Lao People's Democratic Republic
2014 Round Table Implementation Meeting

Statement by Sanjay Kalra
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Vientiane, November 14, 2014

1. Excellencies, ambassadors, distinguished participants, ladies and gentlemen. It is my privilege to represent the International Monetary Fund (IMF) at this Round Table Meeting for the Lao PDR. I would like to thank the Government of Lao PDR and co-organizers of this meeting for the opportunity to speak to you today.

2. In the remarks below, I draw on the close engagement that the IMF has with Lao PDR, including through the annual Article IV Consultation discussions. IMF staff visited Lao PDR during October to conduct the 2014 Article IV Consultation and we expect the IMF's Executive Board to conclude the Consultation in early January. In addition to policy advice, the IMF provides technical assistance to the Government of Lao PDR in several areas within its mandate and offers extensive training opportunities to Lao officials. The IMF also reopened its Resident Representative Office in Vientiane on October 1.

I. Developments and Outlook

3. Real GDP growth is expected to moderate to 7½ percent in 2014 (8 percent in 2013). Fiscal consolidation efforts have contributed to the slowdown while external demand and foreign direct investment (FDI) continue to support activity. Inflation has eased, largely from food and fuel prices. Credit growth has declined from excessive levels, a result of cuts in public infrastructure projects and Bank of Lao PDR's quasi-fiscal lending. Liquidity conditions in the banking sector have eased along with stress in foreign exchange funding.

4. Nevertheless, the external position remains vulnerable. The large current account deficit and the tightly-managed exchange rate continue to hamper reserves accumulation, and gross international reserves are still inadequate by several internationally comparable metrics. As growth slows, the current account deficit is projected to decline and reserves are expected to rise somewhat, though external vulnerabilities will remain elevated in the near term.

5. The government recognizes that the large increase in public sector compensation in 2013 was sharply expansionary and raised government spending and fiscal deficits. Fiscal tightening took place in FY2014 mainly through public sector pay freeze and investment cuts. The FY2015 budget continues to focus on containing the wage bill and reducing capital spending. However, on current policies, fiscal policy is expected to be neutral in FY2015 (compared to 2014) but would revert to easing thereafter. Public debt is projected to rise to about 65 percent of GDP, but the risk of external public debt distress remains moderate in the baseline owing to the high level of official concessional borrowing and a favorable long-term growth outlook.

6. Monetary policy remains accommodative and deposit growth brisk. As the loan-to-deposit ratio has declined, excess kip liquidity in the banking system has risen. Fiscal arrears have impacted

the business sector, with knock-on effects on banks. Bank balance sheets have weakened, with rising nonperforming loans (NPLs), declining profitability and sharply reduced capital-to-asset ratios at state-owned banks.

7. Over the medium term, real GDP growth is projected to average 7½ percent, supported by strong hydropower-related FDI. Inflation is expected to be in the mid-single digits. The external position would improve somewhat, as large-scale power projects come on line and lift exports. With the overall current account in large deficit and reserves projected to be inadequate for precautionary needs, however, the external position would remain very difficult. Delayed fiscal consolidation, a deeper-than-expected regional growth slowdown, and deterioration in terms-of-trade and private capital inflows are also critical risks to sustainable growth.

II. Policy Issues

8. Against this background, the Article IV Consultation discussions focused on:

- The need for an ambitious medium-term fiscal consolidation to put government finances on a sustainable footing and reduce external vulnerabilities. A more ambitious fiscal consolidation anchored around a nonmining deficit target of less than 5 percent of GDP would lower the current account deficit and help build up international reserves. Public sector financial management reforms are crucial to improve the quality of public spending.
- Greater exchange rate flexibility within the BOL's exchange rate band to strengthen the external position and tighter domestic monetary conditions to contain inflation. The exchange rate flexibility would facilitate reserves accumulation. It would also help avoid a sharp, potentially destabilizing, step devaluation and mitigate macroeconomic and financial stability risks from currency mismatches. Monetary tightening should help contain credit growth, and further limit the exchange rate pass-through to consumer prices. This can be achieved by draining excess liquidity from the banking system. Interbank market development and strengthening liquidity management, forecasting and the monetary policy framework are also priorities.
- Strengthening sound lending practices and crisis prevention for macro-financial resiliency. Reliance on liquidity provision, forbearance, and unsafe lending practices could lead to significant asset deterioration. Important steps to safeguard financial stability include: diagnostic assessment of systemic banks; a prompt corrective action framework; achieving minimum mandated capital requirements; and strengthening financial supervision. Timely implementation of the action plan agreed with the Financial Action Task Force to address AML/CFT deficiencies and a stronger crisis management framework should also be pursued.
- Further international trade integration will spur competitiveness, help improve the business climate, promote institutional reform and make growth more productivity-driven.

8. The needs for corrective action going forward does not lessen Lao PDR's achievement in poverty reduction and progress toward MDGs over the last decade, which is commendable. The focus on upgrading health and education infrastructure is the right one, and will contribute toward reducing inequality and making growth more inclusive.

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It only remains to thank once again the Lao PDR authorities and the organizers of this Round Table for the opportunity to participate in this meeting today. I would also like to reiterate the IMF's continued support for Lao PDR.