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Unofficial Translation

Macroeconomic and Banking Sector Development in 2023 and Outlook for 2024 by the National Bank of Cambodia, 29 January 2024

In 2023, the global economy is projected to grow at 3%, a lower rate compared to 3.5% in the previous year. This slowing is attributed to the dragging force of ongoing monetary policy tightening, which has imposed constraints on consumption and investment. In addition, geopolitical fragmentations and tensions have also adversely affected production and international trade.

In Cambodia, economic growth is estimated to remain robust at 5.5%, marking an increment from the 5.2% growth observed in 2022. This growth is primarily fuelled by the flourishing tourism and non-garment manufacturing sectors despite sluggish performance in the garment, construction, real estate, and agriculture sectors. The strong growth in the tourism sector has also contributed to the recovery of related economic activities such as transportation, trade, and telecommunications. Exports of non-garment products such as electronics, auto parts, and solar panels also witnessed strong growth in tandem with the growth in the tourism sector. However, the exports of garments and footwear were hampered by declining demand from major trading partners, especially the European Union and the United States. On the other hand, the growth in the construction sector was modest, driven mainly by the increase in foreign direct investments (FDIs) and the development of public infrastructure. However, FDIs in the real estate sector saw a decline. Furthermore, the agricultural sector grew marginally, driven by higher external demand and production facilitated by favourable weather conditions.

While global inflation stayed high in 2023 at 6.9%, Cambodia's inflation rate noticeably decreased to an average of 2.1% from 5.4% in 2022, thanks to lower prices of oil-related items and subdued food inflation. The moderate imported inflation, resulting from the stabilisation of the exchange rate of the KHR against the USD, also contributed to this low level of inflation. The average exchange rate was 4,110 riel per US dollar, and at the end of December 2023, the rate decreased to 4,081 riel per US dollar, representing a 0.87% appreciation compared to the same period last year (4.117 riel per US dollar). This exchange rate stability significantly contributed to price stability, purchasing power of riel and people's income, and macroeconomic stability. Such success has been achieved by implementing a prudent monetary policy, where the National Bank of Cambodia intervened in the foreign exchange market by purchasing KHR 573 billion (equivalent to USD 139.1 million). In addition, various policy instruments were employed to absorb the excess riel amounting to KHR 15.2 trillion (equal to USD 3.7 billion) from the economy, thereby maintaining an appropriate level of the money supply. However, the persistently high dollarisation (with the ratio of foreign currency deposits to broad money at 83.4%) remains an obstacle for the National Bank of Cambodia in effectively implementing monetary policy. This challenge, particularly in influencing market interest rates to stimulate domestic consumption and investment, hinders further promotion of economic growth.

With respect to the external sector, the overall balance of payments (BOP) maintained a positive trajectory, with a surplus of 0.7% of gross domestic product (GDP), albeit slightly lower than the previous year's 1.2%. This surplus was underpinned by a 14.5% growth in FDI and a narrower trade deficit of 8.6% of GDP, due to decreased imports and a slight increase in exports. The resulting BOP surplus led to a notable 12.3% surge in international reserves, reaching USD 20 billion. This level is sufficiently high, providing coverage for approximately seven months of prospective imports of goods and services, surpassing the three-month threshold for developing countries.

Along with the economic recovery, the banking system continued to dominate the financial sector, actively supporting key economic sectors despite the sluggish credit growth. Credit growth slowed to 4.8%, marking the lowest growth rate in the last two decades, caused by the weak recovery of some sectors. Among the major sectors, credit to the hotel and restaurant industry experienced a modest 0.6% growth, while wholesale trade saw a 4.8% rise, mortgages increased by 6.4%, real estate activities surged by 16.9%, and construction recorded a growth of 13.9%. In response to this scenario, some prudential measures were relaxed to help banking and financial institutions support major sectors requiring financing for sustenance and expansion of investment. For instance, the suspension of tightened USD reserve requirement rates and other prudential measures provided banks and financial institutions with increased liquidity of around USD 1.2 billion, allowing them to extend credit to priority sectors. In addition, the banking system has actively contributed to advancing women's financial inclusion and promoting sustainable finance as a mean to empower women's engagement in economic activities and foster sustainable economic development.

Regarding interest rates, following a minor uptick influenced by higher interest rates in the international market in 2022, the loan rates in the banking sector experienced a slight decrease in 2023, settling at 13.39% for KHR loans and 11.08% for USD loans compared to 13.51% and 11.24%, respectively, in 2022. Meanwhile, deposit rates in KHR and USD saw marginal increases, reaching 7.7% and 6.47%, compared to 6.88% and 5.36%, respectively, in 2022. On the other hand, the microfinance sector continues to grapple with the impact of escalating international interest rates, primarily due to its reliance on external borrowing. The average loan rates in KHR and USD within the microfinance sector increased to 17.44% and 16.2%, respectively, from 16.8% and 15.1% in 2022, while the deposit rates in KHR and USD increased to 8.39% and 8.25%, respectively, compared to 7.42% and 7.38% in 2022.

Aligned with technological advancement, the modernisation of payment systems in Cambodia, instrumental in the process of digitalisation, has improved efficiency, security, and integration at both regional and global levels. This transformation has supported trade, investment, and tourism. In addition, ease of access to payment services has also promoted financial inclusion and the use of the riel. For instance, the total value of electronic payments has increased by 78%, which is more than seven times the GDP. The value in KHR increased by 3.4 times and in USD by 2.4 times. The payment system's connectivity spans across borders, linking with countries such as Thailand, Malaysia, Laos, and Vietnam, and some international payment services providers, and is in the process of establishing connections with China, India, Japan, Singapore, and other nations in the region.

In 2024, amidst prevailing uncertainties, global economic growth is anticipated to shrink slightly from the preceding year due to the potential prolongation of geopolitical crises and the slow growth of certain advanced economies. However, Cambodia remains optimistic about achieving a growth rate of 6.4%, primarily propelled by the growth of tourism and manufacturing sectors. The tourism sector is expected to recover more promisingly due to the improvement in the regional tourism sector as well as the development and improvement of infrastructure that will support the sector. The manufacturing sector, particularly the manufacturing of non-garment products, is expected to achieve better growth than in 2023, facilitated by the implementation of the new investment law. The garment sector is also expected to see incremental growth. Along with that, the agricultural sector is projected to grow slightly higher than 2023, benefiting from diversified exporting markets within the Regional Comprehensive Economic Partnership (RCEP) and other bilateral free trade agreements. This growth will be further supported by the favourable policies implemented by the Royal Government of Cambodia to boost production and marketing. In conjunction with the agriculture sector, the construction and real estate sectors, impacted by the previous crisis, are forecasted to continue their gradual recovery, supported by the development of public infrastructure and the recovery in domestic demand, focusing on the affordable housing segment. However, demand for luxury construction serving non-residents is expected to remain weak. In 2024, inflation is projected at 2.5%, a moderate increase from 2023, mainly due to expectations of a rise in global crude oil prices following planned supply cuts by oil-exported countries.

Against this backdrop, continued prudent monetary policy will help stabilise the exchange rate, thereby stabilising prices and protecting the purchasing power of the riel. The National Bank of Cambodia will continue to enhance the effectiveness of its monetary policy framework, especially the development of monetary instruments and markets. A policy rate of the central bank would be introduced to guide the market interest rate of riel to a reasonable level while continuing collaborative efforts with all stakeholders in promoting the wider use of riel. Additionally, prioritising financial stability becomes imperative in the face of ongoing global economic uncertainty and slow growth. Vigilance, regular monitoring, and assessment of potential risks, and promoting financial literacy and consumer protection constitute essential components of this strategy. Strengthening financial stability as well as monetary policy, especially promoting the use of the riel, will continue to require contributions and cooperation from stakeholders in various sectors and the public.

Along with the optimistic perspective, Cambodia's economy is also facing several risks, of which on the external front, these risks include: (i) slower-than-expected growth in Cambodia's major trading partners, such as China, the United States, and Europe, potentially impacting investment, exports, and tourism; (ii) slower-than-expected monetary policy normalisation in developed countries, which could exert pressure on external borrowing and interest rates in Cambodia; (iii) escalating tensions and geopolitical fragmentation that may disrupt supply chains and hinder the growth of exports and investment; (iv) the adverse effects of climate change on agriculture growth, particularly the El Niño's impact, which could be more detrimental than in 2023; and (v) the growing threat of cybercrime, which has the potential to erode public trust in digital payment systems and the banking system as a whole. On the other hand, the internal risks include: (i) the rising threat of non-performing loans, which could dampen consumption and investment, and (ii) weak growth in the construction and real estate sectors due to low demand, with potential spillover effects on the banking sector. Apart from these factors, Cambodia also faces major persistent structural issues such as (i) slow progress in economic and export diversifications; (ii) limited capacity, skills, and productivity; (iii) high transportation and electricity costs compared to other countries competing in similar export sectors; (iv) the vulnerability of the agriculture sector to climate change; and (V) high dollarisation.

CONTACT :

Communication Unit of National Bank of Cambodia

Phone Number: (885) 23 990 196

Email: nbccommunication@nbc.gov.kh

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