

Transcript of interview by Madame Vathana Dalaloy, Deputy Governor of the Bank of the Lao PDR to Foreign Affairs Magazine (FAM)¹

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**FOREIGN
AFFAIRS**

FAM: In the framework of 2010-2015 Economic Development Plan, what have been the key milestones for the country, especially in the monetary system and banking/financial sector?

DG Vathana: In the implementation of the 7th National Socio-Economic Development Plan (NSEDP), Lao PDR has made remarkable achievements on many fronts. The country has continued to maintain political stability and social order, which are considered as important preconditions to create favorable business and investment environment and promote robust economic growth. Lao PDR's economic growth expanded continuously at an average rate of 7.9% during 2010-2015, making the Lao economy one of the fastest growing economies in the world. This sound economic performance has improved the living conditions for Lao people as shown by the increase in average income per capita from US\$ 1,069 to US\$ 1,970 over the past 5 years, which brought Lao PDR up from a lower income country to a lower-middle-income country according to the World Bank. High economic growth also significantly contributed to lowering the number of poor households to an estimated 6.6 percent of the population in 2015, and allowed significant progress on the Millennium Development Goals.

In the context of these achievements, the Bank of Lao PDR has played a supporting role to implement the 7th NSEDP by maintaining monetary stability in the midst of an unfavorable external environment. We have employed flexible and market-oriented monetary and exchange rate policies to safeguard economic and price stability, while ensuring the soundness of the financial system. The stable macroeconomic environment has been characterized by low and single-digit inflation—4.7% on average per annum—

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and a stable exchange rate against major currencies, with movement within the target band of $\pm 5\%$. Money supply (M2) growth has been contained in line with the pace of economic development and the ratio of M2 to GDP is now at 60 percent. In the financial sector, the banking industry continued to develop and expand. There are now 42 commercial banks in Lao PDR, consisting of 4 state-owned commercial banks, 3 joint-venture banks, 7 private banks and 27 subsidiaries and branches of foreign banks. The Lao financial sector is bank-based, with banks' assets accounting for more than 90% of total assets of the financial industry. Overall, the banking sector remains sound with adequate liquidity in the system. The system-wide average Capital Adequacy Ratio is above the minimum requirement at around 18% in 2015 and the level of Non-Performing Loans has been kept below 5% of the total loans. Besides the expansion of the banking sector, the BOL also promotes non-bank financial institutions (NBFIs) in order to increase financial access to households in rural areas. As of 2015, there were 147 NBFIs supervised by BOL, consisting of 13 deposit-taking FIs, 31 non-deposit-taking FIs, 24 savings cooperatives and credit unions, 16 leasing companies, 32 pawn shops, and other types of NBFIs. To further support financial sector development, Lao PDR established its first stock exchange in 2010 with the purpose to raise long-term capital to finance socio-economic development.

FAM: What are the cornerstones and priorities of the 2016-2020 Economic Development Plan in relation to Lao PDR's central bank, monetary policy and banking governance?

DG Vathana: Under the 8thNSEDP (2016-2020), Lao PDR will aim to develop its economy to achieve sustainable and inclusive economic growth while protecting the environment, and bring the country to the next level of progress and development by graduating from Least Developed Countries (LDC) status in 2020 and ensuring the implementation of the Sustainable Development Goals (SDGs). To realize this aspiration, the government's key priorities for economic targets to be achieved under the 8thNSEDP are as follows: Annual average GDP growth of at least 7.5%; raise GNI per capita income to US\$2,520; and raise GDP per capita to US\$ 3,190.

In light of this development agenda, the Bank of Lao PDR will continue to make every effort for successful implementation of the 8thNSEDP by maintaining a stable macroeconomic environment. The BOL will perform its mandates to conduct

monetary policy and macro-prudential policy to achieve price stability and financial stability. We will continue to achieve key indicators as follows: To keep inflation below 6%; a stable exchange rate within the determined target band; maintain M2 growth within 30% and credit growth of 13%; build foreign reserves to cover at least 5 months of imports. On the banking sector, the Bank of Lao PDR will maintain a sound and resilient financial sector by closely monitoring the financial performance of banks and strictly enforcing prudential regulations. We will also focus on the development of financial infrastructure such as the modernization of national payments systems, accounting system, financial inclusion, and capital markets to support regional financial integration.

FAM: Lao PDR has growth expectations for 2016 of nearly 8%. Do you expect this level of growth to be sustainable?

DG Vathana: Taking into account our key development targets, Lao PDR aims to achieve economic growth of at least 7.5% per annum in order to raise per capita income and graduate from LDC status. However, drawing from the past development experience, the main drivers of economic growth were related to investment in the mining sector, and were likely susceptible to the volatility of global commodity prices. Therefore, in order to sustain economic growth in the long run, the government of Lao PDR will pay close attention to promoting sustainable and well-balanced economic growth with prudent public finance management, sound management of natural resources, and economic diversification. The government will also focus on non-resource sectors by promoting SME development and ensuring a sound investment climate and greater access to finance. In the 8th NSEDP, the government is determined to ensure macroeconomic stability and that economic growth is sustainable and environment-friendly in order to achieve green economic development in line with the objectives of the Sustainable Development Goals (SDGs).

FAM: To what extent does the financial and banking sector drive the country's development?

DG Vathana: The financial sector is undoubtedly a key to the country's economic development. The successful implementation of the 7th NSEDP was in part attributable to the significant lending by the financial sector to boost economic activities. Lending by

the banking sector has steadily increased, with average annual lending growth of 20% bringing the total stock of bank credit outstanding to the equivalent of approximately 50% of GDP. The Bank of Lao PDR also promotes diversification of the types of financial intermediaries, such as the banking sector, non-bank financial institutions and securities companies. A salient feature of financial development that has supported socio-economic development was the establishment of several specialized banking institutions, namely Lao Development Bank, Agricultural Promotion Bank and Policy-based Bank (Nayobay Bank), which provide financial resources with special interest rates to promote SME, agricultural and rural development. These banks have spread a wide network of financial services across the country. Lending by these institutions has allowed firms and households to grow and expand their businesses, thereby improving the livelihoods of people in rural areas and contributing to poverty reduction. Overall, it can be said that the financial sector is a key engine for economic growth and social progress, and helps fulfill the achievement of the government's development policies.

FAM: What are the challenges that you have faced, or still face, in growing and expanding Laos' financial and banking sector? What measures have been taken to tackle such challenges and are there any long-lasting challenges in the sector?

DG Vathana: The evolving financial landscape—which is being driven by regional financial integration, and especially the ASEAN Banking Integration Framework (ABIF)—presents both opportunities and challenges for the Lao banking sector. Regional integration will of course bring benefits for commercial banks through market expansion and a growing volume of cross-border financial and trading activities. In addition, integration will help to accelerate financial development through bringing the domestic regulatory supervisory framework in line with international standards, the enhancement of competitiveness and efficiency of domestic banks, and the improvement of Lao banking standards to match the criteria of Qualified ASEAN Bank (QAB). In terms of challenges, from the perspective of the Bank of Lao PDR, maintaining financial stability, encouraging financial development, and ensuring financial inclusion will require our close attention. For commercial banks, competition will be greater and exposure to risks will be higher, requiring them to enhance their competitiveness through strong capital positions, good strategies for risk management, stronger branch networks, more professional bank management, and a well-developed financial infrastructure. In this environment, there are three issues for banks' management that I would like to highlight. First, commercial

banks must develop correspondent bank and branch networks in the region to enhance their international competitiveness, expand their customer base and increase their market connectivity. Second, commercial banks—while still focusing on their core competencies—need to develop innovative products that enable them to respond quickly and effectively to a wide range of customer demands and to develop new business opportunities. Third, commercial banks must increase the efficiency of their operations to provide cost-effective financial services that are of high quality and cover a broad range of products. Business practices, strategies, and supporting systems will likely need to be improved in order to maintain market share and attract new customers.

In sum, in this era of financial integration, we must enhance the banking supervisory framework and its implementation, strengthen the competitiveness of Lao commercial banks, and improve capacity building for human resources in order to leverage regional integration to advance economic and financial development.

FAM: Can you briefly describe the current level of financial and monetary stability in Lao PDR?

DG: Vathana: Despite some challenges arising from the external environment, we believe that the overall financial and monetary conditions are manageable even in light of fiscal constraints associated with rising public debt. Overall, Lao PDR has been able to maintain robust economic growth, stable financial conditions, and low inflation and a stable exchange rate. The banking sector continues to grow, and remains broadly stable with adequate liquidity in the system. The average capital adequacy ratio is well above the minimum requirement at around 18% and the level of NPLs remains below 5%. Public confidence in the banking sector is high, as indicated by the level of deposits, which are equivalent to 51% GDP. Lending activity has expanded in line with economic growth, while banks have increased provisions in anticipation of default risk. From our perspective, with continued prudent financial policies and practices, including somewhat greater exchange rate flexibility to help absorb external shocks and support international reserves, Lao PDR will continue to maintain macroeconomic stability in the medium term.

FAM: How attractive is Laos for the international investment community? And what would you say are the most attractive opportunities for foreign investment?

DG Vathana: Lao PDR is situated in a strategic location and is surrounded by dynamic economies, and it is also one of the fastest growing economies in the region. At the same time, the country has political stability and an impressive economic record with high economic growth and low inflation. The government's policies and the country's characteristics are also very favorable for investors—in particular the regulatory framework, tax incentives, low labor costs, rich natural resources, and a relatively young and dynamic population. Furthermore, Lao PDR also has set up special and specific economic zones and is also entitled to the Generalized System of Preferences for 42 countries, which investors can enjoy some privileges. This means that there are tremendous opportunities for businesses to share and participate in the benefits from Laos's economic growth and potential. Given our geographical advantages and abundant natural and human resources, we highly encourage investors to seize the opportunity to invest in Lao PDR. Among many sectors in which investment would be welcome, energy, financial services, manufacturing, and tourism may be the most attractive areas for foreign investment.

FAM: How do you view the prospect of economic integration within the region as part of the ASEAN Economic Community? What opportunities does this create for Lao PDR, especially in terms of monetary and financial collaboration with the other country members?

DG Vathana: Lao PDR is integrating its economy into the wider region, and into the ASEAN Economic Community (AEC) that become effective at the end of 2015. The AEC will attempt to transform the ASEAN region into a single market and production base, a highly competitive economic bloc, a region of equitable economic and human capacity development, and a region that is fully integrated into the global economy. The AEC roadmap sets the goal of creating a single market and production base by allowing the free flow of goods, services, investment, and skilled labor, and a freer flow of capital, while attempting to reach out to the rest of the world. Participation in the AEC will bring benefits for the banking sector through market expansion and will provide a great opportunity to accelerate financial development through improvement of the domestic regulatory and supervisory framework, and of efficiency and competitiveness of domestic banks. The AEC will also enhance regional financial cooperation with other ASEAN

member states through sharing experience and best practices for the sake of building a resilient and strong region-wide financial sector.

FAM: Given the upcoming visit of President Obama to Lao PDR at the next ASEAN Summit, how would you characterize the relationship with the United States, as well as with institutions like the World Bank and the IMF? How have these partners assisted Lao PDR along the path of socio-economic development? In which areas do you expect to deepen cooperation?

DG Vathana: Lao PDR is very pleased to welcome President Obama as the first US president to visit the country. We strongly believe that his landmark visit will forge a warm and friendly relationship between Lao PDR and the United States. We sincerely hope that his visit will open a new chapter in our relations and provide a great opportunity to promote constructive dialogue and cooperation in areas of mutual interest. We also expect that more investors and entrepreneurs from US will come to invest in our lovely country. Lao people look forward to welcoming him with gracious hospitality and friendship.

As for the relationships between Lao PDR and the World Bank and the IMF, we have established excellent relationships over the past 50 years. Since Lao PDR joined these institutions, they have played a significant role in providing valuable technical assistance, financial resources and economic policy advice to support the implementation of the government's development agenda and development programs. With the generous support they and other donors have provided, the livelihood of the Lao people has been significantly improved. Lao people now enjoy better public service delivery, including access to electricity in rural areas and improved education and health. The active engagement by the IMF through technical assistance and policy advice has helped Laos to build strong institutions and boost skills to design and implement sound macroeconomic and financial policies. We were extremely delighted with the first visit of IMF Managing Director Madame Christine Lagarde to Lao PDR to witness the economic and financial development in our country and also to enhance cooperation between Lao PDR and the IMF through meetings with high-ranking leaders.

Lao PDR will continue to strengthen its relationships with the Bank and the Fund to promote effective cooperation and long-term macroeconomic stability. We look forward to receiving continued support from the Bank and the IMF in realizing the visions set out in the 8th NSEDP.