

Lao PDR Economic Monitor

Weathering Through Uncertainty

Thematic section:

Lao PDR in the time of COVID

March 2020

Macroeconomics, Trade and Investment
East Asia and Pacific Region



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ACKNOWLEDGEMENTS

The Lao People's Democratic Republic (Lao PDR) is transitioning to a greener, more resilient economy. Biodiversity is a cornerstone of the country's Five-Year National Socio-economic Development Plan and the National Green Growth Strategy 2019-2030.

To support Lao PDR's on going transformation to a green economy, the World Bank carried out this assessment of opportunities and challenges for biodiversity in close cooperation with the Ministry of Planning and Investment (MPI), Ministry of Natural Resources and Environment (MONRE), and Ministry of Agriculture and Forestry (MAF) as an input into their planning processes under way in 2019–2020 including, among others, the Government's 9th National Socio-economic Development Plan (NSED-9), and MONRE's periodic update of the State of Environment Report of the Government of Lao PDR.

As such, this report and accompanying short policy note are outputs under the second phase of the World Bank's Green Growth Advisory Program (P171011). Sister assessments address related topics important for Lao PDR's green economy such as (a) scaling up of investment in sustainable forest management, (b) priorities for environmental management, (c) landscape valuation, and (d) promotion of nature-based tourism. Funding for the report was gratefully provided by the Korean Green Growth Trust Fund and is complemented by World Bank operating budget.

The report and accompanying policy note were prepared by a World Bank Group (WBG) team from the Environment, Natural Resources, and Blue Economy Global Practice, comprising Stephen Danyo, who leads the World Bank's Green Growth Advisory Program, and John Parr, lead adviser for the World Bank Lao PDR program on conservation and protected area management.

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Abbreviations and acronyms

CITES	Convention on International Trade in Endangered Species of Wild Fauna and Flora
DCNEC	Department of Combating Natural Resources and Environmental Crime
DOFI	Department of Forest Inspection
EID	Emerging Infectious Disease
ESIA	Environmental and Social Impact Assessment
FAO	Food and Agriculture Organization
FLEGT	Forest Law Enforcement, Governance and Trade
GDP	Gross Domestic Product
GEF	Global Environment Facility
GOL	Government of Lao PDR
IRRI	International Rice Research Institute
IUCN	International Union for Conservation of Nature
LCD	Lao Customs Department
Lao-WEN	Lao-Wildlife Enforcement Network
LECS	Lao Expenditure and Consumption Survey
MAF	Ministry of Agriculture and Forestry
MOH	Ministry of Health
MONRE	Ministry of Natural Resources and Environment
MPI	Ministry of Planning and Investment
NAFRI	National Agriculture and Forestry Research Institute
NBSAP	National Biodiversity Strategy and Action Plan 2016-2025
NBT	Nature-based Tourism
NGO	Non-governmental Organization
NPA	National Protected Area
NSEDP	National Socio-Economic Development Plan
NTFP	Non-Timber Forest Product
PES	Payments for Ecosystem Services
PMO	Prime Minister's Order
SEA	Strategic Environmental Assessment
UNESCO	United Nations Educational, Scientific and Cultural Organization



Photo credit: Phoonsap Thevongsa.

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Executive Summary

- 1. Although the duration, severity and pervasiveness of COVID-19 pandemic is still highly uncertain, the outbreak and subsequent prevention and containment measures have led to worldwide economic dislocation and inertia.** Measures to contain the spread of the disease such as social distancing, tightening border control, lockdowns have contributed to disruptions to demand and supply of goods and services both between and within countries. For Lao PDR, the main channels of impacts on Lao PDR are through tourism and travel, trade and investment, remittances, commodity prices and exchange rate. As of April 27, 2020 there were 19 confirmed cases of COVID-19, of which 7 were treated. If more community spread or second round of outbreak occurs in the future, the adverse impact on both the economic, health and social sectors will be more acute.
- 2. Some countries, such as Lao PDR, faced structural vulnerabilities prior to the COVID-19 outbreak.** In particular, Lao PDR has a legacy of weak macroeconomic management which has led to limited fiscal and foreign currency buffers prior to the COVID-19 pandemic. The level of international reserves is at a multi-year low and is expected to decline further. The parallel market exchange rate has diverged from the official exchange rate with the gap (parallel market premium) higher than historical norms. Despite expenditure compression, weak revenue collection has resulted in an elevated fiscal deficit which has contributed to the country being at high risk of debt distress according to the WB-IMF 2019 Debt Sustainability Analysis. Additionally, economic growth had declined to historically low levels in 2019 (about 4.7 percent compared to an average growth rate of 7.5 percent over the last 12-15 years), owing to the severe impacts of natural disasters adversely affecting the agriculture sector, lower power and mining sector contribution as well as the tightening of public expenditure and rising inflation contributing to a decline in real disposable income. This has contributed to the diminishing the health of a banking sector with underlying vulnerabilities. As a result, the Government of Lao PDR (GoL) is finding it increasingly challenging to finance its deficit and stay current with debt servicing.





3. **The negative impacts of the global COVID-19 pandemic and containment measures are expected to exacerbate Lao PDR's the weak fundamentals and, similar to other countries, lead to a deterioration in the macroeconomic situation.** Growth in Lao PDR is expected to contract in 2020 to -1.9 percent, with the most severe impact on the service sector, weighed down by the suspension of production of one of the country's two largest mines and construction of hydropower projects and manufacturing exports. Negative impacts on the private sector, particularly on large and SMEs businesses despite at varying degree, are expected to severely affect public revenue collection. As a result, the fiscal deficit is expected to rise to about 8 percent of GDP and public debt of about 67 percent of GDP in 2020. Limited fiscal space, the mounting pressure on deficit financing, debt servicing, refinancing the current debt will limit GoL's ability to implement some of the announced economic relief measures.

Executive Summary

Part I: Recent Economic Developments and Outlook



Photo credit: Phoonsap Thevongsa.

Part II: Public Financial Management for Improving Service Delivery in the Health Sector

4. **The current COVID-19 outbreak worldwide challenges the readiness of the health sector in Lao PDR.** As of April 26, 2020, the outbreak has resulted in 2,897,883 confirmed cases and 203,025 deaths across the world. Lao PDR has 19 confirmed cases out of 1,735 tested cases as of 26 April 2020. The demands on health facilities and health workers are increasing and system capacity is becoming overstretched. As COVID-19 outbreak continue to rapidly evolve, it further strains a health system that faces challenges of expanding coverage and ensuring quality services at all level.
5. **Understanding and identifying the Public Financial Management (PFM) constraints in health financing and service delivery will provide useful lessons that will help shape the implementation of on-going and future health sector reforms to achieve Universal Health Coverage (UHC).** Despite substantial progress in key public health outcomes the rates of maternal mortality and malnutrition remain relatively high compared to the East Asia and Pacific Region.
6. **In the event of an outbreak, the country's public health system will be stretched, disproportionately impacting low-income households who have inadequate access to health care services.** In Lao PDR, low-income households face greater barriers to accessing health care with some households not able to afford transportation costs to the hospital. As a result, they rely mostly on basic health care services from health centers, especially those in rural areas. Inadequacy in access to health care services is expected to be more challenging as testing and treatments of COVID-19 will likely be carried out at the central and provincial hospitals.
7. **Poor access to and quality of health and nutrition services are persistent problems, and disproportionately affect women, the poor and vulnerable groups.** A large part of the population living in rural and remote areas depends on frontline health services for both preventive and basic curative care which have very different quality due to the lack of appropriate medical tools and equipment as well as lack of clear guidelines and supervision. Therefore, a share of the population, particularly the most disadvantaged, in fact does not have access to even basic services and, in addition to provision of financial protection for those vulnerable groups, the delivery of basic preventive and curative services needs to be strengthened and centered to the population needs.
8. **Despite the increase in health sector investment in recent years, health financing in Lao PDR continues to be characterized by low government investment, high out-of-pocket spending and high reliance on external financing** – especially for priority health services – and is hampered by the limited capacity in PFM effecting service delivery, the mobilization of adequate resources for the health sector, as well as the effective and efficient use of available resources for delivery quality services and improving health outcomes.

9. There are several key PFM challenges which are affecting service delivery in Lao PDR, including weak planning and budgeting at central and subnational levels, compressed budget execution period due late approval of budget, weak financial accounting and reporting systems contributing to severe service delivery bottlenecks at all levels, but more acute at health centers. Lack of budget ceiling often results in a long budget preparation which reduces the time available for budget implementation limiting availability of essential medicines and medical supplies as well as cash to delivery of essential services.
10. To address these challenges, a combination of PFM reforms at the national and sectoral levels is necessary. These reforms include, but not limited to, (i) early engagement between MOH and MOF on automated system on record keeping and reporting of budget execution; (ii) developing a framework for internal MoH ceilings early in the budget cycle to guide preparation of baseline budget proposals to the MoF; (iii) improving MoH activity planning tools to provide greater flexibility and responsiveness to changes in ceiling or limitations to cash available through treasury; and (iv) strengthening financial management capacity at health facility level and quantify the impact of National Health Insurance (NHI) implementation on out-of-pocket (OOP) and technical revenue collection.

The April 2020 Lao PDR Economic Monitor in Figures (to be added)

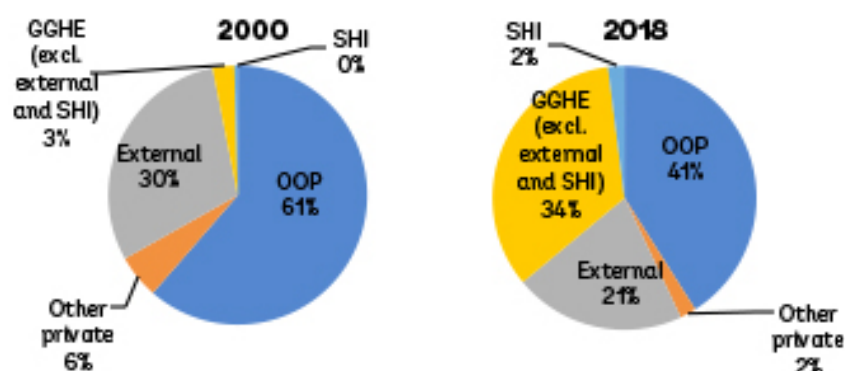


Public Financial Management for Improving Service Delivery in the Health Sector in Lao PDR
Despite progress, Lao PDR health outcomes relatively lag regional peers
Maternal Mortality Ratio in Lao PDR remained high



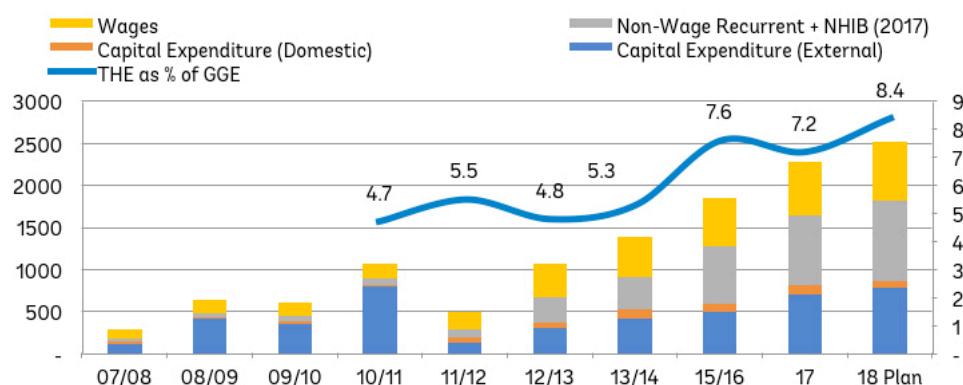
Source: World Development Indicators database

While public health expenditure share has increased, out-of-pocket spending remains high



Source: WHO Global Health Expenditure Database for 2000 data, MOH National Health Accounts for 2018 data

Government Health Expenditure by Function (FY2007-08 to FY2018)



Source: GoL Official Gazette and State Budget Plan, various years.



An aerial photograph of a river scene. In the foreground, several small, rectangular floating houses with green roofs are clustered together on the left side of the river. A long, narrow bridge with a metal truss structure spans the river in the middle ground. The background shows a vast, flat landscape with patches of green and brown, under a hazy sky. A dark blue banner with a white chevron graphic is overlaid on the left side of the image, containing the text 'Part I: Recent Economic Update'.

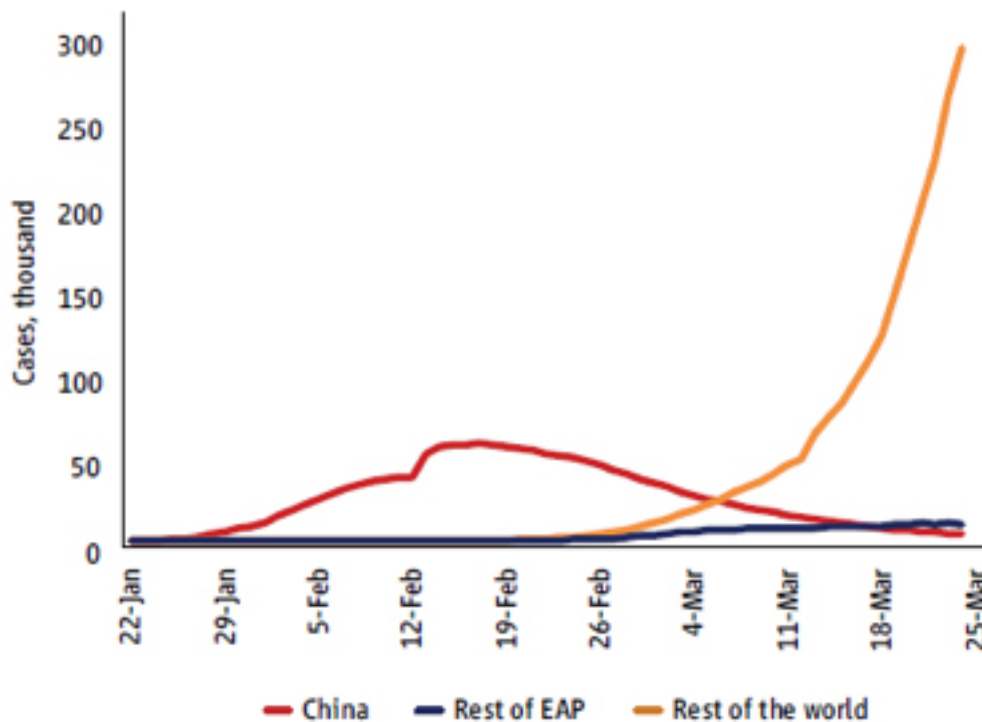
Part I: Recent Economic Update

1. The COVID-19 shock

The COVID-19 outbreak that firstly affected China and has now become a global pandemic.

1. **The COVID-19 respiratory virus has become a global pandemic.** COVID-19, was first reported in Wuhan, China in late-December 2019. It has spread and affected not only countries in the East Asia and Pacific region but around the World. On March 11, 2020, the World Health Organization (WHO) characterized COVID-19 as a pandemic. While the number of new cases is decreasing in China, it is increasing at an exponential rate in other parts of the world. As of April 14, 2020, the outbreak has resulted in 1,983,537 confirmed cases and 125,726 deaths in 213 countries and territories.

Figure 1: Active cases decline in China but increased rapidly in the rest of the world.



Sources: World Bank EAP Economic Update April 2020.

The COVID-19 pandemic and the subsequent prevention and containment measures have led to economic dislocation and inertia.

2. **Notwithstanding the significant impact on the health sector, the COVID19 outbreak initially resulted in supply disruptions in China which has impacted the rest of the world.** Initially, the developments in China substantially impacted the rest of the world through supply disruptions as China undertook strict measures to contain the spread of the virus from Wuhan to the rest of the country. Consequently, final demand in China has been negatively impacted by the subsequent prevention and containment measures. Consequently, the Chinese economy contracted by 6.8 percent in Q1-2020 compared to a year earlier, the first single quarter contraction in decades.

3. **With COVID-19 spreading beyond China's borders and given that China accounts for almost 20 percent of world output, the pandemic has led to economic dislocation and inertia worldwide.** Given that the virus is highly contagious,¹ a ripple effect of supply and demand shocks characterize the second round of impacts of the pandemic. These shocks emerge primarily through lower demand borne through physical distancing measures widely adopted as one of the main prevention and containment measures.² In this context, three types of activities are immediately affected: collective high-density production such as manufacturing, services activities (such as tourism, restaurants, and travel, entertainment (sports, music, and cinemas); and proximate production and consumption such as suppliers meeting consumers, personal care, health care, restaurants, and some types of retail. Therefore, the most immediately affected sectors tend to be in services and labor-intensive production. However, the impacts of the pandemic, country-specific vulnerabilities, the varying degree of responses and mitigating measures will influence the recovery path and growth outlook for countries differently

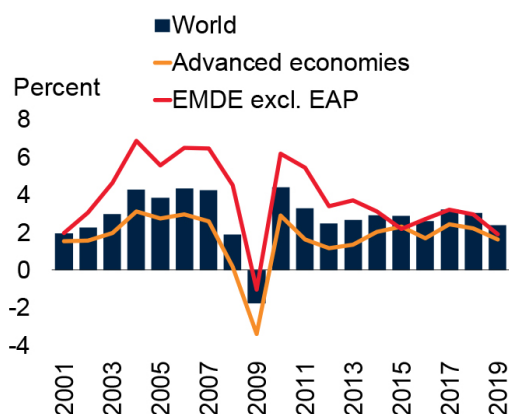
Box 1: The making of a Global Recession

Global growth declined to an estimated 2.4 percent in 2019—the slowest growth rate since the global financial crisis in 2009 (Figure 2). Global growth remained weak in 2019Q4 reflecting mixed performance in major economies. The U.S. economy grew 2.1 percent in 19Q4 (q/q saar), but growth in the Euro Area fell to 0.4 percent in 19Q4 (q/q saar), its slowest pace since 2013. Activity in Japan contracted 7.1 percent in 19Q4 (q/q saar) due to the increase in the value-added tax from 8 to 10 percent on October 1st and the impact of typhoon Hagibis.

At the start of 2020, the global economy was showing incipient signs of recovery. Global composite PMI rose to a 10-month high of 52.2 and the manufacturing PMI reached a 9-month high of 50.4 in January 2020. Global goods trade registered its first positive growth in December 2019 following six months of consecutive contraction, and indicators in January, such as the PMI new export orders index, had suggested a nascent recovery in global trade, spurred by reduced trade policy uncertainty amid progress in U.S.-China trade negotiations.

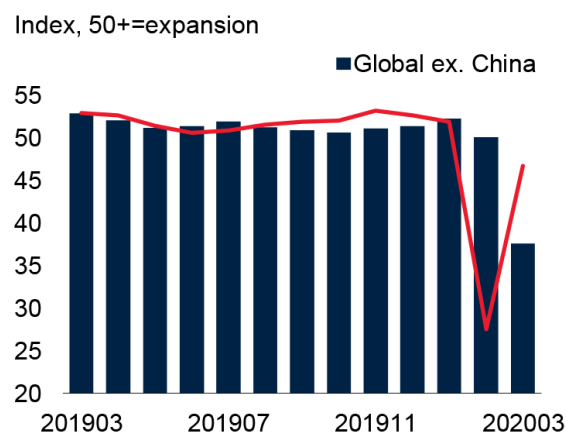
However, a pickup in global economic activity has been disrupted by the global pandemic and

Figure 2: Global economic growth rates, 2010-19



Source: Haver Analytics; World Bank.

Figure 3: Composite PMI, 2019-20



Source: Haver Analytics; World Bank.

1 Ro factor for COVID19 is....compared to SARS and
2 Physical distancing prevents people from working and consuming in proximity.

various mitigation measures implemented first in China and later in the rest of the world to slow the spread of the coronavirus. In China output is estimated to have contracted sharply in the first quarter. The [new cases] peaked in mid-February and activity started to recover in early-March following a relaxation of the domestic lockdown. In the rest of the world, activity deteriorated sharply in the later part of 2020Q1. The global composite PMI excluding China fell by 12.5 points to 37.6 in March. This was the steepest single-month decline ever recorded, which brought the index to its lowest level since January 2009 (Figure 3).

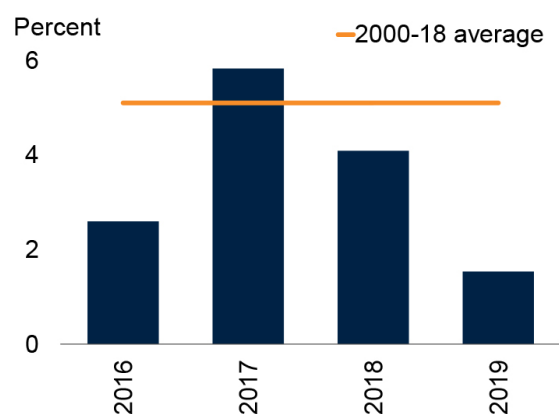
Preliminary data point to a sharp contraction in global trade reflecting major disruption in international travel, tourism, and supply chains. The outbreak has hit global trade as it was recovering from its multi-year low level in 2019 weighed down by trade tensions and subdued global economic growth. Activity at ports fell in February to its multi-year low levels (Figure 4). The travel restrictions and risk aversion have weighed on global tourism and travel. Global new export orders index registered 46.6 percent in March, a decrease of 3.7 percentage points compared to the February reading of 45.2 percent (Figure 5). Manufacturers' stocks of purchases fell in March, while suppliers' delivery times continued to rise pointing to bottlenecks in supply chains.

Global financing conditions have tightened abruptly. Global equity markets have fallen sharply as the coronavirus outbreak has accelerated globally. Flight to safety flows pushed the yield of the benchmark 10-year U.S. Treasury below 1 percent for the first time ever on March 4th, while spreads on higher-risk debt have widened. Markets remain highly volatile, with the VIX volatility index tripling in March, on average (Figure 6). Central banks around the world have aggressively eased monetary policy and provided liquidity support to avoid shortages in credit markets. In a pair of emergency meetings, the Federal Reserve cut its policy interest rates to close to zero.

EMDEs have experienced large capital outflows amid flight to safety. EMDE assets have been under significant pressure. Capital outflows from EMDEs exceed the worst period of the global financial crisis. Spreads on sovereign and corporate bonds have risen as a result, and most EMDEs have experienced drastic falls in domestic stock market indexes and currency values. Stock markets in the largest EMDEs have fallen by about a quarter, on average, since the start of the year. Markets expect central banks to provide significant additional monetary easing in the near term.

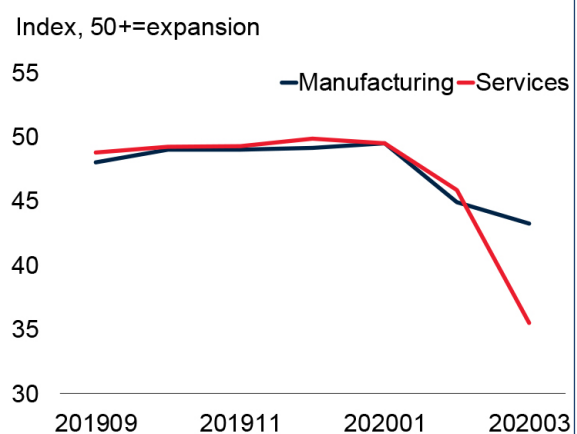
Commodity prices have fallen sharply. Oil prices have fallen more than 60 percent since January

Figure 4: Global trade, 2016-19



Source: Haver Analytics; World Bank.

Figure 5: Global new export orders, 2019-20

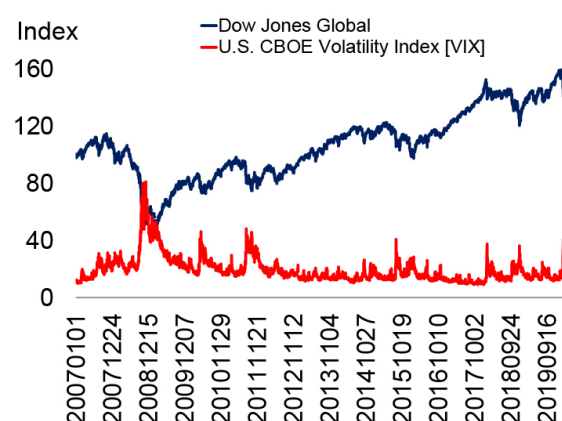


Source: Haver Analytics; World Bank.

Notes: Dow Jones global index (December 31 1991=100. United States CBOE volatility index [VIX].

20th (the date human-to-human transmission of coronavirus was first publicly confirmed), with WTI, the U.S. benchmark, dropping to around \$20/bbl in mid-March. Containment measures taken to control the outbreak have resulted in a sharp decline in travel and therefore oil demand. The fall in oil prices has been exacerbated by the collapse of the production agreement between OPEC and its partners, including Russia. Industrial metals prices have also declined, with significant falls for copper and zinc (around -25 percent). Agricultural prices have been less affected, with the price of the three main grains down by 6 to 11 percent (Figure 7).

Figure 6: Dow Jones global index and United States CBOE volatility index [VIX], 2007-2020

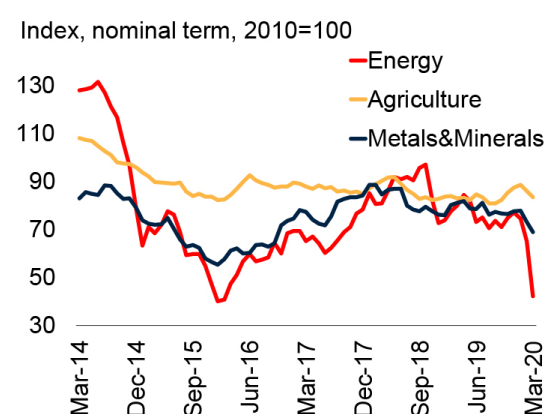


Source: Haver Analytics; World Bank.

Notes: Dow Jones global index (December 31 1991=100).

United States CBOE volatility index [VIX].

Figure 7: Commodity price indices, 2014-2020



Source: Haver analytics; World Bank.

Prepared by Ekaterine T. Vashakmadze



Photo credit: Phoonsap Thevongsa.

Lao PDR has been significantly affected through several channels, which transmit demand and supply shocks to the local economy.

4. **The confirmed cases and containment measures in Lao PDR and trading partners have significantly affected the Lao economy through several channels.** The demand and supply shocks were transmitted through several channels including the tourism and travel and hospitality sectors, commodity prices, exchange rate, trade and investment, supply chain disruptions and spillover of weaker external demand from key trading partners due to preemptive measures to contain the outbreak. Lao PDR was first hit by lower external demand through a significant drop in tourism and travel, particularly among Chinese visitors. Then, the restrictions on travel and border controls caused supply side disruptions, particularly affecting the flows of inputs for production processes and labor from China.³ At the same time, exports to China are also affected by tightened border processes. On the demand side, containment measures, physical distancing and behavioral responses reduced demand for goods and services. With the worldwide spread of the virus, the negative impact on economy, through these and other channels of transmission, is amplified. (See Box 2)



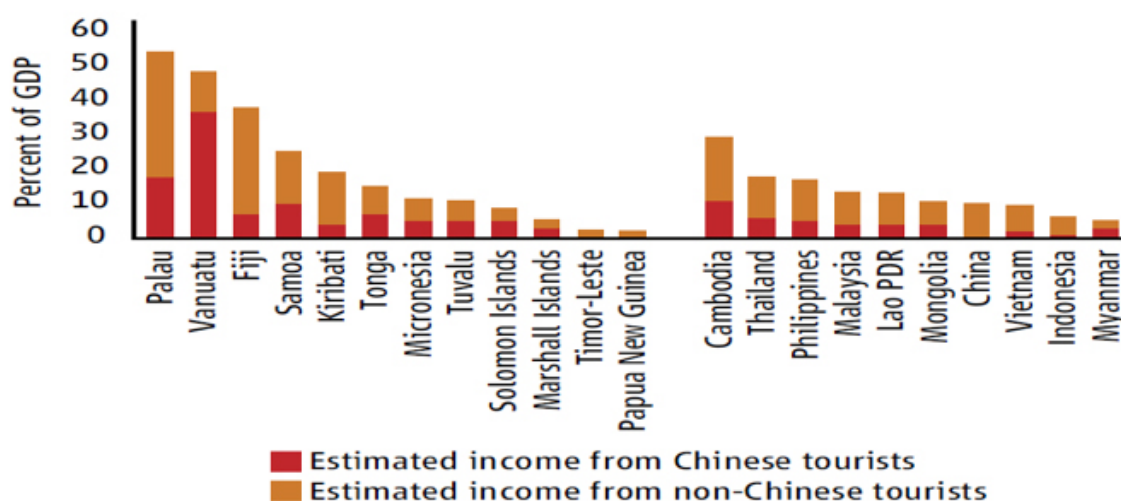
Photo credit: Phoonsap Thevongsa.

3 The garment industry in Lao PDR reported that in February, the tightened border processes and restrictions on outbound travel of Chinese workers and logistics process caused disruptions of immediate goods supply for the production. Restrictions on people movements also caused some delays for construction projects.

Box 2: Key channels of transmission

Tourism and travel sectors first transmitted a demand shock as they were immediately hit first by the developments in China, followed by the global pandemic. Tourism is an important source of income and employment generation in many countries including Lao PDR. The direct contribution of tourism and travel sector to GDP is at around 4 percent while the total contribution (including indirect impacts) is up to 12 percent.⁴ The sector also supports 0.3 million jobs, about 10 percent of the labor force.⁵ China has become an important part of tourism industry in Lao PDR. Chinese visitors account for around 20 percent of total arrivals and tourism revenues in 2019 compared to less than 10 percent five years ago. However, the decline will not be limited to travelers from China only. Other visitors from western countries, who spend more and contribute more to GDP than Chinese tourists, and other Asian countries are also reported to take more precaution by reconsidering or canceling their trips to Asia, including visits to Lao PDR. As a result, there is also expected knock-on effects on the tour operators, transport (Lao Airlines and other transport companies, logistics companies and restaurants. If the outbreak prolongs, tourism revenue could be severely hit in 2020.

Figure 8: Many countries rely on tourism revenues, and increasingly from Chinese visitors



Source: World Bank EAP Economic Update April 2020

Another important channel is through the value chain disruptions, trade and investment. Currently, China is the largest investor in Lao PDR and accounts for about 30 percent of total trade with Lao PDR. Most of China's investments is in energy, real estate, construction, infrastructure, wood pulp and agriculture plantations. As a result, key imports from China include machinery and equipment, construction materials, fertilizers and vehicles. Key exports to China include agriculture produce, wood pulp, rubber and mining products. Containment measures initially through tightened border processes, longer inspection time, logistic disruptions cause delays in transport of intermediate goods for production process such as those for manufacturing export sectors. In addition, China's measure on movements restrictions across borders cause temporary disruption of labor services for infrastructure projects. This was exacerbated by the subsequent lockdown instruction

⁴ Based on World Travel and Tourism Council estimates.

⁵ <https://www.wttc.org/economic-impact/country-analysis/country-data/>

during the period in April, which is extended to 3rd May. If the containment measures continue for a longer period, they can have direct impact on delays in production and export processes, implementing investment projects and potentially a reversal of some investment inflow. In addition, domestic lockdown measure also discourages movement of traders, and relationship between buyer and seller, particularly for agriculture produce, which also contribute to lower exports.

Add remittances and labour migration

As Lao PDR is a commodity exporter, volatile commodity prices could have mixed impacts. Trade is immediately affected by the movements of commodity prices and disruptions on processes at the border. Copper price have slumped in early 2020 amidst the rapid spread of the virus. The fall in copper price due to lower global demand and a fall in copper production in Lao PDR due to lower ore availability and grade in 2020 is expected to more than offset the earnings from higher gold price and gold output due to a transition to a gold operation. On the other hand, lower oil price and domestic demand for fuel due to the lower air travel, lockdown and restriction measures are expected to lower import bills and reduce the pressure on fuel prices in Lao PDR.

The pressure on the exchange rate and inflation is expected to increase. As US dollar appreciates amidst the fear, Kip weakens against US dollar. Overall impact on inflation in Lao PDR is likely to increase due to higher food prices, depreciation of kip, outweighing a decrease in fuel prices. Logistic disruptions to goods transport, shortage or delays in supply of consumable goods, most of which are imported, are expected to result in increasing prices, coupled with the effect of depreciating Kip. Confirmed cases and domestic lockdown measures caused panic buying and stockpiling of some products, which also contributed to higher prices.



2. Economic and Social Impacts

Lao PDR entered the COVID-19 outbreak with prior conditions of structural macroeconomic vulnerabilities

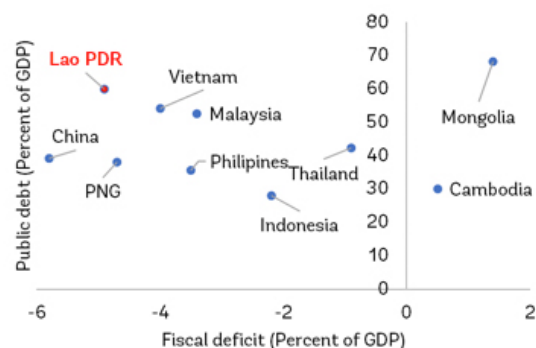
6. **The global pandemic and the spread to Lao PDR is having significant negative impacts on Lao PDR's economy, which already suffers from structural vulnerabilities.** The effects of containment measures in Lao PDR and trading partners cause supply chain and demand disruptions since February 2020. On 29 March 2020, the GoL announced strict containment measures during 1-19 April 2020 including the lockdown, restriction on cross-city travel, temporary suspension of most production activities in manufacturing factories, suspension of mining production and construction of power projects during this period. On 15 April 2020, the lockdown was extended for another two weeks until 3 May 2020 due to persisting uncertainty. While supporting the control of COVID-19 spread locally, these measures first come with severe economic costs to both households and firms, who will struggle to pay taxes and repay loans. Remittances to households and foreign direct investment inflows are likely to decline. Exports of some commodities and most services are declining. Given that Lao PDR has existing vulnerabilities pertaining to limited fiscal space and foreign currency reserve buffers, the significant disruption in the real sector is likely to lead to further fiscal (significant revenue shortfall), financial and external sector weakness. This will limit the GoL's ability to mitigate the negative impacts of the virus on the economy.

Box 3: The macroeconomic environment in Lao PDR faced structural vulnerabilities prior to COVID-19 outbreak

Economic growth has declined to a historically low level of 4.7 percent in 2019. The moderation was driven by lower contribution from the resource sector, exacerbated by the impacts of the weather-related shocks weighing down on the agriculture sector. The industry sector moderated substantially due to contraction in mining output due to lower ore grade and lower power generation affected by unfavorable weather conditions. The services sector slightly moderated as lower disposable income and expenditure compression offset an improvement in tourism in 2019. However, growth in the construction sector remained resilient supported by on-going infrastructure investment.

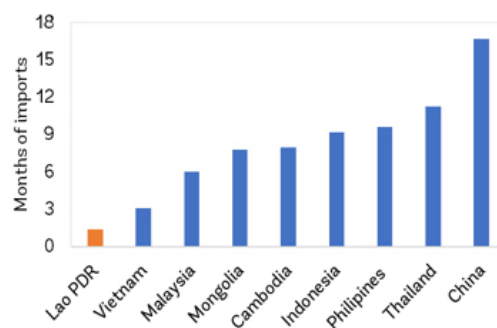
Weak revenue performance keeps the fiscal deficit and public debt levels elevated. Despite revenue modernization reforms, the revenue to GDP ratio declined to estimated 15.1 percent in 2019 from 16.2 percent in 2018. Several factors account for this decline: (i) slowdown in economic activities; (ii) delays in the approval of implementation instructions for tax laws; (iii) weak enforcement of and compliance with tax reforms; (iv) a fall in non-tax revenues due to a fall in forest fund in 2019 compared to 2018; (v) large tax and duties exemptions for many concessions and other investment projects and (v) lower grants. The compression of public expenditure—from 20.9 percent of GDP in 2018 to 20.3 percent in 2019—was achieved by reducing civil servant recruitment and moderating public investment together with expenditure arrears. However, this was not commensurate to revenue shortfall. Consequently, the fiscal deficit trended upward to an estimated 5.2 percent of GDP in 2019 from 4.7 percent of GDP in 2018. Public debt rose to almost 61 percent of GDP, with an increasing share of non-concessional borrowing, from 57.5 percent in the same period, keeping the risk of debt distress high. The level was high compared to regional peers (Figure 9). This has led to central government external debt service obligations of just over US\$ 1 billion/year in 2020.

Figure 9: The fiscal deficit and debt levels remain relatively high compared to regional peers



Sources: World Bank EAP Economic Update April 2020

Figure 10: Reserves buffers remain thin compared to regional peers



Sources: World Bank EAP Economic Update April 2020

Foreign currency buffers remain thin. Foreign reserves increased to US\$997 million in 2019 (owing primarily to the disbursement of the China Development Bank's loan for SMEs of US\$100 million) from US\$873 million in 2018. However, foreign currency buffers remain thin, estimated to cover less than 1.4 months of imports (Figure 10) and only 86 percent of projected total external public debt service obligations (principal and interest) in 2020. The lack of liquidity in the official exchange market exerts more pressure on the exchange rate since the second half of 2019. Kip continues to depreciate against US dollar and Thai baht. The demand-supply mismatch and strengthening of US dollar due to increased uncertainty from the COVID-outbreak caused the spread between the official Kip/USD and the parallel exchange rate in Vientiane capital to widen since mid-2019 to almost 8 percent in mid-April 2020. Despite declining fuel prices due to lower global oil price, the depreciation of Kip and rising food prices have driven up inflation, which climbed to 6.1 percent in March 2020 from 2.5 percent in mid-2019.

The health of the banking sector remains fragile. The Bank of Lao PDR (BoL) strengthened the legal framework in 2018 through the approval of important legislation, such as the Law on the Bank of Lao PDR, and the Law on Commercial Banks, while the finalization of secondary legislation is pending. Although non-performing loans for the sector are reported at 3.1 percent since Q4-2017, there is significant variation across banks,⁶ in particular, two state-owned commercial banks. In addition, the capital to risk weighted assets (CAR) ratio declined from 18.3 percent at end 2018 to 11.8 percent at end 2019 though still above the minimum regulatory level of 8 percent.

Source: Authorities and WB staff estimates.

⁶ Progress has been made in publishing Financial Soundness Indicators (FSIs) but further efforts are needed to publish these as per the IMF's methodology. Therefore, the published average NPL by BoL may be underestimated as NPLs should be identified based on more solid accounting standards and be provisioned for as needed.





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