RAM RATINGS

Media Release

RAM Ratings downgrades Laos' rating to $_{g}B_{2}$(pi)

RAM Ratings has downgraded Laos' global-scale rating to $_{g}B_{2}$(pi)/Stable/$_{g}$NP(pi) from $_{g}B_{1}$(pi)/Negative/$_{g}$NP(pi) in view of the deterioration of its external position and the expected worsening of government finances as contingent liabilities from weak public-sector banks continue to rise. "The vulnerability of the country's external position is seen in reported large double-digit deficits in its current account for 2014 and 2015," notes Esther Lai, RAM's Head of Sovereign Ratings. Hefty imports and weak exports as a result of lower commodity prices are likely to keep the current-account deficit wide in the medium term, against previous expectations of a narrow deficit in 2016. Laos' external vulnerability is compounded by rising external debt amid low reserves. The country's coverage of reserves to imports and short-term external debt has been consistently below the IMF prudential standard and peer-average benchmarks. This heightens external payment risks and increases the country's sensitivity to global conditions, especially during periods of heightened risk aversion.

The downgrade also considers the persistent weakness in the banking sector, evinced by the undercapitalisation of banks and a large proportion of non-performing loans, primarily among state-owned banks. This raises contingent risks, given the government's history of recapitalising and supporting failing banks. The IMF has forecasted a bailout of approximately US$250 million (or 1.8% of GDP), which would pressure the government's already-high and widening fiscal deficit. RAM expects the government balance to reach -5.7% of GDP in 2016 (2015: -4.7 of GDP) on the back of declining revenue owing to weak commodity markets. Additionally, government debt levels are high at over 60% of GDP. With the bulk of government debt denominated in USD, the central bank's limited ability to maintain a tightly managed peg to the USD, given low reserves, exacerbates external payment risks.

Elsewhere, the IMF has forecasted growth of 7.0% and 6.7% in 2016 and 2017, respectively, driven by a less favourable external environment and slowing credit growth. Exports are largely concentrated in the resource and manufacturing sector and, hence, exposed to downturns in the economies of trading partners. Growth is expected to remain at 7% in the medium term, supported by the resumption of resource-related FDI such as hydropower projects.

A narrowing fiscal deficit as a result of a broader revenue base would be positive for the ratings, as would an improvement in the country's long-term economic potential and increased FDI into the country owing to developments in the business environment. Conversely, severe external pressures such as a prolonged, steep decline in FDI inflows, a marked deterioration in economic performance and/or an increasing risk of contingent liabilities, such that the government's financial metrics worsen beyond our expectations, could trigger negative rating action.

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