Lao PDR Economic Monitor
Supporting Economic Recovery

Thematic section:
Livelihoods in the Time of COVID-19

January 2021
Macroeconomics, Trade and Investment Global Practice
East Asia and Pacific Region

WORLD BANK GROUP
Acknowledgements

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The Lao PDR Economic Monitor provides updates on macroeconomic developments and sectoral issues in the country. It is produced biannually and distributed widely to government agencies, development partners, the private sector, think tanks, civil society organizations, and academia.

The findings and interpretations expressed here are those of the authors and do not necessarily reflect the views of the World Bank Group, its Executive Directors, or the countries they represent.

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### Abbreviations

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<thead>
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<th>Abbreviation</th>
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<tr>
<td>BCEL</td>
<td>Banque Pour Le Commerce Exterieur Lao Public</td>
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<tr>
<td>BoL</td>
<td>Bank of the Lao PDR</td>
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<tr>
<td>COVID-19</td>
<td>Coronavirus disease 2019</td>
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<td>EDL</td>
<td>Electricité du Laos</td>
</tr>
<tr>
<td>EMDEs</td>
<td>Emerging Market and Developing Economies</td>
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<td>FDI</td>
<td>Foreign direct investment</td>
</tr>
<tr>
<td>GoL</td>
<td>Government of the Lao PDR</td>
</tr>
<tr>
<td>GSP</td>
<td>Generalized System of Preferences</td>
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<tr>
<td>ICBC</td>
<td>Industrial and Commercial Bank of China</td>
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<tr>
<td>MoF</td>
<td>Ministry of Finance</td>
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<tr>
<td>MOIC</td>
<td>Ministry of Industry and Commerce</td>
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<tr>
<td>NC</td>
<td>Non-concessional</td>
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<tr>
<td>NPV</td>
<td>Net present value</td>
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<tr>
<td>PBOC</td>
<td>People’s Bank of China</td>
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<tr>
<td>PMI</td>
<td>Purchasing Managers’ Index</td>
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<tr>
<td>RCEP</td>
<td>Regional Comprehensive Economic Partnership</td>
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<tr>
<td>TESDA</td>
<td>Technical Education and Skills Development Authority</td>
</tr>
<tr>
<td>UNDESA</td>
<td>United Nations Department of Economic and Social Affairs</td>
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<tr>
<td>yoy</td>
<td>year-on-year</td>
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All dollar ($) amounts are US dollars unless otherwise indicated.
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Executive Summary

The COVID-19 outbreak has intensified the growth slowdown, plunging Lao PDR’s economy into its first recession since the Asian financial crisis in 1998. The World Bank estimates that Lao PDR’s growth will decline drastically in 2020 to −0.6 percent. The pandemic has mainly affected labor-intensive service sectors and those linked to global and regional value chains, having an especially negative effect on tourism-related services, wholesale and retail trade, and manufacturing. It has affected livelihoods and poses a serious risk to Lao PDR’s progress on poverty reduction. The poverty rate (measured as $3.2 a day, 2011 PPP) is expected to increase by at least 1.7 percentage points in 2020, as compared with a non-COVID-19 scenario. The sharp drop in domestic revenue mobilization has led to worsening of the fiscal situation and a growing debt problem. Under the baseline scenario, Lao PDR’s GDP growth rate is projected to rise to 4.9 percent in 2021, assuming that the domestic spread of the virus is brought under control, that the government’s small but targeted COVID-19 fiscal support measures are implemented effectively, and that there are no new interruptions to the global economy recovery. The anticipated recovery will be supported by investment in infrastructure, and growth in services, exports, and private consumption. However, risks are tilted heavily to the downside, as unpredictable evolution of the pandemic and therefore its threats to macroeconomic stability could delay the resumption of regular economic activity. Under the downside scenario, which assumes some of these risks are realized, the growth rate is estimated to rebound to only 2.8 percent in 2021.

Recent Developments

The global economy is expected to slide into its deepest recession since the World War II. Global activity has begun to rebound following a gradual relaxation of lockdown measures. However, the renewed spread of COVID-19 in some regions of the world is weighing on the nascent recovery. Global output is projected to contract by 5.2 percent in 2020, despite unprecedented policy support. Countries in East Asia, with some exceptions, have contained the disease well by acting early and decisively. They have used a combination of mobility restrictions, testing-based strategies, and information programs to encourage precautionary behavior. Nevertheless, the pandemic is likely to have long-lasting impacts on multiple areas of economic activity, including lower investment and innovation, erosion of human capital, and retreat of global trade and supply chains.

It is estimated that Lao PDR’s GDP growth will decline to −0.6 percent in 2020, as all sectors experience adverse effects of varying intensity. The service sector has been hardest hit, due to lockdown measures and the decline in travel and tourism. Supply chain disruptions have negatively affected industry, especially manufacturing, while the agriculture sector has stayed resilient despite COVID-19 related disruptions and is expected to grow by 2 percent in 2020, up from −0.9 percent in 2019, supported by forestry and wood pulp exports. Service sector output is expected to contract by 4.5 percent in 2020, down from an expansion of 6.7 percent in 2019, as precautionary behavior and travel bans negatively affect tourism-related services and transportation. Cautious spending patterns and weakened supply chains are slowing wholesale and retail growth but the information and communication sector has been less exposed to the direct effects of the pandemic. Industrial production growth is expected to decline to 2.9 percent in 2020, down from 4.7 percent in 2019, following contraction in mining and manufacturing activities.
The current account deficit is expected to increase in 2020 because of the sharp decline in tourism activities, overflight fees, remittances, and higher debt service obligations, despite an improved trade balance. The current account deficit is expected to increase to 11.3 percent of GDP in 2020 from 8 percent in 2019. Over the first nine months of 2020, imports dropped by 10.2 percent compared to the same period of 2019, while exports fell by 0.5 percent. COVID-19 is negatively affecting tourism-related activities and is expected to reduce tourism income by more than $500 million in 2020. At the same time, remittances are projected to decline by about 50 percent (or $100 million) in 2020. With a low foreign currency reserve buffer, the country faces heightened balance of payment pressures and difficulties in meeting external debt obligations.

Pressure on the Lao kip remains high. In the foreign exchange market, the gap between the official exchange rate and the rate quoted by exchange bureaus remains large, reaching 9.1 percent in the second week of December 2020. This was slightly down from a peak of 9.7 percent at the end of July, following stricter controls on the parallel foreign exchange market and depreciation of the US dollar against major currencies.

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1 Lao PDR receives overflights fees of around $100 million annually from various airlines. However, overflight fees are expected to reach only about $10 million in 2020 due to the limited number of international flights caused by the pandemic.
Headline inflation has moderated in recent months but remains high because of rising food prices and kip depreciation. Although headline inflation declined from a peak of 6.9 percent in January 2020 to about 2.8 percent in November, it remains high, averaging 5.3 percent over the first eleven months of 2020. Food inflation has been the main driver, increasing by an average of 4.1 percent in the first eleven months of 2020, compared with an average of 1.9 percent over the same period in 2019. The depreciation of the kip in the parallel market has also played a significant role in stoking inflation.

The government is facing unprecedented fiscal challenges. Revenue collection over the first eleven months of 2020 was disappointing, at 76.9 percent of the revised budget and 62.4 percent of the original budget. The government has spent 22.5 trillion kip over the past eleven months, which is 68.3 percent of the revised budget and 63.2 percent of the original budget. If the expenditure plan is maintained and there is no further build up in arrears, the fiscal deficit is projected to increase to 7.6 percent of GDP in 2020, from an estimated 5.1 percent of GDP in 2019. Because of lags between recorded capital expenditure and actual capital expenditure, and in payment of salaries and wages, World Bank estimates for the fiscal deficit have been consistently above the Government of the Lao PDR (GoL) number. The deficit is being financed through external borrowing, T-bonds and T-bills, and borrowing from domestic and foreign commercial banks (foreign branches in Lao PDR).

Exacerbated by the pandemic, Lao PDR’s structural vulnerabilities have led to a significant increase in the public debt burden and difficulties in servicing debt. Public debt is expected to increase to at least 69 percent of GDP in 2020, up from 59 percent in 2019. Rising debt levels and increasing proportion of less concessional debt have significantly increased external debt-service payments, which stood at $1.2 billion for 2020. The weak fiscal framework, a low foreign currency reserve buffer, and limited financing opportunities following sovereign rating downgrades by Moody’s Investor Services in August 2020 and by Fitch Ratings in September 2020, have led to significant difficulties in meeting debt service obligations.

Economic Outlook and Risks

Under the baseline scenario, growth in 2021 is expected to rebound to 4.9 percent, up from −0.6 percent in 2020. Despite economic contraction caused by the pandemic in 2020, growth is projected to gradually recover in the medium term on the back of infrastructure investment allied with growth of services, exports, and private consumption. Infrastructure includes two major transport projects, the China-Laos Railway — expected to commence commercial operations in 2021 — and the Vientiane-Vang Vieng Expressway, which opened in December 2020. Service sector activity is likely to be boosted by increasing demand. Export activities will be positively affected by China recovery and its offering the Generalized System of Preferences (GSP) for 97 percent of Lao export products and by the signing of the Regional Comprehensive Economic Partnership (RCEP). Private consumption is expected to resume with economic recovery.

Downside risks challenge the growth outlook. Under the downside scenario, the 2021 growth rate is estimated at only 2.8 percent. Key downside risks include a prolonged COVID-19 outbreak, delays in rolling out the vaccines, a more sluggish recovery in Lao PDR’s key trading partners, heightened difficulties in meeting external public debt-service obligations, adverse weather-related events, and financial sector vulnerabilities. Rising food prices and job uncertainty for the poor and vulnerable are also major risks.
Thematic Section: Livelihoods in the Time of COVID-19

The COVID-19 pandemic and its containment measures have affected livelihoods in Lao PDR. While efforts to contain the pandemic have been largely successful, the negative impacts of the lockdown have lingered. The poverty rate (measured as $3.20 a day, 2011 PPP) is expected to increase by at least 1.7 percentage points in 2020, as compared with a non-COVID-19 scenario.

A decline in trading volumes and tourism have put thousands of jobs at risk, threatening livelihoods. Lao PDR’s labor market was weak at the onset of the pandemic, with vulnerable households short of livelihood diversification opportunities. The pandemic and the effects of the lockdown have resulted in employment and income losses. With international borders closed, the hospitality and transportation sectors have witnessed extensive job losses. Declining foreign and domestic demand battered the construction and manufacturing sectors, in which one-third of workers lost their jobs by July 2020. This negative economic impact has disproportionately affected informal workers, who lack social protection. The livelihoods of farming households have been only moderately affected by the pandemic, but weather-related shocks have posed a significant risk to farming activities.

Rising food prices have exacerbated food insecurity. Food and nutrition insecurity is a pressing problem, especially among low-income households and non Lao-Tai ethnic groups. Soaring inflation has eroded households’ purchasing power and welfare, with rising food prices increasing food insecurity among the poorest, particularly the urban poor.

Photo: Phoonsab Thevongsa
As remittances declined, some households have lost their main source of livelihoods while others have seen one of their coping strategies disappear. For many Lao people, remittances represent a main source of income and their sharp drop during the pandemic has created a significant challenge. This negative impact has been most pronounced for rural households in central and southern Laos. Restoration of international remittances is expected to be slow.

The COVID-19 pandemic has exposed gaps in the social safety net. In response to the pandemic, the government enacted several measures to protect those whose livelihoods were affected. However, the social protection system coverage is limited and lacks the capacity to sufficiently respond to the scale of the pandemic. Coverage of social assistance programs remains low and is insufficient to safeguard the livelihoods of those households severely affected by the pandemic.

Policy options to safeguard the livelihoods of the most vulnerable during the pandemic include expanding coverage of cash and in-kind food transfers, facilitating transport of agricultural inputs and outputs, and promoting skill development for laid-off workers and returning migrants.

Photo: Phoonsab Thevongsa
Lao PDR: Key Macroeconomic Indicators at a Glance

Real GDP growth and its contributors (percentage point)

<table>
<thead>
<tr>
<th>Year</th>
<th>Services</th>
<th>Industry</th>
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</thead>
<tbody>
<tr>
<td>2016</td>
<td>7.0</td>
<td></td>
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<tr>
<td>2017</td>
<td>6.9</td>
<td></td>
</tr>
<tr>
<td>2018</td>
<td>6.3</td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td>4.7</td>
<td></td>
</tr>
<tr>
<td>2020P</td>
<td>4.7</td>
<td></td>
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</tbody>
</table>

Tourist arrivals have dropped sharply (LHS: arrival number; RHS: yoy change)

Trade deficit has narrowed (million $)

<table>
<thead>
<tr>
<th>Month</th>
<th>Goods imports</th>
<th>Goods exports</th>
<th>Trade balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-Sep 2019</td>
<td>5297</td>
<td>4757</td>
<td>-540</td>
</tr>
<tr>
<td>Jan-Sep 2020</td>
<td>4342</td>
<td>4319</td>
<td>-23</td>
</tr>
</tbody>
</table>

Kip/$ spread remains high (LHS: exchange rate; RHS: percent)

Headline inflation has fallen from recent high (percentage)

<table>
<thead>
<tr>
<th>Month</th>
<th>Food</th>
<th>Transport and Fuel</th>
<th>Others</th>
<th>Headline inflation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jan-17</td>
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<td>Jan-18</td>
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<td>Jan-21</td>
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Baseline and downside public debt scenarios (% of GDP)

Sources:
- Lao Statistics Bureau, World Bank staff estimates.
- DOT, IMF
- IMF International Financial Statistics, CEIC database
- MoF, World Bank staff estimates.

Note: 2020PE – Preliminary estimate for 2020
A. Recent Economic Development
Global Economic Developments

Global activity has begun to rebound following a gradual relaxation of lockdown measures. However, the accelerating spread of COVID-19 in some regions is weighing negatively on economic recovery. Global output is set to contract sharply in 2020, at nearly three times the contraction rate experienced in 2009 during the global financial crisis, which was the deepest recession since World War II (World Bank 2020). China continues to be a bright spot in the global economy (Figure 1) and the global goods trade continues to recover, although trade in services is lagging. The manufacturing of new export orders recovered to 51.7 points in September, compared with its nadir of 27.1 points in April (Figure 2). International tourist arrivals in 2020 remain more than 90 percent below 2019’s levels in many countries. The number of daily commercial flights in 2020 recovered to about half of 2019’s levels by early August, but showed no further increase in September and October.

Central banks around the world have aggressively eased monetary policy and provided liquidity support to avoid shortages in credit markets. The Federal Reserve cut its policy rates to almost zero. Capital outflows from emerging markets and developing economies (EMDEs), which at the outset of the pandemic exceeded those during the worst period of the global financial crisis, have subsided. Debt sustainability concerns are rising as sovereign credit ratings have continued to deteriorate even though yields remain low. Commodity markets have been following diverging trends. Oil prices fell nearly 7 percent in September before stabilizing in October, with the price of Brent crude oil averaging $40 per barrel. Base metal prices, led by copper, continued to recover in October and are now nearly 6 percent higher than their pre-pandemic peak in January. This increase in prices has been supported by the strengthening of global economic activity, particularly in China. Agricultural commodity prices increased by 6 percent in September and are now above their January levels.

Figure 1. Latest GDP growth data in selected countries (percent)

![Figure 1](image1)

Sources: Haver Analytics.

A. Figures show quarter-on-quarter annualized growth rate for 2020Q2 for selected countries. Red bar indicates the 2020 Q3 quarter-on-quarter non-annualized growth rate for China.

B. Manufacturing and services are measured by PMI. PMI readings above 50 indicate expansion in economic activity; readings below 50 indicate contraction. Last observation was September 2020.

Figure 2. New export order sub-index of Purchasing Managers’ Index (PMI) (index)

![Figure 2](image2)
II. The Real Sector

The COVID-19 outbreak has turned the slowdown into a recession

The Lao economy is expected to register its slowest growth rate in three decades, with growth estimated to decline dramatically to −0.6 percent in 2020 (Figure 3). The agricultural sector and industry overall are estimated to grow moderately but the services sector has been severely affected by the pandemic. Lao PDR has so far suffered less from the disease than many of its regional peers, and the lockdown has been relatively mild. This, in addition to the fact that the economy is less integrated with the rest of the world compared to some of its East Asian peers, means that Lao PDR has experienced a relatively milder slowdown than some of its neighbors (Figure 4).

The output effects of the pandemic have varied considerably across sectors. The agricultural sector is estimated to grow by 2 percent in 2020, up from −0.9 percent in 2019, supported by forestry and logging activities. While the agricultural sector has remained resilient despite COVID-19 related disruptions, supply chain disturbances have negatively affected the performance of the manufacturing sector (Figure 5). With a contraction in mining, due to lower ore quality and availability, and export-oriented manufacturing activities partially offsetting robust growth in electricity consumption and exports, overall industrial production is expected to grow by about 2.9 percent in 2020, compared with 4.7 percent in 2019. The service sector has been the hardest hit by the lockdown measures and their resulting decline in travel and tourism. The sector is expected to contract by about −4.5 percent in 2020, compared to growth of 6.7 percent in 2019. The information and communication sector benefited from social distancing measures as more people use internet and online facilities to communicate and run businesses, but cautious spending patterns and weakened tourism related activities and supply chains are slowing the growth of the wholesale and retail sectors.

The growth estimate is based on the fact that real economic performance during the first 9-10 months has converged towards the baseline scenario, which assumes that the economy remains closed until Q3 2020 and will gradually open in Q4, with external demand (especially from China, Thailand and Vietnam) gradually picking up from Q4 2020.

Sources: Global Economic Prospects, January 2021
Agricultural growth, despite export market disruption, has been positive

Despite export market disruption in the first half of 2020, the agricultural sector is expected to grow by an estimated 2 percent in 2020, up from –0.9 percent in 2019. Forestry and logging, fishing, crop, and livestock production are expected to rebound. This is partly helped by reduced imports of food and closure of customary checkpoints due to the lockdown which has reduced competition and facilitated local production. Forestry and logging are expected to grow by an estimated 7.5 percent in 2020, aided by strong external demand for wood and wood pulp. In the first eleven months of 2020, wood pulp export grew by 15.2 percent from the same period last year. Fishing, crop, and livestock production are expected to grow at 3.2 percent, 3 percent and 1.5 percent respectively in 2020. The flooding experienced in Savannakhet and other southern provinces in October had some negative impacts and moderated overall agricultural growth for 2020.

Disruption of supply chains and weakening global demand have affected industry

Industrial output is estimated to contract in 2020 due to a decline in manufacturing and mining activities. The industrial sector’s growth rate will fall from 4.7 percent in 2019 to an estimated 2.9 percent in 2020, reflecting a sharp drop in mining and export-oriented manufacturing activities (garments, electronics, cameras, plus their parts and accessories and other manufactured goods) during the pandemic. Mining sector growth is expected to decline sharply from −2.4 percent in 2019, to –29.4 percent in 2020. This contraction reflects the production of lower-quality ore and the termination of a major copper mine, which transitioned to a gold operation towards 2020. Meanwhile the growth rate in textile manufacturing will fall from 2.5 percent in 2019, to an estimated –21.2 percent in 2020. The decline in manufacturing activity is also reflected in low import demand for cement, construction materials, iron, and steel (see section III).

Flooding and drought in various provinces resulted in a contraction in the agriculture sector in 2019.
The electricity sector is expected to grow in 2020, despite adverse weather conditions. The sector is expected to grow by 33 percent in 2020, with electricity output and exports increasing due to the contribution of new power projects, especially the four key plants, such as Xayaburi, Nam Ngiep 1, Xe Pian — Xe Namnoy, and Don Sahong with a combined installed capacity of 2,245 MW. The country should have a combined installed capacity of about 10 GW by the end of 2020. Lao PDR exports almost 7,000 MW - of which almost 6,000 MW is exported to Thailand, 570 MW to Vietnam, 320 MW to Cambodia, and 10 MW to Myanmar. Another 100 MW goes to the ASEAN Grid via Thailand and Malaysia. Drought and erratic rainfall in 2019 resulted in insufficient water inflows and caused actual power generation in the first half of 2020 to be lower than the set target. More robust outputs and exports are expected in the second half of 2020 due to better rainfall. Electricity exports for the first nine months of 2020 increased by 17 percent and domestic sales by 31 percent.

Behavioral change among consumers alters demand for services

The service sector is estimated to have negative growth of about -4.5 percent in 2020, down from 6.7 percent in 2019, with the pandemic profoundly affecting the types of services consumed. Activities involving transportation, hotels and restaurants, and entertainment have been adversely affected by contagion fears and social-distancing measures. The accommodation and transportation sectors are expected to contract by 39.9 percent and 23.4 percent respectively in 2020. In contrast, the information and communication sector has continued to perform well, with estimated growth of 28.8 percent in 2020. Cautious spending patterns and weakened supply chains are slowing the growth of the wholesale and retail sector, which is expected to expand by 2.2 percent in 2020, down from 8.7 percent in 2019. Increasingly cautious consumers appear to be prioritizing essential items and delaying non-essential purchases.
The pandemic is having a deeply negative impact on travel- and tourism-related services, as travel bans and precautionary behavior constrain activity in the sector. From January to September 2020, Lao PDR saw a 74 percent year-on-year (yoy) decrease in total tourist arrivals.4 Within that same period, arrivals from Asia and the Pacific saw the largest decline of 76 percent against the same period last year. Arrivals from Europe, the Americas, Africa, and the Middle East also experienced a large decline over the same period (Figure 6). Arrivals from the three largest sources—Thailand, Vietnam and China—dropped by 77 percent, 73 percent and 82 percent respectively (yoy, Figure 7). Meanwhile, the number of domestic flights remained low in October (Figure 8). The downward trend in internet search interest (Figure 9) corresponded to the decline in tourism-related earnings from hotels, restaurants, rentals, overland transportation, and other services. Furthermore, because of precautionary behavior, the transportation, hospitality, and tourism industries are expected to recover more slowly than other sectors, even after pandemic-related restrictions have been lifted. Tourism and hospitality operators have massively cut the cost of their services and package tours to encourage domestic travel within Lao PDR. Special promotions are targeted at local visitors in a bid to make up for the absence of foreign tourists during the pandemic.

Figure 6. Tourist arrivals have dropped sharply (LHS: arrival number; RHS: yoy change)

Figure 7. ...with the biggest drops from Thailand, Vietnam and China (LHS: arrival number; RHS: yoy change)

Source: Tourism Office

4 Some argue that the total tourist arrival number contains non-tourism purpose arrivals.
The pandemic threatens to reverse gains made in poverty reduction

The contraction in growth is adversely affecting poverty reduction efforts. The contraction in GDP growth in 2020 has led to the unemployment rate reaching 25 percent in July 2020, up from 16 percent in 2018. With policy space highly constrained, the ability of the authorities to mitigate the impact of COVID-19 is limited. More households are therefore at risk of slipping into poverty. The poverty rate (measured as $3.2 a day, 2011 PPP) is expected to increase by at least 1.7 percentage points in 2020, compared with a non-COVID-19 scenario.

Figure 10. Returning migrants’ interest in vocational training

Source: Lao People’s Democratic Republic Returning Migrants Survey
The COVID-19 pandemic may have a long-term impact on the migration pattern in Lao PDR. It was estimated that 0.9 million Lao nationals lived abroad in 2019. Approximately 9 percent of households receive remittances from abroad, with remittances constituting an average 60 percent of their household income. However, since the pandemic, anecdotal evidence indicates that the wave of returning migrants is likely to alter the local economic landscape with more than 50 percent of returning migrants surveyed indicating that they have no plans to leave Lao PDR for work again, or that they are unsure of their future plans. On the other hand, approximately 36 percent of those surveyed were willing to upskill for better opportunities (Figure 10), especially through vocational training in vehicle mechanics (19%), sewing/tailoring (12%), and cooking (10%). GoL needs to provide new employment opportunities by funding job creation and job-matching, and improve structural conditions for low-skilled returning workers.

III. The External Sector

The pandemic has led to a further widening of the current account deficit

The current account deficit is expected to increase in 2020 because of sharp declines in tourism activities, overflight fees, remittances, and due to higher debt-service obligations despite an improved goods trade balance. The current account deficit is expected to increase to 11.3 percent of GDP in 2020 from 8 percent in 2019 (Figure 11). The trade deficit declined in 2020 due to a combination of imports dropping faster than exports because of supply disruptions, along with lower oil prices and lower demand for fuel during the lockdown. However, the COVID-19 pandemic is also negatively affecting the services sector, with the tourism-related income coming into the economy expected to decline by more than $500 million. At the same time, remittances are projected to decline by about 50 percent (about $100 million) in 2020 because of the pandemic. With a low foreign currency gross reserve buffer, the country faces heightened balance of payment pressures and difficulties in meeting debt obligations. There is a shortage of foreign currency in the official foreign exchange market, which combined with misalignment of the official exchange rate, results in a large gap between the official and parallel market exchange rates.

Figure 11. The current account deficit is expected to widen in 2020 (percent of GDP)

The trade deficit decreased in January-September 2020, compared with the same period in 2019, as imports dropped faster than exports. The goods trade deficit declined by $517 million, from $955 million in Jan-Sep 2019 to $438 million in Jan–Sep 2020 (Figure 12). Imports declined by 10.2 percent from $5,297 million in Jan-Sep 2019 to $4,757 million over the same period in 2020. Exports fell by 0.5 percent over the same period, from $4,342 million to $4,319 million. Compared with nearby countries, Lao export performance contraction was mild in the first nine months of 2020 (Figure 13).
Pandemic-linked supply chain disruptions may cause a decline in trade volumes

Supply chain disruptions from Q2 2020 followed by contracting external demand have led to a severe decline in trading volumes between Lao PDR and its major trading partners, China, Thailand, and Vietnam. Border closures have led to delays in delivering inputs to export-oriented manufacturing industries. In addition, electronic parts and garment exports have been adversely affected by lower demand from Thailand and the EU while mining exports have decreased, mainly due to lower copper outputs. However, wood pulp exports to China performed well between January and November 2020, rising by 15.2 percent compared with the same period last year (Figure 14). Electricity exports also continued to grow by 22.1 percent between January and November 2020, year-on-year. Lower demands in the manufacturing sectors drove lower imports from China, Thailand, and Vietnam. These sectors include cement and construction materials, car and motorbike assembly, iron and steel, and other light manufacturing (Figure 15). Overall import performance from January to November remained weak and was exacerbated by the pandemic. In the future however, trade volumes in Lao PDR are expected to benefit from the RCEP Agreement (Box 1).

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6 Lao PDR commodity exports to the major trading partners of China, Thailand, and Vietnam accounted for 88 percent of total exports in 2019. Imports from these countries made up about 91 percent of total imports over the same period.
Box 1: Lao PDR could benefit significantly from the Regional Comprehensive Economic Partnership

The RCEP — which led to the creation of the world’s largest trading bloc—was signed among fifteen countries on November 15, 2020. RCEP negotiations started in 2012 with 16 countries: China, Japan, India, South Korea, Australia, New Zealand and the ten ASEAN countries. Despite India’s withdrawal in 2019, the agreement is the world’s largest, comprising 30 percent of global GDP, 27 percent of global merchandise trade and over 18 percent of services trade. RCEP aligns rules of origin for all member countries, enabling them to integrate into the same production chain. This may help RCEP attract a larger share of global value chains, with each country deepening its specialization.

Lao PDR is expected to benefit considerably from RCEP, if supported by reform progress. Member countries will benefit from RCEP as global value chains relocate. Reduced trade and investment barriers would increase economic integration among all 15 counties. RCEP is expected to strengthen regional trade and investment cooperation, which would enable Lao PDR to boost trade and investment while mitigating the economic impact of the pandemic. In addition, Lao PDR will gain in terms of the confidence created among foreign investors. However, the benefits from trade agreements are neither automatic nor assured: it is critical for Lao PDR to invest in complementary investments and policy changes, including expediting improvement of the business environment and facilitating the relocation of foreign firms.
In the foreign exchange market, the spread remains large

Pressure on the Lao kip remains high in the foreign exchange market. The Lao kip/US dollar daily reference rate reached Kip9,257/$1.00 on November 20, depreciating by 4.7 percent year-on-year. The commercial banks followed a similar rate of depreciation against the US dollar over the same period. However, in the parallel market, the kip depreciated at a faster rate and the spread between commercial banks and exchange bureaus reached 9.1 percent in the second week of December (Figure 16). The spread declined slightly from its peak of 9.7 percent at the end of July 2020 because of stricter controls on the parallel foreign exchange market coupled with the depreciation of the US dollar against all major currencies (Figure 17).

Gross official reserves increased from $864 million in June to $1,352 million in September. This was made possible as the People’s Bank of China (PBOC) extended a 6 billion renminbi (equivalent to $900 million) swap line to Bank of the Lao PDR (BoL) with a maturity of 3 years. However, there is indication that the funds are earmarked for specific uses, in particular to facilitate imports from China. Accordingly, funds which are earmarked and whose use is determined by PBOC cannot be included as foreign currency reserves, and more importantly cannot be used for debt service payments.

Figure 16. Parallel market premium of Kip/$ and Kip/Baht (percent)

Source: IMF International Financial Statistics

Figure 17. Kip/$ spread remains high (LHS: exchange rate; RHS: percent)

Source: IMF International Financial Statistics, CEIC database

The real effective exchange rate depreciated from Q2 2020 in line with trends in the nominal rate. With significant depreciation of the nominal exchange rate, Lao PDR’s real effective exchange rate has shown a downward trend since April 2020, partly due to a reversal of REER appreciation for a long period (Figure 18).

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7 BoL has indicated that the increase in reserves is for accounting purposes. According to the IMF’s standard recording of swap transactions, no transaction should be recorded until the funds are put at the disposal of BoL. Thus, until the money is disbursed, the swap is considered as a contingent asset (i.e., like an undrawn line of credit or guaranteed), and not a financial asset. This implies that as the funds have not yet been received, they should not be included as FX reserves.

8 According to standard IMF recording of swap transactions, when BoL receives funds through this swap agreement, if the use of the actual funds is subject to authorization by PBOC, the funds do not conform to the definition of reserve assets and should be recorded as “other investment” in external sector statistics. Given that BoL has indicated that the swap agreement is to support imports from China, even when the money is transferred to BoL, PBOC may effectively authorize how the Renminbi should be allocated.
New measures have been introduced by BoL to control exchange bureau operations

Responding to the elevated parallel market premium, the BoL imposed new regulations in July. The new restrictions are as follows: (i) individuals and legal entities who want to operate a currency exchange business must obtain a license from BoL; (ii) only legal entities—which conduct business related to hotels and tourism and meet specified requirements—are eligible to obtain currency exchange business licenses from BoL under this new rule; (iii) once approved, businesses which disregard the rules of BoL will be first warned, with repeat offenders fined or forced to close; (iv) currency exchanges must not offer services outside of their declared business venues or will face fines of 3 million kip per offence; (v) currency exchanges may not engage in direct currency exchange activities with commercial banks (fine of 5 million kip per offence); (vi) businesses must set their exchange rates in accordance with the regulations and the central bank’s rate or face fines of 5 million kip; and (vii) businesses must display their exchange rates so that central bank officials can easily inspect rate fluctuations. Businesses also need to report their exchange rate to the central bank daily or face fines of 100,000 kip per day per infringement.

FDI inflows have been relatively resilient

Foreign direct investment (FDI) inflows stayed relatively resilient in the first nine months of 2020 (yoy), driven mainly by construction of the Laos-China railway, the Vientiane-Vang Vieng highway, and several small and medium-sized power projects (Figure 19). However, the overall trend has declined from 2019 due to the previous completion of various large hydropower projects and the pandemic (Figure 20). Inflows of FDI to Lao PDR have remained stable when compared to those in other regional countries (Figure 21), a fact that may be attributed to government efforts to smooth the path for investors. The government has pledged to further improve the business climate to attract more domestic and foreign investment, especially form the private sector, citing a “three open” policy, that will open “minds”, “doors” and “barriers”.

Figure 18: Changes in real effective exchange rate (index)

Source: https://www.bruegel.org/publications/datasets/real-effective-exchange-rates-for-178-countries-a-new-database/
Note: An increase in the index indicates appreciation of the home currency against the basket of currencies of trading partners
Figure 19. FDI grew by 24 percent in Q1-Q3 2020 and mainly flew to infrastructure sector (LHS: million $; RHS: yoy change)

Source: BoL

Figure 20. FDI inflows rose in Q1 2020 (million $)

Source: BoL

Figure 21: Capital flows exposure in EAP region (Percent of GDP)

Source: EAP Update, October 2020, the World Bank

Photo: Phoonsab Thevongsa
IV. Inflation and the Financial Sector

Headline inflation has remained high in recent months

Headline inflation remains high because of rising food prices and depreciation of the kip. Although headline inflation declined to 2.8 percent in November (Figure 22), it remains high, increasing from an average of 3.0 percent in the first eleven months of 2019 to 5.3 percent over the same period in 2020. Food inflation was the main driver of headline inflation not only in November, but in 2020 overall. Food inflation increased by an average of 4.1 percent in the first eleven months of 2020, compared with an average increase of 1.9 percent over the same period in 2019. The depreciation of the kip in the parallel market in 2020 (see Section III) played a significant role in stoking inflation. Elevated growth in money supply might also contribute to the rising inflation rate. The average money supply growth rate was 17.9 percent for the first nine months of 2020, compared with the average rate of 10.8 percent over the same period last year (Figure 24). Additionally, based on anecdotal evidence, it seems the official inflation numbers do not accurately reflect the exchange rate pass through to inflation for Lao PDR.\(^9\) Inflation is high if compared with rates across the region (Figure 23).

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9 One possible reason is that the weights attached to the basket of goods are outdated. The weights are based on the 2013 Labour Expenditure and Consumption Survey.
Monetizing of the deficit has led to a significant increase in money supply

The growth in money supply has been primarily driven by growth in the monetary base. The monetary base (currency in circulation) increased by an average of 15.3 percent in the first nine months of 2020, compared with an average of 5.2 percent over the same period in 2019\(^\text{10}\). This has led to a significant increase in currency in circulation and effective monetization of the deficit. Direct credit to the government by BoL increased by an average of 127 percent in the first nine months of 2020 compared with an average of 49 percent over the same period in 2019. BoL’s credit to the government was increased to help the government meet its expenditure needs in the face of the shortfall in domestic revenue.

Lending by financial institutions to the government increased markedly in the first nine months of 2020, while credit to the private sector stagnated. Public sector credit growth has surpassed private sector credit growth since January 2020 (Figure 25). Public credit growth in the first nine months of 2020 averaged 21.5 percent, compared with 4.5 percent over the same period in 2019. This was driven by the purchase of the unsubscribed portion of the 1,700 billion kip bond in the first nine months of 2020. In contrast, private sector credit growth stagnated at an average of 7.9 percent over the first nine months of 2020.

Credit to the construction and services sectors increased after the COVID-19 outbreak. The share of credit to the construction sector accounted for 15.2 percent in Q3 2020, higher than the 13.7 percent in Q3 2019. The share of credit to services also rose from 11.4 percent in Q3 2019 to 12.5 percent in Q3 2020. The first and the second largest shares of private sector credit — to industry and commerce — experienced a slight decline over the same period (Figure 26). Overall, lending remains concentrated in the industry, commerce, construction, and services sectors.

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10 The monetary base increased by 9.1 percent (yoy) in September 2020.
While Lao PDR compares reasonably well with its regional peers on most Financial Soundness Indicators, vulnerabilities exist in state-owned banks (Table 1). While the banking sector is well-capitalized overall, regulatory capital to risk-weighted assets (CAR) fell from 18.3 percent in Q4 2018 to 13.9 percent in Q2 2020, but remained above the prudent level of 8 percent. Weaknesses seem to be concentrated in state-owned banks: the largest state-owned bank, Banque Pour Le Commerce Exterieur Laos (BCEL) has decreased its regulatory capital to risk-weighted assets from 10.5 percent in December 2019 to 8.9 percent in September 2020, posing a systemic risk to the sector.

Table 1. Regional comparisons of Financial Soundness Indicators
(percent)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Lao PDR</th>
<th>Cambodia</th>
<th>Myanmar</th>
<th>Thailand</th>
<th>Malaysia</th>
<th>Vietnam</th>
</tr>
</thead>
<tbody>
<tr>
<td>Regulatory capital to risk-weighted assets (CAR)</td>
<td>13.9</td>
<td>18.0</td>
<td>11.8</td>
<td>18.4</td>
<td>17.7</td>
<td>11.6</td>
</tr>
<tr>
<td>Regulatory Tier 1 capital to risk-weighted assets</td>
<td>10.7</td>
<td>21.0</td>
<td>10.5</td>
<td>15.8</td>
<td>15.1</td>
<td>9.4</td>
</tr>
<tr>
<td>Nonperforming loans net of provisions to capital</td>
<td>10.7</td>
<td>4.2</td>
<td>n/a</td>
<td>9.8</td>
<td>5.0</td>
<td>9.9</td>
</tr>
<tr>
<td>Nonperforming loans to total gross loans (NPL)</td>
<td>3.2</td>
<td>4.2</td>
<td>n/a</td>
<td>3.2</td>
<td>1.6</td>
<td>1.8</td>
</tr>
<tr>
<td>Return on assets</td>
<td>1.0</td>
<td>2.0</td>
<td>0.1</td>
<td>1.1</td>
<td>1.2</td>
<td>1.0</td>
</tr>
<tr>
<td>Return on equity</td>
<td>19.5</td>
<td>10.7</td>
<td>-1.8</td>
<td>7.8</td>
<td>10.3</td>
<td>12.8</td>
</tr>
<tr>
<td>Interest margin to gross income</td>
<td>22.9</td>
<td>35.5</td>
<td>49.4</td>
<td>62.6</td>
<td>54.7</td>
<td>71.5</td>
</tr>
<tr>
<td>Noninterest expenses to gross income</td>
<td>67.5</td>
<td>80.7</td>
<td>121.5</td>
<td>44.2</td>
<td>43.0</td>
<td>46.2</td>
</tr>
</tbody>
</table>

Source: BoL
V. Fiscal Developments

Low domestic revenue mobilization has been exacerbated by the economic slowdown

The fiscal deficit is expected to rise because of the low domestic revenue mobilization triggered by the economic contraction in 2020. Domestic revenue-to-GDP ratio 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—up from an estimated 5.1 percent of GDP in 2019—if the expenditure plan is maintained and there is no further build up in arrears (Figure 27). The fiscal deficit is being financed through foreign borrowing, T-bonds and T-bills, and borrowing from domestic and foreign commercial banks (foreign branches in Lao PDR).

Figure 27. Baseline and downside fiscal deficit scenarios
(percent of GDP)

The government is facing unprecedented fiscal challenges. Revenue collection from January to November 2020 was disappointing, at 76.9 percent of the revised budget and 62.4 percent of the original budget. This creates challenges in implementing planning over the remaining month of the year (Table 2). The government has expended 22.5 trillion kip over the past eleven months, accounting for 68.3 percent of the revised budget and 63.2 percent of the original budget. Salaries and allowances accounted for the largest portion of budget expenditure while a sizeable portion of the budget was used for state investment projects, repayment of debts, recovery from natural disasters, and the payment of electricity and water bills. During the revised budgetary implementation over the eleven-month period, the government faced a shortfall of 5,093 billion kip. The main reason why World Bank estimates for the fiscal deficit have been consistently above the government’s figures is that recorded capital expenditure lags actual capital expenditure by around six months. This explains why the fiscal outturn for the previous year is finalized in June of the following year. The government has also reported that recorded capital expenditure lags actual capital expenditure by around six months.

11 According to the previous Article IV.
12 According to PEFA 2019.
Table 2. Lao PDR: Government budgetary operations, Jan-Nov 2020
(billion kip, otherwise indicated)

<table>
<thead>
<tr>
<th></th>
<th>Original plan</th>
<th>Revised Plan</th>
<th>Recorded</th>
<th>Percent of</th>
<th>Percent of</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>2020</td>
<td>2020</td>
<td>Jan-Nov/2020</td>
<td>revised budget</td>
<td>original budget</td>
</tr>
<tr>
<td><strong>Total revenue</strong></td>
<td>28,017</td>
<td>22,725</td>
<td>17,477</td>
<td>76.9%</td>
<td>62.4%</td>
</tr>
<tr>
<td>Domestic income</td>
<td>25,750</td>
<td>20,436</td>
<td>16,716</td>
<td>81.8%</td>
<td>65.0%</td>
</tr>
<tr>
<td>Grants</td>
<td>2,287</td>
<td>2,187</td>
<td>761</td>
<td>33.3%</td>
<td>33.3%</td>
</tr>
<tr>
<td><strong>Total Expenditure</strong></td>
<td>35,693</td>
<td>33,043</td>
<td>22,570</td>
<td>68.3%</td>
<td>63.2%</td>
</tr>
<tr>
<td>Current expenditure</td>
<td>22,818</td>
<td>21,441</td>
<td>15,912</td>
<td>74.2%</td>
<td>65.7%</td>
</tr>
<tr>
<td>Interest payments</td>
<td>3,618</td>
<td>3,618</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>Capital expenditure</td>
<td>12,275</td>
<td>11,602</td>
<td>6,658</td>
<td>57.4%</td>
<td>51.7%</td>
</tr>
<tr>
<td><strong>Overall fiscal balance</strong></td>
<td>-7,676</td>
<td>-10,338</td>
<td>-5,093</td>
<td>49%</td>
<td>66%</td>
</tr>
</tbody>
</table>

Source: MoF

Growing difficulties in meeting debt service payments

Existing structural vulnerabilities in Lao PDR have been exacerbated by the COVID-19 outbreak and led to a significant increase in the public debt burden (Box 2). Public debt is expected to increase to at least 69 percent of GDP in 2020, up from 59 percent in 2019 (Figure 28). Accordingly, the Debt Sustainability Analysis (2019) finds Lao PDR to be at high risk of debt distress. This trend in the debt/GDP ratio is expected to continue. The debt/GDP ratio trajectory is expected to be higher than projected in the 2019 World Bank-IMF DSA, with the ratio rising to between 77 and 88 percent of GDP by 2022. This increase would result in further risk of debt distress. Rising debt levels and an increasing share of less concessional borrowing, have significantly increased debt service payments to $1.2 billion for 2020, resulting in heightened balance of payment pressure. At the end of 2019, arrears associated with 2,091 state-funded projects were approximately $1 billion. Based on a cabinet report to the Prime Minister of Lao PDR. Source: Vientiane Times, August 25, 2020.

Figure 28. Baseline and downside public debt scenarios
(percent of GDP)

Source: MoF, World Bank staff estimates.
Note: 2020PE – Preliminary estimate for 2020
Box 2: The government explains the rising debt burden

The government has cited the following reasons for its spiraling public debt over the past five years.

• The significant size of loans secured to finance the construction of hydropower projects.
• Many loans were allocated to projects that did not yield economic returns or generate income that could repay debt. These projects were unproductive and did not yield the anticipated results.
• Over recent years, a large portion of the budget has been used to buy vehicles and build public offices, which required further spending on maintenance.
• The chronic fiscal deficit has resulted in the government issuing bonds and borrowing more to address budget shortages. The country’s debt burden further escalated due to the need to source additional funding to repay loan principals and interest. In addition, foreign exchange rate fluctuations affected the government’s ability to service its debts because most loans were in foreign currencies, notably Thai baht and US dollars.
• The government bodies in Vientiane and the provinces frequently failed to sufficiently analyze and prioritize development projects before requesting loans to carry them out. Consequently, many of the projects for which loans were secured were seen to be unnecessary and unproductive. Critics claim that all government sectors attempted to source further funding without considering how they would discharge debt obligations.
• Finally, the shortfall in revenue over many years has severely limited the government’s financial liquidity, making it difficult to set aside money for the payment of debts.

The government is considering policy options to reduce its debt burden. It is committed to lowering the fiscal deficit and cutting spending on non-essential projects that do not guarantee economic return. Other measures to reduce the debt burden include converting debt into capital, selling state assets, and selling shares in state enterprises in the hope of sufficiently addressing the country’s liabilities and obligations.
VI. Debt Dynamics

Bilateral loans accounted for 61 percent of total public external debt stock in 2019. Concessional and non-concessional (NC) bilateral loans accounted for 41 percent and 20 percent of the total debt stock in 2019, followed by concessional multilateral loans (16 percent) and non-concessional commercial bonds (16 percent). China is the largest creditor, accounting for 77 percent and 69 percent of concessional and non-concessional bilateral loans respectively (Figure 29). Total commercial bonds and loans outstanding at the end of 2019 totaled $2.2 billion, a relatively large size given the country’s level of development.

Figure 29. Government external debt by concessionality, creditor and instrument, 2019
($, million)

Amortization of government external debt is $1.2 billion in 2020, on a debt stock of $9.9 billion. The largest amortization payments are due to non-concessional commercial bonds and loans, representing half of the total amortization. Commercial bonds account for 16 percent of debt stock, but 27 percent of amortization cost. Similarly, commercial loans account for 6 percent of total public external debt and 23 percent of amortization costs. A large share of amortization payments also goes to bilateral loans, with bilateral concessional and non-concessional loans representing 24 percent and 18 percent of amortization costs respectively (Figure 30).

Figure 30. Amortization of govt. external debt by concessionality, creditor and instrument, 2020
($ million)
Lao PDR’s debt problems are largely due to the extremely high cost of commercial borrowings. The WB defines the effective cost of debt (debt service and principal payments in 2020) as a percentage of 2019 debt stock. By this definition, the commercial loans are 5-8 times more expensive than official sector loans — they have both high interest rates and shorter maturity period (Figure 31). Additionally, 67 percent of all amortization payments will go to non-concessional loans and bonds in 2020, while these account for only 22 percent of total debt.

Figure 31. Cost of borrowing by concessionality, creditor and instrument, 2020
(amortization in 2020/stock of debt in 2019 ratio)

A large portion of Lao PDR’s public and publicly guaranteed debt comes from the energy sector, especially from Electricité du Laos (EDL). Because of large borrowing in previous years, EDL faces a significant debt service burden, rising over the next five years from around $400 million in 2019 to $802 million in 2023. The burden will stay above $300 million annually until 2033. (Figure 32). Around 85 percent of EDL’s overall debt commitment is to China.

Figure 32. EDL’s Forecast Principal and Interest Payments for 2019-2038
($ million)

14 EDL is a large state-owned enterprise that owns and operates the Lao PDR’s electricity generation, electricity transmission and electricity distribution assets. The company also manages the import and export of electricity from the national electricity grid. EDL was founded in 1959 and is headquartered in Vientiane.
The weak fiscal framework, a low foreign currency reserve buffer, and limited financing opportunities following sovereign rating downgrades by Moody’s Investor Services in August 2020 and by Fitch Ratings in September 2020, have led to significant difficulties in meeting debt service obligations. The severe liquidity stress and limited financing opportunities in the face of sizeable debt servicing payments of $1.2 billion in 2020 has led to a downgrade of Lao PDR’s sovereign credit rating by Moody’s and by Fitch, indicating a negative outlook. The heightened liquidity risk is exacerbated by the weak external and fiscal buffers. The foreign currency reserve buffer is expected to remain inadequate. If there is no further accrual of arrears and the revised planned expenditure is maintained, the fiscal deficit is projected to increase to at least 7.6 percent of GDP, up from 5.1 percent of GDP in 2019. However, arrears have been accruing. The negative outlook pertains to the fact that financing stresses are unlikely to abate given that average debt service payments per year are approximately $1.1 billion over 2021–2025 (Figure 33). The government announced that it will no longer accept loans from foreign countries, in order to address this fiscal deficit. Loans will only be taken out to repay the principal on existing loans, when the time arrives for debts to be serviced. As such, the concessional loan ratio is expected to increase in the medium term (Figure 34).

Figure 33. Public sector external debt servicing is around $1.1 billion per year during 2021–25... (million $)

Figure 34. ...with concessional debt ratio expected to also rise (percent)

Source: MoF

Source: BoL

Photo: Phoonsab Thevongsa

Planned public expenditure was revised downward by approximately KN2,000 billion in the first quarter of 2020.
The Government of Lao PDR has started debt payment discussions with China, its largest bilateral creditor. The Ministry of Finance (MoF) and the Export-Import Bank of China have begun a discussion around debt reprofiling. With the debt/GDP ratio expected to rise further, and with a significant increase in debt service payments for the foreseeable future, a debt restructuring which results in significant reduction in debt Net Present Value rather than debt reprofiling would be required to place public debt on a sustainable footing.

In addition, the GoL has taken other policy measures to reduce the public debt. Over the past five years, the government has attempted to reduce the number of loans to ease the country’s financial pressures. The government is committed to lowering the fiscal deficit and cutting spending on non-essential projects that do not guarantee economic returns. Other measures to reduce the debt burden include converting debt into capital, selling state assets, and selling shares in state enterprises in the hope of sufficiently addressing the country’s liabilities and obligations.

The limited capacity of the domestic banking system and the underdeveloped treasury bills market indicates that the scale-up in domestic financing is not expected to compensate for any shortfall in external financing sources. Most recently, on 7 September 2020, the MoF issued domestic bonds of 1,500 billion kip and $50 million (Table 3). The previous US dollar bond of $500 million issued by the central bank was heavily undersubscribed, with only $31 million taken up. This could be attributed to uncertainty associated with the government’s credit worthiness, coupled with the marginal difference between the interest rates offered by these bonds and commercial bank US dollar deposit rates. Moreover, for kip bonds, the real interest rate is only marginally positive, given an average inflation rate of 5.3 percent over the period January to November 2020. Given the recent depreciation of the kip, this makes local currency bonds less attractive and less likely to be taken up by non-state financial institutions or individuals.

Table 3. Interest rates for bond issuance

<table>
<thead>
<tr>
<th>Amount ($, million)</th>
<th>Interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>5.00%</td>
</tr>
<tr>
<td>2 years</td>
<td>-</td>
</tr>
<tr>
<td>3 years</td>
<td>6.00%</td>
</tr>
<tr>
<td>4 years</td>
<td>-</td>
</tr>
<tr>
<td>5 years</td>
<td>7.00%</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Amount (billion kip)</th>
<th>Interest rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 year</td>
<td>-</td>
</tr>
<tr>
<td>3 years</td>
<td>6.80%</td>
</tr>
<tr>
<td>5 years</td>
<td>6.95%</td>
</tr>
<tr>
<td>7 years</td>
<td>7.20%</td>
</tr>
<tr>
<td>10 years</td>
<td>7.50%</td>
</tr>
</tbody>
</table>

Source: BoL, MoF, BCEL
VII. Outlook and Risks

Outlook

Global output is projected to contract by 5.2 percent in 2020,\(^{16}\) despite unprecedented policy support (Figure 35; World Bank 2020). A widespread sudden stop of global activity in the first half of 2020 reflected the national lockdowns implemented worldwide to contain the spread of the outbreak. Although moderate recovery is envisioned in 2021, with global growth reaching 4.2 percent, output is not expected to return to previously predicted levels (Figure 36). The strength and sustainability of a global growth rebound depend on the duration of the pandemic and the effectiveness of policy actions in preventing financial meltdowns, restoring global consumer and investor confidence, and resumption of global travel.

Thus far, extraordinary policy response has prevented the slowdown in activity from becoming a financial crisis. Nonetheless, financial conditions will remain fragile for many market participants. A prolonged disruption to economic activity could exacerbate the current financial stress, which could lead to widespread financial crises. There is high uncertainty around the global growth forecast. The global recession would have been deeper than the baseline forecast if bringing the pandemic under control had taken longer, or if the financial stress caused by the pandemic had triggered cascading defaults.

The pandemic is likely to have long-lasting impacts on multiple areas of economic activity, including lower investment and innovation, erosion of human capital, and retreat from global trade and supply chains. The long-term damage related to the pandemic will be particularly severe in economies that suffer financial crises, and in energy exporters because of plunging oil prices. For example, in the average EMDE, over a five-year forecast, a recession combined with a financial crisis could lower output by almost 8 percent (World Bank 2020).

Figure 35. Global growth by year (percent)

Figure 36. Level of output relative to January 2020 projections (percent)

Note: EMDEs = emerging market and developing economies. Shaded area indicates forecasts. Aggregate growth rates calculated using constant 2010 US dollar GDP weights. Data for 2019 are estimates.
A. Shaded areas indicate forecasts. Data for 2019 are estimates. Aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates.
B. Figure shows the percentage difference between the level of output in the January and June 2020 editions of Global Economic Prospects.

\(^{16}\) Draws on the World Bank’s June 2020 Global Economic Prospects (GEP) report. Updated global forecasts will be published in the January 2021 GEP.
Under the baseline scenario, growth in 2021 is expected to rebound to 4.9 percent, up from −0.6 percent in 2020 (Table 4). Despite the economic contraction caused by the pandemic, growth is projected to gradually return to trend in the medium term on the back of investment in infrastructure, and growth in services, exports, and private consumption. Infrastructure includes two major transport projects, the China-Laos Railway — expected to commence commercial operations in 2021 — and the Vientiane-Vang Vieng Expressway, which opened in December 2020. Activity in the services sector is likely to be boosted by increasing demand. Export activities will be positively affected by China offering GSP for 97 percent of Lao export products and the signing of the RCEP. Private consumption is expected to resume with economic recovery. Under the downside scenario, the growth rate is estimated to rebound to only 2.8 percent in 2021.

The current account deficit is likely to narrow to 8.8 percent in the medium term, down from 11.3 percent in 2020, as exports rebound with global demand recovery. Lao PDR is expected to benefit from the GSP offer for exports to China, its major trading partner, and from transport improvement through investments such as the China-Laos Railway and the Vientiane-Vang Vieng Expressway.
The impact of COVID-19, together with the decline in fiscal revenue, is expected to cause the fiscal deficit to remain at 6.8 percent of GDP in 2021. The COVID-19 pandemic will continue to undermine the government’s already limited revenue collection capacity from 2020 onward. Revenue collection will fall further because the service sector — and the revenues it generates — will take longer to recover. On the other hand, government expenditure will increase as the authorities implement fiscal responses to counter the negative impacts of COVID-19. The magnitude and length of the fiscal response are still unclear and need to be further clarified by the government.

With the fiscal deficit remaining high, the debt/GDP ratio is expected to further increase in the medium term. This ratio is expected to lead to external debt service payments of approximately $1.1 billion/year for the next five years. Public debt is projected to continuously rise to over 77 percent of GDP in the medium term. Coupled with the elevated current account deficit, foreign currency reserve coverage is expected to remain inadequate.

Table 4. Economic Outlook Indicators

<table>
<thead>
<tr>
<th>Indicator</th>
<th>2019</th>
<th>2020a</th>
<th>2021b</th>
<th>2022b</th>
</tr>
</thead>
<tbody>
<tr>
<td>Real growth (%) —baseline</td>
<td>4.7</td>
<td>-0.6</td>
<td>4.9</td>
<td>4.8</td>
</tr>
<tr>
<td>Real growth (%) —downside</td>
<td></td>
<td></td>
<td>2.8</td>
<td>2.7</td>
</tr>
<tr>
<td>Inflation (annual average, %)</td>
<td>3.3</td>
<td>5.5</td>
<td>4.9</td>
<td>5.0</td>
</tr>
<tr>
<td>Current-account deficit (% of GDP)</td>
<td>-8.0</td>
<td>-11.3</td>
<td>-9.5</td>
<td>-8.8</td>
</tr>
<tr>
<td>Trade balance (% of GDP)</td>
<td>-6.1</td>
<td>-4.7</td>
<td>-2.2</td>
<td>0.8</td>
</tr>
<tr>
<td>Fiscal deficit (% of GDP)</td>
<td>-5.1</td>
<td>-7.6</td>
<td>-6.8</td>
<td>-6.3</td>
</tr>
<tr>
<td>Public debt (% of GDP)</td>
<td>58.9</td>
<td>69.1</td>
<td>73.4</td>
<td>77.3</td>
</tr>
<tr>
<td>Months of import cover</td>
<td>1.5</td>
<td>2.5c</td>
<td>0.9</td>
<td>1.0</td>
</tr>
</tbody>
</table>

Source: World Bank staff estimates

a Estimated; b Forecast; c BoL has indicated that the increase in reserves is for accounting purposes. According to standard IMF recording of swap transactions, funds earmarked for specific uses cannot be included as foreign currency reserves or used for debt service payments.

Risks

The economic outlook is challenged by downside risks, particularly the risks in debt servicing. Under the downside scenario, the growth rate is expected to rebound slightly to 2.8 percent in 2021. However, further outbreaks could delay resumptions in economic activity. In addition, despite the fiscal means available to the government, its ability to mitigate the pandemic’s impact on households, banks, and corporate balance sheets could dissipate, resulting in lasting damage. Domestic risks are compounded by heightened external uncertainty, including the possibility of a more severe global recession. Tourism and related industries are expected to recover more slowly than other sectors, even after restrictions have been lifted, because of precautionary behavior. Key adverse risks include: (i) a prolonged COVID-19 outbreak exacerbated by a more sluggish recovery in Lao PDR’s key trading partners; (ii) heightened challenges in meeting public external debt service obligations; (iii) financial sector vulnerabilities; and (iv) adverse weather-related events. Rising food prices and job uncertainty are also major risks posed by the pandemic for poor and vulnerable populations.

17 The downside scenario forecasts that the economy will only gradually reopen in Q1 2021 and fully reopen in Q2 2021 as the availability of a vaccine becomes more widespread in Q2 2021, and external demand beginning to slowly improve from Q1 2021. Under the downside scenario, the agricultural sector is not expected to rebound strongly with the corporate and banking sectors, and balance of payments, significantly affected by the pandemic.
This section draws on results from: (i) Lao PDR Poverty Assessment 2020: Catching Up and Falling Behind; and (ii) Monitoring COVID-19 Impacts on Households in Lao PDR, Report No. 1: Results from a Rapid Monitoring Phone Survey of Households. The survey, conducted in June-July 2020, provided information when the lockdown had just been lifted.
The COVID-19 pandemic and its containment measures have affected the livelihoods of households in Lao PDR. Nearly a year has passed since the virus brought an unprecedented threat to the global community. While the pandemic was declared as a health crisis, its impact has been experienced in multiple dimensions. The first Lao case was confirmed on 24 March 2020, prompting the government to enact sweeping lockdown measures to protect the population. These measures included school and business closures, movement restrictions, and international border closures. The restrictions led to disruptions in economic activities, loss of income, and rising food prices. While the restrictions were intended to protect public health, they had an unprecedented economic impact on livelihoods.

Despite successful efforts to contain the pandemic, the negative economic impact of the lockdown has lingered. As the risk of the virus spreading abated, lockdown measures were gradually eased. By July 2020 most measures, except for international border closures, had been lifted. However, the effects of disruption to businesses and livelihoods over the course of the lockdown have continued. As of November 2020, Lao PDR recorded only 24 COVID-19 cases. Nevertheless, the economy is still affected by low trading volumes, greatly reduced demand for tourism, high inflation driven by rising food prices, depreciation of the kip, and buoyant growth in money supply. As such, the pandemic continues to place strain on many households.

Low trading volumes and tourism demand have put thousands of jobs at risk

The Lao labor market was weak at the onset of the pandemic. The unemployment rate was stubbornly high at 15.7 percent in 2018, a sharp increase from 4.1 percent in 2012. During the same period, the labor force participation rate also declined from 84 percent to 72 percent. Most sectors, except the public and hospitality sectors, experienced a net decline in employment. In 2018, about 80 percent of unemployed people were seasonally unemployed, reflecting disruptions caused by frequent droughts and floods. Youth unemployment in the same period of 2012–2018 quadrupled to 21.8 percent.

Vulnerable households lacked livelihood diversification opportunities. Following a period of declining non-farm employment, household livelihoods have become less diverse, relying on fewer income sources. Low-income households are most vulnerable. Approximately three-quarters of the poorest 40 percent of households have only one income source. The lack of livelihood diversification has increased their vulnerability to employment shocks, and they are at risk of falling deeper into poverty during the pandemic.

The lingering effects of the lockdown and pandemic have resulted in employment and income losses. Disrupted economic activities and the associated reduction in demand for goods and services resulted in lower production, causing a reduction in working hours and labor earnings. The impact persisted even when lockdown measures were lifted, because consumer demand remained subdued. By July 2020, nearly 13 percent of workers employed before the pandemic had lost their jobs, pushing the unemployment rate up to over 25 percent (Figure 37).19 Approximately 70 percent of those laid off cited business closures because of travel restrictions or demand disruptions as the reason for job loss. Among those who retained their jobs, about a third reported reduced income (Figure 38).

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19 World Bank estimate based on the extent of job loss. The estimate is consistent with that reported by the Ministry of Labour and Social Welfare.
The negative impacts on employment and income in Lao PDR are comparable with small East Asia and Pacific economies which have managed to contain the outbreak such as Cambodia and Mongolia. In Cambodia and Mongolia, approximately 14 percent and 18.9 percent of workers employed before the pandemic had stopped working by May 2020, respectively. The impacts are more dramatic in Indonesia (23.4 percent by May 2020) and the Philippines (28.5 percent by August 2020) where the outbreak has been more widespread. Moreover, only 31 percent of households in Lao PDR reported a decline in wage income compared to 37.6 percent in Mongolia, 58 percent in Indonesia and 75.3 percent in Cambodia.

**Figure 37: Employment status in June–July 2020**
(percentage of pre-pandemic employment)

![Employment status chart](image)

**Figure 38: Change in income between March and June–July 2020**
(percentage of non-farm workers who remained in the same job)

![Income change chart](image)

Source: Rapid Monitoring Phone Survey of Households conducted from June 20 to July 16, 2020.

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21 June – July 2020 for Lao PDR. May 2020 for the other three countries.
The pandemic disproportionately affected low-income workers, threatening their livelihoods. Low-income workers were more likely to lose their jobs during the pandemic. Approximately 16 percent of workers from the poorest 40 percent of households employed before the pandemic had lost their jobs by July 2020, compared with 11 percent of their counterparts from the top 60 percent of households.

As international borders remain closed, the hospitality and transportation sector witnessed extensive job losses. Transportation and hospitality were among the first sectors affected by the pandemic, caused by a fall in tourism demand and travel restrictions. These sectors support the livelihoods of 5 percent of households and 10 percent of urban households. Approximately half of all workers employed in the hospitality industry before the pandemic had either lost or changed their jobs by July 2020 (Figure 39). The impact was slightly milder for the transportation industry, where approximately 30 percent of workers were affected. Nearly a year into the pandemic, international borders remain closed, while all tourist visas and most international flights are still suspended. Tourism remains at a halt, and the impact of COVID-19 on employment in tourism-related sectors is expected to persist.

Figure 39: Nonfarm source of livelihood and job loss in June–July 2020

Other nongovernmental service sectors—a source of livelihoods for about 16 percent of households—performed relatively well. Approximately 16 percent of jobs in the wholesale and retail trade industry, and 13 percent of jobs in other nongovernmental service sectors (excluding hospitality and transportation) had been lost by July 2020. These sectors support the livelihoods of 16 percent of households, a significantly larger share of households than are supported by hospitality and transportation. Public employees were least affected by the pandemic, with job losses of only one percent. Following public sector expansion over recent years, public sector employment represents a source of livelihoods for 12 percent of households. Agriculture remains the source of livelihoods for 80 percent of households.

Declining foreign and domestic demand battered the construction and manufacturing sectors, in which one-third of workers lost their jobs by July 2020. Construction and manufacturing create livelihood opportunities for about 15 percent of Lao households. Supply chain disruptions followed by contraction in external demand led to a decline in trading volumes between Lao PDR and its major trading partners. Lower foreign demand in manufacturing goods caused firms to reduce working hours or lay off workers. Construction activities were also affected by lockdown measures and lower domestic demand.
Manufacturing job prospects remain weak while any rebound in construction employment is expected to be slow due to subdued domestic demand. After the lockdown measures were lifted, the situation for manufacturing worsened as border closures continued to cause delays in delivering inputs to export-oriented manufacturing industries. Electronic parts exports have been adversely affected by reduced demand from Thailand. Trading volumes have continued to decline. Although the government is gradually reopening some border crossings to enable businesses to import and export goods, manufacturing job prospects remain uncertain. While the lingering effect of the lockdown on construction activities was expected to subside, declining aggregate domestic demand has continued to hamper the rebound in construction employment.

The negative economic impact fell disproportionately on informal workers, who lack labor and social protection. As in other developing countries, employment in Lao PDR is largely informal, especially in the construction, hospitality, manufacturing and transportation sectors, where less than 10 percent of workers are wage workers protected by written contract and social insurance coverage (Figure 40). Most of these are self-employed workers or the owners and employees of informal (i.e. unregistered) micro and small enterprises. Because informal workers depend on daily earnings to survive, they face the risk of falling into extreme poverty as a result of temporary economic disruptions or business closure.

Figure 40: Informality and job loss of the non-farm sectors

![Image of Figure 40: Informality and job loss of the non-farm sectors]

Source: Rapid Monitoring Phone Survey of Households.
Note: Formal wage workers are employees with a written contract and their employers contribute to social insurance. Bubble size represents the share of all households whose livelihoods depend on employment in each sector.
The livelihoods of farm households were moderately affected by the pandemic but at greater risk of weather-related shocks. Family farming is a source of income for approximately 75 percent of households, and between March and June 2020 92 percent of these households were able to operate their family farms normally. Among those not operating normally, lockdown measures and travel restrictions were cited as the primary reasons: 44.5 percent and 22.7 percent could not operate normally because of stay-at-home requirements and restrictions on travel and transport respectively. Weather-related reasons were also cited by one-fifth of farm households in rural areas. As the lockdown measures were lifted, most farm households were able to resume their normal activities. Indeed, the agricultural sector acted as a buffer during the pandemic, absorbing workers laid off in other sectors. Around 10 percent of workers laid off in manufacturing and wholesale and retail trade switched to agriculture.

Nevertheless, disruptions in transportation and weak demand for agricultural products remain a challenge for commercial farmers. Declining agricultural exports or business closures in other economic sectors, such as hotels and restaurants, could lead to a significant reduction in market outlets for many commercial farmers. Disruptions in transportation increase the cost of production inputs or cause delays in transporting farm products, preventing farmers from bringing their products to markets.

Figure 41: Family business revenue status in June–July 2020 relative to pre-pandemic levels

Income from family businesses has declined and some businesses have permanently closed. One-third of households own a family business, and the majority of these are micro and small enterprises which lack access to finance, resources, and adaptability skills. Family businesses thus tend to be severely affected by lockdown measures, travel restrictions, and disruptions in demand. Even after most containment measures were lifted, the impact lingered. In June–July 2020, 8.4 percent of household businesses had permanently closed or remained temporarily closed, and more than half of businesses that were open experienced a fall in revenue relative to pre-pandemic levels (February 2020).
The impact on family businesses, however, varies across sectors. The most affected sectors were hospitality and transportation. Approximately 12.6 percent of businesses closed in June–July 2020 (Figure 41). Since then, the travel industry has not rebounded and the future of this industry over the next few months remains uncertain. In contrast, close to 20 percent of businesses in the sectors that experienced milder job loss, such as the agricultural and service sectors excluding hospitality, transportation and personal services, reported that revenue had been higher than usual. Thanks to the government’s successful effort to contain the outbreak, these sectors proved resilient to the pandemic after containment measures were lifted.

**Rising food prices have exacerbated food insecurity**

Food and nutrition insecurity are pressing problems in Lao PDR. In 2018 – 2019, almost 20 percent of the population experienced moderate to severe food insecurity. Half of these people experienced moderate food insecurity, meaning they have reduced the quality or quantity of their food and are uncertain about their ability to obtain food because of a lack of money or other resources. The other half faced severe food insecurity, meaning they have run out of food, and in the most extreme cases have gone for a day or more without eating. The stunting rate was stubbornly high, at 33 percent of children under five years of age.22

Food insecurity is more severe among low-income households and non-Lao Tai ethnic groups. Approximately one-third of the poorest 40 percent of households experience moderate to severe food insecurity, compared with 12 percent of the top 60 percent of households. Food-insecure and low-income people can be especially vulnerable to poor nutrition because of the additional risk factors associated with inadequate household resources. Nutritional deficiency is concentrated among the bottom quintile of households, with 13 percent of households having less than acceptable dietary diversity compared with the national average of 6 percent. The stunting and underweight rates among children under five years of age in the poorest wealth quintile, which is predominantly rural, are over three times the rates for their counterparts in the richest quintile. Non-Lao Tai ethnic groups are at higher risk of experiencing food insecurity than the majority Lao Tai households. Approximately 34 percent of Mon-Khmer households and 38 percent of Hmong-Mien households face moderate to severe food insecurity, compared with 11 percent of Lao-Tai households.

Soaring inflation has eroded households’ purchasing power and welfare. Headline inflation increased from an average of 2.5 percent during the first nine months of 2019 to 5.7 percent over the same period in 2020. Food inflation was the main driver of headline inflation, increasing by an average of 4.5 percent in the first nine months of 2020 compared with an average of 1.4 percent over the same period in 2019. The depreciation of the kip and elevated growth in money supply also contributed to the rising inflation rate. High inflation has affected all households but the impact is disproportionate: poor households are unlikely to be able to maintain consumption levels without seeking alternative sources of income. Although better-off families have more buffer space to cope with a price shock, they find their purchasing power eroding rapidly, having far less surplus money.

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22 LECS 6 (2018/19) and LSIS (2017).
Rising food prices have led to growing food insecurity among the poorest. In June–July 2020, 70 percent of households reported being affected by rising food prices (Figure 42). In response to this shock, approximately 37 percent of affected households reduced their food consumption (Figure 43). The poorest 40 percent of households struggled to maintain their consumption levels and meet their minimum basic needs. These households tended to engage in additional income-generating activities or hunted and gathered wild food. The top 60 percent of households opted for different coping strategies; better-off households tended to rely on savings as their alternative income sources or lowered their non-food consumption. Headline inflation has declined since July, easing some pressure on food insecurity. Nevertheless, inflation remains elevated and the risk of food insecurity is still high, especially among vulnerable households.

The urban poor have been hit hardest by a sharp increase in food prices. Lao consumers have become increasingly dependent on market purchases, especially urban consumers who purchase 77 percent of all food consumed. The urban poor have been most directly and adversely affected by rising food prices due to their low-income status and heavy reliance on purchased food. In rural-areas, households still rely mostly on their own-produced food, accounting for 55 percent of total food consumption. However, their consumption baskets have become more diverse, while cultivation remains largely rice based. Purchased foods constitute a large share of rural household expenditure and are crucial in preventing nutritional deficiency. A sharp increase in food prices could also hurt the rural poor, who are net food buyers.

As remittances declined, some households have lost their main source of livelihoods while others have seen one of their coping strategies disappear.

For many households, remittances represent their main livelihood source. Nearly 15 percent of households derive income from remittances, with about 9 percent of households receiving remittances from abroad (Figure 44). For those receiving them, remittances represent 17.9 percent of household consumption, suggesting that remittances are a crucial livelihood element. Transfers from abroad constitute 70 percent of total remittances. The likelihood of receiving remittance transfers is higher among non-poor households, at 15.8 percent, double that of poor households. Among beneficiaries however, remittances prove more vital for poor families, for whom remittances cover as much as 41.5 percent of household consumption.
Remittances dropped dramatically during the pandemic, creating a significant challenge for those who rely on them to survive. Since the outbreak, more than 200,000 Lao migrant workers have returned from abroad, resulting in a loss of remittance income for many households. For those who remained abroad, many have remitted less than usual because their incomes were also affected during the pandemic. Furthermore, lockdown and containment measures temporarily stalled domestic economic activities, affecting the flows of domestic remittances. Between March and July 2020, 58 percent and 54 percent of households receiving remittances experienced a reduction from domestic and international sources respectively. Given the sizable share of remittances in total household consumption, this loss could further impoverish poor and vulnerable households.

The recovery in international remittances is expected to be slow. The majority of Lao nationals living abroad are in Thailand (UNDESA, 2019), which hosts an estimated 300,000 documented Lao migrants (Department of Employment, Thailand), equivalent to approximately 15 percent of the Lao labor force (2017). Lao-Thai border closures and curtailed economic activity in Thailand have led to thousands of jobless migrant workers returning to Lao PDR. Since the COVID-19 outbreak began, more than 200,000 Lao migrants are reported to have crossed the border from Thailand to Lao PDR. Approximately 36 per cent of these indicated that they would stay until the COVID-19 pandemic ends. More than 33 percent planned not to work outside Lao PDR again and 25 percent were unsure.23 A complete loss of one livelihood option thus persists in the foreseeable future.

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The negative impact of declining remittances on household livelihoods is pronounced among rural households in central and southern Lao PDR. Despite a higher rate of migration among urban households, migrants from rural households are more likely to send remittances back home than their urban counterparts. Only 11.8 percent of urban households receive remittances, compared with 16.3 percent of rural households. Remittance-receiving households are concentrated in central and southern provinces (Figure 45). In the central and southern regions, 16 percent and 21 percent of households respectively rely on remittances (both domestic and international) as a livelihood source, compared with only 5 percent of households in the northern region. More than 20 percent of households in Savannakhet and Champassak receive remittances from abroad. International remittances are also important in Savannakhet, Vientiane Capital and Khammouane.

The COVID-19 pandemic has exposed gaps in the social safety net.

In response to the pandemic, the Government of Lao PDR enacted measures to protect those whose livelihoods have been affected. The government issued tax relief measures, decreeing that employees earning below 5 million kip ($540) and micro enterprises were exempt from paying income tax for three months, from April to June 2020. In addition, the COVID-19 unemployment benefit program was introduced for employees who are members of their business’s social insurance scheme. For affected employees to receive unemployment benefits, businesses forced to close during the COVID-19 pandemic had to request financial assistance for temporarily unemployed staff from the National Social Security Fund. However, only 4.3 percent of workers have access to social insurance, making the coverage of this potential benefit extremely limited.

The social protection system coverage is limited and lacks the capacity to respond to pandemic shocks sufficiently. Those covered by social protection programs are mostly limited to social insurance provided by the private sector or civil service. Just a few programs provide limited health insurance to the poor. With a majority of the workforce employed in the informal economy, the social protection gap is significant. Tight fiscal space further constrains Lao PDR’s ability to increase social protection spending. Sectors with larger shares of informal workers have been among the most materially impacted by the pandemic. Low-income earners employed in the informal sector are particularly vulnerable to employment and income shocks due to lack of labor and social protection or back-up savings. Government financial assistance for those unemployed because of the COVID-19 pandemic is only available to workers with access to the social insurance scheme. This group accounts for only 3.1 percent of people employed pre-pandemic, and so far approximately 12,000 affected workers (representing 0.37% of pre-pandemic employment) have claimed the benefit (Figure 46). An overwhelming share of workers who lost their jobs were thus left without any livelihood support.

Figure 46: Gaps in social security

Coverage of social assistance programs remains low and is insufficient to safeguard the livelihoods of households severely affected by the pandemic. While most countries in the East Asia region and beyond have invested significantly in recent decades to develop targeted programs that support the poor and most in need, Lao PDR still lacks such programs. Since the outbreak, sequential shocks have hit households including job loss, food inflation, disruptions in farm activities, and business closures. Many households suffered from losing livelihoods, while some are at high risk of falling deeper into poverty and experiencing food insecurity. Returning migrants and their dependents have also been severely affected by the pandemic. Families have struggled to replace lost remittance income and returning migrants often lack access to healthcare and social services. Furthermore, social assistance programs are not available to help these households safeguard their livelihoods. Less than 8 percent of households reported that they received social assistance, either in cash or in kind, between March and June 2020. Almost all assistance that was received came from social assistance programs which existed before the pandemic.

Safeguarding livelihoods during the COVID-19 pandemic.

The pandemic presents unique policy challenges. The economic consequences of the COVID-19 pandemic call for urgent policy responses to support households and firms. This section focuses on recommended policies for safeguarding household livelihoods, particularly for people not eligible for the relief measures that have been implemented, such as informal workers and household enterprises. While limited fiscal space constrains the government’s capacity to issue fiscal stimulus policies, protecting the livelihoods of the most vulnerable should be the mandate. Given the unique nature of the crisis, this will require reprioritization of fiscal spending and careful design of effective response measures. Policy options to safeguard the livelihoods of the most vulnerable during the pandemic include:
• **Expanding coverage of cash and in-kind food transfers** to protect the livelihoods of households facing high risk of food insecurity because of rising food prices and disruptions in farming activities. In-kind transfers offer a viable alternative where food is not easily available or is at high cost. Cash transfer and in-kind food assistance can be short term, and discontinued as soon as pressure from rising food prices subsides. Where targeting systems are lacking, local authorities must be involved in identifying and targeting the most vulnerable. Action can be implemented at subnational level to ensure that assistance is delivered to those most in need.

• **Facilitating transportation of agricultural inputs and outputs** to ensure continuity of the food supply chain, curb food inflation, and boost the economic activities of the shock-absorbing sector (agriculture). Approximately 20 percent of households whose farming activities were temporarily halted cited transportation as the principal reason for disruption. Many farming households were not able to deliver their products to market, while others faced increased costs in raw materials such as seeds, pesticide, and fertilizer. Boosting agricultural activities not only increases food supply but also creates an employment buffer for job loss in non-farm sectors. Since the outbreak, some low-skilled workers laid off in the manufacturing, construction, and services sectors have returned to rural communities and switched to the agricultural sector.

• **Promoting skill development for laid-off workers and returned migrants.** Addressing unemployment during the pandemic remains a big challenge, as job availability has also declined. The government’s role in addressing labor market mismatch requires renewed efforts. Since the outbreak, skills training programs have been used by governments around the world to deal with employment loss owing to the pandemic. In Cambodia for example, the government funded skill training programs for suspended workers and employees in the garment and tourism industries, while in the Philippines, the Technical Education and Skills Development Authority Scholarship Program supports affected and temporarily displaced workers through upskilling and reskilling by providing free courses. In developed countries like Australia, Ireland and the UK, additional budget was allocated for skills development, job search and assistance measures, to help laid-off workers find new employment, retrain, or develop new skills for emerging growth sectors. For Lao PDR, training programs should prioritize informal workers whose lack of social and labor protection makes them more vulnerable to employment loss. Other viable options include:

  - Rapid training in essential services and in-demand positions, targeting the unemployed who already have some necessary skills for these jobs. This requires relatively little specialized training and can help the unemployed return to work quickly. It could also focus on groups such as youth.

  - Entrepreneurship training for retail companies, shops and stores, including small and medium retailers. In the service sector, the impact of the pandemic has been less severe on wholesale and retail trade than it has been on hospitality and transportation. Moreover, wholesale and retail trade absorbed some laid-off workers from hospitality and transportation. Promoting entrepreneurship in the retail sector can mitigate the employment problem caused by the pandemic. By targeting business owners and laid-off workers, skills training can help develop the knowledge and skills to help people run their own businesses and prepare for a rapidly changing business landscape in which information, communication and technology skills are essential.