Cambodia

Higher inflows of foreign direct investment contributed to strong economic growth in 2012. Outcomes exceeded expectations in agriculture, construction, and tourism. The forecast is for further robust growth, with the trajectory expected to steepen slightly in 2014 as recovery in major export markets takes hold. Inflation subsided in 2012 and is projected to remain modest through the forecast period. Although poverty has declined, persistently high child malnutrition remains a critical development challenge.

Economic performance

GDP growth picked up to 7.2% in 2012, driven by robust consumption and investment (Figure 3.23.1). Consumption expanded by an estimated 9.5% and made the biggest contribution to GDP growth from the demand side. Gross fixed investment increased by 30%, spurred by a surge in foreign direct investment (FDI) and higher bank lending. However, net exports dragged on GDP growth as they fell, partly reflecting elevated imports needed for power-generation projects.

The service sector expanded by an estimated 8% and was the main source of GDP growth from the production side. Strong growth in tourism and resurgence in real estate activity bolstered this sector. Assisted by more direct flights, tourist arrivals rose by 24.4% to 3.6 million and tourism receipts grew by 15.6% to $2.2 billion (Figure 3.23.2).

Growth in the industry sector moderated from the previous year’s pace to just over 9% in 2012. Exports of garments and footwear to the US, Cambodia’s top export market, fell by 1.8% to $2.6 billion, though those to the European Union (EU) rose by 10.8% to $1.8 billion. Industry sector growth was supported by a 5% increase in exports of milled rice to 187,000 tons, mostly to the EU. Construction accelerated as building project approvals nearly doubled to $2.1 billion last year.

Agricultural production increased by an estimated 4%, despite floods in some provinces and dry weather in others. Output of crop production, mainly paddy rice, rose by 4.3%, and fishery yields increased by 6%.

A moderation in food prices brought down inflation from 5.8% in January 2012 to 2.6% in December (Figure 3.23.3). Food comprises 43% of the consumer price index. Year-average inflation decelerated to 2.9%.

The government continued to rein in its fiscal deficit, which had widened sharply in 2009 to 8.6% of GDP. The fiscal gap, excluding grants, narrowed last year to an estimated 5.2% of GDP. Domestic revenue increased to 14.5% of GDP from 13.2% in the previous year, thanks to improved revenue collection and buoyant economic activity. Government spending was contained at 19.7% of GDP, down from 20.7% in 2011. Income from external grants and concessional loans amounted to $3.6 billion in 2012, down from $4.1 billion in 2011.

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to 5.8% of GDP, so the government was able to replenish its savings by the equivalent of 0.6% of GDP after running down its deposits over the previous 3 years.

Growth in credit to the private sector accelerated to 34.1% last year (Figure 3.23.4). Concerned about this rapid pace, the central bank raised the reserve requirement for foreign currency deposits in commercial banks by 50 basis points to 12.5% in September 2012. The ratio of private sector credit to GDP jumped to 41.6%, well above the median for low-income countries. Reflecting a deepening of the financial system, the ratio of broad money to GDP rose to 50.5% from 45.4% in 2011. The Cambodian riel appreciated by an average of 0.8% against the US dollar last year.

Merchandise exports, mainly garments, footwear, and rice, rose in US dollar terms by an estimated 11.4%. Imports, bolstered by purchases of construction materials for power plants and other projects, rose by 17.0%.

As the merchandise trade gap widened, so did the current account deficit, to 11.6% of GDP if official transfers are excluded. The deficit was fully financed by FDI and official loans and grants. Net FDI surged by 75% to $1.5 billion (Figure 3.23.5), contributing to an increase in gross official reserves to $3.5 billion, which covers 4.4 months of imports.

An International Monetary Fund analysis of debt sustainability published this year saw Cambodia at low risk of debt distress. It cautioned that structural reform and revenue mobilization, as well as the careful management of potential contingent liabilities from power-generation projects, will be important to ensuring long-term debt sustainability.

Poverty incidence likely fell below 20%, surpassing the official target to reduce poverty by half from levels in the early 1990s. This reduction has been achieved through sustained economic growth, with particularly good performance in agriculture.

**Economic prospects**

Economic growth is forecast at 7.2% in 2013, picking up to 7.5% next year as recovery in Europe and the US takes hold (Figure 3.23.6).

European demand for Cambodian garments and footwear is expected to maintain good growth, supported by duty-free access to the EU. Shipments to the US will likely be subdued this year but should pick up after that. Increased foreign investment is funding new industries, including the manufacture of automotive parts and processing of agricultural products, as well as diversifying garment production into higher-value products. Last year’s surge in building approvals bodes well for construction. The timing of offshore oil exploitation is unclear. Industry as a whole is expected to expand by 10.5% in 2013.

The service sector is seen growing by 7%. Growth in tourism is benefiting the hotel, restaurant, retailing, and transport and communications subsectors. Buoyant property development stimulates growth in finance and real estate services. Agriculture will likely grow by about 4%, assuming favorable weather. The government is supporting paddy production and exports of milled rice.

Fiscal consolidation looks set to continue in 2013, as the government targets a narrower fiscal deficit at 5.1% of GDP, to be funded by external grants and loans. Nevertheless, public spending could pick up ahead of
national elections scheduled for July 2013, making fiscal consolidation more difficult. The stock of government deposits in the banking system—the country’s buffer to deal with shocks—is likely to increase to 4.6% of GDP, compared with 8% in 2008.

In light of the rapid growth in credit and excess liquidity at some banks, additional increases in bank reserve requirements may be required to reduce risks to financial stability. In this regard, the authorities are considering such macroprudential measures as imposing higher capital requirements for banks, or tightening permitted ratios of loans to value or loans to deposits. The central bank plans to develop the interbank market by introducing negotiable certificates of deposit, moving toward more market-based monetary policy operations. To reduce the heavy use of the US dollar for local transactions, the government will continue to encourage the use of the riel. Last year, the ratio of US dollar deposits to total deposits was 95.7%, down only marginally from 97.0% in 2008.

Good domestic harvests and relatively stable global food prices suggest that inflation this year will be on average similar to that in 2012 (Figure 3.23.7). Inflation is seen quickening in 2014 as continued robust domestic demand likely encounters some supply constraints. These inflation forecasts will be at risk if bad weather pushes up food prices.

Merchandise exports are projected to pick up during the forecast period while growth in imports moderates after the completion of large power projects. Receipts from tourism will keep the services account in surplus. The current account deficit, excluding official transfers, is projected to narrow (Figure 3.23.8). FDI and other capital flows are expected to maintain international reserves at levels that cover more than 4 months of imports.

Developments that enhance the environment for the private sector included the initial public offering of shares in the Phnom Penh Water Supply Authority, the first listing on the Cambodia Securities Exchange. An arbitration center was launched to provide businesses with a faster and less expensive way to resolve commercial disputes, and a credit bureau started to provide banks with better information on potential borrowers. To tackle corruption the government issued lists in January 2013 showing the official fees for public services including customs, taxation, business and trading procedures, and other activities related to investment. Finally, the authorities are strengthening the environment for public–private partnership (Box 3.23.1).

**Policy challenge—child malnutrition**

The high incidence of child malnutrition in Cambodia is a critical development challenge. Poor nutrition in the 1,000 days from conception to the second birthday causes long-term damage to physical and cognitive development. Functional losses in this period can never be fully recovered. In addition to impacts on child health and mortality, malnutrition has adverse health and economic consequences that persist throughout the individual’s lifetime and can be handed down to harm the next generation.

Chronic poor health and malnutrition stunt the growth of 40% of Cambodian children. Demographic surveys show 28% of children under 5 years of age underweight in 2005—and no improvement 5 years later.
Indeed, severe malnutrition increased, with the incidence of wasting among children rising from 8.4% to 10.9% (Figure 3.23.9). The incidence of anemia was at epidemic proportions, affecting 55% of children under 5 in 2010.

The World Health Organization estimated in 2011 that Cambodia loses $146 million in GDP each year from the impacts of vitamin and mineral deficiencies alone. While the full economic impact of malnutrition in the country has yet to be assessed, international evidence cited by the United Nations Development Assistance Framework suggests that a 1% decrease in adult stature translates into a 1.4% decrease in productivity.

Risk factors for child malnutrition include poverty (although child malnutrition also affects higher-income families in Cambodia), lack of toilets, unsafe water supply, inadequate breast feeding, and poor maternal nutrition. The 2010 demographic survey found that 57% of Cambodian households had no toilet and therefore defecated in the open, 26% of infants under 6 months were not exclusively breastfed, and 44% of women suffered some degree of anemia.

The good news is that addressing child malnutrition early can avoid long-term damage to health. Further, the solutions are highly cost-effective. The 2012 Copenhagen Consensus, a meeting of economists to establish cost-effective priorities to improve global welfare, found that fighting malnourishment should be the top priority and that the benefits in terms of improved health, schooling, and productivity would be significant.

Child malnutrition can be countered by

- targeting social transfers, fortifying foods, and improving local food production to overcome seasonal food shortages and ensure food supplies of sufficient quantity, quality, and variety;
- promoting breastfeeding and appropriate complementary feeding practices for young children;
- improving pregnant women’s dietary intake through nutrition education and communication;
- providing to women and children improved basic health services and micronutrient supplementation; and
- reducing nutrient loss through improved hygiene, sanitation, parasite control, and food processing and storage.

The key is to develop mechanisms to scale up existing and future small-scale pilot initiatives that are designed to address these issues, thereby converting them into a government-led, integrated package of interventions for better food security, nutrition, sanitation, and hygiene. This requires a program with active community participation and a concerted strategy to change parental behavior that hinders child nutrition. Malnutrition issues could be addressed under the umbrella of social protection, for example through cash transfers, or through innovative public–private partnership.