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GRAY/23/4586

May 1, 2023

**Statement by Mr. Just and Mr. Akben on Lao People's Democratic Republic
(Preliminary)
Executive Board Meeting
May 3, 2023**

We thank staff for the comprehensive set of reports and, Ms. Lim, Mr. Anwar, and Ms. Xaiyavong for their insightful Buff statement. Consecutive shocks since the pandemic have exacerbated Lao PDR's existing vulnerabilities and have brought it to the brink of a debt-repayment crisis. The debt trajectory will require strict adherence to budget discipline and advancing on far-reaching structural reforms in line with the ambitions set out in the National Socio-Economic Development Plan for 2021-2025 to bolster sources of growth. We broadly concur with staff's appraisal and would like to emphasize the following comments.

Addressing the intertwined imbalances in the economy is critical to address the sluggish post-pandemic growth. Attaining economic growth near the potential will be difficult to achieve without a more sustainable and private sector-led growth model. Fiscal consolidation as well as high inflation will weigh heavily on the population, while cutbacks in government spending will reduce the scale and scope to protect the most vulnerable. *We learned from the Buff that there is a significant divergence between the actual growth rate in 2022 and staff's estimations. What were the main drivers of this stronger-than-expected growth rate, and could it cause changes in staff's baseline assumptions going forward?*

Improvements in the fiscal balance need to be maintained in the medium term to put the public debt on a sustainable downward path. The low tax-to-GDP ratio, along with the significant debt burden, requires a full-fledged and continuous but growth-friendly fiscal consolidation. In addition, refinancing needs increase substantially starting from 2023, especially with the end of debt deferrals to China. *The authorities' plan of asset sales, including concessions to meet financing needs, could be a viable option, but requires macroeconomic stability and predictability. We welcome staff's comments on investor interest in this regard, and the potential impact on fiscal consolidation efforts.* Enhancements to tackle structural weaknesses in governance and transparency, as well as the fight against corruption, would increase investor confidence in the economy. *On the other hand, recent improvements in the fiscal balance were at the expense of capital expenditures, which might*

be undertaken by public-private partnerships (PPP) without significant burden to the budget. Could staff elaborate whether the conditions to develop PPPs are in place?

The monetary policy framework should be strengthened to curb inflation and rebuild confidence in local currency. Staff's assessment that two-thirds of the recent inflation is explained by the exchange rate pass-through effect indicates the need to stabilize the local currency. The local currency depreciation also sparks debt monetization. Furthermore, the improvements in the current account have been reversed by the terms-of-trade shock, and the delayed tourism recovery could not help finance it. Priority should be given to strengthen the operational independence of the central bank and thereby its credibility to reduce very high dollarization, which limits the effectiveness of the transmission of monetary policy. The critically low levels of external buffers also need to be increased over the medium term.

We concur with staff that timely steps should be taken to address the vulnerabilities in the financial sector. Despite improvements in system-wide capital adequacy and asset quality, we share staff's concern that the forbearance measures could conceal the deterioration in nonperforming loans and capital adequacy ratios. In addition, low liquidity ratios and the increasing share of FX credits in an environment where the local currency depreciates should be closely monitored. We also strongly encourage the authorities to both strengthen the AML/CFT framework and expedite its implementation.

The steadfast implementation of structural reforms to enhance the business environment, increase private sector participation, and attract foreign direct investments is essential to achieve the country's development objectives. Investments in physical infrastructure and human capital to boost labor productivity will help unlock Lao PDR's long-term growth potential. Given the importance of data-driven analysis in policy making, we encourage the authorities to continue working closely with development partners and international organizations to improve the quality of statistics. We also welcome the close collaboration between staff and the authorities on capacity development activities, which are critical to supporting the authorities' development efforts.

We urge the authorities to consent to the publication of the Article IV Report.