

ECONOMIC SITUATION REPORT FOR LAOS
FIRST QUARTER 1972

In November 1971 the Royal Lao Government instituted a package of stabilization reforms, including the following measures:

- 1. Twenty-percent devaluation of the free market exchange rate.
- 2. A corresponding 20% increase in kip valuation of imports for tax purposes.
- 3. Increased customs duty rates on some 200 less-essential commodities.
- 4. Prohibition of foreign exchange accounts at local banks.
- 5. Prohibition of money changers.
- 6. Mandatory identification and description of all free market exchange purchases.
- 7. An exchange equalization tax of 20% on imports paid for before devaluation.
- 8. Cancellation of customs and tax forfeit contracts.
- 9. Freezing of RLG salaries and restrictions on RLG recruitment.
- 10. Reinforced controls on consumer product prices.

With few exceptions, the basic reform package instituted in November remained in force through end-March. In early April, however, the RLG implemented a new series of measures designed to further stabilize the Lao economy. The effects of the November reforms, taken separately, can therefore best be assessed by reference to the period ending March 31, 1972. Available data for this period indicates the following main consequences of the November reforms:

- 1. Devaluation plus higher customs duties substantially reduced the volume of taxable merchandise imports. Non-go. customs revenues, however, increased.
- 2. The end-1971 speculative surge in gold imports ceased completely during the first quarter of 1972.
- 3. Domestic economic activity, according to most available indicators, tended to increase in the months following the November reforms. These increases were particularly pronounced in the tin and lumber export industries, whose rates of growth were well in excess of what could be explained by seasonal factors alone.
- 4. As imports fell and exports rose, total free market exchange demand declined 13% between 4Q71 and 1Q72, and a greater per cent of that demand was met from non-FEOP supply, including export earnings.
- 5. The 11.3% rise in the RLG's consumer price index between October 1971 and March 1972 was little more than half the magnitude of the November exchange rate devaluation (USAID's index increased 26% in the same period: 18% in November, and 8% in late March).
- 6. The RLG nonetheless was unable to contain expenditure pressures or to

compensate with other taxes for the 1Q72 fall in gold tax revenues, and therefore allowed its inflationary financing to continue upwards.

During the first quarter of 1972, government revenues fell to their lowest level in over three years. Principally responsible for this decline was the 85% fall in gold imports between the fourth quarter of 1971 and the first quarter of 1972. Gold imports had undergone increasingly violent fluctuations during 1971, and it may be that the fourth quarter spurt (both to make up for the trade's interruption due to flooding in the third quarter and as a speculative reaction to the kip devaluation in November and expectations of renewed gold/dollar convertibility in December) over-supplied Laos' diminishing gold re-export market. A partial recovery of public confidence in the kip in early 1972 plus the rise in world gold prices may also have contributed to the dampening of demand for gold. The November 1971 reforms appeared to have been successful in reducing merchandise imports while protecting the level of customs revenues: although the kip value of taxable merchandise imports declined 19% (a 25% decline in dollar value) between the fourth quarter of 1971 and the first quarter of 1972, non-gold customs revenues rose 6.2% in the same period. Other RIG revenues declined about 5% between these two quarters.

On the other hand, RIG certified expenditures rose by 6.6% from the fourth quarter of 1971 to the first quarter of 1972. All of this increase (kip 0.35 billion) occurred in the civil chapters of the budget.

The RIG budget deficit, in the face of rising expenditures and declining revenues, increased 13%, from kip 3.6 to kip 4.1 billion, between the fourth quarter of 1971 and the first quarter of 1972. To finance this larger deficit, the RIG increased its net inflationary borrowing by 7.3%, from kip 3.7 to kip 4.0 billion in the same period.

Despite the growth in RIG inflationary spending, total expansionary factors declined by 0.5 billion kip during the first quarter. This decline mainly reflected the cessation of France's foreign exchange inputs into and kip withdrawals from F&OF at end-1971, which off-set, in an accounting sense, the increases in kip desteralization by other F&OF donors in the first quarter of 1972. The Japanese Government desteralized about 0.5 billion kip in January to complete Wattay Airport improvements, but none in either February or March. USAID monetary expansion, after a substantial decline in the fourth quarter of 1971, returned to about the same level (kip 0.7 to 0.8 billion) of preceding quarters. Although private credit registered a moderate contraction in the first quarter of 1972 (after a very sharp increase in the fourth quarter of 1971), the level of private sector credit remained 13% above the corresponding quarter of the previous year, despite almost total elimination of foreign exchange accounts (against which no reserves requirements were applied) and with the support of only a moderate growth in kip-denominated deposits. As a percent of total private deposits, private sector credit rose from 89% at end-September to 181% at end-December 1971, and was still 161% at end-March 1972.

The impact of the factors contracting money supply declined substantially in the first quarter of 1972. USIP letters of credit fell to their lowest quarterly level as the last POL products were removed from the qualifying commodity list. BNL foreign transactions were only slightly contractionary: kip 176 million was bought by the BNL versus kip 165 million sold in exchange for foreign currencies during the quarter. F&OF net sales, on average, were well below levels recorded in the fourth quarter of 1971, but they increased sharply in March. Private time and savings deposits moved slightly downward for the first time in five quarters.

Expansionary factors thus continued to outweigh contractionary factors, and money supply rose by 7.4% between end-December and end-March. Part of this increase in kip holdings by the public was related to commodity price increases: the RLG price index rose by 3.6% (and the USAID index by 6.2%) in the same period, obliging the public to increase its money transaction balances by a corresponding amount. Prices could not explain all the growth in kip circulation, however, since real money supply (current supply deflated by the RLG price index) also moved upwards, regaining by end-March the level it registered in September 1971, before the economic reforms. This growth in real money supply implied an increase in liquidity balances (hoarding) or an expansion of real economic activity.

While the available indicators of real economic activity presented no uniform pattern, several did register strong gains which might tend to explain the growth in real money supply. Vientiane bank clearings, after a 27% decline in the fourth quarter of 1971, moved upwards again by 12% in the first quarter of 1972. Charcoal production increased 30%, although seasonal variation in demand may have been partly responsible. Both hog and cattle slaughtering advanced with respect to the preceding quarter and were well above levels attained in the same quarter of the previous year. On the other hand, local civil air travel registered a seasonal decline. Private construction also appeared to continue its long-run decline begun in 1970, but the construction data was not conclusive due to a change in the statistical series.

The most gratifying development was the strong upward movement of Laos's two major export industries, lumber and tin. Both these activities increased rapidly following the November 7 devaluation of the kip. From December 1971 to March 1972 tin concentrate production averaged 178 MT per month, the highest rate in more than three years and 58% above the preceding four months. Timber production in first quarter 1972 increased 69% with respect to the preceding quarter. The decline in local construction described above indicates that most, if not all, this increased timber production was export-oriented. The impact of this resurgence of exports on Lao foreign exchange earnings was indicated by the 37% increase in exchange surrenders to the BNL from exports in the first quarter of 1972, despite the fact that the exchange loss to exporters from such surrenders at the K240/\$ BNL rate increased by K100/\$ in November when the free market rate rose from K500/\$ to K600/\$.

ECONOMIC INDICATORS FOR LAOS - Data as of 5/25/72

	ANNUAL			QUARTERLY					MONTHLY, 1972		
	1969	1970	1971	71-I	71-II	71-III	71-IV	72-I	Jan.	Feb.	Mar.
<u>Foreign Exchange Supply(\$000)a/</u>	52743	48836	50930	13352	12839	12058	12681	10412	4023	2748	3041
Free Market Supply	47878	44659	47018	12715	11738	11283	11282	9817	3872	2533	3412
USIP L/C's	1971	2230	2029	329	609	417	674	200	0	158	42
BNL Official Receipts	2894	1947	1883	308	492	358	725	395	151	57	187
Exports	601	720	646	184	205	117	142	194	58	20	116
Embassies & Missions	2231	963	1048	96	240	178	534	89	47	29	13
French Embassy	812	720	632	3	144	162	324	6	3	3	0
Administration	62	264	187	28	48	63	49	112	46	8	58
BNL Sales of FX (\$000)	2544	2671	1933	374	446	443	670	424	222	108	94
<u>Imports</u>											
Gold Imports (kg)	32024	41766	15916	6250	2796	750	6120	925	475	0	450
Other Taxable Imports(Kip M)	11488	8432	8003	1854	2000	1714	2435	1971	762	538	871
Petroleum	1048	1088	1050	257	271	255	268	312	178	98	38
Other	10440	7344	6963	1657	1679	1460	2168	1659	584	440	635
Exports to Laos by:											
Japan (Million Yen)	2956	2402	2190	729	471	579	412	161	44	60	57
Hong Kong (HK \$000)	9954	8261	12434	2531	3108	2942	3853	2682	989	605	1088
<u>Government Finance (Kip M)</u>											
Revenues	7751	7933	6569	1646	1653	1582	1688	1567	590	472	505
Certified Expenditures b/	16680	18767	20246	4599	5148	5662	5335	5688	2018	1830	18388
Budgetary Deficit b/	8929	10834	13677	2953	3495	4080	3647	4119	1428	1358	1420
Payments	17006	18611	21610	5091	5684	5682	5225	5578	1777	1852	1949
Cash Deficit	9255	10678	15039	3381	4031	4100	3537	4008	1185	1380	1443
Borrowing from BNL	9275	9610	14500	3330	3700	3570	3900	4070	1070	1700	1300
Treasury Assets*	372	130	202	341	125	109	202	246	(-4)	488	246
Liabilities to Private Sector*	528	482	176	258	227	259	176	138	181	197	138
<u>Money Supply (Kip M)*</u>											
Index (1968=100)	114.3	127.3	156.7	132.2	144.2	151.6	156.7	169.1	160.2	163.6	169.1
Increase (Kip M)	1461	1845	3560	600	1448	888	624	1406	419	417	570
Real Money Supply Index(1968=100)	110.4	125.0	139.8	129.3	138.4	144.8	139.8	145.2	142.8	142.6	145.2
% Change, year-to-year	9.4	13.2	11.8	17.9	22.9	20.7	11.8	12.3	10.2	13.7	12.3
<u>Factors Expanding Money Supply (Kip M)</u>											
RLG Net Inflationary Borrowing c/	9723	9806	14122	3154	3627	3617	3724	3997	1281	1233	1483
USAID Monetary Expansion d/	2842	3131	2751	793	710	750	498	737	232	232	273
Private Credit Expansion	293	744	678	199	26	(-49)	502	(-134)	(-5)	247	(-376)
French & Japanese Desterilization	940	1023	1084	0	19	215	850	483	483	0	0

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Banking (Kip M)											
Total Private Deposits*	1965	2536	1774	2382	2767	3058	1774	1920	1930	1834	1920
Kip Demand Deposits	1356	1182	1231	1165	1341	1557	1231	1427	1374	1292	1427
FX Demand Deposits	464	968	40	845	995	1032	40	26	34	27	26
Kip Savings/Time Deposits	145	386	503	372	431	469	503	467	522	515	
Credit Outstanding to Private Sector*	1798	2542	3220	2741	2767	2718	3220	3086	3215	3462	3086
Vientiane Bank Clearings	54786	53023	21291	5208	6153	5738	4192	4684	1751	1332	1601
Prices in Vientiane(1968=100)*											
RLG Lao Household Index g/	103.1	102.2	109.2	102.2	104.2	104.7	112.1	116.5	112.2	114.7	116.5
USAID Food & Household	93.7	78.7	100.2	78.6	83.9	85.5	100.2	106.4	102.7	101.8	106.4
Production											
Timber (Thousand M ³)	117.9	73.2	76.4	19.4	31.2	12.7	13.1	23.1	7.9	7.2	8.0
Tin Concentrate (MT)	1262	1380	1573	442	354	326	451	522	179	155	188
Charcoal (Thousand MT)	13.4	10.4	10.1	2.7	3.3	2.2	1.9	2.5	.4	1.7	.4
Private Construction £/(Kip M)	1112	2516	770	308	235	136	91	69	56	0	13
Private Construction £/ (Thous. M ³)	59.7	61.9	22.3	8.2	6.9	4.4	2.9	2.0	1.7	0	.3
Domestic Civil Passengers(Thous.)	93.9	99.9	66.6	13.7	18.4	16.6	17.9	13.1	4.8	4.6	2.9
Consumption											
Electricity (Vientiane, Million KWH)	31.4	37.9	48.7	11.2	13.7	12.2	10.7				
Petroleum Products(Million Liters)g/	110.5	107.3	143.8	27.1	31.3	24.5	30.5				
Cattle Slaughtered (Thousand)	8.6	8.4	7.5	2.0	1.4	2.0	2.1	2.2	.6	.9	.7
Hogs Slaughtered (Thousand)	55.4	54.2	53.9	13.4	11.2	14.6	14.7	14.8	3.6	6.3	4.9

* Level at end-of-period.

a/ Total supply equals Free Market plus USIP plus BNL receipts. BNL receipts exclude SDR and investment proceeds.

b/ Subject to revision after late reports received from provinces.

g/ Net inflationary borrowing equals borrowing from BNL plus reduction in Treasury assets plus increase in liabilities to private sector.

d/ USAID monetary expansion equals kip receipts in connection with FCOF plus reduction in net holdings.

e/ Average of two semi-monthly surveys.

f/ Construction data until 2/72 is from permits to initiate work; data thereafter is from completion reports.

g/ Excludes deliveries on USAID contract to points south of Vientiane.

M = Million; M³ = Cubic Meters.

For prior month detail, see TOAID A-101, dated 2/25/72.