Recent Economic Developments

Key messages

1. Where are we?
   - The economy is **gradually recovering**, but partly **constrained by macroeconomic vulnerabilities and external environment**.
   - **Addressing macroeconomic instability** is an urgent priority.

2. What could be done?
   - **The Vital 5**
     - Revenue mobilization
     - Expenditure efficiency and reprioritization
     - Debt management
     - Financial sector stability
     - Business environment
The economy is gradually recovering

Gradual recovery

...led by the service sector rebound

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Gradual recovery

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Trade with China, Thailand and Vietnam

<table>
<thead>
<tr>
<th>Year</th>
<th>Trade balance</th>
<th>Exports</th>
<th>Imports</th>
</tr>
</thead>
<tbody>
<tr>
<td>2018</td>
<td>(2,000)</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2019</td>
<td></td>
<td></td>
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<td>2020</td>
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<td>2021</td>
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<td>2022</td>
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but recovery is partly constrained by macroeconomic vulnerabilities

Rising inflation has undermined the economic recovery

Inflation has been driven by a sharp kip depreciation and international prices

Limited foreign reserves and a stronger US dollar resulted in a sharp kip depreciation
but recovery is partly constrained by macroeconomic vulnerabilities

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Fiscal consolidation has been driven by expenditure tightening and interest payment deferrals despite better revenue collection

Source: Ministry of Finance.
but recovery is partly constrained by macroeconomic vulnerabilities

Limited fiscal space and rising debt service have constrained investments in human capital.

Debt sustainability hinges on successful renegotiations with major bilateral creditors and management of contingent liabilities.
but recovery is partly constrained by macroeconomic vulnerabilities

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External public debt stock
A. By creditors

Public external debt service 2022-26 based on 2021 debt stock
A. in US$ million

Source: Ministry of Finance.

While some aggregate financial soundness indicators improve, the financial sector vulnerabilities persist

Accrual interest to loans

Source: MOF
2. What could be done?

The Vital Five
Reforms to Secure Macroeconomic Stability in the Lao PDR

1. CUT COSTLY TAX EXEMPTIONS TO RAISE PUBLIC REVENUE, PROTECT SOCIAL SPENDING

Tax exemptions deprive the budget of much revenue every year, so less can be invested in human capital or used to service debt. Without investment in knowledge, skills and health, Laos will fall further behind.

2. IMPROVE THE GOVERNANCE OF PUBLIC AND PUBLIC PRIVATE INVESTMENT

Inefficient public investment is costly and public-private partnerships often create liabilities for the government.

3. RESTRUCTURE PUBLIC DEBT THROUGH ONGOING NEGOTIATIONS

High public debt levels undermine macroeconomic stability by constraining fiscal space, exerting pressure on the exchange rate, and jeopardizing banking sector stability.

4. STRENGTHEN FINANCIAL SECTOR STABILITY THROUGH LEGAL AND REGULATORY TOOLS

Vulnerabilities in state-owned banks may hamper private sector credit growth. This exposure to risk can have widespread impacts on the rest of the economy.

5. ENHANCE THE BUSINESS ENVIRONMENT VIA EFFECTIVE REGULATORY REFORMS

Burdensome processes and regulations raise business costs and reduce productivity, undermining investment and exports.