LAO PDR

Table 1	2019
Population, million	7.1
GDP, current US$ billion	18.8
GDP per capita, current US$	2660.3
National Official Poverty Rate[a]	18.3
International poverty rate ($1.9)[b]	21.2
Lower middle-income poverty rate ($3.2)[b]	56.8
Upper middle-income poverty rate ($5.5)[b]	84.4
Gini index[a]	38.8
School enrollment, primary (% gross)[c]	102.4
Life expectancy at birth, years[c]	67.6

Source: WDI, Macro Poverty Outlook, and official data.
Notes:
(a) National Statistics Office. Most recent value (2018).
(b) Most recent value (2012), 2011 PPPs.
(c) Most recent WDI value (2018).

Lao PDR is undergoing an unprecedented level of macroeconomic stress. The pandemic has exacerbated an already fragile economic landscape. The country is experiencing an erosion of revenue and difficulty in meeting its debt service obligations. Limited fiscal space has constrained the ability of authorities to mitigate the socio-economic impacts of the pandemic. This has adversely affected poverty reduction. Without actions to stabilize the macro economy and accelerate structural reforms, the economy could trip into a period of extreme macroeconomic vulnerabilities.

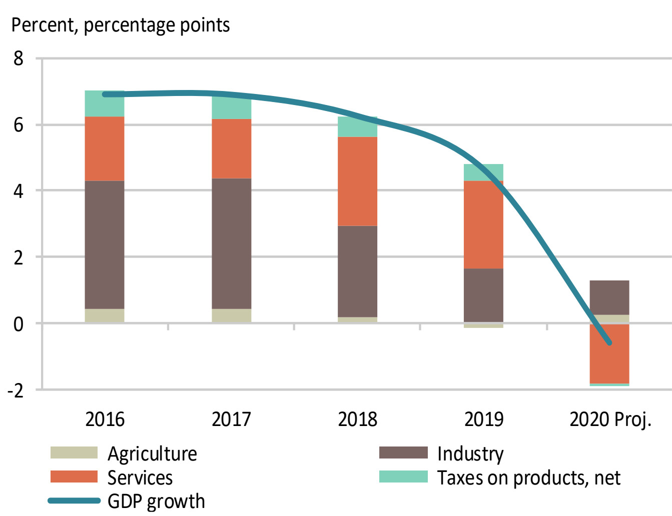
Key conditions and challenges

Laos has been growing fast—GDP growth average of 7 percent annually over the past decade—but rapid growth in Lao PDR has been accompanied by a legacy of weak macroeconomic management. Growth has been driven by the capital-intensive resource sector and supported by debt-driven infrastructure development, with limited spillover to the rest of the economy. Consequently, growth has been accompanied by: (i) macroeconomic instability, sometimes resulting in an economic crisis; (ii) limited non-farm job creation and rising inequality; and (iii) considerable cost to the environment and an adverse effect on the sustainability of growth given the intensive use of natural capital (mines, forestry, hydropower). Exacerbated by the COVID-19 outbreak, structural vulnerabilities in Lao PDR have led to significant deterioration in the macroeconomic situation, including a significant increase in the public debt burden. Public debt is expected to increase to at least 69 percent of GDP in 2020 from 59 percent of GDP in 2019. Rising debt levels have significantly increased debt service payments to USD 1.2 billion for 2020 (equivalent to 55 percent of domestic revenues) resulting in heightened balance of payment pressures. The weak fiscal framework, a low foreign currency reserve buffer and limited financing opportunities with the sovereign rating downgrade by Moody's in August 2020 and by Fitch in September 2020 have led to difficulties in meeting debt service obligations. The limited capacity of the domestic banking system and underdeveloped treasury bills markets indicate that the scale up in domestic financing is not expected to compensate for the shortfall in external financing. The Bank of Lao PDR has also engaged in direct borrowing from commercial banks to help the government meet debt service obligations and provided direct credit to government to help government meet its expenditures. According to a report of a recent cabinet meeting, there has also been a significant buildup of arrears associated with state-funded projects. By the end of 2019, construction costs amounting to approximately US$ 1 billion (6 percent of GDP), linked to 2091 projects, remain unpaid.

Recent developments

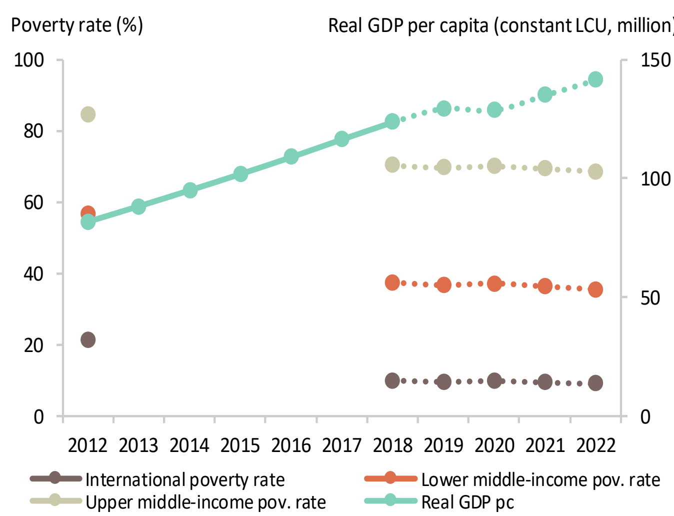
The economy is expected to register the slowest growth rate in three decades, with growth estimated to decline to between -0.6 percent (baseline scenario) and -2.4 percent (downside scenario) in 2020. The service sector has been the hardest hit with the lockdown measures and the decline in travel and tourism. Supply chain disruptions negatively affected the performance of the industry sector while the agriculture sector was adversely affected by adverse climatic conditions and COVID-19 related disruptions. The contraction in GDP growth in 2020 has led to the unemployment rate

FIGURE 1 Lao PDR / Real GDP growth and contributions to real GDP growth



Sources: Lao Statistics Bureau, World Bank staff estimates.

FIGURE 2 Lao PDR / Actual and projected poverty rates and real GDP per capita



Sources: World Bank staff estimates. Note: See table 2.

reaching 25 percent in May 2020 from 16 percent at the end of 2019.

To mitigate the economic impact of COVID-19, the authorities deferred tax payments and reduced the policy rate, along with other measures, to support households and SMEs. However, with policy space highly constrained, the ability of the authorities to mitigate the impact of COVID-19 is limited. Households are therefore at risk of slipping into poverty. The poverty rate (measured as US$ 3.2 a day, 2011 PPP) is expected to increase by at least 1.7 percentage points in 2020 compared to a no-COVID-19 scenario.

Low domestic revenue mobilization, a structural problem, has been exacerbated by the economic slowdown. Domestic revenue-to-GDP is expected to decline further from 13.5 percent in 2019 to 10.2 percent of GDP in 2020. Consequently, the fiscal deficit is projected to increase to 7.6 percent of GDP, from an estimated 5.1 percent of GDP in 2019, if the expenditure plan is maintained and there is no further buildup in arrears.

The current account deficit is expected to increase in 2020 due to lower trade and tourism activities, higher debt service obligations, and declining remittances. Remittances are projected to decline by about 50 percent in 2020 triggered by the pandemic. Lower imports due to supply disruptions, low oil prices and lower demand for fuel will offset only some of the decline in exports. Consequently, the overall trade balance is likely to worsen.

With the foreign currency gross reserve buffer expected to decline to under one month of import cover by the end of 2020, the country faces heightened balance of payment pressures. The misalignment of the official exchange rate and a shortage of foreign currency in the official foreign exchange market is characterized by the elevated spread between the official and parallel market exchange rates. The Kip depreciation together with rising food price inflation and buoyant growth in money supply has led to significantly higher inflation rate in the first seven months of 2020. Money supply growth was driven by a significant increase in the currency in circulation owing to direct credit to government by the Bank of Lao PDR, rising by an average of 142 percent in the first seven months of 2020 compared to an average of 42 percent over the same period in 2019.

Outlook

In 2021-22, growth is expected to rebound to 4.9 percent, with the poverty rate projected to return to its pre-crisis level around 2022, at the earliest. The fiscal deficit is expected to remain elevated, which will further increase the debt/GDP ratio over the medium term. This is expected to lead to external debt service payments of around US$ 1.1 billion/year for the next 3 years. Coupled with the elevated current account deficit, the foreign currency reserve coverage is expected to remain inadequate.

Over the medium term, unless significant structural reforms are undertaken, macroeconomic vulnerabilities are expected to persist. Reforms to strengthen revenue mobilization and improve the competitiveness in the private sector to support economic diversification are key.

TABLE 2 Lao PDR / Macro poverty outlook indicators (annual percent change unless indicated otherwise)

	2017	2018	2019	2020 e	2021 f	2022 f
Real GDP growth, at constant market prices	6.9	6.3	4.7	-0.6	4.9	4.8
Real GDP growth, at constant factor prices	6.9	6.3	4.7	-0.6	4.9	4.8
Agriculture	2.9	1.3	-0.9	2.0	2.9	3.1
Industry	11.6	7.8	4.7	2.9	5.7	4.9
Services	4.5	6.8	6.7	-4.6	4.9	5.3
Inflation (Consumer Price Index)	0.8	2.0	3.3	6.5	4.9	5.0
Current Account Balance (% of GDP)	-12.1	-11.5	-8.0	-11.3	-9.5	-8.8
Fiscal Balance (% of GDP)	-5.5	-4.7	-5.1	-7.6	-6.8	-6.3
Debt (% of GDP)	55.8	57.2	58.9	69.1	73.4	77.3
Primary Balance (% of GDP)	-4.1	-3.0	-3.1	-5.4	-4.7	-4.4
International poverty rate ($1.9 in 2011 PPP)[a,b]		10.0	9.7	9.9	9.5	9.1
Lower middle-income poverty rate ($3.2 in 2011 PPP)[a,b]		37.4	36.7	37.1	36.3	35.5
Upper middle-income poverty rate ($5.5 in 2011 PPP)[a,b]		70.4	69.7	70.2	69.4	68.6

Source: World Bank, Poverty & Equity and Macroeconomics, Trade & Investment Global Practices.
Notes: e = estimate. f = forecast.

(a) Calculations using 2018-LECS based on the revised poverty methodology. Nowcast: 2018. Forecast are from 2019 to 2022.

(b) Projection using annualized elasticity (2012-2018) with pass-through = 1 based on GDP per capita in constant US$ 2015.