

Lao PDR Bond Market Challenges and Opportunities

This chapter discusses some of the real and perceived challenges facing the Lao PDR bond market, its policy bodies and regulatory authorities, as well as its participants, including potential issuers and investors who are nonresidents. This chapter also aims to describe the possible mitigating factors or market developments that could address these challenges in an appropriate manner.

A. Challenges in the Lao PDR Bond Market

The bond market in the Lao PDR is at the early stages of its development, with only a small number of bond issuers and small bond issue sizes. This limited supply naturally leads to a limited number of transactions and, hence, limited liquidity in the market. This is not helped by the fact that most investors interested in debt securities hold their investment to maturity.

One challenge for the bond market in the Lao PDR is the absence of market-making activities. As a result, issuers have experienced a lack of interest from investors who are not sure whether they would be able to sell their holdings in case of need. This entrenches the liquidity problem.

A number of these challenges are reviewed in this section in greater detail.

1. Interest Rate and Government Issuance is too Limited to Serve as Reference

Government bonds are not regularly issued and traded; therefore, there is no benchmark for corporates to use the interest rates as a reliable reference for the issuance of corporate bonds of their own. However, the MOF is considering the creation of government benchmark securities to address this issue.

At the same time, the interest rate in the banking system, in particular rates for deposit products, have been fairly high, which may make it unattractive for corporates to issue bonds if they need to compete with these interest rate levels.

2. Actual Corporate Bond Issuances

Although the LSCO has issued regulations governing corporate bond issuance by enterprises and listed companies, such corporate bonds have not yet been issued in the Lao PDR. In the near future, it is expected that corporate bonds issued by listed companies will be traded on the LSX (see also Chapter IV for details).

3. Lack of Liquidity

The Lao PDR bond market is still small in size, has limited products, and has no market-making function. As a result, there is a lack of liquidity in the market.

In this context, the LSCO, in collaboration with the LSX and relevant authorities, is undertaking research and preparing to develop and improve a wide range of securities products to meet fund-raising needs and increase investment options. These activities include formulating relevant legislation regarding the issuance of central and local government bonds, and government guarantees granted to enterprises wishing to issue corporate bonds to raise funds to finance useful projects for the general public, and other related legislation; promoting eligible enterprises to issue securities and list on the LSX; and preparing the establishment of collective investment schemes.

4. Lack of a Market-Making Function

At present, there is no party that undertakes a market-making function to ensure liquidity in the secondary market in the Lao PDR. As a result, the LSCO is researching the possibility of implementing such a concept and promoting suitable parties to take on this role.

5. Lack of Benchmark Government Bonds

Apart from the role as a fund-raising channel for the government to balance the budget and invest in prioritized projects, government bonds are also considered as a reference securities product for fund-raising of enterprises, particularly the issuance of corporate bonds. However, these bonds are not regularly issued and traded, hence, there is no reliable reference for the issuance of corporate bonds. For the medium- to long-term, relevant legislation is expected to be formulated to enhance investor confidence in the issuance of government bonds as benchmark bonds.

6. No Access for Nonresident Issuers

Nonresident issuers are not yet able to access the Lao PDR bond market. The drafting of specific regulations is expected to be considered in the near future.

7. Lao PDR Financial Reporting Standards versus International Financial Reporting Standards

Companies in the Lao PDR, including companies listed on the LSX, do not have experience in the adoption of the International Financial Reporting Standards. The LSCO has promoted and is ready to assist listed companies in adopting IFRS following 2 years of being listed on the LSX. However, the actual and practical adoption of IFRS by listed companies is proving to be difficult. So far, only one listed company has successfully begun to adopt IFRS and it still needs to implement IFRS in full across all its operations.

8. Capacity Building

The development of human resources and the building of public awareness and understanding of the capital market, including its practices and instruments, poses considerable challenges. In this context, the LSCO is planning to establish a capital market training and education center as it recognizes the importance of developing personnel capable of carrying out and supervising securities market activities.

B. Opportunities in the Lao PDR Bond Market

1. General Policy and Regulatory Environment

The journey toward developing a bond market in the Lao PDR is not without challenges and remains at the early stages. At the same time, the government has put significant efforts into promoting the development of the Lao PDR bond market. Necessary key legislation is being created or amended to ensure that the legislative framework governing the issuance of government and corporate bonds remains relevant and effective. Cases in point can be seen in the development and promulgation of regulations on the issuance of corporate bonds in 2014; the decision on issuance of corporate bonds abroad in 2016; and the decree on government bonds, which the BOL, MOF, and LSCO are jointly in the process of drafting. Following the enactment of such key legislation, subsidiary regulations will be issued and amended, including the LSX bond listing and trading regulations.

2. Introduction of Corporate Bond Issuance

The issuance of corporate bonds in the Lao PDR will represent another significant milestone in the country's capital market development. The introduction of corporate bonds as a new product in the market is expected to attract interest from both domestic and foreign investors and, therefore, should lead to an improvement in market liquidity. By issuing corporate bonds, enterprises will have an alternative channel for their fund-raising rather than relying solely on bank borrowing. It is hoped that successful initial issuances will set good examples for other interested parties to recognize the benefits of fund-raising through the capital market, thereby bringing more participants into the market.

3. Introduction of Bond Listing and Exchange Trading

The introduction of bond listing and trading on the LSX will, undoubtedly, contribute greatly to the efforts of the government in promoting liquidity in the Lao PDR capital market. The listing of bonds will improve transparency, price discovery, public awareness, and the credibility of the issuing companies, as well as make the issuing companies more accessible to investors.

4. Lower Interest Rate Environment

With reference to the challenge of limited interest rate references and interest rate levels not being conducive for potential issuers (see item A.1), the BOL issued a notice on 21 July 2015 to commercial banks to reduce their interest rates in consideration of the low inflation environment prevalent in recent years. This led to a gradual reduction of interest rates in the banking sector. This development could represent an opportunity for corporations to consider issuing bonds and using the bond market as an alternative method of raising funds.