LAO PEOPLE'S DEMOCRATIC REPUBLIC

The economic outlook for Lao PDR remains favorable, but rising inflation poses a risk. GDP growth in 2007 remained stable at above 7 percent, and this stability is expected to continue into 2008. However, inflation has been climbing in recent months and reached approximately 6.5 percent in January 2008, from 4.5 percent in 2007. The government's fiscal position continued to improve in FY2006–07 owing to higher-than-targeted revenue collection and lower-than-planned expenditures, with steady implementation of the public finance management reform agenda. Although the legal framework is in place to support international trade and private sector activity, implementation remains incomplete.

Notwithstanding a more challenging international economic environment, real GDP growth is projected to rise to 7.6 percent, up from 7.1 percent in 2007. Approximately 2 percentage points of this growth are expected to come from new hydro and mining projects, including the construction of four hydro-power dams and a large copper plant. The remaining 5 percentage points are expected to come from investments in plantations for agricultural crops and industrial forestry, steadily rising tourism revenues, and newly emerging food and nonfood processing industries.

The recent upward trend of inflation is due mostly to higher oil and food prices, the latter reflecting low grain harvests caused by bad weather in 2007 and the culling of poultry to avoid the spread of avian flu. The rise in the food CPI has slowed in recent months although food inflation remained high at 6 percent in January 2008.

High commodity prices have proved to be a mixed blessing. Fuel prices pushed up the cost of transport, construction, land clearing, and agriculture. However, since Lao PDR exports metals (copper, gold, tin, and others) and non-metal commodities (rubber, sugar, and other agro-industrial products), strong non-oil commodity prices have proved to be a net benefit, In the last two years, production and exports of Lao agricultural products (maize, coffee, rice, fruits, and vegetables) also have increased due to growing demand from neighboring countries.

Given recent trends, the government's inflation target of 6 percent will be difficult to meet. This stems partly from the high level of circulation of US dollars and Thai baht in the Lao economy, limiting the effectiveness of the central bank's monetary policy. Notwithstanding, the government has established an interagency committee to tackle inflation. Included in this committee are the Bank of Lao PDR to maintain tight monetary policies and stable exchange rates, Ministry of Finance to sustain good fiscal performance and revenue management, Ministry of Agriculture and Forestry to promote agricultural production, and Ministry of Industry and Commerce to monitor retail prices and warn of incipient price increases.

The kip has appreciated against the US dollar but remained steady against the Baht, and the respective real exchange rates have moved similarly. Foreign exchange reserves increased sharply to approximately $540 million in 2007, (more than 5 months of non-resource imports) and are expected to rise further given high mining and agricultural export prices and strong tourism receipts and FDI inflows. At the same time, imports associated with large mineral and hydro projects will exert pressure on the external current account deficit.

The government's fiscal position has continued to strengthen, allowing a slight decrease in Lao PDR's high external debt ratios. The government achieved its revenue targets for a second consecutive year; with revenues increasing from 12.7 percent of GDP in 2005–06 to approximately 13.8 percent in 2006–07. If expenditures remain unchanged, the overall budget deficit is likely to be close to 3 percent of GDP in FY2006–07. Lao PDR's external public debt burden remains elevated. At end-2006, public and publicly guaranteed external debt in present value terms was equal to 70 percent of GDP, 135 percent of exports, and 377 percent of fiscal revenues. All three indicators exceed the indicative sustainability thresholds for countries with comparable CPIA ratings, placing Lao PDR at "high risk of debt distress", according to IDA's debt sustainability framework. However, debt servicing indicators remained less than indicative thresholds, due to the high concessionality of debt (75 percent).

The reform agenda for public financial management is being implemented steadily. A new Budget Law was promulgated in early 2007 allowing recentralization of the Treasury, Customs, and Tax Departments, including a new revenue sharing mechanism. Progress has been made on a revised Chart of Accounts (COA) which is expected to be deployed in the FY2008–09 budget. To strengthen audit performance and oversight of state- owned enterprises, a new Audit Law promulgated in July 2007 requires the Supreme Audit Office (SAO) to report directly to the National Assembly instead of to the Prime Minister.

Progress is being achieved in reforming private sector and trade policies but implementation continues to lag. The Negative List of Business Activities under the new Enterprise Law was approved in November 2007. The new Mining Law and implementing decree of the Tourism Law are other important contributions. To facilitate cross-border trade, the government reduced the number of agencies at border checkpoints from 16 in 2006 to 3 (immigration, customs, and quarantine) in 2007. A new Commercial Banks Law was endorsed and amendments to the Presidential Decree on Foreign Exchange and Precious Metals adopted in 2007. It is now important these new laws and implementing decrees are implemented.