



**LAO P.D.R.—TENTH ROUND TABLE MEETING  
Vientiane, October 20–21, 2010**

**Background Note on the Macroeconomic Situation**

1. The IMF welcomes the opportunity to participate in this Round Table Meeting. Against the backdrop of the ongoing recovery of the world economy from the 2008/09 recession, this meeting provides a timely opportunity to discuss the outlook for the Lao P.D.R. economy. This background note focuses on the IMF’s latest global economic outlook and the opportunities and challenges it may present for Lao P.D.R.

**Global Economic Developments and Outlook**

2. The global economic recovery continued to strengthen during the first half of 2010, supported by a surge in inventory, and more recently fixed investment, which underpinned a sharp rise in manufacturing and global trade. However, the extent of economic recovery differed importantly across regions. Growth remained strong in emerging and developing economies, especially in Asia. The recovery also accelerated in Germany, but the United States and Japan experienced a noticeable slowdown during the second quarter of 2010. Moreover, the turmoil in European sovereign debt markets in the second quarter highlighted the continued fragilities in the global recovery, and while financial conditions have begun to normalize, volatility in financial, currency, and commodity markets remains elevated.

3. In the latest World Economic Outlook, global activity is forecast to expand by 4.8 percent in 2010 and 4.2 percent in 2011, which will continue to be led by strong growth in emerging and developing economies. Balance sheet adjustments by the household and corporate sectors, together with persistent high unemployment, are expected to constrain the recovery in private demand in advanced economies. Nevertheless, the probability of a renewed global slowdown (“double-dip”) still appears low.

**Lao P.D.R.’s Economic Outlook**

4. Lao P.D.R. has weathered the global crisis well, supported by countercyclical macroeconomic policies. While the crisis had an impact on exports, nonregional tourism, and capital inflows, GDP growth held up very well in 2009 (7.6 percent) and is projected to remain close to 8 percent in 2010, one of the highest in the region. Investment in the mining and hydropower sector and major events, such as the South-East Asia Games (2009) and the

450<sup>th</sup> Anniversary of Vientiane (2010) helped support growth during this period. A sizable fiscal expansion and an accommodative monetary policy also provided a boost to domestic demand, especially in 2009, and the strong domestic demand is being supported by a rebound in exports and tourism in 2010. The recent start of commercial operations at the Nam Theun II hydropower project also contributed to growth, while providing further impetus to Lao P.D.R.'s hydropower sector.

5. Despite the uncertain global economic outlook, Lao P.D.R.'s medium-term prospects are promising. The recovery of copper prices and strong demand for electricity in neighboring countries are bringing forward expansion plans in the mining and hydropower sectors, which were delayed in the wake of the global crisis. Provided structural reforms to strengthen the foundations of the economy continue, activity in other sectors is also projected to pick up. This would help Lao P.D.R. make progress toward achieving its commendable goals for poverty reduction and graduating from low-income status.

6. The expansionary macroeconomic policies implemented in recent years, which helped Lao P.D.R. weather the global crisis, were made possible by buffers built up before the crisis. The SDR allocation from the IMF equivalent to US\$65 million was also a helpful supplement to reserves in Lao P.D.R. These buffers should be rebuilt over the medium term, to prepare for future volatility. In this context, attaining the government's medium-term goals will require continued effort in a number of areas:

- ***Maintaining macroeconomic stability.*** As we noted during the recent Article IV Consultation, there are signs that the economy is exceeding its macroeconomic speed limits. While inflation was somewhat higher than anticipated in recent months, it is not expected to pose a serious problem especially if the rice harvest is not impaired. However, addressing ongoing downward pressures on the balance of payments and foreign exchange reserves in the context of the stabilized exchange rate regime will require decisive action by the authorities. Monetary policy—especially direct lending by the Bank of Lao P.D.R.—should be reined in, and fiscal policy should be kept firmly on a consolidation path over the medium term. The latter is also needed to maintain progress in bringing down Lao P.D.R.'s public debt to a sustainable level. We remain of the view that a stabilized exchange rate regime in relation to a weighted basket of Lao P.D.R.'s main trading currencies remains an appropriate monetary anchor for the economy.

- ***Ensuring a sound financial system.*** The government made commendable progress in restructuring the state-owned commercial banks (SOCBs) during the 6<sup>th</sup> National Socio-Economic Development Plan. Their capitalization, governance, internal controls, and risk management were all strengthened during this period. While the reform of the SOCBs will need to continue during the 7<sup>th</sup> National Socio-Economic Development Plan, attention will need to focus increasingly on the safe development of the private portion of the banking sector, as the significant increase in the number of private banks, their continued very rapid credit growth, and emerging linkages to the developing service and casino sectors, all pose

potential risks to the healthy development of the financial sector. The key challenge will be to ensure that the supervisory framework, including that relating to anti-money laundering activities, keeps pace with the development of the financial sector so that the latter supports rather than imperils the development of the economy. In this context, we welcome technical assistance from the Asian Development Bank to support the Bank of Lao P.D.R.'s efforts to bolster financial sector supervision.

- ***Developing a competitive economy.*** We welcome the emphasis being placed on maintaining the momentum of key reforms needed to boost private sector-led growth and the overall competitiveness of the economy. This will be particularly important given the prospective reduction of tariffs under the ASEAN Free Trade Agreement, which will expose Lao P.D.R to increasing competition. In this context we welcome the comprehensive reform plan being drawn up for the SOE sector, as well as the stepped up efforts to prepare for accession to the WTO.

- ***Strengthening the quality and timeliness of statistics.*** We very much welcome the new Statistics Law, which elevates the status of the National Statistics Center. This is an important milestone. As we have noted on many occasions in the past, the development of a robust statistical system, capable of generating high quality, timely statistics will become increasingly important as the economy develops. We very much hope that the new Statistics Law will help strengthen ongoing efforts to address the need for more timely data across all sectors. In this context we would also encourage the authorities to participate in the IMF's General Data Dissemination System, in which almost 100 countries already participate, including many in Asia.

7. The IMF would once again like to thank the government of the Lao P.D.R. for this opportunity to participate in these discussions, and reiterates its continued commitment to providing Lao P.D.R. with the best possible policy advice and support in the period ahead.