

FOREWORD BY THE GOVERNOR

After experiencing a difficult time during the early period of this decade, global economic conditions turned favorable in the second half of 2003, led by a robust recovery in the US economy. The global economy also had a good year in 2004. Following the predictions of the IMF, the world economy expanded by 5.1 percent this year, more than originally forecast, due to better than expected performances by USA, China, Japan and key Euro zone economies like Germany and France. Supported by the global recovery, several emerging markets in Latin America and Asia, especially India, also showed rapid expansion. ASEAN's economy was also in good shape, with a strong growth of 6% to 10% almost across the board. Singapore's economy in particular was also on track and was estimated to reach an annual growth between 8%-9% in 2004 against 1% in the previous year.

As for our national economy, the 2004 growth rate is expected to increase to about 6%, a favorable performance when compared to the 2003 figure of 5.3%. The higher growth rate was made possible as tourism recovered and garment exports continued to play a leading role in the economic expansion. These marked achievements have provided a much-needed impetus to the production activities that offset the slowdown in agricultural performance hampered by the resurgence of the avian flu and this year's adverse weather conditions.

Following an extended period of very low domestic inflation, signs of inflationary pressures have emerged in the second half of the year. The consumer price inflation accelerated noticeably to a year-to-year rate of 5.6% at the end of December 2004, compared with 0.5% in the previous year, owing to rising oil prices and food prices. Against this backdrop, the NBC remains committed to supporting non-inflationary economic growth. As the monetary authority, the NBC has made efforts to ease the pressures on the price level by keeping the course of monetary prudence and safeguarding the external value of the national currency. The value of the riel remained fairly stable throughout 2004 and was not significantly different from the developments of 2003. In fact, the exchange rate of the riel with the USD depreciated by only 1%.

The NBC also gave high attention to foreign reserve management with the aim of ensuring the availability of sufficient hard currency to support and maintain confidence in the policies for monetary and exchange rate management. Official foreign reserves grew by 12.8% during the reporting year 2004. The implementation of the policies set out in the government's paper "Vision and Long-term Strategies for Financial Sector Development 2001-2010" has also brought about satisfactory results. Up to this year, the first sub-program of the Program Loan Cluster to support reforms in the banking and financial sector has been successfully completed, leading to greater soundness in the banking system, while on the other hand raising public confidence in the banking sector.

Following the completion of the bank re-licensing program, the banking system has stabilized remarkably and the fundamentals for further steady growth are in place. Banking assets increased remarkably, whereas credit to the private sector and customer deposits grew by 35.9% and 32.8%, respectively. The ratio of broad money to GDP as an important indicator to determine that the scope of financial intermediation rose by 21% on last year's level of 18%.

As for the regulatory and supervisory aspects of NBC's work during the past year, the NBC has made various improvements to the supervision and control over the activities of banking institutions. Major organizational changes have taken place in the areas that affect the improvement of the reporting practices as well as the implementation of a new chart of accounts for banks based on international standards, making all commercial banks subject to full-scope inspections, stronger prudential policies, and the registration and licensing of micro-finance institutions. The enforcement of the banking regulations is to ensure that banks are prudent and operate in a fair and competitive environment. In 2004, on-site examination for all remaining commercial banks was successfully completed. Weaknesses were identified and actions have been promptly taken to rectify any anomalies. The NBC is also striving to adopt the Basel Core Principles on Banking Supervision. At the same time, the NBC has also taken step-by-step measures to improve its efficiency and modernize its provincial branches. The organizational structure of departments has been changed to meet the need of an efficient internal control and branch management.

To support the broad-based growth in the financial services sector, much attention has been placed over the past year on manpower and skills development. The NBC continues to utilize all external and internal training opportunities, including a special in-house training program to bring its employees' knowledge and professional skills up to a more modern banking level.

Over the last year, the NBC has also continued to strengthen its external relations. We continue to work closely with our ASEAN counterparts to speed up financial sector liberalization in the region. We were also actively involved in the preparation of Cambodia's accession into the WTO. Furthermore, the NBC has participated actively in efforts to combat against money laundering and terrorist financing by preparing a set of laws and regulations in collaboration with other relevant authorities. The enforcement of laws and regulations related to money laundering and financing of terrorism will contribute to improving Cambodia's reputation in the international arena. In that regard, in 2004 Cambodia became a member of the Asia-Pacific Group on Money Laundering.

In addition to developing a sound banking system, attention also needs to be given to promoting financial market development, including the further development and enforcement of an adequate legal framework. Toward this end, in the year ahead the NBC aims to introduce the necessary infrastructure for the development of a credit information system and to set up a legal framework for leasing activities. SMEs are expected to benefit from these measures as they would gain better access to bank and non-bank finance. Achieving this infrastructure is an important part of ensuring that the private sector becomes a stronger and more dynamic vehicle for growth and poverty reduction in Cambodia.

The NBC has also contributed to fostering reforms in the public finance management system that has been implemented by the Ministry of Economy and Finance, through a proper management of government accounts, and the acceptance of tax payments at the NBC's headquarters as well as at its branches.

As Governor of the NBC, I would like to thank to the Royal Government of Cambodia, all ministries and institutions in the government, and to development partners for their support and close collaboration with the NBC. Further, I wish also to express my thanks and sincere appreciation to all NBC officials and staff for their dedication and hard work in obtaining such remarkable achievements.

Governor

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Introduction

In 2004 the Royal Government of Cambodia (RGC) entered into its third mandate 2004-2008. The overriding goal of the RGC during the third legislature of the National Assembly is to build Cambodian society firmly and steadily by strengthening peace, stability and social order, entrenching democracy, promoting respect for human rights and dignity, ensuring sustainable and equitable development, and strengthening Cambodia's social fabric to ensure that the Cambodian people are well-educated, culturally advanced, engaged in dignified livelihood and living in harmony in family and society.

Toward this end the government has introduced a "Rectangular Strategy" for growth, employment, equity and efficiency in Cambodia, which will become an important tool in supporting the implementation of its political platform; good governance is the core of the strategy. Implementation of this "Rectangular Strategy" is essential for Cambodia to advance toward sustainable growth in the 21st century, thereby reducing territorial economic and social development inequality.

On the economic front, the Rectangular Strategy has been aligned with the policies set out in the Socio-Economic Development Plan for 2001-2005 and the national program for poverty reduction called the "National Poverty Reduction Strategy". A priority objective of the strategy is for the RGC to implement policies and programs which will deliver annual GDP growth rates of 6-7% over the medium term. For the RGC, growth is the most powerful weapon in combating poverty and it remains committed to pursuing policies that encourage macroeconomic stability, shift resources to more efficient sectors, and promote integration within the global economy. The renewed political stability that is providing a greater sense of security in the country and the pace and pattern of economic recovery in the region have helped Cambodia consolidate, broaden and deepen the reforms already underway and to maintain the momentum for sustainable social and economic development.

The recent macroeconomic performance in Cambodia reflects the government's efforts to move forward on the path of economic, social and financial reform with the ultimate goals of strengthening the free-market mechanism and ensuring sustainable economic growth and equitable distribution of the fruits of the economic success, thereby alleviating poverty. The government's overall program and policy measures were and continue to be supportive of further economic stability, with stable prices and low inflation, a stable exchange rate with concurrent economic growth, higher output and export.

As a result of this prudent policy stance, Cambodian economic growth increased to an estimated 6% in the year 2004 compared to a growth rate of 5.3% in 2003, despite the prevalence of some uncertainties associated with the general election, the outbreak of the bird flu in the region, and some adverse effects from the external environment. The higher growth for 2004 was due to a steady export boom, a significant upturn in the tourism sector, and continued economic stability, which more than offset a fall in agriculture that was caused by drought in several major rice production areas within the country. This latter factor, combined with the increase in oil prices in the global market, caused the consumer prices inflation to rise 5.6% at the end of the review year, as compared with 0.5% in 2003.

In response, the National Bank of Cambodia has intensified its efforts to perform its duties in maintaining price stability, as "Spelt out in the Law on the Organization and Conducts of the National Bank of Cambodia, by carefully continuing the adoption of tight monetary policy and skillfully managing the exchange rate in a manner that has avoided high currency volatility. This in turn has contributed to boosting public confidence in the macroeconomic environment of Cambodia and enabling the private sector in doing business and in investment planning.

Over the year 2004, the exchange rate of the riel experienced depreciation by about 1% against the US dollar, while the level of net international reserves of the country continued to expand, rising by 12.8%.

The money supply (M2) increased by 30%, whereas net claims on the government recorded a remarkable decline and credit to the private sector continued its increasing trend. Banking intermediation as measured by the ratio of money M2 to GDP also showed improvement.

Reforms in the banking and financial sector proceeded smoothly and achieved the targets set at the beginning of the year and as reflected in the government paper called "Vision and Long-Term Financial Sector Development Strategy 2001-2010". Following the completion of the bank re-licensing program, new measures have been introduced and implemented in order to refine and improve the regulatory framework for the banking and financial sector. Banking infrastructure has been strengthened through various efforts, including: the introduction of a uniform chart of accounts for commercial banks, the requirement for banks to be subject to a full scope on-site inspection, and capacity-building related to combating money laundering and financing of terrorism. The development of the payments system and currency management also received further attention in order to ensure an adequate supply of currency and safety in making payment transactions which, in turn, will gradually contribute to achieving the government's long-term policy objective of de-dollarization of the economy.

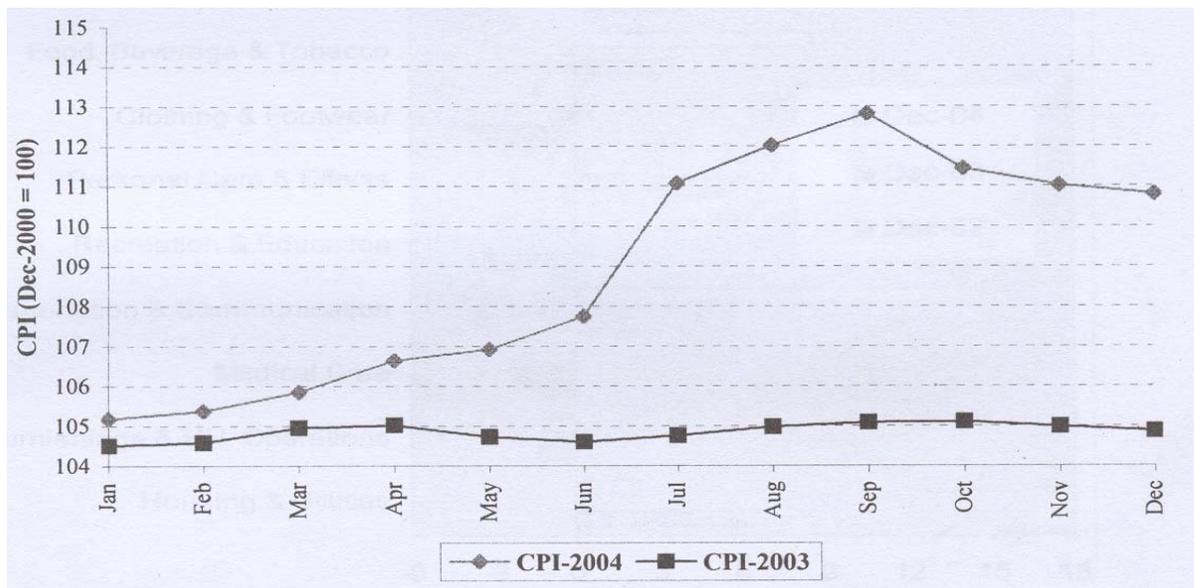
I. Macroeconomic developments

1. Prices and exchange rate movements

1.1. Retail prices and inflations

Movements in the consumer price index indicated a trend of moderate increase in the inflation rate at the beginning of the year up to March, when the inflation rate started to accelerate, before slowing down to some extent during the last three months of 2004. When compared with the figures for the preceding three years, this year's consumer price index recorded the highest increase, which was mainly attributable to a surge in local food prices and the prices of oil-related consumer goods and services.

Chart 1: CPI Trend



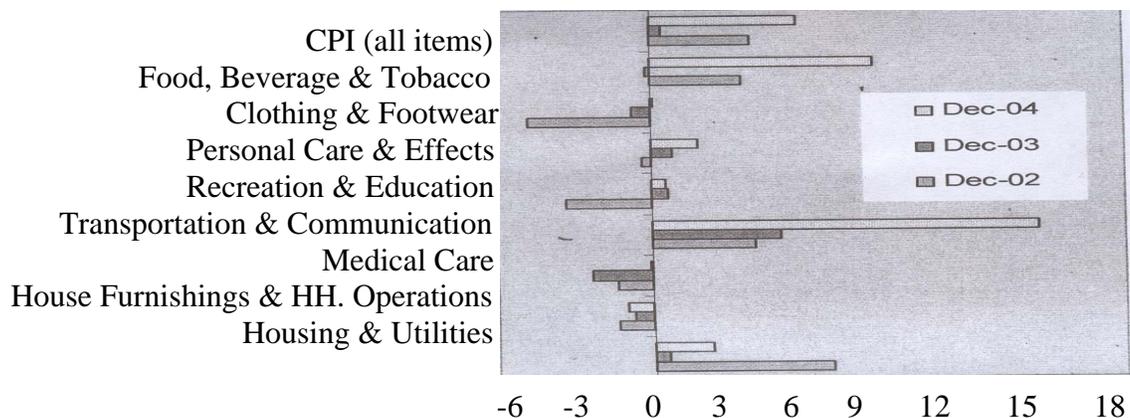
The consumer price index was up from 104.9 in December 2003 to 110.8 in December 2004, leading to an increase in the annual inflation rate to 5.6% compared with 3.8% and 0.5% in 2002 and 2003, respectively. The rise in the inflation rate in the year under review reflected a substantial increase in the sub-index of transportation and communication of 14.7%, and an increase in the sub-index of food, beverage and tobacco of 8.6%. At the same time, all other remaining sub-indices registered a moderate increase, with the exception of the sub-index of house furnishings and household operations and the sub-index of health care, which posted a small decline.

The large increase in the two sub-indices mentioned above was a direct result of the rise in the prices of food products, with price increases being observed in various categories, especially fish, meat and poultry. The abnormally low level of the Mekong River was the main cause for higher prices of fish and fishery products during the second half of the year. Meanwhile, prices of meat and eggs also showed a marked increase, as consumers were

looking for substitutes for fish. Pressure on the price movements was further aggravated by the prolonged absence of rainfall, leading to an increase in prices of several crops, including rice.

The rise in the sub-index of transportation and communication mirrored increases in prices, of all types of petroleum products, reflecting in turn a price hike in the global oil market, These developments were caused by' the following factors: (i) a general concern about the oil supply following a series of terrorist threats on petroleum plants; (ii) the surge in demand for oil with the strong global economic recovery, especially by China; and (iii) the existence of speculative demand, as speculators attempted to take advantage of the expected buoyancy in oil prices.

Chart 2: Movements of the CPI sub-indices



1.2. Exchange rate movements

The exchange rates of the riel against the US dollar for 2004 showed only a moderate change from the previous year. As indicated by the market buying rate, the riel-US dollar exchange rate depreciated by 54 riels or 1.36%, up from 3,891 riels per US dollar at the end of 2003 to 4,035 riels per US dollar at the end of 2004. It should be noted that during the same period of last year the riel was weaker by 42 riels or 1.1 %. Considering the month-on-month changes, the riel market buying rate rose on average more than 20 riels per US dollar per month in April, May, August and September, with May recording the largest depreciation of 26 riels per US dollar. The Riel, however, rebounded remarkably against the US dollar, when the market-buying rate fell to 4,045 riels per US dollar, compared with 4,089 riels at the end of September. These developments followed an active intervention by the central bank which was facilitated by the general weakening of the US dollar in the international currency market. November saw a further strengthening in the value of the riel, with the market buying rate and selling rate averaging 4,030 riels and 4,035 riels per US dollar, respectively. During the last month of the year the value of the riel moved between 4,028 riels and 4,035 riels per US dollar in terms of market-buying rate and between 4,032 riels and 4,041 riels per US dollar in terms of market-selling rate.

In general, the movements of the riel-US dollar exchange rates over the year 2004 showed a similar pattern to the one observed in 2003. The value of the .riel stabilized during the first quarter of the year, then lost its ground to some extent in the second and the third quarters, but started to gain strength gradually in the remaining months of the year.

The table below points to the dual exchange rate system in Cambodia: 'the official rate and the market rate. Adjustments to the official exchange rate are made daily by the NBC to limit the spread between the official and parallel market rates to less than 1 %. The official exchange rate applies mainly to external transactions conducted by the government and state-owned enterprises and is used by banks for recording all transactions in foreign currency.

Chart 3: Trend of Yearly Average Exchange Rate

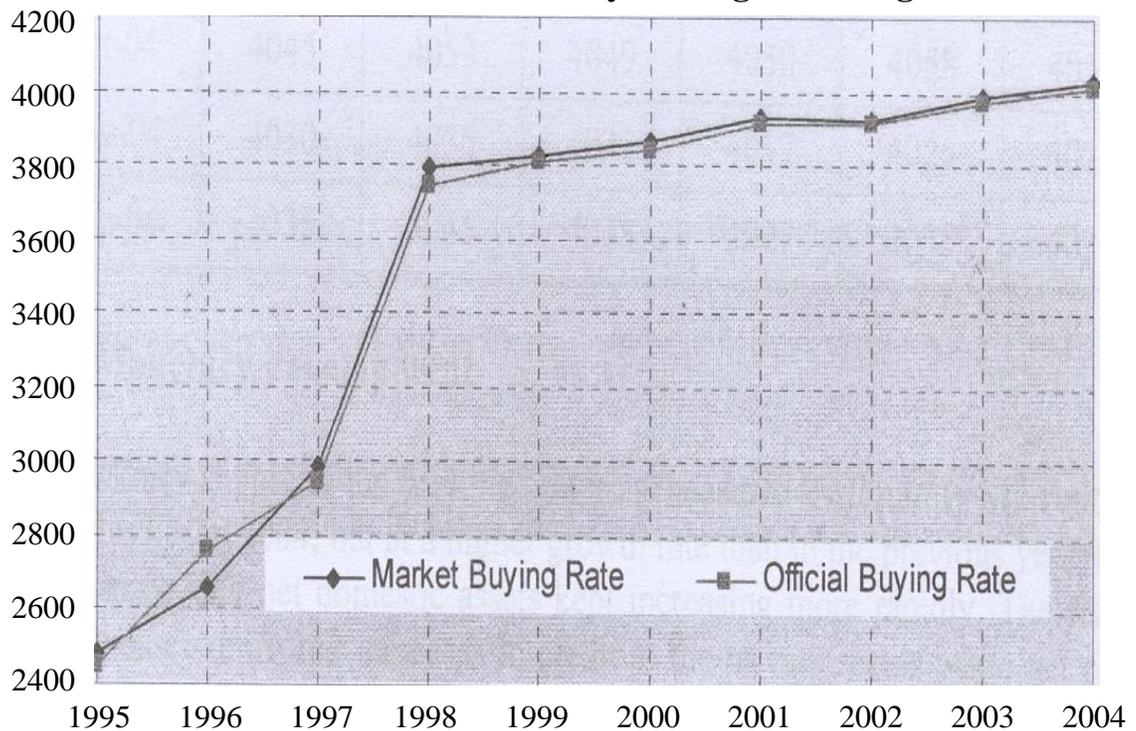


Table: Riel Exchange Rate Against the US dollar**(Riel/Dollar)**

	Monthly Exchange Rate (End month)					
	Market Rate			Official Rate		
	Purchase	Sale	Midpoint	Purchase	Sale	Midpoint
Dec-03	3981	3986	3984	3976	3984	3980
Jan-04	3999	4004	4002	3986	3994	3990
Feb-04	3997	4002	4000	3992	4000	3996
Mar-04	3992	3997	3995	3987	3995	3991
Apr-04	4014	4020	4017	3998	4006	4002
May-04	4040	4046	4043	4025	4033	4029
Jun-04	4030	4036	4033	4020	4028	4024
Jul-04	4044	4051	4048	4025	4033	4029
Aug-04	4067	4075	4071	4050	4058	4054
Sep-04	4089	4095	4092	4050	4058	4054
Oct-04	4045	4053	4049	4050	4058	4054
Nov-04	4030	4035	4032	4017	4025	4021
Dec-04	4035	4041	4038	4027	4035	4031

2. Monetary development

Money supply of the banking sector as measured by liquidity M2 continued to expand further in 2004, but at a higher growth rate than in the previous year when net foreign assets and net domestic assets kept increasing more rapidly. The rise in net domestic assets mirrored increases in credit to the private sector while net claims to the government posted a fall.

Foreign currency deposits of residents remained the most important counterpart to monetary expansion, accounting for more than half of the annual increase in broad money.

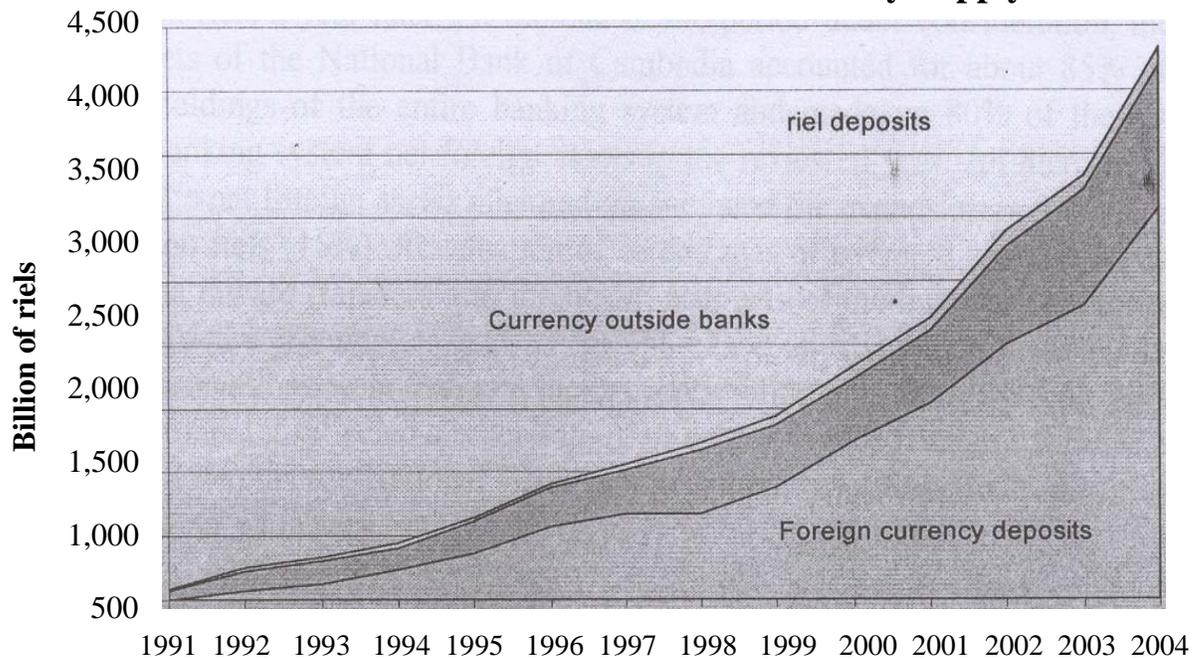
2.1. Monetary aggregates

The money supply of the banking sector rose by 1,000.3 billion riels (30.1%), from 3,329 billion riels in December 2003 to 4,329.3 billion riels twelve months later. The growth of money M2 was mainly caused by an increase in foreign currency deposits of 769.5 billion riels (33.3%), while vigorous growth in currency outside banks also contributed substantially, adding 206.5 billion riels (22.7%).

As usually observed, among the two components of money, M1 currency outside the banks continued to account for about 90% of the increase in this monetary aggregate. However, in absolute terms this year's increase in currency outside banks was the largest ever recorded over the past decade. Increased inflows of foreign exchange associated with the recovery in the tourism sector might be an explanation for the increase in demand for the riel during 2004.

It should be noted that in absolute terms, foreign currency deposits also registered the largest increase since the mid-1990s. Considering the monthly movements, this deposit category rose constantly every month over the whole year, with January, August and October recording the largest increases of 120 billion riels (5.2%), 138.9 billion riels (5%) and 148.2 billion riels (5%), respectively. This development might suggest that the use of the banking services has recovered remarkably during 2004, following a period of concern and uncertainty stemming from the general election in Cambodia and other unfavorable events which occurred in 2003.

Chart 4: Structure of Money Supply



2.2. Factors affecting money supply

Higher monetary expansion during the year under review when compared with the previous year was matched by higher growth in net foreign assets and net domestic assets while being held back to some extent by a decline in "other items net".

Net foreign assets of the banking sector increased by 769.3 billion riels or 19.1%, significantly faster than the 7.8% growth recorded in 2003. The acceleration was observed in the holdings of both the National Bank of Cambodia and the rest of the banking system.

At the same time, net domestic assets of the banking system rose by 231.0 billion riels or 33.1 % as compared with a 17.7% growth rate a year earlier. Growth in net domestic assets

was entirely attributable to a more rapid growth in private sector credit, which was up by 479.9 billion riels (35.9%), as net claims on the government plummeted by 80.8 billion riels (63.2%).

2.2.1 Net domestic assets and net foreign assets of the National Bank of Cambodia

Net domestic assets of the National Bank of Cambodia dropped by 105 billion riels (8.0%), from 1,344 billion riels in 2003 to 1,449.8 billion riels in 2004, after having declined by 44.6 billion riels (0.04%) in the previous year. This change was partly attributable to an increase in Central Bank's reserves of 41 billion riels (3.0%), due to a revaluation of assets. Meanwhile, a fall in net claims on government of 37 billion riels (17%) also contributed to this development, which was a result of an increase in government deposits of 38 billion riels (8%) and a negligible change in central bank's credit outstanding to the government. During the same period, claims on deposit money banks declined insignificantly, down by 3 billion riels (2%) from last year's level.

During 2004, the central bank's net foreign assets recorded a remarkable increase, rising by 620 billion riels (18.0%), from 3,494 billion riels in 2003 to reach 4,114 billion riels a year later. At the end of the period under consideration, the net foreign assets of the National Bank of Cambodia accounted for about 85% of the combined holdings of the entire banking system and made up 80% of the overall growth in banking system net foreign assets in the reviewed year. An increase in the central bank's net foreign assets mirrored on one hand the expansion in foreign assets of 600 billion riels (15%). Revaluation of some types of overseas assets holdings as well as some inward transfers into the nostrp accounts of the monetary authority for the benefit of the government and the net purchase of US dollar in the course of currency interventions were the main factors contributing to the surge during the year. On the other hand it reflected a reduction in the central bank's foreign liabilities of 20 billion riels (5%), as the National Bank of Cambodia made its periodic payments to the International Monetary Fund.

2.2.2 Deposit money banks' balance sheet

. The aggregate balance sheet of deposit money banks during 2004 expanded by 828.5 billion riels (21.4%), as against an increase of 519.5 billion riels (15.5%) in 2003.

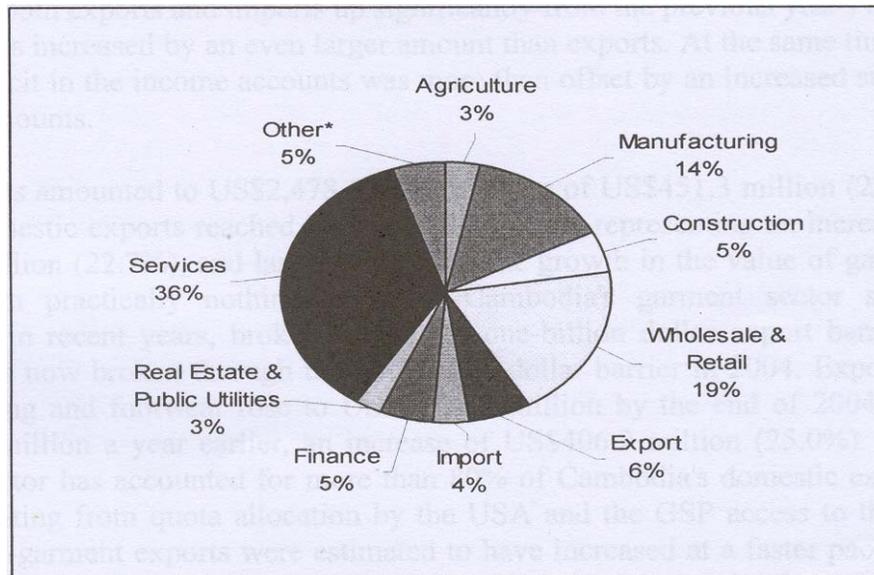
Net foreign assets of the banking system excluding the National Bank of Cambodia rose by nearly 149.4 billion riels (28.0%), compared with a small increase of about 15 billion riels (3.0%) recorded in the previous year. As a result, this item moved up from 532.9 billion riels at year end 2003 to 682.2 billion riels a year later. Increases in international trade-related payments may have prompted domestic commercial banks to enlarge their short-term assets abroad. In fact, total foreign assets of deposit money banks soared by 140.5 billion riels (16.8%) whereas their foreign liabilities posted a slight contraction of 8.9 billion riels (3%), reflecting a small decline in non-residents' deposits with banks in Cambodia.

Net domestic assets showed a very strong rise in 2004, up by 400.0 billion riels (71.7%). In contrast to the previous year where net foreign assets accounted for about the same share as net domestic assets in total DMBs' assets, the latter item amounted to 1.5 times the former item at the end of the year under review. Net claims of the DMBs on the government

contracted by 43.6% billion riels (48%) when government deposits with this sector started to jump rapidly. Meanwhile, banks lending to non-government sectors soared considerably, with growth in absolute terms almost double the previous year's growth. In fact, claims on the private sector rose by 477.3 billion riels (35.7%). This shows the increasing role of banks in Cambodia in financing the real economy and a deepening of banking intermediation.

The acceleration in credit growth in 2004 was broadly based: credit to all categories of borrowers, except lending for import activities and credit to finance, real estate and utilities, expanded, with a majority at faster pace. With an increase of 197.2 billion riels (41.2%), lending to the services sector absorbed the largest share of credit formation during the year, followed by growth in loans to wholesale and retail trade of 137.5 billion riels (61.0%). This sector maintained its second rank in terms of its share to total DMBs' credit outstanding to the private sector, whereas lending to the manufacturing sector remained in third place. In the year under review, credit to the manufacturing sector expanded by 81.6 billion riels (43.5%), a significant amount compared with the 29.0 billion riels (18.3%) increase recorded for 2003. It should be noted that credit to the agriculture sector also showed a remarkable expansion, though from a very low base, reaching a new high of 20.8 billion riels (47.4%). This development may be a reflection of the increased efforts of the banking community to promote the undeveloped agricultural sector in Cambodia, thus contributing to poverty reduction specifically in rural areas.

Chart 5: Bank's credit by types of business activities



Domestic liabilities of deposit money banks, which consist entirely of residents' deposits, increased sharply, up by 789 billion riels (32.6%). All deposit categories were on the increase, led as usual by growth in foreign currency deposits. The riel-denominated deposits, the terms and savings deposits, and demand deposits rose by 15.5 billion riels (18.9%) and 3.9 billion riels (13.2%), respectively. The rise in customers' deposits during the year may explain

the increase of banks' reserves with the National Bank of Cambodia, which expanded by 273 billion riels (21.5%).

3. Balance of payments

The external sector performance during 2004 showed some signs of improvement. Provisional 2004 balance of payments data for Cambodia indicated that the overall balance registered an increased surplus of US\$127.4 million, compared with a surplus of US\$30.6 million a year earlier. This improvement resulted mainly from a larger inflow into capital and financial accounts as against last year's performance, which was more than offset by the increase in the current account deficit. For 2004, it is estimated that the current account deficit, excluding official transfers, increased from 10% of GDP in 2003 to 12.1 % of GDP by the end of 2004, reflecting the impact of higher petroleum prices and net income debits. However, the improved political atmosphere following the elections, coupled with the government's commitments to improving the business environment for private sector development helped to generate an increase in foreign direct investment and tourism receipts. On the whole, a positive overall surplus, though a smaller one, could be achieved, while gross international reserves expanded further to a level equivalent to more than 3 months of import of goods, services and income debits by the end of 2004.

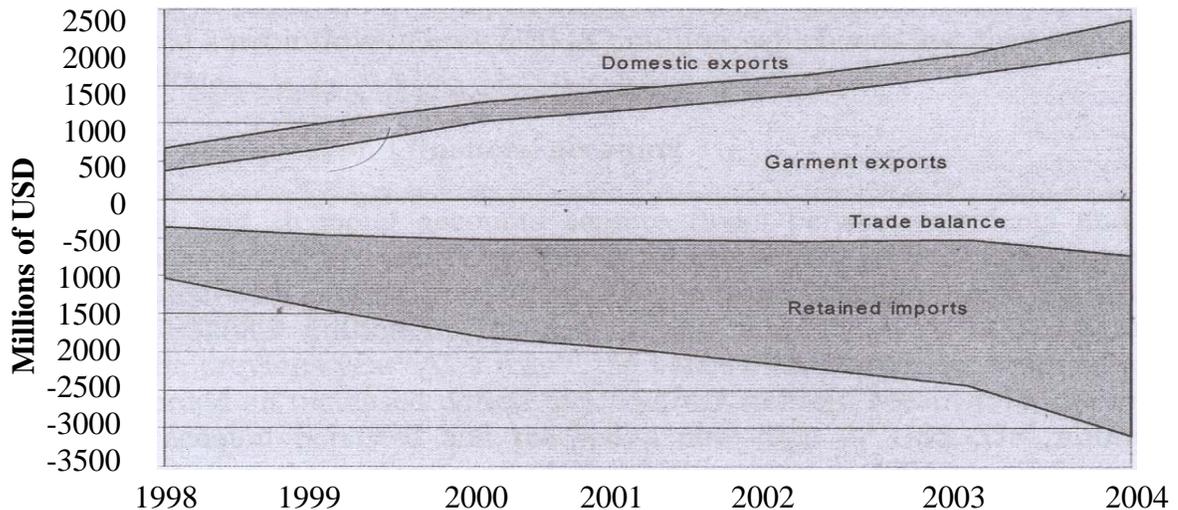
3.1. The current account (excluding official transfers)

The deficit on current account balance (excluding official transfers) widened somewhat and reached a new peak of US\$543.2 million, an increase of US\$125.8 million (or 30.1 %) on the 2003 deficit. This was roughly equivalent to 12.1 % of GDP. Nearly the entire current account deficit was attributable to an increased deficit in the trade balance. The merchandise trade gap grew by US\$217.0 million to US\$749.7 million, with both exports and imports up significantly from the previous year's levels, though imports increased by an even larger amount than exports. At the same time, an increased deficit in the income accounts was more than offset by an increased surplus in services accounts.

Exports amounted to US\$2,478.5 million, a rise of US\$451.3 million (22.3%) on 2003. Domestic exports reached US\$ 2,344.1 million, representing an increase of US\$433.7 million (22.7%), and largely reflecting the growth in the value of garment exports. From practically nothing in 1994, Cambodia's garment sector surged impressively in recent years, broke through the one-billion dollar export barrier in 2000, and has now broken through the two-billion dollar barrier in 2004. Exports of textile, clothing and footwear rose to US\$2,034.1 million by the end of 2004 from US\$1,627.9 million a year earlier, an increase of US\$406.2 million (25.0%). Since 2003, this sector has accounted for more than 80% of Cambodia's domestic exports, largely benefiting from quota allocation by the USA and the GSP access to the EU markets. Non-garment exports were estimated to have increased at a faster pace than the garment sector, albeit from a very low level, and produced only about 13% of Cambodia's total export earnings. This group includes traditional agricultural commodities such as rubber, wood products, fishery products, and paddy rice. In order to reduce the dependence of the economy on a single commodity and to utilize the country's agricultural potential in a more dynamic way, the government has increasingly encouraged private investment in the agricultural sector

and the agro industry, while at the same time advocating the "One village-One product-program". This program aims to promote entrepreneurship and to create jobs in the communities as it encourages the country's micro, small and medium enterprises to produce and market distinct products or services using indigenous raw materials and manpower. These efforts will, however, take some time before Cambodia can enjoy any tangible outcome.

Chart 6: Trade balance



The year under review recorded a further increase in imports, reaching US\$3,228.2 million, an increase of US\$668.3 million (26.1 %) from the previous year's level. Retained imports amounted to US\$3,125.2 million, representing an increase of US\$654.8 million (26.5%). In absolute terms, imports of petroleum recorded the second largest increase in 2004, after raw materials for the garment industry. Petroleum imports went up by US\$190.3 million (46.1%), which was attributable to both volume and significant price increases. This development reflected increased fuel consumption due partly to a rise in imported vehicles during the year as well as a surge in world market prices for oil. Over the past five years, petroleum constituted about 15.8% of Cambodia's imports, while raw material for the garment industry represented 30%, reflecting the structure of the domestic industry and a lack of resource endowments. During the year under consideration, raw material imports for the garment industry grew by US\$211.2 million (24.9%). As in 2003, foods and beverages continued to account for about 5% of total imports in 2004.

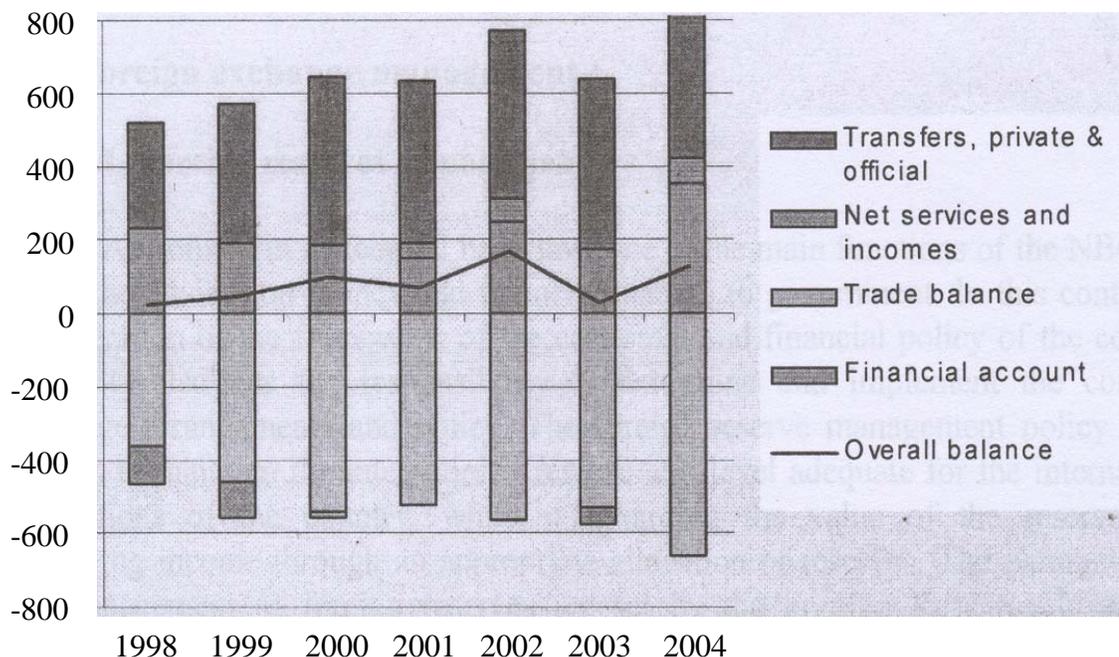
Meanwhile the surplus on services account increased by US\$154.3 million, reaching US\$290.0 million by the end of 2004, when a rise in services receipts were more than enough to offset that of international payments for services rendered by the rest of the world to Cambodia. The main contributing factor to the increase in services receipts was the improving performance of the tourism sector, reflected in increased travel credits which generated foreign exchange earnings equivalent to US\$603.5 million. This was an increase of US\$214.5 million (55.1%), reversing the downward trend of US\$64.5 million (14.2%) recorded in 2003. The superior result in the reviewed year was due to significant increases in the number of tourist arrivals in Cambodia as against a sharp reduction during the previous year due to the outbreak of SARS. The increase in payments was led by growth in transportation services.

The estimated deficit on the income account was US\$225.5 million, an increase of US\$42.4 million (23.2%) from the previous year's level. This widening of the deficit was driven principally by a larger increase- in income outflows which overshadowed- the rise in income inflows. In fact, net outward remittances of profits and dividends on foreign investment in Cambodia rose sharply, which was eased to some extent by a reduction in compensation to foreign workers. Meanwhile, private transfers posted a net inflow of only US\$142 million, which was less than last year by US\$20.8 million.

3.2. The capital and financial accounts

Capital and financial accounts capture flows between residents and nonresidents related to disbursements by donors for the benefit of the public sector and flows associated with private investments. Net official transfers were estimated to amount to US\$268.9 million in 2004, signifying a reduction of US\$37.6 million (12.3%) on the previous year. As a result, the balance on current account and capital transfers recorded an increased deficit to US\$274.3 million. Meanwhile, net inflows of financial account persisted and reached a new high of US\$353.4 million. In contrast to last year, the performance of financial account in 2004 was influenced by the net inflow of private investment rather than by official sector borrowing. In fact, net inflow of official loans from both multilateral and bilateral sources (excluding net borrowing from the IMF) declined by US\$9.5 million (or 6.4%), from US\$148.6 million to US\$139.1 million between 2003 and 2004. This development was, however, fully offset by a remarkable increase in private sector investment in the form of foreign direct investment, which registered a net inflow of US\$126.2 million (63.3%) as against US\$77.3 million in 2003. Other investment net was valued at US\$96.1 million.

Chart 7: Cambodia Balance of Payments



The overall balance recorded four times the surplus recorded in the previous year, reaching US\$127.4 million by the end of 2004. This change was mainly driven by an inflow of net official reserve assets of US\$ 140.1 million, an improvement of US\$96.8 on 2003. Gross official reserves attained a level that is sufficient to cover three months of goods imports.

Net errors and omissions were large and positive in 2004, amounting to US\$ 48.2 million.

II. Policies, operations and activities of the NBC

1. Monetary policy implementation

The principal mission of the central bank is to determine and direct the monetary policy with the aim of maintaining price stability in order to facilitate economic development within the framework of the economic and development policy of the Kingdom. In formulating monetary policies, the National Bank of Cambodia focuses on maintaining low inflation and a stable value of the national currency.

The actual high degree of dollarization of the economy, however, limits the opportunities to conduct the monetary policy of the Central Bank. With the aim of reducing and maintaining stability in the inflation rate at an appropriate level, the NBC has adopted a tight monetary policy and this policy stance is expected to prevail in the future. The central bank controls liquidity and credit growth by utilizing more direct instruments. The data being carefully monitored for monetary policy purpose are domestic assets, net credit to the government, liquidity and its component: namely, currency outside banks and foreign currency deposits.

Under the present economic and social environment, the government recognized that the combination of the adoption of monetary targets, an optimal exchange rate regime attuned to the requirements of the markets, and a fiscal policy supportive of the monetary goal is crucial in achieving the set objective of price and exchange rate stability.

2. Foreign exchange management

2.1. Foreign reserves management

As defined in the central bank law, one of the main functions of the NBC is to act as the advisor on money and financial matters to government. In this context, in consideration of the framework of the economic and financial policy of the country, the NBC also has the responsibility to determine and implement the country's exchange arrangements and policy. The foreign reserve management policy of the NBC is to maintain the international reserve at a level adequate for the international transactions of the country, while safeguarding the value of the reserves and generating income through an appropriate allocation of reserves. The parameters for the management of foreign reserves are set by the Foreign Reserves Investment Committee, which is chaired by the Governor and includes the Deputy Governor and other

senior officials of the NBC. The reserve management principles set by the Committee are: firstly, safety; secondly, liquidity; and finally, profitability.

The NBC's foreign assets portfolio consists of overnight placement abroad, short-and medium-term deposits with highly-rated financial institutions, and listed short-term foreign debt securities. It also included an insignificant claim on the IMF, some amount of foreign currency cash holdings at the NBC, and a small quantity of gold. By the end of 2004, with an increase of 16.9% on the previous year's stock, gross foreign reserves (excluding gold and SDR holdings) reached a level that is sufficient to cover three months of imports. Fund transfers in favor of the government, the increase in banks' deposits with the NBC, interest income from various investment forms mentioned above, and the net purchases of foreign currency from the local foreign exchange market were the main contributors to reserves growth.

During 2004, in particular from the beginning of the second quarter, the Fed Open Market Committee gradually raised its target rate from 1 % to 2.25%, leading to a remarkable increase in return on investment abroad. Overnight rates changed from 0.87% to 2.23%, the interest rate on US Treasury bills from 0.93 to 2.33%, the short-term deposit rate from 0.84% to 2.75%, while the long-term deposit rate went from 1.06% to 2.44%.

2.2. Management of gold and foreign exchange business

During 2004, the NBC issued 212 business permits to 174 gold traders, 37 individual money changers and a permit to one medium-scale exchange company operating in the capital city of Phnom Penh. Such traders are required by law to get prior authorization from the monetary authority before exercising their exchange transactions.' Apart from this, in the provinces and other cities' of Cambodia, the seventeen provincial branches of the NBC issued 1,895 business permits to authorize the conduct of gold and foreign exchange operations; 165 permits were for foreign exchange business; and 1,730 permits were for gold trading.

3. Regulatory and supervisory activities

3.1. Bank supervision

3.1.1. Off-site examination

In carrying out off-site surveillance, regulatory financial reports received from commercial banks and the annual examination report obtained from the external audit were reviewed, synthesized, and a coherent analysis was subsequently produced. In principle, the off-site assessment of banks conditions and performance was accomplished by utilizing the CAEL system (capital adequacy, quality assets, earnings and liquidity). Apart from analyzing the structure of banks' balance sheets, analysts also regularly examined whether each institution complied with the legislation, regulations, and instructions issued by the National Bank of Cambodia. While banks were advised to implement the uniform chart of accounts, the NBC designed new standardized reporting forms for the collection of core information, with accounting codes that are consistent with the uniform chart of accounts, thereby facilitating the reporting by banks. As for banks that showed signs of shortcomings or appeared to be

potentially problematic, the NBC immediately initiated a field examination and made an assessment directly on the spot. With regard to banks found to be experiencing irregularities and serious problems, the NBC requested a face-to-face meeting with their managers for consultation that aimed at seeking remedies to the problems.

Though in general banks' soundness has been improved, there are still some weaknesses that need to be promptly addressed. The major shortcomings that were found in some banking institutions related to incompliance with the prudential requirements, such as a shortfall in net worth, a deficiency in the capital guarantee deposits, a low solvency ratio, a high ratio of investment in fixed assets, and a high prepayment for rent and leases. Those deficiencies were brought to the attention of the respective institutions, while at the same time instruction were given by the authority in order to initiate an immediate correction.

3.1.2. On-site inspection

During 2004, on-site inspection has been focused on the completion of a full-scope examination of fourteen commercial banks that are operating in Cambodia. When carrying out on-site inspection activities, examiners normally applied CAMELS methodology. However, two commercial banks were also subject to a specific supervision based on the TARGET system. As in the case of off-site surveillance, the on-site supervision also covered the assessments related to the bank's compliance with laws, regulations and prudential rules introduced by the NBC. The on-site inspection's report was prepared with the purpose of reflecting and determining the overall conditions and performance of banks by checking and evaluating the truthfulness and correctness of banks' financial reports. For every mistake found, as well as for any incompliance with the laws, regulations and the prudential rules, advice was given by the authority and prompt correcting measures were undertaken by the concerned commercial bank.

3.2. The supervision of specialized banks and micro-finance institutes

Also on a regular basis, the NBC conducts supervision on three specialized banks, ten licensed micro-finance institutes and twenty seven non-governmental organizations (NGOs) that have been registered with the NBC as rural credit operators. In carrying out this function, the NBC also studied and analyzed the financial reports, checked for compliance with banking laws, and carried out on-site examinations over the institutions that are subject to NBC's supervision. At the end of 2004, specialized banks and micro-finance institutions issued credit totaling 49.9 billion riels (to 607 borrowers) and 126.1 billion riels (to 294,451 borrowers), respectively. Loans provided by NGOs as rural credit operators, on the other hand, amounted to 8.9 billion riels (to 26,792 borrowers).

3.3. Banking restructuring

3.3.1. The liquidation of non-viable banks

The banks' liquidation has been completed, while leaving to the NBC the responsibility of continuing to sue the banks' shareholders and to claim the remaining money owed to the

closed banks in order to repay the depositors. Those liquidated banks included First Overseas Bank Ltd, Cambodia Farmers Bank Ltd, Rich Nation Bank, Pacific Commercial Bank Ltd, and Cambodia Agriculture Commercial Bank Ltd. Efforts have been made by the authorities to recover bank debts and to confiscate fixed asset, which could be used to gradually repay the depositors. A payment to depositors was made in December 2004.

3.3.2. The restructuring of the Foreign Trade Bank of Cambodia

The Ministry of Economy and Finance became the principal shareholder of the Foreign Trade Bank by issuing government bonds with a 2-year maturity to replace the bridge capital provided by the NBC. The NBC still possessed 20% of bank equity.

3.4. Regulatory framework

As mentioned earlier, the NBC continued to enhance its supervision over the banking and financial institutions partly through checks for compliance with the issued regulations. Meanwhile, a team has been set up with the task of reviewing and improving the existing regulations and ensuring a proper and an efficient enforcement of the law. During the year under consideration, nine circulars and *prakas* have been issued for implementation. These included *prakas* on payments of dividends in advance, *prakas* on prepaid prepayments on rental and leases, *prakas* on requirement in compliance with fact and substance, *prakas* on amendments relating to liquidity, *prakas* relating to the banks' 'solvency ratio', *prakas* on the annual audit of financial statements of banks and financial institutions, *prakas* on license fees for banks and financial institutions, a circular on installment loan classifications and provisioning and a circular on non-performing loans, provisions and interests accounting.

Two other *prakas* will be soon introduced to banks: (1) on standardized procedure for identification of money laundering at the banking and financial institutions and terrorism financing; (2) on standardized supervision procedures and reports.

3.5. The implementation of the uniform chart of accounts

In 2004, the NBC continued to monitor the implementation by banks of the *uniform* chart of accounts (*COA*) prepared in accordance with the accounting rules prescribed in the international accounting standard as well as the Cambodian accounting standard. Commercial banks and specialized banks started to implement the *COA* on the 1st of January 2003. By the end of 2004, thirteen commercial banks and three specialized banks have fully integrated the uniform chart of accounts into their system, except for one bank that still lagged behind due to a problem related to outdated computer software system which made adjustments and changes to the existing system more difficult than in other banks. Facing this constraint, the NBC gave additional time to this bank to find remedies to its problems and to improve its accounting system in line with the requirements of the uniform chart of accounts.

With the aim of promoting transparency and developing the confidence of the public in the banking system, the NBC has recently required all banks to publish their annual financial reports audited by the external auditors, starting in 2005. The disclosure of the annual financial reports will enhance transparency in banking operations and improve banks' accountability

toward their customers, which in turn could enhance banks' credibility and promote the banks' reputation. To pursue this plan, the NBC held a discussion with external auditors to draw up a disclosure report form to be published by banking institutions.

4. Banking operations' of the National Bank of Cambodia

4.1. Government's accounts and debt management

One of the main functions of the NBC is to act as a bank for the government as well as a bank for the domestic banking system. In fulfilling this duty the NBC managed the accounts of the government, the public sector entities at the central level, and the accounts of banking and financial institutions that have licenses to operate in Cambodia. Various types of accounts have been provided, including current accounts, capital guarantee deposit accounts, reserve requirement accounts, and term deposit accounts. Due to the inevitably high degree of utilization of the US dollar in the domestic market as a whole, and in particular in the banking sector, the NBC allowed deposit accounts to be maintained in both local currency and US dollars. By the end of 2004, there were a total of 1,196 accounts held with the NBC. As a result of public finance reforms during the year, 183 accounts belonging to the government were closed.

4.1.1. Repository of government accounts

The NBC has made continuous efforts in contributing to the implementation of the policy of the RGC toward increasing efficiency in budgetary management and boosting reforms in public finance. As the fiscal agent of the government, the NBC started in 2004 to provide money transfer services to the government by transferring cash from the National Treasury to the provincial treasuries and vice versa. This action of the NBC has made the National Treasury's duty of supplying cash to its provincial offices no longer necessary, which had involved until recently physical transport and distribution of currency by National Treasury-owned means.

In addition to maintaining riel accounts, the NBC has lately also operated US dollar accounts for the provincial treasuries and provincial tax offices of the Ministry of Economy and Finance with the aim of facilitating the collection of foreign currency payments of duties and taxes by private companies to the state. Through an arrangement in October 2004 between the NBC and the Ministry of Economy of Finance, all tax payments can now be made directly at the NBC. The number of transactions related to payments by taxpayers in the real regime increased dramatically toward the end of 2004 as the arrangement to make monthly tax payments at the NBC was extended to cover about 2000 additional companies and individuals who are taxpayers in the middle or expanded real regime.

So far, tax payments have been proceeding smoothly. Total government revenue collected through this mechanism was equivalent to 321 billion riels as of the end of 2004 (including both revenue in local currency and in US dollars).

Pursuant to the new policy decision of the government in the context of public finance reforms, since November 2004 the NBC has undertaken a new responsibility that was transferred from the Ministry of Economy and Finance and which involved the provision of

budgetary transfers related to the payroll for the civil services and the military force to the ministries and other relevant accounts.

Furthermore, the NBC has responded positively to the request made by the Ministry of Post and Telecommunication to open accounts for the provincial post offices at the NBC's provincial branches in order to facilitate international postal money orders.

In addition to the above measures, it is planned that beginning in 2005, collection of customs revenue will also be made directly through the NBC.

4.1.2. Securities management

In April 2003, the Ministry of Economy started to issue for the first time the government debt, treasury bills with a maturity of 91 days for the purpose of funding short-term cash shortage. The role of the NBC in this respect is to manage the government securities and to effect the payments and settlements related to such debt. It maintains a book entry system for treasury bills issued by the Ministry of Economy and Finance and organizes auctions to float the treasury bills on its behalf. To fulfill this mission, the NBC signed an arrangement on the auction rules and procedure with commercial banks that have the intention to participate in such auctions. It also has an arrangement with the Ministry of Economy and Finance on the management of the treasury bills.

Based on the instructions issued by the issuer and the auction schedule for 2004, the NBC organized 12 auctions, with one auction every month. The total value of securities issued during the year was 199,600 million riel. The outstanding balance of the debt, however, was constant over the year at 49,900 million riel as all the new issues during the period were entirely used to repay the due debt.

4.2. Repository of accounts for banks and financial institutions

Commercial banks and other financial institutions have opened various accounts with the NBC. These included current accounts, term deposit accounts with several maturities, capital guarantee deposit accounts and reserve requirement accounts. Terms deposits of all maturities (one month, three months, and six months) and denominations totaled US\$ 256 million at the end of 2004.

4.3. Clearing house activities

4.3.1. Clearing and settlement of riel-denominated checks

The Clearing House for riel-denominated checks had 15 members consisting of commercial banks, the National Treasury, and the National Bank of Cambodia itself. During 2004, there were 236 days in which checks issued were cleared and settled through the Clearing House. The number of checks cleared reached 22,443 by the end of the year, with a total value of 311.2 billion riels. In more detail, clearing and settlement figures during 2004 showed that the number of checks rose by 26%, from 17,874 in 2003 to 22,443 in 2004. An increase in the number of checks was accompanied by an increase in the value involved, though growth in terms of value was less than growth rate in terms of numbers. In fact, over the same period, the value of all checks going through the Clearing House rose by 22% to

attain 311.2 billion riels by the end of 2004, compared with 255.4 billion riels in 2003. On average, 95 riel-denominated checks were settled per day through the Clearing House.

4.3.2. Clearing and settlement of USD-denominated checks

There were 17 institutional members in 2004 participating in the Clearing House for USD-denominated checks. Those members comprised 14 commercial banks, 2 specialized banks, and the National Bank of Cambodia (represented by the Banking Operations Department). Over the year, clearing activities took place during 236 days. Reflecting an increase in the volume and value of transactions, both the number and value of USD-denominated checks accelerated. The number of checks cleared expanded by 20%, from 135,763 in 2003 to 162,550 by the end of the year 2004. During the same period, the value involved rose from US\$931.5 million to US\$1.270 million, with an annual growth rate of 36%.

Experiences so far indicated a clear trend of an increasing use of US dollar checks within the banking system. On average, checks settled daily through this Clearing House amounted to US\$5 million in terms of value and 700 in terms of numbers.

4.4. Currency management

The major functions of currency management relate to note design, issue and distribution of fresh notes and coins, inventory management and accounting, withdrawal of soiled notes from circulation and their eco-friendly destruction, note exchange facilities and anti-counterfeit measures. These activities are performed by the NBC through the Issue Department at the headquarters and its 18 provincial branches spread across the country. Note design and issue, however, are carried out solely by the Issue Department.

The physical movements of riel notes through the banking system and in particular through the teller desks of the NBC increased dramatically in the recent period. The increase in the volume of cash inflows and outflows through the NBC resulted from the implementation of the arrangement between the NBC and the Ministry of Economy and Finance in which all tax payments due to the National Treasury can be made directly at the NBC, either through the headquarters or its regional branches. This development facilitated the NBC's efforts to seek and single out old, worn and torn local currency notes from the circulation. While handling the tax collection on behalf of the government and facilitating cash inflow and outflow through the banking system for other purposes, the NBC constantly encouraged its provincial branches to withdraw soiled and mutilated bank notes from the circulation. For this purpose, the NBC's staff was present on spot at the major marketplaces in the capital city to conduct the exchange of soiled notes with the new ones. With the help of local authorities, the people were encouraged to exchange soiled and mutilated notes. Supplying the markets with fresh bank notes by replacing the soiled with new and clean ones was carried out with the objective of increasing public preference in the local currency, which in turn will contribute to its use nation-wide.

As a result of a continuous effort to reform and improve the functions of the NBC's branches in response to the requirements of a modern banking system and the need to support

public finance reform, financial transactions that were effected through the provincial branches expanded remarkably during 2004. This in turn led to a growing demand for both local currency and foreign currency cash balances to be supplied by the NBC's headquarters to its regional branches so that the latter can adequately meet the requests for cash withdrawal by banks and financial institutions, various government agencies, and other organizations. Consequently, the transports of cash from NBC's, headquarters to the provincial branches occurred more frequently than previously was the case and prompted the NBC to make every effort to ensure the supply of currency in the correct volume and denominations as well as the safety of the physical transports themselves.

III. Internal management of the NBC

1. The activities of the board of directors

The present composition of the Board of Directors of the National Bank of Cambodia is as follows:

.H.E. Chea Chanto	NBC's Governor	Chairman
.H.E. Neav Chanthana	NBC's Deputy Governor	Member
.H.E. Aun Pornmoniroth	Representative of the Head of the Royal Government	Member
.H.E. Iv Thong	Representative of the academics	Member
.H.E. Chou Kimleng	Representative of the MEF	Member
.Mr. Lay Mengsun	Representative of the private sector	Member
.Mrs. Mao Son	Representative of the NBC's staff	Member

In accordance with the Royal Degree No. NS/RKT/09.04/244 dated September 7, 2004, H.E. Neav Chanthana was appointed as Deputy Governor of the NBC, replacing H.E. Eng Thay San, who had finished his terms.

2. Internal audit

During 2004, internal audit activities have been very active, focusing on reviewing, examining reports submitted by various departments and units at the headquarters as well as those provided by the provincial branches of the NBC, punctually producing an analysis and evaluation on the NBC's operations, and conducting field audits on seven branches of the NBC. Strengthening internal audit and control is mainly aimed at ensuring compliance with the legislation, regulations and guidelines issued by the NBC and at assessing whether the objectives have been achieved and the central bank's functions have been carried out in an efficient and risk-free manner. The NBC is fully aware that a sound system of internal auditing and controlling is necessary to manage and minimize the risks. In order to improve the internal audit system and internal control functions at the central bank, during 2004 the NBC has

restructured the General Inspection, including all the departments under it, and redefined their missions, duties, responsibilities. At the same time, staff members of the General Inspection have received extensive training on the subjects concerned so that control and audit functions can be done efficiently and a minimum standard of internal control can be achieved. The reorganization of the General Inspection and its departments, including the training, has been carried out with technical assistance provided by the International Monetary Fund. In particular, the T A assisted in the following areas:

- drafting seven regulations related to the strengthening of the internal audit, which include a draft regulation on the structure, duties and responsibilities of the General Inspection and the relevant departments under it;
- providing training to officials and staff of the General Inspection on the theoretical concepts and practical aspects of the internal audit which covers the following subjects: the power and responsibility of the internal audit, internal audit policies, code of ethics of internal audit staff, and the relations with external audit.

3. NBC branches management

In the spirit of strengthening the two-tier banking system, the NBC has been taking steps in order to re-structure and gradually modernize its provincial branches. This effort is aimed at providing them a new quality of being allowing them to efficiently serve as institutional agencies of the headquarters in the implementation of monetary policy, payment and settlement functions, and other central banking services. Given this policy stance, a new department called "Branches Management Department" was created in early September 2004, which replaced the Legal Department that had been permanently closed down in response to the changing requirements of the present duties of the NBC. The Branches Management Department plays, on the one hand, a role as a cooperation partner with branches and assists them in their missions in order to ensure good governance and efficiency in the central banking operations at provincial level. On the other hand, this department acts as coordinator in facilitating the exchange of information and work flows between the central and regional level.

The strengthening of the 18 NBC branches at the regional level becomes more and more an important component in increasing the safety and upgrading the quality of central banking services provided to the branches of commercial banks, microfinance institutions, and to the regional offices of the National Treasury. By improving their service delivery, the NBC's branches have significantly facilitated the operations of their customers.

4. International relations

4.1. Relation with International Monetary Fund

In the framework of a multilateral cooperation between the government and the various multilateral agencies, the International Monetary Fund remains one of the active partners in Cambodia's development. Despite the completion of the first three year arrangement on Poverty Reduction and Growth Facility in 2003, Cambodia continued to receive various forms

of technical assistance from the Fund and there have been various Fund missions to Cambodia during the year 2004. The objectives of the missions are in general to: (i) monitor and assess the overall economic performance and policy of Cambodia; (ii) update the progress of the restructuring efforts in the banking sector through consideration of the possibilities of providing technical assistance with purposes to strengthen banking operations, especially the operations of the central bank as the monetary and supervisory authority of the country.

In addition to the regular missions, such as the review and surveillance mission in the framework of the consultation in terms of Article IV of the Articles of Agreement of the Fund and the mission from the Monetary and Financial System Department of the IMF, there was also a special visit made by the IMF Safeguards Assessment Mission. The general purpose of this mission was to conduct an assessment of the system of controlling, accounting, reporting and auditing at the NBC in order to ensure the integrity of the operations, and strengthen the management and governance within the central bank. During the visit, the team produced a report. The report noted that progress has been made by the NBC in strengthening the safeguard framework to support its operations (though some weaknesses remain). The mission's recommendations were provided subsequent to their assessment that the NBC is committed to carefully implementing recommendations to improve the existing shortcomings.

As for the financial transactions with the International Monetary Fund, the table below gives a short summary of the movement of accounts related to the payments of principal and interest payments to the Fund:

IMF's Outstanding Loans and Debt Services

	ESAF + PRQF	
	SDR	USD
Ending Balance, 2003	69,700,000	100,980,000
Repayment, 2004	7,000,000	10,850,000
New Borrowing, 2004	0	0
Ending Balance, 2004	62,700,000	90,130,000
Interest Payment, 2004	336,726	491,714

4.2. Relation with the Asian Development Bank

In the implementation of the work program stated in the government paper "The Blueprint and Financial Sector Development for 2001-2010", the National Bank of Cambodia plays a role as the executing agency and the coordinator with other line Ministries.

After the completion of the Sub-program I with a loan disbursement of nearly US\$ 10 millions, there were no further disbursements associated with Sub-program II. In other words, there has been an interruption of credit release since the beginning of 2003 until now. The stall of the First Tranche Release of the Sub-program II resulted from the delay in adopting the law on commercial enterprises that had been stuck at the National Assembly for two years already.

The ADB's mission asked the government to push its passage after formation of the new government.

Meanwhile, all the concerned ministries and institutions have made efforts to gradually implement the conditionality for the Second Tranche Release without waiting until the implementation of the conditions for the First Tranche Release was 'completed.

The reform agenda associated with the Second Tranche Release concerns five areas:

1. Adoption of a guideline for the arrangements for sharing credit information among banks;
2. Establishment of a joint venture between the state-owned' insurance company and a private insurance company;
3. Strengthening accounting and the national audit system;
4. Adopting a plan to establish a public registry for secured transactions;
5. Submitting the draft on Secured Transactions Law to the National Assembly.

The implementation of conditions for the Second Tranche Release of the Subprogram II showed the following progress:

- The National Bank of Cambodia is coordinating with the technical assistance of the Asian Development Bank in order to establish a voluntary credit information sharing system. At present, by signing an MOD, the banking institutions agreed in principle to participate in this project. Following the completion of a study on technical aspects of the system, the pilot project is expected to start in the coming year 2005.

- The Ministry of Commerce has already submitted the draft on Secured Transactions Law to the council minister but not to the National Assembly yet.

- Regarding the insurance sector, in early October 2002 the Government initiated discussions with a private company so as to consider the possibility of creating a joint venture with state-owned insurance company "CAMINCO". This attempt, however, failed as the private company (Indo chine) suffered financial problems. Currently, the Government has no concrete plan with other partners in the private sector. The Ministry of Economy and Finance requested technical assistance in the area of insurance to help develop a strategic plan which would facilitate the implementation of the reform agenda in the insurance sector.

- Meanwhile, the Asian Development Bank and all the government institutions involved in the Program Loan Cluster acknowledge the importance of taking stock of all the changes that have taken place since the Blueprint was first launched in 2001 and updating and making adjustments to the initial strategy in order to adapt to the changing circumstances and the practical needs of the present time.

4.3. Relation with ASEAN

Within the framework of promoting cooperation in the banking and financial sector among ASEAN member countries, besides the regular participation in several meetings to review the performance in the economic and financial sector in the region, the main focus of

the cooperation in 2004 was placed on specific subjects related to ASEAN central banks as follows:

- Strengthening the initiatives on Asian bond market development;
- Review and assessment of the efforts related to ASEAN and bilateral swap arrangement;
- Financial services and capital account liberalization.

Furthermore, in the context of human resource and capacity building, the National Bank of Cambodia has coordinated with several partners in the ASEAN+3 framework on the development of a technical assistance program that is expected to be provided by China, Japan, Korea and advanced ASEAN countries, particularly on the topic of bond market development. In this respect, Korea, Malaysia and Thailand have expressed their intention to provide technical assistance in some fields related to the development of a bond market, thus complementing the study conducted by Japan during 2004. China also organized several working group meetings and seminars aimed at strengthening capacity building in the financial sector. The ASEAN secretariat plays an important role in coordinating activities related to capacity building so that the demand for and the supply of technical assistance to be provided by ASEAN + 3 can be properly matched.

Conclusion

The implementation of the monetary policy and exchange rate policy in the previous year mirrored the solemn commitments of the NBC to contribute to the strengthening of macroeconomic stability and poverty reduction by undertaking a proper liquidity management in the banking system and controlling currency in circulation, timely and adequately intervening in the foreign exchange markets, while at the same time making efforts to accumulate the country's foreign exchange reserves as a buffer against eventual financial crisis.

Meanwhile, the NBC also pays careful attention to the improvement of financial intermediation and savings mobilizing in accordance with the spirit spelled out in the government's 'Rectangular Strategy' for growth, employment, equity and efficiency. To this end, it is important for the NBC to continue strengthening the banking system by enhancing management, strengthening banks' surveillance and supervision, and developing an environment conducive for mobilization of savings which can be used to provide the necessary finance to the private sector, thereby generating economic growth.

The banking sector has indeed been gradually strengthened through the improvement of the regulatory framework, the improved quality of the off-site and onsite supervision, and the establishment of an environment for fair competition in the banking sector in order to achieve good governance and efficiency in banking operations. As a result, a number of banking institutions have been able to expand their operations and transform themselves from micro-finance institutions into specialized banks or commercial banks, whereas some micro-credit operators have been registered or received operating licenses as micro-finance institutions. The latter measure is designed to improve and enhance micro-finance activities that will enable people in rural areas to gain access to the credit market at an acceptable cost. In fact, the

movement of interest rates on bank loans for micro-finance shows a trend of demand for new loans.

On the whole, although many achievements made so far could give rise to complacency, the banking sector in Cambodia has not moved beyond the first stage of its development yet. The consequences of a prolonged war and political crisis over several decades caused serious damage to the foundation of the whole economy, including institutional framework and human resources, and represent a great challenge that cannot be overcome in a short period of time. The same is true for the development of the banking sector in Cambodia. Dedicated participants in the development of Cambodia's banking sector are asked to continue making a concerted effort with close co-operation from all parties concerned.