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Lao People's Democratic Republic—Staff Report; Staff Supplement; Public Information Notice on the Executive Board Discussion; and Statement by the Executive Director for Lao P.D.R.

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 2011 Article IV consultation with Lao People's Democratic Republic, the following documents have been released and are included in this package:

- The staff report for the 2011 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on May 24, 2011, with the officials of Lao P.D.R. on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on June 22, 2011. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.

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

- A Public Information Notice (PIN).

- A statement by the Executive Director for Lao P.D.R.

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

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INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2011 Article IV Consultation[1]

Prepared by the Asia Pacific Department in Consultation with Other Departments

Approved by Masato Miyazaki and Dominique Desruelle

June 22, 2011

Key Issues and Recommendations:

Macroeconomic situation: The Lao P.D.R. economy performed well in 2010. Fiscal and monetary policy were tightened but both remained accommodative. Inflation has picked up and the rapid expansion of domestic demand is still putting pressure on the balance of payments.

Outlook: The outlook for growth in 2011 is favorable but inflation is projected to rise further.

Medium-term prospects: Given the pipeline of large hydropower and mining projects, the authorities' objective to graduate from low-income country (LIC) status by 2020 looks achievable but a strengthening of macroeconomic policy frameworks is needed to mitigate risks to macroeconomic and financial stability.

Focus of the discussion: (i) the need to tighten macroeconomic policies in the near term to address potential pressures on the external position and ensure inflation remains contained; and (ii) the agenda to upgrade the broader framework for macroeconomic policy making and financial sector supervision as Lao P.D.R. pursues its ambitious development objectives.

Fiscal policy: The nonmining fiscal deficit should be kept on a declining path supported by sustained efforts to raise nonresource revenue to ensure that all elements of society contribute their fair share to the funding of Lao P.D.R.'s development and that adequate fiscal space is created for pro-poor spending. Public external debt management needs urgent strengthening.

Monetary and exchange rate policy: The Bank of Lao P.D.R. (BoL) should strengthen its monetary policy framework in order to effectively tighten monetary policy with a view to help sustain the stabilized exchange rate regime which remains the appropriate monetary anchor.

Supporting frameworks: The financial sector supervision framework needs to be strengthened starting with the regular compilation and monitoring of financial soundness indicators. The quality and availability of macroeconomic statistics needs to be upgraded building on the recent adoption of the new Statistics Law.

[1] Discussions were held in Vientiane during May 11–24, 2011. The staff team comprised Mr. Almekinders (head), Mr. Ree, Ms. Yang, and Mr. Vichyanond (all APD). It was assisted by Mr. Bingham (Senior Resident Representative) and Ms. Nga (economist in the IMF's Hanoi office). Ms. Budiman and Mr. Thamnuvong (both OED) participated in the meetings.

Contents

I. Recent Economic Developments and Outlook

A. Introduction

1. **Lao P.D.R., historically one of the poorest countries in Asia, has made impressive progress in developing its economy and reducing poverty.** Spearheaded by the development of the mining and hydropower sectors, GDP growth averaged 7 percent per annum over the last decade, among the highest in the region. This helped halve the share of the population below the national poverty line to less than 25 percent. While Lao P.D.R. is on track to reduce extreme poverty by half by 2015, progress on achieving the other millennium development goals (MDGs) has been mixed (Table 6).

2. **The authorities are well aware that graduation from least-developed country status requires more than exceeding the relevant threshold for average per capita income.** Accordingly, they intend to step up efforts to reach the most vulnerable population groups especially in the rural areas and improve their nutrition, health, and education. Policies to reduce the economic vulnerability of the population also need to be drawn up and implemented.

B. Strong Growth Continues

3. **The Lao P.D.R. economy performed well in 2010.** Growth, estimated at 7.9 percent, was buoyed by ongoing projects in the mining and hydropower sectors, as well as a rebound in garment exports, nonregional tourism, and FDI inflows following the recovery from the global economic crisis. Domestic demand, boosted by still sizable stimulus from fiscal and monetary policy, also supported construction and other sectors (Table 1).

4. **However, inflation has picked up and the rapid expansion of domestic demand is still putting pressure on the balance of payments.** Inflation, which had been relatively subdued in recent years rose to 9 percent in April 2011, as the impact of higher international food and fuel prices fed through the economy. Moreover, while significant capital inflows, associated with the two successful IPOs that inaugurated the new stock exchange and capital brought in by foreign banks, helped gross reserves recover to US$727 million (2.5 months of prospective nonresource imports) at end-2010, the core balance of payments—defined as the current account balance net of FDI and ODA—remained in deficit by over 5 percent of GDP, leaving the external position vulnerable to shifts in potentially volatile portfolio capital flows (Table 2).

5. **Fiscal and monetary policy were tightened but both remained accommodative:**

- **The overall fiscal deficit narrowed from 6.9 to 4.8 percent of GDP in FY10** (October 2009–September 2010, Table 3). While this represents an impressive fiscal consolidation, the deficit remains substantially larger than the 2¾ percent of GDP annual average recorded during 2006–08. It should be noted that the overall fiscal deficit is defined as net government borrowing, as per the *Government Finance Statistics Manual 2001*. Revenue rose 1.5 percentage points, to 18.6 percent of GDP.

The introduction of the VAT in January 2010, along with higher royalties and dividends from the hydropower and mining sectors, more than compensated for the slump in corporate income tax/profit tax related to the low international copper prices in 2009. Spending was reduced by 0.7 percentage points, to 23.4 percent of GDP, driven mostly by a reduction in off-budget capital spending.

- **Credit growth decelerated but an accommodative monetary policy resulted in a substantial build up of excess liquidity in the banking system** (Table 4). The growth of credit to the private sector slowed from 88 percent in 2009 to 44 percent in 2010, as the stock of unmet credit demand from 2005–07 when the state-owned commercial banks (SOCBs) were undergoing reorganizations diminished, and the rising system-wide loan-to-deposit ratio became a constraining factor. The BoL also raised its overdraft lending rate by 100 basis points to 5 percent in September 2010. However, net domestic assets (NDA) of the Bank of Lao P.D.R. continued to expand rapidly, as a result of its direct lending activities to local governments, net injections of liquidity into the banking system, and an expansion of other assets. This resulted in a significant build up of excess reserves in the banking system, which could put pressure on the external position going forward.

6. **Steady progress continues to be made on structural reforms.** The stock market started to operate (January 2011), the new Statistics Law was adopted (mid-2010), and the implementation decree for the new Investment Promotion Law was approved. The latter law is WTO-compliant and provides for a level playing field for domestic and foreign investors.

C. Outlook and Risks

Staff's views

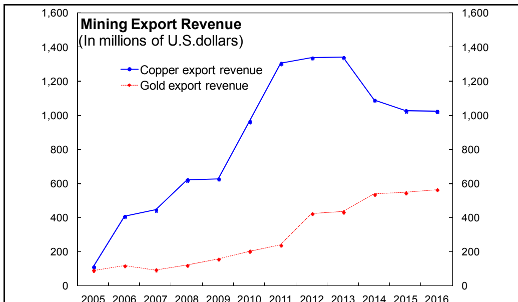
7. **The outlook for GDP growth in 2011 is favorable but inflation is projected to rise further:**

- **Growth is projected to rise to 8.3 percent**, supported by a continued expansion in the mining and hydropower sectors, growth of nonresource exports and tourism, and continued strong domestic demand. Construction for the massive Hongsa Lignite thermal power plant project started in the third quarter of 2010 (Box 1) and commercial operations of the Nam Theun II hydropower project started in March 2010. The full-year effect of both projects will add to growth in 2011.
- **Inflation could rise to 10 percent by June.** Even with favorable base effects related to last year's spike in prices of sticky rice, inflation is expected to average almost 9 percent for 2011 as a whole. International oil prices have stabilized in recent weeks and the outlook for the rice harvest is good. However, shocks to food and fuel prices could quickly translate into higher inflation. And expansionary macroeconomic policies, by boosting imports and putting pressure on the external position, could make it harder to sustain the stabilized exchange rate regime with the attendant risk of a depreciation of the kip raising the prices of imported goods and hence inflation.

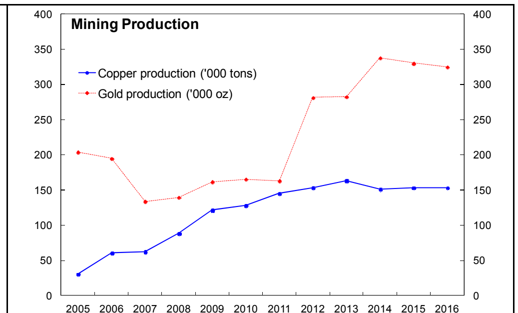
Box 1: The Outlook for the Mining and Hydropower Sectors

Export revenue from copper is projected to exceed US$1.3 billion in 2011, more than double the 2009 level. Based on currently announced plans, the total amount of copper produced by the two main mining companies is projected to peak in 2013 at about 163,000 tons, a 27 percent increase from the 2010 level. However, copper prices have historically been quite volatile and the WEO projects copper prices to soften over the medium term from the early-2011 record levels. On this basis, export revenue from copper is projected to stabilize at US$1 billion over the medium term.

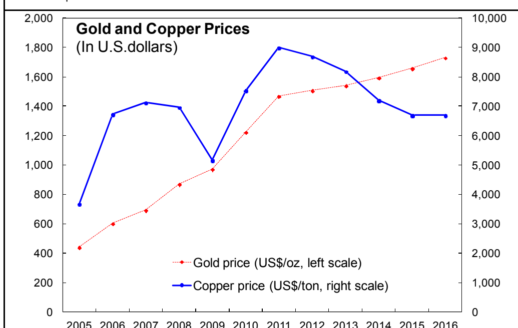
Export revenue from gold is projected to exceed US$0.24 billion in 2011, a 50 percent increase from 2009. As currently announced, the total amount of gold produced by the two main mining companies is projected to peak in 2014 at about 338,000 ounces, a doubling from the 2010 level. Moreover, unlike for copper prices, the WEO projects a continued rise in gold prices over the medium term. On this basis, export revenue from gold is projected to rise to almost US$0.56 billion by 2016.



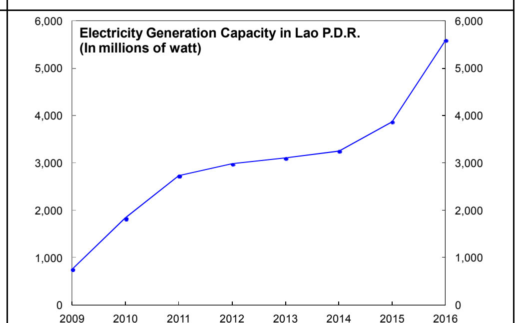
Source: Company reports (www.mmg.com; www.panaust.com); and IMF WEO price forecasts.



Source: Company reports (www.mmg.com; www.panaust.com).



Source: IMF WEO price forecasts.



Source: Electricite du Laos and World Bank.

Lao P.D.R.'s electricity generating capacity doubled when the Nam Theun 2 hydropower project (1,080 MW) commenced operation in March 2010. It is projected to rise further as other hydropower projects, which are currently under construction, are completed and start commercial operations.

Construction of the Hongsa Lignite thermal power plant (1,800 MW) will provide a boost to activity during the construction stage (2010–15) and will raise electricity exports in subsequent years. The total cost of US$3.71 billion (47 percent of 2011 GDP) will be covered on a 75:25 debt-to-equity ratio basis. Debt financing has mostly been raised from Thai commercial banks, while equity will be held by Lao Holding State Enterprise (20 percent) and two Thai power companies.

8. **The external position is projected to strengthen further in 2011.** However, this is dependent on continued strong private capital inflows. While there is some upside potential from further IPOs and the sale by the BoL of the land asset it obtained from Vientiane municipality in late 2010, the increasing reliance on private capital inflows also in the nonresource sectors poses risks to the external position, especially if monetary policy does not address the substantial excess reserves held by commercial banks (Box 2).

9. **Lao P.D.R.'s medium-term prospects are promising.** A pipeline of large hydropower and mining projects, underpinned by record-high copper and gold prices and rapidly rising demand for electricity in neighboring countries, is projected to keep growth broadly in line with the annual average growth target of 8 percent in the 7th five-year plan (2011–15). Activity outside of the mining and hydropower sectors is also projected to remain buoyant, although this would need to be supported by continued reforms to strengthen the foundation of the economy and the business climate. Care will need to be taken that the pursuit of the ambitious growth targets, and the associated target of maintaining investment at 32 percent of GDP, is consistent with the outlook for FDI and concessional funding sources, to avoid risks to macroeconomic and external stability.

10. **However, the implementation of the 7th five-year plan will need to address a number of challenges.** Firstly, ongoing uncertainties in the global economic outlook continue to pose risks. While the outlook for Asia is promising, high oil prices, weak sovereign balance sheets, and continued imbalances in real estate markets could slow the global recovery and have negative spillover effects, both with respect to potential volatility in key commodity prices (copper and gold) and the strength of FDI inflows. Secondly, steps will need to be taken to guard against potential internal risks, notably to macroeconomic and financial stability. As long as the stabilized exchange rate regime remains the monetary anchor, it will be all the more important to maintain appropriately tight macroeconomic policies to preempt potential pressures on the external position and ensure inflation remains contained. And the soundness of the rapidly developing financial sector needs to be safeguarded. Thirdly, achievement of the plan's economic goals will require an improvement in the efficiency of public investment, to ensure that Lao P.D.R. can fund its critical economic and social investments within the existing resource constraints, and the continued implementation of structural reforms to complete the transition to a market economy. Lastly, ongoing reforms to the public financial management will need to be strengthened further—on both the tax and spending side—to ensure that Lao P.D.R.'s resource wealth not only sustains the pace of economic development, but ensures that this economic development results in a generalized improvement in living standards and reduction in poverty.

Authorities' views

11. **The authorities broadly agreed with the staff's assessment of the economic outlook and risks to the outlook.** They expressed a firm commitment to implement the new five-year plan and achieve the ambitious targets it sets. A key objective is to ensure that the

Box 2. Recent Developments in Reserve Money and Banks' Excess Reserves

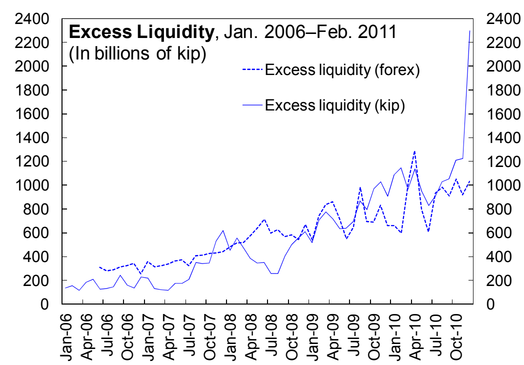
Reserve money doubled over the past two years, as the BoL's quasi-fiscal activities expanded its net domestic assets. On-budget BoL financing of the government was limited, contributing 7 percentage points to the growth of reserve money during 2009 and 2010. To promote the achievement of the government's development objectives outside the budget, the BoL provided some 9 percent of GDP in credit to local governments (kip 3.1 trillion) and to commercial banks and the policy bank (kip 1.4 trillion) over two years. Including the credit to Vientiane municipality which has since been converted into a land asset recorded under "other items (net)" on the BoL's balance sheet, this contributed 95 percentage points to the growth of reserve money during 2009 and 2010. In an attempt to mop up some of the liquidity created by this quasi-fiscal lending, the BoL sold about kip 0.8 trillion in BoL securities to the banks. This made a negative contribution of 17 percentage points to the growth of reserve money during 2009 and 2010.

Lao P.D.R.: Reserve Money, 2008–10

	2008 Dec.	2010 Dec.	2008–10 Change	Contribution to Change
	(In billions of kip)			(In percent of end-08 reserve money)
NFA	5,230	5,133	-98	-2
NDA	-454	4,428	4,882	102
Government (net)	-1,057	-742	316	7
Claims	973	926	-47	-1
Deposits	-2,030	-1,667	363	8
Local governments	685	3,812	3,127	65
Banks	538	1,936	1,398	29
BoL securities	-223	-1,023	-801	-17
Other items (net)	-397	445	843	18
Reserve money	4,776	9,560	4,784	100

Source: Lao P.D.R. authorities.

The counterpart to the rise in reserve money is an increase in commercial banks' excess reserves held with the BoL. Commercial banks in Lao P.D.R. are required to hold unremunerated deposits with the BoL equivalent to 5 percent of their kip-denominated deposit liabilities and 10 percent of their foreign-currency denominated deposit liabilities. In the absence of an interbank market and a treasury bill market, banks hold large excess reserves with the BoL (3½ percent of GDP), which are also not remunerated. Banks appear to do this to self-insure against liquidity shortages and to hold some risk-free assets. The excess liquidity of banks was exacerbated by the successful local-currency denominated IPOs, which triggered the conversion of a substantial amount of foreign currency held offshore. By the end of February 2011, the IPO-ed companies were still holding the bulk of the new funds in the local banking system. However, as they implement their investment plans they can be expected to draw on these funds and cause commercial banks to reduce their excess reserves from the recent peak of more than 5 percent of GDP.



Source: Lao P.D.R. authorities.

country's natural resource wealth generates a sustained improvement in general living standards, including by achieving the MDGs. The five-yearly Party Congress, held in March 2011, vowed to step up the development of human resources, and to strengthen the rule of law and the business climate in the next five years. In this context, the aim is to focus public investment on strengthening the supply side of the economy, reduce reliance on the mining sector, and create more balanced and more pro-poor growth. Other objectives include raising domestic food production and expanding (road) infrastructure to connect producers to markets in order to reduce shortages. The resulting lower transportation costs and increased supply could eventually offset the impact of higher fuel prices.

II. Macroeconomic Policy Discussions

Given Lao P.D.R.'s generous resource endowment, the authorities' objective to graduate from LIC status by 2020 looks achievable, but a strengthening of macroeconomic policy framework is needed to mitigate risks to macroeconomic and financial stability. Overall, the authorities' policy undertakings since the 2010 Article IV consultation have been broadly in line with staff recommendations. The fiscal consolidation and the deceleration of credit growth were both significant. The authorities worked with experts on initial assessments of the anti-money laundering and banking supervision frameworks. And there is an increasing awareness of the need to strengthen the business climate. However, the phasing out of the BoL's quasi-fiscal activities is proceeding slower than expected. Against this background, discussions centered on (i) the need to tighten macroeconomic policies in the near term to address potential pressures on the external position and ensure inflation remains contained; and (ii) the agenda to upgrade the broader framework for managing macroeconomic policies and the financial system as Lao P.D.R. pursues its ambitious development objectives.

A. Fiscal Policy

Background

12. **Fiscal policy remains on a consolidation path.** Government net borrowing is projected to decline from 4.8 to 2.6 percent of GDP in FY11. Revenue is projected to decline by 0.2 percent of GDP as higher mining revenue (1.1 percent of GDP) is more than offset by lower nonresource revenue and lower grants. Expenditure is projected to decline by 2.4 percent of GDP. Implementation of the budget would see expenses decline by 1 percent of GDP. Moreover, net acquisition of nonfinancial assets is projected to decline by 1.4 percent of GDP, driven mostly by lower off-budget capital expenditure financed by the BoL (1 percent of GDP). While appropriate, this fiscal consolidation relies heavily on an increase in mining revenue.

Lao P.D.R.: Medium-Term Fiscal Scenarios, 2010–16

	2010	2011	2012	2013	2014	2015	2016
Baseline scenario (domestic revenue in line with 7th five-year plan)							
Revenue	18.6	18.4	19.4	19.5	19.3	18.6	18.5
Domestic revenue	16.2	16.6	17.7	17.8	17.6	16.9	16.8
Nonresource revenue	13.6	13.0	12.9	13.2	13.3	13.4	13.7
Mining revenue	1.8	2.9	3.8	3.6	3.3	2.4	2.1
Hydropower revenue	0.8	0.7	1.0	1.0	1.0	1.1	1.0
Grants	2.4	1.9	1.7	1.7	1.7	1.7	1.7
Expenditure	23.4	21.0	20.8	21.4	21.1	21.2	21.2
Net lending/borrowing	-4.8	-2.6	-1.4	-1.9	-1.8	-2.6	-2.7
Nonmining balance	-6.6	-5.5	-5.2	-5.6	-5.1	-5.0	-4.8
"Nonresource revenue effort" scenario							
Revenue	18.6	18.4	19.9	20.2	20.4	20.1	20.2
Domestic revenue	16.2	16.6	18.2	18.5	18.7	18.4	18.5
Nonresource revenue	13.6	13.0	13.4	13.9	14.4	14.9	15.4
Mining revenue	1.8	2.9	3.8	3.6	3.3	2.4	2.1
Hydro revenue	0.8	0.7	1.0	1.0	1.0	1.1	1.0
Grants	2.4	1.9	1.7	1.7	1.7	1.7	1.7
Expenditure	23.4	21.0	21.3	21.5	21.8	22.0	22.3
Net lending/borrowing	-4.8	-2.6	-1.4	-1.3	-1.4	-1.9	-2.0
Nonmining balance	-6.6	-5.5	-5.2	-4.9	-4.7	-4.3	-4.1

Source: IMF staff estimates.

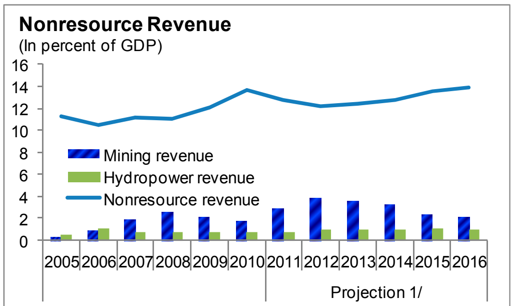
13. **Under current copper and gold price projections, the fiscal framework in the baseline scenario projects the nonmining fiscal deficit to be contained below 5 percent of GDP over the medium term** (previous text table and Box 3). The baseline fiscal scenario projects total domestic revenue (including from the mining sector) at about 17 percent of GDP per annum, broadly in line with the 16–17 percent of GDP target in the 7th five-year

plan. In FY12 and FY13, the overall deficit would narrow to less than 2 percent of GDP, thanks to higher mining revenue. In the baseline scenario, total government expenditure, including any off-budget spending, is maintained at about 21¼ percent of GDP. This would keep public debt, which remains elevated (see below), on a sustainable path.

14. **However, the strong prospects for mining and hydropower revenue could undermine efforts to maintain the momentum in mobilizing nonresource revenue:**

- **Nonresource tax and nontax revenue has strengthened appreciably in recent years.** A new high of 13.6 percent of GDP was achieved in FY10 owing to the introduction of the VAT in January 2010 and the channeling of Road Fund revenues through the budget.

- **The 7th five-year plan includes a target for total domestic revenue of 16–17 percent of GDP.** However, assuming continued strength of international copper prices, resource revenue could reach almost 5 percent of GDP in FY12, implying a near doubling from FY10. In that case, achieving the targets for total domestic revenue would require no further reform efforts. Data for the first half of the fiscal year suggests that nonresource revenue could decline by 0.8 percent of GDP in FY11, suggesting that the revenue effort may already be waning. In fact, except for the VAT, the collection of other nonmining taxes, including nonmining profit tax, excise and import duties, is not keeping up with the expansion of the overall economy.



Source: Lao P.D.R. authorities; and IMF staff projections.
1/ Projections for nonresource revenue implied by the 7th five-year plan given staff's projection of resource revenue (2011–16).

15. **An alternative scenario illustrates the benefits of sustained additional efforts to raise nonresource revenue.** In the "nonresource revenue effort" scenario, nonresource revenue rises to 15½ percent of GDP by FY16, up by almost 2 percentage points of GDP from FY10. This would allow the government to increase expenditure to around 22¼ percent of GDP by FY16 while at the same time reducing the overall and nonmining fiscal balance, and thus to continue the progress being made in developing the country's social and economic infrastructure in a macroeconomically sustainable manner.

16. **There is scope to strengthen the fiscal framework to deal explicitly with increased and volatile resource-related revenues.** Many countries with resource revenues develop such frameworks to address issues typically related to the budget's increasing dependence on natural resources (e.g., tax administration, transparency, and governance; short-term revenue fluctuations; and preservation of some resources for the use of future generations). To help countries manage these challenges, and ensure that countries' natural resource endowments are used productively and their benefits shared equitably, the IMF has

recently launched a "Management of Natural Resources Wealth Topical Trust Fund" (http://www.imf.org/external/np/otm/2010/110110.pdf).

Staff's views

17. **The challenge going forward will be to maintain the process of fiscal consolidation, while reducing the budget's exposure to potentially volatile mining revenues.** One way to do this would be to focus the fiscal policy debate on the path of the nonmining fiscal deficit (Box 3). In this context, a key recommendation would be to gradually bring down the nonmining fiscal balance to less than 5 percent of GDP over the medium term, as illustrated in the baseline scenario. This would imply saving the higher mining and hydropower revenues projected in the next few years, so that the path of expenditure can be smoothed over the medium term to steadily address Lao P.D.R.'s large development needs.

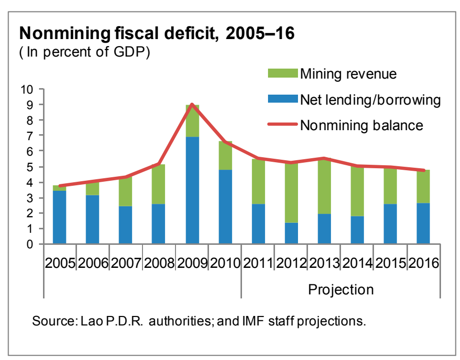
Box 3. The Nonmining Fiscal Balance

In the case of Lao P.D.R., the fiscal consolidation needed to contain pressures on the balance of payments and inflation can best be measured in terms of the reduction in the nonmining fiscal deficit (i.e., the fiscal deficit excluding revenue from mining but including revenue from hydropower):

- In view of their volatility, it is generally recommended to limit the budget's dependence on mining revenues. For example, experience in other countries has shown that, in order to maintain fiscal policy flexibility, care should be taken to prevent temporary increases in mining revenue from leading to permanently higher spending.

- By contrast, fiscal revenue from hydropower can be treated like the revenues from other economic activities, given that hydropower is a renewable energy source and given that Lao P.D.R. has entered into long-term sales contracts for the sale of hydroelectricity at fixed prices (e.g., with Thailand).

Staff's fiscal projections for FY12 assume that higher revenues from mining and hydropower are both saved. Saving the higher mining revenue is in line with the recommendation of the first bullet. The recommendation to save the higher hydropower revenue, while going against the general principle of the second bullet, is informed by the need for fiscal policy to contribute to preserving macroeconomic stability.



18. **Nonmining revenues and the quality of public spending deserve attention:**

- **It would be important to ensure that there is no weakening in the budget's nonmining revenue effort during the period of higher mining revenues.** Continuing efforts to raise nonresource revenue is not only important to protect the budget from adverse shocks in mining revenues, but also to ensure that all elements of society, especially those benefiting most from the economy's rapid growth contribute their fair share to the funding of Lao P.D.R.'s development. In the staff's view, a realistic objective would be to raise nonresource revenues to 15½ percent of GDP by FY16, up by almost 2 percentage points of GDP from FY10.
- **It would also be important to ensure that continued progress is made in improving the quality and efficiency of public spending** to ensure that public resources are fully devoted to improving the economic and social welfare of the population. This would include, inter alia, continuing progress to enhance expenditure control through the phasing out of off-budget capital expenditure.

19. **Staff encouraged the authorities to advance ongoing reforms of the tax system and avail itself of technical assistance financed from the recently launched trust fund** (see paragraph 16). To sustain the momentum of revenue reforms, the IMF would be willing to continue to support the development of a roadmap for modernizing the operations of the customs and tax departments, building on the recent technical assistance provided by the IMF's Fiscal Affairs Department.

20. **Public financial management (PFM) reform should also continue, to strengthen the government's capacity to meet its development goals.** The recommendations of the 2010 Public Expenditure and Financial Accountability (PEFA) Assessment provide a useful framework for this reform agenda. Priority reforms include improving accounting, cash management, and the establishment of the treasury single account. Concrete plans should be drawn up to quantify and resolve arrears and debts to contactors related to public investment projects (PIPs).

21. **The effective management of Lao P.D.R.'s natural resources will also require careful consideration of expenditure priorities.** In this context, staff commend the authorities for continuing to pass through movements in international prices for petroleum products to retail pump prices. Given Lao P.D.R.'s development needs, the priority has to be on increasing investments in the country's physical and human capital and accelerating progress in poverty reduction. While civil servant wages remain low, a large increase in these wages—the media reported that a 33 percent increase was being contemplated—without accompanying civil service reforms could undermine fiscal sustainability. It could also exacerbate demand pressures, including by propelling private credit growth as higher wages raise the borrowing capacity of civil servants.

22. **External debt management needs urgent strengthening.** The external debt sustainability analysis (DSA) suggests that Lao P.D.R. continues to face a high risk of debt distress. Moreover, the debt data suggest that a large amount of debt has been contracted with China in recent years, with the undisbursed amount of debt currently estimated at almost US$1 billion or 12 percent of GDP—though few details are available on these debt contracts. As a result, projected loan disbursements from China over the next six years are now about US$600 million higher than assumed in last year's DSA. Before signing any new loan contracts, it would be important to first carefully assess the implications for macroeconomic stability and external and public debt sustainability of what appears to be an overhang of undisbursed loan commitments from China. It would also be important to improve debt management capacity and develop a medium-term borrowing strategy for the government, including for resource sector activity, as well as greater disclosure of borrowing plans. Recourse to nonconcessional foreign financing should be strictly limited to commercially-viable projects. In this context, efforts should be made to build capacity and establish governance structures to assess the viability and growth benefits of debt-financed projects.

Authorities' views

23. **The authorities broadly shared staff's views.** The prevailing rapid growth of domestic demand provides room for a further gradual withdrawal of fiscal stimulus. The government is working with experts from the Asian Development Bank (AsDB) and the World Bank to draw up a medium-term fiscal strategy. And a broad array of other fiscal reforms is ongoing. Budgetary spending is increasingly being focused on education and health to reduce poverty in the country's more remote areas which are not lifted up by FDI inflows. A centralized Treasury Single Account is being implemented amid broader efforts to strengthen PFM systems. Efforts are under way to improve ODA management to make sure aid inflows are spent well. The authorities did not explicitly comment on the staff's suggestion to raise nonresource revenue. However, they did indicate that efforts to broaden the tax base are ongoing and customs reforms are bearings fruits. The rollout of the VAT proved challenging and additional TA may be requested from the IMF to support efforts to raise revenue further. The authorities would also consider availing themselves of technical assistance financed from the recently launched "Management of Natural Resources Wealth Topical Trust Fund." The FY11 budget established the Government Debt Resettlement Committee and tasked it to quantify and resolve arrears and debts to contactors related to PIPs.

24. **A strengthening of external debt management is under way.** The government is analyzing what would be an appropriate level of annual external borrowing. An important consideration is that borrowing for viable revenue-generating projects produces the resources to cover the additional debt service burden. Current weaknesses in external debt data will be resolved with the introduction of new software, with technical assistance from the UNCTAD.

B. Monetary and Exchange Rate Policy

Background

25. **Monetary policy has been accommodative in recent years** (Box 2). Nevertheless, inflation has remained relatively contained in large part because of rising demand for money and the maintenance of a stabilized exchange rate regime vis-à-vis the Thai baht and the U.S. dollar, and the low inflation in Thailand. The authorities' stated objective is to keep the rate of inflation below the rate of real economic growth. They also aim to reduce the growth of credit to the private sector to 25 percent. A similar credit growth target was pursued in 2010, but few concrete measures were taken and the target was missed. It may be difficult to achieve the 2011 credit growth target without tighter control over the BoL's net domestic assets (NDA). It may also be necessary to address the high level of excess liquidity in the banking system more directly through an increase in the required reserve ratio.

Staff's views

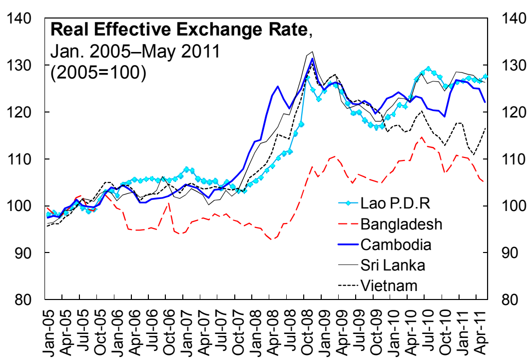
26. **The immediate priority is to contain the expansion of the BoL's NDA.** This, in turn, will require accelerated efforts to exit from the BoL's quasi-fiscal lending to local governments and commercial banks. These activities should be brought onto the government budget and financed through the issuance of government debt. However, it may take time to wind down the BoL's existing commitments in these two areas and transfer them to the ministry of finance. Consequently, it will be important for the BoL to sterilize these lending operations more effectively, while they are being wound down. The BoL has two options in this regard. It can either accelerate the issuance of BoL securities to mop up the excess liquidity, or if this sterilization proves too expensive, the BoL could raise the required reserve ratio. Both may be necessary to bring the level of excess liquidity in the banking system down to safer levels. At prevailing levels of excess liquidity, higher policy interest rates are unlikely to have a tightening effect, other than possibly through signaling.

27. **More generally, the BoL should strengthen its monetary policy framework.** Apart from the fact that the official inflation target being expressed in terms of real GDP growth is unconventional and might give rise to procyclical policy moves, staff noted that this would require enhancing the BoL's liquidity forecasting framework alongside the preparation of foreign exchange cash-flow projections. This would, inter alia, require resolving long-standing problems which hamper the timely compilation of monetary statistics. In the longer term, the strengthening of the monetary policy framework would require the development of a treasury bill market—and/or a well-functioning auction system for BoL securities—and the development of an interbank money market. These would be the next steps in the development of the financial system to complement graduation from LIC status. The successful launch of the stock market shows that, with adequate preparation, it can be done.

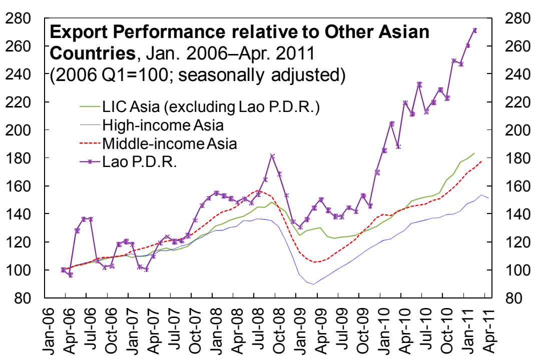
28. **A stabilized exchange rate regime remains the appropriate monetary anchor for Lao P.D.R.** Given the importance of Thailand as a trading partner, there is merit in the authorities' objective to stabilize the value of the kip vis-à-vis a currency basket consisting of the U.S. dollar and the Thai baht. Nevertheless, to sustain this stabilized regime, it will be important to maintain appropriately tight macroeconomic policies, along the lines recommended above. Standardized quantitative analysis suggests that the exchange rate of the kip may be overvalued (Box 4). On the other hand, broader macroeconomic indicators and favorable trends in overall exports (Box 4), tourism revenues, money demand, and dollarization (Figure 3) indicate that the current level of the exchange rate could be sustained.

Box 4: An Assessment of the Real Exchange Rate

Lao P.D.R.'s real exchange rate appreciation has outpaced that in most other Asian LICs, but total exports have also risen faster than the average for Asian LICs. Thanks to rising copper and gold prices and the start of electricity exports to Thailand from the Nam Theun II hydroproject, exports declined only modestly in the aftermath of the global crisis and rose by 46 percent in 2010.



Source: IMF APDCORE database.



Source: Haver analytics; and IMF, *Direction of Trade Statistics*.

An updated CGER-like assessment suggests that the kip is overvalued. Using Lao P.D.R.-specific trade elasticities, the various approaches suggest that the REER is more appreciated than implied by macroeconomic fundamentals by between 8 and 26 percent. Compared with last year's assessment (overvaluation by between 1 and 34 percent), the average overvaluation is broadly similar.

However, the overvaluation estimates should be interpreted with caution. The margin of error can be large, given data limitations. In addition, the macrobalance and equilibrium exchange rate approaches may overestimate the kip's misalignment, as they do not explicitly account for Lao P.D.R.'s stage in the investment cycle. The large current account deficits are related to imports for investments in the resource and tourism sectors, which are mostly financed by FDI. Once completed, these export-oriented projects would boost exports and reduce current account deficits after 2016, beyond the period considered in the CGER exercise.

Estimates of Overvaluation of the Kip

Approach	Estimated Overvaluation (In percent)
Purchasing power parity	9
Macro balance 1/	26 to 42
Equilibrium exchange rate	8
External sustainability 1/	9 to 14

Source: IMF staff estimates.

1/ The lower estimated overvaluation is obtained by using a Lao P.D.R.-specific trade elasticity (WP/10/180). A generic CGER-type elasticity gives the higher estimate.

Going forward, it would be important to expedite productivity-enhancing structural reforms (see paragraph 35) to improve the general competitiveness of the economy. The exchange rate assessment also underscores the importance of the recommended policy tightening to help contain inflation and the appreciation of the real exchange rate.

Authorities' views

29. **Efforts to contain inflation are being stepped up.** As inflation currently exceeds the official target, the BoL intends to tighten policies, including by minimizing BoL lending to local governments and stopping it completely by the end of the year. The BoL will also attempt to reduce excess liquidity, including by putting more BoL securities on offer. A next step would be to raise interest rates on BoL securities. If need be, the BoL would also consider raising reserve requirements. The authorities noted that, given the strong outlook for growth, driven by FDI in a variety of sectors, there is no risk that the formulation of the inflation target in terms of real GDP growth would trigger a procyclical spiral of increasingly tight monetary policy, by pushing down growth and hence successively reducing the inflation target.

30. **The authorities are committed to maintain a stable exchange rate.** They noted that their efforts to stabilize the value of the kip vis-à-vis the U.S. dollar and Thai baht have contributed greatly to overall macroeconomic and financial stability.

C. Financial Sector Issues

Background and staff's views

31. **The entry of new banks and the rapid development of the banking sector require a strengthening of banking supervision.** Reported NPL ratios remain low (Table 5) and compliance-based onsite and offsite inspections of banks take place regularly. However, given the untested risk management capacities, the strong growth of credit to the private sector raises concerns about a possible recurrence of NPL problems, especially given the backdrop of the continued undercapitalization at two major SOCBs. Staff encouraged the authorities to strengthen prudential regulations and supervision, building on recommendations of recent AsDB-provided technical assistance. Staff, jointly with World Bank staff, presented the content, requirements, and potential **benefits of the Financial Sector Assessment Program (FSAP) to the authorities and suggested that they consider partici**pating in the program.

32. **Plans to complete the recapitalization of the SOCBs need to be drawn up.** Capital adequacy of the three SOCBs has increased but remains below the regulatory minimum for two of them. Recapitalization plans should be linked with memoranda of understanding that would lay out structural conditions and performance criteria for the government to inject capital, as was the case with the expired Governance Agreements which tied the hands of the management of the SOCBs during the AsDB-sponsored 2005–09 restructuring program. Independent audits of SOCBs should continue.

33. **Anti-Money Laundering/Countering the Financing of Terrorism (AML/CFT).** Efforts are under way to follow up on the Asia Pacific Group's (APG) recent evaluation of Lao P.D.R.'s AML/CFT framework. Staff understands that the final mutual evaluation report will be discussed for adoption during the APG annual meetings, which will take place in India in July. The authorities should start to work on the APG's recommended actions on the basis of the report.

Authorities' views

34. **Efforts to strengthen banking supervision and the AML/CFT framework are ongoing.** The BoL continues to monitor banks' implementation of existing prudential regulations and the authorities are studying the recommendations of AsDB-provided TA. To strengthen supervision, the BoL recently separated the supervision of commercial banks from the supervision of other financial institutions. However, difficulties in collecting and compiling banking data and financial soundness indicators (FSI) data persist. In view of this, the authorities would rather first prepare a more rigorous system for FSI compilation and reporting before they request an FSAP.

III. Structural Reforms and Statistics

35. **Despite recent progress in some areas, there remains scope to improve the business climate and trade integration.** The continued decline in Lao P.D.R.'s ranking in the World Bank's Doing Business Survey suggests that more needs to be done to make progress in streamlining procedures and strengthening policy frameworks to boost private sector-led growth. The authorities acknowledged that the pace of reforms needs to be accelerated, in view also of the phased mandatory reduction of tariffs under the ASEAN Free Trade Agreement, which will expose Lao P.D.R. to increased competition. They noted that, following the adoption of the implementation decree for the new Investment Law, work is under way to streamline business registration procedures. The authorities also indicated that good progress is being made in simplifying international trade, including by strengthening customs procedures and the introduction of the ASYCUDA customs system. Moreover, they noted that, as part of ongoing efforts to prepare for accession to WTO membership, the government continues the process of revising relevant laws and passing WTO-compliant implementing decrees. The tax code is being reviewed with a view to eliminate the differential treatment of domestic and foreign companies and FAO experts will assist with putting in place a new legal and regulatory framework that is consistent with the WTO's Sanitary and Phytosanitary measures. On the other hand, the authorities imposed a rice export ban during November 2010–February 2011 in response to a price spike.

36. **Modernizing and upgrading the quality and availability of economic data is becoming a more urgent priority as Lao P.D.R. develops.** Serious data shortcomings hamper surveillance, analysis, and policy making. The balance of payments, the national

accounts, and the FSI are in most need of strengthening. Ongoing delays in monetary and FSI statistics associated with implementation of the new chart of accounts are worrisome.

37. **Staff welcomes the adoption of the Statistics Law and the implied commitment to upgrade and expand the Department of Statistics** and encourages the implementation of the new Statistics Strategy 2010–20. However, expedited action is needed to increase the availability of basic economic and financial data. This will also require additional investment in the capacity of the key economic institutions responsible for generating this data. Staff noted that the IMF stands ready to increase its TA to Lao P.D.R. to support efforts to strengthen macroeconomic statistics.

IV. STAFF APPRAISAL

38. **Lao P.D.R. continues to be one of the fastest growing economies in Asia.** Growth in 2010 was buoyed by ongoing projects in the mining and hydropower sectors, as well as a rebound in garment exports, nonregional tourism, and FDI inflows in the aftermath of the global crisis. Domestic demand, boosted by still sizable stimulus from fiscal and monetary policy, also supported construction and other sectors. The commendable performance of the economy facilitated continued gains in living standards and poverty reduction.

39. **However, inflation has picked up and the rapid expansion of domestic demand is still putting pressure on the balance of payments.** Fiscal and monetary policy were tightened in 2010 but both still remained accommodative. The recovery of gross official reserves was mostly related to capital inflows associated with the two successful IPOs that inaugurated the new stock exchange.

40. **The outlook for GDP growth in 2011 is favorable but inflation is projected to rise further.** There is a need to tighten macroeconomic policies in the near term to address potential pressures on the external position and ensure inflation remains contained. The projected further narrowing of the fiscal deficit in FY11 would make an important contribution to this. However, on current policies, and in view of the large excess reserves held by commercial banks with the BoL, the growth of credit is expected to remain strong, boosting domestic demand and imports, and possibly raising risks in the financial sector.

41. **The nonmining fiscal balance should be kept on a consolidation path over the medium term.** The budget’s exposure to potentially volatile mining revenues can be reduced by focusing the fiscal policy debate on the path of the nonmining fiscal deficit. The consolidation efforts should be spearheaded by sustained efforts to raise nonresource revenue beyond the targets implied by the new five-year plan for 2011–15. This should help ensure that all elements of society contribute their fair share to the funding of Lao P.D.R.’s development and that adequate fiscal space is created for pro-poor spending while smoothing government spending over the medium term. The external debt sustainability analysis suggests that Lao P.D.R. continues to face a high risk of debt distress. This underscores the urgent need to strengthen public external debt management.

42. **The BoL should strengthen its monetary policy framework** in order to effectively tighten monetary policy. This requires tighter control over the net domestic assets of the BoL which, in turn, requires phasing out of quasi-fiscal operations and/or accelerating the issuance of BoL securities to mop up the excess liquidity in the banking system. The BoL should also consider raising the required reserve ratio. The tightening of monetary policy is needed to help sustain the stabilized exchange rate regime, which remains the appropriate monetary anchor notwithstanding the fact that standardized quantitative analysis suggests that the exchange rate of the kip is overvalued.

43. **The rapid development of the banking sector requires a strengthening of banking supervision.** Reported NPL ratios remain low and compliance-based onsite and offsite inspections of banks take place regularly. However, given commercial banks' untested risk management capacities and the strong growth of credit in recent years, prudential regulations and supervision need to be strengthened, building on recommendations of recent AsDB-provided technical assistance. Plans to complete the recapitalization of the SOCBs need to be articulated. And the authorities should start to work on APG's on money laundering recommendations to strengthen the AML/CFT framework on the basis of the report.

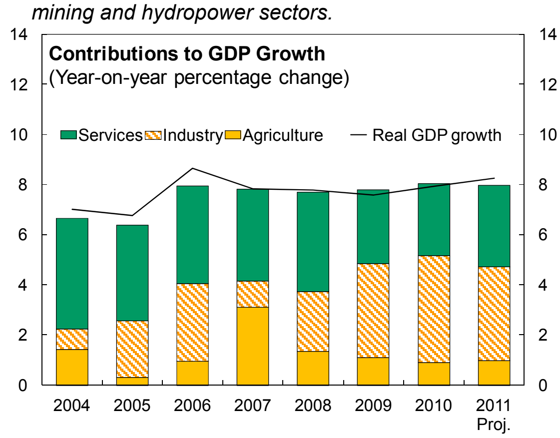
44. **Lao P.D.R.'s medium-term prospects are promising.** Given the pipeline of large hydropower and mining projects the authorities' objective to graduate from LIC status by 2020 looks achievable. However, the broader framework for macroeconomic policy making and financial sector supervision needs to be upgraded to mitigate risks to macroeconomic and financial stability as Lao P.D.R. transitions toward a frontier market economy. Ongoing efforts to improve the business climate and trade integration should be accelerated to support growth of the nonresource sector and poverty reduction. With respect to the rice export ban that was temporarily imposed in response to the rice price spike, staff believe that discretionary measures that seek to isolate domestic markets from international price developments may not be effective and are not advisable.

45. **Modernizing and upgrading the quality and availability of economic data is becoming a key priority as Lao P.D.R. develops.** Staff welcomes the adoption of the Statistics Law and the implied commitment to upgrade and expand the Department of Statistics and encourages the implementation of the new Statistics Strategy 2010–20. Delays in compiling monetary and FSI data should be resolved without delay.

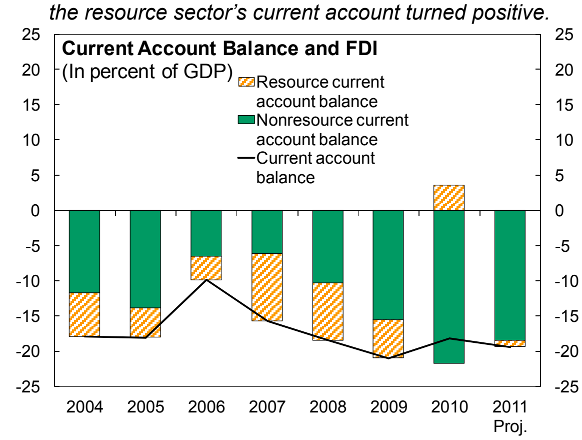
46. It is recommended that the next Article IV consultation take place on the standard 12-month cycle.

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

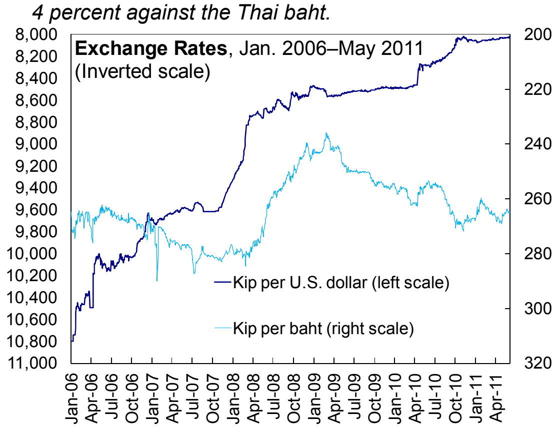
Growth remains strong, supported by investments in the mining and hydropower sectors.



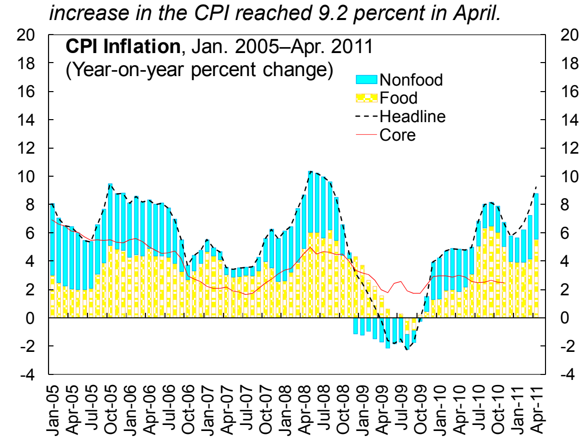
The overall current account deficit narrowed in 2010 as the resource sector's current account turned positive.



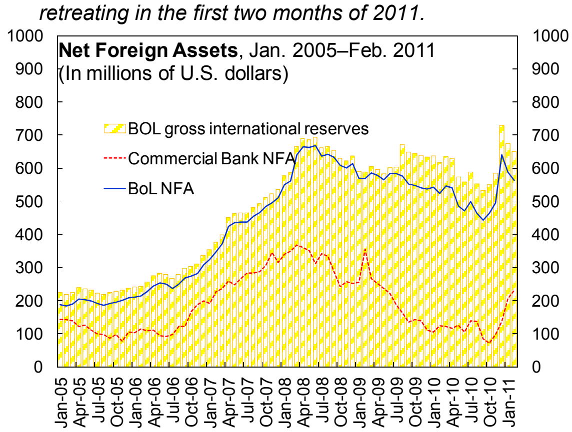
Compared to end-2009, the kip has now appreciated 6 percent against the U.S. dollar and depreciated 4 percent against the Thai baht.



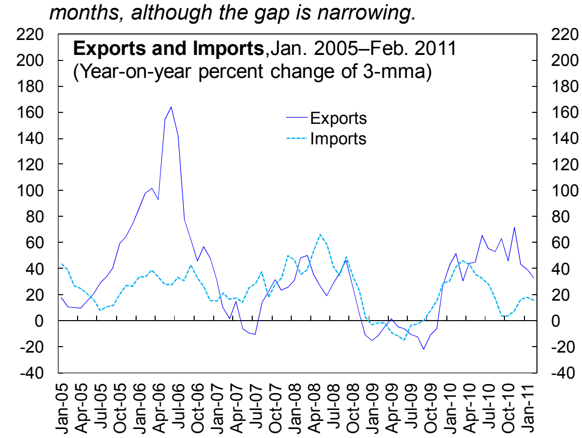
Inflation picked up in recent months. The year-on-year increase in the CPI reached 9.2 percent in April.



Gross central bank reserves strengthened in the last quarter of 2010, boosted by two IPOs, before partially retreating in the first two months of 2011.

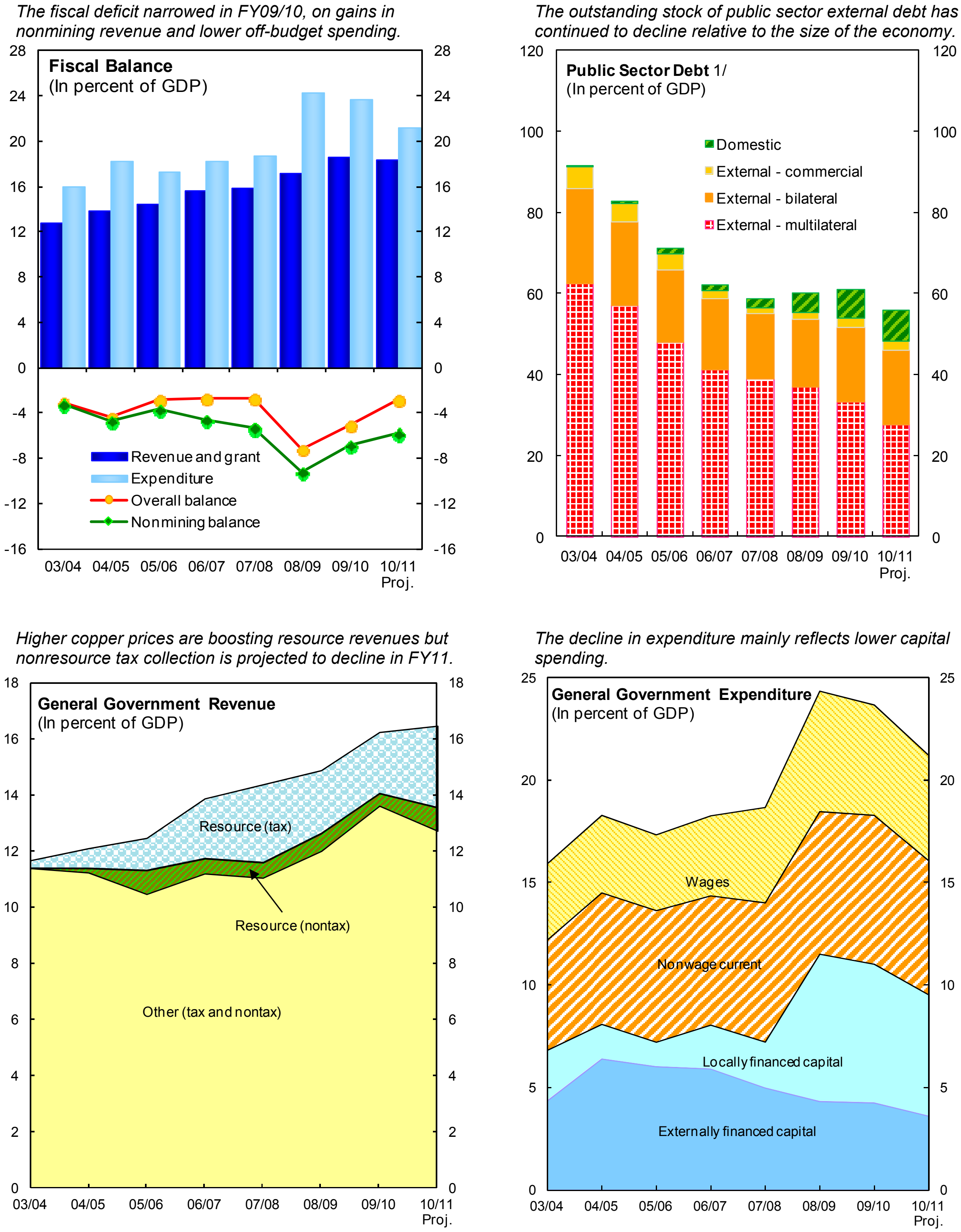


Export growth outpaced import growth in recent months, although the gap is narrowing.



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

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

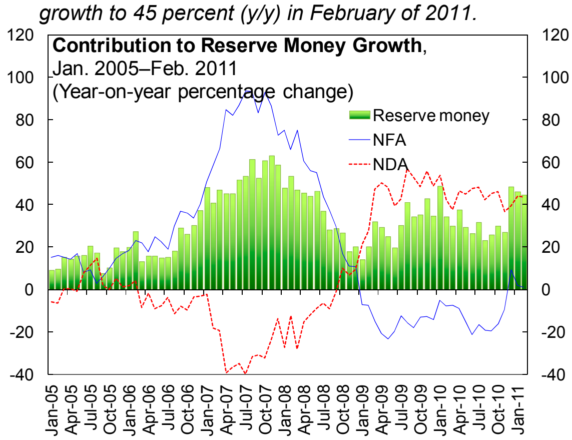


Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

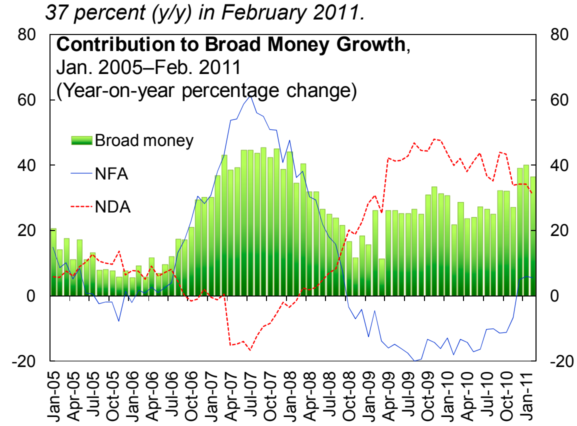
1/ The stock of domestic public debt includes local government borrowing from the central bank.

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

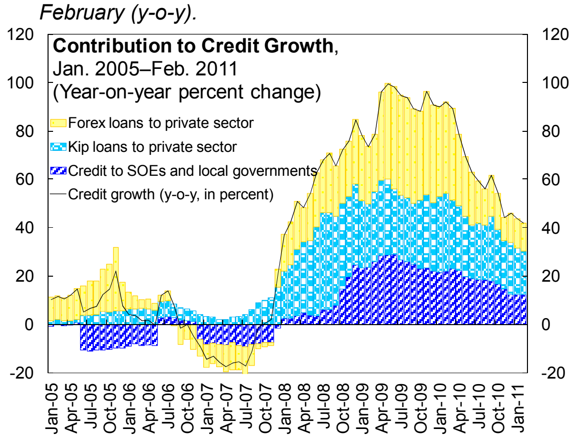
The recovery of BOL NFA pushed reserve money growth to 45 percent (y/y) in February of 2011.



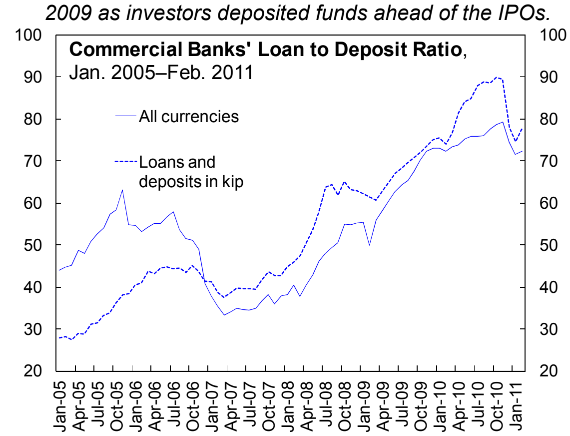
Similarly, broad money growth accelerated to 37 percent (y/y) in February 2011.



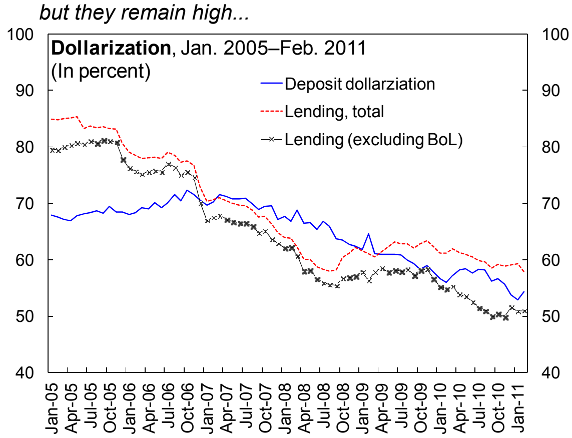
Credit to the economy increased by 42 percent in February (y-o-y).



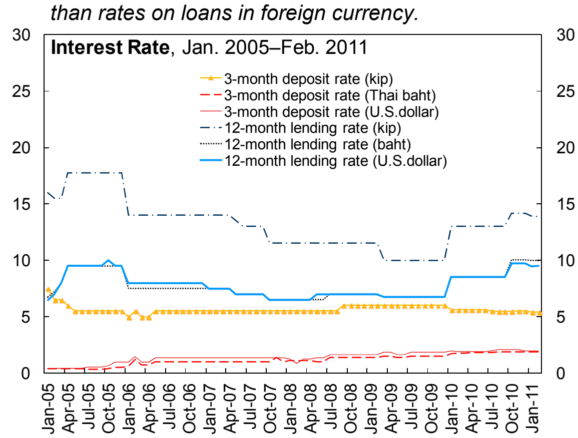
The loan-to-deposit ratio declined toward the end of 2009 as investors deposited funds ahead of the IPOs.



Deposit and lending dollarization continue to inch down, but they remain high...



...as rates on kip loans remain substantially higher than rates on loans in foreign currency.



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

Table 1. Lao P.D.R.: Medium-Term Macroeconomic Framework, 2008–16

	2008	2009	2010	2011	2012	2013	2014	2015	2016
				Projections					
Output and prices	(Percent change, unless otherwise indicated)								
Real GDP	7.8	7.6	7.9	8.3	8.4	7.1	7.4	7.9	7.4
Real GDP (excluding resource projects)	6.4	4.9	6.3	7.5	7.0	7.0	7.0	7.2	7.5
Consumer prices (end-period)	3.2	3.9	5.8	9.7	6.0	4.8	4.6	4.2	4.1
Consumer prices (annual average)	7.6	0.0	6.0	8.7	6.7	5.3	4.6	4.5	3.9
GDP per capita (in U.S. dollars)	856	886	1,003	1,202	1,337	1,427	1,530	1,653	1,770
Public finances (in percent of GDP) 1/									
Revenue	15.9	17.1	18.6	18.4	19.4	19.5	19.3	18.6	18.5
Of which: Mining	2.6	2.1	1.8	2.9	3.8	3.6	3.3	2.4	2.1
Of which: Hydro power	0.7	0.8	0.8	0.8	1.0	1.0	1.0	1.1	1.0
Of which: Grant	1.6	2.3	2.4	1.9	1.7	1.7	1.7	1.7	1.7
Expenditure	18.5	24.1	23.4	21.0	20.8	21.4	21.1	21.2	21.2
Expense	11.5	12.9	12.7	11.7	12.0	12.1	12.2	12.2	12.1
Net acquisition of nonfinancial assets	7.0	11.2	10.7	9.3	8.8	9.4	8.9	9.0	9.0
Of which: Off-budget capital expenditure	0.6	4.1	3.5	2.5	0.6	0.0	0.0	0.0	0.0
Net lending/borrowing	-2.6	-6.9	-4.8	-2.6	-1.4	-1.9	-1.8	-2.6	-2.7
Nonmining balance 2/	-5.1	-9.0	-6.6	-5.5	-5.2	-5.6	-5.1	-5.0	-4.8
Balance of payments	(In millions of U.S. dollars; unless otherwise indicated)								
Current account balance	-982	-1,174	-1,173	-1,530	-1,755	-2,138	-3,004	-2,681	-2,238
In percent of GDP	-18.5	-21.0	-18.2	-19.4	-19.6	-22.0	-28.3	-22.9	-17.5
Exports	1,609	1,521	2,217	2,801	3,215	3,262	3,285	3,569	4,012
In percent change	21.5	-5.5	45.8	26.3	14.8	1.5	0.7	8.7	12.4
Imports	2,837	2,893	3,582	4,649	5,367	5,918	6,975	7,002	6,859
In percent change	31.5	2.0	23.8	29.8	15.4	10.3	17.9	0.4	-2.0
Services and income (net)	106	65	13	102	155	252	395	433	259
Transfers	141	133	179	217	243	265	290	320	350
Capital account balance	1,086	1,097	1,274	1,621	1,890	2,170	3,040	2,752	2,403
Of which: FDI	921	785	692	1,071	1,374	1,629	2,439	2,085	1,729
Overall balance	105	-77	101	91	135	32	36	71	165
Debt and debt service									
Public debt (in percent of GDP)	56.7	61.0	58.8	54.4	53.1	51.4	49.9	48.3	47.1
External debt (in percent of GDP)	96.7	102.3	92.2	86.3	90.0	97.1	108.6	109.3	104.9
External public debt (in percent of GDP)	54.0	55.4	51.8	46.7	45.7	45.3	45.1	44.7	44.4
External public debt service (in percent of exports)	4.3	4.9	4.5	4.6	4.3	4.5	4.8	5.0	5.0
Gross official reserves									
In millions of U.S. dollars	636	633	727	813	945	973	1,005	1,072	1,234
In months of imports (excluding resource projects)	3.7	2.6	2.5	2.5	2.7	2.5	2.4	2.4	2.5
Memorandum items:									
Nominal GDP (in billions of kip)	46,215	47,567	54,195	63,446	73,386	82,775	93,196	105,218	117,503

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

1/ Fiscal year basis (October to September).

2/ Net lending/borrowing minus mining revenues.

Table 2. Lao P.D.R.: Balance of Payments, 2008–16

	2008	2009	2010	2011	2012	2013	2014	2015	2016
			Est.	Projections					
	(In millions of U.S. dollars; unless otherwise indicated)								
Current account	-982	-1,174	-1,173	-1,530	-1,755	-2,138	-3,004	-2,681	-2,238
Merchandise trade balance	-1,228	-1,372	-1,365	-1,848	-2,152	-2,655	-3,690	-3,433	-2,847
Exports, f.o.b.	1,609	1,521	2,217	2,801	3,215	3,262	3,285	3,569	4,012
Mining and hydropower	865	912	1,500	1,949	2,270	2,292	2,235	2,403	2,715
Other exports	743	609	717	851	945	970	1,050	1,167	1,297
Imports, c.i.f.	2,837	2,893	3,582	4,649	5,367	5,918	6,975	7,002	6,859
Mining and hydropower	991	895	788	1,365	1,719	2,026	2,663	2,303	1,737
Mining projects	427	260	414	354	558	570	583	596	526
Hydropower projects	564	635	374	1,012	1,161	1,457	2,080	1,707	1,211
Petroleum imports	422	292	411	596	633	655	686	731	784
Other imports	1,424	1,706	2,383	2,688	3,015	3,236	3,626	3,969	4,338
Services (net)	331	330	367	443	515	590	662	681	706
Of which: Tourism	276	268	383	448	525	603	676	696	717
Income (net)	-226	-265	-354	-341	-360	-338	-266	-248	-447
Interest payments	-79	-81	-137	-151	-148	-148	-166	-162	-376
Of which: Public	-26	-27	-45	-61	-66	-73	-86	-93	-102
Mining and hydropower	-36	-41	-86	-84	-76	-68	-71	-60	-256
Mining projects	-22	-29	-6	-12	-9	-7	-17	-12	-9
Hydropower projects	-14	-12	-79	-72	-67	-61	-54	-47	-247
Dividends and profit repatriation	-298	-322	-451	-628	-648	-636	-496	-478	-490
Of which: Mining and hydropower	-272	-279	-397	-573	-591	-578	-435	-415	-423
Other	152	137	235	438	436	446	395	392	419
Transfers (net)	141	133	179	217	243	265	290	320	350
Private	64	35	70	84	92	102	112	123	135
Official	77	97	109	133	150	163	179	197	215
Capital and financial account	1,086	1,097	1,274	1,621	1,890	2,170	3,040	2,752	2,403
Public sector	124	163	161	191	316	338	388	444	438
Disbursements	185	229	238	287	421	449	506	578	588
Amortization	-61	-67	-78	-97	-105	-111	-118	-135	-150
Banking sector (net)	65	140	-26	-17	-10	-10	-10	-10	-10
Private sector	897	794	1,140	1,447	1,584	1,842	2,662	2,319	1,975
Foreign direct investment (net) 1/	921	785	692	1,071	1,374	1,629	2,439	2,085	1,729
Of which: Mining and hydropower projects	772	729	270	643	943	1,136	1,939	1,645	1,154
Of which: Mining projects	175	45	-17	-38	68	75	32	32	-18
Hydropower projects	597	684	287	681	875	1,061	1,907	1,613	1,172
Other private flows and errors and omissions	-23	9	448	376	210	212	223	234	246
Overall balance	105	-77	101	91	135	32	36	71	165
Core Balance (CA+FDI+ODA)	63	-274	-364	-311	-122	-220	-240	-255	-163
Financing	-105	77	-101	-91	-135	-32	-36	-71	-165
Central bank net foreign assets	-105	77	-101	-91	-135	-32	-36	-71	-165
Assets (increase -)	-100	4	-95	-86	-132	-28	-32	-67	-161
Liabilities (reduction -)	-4	74	-7	-5	-4	-4	-4	-4	-4
Memorandum items:									
Current account balance (in percent of GDP)	-18.5	-21.0	-18.2	-19.4	-19.6	-22.0	-28.3	-22.9	-17.5
Excluding official transfers	-19.9	-22.7	-19.8	-21.1	-21.3	-23.7	-29.9	-24.6	-19.2
Resource current account balance (in percent of GDP) 2/	-8.2	-5.4	3.6	-0.9	-1.3	-3.9	-8.8	-3.2	2.3
Nonresource current account balance (in percent of GDP)	-10.3	-15.6	-21.7	-18.5	-18.3	-18.1	-19.5	-19.7	-19.9
Exports (annual percent change)	21.5	-5.5	45.8	26.3	14.8	1.5	0.7	8.7	12.4
Imports (annual percent change)	31.5	2.0	23.8	29.8	15.4	10.3	17.9	0.4	-2.0
Excluding hydropower and mining related		8.3	39.8	17.5	11.1	6.7	10.8	9.0	9.0
Gold production (000s oz.)	140	162	165	163	282	283	338	330	325
Gold price (U.S. dollar per oz.)	872	973	1,225	1,469	1,510	1,542	1,594	1,660	1,734
Copper production (000s ton)	89	122	128	145	154	163	151	153	153
Copper price (U.S. dollar per ton)	6,963	5,165	7,538	9,003	8,708	8,200	7,200	6,700	6,700
Core balance (in percent of GDP)	1.2	-4.9	-5.6	-3.9	-1.4	-2.3	-2.3	-2.2	-1.3
Gross official reserves	636	633	727	813	945	973	1,005	1,072	1,234
In months of prospective imports of goods and nonfactor services	2.6	2.0	1.8	1.7	1.8	1.6	1.7	1.8	2.1
(Excluding imports associated with large resource projects)	3.7	2.6	2.5	2.5	2.7	2.5	2.4	2.4	2.5
Nominal GDP at market prices	5,313	5,598	6,461	7,891	8,937	9,722	10,627	11,693	12,763

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

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

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

Table 3. Lao P.D.R.: General Government Operations, 2007/08–2011/12

	2007/08	2008/09	2009/10		2010/11		2011/12
			Budget	Est.	Budget	Staff Proj.	Staff Proj.
	(In billions of kip)						
Revenue	7,134	8,099	8,907	9,779	10,383	11,242	13,783
Of which: Resource revenue 1/	1,486	1,357	…	1,376	…	2,284	3,429
Tax revenue	5,627	6,208	6,989	7,503	8,170	8,877	11,221
Income and profit taxes	1,655	1,728	1,487	1,587	1,961	2,090	3,239
Income taxes	333	425	494	462	486	524	618
Profit taxes	1,322	1,303	993	1,125	1,474	1,566	2,621
Of which: Mining	805	664	489	487	783	959	1,965
Of which: Nonmining	516	639	504	638	691	607	656
VAT	1,229	1,401	1,697	1,869	1,911	2,299	2,700
Excise duties	1,190	1,432	1,799	1,687	1,832	1,821	2,082
Import duties	674	726	746	832	1,010	928	1,027
Royalties	373	297	377	560	607	732	1,016
Other taxes	507	623	884	968	849	1,007	1,156
Nontax revenue	812	823	836	1,035	1,042	1,194	1,371
Grants	695	1,068	1,081	1,242	1,171	1,171	1,191
Expenditure	8,284	11,375	10,073	12,302	11,596	12,825	14,779
Expense	5,141	6,070	6,565	6,656	7,159	7,159	8,519
Compensation of employees	2,082	2,772	2,830	2,825	3,138	3,138	4,040
Transfers	1,095	1,369	1,391	1,398	1,462	1,462	1,799
Interest payments	361	264	502	398	498	498	405
Of which: External	291	205	422	318	427	427	349
Other recurrent	1,602	1,666	1,842	2,034	2,061	2,061	2,274
Net acquisition of nonfinancial assets	3,142	5,305	3,508	5,646	4,437	5,666	6,260
Domestically financed	957	3,220	1,104	3,271	1,587	2,988	2,747
Of which: Off-budget	255	1,933	…	1,823	…	1,500	430
Externally financed	2,185	2,085	2,404	2,376	2,850	2,678	3,513
Net lending(+)/borrowing(-)	-1,150	-3,276	-1,166	-2,524	-1,213	-1,583	-996
Net acquisition of financial assets	510	-174	…	54	…	1,352	1,231
Domestic	510	-174	…	54	…	1,352	1,231
Foreign	0	0	…	0	…	0	0
Net incurrence of liabilities	1,659	3,159	…	2,668	…	2,934	2,227
Domestic	296	2,191	…	1,714	…	1,945	430
Foreign	1,363	967	827	954	1,154	989	1,797
Discrepency	-1	56	…	91	…	0	0
Memorandum items:							
Nonmining balance 2/	-2,306	-4,256	…	-3,478	…	-3,378	-3,715
Operating balance	1,992	2,028	2,342	3,123	3,224	4,083	5,265
Mining revenue	1,156	979	…	954	…	1,796	2,719
Hydropower revenue	331	377	…	422	…	488	710
Nonresource revenue	4,953	5,674	…	7,161	…	7,787	9,163
Real expenditure (percent, year on year) 3/	6.4	39.2	…	2.3	…	-4.2	8.5
GDP	44,778	47,225	54,100	52,538	61,133	61,133	70,901

Table 3. Lao P.D.R.: General Government Operations, 2007/08–2011/12 (concluded)

	2007/08	2008/09	2009/10		2010/11		2011/12
			Budget	Est.	Budget	Staff Proj.	Staff Proj.
	(In percent of GDP, unless otherwise indicated)						
Revenue	15.9	17.1	16.5	18.6	17.0	18.4	19.4
Of which: Resource revenue 1/	3.3	2.9	…	2.6	…	3.7	4.8
Tax revenue	12.6	13.1	12.9	14.3	13.4	14.5	15.8
Income and profit taxes	3.7	3.7	2.7	3.0	3.2	3.4	4.6
Income taxes	0.7	0.9	0.9	0.9	0.8	0.9	0.9
Profit taxes	3.0	2.8	1.8	2.1	2.4	2.6	3.7
Of which: Mining	1.8	1.4	0.9	0.9	1.3	1.6	2.8
Of which: Nonmining	1.2	1.4	0.9	1.2	1.1	1.0	0.9
VAT	2.7	3.0	3.1	3.6	3.1	3.8	3.8
Excise duties	2.7	3.0	3.3	3.2	3.0	3.0	2.9
Import duties	1.5	1.5	1.4	1.6	1.7	1.5	1.4
Royalties	0.8	0.6	0.7	1.1	1.0	1.2	1.4
Other taxes	1.1	1.3	1.6	1.8	1.4	1.6	1.6
Nontax revenue	1.8	1.7	1.5	2.0	1.7	2.0	1.9
Grants	1.6	2.3	2.0	2.4	1.9	1.9	1.7
Expenditure	18.5	24.1	18.6	23.4	19.0	21.0	20.8
Expense	11.5	12.9	12.1	12.7	11.7	11.7	12.0
Compensation of employees	4.7	5.9	5.2	5.4	5.1	5.1	5.7
Transfers	2.4	2.9	2.6	2.7	2.4	2.4	2.5
Interest payments	0.8	0.6	0.9	0.8	0.8	0.8	0.6
Of which: External	0.7	0.4	0.8	0.6	0.7	0.7	0.5
Other recurrent	3.6	3.5	3.4	3.9	3.4	3.4	3.2
Net acquisition of nonfinancial assets	7.0	11.2	6.5	10.7	7.3	9.3	8.8
Domestically financed	2.1	6.8	2.0	6.2	2.6	4.9	3.9
Of which: Off-budget	0.6	4.1	…	3.5	…	2.5	0.6
Externally financed	4.9	4.4	4.4	4.5	4.7	4.4	5.0
Net lending(+)/borrowing(-)	-2.6	-6.9	-2.2	-4.8	-2.0	-2.6	-1.4
Net acquisition of financial assets	1.1	-0.4	…	0.1	…	2.2	1.7
Domestic	1.1	-0.4	…	0.1	…	2.2	1.7
Foreign	0.0	0.0	…	0.0	…	0.0	0.0
Net incurrence of liabilities	3.7	6.7	…	5.1	…	4.8	3.1
Domestic	0.7	4.6	…	3.3	…	3.2	0.6
Foreign	3.0	2.0	1.5	1.8	1.9	1.6	2.5
Discrepency	0.0	0.1	…	0.2	…	0.0	0.0
Memorandum items:							
Nonmining balance 2/	-5.1	-9.0	…	-6.6	…	-5.5	-5.2
Operating balance	4.4	4.3	…	5.9	…	6.7	7.4
Mining revenue	2.6	2.1	…	1.8	…	2.9	3.8
Hydropower revenue	0.7	0.8	…	0.8	…	0.8	1.0
Nonresource revenue	11.1	12.0	…	13.6	…	12.7	12.9
Real expenditure (percent, year on year) 3/	6.4	39.2	…	2.3	…	-4.2	8.5
GDP	44,778	47,225	54,100	52,538	61,133	61,133	70,901

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

1/ Resource revenue comprises royalties, taxes, and dividends from the mining and hydropower sectors.
2/ Net lending/borrowing minus mining revenues.
3/ Excluding interest payment.

Table 4. Lao P.D.R.: Monetary Survey 2008–11

	2008	2009		2010				2011	
	Dec.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Sep. Proj.	Dec. Proj.
	(In billions of kip, unless otherwise indicated)								
Bank of Lao P.D.R. (BoL)									
Net foreign assets	5,230	4,690	4,555	4,610	3,876	3,588	5,151	5,516	5,881
In millions of U.S. dollars	614	551	537	546	471	443	641	686	731
Net domestic assets	-454	995	1,880	2,313	2,633	3,571	4,409	5,093	5,253
Government (net)	-1,057	-761	-815	-881	-1,209	-915	-742	-1,365	-1,487
Claims	973	936	925	950	847	719	926	854	905
Deposits	-2,030	-1,698	-1,740	-1,831	-2,056	-1,634	-1,667	-2,219	-2,392
Of which: Foreign currency	-1,501	-1,269	-1,143	-1,209	-1,396	-1,022	-1,243	-1,485	-1,601
State-owned enterprises	685	1,692	2,312	2,739	3,135	3,319	3,367	4,375	4,556
Of which: Kip	0	290	373	405	421	408	419	538	560
Local governments	389	1,397	2,017	2,443	2,839	3,024	3,071	4,079	4,260
Banks	538	1,029	1,173	1,262	1,470	1,701	1,936	2,536	2,736
BoL securities	-223	-670	-660	-844	-1,082	-908	-1,023	-1,323	-1,423
Other items (net)	-397	-295	-129	37	319	374	872	872	872
Reserve money	4,776	5,685	6,436	6,923	6,509	7,159	9,560	10,609	11,134
Currency in circulation	2,508	2,932	3,580	3,588	3,593	3,720	4,505	5,352	5,775
Bank reserves (kip)	878	1,085	1,211	1,429	1,401	1,583	3,013	2,707	2,555
Of which: Capital deposits	170	148	168	306	412	346	511	459	433
Bank reserves (foreign currency)	1,390	1,658	1,644	1,905	1,515	1,856	2,039	2,550	2,805
Monetary survey									
Net foreign assets	7,368	5,835	5,500	5,638	4,742	4,280	6,259	6,726	7,125
In millions of U.S. dollars	865	685	648	668	576	528	778	837	886
Of which: Commercial banks	251	134	111	122	105	85	138	150	155
Net domestic assets	4,196	7,653	9,678	10,370	11,673	13,560	14,856	18,746	19,311
Government (net)	-643	-472	-627	-1,078	-1,264	-774	-420	-1,375	-326
Budget	-1,104	-1,060	-1,215	-1,666	-1,852	-1,361	-1,008	-1,962	-913
Claims	1,194	1,017	1,080	1,177	1,064	907	1,390	2,706	1,259
Deposits	-2,298	-2,076	-2,294	-2,843	-2,916	-2,269	-2,398	-4,668	-2,172
Other	461	588	588	588	588	588	588	588	588
Credit to the economy	5,845	9,157	11,143	12,323	13,415	14,805	16,270	21,115	20,631
In kip	2,208	3,473	4,195	4,688	5,293	6,146	6,659	8,657	8,459
In foreign currencies	3,637	5,684	6,948	7,635	8,121	8,659	9,611	12,458	12,172
Of which: Private credit	4,554	7,198	8,565	9,314	10,004	11,212	12,315	17,315	16,917
Other items (net)	-1,005	-1,032	-838	-875	-477	-471	-994	-994	-994
Broad money	11,564	13,487	15,177	16,008	16,415	17,841	21,114	25,472	26,436
Currency in circulation	2,223	2,409	3,086	2,944	2,862	3,029	3,791	4,652	4,828
Kip deposits	3,517	4,514	5,100	5,587	5,745	6,482	8,012	9,114	9,458
Foreign currency deposits (FCDs)	5,824	6,565	6,992	7,477	7,808	8,330	9,312	11,707	12,149
	(Annual percent change, unless otherwise indicated)								
Reserve money	20.2	34.5	34.7	30.0	26.5	25.9	48.6	48.2	16.5
Broad money	18.3	25.0	31.2	28.6	27.2	32.3	39.1	42.8	25.2
Credit to the economy	84.6	89.1	90.7	89.2	62.8	61.7	46.0	42.6	26.8
Credit to the private sector	71.6	76.3	88.1	86.5	56.5	55.8	43.8	54.4	37.4
Memorandum items:									
Money multiplier (at current exchange rates)	2.4	2.4	2.4	2.3	2.5	2.5	2.2	2.4	2.4
Velocity	4.0	3.5	3.1	3.4	3.3	2.9	2.6	2.4	2.4
Loan/deposit (percent)	55.2	67.4	73.0	73.4	75.9	77.5	74.5	80.4	74.4
In kip (percent)	62.8	70.5	74.9	76.7	84.8	88.5	77.9	89.1	83.5
Gross official reserves (in millions of U.S. dollars)	636	648	633	636	558	531	730	813	813
Net international reserves (in millions of U.S. dollars) 1/	451	356	343	320	287	214	387	369	383
Issue of debt clearance/bank recapitalization bonds 2/	461	588	588	588	588	588	588	588	588
Exchange rate, end-of-period (kip per U.S. dollar)	8,514	8,513	8,483	8,445	8,236	8,107	8,042	8,040	8,040
Nominal GDP (in billions of kip)	46,215	47,225	47,567	54,195	54,195	52,538	54,195	61,133	63,446
Dollarization rate (FCDs/broad money; in percent)	50.4	48.7	46.1	46.7	47.6	46.7	44.1	46.0	46.0
Gross reserve/Reserve Money	113	97	83	78	71	60	61	62	59
Excess reserves in kip	702	859	956	1,150	1,114	1,258	2,612	2,252	2,082
Excess reserves in foreign currency	807	1,001	945	1,157	734	1,023	1,108	1,379	1,590

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

1/ Defined as gross official reserves minus BoL foreign liabilities and the foreign exchange component of reserve money.
2/ Cumulative since end-June 2003.

Table 5. Lao P.D.R.: Financial Soundness Indicators, 2007–09

	2007	2008	2009
Captal adequacy ratio (Basel I)	…	25.0	20.1
State-owned commercial banks (SOCBs)	…	1.7	3.8
Joint-venture banks	…	30.6	9.0
Foreign bank branches	…	26.2	34.0
Private banks	…	41.5	33.5
NPL ratio	5.9	5.4	3.8
State-owned commercial banks	4.2	1.7	1.3
Joint-venture banks	12.7	4.5	1.3
Foreign bank branches	0.6	13.9	10.5
Private banks	…	1.4	1.9
Return on assets (select SOCBs only) 1/	0.9	3.1	…
Banque pour le Commerce Exterieur Lao	4.7	3.6	…
Lao Development Bank	0.8	2.2	…
Agricultural Promotion Bank	-2.8	3.6	…
Number of banks	13	20	23
State-owned commercial banks	4	4	4
Joint-venture banks	2	2	2
Foreign bank branches	6	9	10
Private banks	1	5	7
Sectoral allocation of bank credit (in percent of total)			
Industry and handicraft	22	19	19
Construction	4	4	4
Materials and technical supplies	8	9	8
Agriculture	8	13	14
Commerce	29	26	23
Transportation	1	3	3
Services	8	10	8
Other	19	17	22

Source: Bank of Lao P.D.R., External Audit Reports.

1/ Profit before tax divided by total balance sheet assets.

Table 6. Millennium Development Goals: Progress in Lao P.D.R.

MDGs	Target	Seriously off Track	Off Track	On Track	No Target
Goal 1: Poverty and hunger	Reduce extreme poverty by half			●	
	Reduce hunger by half	●			
	Achieve full and productive employment and decent work for all				●
Goal 2: Universal primary education	Universal primary schooling		●		
Goal 3: Gender equality and women's empower-ment	Eliminate gender disparity at all levels of education		●		
Goal 4: Child mortality	Reduce child mortality under five years of age by two-thirds			●	
Goal 5: Maternal health	Reduce maternal mortality by three-quarters		●		
	Universal access to reproductive health	●			
Goal 6: HIV/AIDS, malaria, and other diseases	Halt and reverse the spread of HIV/AIDS			●	
	Achieve universal access to HIV/AIDS treatment			●	
	Halt and reverse the spread of malaria			●	
	Halt and reverse the spread of TB			●	
Goal 7: Environmental sustainability	Reverse the loss of environmental resources	●			
	Reduce rate of biodiversity loss				●
	Halve the number of people without safe drinking water in rural areas		●		
	Halve the number of people without safe drinking water in urban areas			●	
	Halve the number of people without sanitation in rural areas		●		
	Halve the number of people without sanitation in urban areas			●	

Source: United Nations, "Accelerating Progress Towards the MDGs." (http://www.unlao.org/mediaandpub/publications/2010/MAF%20Report_Lao%20PDR_September%202010.pdf).

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

LAO PEOPLE'S DEMOCRATIC REPUBLIC

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Approved by Masato Miyazaki and Dominique Desruelle (IMF)
and Ivailo Izvorski and Jeffrey D. Lewis (IDA)

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Lao P.D.R.'s risk of debt distress[2] *is still assessed to be high, as one public external debt stock indicator is expected to remain above policy-dependent indicative thresholds over the medium term under the baseline scenario, notwithstanding the recent downward trend in debt indicators and projected strong growth over the medium term. However, debt service ratios remain comfortably within the policy-dependent indicative thresholds, even under the stress tests, due to the high level of concessionality of official borrowing. Debt management needs to be strengthened as a matter of priority and before the government signs any new loan agreements, it would be important to first carefully assess the implications for macroeconomic stability and external and public debt sustainability of the large amount of undisbursed loan commitments from China that appear to have been signed in recent years.*

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

[2] The low-income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels for debt indicators are policy-dependent. In the LIC-DSF, the quality of a country's policies and institutions is measured by the World Bank's Country Policy and Institutional Assessment (CPIA) index and classified into three categories: strong, medium, and weak. Lao P.D.R.'s policies and institutions, as measured by the CPIA, averaged 3.253 over the past three years. Since it is the first year that Lao P.D.R. is above the threshold of "medium performers" (3.25) and the breach is less than 0.05, Lao P.D.R. is still classified in the "weak performer" category according to the "Staff Guidance Note on the Application of the Joint Fund-Bank Debt Sustainability Framework for Low-Income Countries (www.imf.org/external/np/pp/eng/2010/012210.pdf)." Therefore, the relevant indicative thresholds for this category are: 30 percent for the PV of debt-to-GDP ratio, 100 percent for the PV of debt-to-exports ratio, 200 percent for the PV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 25 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

I. BACKGROUND

1. **The results of this DSA are similar to those of the previous DSA.**[3] However, the improved outlook for revenue and exports has lowered related debt-burden indicators. The primary difference is that the present value (PV) of debt-to-revenue ratio is now below the threshold level under the baseline scenario. Compared to the previous DSA, the baseline assumptions for economic growth, revenues, and exports are somewhat more optimistic. This affects longer-term debt dynamics positively. However, the projected rate of external debt accumulation is higher during 2012–16, reflecting increased borrowing from non-Paris Club bilateral creditors, mainly China. As a result, public external debt stock indicators remain flat during those years despite strong growth of GDP, exports, and revenue. The calculations are based on a discount rate of 4 percent, unchanged from last year's DSA.

2. **Key indicators of Lao P.D.R.'s external public and publicly guaranteed (PPG) debt stock have improved as a result of strong macroeconomic performance.** The PV of debt was 37 percent of GDP or 86 percent of exports at end-2010, down from 43 percent of GDP or 129 percent of exports at end-2009. Strong economic growth, appreciation of the kip, and favorable external conditions all contributed to the decline in the ratio of external PPG debt-to-GDP over the past few years. The stock of external PPG debt increased in nominal terms to US$3.5 billion in 2010 from US$2.1 billion in 2005, but declined to 51.8 percent of GDP in 2010 from 82 percent of GDP in 2005. The debt of state-owned enterprises (SOEs) is included into the PPG debt, to the extent possible. The private external debt—which totaled 40.4 percent of GDP at end-2010—is mostly related to mining, hydropower, and construction projects.

Lao P.D.R.: Stock of Public and Publicly Guaranteed External Debt at End-2010

	In billions of U.S. Dollar	As a Share of Total External Debt	In percent of GDP
Total	3.5	100.0	51.8
Multilateral	2.1	60.2	31.2
Bilateral	1.2	35.7	18.5
Commercial 1/	0.1	4.1	2.1

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

3. **Around 60.2 percent of Lao P.D.R.'s external PPG debt is held by multilateral creditors**, mainly the Asian Development Bank (AsDB, 35 percent) and the International Development Association (IDA, 19 percent). About 35.7 percent is held by bilateral creditors—mainly China, Russia, Thailand, and Japan.[4] Besides, India and Korea also increased their lending to Lao P.D.R. in the past three years. The remaining 4.1 percent of PPG external debt comprises external debt incurred by public entities on nonconcessional

[3] See IMF Country Report No. 11/44 and www.worldbank.org.

[4] The Soviet-era debt owed to the Russian Federation has been under negotiation since 2007. The Lao P.D.R. authorities are seeking debt relief comparable to what was granted to other LICs. The authorities reported that negotiations continue.

terms and guaranteed by the government, mainly for hydropower development and electricity generation, including financing equity stakes. The increasing presence of emerging-market creditors, particularly from China, underscores the need to strengthen debt management capacity, particularly to ensure that debt sustainability considerations are taken into account when new debt is contracted.[5] A mitigating factor for Lao P.D.R.'s external debt burden lies in the prospective returns on the hydropower and mining projects that have been financed in part by external PPG debt. While the projects face construction and implementation challenges, the long-term power purchase agreements that are signed for these projects and resulting government revenues in the form of royalties, dividends, and profit tax payments arguably reduce the risk of debt distress.

Lao P.D.R.: External Public Debt Indicators at End-2010

	Indicative thresholds	End-2010
Present value of debt, as a percent of:		
GDP	30	36.6
Exports	100	85.9
Revenue	200	222.1
Debt service, as a percent of:		
Exports	15	4.5
Revenue	25	11.5

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

4. **Recorded domestic public debt rose to 7 percent of GDP in 2010, up from 5.6 percent of GDP in 2009** as the central bank disbursed more loans to finance local government's off-budget infrastructure projects. Lending from the Bank of Lao P.D.R. (BoL) represents 82 percent of the recorded total domestic debt, with the remainder comprising of government bonds, in particular those related to the recapitalization of state-owned commercial banks. Total PPG domestic and external debt stood at 58.8 percent of GDP in 2010. The stock of lending from the Bank of Lao P.D.R. to local governments, which is included in the domestic public debt data, is expected to peak in 2012. This expectation is based on the authorities' 2009 announcement that the BoL would stop signing new loan contracts with local governments. However, no information is available on the amount of undisbursed loan commitments and interest and amortization schedules.

II. Underlying Debt Sustainability Analysis Assumptions

5. **Box 1 summarizes the medium-term macroeconomic framework underlying the DSA.** Most notably, the baseline scenario—which is based on current policies—projects annual average growth for the next six years at 7.7 percent, in line with the average for the last five years and the authorities' targets in the 7th five-year plan. Continuing recent trends, growth would be increasingly supported by large resource (mostly mining and hydropower) projects and to a lesser extent by the improved tourism outlook.[6] The economy is also

[5] As of end-2010, China signed 24 loan agreements with Lao P.D.R., amounting to US$1.35 billion. Of this total amount about US$958 million remained undisbursed. Apart from the fact that they include a US$90 million loan for a hydro project, staff has no information on the projects associated with the loan agreements signed with China, the approximate disbursement schedules, and the currency composition of the debt.

[6] Lao P.D.R. will host the Asia-Europe Summit in November 2012, and has contracted various FDI-financed projects to develop hotels and other infrastructure that will be used for this event.

projected to be supported by agriculture and manufacturing, reflecting increased investment in these two sectors. Stable macroeconomic conditions and continuing reforms to further the transition to a market economy will also continue to contribute to steady growth.

6. **External financing is assumed to remain largely on concessional terms over the medium term.** Over the long term, grant financing decreases with economic development and graduation from low-income status could be achieved in the second half of the projection period. The participation of nontraditional bilateral creditors is expected to increase compared to the previous DSA. The previous DSA assumed total disbursement of US$354 million from China during 2011–16, while this DSA assumes US$958 million for the same period, reflecting newly signed loan contracts with China.

III. DEBT SUSTAINABILITY

A. External Debt Sustainability Analysis

7. **Under the baseline scenario, the PV of debt-to-GDP ratio remains above the policy-dependent indicative debt burden thresholds until 2019** (Figure 1 and Table 1). The PV of debt-to-revenue ratio has improved to below the threshold in the baseline scenario. Unlike in last year's DSA, all three external debt stock indicators are projected to remain basically flat until about 2018 reflecting about US$600 million in additional loan disbursements from China during 2011–16. Debt service ratios (both as a share of exports and government revenues) remain well below indicative thresholds throughout the 20-year projection period, despite falling grant-equivalent financing.

8. **External debt sustainability is most vulnerable to a depreciation of the nominal exchange rate and lower export growth**.[7] Table 3 and Figure 1 illustrate how a one-off 30 percent depreciation of the kip would lead to a sharp rise in the PV of debt-to-GDP and the PV of debt-to-revenue ratios. A decline in export growth (by one standard deviation in 2012–13) would push the PV of debt-to-exports to 151 percent by 2014 and stay above the indicative threshold until 2031. The latter scenario illustrates the vulnerability of Lao P.D.R.'s debt sustainability to a possible sharp decline in copper and gold prices.

9. **Debt dynamics are worse under an alternative scenario in which key variables are at their historical averages.** Through 2014, debt dynamics are more favorable under this "historical scenario" as it takes into account the stronger increase in the GDP deflator in U.S. dollar terms (reflecting the nominal appreciation of the kip) experienced during 2001–10. In later years, this effect is outweighed by the higher historical average of the current account deficit (13.6 percent of GDP per annum compared to 8.5 percent of GDP per

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

annum in the baseline), and the lower historical average for FDI (4.1 percent of GDP per annum compared to 8.7 percent of GDP per annum in the baseline). This implies that for each year the historical scenario assumes almost 10 percentage points of GDP more debt accumulation than the baseline, which would not be sustainable in the long run. Therefore, the historical scenario illustrates the vulnerability to a decline in FDI inflows from the high levels of the past five years, which substantially exceed the 10-year historical average. One obvious mitigating factor is that FDI inflows are a major financing source of Lao P.D.R.'s large current account deficits. Therefore, with lower FDI inflows the current account deficit that would need to be financed would be commensurately lower as well, obviating the need for additional debt financing.

10. **Lao P.D.R.'s external debt dynamics are highly sensitive to assumptions regarding investment and performance of the resource sector.** Large resource-related projects now account for some 10 percent of GDP, with this share expected to nearly double over the medium term. In addition, the Lao P.D.R. economy remains exposed to fluctuations in international copper and gold prices as well as the economic outlook in neighboring countries (e.g., Thailand, Vietnam, and China). Lower growth in Lao P.D.R. and a weaker balance of payments would worsen debt dynamics. Cautious assessment and monitoring of large-scale projects will be required to mitigate the risks posed to external and public debt sustainability, especially if some of these projects may be financed from commercial sources such as bonds backed by future revenues.

11. **A recent study by the staff of the IMF and the World Bank found that Lao P.D.R. is one of the countries that is currently judged to be at a high risk of debt distress where modest but sustained improvements in policies and institutions could significantly reduce debt vulnerabilities** (see http://www.imf.org/external/np/pp/eng/2010/040110.pdf). Lao P.D.R.'s CPIA score improved to 3.28 last year. Going forward, if the CPIA score continues to improve, Lao P.D.R. could be classified as a "medium performer." In that case, higher indicative thresholds would apply, possibly causing the debt distress assessment of Lao P.D.R. to change.

B. Public Sector Debt Sustainability

12. **Under the baseline scenario, the PV of total PPG debt in percent of GDP and in percent of revenue are both projected to decline over the medium term** (Figure 2 and Table 2), in line with the previous DSA's projections. The projected build up of domestic debt is now smaller, mostly reflecting the strong revenue performance in FY10 and the improved outlook for resource revenue. Domestic debt is projected to decline from 7 percent in 2010 to about 3 percent of GDP in 2016. Similarly, the debt service-to-GDP ratio is also projected to decline over the projection period.

13. **Public debt ratios are particularly sensitive to a real depreciation of the kip over the medium term** (Figure 2, Table 4). A one-time 30 percent real depreciation of the kip in

2012 would immediately raise the PV of public debt-to-GDP ratio and the PV of public debt-to-revenue ratio to 54 and 280 percent, respectively, before both indicators taper off. The impact on the debt service-to-revenue ratio is also large, leading to an increase to around 14 percent in 2013, while the impact would also be more persistent over the longer term. It should be noted that this scenario is likely to overstate risks given that a significant share of GDP, including most of the resource GDP, is earned in foreign currency.

14. **Contingent fiscal liabilities could also worsen public debt ratios.** The settlement of arrears and debts to contractors, related to public investment projects implemented by local governments and the recapitalization of the state-owned commercial banks could lead to a rise in recorded domestic public debt. In the absence of comprehensive data it would seem that the fifth bound test in Table 4 which considers the effect of a 10 percent of GDP increase in other debt-creating flows provides some indication of the possible effect of a resolution of relevant contingent fiscal liabilities.

15. **Alternative scenarios point to less positive debt dynamics, especially over the longer term.** The first alternative scenario puts key variables (real GDP growth and the primary balance) at historical averages, and hence primary fiscal deficits about 1.8 percentage points of GDP higher than in the baseline scenario. In this scenario, the PV of public debt-to-GDP ratio rises above 50 percent of GDP by 2031 (grey dashed line in Figure 2). The second alternative scenario keeps the primary balance unchanged from the level projected for 2011 (red dashed line in Figure 2). Given that this level (1.7 percent of GDP) is much smaller than the 10-year average of the primary deficit (3.4 percent of GDP) used in the first alternative scenario, the outlook for debt ratios would improve but remain above the levels in the baseline scenario. These scenarios illustrate the importance of further fiscal consolidation.

16. **Under the baseline, it is assumed that the BoL phases out its quasi-fiscal activities.** During the past few years, the BoL has played an active role in financing local governments' infrastructure expenditures. The authorities announced in 2009 that they had decided to stop signing new loan commitments. Should the resulting envisaged phasing out of BoL lending not materialize, for instance if FDI and ODA come in lower than projected in the government's plans for 2011–15 and the government calls again on the BoL to fill the resulting "investment financing gap," the public debt dynamics could be significantly worse.

IV. The Authorities' View

17. **The authorities broadly agreed with the overall assessment and indicated that they were in the process of modernizing their debt management.** They acknowledged that the external debt data provided for this DSA might be inadequate[8] and they indicated that

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[8] Government debt records cannot be easily reconciled with creditor statements. Moreover, debt data of state-owned enterprises is not readily available. Lao P.D.R. is currently installing the DMFAS debt recording system, which is expected to improve the quality of debt records going forward.

they were analyzing what would be an appropriate level of borrowing each year. At the same time, the authorities believe that an important part of the external debt is related to viable large projects in the resource sector, and will generate high economic returns upon completion.[9] In addition, the relatively long maturity profile of the loans also helps mitigate risks of debt distress.

V. Conclusion

18. **While Lao P.D.R. has made progress in reducing its external and public debt burden, it still faces a high risk of debt distress.** Debt dynamics reflect current and planned large-scale investments in hydropower and mining projects that will only deliver returns over the medium term. The outlook is particularly sensitive to large swings of the exchange rate, highlighting the importance of maintaining macroeconomic stability and deepening structural reforms. It is also sensitive to fluctuations in exports earnings, and in particular commodity prices, and lack of fiscal consolidation. That said, the high level of concessionality of official borrowing keeps debt service ratios relatively contained.

19. **External borrowing should normally be obtained on concessional terms and fiscal and quasi-fiscal liabilities should be carefully managed, to further create buffers against vulnerabilities.** Continued prudent debt management, as well as cautious assessment and monitoring of large-scale projects, will be required to mitigate the risks posed to external and public debt sustainability. Fiscal risk could arise if these projects fail to generate the expected returns, including to the government's own equity stakes. The BoL should follow through on its earlier commitment to exit from direct lending to local governments. Improving debt management capacity and developing a medium-term borrowing strategy for the government, including for resource sector activity, as well as greater disclosure of borrowing plans (particularly with regard to the large loan amounts contracted with China), would substantially enhance the assessment of debt sustainability. In light of the high risk of debt distress, recourse to nonconcessional external financing should be limited to viable projects. And efforts should be made to build capacity and establish governance structures to assess the viability of projects.

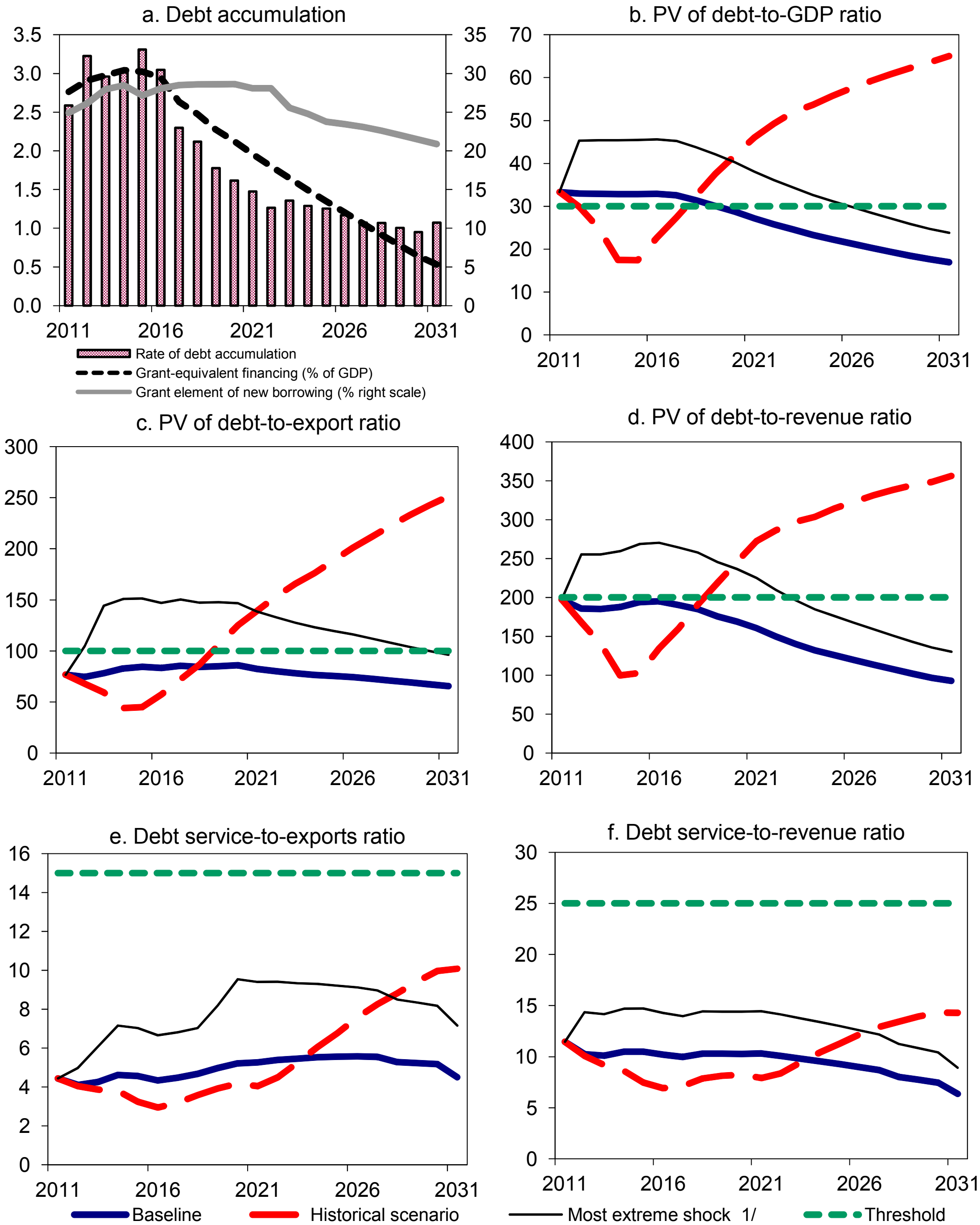
[9] Viable projects are projects in which the rate of return exceeds the cost of financing or the net present value of future income exceeds the net present value of borrowing.

Box 1: Baseline Scenario—Underlying Assumptions (2011–31)

The baseline macroeconomic framework assumes that the economy will be underpinned by further development of Lao P.D.R.'s potential in hydropower and mining, supported by reforms to further the transition to a market economy and a strengthening of macroeconomic policy frameworks.

- **Real GDP growth** is projected to average 7.7 percent in 2011–16. The near-term outlook is boosted by expanding production of gold, copper, and electricity, and work on the US$3.7 billion Hongsa Lignite mining and power station is expected to start operations in 2015–16. In addition, the improved outlook for tourism and agriculture and FDI in these sectors will also support growth. Over the longer term, assumed structural changes and reforms would create an enabling environment, broadening the sources of growth. Real GDP growth is expected to moderate to 6.4 percent on average in 2017–31 as the resource sector matures. Over time, the share of agriculture in GDP declines, as the transition to a market-based economy leads to an increasing share of industry and services. Graduation from low-income status could be achieved in the second half of the projection period.
- The **copper and gold price** projections through 2016 are based on the WEO projections as of May 2011 and are assumed constant in real terms afterward. While the WEO projects a steady rise in gold price through 2016, copper prices are projected to soften to US$6,700 per ton by 2016, down from US$9,000 in 2011.
- **Inflation** could reach 10 percent in the coming months, reflecting high food and fuel prices and strong second-round effects amid rapidly rising domestic demand. Over the medium term, inflation is projected to moderate to about 4 percent.
- The **balance of payments** will go through large swings, reflecting development of the resource sector. The external current account deficit is projected to narrow considerably in the long run. The nonresource current account would slightly deteriorate over the next decade reflecting the increasing cost of industrialization, befor moderating over the longer term, while the resource current account will turn to surplus in 2016 as large projects are completed and start the operating phase. The assumed pick up in nonresource exports and services is driven by strengthened competitiveness and regional integration, supported by improvements in the investment climate, a streamlining of business regulations, and meeting trade commitments. The overall external position is expected to strengthen over time, and the international reserve position will gradually improve. Private capital inflows in the form of FDI are expected to remain high through the first half of the projection period as large new projects get under way before they gradually decline to a more sustainable level.
- **External financing** is assumed to remain largely on concessional terms over the medium term. Over the long term, grant financing decreases with economic development.
  - ***Multilateral creditors:*** Projected loan disbursements in the medium term are relatively low since IDA and the AsDB have a pipeline of operations financed on grant terms. Over the longer term, grant financing decreases with economic development and a moderate increase in project loans is assumed.
  - ***Bilateral creditors:*** For 2011–12, projected loan disbursements increase as donors provide support to the government's development agenda. Over the medium and longer term, greater participation by new emerging market creditors leads bilateral finance to take on an increasing role, including for onlending purposes to SOEs. The undisbursed US$958 million in loans from China is assumed to have $80 million disbursed in 2011 and the rest being evenly disbursed during 2012–16. The terms assumed are 6-year grace period, 15-year repayment period, and an interest rate of 1.5 percent.
  - ***Commercial creditors:*** Over the medium term, commercial disbursements are relatively small, principally used to finance a portion of the government's equity stake participation in new hydropower projects. The DSA assumes that disbursements on the government's borrowing to finance its equity stake in the Hongsa Lignite project will take place in 2014 and 2015.
- **Fiscal policy** is projected to remain on a consolidation path from the 4.8 percent of GDP overall deficit recorded in FY10. The deficit is projected to narrow to about 2.6 percent of GDP in FY11 and following a further narrowing in FY12–13 to revert back to that level in the medium term. The consolidation is expected to be supported by rising resource sector revenues thanks to strong commodity prices.
- **Domestic debt** decreases over the medium term driven by repayments of the lending from the BoL. It increases in the long term as net external financing in percent of GDP declines and a larger share of budget deficits is financed domestically.

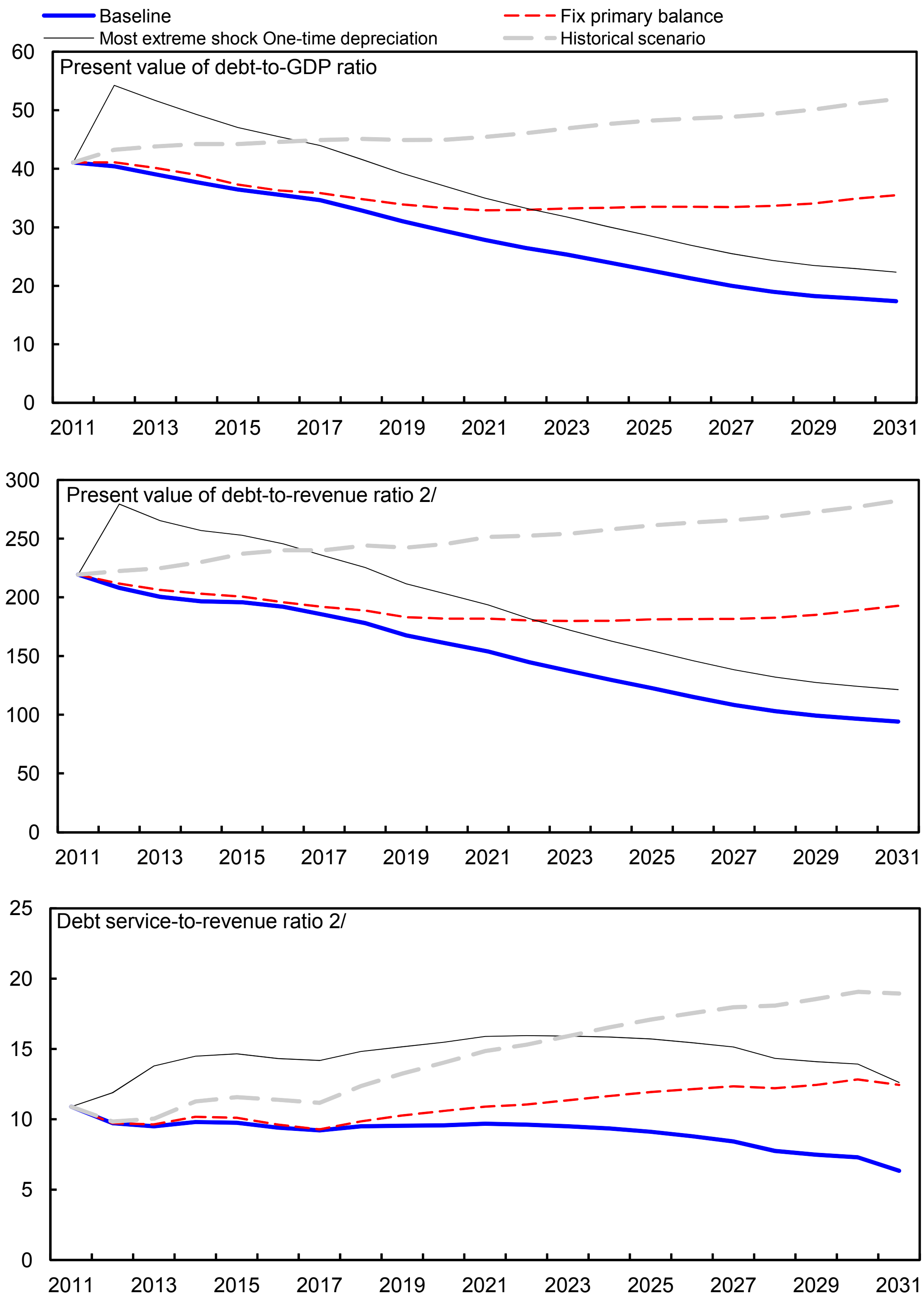
Figure 1. Lao P.D.R.: Indicators of Public and Publicly Guaranteed External Debt Under Alternative Scenarios, 2011–31 1/



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

1/ The most extreme stress test is the test that yields the highest ratio in 2021. In figure b. it corresponds to a One-time depreciation shock; in c. to an Exports shock; in d. to a One-time depreciation shock; in e. to an Exports shock; and in figure f. to a One-time depreciation shock.

Figure 2. Lao P.D.R.: Indicators of Public Debt Under Alternative Scenarios, 2011–31 1/



Sources: Lao P.D.R. authorities; and staff estimates and projections.
1/ The most extreme stress test is the test that yields the highest ratio in 2021.
2/ Revenues are defined inclusive of grants.

Table 1. Lao P.D.R.: External Debt Sustainability Framework, Baseline Scenario, 2008–31 1/

(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average 1/	Standard Deviation 1/	Projections									
	2008	2009	2010			2011	2012	2013	2014	2015	2016	2011–16 Average	2021	2031	2017–31 Average
External debt (nominal) 2/	**96.7**	**102.3**	**92.2**			**86.3**	**90.0**	**97.1**	**108.6**	**109.3**	**104.9**		**73.7**	**36.3**	
Of which: Public and publicly-guaranteed (PPG)	54.0	55.4	51.8			46.7	45.7	45.3	45.1	44.7	44.4		36.4	22.0	
Change in external debt	-3.7	5.6	-10.1			-5.9	3.7	7.1	11.5	0.7	-4.4		-6.9	-2.6	
Identified net debt-creating flows	-10.3	8.4	-6.4			6.3	7.3	10.6	15.0	4.3	-2.0		-4.6	-3.3	
Noninterest current account deficit	**17.3**	**19.7**	**16.1**	**13.6**	**4.1**	**17.6**	**18.1**	**20.6**	**26.8**	**21.6**	**14.7**		**10.7**	**4.0**	8.5
Noninterest current account deficit	16.9	18.6	15.4			17.8	18.3	21.2	28.5	23.5	16.8		12.1	4.5	
Exports	38.1	34.3	42.6			43.5	44.1	42.1	39.7	38.9	39.5		33.0	25.9	
Imports	55.0	52.9	58.0			61.3	62.5	63.4	68.2	62.4	56.3		45.2	30.4	
Net current transfers (negative = inflow)	-2.7	-2.4	-2.8	-3.1	0.9	-2.7	-2.7	-2.7	-2.7	-2.7	-2.7		-2.2	-1.8	-2.1
Of which: Official	-1.5	-1.7	-1.7			-1.7	-1.7	-1.7	-1.7	-1.7	-1.7		-1.2	-0.1	
Other current account flows (negative = net inflow)	3.1	3.5	3.4			2.5	2.5	2.1	1.1	0.8	0.7		0.8	1.3	
Net FDI (negative = inflow)	**-8.3**	**-7.6**	**-10.8**	**-4.1**	**3.7**	**-6.9**	**-5.9**	**-5.6**	**-6.7**	**-10.8**	**-12.2**		**-11.6**	**-5.6**	-8.8
Endogenous debt dynamics 3/	**-19.4**	**-3.7**	**-11.6**			**-4.5**	**-4.8**	**-4.4**	**-5.1**	**-6.5**	**-4.6**		**-3.8**	**-1.7**	
Contribution from nominal interest rate	1.2	1.2	2.1			1.8	1.5	1.4	1.5	1.3	2.8		1.4	0.4	
Contribution from real GDP growth	-6.2	-7.0	-7.0			-6.2	-6.4	-5.9	-6.6	-7.8	-7.4		-5.2	-2.2	
Contribution from price and exchange rate changes	-14.3	2.0	-6.6			…	…	…	…	…	…		…	…	
Residual (3–4) 4/	**6.6**	**-2.8**	**-3.8**			**-12.2**	**-3.7**	**-3.4**	**-3.5**	**-3.6**	**-2.4**		**-2.2**	**0.7**	
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	
Present value (PV) of external debt 5/	...	...	77.0			73.0	77.3	84.7	96.4	97.4	93.3		64.5	31.2	
PV of external debt 5/	...	...	180.7			167.8	175.0	201.1	242.9	250.4	236.2		195.2	120.6	
PV of PPG external debt	**...**	**...**	**36.6**			**33.3**	**33.0**	**32.9**	**32.9**	**32.8**	**32.9**		**27.2**	**17.0**	
In percent of exports	**...**	**...**	**85.9**			**76.7**	**74.7**	**78.1**	**82.8**	**84.4**	**83.2**		**82.3**	**65.7**	
In percent of government revenues	**...**	**...**	**222.1**			**197.7**	**185.7**	**185.0**	**187.8**	**194.0**	**195.0**		**160.8**	**93.0**	
Debt service-to-exports ratio (in percent)	**11.0**	**11.8**	**13.4**			**12.8**	**10.8**	**10.3**	**12.5**	**12.0**	**14.8**		**18.8**	**11.1**	
PPG debt service-to-exports ratio (in percent)	**4.3**	**4.9**	**4.5**			**4.4**	**4.1**	**4.3**	**4.6**	**4.6**	**4.3**		**5.3**	**4.5**	
PPG debt service-to-revenue ratio (in percent)	**11.4**	**10.8**	**11.5**			**11.5**	**10.2**	**10.1**	**10.5**	**10.5**	**10.2**		**10.3**	**6.4**	
Total gross financing need (in billions of U.S. dollars)	0.7	0.9	0.7			1.3	1.5	1.9	2.7	1.8	1.1		1.1	0.7	
Noninterest current account deficit that stabilizes debt ratio	21.0	14.1	26.2			23.5	14.4	13.5	15.3	21.0	19.1		17.6	6.6	
Key macroeconomic assumptions															
Real GDP growth (in percent)	7.8	7.6	7.9	7.1	1.1	8.3	8.4	7.1	7.4	7.9	7.4	7.7	7.1	6.2	6.4
GDP deflator in U.S. dollar terms (change in percent)	16.6	-2.1	6.9	7.3	7.7	12.8	4.5	1.6	1.8	2.0	1.6	4.0	3.8	3.8	3.6
Effective interest rate (percent) 6/	1.5	1.4	2.3	1.8	0.3	2.4	2.0	1.7	1.6	1.3	2.8	2.0	2.0	1.3	1.8
Growth of exports of G&S (U.S. dollar terms, in percent)	26.3	-5.2	43.4	16.5	21.7	24.8	15.0	3.8	3.0	7.9	10.9	10.9	9.7	8.8	7.1
Growth of imports of G&S (U.S. dollar terms, in percent)	30.7	1.4	26.7	18.4	13.4	29.0	15.4	10.3	17.6	0.8	-1.6	11.9	7.8	6.8	5.7
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	24.9	26.1	27.9	28.5	27.2	28.0	27.1	28.1	20.9	25.2
Government revenues (excluding grants, in percent of GDP)	14.3	15.6	16.5			16.9	17.7	17.8	17.5	16.9	16.9		16.9	18.3	17.6
Aid flows (in billions of U.S. dollars) 7/	0.1	0.1	0.1			0.2	0.2	0.3	0.3	0.4	0.4		0.5	0.3	
Of which: Grants	0.1	0.1	0.1			0.1	0.1	0.2	0.2	0.2	0.2		0.2	0.1	
Of which: Concessional loans	0.0	0.0	0.0			0.0	0.1	0.1	0.1	0.2	0.2		0.2	0.2	
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			2.8	2.9	3.0	3.0	3.0	3.0		2.0	0.5	1.5
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			50.2	45.5	47.2	47.2	45.6	47.1		49.0	26.2	41.8
Memorandum items:															
Nominal GDP (in billions of U.S. dollars)	5.3	5.6	6.5			7.9	8.9	9.7	10.6	11.7	12.8		20.4	54.4	
Nominal dollar GDP growth	25.7	5.4	15.4			22.1	13.3	8.8	9.3	10.0	9.1	12.1	11.2	10.3	10.2
PV of PPG external debt (in billions of U.S. dollars)			2.5			2.6	2.9	3.1	3.4	3.8	4.2		5.5	9.2	
(PVt-PVt-1)/GDPt-1 (in percent)						2.6	3.2	3.0	3.0	3.3	3.0	3.0	1.5	1.1	1.4
Gross remittances (in billions of U.S. dollars)	0.1	0.0	0.1			0.1	0.1	0.1	0.1	0.1	0.1		0.2	0.9	
PV of PPG external debt (in percent of GDP + remittances)	...	...	36.2			33.0	32.6	32.6	32.5	32.5	32.5		26.9	16.7	
PV of PPG external debt (in percent of exports + remittances)	...	...	83.7			74.8	72.9	76.2	80.7	82.2	81.1		79.7	61.7	
Debt service of PPG external debt (in percent of exports + remittances)	...	...	4.4			4.3	4.0	4.2	4.5	4.4	4.2		5.1	4.2	

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

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

2/ Includes both public and private sector external debt. The years in the table refer to calendar years.

3/ 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.

4/ 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. The residual is particularly large in 2011 because the nominal bilateral US$/kip-exchange rate is projected to remain constant in 2011, unlike in the outer years.

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

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

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

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

Table 2. Lao P.D.R.: Public Sector Debt Sustainability Framework, Baseline Scenario, 2008–31

(In percent of GDP, unless otherwise indicated)

	Actual					Projections										
	2008	2009	2010	Average 1/	Standard Deviation 1/	2011	2012	2013	2014	2015	2016	2011–16 Average	2021	2031	2017–31 Average
Public sector debt 2/	56.7	61.0	58.8			54.4	53.1	51.4	49.9	48.3	47.1		37.1	22.4	
Of which: Foreign-currency denominated	54.0	55.4	51.8			46.7	45.7	45.3	45.1	44.7	44.4		36.4	22.0	
Change in public sector debt	-3.1	4.3	-2.2			-4.4	-1.3	-1.7	-1.5	-1.6	-1.2		-2.2	-0.9	
Identified debt-creating flows	-8.5	5.0	-5.5			-6.1	-4.0	-2.8	-2.3	-2.0	-1.6		-3.2	-2.3	
Primary deficit	3.2	6.1	3.6	3.4	1.2	1.7	1.0	1.2	1.5	2.0	1.8	1.5	0.1	-0.5	0.0
Revenue and grants	16.0	17.9	18.7			18.7	19.4	19.5	19.2	18.6	18.5		18.1	18.4	
Of which: Grants	1.7	2.3	2.3			1.9	1.7	1.7	1.7	1.7	1.7		1.2	0.1	
Primary (noninterest) expenditure	19.2	24.0	22.4			20.4	20.4	20.7	20.7	20.6	20.3		18.2	17.9	
Automatic debt dynamics	-11.6	-0.9	-9.2			-7.8	-4.9	-4.0	-3.8	-4.0	-3.4		-3.3	-1.8	
Contribution from interest rate/growth differential	-4.9	-3.7	-4.4			-4.8	-4.5	-3.7	-3.6	-3.7	-3.4		-2.6	-1.3	
Of which: Contribution from average real interest rate	-0.6	0.3	0.1			-0.3	-0.2	-0.1	-0.1	-0.1	0.0		0.0	0.0	
Of which: Contribution from real GDP growth	-4.3	-4.0	-4.5			-4.5	-4.2	-3.5	-3.5	-3.7	-3.3		-2.6	-1.4	
Contribution from real exchange rate depreciation	-6.7	2.8	-4.8			-2.9	-0.5	-0.4	-0.2	-0.3	0.0		...	...	
Other identified debt-creating flows	-0.1	-0.3	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	-0.1	-0.3	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g., bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	5.4	-0.6	3.3			1.7	2.7	1.1	0.8	0.4	0.4		1.0	1.4	
Other sustainability indicators	…	…	43.6			41.1	40.4	39.0	37.7	36.5	35.6		27.8	17.3	
Of which: Foreign-currency denominated	…	…	36.6			33.3	33.0	32.9	32.9	32.8	32.9		27.2	17.0	
Of which: External	...	...	36.6			33.3	33.0	32.9	32.9	32.8	32.9		27.2	17.0	
Of which: External	...	...	...			...	...	...	...	...	...		...	...	
Gross financing need 3/	5.6	8.8	6.2			3.9	2.9	3.0	3.4	3.8	4.1		2.3	0.7	
PV of public sector debt-to-revenue and grants ratio (in percent)	…	…	232.8			219.5	208.2	200.5	196.6	195.9	192.0		153.9	94.2	
PV of public sector debt-to-revenue ratio (in percent)	…	…	264.7			243.6	227.9	219.5	215.5	215.4	210.9		164.5	94.9	
Of which: External 4/	…	…	222.1			197.7	185.7	185.0	187.8	194.0	195.0		160.8	93.0	
Debt service-to-revenue and grants ratio (in percent) 5/	11.1	10.2	10.9			10.9	9.7	9.5	9.8	9.8	9.4		9.7	6.3	
Debt service-to-revenue ratio (in percent) 5/	12.5	11.7	12.5			12.1	10.6	10.4	10.8	10.7	10.3		10.4	6.4	
Primary deficit that stabilizes the debt-to-GDP ratio	6.3	1.8	5.9			6.1	2.2	2.9	3.0	3.6	3.0		2.4	0.3	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	7.8	7.6	7.9	7.1	1.1	8.3	8.4	7.1	7.4	7.9	7.4	7.7	7.1	6.2	6.4
Average nominal interest rate on forex debt (in percent)	1.0	0.9	1.4	0.9	0.3	1.6	1.6	1.6	1.8	1.8	1.8	1.7	1.8	1.8	1.9
Average real interest rate on domestic debt (in percent)	3.9	10.0	-2.4	11.5	13.3	-5.9	-5.3	-4.3	-3.7	-3.6	-3.2	-4.3	-2.6	-1.9	-0.6
Real exchange rate depreciation (in percent, + indicates depreciation)	-12.6	5.6	-9.3	-4.9	8.6	-6.1	...	...	...	...	...	...	...	...	...
Inflation rate (GDP deflator, in percent)	6.0	-4.3	5.6	7.9	5.4	8.1	6.7	5.3	4.8	4.6	4.0	5.6	4.0	4.0	4.0
Growth of real primary spending (deflated by GDP deflator, in percent)	0.2	0.3	0.0	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.1
Grant element of new external borrowing (in percent)	...	...	...	…	…	24.9	26.1	27.9	28.5	27.2	28.0	27.1	28.1	20.9	...

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

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

2/ The public sector debt represents general government gross debt. The fiscal year for Lao P.D.R. is October–September, but the DSA is done based on calendar year data.

3/ 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.

4/ Revenues excluding grants.

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

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2011–31

(In percent)

	Projections							
	2011	2012	2013	2014	2015	2016	**2021**	2031
Present value of debt-to-GDP ratio								
Baseline	33	33	33	33	33	33	**27**	17
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	33	30	25	17	17	23	**46**	65
A2. New public sector loans on less favorable terms in 2011–31 2/	33	33	35	36	37	38	**35**	26
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	33	33	33	33	33	34	**28**	18
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	33	38	46	45	44	44	**34**	19
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	33	34	35	35	35	35	**29**	18
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	33	37	41	41	40	40	**32**	18
B5. Combination of B1–B4 using one-half standard deviation shocks	33	39	43	42	42	41	**33**	19
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	33	45	45	45	45	46	**38**	24
Present value of debt-to-exports ratio								
Baseline	77	75	78	83	84	83	**82**	66
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	77	68	59	44	45	57	**139**	251
A2. New public sector loans on less favorable terms in 2011–31 2/	77	76	82	90	95	96	**105**	99
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	77	73	77	82	83	82	**82**	66
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	77	105	144	151	151	147	**138**	96
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	77	73	77	82	83	82	**82**	66
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	77	83	97	102	103	101	**96**	70
B5. Combination of B1–B4 using one-half standard deviation shocks	77	93	108	113	113	111	**105**	76
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	77	73	77	82	83	82	**82**	66
Present value of debt-to-revenue ratio								
Baseline	198	186	185	188	194	195	**161**	93
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	198	168	140	100	103	134	**272**	356
A2. New public sector loans on less favorable terms in 2011–31 2/	198	188	195	204	217	224	**206**	140
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	198	186	188	191	198	199	**166**	96
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	198	215	258	258	262	260	**204**	103
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	198	191	195	198	205	206	**172**	99
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	198	208	231	232	237	236	**188**	99
B5. Combination of B1–B4 using one-half standard deviation shocks	198	219	241	242	247	246	**195**	101
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	198	255	255	260	269	270	**225**	130

Table 3. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public and Publicly Guaranteed External Debt, 2011–31 (concluded)

(In percent)

	Projections							
	2011	2012	2013	2014	2015	2016	2021	2031
Debt service-to-exports ratio								
Baseline	4	4	4	5	5	4	**5**	5
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	4	4	4	4	3	3	**4**	10
A2. New public sector loans on less favorable terms in 2011–31 2/	4	4	4	5	5	5	**7**	7
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	4	4	4	5	5	4	**5**	4
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	4	5	6	7	7	7	**9**	7
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	4	4	4	5	5	4	**5**	4
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	4	4	5	5	5	5	**6**	5
B5. Combination of B1–B4 using one-half standard deviation shocks	4	4	5	6	5	5	**7**	6
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	4	4	4	5	5	4	**5**	4
Debt service-to-revenue ratio								
Baseline	11	10	10	10	10	10	**10**	6
A. Alternative scenarios								
A1. Key variables at their historical averages in 2011–31 1/	11	10	9	9	7	7	**8**	14
A2. New public sector loans on less favorable terms in 2011–31 2/	11	10	10	11	12	12	**14**	10
B. Bound tests								
B1. Real GDP growth at historical average minus one standard deviation in 2012–13	11	10	10	11	11	11	**11**	7
B2. Export value growth at historical average minus one standard deviation in 2012–13 3/	11	10	11	12	12	12	**14**	8
B3. U.S. dollar GDP deflator at historical average minus one standard deviation in 2012–13	11	11	11	11	11	11	**11**	7
B4. Net nondebt creating flows at historical average minus one standard deviation in 2012–13 4/	11	10	11	12	12	11	**13**	7
B5. Combination of B1–B4 using one-half standard deviation shocks	11	11	11	12	12	12	**13**	7
B6. One-time 30 percent nominal depreciation relative to the baseline in 2012 5/	11	14	14	15	15	14	**14**	9
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	24	24	24	24	24	24	**24**	24

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

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

Table 4. Lao P.D.R.: Sensitivity Analysis for Key Indicators of Public Debt 2011–31

	Projections							
	2011	2012	2013	2014	2015	2016	2021	2031
Present value of debt-to-GDP ratio								
Baseline	41	40	39	38	36	36	28	17
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	41	43	44	44	44	45	45	52
A2. Primary balance is unchanged from 2011	41	41	40	39	37	36	33	35
A3. Permanently lower GDP growth 1/	41	41	39	38	37	37	30	24
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	41	42	41	40	40	39	33	24
B2. Primary balance is at historical average minus one standard deviations in 2012–13	41	44	46	44	42	41	32	20
B3. Combination of B1–B2 using one half standard deviation shocks	41	44	45	44	43	42	34	24
B4. One-time 30 percent real depreciation in 2012	41	54	52	49	47	45	35	22
B5. 10 percent of GDP increase in other debt-creating flows in 2012	41	50	48	46	45	43	34	20
Present value of debt-to-revenue ratio								
Baseline	219	208	201	197	196	192	154	94
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	219	222	225	230	237	240	252	282
A2. Primary balance is unchanged from 2011	219	212	206	203	201	196	182	193
A3. Permanently lower GDP growth 1/	219	209	202	199	199	197	167	131
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	219	214	211	210	212	210	181	133
B2. Primary balance is at historical average minus one standard deviations in 2012–13	219	226	235	230	228	223	177	106
B3. Combination of B1–B2 using one half standard deviation shocks	219	226	233	230	230	227	189	129
B4. One-time 30 percent real depreciation in 2012	219	280	265	257	253	246	194	121
B5. 10 percent of GDP increase in other debt-creating flows in 2012	219	257	247	241	240	234	186	111
Debt service-to-revenue ratio								
Baseline	11	10	10	10	10	9	10	6
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	11	10	10	11	12	11	15	19
A2. Primary balance is unchanged from 2011	11	10	10	10	10	10	11	12
A3. Permanently lower GDP growth 1/	11	10	10	10	10	10	10	9
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2012–13	11	10	10	10	10	10	11	9
B2. Primary balance is at historical average minus one standard deviations in 2012–13	11	10	10	12	12	11	12	8
B3. Combination of B1–B2 using one half standard deviation shocks	11	10	10	12	12	11	12	9
B4. One-time 30 percent real depreciation in 2012	11	12	14	14	15	14	16	13
B5. 10 percent of GDP increase in other debt-creating flows in 2012	11	10	11	14	11	11	13	8

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

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

INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

Staff Report for the 2011 Article IV Consultation—Informational Annex

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

June 22, 2011

Contents Page

ANNEX I. LAO P.D.R.: FUND RELATIONS
(As of May 31, 2011)

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

II. **General Resources Account:**

	SDR million	Percent Quota
Quota	52.90	100.00
Fund holdings of currency	52.90	100.00

III. **SDR Department:**

	SDR million	Percent Allocation
Net cumulative allocation	50.68	100.00
Holdings	50.62	99.88

IV. **Outstanding Purchases and Loans:**

	SDR million	Percent Quota
ECF Arrangements	4.53	8.56

V. **Latest Financial Arrangements:**

Type	Approval Date	Expiration Date	Amount Approved (SDR million)	Amount Drawn (SDR million)
ECF 1/	4/25/01	4/24/05	31.70	18.12
ECF 1/	6/04/93	5/07/97	35.19	35.19
SAF	9/18/89	9/17/92	20.51	20.51

1/ Formerly PRGF.

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

	Forthcoming				
	2011	2012	2013	2014	2015
Principal	1.36	2.27	0.91		
Charges/interest	0.00	0.01	0.00	0.00	0.00
Total	1.36	2.27	0.91	0.00	0.00

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

Not applicable.

VIII. Implementation of Multilateral Debt Relief Initiative (MDRI)

Not applicable.

IX. Implementation of Post-Catastrophe Debt Relief (PCDR)

Not applicable.

X. Safeguards Assessments

A safeguards assessment of the Bank of Lao P.D.R. (BoL) was completed in April 2003 in the context of an ECF arrangement (Country Report Nos. 03/308 and 05/08). Progress on implementing the safeguards assessment recommendations has been slow. The authorities indicated that they were not in a position to implement an earlier agreement to undertake a joint audit of the BoL's 2003 and 2004 accounts by the state auditor and an international audit firm. The state auditor has since completed these audits, but the joint audit issue remains unresolved.

XI. Exchange Arrangement

According to AREAER, the de jure regime is a float, and the de facto regime stabilized. The authorities' objective is to limit currency fluctuations vis-à-vis major currencies, including the U.S. dollar and Thai baht within ±5 percent per annum. The BoL sets a daily official reference rate, which is calculated as a weighted average of the previous day's interbank rates. Commercial banks and foreign exchange bureaus are required to maintain their buying and selling rates within ± 0.25 percent of the BoL's daily reference rate for the U.S. dollar. For the euro and baht, the buying and selling rates may not exceed a margin of 0.5 percent. For other currencies, a margin of 2 percent applies.

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

XII. Last Article IV Consultation Discussions

The last Article IV consultation discussions were held in Vientiane during June 2–15, 2010. The staff report (Country Report No. 11/44) was completed on July 14, 2010 and was published on February 7, 2011.

XIII. Technical Assistance During the Past 18 Months

FAD: Peripatetic expert in customs administration, January 2011 and July to August 2010
FAD: Customs Administration Mission, March 28 to April 6, 2011
FAD: Reforms in Tax Administration, March 28 to April 6, 2011

XIV. Resident Representative

Mr. Benedict Bingham assumed the Senior Resident Representative post for Vietnam and Lao P.D.R., based in Hanoi, on October 17, 2007. The IMF's local office in Vientiane was closed in July 2010. Contacts with the authorities are henceforth handled by the Hanoi office.

ANNEX II. LAO P.D.R.: WORLD BANK-IMF COLLABORATION

The Bank and the IMF country teams for Lao P.D.R. met on March 23 and May 19, 2011, to identify macrocritical structural reforms and to coordinate the two teams' work for FY12. The teams were led by Ms. Keiko Miwa (Country Manager, EASPR) and Mr. Gerard Almekinders (IMF Mission Chief for Lao P.D.R.).

The teams agreed that Lao P.D.R.'s main macroeconomic challenges are to maintain macroeconomic and financial stability, and ensure that the country's natural resource wealth is developed in a sustainable way that benefits the entire population. Prudent fiscal policies and a strengthening of the monetary policy framework, both aimed at addressing potential pressures on the external position and ensure inflation remains contained, are key. Vigilance in financial sector supervision will also be needed to meet these challenges. Ongoing reforms to the public financial management will need to be strengthened further—on both the tax and spending side—to ensure that Lao P.D.R.'s resource wealth not only sustains the pace of economic development, but ensures that this economic development results in a generalized improvement in living standards and reduction in poverty.

Lao P.D.R.: Bank and Fund Planned Activities in Macrocritical Structural Reform Areas, June 2011–May 2012

Title	Products	Provisional Timing of Missions	Expected Delivery Date
1. Bank Work Program	Country Partnership Strategy 2011–15	Preparatory work is ongoing	Board discussion expected in October 2011
	New series of Poverty Reduction Support Operations	Preparatory work and missions throughout fiscal year 2011–12 (identification mission tentatively scheduled in September 2011)	Board discussion expected in July 2012
	Customs and Trade Facilitation Project (CTFP)	Ongoing	Implementation throughout fiscal year 2011–12
	Analytical work, technical assistance, and possibly lending operations in the area of social services and social safety net (including education, health, and pensions systems)	Ongoing	Implementation throughout fiscal year 2012
2. Fund Work Program	Staff visit/assessment letter for WB	February 2012	February 2012.
	Article IV Consultation	May 2012	Board discussion in July 2012
	TA on customs revenue administration and modernization	FY2012, peripatetic expert visit and/or an FAD mission	BTO/TA report in FY12
3. Joint Work Program	External Debt Sustainability Analysis	May 2011 May 2012	June 2011 June 2012
	Joint Staff Advisory Note	August–September 2011	October 2011

ANNEX III. LAO P.D.R.: RELATIONS WITH THE ASIAN DEVELOPMENT BANK[1]

The Asian Development Bank (AsDB)'s current Country Strategy and Program (CSP) 2007−11 is aligned with the government's development strategy (National Socio-Economic Development Plan (NSEDP, 6th five-year plan)), and seeks to promote pro-poor sustainable growth, social inclusiveness, and improved governance. The country assistance program evaluation, 2000–09, concluded that the AsDB's assistance was successful, relevant, and effective. The AsDB is currently preparing its next country partnership strategy (CPS) for the period 2012−16. The CPS will be designed to support the implementation of the 7th five-year plan.

At the Third Greater Mekong Subregion (GMS) Summit, the GMS leaders discussed ways to deepen economic cooperation and improve connectivity to expand markets, improve access to social services, and protect the environment. The AsDB aims to maximize benefits from this cooperation and the CSP aims to foster connectivity, promote foreign direct investment, and create regional public goods. The next CPS is likely to focus on infrastructure, education, public sector financial management, agriculture and natural resources, and urban development.

The performance-based allocation of the Asian Development Fund (ADF), based on the country performance assessment finalized in 2010 provided Lao P.D.R. with an ADF allocation in the amount of US$152 million for the biennial period 2011–12. This represents a significant increase from US$115 million in grants for 2009–10. Also starting in 2011, the AsDB provides a loan (56 percent) and grant (44 percent) mix for the next two years (2011–12).

As of end-2010, cumulative grants approved stood at US$339 million, out of which a cumulative amount of US$111 million was awarded for contracts. During 2010, US$35 million of grants were disbursed and US$41 million of contracts were awarded. Eleven new technical assistance (TA) projects for a total of US$10 million were approved in 2010, including project preparation TA projects related to transport and rural access, capacity building TA related to social and environmental needs, and policy and advisory TA related to private sector development.

Lao P.D.R.: Asian Development Bank Commitments and Disbursements, 2001–11 1/

(In millions of U.S. dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010/11 2/
Commitments	65.0	43.2	34.9	54.8	87.0	60.7	47.4	46.6	58.1	70.7 / 5.0
Disbursements	44.7	48.6	54.7	48.5	78.7	76.8	74.8	56.9	66.7	76.6 / 11.7

Source: Data provided by the Asian Development Bank.

1/ Starting from 2006, the commitments and disbursements included both loans and grants.
2/ The commitments and disbursements in 2011 are as of April 2011.

[1] Prepared with support from the Asian Development Bank.

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

As of June 7, 2011

I. Assessment of Data Adequacy for Surveillance

General: Macroeconomic and financial data provided to the IMF have shortcomings that significantly hamper surveillance. Strengthening balance of payments and national accounts statistics is a priority.

National Accounts: National accounts comprise annual estimates of GDP by activity at current and constant base year 2002 prices, broadly following the *System of National Accounts (SNA) 1993*. Despite some improvements following the implementation of annual enterprise and household surveys, unresolved gaps and inappropriate data collection and compilation methodology continues to undermine the coverage and reliability of the GDP estimates. Lao P.D.R. participates in the "Statistics (STA) Project to Implement the SNA and ICP," funded by the government of Japan, and has requested technical assistance (TA) to improve annual national accounts and develop quarterly national accounts.

Price statistics: Lao P.D.R. compiles a monthly CPI (December 2010=100) using weights based on the 2007/08 Lao Expenditure and Consumption Survey. To date no PPI has been developed. Technical assistance on improving the CPI and developing a PPI has been requested by the authorities through their participation in the "STA Project to Implement the SNA and ICP."

Government finance statistics: Government finance statistics remain weak. The timeliness of fiscal reporting needs significant improvement. Off-budget activities are not included in the fiscal data, although they have expanded rapidly. Annual budget and outturn data formats do not follow international standards. Except for the annual data disseminated in the *Official Gazette*, no fiscal data are disseminated in the country.

Monetary statistics: Regarding the compilation of monetary financial statistics (MFS), the sectorization, classification, and valuation of data, and the chart of accounts need to be strengthened. The Standardized Report Forms (SRFs) need to be introduced. Financial soundness indicators should also be compiled and published. STA plans to propose a mission to introduce the SRFs during this financial year.

Balance of payments: Overall, the quality of the balance of payments statistics is considered to be poor. Improvements are needed in all categories, including the current account, foreign direct investment, and private capital flows. A TA mission was proposed to the authorities to be conducted in July 2009 (the previous one was in 2002), however the BoL did not accept it stating that "the implementation of the knowledge transfer (from the 2002 mission) is not yet satisfactory, as data in this field are related to many concerned parties, and there is no completed data that can be provided yet." STA plans to propose a TA mission during this financial year.

II. Data Standards and Quality

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

III. Reporting to STA

Government finance statistics reporting for publication in the *International Financial Statistics (IFS)* and the *Government Finance Statistics Yearbook*, which was initiated in early 2009, is limited to budgetary central government and has been irregular and with long delays.

The reporting of monetary data is very irregular and with long delays. The authorities recently submitted data for 2009 and 2010.

Quarterly balance of payments data are reported once a year in a highly aggregated format. The last published data in the *IFS* and *Balance of Payments Statistics Yearbook* correspond to 2009.

Lao P.D.R.: Table of Common Indicators Required for Surveillance
(As of June 7, 2011)

	Date of Latest Observation	Date Received	Frequency of Data[1]	Frequency of Reporting[1]	Frequency of Publication[1]
Exchange Rates	05/18/11	05/18/11	D	D	D
International Reserve Assets and Reserve Liabilities of the Monetary Authorities[2]	Feb 2011	05/11/11	M	I	Q
Reserve/Base Money	Feb 2011	05/11/11	M	I	Q
Broad Money	Feb 2011	05/11/11	M	I	Q
Central Bank Balance Sheet	Feb 2011	05/11/11	M	I	Q
Consolidated Balance Sheet of the Banking System	Feb 2011	05/11/11	M	I	Q
Interest Rates[3]	Dec 2010	5/18/11	M	M	Q
Consumer Price Index	Mar 2011	04/28/11	M	M	M
Revenue, Expenditure, Balance and Composition of Financing[4]—General Government[5]	Q2 FY11	05/06/11	I	I	I
Revenue, Expenditure, Balance and Composition of Financing[4]—Central Government[5]	Q2 FY11	05/06/11	Q	I	M
Stocks of Central Government and Central Government-Guaranteed Debt [6]			NA	NA	NA
External Current Account Balance	Q1 2011	05/16/11	Q	I	I
Exports and Imports of Goods and Services	Q1 2011	05/16/11	Q	I	I
GDP/GNP	2009/10	05/16/11	A	A	A
Gross External Debt	Dec 2009	05/13/11	M	M	I
International Investment Position[6]			NA	NA	NA

[1] Daily (D); weekly (W); monthly (M); quarterly (Q); annually (A); irregular (I); and not available (NA).
[2] Any reserve assets that are pledged of otherwise encumbered should be specified separately. Also, data should comprise short-term liabilities linked to a foreign currency, but settled by other means as well as the notional values of financial derivatives to pay and to receive foreign currency, including those linked to a foreign currency, but settled by other means.
[3] Both market-based and officially-determined, including discount rates, money market rates, and rates on treasury bills, notes and bonds.
[4] Foreign and domestic bank, nonbank financing.
[5] The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.
[6] Includes external gross financial asset and liability positions vis-à-vis nonresidents.

INTERNATIONAL MONETARY FUND
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August 12, 2011

International Monetary Fund
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IMF Executive Board Concludes Article IV Consultation with The Lao People's Democratic Republic

On July 8, 2011, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao People's Democratic Republic.[1]

Background

The Lao P.D.R. economy performed well in 2010. Growth, estimated at 7.9 percent, was buoyed by ongoing projects in the mining and hydropower sectors, as well as a rebound in garment exports, nonregional tourism, and FDI inflows following the recovery from the global economic crisis. Domestic demand, boosted by still sizable stimulus from fiscal and monetary policy, also supported construction and other sectors.

Inflation, which had been relatively subdued in recent years, rose to 9 percent in April 2011, as the impact of higher international food and fuel prices fed through the economy. Significant capital inflows, associated with the two successful IPOs that inaugurated the new stock exchange and capital brought in by foreign banks, helped gross reserves recover to US$727 million (2.5 months of prospective nonresource imports) at end-2010. However, the core balance of payments—defined as the current account balance net of FDI and ODA—remained in deficit by over 5 percent of GDP.

[1] Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities. An explanation of any qualifiers used in summings up can be found here: http://www.imf.org/external/np/sec/misc/qualifiers.htm.

Fiscal and monetary policy were tightened, but both remained accommodative. The overall fiscal deficit narrowed from 6.9 to 4.8 percent of GDP in FY10 (October 2009 to September 2010). While this represents an impressive fiscal consolidation, the deficit remains substantially larger than the 2¾ percent of GDP annual average recorded during 2006–08. Revenue rose 1.5 percentage points, to 18.6 percent of GDP. The introduction of the VAT in January 2010, along with higher royalties and dividends from the hydropower and mining sectors, more than compensated for the slump in corporate income tax/profit tax related to the low international copper prices in 2009. Spending was reduced by 0.7 percentage points, to 23.4 percent of GDP, driven mostly by a reduction in off-budget capital spending.

The growth of credit to the private sector slowed from 88 percent in 2009 to 44 percent in 2010, as the stock of unmet credit demand from 2005–07, when the state-owned commercial banks were undergoing reorganizations diminished, and the rising system-wide loan-to-deposit ratio became a constraining factor. The Bank of Lao P.D.R. (BoL) also raised its overdraft lending rate by 100 basis points to 5 percent in September 2010. However, net domestic assets of the BoL continued to expand rapidly, as a result of its direct lending activities to local government, net injections of liquidity into the banking system, and an expansion of other assets. This resulted in a significant build up of excess reserves in the banking system.

The outlook for GDP growth in 2011 is favorable but inflation is projected to rise further. Growth is projected to rise to 8.3 percent, supported by a continued expansion in the mining and hydropower sectors, growth of nonresource exports and tourism, and continued strong domestic demand. Construction for the massive Hongsa Lignite thermal power plant project started in the third quarter of 2010 and commercial operations of the Nam Theun II hydropower project started in March 2010. The full-year effect of both projects will add to growth in 2011. Inflation could rise to 10 percent by June. Even with favorable base effects related to last year's spike in prices of sticky rice, inflation is expected to average almost 9 percent for 2011 as a whole. International oil prices have stabilized in recent weeks and the outlook for the rice harvest is good. However, shocks to food and fuel prices could quickly translate into higher inflation. The external position is projected to strengthen further in 2011.

Lao P.D.R.'s medium-term prospects are promising. A pipeline of large hydropower and mining projects, underpinned by record-high copper and gold prices and rapidly-rising demand for electricity in neighboring countries, is projected to keep growth broadly in line with the annual average growth target of 8 percent in the 7th five-year plan (2011–15). Activity outside of the mining and hydropower sectors is also projected to remain buoyant, although this would need to be supported by continued reforms to strengthen the foundation of the economy and the business climate.

However, the implementation of the 7th five-year plan will need to address a number of challenges. Firstly, ongoing uncertainties in the global economic outlook continue to pose risks. While the outlook for Asia is promising, high oil prices, weak sovereign balance sheets, and continued imbalances in real estate markets could slow the global recovery and have negative spillover effects, both with respect to potential volatility in key commodity prices (copper and gold) and the strength of FDI inflows. Secondly, steps will need to be taken to guard against potential internal risks, notably to macroeconomic and financial stability. Thirdly, achievement of the plan's economic goals will require an improvement in the efficiency of public investment. Lastly, ongoing reforms to the public financial management will need to be strengthened further—on both the tax and spending side.

Executive Board Assessment

Executive Directors commended the authorities for sound policies that have underpinned remarkable progress on economic development and poverty reduction. Directors emphasized that, in the near term, further fiscal and monetary tightening will be important to curb inflation and support the external position. They also agreed that medium-term economic prospects for Lao P.D.R. hinge on stronger frameworks for macroeconomic and financial policies as well as accelerated structural reforms to diversify the economy, improve the business climate, and foster trade.

Directors underscored the need to keep the non-mining fiscal balance on a consolidation path aimed at reducing the budget's exposure to volatile mining revenues. This would require sustained efforts to raise non-resource revenue beyond the targets implied by the authorities' development plan, alongside improvements to public financial management to create space for pro-poor spending. Noting the country's high risk of debt distress, Directors highlighted the importance of preserving prudent borrowing policies and improving the management of external debt.

Directors welcomed the authorities' intentions to tighten monetary policy, including by phasing out direct lending by the central bank, and to mop up excess liquidity through additional sales of central bank securities. In this context, consideration could also be given to raising reserve requirements. Directors encouraged the central bank to take additional steps to strengthen the monetary policy framework, including by specifying a numerical inflation objective that would not risk policy pro-cyclicality. They also advised further development of the interbank and treasury bill markets to reinforce the monetary transmission mechanism.

Directors agreed that the stabilized exchange rate regime remains the appropriate monetary anchor. They stressed that a monetary policy tightening is critical to sustain the current level of the exchange rate.

Directors noted that the rapid expansion of the banking sector calls for a strengthening of banking supervision and prudential regulations, building on technical assistance provided by the Asian Development Bank. They considered it a priority to complete the recapitalization of the state-owned commercial banks and improve governance. Directors also saw a need to strengthen the AML/CFT framework based on the recommendations of the Asia Pacific Group.

Directors welcomed the adoption of the Statistics Law and the commitment to improve the quality and availability of macroeconomic data. They encouraged the authorities to avail themselves of the Fund's technical assistance to address remaining shortcomings in this area.

Public Information Notices (PINs) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case.

Lao P.D.R.: Selected Economic and Financial Indicators, 2006–11

	2006	2007	2008	2009	2010 Est.	2011 Proj.
GDP and prices (percentage change)						
Real GDP growth	8.6	7.8	7.8	7.6	7.9	8.3
CPI (annual average)	6.8	4.5	7.6	0.0	6.0	8.7
CPI (end year)	4.7	5.6	3.2	3.9	5.8	9.7
Public finances (in percent of GDP) 1/						
Revenue	14.5	15.6	15.9	17.1	18.6	18.4
Of which: Mining	0.9	1.9	2.6	2.1	1.8	2.9
Of which: Hydropower	1.1	0.8	0.7	0.8	0.8	0.8
Of which: Grants	2.0	1.7	1.6	2.3	2.4	1.9
Expenditure	17.4	18.3	18.5	24.1	23.4	21.0
Overall balance (including grants) 2/	-2.9	-2.7	-2.6	-6.9	-4.8	-2.6
Nonmining balance	-3.7	-4.6	-5.1	-9.0	-6.6	-5.5
Money and credit (annual percent change) 3/						
Reserve money	37.2	58.8	20.2	34.7	48.6	16.5
Broad money	30.1	38.7	18.3	31.2	39.1	25.2
Bank credit to the economy 3/	-9.1	21.0	84.6	90.7	46.0	26.8
Interest rates (end-of-period) 4/						
On three-month kip deposits	5.5	5.5	6.0	6.0	5.5	5.4
On short-term kip loans (1 year)	14.0	11.5	11.5	10.0	14.2	14.0
Balance of payments						
Exports (in millions of U.S. dollars)	1,178	1,324	1,609	1,521	2,217	2,801
In percent change	69.2	12.4	21.5	-5.5	45.8	26.3
Imports (in millions of U.S. dollars)	1,602	2,158	2,837	2,893	3,582	4,649
In percent change	26.1	34.7	31.5	2.0	23.8	29.8
Current account balance (in millions of U.S. dollars)	-352	-663	-982	-1,174	-1,173	-1,530
In percent of GDP	-9.9	-15.7	-18.5	-21.0	-18.2	-19.4
Gross official reserves (in millions of U.S. dollars)	336	536	636	633	727	813
In months of prospective goods and services imports 5/	3.0	3.3	3.7	2.6	2.5	2.5
External public debt and debt service						
External public debt						
In millions of U.S. dollars	2,351	2,521	2,949	3,109	3,491	3,682
In percent of GDP	63.1	58.2	54.0	55.4	51.8	46.7
External public debt service						
In percent of exports	3.5	4.0	4.3	4.9	4.5	4.6
Exchange rate						
Official exchange rate (kip per U.S. dollar; end-of-period) 4/	9,655	9,341	8,514	8,483	8,042	8,020
Real effective exchange rate (2000=100) 4/	102.8	102.8	111.5	118.1	122.3	124.5
Memorandum items:						
GDP at current market prices						
In billions of kip	35,981	40,467	46,215	47,567	54,195	63,446
In millions of U.S. dollars	3,564	4,226	5,313	5,598	6,461	7,891

Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.
1/ Fiscal year basis (October to September).
2/ Includes off-budget investment expenditures.
3/ Excludes debt write-offs. Includes Bank of Lao P.D.R. lending to state-owned enterprises and subnational levels of government.
4/ The figures for 2011 are as of June 2011.
5/ Excludes imports associated with large resource projects.

Statement by Aida Budiman, Alternate Executive Director for Lao P.D.R. and Thamnuvong Soulysak, Advisor to Executive Director

July 5, 2011

Introduction

On behalf of our Lao authorities, we would like to thank the mission team for the constructive policy discussions and invaluable advice provided during the recent Article IV consultation. The authorities acknowledged that the consultations provided a good opportunity to assess the economic situation of the country geared toward strengthening macroeconomic stability and to intensify structural reforms. They broadly agree with the appraisal contained in the report and will thoughtfully consider the recommendations therein.

Recent Economic Development and Outlook

Lao PDR successfully completed their sixth five-year socio-economic development plan (2005-2010) with an annual average growth of 7.9 percent - among the highest in the region. The robust performance was due to the sustained growth in mining sector, hydropower projects, as well as other non-resource sectors. This has helped the country achieve a significant reduction in national poverty, as well as keeping it on track to achieve a number of Millennium Development Goals (MDGs). Continuing this accomplishment, the country has launched the seventh five-year socio-economic development plan (2011-2015), which among others include, to graduate from least-developed country status and to lower the poverty rate by 10 percent by the end of period. Given the existing pipeline of large hydropower and mining projects, as well as other reforms including human resource development, legal system, and business climate, the authorities consider the economic outlook to be promising.

Strong economic growth is expected to continue in 2010 and 2011, at 7.9 percent and 8.3 percent, respectively. Nevertheless, the recent increasing trend of fuel and food prices, and past stimulus of monetary and fiscal policy have put upward pressures on inflation. CPI inflation rose recently from below 6 percent in December 2010 to 9 percent in April 2011. In recognition of the inflationary impact, macroeconomic policies have been shifted in a tighter direction and the authorities remain vigilant on any possible external shocks.

During the first half of 2011, exchange rate management was geared towards maintaining stability, which was reflected by the low fluctuation of Kip exchange rate. The Kip has slightly appreciated against the US dollar by 4.3 percent, but depreciated against the Baht by 2.9 percent. In promoting the use of the domestic currency and de-dollarized policy, the authorities are well aware that a stable exchange rate is particularly important to restore public confidence and to anchor the monetary policy. The external position is expected to improve due to an increase in other private flows at the end of 2010. International reserves increased to $780 million at end-April 2011 from $636 million at end-2009.

The authorities maintain a strong commitment to pursue structural reforms and further mobilizing foreign investments with the support of the international community. The authorities concur with staff that in near term, there is a need to tighten macroeconomic policies to address potential pressures on the external position and ensure inflation remains contained. In the medium and longer term, the broad-based and sustained economic growth underpinned by external and domestic macroeconomic stability is crucial in raising general living standards, achieve further poverty reduction and meet the MDGs.

Fiscal Policy

In light of continuing fiscal consolidation, fiscal performance has been encouraging. The authorities are committed to continuing fiscal consolidation and reforming tax and customs administration, as well as public finance management. The fiscal position is improving even though an increase in the resource revenues from higher gold and copper prices are offset by a decline in non-resource revenues and declining donor financing. The authorities expect the overall budget deficit to narrow down to 2.6 percent of GDP in FY11 from 4.8 percent in FY10, and stabilize over the medium-term. As stated in the seventh five-year socio-economic development plan (2011-2015), the fiscal consolidation strategy will be based more on the strengthening the revenue side[1] while improving the expenditure priorities.

The authorities agree with staff that there is room to raise non-resource revenue. A broader medium-term fiscal strategy is currently being drawn-up with support from the Asian Development Bank (AsDB) and the World Bank. Efforts to widen the tax base are under way, while tax and customs reforms with the support of Fund TA are yielding positive results. VAT was successfully introduced in 2010 to broaden the revenue base. In this regard, the authorities are currently considering a request for further Fund TA towards enhancing the implementation and VAT collection in the provincial areas and the management of country's natural resource endowment.

In the area of debt management, the authorities are currently installing the DMFAS debt recording system which will improve the quality of debt records going forward. To complement this, the authorities are also improving technical capacity in debt management strategy in order to have a better understanding on debt sustainability. Although the risk of debt distress is still a concern, Lao PDR has improved its public external debt performance due to the projected strong growth over the medium term and the high level of concessionality of official borrowing. The authorities have further stepped-up efforts by introducing the so-called government debt ceiling for certain projects[2].

[1] For baseline scenario, domestic revenue target for the seventh five-year plan is 16-17 percent of GDP.

[2] For social and economic development projects such as infrastructure, education and health projects, the ceiling is not to exceed 25 percent of the annual government revenue; with the interest rate is not to exceed 3 percent per annum and with repayment period over 13 years.

Monetary and Exchange Rate Policies

Nothwithstading the inflationary pressures, monetary policy has been geared to achieve and maintain macroeconomic stability. The authorities share the staff's concern on the expansion of the central bank net domestic assets (NDA), and have implemented some policy measures to absorb the excessive liquidity, including a gradual exit from direct lending. Currently, the BOL merely considers loans for some necessary and productive projects to improve the supply of consumption goods, with the approval of the National Assembly and taking into account the potential inflationary pressures.

The BOL continues to improve the monetary policy framework to increase the effectiveness of open market operations. One of the measures undertaken is to promote interbank operations to strengthen liquidity management in the banking system.

The authorities welcome staff's assessment on the exchange rate policy, whereby a stabilized exchange rate regime is the appropriate monetary anchor. The authorities are committed to reduce the volatility of exchange rate and promote the greater use of the Kip. With the recent establishment of the Lao Securities Exchange and successful IPOs, the BOL may face new challenges to deal with the exchange rate volatility due to increased capital flows. In this regard, the BOL takes staff's suggestion on enhancing the capacity for BOL's liquidity forecasting framework alongside the preparation of foreign exchange cash-flow projections.

Financial and Banking Issues

With the current rapid development of the economy, the strengthening of banking supervision is therefore required. Currently, the banking condition is relatively stable with low NPLs and regular banking inspections. As suggested by staff, the BOL will continue to strengthen prudential regulations and supervision by taking into consideration the recommendations of the recent AsDB-provided TA, including the AML/CFT framework. Continuous efforts have been made to modernize the banking system both at the BOL and commercial banks. However, the different level of IT development in commercial banks has complicated the BOL's efforts in collecting and consolidating banking data and financial soundness indicators (FSI). With this in mind, the authorities place greater priority on efforts to strengthen data quality before participating in the FSAP.

Structural Reforms

Attracting foreign capital inflows, especially FDIs, is always at the highest priority of the authorities' development agenda to support economic diversification. In this regard, the authorities are moving forward to enable a business-friendly environment conducive to private sector development. Progress has been made to improve the legal framework so as to provide a level playing field and business climate particularly towards attracting private investments. However, given Lao PDR's low rank in the World Bank's Doing Business Survey, the authorities recognize that ongoing efforts need to be accelerated. The authorities are also currently revising the relevant laws and passing WTO-compliant implementing decrees. Furthermore, as rightly pointed out by staff, the authorities are firmly committed towards modernizing and enhancing the quality and availability of economic and financial data.

A temporary rice export ban was imposed from November 2010 until February 2011. The measure was made necessary to address a speculatively fuelled price increase and excessive foreign demand pressures in September 2010, which endangered the domestic rice stock. However, any future ban would be implemented in accordance with prescribed procedures of the WTO, including prior notification to Lao PDR's trading partners.

Conclusion

Our Lao authorities highly appreciate the Fund's continuous engagement, timely advice and policy recommendations. They call for appropriate technical assistance from the Fund in various areas, and look forward to enhancing the productive and warm relationship with the Fund and the international community.