Cambodia

Despite the worst floods in over a decade, economic growth remained robust in 2011, underpinned by exports of garments and footwear and by tourism. This year growth is forecast to soften, before picking up next year. Average inflation, lifted by higher prices for food and fuel in 2011, is projected to moderate this year. Better public debt strategies led to an upgrade in the debt sustainability rating.

Economic performance

Growth picked up to an estimated 6.8% in 2011, largely on increased exports of garments, footwear, and milled rice, as well as rising numbers of inbound tourists.

Industry remained the primary source of growth, expanding by an estimated 13.9% (Figure 3.23.1) and driven mainly by robust export growth of garments and footwear to the United States (US) and the European Union (EU). US garment and footwear imports from Cambodia in 2011 climbed by 17.8% to $2.7 billion (Figure 3.23.2). Exports of garments and footwear to the EU surged by 51.1% to $1.62 billion, largely due to relaxed rules of origin for imports into the EU that gave Cambodia (and some other developing countries) duty-free access to that market from January 2011.

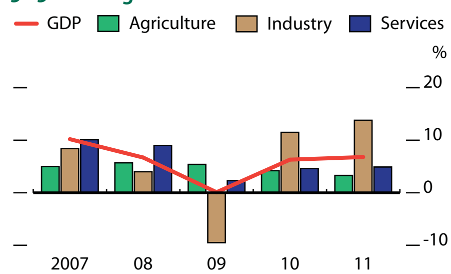
The number of jobs in the garment industry gradually recovered from a little over 319,000 at end-2010 to an estimated 330,000 by end-2011. Although this was still below the 353,000 jobs at end-2007—before the global recession—industry sources estimate that there were also more than 50,000 vacancies.

The strong growth of the industry sector was also supported by a steady increase in milled rice exports. A doubling in the value of approved construction projects in 2011 suggests a welcome recovery in this subsector.

Agriculture, representing about a third of GDP, was disrupted by the most severe flooding in more than a decade in September and October 2011. Damage and economic losses, mainly to infrastructure and agriculture, were estimated at $624 million, some 5% of GDP. The floods lowered wet-season rice production, though output in the dry season increased, and fisheries production rose by 4.5%. Agricultural growth overall expanded by an estimated 3.3%.

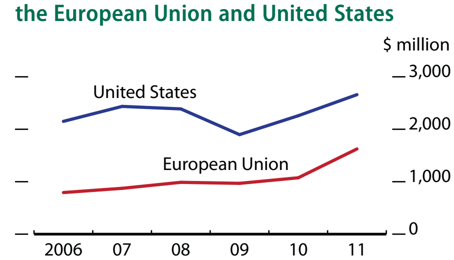
A buoyant tourism industry supported growth of 5.0% in services. Tourist arrivals picked up by 14.8% to 2.9 million in 2011 (Figure 3.23.3), with arrivals from elsewhere in Asia particularly strong. Growth in tourism benefited the hotels and restaurants, retailing, and transport and

3.23.1 GDP growth



Sources: National Institute of Statistics; ADB estimates.

3.23.2 Exports of garments and footwear to the European Union and United States



Notes: Using import data from US OTEXA and Eurostat. Data from Eurostat were converted to US dollars using €/$ average exchange rate for the year. Footwear exports are for January–November 2011 for the US.

Sources: Office of Textiles and Apparel. http://otexa.ita.doc.gov (accessed 20 March 2012); Eurostat. http://epp.eurostat.ec.europa.eu (accessed 21 March 2012).

This chapter was written by Peter Brimble and Poullang Doung of the Cambodia Resident Mission, ADB, Phnom Penh.

communications subsectors. Greater public confidence in the financial sector underpinned continued expansion there.

The surge in global prices for food and fuel pushed inflation from 3.3% year on year in January 2011 to 7.1% in June and July. Inflation then began to ease (Figure 3.23.4), although the floods put some upward pressure on rice prices. For the year, inflation averaged 5.5%, up from 4.0% in 2010.

Reflecting the economic pickup, credit to the private sector accelerated from 27% at end-2010 to 31.7% a year later. More than 95% was denominated in foreign currency, mostly US dollars. Broad money (M2, excluding foreign currency outside banks) increased by 21.5% year on year at end-2011, driven by growing foreign currency deposits as a result of increased export earnings. The riel appreciated by 2.9% against the US dollar during 2011.

An expansionary fiscal stance since 2009 has considerably reduced the government's deposits in the banking system from about 8% of GDP in 2008 to around 4% in 2011 (Figure 3.23.5). The overall fiscal deficit (excluding grants and other expenditure adjustments), though staying high, narrowed to an estimated 7.6% of GDP in 2011 from 8.1% in 2010. Most of the gap (6.5 percentage points of GDP) was financed by external grants and concessional loans, the rest by drawdowns of government deposits.

Domestic revenue, estimated at 12.7% of GDP, fell short of target. Property tax, introduced in July 2010, started to generate income in 2011, making a small contribution. General government spending was above target at 20.2% of GDP.

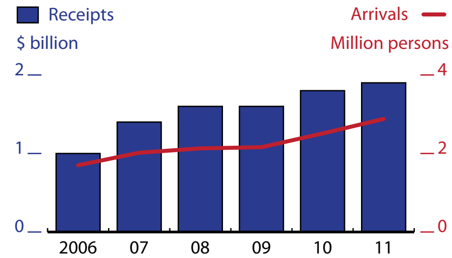
Concessional assistance from the People's Republic of China (mainly for infrastructure) as well as private investment (especially in hydropower) played a greater role in financing infrastructure last year than in 2010.

In the external accounts, the rise in shipments of garments, footwear, and milled rice propelled merchandise exports 35.8% higher in US dollar terms in 2011. Imports increased by an estimated 25.9%, largely reflecting purchases of oil, raw materials for garments, and consumer goods. The current account deficit (excluding official transfers), at an estimated 7.1% of GDP, was covered by inflows of foreign direct investment (FDI) and official loans. Net FDI rose by an estimated 11% to $846.2 million, with a sharp increase for the garment industry. Gross official reserves of $3.0 billion represented about 4.5 months of imports (Figure 3.23.6).

A debt sustainability analysis published in February 2012 by the International Monetary Fund and World Bank upgraded Cambodia from moderate risk of debt distress to low risk. External public debt at end-2011 was manageable at 29% of GDP; domestic debt was less than 1% of GDP. In recent years, the People's Republic of China has become an important creditor, accounting for about two-thirds of total bilateral disbursements in 2010, for example.

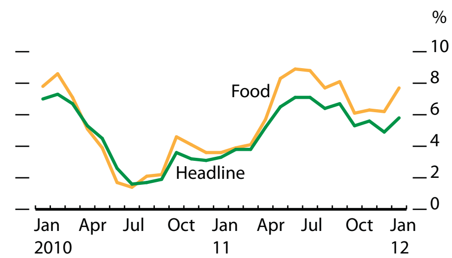
The Ministry of Economy and Finance estimated that poverty incidence declined to 25% as of early 2012, from about 30% in 2007, although there are concerns over apparent increases in income inequality. The government adopted a national social protection strategy in 2011, foreshadowing both an expansion of targeted programs such as free

3.23.3 Tourism indicators



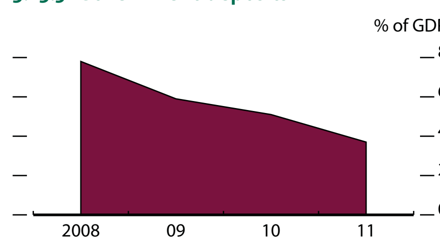
Source: Ministry of Tourism.

3.23.4 Inflation



Source: National Institute of Statistics. http://www.nis.gov.kh (accessed 21 March 2012).

3.23.5 Government deposits



Source: Ministry of Economy and Finance.

3.23.6 Gross international reserves and import cover

Source: National Bank of Cambodia.

health care for the poor and the pilot testing of conditional cash transfers and labor-intensive public works.

Economic prospects

Export-led sectors will remain the main sources of growth during the forecast period, with some new manufacturing industries beginning to emerge, such as automotive parts and assembly of small electric motors. The subdued economic outlook for the EU and US, Cambodia's main export markets, suggests that GDP growth will edge down to 6.5% in 2012 (Figure 3.23.7). In 2013, growth is seen picking up to 7.0%, tracking the expected upturn in the global outlook.

Demand for garment and footwear imports in the EU and US is expected to slow this year, mitigated to some extent by Cambodia's privileged import access to the EU and the development of some high value-added garment production. Given these trends, the growth in industry overall is projected to slow to 11.4%, before picking up to 12.5% in 2013.

Construction is expected to strengthen, stimulated by FDI in property. The extent and timing of exploitation of oil and gas reserves in Cambodia remain unclear, but it is not anticipated to have an impact on GDP before 2015.

Growth in services is expected to edge up to 5.3% in 2012 and 5.6% in 2013 largely on the back of continued increases in tourist arrivals supported by gradual improvement in real estate.

Assuming favorable weather, agriculture is forecast to register higher growth of 3.8% in 2012, partly a result of the base effect of last year's floods on the rice crop. It also reflects government support for agriculture, in particular rice production.

Fiscal consolidation is expected to continue, as envisaged in the 2012 budget. The fiscal deficit (excluding grants and other expenditure adjustments) is targeted at 5.7% of GDP, to be achieved largely by an ambitious domestic revenue target of 13.7% of GDP. Government spending is budgeted at 19.4% of GDP. The budget anticipates that domestic financing of the deficit will be as low as 0.2% of GDP. This indicates an important step toward rebuilding fiscal flexibility, necessary to give the government the leeway to spur the economy if needed.

About $150 million will be spent on flood reconstruction over the next 2 or 3 years, building on an estimated $60 million of flood-related humanitarian and infrastructure spending in 2011.

Inflation in 2012 and 2013 is forecast to ease to about 5% on a year-average basis (Figure 3.23.8), assuming relatively low domestic financing of the budget deficit. (High levels of domestic financing would involve the injection of large amounts of riels that could put upward pressure on inflation.) Rising global oil prices early in 2012 put the inflation forecast for this year at risk.

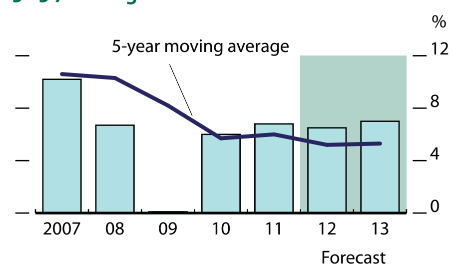
The trade deficit in 2012 is set to widen slightly due to softening external demand. Increases in tourism receipts will keep the services account in surplus. The current account deficit (excluding official transfers) is projected to widen to 7.6% of GDP in 2012 before narrowing a little as the global economy picks up (Figure 3.23.9).

3.23.1 Selected economic indicators (%)

	2012	2013
GDP growth	6.5	7.0
Inflation	5.0	5.0
Current account balance (share of GDP)	-7.6	-7.0

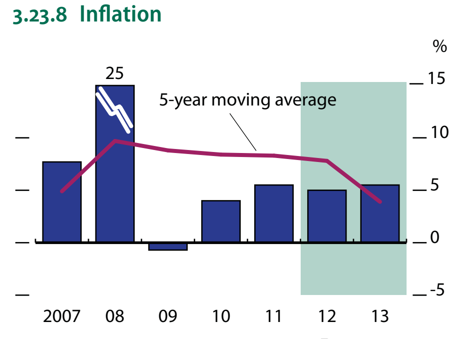
Source: ADB estimates.

3.23.7 GDP growth



Source: Asian Development Outlook database.

3.23.8 Inflation

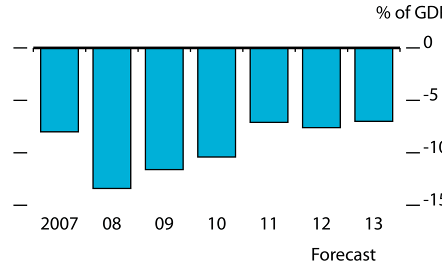


Source: Asian Development Outlook database.

As for policy reforms, the Public Debt Strategy approved by the Prime Minister in February 2012 is a step forward in strengthening the debt strategy and debt management capacity. The government will set an annual borrowing target and aim for concessional loans with tenors of 20–40 years. Yet despite the positive debt sustainability assessment, the country remains vulnerable to uncertain contingent liabilities on major infrastructure investments, mainly public–private hydropower partnerships.

A Public Procurement Law, promulgated in January, laid the foundation for improving this element of public financial management. An overhaul is planned of policies and regulations covering public–private partnerships, which should help mobilize private sector finance for development projects and improve business governance and transparency. Three state-owned enterprises are scheduled to be the first listings on the securities exchange.

3.23.9 Current account deficit



Source: Asian Development Outlook database.

Policy challenge—skills shortages

Skills shortages are hindering Cambodia's development. The share of firms reporting skills as a major constraint to growth in the World Bank's Investment Climate Surveys increased from 6.5% in 2003 to 15.5% in 2007. In a survey of 78 employers by a consulting firm in 2011, 73% of them said that university graduates do not have suitable skills and 62% said the same about vocational training graduates. About one-third of the employers surveyed found it difficult to train or upgrade their workforce. The situation has worsened over the past few years as wage rates have risen, pushing manufacturers up the value-added chain and requiring higher levels of skills.

Improvements in early childhood nutrition and better primary and lower secondary schooling would provide children with a firmer base on which to build their educational and skills training. After that, what is required is a concerted approach to improving human capital, with all stakeholders involved—businesses, the government, development partners, and civil society.

On the supply side, the challenge is to strengthen training programs, building in responsiveness and flexibility to labor market needs. This calls for expansion both of formal programs that are more relevant to industry and of nonformal training that can help those with incomplete education enter the job market. The overall response should aim to manage resources in ways that create incentives for good performance and accountability for results, teach soft and technical skills, and bring schools and industry closer together to promote quality and relevance to market demand.

On the demand side, the focus should be on improving information flows and strengthening institutional capacity, particularly in the National Training Board and Employment Agency. Employers lack channels both to communicate their demands for specific skills and to influence skills development policies.