

# LAO PEOPLE'S DEMOCRATIC REPUBLIC

No. 67/2017

27 September 2017

|                          |          |
|--------------------------|----------|
| <b>Sovereign Rating:</b> | BBB+     |
| <b>Issue Ratings:</b>    |          |
| Senior unsecured         | BBB+     |
| <b>Outlook:</b>          | Negative |

#### Sovereign Rating History:

| Date     | Rating | Outlook/Alert |
|----------|--------|---------------|
| 12/06/17 | BBB+   | Negative      |
| 10/06/15 | BBB+   | Stable        |

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#### Rating Rationale

TRIS Rating affirms the sovereign rating and the issue ratings of the outstanding senior unsecured bonds of the Lao People's Democratic Republic (Lao PDR) at "BBB+", with "negative" outlook. At the same time, TRIS Rating assigns the rating of "BBB+" with "negative" outlook to the Lao PDR's proposed issue of up to Bt14,000 million in senior unsecured bonds. The proceeds from the new bond issuance will be used to finance government budget and investment projects of the government. The ratings reflect the relatively high, albeit slowing, growth rate of the nation's economy. The ratings also reflect the nation's long-term political stability, the abundance of natural resources, rising government revenues from the hydropower sector, and the government's commitment to modernize the economy and alleviate poverty.

The "negative" outlook indicates TRIS Rating's increasing concerns over the rising level of external public debt, the lower-than-expected foreign reserves, and higher debt service payments. A recent decline in government revenues, especially those derived from non-renewable natural resources, could put more pressure on the fiscal budget management over the medium term as the government needs to invest more in infrastructure and hydropower projects. In addition, the up-to-date economic and government budget data are yet to be improved to facilitate the economic policy and public debt management.

The real gross domestic product (GDP) of the Lao PDR grew by 7.02% in 2016, according to the Bank of the Lao PDR (BOL). The growth is down from 7.27% in 2015. The drop is due to lower commodity prices that affect government revenues and export values. GDP in 2016, at current market prices, was US\$15.91 billion. GDP per capita rose to US\$2,221 in 2016, up from US\$2,051 in 2015.

The external public debt of the Lao PDR will increase over the medium term. According to the Ministry of Finance of the Lao PDR (MOFL), the external public debt is estimated to be higher than US\$8,000 million from 2018. TRIS Rating estimates that external public debt service will exceed US\$600 million, equivalent to about 60% of foreign reserves in 2018. This ratio broke the previous record of about 30% before 2015. TRIS Rating believes the Lao PDR's external public debt will rise and remain high over the medium term as the government finances a number of projects undertaken by the government itself and state-owned enterprises. Domestic funding sources remain limited. Because of its large external public debt, the Lao PDR is exposed to the risk from abrupt and large depreciations in the exchange rate. The value of Kip currency has been depreciated since January 2017. As of August 2017, Kip depreciated against US\$ to 8,282.29 Kip/US\$, 1.2% down from 8,185.91 Kip/US\$ in January 2017. At the same time, Kip depreciated against Baht to 250.99 Kip/Baht, 7.9% down from 232.57 Kip/Baht in January 2017.

Nonetheless, this exchange rate risk is partially reduced because bilateral and multilateral creditors are the largest of the Lao PDR government's external creditors. TRIS Rating believes that the terms and conditions of the loans from bilateral and multilateral lenders tend to be more relaxed and flexible than loans made by commercial lenders. In 2016, loans from multilateral and bilateral lenders to the government accounted for about 75% of total external public debt.

*CreditUpdate* reviews ratings of companies or debt issues that have already been rated by TRIS Rating. The *CreditUpdate* occurs when new debt instruments are issued or if significant events have taken place that may impact a company's current ratings or when current ratings are cancelled. The *CreditUpdate* announces whether a rating has been "upgraded," "downgraded," "affirmed" or "cancelled." The update includes information to supplement the previously published ratings.

*CreditUpdates* are part of TRIS Rating's monitoring process. TRIS Rating monitors every rating it assigns until either the debt instrument matures or the rating contract ends. To keep the public informed of changing situations, TRIS Rating periodically issues announcements about the credit ratings it monitors.

Government revenues declined by 12% in FY2016, after several consecutive years of double-digit growth rates between 2010 and 2014. Revenues fell due to an economic slowdown, a decline in commodity prices and a drop in grants. Tax revenue in FY2016 grew slightly, rising by 2.7%, far below the annual rises of 8.7%-15.9% in FY2013-2015. Moreover, revenue from grants dropped for the first time in FY2016, slipping by 63.9% from a year earlier.

Revenues from the hydropower sector are expected to keep rising, as several big hydropower plants are finished. Following the hydropower purchasing plan, 3,577 megawatts (MW) of power generated in the Lao PDR will be sold to the Electricity Generating Authority of Thailand (EGAT) in 2017, up from 3,086 MW in 2015. The International Monetary Fund (IMF) estimated that government revenues from hydropower projects are expected to be about 1.3% of GDP in 2017. The Asian Development Bank (ADB) estimated that the Mekong River sub-basin in the Lao PDR has about 20,000 MW of technically viable hydropower capacity. By 2020, it is expected that the Lao PDR will have about 8,100 MW of installed generating capacity to serve both domestic and export markets.

Government expenditures to service external debts are projected to grow faster over the medium term. Existing multilateral loans will gradually mature and be replaced with more commercial-based external financing at less favorable interest rates. TRIS Rating estimates that the ratio of external debt service to foreign exchange reserves will be as high as approximately 60% on average over the next three to five years.

The government and the monetary authority of the Lao PDR still need to improve their data collection systems and databases so that the databases are more comprehensive and the essential economic data are more up to date. Reliable and comprehensive economic data are needed so that the government can make the appropriate policies to achieve development targets or fix economic problems. At present, the BOL and the Lao Statistics Bureau (LSB), a part of the Ministry of Planning and Investment, are the two major agencies responsible for collecting and publishing key economic statistics. The development of data collection and reporting systems is underway, under the supervision of multilateral institutions. In addition, because the government has an ongoing need to raise funds from foreign capital markets, it needs to develop a comprehensive plan to manage the public debt. With a comprehensive plan, new debts will be used efficiently and the debt repayment schedule will be monitored in an effective manner. The operation of external public debt management is governed by the MOFL.

The political situation in the Lao PDR has been stable for 40 years, since the establishment of the Lao PDR in 1975. The nation has a single political party, the Lao People's Revolutionary Party, which has ruled the country for more than 40 years. The National Assembly of the Lao PDR appoints a president who will appoint the prime minister, vice presidents, ministers, and other officials with the consent of the National Assembly. The degree of political stability in the Lao PDR supports the continuation of the government's economic development plans and policies in a meaningful, effective manner.

### **Rating Outlook**

The "negative" outlook is based on a higher level of government debt and lower-than-expected foreign reserves. A rise in public debt will increase the debt service burden of the Lao PDR government over the medium to long term. The large amount of external public debt also exposes the Lao PDR government to foreign exchange risk and the effects of volatile exchange rates.

Official foreign reserves in 2016 declined to US\$814.93 million, a 17.4% drop from a year earlier. The drop in foreign reserves was caused by higher-than-expected capital outflows. Some of the outflow reflected repayments of external debts and a decrease in net foreign direct investment.

The recent decline in government revenues, especially those revenues derived from non-renewable natural resources, could put more pressure on the fiscal budget management over the medium term as the government needs to invest more in infrastructure and hydropower projects.

A change in outlook to "stable" is dependent upon the higher and greater stability of foreign reserves, the success of the government to enhance revenues on sustainable basis. The broadening of tax base and the completion of hydropower and other productive government investment projects could increase the government revenues and reduce the government dependency on external finance sources of fund. The reduction of the proportions of debt service-to-foreign reserves; the lower proportions of interest payment-to-government revenues; and the lower level of external debts are positive rating factors. The lower-than-expected level of foreign reserves and excessive public debts that lead to higher-than-expected external debt to GDP or the debt service-to-foreign reserves are negative rating factors.

## Lao People’s Democratic Republic (Lao PDR)

**Sovereign Rating:** BBB+

**Issue Ratings:**

|   |      |
|---|------|
| MOFL186A: Bt1,000 million senior unsecured bonds due 2018         | BBB+ |
| MOFL19NA: Bt4,802.90 million senior unsecured bonds due 2019      | BBB+ |
| MOFL206A: Bt5,000 million senior unsecured bonds due 2020         | BBB+ |
| MOFL21NA: Bt1,870.50 million senior unsecured bonds due 2021      | BBB+ |
| MOFL23NA: Bt1,063.80 million senior unsecured bonds due 2023      | BBB+ |
| MOFL256A: Bt6,000 million senior unsecured bonds due 2025         | BBB+ |
| MOFL26NA: Bt1,371.50 million senior unsecured bonds due 2026      | BBB+ |
| MOFL28NA: Bt1,891.30 million senior unsecured bonds due 2028      | BBB+ |
| MOFL25DA: US\$162 million senior unsecured bonds due 2025         | BBB+ |
| MOFL27DA: US\$20 million senior unsecured bonds due 2027          | BBB+ |
| Up to Bt14,000 million senior unsecured bonds due within 15 years | BBB+ |

**Rating Outlook:** Negative

**Key Economic Indicators of Lao PDR**

|  | 2011  | 2012   | 2013   | 2014   | 2015   | 2016p   |
|--|-------|--------|--------|--------|--------|---------|
| GDP (US\$ million)   | 8,061 | 10,193 | 11,980 | 13,274 | 14,420 | 15,910  |
| GDP per capita (US\$)  | 1,236 | 1,534  | 1,770  | 1,924  | 2,051  | 2,221   |
| Real GDP growth rate (%)   | 8.0   | 8.3    | 8.0    | 7.6    | 7.3    | 7.0     |
| Real GDP per capita growth rate (%)                                | 6.0   | 6.3    | 6.0    | 5.6    | 5.3    | 5.0     |
| Government revenue (US\$ million)                                  | 1,798 | 2,122  | 2,500  | 2,779  | 2,934  | 2,583   |
| Government revenue (% growth)                                      | 16.01 | 18.05  | 17.78  | 11.16  | 5.59   | (11.96) |
| Government revenue (% of GDP)                                      | 22.3  | 20.8   | 20.9   | 20.9   | 20.3   | 16.2    |
| Government revenue from tax (% of total revenues)                  | 65.6  | 64.2   | 64.6   | 65.1   | 66.3   | 77.4    |
| - Direct tax   | 15.4  | 17.3   | 15.5   | 12.4   | 13.5   | 15.9    |
| - Indirect tax   | 50.2  | 46.9   | 49.1   | 52.7   | 52.8   | 61.5    |
| Government revenue from non-tax (% of total revenues)              | 7.7   | 8.9    | 10.3   | 11.8   | 11.4   | 13.4    |
| Grant (% of total revenues)  | 26.7  | 26.9   | 25.1   | 23.1   | 22.3   | 9.1     |
| Government expenditures (US\$ million)                             | 1,955 | 2,251  | 3,148  | 3,290  | 3,580  | 3,404   |
| Government expenditures (% growth)                                 | 14.4  | 15.1   | 39.8   | 4.5    | 8.8    | (4.9)   |
| Current expenditures (% of total expenditures)                     | 52.3  | 52.0   | 64.4   | 63.7   | 60.8   | 65.3    |
| Capital expenditures (% of total expenditures)                     | 47.7  | 48.0   | 35.6   | 36.3   | 39.2   | 34.7    |
| Government budget balance (deficit)(% of GDP)                      | (1.9) | (1.3)  | (5.4)  | (3.9)  | (4.5)  | (5.2)   |
| Government external debts (US\$ million)                           | 2,944 | 3,937  | 5,092  | 5,723  | 6,531  | 7,203   |
| Government external debts (% of GDP)                               | 36.5  | 38.6   | 42.5   | 43.1   | 45.3   | 45.3    |
| Government external debts (% growth)                               | 4.8   | 33.7   | 29.4   | 12.4   | 14.1   | 10.3    |
| Bilateral (% of external debts)                                    | 42.4  | 46.7   | 50.7   | 54.3   | 54.1   | 55.2    |
| Multilateral (% of external debts)                                 | 57.6  | 49.3   | 35.8   | 30.8   | 22.8   | 19.2    |
| Government external debt services (US\$ million)                   | 150.5 | 154.7  | 166.8  | 214.9  | 245.6  | 368.6   |
| Government external debt services (% of foreign exchange reserves) | 22.2  | 20.9   | 25.2   | 26.3   | 24.9   | 45.2    |
| Balance of payments (US\$ million)                                 | (51)  | 61     | (78)   | 154    | 171    | (172)   |
| Official foreign exchange reserves (US\$ million)                  | 679   | 740    | 662    | 816    | 987    | 815     |

Sources: BOL, MOFL, and Estimation by TRIS Rating

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