International Monetary Fund

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

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

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.

While medium-term growth prospects remain favorable, based on robust natural resource exports and post-WTO expansion in the non-resource 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.

Executive Board Assessment[2]

The Executive Directors commended the authorities for their impressive economic growth record and the significant progress made toward achieving the MDGs. While medium-term economic prospects remain broadly favorable, expansionary macroeconomic policies have led to a sharp deterioration of fiscal and external balances. To address growing vulnerabilities, Directors emphasized the immediate need to further tighten 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.

Directors stressed that fiscal consolidation is central to restoring macroeconomic stability. They agreed that a more ambitious tightening, anchored by a nonmining fiscal deficit of no more than 5 percent of GDP, would help to restore the fiscal space necessary for adequate capital and human development spending, and would safeguard debt sustainability. Directors welcomed the authorities' intention to restrain the increase in public sector compensation in 2014, and recommended that future increases be implemented at a more measured pace. A medium-term budget strategy and continued improvements in tax collection would be important components of any fiscal consolidation effort. Directors further underscored that cautious assessment of large-scale projects and strengthening of public debt management capacity will be required to mitigate debt sustainability risks.

Directors recognized that the authorities' commitment to a stabilized exchange rate within a reasonably wide and adjustable band has contributed to increased confidence and to de-dollarization over time. They emphasized that the exchange rate anchor requires lower broad money and credit growth, and in this context they urged the authorities to mop up excess liquidity, accelerate the unwinding of quasi-fiscal lending, and raise policy interest rates. Noting that the exchange rate is assessed to be overvalued, and given inadequate reserves, Directors recommended that the kip be allowed to move in line with market conditions with a view toward replenishing international reserves.

Directors noted that years of rapid credit expansion and possible currency mismatches on bank balance sheets pose risks to financial sector stability. They underscored the need for further efforts to strengthen financial supervision, improve compliance with macroprudential regulation, and raise banks' capital. Directors encouraged the authorities to participate in an FSAP, and to use Fund technical assistance to address supervisory weaknesses and strengthen financial stability and crisis management frameworks. They welcomed efforts to strengthen the anti-money laundering and combating the financing of terrorism regime.

Directors welcomed Lao P.D.R.'s recent WTO accession, which should facilitate greater economic diversification. They encouraged further efforts to enhance the business climate, upgrade economic and financial statistics, and improve health and education infrastructure, which would contribute to more inclusive and broader-based growth and would support the authorities' goal of attaining middle-income status by 2020.

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	-4.7	-3.1	-4.8	...	...
Nonmining balance 3/	-6.5	-5.5	-4.5	-8.8	-6.4
Nonmining balance including discrepancy 3/	*-6.5*	-5.6	-7.9	...	...
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.

[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.

[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.

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