

Economic reform initiated

The economic development of Laos is influenced by the political system, the ongoing transition to a market economy, weak public finances and major investment needs. The economy has experienced high growth for an extended period, albeit from a low level. Hydropower and mining have come to serve as the backbone of the economy, as these are sectors that attracted substantial international investments. The energy exports of Laos are crucial for the country's foreign exchange earnings and for the public finances. The country's debt is high, making Laos vulnerable to both exchange rate fluctuations and additional borrowing needs. In the long term, the significance of the energy sector is expected to increase, while the country's dependence on concessional lending and development assistance is expected to decrease.

THE COUNTRY'S STRENGTHS AND WEAKNESSES

Strengths

- Initiated economic reform.
- Rich natural resources such as hydropower, metals and minerals.
- Good relations with donors and an active member of regional and global organisations.

Weaknesses

- A small, vulnerable economy with low GDP per capita.
- High public external debt and very limited international reserves.
- Highly volatile government revenue given dependence on commodity price fluctuations.
- A difficult business environment due to widespread corruption, regulations that are difficult to navigate and a weak and politicised judiciary.

Restrictive policy

The country has been in country risk category 7 since EKN first categorised it in 1999. This categorisation applies to both short and long guarantees – an assessment made in collaboration with the other OECD countries. EKN is cautiously open to guaranteeing transactions with all types of buyers (the sovereign, public buyers, banks and companies).

WHAT MIGHT CAUSE A CHANGE IN THE COUNTRY POLICY?

The policy may be made less restrictive in the event of

- The country managing to reduce economic imbalances in the long term and strengthen the economy's resistance via prudent economic policies.
- The strengthening of the transition toward a modern market economy and substantial simplification and improvement of the country's business environment.

The policy may be made more restrictive in the event of

- A return to public spending that is too high, increasing the country's already high debt.
- A loss of development assistance, multilateral financing or foreign direct investment that impacts the country's ability to manage its debts.
- A conflict with neighbouring countries, concerning matters such as the expansion of power plants along the Mekong River which inhibits the country's export revenue capacity.

EKN'S EXPOSURE AND EXPERIENCE

Low number of guaranteed transactions

The demand for guarantees to cover export transactions with Laos has been very limited. EKN thus has very little experience in guaranteeing transactions. The outstanding volume of guarantees at 31 March 2016 was SEK 104 million.

COUNTRY ANALYST



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Background

Laos is in a transitional phase from a socialist planned economy to a market economy with communist leadership. The country has rich natural resources in the form of metals, minerals, timber and in particular hydropower. Tourism is also beginning to bring in rising export revenue for the country. The political situation in the country has restricted economic growth due to a civil war that lasted over 20 years after independence from France in 1953 and the fact that the country was dragged into the Vietnam War. The communist guerrilla movement took power in 1975 and is currently known as the LPRP, the only political party allowed. The monopoly of power and suppression of opposition creates a hotbed for discontent and thus also a greater risk of political instability. The country experiences protests by groups critical of the regime and incidents of armed resistance.

In recent years, Laos has actively sought to be involved in global contexts and reduce its isolation. The country is a member of regional organisation ASEAN (1997) and the WTO (2013). The country's relations with its closest neighbours as well as India and China are good overall. Relations with the US have improved and the country has been visited by both Hillary Clinton (2012) and John Kerry (2016).

The IMF concluded in its most recent review of the country (Feb 2015) that there are serious deficiencies in data and statistics collection. The deficiencies are related to both collection and processing and the fact that there are often long lead times, which results in newly published data already being out of date. Nevertheless, the IMF forecasts and estimates are considered the most reliable and are the ones that have been used.

Recent development

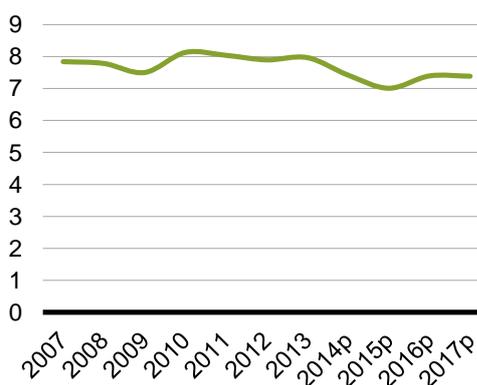
The country's economic growth is based on a very small and still undeveloped economy. Laos is included in the UN's group of least developed countries and the country is aiming to rank outside of that group by 2020. Economic growth is planned in five-year plans on the basis of a long-term vision for the country

A draft of the 2016-2020 plan shows continuing strong focus on high growth (>7.5 per cent per year), an increase in trade and slightly better balanced public finances. The country aims to pursue more responsible economic policies by adopting limits for how high the budget deficit may be.

The country is expected to continue receiving aid from its donors and multilateral partners for yet some time. Aid in the form of donations accounted for 7% of imports in 2014 while non-commercial lenders account for more than one third of the country's new loans.

Continuing growth is expected to come from expansion of the energy sector. Access to the Mekong River has fostered the expansion of power plants and electricity exports to nearby

HIGH GDP GROWTH (%)

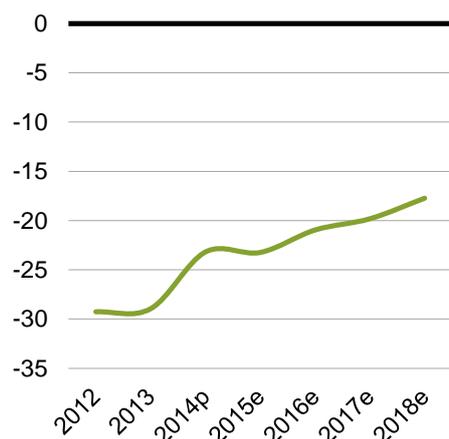


Growth has been stable, even during the financial crisis. Source: IMF World Economic Outlook, April 2016.

countries. Infrastructure investments in the sector mainly come from Thailand, which is also the main destination of these exports. Hydropower is expected to serve as the foundation of the economy going forward.

Although the expansion of hydropower is positive for the economy, it also generates trade imbalances. Capital good imports are not offset by the unrefined exports and the country

CURRENT ACCOUNT BALANCE (% of GDP incl. development assistance)



The deficit remains large even though it is trending towards reduced deficits. Source: IMF World Economic Outlook, April 2016.

shows a major trade deficit which impacts its

current account balance. More than half of the current account deficit is financed by foreign direct investment, which is thus very important for the country to maintain its ability to pay. The IMF forecasts that the current account deficit will continue to be very high due to the country's strong investment phase. It is expected to decrease to around 20 per cent of GDP, from the current high level of 25 per cent of GDP. On the other hand, the country is seeing an increasing inflow of investments mainly from Thailand, Vietnam and China. These investments do not only go to the power sector, but also the property and construction sectors. There are also investments in the banking system.

The IMF's calculation method estimates that the country's international reserves cover barely more than one month of imports, in comparison to the recommendation of four import months. The combination of a regulated exchange rate, which is considered slightly overvalued, high debt in hard currency and low reserves make external liquidity a substantial weakness for the country. The weak confidence in the country's currency is also reflected in the high dollarisation of the economy.

The country's membership in ASEAN also gives it access to the *Chiang Mai Initiative Multilateralization (CMIM)*. This multilateral arrangement entails the ASEAN countries and Japan, China and South Korea accumulating international reserves from which the members can gain access to greater international reserves than their own when needed. In addition to the CMIM, there is also an option to seek support from the IMF in the event of a temporary liquidity crisis. This can be used as a tool to reduce the risk of a balance of payments crisis to a certain extent.

Laos has not had control over its public finances and arrears have occurred due to lacking liquidity. Civil servants have received generous pay increases in certain years and have not been paid on time on other occasions. Unfortunately, the public budget deficit is still large and the country's debt has skyrocketed as a result. The 2015 budget deficit is expected to come in at over 5 per cent of GDP and fluctuate within an interval of 6 to 7 per cent over the coming years. In spite of the rapid GDP growth, the public debt will continue to increase as a percentage of GDP.

The public debt is high, amounting to 60 per cent of GDP (2014). External debt accounts for over 80 per cent of the total public debt, but this is mainly multilateral debt to the Asian Development Bank and the World Bank. The remainder consists of bilateral debt, mainly to China, Russia, Thailand, Japan and South Korea. The debt service ratio is low thanks to the overall favourable debt profile, with preferential conditions and long credit periods. However, debt service as a percentage of international reserves accounts for a substantial share. Laos has never been forced to suspend or renegotiate its payments.

Long-term trends

There is no doubt that Laos' economy has great potential in terms of exploitable natural resources, a favourable position in a dynamic region and proximity to major manufacturing centres. In addition, the country has embarked on economic reform. But high infrastructure investment needs and action to improve the educational system and the health sector will result in public spending that will not be matched by public revenue. As a result, development assistance will continue to play a key part in the country's financing. Development assistance is expected to continue for a certain period of time and then gradually be phased down as the country's level of development and income increases. The high public external debt and the country's limited international reserves will continue to be vulnerabilities.

Overall, the economy is still underdeveloped and the biggest challenge for the future is considered pursuing responsible economic policies which do not jeopardize the country's debt sustainability in the long term. The party has a strong grip on power and this is likely to remain the case, as there is still no organised opposition.

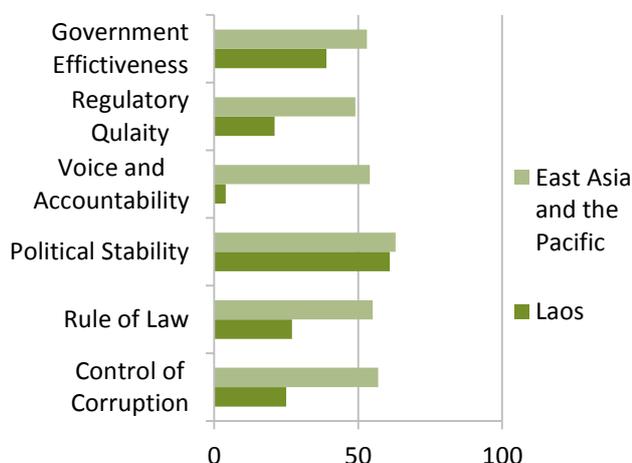
BUSINESS ENVIRONMENT

Difficult business environment

The country has begun modernising its economy and transitioning to a market-oriented economy. A national loan register and 13 economic zones have been established as part of this process. The country plans to simplify and improve entrepreneurship and also offer

BUSINESS ENVIRONMENT

Ranking from 0 (worst) to 100 (best)



Performance of Laos' business environment in comparison to the average in East Asia and the Pacific Source: Governance Indicators 2015, World Bank.

preferential conditions in the economic zones. In the long term, Laos sees itself as a key supplier, or, in the even longer term, an alternative to manufacturing companies in Vietnam and Thailand. The goal for what is to be achieved has been set out and the first steps have been taken, but the business climate is still ranked low. The World Bank's Doing Business Index ranks the country 134th out of 189 countries and Transparency International's corruption index also indicates widespread corruption problems (139th out of 168).