LAO PEOPLE'S DEMOCRATIC REPUBLIC

No. 87/2024

30 May 2024

SOVEREIGNS

Company Rating:	BB+
Issue Ratings:	
Senior unsecured	BB+
Outlook:	Negative

Last Review Date: 22/09/23

Company Rating History:

Date	Rating	Outlook/Alert
22/09/23	BB+	Negative
19/05/23	BBB-	Negative
20/05/22	BBB-	Stable
14/05/21	BBB-	Negative
15/05/20	BBB	Negative
28/06/19	BBB	Stable
12/06/17	BBB+	Negative
10/06/15	BBB+	Stable

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RATIONALE

TRIS Rating affirms the sovereign rating on the Lao People's Democratic Republic (Lao PDR) and the ratings on the Lao PDR's outstanding senior unsecured debentures at "BB+", with a "negative" outlook. The "negative" outlook reflects the risk of further depreciation of the Laotian kip (LAK) over the next 12-18 months, which could lead to further deterioration of the country's income level and exacerbation of its debt burden.

The "BB+" ratings reflect Lao PDR's modest financial buffer for debt servicing and a certain degree of liquidity management risk. They also reflect the country's modest income level, vulnerable external sector, high public debt burden, and challenges to the effectiveness of its monetary policy. We also consider gaps and delays in data reporting.

On a positive note, the ratings reflect the Lao PDR's sovereign profile as a small economy with high growth potential and political stability. Prioritising public debt management as the national agenda highlights the country's willingness to service its financial obligations. Investments in productive infrastructure assets will provide the Lao government with stable revenue sources in the long term and a potential source of liquidity for debt repayments when needed.

KEY RATING CONSIDERATIONS

Lao PDR's debt management strategy

The Lao PDR upholds public debt management as the national priority. The Lao government has consolidated its debt management efforts across key state agencies. The strategy prioritises asset sales, debt rescheduling and refinancing, and higher allocation of state resources for debt services. The intent is to refrain from incurring additional foreign-currency (FCY), or external, commercial borrowing, except for refinancing, and to secure funds from non-borrowing sources for debt repayments. Reliance on external concessional financing is only to fund developmental infrastructure projects.

Lao PDR has total external debt services of USD1.72 billion in 2024, according to the Ministry of Finance of the Lao PDR (MOFL). Of this amount, USD391 million are interest expenses. Repayment for commercial debt obligations is USD906 million. The projected total debt services for 2025 is USD1.53 billion. The Lao National Assembly endorses debt-service budgets ahead of each fiscal cycle. The budgets comprise full interest expense and parts of the principal repayments.

MOFL's recurring sources of funds for debt servicing include allocated debt-service budgets, and debt repayments from on-lending to state-owned enterprises (SOEs). Bilateral debt rescheduling of concessional and government-related loans, and commercial loans to close liquidity gaps should also remain critical. Although we expect the Lao government to continue making progress in asset sales and negotiated upfront payments from concessioned projects to add liquidity, these are subject to negotiation and the timing of transaction closing is uncertain.

Recent efforts to increase coordination across key state agencies should improve overall effectiveness in executing the country's debt management strategy. The consolidated public debt management spans MOFL, Électricité du Laos (EDL) and EDL-Generation Public Company (EDL-GEN). In our view, the participation of representatives from the MOFL at the board level of EDL and EDL-GEN is instrumental in undertaking the integrated debt management strategy.

Domestic financial system could provide some respite

The domestic financial system could help MOFL meet some of its FCY funding needs, but at a cost. The MOFL has been able to access short- to medium-term FCY credits from the domestic financial system on a commercial basis to refinance some of its existing debts. Thanks to excess system liquidity, some domestic commercial banks have provided loans and purchased FCY-denominated bonds issued in USD and THB by the MOFL on the Lao Securities Exchange (LSX). With that said, the domestic financial system is not large enough to sustainably absorb the country's current level of external debt. Higher exposure to government debt could further constrain the future capability of the financial sector to lend more to the government and crowd out credits otherwise available to the private sector.

High public debt burden

The public debt burden should remain high. We expect the high public debt to the gross domestic products (GDP) of 93% at end-2023 to trend down in 2024-2025. This is conditional on the successful implementation of the public debt management strategies, an absence of sharp currency depreciation, continued economic recovery, and an inflationary impact on the nominal GDP. Interest expense as a percentage of government revenue should also remain elevated above 15% level in the same period.

According to the latest MOFL's estimates, the external public debt outstanding was USD10.4 billion at end-2023, of which USD4.2 billion was commercial borrowing. Future improvement will hinge on successful asset sales, higher allocated debt repayment budgets, and proceeds from SOE debt repayments. At the same time, we expect higher local-currency (LCY), or domestic, public debt outstanding to reflect phased-in issuances of the new triangular bonds spanning the next few years. The purpose of the bonds is to finance some of the government's existing LAK17 trillion in arrears. As of end-2023, domestic public debt was LAK32 trillion, equivalent to around 12% of the GDP.

Contingent liabilities made up approximately 15% of GDP at end-2023. These largely reflect MOFL's guarantees for loans of EDL from Chinese lenders. The prospect of these liabilities turning into direct obligations remains limited, in our view.

Addressing external vulnerability will take time

The country's external sector is likely to remain vulnerable in the next few years, which should explain the potentially high volatility of the LAK. Key factors influencing the balance of payments (BOP) include a modest current account (CA) surplus and continued foreign direct investment (FDI) inflows. Major outflows reflect net government debt repayments and errors & omissions (E&O). The latter reflects leakage, or uncaptured outflows, which have been large in the case of the Lao PDR.

Over the next few years, we expect a modest CA surplus of around 2.0%-2.5% of current-account receipts (CAR), from growth in trade exports, tourism receipts, and secondary income. FDI inflows should contribute around USD900-USD1,000 million, mainly from China in the electricity, construction, and mining sectors. Risks facing the CA could stem from a potential surge in oil prices due to a sizable contribution of oil imports to the trade balance. Potential volatile outflows under other investment flows by resident non-governmental sectors could further add to financial-account risks.

We estimate the foreign exchange reserve (FX reserve) to be in the USD1.5-USD1.7 billion range in 2024-2025. This is inclusive of an FX swap line with the People's Bank of China (PBOC), which we estimate to be USD300-USD500 million. The total FX reserve can finance around 2.3-2.5 months of prospective imports, which remains modest. The gross external financing needs (the sum of current-account payments, external debt services and non-resident deposits) should account for around 110% of available sources (the sum of CAR and useable FX reserves).

Measures to be implemented by the Bank of Lao (BOL), once successful, should lower E&O. However, these will take time to implement and, hence, are not in our base-case assessment. These include measures to increase repatriation of export revenues and to improve monitoring of foreign-exchange transactions by residents and FDI investors.

Moderate growth in a highly inflationary environment

We expect moderate economic growth in a highly inflationary environment for the Lao PDR. We forecast real GDP growth of around 4.3%-4.5% in 2024-2025. Key growth drivers include a recovery of tourism-led service activities and FDI, whilst high inflation will curtail real purchasing power and real economic growth. GDP per capita in USD term is likely to be in the modest range of USD2,000-USD2,100 per annum in 2024 and 2025.

Inflation, based on the consumer price index (CPI) on a year-on-year basis, should stay above 20%, at least in 2024. We expect inflation upside risk on the backdrop of a weaker currency and high global commodity prices. The LAK is likely to remain under pressure from a potential spike in energy import bills and the country's net debt repayments.

Challenges to policy effectiveness of the monetary authority

The monetary authority will continue to face major challenges in its efforts to bring back price stability. Strengthening the credibility of the monetary policy will hinge on restoring confidence in the LAK after an extended period of high inflation and sharp currency depreciation. The country's high dollarisation and early-stage development of the domestic financial system with a small domestic debt capital market will continue to constrain the effective functioning of monetary transmission mechanisms. The ability of the BOL to be the lender of last resort for the domestic financial system is also limited.

The Lao PDR operates a managed float exchange rate regime. In a move to discourage foreign-exchange transactions in the parallel market, the BOL has widened the band of exchange rates offered by the commercial banks to +/-7.5% from the reference rate, from +/-4.5% prior to June 2023. Based on commercial banks' mid rates at the end of the period, the currency depreciated by 3% against the USD during the first three months of 2024 and 19% for the entire year of 2023. The gap with the parallel rates, however, widened to around 13%.

Several measures introduced by the BOL, once successfully implemented, could potentially enhance the monetary policy effectiveness and stability to the LAK. Again, these will take time to implement and are not included in our base-case assessment. These measures include the recently introduced open-market operation (OMO), and upcoming measures to improve monitoring of the flows of foreign-exchange transactions by residents and FDI investors and to increase repatriation of export revenues.

BASE-CASE ASSUMPTIONS

- Real GDP Growth: 4.3%-4.5% in 2024-2025
- FX Reserve: USD1.5-USD1.7 billion in 2024-2025 (inclusive of FX swaps)
- Fiscal Balance: around -1.0% of GDP in 2024 and 0.4% in 2025 (Primary Balance: 1.5% of GDP in 2024-2025)
- Public Debt/GDP: 78%-82% in 2024-2025

RATING OUTLOOK

The "negative" outlook reflects the risk of further deterioration in the economic fundamentals of the Lao PDR over the next 12-18 months.

RATING SENSITIVITIES

We could downgrade the ratings if there is further material deterioration in the country's debt serviceability or heightened liquidity risk. We could also downgrade the ratings if there is material deterioration in the country's macroeconomic conditions. A significant deterioration in the fiscal position, leading to a material increase in the public debt level could also lead to a downgrade scenario.

We could revise the outlook to "stable" if there is evidence of a sustained return to macroeconomic stability. This could happen, for instance, if there is an indication of a return to price stability and stabilisation of exchange rates amid a sustained economic recovery. In that scenario, we would also expect continued improvement in the BOP, leading to a sustained build-up of FX reserves, and sustained fiscal discipline.

COUNTRY OVERVIEW

The Lao PDR is the smallest economy in the Association of Southeast Asian Nations (ASEAN). The Lao PDR's GDP was approximately USD15 billion at end-2023, according to estimates from the BOL. The country's real GDP in 2023 grew by 4.2% in local currency terms. In terms of size, the Lao PDR's economy trailed the economies of Myanmar, Cambodia, and Brunei Darussalam.

The Lao PDR has abundant natural resources, such as copper, gold, and lignite, whilst positioning itself as the "Battery of Asia" as it has plenty of water resources suitable for generating power. Electricity, mineral, and agricultural exports to neighbouring countries constitute an important part of the revenues of the Lao PDR, accounting for more than 64% of total goods export value in 2022. However, government's capital investment in several infrastructure projects since 2015, the Coronavirus Disease 2019 (COVID-19) pandemic, and a recent depreciation of the LAK caused the country's public debt burden to reach 98% of GDP in 2022, from 56% in 2016.

Over the medium term, the Lao government has made significant efforts to address the country's fiscal and external vulnerabilities. However, most of these will take time to implement and yield the target results. Relevant measures include improved tax collection, a modernised public procurement system, removal of duplicate public administrative layers, and a contraction of the public-sector workforce. Importantly, under the 9th National Socio-Economic Development Plan (NSEDP), which spans the period of 2021-2025, the country aims to lower its budget deficits to 1%-2%. The plan emphasises allocations of additional government budgets towards public debt repayments, whilst delaying non-strategic capital investments. Other priorities include ways to increase revenues and cut expenses, criteria for eligible public investments, centralised fiscal and debt databases, and an improved legal framework. In addition, the Public Debt Management Law (2018) laid out a legal framework on eligibility and approval procedures of public investments and borrowing. The law is applicable country-wide to all government entities, SOEs, and other parties related to public debt management.

Similarly, promotion of local small- and medium-sized enterprises (SMEs) towards food-import substitution, diversification of agricultural exports, and re-prioritising towards export-oriented FDI, once successful, should greatly help improve the country's CA position. To improve the stability of the LAK, the monetary authority has engaged in currency swaps to support payments of FDI-related imports by directly using the currencies of some major trading country counterparties.

FINANCIAL STATISTICS AND KEY FINANCIAL RATIOS

	2019	2020	2021	2022	2023
GDP (mil. USD)	18,311	19,097	18,982	15,054 *	13,827 *
GDP per capita (USD)	2,654	2,704	2,650	2,072 *	1,876 *
Real GDP growth rate (%)	5.5	3.0	3.5	4.4	4.2
Nominal GDP per capita growth rate (%) (LAK)	6.7	3.9	5.5	14.9 *	21.3 *
Government revenue (mil. USD)	2,976	2,406	2,789	2,273	2,780
Government revenue (% growth)	4.5	(19.2)	15.9	(18.5)	22.3
Government revenue (% of GDP)	16.3	12.6	14.7	15.1	19.6
Government revenue from tax (% of total revenues)	67.1	72.4	68.2	76.8	75.0
Government revenue from non-tax (% of total revenues)	22.9	15.8	18.3	17.2	14.3
Grant (% of total revenues)	10.0	11.8	13.5	6.0	10.7
Government expenditures (mil. USD)	3,447	3,408	3,028	2,258	2,666
Government expenditures (% growth)	(2.9)	(1.2)	(11.1)	(25.4)	18.1
- Current expenditures (% of total expenditures)	67.1	64.0	67.9	70.7	66.5
- Capital expenditures (% of total expenditures)	32.9	36.0	32.1	29.3	33.5
Government budget balance (deficit) (% of GDP)	(2.6)	(5.2)	(1.3)	0.1	0.8
Government primary balance (deficit) (% GDP)	(0.6)	(2.3)	(0.1)	0.4	0.6
Government external debts (mil. USD)	9,936	10,610	10,413	10,495	10,411
Government external debts (% of GDP)	54.2	56.9	62.3	84.1	80.9
Government external debts (% growth)	4.1	6.8	(1.9)	0.8	(0.8)
Government external debt services (mil. USD)	750	933	894	708	1,118
Government external debt services (% of foreign exchange reserves)	78.8	53.3	53.4	50.0	68.7
External debts (mil. USD)	15,654	19,392	18,300	18,113 *	18,229 *
External debts (% of GDP)	85.5	101.5	96.4	120.3 *	131.8 *
Net external debts (% of current account receipts)	195.5	253.8	198.7	181.3 *	159.4 *
Balance of payments (mil. USD)	124	824	(84)	(257)	197
Official foreign exchange reserves (mil. USD)	997	1,821	1,737	1,480	1,677
Official foreign exchange reserves as months of imports (months)	1.9	4.1	3.3	2.5	2.6

Sources: 1) Bank of Lao (BOL)
2) Ministry of Finance of Lao (MOFL)
** Estimates by TRIS Rating*

RELATED CRITERIA

- Sovereign Rating Methodology, 30 May 2024
- Issue Rating Criteria, 15 June 2021

Lao People's Democratic Republic (Lao PDR)

Sovereign Rating:	BB+
Issue Ratings:	
MOFL24OA: THB340.90 million senior unsecured bonds due 2024	BB+
MOFL253A: THB1,119.20 million senior unsecured bonds due 2025	BB+
MOFL256A: THB6,000 million senior unsecured bonds due 2025	BB+
MOFL263A: THB3,880.80 million senior unsecured bonds due 2026	BB+
MOFL268A: THB304.70 million senior unsecured bonds due 2026	BB+
MOFL26NA: THB1,371.50 million senior unsecured bonds due 2026	BB+
MOFL278A: THB480.80 million senior unsecured bonds due 2027	BB+
MOFL27OA: THB2,967.00 million senior unsecured bonds due 2027	BB+
MOFL28NA: THB1,891.30 million senior unsecured bonds due 2028	BB+
MOFL28NB: THB532.50 million senior unsecured bonds due 2028	BB+
MOFL29OA: THB1,505.50 million senior unsecured bonds due 2029	BB+
MOFL30NA: THB2,153.20 million senior unsecured bonds due 2030	BB+
MOFL32OA: THB5,375.50 million senior unsecured bonds due 2032	BB+
MOFL25DA: USD162 million senior unsecured bonds due 2025	BB+
MOFL27DA: USD20 million senior unsecured bonds due 2027	BB+
Rating Outlook:	Negative

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