The economy rebounded faster than expected in 2021 due mainly to a strong recovery in light manufacturing. The current account deficit widened as the imbalance in goods trade rose, but the deficit is expected to narrow this year and next. Growth will accelerate in 2022 and 2023 as economic activity continues to pick up and return to normal. The main policy challenge is sustaining the rapid increase in light manufacturing in areas other than garments for a more resilient and diversified economy.

Economic performance

Growth in Cambodia rebounded to an estimated 3.0% in 2021 after a contraction of 3.1% in 2020 (Figure 3.23.1). In the second half, a robust recovery in external demand for the country’s manufactured products drove the faster-than-expected rebound. Industrial output grew by 7.4% in 2021. Exports of garments, footwear, and travel goods recovered exceptionally well last year, particularly in the second half. Nongarment manufactured products continued their robust expansion, with exports rising by 30.7%.

Agriculture exports rose by 19.0% in 2021 on solid growth in cassava, banana, and rubber exports. Restrictions in pig imports to prevent outbreaks of African swine fever and better domestic prices supported the local pig industry. Fisheries performed worse than expected due to low water levels. Agriculture output expanded by 1.1%.

Services contracted by 0.4% on a continued steep decline in demand for food, accommodation, transportation, and other in-person services due to the prolonged COVID-19 outbreak and lockdowns. The poor performance of these services was partially offset by stronger growth in communication services and a gradual recovery in wholesale and retail trade and real estate. Restrictions on international travel, which were in place for most of 2021, caused an 85% drop in international tourist arrivals (Figure 3.23.2).

Inflation was stable, edging up to 3.7% year on year at the end of 2021, mainly due to rising energy prices. Inflation averaged 2.9%, the same as in 2020. While high dollarization levels constrained monetary policy, the National Bank of Cambodia adopted measures to maintain liquidity in the banking system and facilitate loan restructuring to soften the impact of the pandemic and lockdowns on lenders and borrowers and to

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support economic activity. Growth in money supply accelerated to 16.3% from 15.3% in 2020, mainly reflecting increases in foreign currency deposits. Private sector credit growth accelerated to 24.1% from 17.7%.

Fiscal policy was expansionary to support public health, social interventions, and firms hit by COVID-19 (Figure 3.23.3). Public spending focused on health care, cash transfers to vulnerable households, tax relief, wage subsidies and support for firms retaining workers, and loans and guarantees to pandemic-hit small businesses. These policy responses contributed to public spending at a preliminary estimate of 25.5% of GDP in 2021.

Slow economic activity contributed to an estimated 7.1% decline in domestic revenue in 2021, equal to 21.4% of GDP. Because of these measures, the general government budget deficit widened to an estimated 4.0% of GDP in 2021 from 3.5% in 2020. And as a result, public external debt rose to 35.2% of GDP from 34.7%.

While 2021 saw continuing inflows of foreign direct investment and other capital, the slump in tourism receipts and lower private gold sales, exacerbated by a surge in temporary gold imports, caused the current account deficit to widen significantly (Figure 3.23.4). This led to a modest decline in international reserves to $20.2 billion, cover for 7.4 months of imports. The current account deficit for the full year widened sharply to an estimated 45.7% of GDP.

**Economic prospects**

The economy is forecast to grow by 5.3% in 2022 and 6.5% in 2023 (Figure 3.23.5 and Table 3.23.1). Growth in the economies of major trading partners will continue to support the strong momentum of Cambodia’s merchandise exports and inflows of foreign direct investment. Industry output is expected to grow by 8.1% in 2022 and 9.1% in 2023. Growth in the garments, travel goods, and footwear segment will be driven by strong external demand supported by a relocation of orders from the People’s Republic of China and neighboring countries. This growth will also be buoyed by the implementation of the Garments, Footwear and Travel Goods Development Strategy to raise competitiveness in this segment. Growth of
nongarment manufacturing should reflect expected strong external demand supported by recent free trade agreements with the People’s Republic of China and the Republic of Korea and a new investment law. Agriculture output is expected to grow at 1.2% over the forecast horizon.

**Figure 3.23.5 GDP growth**

Growth will rise above the 5-year moving average in 2022 and 2023.

<table>
<thead>
<tr>
<th>Year</th>
<th>Estimate</th>
<th>Forecast</th>
</tr>
</thead>
<tbody>
<tr>
<td>2017</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2018</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2019</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2020</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2021</td>
<td>0.0%</td>
<td>0.0%</td>
</tr>
<tr>
<td>2022</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
<tr>
<td>2023</td>
<td>6.5%</td>
<td>6.5%</td>
</tr>
</tbody>
</table>

GDP = gross domestic product.
Source: Asian Development Outlook database.

**Table 3.23.1 Selected economic indicators, %**

<table>
<thead>
<tr>
<th>Year</th>
<th>2020</th>
<th>2021</th>
<th>2022</th>
<th>2023</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth</td>
<td>-3.1</td>
<td>3.0*</td>
<td>5.3</td>
<td>6.5</td>
</tr>
<tr>
<td>Inflation</td>
<td>2.9</td>
<td>2.9</td>
<td>4.7</td>
<td>2.2</td>
</tr>
<tr>
<td>CAB/GDP</td>
<td>-8.7</td>
<td>-45.7*</td>
<td>-21.5</td>
<td>-16.1</td>
</tr>
</tbody>
</table>

* Estimate.
CAB = current account balance, GDP = gross domestic product.
Source: Asian Development Bank estimates.

Inflation is projected to accelerate this year, averaging 4.7% on surging energy prices caused by the Russian invasion of Ukraine and broader domestic demand. Pressure on consumer prices is expected to moderate in 2023, when the inflation rate is forecast to average 2.2%, a level in line with expectations of lower energy prices (Figure 3.23.6). Monetary policy will continue to target price stability, with the implicit goal of encouraging greater use of the riel, the local currency, and keeping the exchange rate stable against the US dollar.

**Figure 3.23.6 Inflation**

Inflation will rise in 2022 before slowing in 2023 on lower energy prices.

The services sector is projected to rebound to 4.8% this year and accelerate to 6.8% in 2023. This forecast, however, assumes that renewed COVID-19 infections driven by new variants will only have a mild impact on mobility. The recovery in 2022 will reflect a rebound in hotels and restaurants from the contraction of the last 2 years and continued growth in wholesale and retail trade, transport and communications, and real estate. Reopening the economy and the already remarkably high level of vaccination coverage will allow for a gradual recovery in tourism, which, in turn, will support demand for accommodation, food, transportation, and other in-person services. The growth in services next year will build on the momentum in 2022, especially in the hospitality sector, and will likely be supported by Cambodia hosting the 2023 Southeast Asian Games and the 2023 national election.

Cambodia’s authorities continue to implement policies to mitigate the impact of COVID-19 on business revenue and people’s incomes and to support economic growth. The loan restructuring program has been extended to the end of June, and other regulatory forbearance measures to enable banks and microfinance institutions to continue lending are being kept in place. The finance sector remains stable and well-capitalized, but potential rises in nonperforming loans and loan impairments could put pressure on some banks and microfinance institutions. Achieving a well-managed phase-out of the loan restructuring program and other regulatory forbearance measures will be vital for the stability of the finance sector.
Fiscal policy will remain expansionary this year and next and see a gradual reduction in pandemic-related intervention. Socioeconomic intervention, however, remains a priority to support the implementation of the Strategic Framework and Programs for Economic Recovery in the Context of Living with COVID-19 in the New Normal, 2021–2023, launched in December. The fiscal budget for general government operations has a planned deficit of 5.6% of GDP in 2022. Revenue is budgeted at 20.4% of GDP and expenditure at 25.9%. A gradual drawdown in government deposits from 24.2% of GDP in 2020 is expected to meet the financing gap in the medium term. Despite the high deficit, Cambodia remains at a low risk of debt distress, as total public external debt is projected to rise to a manageable level of 36.2% of GDP in 2022 and 37.1% in 2023. The government plans to issue bonds in 2022 to help diversify its financing sources.

The current account deficit is projected to narrow to 21.5% of GDP and 16.1% in 2023, but this is contingent on unbalanced gold trade ceasing and a gradual improvement in tourism. The projected narrowing of the current account deficit reflects a smaller trade deficit. Goods and services exports are forecast to grow by 17.8% in 2022 and 18.5% in 2023 on strong external demand for Cambodian products supported by a recovery in tourism, albeit a slow one. Imports are expected to fall by 7.7% in 2022 on high base effects from 2021 before growing by 10.3% in 2023. The narrower current account deficit is expected to be offset by capital inflows, enabling an increase in gross international reserves, forecast at $24.9 billion by the end of 2023.

Downside risks to the outlook include renewed COVID-19 infections driven by new variants, a rapid increase in nonperforming loans undermining the performance of banking institutions as the loan restructuring program is phased out, weakened growth of major trading partners, global supply chain disruptions, and a worse-than-expected surge in energy and commodity prices.

**Policy challenge—diversifying manufacturing**

Widespread vaccination against COVID-19 has enabled Cambodia to reopen its borders, but increasing trade and tourism alone will not be enough to achieve sustained economic growth. For this, manufacturing needs to be more diverse. Although the COVID-19 pandemic severely affected large areas of the economy, light manufacturing, such as bicycles, electronic components, and wiring products, has grown dramatically, including over the pandemic (Figure 3.23.7). This growth shows that Cambodia can diversify from its traditional focus on producing and exporting garments, travel goods, and footwear. Being able to sustain this trend will go a long way toward helping the government achieve its vision of a more resilient and diversified economy.

**Figure 3.23.7 Growth trend of garments, textiles, and footwear and other manufacturing**

*Other manufacturing continued its rapid expansion despite COVID-19.*

The Law on Investment, adopted in October 2021, will help attract more domestic and foreign direct investment into manufacturing. The law provides a more comprehensive, transparent, and predictable legal framework to make Cambodia a more attractive investment destination. Specific incentives are...
provided under the law for investing in industries that support regional and global supply chains, and for the production of electronics, spare parts, mechanical and machinery equipment, and agro-processing, among other areas. In addition to incentives, the government has launched a strategic framework and programs for economic recovery that build on existing and ongoing reforms to enhance diversification and improve competitiveness in manufacturing.

Cambodia has an opportunity to develop new manufactured products for export that can sustain productivity growth to help support continued improvements in living standards. But to make the most of this opportunity, it is essential that a wider range of manufactured goods can be developed and produced.

To this end, the government should create a priority set of reforms that can be implemented as part of the strategic framework and programs for economic recovery. Ways of doing this could include using the investment law as a catalyst for a broader effort to strengthen investment promotion and facilitation; working with the operators and key tenants of special economic zones to identify opportunities to streamline regulatory processes and upgrade supporting infrastructure; developing a more comprehensive and clearer vision to leverage environmental sustainability as a source of future competitive advantage; and working with industry stakeholders to develop and implement transformation plans for manufacturing, including skills development and upgrading technology and production processes and product quality.