

IMF Executive Board Concludes 2012 Article IV Consultation with the Lao People's Democratic Republic

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On August 31, 2012, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with the Lao P.D.R.¹

Background

Despite policy tightening, global uncertainty, and natural disasters in Lao P.D.R. and its main trading partner, Thailand, real GDP growth remained strong at 8.0 percent in 2011 compared to an average of 7 percent per annum over the last decade. This has allowed the country to make significant progress with attaining Millennium Development Goals (MDG) targets. Inflation has moderated to 3.8 percent (y/y) in May 2012—reflecting lower food and fuel price pressures, policy tightening, and favorable base effects. The fiscal deficit declined further in 2011 to reach the pre-global financial crisis average. Credit growth, however, has again picked up to over 40 percent (y/y) in the first four months of 2012, reversing positive progress towards maintaining financial stability in 2011. The current account deficit has widened and gross international reserves declined by US\$50 million to US\$677 million at end-2011, covering about two months of prospective nonresource imports, the lowest level in almost a decade.

Macroeconomic policies have remained generally sound;

however, low reserve coverage and rapid credit growth amid high lending rates have emerged as sources of vulnerability. Although the FY2013 budget targets a broadly unchanged fiscal stance, the prospect for rapid increases in civil service wages could crowd out higher priority spending going forward. Monetary policy remains accommodative and recently the Bank of Lao P.D.R. has tempered the sale of its securities, thus contributing to an increase in credit to the economy. The supervisory approach remains compliance-based and the entrance of new banks in recent years have spread supervision capacity thinly. Data gaps and poor data quality also hamper the ability to adequately monitor the economy and to design proactive policies to prevent macroeconomic vulnerabilities.

Structural reforms have been accelerated in the context of commitments under the ASEAN Economic Community and the prospect of World Trade Organization (WTO) accession. The authorities aim to complete entry conditions for WTO accession by year-end.

Executive Board Assessment

Executive Directors commended the authorities for their sound policies, which have contributed to impressive economic growth, reduction in poverty, lower inflation, and improved debt dynamics. Directors encouraged the authorities to take advantage of the favorable conditions to maintain macroeconomic and financial stability, build external and fiscal buffers, and achieve sustainable and broad-based growth.

Directors recommended a further tightening of monetary policy to help address the risks stemming from rapid credit growth. Quasi-fiscal lending to local governments should be phased out, and the pace of monetary expansion reduced through sterilization and higher reserve requirements. Directors also encouraged the authorities to strengthen the monetary policy framework and avoid pursuing multiple policy objectives. Moving to an explicit inflation target range in the medium term would help enhance the effectiveness of monetary policy and anchor inflation expectations. Directors stressed the importance of replenishing international reserves, to be supported by tightening macroeconomic policies and taking advantage of the prospective large capital inflows.

Directors emphasized the need to strengthen banking supervision to maintain financial sector stability. Improving the regulatory and prudential toolkit will ensure the quality of credit amid financial deepening. They encouraged the authorities to participate in the Financial Sector Assessment Program in due course, and welcomed the efforts underway to address the shortcomings in the Anti- Money Laundering/Combating the Financing of Terrorism (AML/CFT) regime.

Directors welcomed the commitment to prudent fiscal policy and to build buffers to deal with future shocks. They encouraged the authorities to exercise restraint in civil service wage increases which could crowd out higher priority

spending. Directors recommended anchoring fiscal goals around the nonmining deficit. They welcomed the establishment of the State Accumulation Fund sourced by excess revenues and underspending, which will strengthen the ability of the budget to respond to future shocks. Directors recognized the improved debt sustainability assessment and called for further strengthening of the debt management framework and maintaining prudent borrowing policies.

Directors welcomed the authorities' reform efforts to achieve sustainable and inclusive growth. Improvements in the business climate, under the umbrella of WTO accession and the ASEAN Free Trade Agreement, will be key to enhancing competitiveness in the nonresource sector, while stepped up efforts to strengthen public financial management will create more space for high impact spending. Directors also noted the importance of improving the quality of data. They agreed that technical assistance by the Fund would support the authorities' reform agenda.

Lao P.D.R.: Selected Economic and Financial Indicators, 2009–13

	2009	2010	2011	2012	2013
			Est.	Proj.	Proj.
GDP and prices (percentage change)					
Real GDP growth	7.5	8.1	8.0	8.3	8.0
CPI (annual average)	0.0	6.0	7.6	5.1	6.8
CPI (end year)	3.9	5.8	7.7	5.3	6.2
Public finances (in percent of GDP) 1/					
Revenue	17.1	18.0	18.1	19.3	19.5
<i>Of which:</i> Mining	2.1	1.8	2.4	3.1	3.0
<i>Of which:</i> Hydro power	0.8	0.8	0.8	0.8	0.9
<i>Of which:</i> Grant	2.3	2.3	2.2	1.9	1.8
Expenditure	24.1	22.7	21.0	21.8	22.1
Expense	12.9	12.3	12.0	12.3	14.0
Net acquisition of nonfinancial assets 2/	11.2	10.4	9.1	9.5	8.1
Net lending/borrowing	-6.9	-4.6	-3.0	-2.5	-2.5
Nonmining balance 3/	-9.0	-6.4	-5.4	-5.5	-5.5
Money and credit (annual percent change)					

Reserve money	25.1	48.6	16.2	16.6	7.7
Broad money	31.2	39.1	24.9	25.3	20.5
Bank credit to the economy 4/	90.7	46.0	38.2	32.1	17.5
Balance of payments					
Exports (in millions of U.S. dollars)	1,521	2,196	2,529	2,737	2,902
In percent change	-5.5	44.4	15.2	8.2	6.0
Imports (in millions of U.S. dollars)	2,893	3,582	4,603	5,202	5,955
In percent change	2.0	23.8	28.5	13.0	14.5
Current account balance (in millions of U.S. dollars)	-1,174	-1,256	-1,773	-2,026	-2,464
In percent of GDP	-21.0	-18.3	-21.4	-21.9	-24.0
Gross official reserves (in millions of U.S. dollars)	633	728	677	723	780
In months of prospective goods and services imports 5/	2.5	2.6	2.2	2.1	2.1
External public debt and debt service					
External public debt					
In millions of U.S. dollars	3,139	3,539	3,685	3,993	4,333
In percent of GDP	56.0	50.3	44.3	43.8	43.1
External public debt service					
In percent of exports	4.9	4.3	3.2	4.7	4.6
Exchange rate					
Official exchange rate (kip per U.S. dollar; end-of-period)	8,478	8,040	8,002
Real effective exchange rate (2000=100)	119.1	126.5	133.1
Nominal GDP					
In billions of kip	47,562	56,523	66,515	75,383	86,736
In millions of U.S. dollars	5,597	6,855	8,302

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/ Net lending/borrowing excluding mining revenue.

4/ Includes Bank of Lao P.D.R. lending to state-owned enterprises and subnational levels of government.

5/ Excludes imports associated with resource projects.

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>.

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