ASIAN DEVELOPMENT BANK
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Cambodia

Agriculture slowed but industry and services expanded in 2013, maintaining economic growth at just above 7% for the third consecutive year. Political tensions and labor unrest suggest growth will subside in 2014 before picking up again next year. Inflation, at modest rates last year, is seen edging higher in 2014. Spurring the development of small and medium-sized firms would help to sustain and diversify economic growth.

Economic performance

Robust growth in services and expanding export industries drove economic growth of 7.2% in 2013 (Figure 3.23.1).

Services remained the largest source of growth from the supply side, expanding by an estimated 8.4% in 2013. This stemmed largely from growth in wholesale and retail trading, real estate services, and tourism-related services. Bank credit to wholesale and retail trading increased by 24.5% to $2.5 billion and to real estate by 36.5% to $250.5 million. Tourist arrivals rose by 17.5% to 4.2 million (Figure 3.23.2).

Industry grew by an estimated 10.5% on strong demand for Cambodian garments and footwear in the European Union. Exports of garments and footwear to that market surged by 26% to $2.0 billion in 2013 and those to the US rose by 6.0% to $2.1 billion, according to customs data.

Construction and rice milling also contributed to industry growth. Bank credit to construction rose by 29% to $577 million, and exports of milled rice almost doubled to 366,000 tons, valued at $262 million.

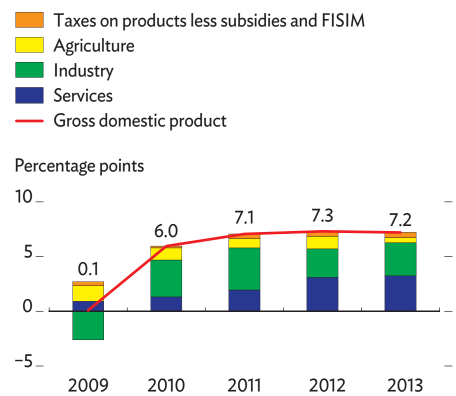
Floods in September and October 2013 damaged crops and slowed growth in agriculture to 1.8% last year.

Increased private consumption, fueled by higher household incomes, contributed much of the GDP growth from the demand side. Investment also made a substantial contribution. Domestic investment remained solid, especially in small and medium-sized businesses. Inflows of net foreign direct investment were buoyant at $1.3 billion, though that figure represented a decline from the previous year, partly a result of political tensions after Cambodia's national elections in July 2013.

Inflation picked up to 4.7% at the end of 2013, mainly because customs duty collection was tightened, which raised some import prices (Figure 3.23.3). The floods had only a modest impact on food prices. For the year, inflation averaged 2.9%, the same as in 2012.

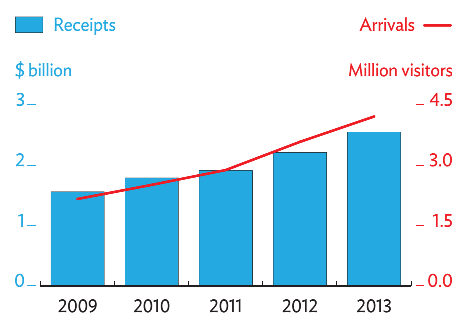
The government continued to rein in the fiscal deficit last year, to an estimated 5.0% of GDP, excluding grants. Solid domestic demand and the stronger tax collection efforts raised revenue to an estimated 14.9% of GDP, while expenditure was an estimated 19.9% of GDP. Foreign loans and grants funded the fiscal deficit.

3.23.1 Supply-side contributions to growth



FISIM = financial intermediation services indirectly measured.
Sources: National Institute of Statistics; ADB estimates.
Click here for figure data

3.23.2 Tourism indicators



Source: Ministry of Tourism.
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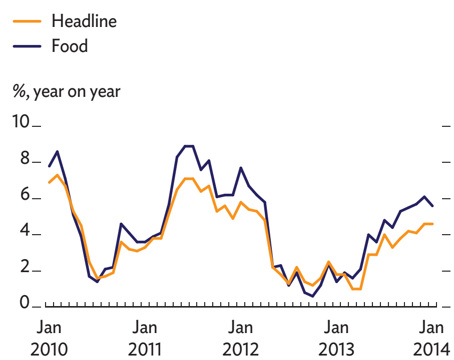
Credit to the private sector expanded by a rapid 26.7% (Figure 3.23.4). Total liquidity (M2), excluding foreign currency outside the banking system, rose by 14.6%. Dollarization remained high, with foreign currency deposits accounting for 82% of total liquidity. The Khmer riel was stable against the US dollar.

Buoyant demand for Cambodia's garments, footwear, and milled rice pushed up merchandise exports by an estimated 15.9% to $6.5 billion in 2013. Merchandise imports rose by an estimated 13.8% to $8.9 billion, largely from higher imports of fabrics for the garment export industry and imports of petroleum products. A trade deficit of $2.4 billion contributed to widening the current account deficit, excluding official transfers, to an estimated 10.8% of GDP. Some official data on past years' trade, foreign direct investment, and the current account were revised in 2013.

The current account gap was fully financed by foreign direct investment and official loans and grants. Gross official reserves edged up to $3.6 billion, covering 4.1 months of imports of goods and services.

3.23.3 Monthly inflation



Source: National Institute of Statistics. http://www.nis.gov.kh (accessed 14 March 2014).
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Economic prospects

Political tensions since national elections last July, together with strikes for higher wages by garment workers, dented investor confidence and disrupted some production of garments and footwear in late 2013 and early 2014. Political uncertainty and the risk of further labor unrest suggest some dampening of investment this year. The uncertainties could weigh as well on tourism and real estate activity. Consequently, economic growth is forecast to ease to 7.0% this year before picking up to 7.3% in 2015 (Figure 3.23.5).

Garments and footwear will benefit during the next 2 years from economic recovery projected for the European Union, which grants Cambodia's exports duty-free access, and the US. These markets together buy 76% of the country's exports of garments and footwear. Industry as a whole is forecast to grow this year by 8.7% and services by 7.1%, both decelerating from 2013.

Agriculture is seen recovering from last year's floods to grow by 4.7% in 2014, assuming better weather. Crops and livestock are benefiting from an increase in the area under cultivation and by investment in irrigation.

Fiscal consolidation efforts should narrow the fiscal deficit further in 2014. Government revenue is budgeted at 15.0% of GDP, helped by measures taken to improve the efficiency of customs and tax collection. Spending is budgeted at 19.8% of GDP. The effective implementation of the revenue-raising effort is critical to rebuild fiscal space, and close monitoring of contingent liabilities will be important to safeguard fiscal space.

The tightening of customs duty collection will maintain some upward pressure on import prices into 2014. Inflation was 4.6% year on year in January 2014 and is expected to average 3.5% for the year as a whole, up from 2013. It will likely remain around 3.5% in 2015 (Figure 3.23.6).

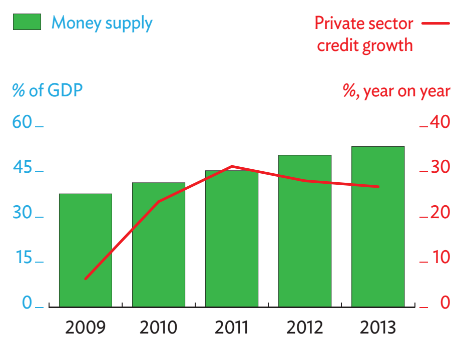
Growth in merchandise exports could be dampened by the disruptions to garment and footwear production and by downward pressure on global rice prices. Robust domestic demand will sustain

3.23.1 Selected economic indicators (%)

	2014	2015
GDP growth	7.0	7.3
Inflation	3.5	3.5
Current account balance (share of GDP)	–11.3	–10.9

Source: ADB estimates.

3.23.4 Money supply and private sector credit



Source: National Bank of Cambodia.
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growth in imports, so that the current account deficit, excluding official transfers, is forecast to widen to 11.3% of GDP in 2014 before narrowing to 10.9% next year (Figure 3.23.7).

The government's development policy for 2013–2018 targets average annual economic growth at 7% and a reduction in the poverty rate by at least 1 percentage point a year. This latest policy framework heightens the emphasis on commercializing agriculture, building urban infrastructure, supporting the development of the private sector, expanding vocational training, and strengthening social protection including health and nutrition. Importantly, the government's commitment to economic reform appears to have intensified.

Policy challenge—strengthening the private sector

Cambodia's private sector has a few large, modern businesses but is dominated by informal and very small enterprises and farms. Micro enterprises, mostly wholesale and retail trading and vehicle-repair services, accounted for 97.7% of the roughly 500,000 enterprises covered by a recent economic census. Large enterprises—primarily in garments, light manufacturing, construction, tourism, and agribusiness—represented a fraction of a percent.

A weakness in the structure of the private sector is the "missing middle," as only 2.1% of enterprises fall into the category of small and medium-sized enterprises. The absence of this segment hinders development and diversification in the economy.

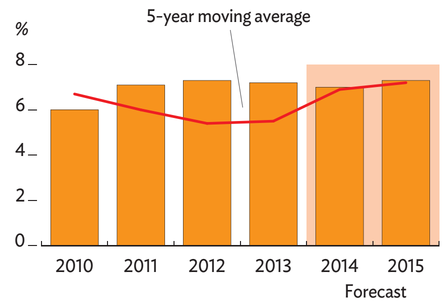
The Investment Climate Survey conducted in 2012 by international development banks showed that Cambodian enterprises ranked electricity supply as the major constraint on their growth, citing insufficient access and high price. Since then, new hydropower plants have come on line, and more will join the grid in the next few years, helping to address the shortage of power.

Other constraints, ranked in the order respondents cited them in the survey, were macroeconomic uncertainty, corruption, difficult transportation, anticompetitive practices, the high cost of finance, and deficient skills and education.

The government is addressing some of these issues, including through reforms unveiled in March 2014 to facilitate domestic and international trade and to simplify business registration procedures. More broadly, the government's development policy identifies private sector development as a core objective. It is pressing ahead with a program to support public–private partnership that will encourages the private sector to invest in infrastructure.

Other steps that would strengthen the private sector include developing sustainable business associations, promoting inclusive businesses and social enterprises to serve the interests of farmers and small enterprises, and supporting the incubation of new businesses. It would be helpful for the government and private sector to work together to improve competitiveness and assist integration into regional supply chains in preparation for the Association of Southeast Asian Nations Economic Community in 2015.

3.23.5 GDP growth



Source: *Asian Development Outlook* database.
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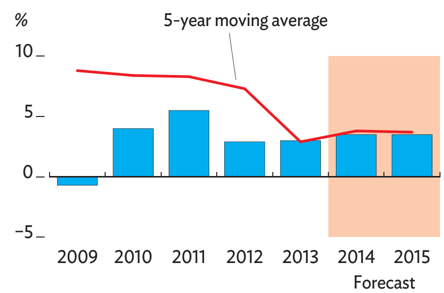
3.23.6 Inflation



Source: *Asian Development Outlook* database.
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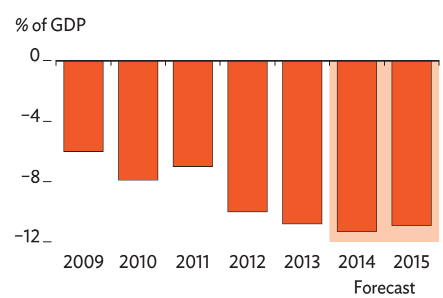
3.23.7 Current account balance



Source: *Asian Development Outlook* database.
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