LAO PEOPLE'S DEMOCRATIC REPUBLIC

The economy continued its moderate recovery in 2023, backed by services, including tourism, transport, and logistics. However, macroeconomic pressures from an unsustainable debt burden persisted, dragging down growth. In addition, a late monsoon season and low rainfall suppressed agriculture and electricity output. External demand will continue to support moderate growth in 2024 and 2025. Continuing macroeconomic imbalances pose risks to refinancing, price stability, and food security.

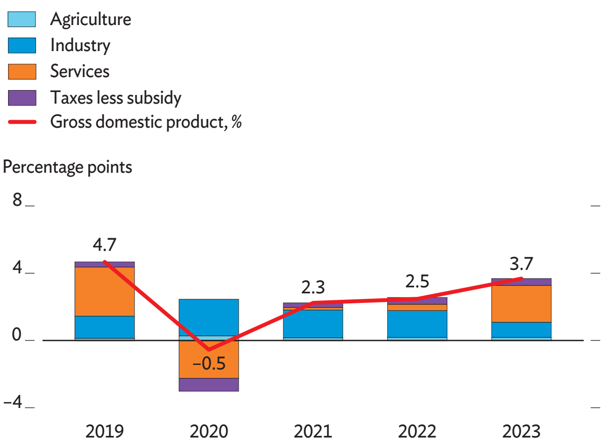
Economic Performance

The economy grew by 3.7% in 2023, supported by services, including tourism, transport, and logistics. As mobility improved across Southeast Asia, regional tourism helped to stimulate spending in domestic services such as hotels, trade, and transport (Figure 2.25.1). Tourist arrivals reached 3.4 million in 2023, up from 1.3 million in 2022, but remained below pre-pandemic levels (Figure 2.25.2). The railway service between the Lao People's Democratic Republic (Lao PDR) and the People's Republic of China (PRC) carried more than 1.8 million passengers in 2023, up from 1.0 million passengers in 2022, and transported 4.2 million tons of freight, up from 2.2 million tons in 2022. Wholesale and retail trade also expanded as international and local retailers opened new franchises.

However, macroeconomic challenges, including high external debt service, low revenues, and exchange rate depreciation, continued to hamper growth. In the official market, the Lao kip lost half its value against the US dollar in 2022 and a further 16.3% in 2023. It also fell against regional currencies in 2023, including 21.3% against the baht and 15.6% against the yuan, contributing to high domestic inflation (Figure 2.25.3). As the kip lost its value against other currencies, the ratio of foreign currency deposits to broad money—or "dollarization"—increased to 68.7% in 2023 (Figure 2.25.4).

Figure 2.25.1 Supply-Side Contributions to Growth

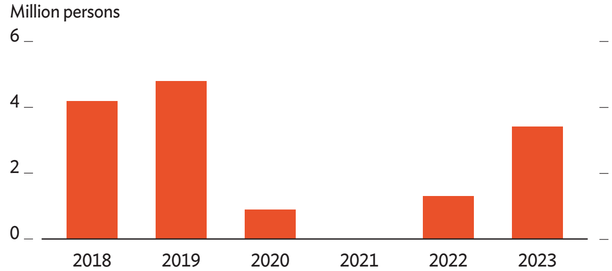
Continued improvement in services supported economic recovery.



Sources: Lao Statistics Bureau; Asian Development Bank estimates.

Figure 2.25.2 Tourist Arrivals

Tourist arrivals more than doubled in 2023.

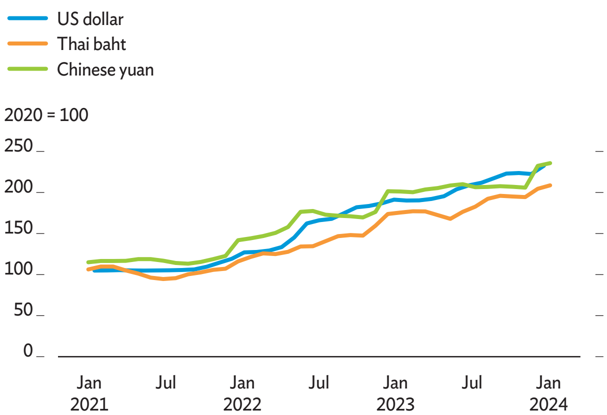


Source: Ministry of Information, Culture, and Tourism.

This chapter was written by Emma Allen and Soulinthone Leuangkhamsing of the Lao Resident Mission, ADB, Vientiane.

Figure 2.25.3 Lao Kip Exchange Rate Index

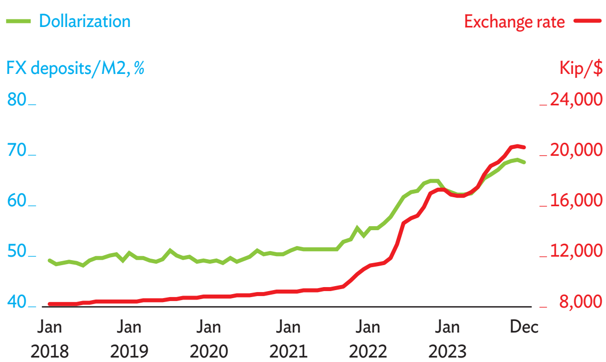
The kip continued to fall against the US dollar and regional currencies.



US = United States.
Sources: Bank of the Lao PDR; Asian Development Bank estimates.

Figure 2.25.4 Foreign Currency Deposits

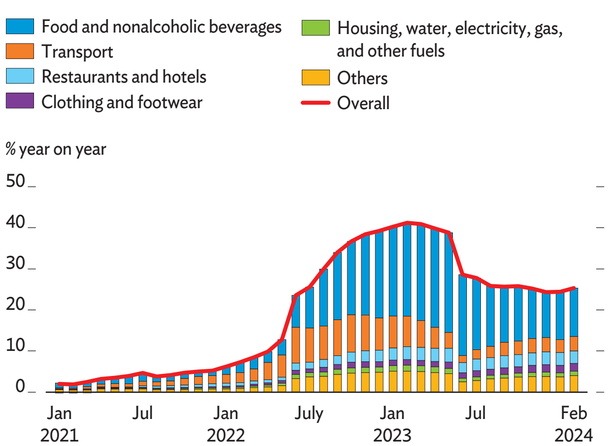
Foreign currency deposits increased as the kip depreciated.



FX = foreign exchange, M2 = broad money.
Sources: Bank of the Lao PDR; Asian Development Bank estimates.

Figure 2.25.5 Monthly Inflation

Inflation was in double digits during 2023.



Source: Lao Statistics Bureau.

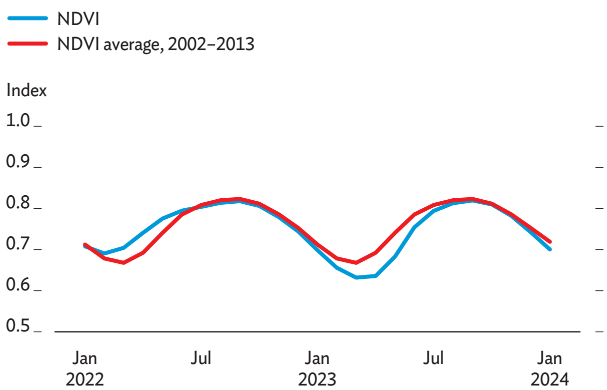
Consumer prices rose more than wages, causing real incomes and purchasing power to fall in many households. Average inflation jumped from 23% in 2022 to 31.2% in 2023, with lags in imported price adjustments and higher domestic prices driving the increase. Prices for rice, sugar, oil, and chicken doubled over the course of 2023. Rising prices for food, hotels, and restaurants coupled with a weak kip pushed the inflation rate to a high of 41.3% in February 2023 before moderating to 24.4% in December (Figure 2.25.5). With household purchasing power declining, school dropouts increased, with as many as one in three children of lower secondary school age not attending school—twice as many as the average lower-middle-income economy. With the kip depreciation, differentials between the statutory monthly minimum wage in the Lao PDR and Thailand have widened, now equivalent to $71 and $225, respectively. As a result, as many as one in eight Lao PDR workers have migrated across the border for work, creating skills and labor shortages in the domestic labor market.

The late start of the 2023 monsoon season delayed cultivation while low rainfall reduced hydropower output. The growing season was delayed due to below-average rainfall, as indicated by the Normalized Difference Vegetation Index (Figure 2.25.6). Other factors affecting agriculture production were labor shortages and rising input costs. Despite poor weather, the country benefited from strong external demand for cash crops, with exports of cassava and sugar rising from $616.9 million in 2022 to $707.7 million in 2023. However, the benefits were partially offset by high prices for agricultural inputs. Hydropower generation suffered from low rainfall, with electricity output contracting by 4.1% to 46.8 million kilowatt-hour compared to 2022 (Figure 2.25.7). Electricity exports reached $2.4 billion, while imports were $117 million, up from $40 million in 2022.

The private sector recovery remained subdued. Total domestic credit, particularly to the private sector, decelerated in 2023, largely due to lower kip lending (Figure 2.25.8). Businesses across the economy reported difficulty in timely access foreign currencies to support operations. Nonetheless, mining continued to be strong, with mineral output increasing in 2023—especially gold bullion, gold ore, iron ore, and potassium. Gold ore and bullion exports earned $703 million, with iron ore exports at $410.6 million

Figure 2.25.6 Normalized Difference Vegetation Index

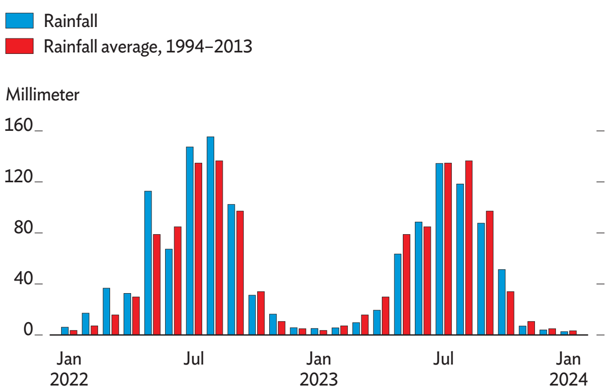
Crop planting was delayed in 2023 by the late monsoon.



NDVI = Normalized Difference Vegetation Index.
Sources: World Food Programme; Asian Development Bank estimates.

Figure 2.25.7 Rainfall

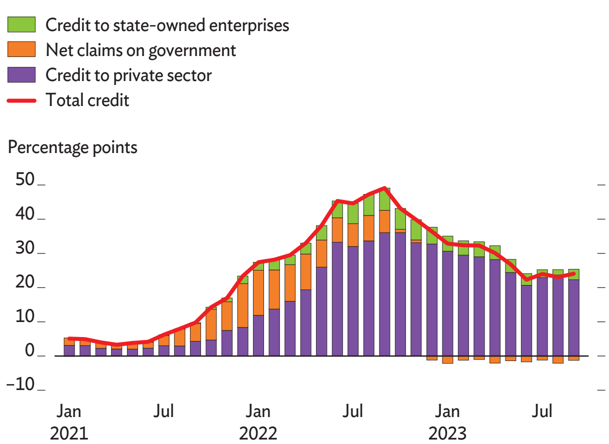
Rainfall fell below the 20-year average in 2023.



Sources: World Food Programme; Asian Development Bank estimates.

Figure 2.25.8 Credit to the Economy

Credit growth decelerated.



Sources: Bank of the Lao PDR; Asian Development Bank estimates.

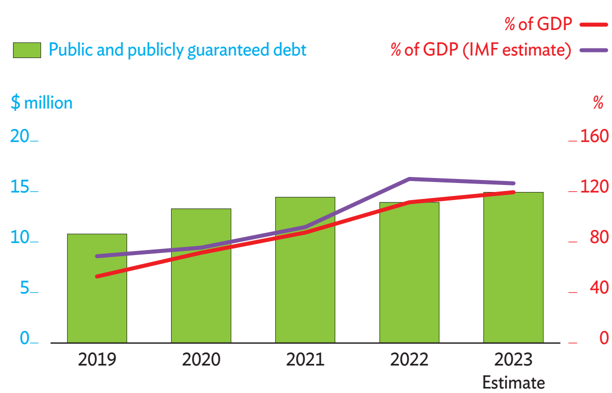
and potassium salt at $400.9 million. This helped to create a small trade surplus of $112 million. Overall export of goods reached $9.6 billion in 2023, an increase of 0.3% from 2022, while goods imports cost $9.5 billion, an increase of 7.4% from 2022. Imports included $1.2 billion for diesel and gasoline.

High debt and debt servicing persisted amid low foreign reserves. As the Lao PDR's ability to service its debt deteriorated, the Thai Rating and Information Services lowered its rating for the sovereign from BBB− to BB+—which closed Thailand's bond market for the Lao PDR government and its state-owned enterprises. Public and publicly guaranteed debt to GDP was estimated above 120% in 2023, with liquidity pressure mounting from scheduled debt servicing requirements averaging more than 10% of GDP annually during 2024–2029 (Figure 2.25.9). Gross official reserves, including a $0.8 billion currency swap with the People's Bank of China, were reported at $1.8 billion as of end-September 2023, equivalent to 2.3 months of imports (Figure 2.25.10). The IMF Article IV 2023 report assessed the Lao PDR as being in debt distress with an unsustainable debt burden.

Expenditure control kept the fiscal deficit from rising further. The fiscal deficit expanded to 2.0% of GDP in 2023 from 0.2% in 2022 as allowances for civil servants increased to offset the rising cost of living and government debt servicing. Overall expenditure was restrained in the first 10 months of 2023, with capital spending reaching only KN27.8 trillion or 62% of the annual plan. Revenue collection

Figure 2.25.9 Public Debt

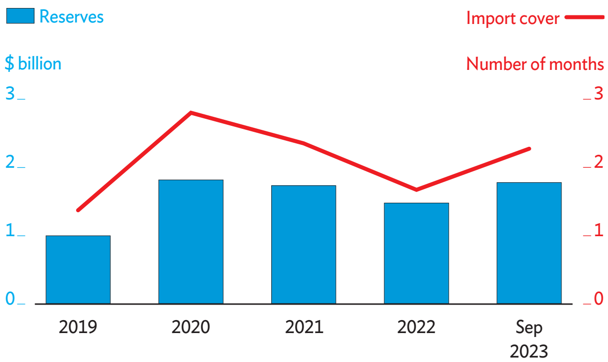
Public debt reached a critical level.



GDP = gross domestic product, IMF = International Monetary Fund.
Sources: IMF; Ministry of Finance; Asian Development Bank estimates.

Figure 2.25.10 Reserves and Imports

Reserve coverage is inadequate.



Sources: Bank of the Lao PDR; Asian Development Bank estimates.

reached KN32.5 trillion or 85% of the plan. The fuel exemption cost the budget KN3.5 trillion or 9.2% of the budget. Deficit financing was supported by bond issuance and central and commercial bank lending to the government.

Economic Prospects

A moderate recovery is projected, with GDP growth at 4% in 2024 and 2025, supported by external demand (Table 2.25.1). Growth in services, including trade, transportation, and logistics, is set to continue with increasing tourist arrivals. Foreign investment will continue to finance logistics and renewable energy projects. However, domestic consumption and investment will continue to be affected by macroeconomic pressures stemming from unsustainable debt, with inflation high and fiscal policy tight, which will constrain the overall economic recovery.

Table 2.25.1 Selected Economic Indicators, %

The outlook is for a moderate growth recovery amid continuing high inflation.

	2022	2023	2024	2025
GDP growth	2.5	3.7	4.0	4.0
Inflation	23.0	31.2	20.0	7.0

GDP = gross domestic product.
Sources: Lao Statistics Bureau; Asian Development Bank estimates.

External demand from tourism and logistics will support services. With open borders and major connectivity infrastructure upgrades complete, particularly the Lao PDR–PRC Railway, international tourist arrivals are projected to increase from 3.4 million to 4.2 million in 2024. With the Lao PDR the Association of Southeast Asian Nations Chairman in 2024, tourism and other hospitality-related businesses should benefit. The Thanaleng dry port, part of an integrated logistics park in the capital, Vientiane, closed a 10-year $67 million loan facility in January 2024, which will boost trade.

Foreign investment in renewable energy will help drive moderate industrial growth. The Lao PDR continues to attract new investment for clean energy exports. In 2023, the $4.0 billion Pak Lay and Pak Beng Hydropower projects totaling 1.7 gigawatt (GW) were signed. Investments for 2GW in wind power are expected for 2024 and 2025. The direct and indirect effects of these investments will support moderate growth in construction, including the expected completion of the Monsoon Wind Power Project by 2025.

Climate risk remains a concern for agriculture. El Niño weather conditions weakened in the first quarter of 2024, but lingering effects will likely lead to above-normal temperatures, influencing rainfall patterns in 2024. There is a chance of a shift to a La Niña weather pattern toward the end of 2024, adding the risk of flooding in 2025. High input costs, labor shortages, and disaster risk weigh on prospects for improved agricultural production. However, external demand for agriculture commodities should remain robust, especially for cassava, banana, and livestock, which have received higher import quotas under bilateral trade agreements with the PRC, Thailand, and Viet Nam.

Regional demand for goods and services will allow a small trade surplus. Regional tourism and export demand for electricity, minerals, and crops are expected to offset import demand to put the overall trade balance in surplus. Imports will likely be subdued by a weaker kip and higher excise charges.

Inflationary pressures will persist due to continuing macroeconomic imbalances. Consumer prices are projected to rise an average of 20% in 2024 before moderating to 7.0% in 2025. Prices are expected to continue to rise as businesses pass on costs linked to currency depreciation from imported goods and wage adjustments. Inflation is projected to gradually return to single digits by 2025, assuming continued tight monetary and fiscal policy as well as effective implementation of Prime Minister's Order No. 10 (2023) that introduced reforms on foreign currency use and export earnings repatriation.

Fiscal and monetary policy will remain tight amid debt stress. The government has reduced external borrowing to improve its debt sustainability and fiscal position. The return of the value added tax rate to 10% in March this year will help reach the target of a primary surplus over the next 2 years. However, despite compressed capital spending, the overall fiscal deficit will be around 2.5% of GDP this year and next due to high debt service payments.

Liquidity constraints due to unsustainable debt remain a key risk. Macroeconomic instability—from debt stress, inadequate foreign exchange reserves, and incomplete reforms—are key risks to economic recovery. In addition, state-owned enterprises face increased refinancing risks, and banking liquidity constraints may hinder private sector recovery. A slower-than-expected recovery in neighboring economies and higher-than-expected commodity prices remain key external risks to the outlook.

Policy Challenge—Addressing Macroeconomic Imbalances Key to Tackling Food Security

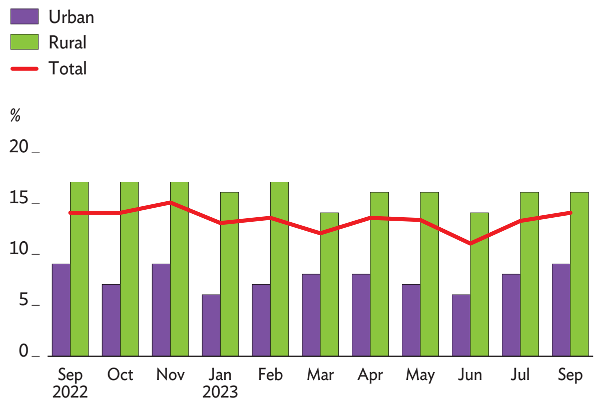
Food insecurity persists. As many as one in seven of the population had to deal with food insecurity in 2023, with rural dwellers twice as likely as urban dwellers to face shortages (Figure 2.25.11). About two-thirds of the population live in rural areas, with many working in agriculture. Yet agriculture contributes only 15% to GDP. Therefore, earnings and farm incomes remain low, and many lack access to enough safe and nutritious food to meet their dietary needs.

Worsening macroeconomic imbalances have affected food security. While household location and livelihood are important determinants of food insecurity, the country's worsening macroeconomic imbalances—notably rising public debt, steep currency depreciation, and elevated inflation—have contributed to persistent food and nutrition challenges. High food inflation is of particular concern, averaging 39.5% in 2023 (Figure 2.25.12). This has reduced purchasing power, affecting almost all households, with half forced to devise food-coping strategies, such as reducing food consumption and meal frequency to bridge their nutritional needs.

Food insecurity and poor nutrition come at a high cost. There are serious long-term consequences associated with households responding to current

Figure 2.25.11 Share of Population that are Food Insecure, 2022–2023

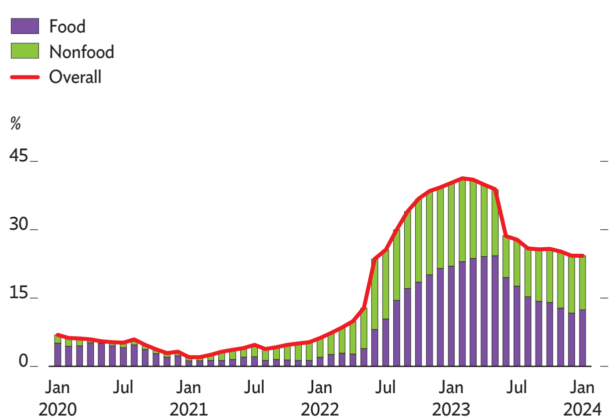
One in seven are food insecure.



Source: World Food Programme. 2023. Lao PDR: Food Security Monitoring—Remote Household Food Security Survey Brief. Vientiane.

Figure 2.25.12 Inflation

High food inflation has contributed to persistent food and nutrition challenges.



Source: Lao Statistics Bureau.

stress by reducing food quality and quantity, including malnutrition-related issues—such as stunting—that can reduce the lifetime productivity of a child. With a children-under-five stunting rate of 32.8%, among the highest globally, malnutrition is estimated to cost the Lao PDR 2.6% of GDP annually.

Measures have been taken to respond to recent household stress. To help address worsening food and nutrition security linked to inflationary pressures, the Ministry of Agriculture and Forestry raised grant financing from the Global Agriculture and Food Security Program to bring down the cost of essential farm inputs, such as pesticides and fertilizers, and promote climate resilient farming by providing grants. The government is also working with development partners using multisectoral approaches to help improve food security and nutrition. These include expanding social assistance, improving health services, and investing in clean water and sanitation.

Moving forward, longer-term sustainable financing mechanisms are needed to address the multidimensional nature of food insecurity within the context of macroeconomic instability. This includes reforms to address the country's economic and financial challenges and continuing to upscale nutrition-sensitive and climate-resilient social assistance. The multisectoral response program must also include strategies to improve rural livelihoods, including solutions for low agricultural productivity and insufficient access to agriculture credit. Improving farmers' access to financial services—including microfinance, microinsurance and adapting financial products to meet agriculture cashflow needs—are part of a broader suite of solutions to address these systemic issues.