medium- to long-term financing strategy, restricting new borrowing and government investment projects, eliminating unplanned and non-essential expenditures, and transitioning borrowing from non-concessional to concessional terms. Discussions with creditors to extend financial support are ongoing.

C. Monetary Policy

23. **Recent measures to modernize monetary tools and tighten monetary policy are welcome**.[17] The alignment of the 7-day BoL bill rate with the policy rate is an important step to effecting transmission to market rates (2023 Article IV Staff Report, ¶26, and Annex VIII), which had been well below even the previous levels of the policy rate.

24. **But more is needed to help stabilize the exchange rate, given very loose monetary conditions.**

- At present, the BoL is charged with multiple targets (2021 Article IV Staff Report), including a target for M2 growth (25 percent y/y) that is incompatible with achieving low inflation. The BoL should focus on price stability as an intermediate objective.

- The policy rate should be raised significantly so that it is positive in real terms, to ensure a sustained period of low reserve money growth. Reserve requirements could also be raised further, but the effect will need to be monitored closely, given already excessive reserves holdings and the risk of pushing banks to lower deposit rates. The BoL should not subsidize development bank loans.[18] Monetary financing of the government should be avoided; any new purchase of government bonds from commercial banks should be fully sterilized. Such steps would come at the cost of a contraction in private sector credit, but if credibly implemented could stabilize the exchange rate, prevent the debt burden in domestic currency from increasing further, and stem the damage to real growth over the medium term (Annex IV).

Authorities' Views

25. **The authorities agreed with the need to tighten monetary conditions, but gradually.** They are committed to continuing the implementation of tight monetary policy through a combination of policy rate and reserve ratio increases, coupled with BoL bond issuance. They also aim to enhance the effectiveness of monetary transmission and ensure that these policies support exchange rate stability, thereby contributing to efforts to reduce the persistent inflation rate. They

[17] The BoL has made significant progress in implementing key recommendations from previous TA missions (Annex VIII). It has introduced a 7-day bill and issues 3- and 6-month bills exclusively to banks at pre-set interest rates anchored to the policy rate. With the issuance of BoL bills exclusively to banks, previous issuance of BoL bills to the public has been discontinued.

[18] The BoL has issued two credit policies to stimulate credit growth in the economy to support and strengthen domestic production and reduce the reliability of the imported goods.

project inflation to fall from 2024, to 4½ percent by 2029. They agreed that monetary financing needs to be discontinued. They attributed the fast M2 growth mainly to the exchange rate depreciation effects of FX-denominated deposits.

D. Exchange Rate Policy

26. Greater exchange rate flexibility is appropriate; in addition, two exchange rate restrictions have been assessed under Article VIII, Section 2(a).

- The first exchange restriction arises from restrictions on commercial banks' setting of a market-clearing exchange rate, contributing to a shortage of FX that results in undue delays in accessing FX for current international transactions. Furthermore, the authorities have also prioritized the allocation of FX:
    - The BoL widened the trading band relative to the daily reference rate from ±4.5 percent to ±7 percent, and the margin for buying and selling rates to (no more than) 2 percent. In the context of overall FX shortages, the BoL has limited commercial banks' ability to adjust exchange rates according to market conditions (e.g., with the trading band and the calculation methodology of the daily reference rate), resulting in a non-market-clearing exchange rate. Market participants report delays or inability to source FX for current international transactions. Market participants also report the existence of a parallel market, where FX is available at a premium.
    - In addition, the authorities, through certain financial intermediaries, prioritize access to foreign exchange for the import of certain "strategic" goods, especially fuel and medicines.[19] Priority allocation of FX for certain goods (e.g., fuel) would further restrict FX supply for other current international transactions (e.g., non-priority goods).
- The second exchange restriction arises from the requirement to provide a tax clearance certificate—covering taxes unrelated to the underlying transactions—prior to obtaining FX for certain current international transactions.
- As of the time of writing, the authorities have not requested approval for these exchange restrictions. Staff advises the elimination of both exchange restrictions; the first exchange restriction should be removed (e.g., through a transition to a market-clearing rate and ceasing priority allocation of FX for certain goods and/or sectors) as part of an overall macro-stabilization plan and policy, as recommended in this Staff Report.

27. New measures to contain exchange rate fluctuations are likely counterproductive. The newly adopted regulation on management of foreign currency revenues that requires (i) exporters to sell foreign exchange from repatriated export proceeds to commercial banks, and (ii) commercial banks sell a portion of foreign exchange purchased from the exporter to the BoL, constitutes an

[19] See IMF 2023 Annual Report, p9 (English version).

outflow capital flow management measure (CFM) under the IMF's Institutional View (IV) on the Liberalization and Management of Capital Flows. The surrender requirement would be appropriate under the IV in the context of Lao P.D.R.'s (near) crisis situation. However, these measures are not advisable due to their side effects and likely ineffectiveness of the measures given a relatively open financial account. The measures are likely to increase transferring costs, and could inflate parallel market activities and create adverse effects on foreign investor confidence. The authorities should assess whether the measure achieves the intended goal and consider phasing it out.

Authorities' Views

28. The authorities emphasized their top priority is to stabilize the exchange rate. Lao PDR maintains a relatively open and liberalized exchange rate management system. The authorities acknowledged imbalances in the economy in terms of FX management. To address these issues, the repatriation and mandatory conversion requirements and limiting imports of non-essential goods are important to foster FX inflows to banking system, thereby strengthening the BoP position and international reserves. They will continue to periodically assess these policy measures until a sound monetary situation has been achieved. They also noted recent efforts to collect debt owed to the BoL, to strengthen FX reserves.

E. Financial Sector Policies

29. Published financial soundness indicators suggest adequate aggregate bank capital and asset quality, but are potentially problematic. At the time of writing, the latest data show the system-wide Capital Adequacy Ratio (CAR) at over 18 percent, while non-performing loans (NPLs) decreased to 1.4 percent in 2023. However,

- The aggregate CAR is skewed by some banks with very small loan books.[20] The capital adequacy ratio of the largest bank in the system, the BCEL, stood at 4.9 percent as of end-2023, below the prudential minimum of 8 percent.[21] Its tier 1 capital ratio was 2 percent, compared with an international norm of around 5 percent.

- Zero risk weights applied on government debt in the calculation of the CAR likely overstate the capital adequacy of some banks.

- Ongoing loan forbearance, introduced in March 2020, gives banks wide latitude to avoid recognizing loan losses, which may overstate capital adequacy and asset quality measures.

30. New capital and liquidity requirements should be implemented immediately. The government has announced plans to supplement the regulatory requirement of 8 percent with a constant 2.5 percent add-on for all banks, a cyclical capital buffer of 0 to 2.5 percent, and a 1-2

[20] The CAR should be an average weighted by balance sheet size, but is currently calculated as a simple average.

[21] The CAR of BCEL is reported to be 4.9 percent under IFRS standards (the regulatory requirement for the Lao stock market). Under BoL standards, it currently stands at 6.4 percent.

percent buffer for systemic banks. The schedule for implementing these changes and which banks are covered by the systemic buffer is yet to be determined. The liquidity coverage ratio is to be increased over a five-year period from currently 50 to 100 percent. Rapid implementation of both would help safeguard the system.

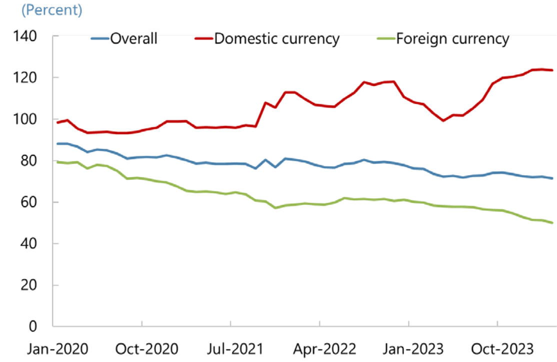
31. Efforts to implement risk-based supervision (RBS) are welcome and should see interventions to address growing risks. The authorities have been receiving TA on RBS for several years (Annex VIII) and can implement those tools to address growing risks:

- *Credit risk:* Rapid credit growth not only arises from loose monetary conditions but raises concern about credit standards. Reported NPLs (for some banks, barely 0.1 percent) stand in contrast to weaknesses in the economy. Loan forbearance should be ended decisively (Annex VIII).[22]

- *Currency imbalances:* Although deposits have increased overall, the share of FX deposits has increased significantly, indicating a desire for insurance against further currency depreciation. Banks have increasingly issued loans in kip as the domestic-currency values of FX deposits—liabilities—have increased because of currency depreciation.

32. The authorities should urgently implement AML/CFT recommendations. The Asia-Pacific Group (APG) for Money Laundering published its Mutual Evaluation Report in August 2023, which identified significant gaps in the legal and institutional framework and its effective implementation, including in the understanding of ML and TF risks and implementation of related preventive measures across a range of financial and non-financial sectors (e.g. banks, casinos, real estate), and insufficient focus on key risks by the relevant government agencies. ML investigations and prosecution were assessed as receiving low priority, and corporate transparency and preventative measures were deficient (e.g. customer due diligence, PEPs, and targeted financial sanctions). Some aspects of AML/CFT supervision over banks have started, but need significant enhancement.

Loan-to-Deposit Ratio
(Percent)



Sources: National authorities and IMF staff calculations.

Authorities' Views

33. The authorities take a more positive view on developments in the financial sector. While taking note of staff's recommendation to relook at the computation of financial stability indicators, the authorities' clarified that some of the apparent weaknesses could be explained by the differences in accounting standards—for example, they noted that one of the big banks' capital is

[22] The rules currently allow banks to make 1 or 2 more reclassifications on loans, depending on the terms of the loan and how many times they have already been reclassified.

only below the regulatory minimum under IFRS standards, whereas under BoL accounting rules its capital ratio has been rising. However, a recovery plan has been established and is now to be implemented. In addition, they noted that loans under forbearance constitute a very small part of the overall loan book of banks, and that they have instructed banks to end the practice. On financial supervision, the BoL is working toward implementing forward-looking supervisory reforms, including conducting stress tests and laying the foundation for risk-based supervision, with Fund support. The supervision of AML/CFT activities has been enhanced through the adoption of the amended Law on AML/CFT in July 2024.

F. Structural Policies, Governance, and Data

34. Supporting growth and employment will require accelerating reforms to improve the business environment and human capital. The pre-pandemic growth model of high public investment did not generate sustained growth in employment and productivity (Annex IV). Private sector-led growth is hampered by skills shortages and administrative burdens. To address these challenges, broader reforms are needed, including: (i) reducing the regulatory burden on small businesses; (ii) ensuring a consistent and transparent implementation of tax and regulations; (iii) encouraging a shift away from informality through coordinated tax policy, revenue administration and expenditure broader reforms; (iv) strengthening legal and regulatory frameworks and enhancing social safety nets; and (v) improving educational attainment and skills acquisition through developing education infrastructure and expanding technical and vocational education and training program.

35. Addressing pervasive corruption and governance weaknesses is critical for improving the quality of policymaking and the business climate. In 2023, Lao P.D.R. obtained its lowest score since 2016 in the Corruption Perception Index.[23] Corruption and clientelism are perceived to play a role in the inefficiency of the use of budget resources,[24] and the influx of foreign investment, the development of public-private initiatives and the implementation of mega-projects pose major corruption risks.[25] Significant concerns remain with the independence and impartiality of the judiciary stemming from corruption.[26] The authorities' decision not to engage in discussions regarding corruption-related issues during this consultation limited the staff's ability to offer the most tailored analysis and policy advice.

36. Enhancing transparency will be key to address governance weaknesses. Greater transparency in government operations and financial management could lead to more informed decision-making, reduce opportunities for corruption, and foster an environment conducive to investment and economic growth. Enhanced transparency would also promote confidence among

[23] 2023 Corruption Perceptions Index - Transparency.org

[24] BTI 2024: Lao PDR: BTI 2024 (bti-project.org)

[25] Strengthening Anti-Corruption Investigations in the Lao PDR (unodc.org)

[26] https://www.fatf-gafi.org/content/dam/fatf-gafi/fsrb-mer/Lao-APG-MER.pdf.coredownload.inline.pdf

foreign investors and development partners. The authorities should enact a comprehensive law on transparency and access to information based on best international practice.

- Transparency about public financial management would enhance institutional capacity in the management of public resources and boost credibility in eyes of external investors, reducing potential vulnerabilities to corruption. Procurement contracts, names of awarded firms, and their beneficial owners should be published. The asset sales plan appears to have been formulated by the Ministry of Finance with very limited input from any other concerned agencies and stakeholders and without inspection of independent assessors. Full implementation of the FMIS based on a sound Chart of Account and the implementation of Treasury Single Account will be critical to improve budget preparation, the predictability and control of budget execution, as well as transparency and accountability. Improvements in the governance of SOEs, building on the ongoing corporate governance assessments of EDL and Lao Airlines, will be especially important.

- The BoL could improve transparency with published financial statements audited by a reputable and independent agency and implementation of the IMF's central bank transparency code. The recent announcement of debt recovery by the BoL suggests that significant amounts have been lent to private and public entities; it is not clear whether the size of the recoveries is consistent with lending recorded in the BoL's balance sheet.[27] Financial stability would greatly benefit from greater transparency in terms of banks' governance, related party lending, and individual bank's reporting, especially under International Financial Reporting Standards (IFRS). Continued efforts are required to enhance the implementation of AML/CFT requirements, including to ensure fitness and proprietary of bank ownership and control on an ongoing basis.

- The State Inspection and Anti-Corruption Authority (SIAA) provides an annual report to the National Assembly—publishing the report and cases pursued would improve enforcement.

- Improvements in transparency would help improve the business climate. For example, transparency in investor protection and resolution of disputes are weak—publishing court judgments would help to bring greater predictability of decision-making and address corruption vulnerabilities within the legal system. More detailed and more timely information about economic and financial challenges (e.g. the size of expenditure arrears, size of financing needs, the financial health of SOEs) as well as the authorities' detailed plans on how to tackle these challenges (e.g. revenue mobilization, financing assumptions, and/or debt rescheduling assumptions) would facilitate better assessments of the country's growth potential.

37. A stronger anti-corruption framework would incentivize the adoption and implementation of good governance practices:

[27] The BoL reported to the National Assembly that it had recovered principal and interest payments from past loans by the BoL totaling 11,458 billion kip (US$ 525 million dollars at the time of writing) in the two years to July 2024. The latest published BoL balance sheet records zero credit to the private sector after November 2007.

- More efforts should be made for the follow up and publication of results of the Plan of Action on Prevention and Anti-corruption 2016-2025 (which has been incorporated into the current Five-Year National Social Economic Development Plan). Further, the authorities should start the preparation of a new Plan of Action on Prevention and Anti-Corruption for the period 2026 through 2030. The Plan should consider corruption aspects of the political economy of the country, the main corruption risks across key state functions (e.g. tax and customs administration, procurement, and public spending), and steps to strengthen prosecutorial and judicial independence to safeguard the rule of law, contract enforcements, and property rights.

- The legal framework should be strengthened and implemented. The Anticorruption Law (2012) punishes the abuse of power, embezzlement, passive bribery and fraud in the public sector, but requires improvements to ensure the country meets its criminalization obligations under the United Nations Convention against Corruption (UNCAC). Lao P.D.R. lacks laws on access to information and whistleblower protection, and the norms on asset declarations (Decree on Asset Declaration of 2013)[28] have loopholes that require improvement (such as publication of declarations of at least top-level officials). The AML/CFT regime should also be leveraged to prevent and deter the laundering of proceeds of corruption, and rules established to disclose beneficial ownership of individuals and companies bidding for, and entering into, public contracts.

- Implementation would benefit from ensuring resource's and independence of key anti-corruption institutions, including by adopting legal measures to grant the SIAA the necessary independence to carry out its functions effectively and free from any undue influence.[29] The authorities should also ensure the independence of prosecutors and judges, particularly those in charge of the investigation of corruption cases, in line with the Bangalore Principles of Judicial Conduct.

38. Addressing data gaps would help better understand economic situations, inform policy making, and manage risks. The authorities have made progress in improving data dissemination and provision, but significant gaps remain. Overall, the data provided to the Fund has some shortcomings that somewhat hamper surveillance (Annex VII). Ongoing and further technical assistance by development partners—including the Fund support on the government finance, public sector debt, and external sector statistics—and accelerated efforts by the authorities are crucial to improve statistics. More sharing of data would also facilitate the design and evaluation of policies.[30] It will be key to make improvements on:

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[28] Decree-on-Declaration-of-Asset.pdf (asean-pac.org)

[29] https://www.unodc.org/documents/treaties/UNCAC/CountryVisitFinalReports/2022-09-21_Lao_Cycle_II_Country_Review_Report_EN.pdf

[30] For example, the law of the Lao Statistics Bureau limits the BoL's access to only 12 broad categories of the CPI, and not the full 485 items of the basket.

- *National accounts.* Staff has concerns over the reliability of the GDP data and has been using own estimates since 2019. Expenditure GDP and (un)employment data are not available, limiting the ability to analyze business cycles in a comprehensive and timely manner.

- *Government finance statistics.* Timely and accurate reporting of expenditure arrears is notably absent. An important step will be implementing the new Financial Management Information System (FMIS) and Treasury Single Account (TSA), enabling the collection of timely, comprehensive, and reliable data used for governments' financial statements and fiscal performance monitoring.

- *External sector statistics.* Errors and omissions in the balance of payment data have been persisting at notably high levels. International investment position data were provided on a preliminary basis but only for 2015-19.

- *Monetary and financial statistics* are limited; the timeliness and quality of existing data could also be improved. Given exchange rate restrictions, it will be important for the BoL to improve collection of data on the supply and demand of FX and FX backlogs.

Authorities' Views

39. The authorities agreed on the need to improve business environment and statistics. They noted that the amended Investment Promotion Law was recently approved and would help foster a business environment conducive to investment and growth. The government has been instructed to promote domestic production. The authorities appreciated the Fund support in statistics and are working closely with different development partners to make further improvements. The authorities declined staff requests for comprehensive in-person coverage of governance and anticorruption for the 2024 Article IV consultation, citing inadequate resources and time to prepare due to their primary focus on other priorities, notably this year's chairmanship of ASEAN. However, they agreed to permit staff to conduct a foundational seminar on governance and anticorruption frameworks during the 2024 Article IV consultation mission to develop essential knowledge for future implementation.

STAFF APPRAISAL

40. The economy continues to exhibit signs of stress. Exchange rate depreciation continues and FX reserves are low, leading to persistently high domestic inflation while worsening the public debt burden. Firms face FX and labor shortages.

41. Against this backdrop, the economic outlook is for growth significantly below pre-pandemic averages and elevated inflation. Despite primary surpluses and debt servicing deferrals, the expected increase in government's financing needs is substantial. If financing needs have to be met by domestic financing, pressures on the exchange rate and inflation would reignite, damaging potential growth over the medium term.

42. A balanced and credible medium-term fiscal consolidation plan is needed to restore crucial expenditures and to fully restore international market access. Fiscal adjustment efforts should target raising more revenues—focusing on removing costly tax exemptions and further improving tax administration and compliance—to enable restoring spending on education, health, and critical infrastructure, which have been cut to very low levels. This would help maintain a moderate primary surplus while avoiding drag on potential growth.

43. Monetary policy should prioritize reducing inflation, and financial stability should be closely monitored. Steps would include raising the policy rate to slow the expansion of broad money to rates consistent with low inflation, stopping monetary financing, and issuing BoL bonds to soak up excessive liquidity. Bank supervision should be strengthened, and the new capital and liquidity requirements should be implemented immediately to safeguard the financial system.

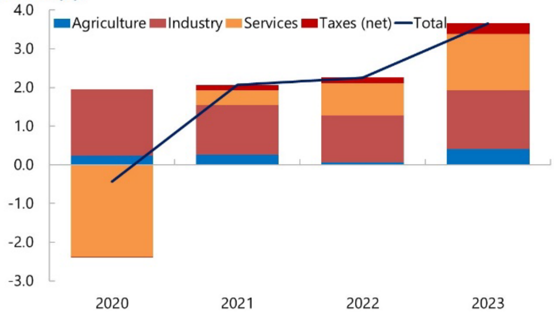
44. Broader structural reforms, mainly on governance and anti-corruption, enhanced transparency, and better statistics, are crucial to improve the business environment. Strengthening institutions, legal and regulatory frameworks, and investing in human capital would help foster a business environment that is conducive to investment and growth. Enhancing transparency, implementing anti-corruption measures, and addressing remaining gaps in the AML/CFT framework and data gaps would help better design policies, manage risks, and promote confidence of investors and development partners.

45. It is recommended that the next Article IV consultation with the Lao P.D.R. be held on the standard 12-month cycle.

Figure 1. Lao P.D.R.: Real Sector Development

Growth in 2023 was driven by industry and services, with the latter led by a strong recovery in tourism.

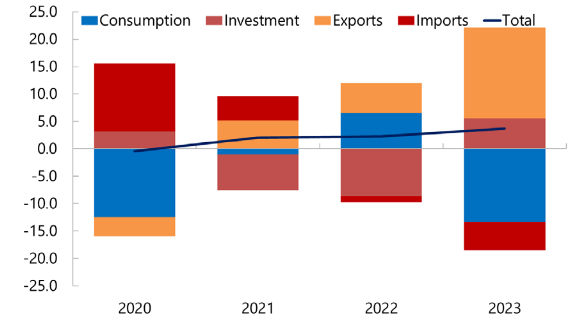
Real GDP Growth and Sectoral Contributions
(Percent, y/y)



Sources: National authorities and IMF staff estimates.
Notes: 2020–23 numbers are staff estimates using leading indicators .

Exports were the main demand-driver, while consumption declined due to the high and persistent inflation.

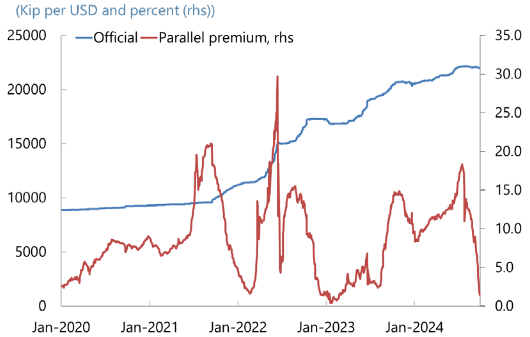
Real GDP Growth and Expenditure Contributions
(Percent, y/y)



Sources: National authorities and IMF staff estimates.
Notes: 2020–23 numbers are staff estimates using leading indicators.

Lao kip continued to depreciate, with the parallel FX premium fluctuating and remaining positive.

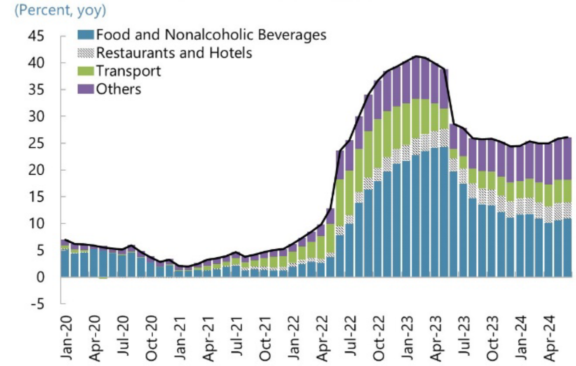
Exchange Rate and Parallel Premium
(Kip per USD and percent (rhs))



Sources: National authorities and IMF staff calculations.
Notes: Parallel premium is calculated against commercial banks' exchange rates.

Inflation, while having come down from its peak in early 2023, is still at uncomfortably high level.

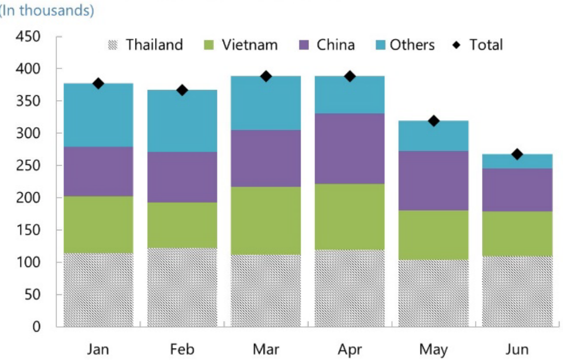
Headline CPI Inflation and Contributions
(Percent, yoy)



Sources: National authorities and IMF staff calculations.

Tourism arrivals rebounded strongly, ...

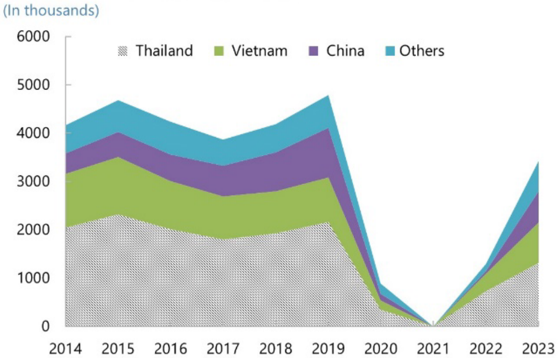
Arrivals of International Visitors, 2024
(In thousands)



Sources: National authories and staff calculations.

... although there is substantial room for recovery.

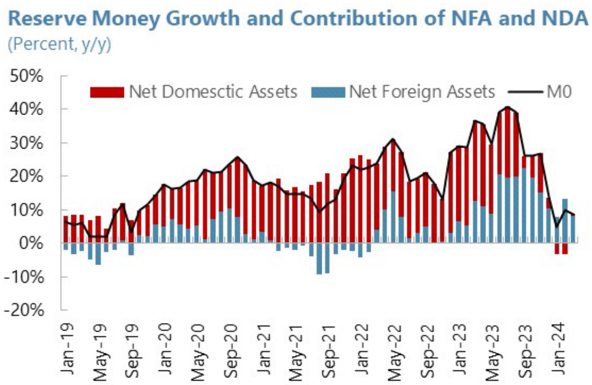
Arrivals of International Visitors
(In thousands)



Sources: National authories and staff calculations.

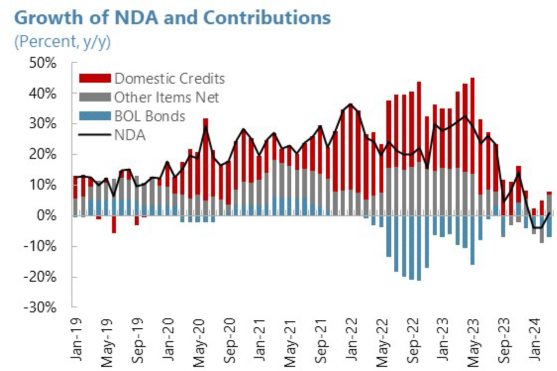
Figure 2. Lao P.D.R.: Monetary Developments

After accelerating since late 2022, reserve money growth slowed since the second half of 2023.



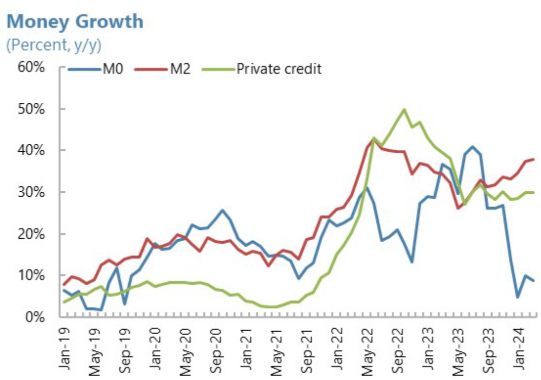
Sources: National authorities and IMF staff calculations.

... while the BoL slowed down the issuance of BoL bonds.



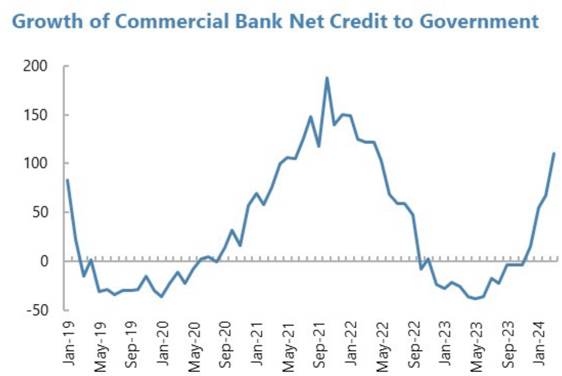
Sources: National authorities and IMF staff calculations.

However, M2 and private sector credit growth did not follow suit and kept growing fast.



Sources: National authorities and IMF staff calculations.

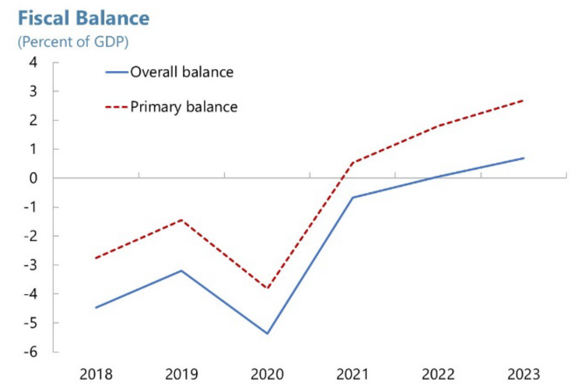
Commercial banks' kip credit to the government started to rise since late 2023.



Sources: National authorities and IMF staff calculations.

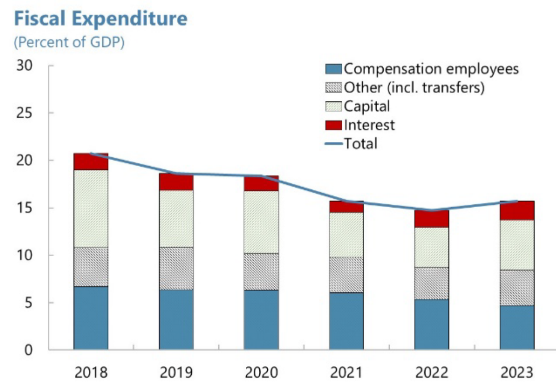
Figure 3. Lao P.D.R.: Fiscal Sector Developments and Outlook

Strong fiscal consolidation led to primary surpluses since 2021, ...



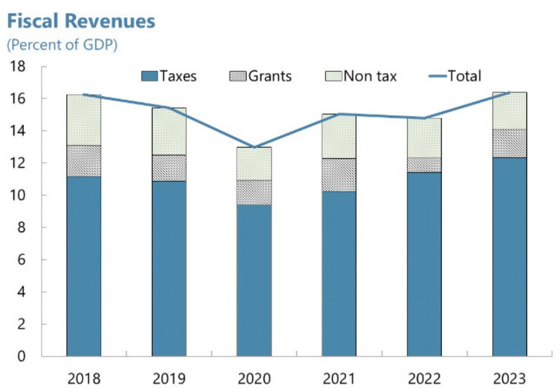
Sources: National authorities and IMF staff calculations.

... driven by a compression of wages, social and capital spending, ...



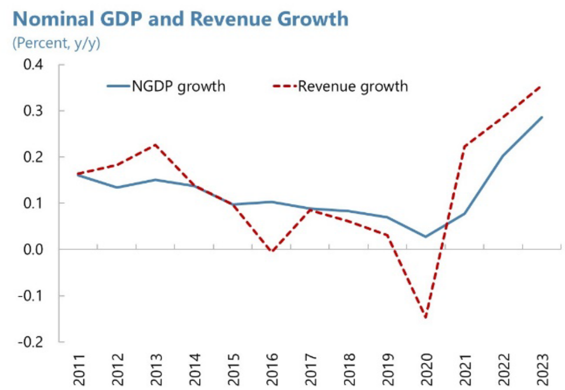
Sources: National authorities and IMF staff calculations.

... and by a stabilization of the significant revenue gains achieved in 2021, ...



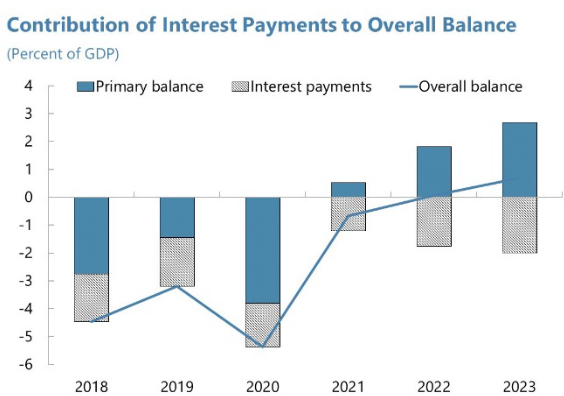
Sources: National authorities and IMF staff calculations.

... albeit additional revenue mobilization is unlikely, and revenue growth is expected to be aligned with output growth.



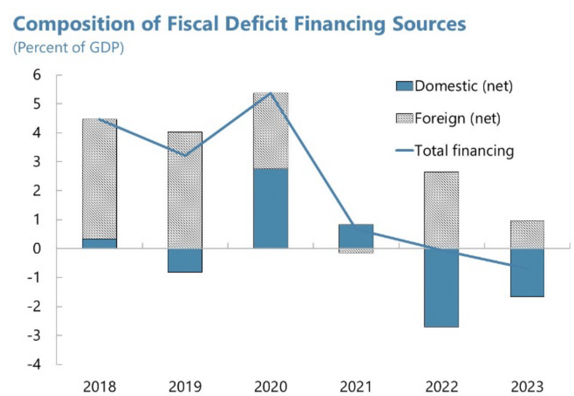
Sources: National authorities and IMF staff calculations.

Rising interest payments drive a wedge between overall and primary balances.



Sources: National authorities and IMF staff estimates and projections.

The overall surplus was mainly used to pay domestic debt obligations.



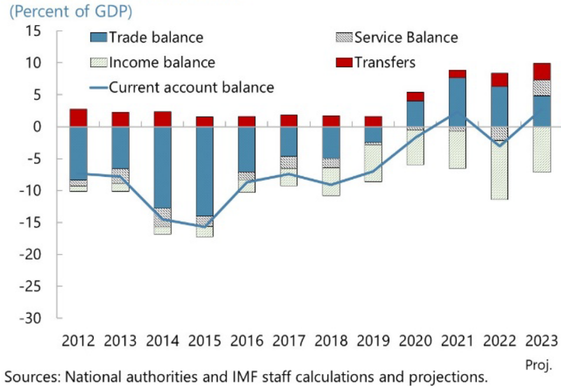
Sources: National authorities and IMF staff estimates and projections.

Figure 4. Lao P.D.R.: External Sector Developments

Strong trade surpluses and tourism receipts led to a current account surplus in 2023.

Current Account Balance

(Percent of GDP)

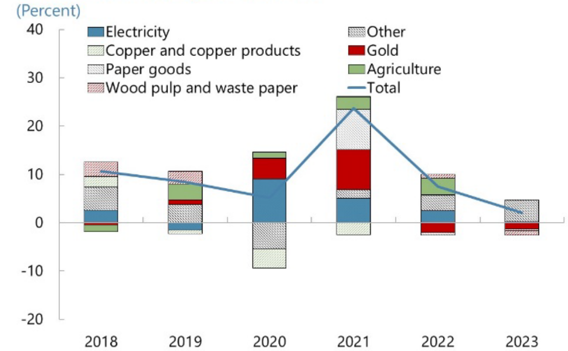


Sources: National authorities and IMF staff calculations and projections.

Exports growth slowed down, with electricity exports barely growing from 2022, …

Contribution to Export Growth

(Percent)

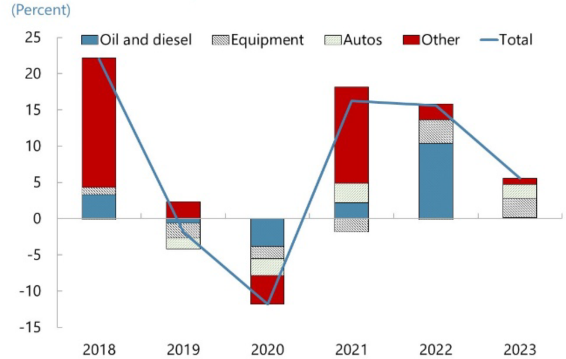


Sources: National authorities and IMF staff calculations.

… while import growth also slowed, due to both declining international commodity prices and the exchange rate depreciation.

Contribution to Import Growth

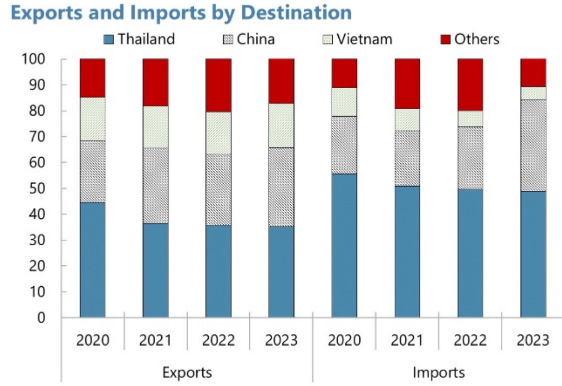
(Percent)



Sources: National authorities and IMF staff calculations.

Imports from China grew significantly, increasing their share in total imports.

Exports and Imports by Destination

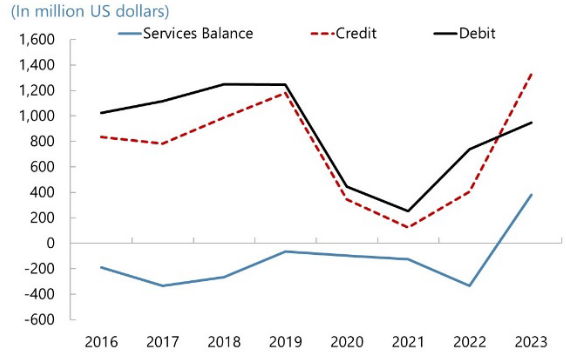


Sources: National authorities and IMF staff calculations.

Meanwhile, the services balance flipped to surplus, driven by the strong recovery in tourism.

Services Balance

(In million US dollars)

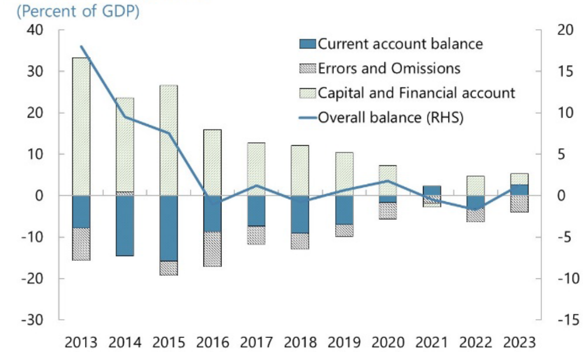


Sources: National authorities and IMF staff calculations.

The current account surplus was offset by net financial outflows, leaving FX reserves largely unchanged.

Balance of Payments

(Percent of GDP)



Sources: National authorities and IMF staff calculations and projections.

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2020–29

	2020	2021	2022 Est.	2023 Proj.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.	2029 Proj.
Output and prices	(percentage change, unless otherwise indicated)									
Real GDP growth 1/	-0.4	2.1	2.3	3.7	4.1	3.5	3.1	2.8	2.6	2.5
Consumer prices (annual average)	5.1	3.8	23.0	31.2	22.0	23.7	37.3	37.4	33.1	31.4
Consumer prices (end-period)	3.2	5.3	39.3	24.4	16.2	37.7	41.1	33.1	32.4	31.2
GDP deflator	4.6	5.6	25.6	24.1	14.6	13.5	21.5	20.9	18.1	16.8
Public finances	(in percent of GDP, unless otherwise indicated)									
Revenue and Grants	13.0	15.0	14.8	16.4	16.5	16.5	16.5	16.5	16.5	16.5
Tax and nontax revenue	11.5	13.0	13.9	14.6	15.2	15.2	15.2	15.2	15.2	15.2
Grant	1.5	2.0	0.9	1.7	1.3	1.3	1.3	1.3	1.3	1.3
Expenditure	18.4	15.7	14.7	15.7	17.0	16.6	16.8	17.1	17.2	17.3
Current Expenditure	11.8	11.0	10.4	10.4	10.9	11.1	11.3	11.5	11.6	11.7
of which : interest payment	1.6	1.2	1.8	2.0	3.2	3.3	3.5	3.7	3.8	3.9
Net acquisition of nonfinancial assets	6.6	4.7	4.3	5.3	6.1	5.6	5.6	5.6	5.6	5.6
Overall balance	-5.4	-0.7	0.1	0.7	-0.5	-0.1	-0.3	-0.6	-0.7	-0.8
Primary balance	-3.8	0.5	1.8	2.7	2.7	3.1	3.1	3.1	3.1	3.1
Public and public guaranteed debt 2/	76.0	92.9	130.7	115.9	108.3	118.3	122.7	122.3	124.2	126.7
Domestic	5.0	13.3	26.8	20.2	18.8	20.3	23.8	25.2	26.9	27.2
External	70.9	79.6	103.9	95.6	89.6	98.0	99.0	97.1	97.3	99.5
Public and public guaranteed external debt service (in millions of U.S. dollar)	932.9	650.5	517.5	1006.2	1187.7	1546.4	1855.3	1474.1	1338.3	1066.8
In percent of exports of goods and services	14.4	8.3	6.0	10.4	12.6	16.4	21.6	19.1	19.0	16.4
Money and credit	(percentage change, unless otherwise indicated)									
Broad money	16.3	24.0	36.9	33.3	30.7	22.6	21.1	18.9	16.9	16.6
Credit to the economy	4.3	11.5	45.6	27.8	27.4	14.2	8.8	10.9	7.0	9.9
Balance of payments	(in millions of U.S. dollars, unless otherwise indicated)									
Current account balance	-304	432	-459	405	351	314	256	229	200	176
In percent of GDP	-1.6	2.3	-3.0	2.7	2.4	2.2	1.9	1.8	1.7	1.6
Trade balance	745	1,419	954	721	612	592	559	489	426	377
Exports	6,115	7,695	8,198	8,370	8,505	8,553	7,760	6,936	6,342	5,826
Imports	5,370	6,275	7,244	7,649	7,893	7,962	7,201	6,447	5,916	5,449
Services	-99	-127	-332	380	478	440	350	316	289	263
Investment income	-1,202	-1,087	-1,395	-1,075	-1,068	-1,024	-947	-868	-802	-746
Transfers	252	226	315	378	329	307	295	292	287	282
Capital and Financial account balance	1,355	-158	717	385	-86	-524	-568	-466	-380	-304
FDI	968	1,072	726	1,781	680	677	644	607	576	536
Gross official reserves 3/	1325.0	1245.0	990.5	1182.5	1463.0	1273.9	990.4	790.6	659.4	593.5
In months of prospective imports of goods and services	2.4	1.9	1.4	1.7	2.1	2.0	1.7	1.5	1.4	1.3
External debt (in percent of GDP)	106.0	122.1	154.3	146.5	139.6	147.1	147.3	146.0	146.6	150.0
Memorandum items:										
Nominal GDP (in billions of kip)	167,669	180,751	217,350	279,576	333,607	391,737	490,822	609,846	739,447	885,692
GDP per capita (in billions of kip)	22.9	24.3	29.1	36.9	43.4	50.3	62.2	76.3	91.4	108.3
Official exchange rate (kip per U.S. dollar; end-of-period)	9,285	11,166	17,238	20,480	…	…	…	…	…	…
Real GDP growth (published by authorities) 4/	3.3	3.5	4.4	4.2	…	…	…	…	…	…

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Staff estimate 2019–23 numbers using leading indicators such as electricity and mining productions, harvest volumes in major crops, export of goods and services, and tourism revenues (due to concerns over data quality and availably).
2/ Includes publicly-guaranteed debt in the stock of external debt for which data was missing prior to 2020, and Swap drawings with the People's Bank of China (PBoC).
3/ Includes Swap drawings with the People's Bank of China (PBoC), and the Special Drawing Right (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.
4/ Lao Statistics Bureau (LSB) data.

Table 2. Lao P.D.R.: Central Government Operations, 2020–29

(Percent of GDP unless otherwise indicated)

	2020	2021	2022	2023 Est.	2024 Proj.	2025 Proj.	2026 Proj.	2027 Proj.	2028 Proj.	2029 Proj.
Revenue and Grants	**13.0**	**15.0**	**14.8**	**16.4**	**16.5**	**16.5**	**16.5**	**16.5**	**16.5**	**16.5**
Taxes	9.4	10.3	11.4	12.3	13.2	13.2	13.2	13.2	13.2	13.2
Income and profit taxes	1.9	2.3	2.9	2.9	2.9	2.9	2.9	2.9	2.9	2.9
Income taxes	0.9	0.8	1.0	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Profit taxes	1.0	1.5	1.8	1.6	1.6	1.6	1.6	1.6	1.6	1.6
VAT	2.8	3.2	2.7	3.1	3.5	3.5	3.5	3.5	3.5	3.5
Excise duties	2.1	2.4	2.6	2.6	3.1	3.1	3.1	3.1	3.1	3.1
Import duties	0.6	0.7	1.0	1.1	1.1	1.1	1.1	1.1	1.1	1.1
Royalties	0.5	0.9	1.5	1.6	1.6	1.6	1.6	1.6	1.6	1.6
Mining	0.3	0.7	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Hydropower	0.2	0.3	0.2	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Other taxes	1.4	0.8	0.9	1.0	1.0	1.0	1.0	1.0	1.0	1.0
Nontax revenues	2.1	2.7	2.5	2.3	2.0	2.0	2.0	2.0	2.0	2.0
Of which: Dividends 1/	0.4	0.8	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Grants	1.5	2.0	0.9	1.7	1.3	1.3	1.3	1.3	1.3	1.3
Total Expenditure	**18.4**	**15.7**	**14.7**	**15.7**	**17.0**	**16.6**	**16.8**	**17.1**	**17.2**	**17.3**
Current Expenditure	11.8	11.0	10.4	10.4	10.9	11.1	11.3	11.5	11.6	11.7
Compensation of employees	6.3	6.1	5.4	4.7	4.5	4.5	4.5	4.5	4.5	4.5
Transfers	2.0	1.9	1.5	1.6	1.7	1.9	1.9	1.9	1.9	1.9
Interest payments	1.6	1.2	1.8	2.0	3.2	3.3	3.5	3.7	3.8	3.9
Of which: External	1.3	1.0	1.1	1.6	2.4	2.3	2.4	2.2	2.1	2.0
Other recurrent	1.9	1.9	1.8	2.0	1.5	1.5	1.5	1.5	1.5	1.5
Net acquisition of nonfinancial assets	6.6	4.7	4.3	5.3	6.1	5.6	5.6	5.6	5.6	5.6
Domestically financed	2.0	1.5	1.7	1.5	1.5	1.5	1.5	1.5	1.5	1.5
Externally financed	4.6	3.2	2.6	3.8	4.6	4.1	4.1	4.1	4.1	4.1
Net lending/borrowing	**-5.4**	**-0.7**	**0.1**	**0.7**	**-0.5**	**-0.1**	**-0.3**	**-0.6**	**-0.7**	**-0.8**
Net acquisition of financial assets	-1.0	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Domestic	-1.0	0.1	1.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Foreign	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.4	0.8	0.9	-0.7	0.5	0.1	0.3	0.6	0.7	0.8
Domestic	2.5	1.0	-1.7	-1.7	2.0	5.3	9.4	7.3	7.2	5.6
Foreign	1.9	-0.2	2.7	1.0	-1.5	-5.2	-9.1	-6.7	-6.5	-4.8
Discrepancy	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Public and publicly guaranteed debt	76.0	92.9	130.7	115.9	108.3	118.3	122.7	122.3	124.2	126.7
Domestic	5.0	13.3	26.8	20.2	18.8	20.3	23.8	25.2	26.9	27.2
External	70.9	79.6	103.9	95.6	89.6	98.0	99.0	97.1	97.3	99.5
Memorandum items:										
Primary balance	-3.8	0.5	1.8	2.7	2.7	3.1	3.1	3.1	3.1	3.1
Nominal GDP (in billions of kip)	167,669	180,751	217,350	279,576	333,607	391,737	490,822	609,847	739,448	885,693

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

1/ Includes dividends from mining and hydropower projects.

Table 3. Lao P.D.R.: Balance of Payments, 2020–29

(Percent of GDP unless otherwise indicated)

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
				Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
				Percent of GDP, unless otherwise specified						
Current Account	**-1.6**	**2.3**	**-3.0**	**2.7**	**2.4**	**2.2**	**1.9**	**1.8**	**1.7**	**1.6**
Merchandise trade balance	4.0	7.7	6.3	4.8	4.1	4.1	4.2	3.9	3.7	3.5
Exports, f.o.b.	33.0	41.5	54.2	56.0	56.9	59.2	57.7	55.9	54.9	54.2
Imports, c.i.f.	29.0	33.9	47.9	51.2	52.8	55.1	53.6	51.9	51.2	50.7
Services (net)	-0.5	-0.7	-2.2	2.5	3.2	3.1	2.6	2.6	2.5	2.5
Of which: Travel	1.4	1.4	1.9	2.0	2.9	3.2	3.6	4.1	4.6	5.2
Income (net)	-6.5	-5.9	-9.2	-7.2	-7.1	-7.1	-7.0	-7.0	-6.9	-6.9
Interest payments	2.6	1.4	1.6	4.1	4.9	4.4	4.1	3.9	3.5	3.2
Transfers (net)	1.4	1.2	2.1	2.5	2.2	2.1	2.2	2.3	2.5	2.6
of which: Private (net)	-0.1	-0.6	1.3	0.9	1.0	1.0	1.1	1.2	1.3	1.5
of which: Official (net)	1.5	1.8	0.7	1.6	1.2	1.1	1.1	1.1	1.1	1.1
Capital account	**0.1**	**0.0**	**0.1**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Financial account	**7.3**	**-0.9**	**4.7**	**2.6**	**-0.6**	**-3.6**	**-4.2**	**-3.8**	**-3.3**	**-2.9**
Direct investment (net)	5.2	5.8	4.8	11.9	4.6	4.7	4.8	4.9	5.0	5.0
Portfolio investment (net)	-1.4	-1.7	0.5	-0.7	-0.1	-0.1	-0.3	-0.2	-0.2	-0.3
Other investment (net)	1.8	-5.0	-0.6	-8.7	-5.1	-8.2	-8.7	-8.5	-8.1	-7.6
Public sector	4.3	-0.1	2.2	-1.1	-1.4	-4.5	-7.7	-5.8	-5.7	-4.2
Disbursements	7.7	2.7	4.5	4.3	4.3	4.2	4.2	4.1	4.1	4.0
Amortization	3.4	2.8	2.3	5.4	5.7	8.7	11.8	9.9	9.8	8.2
Banking sector (net)	-1.5	-4.4	-0.9	-4.3	-3.0	-2.1	-2.6	-2.6	-2.4	-2.0
Other flows	-1.0	-0.5	-1.9	-3.3	-0.6	-1.6	1.5	-0.1	0.0	-1.4
Errors and omissions	**-3.9**	**-1.9**	**-3.4**	**-4.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**	**0.0**
Overall balance	**1.8**	**-0.4**	**-1.7**	**1.3**	**1.8**	**-1.5**	**-2.3**	**-1.9**	**-1.6**	**-1.2**
Memorandum items:										
Gross official reserves 1/	7.2	6.7	6.6	7.9	9.8	8.8	7.4	6.4	5.7	5.5
In months of prospective imports of goods and services	2.4	1.9	1.4	1.7	2.1	2.0	1.7	1.5	1.4	1.3
Current account excluding official transfers	-3.1	0.6	-3.8	1.1	1.1	1.1	0.8	0.7	0.6	0.5
Current account excluding petroleum imports	0.5	6.2	3.9	9.0	9.1	9.2	9.6	10.4	11.2	12.4

Sources: Lao P.D.R. authorities and IMF staff estimates and projections.
1/ Includes drawings on the swap line with the People's Bank of China (PBoC), and the Special Drawing Rights (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.

Table 4. Lao P.D.R.: Monetary Survey, 2020–29

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
					Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
	(In billions of kip, unless otherwise indicated)									
Bank of Lao P.D.R. (BoL)										
Net foreign assets	**8,556**	**7,815**	**9,046**	**14,402**	**22,923**	**25,066**	**22,311**	**17,753**	**13,376**	**10,955**
In millions of U.S. dollars	921	700	525	703	985	796	513	313	182	116
Net domestic assets	**23,913**	**32,195**	**41,856**	**43,492**	**40,123**	**45,177**	**57,197**	**72,268**	**88,755**	**105,219**
Government (net)	1,173	3,129	6,358	5,537	8,811	19,236	42,405	64,652	91,389	116,081
Claims	2,509	5,026	9,482	11,812	15,087	25,511	48,680	70,927	97,664	122,357
Deposits	-1,336	-1,897	-3,124	-6,275	-6,275	-6,275	-6,275	-6,275	-6,275	-6,275
State-owned enterprises	6,243	6,908	8,631	9,192	10,571	12,157	13,981	16,078	18,489	21,263
Banks	9,554	13,309	15,331	16,677	18,142	19,735	21,468	23,354	25,405	27,636
BoL securities	-2,193	-2,251	-4,298	-6,081	-7,719	-12,931	-24,515	-35,639	-49,008	-61,354
Other items (net)	9,136	11,100	15,835	18,167	10,318	6,980	3,859	3,823	2,479	1,592
Reserve money	**32,469**	**40,011**	**50,902**	**57,894**	**63,046**	**70,243**	**79,508**	**90,020**	**102,131**	**116,174**
Currency in circulation	12,195	13,386	12,662	13,014	16,013	20,370	28,468	39,640	48,064	57,570
Deposits	20,274	26,624	38,240	44,880	47,033	49,872	51,040	50,380	54,066	58,604
Monetary survey										
Net foreign assets	**-5,071**	**461**	**5**	**16,768**	**30,855**	**42,183**	**45,969**	**48,594**	**53,376**	**62,323**
In millions of U.S. dollars	-546	41	0	819	1,326	1,340	1,057	857	726	660
Of which: Commercial banks	-1,468	-659	-524	116	341	544	544	544	544	544
Net domestic assets	**116,966**	**138,264**	**189,843**	**236,224**	**299,755**	**362,998**	**444,759**	**534,801**	**628,358**	**732,538**
Government (net)	7,630	19,506	18,050	16,288	22,838	43,688	90,024	134,519	187,993	237,378
Credit to the economy	84,481	94,206	137,189	175,282	223,332	255,009	277,573	307,687	329,252	361,824
Of which: Private credit	72,301	79,963	117,316	150,394	190,847	212,256	220,875	240,349	249,250	266,746
Other items (net)	24,856	24,551	34,604	44,654	53,585	64,302	77,162	92,594	111,113	133,336
Broad money	**111,895**	**138,724**	**189,849**	**252,993**	**330,610**	**405,181**	**490,729**	**583,396**	**681,734**	**794,861**
Currency outside banks	9,312	10,490	9,500	9,174	14,963	19,016	23,526	29,231	35,443	42,453
Kip deposits	45,865	52,839	60,356	70,057	91,550	112,199	135,888	161,549	188,780	220,106
Foreign currency deposits (FCDs)	56,718	75,395	119,993	173,762	227,072	278,289	337,045	400,691	468,232	545,931
	(Annual percentage change)									
Reserve money	**18.8**	**23.2**	**27.2**	**13.7**	**8.9**	**11.4**	**13.2**	**13.2**	**13.5**	**13.8**
Broad money	**16.3**	**24.0**	**36.9**	**33.3**	**30.7**	**22.6**	**21.1**	**18.9**	**16.9**	**16.6**
Credit to the economy	**4.3**	**11.5**	**45.6**	**27.8**	**27.4**	**14.2**	**8.8**	**10.8**	**7.0**	**9.9**
Credit to the private sector	**5.5**	**10.6**	**46.7**	**28.2**	**26.9**	**11.2**	**4.1**	**8.8**	**3.7**	**7.0**
Deposit growth	**17.1**	**25.0**	**40.6**	**35.2**	**30.7**	**22.6**	**21.1**	**18.9**	**16.9**	**16.6**
Memorandum items:										
Loan/deposit (percent)	76.3	68.1	71.3	68.1	66.8	62.2	55.7	51.9	47.3	44.5
Gross official reserves (in millions of U.S. dollars) 1/	1,823	1,743	1,489	1,681	1,463	1,274	990	791	659	593
Dollarization rate (FCDs/broad money; in percent)	50.7	54.3	63.2	68.7	68.7	68.7	68.7	68.7	68.7	68.7
Gross reserve/Reserve Money (percent)	52.1	48.6	50.4	59.5	54.0	57.1	54.2	49.8	47.5	48.2

Sources: Lao P.D.R. authorities; and IMF staff estimates and projections.

1/ Defined as foreign assets of the Bank of the Lao P.D.R. Includes drawings on the swap line with the People's Bank of China (PBoC), and the Special Drawing Rights (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.

Table 5. Lao P.D.R.: Selected Financial Soundness Indicators, 2017–2023

(Percent y/y, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023			
							Mar	Jun	Sep	Dec
Capital Adequacy										
Regulatory Capital to Risk-Weighted Assets	15.8	18.3	11.8	13.2	17.5	18.7	19.1	19.8	19.2	18.2
Tier 1 Capital to Risk-Weighted Assets	12.5	13.6	8.3	10.4	14.1	14.7	16.3	15.9	14.2	13.1
Tier 1 Capital to Total Assets	n.a.	n.a.	n.a.	n.a.	6.2	6.1	6.7	6.3	5.8	5.4
Capital to Total Assets	n.a.	n.a.	n.a.	n.a.	8.1	8.7	8.6	8.7	8.6	8.2
Liquidity										
Liquid Assets to Total Assets	n.a.	n.a.	n.a.	n.a.	54.3	53.6	48.7	56.5	57.1	57.5
Liquid Assets to Total Liabilities	n.a.	n.a.	n.a.	n.a.	72.9	58.3	53.0	61.6	62.1	62.4
Liquid Assets to Short Term Liabilities	n.a.	n.a.	n.a.	n.a.	80.7	82.8	85.6	88.7	88.6	88.4
Gross Loans to Deposits	n.a.	n.a.	n.a.	n.a.	68.1	71.3	69.4	69.4	69.5	68.1
Asset Quality										
Non-performing Loans to Total Gross Loans	3.1	3.1	3.0	3.2	2.2	2.2	1.9	1.9	1.6	1.4
Non-performing Loans Net of Provisions to Capital	9.3	10.2	12.7	9.6	4.5	5.9	6.6	4.7	4.6	4.4
Earnings and Praftitability										
Return on Assets	0.5	0.8	1.7	0.6	0.7	1.1	0.9	1.5	1.7	1.5
Return on Equity	7.8	10.9	25.0	12.0	11.6	12.9	11.1	18.5	21.0	18.5
Interest Margin to Gross Income	n.a.	30.2	27.7	18.8	12.0	11.5	21.2	16.4	15.2	12.8
Non-interest Expenses to Gross Income	n.a.	33.1	40.4	74.4	84.5	83.7	65.6	70.4	72.1	77.9
Sectoral Distribution of Loans										
Industry	25.0	28.0	27.8	27.4	26.9	27.9	28.2	30.4	29.8	28.9
Construction	13.6	12.5	14.3	14.3	13.7	13.6	14.7	14.5	14.5	13.6
Materials and Supplies	0.7	0.8	1.3	1.1	3.0	5.1	4.9	3.8	3.8	3.8
Agricultural and Forestry	8.6	8.6	8.2	7.7	7.6	5.5	5.3	5.0	4.9	5.1
Commerce	19.4	19.8	20.1	19.1	19.0	20.2	19.8	19.7	19.0	20.6
Transport	1.6	1.6	1.5	1.9	2.0	2.0	1.9	2.0	1.9	2.1
Services	10.1	10.0	11.3	13.3	14.6	13.2	13.4	13.0	13.4	14.0
Handicrafts	3.9	1.7	1.5	1.3	1.2	0.1	0.1	0.1	0.1	0.1
Others	17.1	17.0	14.1	13.9	12.0	12.4	11.7	11.5	12.6	11.8

As at end period.

Sources: Bank of Lao P.D.R.

Table 6a. Lao P.D.R.: Selected Macro-Critical Gender-Related Indicators

	2020	2021	2022	Emerging and Developing Asia 1 / Latest year available	25th Percentile	75th Percentile	Median	Average
Composite Gender Indices								
Female Human Capital Index (HCI) 2/	0.47	...	...	2020	0.47	0.62	0.53	0.54
Gender Development Index (GDI) 2/	0.92	0.92	0.92	2022	0.93	0.98	0.95	0.95
Gender Inequality Index (GII) 3/	0.46	0.47	0.47	2022	0.33	0.47	0.40	0.39
Global Gender Gap Index 2/	0.73	0.75	0.73	2022	0.67	0.71	0.69	0.69
Women Business and the Law Index (WBL) 4/	85.63	85.63	85.63	2022	58.75	79.69	74.06	70.22
Labor and Income								
Female Employment-to-Population Ratio, Modeled ILO Estimate (15-64 yrs) (as share of the female population)	53.58	53.50	54.04	2022	37.99	58.81	50.12	43.98
Gender Wage Gap 5/	...	...	18.01	...	...	...	...	...
Female Informal Employment Rate	...	...	91.60	...	...	...	...	...
Female Labor Force Participation Rate, Modeled ILO Estimate (15-64 yrs)	55.30	55.40	55.82	2022	41.20	60.55	52.15	45.87
Female Unemployment Rate, Modeled ILO Estimate (15-64 yrs)	3.12	3.43	3.19	2022	2.48	6.30	3.81	4.13
Female Gross Pension Replacement Rate (as share of average worker earnings)	...	...	...	...	...	...	...	...
Leadership and Social								
Proportion of Seats Held By Women in National Parliaments	27.52	21.95	21.95	2022	6.25	21.39	14.26	14.97
Proportion of Women in Managerial Positions	...	...	...	...	...	...	...	...
Prevalence of Intimate Partner Violence among Ever-partnered Women (in percent)	...	...	...	2018	22.00	40.00	31.00	27.20
Access to Finance								
Number of Household Loan Accounts with Commercial Banks, Females' Accounts per 1,000 Female Adults	...	...	...	...	...	...	...	...
Number of Household Deposit Accounts with Commercial Banks, Females' Accounts per 1,000 Female Adults	...	...	...	...	...	...	...	...
Share of Female Adults (in Total Female Adults) Who Borrowed From a Financial Institution (in percent)	...	9.83	...	2017	11.15	20.64	17.53	13.88
Share of Female Adults (in Total Female Adults) Who Own a Financial Institution Account (in percent)	...	37.85	...	2017	31.87	76.64	51.14	68.88
Share of Female Adults (in Total Female Adults) with Mobile Money Account (in percent)	...	4.32	...	...	...	...	...	...
Share of Female Adults (in Total Female Adults) Who Made or Received Digital Payments in the Past Year (in percent)	...	20.22	...	2017	15.14	62.16	26.70	41.31
Education								
Female Adult Literacy Rate	...	...	83.37	...	...	...	...	...
Female Mean Years of Schooling	5.00	5.00	5.00	...	...	...	...	...
Female Primary Gross Enrollment Rate 6/	99.47	98.95	96.20	2022	97.27	109.26	104.70	105.58
Female Secondary Gross Enrollment Rate 6/	60.76	58.46	55.99	2022	79.50	99.57	96.09	83.48
Female Tertiary Gross Enrollment Rate 6/	13.62	13.40	...	2021	19.28	46.67	31.58	44.78
Health								
Female Adult Mortality Rate per 1,000 Adults 7/	139.04	147.60	...	2021	100.97	161.94	138.51	132.57
Female Life Expectancy at Birth	70.59	70.08	...	2021	69.34	76.29	72.62	73.35
Maternal Mortality Ratio per 100,000 Live Births, Modeled Estimate (15-49 yrs)	126.00	...	...	2020	44.00	126.00	78.00	98.44
Total Fertility Rate (Births Per Woman)	2.54	2.50	...	2021	1.96	3.16	2.41	1.75

Sources: GenderDataHub /8

1/ Group aggregates are calculated where data are available for at least 50 percent of countries for a given indicator, and for weighted averages, where the relevant weights are also available. Data are reported for the latest year for which aggregates are available. Detailed metadata, including weights used for averages, are

2/ This index is scored on a scale of 0-1, with a higher score corresponding to better outcomes for women.

3/ The Gender Inequality Index is scored on a scale of 0-1, where a higher score indicates highter inequality.

4/ The Women, Business, and the Law Index is reported on a scale of 0-100, with a higher score corresponding to better outcomes for women.

5/ The Gender Wage Gap is the difference between average earnings of men and average earnings of women expressed as a percentage of average earnings of men (as calculated by the International Labor Organization). The gap listed here is for Occupation = "Total" under the ICSO 08 Classification.

6/ Gross enrollment rates can exceed 100% due to the inclusion of over-aged and under-aged pupils/students because of early or late entrants, and grade repetition.

7/ The adult mortality rate refers to the probability that those who have reached age 15 will die before reaching age 60 (shown per 1,000 persons). In other words, a value of 150 means that out of 1,000 persons who have reached age 15, 150 are expected to die before reaching age 60, and 850 are expected to survive to age 60. This is based on a "synthetic cohort": current life-table mortality rates are applied to the current cohort of 15 year olds, assuming no changes in mortality.

8/ See Gender Data Hub metadata for original data sources and definitions.

Table 6b. Lao P.D.R.: Gender Gaps: Selected Macro-Critical Gender-Related Indicators

				Emerging and Developing Asia 9 /				
	2020	2021	2022	Latest year available	25th Percentile	75th Percentile	Median	Average
Composite Gender Indices								
Female Human Capital Index (HCI) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gender Development Index (GDI) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gender Inequality Index (GII) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Global Gender Gap Index 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Women Business and the Law Index (WBL) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Labor and Income								
Gender Gap (F-M) in Employment-to-Population Ratio, Modeled ILO Estimate (15-64 yrs)	-6.14	-5.56	-6.32	2022	-28.31	-16.59	-20.80	-27.21
Gender Wage Gap 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Gender Gap (F-M) in Informal Employment Rate	...	...	2.13	...	...	...	...	...
Gender Gap (F-M) in Labor Force Participation Rate, Modeled ILO Estimate (15-64 yrs)	-7.24	-6.63	-7.30	2022	-27.74	-17.82	-21.49	-28.80
Gender Gap (F-M) in Unemployment Rate, Modeled ILO Estimate (15-64 yrs)	-1.40	-1.35	-1.19	2022	0.41	1.77	0.02	-0.56
Gender Gap in Gross Pension Replacement Rate (as share of average worker earnings)	...	...	...	...	...	...	...	...
Leadership and Social								
Proportion of Seats Held By Women in National Parliaments 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Proportion of Women in Managerial Positions 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Prevalence of Intimate Partner Violence among Ever-partnered Women (in percent) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Access to Finance								
Gender Ratio: Number of Household Loan Accounts with Commercial Banks (Females' Accounts for 1,000 Female Adults / Males' Accounts per 1,000 Male	...	...	...	...	...	...	...	...
Gender Ratio: Number of Household Deposit Accounts with Commercial Banks (Females' Accounts per 1,000 Female Adults/ Males' Accounts per 1,000 Ma	...	...	...	...	...	...	...	...
Gender Gap in Adults Who Borrowed From a Financial Institution (Share of Female - Share of Male, percentage points)	...	1.41	...	2017	0.61	-3.78	-1.31	-3.59
Gender Gap in Adults Who Own a Financial Institution Account (Share of Female - Share of Male, percentage points)	...	1.10	...	2017	3.85	-6.72	0.90	-6.18
Gender Gap in Adults with Mobile Money Account (Share of Female - Share of Male, percentage points)	...	-2.39	...	...	...	...	...	...
Gender Gap in Adults Who Made or Received Digital Payments in the Past Year (Share of Female - Share of Male, percentage points)	...	-2.12	...	2017	-5.01	-8.14	-8.05	-8.48
Education								
Gender Gap (F-M) in Adult Literacy Rate	...	...	-8.27	...	...	...	...	...
Gender Gap (F-M) in Mean Years of Schooling	-1.92	-1.92	-1.92	...	...	...	...	...
Gender Gap (F-M) in Primary Gross Enrollment Rate	-3.38	-2.74	-2.01	2022	-1.56	-0.92	1.61	0.98
Gender Gap (F-M) in Secondary Gross Enrollment Rate	-3.29	-2.70	-1.76	2022	-0.96	3.17	9.33	1.23
Gender Gap (F-M) in Tertiary Gross Enrollment Rate	2.03	1.85	...	2021	5.47	7.55	2.38	5.22
Health								
Gender Gap (F-M) in Adult Mortality Rate per 1,000 Adults	-55.20	-54.15	...	2021	-65.93	-82.27	-64.64	-72.16
Gender Gap (F-M) in Life Expectancy at Birth	4.07	3.92	...	2021	3.70	5.83	5.47	5.06
Maternal Mortality Ratio per 100,000 Live Births, Modeled Estimate (15-49 yrs) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
Total Fertility Rate (Births Per Woman) 10/	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.

Sources: GenderDataHub

9/ Group aggregates are calculated where data are available for at least 50 percent of countries for a given indicator, and for weighted averages, where the relevant weights are also available. Data are reported for the latest year for which the aggregates are available. Detailed metadata, including weights used for averages, are available on the Gender

10/ Gender Gap is not calculated for this indicator. See the Levels table instead.

Annex I. Contributions to Inflation[1]

Against the backdrop of persistently high inflation, this annex investigates into factors that contribute to the inflation dynamics and disentangle the effects of domestic and external factors empirically. Results show that significant and persistent exchange rate pass-through fuels high and persistent inflation. Broad money growth is also correlated with inflation.

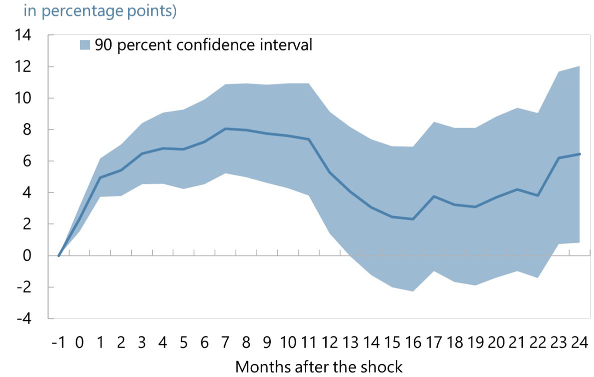
1. **Regression analysis accounts for both domestic and external factors to disentangle their effects on domestic inflation.** External factors have been cited as main causes of the persistently high domestic inflation by the authorities, which could be true during 2021-22, a period seeing rising global commodity prices and inflation in neighboring countries. However, global commodity prices and inflation in neighboring countries have receded since 2023 but domestic inflation has remained persistently high. To investigate into factors that have contributed to the inflation dynamics and disentangle effects of domestic and external factors, a local projection approach (Jordà, 2005) is employed with the following specification:

$$\log(CPI)_{t+h} - \log(CPI)_{t-12+h} = \beta_{0,h} + \beta_{1,h}\Delta\log(ER)_{t,12} + \beta_{2,h}\Delta\log(M2)_{t,12} + \beta_{3,h}\Delta\log(GFP)_{t,12} + \beta_{4,h}\Delta\log(GEP)_{t,12} + X_t\beta_{5,h} + \varepsilon_{t+h},$$

where $\log(CPI)_{t+h}$ is the log of domestic CPI in month $t+h, h = 1, \ldots, 24$, $\Delta\log(ER)_{t,12}$ is the y-o-y change in the log of nominal exchange rate relative to the US dollar in month t, $\Delta\log(M2)_{t,12}$ is the y/y change in the log of broad money in month t, $\Delta\log(GFP)_{t,12}$ is the y/y change in the log of global food price index in month t, and $\Delta\log(GEP)_{t,12}$ is the y/y change in the log of global energy price index in month t, and X_t includes lags of the explanatory variables, up to six months. β_h therefore, captures the cumulative effect on domestic inflation of different shocks, including on domestic factors such as exchange rate depreciation and broad money growth and external factors including global food and energy prices increases. The analysis uses data of Lao P.D.R. during 2000 and 2023, consisting of periods of stable and low inflation as well as volatile and high inflation.

2. **Significant and persistent exchange rate passthrough fuels high inflation.** Results show that a 10 percentage points increase in y/y depreciation would feed into inflation fast, associated with an increase in y/y inflation by about 5 percentage points only after two months. The maximum passthrough is reached after eight months, with inflation increasing by about 8 percentage points. One year after, inflation would increase by 5 percentage points, suggesting a persistent passthrough. These estimates are in line with staff's previous

Exchange Rate Passthrough
(Change in y/y CPI inflation following a y/y depreciation of 10 percent, in percentage points)



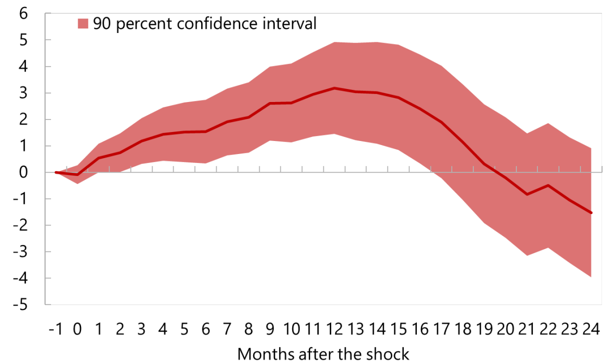
Sources: Staff calculations.

[1] Prepared by Weining Xin.

finding (2023 Article IV Staff Report) which are relatively high compared to the literature (Aron, MacDonald, and Muellbauer, 2014; Carrière-Swallow, Koumtingué, and Weber; 2023) which is likely due to the large share of food items the CPI basket of Lao P.D.R.

3. **Inflation is also positively correlated with broad money growth.** Following a 10 percentage points increase in y/y M2 growth, inflation would increase by more than 3 percentage points after one year. Such positive correlation also persists, with inflation still increasing by about 2 percentage points after one and a half years. Putting this into context, M2 growth accelerated to about 40 percent y/y by end-June 2022, an increase of 27 percentage points from historical average, which would be associated with an increase in inflation at end-June and end-December 2023 by about 8 and 5 percentage points respectively. The 33.3 percent y/y growth in M2 at the end of 2023 would imply a 6 percentage points increase in inflation by the end of 2024.

Correlation between Inflation and M2 Growth
(Change in y/y CPI inflation following a y/y M2 growth of 10 percent, in percentage points)



Sources: Staff calculations.

References

Aron, J., Macdonald, R. and Muellbauer, J., 2014. Exchange rate pass-through in developing and emerging markets: A survey of conceptual, methodological and policy issues, and selected empirical findings. *Journal of Development Studies,* 50(1), pp.101-143.

Carrière-Swallow, Y., Koumtingué, N.F. and Weber, S., 2024. Inflation and Monetary Policy in a Low-Income and Fragile State: The Case of Guinea. *Journal of African Economies,* p.ejad024.

Annex II. The Authorities' Financing Plans[1]

1. The authorities' financing plan for 2024 critically relies on the continued extension of debt relief from China and, to a smaller extent proceeds from the asset sale. Elements include:

(i) External financing of around US$ 1.2 billion, largely consisting of project loan disbursements amounting to US$ 484 million, deferral of principal repayments on debt owed to China (US$463 million) and FX denominated borrowings from commercial banks and onshore bonds (US$ 250 million);

(ii) US$ 300 million from a government asset sale, with an additional US$600-700 million to be received in 2025;

(iii) LAK 5,000 trillion (around US$200 million) of domestic bond issuance;

(iv) US$ 200 million of on-lending repayments from SOEs;

(v) an advance payment of around US$ 100 million from a hydropower project; and

(vi) around US$ 86 million of revenue surpluses from the 2023 budget.

Lao P.D.R.: Financing Plan for 2024
Percent of GDP

	Authorities	IMF staff assumptions
Total financing identified	**13.5**	**11.8**
Non-debt creating flows	**3.9**	**1.8**
Surplus carried over from 2023	0.6	0.5
Return on SOEs On-lending	1.3	1.3
Privatisation	2.0	0.0
Debt financing	**6.5**	**6.9**
Domestic	1.6	2.7
External Financing	4.9	4.2
Deferral of principal repayments	**3.1**	**3.1**
Financing needs (excluding primary surplus)	12.6	14.4
Primary deficit before energy revenue prepayments 1/	-1.3	-2.0
Primary deficit after energy revenue prepayments 1/	-1.9	-2.7
Gross financing needs	**10.6**	**11.8**
Surplus (+)/deficit (-)	**2.9**	**0.0**

1/ A negative value indicates a primary surplus.
Sources: National authorities and IMF staff calculations.

[1] Prepared by Narayanan Raman.

Taken together, the authorities' financing program would more than cover their financing needs in 2024. The authorities anticipate rolling over the over-performance to address potential financing needs in 2025 and beyond.

2. The asset sale plan, which was announced in May 2024, is based on a project development contract with a Thai renewable energy company, Energy Absolute Public Company Limited (EA). The agreement establishes a joint venture company, Super Holding Company (SH), with EA would taking up a 35 percent of SH for a payment of around US$1 billion with the government holding the other 65 percent. Under the deal, EA is expected to undertake efforts that enhance the value to the assets and develop and roll out the capacity to transition to electric vehicles. Specific measures to realize this value addition/enhancement was not shared with staff. Over the medium term, the authorities intend to list SH on an overseas bourse at multiples of the original valuation.

3. However, there are open questions as to the financing of the asset sale.

- On the basis of its 2023 annual report, EA reported equity of around US$ 1.3 billion and revenue of just over US$ 900 million, while it would have to make a payment of around US$1 billion for the purchase;
- Existing external shareholders in projects to be transferred to SH do not appear to have been consulted on the sale, which may invite legal challenges, further delaying the deal; and
- EA itself has come under regulatory scrutiny in Thailand, which is likely to impact its capacity to raise the needed financing.[2]

Staff therefore does not assume that the initial sale of shares in SH or the on-sale of SH takes place. Given this, staff estimates there will be a shortfall of around 2 percent of GDP. The difference is assumed to be met with a combination of domestic commercial and central bank lending.

4. Over the medium term, staff sees significant downside risks to the authorities' projections, particularly the assumption of steady increases in the size of the primary fiscal surplus, and significantly slower exchange rate depreciation from 2024 onward. Thus, staff's medium-term baseline takes a more conservative view on both these elements to avoid building a baseline on optimistic assumptions.

[2] In July 2024, after a nearly 40 percent drop in the share price, the Thai Securities Exchange accused the CEO and deputy CEO of EA of fraud and suspended trading in EA. Both resigned and a new board has been named, resulting in a lifting of the suspension. However, upon resumption of trading, the share price of EA fell again by nearly a third. The Thai rating agency, TRIS, downgraded EA's rating from "BBB+" to "BB+" and assigned a negative outlook to the rating, citing "heightened liquidity risk the company is likely to face in the near term and the corporate governance issue..." EA is estimated to have around THB 19.6 billion (US$540 million) in debt obligations coming due in the next 12 months.

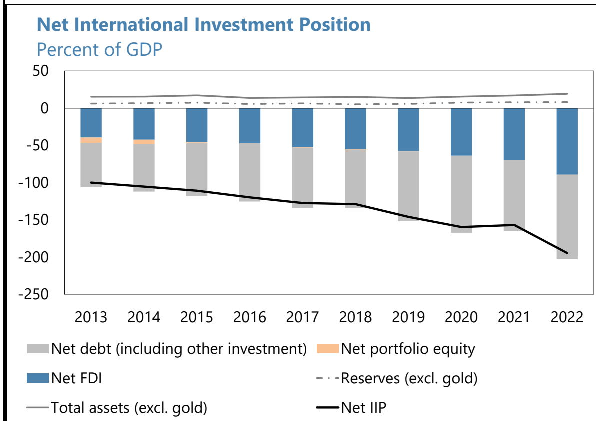
Annex III. External Sector Assessment

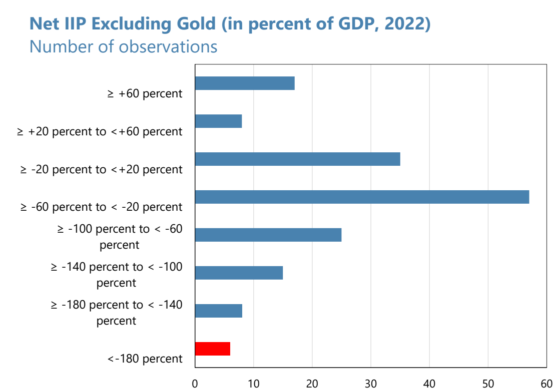
Overall Assessment: *The external position of Lao P.D.R. in 2023 was weaker than the level implied by fundamentals and desirable policies. The assessment is based on a very large and deteriorating negative net international investment position, which poses a risk to the country's external sustainability; and the low level of net international reserves, which remain below adequate levels. However, the improvement in the current account balance suggests some improvement in the external position relative to the 2022 Assessment. The assessment for 2023 is constrained by data availability and remains subject to considerable uncertainty around the degree of the temporary nature of these factors, particular those related to the impacts of the COVID-19 pandemic, the composition of external reserves, and weaknesses in balance of payments data (see Annex IX of the 2023 Staff Report).*

Potential Policy Responses: *Continued tight fiscal policy, fiscal consolidation based on tax revenue mobilization, tighter monetary policy and continued official exchange rate flexibility would help improve the trajectory for external debt, help regain market confidence and build reserves. In this context, it is important to announce a credible multi-year financing plan to demonstrate a path toward debt sustainability and follow through on appropriate monetary policy tightening to avoid exchange rate overshooting. Structural policies to reduce skills shortages, target informality, reduce start-up costs for investment and improve transparency would contribute to improve external competitiveness and diversification.*

Foreign Assets and Liabilities: Position and Trajectory

Background. Lao P.DR.'s estimated net international investment position (NIIP) continued deteriorate. As at end-2022, which is the most recent data available, NIIP (excluding gold) stood at -US$29.4 billion (-195 percent of GDP). Among the 171 countries and territories for which data was available, Lao P.D.R.'s NIIP position was in the bucket with the largest net liability positions. The largest component driving the large negative NIIP position was the accumulation of debt liabilities (-124 percent of GDP, up from the 104 percent in 2021), due to the contraction in nominal GDP in US dollar terms.





Source: Milesi-Ferretti, Gian Maria, 2022, "The External Wealth of Nations Database," The Brookings Institution (based on Lane, Philip R. and Gian Maria Milesi-Ferretti, 2018, "The External Wealth of Nations Revisited: International Financial Integration in the Aftermath of the Global Financial Crisis," *IMF Economic Review 66, 189-222*)

Assessment. The large liability position in the NIIP is mirrored in the debt sustainability analysis (see the Debt Sustainability Analysis issued with this staff report), which shows Lao P.D.R. is in debt distress and its debt position is unsustainable. Further, the large stock of external debt, coupled with rapid exchange rate depreciation in recent years, exacerbated the overall debt position.

2022(% GDP)	NIIP: -195	Gross Assets: 19.1	Debt Assets: 10.3	Gross Liab.: -214	Debt Liab.: -124

Current Account

Background. The current account (CA) recorded a surplus of 3.7 percent of GDP in 2023. This is a reversal from the 10-year average of -15 percent of GDP recorded between 2010-19, reflecting both higher savings and lower investment. The increase in savings reflected both the sharp decline in the overall fiscal deficit in the wake of the tight fiscal stance and likely increase in private savings. On the expenditure side, the curtailment of the public investment reduced overall investment. The merchandise surplus was bolstered by a surplus in the income account as tourist arrivals rebounded following the reopening of the economy after the pandemic. Nonetheless, at 3.5 percent of GDP, tourism receipts remain below the pre-pandemic average of 4.4 percent, suggesting the recovery in the sector is not yet complete. The merchandise surplus was also around 0.8 pp of GDP lower than in 2022 as both exports and imports rose. Balance of payments data show persistent weaknesses, with a large errors and omissions item in the published data showing large and persistent outflows that are not fully captured in identified flows. Further, trade data may be understating the extent of flows, with a persistently larger divergence recorded for imports, suggesting larger imports than reported in the official data (see Annex IX of the 2023 Staff Report).

Lao P.D.R.: Model Estimates for 2023 (in percent of GDP)

Lao P.D.R.: EBA-lite Model Results, 2023

	CA model 1/	REER model
	(in percent of GDP)	
CA-Actual	**2.7**	
Cyclical contributions (from model) (-)	0.5	
Natural disasters and conflicts (-)	0.0	
Adjusted CA	**2.2**	
CA Norm (from model) 2/	**-7.2**	
Adjustments to the norm (+) 3/	5.2	
Adjusted CA Norm	**-2.0**	
CA Gap	**4.2**	**7.9**
o/w Relative policy gap	1.8	
Elasticity	-0.3	
REER Gap (in percent)	**-13.9**	**-26.1**

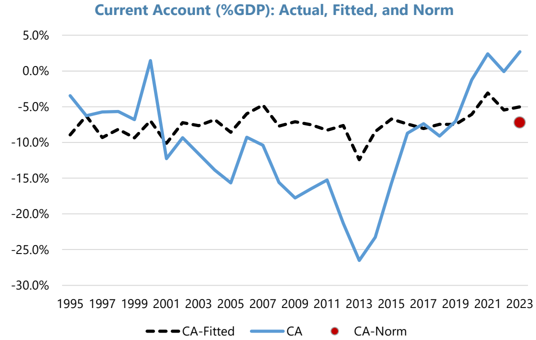
1/ Based on the EBA-lite 3.0 methodology
2/ Cyclically adjusted, including multilateral
3/ Additional adjustments to account for the increased income outflows on the significantly higher external debt position. The 10-year average income outflows to 2019 were 2.9 percent of GDP; the outflow for 2023 was 7.4 percent. An additional 0.7 pp adjustment was included to account for the need to bring down external debt to sustainable levels.

Assessment. The assessment using the EBA-lite CA model confirms the improved position with the cyclically adjusted CA balance in 2023 exceeding the norm or equilibrium value. In making the assessment, additional adjustments were made to the CA norm of 7.2 percent of GDP to account for the net outflows in the income account that are largely on account of the unsustainable external debt position. This adjustment was estimated from the difference in average net income outflows of 2.9 percent of GDP between 2010-19 and 7.2 percent recorded in 2023. The norm was further lowered by 0.7 pp of GDP to reflect the need to address the stock of external liabilities, yielding an adjusted norm of -2.2 percent of GDP.

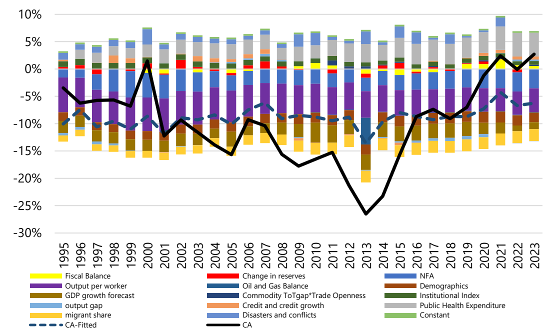
Based on these adjustments, the CA gap was estimated at +4.4 percent of GDP. This reflected a policy gap of 1.8 pp, largely due to public health spending that was below desirable levels (-1.5 pp of GDP). The underspending on meeting critical needs underscores the need to improve domestic revenue mobilization to ensure the needed fiscal consolidation efforts do not come at the expense of critical public services.

Applying the estimated exchange rate elasticities to the estimated CA gap, the real effective exchange rate (REER) was found to be 14.5 percent below its equilibrium value. The estimated current account gap should be interpreted with caution: the narrowing of the deficit reflects both the nominal exchange rate depreciation experienced by the kip over the last two years as well as forced import compression due to exchange rate rationing in the face of a persistent FX shortage. Thus, the observed current account may overstate the implied real exchange rate adjustment experienced over the last two years.

Current Account (%GDP): Actual, Fitted, and Norm



CA: Contributions to Fitted Values

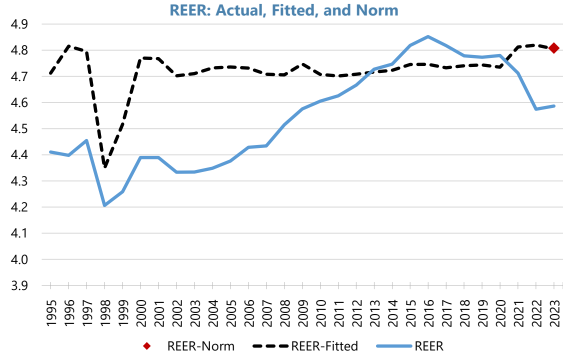


Real Exchange Rate

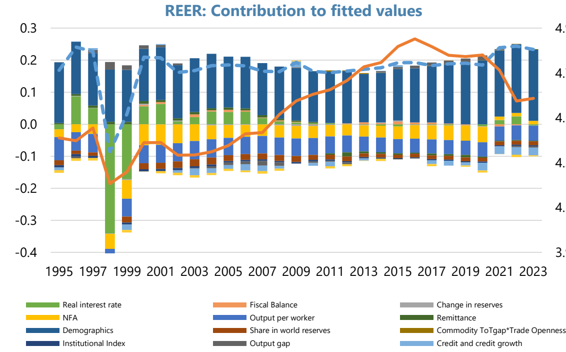
Background. After steadily appreciating until 2016, the REER stabilized until 2020 before depreciating. This mainly reflects the nominal depreciation of the kip during that period: the average LAK-USD exchange rate depreciated by 38 percent in 2022 and by 31.8 percent in 2023. However, the parallel LAK-USD exchange rate exhibits a persistent and, most recently, widening gap relative to the official rate of around 11.7 percent, suggesting pressures are intensifying. The pressure is largely driven by an increase in the demand for FX to meet the mounting external debt service payments.

Assessment. The REER model suggests the real exchange rate is undervalued by 26.1 percent relative to equilibrium, likely reflecting the significant nominal exchange rate depreciation experienced during the year. That said, the significant data gaps mean this estimate is subject to significant uncertainty. Further, the ongoing shortage and rationing of FX and the large and persistent premium between the parallel and official exchange rates suggest there may still be some overvaluation of the exchange rate that has not been fully corrected.

REER: Actual, Fitted, and Norm



REER: Contribution to fitted values



Capital and Financial Accounts: Flows and Policy Measures

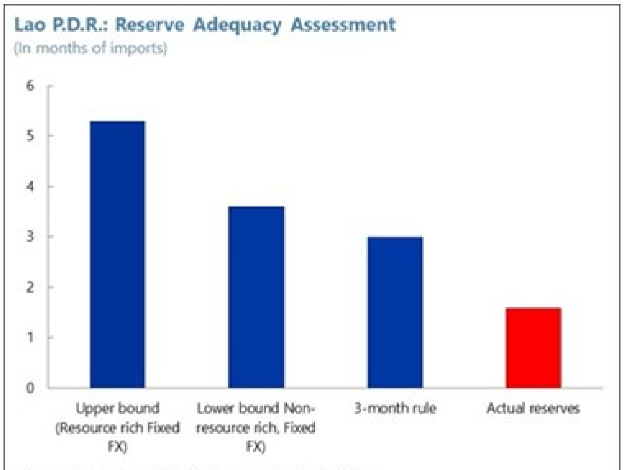
Background. Lao P.D.R. continued to receive net FDI inflows amounting to 11.9 percent of GDP in 2023, but half of that reflected payments for a lease on power transmission infrastructure from the publicly-owned power generation utility by a joint venture holding partly owned by a foreign investor. Excluding this transaction, net FDI was 6.4 percent of GDP, in line with the annual average between 2010-19. Debt disbursements to the public sector also continued to flow in, but this is now exceeded by amortization payments. As a result, other investment flows (including debt) recorded a net outflow of 8.7 percent of GDP. In addition to the large repayments recorded by the public sector, the banking sector also reported net outflows of 4.3 percent of GDP during the year. In response to this, the authorities imposed a series of administrative measures in 2023 to improve the supply of FX into the market. Foreign investors are now required to open bank accounts in domestic banks to undertake both their kip and FX transactions. In March 2024, the BoL issued a directive to require exporters to repatriate export proceeds to local bank accounts.

Assessment. The newly adopted regulation on management of foreign currency revenues that requires (i) exporters to sell foreign exchange from repatriated export proceeds to commercial banks, and (ii) commercial banks to sell portion of foreign exchange purchased from the exporter to the BoL constitutes an outflow capital flow management measure (CFM) under the IMF's Institutional View (IV) on the Liberalization and Management of Capital Flows. The surrender requirement would be appropriate under the IV in the context of Lao PDR's (near) crisis situations. However, these measures are not advisable due to their side effects and the question on effectiveness of the measures due to relatively openness of financial account. The measures are likely to increase transferring costs and could inflate parallel market activities, and create adverse effects on foreign investor confidence. The authorities should assess whether the measure achieves the intended goal and consider phasing it out once ready if it is the case.

FX Intervention and Reserves Level

Background. Lao P.D.R.'s gross international reserves was estimated to be US$1.2 billion at the end of 2023 (1.7 months of imports), an improvement from the US$1 billion (1.5 months) reported at the end of 2022. The current account surplus was offset by large amortization payments on external debt repayments and unidentified outflows captured in the errors and omissions item in the balance of payments. Reserves were also boosted by the continued inclusion of US$250 million drawn on a US$800 million swap line with the People's Bank of China (PBC). Reserves were also boosted by FDI flows from a large transaction in Q3 2023, reflecting lease payments for the use of power transmission infrastructure (see above).

Assessment. Based on the Assessment of Reserve Adequacy for Credit Constrained Economies, Lao P.D.R.'s reserve position is assessed to be below the minimum level recommended for a resource-rich country with a fixed exchange rate (between 3.6 to 5.3 months) based on a cost of holding reserves of 6.2 percent, which was the estimate for the marginal product of capital in a sample of low-income countries estimated in 2014. This level is also below the conventional 3-month rule of thumb minimum.



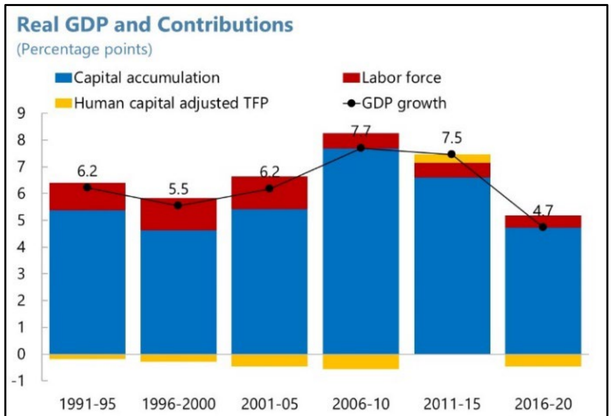
Source: National authorities and IMF staff calculations.

Reducing the estimated cost would raise the minimum. Conversely, changing the exchange rate regime to floating would reduce the minimum. These estimates are predicated on the BoL's reserves being fully useable and unencumbered. As previously noted, the reserves were boosted by drawings on a swap line with the PBC, which staff has treated as a long-term debt. It is also not clear if the disbursed amounts come with additional conditions that may limit their use as reserves. Removing the swap from gross international reserves would lower total reserves even further to US$933 million (1.3 months of imports).

Annex IV. Medium-Term Growth Rates[1]

This annex explains the growth accounting behind the baseline projections.

1. Before the pandemic: high growth and rapid industrialization, driven by capital investment.

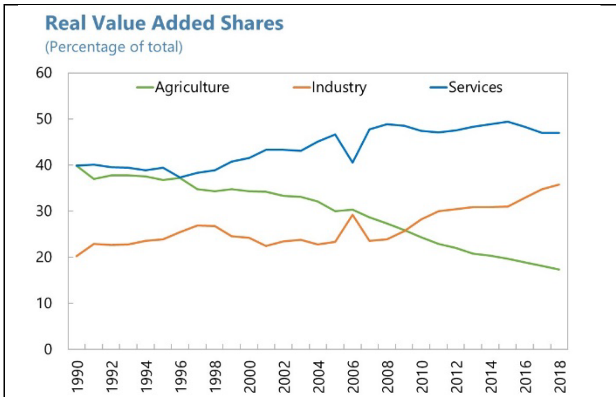


Sources: Penn World Tables and IMF staff calculations.

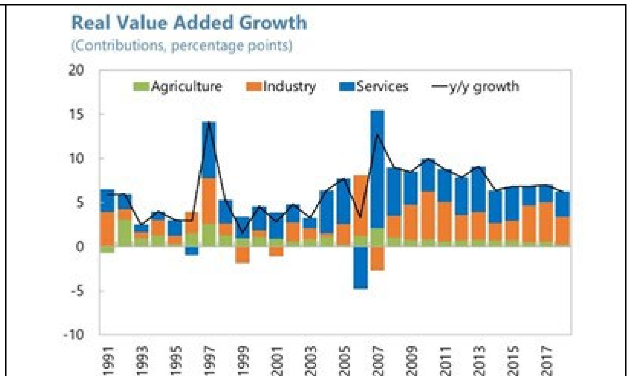
- Pre-crisis growth had been strong, averaging 7½ percent from 2006 to 2015. However, growth accounting indicates that it was driven almost entirely by capital accumulation: a standard Cobb-Douglas production function (with capital share of about 60 percent) applied to data from the Penn World Tables shows that the contribution from capital accumulation was at least 4¼ percent and as high as 7½ percent over the three decades since 1990.

- The strong investment was largely public, for major infrastructure and energy projects. Labor force growth was the next largest contribution to growth. The decomposition indicates that there was little benefit to the private economy, both in terms of productivity and employment growth.

- The substantial investment facilitated rapid industrialization, associated with a substantial fall in the share of real value added in agriculture. As a result, services and industry contributed the most to real growth in the decade before the pandemic.



Sources: Economic Transformation Database and IMF staff calculations.



Sources: Economic Transformation Database and IMF staff calculations.

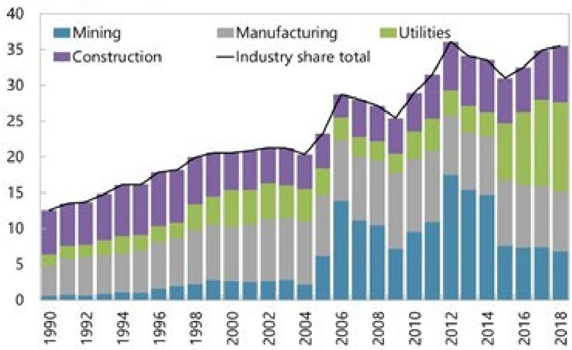
- The share of industry in real value added is in line with other economies for the stage of development. However, whereas other South-East Asian economies typically achieved industrialization through high levels of manufacturing, the industrialization in the Lao P.D.R. was

[1] Prepared by Alasdair Scott.

driven mostly by resource extraction: mining and energy (the latter classified as utilities in the data source). These sectors have tended to have low employment and correspondingly high labor productivity, whereas productivity in other sectors has been relatively low.

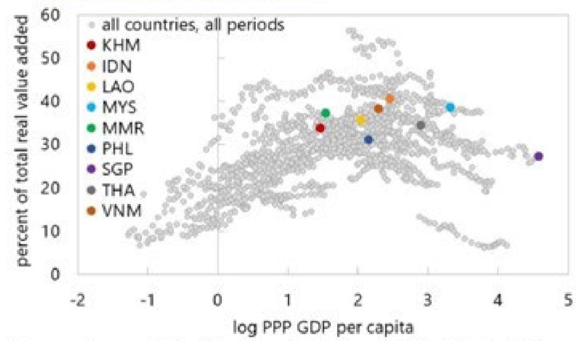
Nominal Industry Value Added

(Percentage of total)



Sources: Economic Transformation Database and IMF staff calculations.

Real Industry Value Added

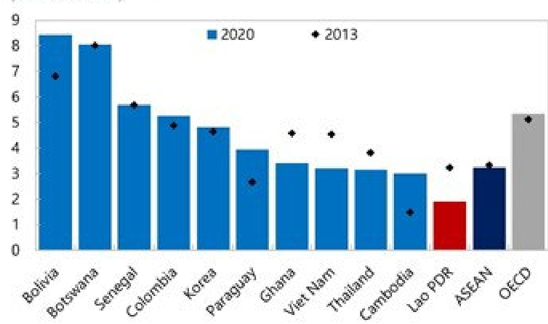


Sources: Economic Transformation Database and IMF staff calculations.
Notes: plots are for all countries in sample from 1990 to 2018. Country dots are as of 2018.

- At same time, resources for human capital development have been low: education expenditure is relatively low and had fallen in the decade up to the pandemic, and education performance was also relatively low.

Government Expenditure on Education

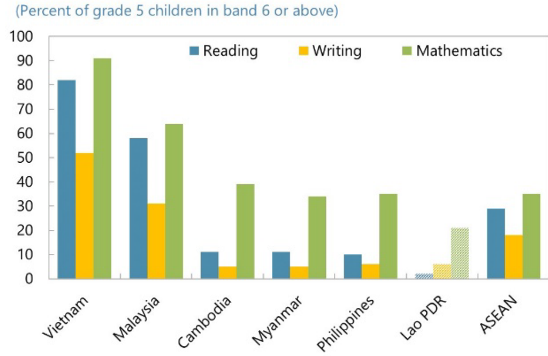
(Percent of GDP)



Sources: World Bank World Development Indicators Database.

Education Performance

(Percent of grade 5 children in band 6 or above)



Sources: SEA-PLM 2019.

- In addition, recent data from the government of the Lao P.D.R. indicates that nearly one third of children under the age of 5 suffer from impaired growth and development due to chronic malnutrition, which will affect educational attainment and productivity, in addition directly through chronic illnesses.

2. Medium-Term Growth Calculations:

- Under the baseline scenario, with reliance on domestic financing and no change in policy settings (¶11-12), growth would decline over the medium term, as purchasing power deteriorates, real wages fall and outward migration intensifies, non-resource sector investment is deterred, and prolonged fiscal tightness drags on aggregate demand. This would be reflected in the supply potential of the economy:

- *Labor force growth:* the UN projects annual working-age population (defined as those aged 15 to 64) growth of 1.5 percent by 2029. The Lao P.D.R. census estimates a workforce base of 2.5 million in 2022. Information obtained during the mission is that outward migration is in the order of 50,000 in 2022, estimated to increase by up to 180,000 this year; the exchange rate depreciation and consequent loss of purchasing power implies that this trend will continue, which would imply negative workforce growth by 2029. However, a judgment is made of less-than-proportionate increase in outward migration, and a small positive workforce growth of 0.2 percent—but nonetheless smaller than what was seen before the pandemic.

- *Physical capital accumulation:* There is further potential growth from resource extraction (see below) that is less likely to be affected by the crowding out of domestic private credit conditions implied by the baseline scenario. However, the government is not able to finance the levels of investment seen before the pandemic. Physical capital accumulation is judged to contribute around 2¼ percent to growth, compared with an average of 5¾ percent in the decade before the pandemic.

- *Human capital accumulation:* Low spending on education and reports of falling enrollment rates could result in negative human capital accumulation. The judgment is made that this will fall to zero percent growth by 2029, compared with 0.2 percent from before the pandemic.

- *Productivity growth:* Difficulties obtaining FX, extended forbearance, and weak credit risk assessment imply low productivity growth. The judgment is for 0.1 percentage point contribution compared with 0.2 percentage point from before the pandemic.

- The implication from these factors is for growth of around 2.5 percent, compared with 6.8 percent on average during the decade before the pandemic. Naturally, should the adverse factors from the baseline not eventuate, then growth would be higher. However, the adverse factors could worsen, and in many cases—such as the assumption about labor force growth—the benefit of the doubt has been given.

Potential growth assumptions
(percentage points)

	Averages 2010-2019	Medium-term assumptions based on current policies
Labor force growth	0.7	0.2
Physical capital accumulation	5.7	2.2
Human capital accumulation	0.2	0.0
Productivity growth	0.2	0.1
TOTAL	6.8	2.5

Annex V. Risk Assessment Matrix[1]

Nature/source of the shock	Likelihood	Impact	Policies to mitigate impact
		Conjunctural Risks—Global	
Global growth Slowdown. Growth slowdown in major economies, including due to supply disruptions, tight monetary policy, rising corporate bankruptcies, or a deeper-than-envisaged real estate sector contraction, with adverse spillovers through trade and financial channels, triggering sudden stops in some EMDEs.	**Medium**	Export demand would deteriorate, which could lead to severer FX shortages and set off more exchange rate depreciation. This in turn would fuel higher inflation, and hinder growth, both from the domestic and external side.	Options are limited in the near term, given the low level of FX reserves and existing macroeconomic imbalances. However, the government should provide very targeted support to the low-income households that are most affected by the rising inflation to the extent possible.
Commodity price volatility. Supply and demand fluctuations (e.g., due to conflicts, export restrictions, OPEC+ decisions, and green transition) cause recurrent commodity price volatility, external and fiscal pressures and food insecurity in EMDEs, cross-border spillovers, and social and economic instability.	**High**	Increases in commodity prices, especially intermediate goods for agricultural and industrial production in the economy, for example, fertilizers and oil, would exacerbate the FX shortages and set off more exchange rate depreciation, which would lead to higher inflation and lower growth.	Options are limited in the near term, given the low level of FX reserves and existing macroeconomic imbalances. However, the government should provide very targeted support to the low-income households that are most affected by the rising inflation to the extent possible.

[1] The Risk Assessment Matrix (RAM) shows events that could materially alter the baseline path. The relative likelihood is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 and 30 percent, and "high" a probability between 30 and 50 percent). The RAM reflects staff views on the source of risks and overall level of concern as of the time of discussions with the authorities. Non-mutually exclusive risks may interact and materialize jointly. The conjunctural shocks and scenarios highlight risks that may materialize over a shorter horizon (between 12 to 18 months) given the current baseline. Structural risks are those that are likely to remain salient over a longer horizon.

Nature/source of the shock	Likelihood	Impact	Policies to mitigate impact
		Conjunctural Risks—Domestic	
Bank stress: Asset quality deteriorates given loose credit and weakening potential growth. Funding pressures and currency mismatch may be exacerbated by persistently high inflation and exchange rate weakness. The weakness of BCEL creates systemic risks.	**High**	Banks' balance sheets are weakened, crowding out private sector credit and further impairing growth. Fiscal resources could be needed for bank recapitalizations, exacerbating the government's financing challenges.	Tighten monetary policy to reduce money supply while closely monitoring financial stability. The new capital and liquidity requirements should be implemented immediately to safeguard the financial system. Develop a credible medium-term fiscal consolidation plan, with strong emphasize on revenue mobilization to the extent possible. A credible multiyear financing strategy would help ease financing pressures and stabilize the exchange rate.
		Structural Risks	
Potential growth:			
Upside. Implementation of a coherent and comprehensive policy response could stabilize the exchange rate and inflation, and result in less scarring on the economy. As a result, growth will reaccelerate, and public debt sustainability indicators should strengthen.	**Medium**	More rapid economic stabilization will see a faster return to growth and less scarring to medium-term potential growth. Lower inflation, coupled with higher spending on critical social services, would reduce the incentives for outmigration, thereby increasing potential growth.	Fiscal policy should stick to a medium-term adjustment plan to restore investors' confidence and regain international market access, while accelerating steps to improve the composition of fiscal adjustment to prioritize spending on education, health, and infrastructure. Monetary policy should not be eased prematurely to avoid renewed credit growth and inflation pressures.
Downside. Outward labor migration intensifies.	**Medium**	Lower labor and capital growth result in lower potential growth. Weaker growth prospects further harms investors' confidence and creates a doom loop.	Have a coherent and comprehensive policy response to contain inflation and stabilize exchange rate, restoring macroeconomic stability. Fiscal consolidation should put a strong focus on revenue mobilization to allow for restoring social spending and public investment.

Nature/source of the shock	Likelihood	Impact	Policies to mitigate impact
Dollarization. Persistent high inflation environment could lead to abandonment of domestic currency, removing monetary policy as a tool.	Medium	The BoL loses its ability to conduct independent monetary policy to respond domestic economic situations, and the economy becomes more directly affected by the monetary policy of the U.S. The government loses domestic currency funding source.	Tighten monetary policy, especially interest rates on kip, and mop up excessive kip liquidity.
Climate change and weather events. Extreme climate events driven by rising temperatures cause loss of life, damage to infrastructure, food insecurity, supply disruptions, lower growth, and financial instability.	Medium	The economy is highly vulnerable to extreme weather events, including floods and drought. Changing monsoon patterns pose a severe threat to agricultural production, a crucial source of income for the most vulnerable segments of the population and an important source of export revenue.	Develop plans for adaptation, through investment in climate-resilient infrastructure, reforestation, and focus on securing agricultural production and food security. In the long run, it is crucial to budget for support to households and firms affected by extreme weather events.

Annex VI. Active Policy Scenario

An active policy scenario would aim to arrest exchange rate depreciation, bring inflation down to single digits, and rebalance fiscal policy to boost growth. To enable this, monetary policy would be tightened significantly and remain tight for a sustained period, while greater revenue collection would be directed at restoring needed social and capital spending. These measures would not be sufficient for complete stabilization, but even slowing the pace of depreciation compared to the baseline would bring substantial benefits for inflation, purchasing power, investment and migration, and the public finances. Under such a scenario, real GDP growth would be lower in the near term, but higher over the medium term as the exchange rate stabilizes and inflation recedes. Stabilization of the exchange rate would also bring the debt-to-GDP ratio down over the medium term, though debt would continue to be assessed as unsustainable in the absence of wider actions to restore debt sustainability part of a credible, comprehensive, and actionable multiyear financing and debt management plan.

1. An active policy scenario would aim for a consistent policy mix, aimed at the priority of stabilizing the exchange rate and lowering inflation, and boosting medium- to long-term growth. Stronger growth-friendly fiscal consolidation from improved revenue collection combined with high-quality spending (see below), in addition to a credible debt management and financing strategy, would be critical to advance in restoring debt sustainability. All other near-term considerations would be placed on a lower priority until these key objectives are met. In particular, this scenario would entail:

(i) *Maintaining a tight fiscal stance, focused on increasing domestic revenues.* This would mean building on the authorities' ongoing policy of achieving and maintaining primary surpluses over the medium term.

(ii) *Realigning the composition of fiscal policy to restore social and other critical expenditures that have been cut.* The severe curtailment of needed social and capital spending, particularly on education, health, and social safety nets has led to lower capital investment, an uptick in outbound migration and an exodus of workers into the informal sector, which are expected to lower potential growth going forward. Instead, staff's advice would be to maintain a primary surplus of around 3 percent of GDP, the same as in the baseline, with any overperformance used to restore spending on education, healthcare and, where feasible, investment.

(iii) *Further monetary tightening the address inflation.* Notwithstanding recent tightening measures, monetary policy and operations remain too loose and need to be raised further. In particular, the monetary stance should aim to raise the policy rate to positive levels in real terms. As noted in the staff report, current interest rates in the system are significantly below the inflation rate. Until recently, the BoL's monetary operations offered limited support to the exchange rate, but this changed in July 2024 when the central bank announced that it would cease to conduct open market operations at anything below the policy rate. This is a step in the right direction and should be complemented by a further tightening of the monetary stance by raising the policy rate and the reserves requirements. Moreover, any monetary financing should be fully sterilized and the central bank's lending to SOEs should be ceased.

(iv) *Continuing to allow for greater exchange rate flexibility.* The steps taken to accommodate the needed depreciation should form the basis for greater exchange rate flexibility. In particular, a greater commitment to exchange rate competitiveness would help spur exports while lowering the demand for FX at the margin.

2. The specific measures are:

- Monetary policy tightens with M2 growth at 10 percent from 2025 through the forecasting horizon, achieved through (i) raising the policy rate and reserves requirement, (ii) fully sterilizing monetary financing (if any), and (iii) ceasing the central bank's lending to SOEs.
- Fiscal policy mobilizes revenue with the additional revenues directed to higher wage spending and transfers, so primary balances are kept the same as in the baseline, i.e., around 3 percent of GDP.

3. Staff's preliminary analysis shows that implementing the preferred policy mix could lower inflation and exchange rate depreciation and boost medium- to long-term growth, although there would be a trade off in terms of near-term growth.

- The significant monetary tightening reduces domestic currency liquidity growth—an important factor that has contributed to exchange rate depreciation and inflation. Exchange rate depreciation would still continue for a while, given the large FX-denominated debt repayments during 2025-26 and the time monetary tightening would take to be effective, but nonetheless would be much less than in the baseline. The exchange rate stabilizes (i.e., depreciating at pre-pandemic trend rates) over the medium term.
- Inflation comes down, as a result of both monetary tightening and exchange rate stabilization, with significant exchange rate passthrough assumed consistently across both the baseline and the active scenario (a 10 percentage points increase in depreciation leads to 8 percentage points increase in inflation within the year, see Annex I). In tandem with the gradual stabilization of the exchange rate, inflation gradually returns to its pre-pandemic level by end-2029.
- Growth is expected to be impacted by the drag from tighter monetary policy in the near term. However, as macroeconomic conditions stabilize where inflation comes down and exchange rate stabilizes, domestic demand and growth would rebound over the medium term due to the improved economic climate. Further, the restoration of some critical social and capital spending by the government is expected to limit the damage to potential growth, further supporting growth in the medium term.

4. There is a significant improvement in the outlook for public debt. The debt-to-GDP ratio starts to decline over the medium term as the kip value of external debt is lower due to a more benign exchange rate outlook. As a result, debt indicators improve significantly. However, the large financing needs remain, and debt would remain unsustainable, though indicators are expected to reach the thresholds more rapidly.

5. This assessment is illustrative and subject to significant uncertainties, but points to a narrow scope for steering a softer landing for the economy.

- *Uncertainties.* As noted in Annex V, Lao P.D.R. is subject to significant downside risks and remains in a vulnerable position with few buffers to address any potential shock. Further, this analysis does not consider the possibility of balance sheet weaknesses among domestic agents—the government and the public sector, banks and financial institutions, and private firms and households—which could be significant. Significant vulnerabilities due to mismatches could mean that monetary tightening would have an outsized adverse impact, leading to a significant growth impact that may be more persistent than outlined above.

- *Opportunities.* A macroeconomic package that prioritizes arresting inflation and exchange rate depreciation, along with decisive plans to address the unsustainable debt situation could provide a stronger fillip to domestic demand, FDI prospects and growth.

Annex VI. Table 1. Lao P.D.R.: Selected Economic and Financial Indicators in the Active Scenario

	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029
			Est.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.	Proj.
Output and prices	(percentage change, unless otherwise indicated)									
Real GDP growth 1/	-0.4	2.1	2.3	3.7	4.1	2.7	2.3	3.4	3.6	4.1
Consumer prices (annual average)	5.1	3.8	23.0	31.2	22.0	17.5	16.8	16.4	11.5	9.7
Consumer prices (end-period)	3.2	5.3	39.3	24.4	16.2	25.0	14.9	14.3	12.6	3.0
GDP deflator	4.6	5.6	25.6	24.1	14.6	10.7	10.9	10.4	5.6	4.6
Public finances	(in percent of GDP, unless otherwise indicated)									
Revenue and Grants	13.0	15.0	14.8	16.4	16.5	17.5	18.1	18.1	18.1	18.1
Tax and nontax revenue	11.5	13.0	13.9	14.6	15.2	16.2	16.8	16.8	16.8	16.8
Grant	1.5	2.0	0.9	1.7	1.3	1.3	1.3	1.3	1.3	1.3
Expenditure	18.4	15.7	14.7	15.7	17.0	17.6	18.2	18.4	18.5	18.5
Current Expenditure	11.8	11.0	10.4	10.4	10.9	12.0	12.6	12.8	12.9	12.9
of which : interest payment	1.6	1.2	1.8	2.0	3.2	3.1	3.2	3.4	3.6	3.6
Net acquisition of nonfinancial assets	6.6	4.7	4.3	5.3	6.1	5.6	5.6	5.6	5.6	5.6
Overall balance	-5.4	-0.7	0.1	0.7	-0.5	-0.1	-0.1	-0.3	-0.5	-0.4
Primary balance	-3.8	0.5	1.8	2.7	2.7	3.1	3.1	3.1	3.1	3.1
Public and public guaranteed debt 2/	76.0	92.9	130.7	115.9	108.3	112.5	108.8	104.0	102.4	95.1
Domestic	5.0	13.3	26.8	20.2	18.8	20.7	24.9	26.4	28.2	28.5
External	70.9	79.6	103.9	95.6	89.6	91.9	83.9	77.6	74.2	66.5
Public and public guaranteed external debt service (in millions of U.S. dollar)	932.9	650.5	517.5	1006.2	1187.7	1546.4	1855.9	1481.7	1363.4	1112.6
In percent of exports of goods and services	14.4	8.3	6.0	10.4	12.6	17.2	21.5	17.6	16.5	13.5
Money and credit	(percentage change, unless otherwise indicated)									
Broad money	16.3	24.0	36.9	33.3	30.7	10.0	10.0	10.0	10.0	10.0
Credit to the economy	4.3	11.5	45.6	27.8	27.4	1.5	1.7	6.0	7.4	10.0
Balance of payments	(in millions of U.S. dollars, unless otherwise indicated)									
Current account balance	-304	432	-459	405	351	-90	-81	-113	-250	-269
In percent of GDP	-1.6	2.3	-3.0	2.7	2.4	-0.6	-0.6	-0.8	-1.7	-1.8
Trade balance	745	1,419	954	721	612	189	245	207	69	48
Exports	6,115	7,695	8,198	8,370	8,505	8,100	7,760	7,533	7,369	7,307
Imports	5,370	6,275	7,244	7,649	7,893	7,912	7,514	7,326	7,301	7,259
Services	-99	-127	-332	380	478	449	380	373	366	363
Investment income	-1,202	-1,087	-1,395	-1,075	-1,068	-1,045	-1,029	-1,022	-1,017	-1,030
Transfers	252	226	315	378	329	318	322	329	332	350
Capital and Financial account balance	1,355	-158	717	385	-86	114	118	257	395	475
FDI	968	1,072	726	1,781	680	691	729	766	804	829
Gross official reserves 3/	1325.0	1245.0	990.5	1182.5	1462.9	1019.2	1077.4	1245.4	1416.1	1649.1
In months of prospective imports of goods and services	2.4	1.9	1.4	1.7	2.1	1.5	1.6	1.9	2.2	2.3
External debt (in percent of GDP)	106.0	122.1	154.3	146.5	139.6	140.1	128.6	119.8	114.0	104.6
Memorandum items:										
Nominal GDP (in billions of kip)	167,669	180,751	217,350	279,576	333,607	379,523	430,380	490,968	537,184	584,608
GDP per capita (in billions of kip)	22.9	24.3	29.1	36.9	43.4	48.7	54.6	61.5	66.4	71.5
Official exchange rate (kip per U.S. dollar; end-of-period)	9,285	11,166	17,238	20,480	…	…	…	…	…	…
Real GDP growth (published by authorities) 4/	3.3	3.5	4.4	4.2	…	…	…	…	…	…

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Staff estimate 2019–23 numbers using leading indicators such as electricity and mining productions, harvest volumes in major crops, export of goods and services, and tourism revenues (due to concerns over data quality and availably).
2/ Includes publicly-guaranteed debt in the stock of external debt for which data was missing prior to 2020, and Swap drawings with the People's Bank of China (PBoC).
3/ Includes Swap drawings with the People's Bank of China (PBoC), and the Special Drawing Right (SDR) allocations of SDR 41.3 million in 2009 and SDR 101.4 million in 2021.
4/ Lao Statistics Bureau (LSB) data.

Annex VII. Data Issues

Annex VII. Table 1. Lao P.D.R.: Data Adequacy Assessment for Surveillance

Data Adequacy Assessment Rating 1/							
C							
Questionnaire Results 2/							
Assessment	National Accounts	Prices	Government Finance Statistics	External Sector Statistics	Monetary and Financial Statistics	Inter-sectoral Consistency	Median Rating
	D	B	C	C	C	B	C
Detailed Questionnaire Results							
Data Quality Characteristics							
Coverage	D	C	D	C	B		
Granularity 3/	D		C	B	C		
			C		D		
Consistency			C	C		B	
Frequency and Timeliness	C	A	C	B	A		

Note: When the questionnaire does not include a question on a specific dimension of data quality for a sector, the corresponding cell is blank.
1/ The overall data adequacy assessment is based on staff's assessment of the adequacy of the country's data for conducting analysis and formulating policy advice, and takes into consideration country-specific characteristics.
2/ The overall questionnaire assessment and the assessments for individual sectors reported in the heatmap are based on a standardized questionnaire and scoring system (see IMF *Review of the Framework for Data Adequacy Assessment for Surveillance* , January 2024, Appendix I).
3/ The top cell for "Granularity" of Government Finance Statistics shows staff's assessment of the granularity of the reported government operations data, while the bottom cell shows that of public debt statistics. The top cell for "Granularity" of Monetary and Financial Statistics shows staff's assessment of the granularity of the reported Monetary and Financial Statistics data, while the bottom cell shows that of the Financial Soundness indicators.

A	The data provided to the Fund is adequate for surveillance.
B	The data provided to the Fund has some shortcomings but is broadly adequate for surveillance.
C	The data provided to the Fund has some shortcomings that somewhat hamper surveillance.
D	The data provided to the Fund has serious shortcomings that significantly hamper surveillance.

Rationale for staff assessment. There are some significant shortcomings in national accounts statistics. For example, IFIs (including the ADB, IMF and World Bank) have questions on the published real GDP growth, especially since the pandemic, in addition to the lack of expenditure-side GDP. Quarterly GDP is available but only for production-side GDP. As a result, staff have been using their own estimate of national accounts data instead of relying on published statistics. On prices, there is a lack of several important data sources needed to measure GDP deflator properly from a methodological standpoint, such as the supply and use table and PPI. On government statistics, the coverage has significant shortcomings, especially on expenditure arrears which are not included in debt statistics, and financial position of state-owned enterprises. On the external sector, large errors and omissions entries (E&O) in the BOP suggests there are shortcomings in the published data. Lao P.D.R. has provided IIP data on a preliminary basis but only for 2015-19, which was shared with the Fund with a significant lag. There are issues in the calculation of some financial stability indicators, which affects staff assessment of the financial sector health. Moreover, financial stability data does not show the impact of crisis-related policy measures (e.g., loan forbearance) on asset quality and capitalization, which could be significant. Data on development banks, which are significant providers of credit but not included in the monetary statistics, is also lacking. In view of the application of exchange rate restrictions, it will be important for the BoL to improve collection of data on the supply and demand of FX and FX backlogs.

Changes since the last Article IV consultation. There have been no significant changes since the last Article IV consultation.

Corrective actions and capacity development priorities. To a large extent, gaps reflect capacity limitations and current technical assistance by development partners are helping address exisiting data gaps. For example, IMF TA currently focuses on government finance statistics and external sector statistics. The World Bank provides support on statistical system modernization, including to improve availability and quality of statistics, to enhance the use of statistics, to strengthen instituitional capacity, and to develop contingent emergency response component.

Looking ahead, the authorities should prioritize collating data relevant to current issues, such as reliable national accounts data and financial stability indicators, accurate and timely data on the health of the overall public sector, and addressing remaining gaps in external sector data (reducing the E&O in the BOP and compiling IIP data).

Use of data and/or estimates in lieu of official statistics available to staff. The team uses own estimates on real GDP since 2019, which are different from the official published numbers, due to the unreliability of the published real GDP data. The estimates are constructed by consulting with other development partners, including the Asian Development Bank and the World Bank.

Other data gaps. The quality of data on outmigration of Lao nationals to other countries, which is highly significant, is not clear and would be an important gap to address.

Annex VII. Table 2. Lao P.D.R.: Data Standards Initiatives

Lao P.D.R. participates in the Enhanced General Data Dissemination System (e-GDDS) and publishes the data on its National Summary Data Page since November 2018.

Annex VII. Table 3. Lao P.D.R.: Table of Common Indicators Required for Surveillance

As of September 27, 2024

	Data Provision to the Fund				Publication under the Data Standards Initiatives through the National Summary Data Page			
	Date of Latest Observation	Date Received	Frequency of Data[6]	Frequency of Reporting[6]	Expected Frequency[6,7]	Lao P.D.R.[8]	Expected Timeliness[6,7]	Lao P.D.R.[8]
Exchange Rates	9/26/2024	9/27/2024	D	D	D	M	...	1M
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[1]	Jun-2024	9/1/2024	M	Q	M	M	1M	2Q
Reserve/Base Money	Jun-2024	9/1/2024	M	Q	M	M	2M	2Q
Broad Money	Jun-2024	9/1/2024	M	Q	M	M	1Q	2Q
Central Bank Balance Sheet	Jun-2024	9/1/2024	M	Q	M	M	2M	2Q
Consolidated Balance Sheet of the Banking System	Jun-2024	9/1/2024	M	Q	M	M	1Q	2Q
Interest Rates[2]	Aug-2024	8/30/2024	M	M	M	M	...	1M
Consumer Price Index	Aug-2024	8/30/2024	M	M	M	M	2M	1M
Revenue, Expenditure, Balance and Composition of Financing[3]–General Government[4]	Q1 2024	Jul-2024	Q	Q	A	...	3Q	...
Revenue, Expenditure, Balance and Composition of Financing[3]–Central Government	Q1 2024	Jul-2024	Q	Q	Q	A	1Q	12M
Stocks of Central Government and Central Government-Guaranteed Debt[5]	2023	Jul-2024	A	A	Q	...	2Q	...
External Current Account Balance	Q1 2024	Jun-2024	Q	Q	Q	Q	1Q	1Q
Exports and Imports of Goods and Services	Q1 2024	Jun-2024	Q	Q	M	A	12W	6M
GDP/GNP	Q1 2024	Jun-2024	Q	Q	Q	A	1Q	6M
Gross External Debt	NA	NA	NA	NA	Q	...	2Q	...
International Investment Position	NA	NA	NA	NA	A	...	3Q	...

[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, rates on treasury bills, notes and bonds.
[3] Foreign, domestic bank, and domestic 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] Including currency and maturity composition.
[6] Frequency and timeliness: ("D") daily; ("W") weekly or with a lag of no more than one week after the reference date; ("M") monthly or with lag of no more than one month after the reference date; ("Q") quarterly or with lag of no more than one quarter after the reference date; ("A") annual.; ("SA") semiannual; ("I") irregular; ("NA") not available or not applicable; and ("NLT") not later than;.
[7] Encouraged frequency of data and timeliness of reporting under the e-GDDS and required frequency of data and timeliness of reporting under the SDDS and SDDS Plus. Any flexibility options or transition plans used under the SDDS or SDDS Plus are not reflected. For those countries that do not participate in the IMF Data Standards Initiatives, the required frequency and timeliness under the SDDS are shown for New Zealand, and the encouraged frequency and timeliness under the e-GDDS are shown for Eritrea, Nauru, South Sudan, and Turkmenistan.
[8] Based on the information from the Summary of Observance for SDDS and SDDS Plus participants, and the Summary of Dissemination Practices for e-GDDS participants, available from the IMF Dissemination Standards Bulletin Board (https://dsbb.imf.org/). For those countries that do not participate in the Data Standards Initiatives, as well as those that do have a National Data Summary Page, the entries are shown as "..."

Annex VIII. Implementation of Past Advice

Recommendation	Actions Taken	Technical Assistance
Fiscal		
Gradual fiscal consolidation based on revenue mobilization	- Fiscal consolidation has been substantial, mainly driven by expenditure cuts, revenue collection, and interest payment deferrals. - Work is ongoing on domestic revenue mobilization (DRM) and tax administration. - Excise tax rates and government service fees have been increased. - VAT rate has been reversed to pre-pandemic level at 10 percent. - Tax exemptions have not been reviewed and there is no estimate of foregone revenues. - No progress on Treasury Single Account (TSA). - Other measures and ongoing TA include: i. Mining tax policy settings. ii. Risk-based audit (RBA) has been approved. iii. International taxation. iv. Instructions for the Excise Tax Law adopted in February 2022. v. Property tax law (an upgrade from the Land tax decree). vi. VAT on digital services and reviewing legislation on transfer pricing	IMF, WB/EU, ADB and JICA IMF WB, EU, DFAT IMF IMF, WB, EU WB, EU, DFAT WB, EU, DFAT
Strengthening public financial management	- Some progress on budget preparation and implementation, and public procurement. The Ministry of Finance is piloting medium-term budget plans and annual budget ceilings. Expenditure arrears persist. - Other measures and ongoing TA include: i. Implementation of Financial Management Information System (FMIS) has not started pending procurement of the system. ii. Upgrade of GFIS to GFIS+ under piloting.	WB, EU, ABD, and DFAT WB, IMF

Recommendation	Actions Taken	Technical Assistance
	iii. TA to improve general government accounting and reporting and expansion of Chart of Accounts has mostly been finalized. iv. Improving the compilation of fiscal data in compliance with GFS and PSDS guidelines is ongoing. v. Alignment of spending priorities with SDGs is ongoing.	IMF, UN, WB, JICA and multi donors
Strengthening debt management	- The debt recording system was upgraded (DMFAS 6.0) and external and domestic debt are recorded, including some part of on-lending and guarantees, but not yet arrears clearance bonds. - An annual official Debt Bulletin is being published. - Other measures and ongoing TA include: i. Improvements in compilation and dissemination of public sector debt statistics are ongoing. ii. Institutional arrangements and operational practices for public debt and contingent liabilities management are under review. iii. Debt dynamics tool is being incorporated into Macroeconomic Framework Development TA	WB, ADB WB, EU, DFAT IMF, ADB, JICA IMF IMF
Building resilience to natural disasters	- Work to enhance preparedness for disaster recovery and resilience is ongoing. - National Strategy on Disaster Risk Reduction (NSDRR) 2021 – 2030 and Resilience Framework has been formulated - Disaster risk reduction and climate change have been integrated into the 9th National Socio-Economic Development Plan.	Multiple donors
	Monetary	
Modernizing monetary governance, rebuilding reserves supported by	- The BoL widened the exchange rate band, facilitating greater exchange rate flexibility.	IMF

Recommendation	Actions Taken	Technical Assistance
greater exchange rate flexibility	- The Foreign Exchange Management Law was amended to introduce mandatory conversion requirements. - BoL has introduced FX Management Department and issued Decisions on FX Management related to import-exports of goods and service; related to FDI and FX Management in Special Economic Zones to support implementation of FX Management Law - BoL is to launch the foreign currency flow management system (CMS) to monitor the flow of foreign currency related to trade and foreign investments.	
Raising real interest rates to stabilize exchange rate and lower inflation through issuing central bank bonds and adjusting reserve requirements	- Reserve requirement local and foreign currency was raised in Aug 2023. Policy rates were increased. However, excess liquidity persists and real interest rates remain negative.	
Improving monetary policy framework	- BoL has introduced a 7-day BoL bills and deposits - fixed rate full allotment - at the policy rate. - BoL issued 3- and 6-month BoL bills exclusively to banks at pre-set interest rates anchored to the policy rate. With the issuance of BoL bills exclusively to banks, previous issuance of BoL bills to the public has been discontinued. - BoL has established a Liquidity Monitoring and Forecasting Group (LFG) to monitor market liquidity. - BoL decreased T-bills and BoL bills share in the maintenance of Reserve Requirement in LAK from 70 percent to 50 percent, gradually going to zero. - BoL continues to actively engage with the IMF TA to further strengthen monetary operations and liquidity management. - BoL received ongoing TA to improve macroeconomic forecasting and policy analysis through increased diagnostic	IMF IMF

Recommendation	Actions Taken	Technical Assistance
	capacity, development of a forecasting and policy analysis system, and streamlining monetary policy implementation.	
	Financial	
Strengthening banking regulation and supervision, ending forbearance and recognizing losses, and building capital buffers	- No improvement in asset classification, provisioning standards and financial sector indicators (FSIs). - Implementation and dissemination of a risk-based supervision manual is ongoing. - Work on transition to Basel II and IFRS accounting and reporting standards is ongoing. - Secondary regulations for the implementation of the 2019 Commercial Bank Law, including regulation on CAR, are being drafted. - BoL received training on Internal Capital Adequacy Assessment Process (ICCAP) and Supervisory Review Process (SRP) of Basel Pillar 2. - Ongoing TA on early warning system and future support on enhanced liquidity monitoring and emergency liquidity assistance (ELA)	IMF WB WB IMF WB
Developing debt securities market	- Progress has been made to standardize issuance of government securities with a pre-specified target and a regular auction schedule. - Trading infrastructure has improved but compilation of statistics and publication of information require improvement. - Authorities have received technical assistance on developing the debt securities market. - Support for development of sustainable finance policy framework and standards and guidelines for green finance and issuance of thematic bonds.	MOF, ADB Stock Exchange ADB, UNCDF, UNDP IFC

Recommendation	Actions Taken	Technical Assistance
Putting in place crisis management and prompt corrective action frameworks	- Work on implementation guidelines for prompt corrective actions and bank resolution is ongoing. - Stress testing and early warning systems are under development. - TA to establish a Financial Stability Committee.	WB WB, AMRO WB
Implementation of the AML/CFT law in line with FATF standards	- APG's July 2023 Mutual Evaluation Report (MER) found that while steps were taken to strengthen the legal framework, however, significant deficiencies remain in the AML/CFT framework and its effective implementation.	UNODC, WB, ADB, IMF
Inclusive and sustainable growth		
Reducing corruption-related vulnerabilities/improving governance	- MPI launched the Investment Tracking Application system to track and monitor investment permit applications and comments on related sectors to speed up investment license process. - Limited progress has been made in terms of improving transparency and the business environment.	ADB, WB
Data and statistics		
Improving quality and timeliness of economic statistics	- Preliminary IIP was shared with IMF staff, but with a lag, for 2015-2019 only. - Received TA on Macroeconomic Framework to help improve consistency in macroeconomic data and inter-agency coordination for building an informed macroeconomic analysis framework. - Ongoing work to improve: i. Government Finance Statistics and Public Sector Debt Statistics ii. External sector statistics. iii. Annual GDP by expenditure estimates and of quarterly GDP by production estimates. iv. Improving national accounts (GDP Rebasing), price (CPI basket revision), and sectoral statistics. v. Improving poverty, labor, and social statistics.	IMF, WB IMF IMF WB WB, ADB, UNFPA

Annex IX. Capacity Development Strategy

1. **Monetary Operations and Liquidity Management:** The BoL has demonstrated strong ownership of the IMF CD program by establishing an internal core group, led by the Deputy Governor. Furthermore, the BoL solidified its commitment by endorsing the respective multi-year CD workplan in July 2023. The BoL has made considerable progress within less than a year since the initiation of this multi-year workplan. Important achievements are the introduction of the 7-day instrument at the policy rate to absorb liquidity, issuing 3- and 6-month BoL Bills to banks, establishing a liquidity monitoring framework, and setting up a Liquidity Monitoring and Forecasting Group (LFG) to monitor market liquidity and estimate next week's liquidity changes. The BoL continues to actively engage with the IMF TA to further strengthen monetary operations and liquidity management.

2. **Macroeconomic Forecasting:** The BoL is receiving technical assistance to develop capacity in macroeconomic forecasting and policy analysis with a multi-year program beginning in 2023. Complimentary to this, the BoL together with other government ministries and agencies including MoF, MPI, LSB and LASES receives Fund TA under the Macroeconomic Framework Project.

3. **Risk-Based Supervision:** The BoL is pursuing in risk-based supervision to improve its on-site and off-site oversight. A new risk-based supervision manual is being implemented. There is ongoing IMF TA on an Internal Capital Adequacy Assessment Process.

4. **Debt Management:** The authorities are taking steps to modernize debt management including the regular publication of a debt bulletin. IMF TA delivered recommendations to strengthen the institutional framework, enhance operational capacity, manage debt-related contingent liabilities, and has helped the authorities to better understand the IMF-WB DSA framework and to improve debt statistics. Upcoming TA will focus on the formulation of a medium-term debt management strategy and a review of the Decree on Public Debt Management.

5. **Revenue Mobilization:** To strengthen revenue collection, the authorities have received IMF TA on improving compliance risk management, compliance improvement program, HQ functions, auditing, integrity of the tax registry, debt collections, and on improving cooperation between the Lao Customs Department and Lao Tax Department. TA with a focus on revenue mobilization and administration is ongoing under the current three-year CD program (2023-25) for the Lao Tax Department (LTD).

6. **Statistics:** The authorities have taken steps to improve their statistics and have engaged with the IMF on improving government finance statistics, public sector debt statistics, the chart of account, national accounts, and improving the collection and reporting of external sector statistics. (See also Annex VII. Data Issues).

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

October 15, 2024

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—INFORMATIONAL ANNEX

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

CONTENTS

FUND RELATIONS

(As of August 31, 2024)

Membership Status: Joined on July 5, 1961; Article VIII.

General Resources Account:

	SDR Million	% Quota
Quota	105.80	100.00
IMF's Holdings of Currency (Holdings Rate)	92.58	87.50
Reserve Tranche Position	13.23	12.50

SDR Department:

	SDR Million	% Allocation
Net Cumulative Allocation	152.08	100.00
Holdings	52.99	34.84

Outstanding Purchases and Loans: None

Latest Financial Commitments:

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

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

	Forthcoming				
	2024	2025	2026	2027	2028
Principal					
Charges/Interest	0.96	3.79	3.79	3.79	3.79
Total	0.96	3.79	3.79	3.79	3.79

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

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

Exchange Rate Arrangement

The de jure arrangement is a managed float, and the de facto exchange rate arrangement is classified as crawl-like since September 29, 2023. The Bank of the Lao P.D.R. (BoL) sets a daily official reference rate for LAK to USD which is calculated based on the weighted average of the previous day's overall rate, and other adjustments by the BoL, including the estimation of the domestic demand for USD and the forecasting of USD rate in the international market. Commercial banks and foreign exchange bureaus are required to maintain their buying and selling rates of LAK/USD within ±7 percent of the daily official reference rate. In addition, the buying and selling rates may not exceed a margin of 2 percent.

Lao P.D.R. has accepted the obligations under Article VIII, Sections 2(a), 3 and 4. Lao P.D.R. maintains two exchange restrictions: (i) an exchange restriction arising from the authorities' restrictions on the commercial banks' setting of a market-clearing exchange rate, contributing to a shortage of foreign exchange that results in undue delays in accessing foreign exchange for current international transactions. In addition, the authorities, through certain financial intermediaries, also prioritize the allocation of foreign exchange for payment for certain goods and sectors (e.g., fuel), and (ii) an exchange restriction arising from the requirement to provide a tax clearance certificate, covering taxes unrelated to the underlying transactions prior to obtaining FX for certain current international transactions.

Article IV Consultation

The last Article IV consultation discussions took place from January 26 to February 8, 2023 and were concluded by the Executive Board on May 3, 2023. The staff report was published on May 22, 2023.

Technical Assistance

Over the past five years, Lao P.D.R. has received technical assistance in the areas of: banking supervision; customs administration; tax administration; tax policy; public financial management; macroeconomic management; price statistics; external sector statistics; government finance statistics; and the national accounts. A Bangkok-based IMF office, Capacity Development Office in Thailand (CDOT) has facilitated technical assistance to Lao P.D.R. (as well as Cambodia, Myanmar, and Vietnam) and has provided technical assistance in macroeconomic analysis and forecasting, monetary operations, government finance statistics, external sector statistics, and public financial management.

Resident Representative

Jochen Schmittmann assumed the Resident Representative post for Cambodia, Lao P.D.R., and Vietnam, based in Hanoi, on August 23, 2023.

INFORMATION ON THE ACTIVITIES OF OTHER INTERNATIONAL FINANCIAL INSTITUTIONS

Information on the activities of other international financial institutions in Lao P.D.R. can be found at:

- World Bank: https://www.worldbank.org/en/country/lao
- Asian Development Bank: https://www.adb.org/countries/lao-pdr/main

LAO PEOPLE'S DEMOCRATIC REPUBLIC

STAFF REPORT FOR THE 2024 ARTICLE IV CONSULTATION—DEBT SUSTAINABILITY ANALYSIS

October 15, 2024

Approved By
Rupa Duttagupta and Peter Dohlman (both IMF), Manuela Francisco and Lalita Moorty (both IDA)

Prepared by the staff of the International Monetary Fund and the International Development Association (IDA)[1]

Risk of external debt distress	In debt distress
Overall risk of debt distress	In debt distress
Granularity in the risk rating	Unsustainable
Application of judgement	No

The Lao P.D.R. is assessed to be in external and overall debt distress under the Low-Income Countries Debt Sustainability Framework (LIC-DSF).[2]The Lao P.D.R. is assessed to be in external and overall debt distress under the Low-Income Countries Debt Sustainability Framework (LIC-DSF). As the 2023 Debt Sustainability Analysis, the country's debt sustainability is still in a challenging situation due to the significant amount of debt at the starting point and a continuing currency depreciation against the backdrop of surging external financing needs and the expansionary monetary policy. PPG and external debt to GDP ratios are projected to decline in 2024 due to deferrals on principal repayments, lowering gross financing needs. But after that currency depreciation would drives up the debt ratio, despite primary surpluses and positive real GDP growth. As a result, most of the PPG external and public debt indicators for both solvency

[1] This DSA has been prepared jointly by the IMF and World Bank, following the 2018 Guidance Note on the Bank-Fund Debt Sustainability Framework for Low-Income Countries.

[2] The Lao P.D.R. Composite Indicator of 2.306 indicates a weak debt-carrying capacity, based on the April 2024 IMF's World Economic Outlook (WEO) and the 2022 World Bank's Country Policy and Institutional Assessment (CPIA).

and liquidity, including the present value of PPG debt-to-GDP ratio, would remain very high and above the indicative threshold significantly for two decades, which indicate a high probability of a future distress event. The continued debt servicing deferrals over recent years, including again in 2024, and on-going negotiations also indicate debt distress. This result, along with the evidence of major economic vulnerabilities (including significant financing needs, limited access to international markets, limited international reserves, increasing rollover risks, potential for additional exchange rate depreciation pressures and bank recapitalization, and substantial contingent liabilities), warrants a rating of "in debt distress" for both external and public debt and an assessment of unsustainable public debt. Adjustment options are limited, as the primary surpluses required to reduce debt indicators below risk thresholds in the medium-term are not politically feasible or socially desirable.

PUBLIC DEBT COVERAGE

1. The debt coverage in this Debt Sustainability Analysis (DSA) comprises debt owed by the central government and government guarantees, including to state-owned enterprises (SOEs) (Text Table 1). Publicly guaranteed SOE external debt included in the DSA baseline is on-lent or guaranteed by the central government. There is no outstanding debt to the IMF. External debt is defined based on the currency criterion in this analysis. The debt stock includes a swap line with the People's Bank of China (PBoC) dating from 2020, which is for balance of payments support to help shore up gross reserves. Debt stock data also take into account deferrals of interest payments (mainly to China) from 2021 to 2023, and expenditure arrears.

2. There have been ongoing efforts by the authorities to enhance debt transparency. The government published an annual debt statistics bulletin for the first time in 2021 that includes publicly guaranteed external debt and domestic debt contracted by the central government, and the following bulletins included more detailed information.[3] Although the current debt bulletin provides information by creditor to the central government, information on subsectors, such as debt owed by local governments, other data such as the debt servicing schedule on guaranteed SOE debt, and statistics on non-guaranteed SOE debt and borrowing of the central bank on behalf of the government are still unavailable. Therefore,

Text Table 1. Coverage of Public Debt

	Subsectors of the public sector	Sub-sectors covered
1	Central government	X
2	State and local government	
3	Other elements in the general government	
4	o/w: Social security fund	
5	o/w: Extra budgetary funds (EBFs)	
6	Guarantees (to other entities in the public and private sector, including to SOEs)	X
7	Central bank (borrowed on behalf of the government)	
8	Non-guaranteed SOE debt	

[3] In addition to the information reported in the 2020 bulletin (published in 2021), the 2021 debt bulletin (issued in 2022) included the composition of on-lending and guaranteed debt by SOE, as well as expenditure arrears by type.

(continued)

the DSA coverage does not include most of these subsectors, and the contingent liability stress test is used with tailored settings under the DSF to investigate potential effects of the uncovered public debts. On guaranteed SOE debt, which is included in the DSA coverage, the debt bulletin contains only the debt stock, and the debt servicing plan is still unavailable.[4] The authorities seem to have been addressing debt management transparency and intend to expand their debt coverage to cover other forms of public debt in the future.

3. A customized contingent liability stress test is used to analyze the impact of additional pressures on public debt, including contingent liabilities from PPPs and SOEs, additional occurrence of government arrears in the future, and recapitalization needs from the banking sector (Text Table 2).[5] Given continuing risks of SOEs default, the contingent liability stress test assumes an additional shock related to SOEs by 6.3 percent of GDP in the second year of the projection, of which; (i) US$627 million (4.3 percent of GDP) coming from potential need to cover guaranteed state enterprise (Électricité du Laos , EDL) debt, [6] and (ii) the default parameter value (2 percent of GDP) to capture non-guaranteed SOEs, which is not included in the debt coverage. The shock related to PPPs is set to the default value of 35 percent of the PPP capital stock (equivalent to 26.5 percent of GDP) to capture contingent liabilities from the private sector share of PPPs.[7] A shock covering 0.5 percent of GDP has been added to analyze the effect of the discovery of potential domestic arrears. The test assumes a financial market shock of 10 percent of GDP, higher than the default shock of 5 percent, which is due to potential commercial bank recapitalization needs (of which, the estimated needs for one state-owned commercial bank was estimated at around 1.5 percent of GDP, similar to the estimate in 2023) and the continued weak conditions in the financial sector.

The latest debt bulletin published in 2023 additionally includes an overview on public debt by the authorities and information on lending conditions by creditor. An updated bulletin, covering data through 2023, was published in 2024. The International Development Association (IDA), through its Sustainable Development Finance Policy (SDFP) Performance and Policy Actions (PPAs), has supported reforms to enhance debt transparency (publication of an annual public debt bulletin), debt management (compliance with a non-concessional borrowing ceiling), and fiscal sustainability (restoring the VAT rate to 10 percent).

[4] As a result, the DSA assumes no future debt servicing and keeps the amount of SOE guaranteed debt constant over the projection horizon.

[5] The DSA assumes that the additional financing needs due to the stress test shock will be covered mainly by domestic financing, given the limited access to external borrowing in the next few years.

[6] For the shock coming from the guaranteed EDL debt, while the stock of guaranteed debt is included in the stock of public debt, no assumption is made as to the debt service flows due to a lack of information. Thus, staff assumes an additional public debt increase equivalent to one-sixth of the US$3.8 billion on the total outstanding debt on-lent by the government as of end-2023, which will then translate into additional debt service flows for the government in the event EDL is unable to meet its debt service obligations.

[7] Data on PPP capital stock are from the World Bank's Private Participation in Infrastructure Database and are available at https://ppi.worldbank.org/.

Text Table 2. Calibration of Shock Scenarios

1	The country's coverage of public debt	The central government, government-guaranteed debt		
		Default	Used for the analysis	Reasons for deviations from the default settings
2	Other elements of the general government not captured in 1.	0 percent of GDP	0.5	Accounts for potential discovery of additional arrears.
3	SoE's debt (guaranteed and not guaranteed by the government) 1/	2 percent of GDP	6.3	Captures non-guaranteed domestic SOEs debt and restructuring of SOEs.
4	PPP	35 percent of PPP stock	26.47	Captures the contingent liabilities of the private sector share of PPPs.
5	Financial market (the default value of 5 percent of GDP is the minimum value) 2/	5 percent of GDP	10	Captures bank recapitalization needs and risks from financial market volatility.
	Total (2+3+4+5) (in percent of GDP)		43.3	

1/ The default shock of 2% of GDP will be triggered for countries whose government-guaranteed debt is not fully captured under the country's public debt definition (1.). If it is already included in the government debt (1.) and risks associated with SoE's debt not guaranteed by the government is assessed to be negligible, a country team may reduce this to 0%.

2/ A shock higher than the default shock of 5 percent was used to account for possible recapitalization needs of the major state-owned commercial bank (estimated at around 1.5 percent of GDP, smilar to the estimate in 2023) and the overall weakness of the financial sector.

DEBT STOCK AND COMPOSITION

4. The authorities have established a Public Debt Management Committee led by the Deputy Prime Minister. All borrowing by central and provincial governments, and SOEs, and any Public-Private Partnerships (PPPs) must be approved by the National Assembly, with the Ministry of Finance given the responsibility to negotiate all relevant contracts. To improve the legal and regulatory framework, the government has issued a decree which mandates that SOEs report debt data to the Ministry of Finance and to consult the Ministry before undertaking any significant borrowing.

5. The Lao P.D.R.'s total public and publicly guaranteed (PPG) debt is estimated to be 116 percent of GDP as of end-2023.

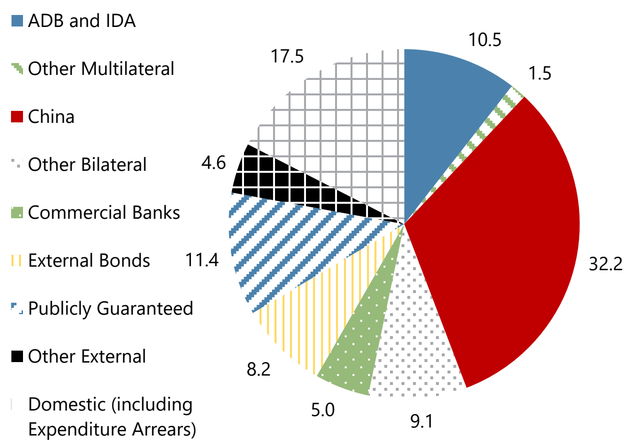
- External PPG debt accounts for a large portion of the total PPG debt, representing around 82.5 percent of total PPG debt (Text Table 3). Lao P.D.R. relies mainly on bilateral borrowing, in which Chinese institutions are the largest creditors (Text Figure 1).[8] Multilateral creditors–mainly the International Development Association (IDA) and the Asian Development Bank (ADB)—account for 12 percent of external PPG debt. The remaining external PPG debt is from external sovereign bonds, and commercial banks and private companies, which account for 10 percent and 6.1 percent of the external PPG debt stock, respectively. In terms of public external debt, around half of the total is on concessional or semi-concessional terms.[9] Public external debt guaranteed by the government but contracted by other entities (mainly SOEs) has been included in the external PPG debt stock since 2019 (Text Figure 2). In 2023, guaranteed debt represented 11.4 percent of the total external PPG debt stock.

[8] Text Figure 2 and Text Table 3 are based on the authorities' Debt Bulletin, which does not provide a creditor-level breakdown for publicly guaranteed debt.

[9] The Lao P.D.R. did not participate in the Debt Service Suspension Initiative (DSSI), with the authorities preferring direct discussions with key bilateral creditors.

Text Figure 1. Stock of Public Debt As Of End-2023

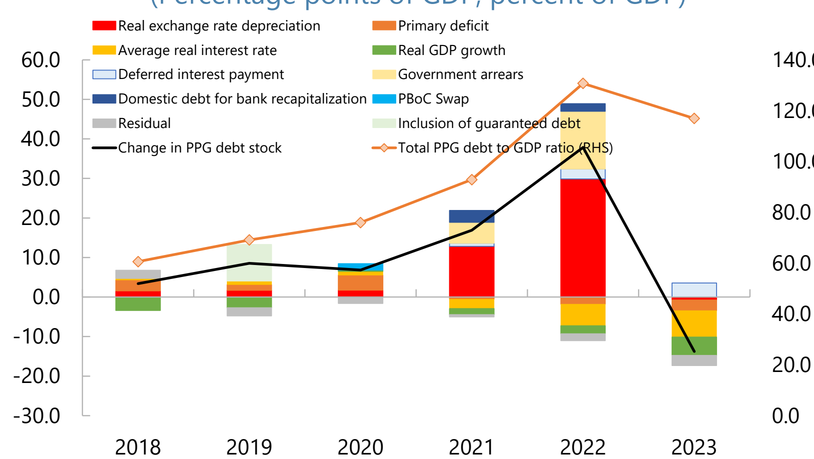
(In percent of total PPG debt)



Soueces: National authorities and IMF staff calculations

Text Figure 2. Change in PPG Debt and Contributions

(Percentage points of GDP, percent of GDP)



Sources: National authorities and IMF staff calculations and projections.

- Domestic debt (including expenditure arrears), stood at US$2.8 billion (20.2 percent of GDP) at the end of 2023, and accounts for 17.5 percent of PPG debt. Of this, the largest portion consisted of the stock of kip-denominated bonds, which amounted to LAK 31.1 trillion (US$1,519 million, Text Table 3). The stock of bonds includes the issuance of triangular bonds amounting to LAK 4.1 trillion (1.4 percent of GDP) to address arrears. The reported stock of domestic debt does not include domestic debt issued by SOEs (which is not explicitly guaranteed by the government) due to technical difficulties in consolidating the data.

Text Table 3. Stock of Public Debt as of End-2023

	Percent of total PPG debt	Percent of total external PPG debt	Percent of GDP	Million US dollars
Total PPG debt	**100.0**		**115.9**	**15,819**
External debt	**82.5**	**100.0**	**95.6**	**13,057**
ADB and IDA	10.5	12.7	12.2	1,665
Other Multilateral	1.5	1.8	1.7	235
China	32.2	39.0	37.3	5,096
Other Bilateral	9.1	11.0	10.5	1,435
Commercial Banks and Private Companies	5.0	6.1	5.8	792
External Bonds	8.2	10.0	9.5	1,303
Publicly Guaranteed	11.4	13.8	13.2	1,797
PBOC Swap [1/]	1.6	1.9	1.8	250
Deferrals on interest payments [1/]	3.1	3.7	3.5	484
Domestic debt	**17.5**		**20.2**	**2,762**
Domestic Bonds	9.6		11.1	1,519
Expenditure Arrears [1/]	7.9		9.1	1,243

[1/] Not included in the official debt data published by the authorities.
Sources: National authorities and IMF staff calculations.

6. **There still exists a significant amount of domestic expenditure arrears that have not been cleared through domestic bond issuance, and a risk of further domestic expenditure arrears going forward**. Staff has increased the estimate of expenditure arrears for 2022 from the LAK 23.5 trillion identified in the 2023 Article IV Staff Report to LAK 31.8 trillion, to account for additional expenditure arrears for completed works as of end-2022, an increase of 4 percent of GDP. In 2023, no new arrears were reported and staff estimates that some LAK 6.3 trillion (2.2 percent of GDP) in arrears were cleared, partly financed by the issuance of the triangular bond (see above).[10]

7. **External debt repayment deferrals to some creditors have taken place since 2020:** debt servicing (both principal and interest) to China was deferred during the past three years (US$222 million in 2020, US$454 million in 2021, and US$608 million in 2022). Staff included the cumulative suspended interest payments totaling US$485 million for the three years in the debt stock.

8. **The DSA includes drawings on a PBoC swap line as public debt.** The 2023 DSA included US$300 million drawn from a swap line totaling US$800 million[11] with the PBoC that was provided in 2020 and was scheduled to be repaid in 2023. In 2023, the line was renewed and the authorities made a repayment of around US$50 million, leaving around US$250 million outstanding, which is now expected to be repaid in 2026.

[10] The 2023 Debt Statistics Bulletin reports that remaining government arrears as of end-2023, which are not settled through domestic bond issuance, are LAK 4.3 trillion. The National Assembly has approved bond issuances of up to LAK 8 trillion for the clearance of arrears, which the authorities plan to do over the course of 2023 and 2024. The remaining arrears are planned to be settled through budget allocation and additional domestic bond issuance.

[11] FX reserve statistics released by the authorities in 2023 revised the value of foreign reserves in 2020 up by US$500 million as they included the entirety of the swap line, which totals US$800 million, and not just the amount drawn. In line with the Sixth Edition of the Balance of Payments and International Investment Position Manual (BPM6), this DSA includes only the amount drawn down, which now stands at US$250 million, as a part of public debt.

9. The DSA estimates total private external debt to be, US$7.6 billion (50.8 percent of GDP) as of end-2023. Private external debt was estimated based on data published by the World Bank for 2022 and incorporates the large numbers of PPP contracts. Updated data for 2023 has not yet been published.

RECENT MACROECONOMIC DEVELOPMENTS

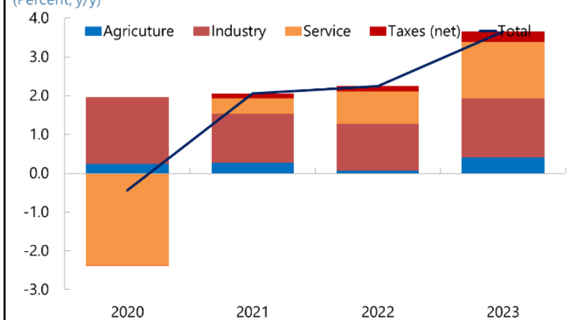
10. The post-pandemic recovery gathered momentum in 2023, but firms report increasing labor and FX shortages.

- Growth in 2023 is estimated at 3.7 percent, mainly driven by industries and services. Tourism and the natural resource sector continue to perform well in 2024. However, agriculture and electricity generation have been affected by drought.

- Outward migration has reportedly intensified, implying a shrinking labor force despite strong working age population growth. The parallel exchange rate premium persists and firms report difficulties obtaining FX at official rates.

Real GDP Growth with Sector Contributions

(Percent, y/y)



Sources: National authorities and IMF staff estimates.

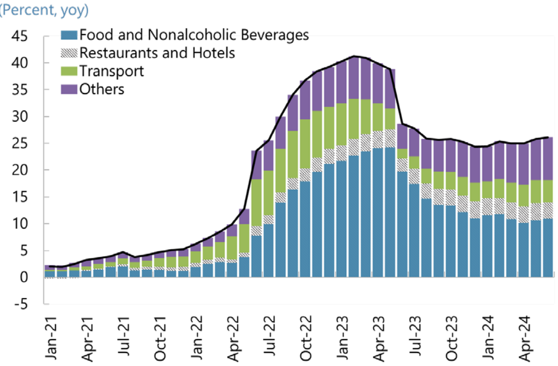
Notes: 2020–23 numbers are staff estimates using leading indicators due to concerns over data availability and quality.

11. Inflation has been high and persistent. Headline inflation peaked at 41 percent y/y in February 2023; a deceleration in exchange rate depreciation and slowdown in money growth have seen inflation declining, but persisting at around 25 percent y/y.

- The persistence of inflation points to domestic factors: inflation increased in 2021 and 2022 as in other countries, but by much more; it has persisted while falling in neighboring countries.

Headline Inflation

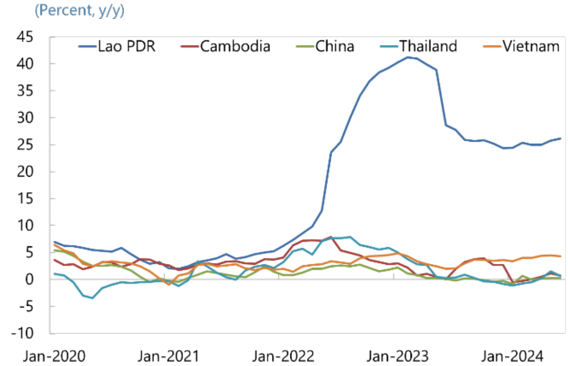
(Percent, yoy)



Sources: National authorities and IMF staff calculations.

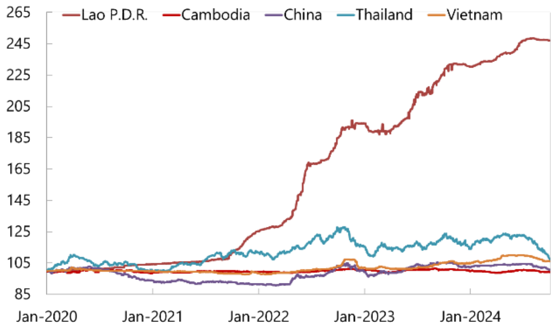
Average Headline Inflation

(Percent, y/y)

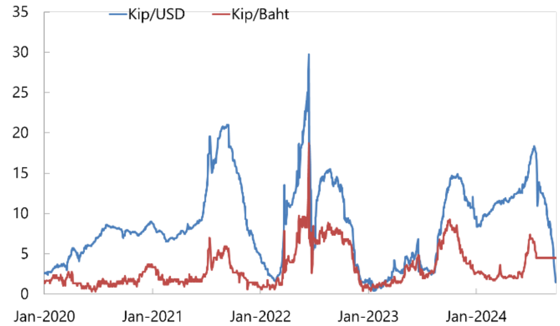


Sources: National authorities and IMF staff calculations.

- Inflation was fueled by exchange rate depreciation—largely reflected in the imported inflation of food and fuel, accounting for more than half of the headline inflation—and monetary expansion,[12] including monetary financing of the government.[13] Parallel rate premia fluctuates but remains positive, indicating more depreciation to yet come.



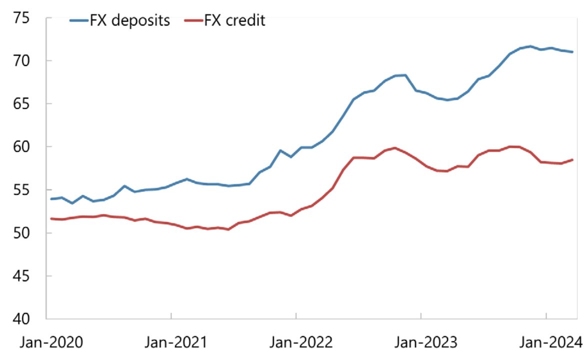
Sources: Bloomberg and IMF staff calculations.
Notes: Commercial banks' exchange rates are used.



Sources: National authorities and IMF staff calculations.
Notes: Parallel premium is calculated against commercial banks' exchange rates.

- Firms report that prices have not yet caught up with increases in import costs and that labor costs are increasing for qualified workers. In addition, anecdotal reports indicate that inflation expectations are becoming entrenched, adding to inflation pressures.

- There are signs of increasing dollarization, consistent with other countries' experiences of high inflation and persistent exchange rate depreciations. Invoicing and settlement are increasingly in foreign currency. The share of FX-denominated bank credit and deposits have notably increased since 2022.

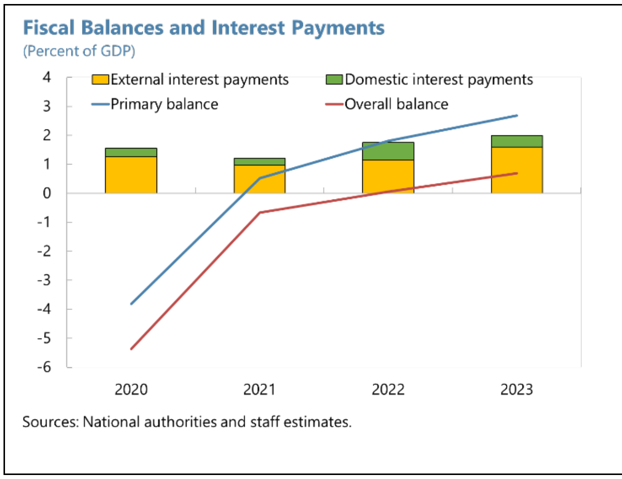


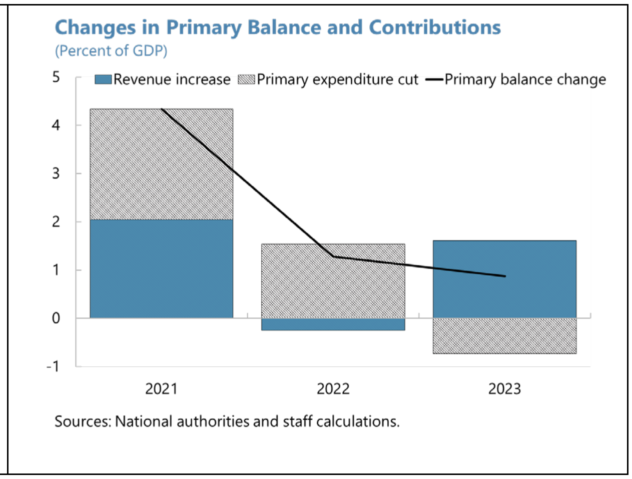
Sources: National authorities and IMF staff calculations.

12. The government has maintained a tight fiscal stance. The primary fiscal balance has been in surplus since 2021, reaching 2.7 percent of GDP in 2023. The balance was achieved largely through low primary spending (14 percent of GDP, compared with an average of 21 percent during 2010-19). Excise tax rates were increased in October 2023 and the VAT rate restored to 10 percent in March 2024. However, interest payments (2 percent of GDP) largely offset the primary surplus.

[12] Modeling work by conducted by ICD in the context of engagement for technical assistance finds the same result: exchange rate depreciations account for most of the inflation, whereas contributions from external factors are small. M2 growth and, separately, the central bank's gross claims on government are also significant factors.

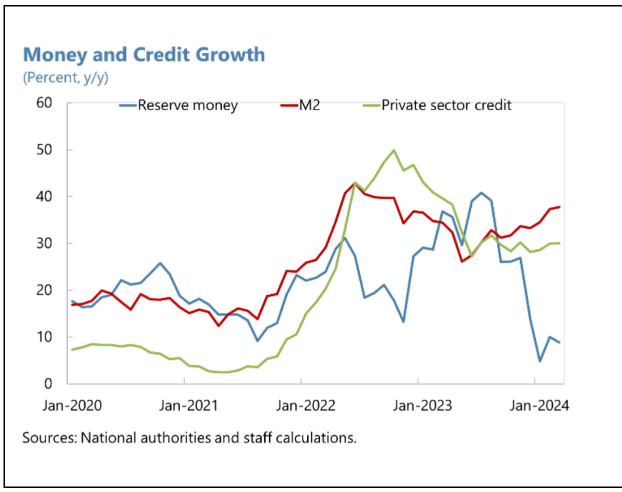
[13] The full extent of monetary financing not only includes direct lending—which remains within the statutory limit of 20 percent of the total annual budget revenue—but also the central bank's purchases of government bonds from commercial banks.

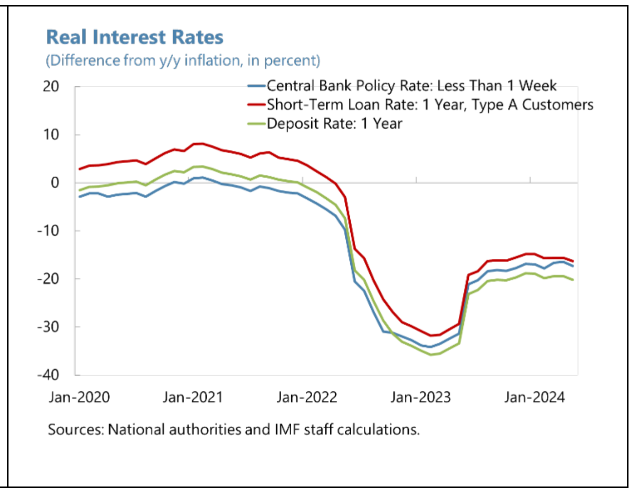




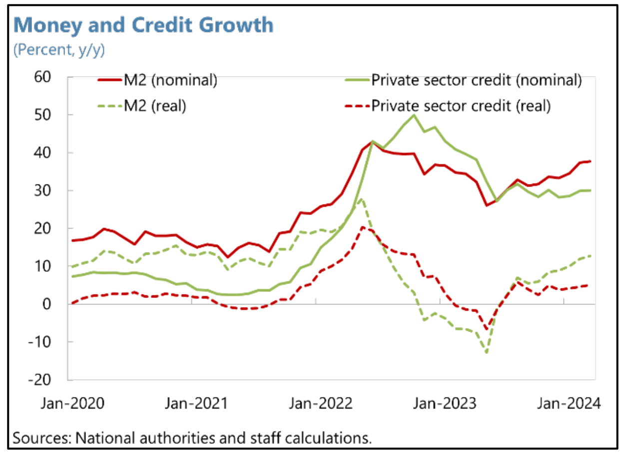
13. Monetary conditions remain extremely loose, despite steps to tighten monetary policy and control the exchange rate:

- Monetary conditions have been extremely loose. Real interest rates are substantially negative. Reserve money growth hit 40 percent y/y in the middle of 2023, driven substantially by an increase in gross claims on the government that exceeded the net issuance of Bank of the Lao P.D.R. (BoL) bonds, suggesting monetary financing of the budget was significant. With ample domestic currency liquidity, larger banks (notably Banque Pour Le Commerce Exterieur Lao Public (BCEL)) lent in the interbank market at lower rates than the policy rate. Private sector credit growth averaged nearly 30 percent in 2023, reflecting both high demand for kip-denominated borrowing given negative real interest rates and increased supply of credit by banks in kip to match the increasing kip value of the FX liabilities on their balance sheets.





- The BoL has raised the policy rate, in stages, to 10.5 percent as of August 2024. Reserve requirements on Lao kip and FX deposits have been raised, to 8 percent and 8 to 11 percent, respectively. BoL bonds have been issued to mop up liquidity, and BoL's claims on the government have declined. In June 2024, the 7-day bill rate was brought to the same level as the policy rate. Reserve money growth has receded, to about 9 percent as of March 2024. But real interest rates are well below zero and M2 and private sector credit growth rates remain high (37 and 30 percent y/y, respectively), above the inflation rate.



- The BoL had previously closed exchange rate bureaus and restricted trading to commercial banks. In addition, the BoL has recently added mandatory conversion requirements to the existing repatriation requirement,[14] which constitutes a capital flow measure.

14. Published financial soundness indicators suggest broadly adequate aggregate bank capital and asset quality, but are potentially problematic. At the time of writing, the latest data show the system-wide Capital Adequacy Ratio (CAR) at over 18 percent, while non-performing loans (NPLs) decreased to 1.41 percent in 2023. However,

- The aggregate CAR is skewed by some banks with very small loan books.[15] The capital adequacy ratio of the largest bank in the system, the state-owned BCEL, stood at 4.9 percent as of end-2023, below the prudential minimum of 8 percent. [16] Its tier 1 capital ratio was 2 percent, compared with an international norm of around 5 percent.

- Zero risk weights applied on government debt in the calculation of the CAR likely overstate the capital adequacy of some banks.

- Ongoing loan forbearance, introduced in March 2020, gives banks wide latitude to avoid recognizing loan losses, which may overstate capital adequacy and asset quality measures.

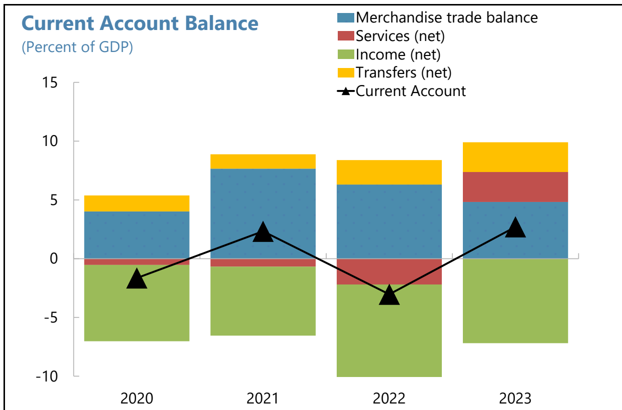
15. The current account balance has improved, but financial outflows remain large. Surpluses in merchandise and services accounts have improved the current account balance from the pre-pandemic

[14] Currently, exporters are required to repatriate their FX proceeds through import-export deposit accounts at commercial banks. The amount to be repatriated depends on the economic sector. In addition, the exporters are subject to mandatory conversion requirements, under which they have to sell a portion of the repatriated FX to commercial banks, with the amount to be sold depending on the specific sector the exporters are in. Lastly, commercial banks will have to sell 30 percent of the foreign currency they receive from exporters to the BoL.

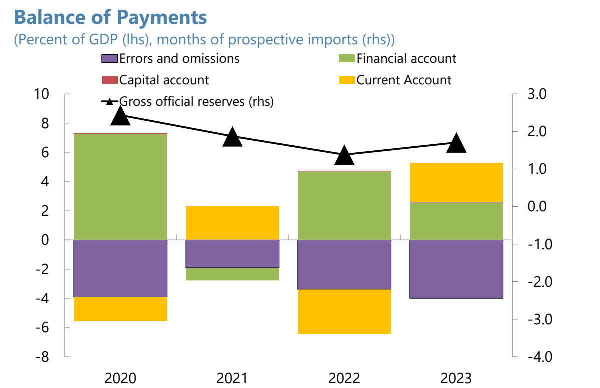
[15] The CAR should be an average weighted by balance sheet size, but is currently calculated as a simple average.

[16] The CAR of BCEL is reported to be 4.9 percent under IFRS standards (the regulatory requirement for the Lao stock market). Under BoL standards, it currently stands at 6.4 percent.

deficits to a surplus of 2.7 percent of GDP in 2023. Imports of some categories of vehicles have recently been halted, to improve the trade balance. FDI increased to 12 percent of GDP, but largely from a one-off inflow,[17] while errors and omissions indicate outflows of 4 percent of GDP, suggesting capital flight and/or mis-invoicing of trade flows. Staff assesses Lao P.D.R.'s external position to be weaker than the level implied by fundamentals and desirable policies, reflecting high debt, thin reserves (estimated by staff to cover 1.7 months of imports), and a weak net international investment position (estimated at around -195 percent of GDP in 2022).



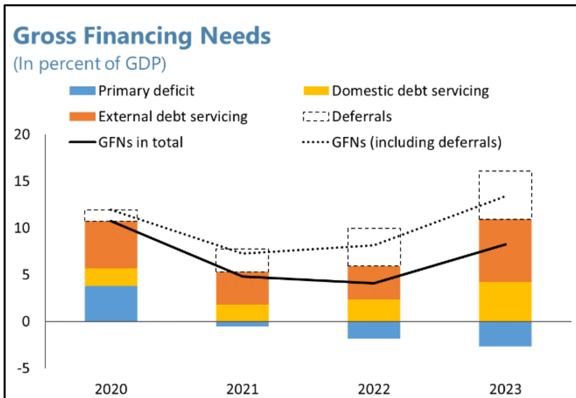
Sources: National authorities and staff estimates.



Sources: National authorities and staff estimates.

16. The government has used debt deferrals to help meet financing needs:

- China has granted debt servicing deferrals since 2020; in 2023 they amounted to US$770 million (about 5 percent of GDP). The authorities have indicated that they are in discussions with development partners and creditors on future financing and debt servicing deferrals, but wider debt restructuring has not been announced.[18]



Sources: National authorities and staff estimates.

- The authorities continued to receive disbursements from bilateral and multilateral development partners, and net issuance of domestic debt amounting to LAK 5.8 trillion (2.1 percent of GDP).

- Net borrowing of the government from the central bank reversed its upward trend since second half of 2023, declining to around 60 percent of its peak.

[17] Investment from China to pay for leases provided by the state-owned power company, EdL, of around 2 percent of GDP was made in 2023Q3.

[18] Debt owed to a foreign commercial bank (about US$ 50 million) was restructured in 2023.

MACROECONOMIC AND DEBT FORECASTS

17. Government financing and the exchange rate play central roles in staff's projections. Substantial FX demands to service external debt and rapid expansion in broad money and credit fuel depreciation pressures. Exchange rate depreciation raises the kip value of debt and leads to domestic inflation, reducing real incomes, intensifying outward migration and creating labor shortages, and increasing uncertainty about investment returns.

18. The baseline's assumptions for financing plans, policy settings, and the external environment are subject to considerable uncertainty:

- *Financing and debt management:* The authorities' financing plan for 2024 relies largely on continued disbursements of contracted external borrowing (US$484 million), deferrals on principal repayments on external debt (US$463 million), commercial borrowing in foreign currency (US$250 million), and debt-reducing flows mainly from a government asset sale (US$300 million). [19] The authorities are also assuming substantial increases in tax revenues, incorporating the recent reinstatement of VAT rates and potentially other as yet undisclosed measures. Under this plan, domestic borrowing is to be capped at LAK 5 trillion, resulting in gross financing needs being overfinanced. In the projections in this DSA, staff excludes the proposed asset sale, given significant uncertainties for its successful completion (Box 1), and is assuming a smaller contribution from the revenue surplus carried over from 2023 (US$70 million, see footnote 19). This implies a financing gap of LAK 4.1 trillion, which staff assume will be met by additional domestic financing, split equally between central bank and commercial banks. [20] Central bank financing is not sterilized, increasing base money growth and nominal exchange rate depreciation substantially, [21] especially when gross financing needs (GFNs) increase again in 2025. Financing terms for external and domestic borrowings are described in Text Tables 5 and 6, respectively: given the continuing inflation in the baseline, the interest rate for domestic financing is also assumed to be high than the recent historical number, which is assumed to be 7 percent for short-term tenor and 10 percent for medium-term tenor.

- *Debt deferrals*: Deferrals of scheduled principal repayments amounting to US$463 million have been incorporated into the DSA, with no further deferrals on interest assumed from 2024, and on all debt servicing from 2025, nor debt restructuring, in the absence of a concrete plan. In terms of deferred debt servicing on which there is no agreement of the reprofiling, staff assume

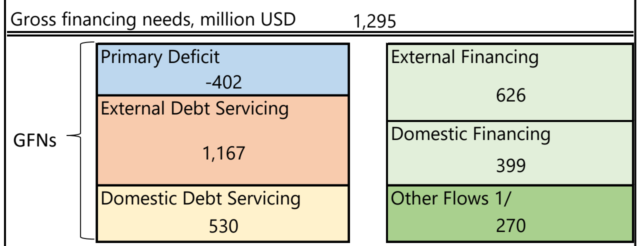
[19] Other debt reducing flows include US$200 million of on-lending repayments from SOEs and US$86 million in revenue surplus from the 2023 budget.

[20] The maturity structure of debt will affect the path of gross financing needs. The projections assume relatively shorter maturities than did the 2023 Article IV baseline, given recent history and increased financing pressures. This assumption does not however sway the direction of the debt ratio or the debt sustainability assessment.

[21] The real exchange rate is expected to continue to depreciate over the projection horizon as the increase in inflation is projected to lag that of the change in the nominal exchange rate (see para 23).

that; (i) repayment of the deferred debt servicing is reallocated to later years (no earlier than 2029) and is fully repaid in the long run,[22, 23] (ii) the deferred interest payments incurred up to 2023 are included in the debt stock as a part of debt, in line with the treatment used in the last DSA.

Financing Assumptions for 2024



Sources: National authorities and staff projections.

1/ Includes on-lending payment from SOEs, and revenue surpluses from 2023.

- *Market access:* The international market access is expected to be limited and is likely to remain shut until 2026, if not longer. Staff assume that international market access is constrained over time (Box 2).

- *Policies:*

  - *Fiscal.* Consistent with the authorities' plans, fiscal consolidation (including continued restraint on spending) leads to ongoing primary surpluses. Tax revenues are assumed to increase, but not as much as assumed by the authorities, owing to implementation concerns. Specifically, revenues are projected to increase as a share of GDP in 2024 due to the authorities' revenue mobilization efforts including the restoration of the VAT, and excise tax increases. The revenue ratio is projected to remain constant thereafter as they do not assume any further measures that have not been announced or legislated, hence shall represent a credible path. On expenditure, restraint on wages, transfers, and public investments are assumed to continue, thereby remaining constant as a percentage of GDP. Grants as a percentage of GDP are assumed to be maintained at the 5-year average between 2018 and 2023, with a slight downward adjustment to be conservative (e.g., no repetition of the extraordinary level of support during the pandemic) as well as to adjust for the volatility seen in recent years.

  - *Monetary.* Monetary policy is assumed to tighten gradually such that M2 growth converges to GDP deflator growth over the medium term. Monetary financing is partially sterilized (i.e., the BoL issues bonds amounting 50 percent of its new purchase of government bonds.) No changes from current prudential settings are assumed, except the announced gradual increase in liquidity coverage ratio.

- *External environment:* External demand is assumed to remain steady, with no major fluctuations in commodity prices, consistent with the latest *World Economic Outlook* projections.

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[22] The DSA assumes that for each external creditor, the total amortization is nearly equal to the initial debt stock, which comes from the authorities' debt bulletin. This means that the initial stock of debt from each external creditors will eventually be repaid in the future.

[23] In terms of the debt servicing deferrals to a commercial bank in 2023 (US$50 million), the authorities plan to pay back in 2026. Staff assume this repayment in the DSA.

Box 1. Proposed Asset Sale Program

The asset sale plan, which was announced in May 2024, is based on a project development contract with a Thai renewable energy company, Energy Absolute Public Company Limited (EA). The agreement establishes a joint venture company, Super Holding Company (SH), with EA would taking up a 35 percent of SH for a payment of around US$1 billion with the government holding the other 65 percent. Under the deal, EA is expected to undertake efforts that enhance the value to the assets and develop and roll out the capacity to transition to electric vehicles. Specific measures to realize this value addition/enhancement was not shared with staff. Over the medium term, the authorities intend to list SH on an overseas bourse at multiples of the original valuation.

However, there are open questions as to the financing of the asset sale.

- On the basis of its 2023 annual report, EA does reported equity of around US$1.3 billion and revenue of just over US$900 million, while it would have to make a payment of around US$1 billion for the purchase;
- Existing external shareholders in projects to be transferred to SH do not appear to have been consulted on the sale, which may invite legal challenges, further delaying the deal; and
- EA itself has come under regulatory scrutiny in Thailand, which is likely to impact its capacity to raise the needed financing.[1]

[1] In July 2024, after a nearly 40 percent drop in the share price, the Thai Securities Exchange accused the CEO and deputy CEO of EA of fraud and suspended trading in EA. Both resigned and a new board has been named, resulting in a lifting of the suspension. However, upon resumption of trading, the share price of EA fell again by nearly a third. The Thai rating agency, TRIS, downgraded EA's rating from "BBB+" to "BB+" and assigned a negative outlook to the rating, citing "heightened liquidity risk the company is likely to face in the near term and the corporate governance issue…" EA is estimated to have around THB 19.6 billion (US$540 million) in debt obligations coming due in the next 12 months.

Box 2. External Financing Assumptions

External financing assumptions tell a story of limited access to international markets over the medium- to long- term, given the unsustainable path of PPG debt ratios in the baseline.

Total external disbursement is assumed to be 4.3 percent of GDP in 2024 and will decrease gradually over the projection horizon to reach 2.6 percent by 2043. External financing is made up of multilateral financing, bilateral financing, bonds, and loans from commercial banks and private companies:

- Multilateral financing represents around 36 percent of the total external financing from 2024 to 2029. ADB and IDA are expected to remain the main multilateral creditors.
- External bond issuance accounts for around 24 percent of the total external financing for 2024. Staff assume that the share is largely constant over the projection horizon, in line with the limited international market access. Loans from commercial banks and private companies are also assumed to be limited at around 16 percent of the total external financing in the long-term.
- Other external financing is bilateral, representing around 7.5 percent of the total external financing on average from 2024 to 2029.

All remaining financing needs are met through domestic borrowing, in the absence of other debt-reducing flows are assumed.

Text Table 5. Loan Terms for Future External Disbursements

	Interest rate	Grace period	Maturity	Grant Element
Multilateral				
IDA (Blend)	2.0%	5	30	36%
AsDB	1.3%	8	32	45%
Others	2.0%	8	35	38%
Bilateral				
Paris Club	0.8%	9	30	51%
Non Paris Club (excluding China)	2.6%	6	22	24%
China	2.3%	6	20	26%
Commercial	7.5%	1	2	0%

Note: Disbursements from multilateral creditors other than the World Bank (IDA) and the Asian Development Bank ("Multilateral, Others") comprises around 20 percent of total disbursement amounts from multilateral creditors.

Text Table 6. Loan Terms for Future Domestic Loans

	interest rate				grace period	maturity	composition			
	2024-29	2030-34	2035-39	2040-44			2024-29	2030-34	2035-39	2040-44
Short-term debt										
T-bills (denominated in local currency)	7.0%	7.0%	7.0%	7.0%	0	1	40%	40%	40%	40%
MLT debt										
Denominated in local currency (LC)										
Bonds (1 to 3 years)-LC	10.0%	10.0%	10.0%	10.0%	1	3	30%	30%	30%	30%
Bonds (4 to 7 years)-LC	10.0%	10.0%	10.0%	10.0%	3	7	30%	30%	30%	30%

Sources: National authorities and IMF staff calculations.

19. Given these assumptions, the baseline projections imply intensifying macroeconomic pressures that would reduce growth over time.

- Recovering tourism accelerates growth to 4.1 percent in 2024. Inflation, however, declines only moderately, reaching 16 percent y/y by year-end and 22 percent y/y on average.

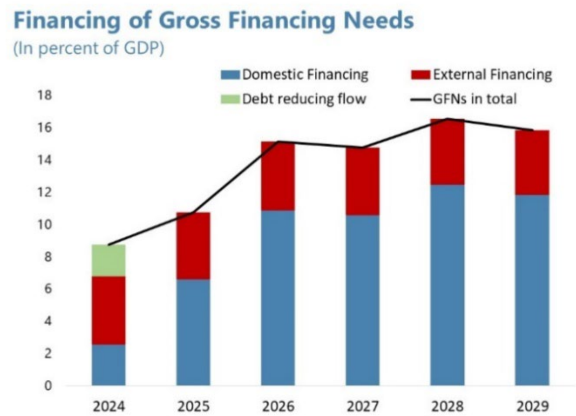
- Gross financing needs are projected to surge during 2025-26 due to scheduled external debt repayments and stay elevated afterwards due to increasing domestic debt servicing. Substantial reliance on domestic financing sources would renew pressures on the exchange rate; recent monetary tightening mitigates depreciation somewhat, but is outweighed by the effects of not-fully-sterilized central bank financing. Government borrowing from commercial banks crowds out private sector credit.[24]

- Inflation would increase during 2025-26 and remain elevated. The GDP deflator is also projected to increase, though more slowly, reflecting the potential substitution effect of the high inflation

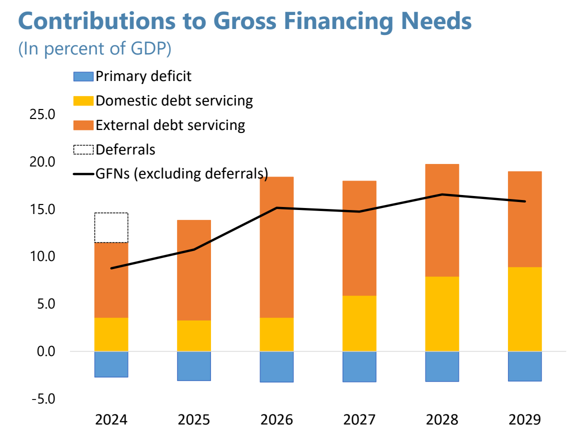
[24] Banks are assumed to be able to withstand the implied crowding out of private sector credit from government borrowing and manage currency mismatches—see risks (¶13).

while CPI basket's weights have not been updated since 2015 and the more stable exports and imports prices.

- Growth would decline over the medium term to around 2½ percent—sharply below the average of 7.2 percent during 2010-19—reflecting deteriorating real wages and purchasing power, prolonged fiscal tightness, outward migration, and declining non-resource sector investment (Annex IV). Resource sectors would be largely unaffected by exchange rate depreciation and FX and labor shortages and continue to receive FDI. FX reserves would fall to very low levels.



Sources: National authorities and staff estimates and projections.

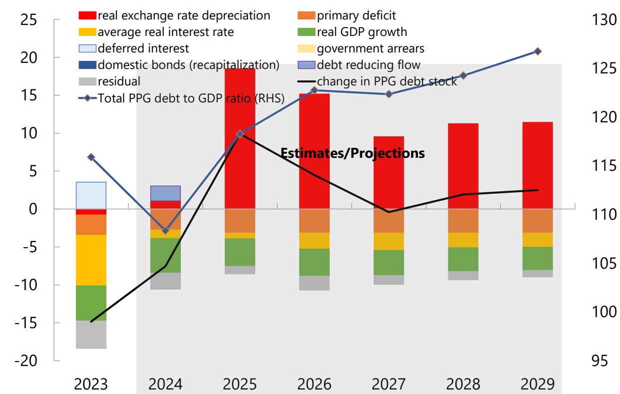


Sources: National authorities and staff estimates and projections.

20. The PPG debt stock is projected to decline further in 2024, but an acceleration in exchange rate depreciation results in the ratio rising over the medium term (Text Figure 3 and Table 2). The debt to GDP ratio is estimated to decline to around 108 percent of GDP by end 2024, mainly due to accelerated growth and lower gross financing needs due to the deferral of principal payments on external debt. The main driver for the upward trend of debt is the continuing real exchange rate depreciation against the backdrop of the surging financing needs for the next several years: in the baseline with currency depreciation, real exchange rate depreciation drives the increase in PPG debt, offsetting the declining pressure from other drivers, such as real GDP growth, average real interest rate and primary surpluses. The debt ratio is projected to reach its peak in 2030 at around 127 percent of GDP.

Text Figure 3. PPG Debt Changes and Contributions

(In percent of GDP)



Sources: National authorities; and IMF staff calculations and projections.

Box 3. Medium-term and Long-term Growth Assumptions

With reliance on domestic financing, growth would decline over the medium term to 2.5 percent in 2029 (compared to an average of 7.5 percent from 2006 to 2015) and is then assumed to be maintained at 2.5 percent from 2030 onwards, as purchasing power deteriorates, real wages fall and outward migration intensifies, non-resource sector investment is deterred, and prolonged fiscal consolidation weighs on aggregate demand. This would be reflected in the supply potential of the economy:

- *Labor force growth:* the UN projects annual working-age population (defined as those aged 15 to 64) growth of 1.5 percent by 2029. The Lao P.D.R. census estimates a workforce base of 2.5 million in 2022. Information obtained during the mission is that outward migration is in the order of 50,000 in 2022, estimated to increase by up to 180,000 this year; the exchange rate depreciation and consequent loss of purchasing power implies that this trend will continue, which would imply negative workforce growth by 2029. However, a judgment is made of less-than-proportionate increase in outward migration, and a small positive workforce growth of 0.2 percent-but nonetheless smaller than pre-pandemic levels.
- *Physical capital accumulation:* There is further potential growth from resource extraction (see below) that is less likely to be affected by the crowding out of domestic private credit conditions implied by the baseline scenario. However, the government is not able to finance the levels of investment seen before the pandemic. Physical capital accumulation is judged to contribute around 2¼ percent to growth, compared with an average of 5¾ percent in the decade before the pandemic.
- *Human capital accumulation:* Low spending on education and reports of falling enrollment rates could result in negative human capital accumulation. The judgment is made that this will fall to zero percent growth by 2029, compared with 0.2 percent from before the pandemic.
- *Productivity growth:* Difficulties obtaining FX, extended forbearance, and weak credit risk assessment result in low productivity growth. The judgment is for 0.1 percentage point contribution compared with 0.2 percentage point from before the pandemic.

The implication from these factors is for growth of around 2.5 percent, compared with 6.8 percent on average during the decade before the pandemic. Naturally, should the adverse factors from the baseline not eventuate, then growth would be higher. However, the adverse factors could worsen, and in many cases-such as the assumption about labor force growth-the benefit of the doubt has been given. Annual growth is then assumed to be maintained at 2.5 percent from 2030 onwards.

Text Table 7. Comparison of Medium- and Long-Term Macroeconomic Projections

	2022	2023	2024	2025	2026	2027	2028	2029	Long-term 1/
Real GDP (y/y growth)									
Current DSA	2.3	3.7	4.1	3.5	3.1	2.8	2.6	2.5	2.5
Previous DSA (2023 AIV)	2.3	4.0	4.0	4.1	4.2	4.3	4.5	n.a.	4.7
GDP deflator (y/y growth)									
Current DSA	17.6	24.1	14.6	13.5	21.5	20.9	18.1	16.8	21.5
Previous DSA (2023 AIV)	17.6	16.1	3.5	3.0	3.0	3.0	3.0	n.a.	3.0
Primary fiscal balance (percent of GDP)									
Current DSA	1.8	2.7	3.5	3.8	3.8	3.8	3.8	3.8	3.8
Previous DSA (2023 AIV)	0.1	0.3	0.3	0.2	0.2	0.1	0.1	n.a.	-0.3
Revenue and grants (percent of GDP)									
Current DSA	14.8	16.4	16.4	16.4	16.4	16.4	16.4	16.4	16.4
Previous DSA (2023 AIV)	14.9	15.1	15.1	15.1	15.1	15.0	15.0	n.a.	14.7
Primary expenditure (percent of GDP)									
Current DSA	13.0	13.7	12.9	12.6	12.6	12.6	12.6	12.6	12.6
Previous DSA (2023 AIV)	14.8	14.8	14.8	14.9	14.9	14.9	14.9	n.a.	15.0
Fiscal balance (percent of GDP)									
Current DSA	0.1	0.7	0.0	0.6	0.4	0.2	0.0	-0.2	-0.5
Previous DSA (2023 AIV)	-1.6	-3.4	-3.5	-3.4	-3.6	-3.0	-3.0	n.a.	-2.6
Current account balance (percent of GDP)									
Current DSA	-0.1	3.7	3.8	3.6	2.7	2.9	2.8	2.7	5.2
Previous DSA (2023 AIV)	-6.0	-2.6	-6.2	-7.8	-8.4	-7.6	-5.8	n.a.	-6.1
Exports of goods and services (percent of GDP)									
Current DSA	56.9	64.9	62.9	65.3	63.8	62.0	61.1	60.4	55.2
Previous DSA (2023 AIV)	53.2	64.4	68.0	68.4	68.4	68.4	69.6	n.a.	70.0
Imports of goods and services (percent of GDP)									
Current DSA	52.8	57.5	55.6	58.1	57.1	55.5	54.9	54.5	50.9
Previous DSA (2023 AIV)	52.8	60.0	66.1	69.0	70.3	70.9	71.1	n.a.	75.5

Sources: Authorities' data and IMF staff estimates and calculations.
1/ Average 2030-2043 for the current DSA and 2029-2042 for the previous DSA.

21. The realism tools do not undermine the credibility of assumptions. Although there are some discrepancies between the baseline and the realism tool outputs, these gaps can be explained.

- The divergence between the historical and baseline scenarios for the PV of PPG external debt-to GDP ratio is due to the large historical average of non-interest current account deficit, reflecting large deficits in early 2010s.[25] The divergence between the historical and baseline scenarios of PV of PPG debt-to GDP ratio is due to the lower level of primary surplus and GDP deflator in the past decade compared to the recent years and in the projections.

- The projected 3-year adjustment in the fiscal primary balance is below the top quartile for LICs, suggesting the assumptions are reasonable.

[25] The average deficit over the past 10 years is 7.9 percent of GDP, and the average for 2013-2015 is 20.3 percent of GDP.

- The baseline growth rates for 2023 and 2024 are higher than the potential growth paths under various fiscal multipliers in the fiscal realism tool, reflecting increased industrial production following the pandemic, and a strong rebound in exports and tourism.

- The growth-investment realism test could not be conducted due to a lack of data on the size of capital stock and efficiency of capital investment.

COUNTRY CLASSIFICATION AND DETERMINATION OF STRESS TESTS

22. Debt-carrying capacity is assessed as weak. The country's Composite Indicator (CI) index of 2.30 indicates a weak debt-carrying capacity (DCC), based on April 2024 WEO and 2022 World Bank's Country Policy and Institutional Assessment (CPIA) (Text Table 8). The current CI is higher than the value in the previous DSA, which was 2.15. However, the DCC rating remains unchanged (weak) and therefore the indicative thresholds for external debt and benchmarks for public debt are: 30 percent for the present value (PV) of external debt-to-GDP ratio, 140 percent for the PV of external debt-to-exports ratio, 10 percent for the external debt service-to-exports ratio, 14 percent for the external debt service-to-revenue ratio, and 35 percent for the PV of public debt-to GDP ratio.

Text Table 8. Composite Indicator and Applicable Thresholds

Components	Current DSA				2023 DSA	
	Coefficients (A)	10-year average values (B)	CI Score components (A*B) = (C)	Contribution of components	CI Score components (A*B) = (C)	Contribution of components
CPIA	0.385	3.022	1.16	51%	1.17	54%
Real growth rate (in percent)	2.719	3.292	0.09	4%	0.10	5%
Import coverage of reserves (in percent)	4.052	20.231	0.82	36%	0.56	26%
Import coverage of reserves^2 (in percent)	-3.990	4.093	-0.16	-7%	-0.08	-4%
Remittances (in percent)	2.022	0.067	0.00	0%	0.01	0%
World economic growth (in percent)	13.520	2.909	0.39	17%	0.39	18%
CI Score			2.30	100%	2.15	100%
CI rating			Weak		Weak	

Applicable Thresholds

APPLICABLE EXTERNAL debt burden thresholds	
PV of debt in % of	
Exports	140
GDP	30
Debt service in % of	
Exports	10
Revenue	14

APPLICABLE TOTAL public debt benchmark	
PV of total public debt in percent of GDP	35

Sources: LIC DSF

23. Given the exposure to natural disasters and market financing, two tailored stress tests were added to the standard set of stress test scenarios.

- Lao P.D.R.'s exposure to natural disaster risks has increased in the past years. The 2018 disasters (two tropical cyclones and one dam collapse) have generated damages and losses estimated at 2 percent of GDP and recovery needs of around 3 percent of GDP. To mitigate future risk, the government of Lao P.D.R. has joined the regional catastrophe risk insurance pool. To account for Lao P.D.R.'s exposure to disasters, a natural disaster tailored stress test is added: a one-off shock of 3 percentage points to the external debt-to-GDP ratio in 2025 (the second year of the debt projection period), in line with the recent evidence and the 2023 DSA.[26]

- Lao P.D.R. has been accessing the Thai capital market since 2013 (although access is likely to be highly restricted at least until 2026, if not longer) justifying the inclusion of a market financing shock occurring also in 2025. The calibrations include a 400-bps increase in the cost of new external commercial borrowing, a shortening of maturities by one-thirds and one-off foreign exchange depreciation by 15 percent.

24. Shocks related to contingent liabilities are incorporated in the contingent liabilities stress test using the tailored parameters. The contingent liability stress test applies a one-off 43.3 percentage point-increase in the debt-to-GDP ratio in the second year of the projection (see Text Table 2).

DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

25. The baseline scenario shows that three out of four external debt sustainability indicators breach their thresholds from 2024 to 2029 (Table 1 and Figure 1). Breaches are reported for both solvency (the present value (PV) of PPG external debt-to-GDP ratio) and liquidity ratios (PPG debt service-to-export and PPG debt service-to-revenue ratios). The magnitude of breaches is significant (Text Table 8): for the PV of PPG external debt-to-GDP and PPG debt service-to-revenue ratios, the debt sustainability indicators continue above their thresholds during the entire of the next decade. The PV of PPG external debt-to-GDP ratio reaches around 61 percent in 2024, above the 30 percent threshold and remains above that level throughout the projection horizon. The external PPG debt service-to-revenue ratio goes up to 91 percent in 2026 and remain over the 14-percent threshold throughout the projection horizon. The PPG debt service-to-exports ratio also remains above its sustainability threshold (10 percent) until 2030. Only the PV of PPG external debt-to-exports ratio stays below its threshold (140 percent) over the entire projection period.

26. The stress tests indicate the vulnerability of Lao P.D.R.'s external debt dynamics to exports and currency depreciation and, to a lesser extent, to natural disasters and contingent liabilities

[26] Lao P.D.R. is not included in the group of countries for which the climate disaster stress test scenario is automatically applied. As such, the default parameters, which are tailored to this group of countries, need to be adjusted when the stress test is applied to Lao P.D.R.

(Figure 1 and Table 3). An export shock generates the most severe deterioration of three of the four external debt burden indicators (both the solvency indicators and the debt service-to-exports ratio), while the most extreme shock for the debt service-to-revenue ratio is the one-time depreciation shock. Focusing on the extreme shocks, all of four sustainability indicators exceed the corresponding thresholds over the next several years.

B. Public Sector Debt Sustainability Analysis

27. The sustainability indicator for total PPG debt also breaches its benchmark significantly over the next two decades (Table 2 and Figure 2). The PV of the debt-to-GDP ratio is projected to decline gradually but continues to exceed its benchmark (35 percent) by a significant amount over the entire projection period. The debt service-to-revenue and grants ratio is projected to exceed 100 percent from 2026-33.

28. Public debt is most vulnerable to the combined contingent liabilities shock in the medium term (Figure 2 and Table 4). The PV of public debt-to-GDP ratio under the contingent liabilities shock reaches 129 percent on average until 2029. The debt service-to-revenue and grants is also most vulnerable to the contingent liabilities shock and would peak at 174 percent in 2029.

RISK RATING AND VULNERABILITIES

29. The Lao P.D.R. is assessed to be in external and overall debt distress. The assessment reflects the on-going negotiations about debt service deferral and the significant debt vulnerabilities emanating from the large and protracted threshold breaches of most solvency and liquidity indicators.

30. Overall debt is assessed to be unsustainable under the current baseline.

- The baseline, in which the economic stabilization is unachieved automatically, implies the debt path is on an upward trajectory in the medium-term. The improvement in fiscal balances and continued real GDP growth rates contribute to reduce the PPG debt. Against the backdrop of the surging government financing needs to serve external debt servicing, however, the economy is under further pressure of currency depreciation, and the real exchange rate depreciation in the baseline dominates these declining pressures on the PPG debt. As a result, the debt path is projected to increase in the next several years.

- The primary surpluses required to reduce debt below risk thresholds in the DSA within a few years (without harming long-term development prospects and without debt restructuring) are not socially feasible. Staff estimates that to reduce the PV of PPG debt to 35 percent of GDP by 2029, equivalent to the benchmark in the DSA, the government would have to run a primary surplus of around 17 percent of GDP on average each year between 2025-29, and assuming nominal GDP remains unchanged.

31. Risks are tilted to the downside.

- *Banks* face risks of asset quality deterioration from loose credit and weakening potential growth, funding pressures from renewed inflation and exchange rate weaknesses, and currency mismatches. The weakness of BCEL creates systemic risks. Potential bank recapitalizations would exacerbate the government's financing challenges.

- *Borrowing costs and rollover risks:* another risk which comes from the substantial financing needs and the debt is that the required increase of interest rate to induce the private sector to finance the government would be significantly larger than in the baseline. This does not only increase the government borrowing cost, but also it could increase rollover risks.

- *Potential growth:* The baseline projections assume positive workforce growth, even though estimates indicate negative growth currently. Capital accumulation could be lower as exchange rate pressures accumulate.

- Other pressures, including the further deterioration in the external environment and unanticipated fiscal worsening, such as additional arrears and contingent liabilities from SOEs, could materialize. Persistent high inflation environment could lead to abandonment of domestic currency, removing monetary policy as a tool. Climate change risks would also exacerbate the debt situation by impeding hydroelectric and agricultural production, in addition to requiring additional fiscal expenditure to recover.

32. To achieve macroeconomic stabilization and build a more resilient economy over the medium term, a comprehensive and mutually consistent set of policies is needed. There have been improvements in policies since the 2021 Article IV consultation: primary surpluses have limited the need for additional financing; the government has sought external debt reprofiling, and has received debt service payment deferrals; and the Bank of the Lao P.D.R. has taken steps to tighten monetary policy and indicated willingness to tighten further. However, the government will not be able to achieve debt sustainability with feasible levels of primary surpluses, and constraints on public spending on education, health, and infrastructure are harming medium-term growth. The BoL is charged with multiple targets (2021 Article IV Staff Report), including a target for M2 growth (25 percent y/y) that is incompatible with achieving low inflation, and has financed the government previously and subsidizes cheap credit. Rather than stabilize the exchange rate, the new surrender and conversion requirements are likely to increase the costs of financial transactions, increase funding costs, and reduce FX liquidity. Staff recommends:

- *Debt management:* given the constraints on technical capacity in the Lao P.D.R., the authorities should prioritize strengthening the capacity to assess and manage debt, with a view toward developing a coherent and realistic medium-term financing plan and debt strategy. As the process of developing this capacity continues, there could be a role for engaging expert advisors who can provide technical assessments and policy advice to directly tackle the debt burden.

- *Fiscal policy:* The balance of fiscal policy should be shifted to greater social spending and more revenue mobilization, while minimizing the consequent economic drag from consolidation. A medium-term primary surplus of around 3 percent of GDP would strike the right balance between feasibility and setting the right signal of commitment to restoring the sustainability of public finances. Expenditure and public financial management (PFM) would benefit from strengthening budget processes and improving transparency and SOE oversight.

- *Monetary policy:* The policy rate should be raised significantly so that it is positive in real terms. Monetary financing of the government should be avoided, and any new purchase of government bonds from the commercial banks should be fully sterilized through issuing BoL bonds. Such steps would come at the cost of a contraction in private sector credit but would contribute to stabilizing the exchange rate, which would prevent the debt burden in domestic currency from increasing further and stem the damage to real growth over the medium term.

- *Exchange rate policy:* The newly adopted regulation on management of foreign currency revenues (BoL Decision No. 333) that requires (i) exporters to sell foreign exchange from repatriated export proceeds to commercial banks, and (ii) commercial banks to sell portion of foreign exchange purchased from the exporter to the BOL constitutes a capital flow management measure under the IMF's Institutional View (IV) on the Liberalization and Management of Capital Flows. The surrender requirement would be appropriate under the IV in the context of Lao PDR's (near) crisis situation. The measures are likely to increase transferring costs and could inflate parallel market activities, and create adverse effects on foreign investor confidence. The authorities should assess whether the measure achieves the intended goal and consider phasing it out.

- *Financial sector:* The government has announced plans for capital buffers and to increase the liquidity coverage ratio, but there is no timetable for the former and that for the latter is gradual—more rapid implementation of both would help to safeguard the system. The supervisor should intervene more proactively to address growing credit risks and currency imbalances in the banking system.

- *Structural policies* should focus on addressing impediments to private sector growth and aim for uniform application of policies and regulations.

AUTHORITIES' VIEWS

33. **The authorities remain committed to fulfilling their obligations and reiterated that their capacity to repay remains adequate including under a downside scenario.** They maintained their financing plans were feasible, while acknowledging the difficulty in projecting exchange rates, which remain a key element of the government's financing needs. To enhance management and address public debt challenges, the authorities are undertaking a series of strategic measures, including enhancing debt management tools and mechanisms by developing a medium- to long-term financing strategy, restricting new borrowing and government investment projects, eliminating unplanned and non-essential expenditures, and transitioning borrowing from non-concessional to concessional terms. Discussions with creditors to extend financial support are ongoing.

34. The authorities emphasized their commitment to a tight fiscal stance. They noted that recent efforts and planned measures to enhance revenue mobilization would significantly increase revenues and help meet the government's financing needs. They aim to diversify sources of income, to limit tax exemptions to those specified by law, and to focus on collecting taxes from property, natural resources, and environmental protection efforts, with a goal of increasing revenue to 20 percent of GDP. They aim to allocate a higher proportion of funds to investments and reduce current expenditures, and to promote transformation of state-owned enterprises into partnerships and expand the state's shares in activities, projects, and business units that are crucial for important national income or strategy.

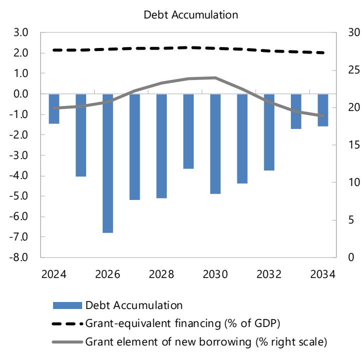
35. The authorities emphasized the economy's positive growth potential and were confident of meeting financing needs. They were more optimistic about growth. While acknowledging that inflation was not likely to fall quickly, they did not forecast a surge in inflation, expecting exchange rates to stabilize. They were confident about revenue gains, the planned asset sales, and rolling over external financing, which would avoid substantial domestic financing and monetary financing of the government.

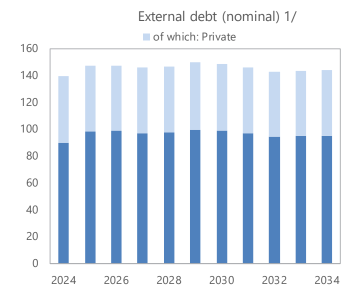
Table 1. Lao P.D.R.: External Debt Sustainability Framework, Baseline Scenario, 2021–2043

(In percent of GDP, unless otherwise)

	Actual			Projections								Average 8/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2043	Historical	Projections
External debt (nominal) 1/	122.1	154.3	146.5	139.6	147.1	147.3	146.0	146.6	150.0	143.7	149.0	109.3	145.5
of which: public and publicly guaranteed (PPG)	79.6	103.9	95.6	89.6	98.0	99.0	97.1	97.3	99.5	95.3	98.8	65.5	96.4
Change in external debt	16.1	32.1	-7.8	-6.9	7.6	0.2	-1.2	0.6	3.4	0.6	0.4		
Identified net debt-creating flows	-8.2	25.8	-12.8	-12.9	-11.9	-11.6	-11.1	-10.8	-10.6	-9.3	-7.8	-0.8	-10.6
Non-interest current account deficit	-4.1	0.7	-7.7	-8.0	-7.2	-6.8	-6.5	-6.0	-5.5	-3.7	-1.4	4.6	-5.5
Deficit in balance of goods and services	-7.0	-4.1	-7.4	-7.3	-7.1	-6.8	-6.5	-6.2	-6.0	-4.8	-2.6	4.2	-6.0
Exports	42.2	56.9	64.9	62.9	65.3	63.8	62.0	61.1	60.4	56.9	50.5		
Imports	35.2	52.8	57.5	55.6	58.1	57.1	55.5	54.9	54.5	52.1	47.9		
Net current transfers (negative = inflow)	-1.2	-2.1	-2.5	-2.2	-2.1	-2.2	-2.3	-2.5	-2.6	-3.4	-5.3	-1.8	-2.6
of which: official	-1.8	-0.7	-1.6	-1.2	-1.1	-1.1	-1.1	-1.1	-1.1	-1.4	-2.2		
Other current account flows (negative = net inflow)	4.1	6.9	2.2	1.5	2.0	2.2	2.4	2.7	3.1	4.6	6.5	2.2	3.2
Net FDI (negative = inflow)	-5.8	-4.8	-11.9	-4.6	-4.7	-4.8	-4.9	-5.0	-5.0	-4.3	-3.8	-6.9	-4.6
Endogenous debt dynamics 2/	1.7	29.9	6.8	-0.4	0.1	-0.1	0.2	0.2	-0.1	-1.3	-2.6		
Contribution from nominal interest rate	1.8	2.3	5.0	5.6	5.1	4.9	4.6	4.3	3.8	2.4	1.2		
Contribution from real GDP growth	-2.2	-3.4	-5.7	-6.0	-5.0	-4.9	-4.4	-4.1	-4.0	-3.7	-3.8		
Contribution from price and exchange rate changes	2.1	30.9	7.6	...	...	...	...	...	...	...	...		
Residual 3/	24.4	6.3	5.0	6.0	19.4	11.8	9.9	11.4	14.0	9.9	8.3	5.9	10.4
of which: exceptional financing	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Sustainability indicators													
PV of PPG external debt-to-GDP ratio	...	...	62.8	61.3	59.3	56.4	55.5	54.2	54.2	46.2	42.9		
PV of PPG external debt-to-exports ratio	...	...	96.8	97.5	90.8	88.4	89.5	88.6	89.7	81.2	84.9		
PPG debt service-to-exports ratio	8.3	6.0	10.4	12.6	16.4	21.6	19.1	19.0	16.4	12.4	11.9		
PPG debt service-to-revenue ratio	27.0	24.6	46.0	52.2	70.3	90.6	78.0	76.1	65.2	46.3	39.4		
Gross external financing need (Million of U.S. dollars)	-27.6	1073.9	149.4	1414.6	1906.1	2335.2	1960.1	1931.2	1746.9	720.0	56.1		
Key macroeconomic assumptions													
Real GDP growth (in percent)	2.1	2.3	3.7	4.1	3.5	3.1	2.8	2.6	2.5	2.5	2.5	4.7	2.8
GDP deflator in US dollar terms (change in percent)	-1.9	-20.2	-4.7	-3.9	-6.6	-9.7	-10.2	-9.3	-9.2	-5.2	-5.2	-2.1	-7.1
Effective interest rate (percent) 4/	1.7	1.6	3.2	3.8	3.5	3.1	2.9	2.7	2.4	1.6	0.8	2.5	2.5
Growth of exports of G&S (US dollar terms, in percent)	21.0	10.0	12.7	-3.0	0.3	-9.0	-10.3	-8.3	-7.9	-3.9	-4.2	8.9	-5.6
Growth of imports of G&S (US dollar terms, in percent)	12.2	22.3	7.7	-3.3	1.0	-8.6	-10.1	-8.0	-7.7	-3.6	-3.5	2.2	-5.3
Grant element of new public sector borrowing (in percent)	...	...	...	19.9	20.1	20.8	22.2	23.3	23.9	18.9	18.3	...	21.4
Government revenues (excluding grants, in percent of GDP)	13.0	13.9	14.6	15.2	15.2	15.2	15.2	15.2	15.2	15.2	15.2	14.3	15.2
Aid flows (in Million of US dollars) 5/	377.1	132.8	261.0	372.7	371.1	354.8	355.9	353.1	336.2	194.2	127.8		
Grant-equivalent financing (in percent of GDP) 6/	...	...	...	2.1	2.1	2.2	2.2	2.2	2.3	2.0	1.8	...	2.2
Grant-equivalent financing (in percent of external financing) 6/	...	...	...	38.6	39.0	39.6	40.9	41.9	42.5	39.7	45.5	...	40.7
Nominal GDP (Million of US dollars)	18,533	15,121	14,943	14,949	14,440	13,444	12,410	11,546	10,750	9,039	7,022		
Nominal dollar GDP growth	0.1	-18.4	-1.2	0.0	-3.4	-6.9	-7.7	-7.0	-6.9	-2.8	-2.8	2.6	-4.4
Memorandum items:													
PV of external debt 7/	...	...	113.6	111.3	108.4	104.7	104.4	103.5	104.7	94.6	93.1		
In percent of exports	...	...	175.1	177.0	166.1	164.1	168.3	169.3	173.3	166.2	184.4		
Total external debt service-to-exports ratio	23.1	19.7	31.8	34.9	38.5	45.3	43.8	45.3	44.2	28.0	11.9		
PV of PPG external debt (in Million of US dollars)			9383.1	9166.4	8562.0	7581.9	6887.1	6255.3	5830.7	4178.2	3011.7		
(PVt-PVt-1)/GDPt-1 (in percent)				-1.5	-4.0	-6.8	-5.2	-5.1	-3.7	-1.6	-1.7		
Non-interest current account deficit that stabilizes debt ratio	-20.2	-31.4	0.1	-1.0	-14.8	-6.9	-5.2	-6.6	-8.9	-4.3	-1.9		

Definition of external/domestic debt	Currency-based
Is there a material difference between the two criteria?	Yes





Sources: Country authorities; and staff estimates and projections.

1/ Includes both public and private sector external debt.

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

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

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

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

6/ 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).

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

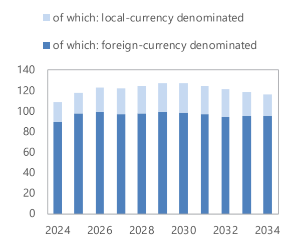
8/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

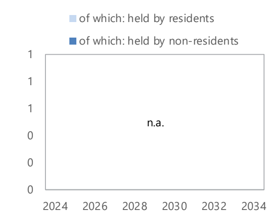
Table 2. Lao P.D.R.: Public Sector Debt Sustainability Framework, Baseline Scenario, 2021–2043

	Actual			Projections								Average 6/	
	2021	2022	2023	2024	2025	2026	2027	2028	2029	2034	2043	Historical	Projections
Public sector debt 1/	92.9	130.7	115.9	108.3	118.3	122.7	122.3	124.2	126.7	116.4	105.8	76.3	121.0
of which: external debt	79.6	103.9	95.6	89.6	98.0	99.0	97.1	97.3	99.5	95.3	98.8	65.5	96.4
Change in public sector debt	16.9	37.9	-14.9	-7.5	9.9	4.5	-0.4	1.9	2.5	-2.4	-0.4		
Identified debt-creating flows	8.4	20.5	-14.7	-8.5	-7.5	-8.9	-8.7	-8.2	-8.1	-8.8	-7.1	2.5	-8.6
Primary deficit	-0.5	-1.8	-2.7	-2.7	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	-3.1	1.8	-3.1
Revenue and grants	15.0	14.8	16.4	16.5	16.5	16.5	16.5	16.5	16.5	16.5	16.5	16.5	16.5
of which: grants	2.0	0.9	1.7	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3		
Primary (noninterest) expenditure	14.5	13.0	13.7	13.8	13.4	13.4	13.4	13.4	13.4	13.4	13.4	18.3	13.4
Automatic debt dynamics	8.9	22.3	-12.1	-5.7	-4.4	-5.7	-5.6	-5.1	-4.9	-5.6	-3.9		
Contribution from interest rate/growth differential	-3.9	-7.5	-11.3	-5.7	-4.4	-5.7	-5.6	-5.1	-4.9	-5.6	-3.9		
of which: contribution from average real interest rate	-2.4	-5.5	-6.7	-1.1	-0.8	-2.1	-2.3	-1.9	-1.9	-2.7	-1.3		
of which: contribution from real GDP growth	-1.5	-2.0	-4.6	-4.6	-3.6	-3.6	-3.3	-3.1	-3.1	-2.9	-2.6		
Contribution from real exchange rate depreciation	12.8	29.9	-0.8	`	...	...	...	...	...	...	...		
Other identified debt-creating flows	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Privatization receipts (negative)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Recognition of contingent liabilities (e.g., bank recapitalization)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
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 debt creating or reducing flow (please specify)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		
Residual	8.5	17.4	-0.1	0.9	17.5	13.3	8.3	10.1	10.6	6.4	6.6	4.1	8.7
Sustainability indicators													
PV of public debt-to-GDP ratio 2/	...	...	89.0	82.7	89.0	91.0	89.3	89.1	89.4	74.0	56.1		
PV of public debt-to-revenue and grants ratio	...	...	542.7	500.1	538.7	550.2	540.0	539.2	540.6	447.5	339.3		
Debt service-to-revenue and grants ratio 3/	35.3	39.1	66.6	69.9	89.9	114.2	116.3	121.3	116.6	92.7	53.1		
Gross financing need 4/	4.8	4.0	8.2	8.8	11.7	15.7	16.1	16.9	16.1	12.2	5.6		
Key macroeconomic and fiscal assumptions													
Real GDP growth (in percent)	2.1	2.3	3.7	4.1	3.5	3.1	2.8	2.6	2.5	2.5	2.5	4.7	2.8
Average nominal interest rate on external debt (in percent)	1.1	1.3	1.5	2.6	2.3	2.2	2.1	2.0	1.9	1.6	1.4	2.2	1.9
Average real interest rate on domestic debt (in percent)	-0.8	-10.3	-17.8	-8.3	-6.7	-12.1	-10.9	-8.3	-7.0	-10.3	-10.2	-1.2	-9.3
Real exchange rate depreciation (in percent, + indicates depreciation)	19.1	40.5	-0.8	...	...	...	...	...	...	...	...	6.4	...
Inflation rate (GDP deflator, in percent)	5.6	17.6	24.1	14.6	13.5	21.5	20.9	18.1	16.8	21.8	21.8	6.8	19.1
Growth of real primary spending (deflated by GDP deflator, in percent)	-11.9	-8.5	9.5	4.7	0.4	3.1	2.8	2.6	2.5	2.5	2.5	-0.3	2.6
Primary deficit that stabilizes the debt-to-GDP ratio 5/	-17.4	-39.7	12.2	4.8	-13.1	-7.6	-2.7	-5.1	-5.6	-0.7	-2.7	-15.0	-3.2
PV of contingent liabilities (not included in public sector debt)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0		

Definition of external/domestic debt	**Currency-based**
Is there a material difference between the two criteria?	**Yes**

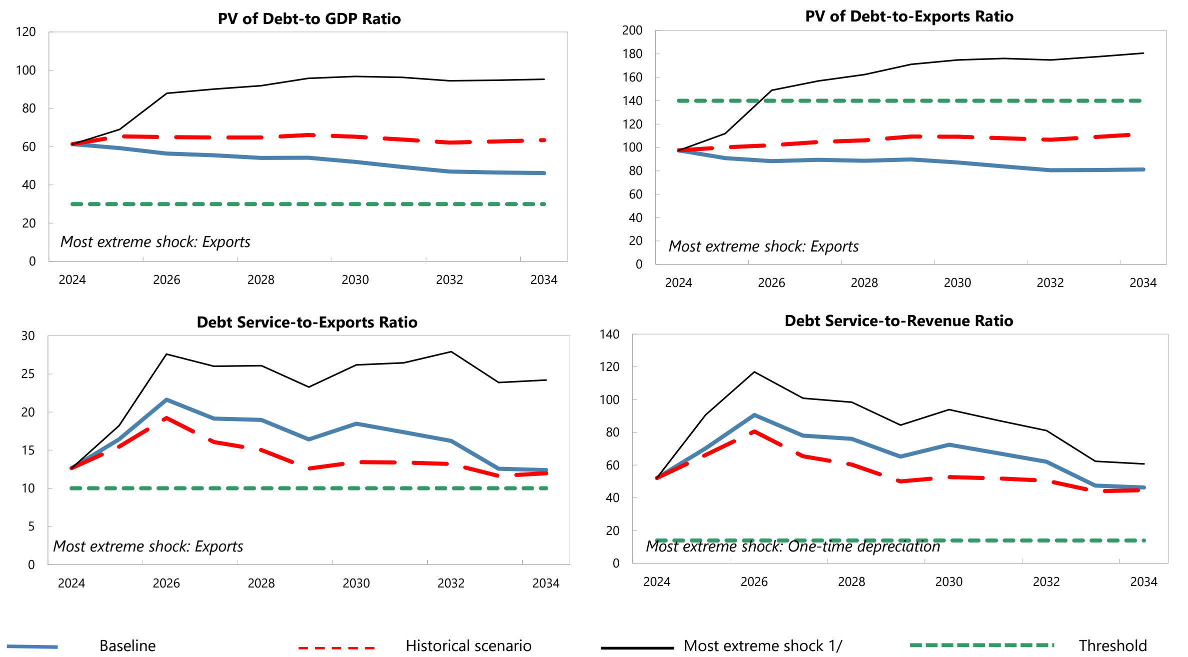
Public sector debt 1/





Sources: Country authorities; and staff estimates and projections.
1/ Coverage of debt: The central government, government-guaranteed debt . Definition of external debt is Currency-based.
2/ The underlying PV of external debt-to-GDP ratio under the public DSA differs from the external DSA with the size of differences depending on exchange rates projections.
3/ Debt service is defined as the sum of interest and amortization of medium and long-term, and short-term debt.
4/ 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 and other debt creating/reducing flows.
5/ Defined as a primary deficit minus a change in the public debt-to-GDP ratio ((-): a primary surplus), which would stabilizes the debt ratio only in the year in question.
6/ Historical averages are generally derived over the past 10 years, subject to data availability, whereas projections averages are over the first year of projection and the next 10 years.

Figure 1. Indicators Of Public And Publicly Guaranteed External Debt Under Alternative Scenarios, 2024–2034



Customization of Default Settings		
	Size	Interactions
Tailored Stress		
Combined CL	Yes	
Natural disaster	Yes	No
Commodity price 2/	n.a.	n.a.
Market financing	No	No

Note: "Yes" indicates any change to the size or interactions of the default settings for the stress tests. "n.a." indicates that the stress test does not apply.

Borrowing assumptions on additional financing needs resulting from the stress tests*		
	Default	User defined
Shares of marginal debt		
External PPG MLT debt	100%	
Terms of marginal debt		
Avg. nominal interest rate on new borrowing in USD	4.1%	5.0%
USD Discount rate	5.0%	5.0%
Avg. maturity (incl. grace period)	18	20
Avg. grace period	4	5

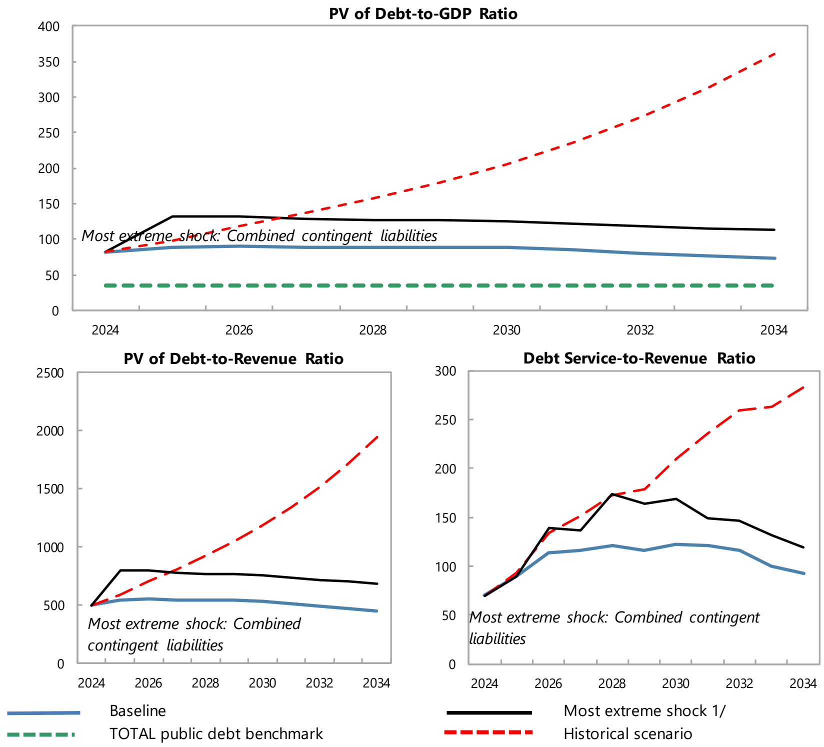
* Note: All the additional financing needs generated by the shocks under the stress tests are assumed to be covered by PPG external MLT debt in the external DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

2/ The magnitude of shocks used for the commodity price shock stress test are based on the commodity prices outlook prepared by the IMF research department.

Figure 2. Indicators Of Public Debt Under Alternative Scenarios, 2024–2034



Borrowing assumptions on additional financing needs resulting from the stress tests*	Default	User defined
Shares of marginal debt		
External PPG medium and long-term	29%	20%
Domestic medium and long-term	43%	79%
Domestic short-term	29%	1%
Terms of marginal debt		
External MLT debt		
Avg. nominal interest rate on new borrowing in USD	4.1%	4.1%
Avg. maturity (incl. grace period)	18	18
Avg. grace period	4	4
Domestic MLT debt		
Avg. real interest rate on new borrowing	-9.1%	-9.1%
Avg. maturity (incl. grace period)	5	5
Avg. grace period	2	2
Domestic short-term debt		
Avg. real interest rate	-12.1%	-12.1%

* Note: The public DSA allows for domestic financing to cover the additional financing needs generated by the shocks under the stress tests in the public DSA. Default terms of marginal debt are based on baseline 10-year projections.

Sources: Country authorities; and staff estimates and projections.

1/ The most extreme stress test is the test that yields the highest ratio in or before 2034. The stress test with a one-off breach is also presented (if any), while the one-off breach is deemed away for mechanical signals. When a stress test with a one-off breach happens to be the most exterme shock even after disregarding the one-off breach, only that stress test (with a one-off breach) would be presented.

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2024–2034

(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of debt-to GDP ratio											
Baseline	**61**	**59**	**56**	**55**	**54**	**54**	**52**	**49**	**47**	**47**	**46**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	**61**	**65**	**65**	**65**	**65**	**66**	**65**	**64**	**62**	**63**	**63**
B. Bound Tests											
B1. Real GDP growth	**61**	**62**	**62**	**61**	**59**	**59**	**57**	**54**	**51**	**51**	**51**
B2. Primary balance	**61**	**61**	**61**	**60**	**60**	**61**	**59**	**57**	**55**	**54**	**54**
B3. Exports	**61**	**69**	**88**	**90**	**92**	**96**	**97**	**96**	**94**	**95**	**95**
B4. Other flows 3/	**61**	**62**	**63**	**63**	**63**	**64**	**63**	**61**	**59**	**59**	**59**
B5. Depreciation	**61**	**77**	**74**	**72**	**71**	**71**	**68**	**65**	**62**	**61**	**61**
B6. Combination of B1-B5	**61**	**65**	**67**	**67**	**67**	**69**	**68**	**66**	**64**	**63**	**63**
C. Tailored Tests											
C1. Combined contingent liabilities	**61**	**67**	**66**	**66**	**68**	**70**	**70**	**69**	**69**	**70**	**71**
C2. Natural disaster	**61**	**61**	**58**	**57**	**56**	**56**	**54**	**52**	**50**	**50**	**49**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**61**	**67**	**64**	**60**	**59**	**59**	**56**	**53**	**50**	**49**	**49**
Threshold	30	30	30	30	30	30	30	30	30	30	30
PV of debt-to-exports ratio											
Baseline	97	91	88	89	89	90	46	38	32	27	23
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	97	100	102	105	106	109	58	48	42	37	32
B. Bound Tests											
B1. Real GDP growth	97	91	88	89	89	90	46	38	32	27	23
B2. Primary balance	97	93	95	97	97	100	52	43	37	32	27
B3. Exports	97	112	**149**	**157**	**162**	**171**	92	79	68	60	52
B4. Other flows 3/	97	96	99	102	103	106	56	46	40	34	30
B5. Depreciation	97	91	89	91	90	91	47	38	32	28	24
B6. Combination of B1-B5	97	104	101	116	118	122	64	54	46	40	34
C. Tailored Tests											
C1. Combined contingent liabilities	97	103	103	107	111	116	62	53	46	41	36
C2. Natural disaster	97	95	93	94	94	95	49	40	34	30	25
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	97	91	88	86	85	86	44	36	30	26	22
Threshold	140	140	140	140	140	140	140	140	140	140	140
Debt service-to-exports ratio											
Baseline	**13**	**16**	**22**	**19**	**19**	**16**	10	8	6	4	4
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	**13**	**15**	**19**	**16**	**15**	**13**	7	6	5	4	3
B. Bound Tests											
B1. Real GDP growth	**13**	**16**	**22**	**19**	**19**	**16**	10	8	6	4	4
B2. Primary balance	**13**	**16**	**22**	**20**	**19**	**17**	**10**	8	7	5	4
B3. Exports	**13**	**18**	**28**	**26**	**26**	**23**	**14**	**12**	**11**	8	7
B4. Other flows 3/	**13**	**16**	**22**	**20**	**20**	**17**	**10**	8	7	5	4
B5. Depreciation	**13**	**16**	**22**	**19**	**19**	**16**	10	8	6	4	4
B6. Combination of B1-B5	**13**	**17**	**25**	**22**	**22**	**19**	**11**	10	8	6	5
C. Tailored Tests											
C1. Combined contingent liabilities	**13**	**16**	**22**	**20**	**20**	**17**	**10**	8	7	5	4
C2. Natural disaster	**13**	**17**	**22**	**20**	**20**	**17**	**10**	8	7	4	4
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**13**	**16**	**25**	**22**	**18**	**13**	10	8	6	4	3
Threshold	10	10	10	10	10	10	10	10	10	10	10
Debt service-to-revenue ratio											
Baseline	**52**	**70**	**91**	**78**	**76**	**65**	**72**	**67**	**62**	**48**	**46**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	**52**	**66**	**81**	**65**	**60**	**50**	**53**	**52**	**51**	**44**	**45**
B. Bound Tests											
B1. Real GDP growth	**52**	**74**	**99**	**85**	**83**	**71**	**79**	**74**	**68**	**52**	**51**
B2. Primary balance	**52**	**70**	**91**	**80**	**78**	**68**	**76**	**72**	**67**	**53**	**52**
B3. Exports	**52**	**74**	**107**	**98**	**97**	**86**	**95**	**95**	**99**	**84**	**84**
B4. Other flows 3/	**52**	**70**	**92**	**80**	**79**	**68**	**76**	**73**	**70**	**56**	**55**
B5. Depreciation	**52**	**91**	**117**	**101**	**98**	**84**	**94**	**87**	**81**	**62**	**61**
B6. Combination of B1-B5	**52**	**71**	**96**	**85**	**83**	**72**	**80**	**78**	**75**	**60**	**59**
C. Tailored Tests											
C1. Combined contingent liabilities	**52**	**70**	**93**	**81**	**80**	**69**	**77**	**73**	**68**	**54**	**53**
C2. Natural disaster	**52**	**70**	**91**	**78**	**76**	**66**	**73**	**68**	**63**	**48**	**47**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**52**	**70**	**103**	**91**	**73**	**52**	**72**	**67**	**61**	**47**	**45**
Threshold	14	14	14	14	14	14	14	14	14	14	14

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the threshold.
2/ Variables include real GDP growth, GDP deflator (in U.S. dollar terms), non-interest current account in percent of GDP, and non-debt creating flows.
3/ Includes official and private transfers and FDI.

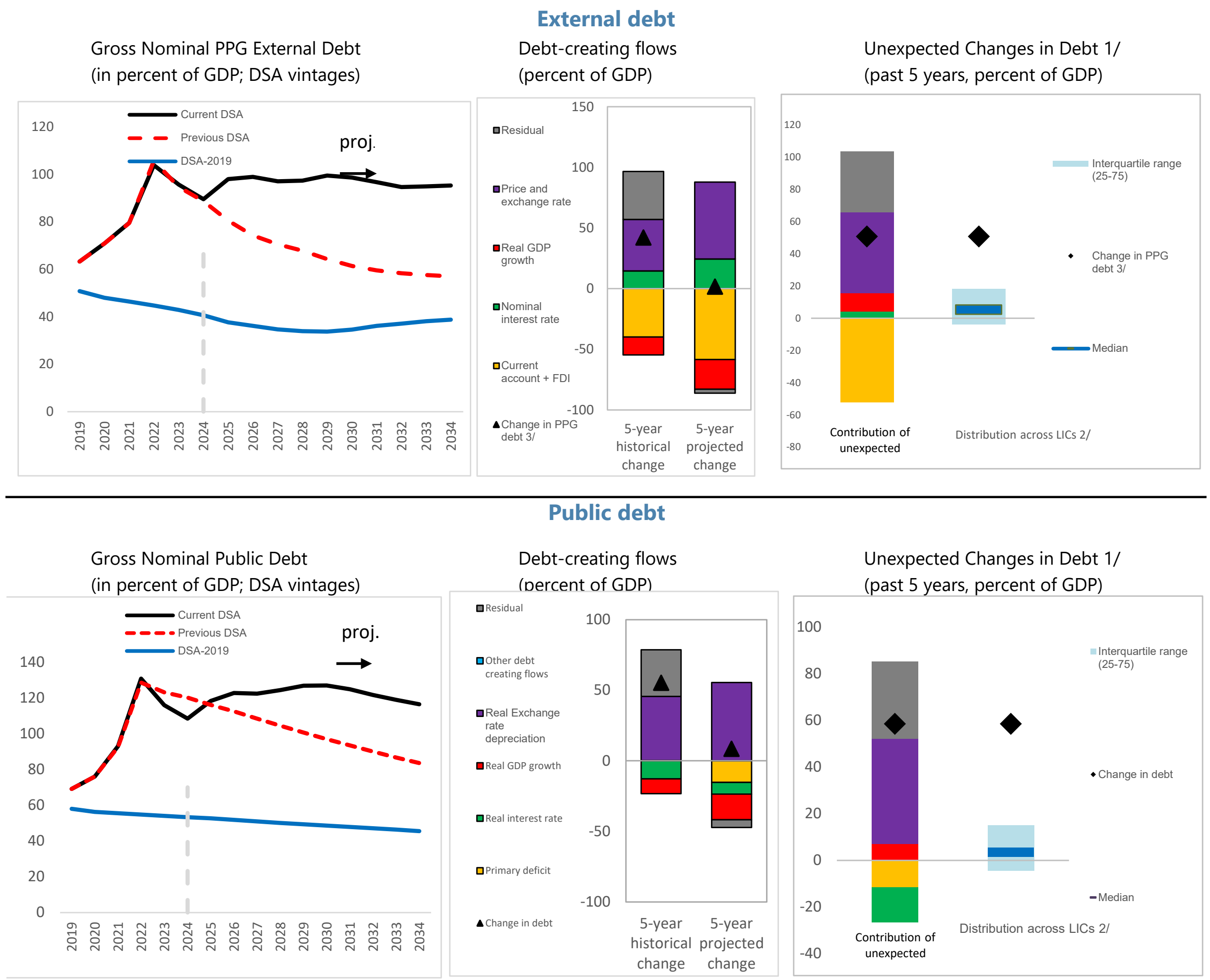
Table 4. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public Debt, 2024–2034

(In percent)

	Projections 1/										
	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034
PV of Debt-to-GDP Ratio											
Baseline	**83**	**89**	**91**	**89**	**89**	**89**	**88**	**85**	**81**	**77**	**74**
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	**83**	**98**	**118**	**137**	**157**	**180**	**206**	**236**	**271**	**312**	**361**
B. Bound Tests											
B1. Real GDP growth	**83**	**93**	**101**	**100**	**101**	**102**	**102**	**100**	**96**	**93**	**91**
B2. Primary balance	**83**	**96**	**107**	**105**	**104**	**105**	**103**	**100**	**96**	**92**	**89**
B3. Exports	**83**	**97**	**115**	**115**	**118**	**122**	**124**	**124**	**121**	**118**	**116**
B4. Other flows 3/	**83**	**93**	**99**	**98**	**99**	**101**	**100**	**98**	**94**	**91**	**88**
B5. Depreciation	**83**	**85**	**87**	**84**	**83**	**83**	**80**	**76**	**72**	**67**	**63**
B6. Combination of B1-B5	**83**	**93**	**103**	**102**	**103**	**105**	**104**	**103**	**100**	**97**	**96**
C. Tailored Tests											
C1. Combined contingent liabilities	**83**	**132**	**132**	**128**	**127**	**127**	**125**	**122**	**119**	**116**	**114**
C2. Natural disaster	**83**	**94**	**96**	**94**	**94**	**94**	**93**	**90**	**86**	**83**	**80**
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	**83**	**89**	**91**	**87**	**87**	**87**	**85**	**82**	**78**	**74**	**71**
TOTAL public debt benchmark	35	35	35	35	35	35	35	35	35	35	35
PV of Debt-to-Revenue Ratio											
Baseline	500	539	550	540	539	541	532	512	489	467	448
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	500	592	707	807	920	1,044	1,183	1,340	1,516	1,714	1,948
B. Bound Tests											
B1. Real GDP growth	500	563	605	601	607	615	612	598	579	561	547
B2. Primary balance	500	583	647	634	632	633	624	605	581	559	540
B3. Exports	500	584	693	698	716	740	752	748	730	714	699
B4. Other flows 3/	500	561	599	594	600	609	607	593	571	551	533
B5. Depreciation	500	520	527	512	507	503	489	465	437	410	386
B6. Combination of B1-B5	500	561	623	617	624	633	632	621	604	590	579
C. Tailored Tests											
C1. Combined contingent liabilities	500	796	796	775	768	767	758	740	718	701	687
C2. Natural disaster	500	565	577	567	567	570	562	543	521	500	482
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	500	539	551	526	525	525	515	495	471	449	429
Debt Service-to-Revenue Ratio											
Baseline	70	90	114	116	121	117	123	121	116	101	93
A. Alternative Scenarios											
A1. Key variables at their historical averages in 2024-2034 2/	70	94	134	152	172	179	210	235	259	263	283
B. Bound Tests											
B1. Real GDP growth	70	93	124	126	133	129	138	138	133	117	110
B2. Primary balance	70	90	119	126	135	136	143	139	131	116	109
B3. Exports	70	90	116	123	129	125	132	135	138	124	117
B4. Other flows 3/	70	90	115	119	124	119	126	127	124	109	101
B5. Depreciation	70	86	113	113	117	112	118	116	111	95	87
B6. Combination of B1-B5	70	88	116	123	128	128	135	132	126	111	103
C. Tailored Tests											
C1. Combined contingent liabilities	70	90	139	137	173	164	169	149	146	132	120
C2. Natural disaster	70	91	118	120	127	122	129	126	121	106	97
C3. Commodity price	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.
C4. Market Financing	70	90	125	128	118	104	122	121	116	100	92

Sources: Country authorities; and staff estimates and projections.
1/ A bold value indicates a breach of the benchmark.
2/ Variables include real GDP growth, GDP deflator and primary deficit in percent of GDP.
3/ Includes official and private transfers and FDI.

Figure 3. Drivers of Debt Dynamics—Baseline Scenario



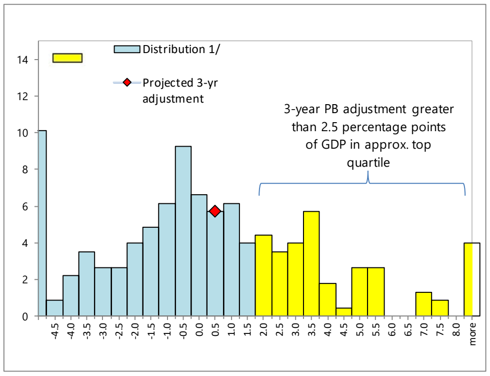
1/ Difference between anticipated and actual contributions on debt ratios.

2/ Distribution across LICs for which LIC DSAs were produced.

3/ Given the relatively low private external debt for average low-income countries, a ppt change in PPG external debt should be largely explained by the drivers of the external debt dynamics equation.

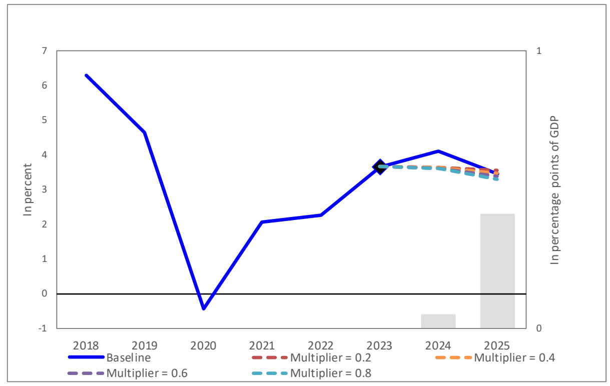
Figure 4. Realism Tools [1/]

3-Year Adjustment in Primary Balance
(Percentage points of GDP)



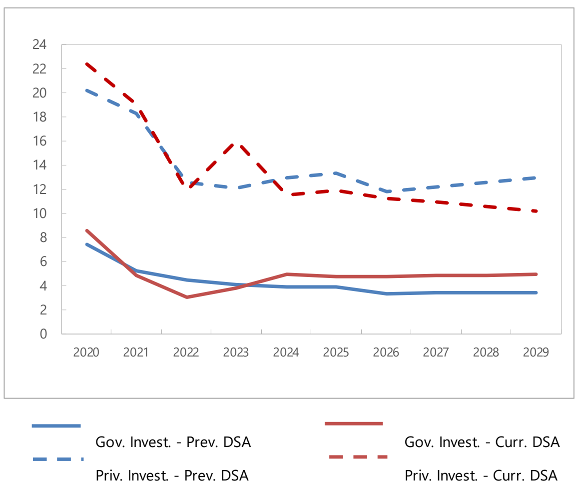
1/ Data cover Fund-supported programs for LICs (excluding emergency financing) approved since 1990. The size of 3-year adjustment from program inception is found on the horizontal axis; the percent of sample is found on the vertical axis.

Fiscal Adjustment and Possible Growth Paths 1/



1/ Bars refer to annual projected fiscal adjustment (right-hand side scale) and lines show possible real GDP growth paths under different fiscal multipliers (left-hand side scale).

Public and Private Investment Rates
(percent of GDP)

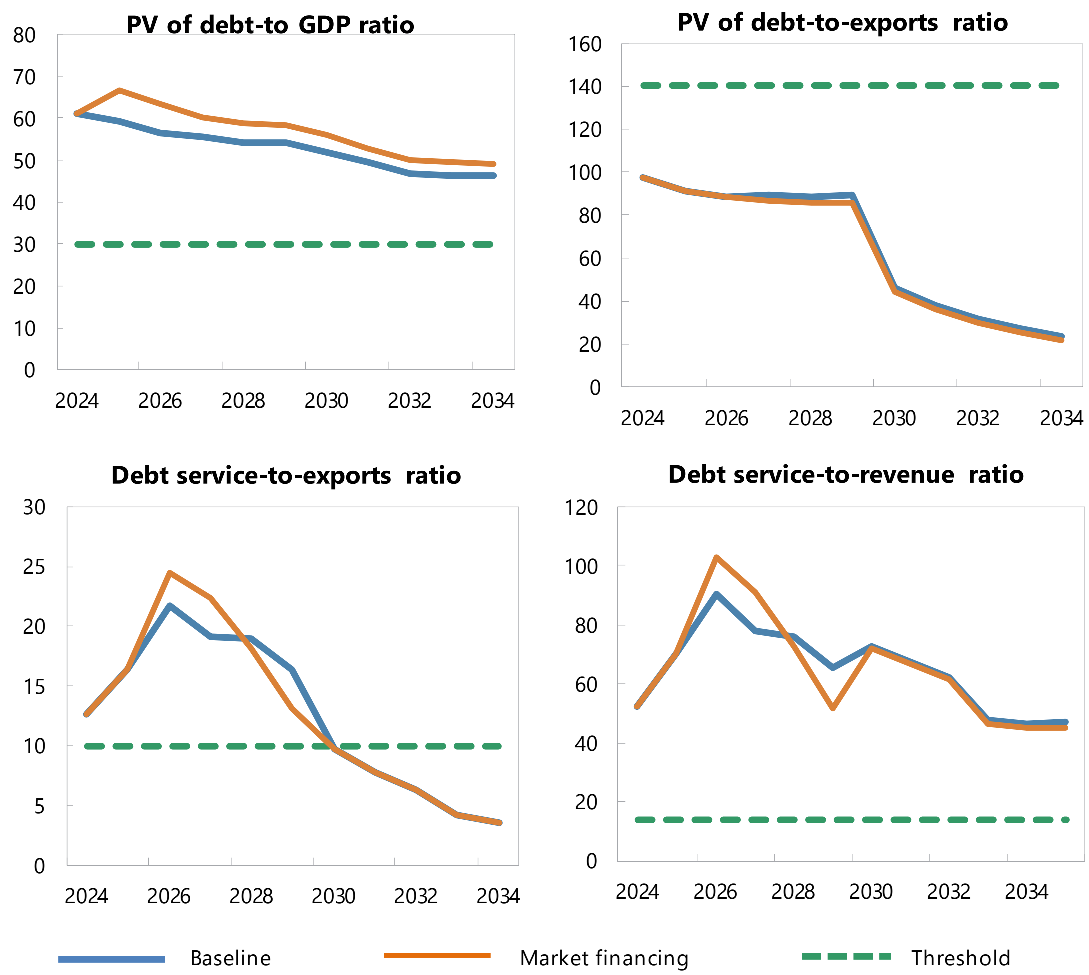


[1/] The data needed to conduct the investment growth tool is not available for the DSA exercise.

Figure 5. Market Financing Risk Indicators

	GFN	1/	EMBI	2/
Benchmarks	14		570	
Values	16		n.a.	
Breach of benchmark	Yes		n.a.	
Potential heightened liquidity needs	Moderate			

1/ Maximum gross financing needs (GFN) over 3-year baseline projection horizon.
2/ EMBI spreads correspond to the latest available data.



Sources: Country authorities; and staff estimates and projections.

Statement by Ms. Yati Kurniati, Executive Director for Lao People's Democratic Republic, Mr. Raja Anwar, Alternate Executive Director, and Ms. Bounchanthaphone Philavong, Advisor to Executive Director

November 4, 2024

INTRODUCTION

1. On behalf of the Lao authorities, we would like to convey our appreciation to Mr. Alasdair Scott and his team for the candid and close engagement during the 2024 Article IV consultation. We take note of the analysis and policy recommendations presented to address the economic challenges. The authorities are confronting the challenges through a pragmatic blend of policies and actively working to bolster longer-term growth prospects. At the same time, the authorities are committed to preserving the sustainability of public finances and managing the risks to monetary and financial stability.

RECENT ECONOMIC DEVELOPMENT AND OUTLOOK

2. The Lao economy has demonstrated a steady recovery trajectory from the significant impacts of the COVID-19 pandemic. In 2023, the Lao economy expanded by 3.7 percent, reflecting a firm recovery. This positive trend persisted into 2024, indicating potential for further improvement. Key sectors driving this growth include construction, retail, agriculture, industry, and services, which are expected to continue fueling economic expansion. Looking ahead, the Lao government is committed to enhancing growth through various policies and reforms. These efforts are aligned with the 9th National Socio-Economic Development Plan (NSEDP) for 2021-2025, aimed at addressing both global and national challenges while promoting sustainable growth.

3. Inflation in Lao PDR has shown signs of improvement and is on a declining trajectory. By September 2024, the inflation rate had decreased to 21.74 percent from its peak of 41.26 percent in February 2023. This decline suggests that the measures taken to control inflation including the tightening of monetary policy and controlling money supply are taking effect. However, inflation remains elevated, suggesting further efforts are needed to stabilize prices. Looking ahead, the authorities recognize the external uncertainties, including exchange rate volatility of major currencies and challenges posed by global monetary tightening. Heavy reliance on imports exposes the economy to external shocks and price fluctuations. The authorities are committed to bring inflation down further. Future projections are cautiously optimistic, with expectations that inflation will fall to single digit by 2025. This outlook is conditioned on the continued effectiveness of current policies, particularly in alleviating exchange rate pressures. The

authorities are closely monitoring developments and are prepared to respond proactively to sustain the downward trend in inflation.

MACROECONOMIC POLICIES

4. Efforts to tackle various challenges confronting the economy are supported by robust macroeconomic policies. These policies include measures to ensure fiscal sustainability, manage public debt, stabilize the currency, lower inflation, and enhance structural reforms.

Fiscal Policy and Debt Management.

5. The authorities have maintained a tight fiscal stance, supported by expenditure cuts, and enhanced revenue collection. This resulted in a primary surplus of 2.7 percent of GDP in 2023, driven by an expanded tax base, including reinstatement of the VAT rate and increases in excise taxes. The primary surplus is projected to continue, reaching 3.1 percent of GDP by 2025.

6. Given the elevated public debt and persistent fiscal difficulties, the authorities have outlined a comprehensive plan and reform strategies Together with fiscal consolidation policies, the aim is to enhance revenue collection to reach 20% of GDP and limit expenditure to not exceed 20% of GDP for 2024-2026. On the revenue side, the authorities enhance the budget structure by diversifying revenue streams, broadening the tax base, and restricting exemptions that fall outside regulatory frameworks. On the expenditure side, comprehensive reforms will be implemented, focusing on increasing public investment, reducing current expenditures, and adjusting civil servants' salaries to reflect the prevailing economic conditions. Comprehensive reforms of state-owned enterprises (SOEs), promotion of joint ventures, increasing government shares in economic projects, and withdrawal from unprofitable projects could redirect additional revenue towards economic development.

7. On public debt management, government is highly committed to improve overall public and publicly guaranteed debt status aiming to decrease the debt-to-GDP ratio in medium term, especially by balancing repayment obligations using nonborrowing sources and new disbursements with an objective to limit new debt accumulation or reduce outstanding external public debt further. In addition, the government also has a concrete financing plan involving (1) utilizing at least 50 percent from surplus revenue as a 1.7 percent of GDP in 2025; (2) collecting approximately US$ 200 million from the return on SOE's on lending and (3) the partial sale of hydroelectricity general assets, with receipts expected to cover short term public obligations. An agreement has been signed with a foreign partner, which has shown their commitment through an initial financial contribution in the first half of 2024. Additionally, the authorities are actively negotiating with bilateral and commercial creditors for debt restructuring. These negotiations are expected to alleviate debt repayment obligations, provide more fiscal space for debt

management, and allocate resources to other priority sectors. Consequently, contrary to staff assessment of debt being in distress and unsustainable, the authorities maintain that its debt obligations remain manageable and anticipate a gradual improvement in public debt over the medium to long term.

Monetary Policy

8. The authorities have reservation about staff projections for 2026-2029 inflation, which suggest excessively loose monetary conditions. The BOL has been progressively tightening its monetary policy stance including gradually increasing the policy rate, strengthening monetary policy transmission, raising reserve requirements and issuing the BOL bonds. The policy rate for short-term Lao kip instruments (with maturities not exceeding 7 days) increased from 8.5% in March 2024 to 10% in June 2024, and further to 10.5% in August 2024. Since June 2024, the policy rate has served as an anchor for other interest rates, aiming to align interbank market rates with the policy rate. This has quickly impacted interbank market rates (an increase from 5% to 12%), banks' deposit rates (an increase of 5-6 percentage points for deposits of up to 1-year and longer), and lending rates (an increase in base lending rate by 1-3 percentage points), albeit with some lags, and contributed somewhat to kip exchange rate appreciation, which rose 11% since the change in framework. Monetary aggregates, particularly the expansion of M2 has continued to be at a slower pace. Deposit mobilization has sustained growth, and credit supply within the banking system has shown signs of recovery following the disruptions caused by the COVID-19 pandemic. These adjustments are referred to the team's recommendations and correspondent with the advisors during the Technical Assistance mission for the Lao PDR. The BOL also raised the reserve ratio for foreign currency deposits from 10% to 11% at the end of August 2024 to minimize the foreign currency lending as well as updated the obligation which requires banks to hold 50% of reserves in cash, reducing the portion held in low-risk securities from 70% to 50%. As result of these policies and efforts, the authorities anticipate that the inflation rate will revert to a single digit by the end of 2025.

Exchange Rate Policy.

9. The mission team assessed that the authorities maintain two exchange rate restrictions inconsistent with Article VIII, as outlined in paragraph 26[1]. In coming up with the assessment, the authorities felt that their views was not adequately taken on board and considered by staff during the recent Article VIII mission. In this context, the authorities emphasized two points.

[1] This includes restrictions arising from **(1)** restrictions on commercial banks' setting of market clearing rate, contributing to the shortage of FX that results in undue delays in accessing FX for current international transactions and priority access for the import of certain strategic goods and **(2)** the requirement to provide a tax clearance certificate – covering taxes unrelated to the underlying transactions – prior to obtaining FX for certain current international transactions.

10. First, the current exchange rate regime has been maintained for a long period of time[2], while the gap between commercial and parallel exchange rates has fluctuated depending on economic conditions and the demand and supply balance of foreign currencies in the banking system. Hence, it is not a new or temporary balance of payment measure but rather a means to achieve monetary stability. The BOL is however open to phase out the requirement to provide a tax clearance certificate as it is a measure to support tax compliance.

11. Second, while closing the gap is desirable, it is challenging to pursue a unified exchange rate given shocks from global oil price increases in the wake of geopolitical tensions, US dollar strength, and high public and private external debt payment obligations, which has driven the sharp demand for foreign exchange (FX) and significant movement of the parallel rate. Given the limited international reserves, allowing the exchange rate of commercial banks to follow the parallel rate risks compounding downward pressure on the Lao kip. To address this issue, authorities maintained a managed floating exchange rate aligned with a flexible approach for commercial banks by setting their daily rate with a widened trading band relative to the daily reference rate. In June 2023, they increased it from ±4.5% to ±7.5% to narrow the gap between the market rate and the official rate. This was followed by a further adjustment in September 2024, when the reference rate band was reduced from ±7.5% to ±7%, resulting in a significant decrease in the gap from 2 digits to only one digit (1.6% as of 11 October), since September 2024. Moreover, BOL's new operational framework (7-day BOL bills) has had the desired effect on market liquidity, contributing to the exchange rate appreciation. Recently, the BOL has introduced an electronic foreign exchange trading platform or the Lao Foreign Exchange (LFX) which provides an avenue for residents to directly conduct FX trade via banks' mobile app. This has helped ease demand pressure in FX, supporting the narrowing of the gap between official and parallel market exchange rates.

12. Further, staff assessed the newly implemented FX conversion requirements[3] constitutes an outflow Capital Flow Measures (CFMs) under the IMF's Institutional View on the Liberalization and Management of Capital Flows, as outlined in paragraph 27. The authorities emphasize that the mandatory conversion of FX proceeds, a practice common in many countries, aims at addressing structural issues by ensuring foreign exchange earnings from Lao's exports are available as part of liquidity in the banking system to meet FX domestic demand, thereby contributing to currency stability. The BOL has set a minimal FX conversion rate that aligns with

[2] the current exchange rate regime has been in place since 2003.

[3] This includes the requirement (i) exporters sell foreign exchange from repatriated export proceeds to commercial banks, and (ii) commercial banks sell a portion of this foreign exchange to the Bank of Laos (BOL).

exporters' domestic use of the Lao kip, making it feasible for many businesses to comply and avoid disruptions to exporters' activities. The BOL will continue to periodically review these policy measures to ensure a stable monetary environment.

13. The authorities emphasize the need for the Fund to be constructive in the spirit of the integrated policy framework. Against a very challenging backdrop, the Fund should provide space for policymakers to take measured responses to manage risks to the economy and financial system.

Financial Sector Policies.

14. The banking system continues to demonstrate resilience and is well-capitalized. Despite a capital shortfall in some banks, including a state-owned bank, the BOL has formulated a concrete plan to bolster capital, which has been submitted to the government for approval. By the first quarter of 2024, the return on equity and return on assets reached 21.49 percent and 1.7 percent from 11.11 percent and 0.89 percent in the first quarter of 2023, respectively, while Non Performing Loans (NPLs) were maintained at a low 1.68 percent. Additionally, the Capital Adequacy Ratio (CAR) stood at a robust 18.20 percent as of July 2024 Despite some short-term challenges with foreign exchange liquidity, the issues are manageable, and recent measures are expected to alleviate the current pressures.

15. The BOL is continuously improving the prudential management of the banking sector. This includes developing and refining supervisory regulations and tools, notably transitioning from a regulatory-based supervision model to a risk-based supervision approach that aligns more closely with international standards. The newly amended law on bank supervision, which came into effect in August 2023 further strengthened the framework for banking oversight. This law enhances the BOL's ability to adapt to changes in the economic environment, ensuring that the banking system remains robust and resilient in the face of evolving challenges.

16. The AML/CFT framework has been enhanced, including adoption of the amended law on AML/CFT in July 2024 by the national assembly. The authorities have also completed part of the second Mutual Evaluation Assessment by the Asia/Pacific Group on Money Laundering (APG) and are implementing the recommendations outlined in the APG's July 2023 Mutual Evaluation Report (MER). By 2024, the authorities aim to accomplish the amendment of 17 relevant legislations including 1 law, 5 decisions, 3 guidance, 1 regulation and 7 instructions.

Structural reforms.

17. The authorities emphasize that structural reforms are crucial for advancing the inclusive economic growth agenda and fostering resilience. They acknowledge the pivotal role of the private sector as a growth engine and are committed to reducing the regulatory burden on small businesses, ensuring consistent and transparent tax and regulatory implementation, increasing business registration and labor formalization, and enhancing educational attainment and skills training. To address these priorities, the government is enacting policy measures under the 9th National Socio-Economic Development Plan (NSEDP). These measures include improving trade facilitation to lower the regulatory burden and trade costs, creating a competitive environment for micro, small, and medium-sized enterprises (MSMEs), and developing human resources and workforce skills to boost labor productivity.

18. The authorities also recognize the importance of reforms to strengthen governance as a vital step toward improving the business environment. The Fund's assistance would be valuable in helping to close gaps in this area.

CONCLUSION

19. Following the preliminary assessment provided to the authorities at the conclusion of the mission and after several follow up discussions, we note several critical areas where the views and explanations of the Lao authorities have not been fully taken on by staff. We acknowledge that differences in views between staff and authorities are a common aspect of Article IV consultations. However, in presenting points of view, it is essential to manage the tone carefully. The staff report is an important public point of reference. As such, it should maintain the objectivity of assessments and provide constructive recommendations for plausible and practical improvements, while taking care to avoid overly discouraging or negative tone as this may risk unintended adverse market reaction.

20. The authorities will remain vigilant against risks from global and domestic developments and committed to maintaining macroeconomic and financial stability. The authorities stand ready to deploy appropriate policies as necessary, commensurate with the risks being managed and carefully considering the policy trade-offs. They kindly ask for the executive board's support as they navigate through these challenging times.

21. Our authorities look forward to continued engagements and collaboration with the Fund, including on capacity development. In this regard, a number of programs are underway in different areas, such as strengthening public financial management, modernizing monetary governance, strengthening bank supervision, and enhancing external sector statistics. The authorities are in the process of requesting additional TA to improve their capacity in foreign exchange management.