

Cambodia

Strong economic growth continued in 2007, driven by garment exports, construction, and tourism. Rising food prices helped lift inflation. The prolonged economic expansion is forecast to slow, both this year and next, in large part reflecting reduced external demand for domestically made clothes. The major challenges are to diversify sources of growth, by such means as greater rural development, and to reduce poverty faster.

Economic performance

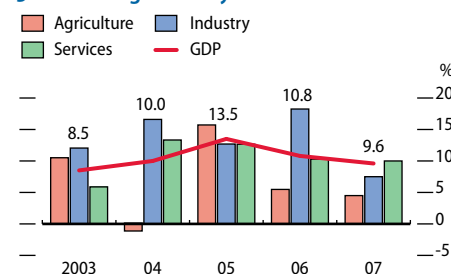
Robust GDP growth of 9.6% is estimated for 2007, slightly below the average of about 11% in the 3 previous years. Growth continued to rely on garments, construction, and tourism. The moderation in growth stemmed from a sharp slowdown in garment exports and a pullback in the expansion of agriculture. Clothing exports grew by an estimated 7% in United States (US) dollar terms, reflecting increasing competition in US and European Union (EU) markets. In agriculture, rice production rose by about 5% to 6 million tons, of which 2 million tons were exported. But weaker growth in fisheries and forestry brought overall agriculture growth down to an estimated 4.5% (Figure 3.22.1), lower than in recent years.

A robust services sector was underpinned by a sustained increase in tourist arrivals (up by 18.5% to about 2 million—Figure 3.22.2), combined with a pickup in finance and trading. Construction activity—much of it financed by foreign investment—remained relatively strong due to a boom in residential and commercial building in Phnom Penh and Siem Reap. On the demand side, consumption and private investment contributed to GDP growth, but a contraction in net exports subtracted from it.

Inflation accelerated to an average of 5.9% in 2007, mainly as a result of increases in food prices. Rice prices rose owing to some domestic supply shortages, and prices of other food items also rose, reflecting rising consumption, including that of imported food items (mostly from Thailand). The price of meat (pork and chicken) also increased, in part following a ban on meat imports from Viet Nam to prevent the spread of animal diseases. Higher global fuel prices added to inflation pressure, as did the weakening of the US dollar, which is widely used in Cambodia (its depreciation against the Thai baht contributed to imported inflation).

Government estimates put the overall budget deficit in 2007 at 3.2% of GDP, narrower than the 2006 gap after excluding a one-time impact of debt forgiveness granted by the International Monetary Fund (IMF) in 2006. This improvement reflected higher tax revenues and lower capital spending. Preliminary data indicate that tax receipts increased to about 9.0% of GDP, up from 8.6% of GDP in 2006, largely a result of better tax

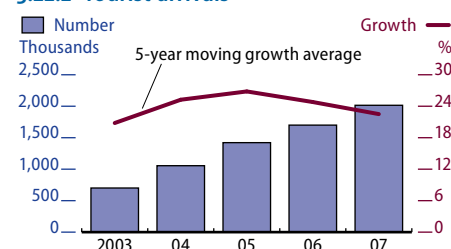
3.22.1 GDP growth by sector



Sources: Asian Development Outlook database; staff estimates.

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3.22.2 Tourist arrivals



Source: Ministry of Tourism, available: <http://www.mot.gov.kh>, downloaded 28 February 2008.

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administration and collection. Total budget expenditures declined to 13.9% of GDP (from 14.4% in 2006), as a fall in capital spending recorded in the budget (which does not record all externally financed capital expenditures) outweighed a modest increase in current expenditures. The overall deficit was financed by concessional loans and grants.

Demand for money is rising rapidly in this expanding economy. Broad money growth accelerated to 63% in 2007, owing to sharp increases in private sector credit and a buildup of net foreign assets. Credit to the private sector surged by 76% (Figure 3.22.3), fueled by greater demand for credit by the services sector, especially tourism, followed by wholesale and retail trade, and construction. Nevertheless, the ratio of private sector credit to GDP remains low, at around 19% of GDP. The central bank continued to smooth volatility in the exchange rate, while not resisting adjustments that reflect fundamental factors. The average exchange rate of the riel against the US dollar appreciated by 1.2% in 2007, to 4,060/\$1.

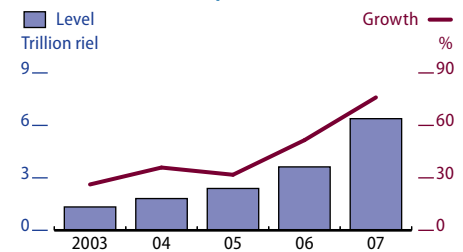
Merchandise exports rose by 9.5% last year, damped by the slowdown in clothing exports (about 70% of the total), according to preliminary data from the National Bank of Cambodia. In contrast, imports are estimated to have increased by 14.1% (Figure 3.22.4), mostly reflecting the impact of higher oil prices. The trade deficit was partially offset by growth in receipts from tourism in the services account, but the current account deficit (excluding official transfers) widened to an estimated 8.5% of GDP (Figure 3.22.5). This gap was readily covered by aid and inflows of foreign direct investment, leading to a larger overall balance-of-payments surplus. Gross international reserves were estimated at \$1.6 billion at year-end (3.2 months of imports).

According to a debt-sustainability analysis conducted by the World Bank and IMF in mid-2007, external public debt is sustainable and the risk of debt distress is moderate. At end-2007, external public debt was estimated at \$2.4 billion (30% of GDP), of which 54% was owed to multilateral institutions and around 35% to the Russian Federation and the US. Most external public debt is concessional and there is no external private debt other than that related to trade financing. Domestic public debt amounts to only about 2% of GDP and is all denominated in local currency. The debt service ratio relative to exports of goods and services at end-2007 was estimated at 0.5% on a cash basis, while the net present value of external debt outstanding to exports is estimated to be 32%.

Pushing ahead with structural reforms, the Government achieved some important milestones in adopting laws and regulations to improve the business environment, in addressing impediments in the judicial system, in fulfilling its World Trade Organization (WTO) commitments, and in implementing its public financial management reform program. Following the enactment of a Commercial Arbitration Law in 2006, it started work on establishing an arbitration center and a commercial court.

In the financial sector, a Law on Secured Transactions was passed and the Government launched an on-line filing registry that extends collateral instruments beyond land title to other forms of property, and thus increases access to finance. A law on government securities and a law on the issuance and trading of nongovernment securities were passed, allowing the Government to issue debt securities and helping set the stage for the development of a capital market.

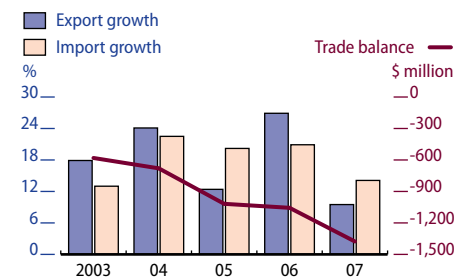
3.22.3 Credit to the private sector



Sources: Asian Development Outlook database; staff estimates.

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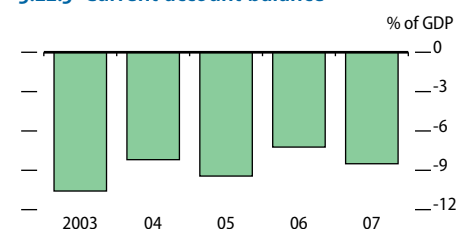
3.22.4 Trade indicators



Sources: Asian Development Outlook database; staff estimates.

[Click here for figure data](#)

3.22.5 Current account balance



Sources: Asian Development Outlook database; staff estimates.

[Click here for figure data](#)

A new regulation requiring medium to large enterprises to have their financial accounts audited by external auditors should improve corporate governance and tax administration, as well as help pave the way for the establishment of a stock market, targeted for 2009. Moving to support economic diversification, the Government launched its trade development strategy that focuses on promoting the export of 19 products (including a variety of agricultural products, rubber, silk, and footwear) and approved 15 special economic zones around border and urban areas.

Economic prospects

The outlook for 2008 and 2009 is generally good provided that macroeconomic stability is maintained and that further progress is made in implementing structural reforms in the National Strategic Development Plan 2006–2010. More specifically, the following forecasts are predicated on the Government maintaining fiscal discipline—fiscal policy is the main macroeconomic policy instrument in the highly dollarized economy—by further strengthening revenue collection and public financial management. Such improvements, together with better fiscal planning, would enable higher and more efficient spending on social sectors and rural development.

It is also assumed that the central bank will closely monitor financial sector developments, including potential vulnerabilities related to credit concentration and exposure to the booming real-estate market. Finally, the forecasts presuppose further progress in improving the functioning of institutions and enhancing the investment environment for private sector development. However, some investment might be put on hold ahead of national elections scheduled for July this year.

Given these assumptions, GDP growth is projected to ease from the high rates in recent years to 7.5% in 2008 and to 7.0% in 2009 (Figure 3.22.6). This reflects an expected slowdown in growth in garment exports as a result of increased competition from Viet Nam since that country joined WTO in January 2007, and the scheduled end-2008 termination of safeguards imposed by the US on garment exports from the People's Republic of China. Reduced demand for clothing exports will dent overall manufacturing output, although the effect should be mitigated somewhat by continued robust growth in services, especially those related to tourism and finance.

Agricultural output is expected to pick up by 4–5%, as the sector takes advantage of an expansion in irrigation facilities to raise paddy output and to diversify crops. Although offshore oil and gas deposits have been discovered in recent years, the potential size of exploitable deposits remains uncertain and economic activity related to the find is unlikely to have much impact on GDP in the forecast period, other than through exploration drilling. More specifically, government revenues from commercial exploitation of hydrocarbons are not expected before 2011.

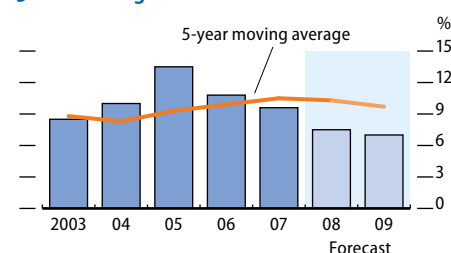
Persistently high food prices and anticipated further increases in oil prices, combined with buoyant domestic demand and a weakening US dollar, will likely keep average inflation uncomfortably high at about 5.5% in 2008 (Figure 3.22.7). The 2008 budget projects a widening of the overall central government deficit, to 4.2% of GDP, as modest gains

3.22.1 Selected economic indicators

	2008	2009
GDP growth	7.5	7.0
Inflation	5.5	5.0
Current account balance (% of GDP)	-10.6	-11.1

Source: Staff estimates.

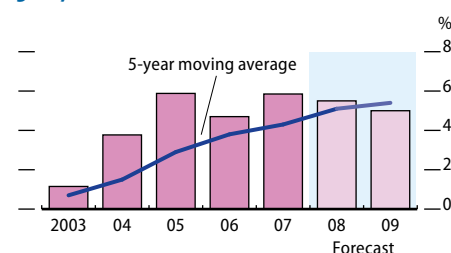
3.22.6 GDP growth



Source: Asian Development Outlook database; staff estimates.

[Click here for figure data](#)

3.22.7 Annual inflation



Sources: National Institute of Statistics, available: <http://www.nis.gov.kh>, downloaded 28 February 2008; staff estimates.

[Click here for figure data](#)

in revenues—from further improvements in tax administration—are expected to be outweighed by rises in both recurrent and development spending. The budgeted increases in tax revenues appear conservative though, and the outturn could be appreciably higher and the overall budget deficit correspondingly lower. As in recent years, domestic revenues and concessional external financing are expected to cover the budget deficit, so that no additional inflation pressure is expected from the fiscal stimulus.

The external current account deficit is projected to widen further to 10.6% of GDP this year (Figure 3.22.8), principally reflecting slower growth in exports of goods and the impact of persistent domestic demand on imports. Nevertheless, inflows of foreign direct investment and concessional loans and grants, including those expected from pledges made by development partners at the Cambodia Development Cooperation Forum last year, should result in a continued, though slower, accumulation of gross international reserves.

The main risk to this outlook is a deeper than anticipated downturn in global economic activity, which could depress Cambodian exports further, and weaken inward investment and tourism. Domestic risks as usual include bad weather, which would lower agricultural production. Also, any sudden reversal in rapidly rising land prices and real-estate speculation could prompt a generalized slowdown in bank lending, temper construction activity, and impede other investments.

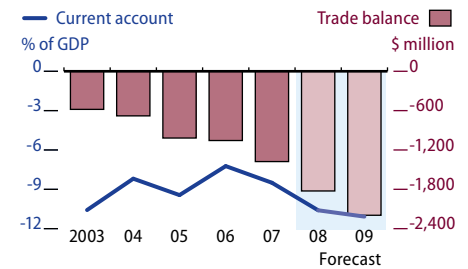
Development challenges

Although progress has been made in reducing overall poverty incidence, the country still faces many challenges both in reducing poverty more rapidly (estimated by the Government at 31% in 2007), especially in rural areas, and in narrowing income disparities between rural and urban areas. Despite strong expansion of the economy over the past decade, it remains narrowly based. The clothing industry, the main engine of exports (Figure 3.22.9), has an uncertain future. The scheduled removal at end-2008 of the US safeguards, coupled with Viet Nam's accession to WTO, will expose it to much stiffer competition.

Economic diversification requires an investment environment conducive to establishing and expanding new private businesses. Preliminary indications are that the costs of doing business have been reduced and the business climate has improved through trade facilitation measures (a new customs law was enacted in late 2007 and most of the key implementing regulations have been prepared). However, further progress is needed in streamlining business licensing and inspections and in improving overall governance.

With 90% of the population in rural areas, diversifying sources of growth and reducing poverty at a quicker rate require further efforts to develop agriculture, fisheries, and forestry. Improvements in irrigation and land titling (about 800,000 land titles have been issued) will help increase production by encouraging farmers to invest in their land. Remaining constraints to faster, sustainable rural growth include poor rural infrastructure, lack of access to finance, and weak institutional capacity in rural areas.

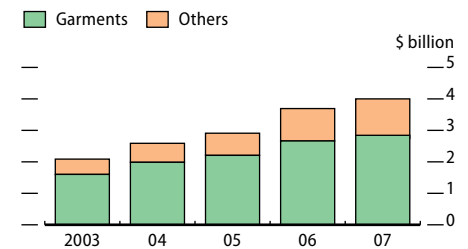
3.22.8 Current account indicators



Sources: Asian Development Outlook database; staff estimates.

[Click here for figure data](#)

3.22.9 Exports



Note: Figures for 2007 are estimates.

Sources: International Monetary Fund, *Country Report* Nos. 06/264 and 07/290, available: <http://www.imf.org>; staff estimates.

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