Euler Hermes Economic Research

Country Report

Cambodia

Encouraging signs

General Information

GDP	USD14.1bn (World ranking 119, World Bank 2012)
Population	14.9 million (World ranking 67, World Bank 2012)
Form of state	Constitutional Monarchy
Head of government	HUN SEN
Next elections	2018, legislative (National Assembly)

Strengths

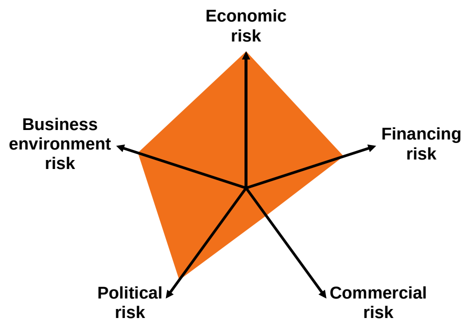
- Large growth potential
- Strong foreign direct investment inflows since 2011
- Manageable public and external debt burden
- High aid level
- Natural resources (hydrocarbon sector)
- ASEAN member
- Competitive in low-end manufacturing

Weaknesses

- Social unrest in recent years
- Difficult relations with neighbouring Thailand
- One of the poorest countries in Asia
- Weak economic structure and business environment
- Rapid credit growth threatens price stability and banking sector stability
- High current account deficits
- Vulnerable export base (concentrated in the garment industry)

Country Rating

D3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports		Rank		Imports
United States	31%	1	27%	Thailand
United Kingdom	8%	2	20%	Vietnam
Germany	8%	3	20%	China
Canada	7%	4	7%	Singapore
Singapore	6%	5	6%	Hong Kong

By product (% of total)

Exports		Rank		Imports
Apparel and clothing accessories	66%	1	21%	Textile yarn and related products
Footwear	8%	2	15%	Petroleum and related materials
Miscellaneous manufactured articles, n.e.s.	4%	3	6%	Road vehicles
Non-monetary gold	3%	4	4%	Iron and steel
Road vehicles	3%	5	3%	Specialised machinery

Source: UNCTAD (2012)

Structural weaknesses prevail

Level of economic development is weak. Gross nominal income per capita (estimated at USD 1,024 in 2013) is among the lowest in Asia. The poverty rate is around 18%. The economy structure remains inefficient for growth with a strong dependency on the agriculture sector (1/3 of GDP and 64% of employment) and on the garment industry (2/3 of exports). The country continues to suffer from poor infrastructure including electricity shortages which limit industrial performance, and weak business environment (Doing business rank is 135 out of 189).

But short term economic outlook is improving

However economic growth is performing well. After stagnation in 2009, the economy has recovered with growth averaging 7% per year between 2008 and 2013. In 2014, latest indicators point to a growth of 7.2% even while the economy was faced with domestic (political deadlock until July 2014) and external uncertainties (political risk in Thailand, global demand slow down). GDP growth was supported by improvement in the construction and the garment industries, and services.

In 2015, economic growth is projected to remain strong (7.3%). Under the assumption of further political stability, domestic demand is set to strengthen benefitting from: solid credit growth, large long-term Investment inflows (factories relocations related) and weak energy prices. External trade is projected to remain a key driver with exports amounting 60% GDP. In particular, improving demand in the USA, the Eurozone and ASEAN should give a boost to Cambodia's exports.

Risks to the baseline scenario stems from domestic and external sources. For the first one it includes overheating risk due to too strong credit growth to real estate sector and renewed social-political risks. Regarding external risk, the main concern is related to the demand from Eurozone if economic recovery were to be delayed.

Inflationnary risks have receded but should remain on the radar

Inflationary pressures are decreasing and should stabilize at manageable levels. Headline inflation shows some volatility during the past reflecting volatility in food prices (food comprises 43% of the consumer price index). Weak energy prices should counterbalance further rise in food prices. Inflation will likely go below 5% in2015.

Rapid credit growth remains a risk to the undeveloped banking sector. Claims to private sector growth remain elevated (22% y/y mid 2014) even if some progress have been made (27% end 2013, 49% end 2012).

Fiscal deficit is set to stabilize

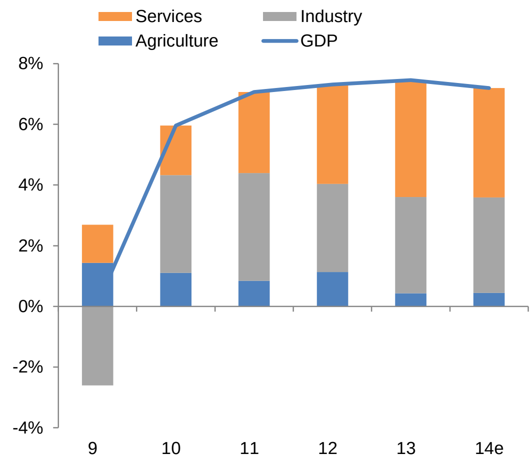
Fiscal management is improving. The overall fiscal balance (including grants) is set to stabilize around -2.7% GDP. Public expenditures are set to rise reflecting increasing wage bill in the public sector. Revenues are set to improve with broader tax collection. Gross public debt should remain relatively low at just below 30% of GDP.

Key economic forecasts

	2012	2013	2014f	2015f
GDP growth (% change)	7.3	7.5	7.2	7.3
Inflation (%, year average)	2.5	4.6	4.2	4.0
Fiscal balance (% of GDP)	-3.3	-2.7	-2.8	-2.7
Public debt (% of GDP)	28.7	28.4	28.8	29.0
Current account (% of GDP)	-7.4	-10.5	-11.0	-10.9
External debt (% of GDP)	32.1	33.3	34.4	33.9

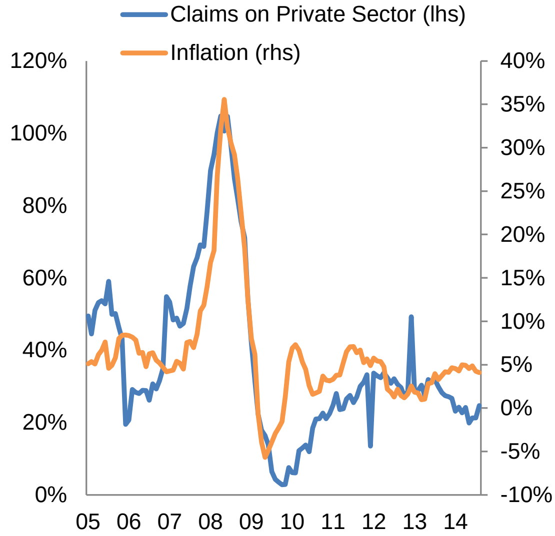
Sources: National sources, ADB, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Inflation and claims on private sector (y/y)



Sources: National sources, IHS, Euler Hermes

Current account deficit is large but FDI inflows offset associated risks in the short run

The annual current account deficit remains large (around -11% GDP). Exports are set to increase in the medium term with Cambodia emerging as a manufacturing hub. However in the short run, goods imports growth will remain elevated reflecting rising domestic demand and rising demand of investment related imports (equipment material).

However, this large external deficit should not be a cause of concern in the short run. Since 2011 it has been almost completely financed by net FDI inflows – largely related to power sector projects – and this is likely to continue in the next years. FDI inflows have also boosted official foreign exchange reserves to about USD4.2bn, which is almost 3.5 months import cover mid-2014 (3.4 months end-2013).

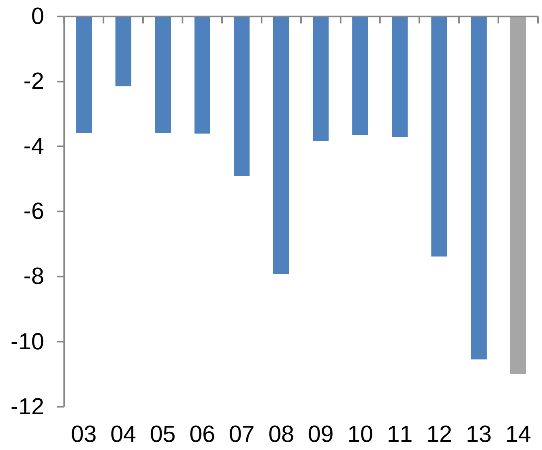
External debt burden is manageable

External debt is relatively high as a proportion of GDP (34%), but moderate in relation to export earnings (60%). And as most of the debt is on concessional terms, external debt-servicing is very low.

Macro- financial risk remain an issue

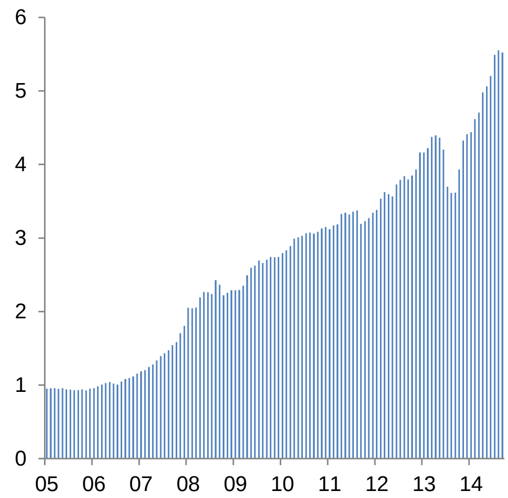
The financial system is very fragile with a high sensitivity to confidence shocks and capital outflows. The first reason behind this fragility is the lack of effectiveness of the monetary policy due to high dollarization in the economy. Second, the banking supervision is poor with the current prudential framework underdeveloped. The banking system, saw a significant confidence shocks during the last election, the banking sector was subject to large withdrawal (-10% of total deposit in summer 2013). Third, the banking sector continues to be faced with high risks including rising foreign funding, strong exposure to the real estate sector and fast credit growth.

Current account balance (% GDP)



Sources: ADB, IHS, Euler Hermes

Foreign exchange reserves (USD bn)



Sources: National sources, IHS, Euler Hermes

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