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Impact of the Global Financial Crisis on Cambodian Economy at Macro and Sectoral Levels

Hem Socheth

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April 2013

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Responsibility for ideas, facts and opinions presented in this research paper rests solely with the authors. Their opinions and interpretations do not necessarily reflect the views of the Cambodia Development Resource Institute.

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Acronyms and Abbreviations

ACFID	Australian Council for International Development
ASEAN	Association of South East Asian Nations
ATM	Automatic Teller Machine
BOP	Balance of Payment
CDC	Council for the Development of Cambodia
CIDS	Cambodian Institute for Development Studies
EU	European Union
FDI	Foreign Direct Investment
GFC	Global Financial Crisis
GDP	Gross Domestic Product
KHR	Khmer Riel
IMF	International Monetary Fund
ILO	International Labor Organization
MAFF	Ministry of Agriculture, Forestry and Fisheries
MFI	Micro Finance Institution
NGO	Non-Governmental Organization
NIS	National Institute of Statistics
NBC	National Bank of Cambodia
ODA	Official Development Assistance
RHS	Right Hand Side
ROW	Rest of the World
SEZ	Special Economic Zone
UNDP	United Nations Development Program
US	United States
USD	US Dollars

ACKNOWLEDGEMENTS

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Phnom Penh
April 2013

EXECUTIVE SUMMARY

Although the global economy is recovering from the financial and economic crisis that started in 2008, many countries have not returned to their pre-crisis growth rates. Cambodia is no exception. Despite its rich endowment of natural resources, especially minerals, oil and gas, the country still depends on a narrow growth base of just four sectors: garments and textiles, tourism, construction and agriculture. Agriculture apart, heavy reliance on foreign investment and markets makes these sectors vulnerable to external shocks, which have significant consequences for overall and sectoral economic growth and impact disproportionately on the employment and income of workers, who are mainly the poor. There is no evidence of adverse impacts from the global economic downturn on the banking and financial sector, though reports suggest that many foreign investors have withdrawn investment capital from Cambodian banks, which to some extent manifests a setback in the banking sector. Some economists point out that the weak linkage of Cambodia's banking and financial sector to the world financial system has insulated it from the effects of the crisis. The financial crisis was however a wake-up call for the Cambodian government to review and rearrange its banking and financial policies to avoid a recurrence of the credit crisis that stalled the construction sector.

Not everything turned out to be as bad as predicted. Garments and textiles, one of the main engines of Cambodia's export sector, suddenly picked up amid the start of world economic recovery. Ministry of Commerce figures indicate that the sector's export performance began to improve in 2010 as demand for Cambodia's low price apparel products shot up at a remarkable rate. Despite sluggishness in the property market, customs and excise reports show that imports of construction materials have continued to grow. The agricultural sector has performed modestly well and provided a vital safety net for laid-off workers and returning migrants. Milled rice export is currently the focus of government efforts to develop the sector, and newly set production targets should make Cambodia one of the top three rice-exporting countries in the near future. To promote commercial rice production, the government has waived tariffs on agricultural products and encouraged private sector investment in rice processing to grasp higher value-added. National Bank of Cambodia data indicates that disruption to the financial and banking sector's performance has been negligible while that of microfinance institutions has improved. To tackle the global economic meltdown, the government formulated a series of strategies including fiscal and monetary policies, stimulus packages, and the social equity fund that provides a social safety net to help the poor mitigate the hardship they face, all of which stand the country in good stead for solid economic growth and prosperity.

1

INTRODUCTION

Widely acclaimed as the worst recession since the 1930s Great Depression, the global financial crisis (GFC) arrived in the wake of the dual shocks of the 2007 food and oil price hikes. The crisis was triggered by the collapse or failure of large financial institutions, illiquid assets and uncertainty over loan security due to high defaults in the United States (US) financial markets, where loopholes in regulations and slack control over lending resulted in the subprime mortgage crisis. Competition between financial and banking institutions to profit from the subprime loan market had led to a cavalier attitude towards evaluating high-risk borrowers' criteria, allowing poorly rated borrowers to access loans they would not be able to repay, not even the interest. House prices rose as more people bought property with borrowed money, which accelerated by extraordinarily low interest rates (Baker 2008) to beyond justifiable economic calculation created the economic bubble that burst in late 2007, instantly slashing house prices by over 15 percent. Speculation in the real estate market was beneficial to some traders but hurt others, who stuck with huge loans found themselves in negative equity and unable to sell their property quickly.

As the crisis reverberated around the globe, tumbling stock markets created domino effects. The British Broadcasting Corporation (BBC 2008) reported unprecedented drops in major stock markets – New York down 33.84 percent, London by 31.3 percent, Paris by 42.7 percent, Frankfurt by 40.4 percent, Mumbai by 51.9 percent, Singapore by 49.2 percent, Sydney by 41.3 percent, Hong Kong by 48.3 percent, Shanghai by 65.2 percent, and Tokyo down 42.1 percent.

Banks that lost vast sums of money to property bubble bursts clamped down hard on loans, making it difficult for even thriving businesses to function. Failing businesses resulted in higher unemployment that spiralled economies into recession, which according to a joint statement by the World Bank and International Monetary Fund (IMF) in April 2009 (cited in ACFID n.d.), had already driven more than 50 million people, in particular women and children, into extreme poverty. Global economic slowdown resulted in an employment crisis pushing global unemployment up by 8.4 million (7.4 percent) in 2008 while global job losses hit 50 million in 2009 (World Bank 2009).

In the quest to revitalise their economy, many countries deployed stimulus packages. Governments bailed out banks and insurance companies to save jobs and reenergise economic performance. For example, China announced a USD586 billion stimulus plan in November 2008 (Xu 2009) and the United States approved a USD780 billion stimulus in February 2009 (Wang & Alvi 2010) – approaches emulated by Euro zone countries, Japan and Korea.

Rapid assessment of the impact of the crisis by Kang *et al.* (2009) revealed Cambodia to be one of the worst affected countries in Asia. The Cambodian economic contraction stemmed from shaky performances in key sectors that traditionally constitute Cambodia's economic backbone – garments, tourism and services. Although short-lived, it tumbled the labour market, leading to the retrenchment of many workers in these sectors. Unemployment resulted in lost household income, especially for rural households dependent on remittances from members who worked in the worst affected sectors.

The crisis decelerated Cambodia's economic progress. The IMF revised its growth projection downwards from 10.3 percent in 2007 to 6.4 percent in 2008 and then -0.5 percent in 2009, quite different from the government's more optimistic forecast of six percent growth (Jalilian *et al.* 2009: 3). Growth hovered around the 6 percent mark in 2010 and 2011, though the extensive floods in 2011 possibly hampered growth in 2011-12. The government launched a series of strategies to mitigate the effects of the crisis including administrative measures and fiscal and monetary policies. It also invested in a vocational training and career placement programme as a social safety net for laid-off workers and unemployed youth.

The main goal of this study is to analyse the impacts of the GFC on Cambodia's economy. Specifically, it focuses on investment, trade and employment, and the core growth sectors – garments and textiles, agriculture, construction, and tourism. The paper draws on a desk review of literature, research reports, policy documents and secondary data from government ministries, research institutions, international organisations and electronic publications. Descriptive data analysis attempts to identify the intensity of GFC impacts on Cambodia's economy at macro and sectoral levels, and the sectors most affected.

The rest of the paper is structured as follows. Section two gives an overview of Cambodia's economic performance over the last 15 years. Section three considers the macro-economic impacts of the crisis on the Cambodian economy at macro level, while section four looks at the effects at sectoral level. Section five concludes the paper.

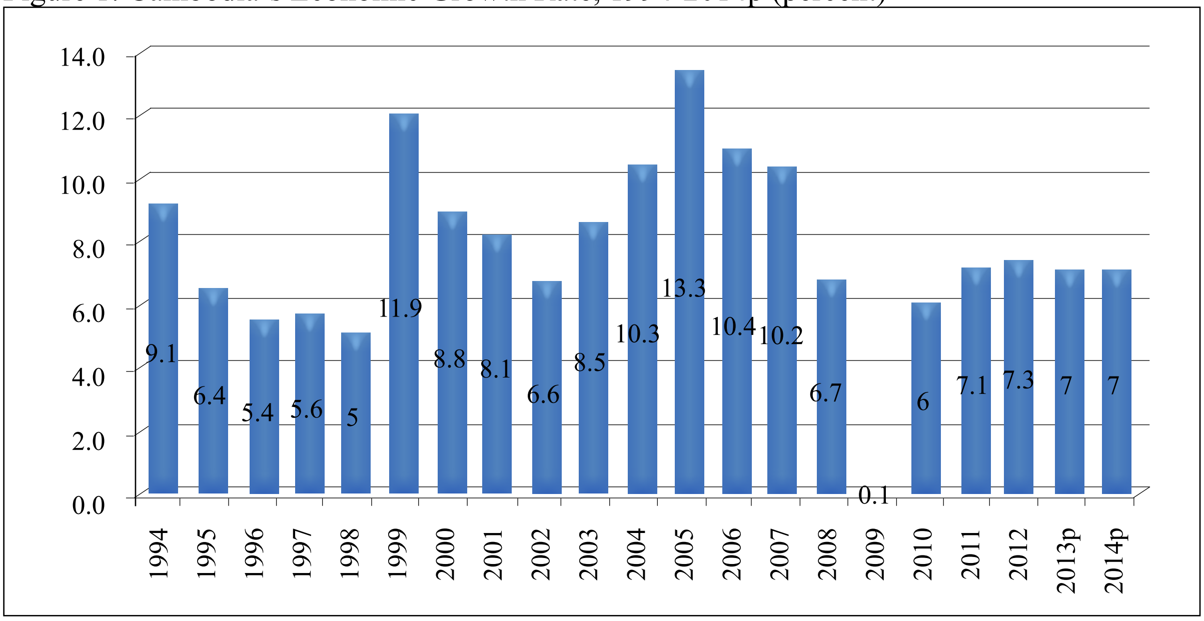
2

OVERVIEW OF CAMBODIA'S ECONOMIC PERFORMANCE 1994-2012

After nearly three-decades of civil war and isolation, Cambodia turned a new page in its history by reuniting all parties, once bitter enemies, at the mediation table to broker peace. The Paris Peace Accord, signed on 23 October 1991, led to the national election in 1993 under the auspices of the United Nations Transitional Authority in Cambodia (UNTAC). With peace completely restored, the government set about rehabilitating the country's decimated socioeconomic infrastructure from the ground up. Development efforts involved the promotion of private investment to create a vibrant private sector as the backbone of the national economy; the building and upgrading of physical infrastructure through public sector investment and assistance from international organisations and development partners; and the reform of soft infrastructure, including the judicial system, to promote social justice and create an enabling business environment.

Cambodia was integrated into the Association of South East Nations (ASEAN) in 1999, and took its seat as the 148th member of the World Trade Organisation in 2004. The country has since entered into numerous bilateral and multilateral agreements with other countries and international communities in diplomatic, social and economic cooperation.

Figure 1: Cambodia's Economic Growth Rate, 1994-2014p (percent)



Note: p=projection
Source: Ministry of Economy and Finance (2013)

Strategic government planning, economic openness and policy to create an environment conducive to private sector development culminated in Cambodia achieving remarkable progress over the fifteen years to 2008, making it the fastest growing economy in Asia (Figure 1). Economic growth averaged 9.3 percent from 1997 to 2008, while poverty declined from 34.7 percent in 2004 to 30.1 percent in 2007. This extraordinary performance stemmed from huge strides in the garment sector and improvements in tourism and construction underpinned by steady growth in agriculture, which remained crucial to overall socioeconomic growth as around 80 percent of the population live and work in rural areas. Robust economic growth enabled the country to improve infrastructure, develop human resources, and undertake many key government reforms.

The run of high growth came to an abrupt halt in late 2007 as the financial crisis broke out, initially paralysing the global economy. The crisis soon transformed into economic recession, sending shock waves reverberating around the world and hitting Cambodia in early 2008. Cambodia's industry took a hard blow as the global economy slowed. Economic growth nosedived to 0.1 percent in 2009 before recovering to 6 percent in 2010 and to around 7 percent in subsequent years.

The agriculture sector came into its own during the crisis, acting as a safety net for laid-off and returning migrant workers. Table1 shows that the agricultural sector's GDP share has gradually decreased from 45.3 percent in 1993 to 33.2 percent in 2010, while growth held steady at between 5 and 5.6 percent in the period 2007 to 2010 before falling to 2.3 percent in 2011.

Table 1: Share of Gross Domestic Product by Sector (percent)

Sector	1993	1997	2001	2005	2008	2009	2010	2011
Agriculture fishery and forestry	45.3	44.4	34.3	30.7	32.8	33.5	33.2	32.5
Crops	16.9	20.0	14.5	15.7	17.9	18.4	18.3	18.0
Livestock and poultry	7.3	5.9	5.4	4.7	4.4	4.5	4.6	4.5
Fisheries	16.6	12.1	11.2	7.3	7.4	7.7	7.5	7.3
Forestry and logging	4.5	6.4	3.3	3.0	3.0	2.9	2.8	2.7
Industry	12.6	16.4	22.3	25.0	22.4	21.7	21.2	21.5
Mining	0.2	0.2	0.3	0.4	0.4	0.5	0.5	0.5
Manufacturing	8.6	11.6	16.8	17.8	15.3	14.4	14.0	14.3
Food, beverages and tobacco	4.1	3.7	3.0	2.4	2.2	2.3	2.3	2.3
Textiles, apparel and footwear	1.0	3.7	10.8	12.3	10.3	9.1	8.8	9.0
Wood, paper and publishing	1.2	1.6	0.7	0.6	0.6	0.6	0.6	0.6
Rubber manufacturing	0.3	0.5	0.4	0.5	0.4	0.4	0.4	0.4
Other manufacturing	1.9	2.1	2.0	2.1	1.9	2.0	2.0	2.0
Electricity, gas and water	0.4	0.5	0.5	0.5	0.5	0.5	0.5	0.6
Construction	3.5	4.1	4.8	6.3	6.1	6.3	6.2	6.2
Services	39.4	35.1	38.4	39.1	38.8	38.8	38.4	39.0
Trade	14.6	12.1	10.3	9.2	8.9	9.0	8.9	8.9
Hotel and restaurants	2.3	2.9	4.4	4.3	4.5	4.5	4.4	4.6
Transport and communications	5.5	5.5	7.0	7.4	7.4	7.5	7.5	7.6
Finance	0.3	1.0	1.0	1.1	1.3	1.4	1.4	1.4
Public administration	2.1	3.0	2.3	1.8	1.8	1.8	1.8	1.8
Real estate and business	9.1	5.9	6.2	6.6	6.4	6.1	6.1	6.2
Other services	5.5	4.6	7.3	8.6	8.5	8.5	8.4	8.5
Taxes on products less subsidies	2.9	5.3	5.9	6.2	7.0	7.3	8.3	8.2
Less: subsidies	0.0	0.1	0.2	0.3	0.1	0.1	0.2	0.2
Less: finance service charge	0.2	1.2	0.9	1.0	1.0	1.1	1.2	1.2

Source: National Institute of Statistics (2012)

The still largely subsistence-based agricultural sector absorbed a considerable number of labourers from the industrial sector during the crisis as many laid-off garment and construction workers unable to find jobs returned to their rural villages to help their families cultivate rice and other crops. The most recent blow – the extensive flooding in 2011 – destroyed tens of thousands of hectares of cultivated land and took its toll on Cambodian economic and social wellbeing, further adding to economic difficulty. The huge losses incurred through destroyed crops and damaged infrastructure will likely decelerate growth and threaten food security, though government has given assurances that Cambodia can still export rice.

The government's strategic directive to increase milled rice export by intensifying rice production and encouraging private sector investment in rice processing should boost the agriculture sector's performance in the near future. Besides increasing local value-added, policy to promote commercial agricultural production is linked with tourism sector development in a bid to substitute food imports from Thailand and Vietnam.

The industry sector's modest yet steady rise from just 12.6 percent of GDP in 1993 to 21.5 percent in 2011 is chiefly due to dramatic improvements in garment and textile manufacturing. Growth in this sector tailed off in 2010 as demand from the European Union (EU) and US, which together constitute around 90 percent of Cambodia's apparel export market, suddenly fell. Services sector growth plummeted in 2008 and bottomed at 2.4 percent in 2010. This suggests that people refrained from spending money on holidays, and indicates a drop in the number of "big spending" tourists. Nonetheless, the number of tourist arrivals from within the region, especially from Vietnam, Laos and Thailand, remained high even amid the recession (Ministry of Tourism 2012).

In order to strengthen economic growth, in particular to boost exports, the Cambodian government is promoting investment in special economic zones (SEZs). To date, nine of the 21 planned SEZs across the country are operational, while the rest are still awaiting both local and foreign investors. The government considers SEZs an important tool for the country's economic development because they enhance productivity and bring in infrastructure, jobs and skills. Factories already operating in the SEZs include vehicle assembly; electricity pylon, spare parts, bicycle, garments and footwear manufacture; jewellery packaging; drinking water, sugar and other agro-product processing. Even with Cambodia's generous investment law and tax incentives, investors in Cambodia face high production costs, namely electricity, transport, customs clearance, and bureaucracy. Overcoming these constraints will help attract more foreign direct investment into the country.

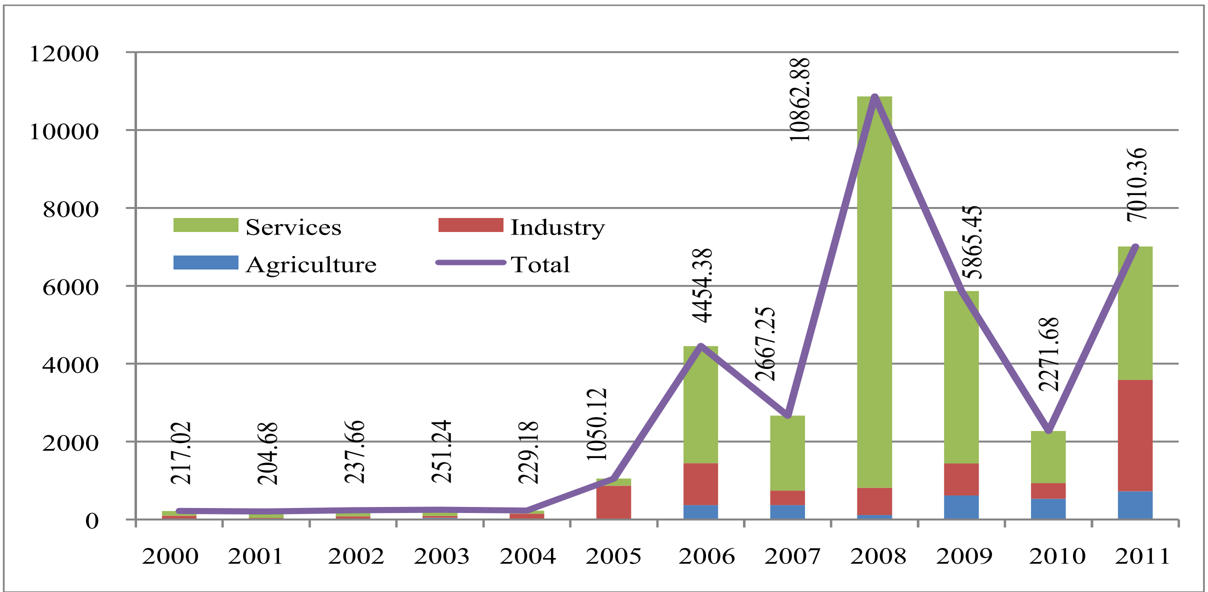
3

MACRO LEVEL IMPACTS OF THE GLOBAL FINANCIAL CRISIS

3.1 Investment and Trade

Cambodia has been promoting foreign direct investment (FDI) since it shifted from a centrally planned to free market economy in the early 1990s. The trend in FDI inflows (asset approvals), illustrated in Figure 2, rose steeply from 2004 onwards owing to dramatic increase in investment in garments, energy (hydropower) and services sectors, and peaked at nearly USD11 billion in 2008.[1] Because of the economic downturn forcing many investors to cut back their investments in Cambodia, FDI approvals dropped sharply in 2009 and 2010. Standing at around USD7 billion in 2011, the value of FDI inflows had regained some lost ground as the world economy began to make significant recovery from the crisis.

Figure 2: Foreign Direct Investment by Sector 2000-2011 (USD million)



Source: Council for the Development of Cambodia, 2012

Looking at FDI by sector, investment in agriculture jumped from USD19.58 million in 2005 to USD372.98 million in 2006, in industry from USD848.62 million to USD1073.74 million, and in services from USD181.92 million to USD3007.66 million in the same period. However, investments in 2007 started to shrink to USD368.51 million for agriculture, to USD375.27 million for industry and to USD1923.47 million for services. Beginning in late 2008, investment in all sectors declined quite steeply before the upturn in 2011.

The push to attract more FDI to SEZs throws into sharp focus the urgent need to create an enabling investment/business climate, specifically to improve hard and soft infrastructure, streamline official procedures and reduce business costs. To date, government has made strong efforts to attract large-scale investments in manufacturing, car assembly, agro-industry and commercial rice farming. Japanese firms have already eyed Cambodia's manufacturing sector and set up large electronic companies in SEZs. A Korean company has established a car

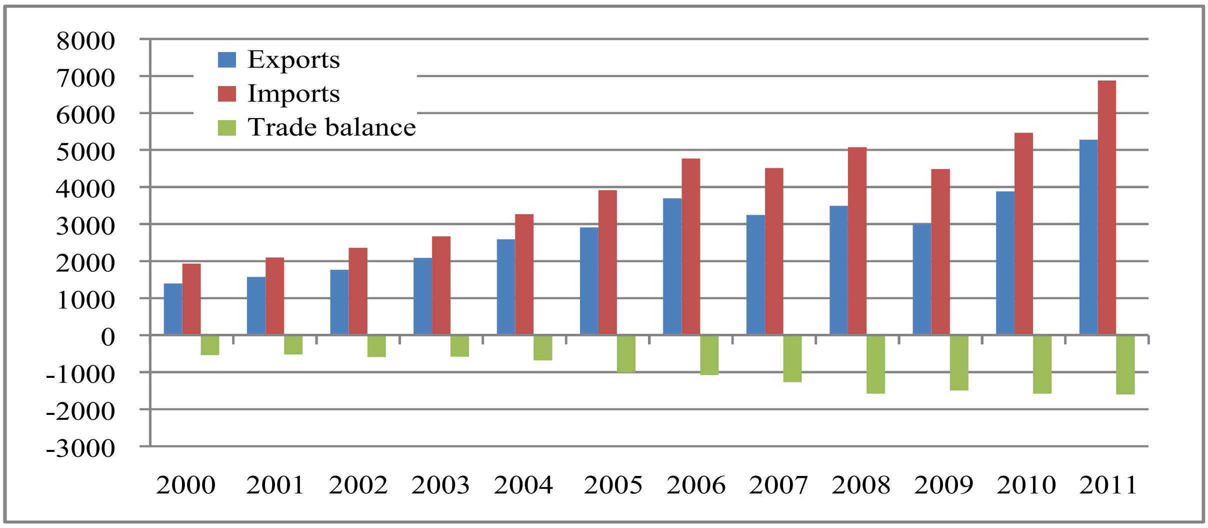
[1] Investment approval figures are assets put in the investment plan by foreign investors, and do not represent the actual amounts invested.

assembly plant in Koh Kong province, while a North American car manufacturer is planning to install a factory in Cambodia.

Cambodia has trade deficits with its partners because it has to import many goods from overseas to meet domestic demand (Figure 3). Nonetheless, the export trend clearly indicates that the country's economy is moving in a positive direction. This is partly due to higher investment in the garment sector, which produces majority of the country's exports, and investment in agriculture, especially in the rice sector. However, as Figure 3 shows, the trade deficit does not seem to be getting smaller.

The widening trade imbalance suggests that Cambodia needs to import more than it can export. Imported products include raw materials for garment manufacturing, components for the electronics industry, and capital goods such as machinery and spare parts. It also imports food, especially from Thailand and Vietnam. Because the country's export largely relies on garment and textile products, a drop in garment export has a pivotal effect on total export values.

Figure 3: Trade Balance, 2000-2011 (USD million)



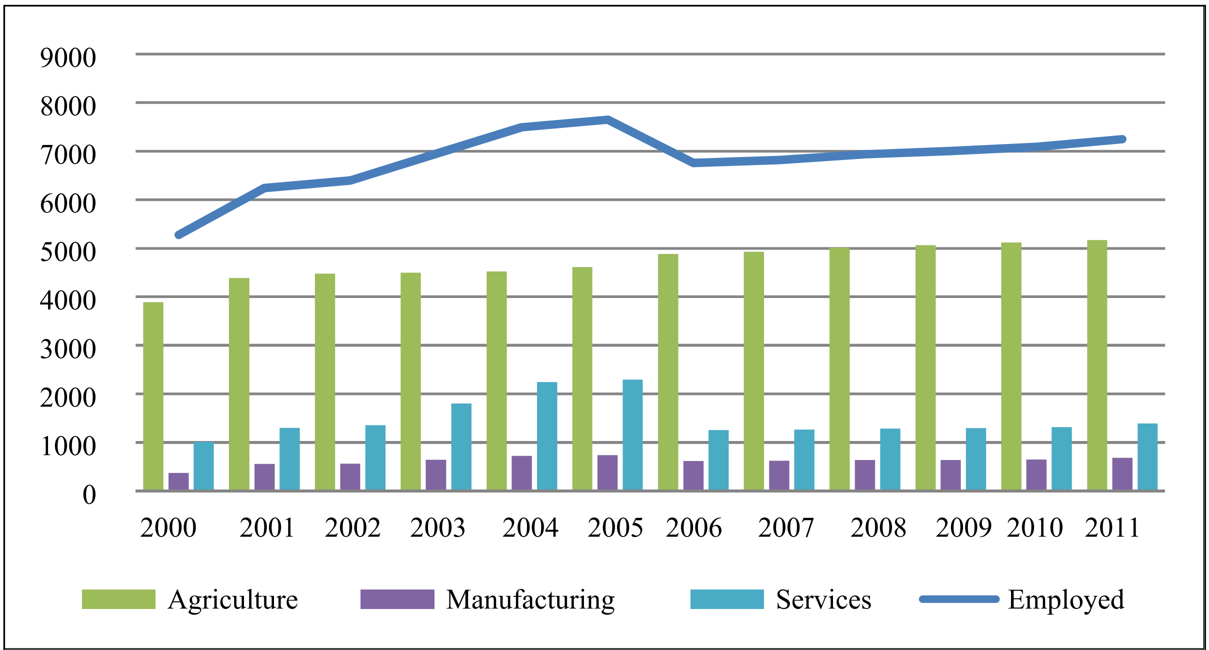
Source: ADB 2012

Cambodia's trade gap persists because the country is still unable to produce raw materials locally to supply the manufacturing sector even though it has high potential in terms of primary products. Lack of technology and the high cost of electricity discourage investment in domestic manufacturing industries as product prices cannot compete with cheaper imported goods. Producers therefore tend to seek external sources of supply, especially in the case of the garment industry where almost all fabrics and accessories are imported from China, Taiwan and Hong Kong. Because industries have been unable to strengthen domestic linkages, Cambodia's value-added chains remain weak. Nonetheless, requirements set by importing countries that all goods must have a certain level of local content will press Cambodia to reform its industrialisation policy and promote investment in industrial clusters.

3.2 Employment

With annual average population growth of around 1.7 percent, around 250,000 new entrants join the workforce every year (Chan 2009). Although at around 5 percent the unemployment rate in Cambodia is relatively low, majority of workers are unskilled and find it difficult to earn a good living. As Figure 4 shows, agriculture employs around 5 million people or 70 percent of the labour force, the services sector absorbs nearly 20 percent and manufacturing less than 10 percent.

Figure 4: Employment by Sector, 2000–2011



Source: Asian Development Bank (2012)

Rural households commonly send family members to seek employment usually in garment factories and on construction sites in urban areas, especially in Phnom Penh. These groups of workers were the most affected when the economic downturn hit in late 2008. They had to either return to their hometowns and villages or find jobs in other sectors such as tourism and services. Kang *et al.* (2009) estimated that income losses due to the global financial crisis would likely affect 93,000 households (470,000 people) in 2008 and 217,000 households (more than 1 million people) by the end of 2009. A study by the International Labour Office on the garment and textile industry found that by end of 2009, around 70,000 workers had been laid off and 70 factories closed (Dasgupta *et al.* 2011).

The retrenched workers from garment factories, construction and tourism industries would return to their rural villages, putting pressure on agricultural resources. Migrant workers, numbering around 200,000 and mostly working in Thailand and Malaysia, were highly likely to come back to Cambodia. The concern was that unless the government devised bold policy to create jobs and provide a social safety net, the number of laid-off workers and new entrants to the labour market would create a heavy burden on government, widen social inequality, and push people back into poverty.

As industry develops, it is expected that workers will move from the agriculture sector to take up jobs in the manufacturing sector. The immediate concern is that with low skills, people cannot easily move from one sector to another. Government has to meet this challenge and invest in human capital by promoting vocational training and long-term human resource planning to meet potential demand for labour. In addition, the full establishment of the ASEAN Economic Community in 2015 will allow freer movement of skilled labour, which will likely hurt Cambodia's employment if it does not act to improve local capacity.

3.3 Exchange and Inflation Rates

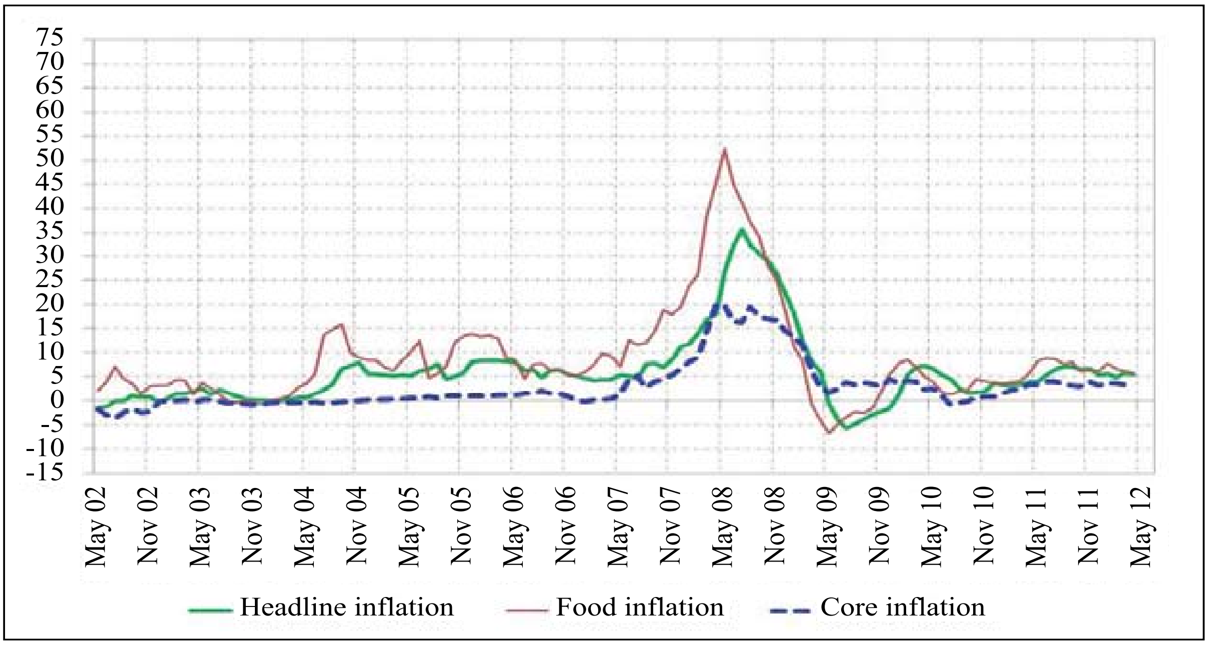
The official exchange rate between the riel and the US dollar – between 3900 and 4200 riels per dollar – has been kept well under control. Despite minor fluctuations, it remained stable in the face of the oil and food price hikes in 2007 and when the global financial crisis hit in 2009 (Figure 5).

Figure 5: Nominal and Real Effective Exchange Rates, 1990–2012

Source: World Bank 2012

By contrast, inflation rates fluctuated in the early to mid-2000s, peaking at 20 percent for core inflation, 35 percent for headline inflation and over 50 percent for food inflation in mid-2008 (Figure 6). After dropping sharply from the third quarter of 2008 to pre-crisis rates, overall inflation has remained stable at around 5 percent. If not well contained, high inflation would have worsened the country's economy by pushing commodity prices even higher, which in turn would have risked undermining government efforts to alleviate poverty.

Figure 6: Monthly Consumer Price Index (year-on-year growth %)

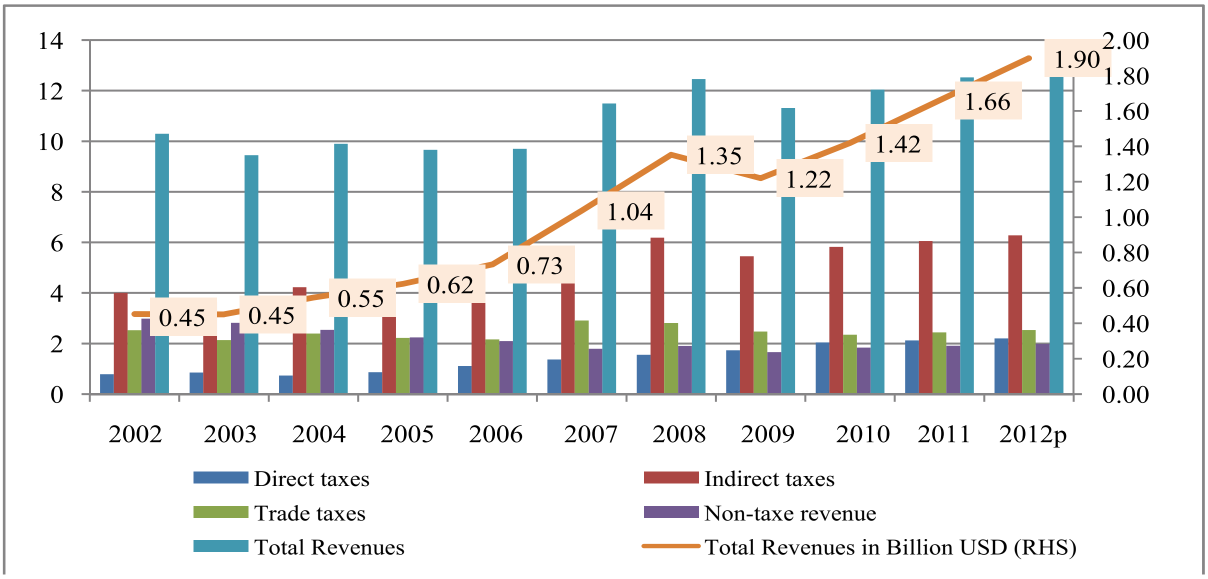


Source: World Bank 2012

3.4 Government Revenues and Reserves

Government revenue collection has increased in tandem with economic growth (Figure 7). Revenue collection declined from around USD1.35 billion in 2008 to USD1.22 in 2009, when the economic meltdown started to impact on the Cambodian economy. Since then, annual revenues – expected to reach around USD1.9 billion in 2012 – have increased constantly. This increase is partly due to the new source of revenue from property tax introduced in 2011 and rebound of economic performance.

Figure 7: Sources of Government Revenue, 2002-2012p



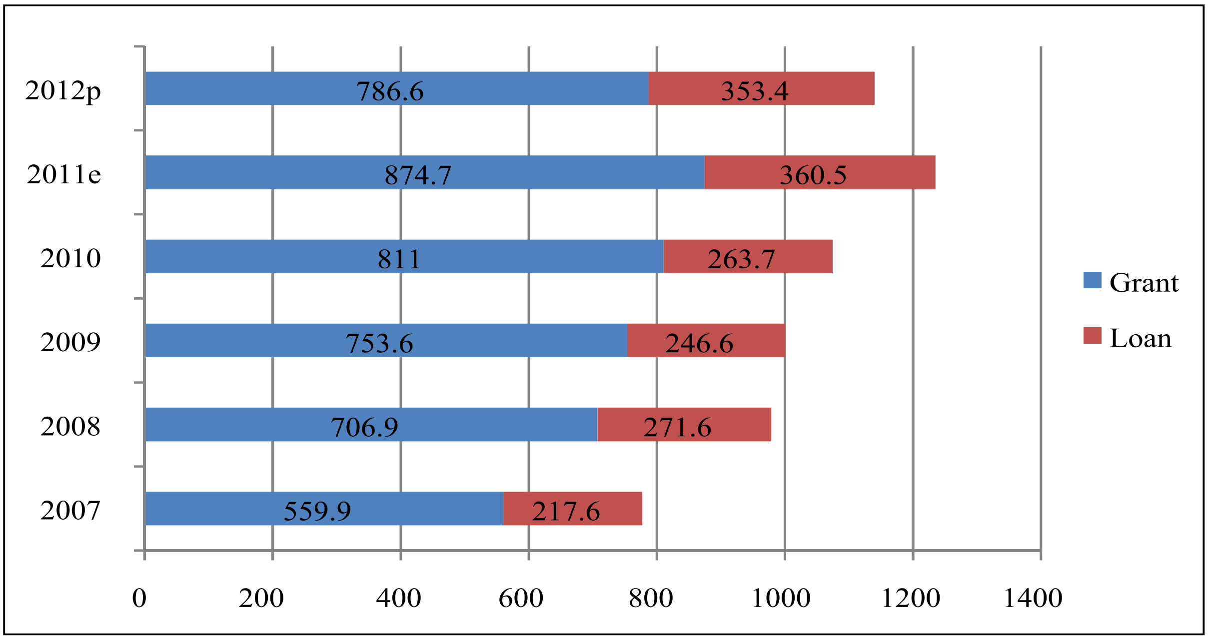
Note: e=estimate, p=projection; left axis denotes value in percentage and the right axis denotes value in billion riels
Source: Asian Development Bank 2012

Along side rapid economic growth, Cambodia has built up its international reserves from just USD500 million in 2000 to over ÚSD3 billion in 2011. Reserves rose by 14% to US$3 billion by the end of 2011 (accounting for 4.5 months of exports) while net foreign asset rose by 7% in 2011. If growth continues as projected, the country's reserves will further increase in the future.

3.5 Official Development Assistance

Despite the crisis, Cambodia continues to receive increased official development assistance and loans from its development partners, including Japan, China, EU and US, and non-governmental organisations (NGOs). Grants increased from around USD560 million in 2007 to just over USD700 million in 2008, then to USD900 million in 2011. Loans went up from USD217 million in 2007 to around USD270 million in 2008, and reached USD360 million in 2011. At the time of study, it was projected that grants would decline to around USD790 million in 2012 and loans would fall to USD350 million (Figure 8).

Figure 8: Development Assistance to Cambodia, 2007–2012 (USD million)



Source: CDRB (2011)
Note: e=estimate; p=projection

4

SECTORAL LEVEL IMPACTS OF THE GLOBAL FINANCIAL CRISIS

Although insulated from the initial impact of the crisis by its lack of integration into global financial systems, some of Cambodia’s main economic sectors sustained a hard blow when the financial crisis transformed into economic recession. Discussion in the following sections attempts to shed more light on these impacts.

4.1 Banking and Finance

The banking sector was not directly affected by the financial crisis as local banks held no toxic assets. However, this does not necessarily mean that the banking system remained unscathed. Data from government ministries show that the country’s exports plummeted, the construction sector suffered a drastic price correction, tourism activity slumped and overall business prospects were less favourable. Cambodia's financial sector is moderately vulnerable because of its exposure to those sectors most affected by the economic downturn and the decline in FDI during the recession.

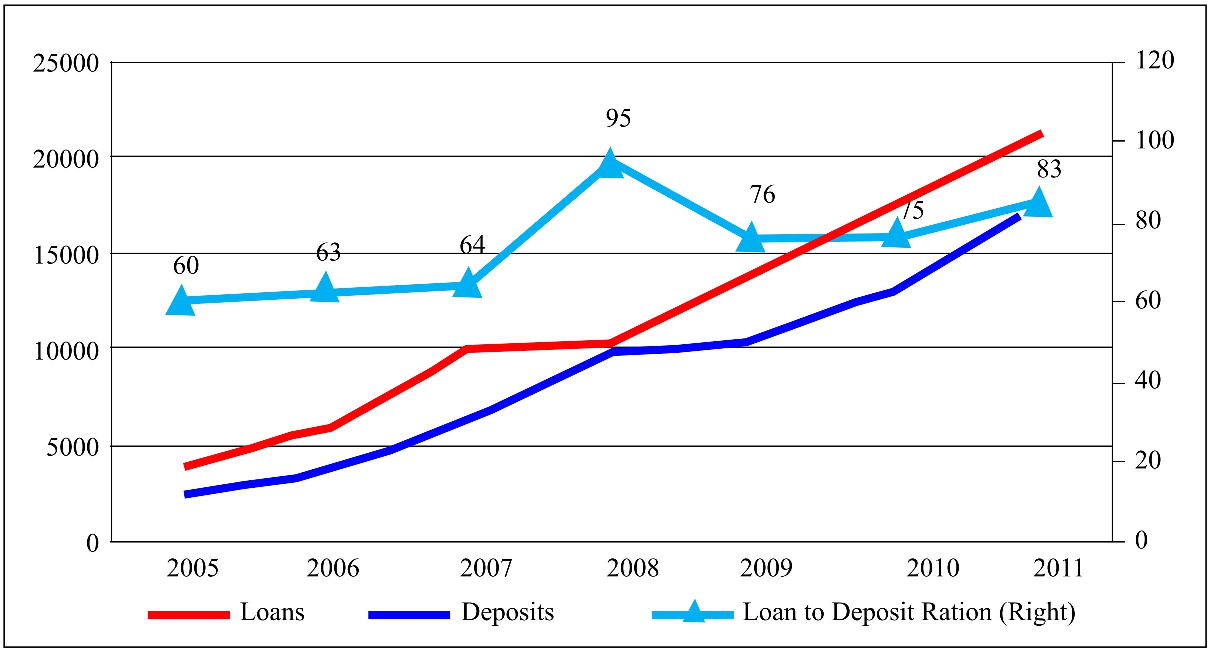
The National Bank of Cambodia’s Annual Report 2011 reveals that by the end of 2011, Cambodia had 31 commercial banks, 22 of which are local incorporated banks, nine foreign bank branches and seven specialised banks, including one owned by the state. It also had 32 licensed microfinance institutions, seven of which are eligible to collect customer deposits, and 29 registered microfinance institutions (NBC 2011).

The banking sector has made substantial progress. The number of deposit accounts has risen steadily to more one million accounts in 2011, with the number of loans showing a similar trend though a more modest increase to nearly 300,000. Meanwhile, the numbers of bank branches and modern services including automatic teller machines (ATM), debit and credit cards have also increased, suggesting that the sector has improved in terms of outreach and services.

Currency deposits continued on a steep upward trend until 2007-end, but then started to stall and tailed off from the third quarter of 2008 to the first quarter of 2009 before moving sharply upwards in subsequent quarters (Figure 9). This suggests that the crisis shook depositors’ confidence in banks and many decided to withdraw money for security reasons. Further, some foreign investors –mainly those involved in construction and real estate projects – withdrew funds to finance projects elsewhere.

When the property market scrambled, houses and land no longer fetched the high prices as before. Fewer people were willing to trade, transactions dropped, and property prices slid ever lower. Those who had bought investment property with bank loans were unable to pay the interest and had to salvage the capital left in their real estate by selling at even lower prices to repay debts. The numerous foreclosures during the crisis made many banks extremely cautious about lending to real estate businesses.

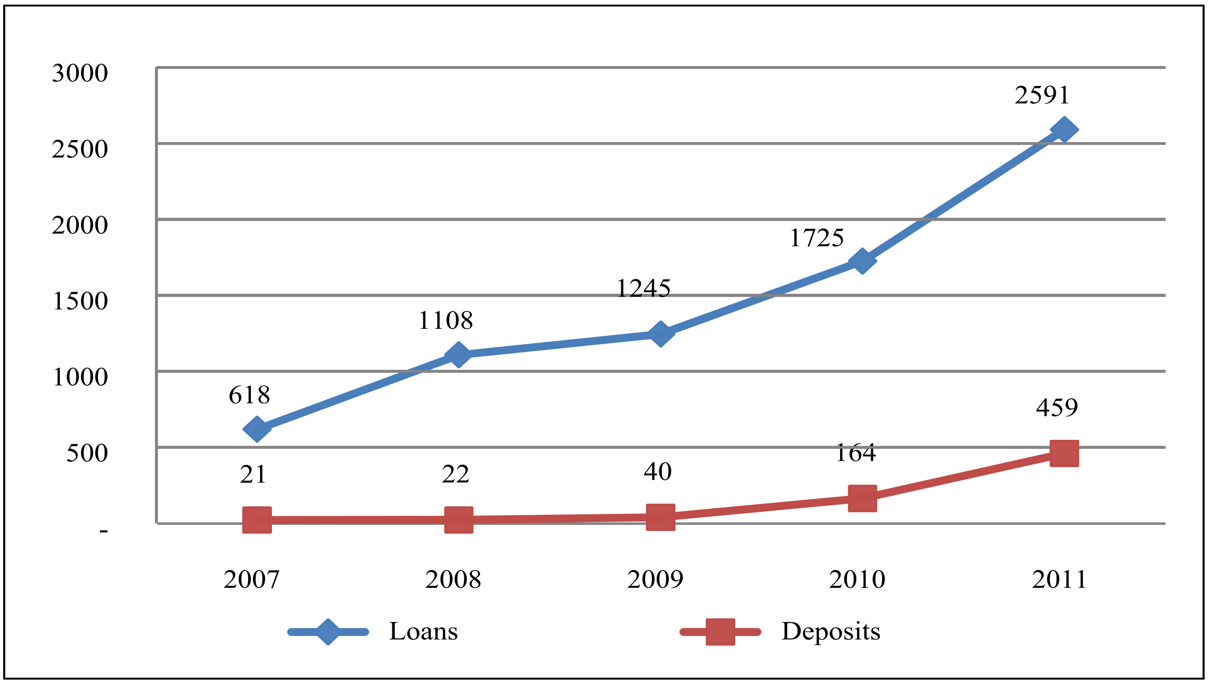
Figure 9: Bank Deposits and Loans (billion riels)



Source: National Bank of Cambodia (2011)
Note: NBC (2011) is unaudited and excludes Mega Bank, Industrial Commercial Bank of China (ICBC) and Military Commercial Joint Stock Bank (MB)

Although the banking sector was able to make positive profit during the crisis, its growth rate declined drastically from 31 percent in 2008 to -46 percent in 2009 before rebounding to 42 percent in 2010 and further to 62 percent in 2011 (NBC 2011).[2]

Figure 10: MFI Deposits and Loans (billion riels)



Source: National Bank of Cambodia (2011)

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2 NBC (2011) profit report is unaudited and excludes Mega Bank, Industrial Commercial Bank of China (ICBC) and Military Commercial Joint Stock Bank (MB).

As the name suggests, MFIs provide tiny loans to individuals for investment in small businesses. The overall performance of MFIs has been outstanding, as proven by the constant upward trend in MFI loans (Figure 10). Despite the crisis, microfinance institutions (MFIs) and NGO credit operators seem to have performed fairly well in 2008 and 2009, as the number of loans and household borrowers continued to increase every quarter (see Table 2).

Table 2: Credit Granted by Micro-Finance Institutions and Non-government Organisations

Quarterly	Number of				Loans	Interest rates (%)	
	Districts	Communes	Villages	Households	KHR (billion)	Monthly	Annually
2007							
Q1	687	4469	21012	484861	436	2-3	24-36
Q2	753	4665	22751	536916	490	2-3	24-36
Q3	822	5091	24908	595421	576	2-3	24-36
Q4	839	5314	26471	624104	642	2-3	24-36
2008							
Q1	943	5794	28245	637438	750	2-3	24-36
Q2	986	6216	30872	689197	906	2-3	24-36
Q3	1021	6547	33238	793097	1105	2-3	24-36
Q4	1046	6820	33963	852090	1162	2-3	24-36
2009							
Q1	982	6629	34004	830068	1121	2-3	24-36
Q2	1172	7471	37691	857000	1129	2-3	24-36
Q3	1220	7886	40888	854495	1151	2-3	24-36
Q4	1277	8189	42729	904298	1286	2-3	24-36
2010							
Q1	1330	8480	44191	889421	1351	2-3	24-36
Q2	1403	8858	46528	926856	1435	2-3	24-36
Q3	1452	9349	50068	1,005180	1650	2-3	24-36
Q4	1509	9730	52122	1020784	1780	2-3	24-36
2011							
Q1	1495	9758	53776	1004568	1939	2-3	24-36
Q2	1616	10441	56357	1077809	2119	2-3	24-36
Q3	1732	11132	60716	1134579	2383	2-3	24-36
Q4	1648	10920	60551	1141913	2591	2-3	24-36
2012							
Q1	1942	12,197	66,195	1188096	2878	2-3	24-36
Q2	2042	12739	68548	1224159	3032	2-3	24-36

Source: Economic and Monetary Statistics 2012, National Bank of Cambodia

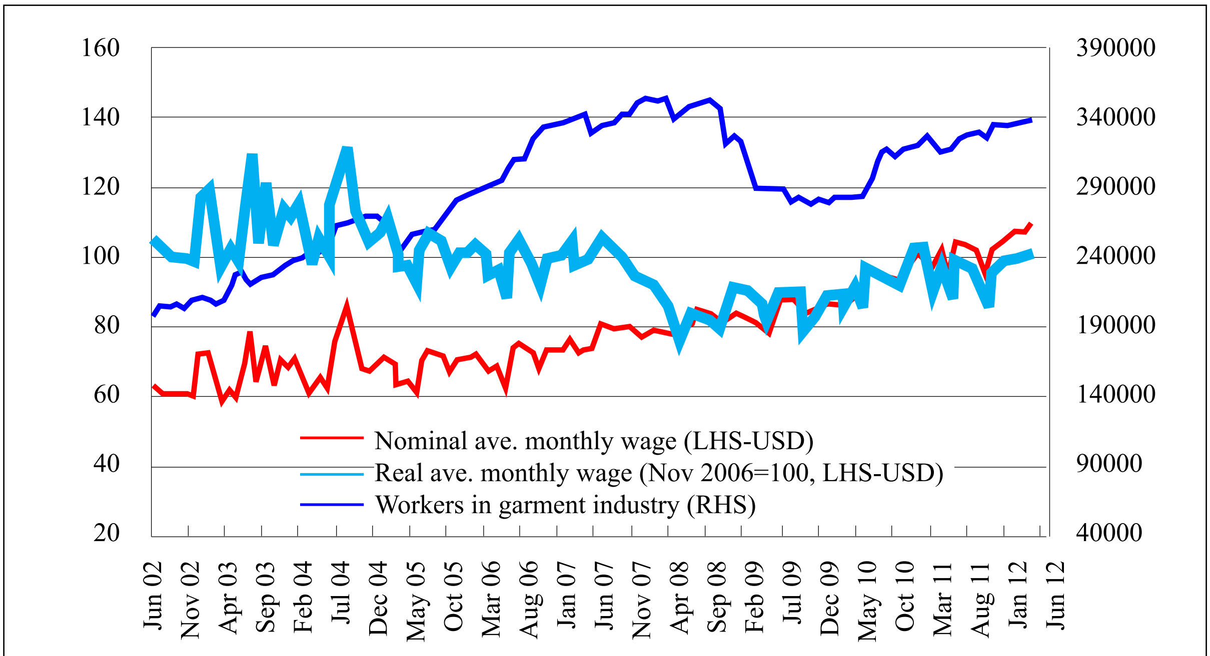
Although the number of deposit accounts is marginal compared to loans, MFIs and rural credit operators mobilised approximately KHR172 billion of public savings from 240,153 depositors, increasing by four times and 43 percent, respectively, compared to 2009. This reflects rural economic growth, the public's and local and foreign investors' confidence, and the country's political and economic stability. According to the National Bank of Cambodia (2012), the banking and financial sector is performing better as global economic recovery gets underway.

The net profit in the MFI sector plummeted from 62 percent in 2008 to -25 percent in 2009, suggesting a reduction in net profit during the economic slowdown. However, MFI net profit shot up again in the following years, which shows good sign of improvement in this sector.

4.2 Garment Manufacturing

The garment industry took root in 1994 when Cambodia started to open its economy to the world. Like in other sectors, very few factories were built at that time as security and political stability remained a big concern. From just 186 in 1998, the number of factories had increased to 292 by 2007. Between 2008 and 2009, the global economic downturn slowed demand from Cambodia's largest markets – the US and EU, resulting in the reduced export orders and factory closures and thus generating loss of around 50,000 jobs in this industry (Figure11) where an average of USD36 million monthly wage bill are paid to the industry's workers.

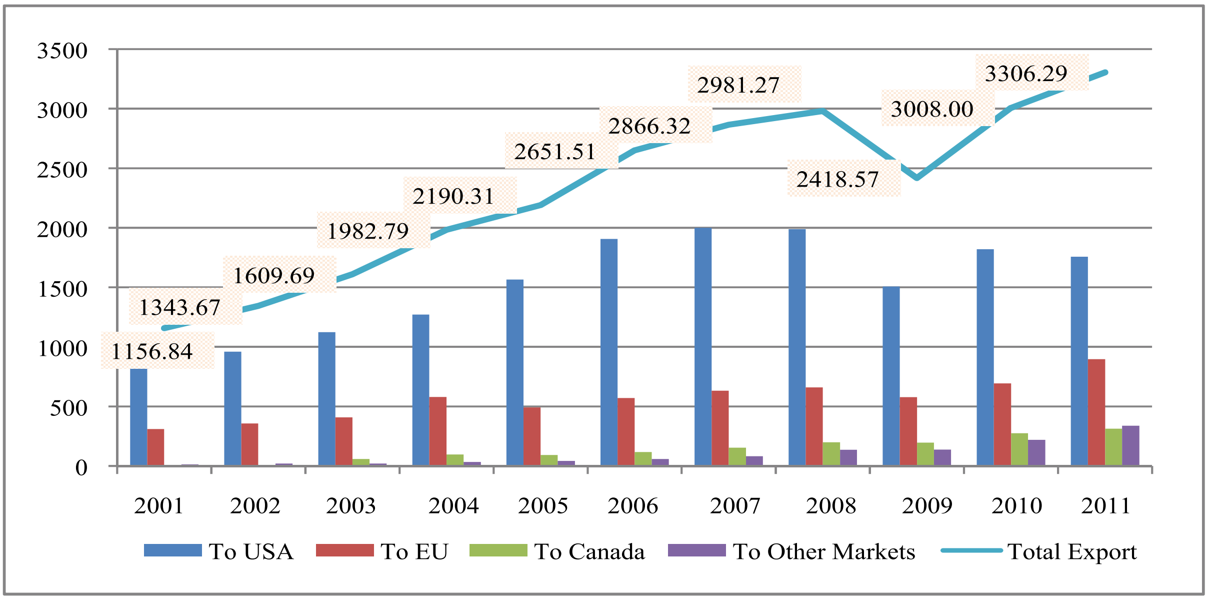
Figure 11: Number of Garment Workers and Wages, June 2002–June 2012



Source: Cited from Dr Hout Pum's Presentation at Royal School of Administration, 10 August 2012, Phnom Penh

This had a drastic effect on the income of rural households reliant on remittances from household members working in the industry. However, with signs of economic recovery worldwide, rebound became evident as employment and the number of garment factories started to make a U-turn in 2009-10. Many observers speculated that Cambodia's garment and textile industry would not make such rapid recovery, at least not in the short run, but the export figures illustrated in Figure 12 prove otherwise.

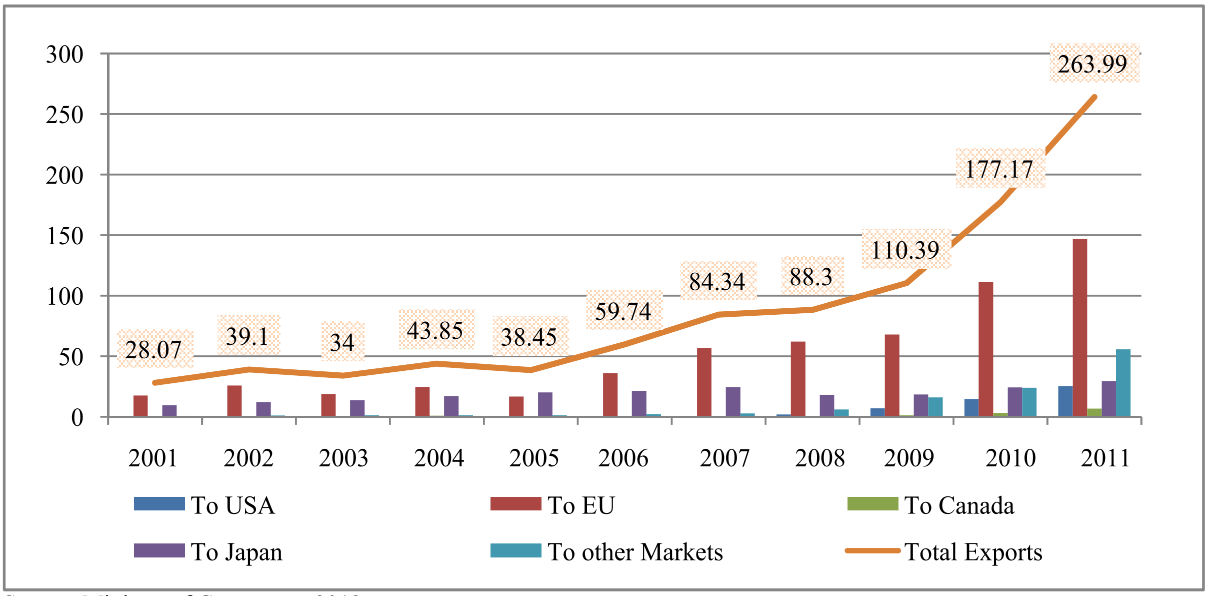
Figure 12: Garment and Textile Exports (USD million)



Source: Ministry of Commerce, 2012

As a result of government policy to promote investment, footwear industry growth has also picked up pace in the last few years, with exports increasing to around USD264 million in 2011 (Figure 13). The sector is an important source of national revenue, though still modest compared to that of the garment sector. Further, it has created many jobs especially in recent years, employing around 60,000 workers in 2011 (World Bank 2012).

Figure 13: Footwear Exports, 2001-2011 (USD million)



Source: Ministry of Commerce, 2012

Since the first signs of recovery in 2010-11, garment and textile exports have increased to over USD3 billion, exceeding pre-crisis export values in 2007-08. This is attributable to several factors. First, rapidly rising labour costs in China and other ASEAN member countries have rendered their garment and textile exports less competitive. Second, the US and EU have levied tariffs on Chinese products, making them more expensive for consumers. And third, investors have had to relocate production to lower cost countries such as Cambodia, which still enjoys advantages of low labour costs and preferential status from the US and EU. Other contributory factors are the simple design of Cambodia's garment and textile products –meaning they are cheaper to produce and affordable by a broad range of customers, government incentives including tax holiday, and reduced business costs due to improved import-export procedures.

Because the garment and textile industry is the backbone of Cambodia's export sector, contraction in this sector has pivotal effects on Cambodia's economy. It is essential therefore that the Cambodian garment industry diversify its export markets in order to expand and sustain its growth.

4.3 Tourism

Cambodia has beautiful natural landscapes and a rich cultural heritage. There are thousands of ancient ruins. Parts of the coastline offer some of the most beautiful beaches, especially the offshore islands. With security restored, the country is rapidly becoming one of the newest popular tourist destinations in Asia. This sector has played an increasingly important role in generating revenues since the country reintegrated into the world economy.

Table 3: Tourism Sector Highlights, 2000–2011

Year	Visitor arrivals		Average stay	Hotel occupancy	Tourism receipts
	No.	% change	No. days	%	USD million
2000	466365	26.82	5.50	45.00	228
2001	604919	29.71	5.50	48.00	304
2002	786524	30.02	5.80	50.00	379
2003	701014	–10.87	5.50	50.00	347
2004	1055202	50.53	6.30	52.00	578
2005	1421615	34.72	6.30	52.00	832
2006	1700041	19.59	6.50	54.79	1049
2007	2015128	18.53	6.50	54.79	1400
2008	2125465	5.48	6.65	62.68	1595
2009	2161577	1.70	6.45	63.57	1561
2010	2508289	16.04	6.45	65.74	1786
2011	2881862	14.90	6.50	66.15	1912

Source: Ministry of Tourism (2012)

In terms of visitor arrivals, sector growth has remained high since 2000 except for in 2003 when political deadlock following the general election resulted in a brief period of political uncertainty (Table 3). Global recession cut growth from 18.53 percent in 2007 to 5.48 percent in 2008 and even further to 1.70 percent in 2009. The sector quickly regained momentum with growth of around 16 percent in 2010 and 14.9 percent in 2011 as global economies began to recover. Tourism receipts followed a similar trend. The increase would have been higher had it not been for the border skirmishes between Cambodia and Thailand in 2010 that led to the closure of the Cambodian–Thai border.

Table 4 illustrates the tourism sector's top five markets over the period 2004 to 2011. Korea, Japan and USA led until Vietnam took Japan's place in 2008 and then claimed top position in 2009, while Laos joined the top ten markets. This table indicates the increasing importance of regional tourists to Cambodia's tourism industry. Many ASEAN member countries have already waived visa requirements among themselves to promote intra-ASEAN tourism, but the ASEAN Economic Community in 2015 will further promote regional tourism by reducing border procedures to facilitate cross-border trade and transport.

Table 4: Tourism Sector's Top Five Markets, 2004-2011

Ranking	Nationality	No. of Visitors	Ranking	Nationality	No. of Visitors
2004			2005		
1	Korea	128423	1	Korea	216584
2	Japan	118157	2	Japan	137849
3	USA	94951	3	USA	109419
4	UK	64129	4	France	68947
5	France	58078	5	UK	66535
2006			2007		
1	Korea	285353	1	Korea	329909
2	Japan	158353	2	Japan	161973
3	USA	123847	3	USA	137539
4	Taiwan, China	85139	4	Vietnam	125442
5	China	80540	5	China	118417
2008			2009		
1	Korea	266525	1	Vietnam	316202
2	Vietnam	209516	2	Korea	197725
3	Japan	163806	3	USA	148482
4	USA	145079	4	Japan	146286
5	China	129626	5	China	128210
2010			2011		
1	Vietnam	514289	1	Vietnam	614090
2	Korea (ROK)	289702	2	Korea (ROK)	342810
3	China (RPC)	177636	3	China (RPC)	247197
4	Japan	151795	4	Japan	161804
5	USA	146005	5	USA	153953

Source: Ministry of Tourism (2012)

More hotels and guest houses are needed to accommodate the growing number of tourists. The number of hotels increased from just 179 in 1997 to 395 in 2007 and then to 451 in 2009, declining to 440 in 2010. Likewise, the number of guest houses rose sharply from only 60 in 1997 to 891 in 2007, reaching 1087 in 2010. However, guest houses lag far behind hotels in terms of the number of rooms. The total number of travel agencies has steadily increased since 1996, but the rate of increase has been slower since 2008 when recession started to bite.

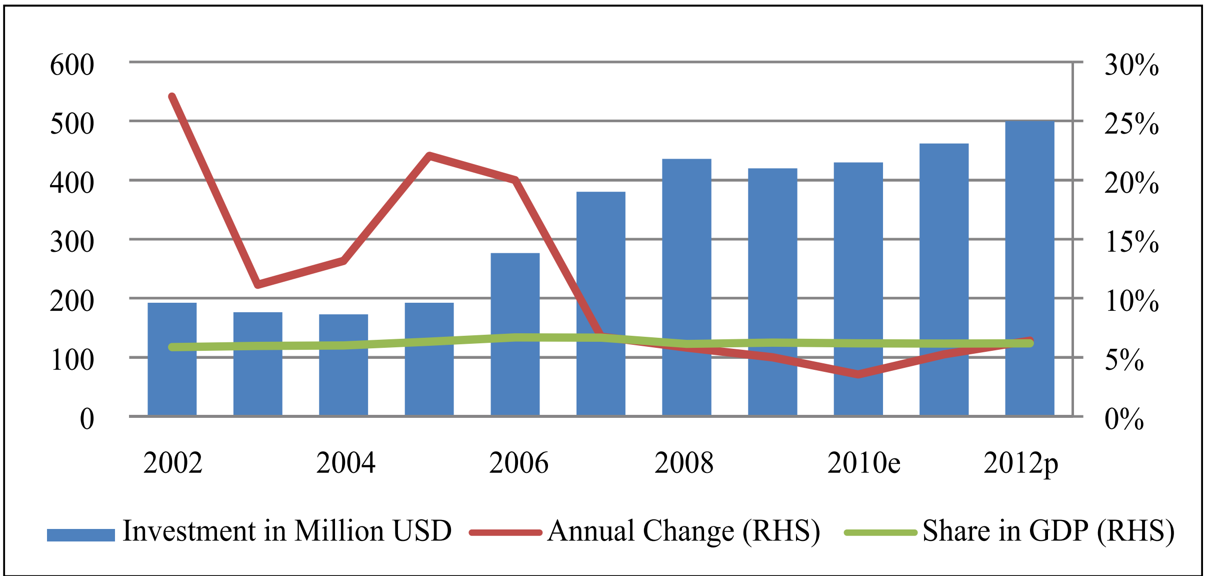
Cambodia's tourism industry has not been able to tap its potential to attract high-spending tourists due to lack of tourist products and poor infrastructure. It is important that the government fast tracks tourism sector development by promoting supporting sectors such as transport, agriculture, services, handicrafts and culture. However, the benefits of attracting more local tourists should not be overlooked as they are also an important source of revenue generation.

4.4 Construction and Real Estate

Before the crisis hit, Cambodia's construction sector had been enjoying a boom largely led by a surge in foreign investment (Figure 14). The largest investors, whose mega projects are closely involved with the building of new townships in and around Phnom Penh, are from South Korea and China. Local investors have also been active in the sector. The inflow of foreign investment brought a huge chunk of capital into the country. As a result, real estate prices per square meter were pushed very high in a short space of time, peaking at USD5000 for commercial and nearly USD3000 for residential areas in Phnom Penh in the last quarter of 2007 and first quarter of 2008 according to Bonna Realty Group, a local real estate firm (Huot 2012).

Overheating caused by intense speculation led to the property bubble burst that coincided with the first shock waves of the global financial crisis. Ensuing turbulence in the construction and real estate sectors quickly deflated property prices as the price of land started to drop in the second quarter of 2008. Many people who had borrowed money from the banks to invest in property had to sell their houses and land at much lower prices to get out of debt and avoid foreclosure.

Figure 14: Value of Construction Investment, 2002–2012 (USD million)



Source: National Institute of Statistics (2012)

The growth rate of the construction sector was over 20 percent in 2006, and then nosedived sharply in the following years before starting to rise again in 2011. However, the sector's contribution to GDP remained stable at an average of 6 percent.

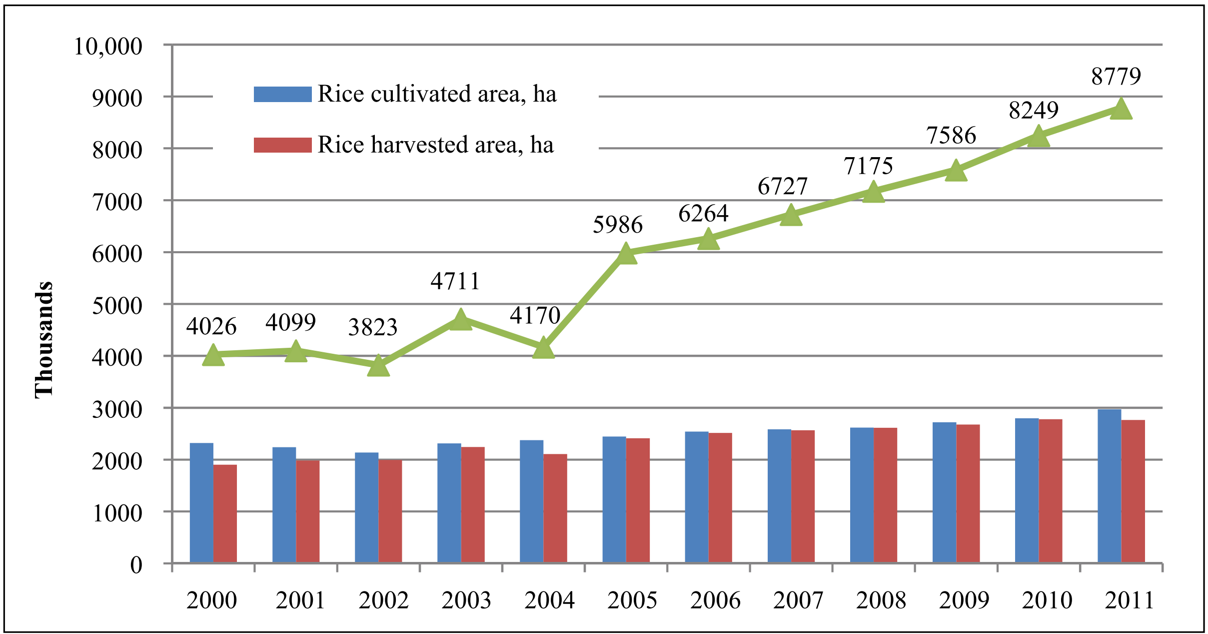
The construction of houses, condominiums and other buildings is now picking up pace, especially in Phnom Penh city and other metropolitan areas. The recent extension of Phnom Penh's boundary is pushing up land prices in suburban areas. There is a plethora of new construction sites, especially for townships and factories, in the outskirts of Phnom Penh. Hotels and resorts are being constructed in popular tourist locations such Kampong Som, Kep, Koh Kong, Siem Reap, Ratanakiri and Mondulkiri provinces. All this activity reflects real improvements in the construction and real estate sectors since the slack years of recession.

4.5 Agriculture

Overall, the global economic crisis does not seem to have had a serious impact on the agricultural sector. Indeed, the higher food prices since 2007 could be an opportunity for Cambodian farmers to profit from producing surpluses for export. On the other hand, the higher oil price translates into increased farm production costs, which along with the volatility of rice and other crop prices cuts into farm profit margins.

The Cambodian government has renewed efforts to develop the agricultural sector by promoting private sector investment in commercial rice farming and rice milling through waiving duties on agricultural products. Modern agricultural technologies have been introduced to increase yields and ensure food security. As a result, rice production has increased steadily since 2004 in tandem with expansion of the rice-cultivated area (Figure 15).

Figure 15: Rice Production and Cultivated Area, 2000–2011

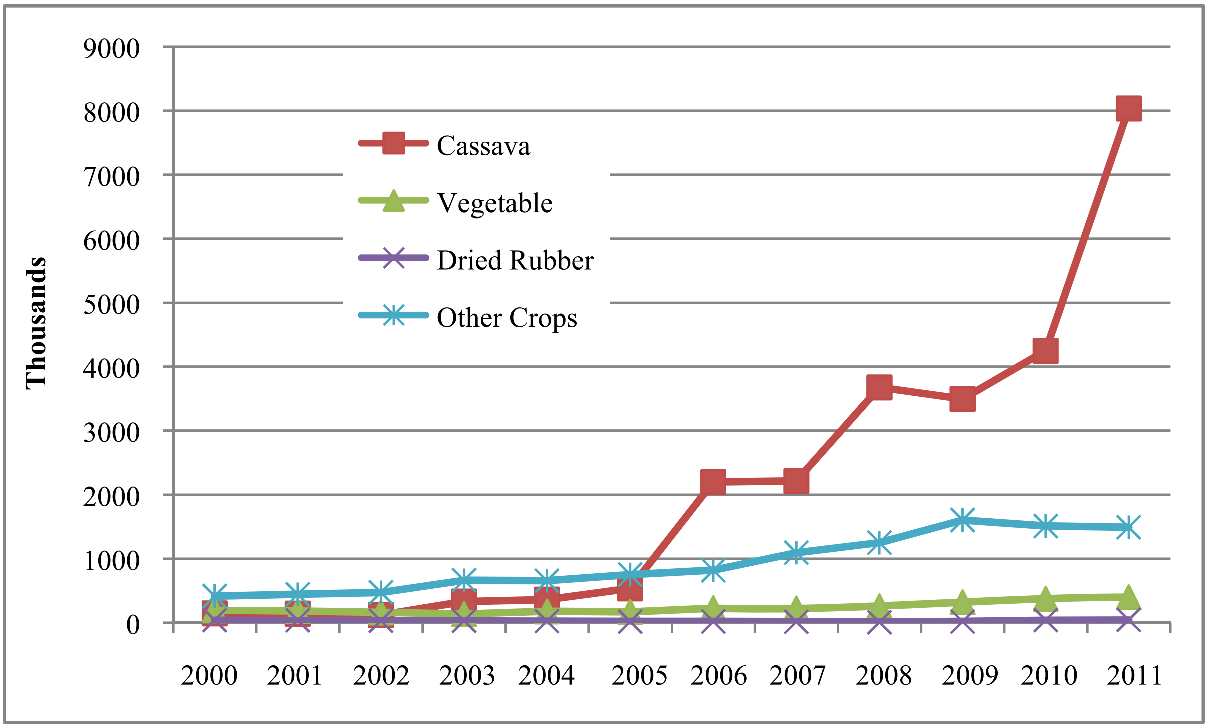


Source: Ministry of Agriculture, Forestry and Fisheries (2012)

Besides rice, Cambodian farmers grow cash crops such as cassava, mung beans, soybeans and rubber (Figure 16). The leap in cassava production is largely due to increased world demand for ethanol to produce bio-fuel.

Despite the upward trend in rice production and other crops, the agricultural sector has likely been affected to some extent by the global recession, albeit indirectly. Dwindling remittances to rural households from members working in garment, construction and services sectors likely affected household on-farm investment. Further, the many retrenched workers who returned to their home villages to seek agricultural jobs possibly put more pressure on the agricultural sector.

Figure 16: Main Crop Production, 2000–2011 (Thousand tonnes)



Source: Ministry of Agriculture, Forestry and Fisheries (2012)

4.6 Exports

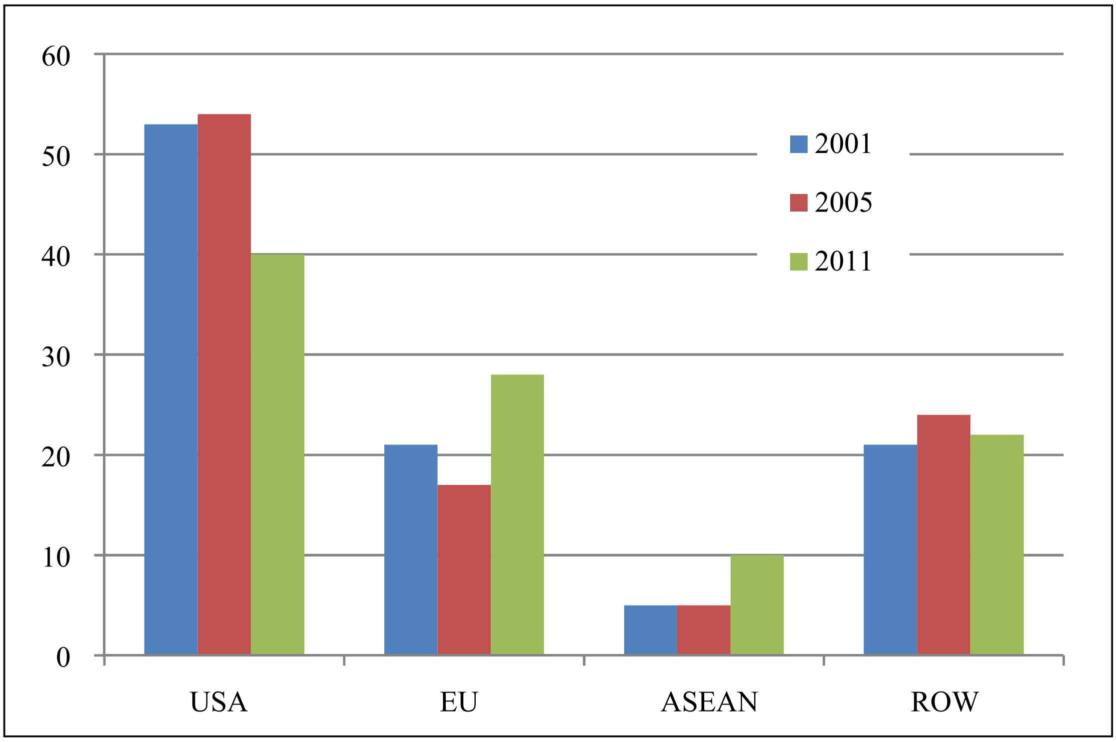
As the world recovers from the economic slowdown, there is concern in the Euro zone over the Greece debt crisis, which if not well managed may transform into another recession that could derail fragile global economic recovery. Given that the EU is the second largest destination for Cambodian products, especially garments and rice, slow demand in this market could disrupt Cambodia's export sector.

Figure 17 indicates the growing trend of Cambodian merchandise exports to the EU – from less than 20 percent market share in 2005 to nearly 30 percent in 2011, and the declining trend of exports to the US – from 50 percent in 2005 to 40 percent in 2011.

However, one should also look at which EU countries are the main buyers of Cambodian products. France, Germany, and the United Kingdom are the top importers of garment and agricultural products and they are presently in a more sound financial position than Greece.

Cambodia can therefore still count on maximising its EU market preferential status and continue exporting to EU markets. Nonetheless, the country should seek to diversify its export markets. For example, intra-ASEAN trading, albeit small scale, accounted for up to 10 percent of export shares in 2011, proving the potential for Cambodia to expand its markets in the region.

Figure 17: Market Share of Cambodian Merchandise Exports 2001, 2005 and 2011



Source: Cited from Dr. Hout Pum's presentation at Royal School of Administration, 10 August 2012, Phnom Penh

5

CONCLUSION

The global financial crisis arrived hot on the heels of the 2007 food and oil prices hike that had already shaken the livelihoods of many Cambodians, especially those living below or even moderately above the poverty line. It decelerated the growth momentum that Cambodia had enjoyed for more than a decade. The crisis was detrimental to Cambodia's economy, at least in the short run, due to its dependence on external factors such as the US and EU garment markets and FDI inflows for construction, garment and tourism sectors. The country's banking and financial sector was barely affected by the crisis given its insulation from global financial systems where banks in many mature economies hold toxic assets result ant of the US subprime crisis. However, based on National Bank of Cambodia data, profit growth was slashed in 2009 with the percentage changes dropping to -46 percent for banks and -25 percent for MFIs.

For the agricultural sector as a whole, there was no direct adverse impact from the global downturn. Indeed, higher food prices since 2007 offer opportunity and have enabled higher productivity. Albeit there is no discernable direct impact, one could argue that there must have been some indirect impact in terms of lower local agricultural investment given rural households' reduced remittances from members working in garment factories and other industries. New policy to promote rice sector productivity and milled rice export by attracting private sector investment in rice milling and packaging to meet export standards should help increase local value-added and create more jobs for Cambodians.

Cambodia still has room to improve the garment and tourism sectors to generate more revenue. That is, the country should target higher value apparel products, improve productivity and quality and thus reduce unit costs. It also has high potential in footwear export to regional markets. Cambodia should learn from Japan's strategy of promoting local tourism, as this could be a sustained source of income earning for the country.

The current debt crisis in the Euro zone poses another threat to world economic recovery and thus affects Cambodia's textile and garment export markets. However, since the main importers of Cambodian products are in sound economic position, one should be optimistic about trade growth potential between Cambodia and EU countries.

Cambodia however should no longer confine itself to its traditional sources of growth. It needs to broaden its economic foundation and market stakes by grabbing new opportunities and realising its potential to expand economic growth. The Cambodian government has explored the potential to expand growth in other sectors such as food processing, economic land concessions for agro-industry, electronics, car assembly, and oil and gas, all of which demand human resources development that needs long term investment and commitment. The prime minister stressed during the opening of the Fourth Cambodia Economic Forum in 2011[3] that there is an urgent need for Cambodia to modernise its economy through promoting the development of the industrial sector in order to achieve sustainable growth.

Finally, more efforts should be put into reforms that reduce costs of doing business, bureaucracy and corruption so that Cambodia can create an enabling environment to attract investments, then creates decent jobs and ultimately reduces poverty.

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[3] Keynote Address at the Opening of the 4th Cambodia Economic Forum on "Cambodian Economy in Post-Crisis Environment: Industrial Policy-Options Toward a Sustainable Development", Feb, 16, 2011, Phnom Penh

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