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## Media Release

# RAM Ratings revises Laos' $_{g}B_{1(pi)}$ rating outlook to negative

RAM Ratings has revised the outlook on the sovereign ratings of the Lao People's Democratic Republic (Laos) to negative from stable, in view of the deterioration of its external position and the rising risk of financial instability. However, Laos' ratings remain intact for now at $_{g}B_{1(pi)}$ and $_{sea}BB_{3(pi)}$ on RAM's global and ASEAN scales, respectively, as these factors have not severely impaired fiscal and economic performance at this juncture. Laos' ratings could be moved downwards in the event of the crystallisation of contingent liabilities stemming from its weak banking sector. Increasing external risk, such as further deterioration of the country's reserves to short-term external debt coverage, would also be viewed as credit negative.

We highlight that Laos' ratings will be moved downwards in the event of the crystallisation of contingent liabilities stemming from the troubled banking sector. Increasing external risk, such as further weakening of the country's reserves to short-term (ST) external debt coverage, would also be viewed as credit negative. Conversely, the stable outlook could be reinstated if the abovesaid metrics display a marked improvement.

Based on the latest available data, the Laotian banking sector observed severe deterioration in 2014, with the non-performing loans ratio of state-owned commercial banks quadrupling to over 8% in Q2 2014 from a year earlier and capital adequacy ratios declining rapidly to 2.9%. The government's history of recapitalising banks during events of severe stress increases the likelihood of a near-term banking sector bailout. That said, Laos' fiscal position is expected to weaken in 2015 and 2016 as dampened commodity prices affect resource-based revenues. Coupled with elevated debt levels (2014: 60.6% of GDP), the tight fiscal space in our view limits the government's ability to support the banking sector.

Meanwhile, Laos' external vulnerabilities had been exacerbated by a spike in the short term external debt in 2014. A low level of foreign exchange reserves provided a short term external debt cover of only 0.9 times in 2014. This amplifies external payment risks and increases the country's sensitivity to global conditions, especially during periods of heightened risk aversion.

As a silver lining, GDP growth remained robust, clocking in at 7.6% in 2014, driven by the manufacturing and services sector. Strong FDI inflows, thanks to an improved

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business environment and competitive labour prices, have also contributed to economic performance and helped fund Laos' large current account deficit (2014: -10.0% of GDP). That said, the resource-rich country's growth is expected to slow slightly in the near term, as lower commodity prices affect economic activities and trade.

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**Date of release: 14 June 2016**



Published by RAM Rating Services Berhad