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Macroeconomic and Banking Sector Development in 2022 and Outlook for 2023
By the National Bank of Cambodia, January 6, 2023

In 2022, the global economy rebounded due to the recovery of the COVID-19 pandemic; but several challenges remain, such as supply chain disruptions due to lockdown measures in China and the ongoing Russia-Ukraine war causing a hike in prices of goods, especially in fuel and raw materials. These factors pushed global inflation to 8.8% in 2022 (compared to 3.4% in 2021) in both advanced and emerging economies (7.2% and 9.9% respectively). In response, most central banks have attempted to curb the increase in inflation by raising policy rates aimed at reducing the overall level of demand for investment and consumption. For instance, the US Federal Reserve raised interest rates faster than expected, resulting in an influx of capital into the United States and therefore the strong US dollar. The capital outflows, which have been mainly from emerging and developing economies, have continuously put pressure on the value of local currencies, international reserves, and debt payment capacity in these countries. These challenges have led to a downward revision in the global growth projection to 3.2% in 2022 compared to earlier projection of 4.4% (January 2022).

In Cambodia, the effectiveness of health policy and management of the COVID-19 pandemic by the government have ensured the resumption of domestic economic activities in 2022. The introduction of a series of economic and financial measures, especially the Strategic Framework and Programs for Economic Recovery in the context of "Living with COVID-19 in a New Normal 2021-2023" and the relaxation of regulatory forbearance in the banking sector have supported and accelerated the recovery of Cambodia's economy. These favorable domestic conditions coupled with an increasing external demand have accelerated Cambodia's economic growth to 5.1% in 2022. This growth rate was driven by a 9.4% increase in the manufacturing sector, 15.2% in hotels and restaurants, 6.1% in transportation and 4.5% in wholesale and retail trades. Meanwhile, exports grew by 19.8%, much faster than that of imports, 8%; and tourism revenues noticeably grew at a 6.6% rate, while remittances from Cambodian workers working overseas increased by 4%. Moreover, foreign direct investment inflows rebounded by 4%, mainly due to the garment and food processing sectors, although the inflows to some other sectors remained subdued.

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The increase in foreign direct investment and export have prevented a further decline in Cambodia's international reserve. Despite a moderate decline, foreign exchange reserves remained adequate and will last for about seven months of prospective imports of goods and services, which is well above the threshold level for developing countries (three months). The appropriate level of international reserves has supported the implementation of monetary and exchange rate policies, especially in stabilizing exchange rate and providing sufficient liquidity, to main price stability and sustain economic growth. The Riel-to-USD exchange rate remained stable at around 4,102, depreciating by 0.1% compared to that in the previous year. The average inflation rate in 2022 reached 5.3%, higher than that in 2021 (2.9%) due to higher fuel and food prices. The inflation rate peaked at 7.8% at the end of the first half of 2022 and have gradually declined in the second half as fuel and food prices subdued.

The banking system has played a crucial role in supporting Cambodia's economic recovery by actively pursuing financial services to meet the needs of economies. Credit in private sector, which was disbursed to various main economic sectors, increased by 21% while consumer deposits rose by 11.3%. Prudential regulations, which were relaxed during the pandemic to relieve financial burdens of borrowers and maintain credit intermediation, have been strengthened gradually to in line with domestic economic recovery and the NBC exit strategy to safeguard financial stability and rebuild policy buffer for future needs. The loan restructuring policy was withdrawn at the end of June 2022 and the amount of restructured loan declined from 10.5% to only 6% of total bank credit. Besides, the payment system has been modernized to increase the efficiency of payment and settlement in both domestic and international transfers, as E-wallet accounts reached 17.9 million. Regional connectivity with other countries has also been strengthened to help facilitate interoperability between banks and financial institutions, thus promoting trade, investment, and tourism.

In 2023, the reopening of the economy will support the recovery of key economic sectors including trade, tourism, and investment although the global economy still faces numerous challenges and an increasing uncertain outlook. The International Monetary Fund has projected the global economy to grow by 2.7% this year down from 3.2% in 2022. The prolongation of the Russia-Ukraine war will have far-reaching consequence on supply chains and pressure on inflation. As inflation remains high, the US Federal Reserve is likely to continue increasing federal fund rate, which could further tighten international financial conditions, causing a further appreciation of the US dollar, putting more pressure on other currencies and international reserves of emerging economies. Meanwhile, the world needs to deal with challenges posed by the pandemic such as elevated public and private debt levels, risks of renewed lockdowns caused by new variants of COVID-19 and the growing threats posed by climate change, as they have the potential to further derail economic recovery.

Despite these external challanges, Cambodia's economy is expected to grow by around 6% in 2023. This projected growth rate is supported by an expected 6.9% increase in the garment sector and 14.3% rise in non-garment manufacturing products. The tourism sector is estimated to grow by 18.5% due to an increase in local tourists and international tourist arrivals as flight operations from China to Cambodia have been gradually resumed and travel restrictions on Chinese people going abroad have been lifted. The agricultural sector is forecasted to further pick up by 1.1%, on the back of the implementation of the Regional Comprehensive Economic Partnership Agreement (RCEP) and the Bilateral Free Trade Agreements (FTAs), as well as the withdrawal of the tariff preference for the import of rice to European markets. However, the construction and real estate sectors are expected to continue experiencing slower growth, at 1.7% and 1.2% respectively; though rising domestic demand in the affordable real estate market segment and the market demand of non-residents for high-end properties will take some time to return to pre-crisis levels.

Inflation in 2023 remains highly uncertain due to the prolongation of the Russia-Ukraine war and the uncertainty of global economy. In the scenario of slowdown in the global economy and declining food prices, inflation in Cambodia is projected to decelerate to 2.5%. It is worth noting that in the context of high dollarization, stabilizing exchange rate is an important factor to maintain price stability. The stability of exchange rate, especially between the Riel and the US dollar, will maintain the purchasing power of the people whose income is in Riel and contribute in lowering the prices of imported goods. However, given the high dollarization, the appreciation of the US dollar will also raise the prices of Cambodia's exported goods, which is another potential challenge that Cambodia will face.

On the other hand, tightening international financial conditions would also weight-down external borrowing capacity of banks and financial institutions as well as the private sector. This could also lead to higher interest rates in Cambodia if financial conditions remain tight for long, while tighter financial conditions and uncertainties in the international financial markets could also incur a loss of international reserves. However, the recovery of the domestic economy, through the expected increase in inflows of foreign direct investment, exports, tourism sector, and other transfers, is expected to accelerate the accumulation of international reserves that could cover approximately seven months of prospective imports of goods and services.

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