



NATIONAL BANK OF CAMBODIA

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Macroeconomic and Banking Sector Developments in 2020 and Outlooks for 2021

By the National Bank of Cambodia, December 31st, 2020

In 2020, the COVID-19 pandemic has led the world into the worst global recession since the Great Depression in 1930s. In Cambodia, under the firm and visionary leadership of Samdech Akka Moha Sena Padei Techo Hun Sen, Prime Minister of Cambodia, the Royal Government has effectively contained the spread of the pandemic in a timely manner. However, being an open economy and strongly relying on external sector, Cambodia experienced a recession after constantly achieving strong growth in the last two decades. The most affected sectors include tourism and exports of garment and footwear, followed by construction and real estate sectors which represent 2/3 of the contribution to GDP growth. Foreign direct investment (FDI) and remittances have also decreased remarkably, while agriculture and financial sectors have been the most resilient sectors which continued to register positive growth and have contributed to reducing the negative impacts of the COVID-19 on the economy as well as safeguarding jobs and ensuring business continuities. On the other hand, cash transfer programs for workers and poor families, tax relief, and government spending on infrastructure construction projects have also supported the vulnerable segments of the population as well as the economic activities. Although small, the exports of travel goods and other non-garment products such as vehicle parts, electronics as well as bicycles continued to record strong growth thanks to the Generalized System of Preferences (GSP) and relatively low labor costs.

In this context, Cambodia's economic growth for 2020 has been estimated to contract more than -1.9 percent which was expected at the beginning of the year, while other international institutions have estimated growth to fall between -2 and -4 percent. This recession is mainly due to continued downfall of tourism sector in the second half of 2020, coupled with shrinking exports of garment products which shared about 70 percent of total exports.

As for price stability, inflation in 2020 rose on average by 2.9 percent mainly driven by food price hikes, especially during the beginning of the pandemic and the flash flood episode.

International oil price is also an important factor to inflation as the declining oil price has remarkably contributed to lowering the inflation rate, while other commodities (core inflation) remained stable. Meanwhile, the exchange rate of KHR against USD has been rising since the end of 2019 and stood at higher level than the previous year until the end of 2020. This depreciation was caused by subdued local economic activities, which resulted in lower demand for local currency in both for general settlements and tax payments, coupled with the decrease in inflows of foreign currencies. Nevertheless, the depreciation of KHR was relatively small compared to regional currencies. At the end of 2020, however, KHR value returned to its level of 2016-2018 period (around 4,045 KHR/USD) supported by increasing demands in the agriculture sector and policy measures implemented by the National Bank of Cambodia such as foreign exchange intervention and other monetary instruments. Maintaining exchange rate stability has contributed to keeping the inflation and the economy stable while the international reserves have accumulated to threefold of the required level for developing countries and are able to strengthen exchange rate stability as well as the public confidence in Cambodia's economy.

The financial sector, of which 90 percent of the total assets came from the banking sector, has seen continuously developed and highly resilient amid the slowdown in real sector. During the last two decades, macro-prudential regulations such as raising minimum registered capital, liquidity coverage ratio and managing systemic risks have been continuously strengthened, and thus greatly improving the sector's resilience. This improvement has allowed the banking sector to play an important role in safeguarding financial stability and supporting the economic activities, especially alleviating burdens of individuals and businesses who are facing income loss by loan restructuring. Noticeably, credit quality remained in good shape, and credits positively grew in accordance with the needs of economic activities although at a slower pace, compared to the previous year. The financial sector continued to provide necessary services including deposits, settlements and transfers, which has bolstered strong public confidence in the banking system.

The International Monetary Fund (IMF) expected that, in 2021, the global economy would recover but unevenly under high uncertainties. These may continue to put pressure on the Cambodia's external sector, of which tourism sector would continue to fall due to the uncertainty of vaccination availability, the emergence of a mutated COVID-19 variant and international tourists' hesitation to travel due to concern over transmission and low revenues and savings. Manufacturing sector is expected to gradually recover, especially the garment and footwear, while the agriculture sector is expected to grow as strongly as in 2020. The exports of agricultural products, especially rice and rubber, are expected to reach higher growth supported by market

diversification and rising demands for rubber from global recovery. Construction and real estate sectors are expected to get back on track at a slower pace alongside FDI, income recovery, as well as the expectation on future economic recovery. The recovery of hotel and restaurant and logistics sectors would be slow due to the drop of international tourists though domestic tourism has been on the rise. In the context of effective vaccination in the first half of 2021, Cambodia's economy is expected to grow at around 4 percent with a manageable level of inflation at around 3 percent. International institutions have forecasted Cambodia's economy to grow between 4 percent and 6.8 percent. However, those forecasts would mainly depend on the effectiveness of vaccines, the recovery pace of Cambodia's partner countries, and the strength of local economy.

Under the above-mentioned circumstances, strengthening local economic activities will support Cambodia's economic growth while this will help reduce negative impacts from the shrinking external sector. In this regard, the implementation of the Royal Government policies in promoting SMEs, fostering innovations, and adopting new technologies in all sectors are crucial to enhance and broaden economic base. Agriculture sector will remain as a key and potential sector, which was able to partially absorb crisis impacts such as job loss and support the poor population. In addition, accelerating the economic diversification and the implementation of Industrial Sector Development Strategy would help Cambodia recover faster from the crisis. Furthermore, income expectation from oil extraction will be an additional source of government revenues to further develop prioritized sectors in the future.

Of equal importance, the financial sector will remain as a key player in supporting economic activities as well as safeguarding macroeconomic and financial stability. Moreover, the expectation of economic recovery would reduce pressure on the banking sector, especially the possibility of higher growth of credits and deposits than in 2020. Nevertheless, the decrease of incomes and savings in 2020 may cause an increase in debts, which may pose a major risk as other developing countries have been experiencing during the COVID-19 period. Additionally, uncertainties in some parts of the economy that have been negatively affected by the pandemic may also bring about some risks for the banking system. In response, the National Bank of Cambodia will continue to strengthen the supervision of the banking system and stand ready to issue prudential and other supporting measures to safeguard the sustainability, resilience, and confidence in the banking system. The banking sector will continue to provide credits with strong sense of responsibility, improve public financial awareness, strengthen customer protection, and enhance the quality and transparency of the credit information sharing system, which will ensure financial stability and prevent from over-indebtedness.

Cambodia remains a highly dollarized economy despite many achievements such as setting price tags for goods and services in KHR as well as increasing credits and public services payment in KHR. The wider use of KHR will support the effectiveness of fiscal and monetary policies, especially during the stage of economic recovery such as through reduction of market interest rates, liquidity injection and capitalization through the issuance of government bonds. In this regard, the preparation of government bonds framework and mechanism and realization policies will allow the government to receive longer term financing and allow the National Bank of Cambodia to conduct the monetary policy in a more effective manner based on market mechanism.

It is worth noting that the COVID-19 crisis has changed the ways of living and interacting as well as conducting economic activities which therefore led to a new normal, in which the use of technology become popular and might serve as a new source of revenues for the economy. In this direction, the National Bank of Cambodia has developed a new payment system based on innovative technologies, which have become increasingly crucial to facilitating and supporting the rise of commercial transactions, investments, and international trade. Payment system modernization and the adoption of cutting-edge financial technologies will contribute to supporting Cambodia's digital economy as well. Among the payment systems previously launched in Cambodia, Bakong using Blockchain technology has been internationally recognized as a system using the latest technology in the world. Bakong is becoming a backbone payment system that facilitates money transfer and settlement between financial institutions and payment service providers. Nevertheless, customers and financial service providers need to be highly prudent when using new financial technologies so as to avoid risks arising from these technologies, especially cybercrime.