



# Lao PDR in the time of COVID-19



## Lao PDR Economic Monitor Main findings

May 2020

- Lao PDR has so far avoided a health crisis but it has not been immune from the global economic downturn.** The COVID-19 induce economic downturn has affected Lao PDR through multiple channels including tourism, trade and investment, commodity prices, exchange rates and lower remittances. Given the uncertainty regarding the duration, pervasiveness and severity of the COVID-19 outbreak both at the global and domestic levels, this report presents a range of growth estimates for 2020 under two scenarios. These scenarios reflect different assumptions regarding: (i) the duration and depth of outbreaks and lockdown in Lao PDR; (ii) the magnitude and effectiveness of economic relief policies; and (iii) the depth and duration of the global downturn. In the more favorable scenario, the Lao PDR's economy is expected to grow at 1 percent while in the downside scenario the economy could contract by 1.8 percent. In either case, this will be the slowest growth rate since 1990.
- COVID-19 will further aggravate the long-standing structural vulnerabilities of Lao PDR.** The country has a legacy of weak macroeconomic management, resulting in limited fiscal and foreign currency buffers even before the global pandemic. The level of international reserves is at a multiyear low. The gap between the official and parallel market exchange rates has increased and is higher than historical norms. Despite lower public expenditure, weak revenue collection has resulted in an elevated fiscal deficit. The fiscal deficit is expected to rise to 7.5 to 8.8 percent of GDP and public debt to 65 to 68 percent of GDP in 2020, leaving the country at high risk of debt distress. Limited fiscal space, the mounting pressure of deficit financing and debt servicing will limit the ability of the Government of Lao PDR (GoL) to stimulate the economy, exacerbating the downturn.

### *The employment and welfare impacts have been severe*

3. **The COVID-19 crisis has affected mostly labor-intensive sectors and those linked to global and regional value chains.** Tourism-related sectors, including transport, food and accommodation services and the retail trade have been hard hit due to fewer tourists from China and other neighboring countries in Q1. This trend will further deteriorate in Q2 due to mitigation measures adopted in response to COVID-19 in other countries, the continued closure of Lao borders and the current domestic lockdown. Investment in these sectors is also expected to moderate. Small and medium-sized enterprises (SMEs) are particularly vulnerable in the current crisis. Supply chain disruptions have caused delays in delivering inputs to export-oriented manufacturing industries and the construction sector. Export-oriented industries have also been significantly hit by lower external demand.

4. **The COVID-19 outbreak and containment measures in Lao PDR and key economic partners are causing unprecedented disruption to the labor market.** A sharp drop in demand is leading to job losses in tourism-related sectors, which account for 11 percent of total employment. As the labor market comprises a considerable share of informal employment and workers outside the social insurance system, protection is minimal. In order to help those affected, the GoL is providing social insurance support to around 96,000 affected workers who are members of social insurance scheme. However, this coverage only amounts to 3.1 percent of total employment and 26 percent of total urban wage workers.

5. **The economic shock due to COVID-19 is also adversely impacting the flow of remittances and could push as much as 214,000 people into poverty.** Since the outbreak began, more than 100,000 migrant workers have returned to Lao PDR. This has resulted in an estimated reduction of up to US\$125 million in remittances in 2020, or 0.7 percent of GDP. Around 9 percent of households receive remittances from abroad, and remittances constitute 60 percent of their household income. This implies a significant reduction in recipient household income. Based on the two growth scenarios, poverty is estimated to increase by 1.4 to 3.1 percentage points in 2020. In other words, poverty is estimated to increase by about 96,000 people as a result of the pandemic or by 214,000 people if the downside scenario prevails. The impact of the pandemic on poverty is expected to linger, with poverty projected to return to its pre-crisis level in 2021 under the upside scenario, or later than 2022 under the downside scenario.

### *Public finances will reach a new low*

6. **Weak performance in the real sector will exacerbate the country's already weak fiscal position, further eroding fiscal space.** Declining business income, particularly in the services and manufacturing sectors, resulted in lower GoL revenue collection in the first two months. Preliminary estimates indicate that domestic revenue collection for January–February 2020 dropped by 30 percent year-on-year. The Ministry of Finance (MOF) estimates that revenue loss for 2020 will be about 3 to 4 percent of GDP, mostly from the fall of value-added tax (VAT), excise tax, profit tax, and customs duties. As a result, the fiscal deficit is estimated to increase to 7.5 to 8.8 percent of GDP in 2020 from 5.2 percent in 2019, while public debt is estimated to rise to around 65 to 68 percent of GDP from 59 percent during the same period. The risk of debt distress remains high.

7. **With large external debt service payments, GoL has limited options to refinance its debt.** Restricted domestic financing opportunities, coupled with the downgrading of Lao PDR bonds in the Thai

capital market, led GoL to issue bonds on the international financial markets at a below-investment-grade rating in 2019. The external debt servicing burden (interest and principal) is expected to increase to over US\$1.1 billion for each year in the medium term (about 55 percent of domestic revenues, on average). In this context, GoL may have to consider renegotiating debt with key creditors, participate in the recent Debt Service Suspension Initiative announced by the G20, and seek a joint donor support program.

### *Growing fragilities in balance of payments and financial sector*

8. **The country's external balance is vulnerable, with persisting low reserve buffers and a widening exchange rate premium.** The current account deficit is expected to increase in 2020 due to lower tourism activities, higher debt service obligations and lower remittances. As a result, the financing gap will widen and will require to be financed by fresh external borrowing and the drawing down of reserves. As a result, reserves are expected to decline to below one month of imports. The gap between the official and parallel market exchange rate has increased in recent months and is currently higher than historical norms. With limited access to commercial borrowing at reasonable cost, Lao PDR will need considerable support from its development partners to avoid a balance of payment crisis in 2020.

9. **The financial sector entered the COVID-19 crisis with considerable preexisting vulnerabilities.** While on average banks still hold regulatory capital above the minimum thresholds, the capital adequacy ratio significantly declined – from 18 percent in 2018 to 12 percent in 2019. Nonperforming loans (NPLs), as of end-March 2020, remain at 3 percent. However, the significant slowdown in economic activities due to the COVID-19 impact implies a higher level of NPL, which could in turn further weaken banks' balance sheets and constrain credit and growth. Significant deceleration of economic activities and forbearance given as part of the monetary stimulus measures are expected to exert more pressure on the already fragile financial sector.

### *Outlook and risks*

10. **The economic outlook will depend on the depth and duration of the global outbreak and the effectiveness of domestic economic relief measures.** Although subject to high uncertainty, growth is expected to gradually rebound to an average of 4.5 percent over the next two years under the upside scenario, assuming a gradual recovery in key trading partners and the resumption of some domestic economic activities. However, the pace of growth would remain below its 2019 level, due to limited fiscal and monetary buffers to support the implementation of economic relief measures. On the other hand, the downside case assumes a much slower recovery path due to limited policy buffers and a slower and longer recovery in key trading partners, resulting in growth rebounding to an average of 2.5 percent over the next two years.

11. **The medium-term outlook is characterized by significant downside risks.** These include: (i) a more prolonged and/or severe outbreak of COVID-19 either globally, regionally, or domestically, exacerbated by a more sluggish recovery in Lao PDR's key trading partners; (ii) heightened challenges in meeting public external debt service obligations; (iii) adverse weather-related events; and (iv) more significant impacts on the private sector, which could cause liquidity problems in business and defaults, exacerbating the already fragile fiscal situation and further weakening the financial sector. Given the

current fragile economic situation, one or a combination of these risks could result in a more severe downside scenario.

### *Policy options*

12. **To foster economic recovery, some measures have already been put in place such as tax relief and deferrals to businesses, expansionary monetary policy and credit moratorium.** The gains from these measures depend on targeting viable businesses (SMEs and large firms) that are temporarily affected by the COVID-19 shock but have ability to rebound. While providing support to businesses, accelerating revenue administration reforms would be essential to build the fiscal space for the GoL to mitigate shocks. Engaging in restructuring of external debt through the debt service suspension initiative and joint-donor support program could help alleviate some of pressure on the debt service in the medium term.

13. **Policy options to mitigate the impacts of the COVID-19 outbreak should provide immediate economic relief while supporting recovery and fostering resilience in the medium and long-terms.** First, given the limited fiscal space, it is important to reprioritize spending and mobilize additional resources to support well-targeted social assistance to affected households and businesses. These include direct cash transfer programs to economically vulnerable households and displaced workers. In the longer term, accelerating reforms to promote diversification and improve competitiveness in the private sector, supported by improved connectivity, will be important to strengthen economic and social resilience. More and better investment in human capital and social protection can also improve households' ability to handle the impacts of shocks.

### *Building a resilient health system for health emergency: Addressing system constraints for improving financing and service delivery*

14. **The global COVID-19 outbreak has challenged the readiness of the health system and the health emergency response capacity in Lao PDR.** Large gaps already exist in service availability and readiness across health facilities including the lack of basic amenities, limited diagnostic capacity, and low availability of essential medicines. The country urgently needs to invest more in building a strong foundation for emergency health response capacity in the areas of infection prevention and control, surveillance systems, laboratory networks, quarantines and isolation, case management, essential health service delivery, and risk communication to stop transmission and keep the virus under control.

15. **The COVID-19 outbreak has further strained the existing weaknesses in the health sector.** Most health facilities have insufficient isolation rooms and equipment for the treatment of patients with severe respiratory diseases. Frontline health workers lack personal protective equipment and adequate training on infection prevention and control and case management while demand on health facilities and health workers are rapidly increasing. Safety for health workers with appropriate training and reorientation of services for both COVID and non-COVID services are urgently needed to ensure delivery of effective health services for health workers and patients.

16. **Early evidence suggests that the COVID-19 outbreak has affected essential service delivery and disproportionately impacted women as well as poor and vulnerable groups who had inadequate access to quality health care services even before the outbreak.** The immediate impact of COVID-19 was felt in

disruption of essential service delivery. While it is still early to capture the full impact of COVID-19 to date, inpatient admissions and facility-based deliveries declined by 18 percent and 6 percent, respectively in Q1 2020 from Q1 2019. Antenatal care visits, skilled birth attendance and immunization rates have also declined. Providing financial protection and ensuring access to essential health services for those most vulnerable groups need to be prioritized to mitigate the impact of COVID-19.

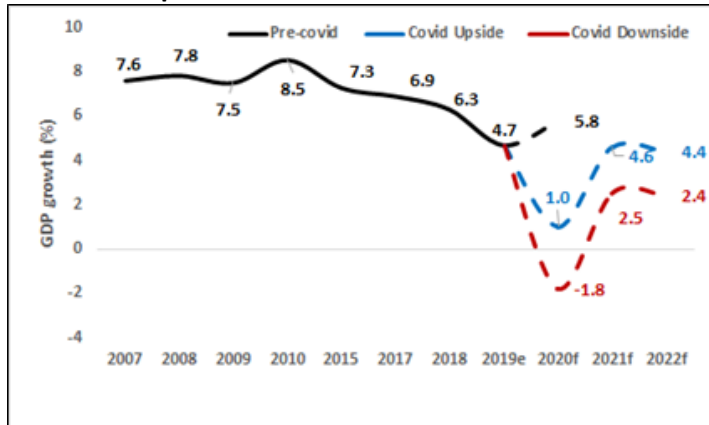
17. **Existing public financial management (PFM) bottlenecks in the health system can become major constraints for timely reallocation and release of public funds to frontline for emergency response.** In the context of health emergencies, a well-functioning PFM system would allow rapid transfer of resources to decentralized levels to help scale up service delivery, reprogramming and reallocation of sector budget for immediate response measures. Addressing key PFM challenges affecting service delivery will help shape the implementation of immediate response measures for COVID-19 and accelerate the health sector reforms to achieve Universal Health Coverage (UHC) and Sustainable Development Goals (SDGs).

18. **GoL needs to build a resilient health system to effectively respond to COVID-19 and other health emergencies while maintaining essential health services for all during the crisis.** The Ministry of Health (MOH) maintains that the country is at high risk with respect to the COVID pandemic, given the proximity and links with countries affected by COVID-19, and the limited capacity for public health emergency response. GoL needs to invest in building a resilient health system for public health emergencies and keep its commitment on UHC to ensure quality essential health services are available for all during the crisis.

19. **As the country anticipates the budget impact of COVID-19, it is important to protect the regular health budget while mobilizing additional resources for the COVID-19 response.** Failure to rapidly mobilize financing and coordination of response across sectors would result in adverse health and socioeconomic consequences. Given the limited fiscal space, getting support from development partners will be key to respond to this emergency shock and ensure essential services during the crises. In the medium term, more and better spending is needed to enhance the health system's capacity to respond to public health emergencies.

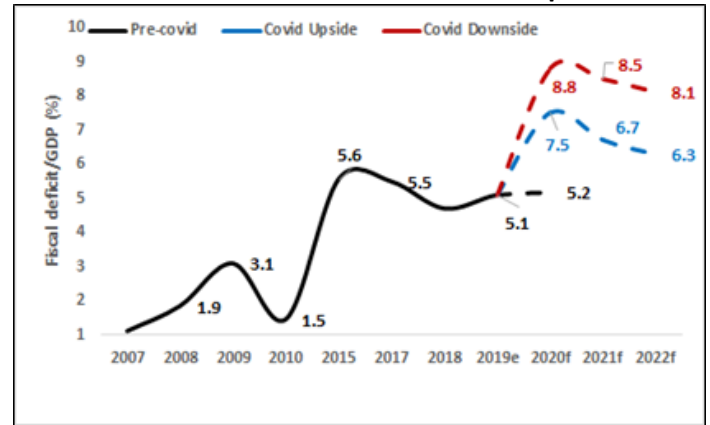
## May 2020 Lao PDR Economic Monitor at a Glance

### Growth is expected to decline in 2020



Sources: LSB; WB staff estimates and projections.

### The fiscal deficit and debt levels will trend upward...



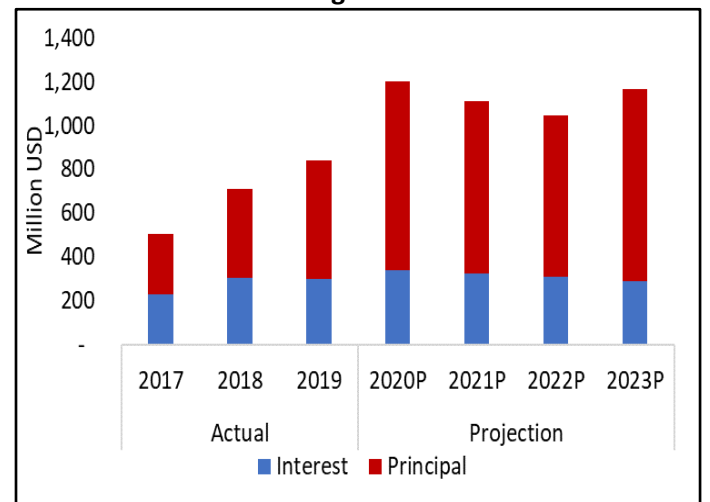
Sources: MoF, IMF WEO and World Bank staff estimates.

### ...and foreign reserves buffers will continue to decline



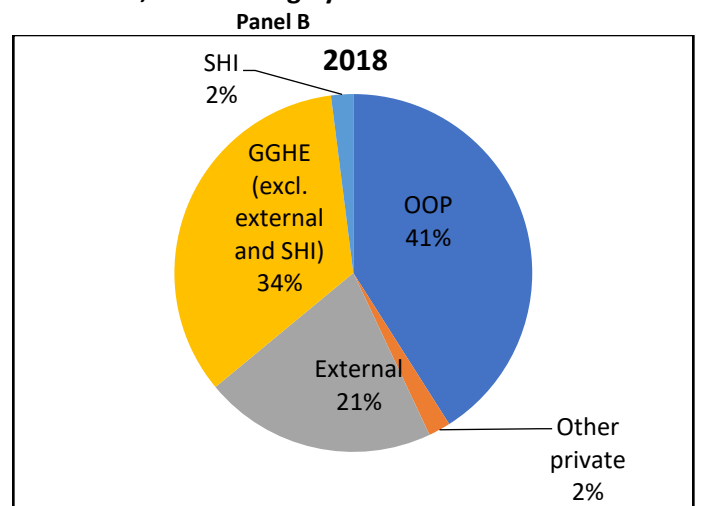
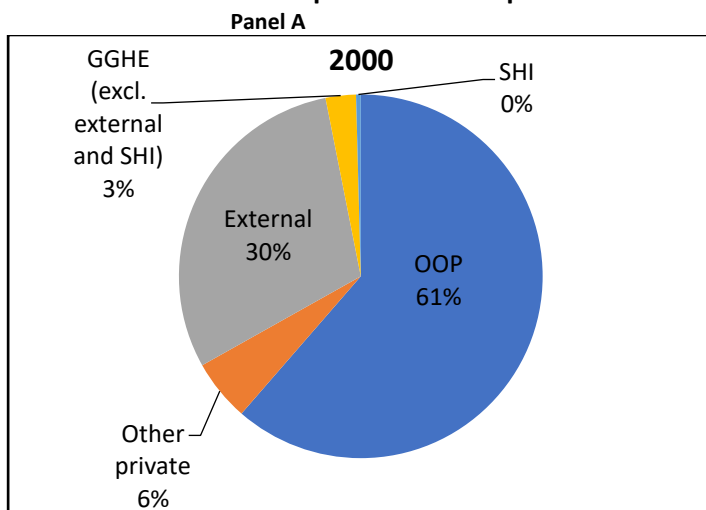
Sources: BoL; MoF; and World Bank staff estimates.

### Public sector debt servicing will rise in the medium term



Source: MoF.

### While the public health expenditure share has increased, it is still largely under resourced



Source: WHO Global Health Expenditure Database for 2000 data; MOH National Health Accounts for 2018 data.

Note: GGHE = general public health expenditure; OOP = out of pocket; SHI = social health insurance.