LAO PEOPLE'S DEMOCRATIC REPUBLIC

No. 76/2022
20 May 2022

SOVEREIGNS

Sovereign Rating:	BBB-
Issue Ratings:	
Senior unsecured	BBB-
Outlook:	Stable

Last Review Date: 17/02/22

Company Rating History:

Date	Rating	Outlook/Alert
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 bonds at "BBB-". At the same time, we revise the rating outlook on Lao PDR to "stable" from "negative" to reflect the stabilising trend of the country's debt servicing ability and the prospect of sustained improvements in the country's fiscal and external positions.

The ratings reflect the Lao PDR's sovereign profile as a small economy with high growth potential and political stability. We expect investments in productive infrastructure assets will provide the Lao government with stable revenue sources in the long term. However, the ratings also reflect the country's limited financial buffer and high public debt level, which is exacerbated by the volatility of the Laotian kip (LAK). The government's ability to meet its debt obligations, together with sustained improvements in fiscal and external positions will be among the key issues in our rating assessment on the Lao PDR over the next few years.

KEY RATING CONSIDERATIONS

Liquidity management remains critical

We expect the Lao PDR will be able to meet its near-term obligations, as it has prepared sufficient funding for debt repayment. With that said, the current ratings reflect the country's modest financial buffer and a certain degree of liquidity management risk. We expect major sources of foreign-currency funding to meet the country's upcoming external debt services will be as follows: 1) the government's ordinary revenue inflows, 2) receipts of debt repayments from the government's on-lending to certain state-owned enterprises (SOEs), 3) issuance of government securities in the domestic bond market, and 4) timely completion of negotiated debt refinancing and other non-borrowing sources, as was the case in 2021.

The country has scheduled external debt services of USD1.14 billion in 2022, according to the Ministry of Finance of the Lao PDR (MOFL). Of this amount, USD735 million are interest expenses on all borrowings and principal repayments of commercial debt obligations. Of all the public debts as of end-2021, around 82% were fixed interest rates obligations.

Fiscal deficits gradually narrowing amid high public debt

We expect the fiscal deficits of the Lao PDR will gradually narrow over the next few years. Fiscal deficits fell to 2% of gross domestic product (GDP) in 2021, from 5% in 2020, supported by higher revenues and lower expenditures. The 9th National Socio-Economic Development Plan (NSEDP: 2021-2025) aims to maintain the stability of fiscal and public debts under a comprehensive approach to fiscal and public debt management. Accordingly, the plan targets fiscal deficits of no higher than 2% over a five-year period, whilst prioritising expenditure cuts and debt burden control.

We expect the Lao PDR' public debt level will stay around 70% of GDP over 2022-2023, compared with 73% at end-2021, and 62% at end-2020. The higher figure is driven primarily by an increase in domestic borrowing and the weakening of the LAK. The public debt level in USD terms will likely gradually fall as the country closes its fiscal gap and the economy continues to grow.

In 2021, domestic public borrowing rose by LAK 10 trillion under the triangle-debt diversion initiative to restructure its previously undisclosed arrears to local private enterprises. A majority of these were 10-year amortising bonds at 6% annual interest, with principal repayments starting in the fourth year. Domestic commercial banks are the main subscribers of the bond issues. This in effect pushed domestic public debt to 11% of GDP at end-2021, up from 5% at end-2020. According to the MOFL, the bond issuance covers the amount of most of the arrears which should be non-recurring. In addition, we expect the external public debt of USD10.2 billion for 2022 will stabilise or gradually decline in subsequent years. New external borrowings should be primarily from concessional financing. Based on the end-2021 preliminary debt profile, around 63% of the external debts were concessional financing earmarked for development projects.

Contingent liabilities, which consist mainly of loan guarantees to Électricité du Laos (EDL), represent potential additional obligations for an amount equivalent to 12% of GDP. However, the prospect of these liabilities turning into direct obligations remains limited, in our view.

External vulnerability remains high

The external sector will likely remain vulnerable over the next few years. A combination of balance of payments (BOP) pressure and modest foreign exchange (FX) reserves will likely continue to weigh on the value of the LAK. Despite the expected deceleration in borrowing, we see the capital outflow pressure from scheduled repayments of external government debt will remain over the next few years. To a lesser extent, outflows from treasury management in the banking sector and portfolio investments should also persist amid global interest rate hikes and the weakening of the LAK.

However, we observe some positive developments that should help stabilise external balance in the longer term. These include the prospect of sustained improvements in the current accounts position in 2022, helped by improvements in merchandise trade balances and expected further recovery in service balances from the second half of 2022 onward. The projected private foreign direct investment (FDI) inflows of about USD950 million in 2022 should also help. We also note that upcoming regulations from the Bank of Lao (BOL), expected to be announced in 2022, aim to facilitate more timely inflows of offshore capital and reduce outflows of domestic funds.

We expect FX reserves will remain at a level near our previous forecasts of around 2.5 months of imports in 2022-2023, or four months when excluding FDI-related imports. This broadly equates to around a year of external debt services. The Lao PDR's FX reserves stood at USD1.45 billion as of April 2022, up from USD1.26 billion at end-2021. The BOP was USD57 million in deficit in 2021.

Additionally, we expect the Lao PDR's net external debt to remain elevated at around 190% of current-account receipts (CAR) in 2022, with external services of around 85% of FX reserves over the same period. We estimate the combined public and private sector external debt balance will be around USD16 billion in 2022.

A fragile economic recovery

We expect growth in real GDP of around 4%-5% in local currency terms in 2022, up from 3.5% in 2021. Sustained growth in electricity as well as agricultural and mineral exports should help contribute to the economic growth. Relaxed travel restrictions should help recoveries in service trades, invigorating local consumption. At the same time, we expect to see sustained FDI in targeted industries and public investments in infrastructure projects, which are funded by concessional borrowings. The most visible benefit from the new Lao-China rail link is an increase in the volumes of agricultural and mineral exports to southern China, thanks to the lower transport costs. The much-anticipated increase in incoming tourist traffic once the Coronavirus Disease 2019 (COVID-19) induced border-crossing restrictions are lifted, should further boost trade in services.

Notwithstanding the recovery prospect, as a small economy highly dependent on external trade, the Lao PDR is susceptible to the heightened uncertainty in global economy. Downside risks include external inflationary pressure from the weakening of the LAK to hamper growth of domestic economy and fragile economic recoveries of the country's key trading partners. As an indication, data from the Lao Statistics Bureau reported a year-on-year (y-o-y) growth in the consumer price index (CPI) of 9.9% in April 2022, up from 5.9% in April 2021.

Important steps taken to address vulnerabilities

In our opinion, the Lao government has made significant efforts to address the country's fiscal and external vulnerabilities over the past 3-5 years. 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 NSEDP Plan, the country aims to lower budget deficits to 1%-2% over a five-year period. The plan further 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.

We also view the government's ability and willingness to privatise certain state assets or offer concessions to the private sector as a source of financial flexibility. 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 current accounts. 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. However, most of these measures will take time to implement and yield the target results.

RATING OUTLOOK

The "stable" outlook reflects our view on the stabilising trend of the Lao PDR's debt servicing ability and the prospect of sustained improvements in the country's fiscal and external positions.

RATING SENSITIVITIES

We could downgrade the ratings if there are signs of heightened liquidity risk, or deepening deterioration in the fiscal and external positions that leads to further weakening of the external debt servicing ability of the Lao PDR.

We could upgrade the ratings if the country can demonstrate material progress in improving its economic fundamentals, its fiscal and external positions, and stabilising funding sources to service debt obligations.

COUNTRY OVERVIEW

The Lao PDR is the smallest economy in the Association of Southeast Asian Nations (ASEAN). The Lao PDR's GDP was approximately USD18 billion at end-2021, according to estimates from the BOL. The country's real GDP in 2021 grew by 3.5% 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's GDP per capita was projected to be USD2,552 in 2021.

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. Mineral and electricity exports to neighbouring countries are an important part of the revenues of the Lao PDR, accounting for more than 46% of total export value in 2020. However, government capital investment in several infrastructure projects since 2015 and the COVID-19 pandemic have caused the Lao PDR's external public debt burden to reach 60% of GDP in 2021 from 46% in 2016.

KEY ECONOMIC INDICATORS OF LAO PDR

	2017	2018	2019	2020	2021
GDP (mil. USD)	16,926	17,824	18,311	18,601	16,509
GDP per capita (USD)	2,467	2,585	2,654	2,634	2,305*
Real GDP growth rate (%)	6.9	6.3	5.5	3.0	3.5
GDP per capita growth rate (%)	2.2	7.8	6.7	3.9	5.5*
Government revenue (mil. USD)	2,750	2,849	2,976	2,427	2,281
Government revenue (% growth)	8.4	3.6	4.5	(18.5)	(6.0)
Government revenue (% of GDP)	16.2	16.0	16.3	13.0	13.8
Government revenue from tax (% of total revenues)	74.0	70.1	67.1	69.8	68.6
Government revenue from non-tax (% of total revenues)	8.1	4.9	4.9	20.4	20.1
Grant (% of total revenues)	9.6	6.2	10.0	9.8	11.4
Government expenditures (mil. USD)	3,698	3,552	3,447	3,357	2,614
Government expenditures (% growth)	10.8	(3.9)	(2.9)	(2.6)	(22.1)
- Current expenditures (% of total expenditures)	57.5	62.6	67.1	65.4	67.7
- Capital expenditures (% of total expenditures)	42.5	37.4	32.9	34.6	32.3
Government budget balance (deficit)(% of GDP)	(5.6)	(4.4)	(2.6)	(5.0)	(2.0)
Government external debts (mil. USD)	8,729	9,548	9,936	10,574	10,213
Government external debts (% of GDP)	51.6	53.6	54.3	56.8	61.9
Government external debts (% growth)	18.3	9.4	4.1	6.8	2.8
Government external debt services (mil. USD)	444	644	750	1,203	1,275
Government external debt services (% of foreign exchange reserves)	43.7	73.8	78.8	93.9	104.0
External debts (mil. USD)	14,189	15,137	15,654	16,287	16,326*
External debts (% of GDP)	83.8	84.9	85.5	87.6	98.9
Net external debts (% of current account receipts)	212.3	205.7	195.5	216.2	180.9
Balance of payments (mil. USD)	201	(143)	124	322	(57)
Official foreign exchange reserves (mil. USD)	1,016	873	997	1,319	1,262
Official foreign exchange reserves as months of imports (months)	2.2	1.7	1.9	2.9	2.4

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

RELATED CRITERIA

- Issue Rating Criteria, 15 June 2021
- Sovereign Credit Rating, 8 October 2013

Lao People's Democratic Republic (Lao PDR)

Sovereign Rating:	BBB-
Issue Ratings:	
MOFL22OA: THB1,019.80 million senior unsecured bonds due 2022	BBB-
MOFL23NA: THB1,063.80 million senior unsecured bonds due 2023	BBB-
MOFL23NB: THB2,546.50 million senior unsecured bonds due 2023	BBB-
MOFL24OA: THB340.90 million senior unsecured bonds due 2024	BBB-
MOFL253A: THB1,119.2 million senior unsecured bonds due 2025	BBB-
MOFL256A: THB6,000 million senior unsecured bonds due 2025	BBB-
MOFL263A: THB3,880.8 million senior unsecured bonds due 2026	BBB-
MOFL26NA: THB1,371.50 million senior unsecured bonds due 2026	BBB-
MOFL27OA: THB2,967.00 million senior unsecured bonds due 2027	BBB-
MOFL28NA: THB1,891.30 million senior unsecured bonds due 2028	BBB-
MOFL28NB: THB532.50 million senior unsecured bonds due 2028	BBB-
MOFL29OA: THB1,505.50 million senior unsecured bonds due 2029	BBB-
MOFL30NA: THB2,153.20 million senior unsecured bonds due 2030	BBB-
MOFL32OA: THB5,375.50 million senior unsecured bonds due 2032	BBB-
MOFL25DA: USD162 million senior unsecured bonds due 2025	BBB-
MOFL27DA: USD20 million senior unsecured bonds due 2027	BBB-
Rating Outlook:	Stable

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