

# Cambodia

## Economic Assessment

Estimated GDP growth in 2003 has been updated to 5.2% from 5.0% in *ADO 2004*, on the back of a recovery in agriculture from a drought-induced decline in 2002 (Figure 2.5). However, the dry season paddy crop in 2004 is estimated at 873,000 tons, a 3.7% decline from a year earlier, mainly due to drought conditions in the first half of the year. Bad weather also delayed cultivation of the larger wet season crop, and the 900,000 hectares that were reportedly cultivated by mid-August 2004 were 10% less than the area cultivated in 2003.

Although no official data on industrial output are yet available for the first half, robust export growth in garments, the main manufacturing industry, suggests a healthy expansion. So, too, does the increase in the number of tourist arrivals, up 21.8% in the first quarter, displaying a recovery from 2003 when the SARS outbreak and riots hurt visitor numbers. Investment approvals show a less optimistic picture though, with the total for the first quarter of 2004 falling by 42% from the previous year to \$63.3 million. The 12-month delay in forming a government after elections in July 2003 soured the business and private investment climate.

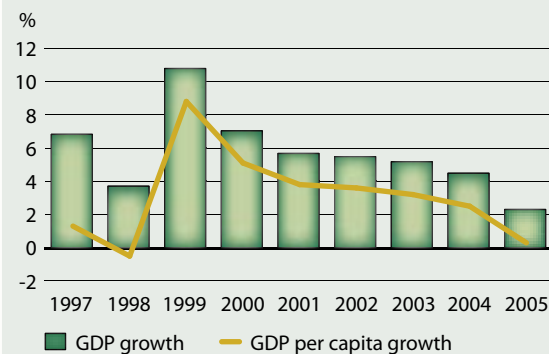
This political impasse also meant that the 2004 budget has yet to be passed. As an interim measure, revenue collections and expenditure allocations have been made in accordance with the 2003 budget provisions. Actual revenues and expenditures lagged the targets, though the revenue intake in the first half still exceeded the corresponding intake in 2003 by 25% because of increases in the collection of VAT and excise duties. Expenditures fell by 12%, with much of the decrease seen in nonwage operating costs and social transfers. The decline is attributed to a lack of absorption capacity and entrenched governance problems.

Broad money (M2) growth accelerated to 13.5% in the first 5 months of 2004, from 5.1% a year earlier. The main reason was a rise in net foreign assets of the banking system, reflecting an improved external account. However, domestic—largely private sector—credit expansion moderated, in response to a business environment somewhat subdued by the political uncertainties.

Inflation on a year-on-year basis accelerated from 0.5% in December 2003 to 3.0% in June 2004, on account of greater transportation costs (pushed up by higher fuel prices) and steeper food prices. The latter were driven by higher fresh fish prices, which in turn derived from the impact of a smaller catch in the Mekong River's lower water levels in the first half of the year.

Preliminary customs data for the first quarter of 2004 indicate that merchandise exports climbed by 24.2% year on year, with significant rises in shipments of garments and natural rubber. Import data for this period, however, indicate that merchandise imports contracted by 10.4% owing to a decline in tax-exempt imports (aid-financed imports and inputs for the export-oriented garment industry) and in petroleum products. The downturn in tax-exempt imports may be a

Figure 2.5 GDP and GDP Per Capita Growth, Cambodia, 1997–2005



Sources: National Institute of Statistics; staff estimates.

**Table 2.5 Selected Economic Indicators, Cambodia, 2004–2005, %**

Item	2004		2005	
	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update	ADO 2004 Update
GDP growth	5.4	4.5	5.4	2.3
Inflation (CPI)	2.9	2.3	3.3	3.0
Current account/GDP	-4.3	-10.0 <sup>a</sup>	-5.6	-11.2 <sup>a</sup>

<sup>a</sup> Current account excludes official transfers.

Source: Staff estimates.

reflection of slower aid disbursements during the period before the new Government was formed. The decline in petroleum imports, despite a sharp increase in price, has been attributed to greater smuggling across the country's porous borders. Based on these preliminary figures, the trade balance for the first quarter moved to a surplus of \$80.5 million from a deficit of \$36.6 million a year earlier. The pickup in tourist arrivals augurs well for a net services surplus.

### Policy Developments

Cambodia's many development challenges were exacerbated by the delay in forming a government, which meant that the National Assembly could not meet and no legislative business could be carried out. Apart from the general climate of uncertainty, the implementation of reform measures slowed. With the formation of the new Government in July 2004, the prime minister launched an economic policy agenda, the Rectangular Strategy 2004–2008, so called as it can be represented schematically as a series of interlocking rectangles, with good governance at its core. According to the strategy, growth is to be promoted by development of agriculture, expansion of the private sector, rehabilitation and construction of physical infrastructure, and capacity building and human resource development.

The Government ratified the long-delayed WTO accession package. It also adopted measures aimed at reducing the cost and time associated with import and export procedures and with company registration, and is developing a plan to implement public financial management reforms. Still, progress has been slow on governance reforms, as for example in the legal and judicial areas, and in tackling corruption.

The garment industry, which has expanded rapidly in recent years to employ around 230,000 people, accounted for almost 80% of total exports in 2003. Its growth has been based on preferential access to major markets and, to a lesser extent, on low labor costs. Cambodia will probably hold on to some preferential market access in the post-Multifibre Arrangement (MFA) period, but its low productivity, high infrastructure costs, and corruption mean that the ending of MFA quotas will likely lead to a fall in exports, layoffs, and an economic downturn. Although agriculture has considerable potential, much needs to be done to improve the policy environment for small farmers and agro-based enterprises.

### Outlook for 2004–2005

Growth in 2004 is now projected at 4.5%, revised down from 5.4% in *ADO 2004*. It is led by export-oriented manufacturing (mainly garments) and a recovery in tourism and construction. However, the uncertain prospects for paddy production, the impact of avian flu earlier this year, a smaller fish catch, and the base effect of a large crop in 2003 suggest weaker growth in agricultural output. This in turn, is likely to erode rural incomes and domestic consumption. GDP growth is forecast to slow further in 2005 to 2.3%, mainly because of the adverse impact of the ending of MFA quotas.

Inflation is forecast to edge up during the rest of 2004 to an annual average rate of 2.3%, and reach 3.0% in 2005, underpinned by high oil and food prices. In 2005, the probable continuation of high oil prices will be reinforced by any depreciation of the riel, caused by an expected widening of the current account deficit.

Exports are likely to pick up and imports, too, will rise due both to the import-dependent nature of garment exports, and to a likely increase in capital goods imports as public investment revives now that the new Government has been formed. As a result, the trade balance is projected to move into deficit in the second half of 2004. The services and income account will go the other way and post a modest surplus in 2004 as a consequence of higher tourist arrivals. These factors should marginally narrow the current account deficit to 10.0% in 2004, but in 2005 the deficit is forecast to widen to 11.2% as the trade balance deteriorates with the ending of MFA quotas.