Impact of the Global Financial Crisis and Recent Economic Developments in Lao PDR
The Global Economic Outlook

Some positive changes took place recently in the global economy, including an unexpected increase in durable and capital goods orders in the US in May, as well as several positive rallies in the stock markets. However, the global outlook and the length of the global recession still remain uncertain at this time. This Monitor bases its country-level projections for Lao PDR’s FDI and export demand on the World Bank’s projections for the regional and global economic outlook and commodity prices, presented in Table 1.

Annex Table 1. The Global Economic Outlook in Summary

(percentage change from previous year, unless otherwise specified)

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Note:
1/ Canada, France, Germany, Italy, Japan, the United Kingdom, and the United States.
2/ Unit value index of manufactured exports from major economies, expressed in USD.

The Lao PDR Economic Monitor is issued in Lao and English, twice a year (Spring and Autumn) by the World Bank Office in Lao PDR. The Spring issue - Mid-Year Update - reports mainly on recent economic developments and medium-term outlook for the country. The Autumn publication - Main Report - includes reviews of recent economic performance (Part 1), progress in the implementation of the Government’s policy reform agenda (Part II), and donor activities in the relevant reform areas (Part III). This issue of the Monitor was prepared by Somneuk Davading (Country Economist) under the overall supervision of Ekaterina Vostroknutova (Senior Country Economist) and Mathew Verghis (Lead Economist). We are grateful to the Government and donor community for providing inputs and feedback. We would like to thank our World Bank colleagues: Sengxay Phousinghoa for the rapid enterprise survey, Konesawang Nghardsaysone for trade data and graphs, Thalavanh Vongsonephet for cover design, Vattana Singharaj, Boualamphan Phouthavisouk, Souridahak Sakonhninhom and other staff for printing and dissemination of the Monitor.

THE WORLD BANK TEAM APPRECIATES FEEDBACK ON THE STRUCTURE AND CONTENT OF THE MONITOR.
EXECUTIVE SUMMARY

Lao PDR is weathering the global financial crisis better than many of its neighbors. The real sector continued to perform fairly well while fiscal management (especially budget deficit and off-budget spending) became a serious concern. The impacts of the crisis are felt through falling foreign direct investment, prices and demand for exports, especially for resource sectors and agriculture. Tourism and manufacturing (garments) are less affected by the crisis in early 2009 but remain vulnerable. Going forward the challenge is to maintain macroeconomic stability while dealing with crisis impacts.

GDP growth, which was at about 7 percent in 2008 is projected to slowdown to 5 percent in 2009 due to the global economic crisis. The relatively sluggish growth of 5 percent this year is mainly due to reduced external demand and tourism receipts and consequently lower contribution from manufacturing and services sector to the overall growth. However, growth in agriculture and mining sector remains strong (at 2.6 percent and 18.6 percent, respectively) and contributes nearly half to the overall growth of 5 percent. Major contribution from services comes from the recent increases in bank lending and public wage spending.

Fiscal deficit is posed to increase sharply in FY2009, as expenditure pressures from SEA Games and other infrastructure projects mount against the revenue shortfalls due to the impact of the global financial crisis. The GOL’s revenue collection is expected to drop from 14.2 percent of GDP in FY2008 to 13.2 percent of GDP in FY2009 due to decline in mining and non-resource revenues. At the same time, expenditure increased to about 22.8 percent of GDP in FY2009 from 17.6 percent in FY2008 due to GOL’s plan to stimulate economy and promote domestic consumption, increased public wage spending as well as preparation for the SEA Games and local infrastructure development (including 450 Anniversary Road). Without additional measures, the overall budget deficit is expected to be at around 8 percent of GDP in FY2009. If the proposed at NA Session measures are taken on revenue side and additional measures envisioned on the expenditure side, the Government may be able to contain the deficit at around 6.7 percent of GDP.

The headline inflation has been very low in recent months largely due to reduced import prices while kip exchange rates remained fairly stable against major foreign currencies. The year-on-year inflation has declined significantly in recent months (just below zero in June 2009) due to lower energy and food prices. After appreciation by 9.7 percent in 2008, kip nominal exchange rate was steady against US dollar but depreciated slightly by 2.2 percent against baht during the first six months of 2009. The relative movement of these rates suggests market interventions to support the dollar exchange rate.

International reserves fell sharply in 2008Q4 and 2009Q1, and are projected to fall significantly in 2009, due to reduced capital inflows and exchange rate interventions. The capital account surplus is expected to decrease to about 14.2 percent of GDP in 2009 from 18.6 percent in 2008 as FDI slumps by about 30 percent. Current account deficit, which was about 16.5 percent of GDP in 2008, is projected to decline marginally to 15.8 percent of GDP in 2009, as imports drop faster than exports due to lower commodity prices and capital imports by large resource projects; this dynamic however does not compensate for the losses on the capital account side.

The Government is facing a number of challenges in dealing with the global economic downturn. Major challenges for the GOL to overcome during this difficult time include: (1) financing the significant budget deficit; (2) fiscal and monetary expansionary spending could jeopardize fiscal sustainability and macroeconomic stability in the near future; (3) controlling future NPLs from recent high credit growth, especially for state-owned commercial banks; (4) and finally, the need for accelerating reforms in order to sustain growth and achieve the 2020 goal of graduating from LIC status.
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1. IMPACT OF THE GLOBAL FINANCIAL CRISIS AND RECENT ECONOMIC DEVELOPMENTS IN LAO PDR

GDP growth in Lao PDR is less affected by the global financial crisis than in many of its neighbors. The crisis is transmitted mainly through FDI, and prices and demand for exports. As a result, the real GDP growth is projected to slow to 5 percent in 2009 but remains fairly robust. The inflation has been low in recent months due to lower imported commodity prices. SEA Games related spending and recent high credit growth while acting as a stimulus have started to jeopardize balance of payments stability. After significant appreciation in 2008, kip exchange rates remained fairly stable against major foreign currencies, but at a cost of sharp fall in reserves. GOL's budget deficit is expected to rise in FY2009 due to the crisis and increased spending. The main challenge going forward is to maintain macroeconomic stability while dealing with crisis impacts and expenditure pressures.

1.1 GROWTH AND INFLATION

GROWTH

Real GDP growth in 2008 is estimated to have decelerated only slightly, to 7 percent from 7.5 percent in 2007 (Figure 1). The resource sectors (hydro and mining projects) contributed around 2.0 percentage points to this growth (Figure 2), including the construction of four hydro-power dams, an extension of a large copper plant and increased outputs. The remaining 5 percentage points came from non-resource sectors: investment in plantations for agricultural crops and industrial forestry, manufacturing (including garments), steadily rising tourism revenues, growing retail and construction, and newly emerging food and nonfood processing industries.

GDP growth is projected to slow to around 5 percent in 2009 (see Figure 3). Relatively sluggish growth in 2009 is mainly due to reduced external demand and tourism receipts and consequently lower contribution from manufacturing and services sectors. Nevertheless, growth remains fairly robust and continues to be driven by the increases in agricultural output (by 2.6 percent), copper production (by at least 25 percent) in 2009, and by the service sector (mainly an increase in public wage spending, improved retail trade, and the consequences of lending growth in 2008 of 85 percent). The Rapid Enterprise Survey conducted recently to monitor the impacts of the crisis confirms these projections (see Annex 1). Out of an overall 5 percent growth, agriculture
contributes 0.8 percentage points, mining - 1.5, hydropower - 0.4, and services - 1.9 (public wage expenditures 1.4 points, retail trade 0.3 points, and credit growth 0.2 points). The category “other” (primarily net indirect taxes) accounts for the remaining 0.3 percentage points (see Figure 4).

Provided reforms continue and global economic outlook improves (Annex Table 1), growth is projected to rebound over the medium term (Figure 3). The projected growth is driven mainly by the resource sector (hydropower and mining), agriculture, and services. The contribution from manufacturing and construction is also expected to climb in the medium term. The power sector, especially with NT2 coming on stream in early 2010 and other power projects afterward, is expected to increase its contribution to GDP remarkably in 2010 and onward (Figure 4). The medium-term growth prospects are sensitive to changes in global commodity prices (mainly metals and agriculture), recovery in regional tourism, implementation of large hydropower projects in the pipeline, and changes in demand from neighboring countries (especially Thailand, China and Vietnam) and the EU.

**INFLATION**

Headline inflation has declined rapidly, to below zero by June 2009, and is expected to remain at a low level in the coming months. Lao PDR’s inflation stayed at or below 10 percent throughout the 2008 food and oil price rises. Average annual inflation (as measured by the Consumer Price Index) was recorded at 7.6 percent in 2008 and is expected to decline to below 2 percent in 2009 due to recent sharp falls in global commodity prices (Figure 3). Among other groups, energy and food prices have declined most in recent months from their highs in 2008 (see Figure 5). The core inflation (without food and energy) has also dropped to just below 1 percent by mid-2009 from 4.2 percent in mid-2008.

A drop in global commodity prices (especially food and energy) led to overall low inflation in recent months.
1.2 Government’s Revenue and Expenditure

GOL is facing significant revenue shortfalls in FY2009. The GOL’s revenue collection is expected to drop from 14.2 percent of GDP in FY2008 to 13.2 percent in FY2009 due to decline in mining and other non-resource revenues compared to the approved plan. Revenue collection in the first six months of this fiscal year was much lower compared to the same period of last year due to the crisis and delays in payment of mining profit tax (Figure 6). However, revenue is expected to improve in the second half of the year as GOL has taken a number of measures to raise tax revenues including the expected receipt of the deferred mining tax payments as well as introduction of the new excise taxes.

Expenditures increased noticeably in the first six months of the year due to recent increases in wages and allowances for the government’s civil servants and expenses related to the upcoming SEA Games, as well as the upgrading of secondary education systems (an increase in the number of school years from 11 to 12, see Figure 7). Much of the expenditure bill is off-budget this year, and administered by the BOL, making overall fiscal policy intransparent.

The budget deficit is projected to be about 7.6 percent of GDP in FY2009 and 5.6 percent in FY2010 (Figure 8). However, if measures are introduced, the Government may be able to maintain deficit of 6.7 percent of GDP in FY2009 and to 4.4 percent of GDP in FY2010. Key measures (both revenue and expenditure, see Section 2 for more detail) account for 0.9 percent of GDP in FY2009 and 1.2 percent in FY2010. Overall, the budget deficit is expected to decline to 3-4 percent of GDP over the medium term given revenue collection to improve as global economy recovers and provided GOL reverts back to a prudent fiscal policy stance.

A rapid growth in quasi-fiscal activities conducted by the BOL, including direct lending to infrastructure projects and provinces, is the main source of the increase in overall budget deficit. The off-budget spending in FY2009 is estimated at...
about 2.7 percent of GDP. If the quasi-fiscal operations continue, it will undermine the future fiscal sustainability and macroeconomic stability. The direct lending and borrowing by the BOL also raise concerns about soundness of its balance sheet.

**Public Debt**

According to the recent assessment, Lao PDR continues to face a high risk of debt distress.¹ External public and publicly-guaranteed (PPG) debt stocks remain at about US$2.9 billion at end-2008 (or about 53 percent of GDP), but the high level of concessionality of official borrowing, which comprises most of Lao PDR’s debt, keeps debt service ratios relatively contained (Figure 9). Strong economic growth, currency appreciation, and prudent debt management contributed to a decline in the debt ratio over the past few years. The corresponding net present value (NPV) of debt at end-2008 was 35 percent of GDP.

In terms of composition, nearly 70 percent of PPG debt is held by multilateral creditors, mainly the Asian Development Bank and World Bank (IDA). About 29 percent is held by bilateral creditors, including a large Soviet-era debt to Russia. Only 2 percent comprises external debt incurred by public entities on nonconcessional terms, mainly for hydropower development and electricity generation.

The stock of recorded domestic public debt amounted to 2.1 percent of GDP at end-2008, but is expected to increase remarkably in the short- and medium-term as the Government resorts to domestic borrowing to finance large fiscal deficit.

**1.3 External Balance**

**Lao Exports and Imports**

With exports representing only about 30 percent of GDP in 2008, Lao PDR is a relatively closed economy in comparison to others in the region. In nominal terms, Lao exports of goods grew at around 21 percent in 2008, compared to an annual average of 29 percent for the five-year period 2004-2008. The country has been exporting mostly metals and hydropower, but also other products, such as garments, wood and wood products, and agricultural produce (Figure 10).

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¹ The last Lao external debt assessment (DSA) was completed in 2008. A new assessment is currently being prepared jointly by the World Bank and the IMF, in collaboration with the Asian Development Bank.
Lao PDR exports mostly to the countries in the region (Thailand, China, Vietnam, Malaysia, and Australia) as well as Europe (garments, coffee, and most recently copper concentrates), see Figure 11. The power sector’s contribution to exports is expected to continue growing in the near future, with NT2 and other dams coming on stream in and after 2010. The garment industry, which grew vigorously last year, exports mostly to Europe (about US$150 million in 2008) and recently to the United States and Canada (around US$31 million in 2008). Lao PDR imported mostly capital goods for large investments projects, raw materials, and consumer products.

The exports are expected to drop on average by 15 percent in 2009 (in value terms) due to the sharp fall in commodity prices. Compared to Q1 of 2008, Lao exports dropped by 16.5 percent in Q1 of 2009 due to lower copper and agricultural prices (Figure 12). Similar trends are expected for imports due to reduced prices for fuel and for imported capital goods. However, both exports and imports are expected to grow in volume terms in 2009. Among others, copper export volume is expected to increase by 25 percent and fuel imports to go up by about 15 percent this year.

Assuming global economy recovery (Annex Table 1), Lao exports are expected to rebound in the medium term, with NT2 and other dams coming on stream in and after 2010 and with the recovery of global commodity prices especially for mining and agriculture, see Figure 13. At the same time, imports will surge as major resource projects in pipeline and non-resource FDI resume from 2011 onward. Projected rapid growth in capital imports by large projects will push up overall imports in the medium term.

Recovery of demand from the East Asia region is the key to Lao exports growth as most of its exports (85 percent) go to this region.
Lao PDR’s exports largely depend on demand from the region: Thailand, China, Vietnam, Australia, Japan, and Korea. These countries are already experiencing a slowdown in production and in their own exports, which in turn will have an impact on the Lao PDR. However, many of Lao PDR’s exports to these countries are food and wood products, for which no decline in demand is projected so far. European demand for exports is also projected to decrease as is European tourism to Lao PDR. After growing by 35 percent in 2007 and nearly 20 percent in 2008, tourist receipts are expected to decline by around 10 percent in 2009. Garment exports are expected to decline only slightly in 2009.

**CURRENT ACCOUNT BALANCE**

The current account deficit in 2008, which was recorded at 16.5 percent of GDP, has declined in 2009 (Figure 14). The high current account deficit reflects the vulnerability of the Lao economy to external shocks. However, this deficit stemmed mostly from large capital imports for the construction of big resource sector projects and the high prices of imported fuel. On the other hand, high copper prices have been compensating on the export side. The capital account was in surplus at 18.6 percent of GDP in 2008, driven by resource FDI. The balance of payments also showed a surplus of 2.1 percent of GDP last year.

In 2009, the current account deficit is projected to drop to 15.8 percent of GDP from 16.5 percent in 2008 as imports for the construction of large projects are expected to fall faster than export value. The non-resource current account deficit is projected at around 10.4 percent. The overall balance is projected to be negative in 2009 (about 1.6 percent), see Figure 14. Thus, foreign reserves, which grew rapidly in the past years, are expected to fall this year (Figure 15). The broad money (M2), which grew by 18 percent in 2008, is projected to rise by about 17 percent by end-2009.

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2 M2 is the total amount of money available in an economy at a particular point in time. It includes physical currency in circulation, demand deposits, time deposits, savings deposits, and non-institutional money-market funds.
**FOREIGN DIRECT INVESTMENT (FDI)**

In the last few years, Lao PDR economic growth has been heavily dependent on FDI, which is mostly flowing into the natural resource sectors. FDI doubled in dollar terms between 2006 and 2008 (to about US$850 million); with 80 percent of this FDI in the resource industry. FDI in non-resource sectors (agriculture, light manufacturing, processing industries, and services) also grew rapidly in recent years but is still small in value terms and in comparison to that in the resource sector.

FDI is expected to fall markedly in 2009 (by about 30 percent), through deferred new hydropower and mining projects, as well as sluggish growth in the non-resource sectors during this period (Figure 16). If the global economic outlook improves (Annex Table 1), FDI to the country is expected to rebound in the medium term as large resource and non-resource projects resume.

1.4 MONETARY SECTOR

**EXCHANGE RATE**

After appreciation in 2008, the kip nominal exchange rate has remained fairly stable against both the US dollar and baht in 2009, with slight fluctuations. Before the crisis, BOL allowed the kip to appreciate managing pressures arising from exports of natural resources and commodity price increases. The kip exchange rate appreciated by about 9.7 percent against the US dollar and by 13.4 percent against baht in 2008. In contrast, it has depreciated slightly by 0.5 percent against the US dollar and by 2.2 percent against baht, during the first six months of 2009 (Figure 17). The relative movement of the exchange rates suggests a market intervention in support of the dollar rate.

Reserves fell sharply by about US$50 million (or by about 8 percent, see Figure 18), between September 2008 and March 2009. Strong and stable kip exchange rate policy in 2008 has served the country well, resulting in significant de-dollarization benefits. At the same time, foreign reserves accumulated to US$ 636 million by end-2008 (compared to $530 million at end-2007) reaching nearly 6 months of non-resource imports in 2008.
With the change in the external environment, it is important that the exchange rate policy remains competitive, and does not jeopardize long-term growth. If the fall in reserves continues, it would significantly limit BOL’s ability to control the exchange rate, as well as may erode public trust in the stable kip. The current fiscal and monetary expansion and credit growth create an unusually high demand for imports and thus depreciation pressure. If these continue against the policy of stable kip, reserves would drop significantly. It is currently projected that reserves will fall by US$100 million, to about US$536 million in 2009 from US$636 million in 2008 (or to about 5 month of non-resource imports). At the same time, broad money (M2), which grew at 18.3 percent in 2008 (compared to 38.7 percent in 2007), is expected to slow to about 16.7 percent in 2009 (Figure 19).

**Bank Lending**

Credit grew by 85 percent in 2008, including accelerated lending to SOEs. The economy has been historically starved for credit against the background of high liquidity in the banking system, and therefore some growth in credit was warranted in 2008. The SOCBs increased their loan portfolios in 2008 by 152 percent (in kip nominal terms) and contributed 19 percentage points to total credit growth (Figure 20). The private and joint-stock banks increased their loan portfolios by about 72 percent and contributed 66 percentage points to the credit growth. Over the same period, policy lending also increased. Total lending as percent of GDP increased from 7.8 percent in 2007 to 12.5 percent in 2008, and is projected at 16 percent in 2009 (Figure 21). The lending to SOEs is likely to climb from 2.8 percent of GDP in 2008 to 3.9 percent in 2009. The announced slow down in credit growth in 2009 to about 26 percent is a welcome target in the current circumstances. Nevertheless, the overall banking sector’s loan to deposit ratio, which increased from 40 percent at end-2007 to 62.6 percent by end-2008, is expected to rise to 68.5 by end-2009.
Most recent rapid growth in credit is likely to result in a significant increase in NPLs. The sharp increase in lending against the background of poor capacity to screen borrowers raises concerns about growth in contingent liabilities, and a possible deterioration of the balance sheets of the SOCBs. It is very important that the ongoing reforms in the financial sector and in SOE management continue and accelerate so as to deepen the financial sector in order to ensure its continued resilience to shocks and to make sure that SOEs are better managed. At the same time, the supervisory and regulatory role of the BOL should be strengthened in order to closely monitor the performance of banks and the banking sector including NPL performance.

BOL has started directed lending operations, raising concerns about the soundness of its balance sheet and the banking system as a whole. BOL’s direct lending contributed about 24 percent to the total credit growth by March 2009 (on a year-to-year basis). It is also evident that BOL has started to borrow in order to finance such operations directly (the latest bond issue in the amount equivalent to about US$60 million was announced in June). To ensure BOL’s performance in its role as a guarantor of macroeconomic stability, it is important that its function as a quasi-fiscal agent and a quasi-commercial bank are phased out in the near future.
2. GOVERNMENT’S RESPONSE TO THE CRISIS

The impact of the crisis on real GDP growth is relatively small in the Lao PDR. This is partly due to the relative closeness of its economy and partly to the effects of the 2008 credit growth and recent SEA Games and related infrastructure spending.

Nevertheless, the Government is facing significant risks in dealing with the global financial crisis and the increased spending, without appropriate fiscal space. The decline in revenues coupled with expenditure pressures have effectively resulted in abandonment of the recent prudent fiscal policy, as off-budget financing and directed lending by BOL have started and intensified this year. At the same time, an expansionary monetary policy is creating risks in the banking sector. The rapid fall in reserves supported by the decline in net capital inflows, is pointing at the vulnerability of the current stable exchange rate policy, if the expansionary trends continue on all fronts. At a minimum, high deficit will put upward pressures on domestic debt and increase domestic arrears. A balance of payments crisis and a disorderly adjustment of the exchange rate may occur as the worst case scenario.

The GOL presented some measures to deal with the budget deficit, at the NA’s meeting in June 2009. The GOL will rely on three main sources to finance the deficit: (1) raising additional revenues through imposition of additional excise taxes, as well as the restructuring of taxes and fees on luxury goods, and reduction in revenue leakages; (2) mobilization of additional donor funding; and (3) increase of domestic financing (issue of bonds). In addition, the GOL has expressed its strong intention to maintain macro-economic stability; continue economic reforms and make use of opportunities from the global crisis; accelerate regional and global integration; improve investment climate and increase private sector competitiveness; and promote equitable growth and reduce poverty in the country.

Provided the growth rates projected in this report materialize, additional measures would be needed on the expenditure side. In this regard the prioritization of expenditures would be key for the policies to support future growth. In order to reduce risks associated with the high credit growth, it is important that BOL substantially controls bank lending this year (it should slow to about 26 percent compared to 85 percent in 2008).

To be successful, any stimulus should be timely, targeted, temporary, and transparent. In this regard, there is a need to strengthen the fiscal and monetary policy coordination to maintain macroeconomic stability. It is also important that the expansionary fiscal policy is withdrawn as soon as SEA Games expenditures have been implemented. Without the fiscal space, Laos would not be able to maintain high fiscal deficits without a significant deterioration in stability through an unsustainable increase in domestic borrowing, followed by inflation, and exchange rate adjustment.

Major challenges for the GOL to overcome during this difficult time include: (1) financing the significant budget deficit (among other policy actions, some revenue and expenditure measures are needed to deal with this issue); (2) fiscal, quasi-fiscal, and monetary expansion could jeopardize fiscal sustainability and macroeconomic stability in the near future (phasing-out of quasi-fiscal operations and improvement of fiscal and monetary policy coordination is essential); (3) controlling future NPLs from recent high credit growth, especially for state-owned commercial banks; (4) and finally, the need for accelerating reforms in order to sustain growth and achieve the 2020 vision.

Lao PDR, a small country with limited resources and low capacity, cannot easily overcome the impact of the global crisis without a well-designed response plan and a clear financing strategy, for which significant external support will be needed. A balance between the announced measures and short- and medium-term macroeconomic stability is fragile and additional steps will be needed to ensure consistency of policy response.
Annex 1. Rapid Enterprise Survey monitors crisis impacts in the absence of quarterly data

In order to collect real time information on the possible impact of the global economic crisis on the Lao corporate sector, a Rapid Enterprise Survey was conducted during April 20-24, 2009. In total 140 firms located in four urban districts of Vientiane Capital were interviewed: 53 firms from retail trade, 40 from general manufacturing (11 export-oriented manufacturers) and 47 tourism businesses (33 hotels/guesthouses and 14 travel agencies).

Although about 69 percent of firms said that their businesses have been affected by the global economic crisis, impact on business performance and operations has so far been limited. About 44 percent of all firms surveyed reported higher revenues for the first quarter of 2009, compared to the same period last year (Annex Figure 1). Around 16 percent of firms did not experience change in their first quarter revenues and about 40 percent of firms suffered a decline in their first quarter revenues. Similar sales patterns can be observed across three of the three major sectors covered in the survey. The exception is the retail sector, where the percentage of firms reporting a decline in sales is slightly higher than those reporting increases (Annex Figure 2).

Limited impact of the crisis on firms’ operations further confirmed by limited adjustment made in employment and working hours. Findings of the survey indicated that overall only about 14 percent of firms reduced their staff in the past three months (about 10 percent for the tourism sector, 15 percent for retail and 18 percent for manufacturing), see A-Figure 3. Furthermore, the survey revealed that less than 3 percent of firms reduced the number of working hours and number of work shifts; only about 1 percent of all the firms surveyed reduced overtime hours or average wage during the first quarter of 2009.

Business confidence across the manufacturing, retail, and tourism sectors remains strong. None of the companies surveyed has plans to reduce the number of work shifts or overtime hours and only about 1 percent of firms have plans to reduce their average wage. Fewer than 3 percent plan to reduce working hours. Overall, about 6.5 percent of firms plan to reduce staff in the next three months. As expected, this number is higher for labor intensive sectors. For example, among manufacturers, about 13 percent of firms plan to reduce staff in the coming months, followed by the tourism sector, where about 6 percent of all the firms surveyed reduced overtime hours or average wage during the first quarter of 2009.

Although the majority of firms interviewed were less affected by the crisis in early months of 2009 they are likely to face more challenging environment during the second half of the year. About 44% of firms are still projecting higher revenues for 2009 compared to 2008 and about 40% are still planning to increase their investment during 2009 as they believed the domestic consumption will continue to be strong in coming months. Nevertheless, the impact of the crisis on local economy (especially export-oriented and tourism-related activities) is expected to increase during the second half of the year as the global economic recession continues, including recent spread of H1N1 virus.

1 The key findings of this survey are also consistent with the results of the Retail Confidence Survey conducted by Indochina Research Co., Ltd. According to which, most retailers in Indochina Region have been hard hit by the crisis with the exception of Lao PDR, where retailer conditions have actually improved (see details at: http://www.indochinaresearch.com/i-trak/reports.php)