

Structural weaknesses limit growth potential

General Information



GDP	USD9.3bn (World ranking 135, World Bank 2012)
Population	6.65 million (World ranking 103, World Bank 2012)
Form of state	Communist State
Head of government	THONGSING Thammavong
Next elections	2016, presidential and legislative



Strengths

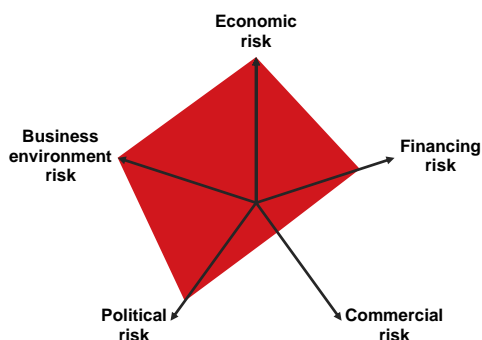
- Strong and stable GDP growth
- Large natural resources (mining, agriculture and water) boosting exports
- Increased FDI inflows
- Member of the ASEAN since 1997 and the WTO since 2013

Weaknesses

- Weak economic structure
- Very weak business environment
- Poor public finances with a sharp deterioration of the fiscal deficit in past years
- High external debt
- Low foreign exchange reserves
- Lack of transparency
- Excessive credit growth and risk of overheating

Country Rating

D4



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
Thailand	39% 1	62% Thailand
China	25% 2	16% China
Vietnam	14% 3	7% Vietnam
India	5% 4	3% Korea, Republic of
Japan	4% 5	3% Germany

By product (% of total)

Exports	Rank	Imports
Non-ferrous metals	21% 1	17% Petroleum and related materials
Cork and wood	19% 2	15% Road vehicles
Metalliferous ores and metal scrap	16% 3	6% Specialised machinery
Electric current	15% 4	5% Iron and steel
Apparel and clothing accessories	8% 5	4% Manufactures of metal, n.e.s.

Source: UNCTAD (2012)

Economic Overview

A buoyant growth path, driven by large investments and private consumption

Buoyant GDP growth in recent years (+7.8% 10-year average) has been largely driven by increased investment and rapidly growing domestic demand. Concerns over overheating of the economy have emerged since the rapid economic growth has been spurred by fiscal expansion and rapid credit growth. Growth is one of the least volatile in the region.

GDP growth is set to decelerate to +7.4% in 2014 and +7.0% in 2015, on the back of lower growth in Laos' two main partners: China (25% of exports) and Thailand (39% of exports). We expect that the Chinese appetite for metals and other raw materials which drove Laos' rapid export growth and large investments in these sectors, will be more moderate going forward.

Poor business environment remain a drag

Despite recent improvements, notably concerning the availability of credit and protecting minority investors, Laos is still ranked 148 out of 189 economies by the World Bank's 2015 Doing Business survey. Laos ranks at 189, in last place, regarding insolvency resolution. Moreover, the World Bank Institute's Worldwide Governance Indicators 2013 survey highlights serious concerns with regard to rule of law and control of corruption (ranked below the average of the East Asia and Pacific region).

Infrastructure is still poor, limiting export potential for this landlocked economy. Laos is ranked 131 st (out of 160 countries) in terms of International Logistics performance in the World Bank survey. This aspect is likely to improve going forward with rising infrastructure investment (international airports, railways) supported by public sector and foreign investors.

Lowering inflationary pressures

Inflationary pressures were elevated (+6.7% y/y in December 2013) but these decelerated sharply through 2014, reaching +3.05% in October 2014. It should average +4.3% over 2014 and pick up slightly to +5.0% in 2015.

Laos' buoyant growth has been accompanied by a rapid rise in credit (+32.1% y/y in September 2013), increasing the risk of overheating. It however slightly slowed down in 2014 (+20.1% in June 2014). Authorities are forcing commercial banks to implement Basel 2, to raise capital and increase supervision of the banking system. Non-performing loans are relatively low, at 2.1% in June 2014.

Public finances have deteriorated rapidly but fiscal consolidation is on the way

From 2012 to 2013, the fiscal balance deteriorated sharply, from -1.2% in fiscal year 2011-12 to -5.6% in FY2012-13. Government expenditures have surged from 24.8% of GDP to 29.9% in FY2012-13 due to (i) an increase in public sector wages, (ii) and higher capital spending while revenues growth has decelerated with lower revenues from mining. Faced with financial pressures, the government introduced new measures and amended budget laws to aim at reducing the large fiscal deficit. The ongoing fiscal consolidation should help contain the fiscal deficit to -4.6% of GDP in FY2013-14 and -4.0% in FY2014-15.

Public debt represents over 60% of GDP and is expected to stay at a similar level over the next years. Over 75% of the public debt is externally financed. Half of the total domestic debt is financed by the Central Bank for local

Key economic forecasts

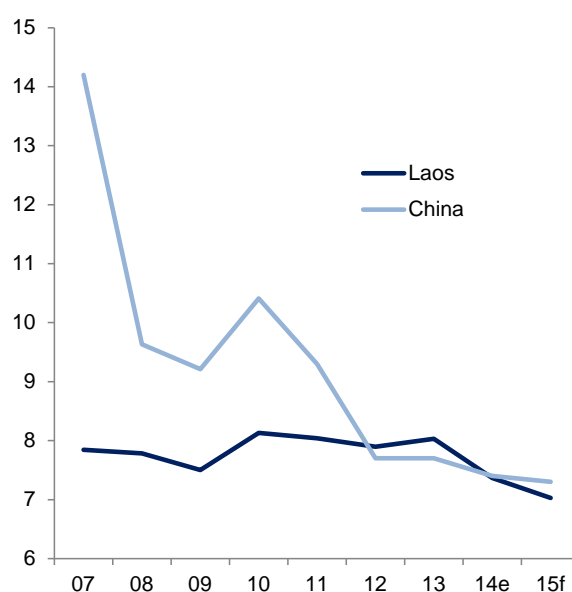
	2012	2013	2014	2015
GDP growth (% change)	7.9	8.0	7.4	7.0
Inflation (% , year average)	4.3	6.4	4.3	5.0
Fiscal balance (% of GDP)*	-1.2	-5.6	-4.6	-4.0
Public debt (% of GDP)*	62.2	61.3	61.2	60.1
Current account (% of GDP)**	-4.5	-3.6	-3.3	-2.8
External debt (% of GNI)**	70	68	65.6	64.2

*National data correspond to fiscal years, running from October 1 to September 30

** based on ADB historical figures

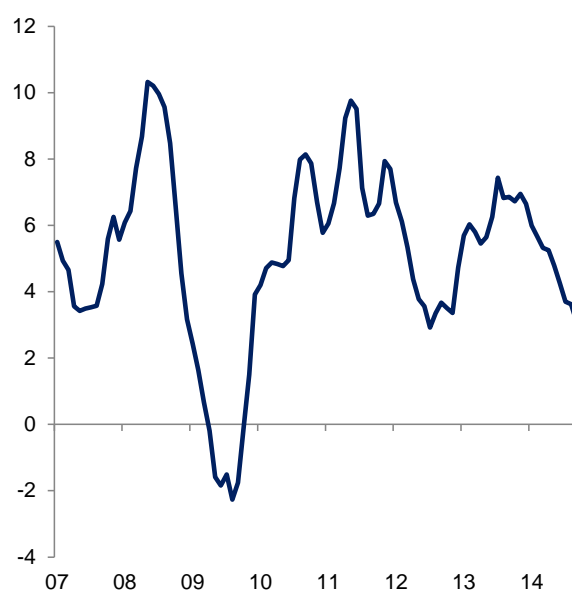
Sources: ADB, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IMF, IHS, Euler Hermes

Inflation rate (% , y/y)



Sources: National sources, IHS, Euler Hermes

government's off-budget infrastructures projects.

Large import growth led to a sharp deterioration of Laos' external position

In 2012, approximately 80% of exports were directed towards Thailand, China and Vietnam. Over a third of exports are composed of non-ferrous and ferrous metals, principally exported to China. With large hydraulic resources, the country also exports electric current to neighbouring countries (approximately 15% of exports in 2012). Laos has joined the ASEAN in 1997 and is part of the WTO since the beginning of 2013. The latter accession to the WTO should help the country diversify its export structure.

Current account figures are problematic and differ a lot between sources depending on the measurements of external trade figures. According to Asian Development Bank figures (figures in line with the Central Bank releases), Laos' current account deficit fell drastically from +2.0% in 2011 to -4.5% of GDP in 2012 given (i) increased domestic demand (in 2012, imports grew by +37.1% while exports by only +6.5%), (ii) falling mineral prices and (iii) the growing fiscal deficit. We anticipate that it will edge lower to approximately -3.3% of GDP in 2014.

FDI cover approximately 54% of the current account deficit. They have increased rapidly in recent years, notably in the hydropower sector.

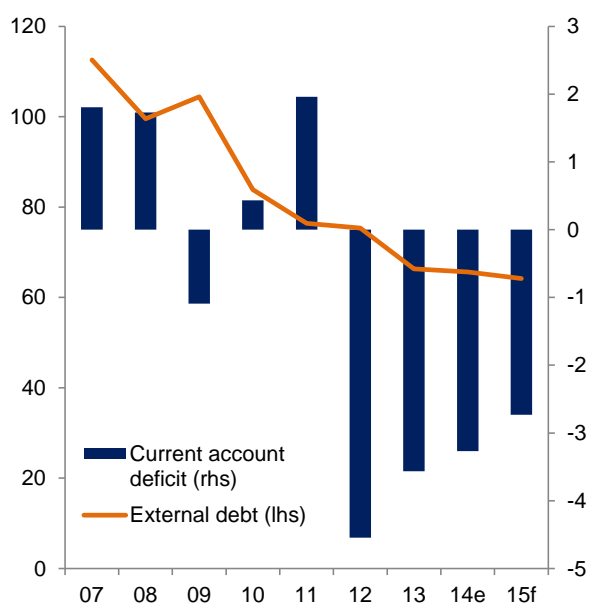
The country is highly vulnerable to external shocks

Laos' external debt is expected to account for approximately 65.6% of GDP in 2014. However a large share is based on concessional debt (mostly from the Asian Development Bank). In 2013, Laos sell its first sovereign bonds on the Thai market and two other bonds in 2014.

The currency is allowed to float within a +/- 5% band. The strong commitment helped the country to slowly become less dollarized. The dollarization rate, as measured by foreign currency deposits as a ratio of broad money, declined from 76% in 2000 to approximately 40% in 2013.

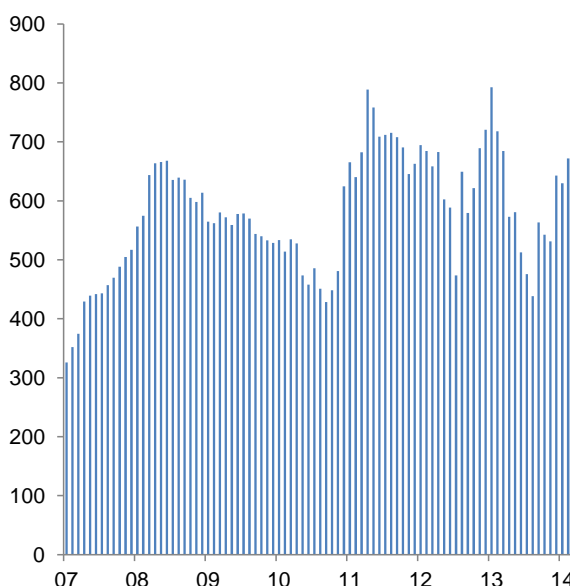
Foreign exchange reserves are volatile, often covering less than the recommended three-months of imports. In March 2014, reserves covered approximately 2 months of imports.

Current account balance and external debt (% of GDP)



Sources: ADB, IHS, Euler Hermes

Foreign exchange reserves (USD million)



Sources: National sources, IHS, Euler Hermes

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