

**Swiss Agency  
for Development  
and Cooperation  
(Laos Program)**

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# Lao PDR Macroeconomic Monitor

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**A Biannual Report**

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September 17, 2012

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## **An Executive Summary:**

In 2011, the Lao economy experienced another robust growth, estimated between 7.8% (by ADB) and 8% (by WB), despite the damages caused by Haima and Nock Ten typhoons and the global economic uncertainties. Although the duo storms had reduced wet season rice output by as much as 18.4% in the affected provinces, where 63.4% of wet season rice was produced in 2010, and upland rice output by 11.5%, the damages were offset by growth in other regions and the country's total rice output was reduced by just 0.2%. Nonetheless, the agricultural sector as a whole grew 2.7% in 2011, mainly due to other food crops, fishery, livestock and cash crops such as coffee and tea. Main contributors were industry and service sectors, which respectively expanded 14.6% and 8.1% and each carried 35.5% and 37.1% weight in GDP. Main growth drivers in the industry sector were electricity, manufacturing and construction. In the service sector, growth leaders include hotels and restaurants, financial intermediary, real estate and transport. This robust growth trend is expected to continue in 2012, with a rebound of mining, which paused in 2011, with 5.2% growth rate.

The employment situation is unclear due to the lack of a monitoring system. While a robust growth in GDP should have created more room to absorb new entries in the labor market, job creation may have been lagging behind new entries due to two main reasons. First, the country has proportionally large rural population at a prime age to enter the labor market and do not attend school beyond the lower secondary level. Second, GDP growth has been highly concentrated in the capital-intensive resource sector. Poverty in general has reduced as a result of sustained high economic growth, but income inequality has most likely been worsened due to low growth in the agricultural sector, where 77% of the population depending on, and the lack of growth diversification in the non-agricultural sector.

Inflation, measured by the CPI, has declined from an annualized rate of 7.9% in November 2011 to 3.6% by June 2012, due mainly to declining fuel prices and rate of food price inflation. Growth in broad money supply M2 has fallen from an annualized rate of 40.9% in June 2011 to 25% in December 2011, reducing money-induced inflationary. Total credit growth decelerated from 46% in 2010 to an annualized rate of 38% by the end of 2011. Credit growth to the private sector decelerated from 34% in 2010 to 23.4% in 2011. However, credit to SOEs has accelerated moderately from 53.4% in 2010 to 60.8% in 2011, mainly due to loans to Lao Airlines to finance the purchase of two Airbus aircrafts. The deceleration of lending to the private sector was a result of long-term deposit constraint and, also, as a result of the BOL reducing direct lending to infrastructure projects and measures the bank took to curtail lending for real estate speculation. ADB also indicates that the BOL is targeting to limit credit growth to 28%.

Government fiscal conditions are generally in good shape, with growing revenues from both the resource sector (mining and hydropower) and non-resource sector, but the relative importance of the resource sector is growing. Government revenue from domestic source rose to 16.8% of GDP in 2011 and is expected to rise only slightly to 16.9% in 2012. Revenue from taxes accounts for 15% of GDP in 2011, growing from 12.5% of GDP in 2008. Government's fiscal expenditures account for 23.9% of GDP in 2011 and is expected to rise to 25.2% in 2012. Deficit spending has been kept below the 5% fiscal deficit limit the government is committing to.

Foreign aids filled the gap between total fiscal expenditures and fiscal deficit plus revenue from domestic source.

Lao gross domestic savings slightly declined from 21.96% of GDP in 2010 to 21.23% in 2011, according to the WB. However, gross savings as a percent of GDP was likely growing in 2012, as WB's report indicates strong growth in the overall bank deposit that was accompanying high GDP growth. Private investment of foreign capital has been growing, as gross FDI grew from \$770 million in 2010 to \$1,157 million in 2011 and is predicted to grow to \$1,580 million in 2012.

The country's financial sector, which is still relatively small, is expected to continue to grow and improve, with growth trend widely expected to continue in the coming years, growing deposits, and efforts by the central bank to improve supervisory and transparency. The commercial banking industry, dominated by four state-owned commercial banks (SOCBs) with 60% of total assets in the country's commercial banking industry, grew rapidly since 2007, with entries on private local banks and more foreign banks. However, private banks' asset size grew substantially in 2011, by 57% in comparison to 30% of the whole banking industry. As of December 2011, the banking sector as a whole gained 15.35% of cumulative capital. Non-performing loans has reduced from 3.2% in 2010 to 2.18% in 2011, much due to rapid expansion of new loans, which raises the base of total outstanding loans. With growing competition in the industry, access to finance has increased as banks setting up more branches and service units and installing ATMs throughout the country. Access to finance by the poor has also slowly improved as the microfinance sector has about doubled its assets in the past several years, but coverage remained very low, with only 82,000 customers in total served in 2011.

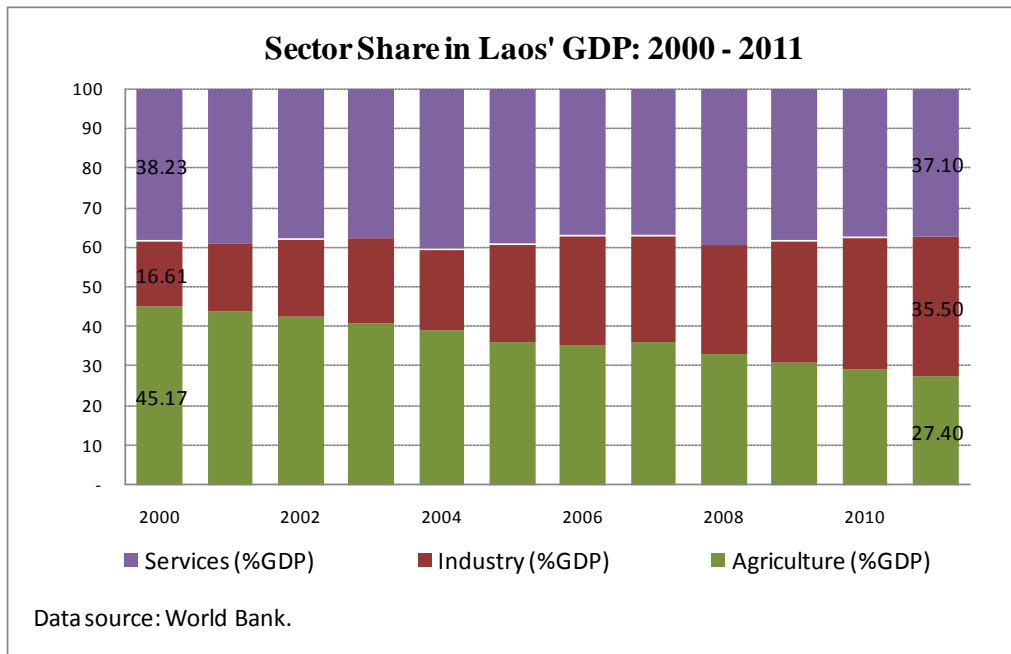
Laos' international trade has been growing with deteriorating trade balance. Although the country's exports grew, from \$US2,149 million in 2010 to \$US2,644 million in 2011 and is forecast to grow to \$US3,077 in 2012, imports grew even faster, as a result of increased foreign capital inflow and the need to import machinery and equipment for investment projects. Thus, import-export ratio rose from 1.20 in 2010 to 1.31 in 2011 and is expected to rise to 1.34 in 2012. The economy has been growing slightly in openness to the global system, with openness measure growing from 0.678 in 2010 to 0.757 in 2011 and is expected to grow to 0.763 in 2012. International and domestic trade barriers, overall, have most likely been slightly lowered as the country was preparing to become a member of the WTO and for ASEAN Economic Community while there have been some government measures recently issued in contradiction to liberalizing trade regime. Foreign exchange reserve slightly declined from \$US729.9 million, equivalent to about 3.2 months of imports, in 2010 to \$678.8 million, which can cover 2.2 months of imports in 2011, and is expected to be roughly the same in 2012. Laos' total external debt in 2011 rose 12.1% to \$US7,429, accounting for 92.2% of GDP, and it is expected to grow further to \$US8,612 million (90% of GDP) in 2012. Public and publicly guaranteed external debts account for 47% of the country's total in 2011. External debt service ratio as a percent of the country's exports, however, reduced from 13.4% in 2010 to 12.8% in 2011, and is expected to lower to 10.8% in 2012.

## Production

In 2011, the Lao economy experienced another robust growth, estimated between 7.8% (by ADB) and 8% (by WB), despite the damages caused by Haima and Nock Ten typhoons and the global economic uncertainties.<sup>1</sup> High growth in 2011 was mainly contributed by the industry sector, which grew 14.6%, particularly electricity, manufacturing and construction, and service sector with 8.1% growth rate. High growth contributors in the service sector include hotels and restaurants, financial intermediary, real estate and transport. This trend is expected to continue in 2012, with a rebound of mining, which paused in 2011, with 5.2% growth rate, after a robust growth of 12.6% in 2010.<sup>2</sup>

In 2012, the country's GDP is expected to grow slightly higher than in 2011, between 7.9% (ADB) and 8.3% (WB), despite global uncertainties relating to the European Union economic crisis and weak global economic performance.<sup>3</sup> Strong FDI inflows, growth in the mineral and power sectors, manufacturing, services and construction, and continued foreign aid inflows are likely to be among the major contributors to sustain high growth in 2012. The Lao economy has been undergoing rapid structural transformation over the past decade (Figure 1), with continual decline in the share of agriculture while industry share was growing rapidly, especially since 2005, and this trend is likely to continue for some time.

Figure 1.



<sup>1</sup> Lao PDR Economic Monitor May 2012 – Update, World Bank; Asian Development Outlook 2012, Lao People's Democratic Republic, Asian Development Bank.

<sup>2</sup> According to the *Statistical Yearbook* (August 2011), Lao Statistics Bureau.

<sup>3</sup> Lao PDR Economic Monitor May 2012 – Update, World Bank; Asian Development Outlook 2012, Lao PDR, Asian Development Bank. However, with China's recent reports of slowing down, Lao DGP growth is remained to be seen.

**Agricultural sector:** Agriculture in 2011, with 27.4% share of GDP, was setback by Nock Ten and Haima typhoons that occurred between July and August. Although the sector as a whole grew slightly, at 2.7%, wet season paddy and upland rice were badly affected by the storms, with an estimate of more than 89,000 hectares of crops damaged, accounting for 10.4% of total rice harvested area in 2010.<sup>4</sup> The storms caused damages to wet season rice production mainly in the central provinces of Bolikhamxay, Khammouane and Savannakhet. As a result of the storms, wet season rice output in 2011 was reduced by 31% in Bolikhamxay and by 65% in Khammouane, compared to the province's own 2010 total output.<sup>5</sup> Savannakhet, where about a quarter of the country's wet season rice was produced in 2010, had a decline of 16%, from 570,130 tons in 2010 to 479,480 tons in 2011. Other provinces that experienced a decline in wet season rice production as a result of the 2011 storms include Vientiane Province (-6%), Vientiane Capital (-8%) and Sekong (-6%) in the south, and two Northern provinces of Bokeo and Luangprabang, with each suffered a 2% decline. The combined damages caused by the storms to wet season rice output in these provinces, where 63.4% of the country's total wet season rice was produced in the season prior to the storm, was a drop of 18.4% compared to their 2010 total output.<sup>6</sup> However, nationwide, wet season rice output declined by only 0.3%, from 2.331 million tons in 2010 to 2.323 million tons in 2011, due to output growth in other provinces, especially in Champasak Province, as a combined result of crop land expansion and productivity gain and rebound from 2010 unusually low yield.<sup>7</sup>

Upland rice, normally grown by poor ethnic minorities, total output declined 11.5%, from 226,880 tons in 2010 to 202,250 tons in 2011, with 11 provinces experienced output decline. Provinces in the north, where most upland rice was grown, suffered the most.

However, irrigated rice output increased 5.3%, from 512,430 tons in 2010 to 540,315 tons in 2011, partially offsetting the decline in other categories. Thus, total rice production from all categories declined only 0.2%, from 3.07 million tons in 2010 to 3.066 million tons.

Other food crops output volume expanded in 2011. Maize grew 7.1% (from 1.021 million tons in 2010); starchy roots grew 42.5% (from 725,925 tons in 2010); vegetables and beans, peanuts, soybeans and mungbeans together grew 25.9%. See Table for details.

Fishery also grew quite substantially, with culture fishery production growing 15.2%, mainly contributed by Vientiane Capital's nearly doubling its production from 15,700 tons in 2010 to 27,837 tons in 2011, accounting for about 28% of total national culture fishery production.

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<sup>4</sup> The estimate of damaged cropland area is government report cited in the WB's Lao PDR Economic Monitor (December 2011). The cropland area damaged as a percent of rice land is estimated using more updated agricultural data from *Statistical Yearbook 2011*.

<sup>5</sup> As a result of the typhoons, Khammouane's wet season rice harvested area was reduced from 54,037 ha (2010) to 29,326 ha (2011) and output, from 1885,550 tons to 96,565 tons.

<sup>6</sup> According to the *Statistical Yearbook 2011*, wet season rice output in Bokeo, Luanprabang, Vientiane Capital, Vientiane Province, Bolikhamxay, Khammouane, Savannakhet and Sekong together was 1.487 million tons in 2010; it reduced to 1.238 million tons in 2011.

<sup>7</sup> Champasak had a bad year in 2010, with average yield of only 2.77 tons per ha. The province's yield bounced back to its normal yield of about four tons per ha in 2011, and harvested area also increased 18.5%, as suggested by a report in the *Statistical Yearbook 2011*.

Capture (river) fish is also reported to have increased 10% in 2011.<sup>8</sup> Livestock also experienced growth, particularly in the number of heads of buffalo, cattle, goat and sheep, and poultry. Sugarcane production grew 40.1%, from 818,675 tons in 2010, mainly due to land expansion in Savannakhet and Attapeu provinces. Coffee and tea production volume also grew respectively by 11.7% and 32%.<sup>9</sup>

Table 1.

	Changes in Staple Crops and Other Common Food Crops: 2010 - 2011							
	Harvested Area (ha)			Output (metric tons)			Yield (ton/ha)	
	2010	2011	Change	2010	2011	Change	2010	2011
<b>Rice</b>	<b>855,114</b>	<b>817,250</b>	<b>-4.4%</b>	<b>3,070,640</b>	<b>3,065,760</b>	<b>-0.2%</b>	3.59	3.75
Season Rice	627,865	598,358	-4.7%	2,331,330	2,323,195	-0.3%	3.71	3.88
Irrigated Rice	108,410	112,210	3.5%	512,430	540,315	5.3%	4.73	4.82
Upland Rice	118,839	106,682	-10.2%	226,880	202,250	-11.5%	1.91	1.90
<b>Maize</b>	<b>212,745</b>	<b>212,105</b>	<b>-0.3%</b>	<b>1,020,875</b>	<b>1,096,235</b>	<b>7.1%</b>	4.80	5.17
<b>Starchy Roots</b>	<b>40,840</b>	<b>58,120</b>	<b>42.3%</b>	<b>725,925</b>	<b>1,110,530</b>	<b>42.5%</b>	17.77	19.11
<b>Veg., Beans &amp; Nuts</b>	<b>160,220</b>	<b>176,250</b>	<b>10.0%</b>	<b>1,014,515</b>	<b>1,314,175</b>	<b>25.9%</b>	6.33	7.46
Veget. & Beans	126,270	130,640	3.5%	947,670	1,225,370	25.7%	7.51	9.38
Peanuts	23,570	32,780	39.1%	50,945	70,195	32.1%	2.16	2.14
Soybeans	7,235	9,145	26.4%	11,435	13,820	18.9%	1.58	1.51
Mungbeans	3,145	3,685	17.2%	4,465	4,790	7.0%	1.42	1.30

Source: Ministry of Agriculture and Forestry, in *Statistical Yearbook 2011*.

**Industry sector:** In 2011, the industry sector as a whole grew 14.6%, accounts for 35.5% of GDP growth.<sup>10</sup> However, growth in recent years has been highly concentrated in the resource sector—hydropower and mining, with the construction sector emerging.

Although growth in mining output has slowed from 49.3% in 2009 to 12.6% in 2010 and to 5.2% in 2011, it is not a trend and it does not indicate that mining in Laos is in decline.<sup>11</sup> Wide variation in mining output, which tends to swing with world market price and some other technical reasons, is normal. Mining output, which is accounted for 7.5% of GDP in 2011 (dropped from 9.3% in 2010) is expected to rebound in 2012, and it is expected to continue to be a major growth contributor to GDP for a number of years ahead.

<sup>8</sup> *Statistical Yearbook 2011*. Normally, the amount of capture fish and the level of river water are positively correlated.

<sup>9</sup> Most coffee in Laos is produced in Champasak Province, with 68.3% share of the country's 2011 total, followed by Saravanh, with 24.5% share in the same year, according to *Statistical Yearbook 2011*. About 95% of tea production in Laos, in 2011, was produced in Phongsaly, Odomxay and Luangprabang.

<sup>10</sup> There is quite a big gap between the industrial share figures reported by the WB (35.5%), in WB's Economic Monitor (May 2012), and by the Lao Statistics Bureau (27.3%), in the *Statistical Yearbook 2011* (August 2012). The difference is due to definition, whereas the Statistics Bureau reports "Taxes on products and import duties" as a separate category, which accounts for 6.2% of GDP in 2011, while the WB includes the "Taxes on products and import duties" in "Industry" and "Service" sectors. Thus, the WB reports the service sector had 37.1% share in 2011 GDP while the Statistics Bureau reports 39.1%; and for agriculture, the WB and the Statistics Bureau reported an identical figure of 27.4%.

<sup>11</sup> All figures are from *Statistical Yearbook 2011*.

Electricity and water category, which has been gaining share in GDP from 2.7% in 2009 to 4.5% in 2011, grew 29.5% in 2011.<sup>12</sup> Manufacturing grew 9.7% in 2011, although its share in GDP decreased slightly, from 9.8% in 2010 to 9.3% in 2011. Growth in manufacturing came from garment, food processing (particularly meat, drinking water, bread and candies, noodle, beer, tobacco, cassava flour, polished rice and sugar), chemicals (medicine, paint, plastic goods, leather shoes, soap, detergent powder, oxygen-Acetylene), wood furniture, articles of construction (cement, tiles, CPAC, bricks, blocks), and base metal articles (agricultural tools, electric wire, iron rod, nails). Construction sector, which has rapidly been gaining share in GDP, from 4.8% in 2009 to 5.9% in 2011, expanded 24.8% in 2011 and has continued to grow consistently at a rate of 20% and above since 2009.<sup>13</sup>

**Service sector:** The service sector in 2011, which accounts for 37.1% of GDP, as a whole grew 8.1%, with the tourism-related hotels and restaurants, financial intermediation and wholesale and retail trade as growth leaders.<sup>14</sup> Other notable fast growing subsectors include transport, storage, post and communication and real estate.

The number of foreign visitors increased 8.4% in 2011, growing from 2.513 million in 2010 to 2.724 million visitors, with Asia and Pacific (excluding the American Continent), which accounted for 90.5% of the total, growing 9.1%. Thailand continued to be a single dominant market in the Lao tourism industry, which made up 58% of the total in that year, but grew just 4.1%.

**Changes in the number of visitors in Laos: 2009 - 2011**

Origin	Number of Visitors			Change from Previous Year		Share in Total		
	2009	2010	2011	2010	2011	2009	2010	2011
Asia & Pacific	1,820,571	2,260,026	2,464,651	24.1%	9.1%	90.6%	89.9%	90.5%
Europe	130,176	178,140	181,539	36.8%	1.9%	6.5%	7.1%	6.7%
America	53,348	67,291	69,990	26.1%	4.0%	2.7%	2.7%	2.6%
Africa & others	4,268	7,571	7,384	77.4%	-2.5%	0.2%	0.3%	0.3%
<b>TOTAL</b>	<b>2,008,363</b>	<b>2,513,028</b>	<b>2,723,564</b>	<b>25.1%</b>	<b>8.4%</b>	<b>100.0%</b>	<b>100.0%</b>	<b>100.0%</b>

Source: Lao National Tourism Administration, in *Statistical Yearbook 2011*.

The number of visitors from ASEAN countries, which accounts for 80.5% of the total, grew 10.1%. ASEAN countries with relatively large numbers of visitors to Laos and with high growth include Vietnam, Malaysia, the Philippines and Singapore. The number of visitors from Japan, Korea and Australia respectively grew 11.2%, 27.1% and 4.4%, while the number of Chinese visitors dropped 6.8% from nearly 162,000 in 2010.

<sup>12</sup> Ibid.

<sup>13</sup> Ibid.

<sup>14</sup> According to the *Statistical Yearbook 2011*, hotels and restaurants, though accounts for only 0.7% of GDP, grew 13.8%; financial intermediation, with 3.7% share of GDP, grew 12.3%; and wholesale and retail trade, which accounts for 20.4% of GDP, grew 8.7%.

Due to the economic trouble in Europe, the number of European visitors, which together accounted for 6.7% of the 2011 total number of visitors in Laos, grew 1.9%, a considerable drop from 36.8% growth in 2010. The numbers of visitors from major European markets such as France, Germany, United Kingdom, Netherland, Italy and Sweden were all declined. Growth in the number of visitors particularly from Russia, Switzerland, Austria and others was more than making up for the loss from Laos' traditionally large European tourist markets. The number of visitors from the American Continent also slowed from a 26% growth rate in 2010 to 4% in 2011.

However, despite the global economic uncertainties, the tourism sector in 2012 is expected to speed up somewhat from the previous year as Laos will host the 9th ASEM Summit in November and the ASEAN University Games in December, and the country gets an international promotion of 2012 as Visit Laos Year.

## Employment

According to the *Lao Census of Agriculture 2010/11*, roughly 77% of the population was still engaging in agriculture. With limited non-agricultural job and income generation opportunity available, pre- and post-harvest seasonal unemployment is still the norm. Current unemployment situation, particularly urban, non-agricultural job is an area leading institutions (WB, ADB, ILO) and the Ministry of Labor (MoL) do not have a clear picture of, due to the lack of a monitoring system. It is most likely stable at best, due to continued economic growth, although highly concentrated in the highly capital-intensive sector. A labor survey has been conducted jointly by the ILO, National Statistics Bureau and the MoL, and the report is expected to be available later this year or early in 2013.

However, it is widely acknowledged that recently high economic growth did not create as many jobs as the number of youth entering the age of 15 years old yearly and do not attend school, which is around 115,000.<sup>15</sup> Population within the age group of 15-19 who did not attend school in 2011 is estimated at between 600,000 and 650,000.<sup>16</sup> Given that nearly 70% of the population resides in rural area and that rural and ethnic minority population tends to have higher birth rates and larger family sizes, there are proportionally more youth among rural and ethnic minority population entering working age each year. Opportunity to continue education in upper secondary school and beyond for rural youth and especially ethnic minority is much slimmer than that for urban youth. Thus, unemployment among the youth and ethnic minority may have been growing.

Imported expertise and specialized skills at various levels in virtually all sectors are necessary to meet the growing demand of the growing Lao economy. The number of both registered and unregistered foreign workers has increased, according to the MoL, although the figure is unclear, as a result of increased foreign-invested projects, growing number of large foreign-invested construction-related projects undergoing simultaneously, and of shortages of labor in

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<sup>15</sup> Estimated using population data and school enrolment data from the *Statistical Yearbook 2011*.

<sup>16</sup> There were 753,855 people aged 15-19 in 2011, according to population estimate reported in the *Statistical Yearbook 2011*, and 142,860 who would be in this age group were in upper secondary school. Thus, 610,995 of them were not in school.



rubber and coffee plantations. Official figures of registered foreign workers employed in Laos range from nearly 20,000 to more than 40,000.

## Inequality and Poverty

Per capita GNI, in current US dollar, grew 11.2% between 2010 and 2011, rising from \$US1,010 to \$US1,130.<sup>17</sup> With a slightly higher growth forecast in 2012 than in 2011, growth in GNI per capita is expected to be similar to that of 2011. The National Committee for Rural Development and Poverty Eradication (NCRDPE) suggested that poverty rate has declined, although the figure has not been confirmed yet. The view that poverty in general has declined is generally accepted, with a sustained economic growth and government's poverty reduction program that focuses on the poorest villages.

Despite that, income distribution has most likely worsen due to economic growth being highly concentrated in few sectors, mainly hydropower and mining, and the damages caused by duo typhoons last year on agriculture, where employment accounts for approximately 77% of the country's total.<sup>18</sup> The Gini Coefficient indicates that inequality has been growing, with Gini Coefficient growing from 32.6 in 2003 to 36.7 in 2008, common for growing economies in early phases of economic development with low per capita income.<sup>19</sup>

The more updated Gini Coefficient, which computed from the Lao Expenditure and Consumption Survey, conducted every five years, is expected to be available in 2014. However, if the Gini Coefficient has been growing at least at the same pace as it did between 2003 and 2008, Laos' Gini Coefficient would have grown to roughly 40 by 2012. Inequality may have grown faster after 2008, due to higher growth with sector-concentration in mining and hydropower, which could put the country's Gini Coefficient on par with China's 41.5 (2005), but still well below that of Thailand's 53.6 (2009), Malaysia's 46.2 (2009), Cambodia's 44.4 (2007), the Philippines' 44 (2006), and Singapore's 42.5 (2007).

With growing inequality, portion of GDP earned by the poorest 20% of the population has likely declined. Many poor households affected by the Haima and Nock Ten typhoons that hit the country in the second half of 2011 are in the process of recovering from the damages caused to farmland and farm infrastructure. As a result of the duo storms, access to productive land has been reduced, at least temporarily, while government is making efforts to rehabilitate irrigation, road access and the related infrastructure in the typhoon-damaged areas.

Access by the poor to means of production, particularly land, has not been even across households and geographical locations. While there have been reports of encroachment by plantations and large foreign-invested projects on local villagers' farmland, the recently released *Lao Census of Agriculture 2010/11* indicates that in the past decade the average farm

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<sup>17</sup> *Lao PDR Economic Monitor*, May 2012 and December 2011 issues, World Bank.

<sup>18</sup> *Lao Census of Agriculture 2010/11 Highlights* (May 2012), Agricultural Census Office, Steering Committee for the Agricultural Census, Department of Planning, Ministry of Agriculture and Forestry.

<sup>19</sup> Human Development Report, 2009 and 2011, UNDP. Vietnam's Gini Coefficient in 2008, at 37.6, was similar to that of Laos in the same year.

household's agricultural land grew from 1.5 ha in 1998/99 to 2.1 ha in 2010/11, with 22% of farm households having less than one ha each.<sup>20</sup> Farm households in the north tend to have smaller farmland than those in the central and southern regions. Another note worthy characteristic of farm households' land tenure is that each farm household tends to have multiple—two or three—separate farm plots, with northern provinces having more separate and smaller plots since land is more fragmented in the mountainous north.<sup>21</sup> Land was operated under an "owner-like" tenure for 93% of farm households.

Given that there has been rising land encroachment and many poor villagers have lost their lands to large plantations and foreign-invested projects involving the extensive use of land, growing land area for an average farm household can be explained by land clearing in new territories (virgin forest or unoccupied lands) as a combined result of villagers were being pushed away from their formerly occupied lands and induced by growing agricultural commercialization. The agricultural census suggests that 71% of subsistence farmers sold some of their harvests in 2010/11; only 35% of them did so in 1998/99. Market incentives may have encouraged villagers to clear more land in unoccupied areas for farming. Access by the poor to means of production through credits may have been slowly improving due to increased competition in the commercial banking sector for geographical coverage and a gradual expansion in microfinance services.

Although GNI per capita at current price grew 11.2% on average between 2010 and 2011, food basket price also grew 11% over the same period (while the overall CPI rose 7.7%). However, since much of what contributed to high GNI per capital growth rate was simply national output that was not related to average wage-income, the average salary-food inflation ratio was more likely deteriorating, though slowing down in the first half of 2012, as food price inflation slows down. Low-income households were more adversely affected by food price inflation, as low-income households must allocate proportionally more income for purchasing food than do high-income households. Effective in January 2012, the government raised the basic minimum monthly wage from kip348,000 to kip626,000 (or \$US78.25 at kip8,000/1\$US), excluding other mandatory benefits such as lunch and health benefits.

## **Inflation, monetary policy and exchange rate**

From the perspective of controlling inflation, Laos has performed reasonably well on the monetary side of the economy, as inflation has subsided from 7.9% in November 2011 to 3.6% by June 2012. Inflation peaked at 9.8% in May 2011 and then receded, lowering the annual

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<sup>20</sup> However, the report also indicates, in page 3, that "the smallest 40% [of farm households] have less than 15% of the land," which comes out to less than 0.78 ha per household, since there were 782,800 farm households and 1,623,000 ha of agricultural land in 2010/11. *Lao Census of Agriculture 2010/11 Highlights* (May 2012), Agricultural Census Office.

<sup>21</sup> For example, an average farm household in the south-central province Savannakhet had 3.1 ha while 1.3 ha was an average in Huaphan in the north. In Phongsaly in the north, an average farm household had 3.8 plots with an average plot size of 0.43 ha while in Sekong in the south, an average farm household had 1.9 plots with 1.25 ha per plot on average.

average CPI rate of change to 7.6%.<sup>22</sup> Major contributors to recent rise in inflation were food and fuel prices. However, growth in broad money supply M2 has fallen from an annualized rate of 40.9% in June 2011 to 25% in December 2011, reducing money-induced inflationary concerns.<sup>23</sup> Although 25% is still considered a relatively high growth rate of the money supply, strong economic growth and growth in the overall bank deposits coupled with the BOL's issuance of security together has helped prevent money-induced inflation.

Total credit growth decelerated from 46% in 2010 to an annualized rate of 38% by the end of 2011, according to the WB's Economic Monitor (May 2012), which is still considered high. Credit growth to the private sector decelerated from 34% in 2010 to 23.4% in 2011. However, credit to SOEs has accelerated moderately from 53.4% in 2010 to 60.8% in 2011, mainly due to loans to Lao Airlines to finance the purchase of two Airbus aircrafts. The deceleration of lending to the private sector was a result of long-term deposit constraint. ADB's Asian Development Outlook, Lao PDR 2012 indicates that the deceleration of credit growth was also a result of the BOL reducing direct lending to infrastructure projects and measures the bank took to curtail lending for real estate speculation. ADB also indicates that the BOL is targeting to limit credit growth to 28%.

Lao government continues its policy of maintaining a stable exchange rate against major foreign currencies. Despite that, the kip has continued to strengthen against major foreign currencies as demand for kip grew, resulting from inflows of foreign exchanges associated with exports and foreign investments adding to foreign aids. Kip effective exchange rate, appreciated 1.5% in nominal term and 4.22% in real term in 2011.<sup>24</sup> Most recently, between October 2011 and March 2012, the kip appreciated 0.3% against the US dollar and 1% against the baht. Since 2006, the kip has appreciated roughly 20% against the US dollar, with today's exchange rate fluctuating around kip8,000 to a dollar.

Low inflation is clearly beneficial to the economy as a whole. However, the appreciation of the kip has conflicting effects. While a stronger kip lowers import prices, benefitting consumers and domestic market oriented businesses that must import material inputs, equipment and machinery, it also erodes the competitiveness of Lao export sector by raising costs associated with local inputs.

While stronger kip benefits domestic market oriented businesses by holding down the cost of imported material inputs, equipment and machinery, it also makes imported consumer goods cheaper. Thus, it is unclear that the domestic-oriented sector will be advantageous with a stronger kip, making importers and kip-earning consumers the only clear winners.

Exporters earn foreign exchange that is depreciating against the kip. With each unit of foreign exchange earned can be converted for less kip, exporters' real operation costs increased as a result, given other things remain constant—namely input prices in local currency and output prices in foreign exchange. In a competitive market, producers' ability to set prices is extremely

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<sup>22</sup> Details of CPI are obtained from CPI monthly report by the Lao Statistics Bureau. The World Bank uses CPI figures from the LSB in its economic report.

<sup>23</sup> *Lao PDR Economic Monitor* (May 2012).

<sup>24</sup> According to the IMF's Exchange Rate Index, as reported in the WB's *Lao PDR Economic Monitor* (May 2012).

limited. Thus, exporters often absorb higher cost of local inputs instead of passing it to buyers by raising prices. This makes the export-oriented sector a clear loser, especially those with relatively more domestic inputs and a lack of the ability to set their own product prices, and discourages especially the export-oriented non-resource sector. If the negative effect on (raising cost to) the export-oriented sector outweighs the positive effect on (lowering cost to) the domestic-oriented sector, the economy will be worse off in the long run. In any case, with kip appreciation, the export-oriented sector operating in a competitive world market is worse off. With a sluggish non-resource export-oriented industries and import-substituting industries, the government will be pushed deeper into resource sector dependency, an unsustainable path.

However, to get out of this path, a monetary policy deliberately making the kip weak could make things worse. A weakening kip will immediately result in inflation and a loss of confidence in the kip, which would lead to other economic problems.

## **Government fiscal conditions, revenues and expenditures**

Government fiscal conditions are generally in good shape, with growing revenues from both the resource sector (mining and hydropower) and non-resource sector, but with growing relative importance of the resource sector. The WB predicts that government revenue from mining as a percent of GDP will rise from 2.9% in 2011 to 3.4% in 2012 and to 3.9% in 2013; and from hydropower, from 0.7% in 2011 to 1% in 2012 and 2013.

Government revenue from domestic source rose to 16.8% of GDP in 2011 and is expected to rise only slightly to 16.9% in 2012. Taxes made up the majority of government revenue, accounting for 15% of GDP in 2011, growing from 12.5% of GDP in 2008.

Lao government's fiscal expenditures in 2011 account for 23.9% of GDP and are expected to rise to 25.2% in 2012, with deficit spending accounting for 2.7% of GDP in 2011 and is forecasted to rise to 3.2% in 2012, according to the WB.<sup>25</sup> However, ADB forecasts a rise of budget deficit to 4.6% of GDP in 2012.<sup>26</sup> The difference between total fiscal expenditures and fiscal deficit plus revenue from domestic source was financed with grants. Growth in deficit spending is contributed by government's 2011-flood recovery program, preparation for the 9th ASEM to take place in November this year, poverty reduction projects and expanded recurrent expenditures on wages, compensations and allowances to augment public services in remote rural areas.<sup>27</sup> However, deficit spending has been kept below the 5% fiscal deficit limit the government is committed to, as approved by the National Assembly.<sup>28</sup>

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<sup>25</sup> WB's Lao PDR Economic Monitor - May 2012.

<sup>26</sup> Asian Development Outlook 2011, Lao PDR, ADB.

<sup>27</sup> WB's Lao PDR Economic Monitor - May 2012.

<sup>28</sup> Budget Preparation Instruction for fiscal 2012/13, No. 999/MOF, April 2012, cited in WB's Lao PDR Economic Monitor - May 2012.

While expansionary fiscal spending is in place, the government is also making efforts to tightening control of expenditures. Particularly, the government has gradually reduced its off-budget (quasi-fiscal) spending from 2.8% of GDP in fiscal year 2009/10 to 1.4% in fiscal year 2010/11 and is committed to eliminate off-budget spending. Past off-budget commitments would be re-paid on-budget for fiscal year 2012/13, according to the Budget Preparation Instruction No. 999/MOF approved by the National Assembly.<sup>29</sup>

## Savings and Investment

Lao gross domestic savings in 2011 was estimated at 21.23% of GDP, a slight decline from 21.96% in 2010, according to the WB.<sup>30</sup> Domestic savings as a percent of GDP was likely growing in 2012, as WB's report indicates strong growth in the overall bank deposit that was accompanying high GDP growth. Although bank deposits are incomplete parts of national savings, they serve as proxy for direction of changes.

Private investment of foreign capital has been growing, as gross FDI grew from \$770 million in 2010 to \$1,157 million in 2011 and is predicted to grow to \$1,580 million (increase 31%) in 2012.<sup>31</sup> WB's report in May indicates that public as well as private domestic and foreign investments have been growing in relation to GDP.

## Financial infrastructure

The country's financial system is expected to continue to grow and improve with growth trend widely expected to continue in the coming years, growing deposits, and efforts by the central bank to improve supervisory and transparency. Laos' financial sector, which is still relatively small, comprises of banking, insurance, capital markets—the Lao Securities Exchange and non-bank financial institutions (including microfinance institutions, savings and credit unions and postal savings), dominated by the banking system. In the capital market, which started trading in January 2011, the Lao Security Exchange's (LSX) market capitalization is approximately \$US601 (kip5,113 billion), about 7% of GDP. Currently, there are two listed SOEs, EDL-Generation and BCEL, with six potential companies in the pipeline to be listed.<sup>32</sup> The insurance market is a small portion of the country's financial market; its penetration is less than 1% of GDP.

The commercial banking industry grew rapidly since 2007, with entries on private local banks and more foreign banks. The BOL has recently issued three new banking licenses, adding to the existing 25 commercial banks, including four state-owned commercial banks (SOCBs), two joint venture banks, eight private banks and 11 foreign bank branches. Currently, the Lao banking sector is dominated by four state-owned commercial banks (SOCBs). As of 2011,

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<sup>29</sup> Cited in WB's Lao PDR Economic Monitor - May 2012.

<sup>30</sup> <http://data.worldbank.org/country/lao-pdr>.

<sup>31</sup> *Lao PDR Economic Monitor* (May 2012), World Bank.

<sup>32</sup> Companies in the pipeline for listing include three SOEs (one in commercial banking, one in telecommunication, one airline) and three private companies.

SOCBs control 60% of total assets in the commercial banking industry in the country. However, private banks' asset size grew substantially in 2011, by 57% in comparison to 30% of the whole banking industry. As of December 2011, the banking sector as a whole gained 15.35% of cumulative capital.

Non-performing loans has reduced from 3.2% in 2010 to 2.18% in 2011, much due to rapid expansion of new loans, which raises the base of total outstanding loans. As new loans have not entered a period of loan performance classification yet, the non-performing loans percentage is thus lowered. Credits to private sector in Laos account for 24% of the country's GDP in 2011, although still relatively low, was a significant increase from just 7.5% in 2006.<sup>33</sup> However, total credits as a percent of GDP from the Lao banking sector remains much lower than (about half of) the average of lower middle income country group.

The number of bank branches and service units increased from 282 in 2010 to 316 in 2011 and the number of ATMs installed throughout the country also grew from 248 in 2010 to 414 in 2011, suggesting that access to financial services has improved. Access to finance by the poor has also slowly improved as the microfinance sector has about doubled its assets in the past several years, according to the WB, but coverage remained very low. Of all 34 MF institutions combined, there were 82,000 customers served (46,000 deposit accounts and 36,000 loan accounts) in 2011, according to the WB's report.

## International trade and finance

Laos' trade balance is deteriorating, but is not threatening the stability of the macro economy. The WB reports that while the country's exports grew, from \$US2,149 million in 2010 to \$US2,644 million in 2011 and is forecast to grow to \$US3,077 in 2012, imports grew even faster, as a result of increased foreign capital inflow.<sup>34</sup> Thus, import-export ratio rose from 1.20 in 2010 to 1.31 in 2011 and is expected to rise to 1.34 in 2012.

The economy has been growing slightly in openness to the global system, as openness measure ((import + export)/GDP) grew from 0.678 in 2010 to 0.757 in 2011 and is expected to grow to 0.763 in 2012. Trade barriers, overall, have most likely been slightly lowered—meaning the situation has slightly improved—as the country was preparing to become a member of the WTO and for Asean Economic Community while there have been some government measures recently issued in contradiction to liberalizing trade regime. While the implementation of the Automated System for Custom Data (ASYCUDA) at Laos' largest border checkpoint starting in mid-2011, which accounted for half of the country's total imports, has markedly reduced import processing time, in June the President ordered the Ministry of Industry and Commerce (MoIC) to "... *check and recheck to ensure that the import of secondhand vehicles is really halted.*"<sup>35</sup> The President order came after a failed attempt by the MoIC to halt used vehicles imports late last year. Government has also issued measures to limit rice export for reason of food security

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<sup>33</sup> Lao PDR Economic Monitor (May 2012), World Bank.

<sup>34</sup> Ibid.

<sup>35</sup> Vientiane Times (June 25, 2012).

in response to last year's regional flood damages and this year droughts. Internal trade barriers overall have also been slightly lowered as toll booths along national highways have all been abolished and checkpoints where police stopped and checked transported goods were also abolished, although not all in practice, while trade barriers in some localities were erected. For instance, Xiengkhouang Province, in an effort to control the potential spread of animal diseases, has prohibited traders to use the province as a transit point for cattle trade.

Foreign exchange reserve slightly declined from \$US729.9 million, equivalent to about 3.2 months of imports, in 2010 to \$678.8 million, which can cover 2.2 months of imports in 2011. In 2012, the WB suggests that Lao foreign exchange is expected to remain roughly constant, with \$US680.9 million, or 1.9 months of imports for the year, despite strong inflows of foreign exchange, as the country's imports grow and a portion of incomes generated by FDIs are subject for repatriation.

Laos' total external debt in 2011 rose 12.1% to \$US7,429, accounting for 92.2% of GDP, and it is expected to grow further to \$US8,612 million (90% of GDP) in 2012.<sup>36</sup> Public and publicly guaranteed external debts account for 47% of the country's total in 2011.<sup>37</sup> External debt service ratio as a percent of the country's exports, however, reduced from 13.4% in 2010 to 12.8% in 2011, and is expected to lower to 10.8% in 2012.<sup>38</sup>

## **Global and regional integration**

Laos is expected to gain accession to become a member of the WTO by later this year or early next year. Laos has received endorsement from all negotiating TWO members for accession. The only remaining issue to address, which was raised by the United States, is improving and clarifying laws regarding intellectual properties. By 2015, if the progress on preparation for the ASEAN Economic Community goes according to plan, import taxes on goods and services originated in any ASEAN member country would reduce to zero or at most 5%. Labor and capital will be allowed to move freely within the community.

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<sup>36</sup> *Lao PDR Economic Monitor* (May 2012), World Bank.

<sup>37</sup> *Asian Development Outlook 2012*, Lao People's Democratic Republic, Asian Development Bank.

<sup>38</sup> *Lao PDR Economic Monitor* (May 2012), World Bank.

Appendix Table A1.

## Lao PDR's Key Economic Indicators: 2009 - 2012

	2009	2010	Estimate 2011	Forecast 2012
GDP (mil. USD, current price)	5,722	6,967	8,080	9,427
GDP per Capita (Atlas method, USD, current price)*	936	1,124	1,285	1,478
GNI per Cap (Atlas method, USD, current price)	900	1,010	1,130	
GDP Growth (%)	7.50	8.50	8.00	8.30
Agriculture Growth (%)	2.8	3.2	2.7	
Industry Growth (%)	18.5	17.5	14.6	
Service Growth (%)	6.0	7.0	8.1	
Agriculture Share in GDP (%)	31.00	29.40	27.40	25.90
Industry Share in GDP (%)	30.80	33.30	35.50	37.30
Service Share in GDP (%)	38.20	37.30	37.10	36.80
CPI (%change)	0.10	6.00	7.50	6.00
LAK/USD	8,516	8,259	8,052	7,932
LAK/THB	248.96	260.69	264.86	
M2 Growth (%)	31.30	39.13	25.00	22.50
Bank Credit Growth (%)	90.70	46.00	38.20	32.90
Total Deposits Growth (%)	29.50	43.30	21.60	22.70
M2 as %GDP (measuring monetization of economy)	29.20	34.10		
Bank Total Deposits as %GDP	23.30	28.00		
Bank Credit (%GDP, measuring importance of financial sector)	21.50	26.30		
Total Government Revenues (incl. grants, %GDP)	16.80	19.50	21.20	22.00
Government Revenues from Domestic Source (%GDP)	14.60	14.90	16.80	16.90
Government Revenues from Taxes (%GDP)	12.90	13.40	15.00	15.10
Gross Domestic Savings (% GDP)	21.08	21.96	21.23	
Net Domestic Savings (%GNI)	9.30	10.75		
Import (mill USD)	2,215	2,573	3,472	4,115
Export (mill USD)	1,489	2,149	2,644	3,077
Trade as %GDP (measuring openness)	64.73	67.78	75.69	76.29
FDI Gross Inflow (mill USD)	848	770	1,157	1,580
Total External Debt (mill USD)	6,050	6,574	7,420	8,612
Public and Public Guaranteed External Debt (nominal, %GDP)	55.40	51.80	47 **	
Foreign Reseve (mill USD)	633.40	729.90	678.80	680.90
Foreign Reseve (in months of import)	3.30	3.20	2.20	1.90
External Debt Service (%export)	11.80	13.40	12.80	10.80

Sources: \* Estimated using GDP data from WB's Economic Monitor and WB's population estimate from [data.worldbank.org/country/lao-pdr](http://data.worldbank.org/country/lao-pdr). \*\* ADB Asian Development Outlook 2011, Lao PDR. Sector growth rates, from Statistical Yearbook 2011, Lao Statistics Bureau; LAK/THB exchange rates, from Bank of Lao PDR; all others, from Lao PDR Economic Monitors, various issues, World Bank, and <http://data.worldbank.org/country/lao-pdr>.