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FOR AGENDA

SM/13/283

October 31, 2013

To: Members of the Executive Board

From: The Secretary

Subject: **Lao People's Democratic Republic—Staff Report for the 2013 Article IV Consultation**

Attached for consideration by the Executive Directors is the staff report for the 2013 Article IV consultation with the Lao People's Democratic Republic, which is tentatively scheduled for discussion on **Friday, November 15, 2013**. At the time of circulation of this paper to the Board, the authorities of the Lao People's Democratic Republic have indicated that they need more time to consider whether they will consent to the Fund's publication of this paper. Publication will only proceed upon the receipt by the Fund of the member's explicit consent. Any requests for modifications for publication are expected to be received two days before the Board concludes its consideration.

Questions may be referred to Mr. Ahuja (ext. 35464) and Mr. Bannister (ext. 35975) in APD.

Unless the Documents Section (ext. 36760) is otherwise notified, the document will be transmitted, in accordance with the procedures approved by the Executive Board and with the appropriate deletions, to the Asian Development Bank, following its consideration by the Executive Board.

This document, together with a supplement providing an informational annex, will shortly be posted on the extranet, a secure website for Executive Directors and member country authorities. The supplement, which is not being distributed in hard copy, will also be available in the Institutional Repository; a link can be found in the daily list (http://www-int.imf.org/depts/sec/services/eb/dailydocumentsfull.htm) for the issuance date shown above.

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INTERNATIONAL MONETARY FUND

LAO PEOPLE'S DEMOCRATIC REPUBLIC

STAFF REPORT FOR THE 2013 ARTICLE IV CONSULTATION

October 31, 2013

KEY ISSUES

Economic context. Growth was strong in 2012, and the economy is overheating from expansionary macroeconomic policies. The current account deficit has deteriorated significantly, a product of a currency appreciation in real effective terms, a growing fiscal deficit, and strong domestic demand. International reserves are inadequate for precautionary needs. Credit growth has declined, but remains excessive, raising financial stability concerns. Inflation is accelerating, and could become more broad-based.

Outlook and risks. Growth is projected at 8¼ percent in 2013 before reverting toward potential of about 7½ percent in the medium-term. Inflation is projected to remain elevated, a result of excess demand. A recent tightening of public wages should reduce the headline fiscal deficit to 4 percent of GDP in 2014, although the current account deficit is expected to remain high. FDI inflows should be vigorous, but reserve levels would remain inadequate. The economy is vulnerable to trading partners' growth and terms-of-trade shocks, and policy slippage. Banks' asset quality could also deteriorate.

Policy focus. There was broad agreement that policies should be tightened to replenish international reserves and manage a soft landing while building the foundations for broader-based growth. Restoring economic stability is a key priority.

Fiscal policy. A comprehensive medium-term budget strategy anchored around a nonmining fiscal deficit target of no more than 5 percent of GDP beginning this fiscal year would ensure debt sustainability and reduce existing vulnerabilities. Further tightening through revenue administration, public employee compensation restraint along with civil service reform, and possibly a VAT rate hike, will be needed.

Monetary, exchange rate, and financial sector policies. The USD/kip exchange rate should move more flexibly in line with market conditions with a view toward gradually building up international reserves. Domestic monetary conditions should be tightened to moderate credit growth and inflation. Financial supervision requires strengthening, with prudential measures to reduce leverage and balance sheet mismatches.

Building broader-based growth. Efforts to improve the business climate and accelerate legal compliance with the WTO will bolster trade integration and private-sector growth, enhance productivity in the nonresource sector, thereby improving economic resiliency. Public sector financial management reform will improve the quality of public spending. Upgrading health and education infrastructure will help reduce inequality.

Approved By
John Nelmes and Masato Miyazaki

Mission team: A. Ahuja (Head), G. Bannister, W. Liao, P. Ng (all APD); J. Quill (MCM); and N. Ha (Resident Representative Office). S. Kalra (Resident Representative), S. Creane, M. Seetharaman (both TAOLAM), and Q. He (STA) joined part of the mission.
Mission dates: August 28–September 12, 2013

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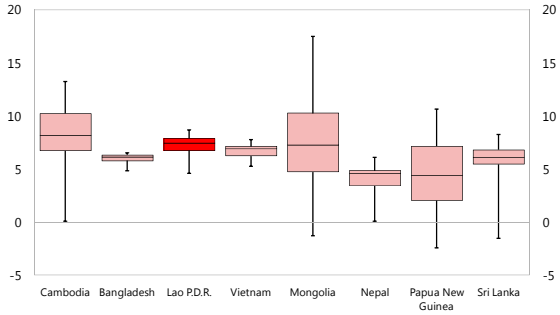
INTRODUCTION

1. A notable growth takeoff. Since the global financial crisis, the Lao economy has been growing at an average annual rate of 8 percent, supported by brisk credit expansion and robust foreign direct investment (FDI) inflows. Growth has been among the least volatile in the region over the past decade. The country has also made significant progress towards achieving the Millennium Development Goals (MDGs), and become a member of the World Trade Organization (WTO) in early 2013. The authorities are committed to achieving middle-income country status by 2020 (Vision 2020), and are targeting 8 percent annual growth over the medium term.

Volatility of GDP Growth, 2000–12 1/
(In percent)



Source: IMF's *World Economic Outlook*
1/ Each candlestick shows maximum, 3rd quartile, median, 1st quartile, and minimum growth rates, respectively, during the sample period.

2. Backdrop. In concluding the 2012 Article IV consultation, Executive Directors recommended a tightening of monetary policy to stem the risks from rapid credit growth and to replenish international reserves. Moreover, they urged restraint in civil service compensation increases to protect the fiscal buffers to deal with future shocks. Since then, the economy has been overheating from expansionary macroeconomic policies. The fiscal budget has come under stress, credit growth remains excessive, international reserves have declined further and are inadequate for precautionary needs, and signs of foreign currency shortage have emerged. Against this backdrop, the 2013 Article IV consultation focused on policies to return the economy toward macroeconomic and financial stability while building the foundations for broader-based growth.

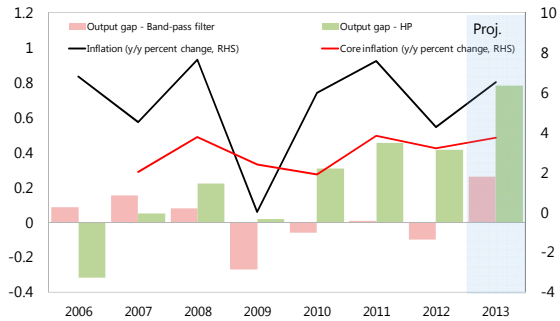
PRESSING CHALLENGES, OUTLOOK, AND RISKS

3. An overheating economy. Spurred by the fiscal expansion and rapid credit growth, the economy is growing beyond short-term capacity constraints. Real GDP expanded by 8 percent in 2012, buoyed by investment and private consumption. Investment in hydropower, infrastructure, and real estate—some related to the 2012 Asia-Europe Meeting—significantly lifted construction activities and imports. Strong expansion in the services sector and nonresource imports reflected robust domestic consumption and tourism activity. Growth is projected to rise to 8¼ percent in 2013 and moderate to 7½ percent in 2014 on account of a less expansionary fiscal stance. Staff's medium-term baseline projection (Table 5) is predicated on the authorities' announced policy intentions, which are weaker than staff's recommendations, particularly with regard to a re-loosening of public employee compensation. It also depends on vigorous resource-related FDI inflows, growing electricity demand from neighboring countries, a gradual pickup of investment inflows into nonresource sectors following recent WTO accession, and progress on tax system and administration reforms.

4. A vulnerable external position. The current account deficit surged from 15½ percent of GDP in 2011 to 28½ percent of GDP in 2012, a product of strong domestic demand, a growing fiscal deficit, a moderate terms-of-trade deterioration, and a sharp currency appreciation in real effective terms. International reserves decline further to 0.8 month of prospective imports (June 2013), and remain inadequate for precautionary needs (Box 1). While FDI remained strong in 2012, covering approximately 54 percent of the current account deficit, the portion of the current account not financed by FDI or official development assistance—the core balance of payments—is estimated to be in deficit at 10½ percent of GDP. These developments confirm staff's model-based assessment of a growing real exchange rate overvaluation relative to medium-term fundamentals. Looking ahead, the current account deficit is expected to remain close to 30 percent of GDP in 2013–14 before large-scale power projects come on stream in 2015–16 and lift medium-term exports. Although FDI inflows are expected to be vigorous over the next two years, reserve levels would be inadequate by low-income country (LIC) metrics at less than 1½ months of imports.

5. Rising price pressures. After easing considerably in 2012, headline inflation accelerated to 6.9 percent (y/y) in September 2013, mostly a result of fresh food prices. The appreciation in the nominal effective exchange rate and sluggish adjustment in the prices of publicly provided goods and services have kept core inflation in check. Nevertheless, core inflation has picked up momentum during the past few months. As economic activity expands beyond potential, consumer price inflation is projected to reach 7½ percent by end-2013 and average at that level in 2014.

Output Gap and Inflation 1/
(In percent of potential GDP)



Sources: Country authorities; and IMF staff estimates.
1/ Latest core inflation as of September 2013.

6. Strained public finances. Instead of consolidating as expected in last year's report, the fiscal position deteriorated in FY2011/12–FY2012/13, with the overall deficit estimated at 6½ percent of GDP and a nonmining deficit of 8¾ percent of GDP in FY2012/13. Government liquidity is tight, with deposits covering around 1 month of current spending (June 2013), down from 3¼ months at the end of the previous fiscal year. Wage and other arrears of about 2–3 percent of GDP are emerging with knock-on effects on private contractors' ability to pay suppliers and service debt. This is the result of: (i) a 37 percent increase in public sector salaries and an additional 140 percent increase in benefits; (ii) higher capital spending, some of which is off-budget and financed by the Bank of the Lao P.D.R. (BOL); and (iii) lower revenue from the natural resource sector from declining copper and

Lao P.D.R.: Main Fiscal Aggregates
(percent of GDP)

	2011/12	2012/13	2013/14		
		Proj.	Prelim. Budget	Revised Budget	Proj.
Revenue	19.6	19.6	22.2	22.2	20.6
Expenditure 1/	24.4	26.1	25.7	23.6	24.5
Compensation of employees	5.0	10.0	11.8	9.7	9.7
Capital spending	9.2	8.9	6.8	6.8	6.8
Other 1/	10.2	7.2	7.1	7.2	7.2
Net lending/borrowing 1/	-4.8	-6.5	-3.6	-1.5	-3.8

1/ Including discrepancy from financing below the line in 2011/12.

Box 1. Lao P.D.R.: External Sector Assessment

External competitiveness has further eroded. Overall labor costs have risen by approximately 25 percent per year during 2009–2012. The Kip real effective exchange rate (REER) has appreciated by about 7 percent during the past 12 months (July 2013), roughly half of this is due to higher domestic inflation. Analysis based on the current account approach indicate that the underlying current account deficit is significantly higher than the norm estimated using cross-country panel regressions with a 24 percent real depreciation (in effective terms) necessary to bring the deficit down to the current account norm, *ceteris paribus*. Similarly, the external sustainability approach finds that a 16 percent real depreciation would be needed to stabilize net foreign asset (NFA) at the levels estimated in 2012. Targeting a healthier NFA position of -80 percent of GDP would imply a degree of overvaluation of 30 percent.

Exchange Rate Assessment

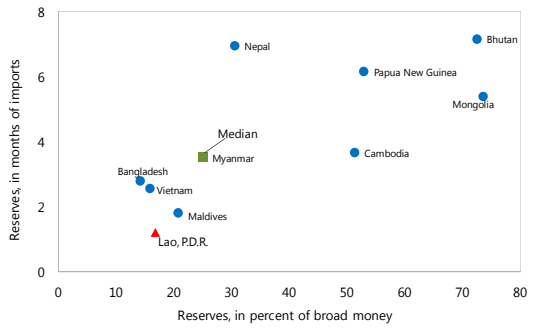
	Macrobalance	External Sustainability
Approach:		
Underlying current account balance	-15.1	-17.0
Current account norm	-9.0	-13.0
Required improvement in the current account	-6.2	-4.0
Implied over (+) / under (-) valuation	24.3	15.8

Source: IMF staff estimates.

In contrast to the current account approach, the equilibrium exchange rate approach indicates no misalignment of the kip. These results are well within the margin of error, which can be large because of data limitations. In staff's view, the broader trends in the current account balance suggest a growing overvaluation.

Capital account inflows have strengthened in 2012, particularly public sector inflows and FDI, the vast majority of which continues to finance hydropower projects. Moreover, private inflows appear to have picked up.

Reserves: South and East Asian LICs
End 2012



Sources: Country authorities; IMF WEO.

Despite steady capital inflows, at current levels, international reserves do not offer adequate protection against adverse external shocks. As of June 2013, international reserves cover only 0.8 months of prospective imports and 10 percent of broad money. These reserve coverage levels are the lowest among Asian LICs, and significantly below the traditional metrics of at least three months of prospective imports or up to 50 percent of broad money, respectively. The optimal reserves level is estimated to be close to 4 months of imports.[1] However, given the high degree of dollarization in the Lao economy, this optimal reserves coverage should be interpreted as a lower bound, as currency substitution would add to the need for international reserves coverage.

Lao P.D.R.: Measures of International Reserves Coverage

	2000–08 Average	2009	2010	2011	2012	2013 Latest
Gross International Reserves						
In millions of U.S. dollars	295.3	632.9	728.3	677.4	739.6	532.0
In months of prospective imports	2.2	2.0	1.8	1.2	1.2	0.8
In months of prospective imports, excluding resource imports	2.8	2.5	2.6	1.7	1.7	1.2
In percent of foreign currency deposits	81.3	76.8	63.9	45.4	39.0	25.5
In percent of broad money	50.8	35.4	28.1	19.9	16.5	9.9
In percent of external debt service	551.4	670.4	611.4	671.8	452.3	224.0

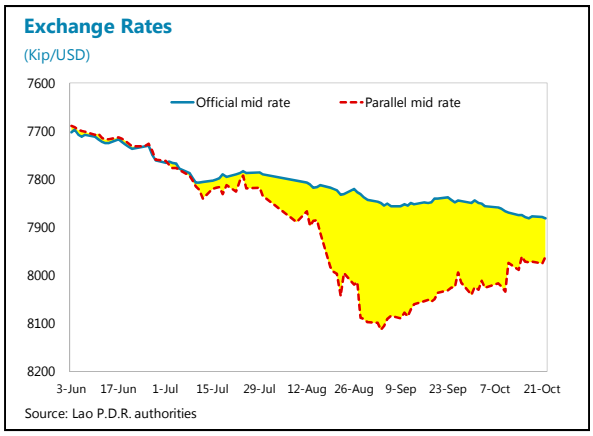
Sources: Data provided by the Lao P.D.R. authorities; and IMF staff estimates and projections.

Staff's overall assessment is that the external position is vulnerable to shocks, and would benefit from further strengthening through fiscal consolidation, the tightening of domestic monetary conditions, and structural reforms to improve productivity over time, particularly in the nonresource sectors.

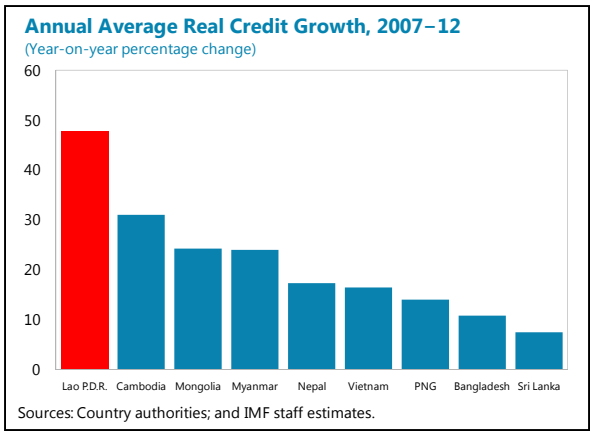
1. See the IMF Working Paper *Optimal Precautionary Reserves for Low-Income Countries: A Cost-Benefit Analysis* (WP/11/249) and IMF Board Paper *Assessing Reserve Adequacy* (February 14, 2011).

gold prices. As a result of the wage increase, public sector wage bill has risen to 50 percent of revenue, and is now well above LIC average (Box 2). With the suspension of additional benefits payment to public sector employees and the reduction in capital spending announced in September 2013, the headline deficit is projected to decline to around 4 percent of GDP in 2014 (nonmining deficit of 6½ percent of GDP). The headline deficit is expected to rise to around 5½ percent of GDP in 2015 (FY2014/15) on account of further increases in public sector salaries, before declining gradually to 3½ percent of GDP over the medium term. Public sector debt, which remains elevated compared with regional LICs, has risen sharply, and is expected to peak at 64 percent during 2014–16. Staff expects additional bond issuance in Thailand following the US$50 million issuance this year, which was oversubscribed.

7. Loose financial conditions. Credit growth remains vigorous at 35 percent (y/y) (June 2013). Kip liquidity in the banking system remains ample, giving banks scope to expand credit supply. Though banks' direct exposure to real estate is limited, urban land prices, reportedly up by 30 percent during the past few years, have boosted credit demand and encouraged some banks to ease lending standards. Deposit growth is rapid at 28 percent (y/y) in June 2013 while short-term deposit interest rates are negative in real terms. Overall banks' excess reserves at the BOL are high at 11 percent of total deposits (June 2013), though signs of foreign currency liquidity shortage in the banking system have emerged. Reflecting this shortage, the parallel foreign exchange market has been trading at a premium over the BOL's reference exchange rates since mid-August. Foreign currency lending capacity will become more constrained, as banks' claims on the economy have exceeded 90 percent of deposits.



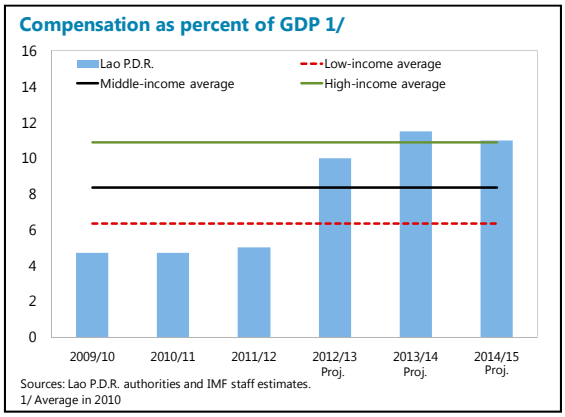
8. Financial stability concerns. Bank credit has expanded rapidly since 2008, considerably faster than in other Asian LICs (Box 3). Financial soundness indicators available are not up-to-date. Supervisory capacity and risk management practices at banks are untested, and therefore unlikely to be robust enough to ensure high lending standards, raising concerns about domestic banking sector soundness. Furthermore, the capital of two state-owned commercial banks is well below the regulatory minimum, potentially a fiscal risk.



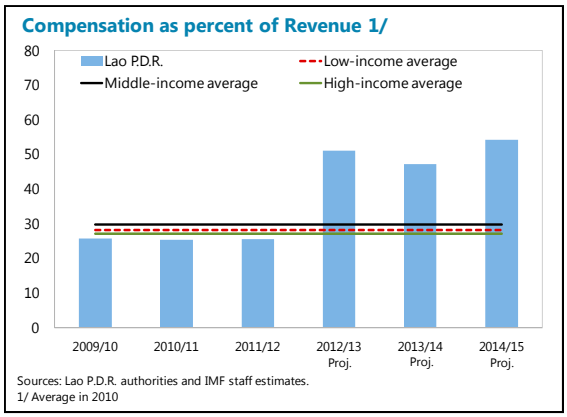
Box 2. Lao P.D.R.: Increase in Civil Service Compensation[1]

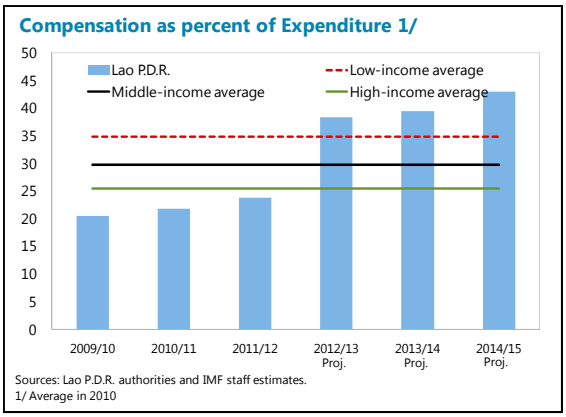
A large increase in salaries and benefits for public employees was implemented in 2013, as part of the stated plan to increase the compensation of public employees over three years:

- The civil service salary index rose by 37 percent in 2013 and is expected to rise by the same percent each year in 2014 and 2015.
- Benefits (salary supplements) rose by 140 percent in 2013; this increase was reversed in 2014, bringing benefits back to the level of 2012. For 2015 they are assumed to rise with inflation.



Evidence for the increase is mixed. The increase has been justified to attract workers with the required skills and to discourage turning to outside employment to supplement incomes. A World Bank study, published in 2010, found that compensation from the formal salary for civil service workers was well below private sector comparators. However, when the calculation took into account intangible benefits, such as fewer hours worked and lower work demands, more stable employment and earnings, in-kind benefits, housing and education allowances, and opportunities to supplement incomes through per-diems, the private sector premium disappeared.





Nevertheless, the study also documented a strong perception among civil servants that their remuneration was not sufficient to cover even basic expenses.[2]

The increase brings civil service compensation well above the average level for international comparators. Public compensation doubled from 5 percent of GDP in 2012 to 10 percent of GDP in 2013, well above the level of 6.3 percent for LICs.[3] In terms of revenue, compensation rose over the same period from 25 percent to 50 percent, well above the low-income average of 28 percent. Finally, in terms of expenditure, compensation rose from 24 to 38 percent, above the low-income average of 35 percent.

1. All figures are on a fiscal year basis.

2. "Lao P.D.R. Civil Service Pay and Compensation Review: Attracting and Motivating Civil Servants". World Bank, June 2010.

3. International comparator averages are from 2006 to 2010, calculated from the FAD employment and wages database.

Box 3. Lao P.D.R.: Normal Financial Deepening or Excessive Credit Growth?

Financial fragility is generally built up over an extended period. Episodes of sustained, rapid credit growth can take place in a period of low inflation but accompanied by sharp rises in asset prices. They tend to end abruptly, with a possibility of a financial crisis, and can be difficult to identify ahead of time. To add to the complication, policymakers in LICs do not have access to reliable asset price statistics. This box provides a simple, robust indicator, constructed using only information available to the policymakers in real time, that can help identify an excessive credit growth episode with enough lead time to analyze and act.[1]

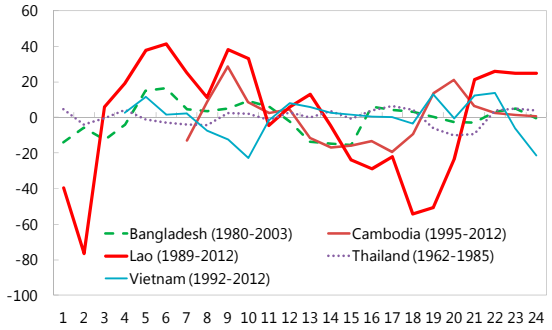
Performance of the Early Warning Indicator

Horizon	Noise/Signal	Number of Crisis predicted	% predicted
1 year	0.45	24	56
2 year	0.35	30	70
3 year	0.31	34	79

Source: Staff estimates.

Identifying a credit boom in the making. Benign credit growth episodes can be distinguished from those that could undermine financial stability by observing the deviation in percentage points of credit-to-GDP from trend. This credit gap measure signals a valid warning, producing a low noise-to-signal ratio. Specifically, the credit gap threshold of 4 percentage points enables us to predict past financial crises correctly within three years with close to 80 percent probability, including 5 out of 9 banking crisis episodes in LICs.

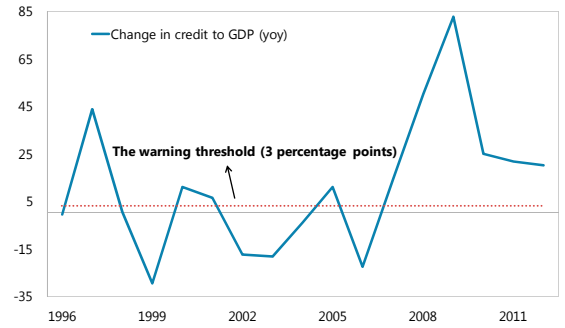
Selected Asian Countries - Private Credit Gap
(In percent of GDP)



Sources: Authorities; and IMF staff calculations.

Is Lao P.D.R.'s credit growth excessive? The credit gap measure suggests that credit growth has been excessive during the past few years, providing an early warning of possible distress down the road. It also exceeded most regional comparators in their initial financial deepening stages, including Vietnam, Bangladesh, Cambodia, and Thailand. Moreover, credit-to-GDP ratio has been growing beyond the warning threshold of 3 percentage points over a period of time (GFSR, September 2011)

Credit to GDP Ratio
(In percentage points, yoy change)



Source: Lao P.D.R. authorities

Other useful indicators. The period before crisis episodes is typically associated with large capital inflows, expansionary macroeconomic policy stances, lack of macro-prudential attention, higher-than-normal current account deficits, and buoyant domestic demand. A loose fiscal stance and lack of macro-prudential control have been identified as significant contributors to the probability of future financial distress. These indicators currently suggest that credit overheating in Lao P.D.R merits close monitoring.

1. See Ahuja, A. and W. Liao, 2013, "Assessing Credit Boom: The Case of Lao P.D.R," forthcoming IMF working paper.

9. External debt sustainability. Because of the high level of concessionality of official external borrowing and favorable long-term GDP growth outlook, the risk of external public debt distress remains moderate (see the Debt Sustainability Analysis). Nevertheless, compared to last year's assessment, the external public and publicly guaranteed (PPG) debt level is closer to its safety threshold, which leaves few buffers in the near term in case of an adverse shock. Staff's analysis also shows that the external PPG debt-to-GDP ratio could be pushed beyond sustainable levels under certain stress scenarios, including sharp currency devaluation, less favorable FDI inflows, a significant deterioration in domestic and external environment, and higher borrowing costs which may be associated with new infrastructure mega-projects.

10. Risks to growth and stability. Although trade and investment reforms could be accelerated to take full advantage of recent WTO membership, thereby increasing foreign-funded nonresource investment and growth relative to the baseline, on balance, risks to the outlook are skewed toward the downside (see the Risk Assessment Matrix). The external position is vulnerable to a slowdown in trading partners' growth and terms-of-trade shocks. Moreover, the heightened vulnerabilities have subjected the outlook to considerable uncertainty. Policy slippage beyond an already weak baseline scenario could raise near-term pressures on the balance of payments and inflation, and further deplete international reserves. This would bring into question the sustainability of the exchange rate anchor, domestic banking sector soundness, and undermine the prospects for high-quality growth and attaining middle-income status by 2020.

- **External spillovers.** A deeper-than-expected slowdown in China, Thailand, and Vietnam could weaken nonresource exports and foreign investment flows to Lao P.D.R. A sharp slowdown in China, in particular, could depress world mineral prices and neighbors' electricity demand, putting further pressure on Lao P.D.R.'s fiscal revenue, export earnings, international reserves, and the exchange rate, raising concerns over external debt sustainability.
- **Financial sector risks.** A deterioration of banks' asset quality would erode capital, which could become future contingent liabilities for the state. In the most adverse scenario—assessed to be of medium likelihood—a loss of confidence in the domestic banking system could be precipitated by a large loss of international reserves and sudden currency devaluation. The initial impact would be limited for dollarized economic entities, but the degrees of currency mismatch in the balance sheets of the economic sectors remain unknown. Given the elevated external debt position and considerable foreign currency lending, credit risks would increase. The impact on business, bank, and household balance sheets would be difficult to endure, also putting into doubt the sustainability of public debt.
- **Fiscal risks.** The pressure to meet social spending targets or respond to natural disasters in the presence of higher public sector wage bills could weaken the fiscal position more than already expected. This could worsen the public debt dynamics, and give rise to larger off-budget capital spending and more contingent liabilities down the road. The pressure for financing could further undermine the BOL's monetary control.

11. Authorities' view. There was broad agreement that the medium-term outlook for Lao P.D.R. remains generally favorable, but the growing vulnerabilities, including low international reserves cover, have significantly raised the uncertainty around the near-term outlook. The authorities noted that international reserves coverage remains around 2½ months of officially reported nonresource imports, which are significantly lower than trading partners' export data that staff uses. While the authorities share concerns about regional spillovers, terms-of-trade, and fiscal risks, they emphasized the ongoing efforts to contain financial sector risks, pointing to the slowly declining credit growth and efforts to ensure that lending is channeled toward productive use. The authorities would continue to monitor financial market conditions closely for signs of distress. Moreover, they expressed confidence that international reserves would rise toward the end of 2013 from scheduled foreign banks' registered capital increase and domestic foreign currency debt repayment to the BOL.

ENGINEERING A SOFT LANDING

12. Key policy recommendations. The tightening of fiscal and monetary policies is an urgent priority for reducing external and financial sector vulnerabilities, replenishing international reserves, and restoring macroeconomic stability to ensure high and sustainable medium-term growth. Success will require an acceptance that the short-term growth outcome could be lower than the 8 percent annual target. Fiscal policy needs to be put back on a consolidation path during the next few years. This will require improving tax collection by broadening the tax base, eliminating exemptions, and possibly a VAT tax rate increase, while rationalizing expenditure to concentrate on priority social spending and investments and postpone further civil service pay increases. Given the extent of the estimated real effective exchange rate overvaluation and loss of external competitiveness, the kip nominal exchange rate should be allowed to move in line with market conditions with a view toward enhancing competitiveness and gradually building up international reserves. The credit and M2 growth targets should be lowered to contain inflation. Financial sector supervision will need to be strengthened and regulatory measures put in place to reduce leverage and balance sheet mismatches. If implemented, this mutually supporting policy package would result in lower near-term growth than staff's baseline projection, but it would also reduce current vulnerabilities and enhance macroeconomic and financial sector resiliency, supporting robust, sustainable medium-term growth.

13. Authorities' view. The authorities attached great importance to achieving Vision 2020, and were receptive to staff's call for policy tightening. They indicated that the bulk of near-term adjustments would be borne by fiscal policy, and have undertaken action to boost revenue as well as limit capital spending and civil service compensation increase. There is room for the USD/kip exchange rate to move within the current band, in line with market conditions and external developments. The credit and broad money growth targets would be lowered as public investment demand softens going forward.

A. Fiscal Policy

14. Deficit targets. Fiscal consolidation is essential to reduce excess demand, credit growth, and the current account deficit. It will also enable capital to be put to more efficient use, which in turn will enhance the resiliency of the financial system. Staff recommends a medium-term budget strategy that is anchored around a nonmining fiscal deficit target of no more than 5 percent of GDP starting in FY2013/14 to reduce public debt to 40 percent of GDP by 2020. In the process, the saving of mining revenue will help ensure a smooth expenditure path and a comfortable level of government deposits. The authorities' announced plans are, however, less ambitious—the nonmining deficit would fall from 6½ percent of GDP in FY2013/14 below 5 percent of GDP only by FY2017/18.

15. Expenditures. Staff recognizes the need for an increase in civil service pay to compensate for cost-of-living increases, enhance competitiveness with the private sector, especially in health and education, and to combat graft. But containing overheating pressures and ensuring fiscal sustainability will require a more measured pace of future compensation increases. Moreover, there is an urgent need for progress on civil service reform and for rationalizing other spending to reduce the burden on the budget. In addition to controlling nonwage current expenditures, the government should also trim capital spending in FY2013/14 to the average level of the previous two years (equivalent to 7 percent of 2014 GDP) and draw up a plan to eliminate arrears. This would also be more in line with implementation capacity, reduce off-budget financing, and enhance monetary discipline. Public sector financial management reforms are needed to enhance control over spending and efficiency at all levels of government.

16. Revenues. Meeting the authorities' deficit target over the next few years would require raising revenue (excluding grants) from about 18 percent of GDP to at least 19½ percent of GDP by 2015. This will require an additional tax effort of 1–1½ percent of GDP, which can be achieved by moving decisively on ongoing reforms of the tax system and administration. Specifically, these will require efforts to simplify the tax system and enhance compliance, including a simplification to the VAT system, profit tax rate unification across firms, the introduction of a lump-sum tax for small businesses, as well as taxes on property value, and increases in petrol and vehicle excise duties. Building on recent IMF TA recommendations, the government should also reform customs and natural resources revenue administration, and the management of large taxpayers. To achieve staff's recommended fiscal consolidation, however, a VAT rate increase (from the current 10 percent) may also be needed starting in the emerging fiscal year.

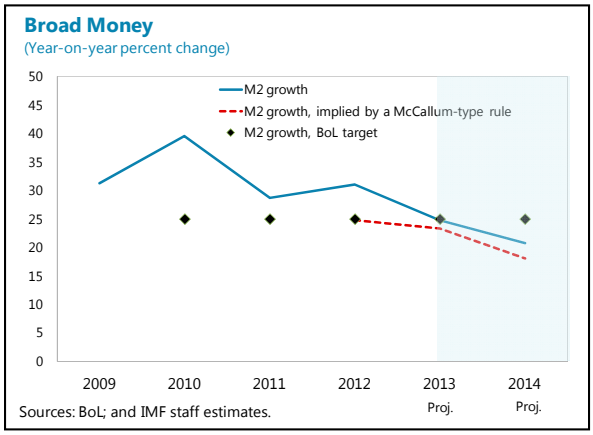
17. Authorities' view. The authorities acknowledged that the fiscal expansion from public sector pay increases in FY2012/13 was sharper than they originally expected and posed serious risks to macroeconomic stability. While the near-term focus would be on addressing liquidity challenges, the government also recognized the need to formulate a comprehensive medium-term budget strategy and impose stricter expenditure control. Action has been taken to contain domestically financed current and capital spending, broaden the tax base, limit tax exemptions for new investment contracts as well as for imports of vehicles and fuel, reduce off-budget spending, and pay down wage arrears. The authorities also recognized that revenue mobilization would have to go

hand in hand with technology and staff capacity, which would take time to improve. With these measures in place, they believed that the headline fiscal deficit would not exceed 5 percent of GDP on average over the medium term.

B. Monetary and Exchange Rate Policy

18. Exchange rate management. Staff continues to support the use of the USD/Kip exchange rate anchor within a band, which is reasonably wide and adjustable annually. However, to maintain this nominal anchor, especially during a turbulent period when the US Federal Reserve is expected to exit from unconventional monetary policy, the BOL will need to: (i) make full use of exchange rate flexibility in line with market conditions with a view toward building a considerably larger international reserves cushion; and (ii) tighten domestic monetary conditions. These measures will lessen the need for tighter administrative measures, such as limits on commercial bank supply of foreign exchange, which could undermine the confidence in the kip and fuel one-way depreciation expectations, potentially reversing de-dollarization gains (Box 4). Were downside risks to materialize, exchange rate depreciation would be needed to preserve international reserves and support growth.

19. Monetary policy. Given that output is already above potential, inflation risks breaching the official 8 percent threshold, and credit growth appears excessive, domestic monetary conditions should be tightened. To absorb excess liquidity in the banking system, the BOL should: (i) issue a sufficient amount of securities; (ii) increase the reserve requirement ratio on kip deposits, which could be done in small increments with guidance ahead of time; and (iii) accelerate the unwinding of quasi-fiscal lending operations to local government entities and SOEs. It will be important to ensure access to bank reserves (including foreign currency) through BOL facilities and interbank borrowing to avoid financial market disruption. In tandem, the BOL should raise interest rates at its lending facilities. Over the medium term, interest rates should play a central role in monetary policy conduct. Toward that end, staff encourages the BOL to make use of technical assistance to help strengthen the monetary policy framework, liquidity forecasting and liquidity management, and interbank market development.

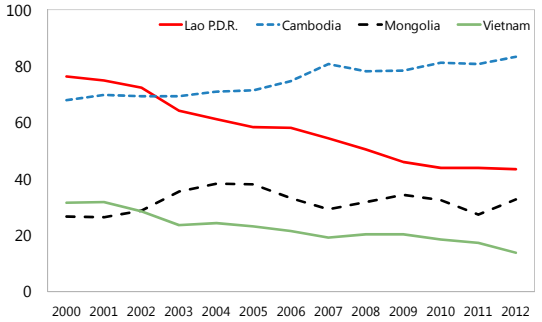


20. Authorities' view. The BOL agreed with the need to allow the exchange rate to adjust flexibly within the current band to preserve international reserves. In their view, as international reserves are expected to increase by end-year, the current foreign currency liquidity shortage should be temporary, and the resulting parallel market premium is unrepresentative of market expectations. With the government already committed to stop borrowing for new development projects and eschew from central bank deficit financing, monetary discipline will be enhanced and credit expansion should be weaker in 2014.

Box 4. De-dollarizing the Lao P.D.R. Economy

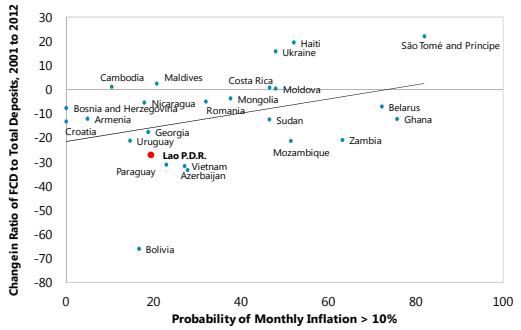
Substantial progress made. Over the past decade, Lao P.D.R has made substantial gains in de-dollarization. The dollarization rate, as measured by foreign currency deposits as a ratio of broad money, declined from 76% in 2000 to 43% in 2012, far outperforming regional comparator countries. The decline in the dollarization rate is consistent with a significant improvement in macroeconomic stability. In particular, inflation has fallen markedly, from a peak of 128% in 1999, to an average of around 5% in 2005–12. Confidence in the Kip has increased, as suggested by the uptrend in both the NEER and the REER over the past five years. The authorities have also actively taken measures to promote Kip usage.

Foreign Currency Deposits to Broad Money
(In percent)



Sources: Country authorities

Degree of Dollarization vs Probability of High Inflation



Sources: Country authorities; and IMF, *WEO*

Further de-dollarization requires sustained macroeconomic stability. International experience shows that reversing dollarization is a protracted process, requiring sustained prudent macroeconomic policies. Countries such as Israel and Poland that have been identified in the literature as having successfully de-dollarized with minimal side effects and capital flight have implemented and persisted in economic stabilization programs. Conversely, countries that exhibited repeated bouts of high inflation over the past decade generally have been less successful in reducing dollarization rates.

Risks associated with dollarization. A partially dollarized financial system carries with it specific risks. First, banks will not be able to accommodate persistent withdrawals of foreign currency deposits, given limited holdings of liquid foreign assets, and the central bank's ability to act as a lender of last resort in these events is constrained. Second, vulnerabilities may result from currency mismatches in banks' balance sheets, as borrowers' currency mismatches could expose banks to foreign currency-induced credit risk.

Risk mitigation. To mitigate these risks, robust banking sector supervision and higher international reserves are required. In addition to measures that limit currency mismatches on bank balance sheets and moving towards risk-based supervision, the central bank should have sufficient foreign exchange reserves to forestall a run on foreign currency deposits.

1. See IMF Occasional Paper by Balino, Tomas, Adam Bennett, and Eduardo Borensztein, *Monetary Policy in Dollarized Economies* (1999).

C. Bank Supervision and Prudential Policies

21. Achievements and challenges. The entry of new foreign and private banks in recent years has brought in technical skills, expanded access to banking services, and helped create a more commercially oriented banking sector. The depth of the financial system has increased significantly, but financial access by small and medium enterprises remains limited. The existing body of the law is reasonably constructed to provide for appropriate supervisory authorities and sound commercial bank requirements. External auditing requirements have been introduced, and a depositor protection system established. That said, much work remains to build a resilient financial sector. Given that financial activities are driven largely by the government's development objectives, there are concerns that supervision and regulatory enforcement and bank risk management practices could be compromised. Furthermore, weaknesses remain in the regulatory framework, in particular the lack of a clear and uniformly applied accounting framework and an effective and prompt debt resolution process.

22. Strengthening financial supervision. Staff reiterates the need to ensure that the pace of financial deepening is in line with progress in regulatory and supervisory capacity. At this stage, a more rigorous application and enforcement of laws and regulations is needed to ensure consistent compliance. To reduce balance sheet vulnerabilities, staff supports the BOL's strict monitoring of banks' compliance with the regulation on net open foreign exchange positions, as well as enforcing the limits on foreign currency lending to borrowers without sufficient foreign currency income. Furthermore, the BOL's requirement for banks to publish their balance sheets online should be enforced, and financial soundness indicators should be updated and complete. In addition to the required increase in commercial banks' registered capital, which will be completed in 2014, riskier banks should be required to maintain higher capital-to-asset (CAR) ratios than the minimum mandated CAR of 8 percent. This measure would also contribute to leverage control. More urgently, under-capitalized banks should not continue to increase their loan portfolios, and potentially incur additional risk. In this light, a prompt corrective action framework should be developed. It will also be critical to develop a forward looking, risk-based approach to supervision to identify and mitigate emerging risks at an early stage. Staff also urges the BOL to prepare a contingency plan for the banking sector in the event of financial distress, and enhance the size and operational readiness of the Depositor Protection Fund. Staff welcomes the authorities' commitment to move forward on the Anti-Money Laundering/Combating the Financing of Terrorism (AML/CFT) Law to address deficiencies identified by the Financial Action Task Force during the upcoming fiscal year, and continues to encourage their participation in an FSAP.

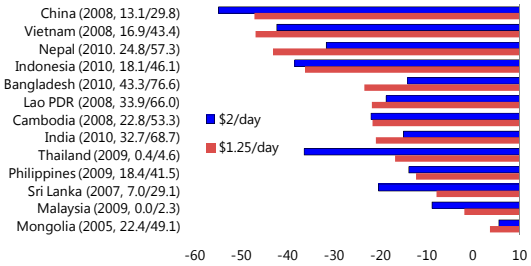
23. Authorities' view. The authorities agreed with staff's overall assessment and recommendations, although the plan to require riskier banks to maintain higher CAR than the regulatory minimum would need to be considered carefully. They noted that internal CAMEL-based financial soundness indicators point to a generally sound banking system. Furthermore, the BOL has already started to tackle some of the supervisory weaknesses raised by staff, including strengthening the loan origination process based on income flow projection as well as collateral, and will receive

IMF TA on banking supervision in 2013Q4. Over time, as the financial system becomes more complex, the BOL plans to build the framework and capacity for risk-based supervision.

BUILDING SUSTAINABLE AND INCLUSIVE GROWTH

24. Key issues. Lao P.D.R. continues to make impressive progress in growing its economy and poverty reduction. However, the World Bank Doing Business Survey (2013) indicates limited progress in public service delivery and facilitation of private sector-led growth. Moreover, inequality has increased significantly during the past two decades and could raise social and ethnic tensions (Box 5).

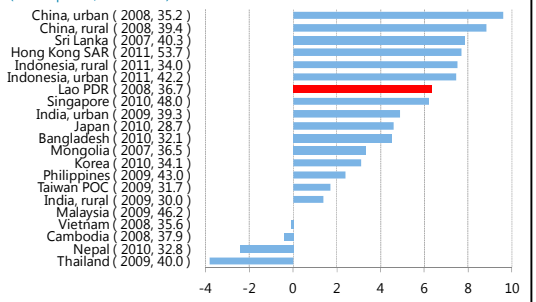
Asia: Change in Poverty Headcount, Last Two Decades[1]
(in percentage points since 1990)



Sources: World Bank; and IMF staff calculations.
[1] At 2005 PPP prices. In parentheses, the latest available year and corresponding poverty headcount ratios at $1.25 and $2 per day, respectively.

25. Structural policies. To sustain the growth takeoff and improve its inclusiveness, efforts are needed to improve the business climate, enhance information exchanges and coordination among government agencies, and undertake public sector financial management reforms to upgrade the quality of public spending. Public spending should be prioritized toward health, education and skills training, as well as basic infrastructure. Further trade liberalization should promote institutional reform and economic competition, offering potential to make growth more productivity-driven and broader-based. Productivity enhancement in the nonresource sector would in turn improve the trade balance and strengthen the international reserves cover, which will help reinforce economic resiliency.

Asia: Change in Gini Index, Last Two Decades[1]
(in Gini points, since 1990)



Sources: World Bank; national authorities and IMF staff calculations.
[1] In parentheses, the latest available year and corresponding Gini coefficients.

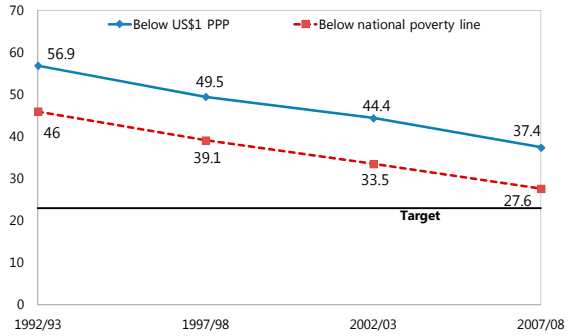
26. A statistical strategy for growth. Modernizing and upgrading the quality and comprehensiveness of economic and financial sector data is a key priority. Data weaknesses have obstructed monitoring and analysis of risks, and led to shortcomings in policy formulation and policy evaluation. Staff welcomes the government's commitment to implement the Strategies for the Development of the National Statistical System, and the intention to collaborate with the IMF in moving Lao's macroeconomic statistics closer to the international standards, including using the General Data Dissemination System (GDDS) in compiling and disseminating data.

27. Authorities' view. The authorities are undertaking significant revisions to trade-related laws and regulatory regime in anticipation of the opportunities for further trade integration under the WTO and ASEAN Free Trade Agreement. Over time, private investment is expected to be the key

Box 5. Lao P.D.R.: Poverty and Inequality: Trends, Determinants and Policies[1]

Profile and trends. National poverty rate declined from 46 percent in 1992/93 to 28 percent in 2007/08 (latest available estimate). There has also been a steady reduction in the poverty gap and severity over this time, implying that the drop in poverty benefitted the neediest. While progress in poverty reduction has lagged somewhat behind China, Vietnam, and Indonesia, Lao P.D.R. is on track to achieving the MDG target of halving the poverty rate by 2015. Poverty rates have declined across nearly all population groups, including rural, mountainous and upland areas which show the highest poverty incidence due to difficulties in access to markets. Even though the Gini coefficient is still low compared to regional emerging markets, inequality has increased substantially since 1990.

Poverty ratios
(in percent)



Source: Lao Expenditure & Consumption Surveys (LECS 1-4), Lao Statistics Bureau, MPI.

Determinants. Overall, rapid economic growth has benefited the poor. Major drivers of poverty reduction include liberalization of the private sector, which increased access to markets for trade and employment, increasing access to electricity, and expansion of the road network. Increased integration with regional neighbors benefited a significant part of the population, especially those along the regions bordering Thailand, China, Myanmar and Cambodia. Rural poverty reduction lags behind largely due to fewer livelihood options, and pockets of urban poverty are emerging. The benefits of growth have been especially limited to those in geographically disadvantaged areas.

Policy focus. The Seventh National Socio-Economic Development Plan (2011–2015) has a strong focus on sustainable economic growth and poverty reduction, and the government is making efforts to tackle disparities. Strategies include providing basic infrastructure and services in remote areas, improving skills of local populations, providing incentives to government workers serving in remote areas, promoting measures to improve food security and nutrition in the uplands, supporting Farmer Organizations, and increasing the commercialization of the agriculture sector. The government is also taking special measures to address concerns about the threat facing rural livelihoods as agricultural lands are converted into land used for FDI projects. For example, the government has established special revenue-sharing arrangements for the Nam Theun II Hydroelectric Project (funds for health, education, rural infrastructure and environment) and direct intervention schemes (e.g., funds for village poverty eradication and small entrepreneurs in the poorest districts).

Challenges. At the national level, reform of education and training systems are necessary to develop well-functioning labor markets that meet investors' needs and long-term economic goals. Targeted interventions are needed for the poorest groups, where the lack of access to infrastructure, markets and services remain barriers to growth and poverty reduction. These interventions should include specific strategies to increase access to resources and markets, health insurance, and ensuring long-term investments in education and skills training. As human development and gender relations are structurally different across ethnic groups, policies should be tailored to specific needs, capabilities and gender gaps.

1/ The MDG Progress Report for the Lao P.D.R. 2013, prepared by the Government of the Lao P.D.R. and the United Nations.

driver of growth, with government support, especially in the areas of agriculture and tourism. The strategy for growth will increasingly rely on fostering human capital through investment in health and education, spotlighting on expanding networks of rural health clinics and vocational training to anticipate future labor market demand. Decisions on public investment would be based more on expected social returns and reducing wastefulness. Moreover, the authorities realize the importance of high-quality and timely statistics in realizing Vision 2020, and the need for producing and disseminating these statistics in line with the international guidelines. They intend to make more use of IMF TA in national accounts, prices, government finance statistics, monetary and financial statistics, and balance of payments statistics.

STAFF APPRAISAL

28. Outlook and risks. Lao P.D.R. continues to make impressive development progress, and medium-term prospects remain favorable. The near-term outlook, however, is clouded by growing vulnerabilities induced by current macroeconomic policies, particularly the pressures from public sector employee compensation which is already well above the LIC average. These heightened vulnerabilities have manifested themselves in the recent fiscal stress and foreign currency liquidity shortage. Inflation pressures are expected to persist over the next two years. The current account deficit is expected to widen in 2013–14, and although FDI inflows should remain vigorous, reserve levels would remain inadequate. A deterioration of banks' asset quality from excessive credit growth could erode capital, raising concerns about domestic banking sector soundness. In addition to these policy-induced risks, the external position is also vulnerable to a slowdown in trading partners' growth and terms of trade shocks.

29. The time to act is now. These escalating pressures argue forcefully for the immediate tightening of fiscal and monetary policies to support the exchange rate anchor, replenish international reserves, build up fiscal buffers, and guide the economy toward a soft landing. To shift firmly toward a more sustainable growth path, the authorities would need to accept a more moderate near-term growth outcome than under the baseline projection. After macroeconomic stability is restored, continued institutional reforms to enhance private sector-led competition will lead to higher productivity and broader-based growth over time.

30. Fiscal policy. The commitment to fiscal consolidation is central to restoring macroeconomic stability. It would also bolster Lao P.D.R.'s moderate risk of external debt distress status and its ability to absorb future shocks. Communicating this commitment clearly will send a strong signal to investors, and facilitate future external debt issuance. Staff supports the authorities' determination to formulate a comprehensive medium-term budget strategy. This strategy should be anchored around a nonmining fiscal deficit target of no more than 5 percent of GDP starting from the current fiscal year to lower public debt to 40 percent of GDP by 2020. This target, which requires further tightening efforts, will help reduce near-term inflation and balance-of-payments pressures. In addition to measures to improve tax collection, which the authorities have started, staff would support a VAT rate increase. A political consensus is also needed to moderate the pace of future compensation increases and implement civil service reform. This would restore the fiscal space

necessary for adequate level of capital and human development spending, including for paying down arrears related to public investment and poverty reduction outlays.

31. Monetary and exchange rate policy. The authorities' commitment to maintaining a stabilized exchange rate within a reasonably wide and adjustable band has contributed to increased confidence in the kip and de-dollarization efforts during the past decade. This exchange rate anchor now needs to be bolstered by tighter macroeconomic policies. Moreover, given the extent of the estimated real exchange rate overvaluation, the kip should be allowed to move in line with market conditions with a view toward gradually building up international reserves to four months of import cover. This exchange rate strategy along with the lower credit and broad money growth targets amid tighter fiscal policy will enhance financial sector resiliency and restore macroeconomic stability. To achieve a lower credit growth target, it will be necessary to mop up excess kip liquidity in the financial system, accelerate the unwinding of quasi-fiscal lending operations, and raise policy interest rates. In addition, the BOL should continue to reduce currency mismatch on the balance sheets of banks and their borrowers.

32. Financial supervision. Efforts to strengthen financial supervision should be intensified, with regulatory measures put in place to reduce leverage. All banks should be required to achieve the minimum mandated CAR of 8 percent, with riskier banks required to maintain higher CARs. The BOL should develop detailed plans to address supervisory weaknesses as well as a crisis contingency plan for the banking sector, and seek sustained technical assistance. Over time, these efforts along with a clear and uniformly applied accounting framework and an effective and prompt debt resolution process will help foster a resilient financial system. The IMF is ready to provide further technical assistance and training on financial stability and crisis management frameworks, as well as stress testing, and encourages the authorities' participation in an FSAP.

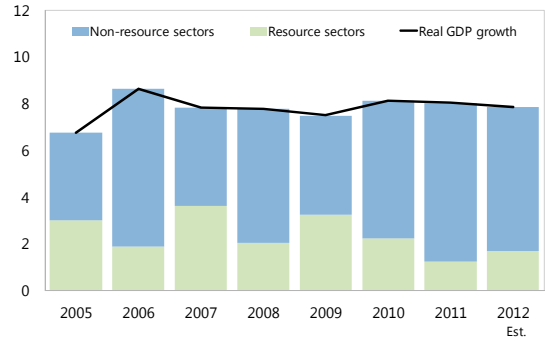
33. Sustainable and inclusive growth. The authorities' achievement in poverty reduction and progress toward MDGs is laudable. The focus on upgrading health and education infrastructure is the right one, and will contribute toward reducing inequality. Public sector financial management reforms will be crucial to improve the quality of public spending, and the IMF stands ready to provide technical assistance in this area. Looking forward, international trade integration will promote economic competition, which will in turn improve the business climate, promote institutional reform, statistical upgrades, and offer potential to make growth more productivity-driven and broader-based.

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

Figure 1. Lao P.D.R.: Growth is Strong; Price Pressures are Picking Up

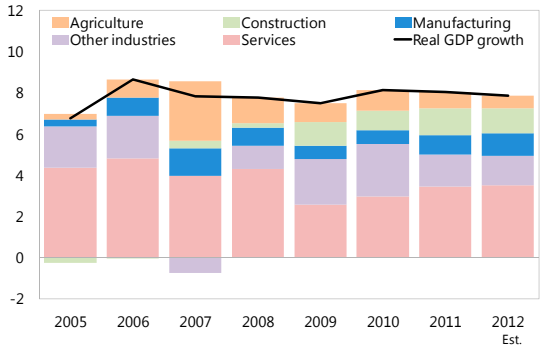
Growth remained close to 8 percent in 2012, …

Contribution to GDP Growth (2002 prices)
(In percent)



…with impetus from services, construction, and manufacturing, similar to 2011.

Contribution to GDP growth (2002 prices)
(In percent)

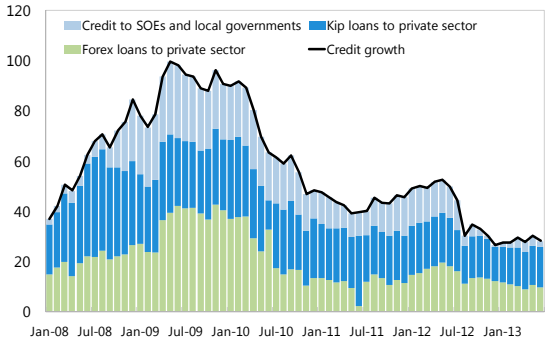


Official import data indicated strong consumption, while machinery and equipment imports weakened.

Import growth
(Year-on-year percent change)

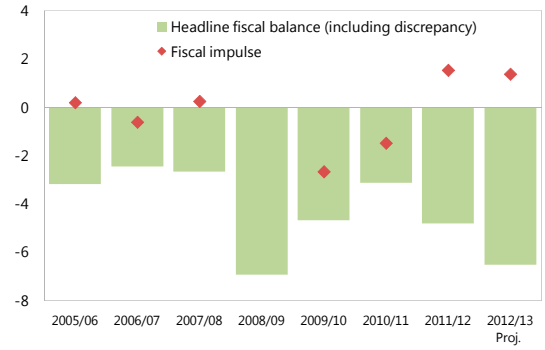
Activity continues to be supported by strong private credit growth, …

Contribution to Credit Growth
(Year-on-year percent change)



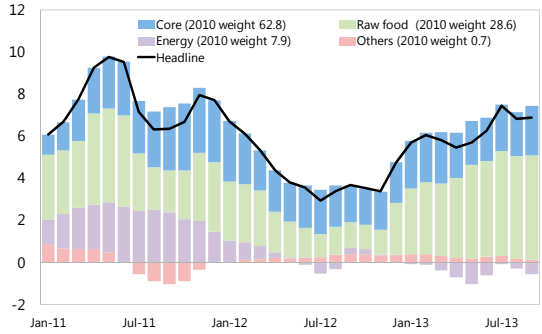
…, and stimulus from fiscal policy.

Fiscal Balance and Impulse 1/
(In percent of GDP)



Inflation is accelerating, mainly from fresh food. Core inflation has recently started to pick up.

Contribution to Headline Inflation 1/
(In percentage points)



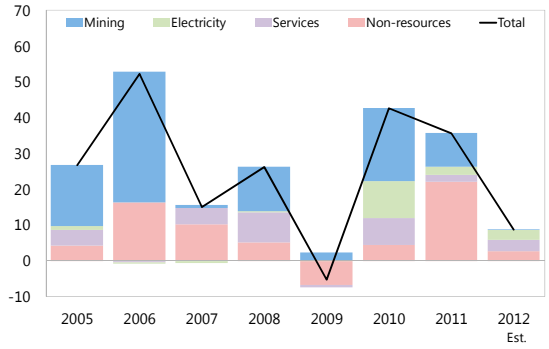
1/ Core inflation excludes raw food, fuel, gold, electricity tariffs.

Sources: Lao P.D.R. authorities; CEIC; IMF's *World Economic Outlook*; and IMF staff estimates.

Figure 2. Lao P.D.R.: External Vulnerabilities are Growing

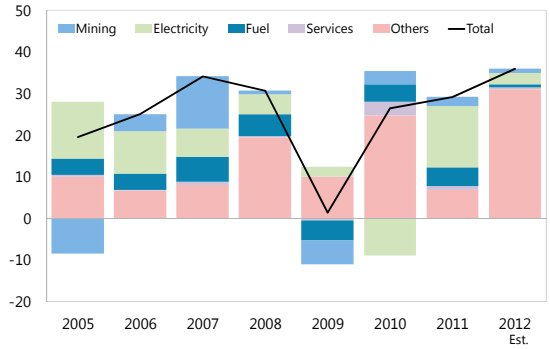
After two years of stellar performance, export growth weakened substantially in 2012.

Contribution to Export Growth
(In percentage points)



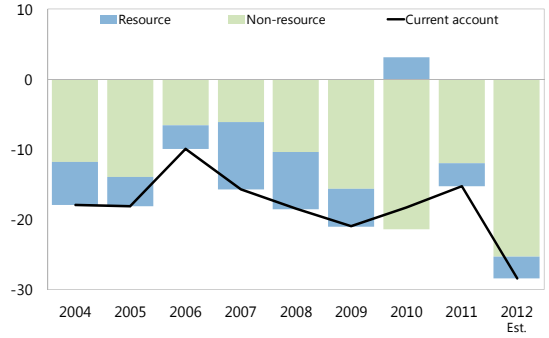
Meanwhile, nonresource imports surged to an unusually high level as preparation for the Asia Europe Meeting intensified.

Contribution to Import Growth
(In percentage points)



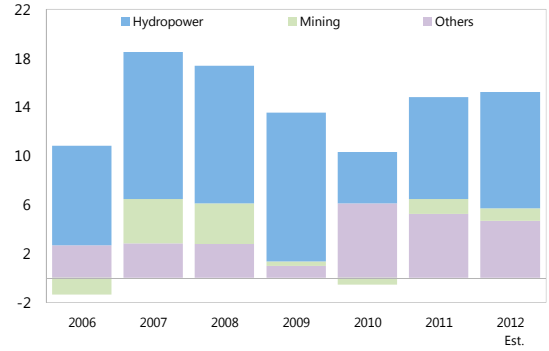
The result is a substantially worsened nonresource current account position.

Current Account Balance
(In percent of GDP)



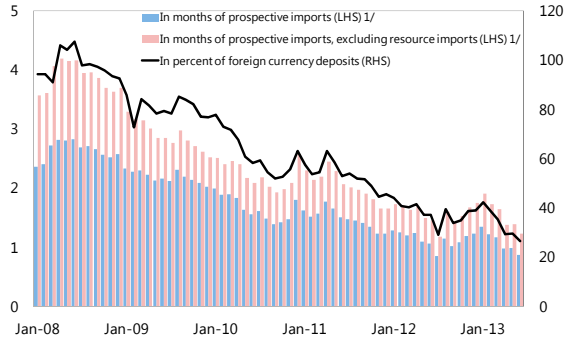
FDI remains vigorous. While the bulk of new FDI is still dominated by hydropower projects, foreign-funded investment in other sectors is strong.

FDI, Private Sector
(In percent of GDP)



Nevertheless, the international reserves position is at its weakest in a decade, and remains inadequate.

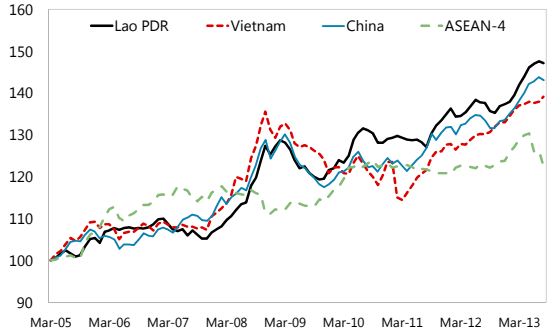
International Reserves



1/ 12-month moving average

Sharp real exchange rate appreciation threatens to erode external competitiveness further.

Real Effective Exchange Rates 1/
(Index, March 2005=100)



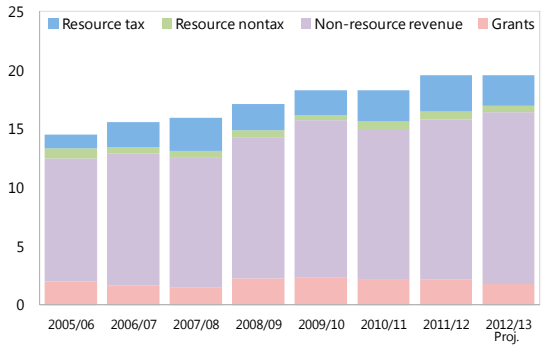
1/ ASEAN-4 includes Indonesia, Malaysia, Philippines and Thailand.

Sources: Lao P.D.R. authorities; CEIC; IMF's *World Economic Outlook*; and IMF staff estimates.

Figure 3. Lao P.D.R.: Fiscal Performance Gains have been Reversed

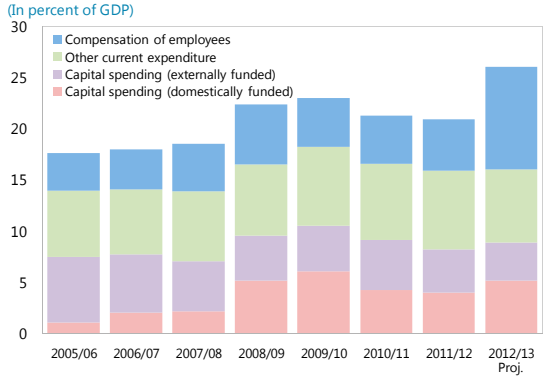
Overall revenue performance was strong in FY2012/13 from nonresource revenue gains. Mining revenue weakened from lower commodity prices.

Government Revenue and Grants
(In percent of GDP)



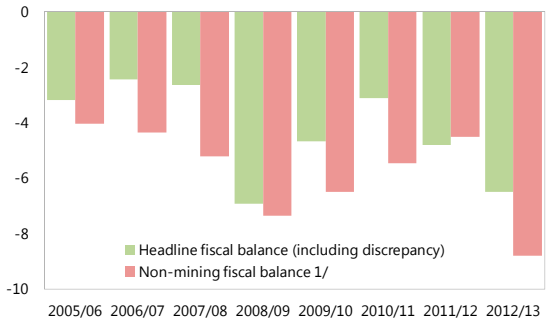
Expenditures surged from public pay increases and capital spending, which was not retrained like in FY 2011/12.

Government Expenditure
(In percent of GDP)



As a result, both overall and nonmining fiscal deficits are on the rise, reversing the trend observed since 2009, …

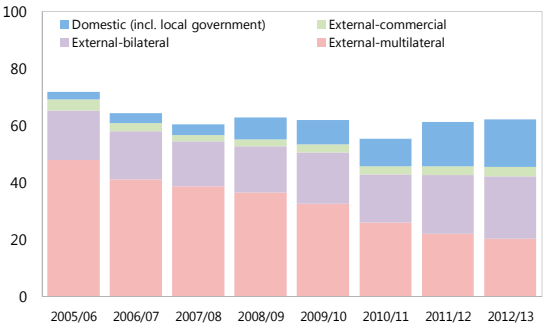
Fiscal Balance
(In percent of GDP)



1/ Net lending/borrowing minus mining revenues.

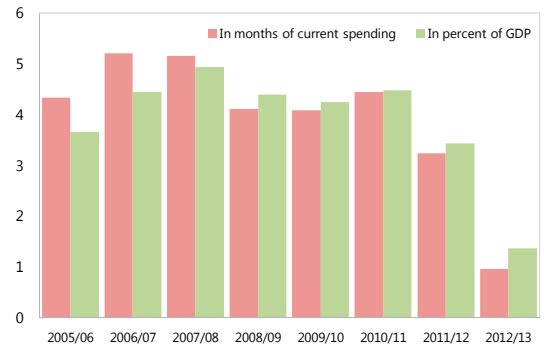
…, and causing domestic public debt to rise sharply.

Public Sector Debt
(In percent of GDP)



With larger financing needs, the stock of government deposits has declined dramatically.

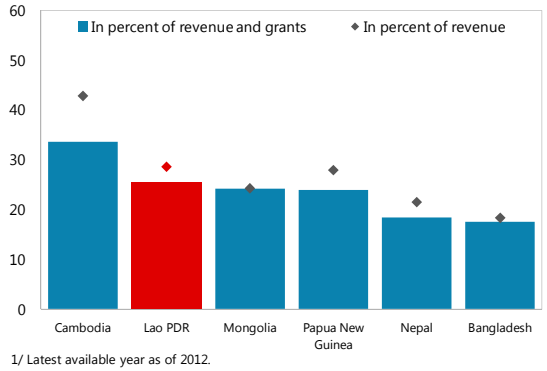
Stock of Government Deposits 1/



1/ For FY 2012/13, stock of government deposits are as of June 2013.

Even before the FY2012/13 wage increase, the share of public sector compensation in Lao P.D.R.'s revenue was already on the high side.

Compensation of Government Employees 1/



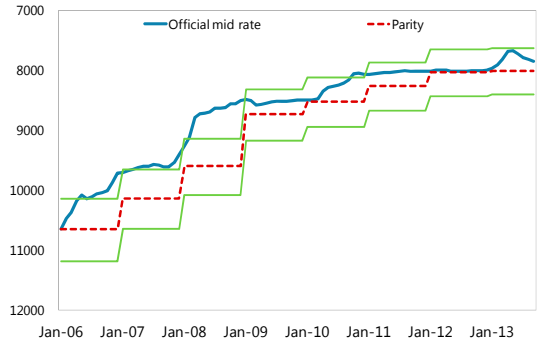
1/ Latest available year as of 2012.

Sources: Lao P.D.R. authorities; CEIC; IMF's *World Economic Outlook*; and IMF staff estimates.

Figure 4. Lao P.D.R.: Domestic Monetary and Credit Conditions Remain Highly Accommodative

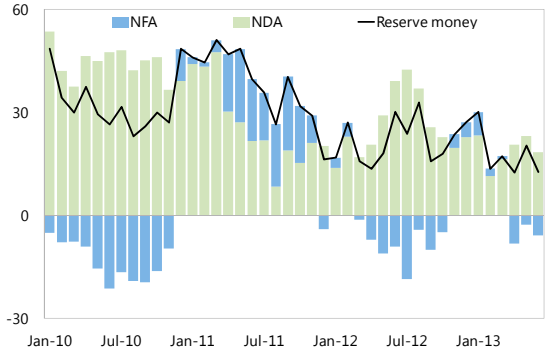
The Kip approached the upper end of the +/-5 percent band in early 2013, but has since depreciated against the US dollar.

Exchange Rates
(Kip/USD)



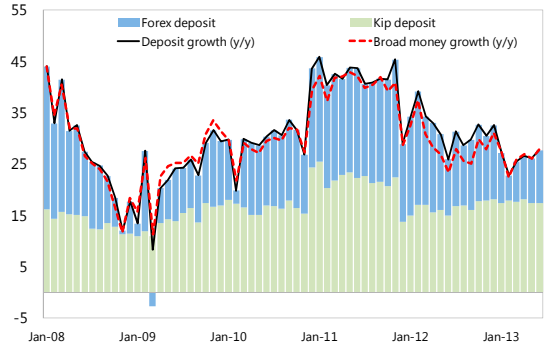
With weak international reserves gains, reserve money is driven by central bank lending to the government and SOEs.

Contribution to Reserve Money Growth
(In percentage points)



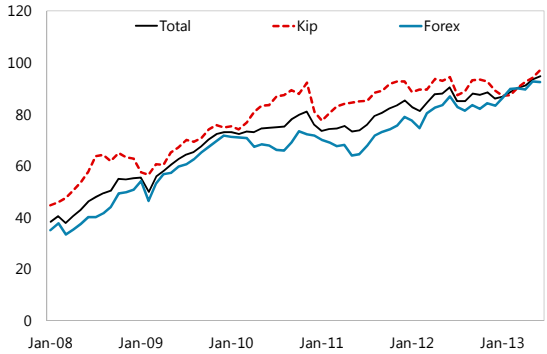
Broad money and deposit growth has slowed, but continues to be brisk, ...

Broad Money and Deposit Growth
(Year-on-year contribution in percentage points)



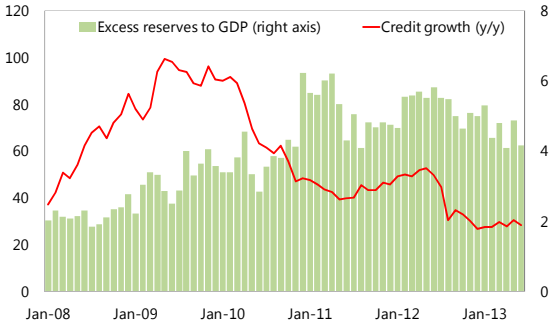
... while banks' risk appetite continues to push up loans against the deposit base.

Claims on the Economy, Commercial Banks
(In percent of deposits)



Kip liquidity remains ample, and banks have plenty of room to expand credit supply.

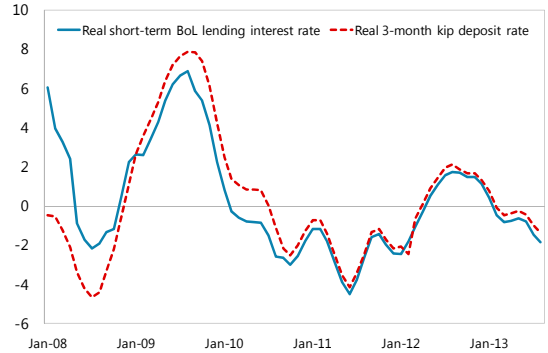
Credit to the Economy and Excess Reserves
(In percent)



Sources: BoL; and IMF staff estimates.

Without pressure on interest rates to rise, real interest rates have again become negative with rising inflation.

Real Interest Rate
(In percent per annum)



Sources: Lao P.D.R. authorities; CEIC; IMF's *World Economic Outlook*; and IMF staff estimates.

Appendix 1. Lao P.D.R.: Risk Assessment Matrix (RAM) 1/

Risk	Likelihood	Potential Impact	Policy Response
Protracted economic and financial volatility, especially for emerging markets (triggered by prospective exit from UMP).	**High** Prospects of higher interest rates in advanced economies could trigger a sustained reversal of capital flows from the region, intensifying foreign currency liquidity strains.	**Medium** Pressure on international reserves and the exchange rate, with effects on balance sheets, and potentially, a reacceleration of dollarization.	Allow the currency to depreciate and refrain from domestic demand stimulus to preserve limited international reserves and contain inflation.
Lower than anticipated emerging market growth potential (earlier maturing of the cycle and incomplete structural reforms with spillovers to LICs and advanced economies).	**Medium** Growth relies to a large extent on trade and FDI links with other Asian countries, particularly China, Thailand and Vietnam.	**Medium** Slowdown in trading partner growth will put pressure on the balance of payments as exports decline and domestic demand continues to be stimulated by expansionary policies. Could lead to further pressure on exchange rate and international reserves.	Allow the currency to depreciate and avoid stimulating domestic demand to preserve limited external buffers and contain inflation. Over time, take advantage of WTO to diversify export destinations.
Loss of confidence in the domestic banking system caused by a sharp loss of international reserves.	**Medium** International reserves are low and expansionary monetary and fiscal policies threaten to deplete them further.	**High** Loss of confidence in the currency leading to currency substitution, capital flight and exchange rate pressure, with effects on bank and corporate balance sheets and a prolonged downturn in growth.	Activate banking sector contingency plan, including depositor protection. Inject kip liquidity to solvent banks. Preserve international reserves by allowing the currency to depreciate and limiting fiscal expansion. Strengthen banking supervision.
Terms-of-trade shock (particularly declining global copper and gold prices).	**Medium** Growth relies on exports of commodities and imports of intermediate goods and petroleum products.	**Medium** Pressure on the balance of payments, exchange rate and international reserves.	Increase exchange rate flexibility and avoid stimulating domestic demand to preserve limited international reserves; Over time, diversify exports.
Reversal of fiscal consolidation	**Medium** Pressure for greater spending and response to external shocks or natural disasters could lead to an increase in the debt ratio.	**Medium** Crowding out of public and private productive investments and social spending, and overvaluation of the real exchange rate could lead to a slower or stagnating growth in the medium-term.	Continue fiscal consolidation, improve nonmining revenue collection, and rationalize expenditure, with a focus on fostering physical and human capital.

1/ Assumes no policy response to external shocks. The RAM shows events that could materially alter the baseline path (the scenario most likely to materialize in the view of IMF staff). The relative likelihood of risks listed is the staff's subjective assessment of the risks surrounding the baseline ("low" is meant to indicate a probability below 10 percent, "medium" a probability between 10 percent and 30 percent, and "high" a probability of 30 percent or more). The RAM reflects staff views on the sources of risks and the overall level of concern as of the time of discussion with the authorities.

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2010–14[1/]

	2010	2011	2012	2013	2014
			Est.	Proj.	
GDP and prices (percentage change)					
Real GDP growth	8.1	8.0	7.9	8.2	7.5
CPI (annual average)	6.0	7.6	4.3	6.5	7.5
CPI (end year)	5.8	7.7	4.7	7.4	7.7
Public finances (in percent of GDP)					
Revenue	18.3	18.3	19.6	19.6	20.6
Of which : Resources	2.6	3.3	3.8	3.2	3.4
Of which : Mining	1.8	2.5	3.1	2.3	2.5
Of which : Hydro power	0.8	0.8	0.8	0.9	0.9
Of which : Grant	2.3	2.2	2.1	1.8	1.7
Expenditure	23.0	21.3	21.0	26.1	24.5
Expense	12.5	12.1	12.7	17.2	16.7
Net acquisition of nonfinancial assets 2/	10.6	9.2	8.2	8.9	7.8
Net lending/borrowing	-4.7	-3.0	-1.4	-6.5	-3.8
Net lending/borrowing including discrepancy	-4.4	-3.0	-4.7	…	…
Nonmining balance 3/	-6.5	-5.5	-4.5	-8.8	-6.4
Nonmining balance including discrepancy 3/	-6.2	-5.5	-7.8	…	…
Money and credit (annual percent change)					
Reserve money	48.6	16.2	27.2	12.7	14.9
Broad money	39.5	28.7	31.0	24.7	20.8
Bank credit to the economy 4/	48.4	45.8	26.6	32.9	19.4
Bank credit to the private sector	48.4	39.3	35.1	34.2	21.0
Balance of payments					
Exports (in millions of U.S. dollars)	2,196	3,120	3,323	3,451	3,661
In percent change	44.4	42.1	6.5	3.9	6.1
Imports (in millions of U.S. dollars)	3,574	4,635	6,355	6,940	7,242
In percent change	23.6	29.7	37.1	9.2	4.4
Current account balance (in millions of U.S. dollars)	-1,251	-1,243	-2,606	-2,946	-2,956
In percent of GDP	-18.2	-15.2	-28.4	-29.5	-27.3
Gross official reserves (in millions of U.S. dollars)	728	677	740	666	712
In months of prospective goods and services imports	1.8	1.2	1.2	1.1	1.1
(Excluding imports associated with large resource projects)	2.6	1.7	1.7	1.5	1.5
External public debt and debt service					
External public debt					
In millions of U.S. dollars	3,539	3,664	4,221	4,611	5,167
In percent of GDP	50.3	44.8	46.1	47.4	49.1
External public debt service					
In percent of exports	4.4	2.7	4.1	5.6	5.4
Exchange rate					
Official exchange rate (kip per U.S. dollar; end-of-period)	8,040	8,002	7,992	…	…
Real effective exchange rate (2000=100)	125.2	127.6	133.7	…	…
Nominal GDP					
In billions of kip	56,523	65,398	73,257	82,260	94,041
In millions of U.S. dollars	6,855	8,162	9,169	10,002	10,814

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

1/ Public finances are on a fiscal year (October to September) while other data are on a calendar year.
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.

Table 2. Lao P.D.R.: Balance of Payments, 2010–14

	2010	2011	2012 Est.	2013 Projection	2014 Projection
	(In millions of U.S. dollars; unless otherwise indicated)				
Current account	-1,251	-1,243	-2,606	-2,946	-2,956
Merchandise trade balance	-1,379	-1,515	-3,032	-3,489	-3,581
Exports, f.o.b.	2,196	3,120	3,323	3,451	3,661
Mining and hydropower	1,500	1,821	1,924	1,868	1,873
Other exports	696	1,299	1,399	1,583	1,788
Imports, c.i.f.	3,574	4,635	6,355	6,940	7,242
Mining and hydropower	728	1,447	1,648	2,109	2,161
Mining projects	354	436	488	475	360
Hydropower projects	374	1,012	1,161	1,634	1,801
Petroleum imports	412	585	626	655	674
Other imports	2,434	2,602	4,081	4,176	4,407
Services (net)	374	396	496	539	580
Of which: Tourism	382	406	506	557	612
Income (net)	-425	-336	-315	-265	-249
Interest payments	-135	-115	-147	-165	-158
Of which: Public	-41	-27	-59	-86	-87
Mining and hydropower	-86	-82	-81	-71	-63
Mining projects	-6	-10	-14	-10	-9
Hydropower projects	-79	-72	-67	-61	-54
Dividends and profit repatriation	-525	-616	-544	-467	-437
Of which: Mining and hydropower	-470	-561	-487	-409	-377
Other	235	394	376	368	347
Transfers (net)	179	213	246	269	293
Private	70	84	101	111	122
Official	109	129	145	158	171
Capital and financial account	1,353	1,198	2,670	2,876	3,006
Public sector	155	145	308	390	556
Disbursements	231	220	412	541	711
Amortization	-77	-74	-104	-151	-155
Banking sector (net)	-29	23	39	240	39
Private sector	1,227	1,030	2,323	2,246	2,411
Foreign direct investment (net) 1/	671	1,210	1,399	1,846	2,011
Of which: Mining and hydropower projects	250	783	969	1,343	1,552
Of which: Mining projects	-37	102	94	81	-30
Hydropower projects	287	681	875	1,262	1,582
Other private flows and errors and omissions	556	-180	925	400	400
Overall balance	102	-45	65	-70	50
Core Balance (CA+FDI+ODA)	-425	66	-942	-753	-446
Financing	-102	45	-65	70	-50
Central bank net foreign assets	-102	45	-65	70	-50
Assets (increase -)	-95	51	-62	74	-46
Liabilities (reduction -)	-7	-6	-3	-4	-4
Memorandum items:					
Current account balance (in percent of GDP)	-18.2	-15.2	-28.4	-29.5	-27.3
Excluding official transfers	-19.8	-16.8	-30.0	-31.0	-28.9
Resource current account balance (in percent of GDP) 2/	3.2	-3.3	-3.2	-7.2	-6.7
Nonresource current account balance (in percent of GDP)	-21.4	-11.9	-25.2	-22.2	-20.6
Exports (annual percent change)	44.4	42.1	6.5	3.9	6.1
Mining and hydropower	64.5	21.4	5.7	-2.9	0.2
Other exports	14.3	86.7	7.7	13.2	13.0
Imports (annual percent change)	23.6	29.7	37.1	9.2	4.4
Of which: Hydropower and mining related	-18.6	98.8	13.9	27.9	2.5
other imports	42.6	6.9	56.8	2.3	5.5
Oil imports	41.5	42.0	6.9	4.8	2.9
Gross official reserves	728	677	740	666	712
In months of prospective imports of goods and nonfactor services	1.8	1.2	1.2	1.1	1.1
(Excluding imports associated with large resource projects)	2.6	1.7	1.7	1.5	1.5
Nominal GDP at market prices	6,855	8,162	9,169	10,002	10,814

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, 2009/10–2013/14

	2009/10	2010/11	2011/12	2012/13 Proj.	2013/14 Proj.
	(In billions of kip)				
Revenue	9,779	11,571	13,960	15,666	18,787
Of which: Resource revenue 1/	1,376	2,098	2,716	2,533	3,126
Taxes	7,503	9,109	10,915	12,490	15,313
Income and profit taxes	1,587	2,136	2,940	3,072	4,173
Income taxes	462	543	744	949	1,294
Profit taxes	1,125	1,592	2,196	2,123	2,879
Of which: Mining	487	888	1,287	1,069	1,513
Of which: Nonmining	638	705	909	1,054	1,366
VAT	1,869	2,403	2,827	3,201	3,663
Excise duties	1,687	1,948	2,344	2,554	2,965
Import duties	832	965	1,047	1,546	2,155
Royalties	560	722	884	946	1,024
Other taxes	968	936	872	1,172	1,332
Other revenues	1,035	1,073	1,513	1,738	1,932
Grants	1,242	1,389	1,532	1,438	1,542
Expenditure	12,302	13,461	14,945	20,875	22,294
Expense	6,656	7,652	9,065	13,725	15,220
Compensation of employees	2,525	2,940	3,560	8,000	8,800
Transfers	1,698	1,866	2,015	2,244	2,649
Interest payments	398	431	591	962	925
Of which: External	318	373	473	612	725
Other recurrent	2,034	2,415	2,899	2,519	2,846
Net acquisition of nonfinancial assets	5,646	5,808	5,881	7,150	7,074
Domestically financed	3,271	2,699	2,876	4,150	4,250
Of which: Off-budget	1,823	1,130	314	1,200	1,000
Externally financed	2,376	3,109	3,005	3,001	2,824
Net lending/borrowing	-2,524	-1,889	-986	-5,209	-3,507
Net acquisition of financial assets	-59	-408	565	1,987	121
Domestic	-59	-408	565	1,987	121
Foreign	0	0	0	0	0
Net incurrence of liabilities	2,559	2,379	2,866	3,222	3,628
Domestic	1,708	1,116	1,828	2,178	1,992
Foreign	851	1,262	1,038	1,043	1,636
Discrepancy	-24	82	2,446	0	0
Memorandum items:					
Net lending including discrepancy	-2,500	-1,971	-3,431	...	...
Nonmining balance 2/	-3,478	-3,456	-3,218	-7,038	-5,809
Operating balance	3,123	3,919	4,895	1,941	3,567
Mining revenue	954	1,567	2,232	1,829	2,302
Hydropower revenue	422	530	484	705	824
Nonresource revenue	7,161	8,085	9,711	11,695	14,119
GDP	53,438	63,179	71,292	80,009	91,096

Table 3. Lao P.D.R.: General Government Operations, 2009/10–2013/14 (concluded)

	2009/10	2010/11	2011/12	2012/13 Proj.	2013/14 Proj.
	(In percent of GDP, unless otherwise indicated)				
Revenue	18.3	18.3	19.6	19.6	20.6
Of which: Resource revenue 1/	2.6	3.3	3.8	3.2	3.4
Taxes	14.0	14.4	15.3	15.6	16.8
Income and profit taxes	3.0	3.4	4.1	3.8	4.6
Income taxes	0.9	0.9	1.0	1.2	1.4
Profit taxes	2.1	2.5	3.1	2.7	3.2
Of which: Mining	0.9	1.4	1.8	1.3	1.7
Of which: Nonmining	1.2	1.1	1.3	1.3	1.5
VAT	3.5	3.8	4.0	4.0	4.0
Excise duties	3.2	3.1	3.3	3.2	3.3
Import duties	1.6	1.5	1.5	1.9	2.4
Royalties	1.0	1.1	1.2	1.2	1.1
Other taxes	1.8	1.5	1.2	1.5	1.5
Other revenues	1.9	1.7	2.1	2.2	2.1
Grants	2.3	2.2	2.1	1.8	1.7
Expenditure	23.0	21.3	21.0	26.1	24.5
Expense	12.5	12.1	12.7	17.2	16.7
Compensation of employees	4.7	4.7	5.0	10.0	9.7
Transfers	3.2	3.0	2.8	2.8	2.9
Interest payments	0.7	0.7	0.8	1.2	1.0
Of which: External	0.6	0.6	0.7	0.8	0.8
Other recurrent	3.8	3.8	4.1	3.1	3.1
Net acquisition of nonfinancial assets	10.6	9.2	8.2	8.9	7.8
Domestically financed	6.1	4.3	4.0	5.2	4.7
Of which: Off-budget	3.4	1.8	0.4	1.5	1.1
Externally financed	4.4	4.9	4.2	3.8	3.1
Net lending/borrowing	-4.7	-3.0	-1.4	-6.5	-3.8
Net acquisition of financial assets	-0.1	-0.6	0.8	2.5	-0.1
Domestic	-0.1	-0.6	0.8	2.5	-0.1
Foreign	0.0	0.0	0.0	0.0	0.0
Net incurrence of liabilities	4.8	3.8	4.0	4.0	4.0
Domestic	3.2	1.8	2.6	2.7	2.2
Foreign	1.6	2.0	1.5	1.3	1.8
Discrepancy	0.0	0.1	3.4	0.0	0.0
Memorandum items:					
Net lending including discrepancy	-4.7	-3.1	-4.8	...	...
Nonmining balance 2/	-6.5	-5.5	-4.5	-8.8	-6.4
Operating balance	5.8	6.2	6.9	2.4	3.9
Mining revenue	1.8	2.5	3.1	2.3	2.5
Hydropower revenue	0.8	0.8	0.7	0.9	0.9
Nonresource revenue	13.4	12.8	13.6	14.6	15.5
GDP	53,438	63,179	71,292	80,009	91,096

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.

Table 4. Lao P.D.R.: Monetary Survey, 2010–14

	2010	2011	2012				2013				2014
	Dec.	Dec.	Mar.	Jun.	Sep.	Dec.	Mar.	Jun.	Sep.	Dec.	Dec.
									Projection		
	(In billions of kip, unless otherwise indicated)										
Bank of Lao P.D.R. (BoL)											
Net foreign assets	5,151	4,772	4,727	4,220	4,131	5,255	4,833	3,529	4,260	4,992	5,721
In millions of U.S. dollars	639	595	593	527	517	660	625	455	543	590	640
Net domestic assets	4,409	6,341	7,394	7,615	7,512	8,878	9,379	9,802	10,344	10,935	12,572
Government (net)	-742	-653	43	-271	-97	630	606	711	871	846	821
Claims	926	688	883	929	929	1,228	1,218	1,113	1,247	1,247	1,247
Deposits	-1,667	-1,341	-840	-1,200	-1,026	-598	-612	-402	-376	-401	-426
Of which: Foreign currency	-1,243	-1,091	-618	-794	-708	-504	-409	-344	-288	-307	-326
State-owned enterprises	3,367	4,997	5,228	5,554	4,764	4,959	5,964	5,890	5,964	6,214	7,076
Of which: Kip	419	1,255	1,348	1,429	1,725	1,980	2,446	2,804	2,839	2,958	3,368
Local governments	3,071	4,701	4,932	5,259	4,468	4,664	5,668	5,594	5,668	5,918	6,781
Banks	1,936	3,168	3,188	3,342	3,287	3,647	3,658	3,837	3,837	4,197	4,747
BoL securities	-1,023	-2,145	-2,003	-2,025	-2,014	-1,786	-2,000	-2,194	-2,150	-2,000	-2,000
Other items (net)	872	974	938	1,016	1,572	1,428	1,151	1,558	1,822	1,678	1,928
Reserve money	9,560	11,113	12,120	11,836	11,643	14,133	14,212	13,331	14,604	15,926	18,293
Currency in circulation	4,505	5,661	5,777	5,370	5,550	7,169	7,517	7,079	7,756	8,300	9,533
Bank Reserves	5,056	5,452	6,343	6,465	6,093	6,964	6,695	6,252	6,849	7,626	8,760
Of which: Foreign currency	1,850	2,304	2,680	2,732	2,575	2,943	2,829	2,642	2,894	3,223	3,702
Monetary survey											
Net foreign assets	6,280	5,711	6,667	3,787	4,366	5,879	4,501	1,635	2,667	3,624	3,930
In millions of U.S. dollars	779	712	836	473	546	738	582	211	340	429	440
Of which: Commercial banks	140	117	243	-54	29	78	-43	-244	-203	-162	-200
Net domestic assets	14,889	21,535	23,101	25,506	27,254	29,826	32,964	35,823	38,470	40,905	49,855
Government (net)	-481	-1,211	-1,123	-892	540	2,032	1,838	2,411	3,130	3,320	4,555
Budget	-1,068	-1,799	-1,710	-1,479	-47	1,444	1,250	1,823	2,543	2,733	3,967
Claims	1,387	929	1,684	1,913	2,401	2,976	3,291	2,911	3,380	3,620	4,854
Deposits	-2,455	-2,727	-3,394	-3,392	-2,448	-1,532	-2,041	-1,088	-837	-887	-887
Other	588	588	588	588	588	588	588	588	588	588	588
Credit to the economy	16,537	24,104	26,428	28,221	28,706	30,525	34,243	36,183	38,210	40,555	48,421
In kip	6,923	10,927	11,763	12,751	13,868	14,909	16,906	18,667	19,713	20,950	25,096
In foreign currencies	9,614	13,177	14,665	15,470	14,838	15,616	17,337	17,516	18,498	19,605	23,325
Of which: Private credit	12,712	17,713	19,782	21,202	22,395	23,934	26,538	28,501	30,099	32,119	38,864
Other items (net)	-1,167	-1,358	-2,205	-1,823	-1,993	-2,730	-3,117	-2,771	-2,871	-2,971	-3,121
Broad money	21,169	27,246	29,768	29,293	31,621	35,705	37,465	37,458	41,137	44,529	53,785
Currency in circulation	3,800	4,844	4,738	4,215	4,437	6,020	6,064	5,457	5,768	6,744.3	8,146
Kip deposits	8,056	10,453	11,621	12,026	13,040	14,517	16,038	16,374	18,122	19,276	23,283
Foreign currency deposits (FCDs)	9,313	11,949	13,409	13,052	14,143	15,169	15,364	15,627	17,247	18,509	22,356
	(Annual percent change, unless otherwise indicated)										
Reserve money	48.6	16.2	15.8	30.2	15.8	27.2	17.3	12.6	25.4	12.7	14.9
Broad money	39.5	28.7	30.8	23.3	25.1	31.0	25.9	27.9	30.1	24.7	20.8
Credit to the economy	48.4	45.8	49.3	49.8	34.7	26.6	29.6	28.2	33.1	32.9	19.4
Credit to the private sector	48.4	39.3	47.7	49.9	40.0	35.1	34.2	34.4	34.4	34.2	21.0
Memorandum items:											
Velocity	2.67	2.40	2.46	2.50	2.32	2.05	2.20	2.20	2.00	1.85	1.75
Money multiplier	2.21	2.45	2.46	2.47	2.72	2.53	2.64	2.81	2.82	2.80	2.94
Loan/deposit (percent)	75.8	85.3	84.7	90.4	88.1	86.1	90.1	94.7	91.2	90.9	90.6
In kip (percent)	80.7	92.5	89.6	94.1	93.1	89.1	90.2	96.9	93.1	93.3	93.3
In foreign currency (percent)	71.6	79.0	80.4	86.9	83.4	83.3	90.0	92.3	89.1	88.3	87.8
Gross official reserves (in millions of U.S. dollars)	728	677	675	608	598	740	704	532	621	666	712
Net international reserves (in millions of U.S. dollars) 1/	410	308	257	186	195	290	259	114	174	209	226
Exchange rate, end-of-period (kip per U.S. dollar)	8,058	8,023	7,976	8,006	7,990	7,966	7,735	7,753	7,850	...	...
Nominal GDP (in billions of kip)	56,523	65,398	73,257	73,257	73,257	73,257	82,260	82,260	82,260	82,260	94,041
Dollarization rate (FCDs/broad money; in percent)	44.0	43.9	45.0	44.6	44.7	42.5	41.0	41.7	41.9	41.6	41.6
Gross reserve/Reserve Money	61	49	44	41	41	42	38	31	33	35	35
Required reserves	1,023	1,515	1,643	1,629	1,764	1,778	1,753	1,834	2,100	2,248	2,715
Excess reserves (percent of GDP)	6.2	4.8	5.6	5.8	5.0	5.0	4.8	4.2	4.4	4.4	4.3

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.

Table 5. Lao P.D.R.: Medium-Term Macroeconomic Framework, 2010–18

	2010	2011	2012	2013	2014	2015	2016	2017	2018
			Est.			Projections			
Output and prices			(Percent change, unless otherwise indicated)						
Real GDP	8.1	8.0	7.9	8.2	7.5	7.8	8.0	7.7	7.5
Consumer prices (end-period)	5.8	7.7	4.7	7.4	7.7	7.3	6.6	5.5	5.8
Consumer prices (annual average)	6.0	7.6	4.3	6.5	7.5	7.5	7.6	6.0	5.7
GDP per capita (in U.S. dollars)	1,064	1,244	1,371	1,468	1,557	1,688	1,841	2,020	2,237
Public finances (in percent of GDP) 1/									
Revenue	18.3	18.3	19.6	19.6	20.6	21.2	21.1	20.9	20.7
Tax and nontax revenue	16.0	16.1	17.4	17.8	18.9	19.5	19.5	19.3	19.3
Mining	1.8	2.5	3.1	2.3	2.5	2.1	1.9	1.7	1.6
Hydro power	0.8	0.8	0.7	0.9	0.9	1.0	1.0	0.9	0.9
Others	13.4	12.8	13.6	14.6	15.5	16.5	16.6	16.7	16.8
Grant	2.3	2.2	2.1	1.8	1.7	1.7	1.6	1.5	1.4
Expenditure	23.0	21.3	21.0	26.1	24.5	26.7	25.5	24.7	23.9
Expense	12.5	12.1	12.7	17.2	16.7	18.5	18.0	17.9	17.4
Net acquisition of nonfinancial assets 2/	10.6	9.2	8.2	8.9	7.8	8.2	7.5	6.8	6.5
Net lending/borrowing	-4.7	-3.0	-1.4	-6.5	-3.8	-5.5	-4.4	-3.8	-3.3
Net lending/borrowing including disrepancy	-4.4	-3.0	-4.7	...	...	...	...	...	...
Nonmining balance 3/	-6.5	-5.5	-4.5	-8.8	-6.4	-7.5	-6.3	-5.6	-4.8
Nonmining balance including discrepancy 3/	-6.2	-5.5	-7.8	...	...	...	...	...	...
Balance of payments			(In millions of U.S. dollars; unless otherwise indicated)						
Current account balance	-1,251	-1,243	-2,606	-2,946	-2,956	-2,831	-2,579	-2,522	-2,855
In percent of GDP	-18.2	-15.2	-28.4	-29.5	-27.3	-23.7	-19.4	-17.0	-17.0
Exports	2,196	3,120	3,323	3,451	3,661	3,997	4,658	5,124	5,507
Of which: Resources	1,500	1,821	1,924	1,868	1,873	1,976	2,373	2,543	2,585
In percent change	44.4	42.1	6.5	3.9	6.1	9.2	16.5	10.0	7.5
Of which: Resources	64.5	21.4	5.7	-2.9	0.2	5.5	20.1	7.1	1.7
Imports	3,574	4,635	6,355	6,940	7,242	7,488	7,825	8,330	9,173
In percent change	23.6	29.7	37.1	9.2	4.4	3.4	4.5	6.4	10.1
Of which: Resources	-18.6	98.8	13.9	27.9	2.5	-7.8	-12.5	-15.8	4.4
Services and income (net)	-51	59	181	274	332	336	230	301	400
Transfers	179	213	246	269	293	323	358	383	410
Capital account balance	1,353	1,198	2,670	2,876	3,006	3,012	2,909	2,865	3,121
Of which: FDI	671	1,210	1,399	1,846	2,011	2,015	1,938	1,970	2,296
Overall balance	102	-45	65	-70	50	181	330	344	267
Debt and debt service									
Public debt (in percent of GDP)	59.1	56.2	61.8	63.5	65.4	65.9	65.5	61.9	57.6
External debt (in percent of GDP)	87.1	84.0	89.9	110.8	127.8	133.6	127.4	120.7	113.2
External public debt (in percent of GDP)	50.3	44.8	46.1	47.4	49.1	49.2	48.2	46.0	43.0
External public debt service (in percent of exports)	4.4	2.7	4.1	5.6	5.4	5.1	4.6	4.4	4.2
Gross official reserves									
In millions of U.S. dollars	728	677	740	666	712	889	1,215	1,555	1,818
In months of imports (excluding resource projects)	2.6	1.7	1.7	1.5	1.5	1.7	2.0	2.3	2.5
Memorandum items:									
Nominal GDP (in billions of kip)	56,523	65,398	73,257	82,260	94,041	109,595	127,895	148,818	173,464

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 minus mining revenue.

Table 6. Lao P.D.R.: Millennium Development Goals (MDG) Indicators

MDGs	Indicator	Baseline	Current Status	2015 Target
1. Eradicate extreme poverty and hunger	Proportion of population below the national poverty line	46	27.6	24
	Employment-to-population ratio	47	77.7	no target
	Prevalence of underweight children under five years of age	44	27	22
	Prevalence of stunting in children under five years of age	48	38	34
2. Achieve universal primary Education	Proportion of pupils starting grade 1 who reach grade 5	48	70	95
	Literacy rate in the age group of 15–24 years	71	73.1	99
3. Promote gender equality and empower Women	Number of girls per 100 boys enrolled in:			
	Primary	77	91	100
	Lower secondary	66	89	100
	Upper secondary	56	83	100
	Tertiary	49	77	100
	Share of women in wage employment	38	34	no target
4. Reduce child mortality	Under–five mortality rate	170	79	55
	Proportion of one-year-old children immunized against measles	41.8	55	90
5. Improve maternal Health	Proportion of births attended by skilled birth personnel	14	42	49
	Maternity mortality rate (per 100,000 live births)	...	357	80
6. Combat HIV/AIDS, malaria and other diseases	HIV prevalence among general pop. (percentage)	0.006	0.1	less than 1
7. Ensure Environmental Sustainability	Proportion of land areas covered by forests (percentage)	70	40.3	65
	Consumption of ozone-depleting substances (mt)	50	2.5	0

Source: United Nations and Government of Lao P.D.R., "The Millenium Development Goals, Progress Report for the Lao P.D.R., 2013", (http://www.undp.org/content/lao_pdr/en/home/library/mdg/mdgs-progress-report-lao-pdr-2013).

Appendix II. Lao P.D.R.—Draft Press Release

Press Release No. 13/xx
FOR IMMEDIATE RELEASE
[November XX, 2013]

International Monetary Fund
700 19th Street, NW
Washington, D. C. 20431 USA

IMF Executive Board Concludes 2013 Article IV Consultation with Lao People's Democratic Republic

On November 15, 2013, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation[1] with Lao P.D.R.

Background

Lao P.D.R. continued to make progress towards achieving the Millennium Development Goals (MDGs) and became a member of the World Trade Organization (WTO) in 2013. Over the past year, however, the economy has been overheating from expansionary macroeconomic policies. The fiscal deficit is estimated to have widened to 6½ percent of GDP, mainly from a doubling of public sector employee compensation and higher capital spending. Government liquidity is tight, and wage and other arrears of 2–3 percent of GDP have emerged. Monetary policy has been accommodative, and credit growth remains vigorous. Real GDP growth is projected at 8¼ percent this year, led by investment and private consumption, and consumer price inflation is projected to rise to 7½ percent by year-end. The current account deficit is expected to remain close to 30 percent of GDP, and despite strong foreign direct investment inflows, international reserves—amounting to US$0.5 billion (0.8 month of prospective imports) in June 2013—are very low.

[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.

While medium-term growth prospects remain favorable, based on robust natural resource exports and post-WTO expansion in the nonresource sectors, heightened vulnerabilities have subjected the outlook to considerable uncertainty. A recent tightening of public employee compensation and public investment should reduce the headline fiscal deficit to 4 percent of GDP in 2014, although the current account deficit is expected to remain high owing to an overvalued real effective exchange rate, and reserve levels would remain inadequate for precautionary needs. After years of rapid credit expansion, banks' asset quality could deteriorate. If policies remain expansionary, near-term pressures on the balance of payments and inflation could escalate, further depleting international reserves, and putting at risk the sustainability of future growth and the authorities' objective to achieve middle-income status by 2020.

The tightening of fiscal and monetary policies is an urgent priority for reducing these vulnerabilities and restoring macroeconomic stability. A comprehensive medium-term fiscal consolidation strategy anchored around a non-mining fiscal deficit target of no more than 5 percent of GDP would bring public debt down to 40 percent of GDP by 2020, and help reduce near-term inflation and balance-of-payments pressures. Revenue administration reform, public employee compensation restraint along with civil service reform, and possibly a VAT rate hike, will be needed. Domestic monetary conditions should be tightened and the U.S. dollar-kip exchange rate should move more flexibly in line with market conditions with a view toward gradually rebuilding international reserves. Financial supervision requires strengthening, with prudential measures to reduce leverage and balance sheet mismatches. Continued reforms to take advantage of WTO membership, enhance private sector-led competition, and strengthen public sector financial management would lead to higher productivity and broader-based growth over time.

Executive Board Assessment[2]

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[2] 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.

Table 1. Lao P.D.R.: Selected Economic and Financial Indicators, 2010–14[1/]

	2010	2011	2012	2013	2014
			Est.	Proj.	
GDP and prices (percentage change)					
Real GDP growth	8.1	8.0	7.9	8.2	7.5
CPI (annual average)	6.0	7.6	4.3	6.5	7.5
CPI (end year)	5.8	7.7	4.7	7.4	7.7
Public finances (in percent of GDP)					
Revenue	18.3	18.3	19.6	19.6	20.6
Of which : Resources	2.6	3.3	3.8	3.2	3.4
Of which : Mining	1.8	2.5	3.1	2.3	2.5
Of which : Hydro power	0.8	0.8	0.8	0.9	0.9
Of which : Grant	2.3	2.2	2.1	1.8	1.7
Expenditure	23.0	21.3	21.0	26.1	24.5
Expense	12.5	12.1	12.7	17.2	16.7
Net acquisition of nonfinancial assets 2/	10.6	9.2	8.2	8.9	7.8
Net lending/borrowing	-4.7	-3.0	-1.4	-6.5	-3.8
Net lending/borrowing including discrepancy	-4.4	-3.0	-4.7	…	…
Nonmining balance 3/	-6.5	-5.5	-4.5	-8.8	-6.4
Nonmining balance including discrepancy 3/	-6.2	-5.5	-7.8	…	…
Money and credit (annual percent change)					
Reserve money	48.6	16.2	27.2	12.7	14.9
Broad money	39.5	28.7	31.0	24.7	20.8
Bank credit to the economy 4/	48.4	45.8	26.6	32.9	19.4
Bank credit to the private sector	48.4	39.3	35.1	34.2	21.0
Balance of payments					
Exports (in millions of U.S. dollars)	2,196	3,120	3,323	3,451	3,661
In percent change	44.4	42.1	6.5	3.9	6.1
Imports (in millions of U.S. dollars)	3,574	4,635	6,355	6,940	7,242
In percent change	23.6	29.7	37.1	9.2	4.4
Current account balance (in millions of U.S. dollars)	-1,251	-1,243	-2,606	-2,946	-2,956
In percent of GDP	-18.2	-15.2	-28.4	-29.5	-27.3
Gross official reserves (in millions of U.S. dollars)	728	677	740	666	712
In months of prospective goods and services imports	1.8	1.2	1.2	1.1	1.1
(Excluding imports associated with large resource projects)	2.6	1.7	1.7	1.5	1.5
External public debt and debt service					
External public debt					
In millions of U.S. dollars	3,539	3,664	4,221	4,611	5,167
In percent of GDP	50.3	44.8	46.1	47.4	49.1
External public debt service					
In percent of exports	4.4	2.7	4.1	5.6	5.4
Exchange rate					
Official exchange rate (kip per U.S. dollar; end-of-period)	8,040	8,002	7,992	…	…
Real effective exchange rate (2000=100)	125.2	127.6	133.7	…	…
Nominal GDP					
In billions of kip	56,523	65,398	73,257	82,260	94,041
In millions of U.S. dollars	6,855	8,162	9,169	10,002	10,814

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

1/ Public finances are on a fiscal year (October to September) while other data are on a calendar year.
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.