

Cambodia

Cambodia's robust economic performance continued in 2006. Real GDP growth is estimated at about 10.5 percent, a third consecutive year of double-digit growth. Growth continues to be underpinned by garment exports, tourism, construction, and agricultural expansion. The garment sector, which employs 10 percent of the labor force and which accounts for 14 percent of GDP, expanded further, with exports rising by 20 percent in 2006. At the same time 20 percent growth in tourist arrivals resulted in a 26 percent jump in tourism receipts. Agriculture continued to expand (4.4 percent) while construction slowed slightly.

International and domestic conditions bode well for economic prospects in 2007. The four growth pillars—garments, tourism, construction, and agriculture—are expected to continue to thrive in 2007 with real GDP growth projected at about 9.0 percent and expected to remain strong in the medium term. Growing FDI and the discovery of offshore oil and gas reserves will likely bring about even higher growth (production is expected to start in 2009 or 2010). However, the garments sector is now facing stiffer competition from Vietnam's accession to the WTO and the possibility of greater competition from China in 2008. Agricultural growth in Cambodia has been particularly volatile in recent years, and is therefore somewhat unpredictable. The new oil sector will also pose challenges for macroeconomic and fiscal management.

External developments were also positive. Despite pressure from high world oil prices, the current account deficit (excluding transfers) declined to -7.7 percent in 2006 (from -9.6 percent in 2005) and gross international reserves expanded by 20 percent to US\$ 1.1 billion. FDI continued its upward trend reaching a record high of US\$ 475 million. Consumer price inflation declined to 2.8 percent (from 6.7 percent in 2005), due to an easing of oil prices and a significant drop in food and clothing prices. The consumer price index is expected to remain low (below 5 percent) for 2007 and the riel (local currency) to remain stable both in terms of dollars and partner country currencies.

The fiscal front saw some improvement in 2006. Tax revenue grew modestly from 7.6 percent of GDP in 2005 to an estimated 8.0 percent in 2006. Non-tax revenue remained constant at 2.3 percent of GDP. Expenditure is estimated to have fallen slightly to 13.1 percent of GDP in 2006 (down from 13.6 percent of GDP in 2005) but greater emphasis continued to be put on the social sectors with a significant increase in nominal spending, though total capital spending declined in real terms. In the medium term, the overall budget balance is anticipated to be stable at around -3.7 percent of GDP (excluding grants).

Similarly, the financial sector saw some improvement in 2006. Combined deposits (in riel and foreign currency) of banks rose by 43 percent and the lending-to-deposit ratio has continued to trend upward, reaching 68 percent in 2006 (from 64 percent in 2005), reflecting growing business activities in 2006 (business registration grew by nearly 50 percent over 2005, for example). There are now 20 banks operating in Cambodia, up from 18 in 2005. Cambodia, however, remains a highly-dollarized economy with nearly 75 percent of broad money (M2) and 97 percent of banking deposits in US dollars. The commercial interest rate is still high at around 16 percent per annum.

On the structural reform agenda, the Government's Public Financial Management Reform Program continues to yield results. Following achievements in 2005 and 2006, a second wave of reforms started in January 2007, including: a streamlining of budget execution procedures to speed disbursements to spending agencies, the introduction of program budgeting to better align spending with priority National Strategic Development Plan objectives, and adoption of a new chart of accounts to improve expenditure reporting. These measures should improve the efficiency of the PFM system as well as reduce fiduciary risk by reducing the threat of corruption. From January 2007 import tariff rates have been reduced to reflect the ASEAN Harmonized System and the World Customs Organization Protocol Requirement. Though much remains to be done, banking reform has also shown progress. The Financial Sector Development Strategy (FSDS) 2006-2015 will focus on a number of key challenges in the medium term, including improving financial institution operations, increasing intermediation, and strengthening the links between banking and microfinance.

Despite progress in many areas, Cambodia still faces difficult challenges in light of the Millennium Development Goals. The challenges include a high rural poverty rate, achieving high survival rates at all

levels of the educational system, and improving access to quality health services, especially in terms of child and maternal health. However, a recently released demographic and health survey shows some progress. The infant mortality rate (per 1,000 live births) fell from 95 in 2000 to 66 in 2005 and child (under 5) mortality (per 1,000 live births) decreased from 124 in 2000 to 83 in 2005. HIV prevalence also appeared to have fallen remarkably. The notable lagging indicator is the maternal mortality rate, which likely remains unchanged over the past five years.