

# Lao People's Democratic Republic

Strong demand for exports of metals and electricity, coupled with a recovery in tourism, spurred GDP growth in 2010. Similar factors are forecast to underpin a slightly higher expansion this year and next. But inflation has been rekindled, so far at moderate levels. A central challenge is to preserve macroeconomic stability while pursuing growth.

## Economic performance

After decelerating a little during the global recession, economic growth picked up to 7.5% in 2010 (Figure 3.25.1), returning to the average expansion rate of 2004–2008. This prolonged period of growth mainly reflects substantial investment in mining and hydropower.

Industry, representing about one-quarter of GDP, grew by 18.0% in 2010 and contributed most of the growth. Output of electricity more than doubled as the Nam Theun 2 hydropower plant, the biggest in the country at 1,070 megawatts, reached full capacity in April. Some smaller new plants, including Xeset 2 and Nam Leuk 1 and 2, also started generating power. Most of their output is exported to Thailand (Figure 3.25.2).

Mining production rose by 19.0% last year, spurred by higher global metal prices. Output of copper from the two main mines—Phu Bia and Sepon—rose by 21.0% to 147,500 tons. Gold production rose by 7.0% to 173,000 ounces and silver by 13.5% to about 500,000 ounces.

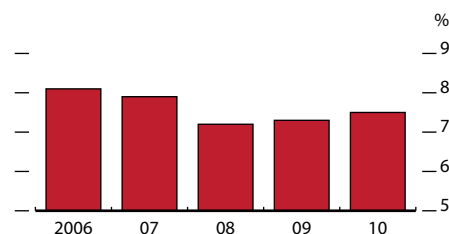
Construction activity benefited from expansionary fiscal and monetary policies.

The global recovery in travel lifted the number of tourists by about 25% to 2.5 million in 2010, with a strong rebound in tourism from Europe and the United States. That supported growth of 6.0% in the hotel and restaurant industry. Other services to grow by at least 6% were financial services, wholesale and retail trading, and transport and communications (boosted by the introduction of third-generation mobile telephone and Internet services). Services as a whole grew by 5.0%.

Agriculture, in contrast, which accounts for a third of GDP but employs about three-fifths of the workforce, suffered from bad weather (droughts followed by floods) as well as from diseases in pigs and cattle. Production of rice, the main crop, increased by about 4% to 3.26 million tons and fisheries recorded solid growth of 7.0%. The sector as a whole, though, grew by just 2.0%.

Consumer prices were on an upward trajectory last year, putting average inflation at 6.0%. Higher global oil prices pushed up the cost of fuel and transport, and bad weather and animal diseases disrupted food supplies, raising food prices. Strengthening domestic demand, the rollout of a value-added tax from April 2010, and growth in credit also fueled

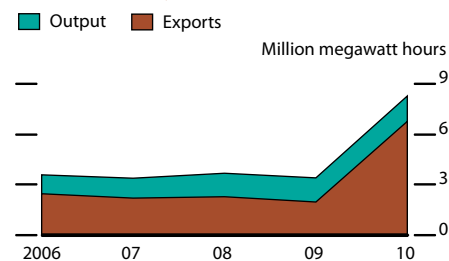
3.25.1 GDP growth



Sources: Lao Statistics Bureau; Asian Development Outlook database.

[Click here for figure data](#)

3.25.2 Electricity indicators



Source: Ministry of Energy and Mines.

[Click here for figure data](#)

inflation. Bank credit expanded by 46% last year, moderating from over 80% in 2008 and 2009. Growth in M2 money supply quickened to 39% in 2010 from 31% in the previous year (Figure 3.25.3).

Moving to counter inflation pressures, the Bank of the Lao PDR in September 2010 raised its policy interest rate, from 4.0% to 5.0% for loans of less than 1 week. It phased out direct lending for off-budget infrastructure projects, which had been a cause of high rates of growth in credit. However, disbursement of central bank lending committed in 2009 continued to feed credit growth.

The central bank also uses exchange rate policy to address inflation, aiming to limit fluctuations in the Lao kip to 5% a year against major currencies. In 2010, the kip rose against the US dollar by 3.0% but fell by 5.0% against the Thai baht (Thailand is a major source of imports).

The effectiveness of monetary policy is hampered by the widespread use of the US dollar. To promote use of the kip, the government has directed most of its revenue departments to accept only that currency and has asked wholesalers and retailers to use it for quoting prices. Such measures have helped to lower the level of dollarization to below 50% in 2010, from a peak of 79% in 1999.

Strong growth in government revenue, in part a result of high global prices for copper and gold, helped to rein in the budget deficit in FY2010 (ended 30 September 2010). Growth in spending moderated relative to FY2009, when the government had lifted outlays to cushion the impact of the global recession. The budget deficit, including grants but excluding off-budget spending, narrowed to an estimated 3% of GDP from 5.1% in FY2009. Including off-budget spending, it was close to 5%.

Higher metal production and prices, along with the start of exports from Nam Theun 2, raised the US dollar value of merchandise exports by an estimated 30% to \$1.9 billion in 2010. Mineral exports exceeded \$1 billion for the first time and electricity exports rose to \$375 million. Shipments of clothing increased in value by about 14% to \$184 million, mainly on better demand from Japan and the Republic of Korea.

Merchandise imports rose by an estimated 13.5% to \$2.8 billion. The trade and current account deficits narrowed, the latter to an estimated 9% of GDP from 12% in 2009 (Figure 3.25.4). After accounting for capital inflows, gross international reserves climbed to \$727 million at end-2010, sufficient for about 3.5 months of nonresource imports.

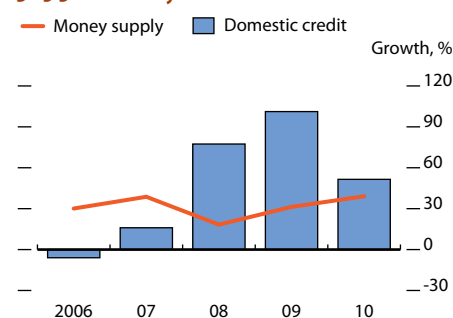
As part of a more than decade-long effort to join the World Trade Organization, the government made progress in bringing foreign exchange, investment, tax, and trade regulations into line with the organization's requirements, and completed bilateral goods and services agreements with the People's Republic of China and Japan.

## Economic prospects

The government's Seventh Socio-Economic Development Plan (2011–2015) strongly emphasizes growth, targeting annual average GDP expansion of 8% and moving the country from least developed country status by 2020.

Scheduled hydropower and mining activity in 2011 and 2012 will underpin growth. Nam Theun 2 will contribute to GDP for a full year from this year, and another relatively large new plant, Nam Ngum 2

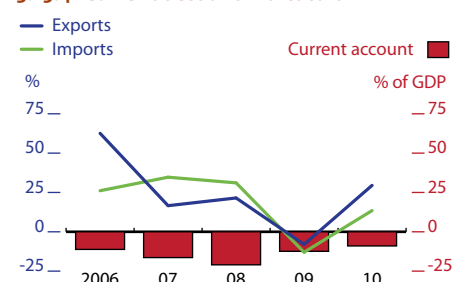
### 3.25.3 Monetary indicators



Source: Asian Development Outlook database.

[Click here for figure data](#)

### 3.25.4 Current account indicators



Sources: Asian Development Outlook database.

[Click here for figure data](#)

### 3.25.1 Selected economic indicators (%)

	2011	2012
GDP growth	7.7	7.8
Inflation	6.5	6.0
Current account balance (share of GDP)	-9.0	-10.0

Source: ADB estimates.

(615 megawatts) is expected to be running at full capacity from April this year. Construction is set to start on a Nam Ngum 3 plant by midyear.

The Phu Bia and Sepon mines are scheduled to increase output this year, and construction is getting under way at the Hongsa coal-fired power plant (1,878 megawatts) and an associated coal mine. This project will cost more than \$3 billion and is scheduled to generate electricity, mainly for export, from 2015.

A potash mine is being brought into production and a new rail line from the capital Vientiane to Yunnan province in the People's Republic of China is scheduled to be built by companies from that country. If this 5-year rail project starts as planned, it will likely have only a small impact on GDP this year but a greater contribution from 2012.

Services and construction are expected to maintain solid growth, bolstered by expansion of domestic demand and of tourism. Export orders suggest that clothing shipments will increase by about 10% in 2011.

Further, agriculture is expected to return to trend growth of about 2%, if weather permits, while higher global prices for cassava, corn, and sugar are likely to encourage wider planting. Private investment in plantation and contract farming is laying the basis for production gains for coffee, sugarcane, and some other crops in the years ahead.

Taking these factors into account, GDP growth is forecast to edge higher to 7.7% in 2011 and to 7.8% in 2012.

The government has budgeted to increase spending by 23% in nominal terms in FY2011, and it expects revenue to rise by about 27% owing to projected high prices for metals and April's rollout of the value-added tax. This would put the budget deficit at about 3% of GDP. On monetary policy, the target is to restrain growth in M2 money supply to 20% and in credit to 25% in 2011. The phasing out of central bank lending for off-budget projects should facilitate this tightening.

Higher prices for imported oil, coupled with growth in credit and a possible further depreciation of the kip against the Thai baht, will maintain upward pressure on inflation, which is projected at about 6.5% in 2011.

Merchandise exports are forecast to rise by about 25% in value this year, reflecting buoyant copper and gold prices and higher exports from the Nam Theun 2 and Nam Ngum 2 power plants. Exports of clothing and farm products, too, are projected to increase. Merchandise imports will likely grow at a slower rate than exports this year, but imports of machinery and materials for new projects are expected to pick up in 2012. The current account deficit is forecast to remain at around 9% of GDP in 2011 before widening in 2012 as imports accelerate.

The stock of external public debt, most of which is on concessional terms, has increased to \$3.3 billion in absolute terms, but as a share of GDP it has declined to 52% from 82% over 5 years, owing to the growth in the economy and the kip's appreciation.

### 3.25.1 Development challenges

A central challenge is to pursue growth, as called for in the new development plan, while preserving macroeconomic stability.

A related issue is banking system soundness: high rates of growth in credit and a rapid expansion in the number of banks (from 13 to 23 in the 3 years to 2010) has increased risks for the banking system, which need to be addressed through vigilant supervision and a recapitalizing of state-owned banks.

Enduring challenges involve reducing poverty (the incidence was about 27% in 2008) and, related to this imperative, diversifying the economy's narrow base. Mining and hydropower have limited potential for job creation, and a heavy reliance on mining leaves the economy and the budget vulnerable to the inevitable downswings in global metal prices.

These twin goals therefore require investment and reforms in agriculture, which still supports the majority of the population, and improvements in the business environment to encourage a vibrant private sector.

Progress on the latter depends heavily on reforms in public sector management (including state-owned enterprises) and in public service delivery, as well as a more transparent and predictable policy and legal environment. The country is near the bottom (171 out of 183 countries) in the World Bank's *Doing Business 2011* ranking.

Transparency International places the country 154 out of 178 on its 2010 Corruption Perceptions Index, partly because the implementation or enforcement of approved laws and regulations remains weak.

The government has strategies to address governance and corruption, which focus on the public service, public participation, rule of law, and public finance. Their success will, though, depend on commitment from political leaders to ensure enforcement.