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1. Recent Economic Developments
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Key Findings

- Economic growth moderated slightly, but Lao PDR remains among the fastest growing economies in the EAP region.

- Inflation is low but has picked up slightly as oil prices rise.

- The fiscal deficit widened significantly further increasing the public debt.

- The external balance improved over the last year; however, pressures emerged on the exchange rate.

- Credit growth stabilized at more sustainable levels.

- The banking sector continues to expand, but some banks still face low capital buffers and weakening loan portfolios.
The global economy started to recover from its weakest post-crisis performance in early 2016.

Global GDP growth (Year-on-year growth)

Sources: World Development Indicators; Haver Analytics; and World Bank staff estimates.

Global IP and manufacturing PMI (IP – yoy growth, left scale; PMI – index, right scale)

Sources: Haver Analytics, World Bank staff estimates.
Note: LHS: percent, 3-month on 3-month moving average, SAAR; RHS: index, >50 denotes expansion.
Global and regional environment

In EAP, growth is resilient: China is rebalancing; the others built on their strong performance

Exports have started to recover as demand and commodity prices recovered gradually …

… However, domestic demand continues to drive growth in response to:

• Low interest rates;
• Rapid credit growth and
• Low unemployment

Sources: World Development Indicators; Haver Analytics; and World Bank staff estimates.
In Lao PDR, GDP Growth moderated but remains strong

Growth moderated to 7%, reflecting:
- Strong contribution from the power sector
- Manufacturing - parts and components from SEZs
- Construction remained resilient

However:
- Mining output remained largely flat
- Tourist arrivals declined

Source: Lao PDR authorities and WB staff estimate
Inflation is low; but picked up as fuel prices recover

Higher world oil prices resulted in higher energy inflation

Food inflation also moderated reflecting good harvest and well stocked regional food markets.

Overall inflation remains low with core inflation around 1%.

Source: Lao Statistics Bureau
Fiscal deficit remains high

The deficit increased as revenues underperformed

Revenues declined to 19% of GDP due to:
• Low commodity prices
• Moderating growth
• Lower grants

Expenditure adjustment was more modest also due to the rigid spending patterns and ASEAN chairmanship activities.

Source: Ministry of Finance
Public debt continues to increase

- Public debt reached 68% of GDP in 2016
  - the 2017 IMF/WB Debt Sustainability Analysis moved the risk of debt distress from moderate to high
- Increasing share of bilateral and commercial sources
- Public sector arrears remain a challenge

Source: Ministry of Finance
Public debt stock is high, risk of debt distress moved from moderate to high

- Debt servicing needs increased
  - Double allocation to agriculture in FY15/16
- Two thirds of allocation to health
- Pipe-line of large infrastructure projects investment – concern on debt sustainability and implementation capacity
- Strengthened public debt management capacity, promulgation of Public Debt Law is important for keeping debt manageable

Source: Ministry of Finance
The current account deficit narrowed, but reserves remain low

The current account deficit declined to around 14% of GDP in 2016:
- Higher exports of electricity and manufacturing products offset the impact of lower copper prices and decline in timber exports
- Lower fuel import prices

FDI inflows remained resilient

Still, reserves remain low
- less than 25% of forex deposits, 11% of broad money

Source: Bank of Lao PDR

Source: WB EAP Economic Update, April 2017
The exchange rate remains tightly managed

- Exchange rate policy focuses on tight management of Kip/USD rate
- However, in an environment of low reserves, pressures emerged on the exchange rate at the exchange offices’ market
- Slower pace of appreciation of the Kip’s real effective exchange rate (REER) in 2016 as regional currencies stabilized and inflation pressure was low

Source: www.BIS.org

Note: Increasing index means appreciation.
Declining index means depreciation
Credit growth stabilized at a more sustainable level

- Monetary policy aimed at stimulating credit growth
- Credit expanded at around 20% y-o-y, financed through deposits growth as well as foreign borrowing
- The share of loans and deposits in foreign currency increased

Source: Bank of Lao PDR
Financial sector performance

- Most lending went to industry sector and concentrated in a few banks.
- Banking sector more than doubled as share to GDP during 2010-2016, but the sector continues to face challenges.
  - Banking sector assets increased four folds between 2010-2016.
- However, parts of the banking sector face challenges.
  - Some SOEs and private banks have capital levels below the required minimum (8%).
  - High and growing non-performing loans in some banks.
  - Low profitability.
    - Only around 20% of banks had Return on Assets of around 2% or above at end 2016.
Medium term growth outlook remains broadly favorable

- Regional growth is expected to remain resilient
- Power sector as key driver – 500 MW added annually
- Non-resource sector – opportunities from regional integration and better connectivity
Outlook

- Challenges in addressing business environment to promote other sectors outside the natural resources

- Perceptions on major constraints in doing business
  - Informality
  - Tax rates
  - Infrastructure
  - Skills
Outlook

- Fiscal deficit is expected to remain high in 2017 and gradually decline over medium term; however, public debt will remain elevated.

- External sector – current account deficit is likely to increase reflecting expected large imports for infrastructure projects. FDI and external borrowing is expected to finance this deficit.
Policy Considerations

- High risks to macroeconomic stability strengthens the case for macroeconomic prudence:
  - Reduce the fiscal deficit in line with plans – widen tax base, improve tax administration, keep tight control over the wage bill, improve public procurement and reconsider investment projects.
  - Strengthen the legal framework and capacity for public debt management
  - Allow more flexibility in the exchange rate movement within the existing policy band, along with supportive monetary and fiscal policies
  - Address risks in the banking sector – restructuring of weak SOBs, enforcing capital adequacy requirement, strengthen bank supervision capacity of BOL
Policy Considerations

• Introduce reforms to increase productivity and to ensure gains from increased regional integration opportunities:
  • Ensure a level playing field to address one of the business’ main concern on informality
  • Building skills, including through more efficient public spending on education and health (see next presentation)
  • Simplify the business environment and
  • Improve quality of infrastructure