ក្រសួងសេដ្ឋកិច្ច និង ហិរញ្ញវត្ថុ
Ministry of Economy and Finance
ធានានូវកំណើន និង អភិវឌ្ឍន៍ប្រកបដោយចីរភាព
Ensure Sustainable Growth and Development

CAMBODIA MACROECONOMIC MONOTIROING (CMM) 2017

General Department of Policy (GDP)

Macroeconomic and Fiscal Policy Department (MFPD)

JANUARY 2018

CONTENTS

Executive Summary

Cambodia's economy remains robust and strong, growing at around 7 percent in 2017, supported by continued growth of construction, garments, non-garment manufacturing and tourism. Headline inflation is estimated to maintain a stable rate of 3 percent in 2017, mainly attributed to the modest growth in food prices and the pick-up of oil prices[1]. Core inflation, on the other hand, rose to 2.17 percent, up from 1.60 percent in 2016, partly due to the rebound in oil price.

Industry is estimated to achieve a near two-digit growth of 9.93 percent in 2017, making it the biggest contributor to overall growth. This expansion is supported by the accelerated growth of non-garment manufacturing, including food and beverage, electronic equipment, and spare parts, offsetting softer growth in garment and construction. The growth of service sector is estimated to pick up to 7.1 percent in 2017 mainly attributed to higher-than-expected growth in tourism sector, stronger wholesale and retail activities, stronger transport and communications, moderate-yet-solid growth in real estate and business, and strong growth in other services. Agriculture, after experiencing a low growth of 0.7 percent between 2013 and 2015, started to rebound to 1.4 percent in 2016 and then is estimated to pick up to 1.6 percent in 2017, mainly attributed to favorable weather conditions, increase of fishery production due to higher water levels along the river, and increased investments in aquaculture.

In 2017, estimated fiscal deficit has escalated yet it still remains lower than that stated in the budget law, while the RGC continuously manages to have a better-than budgeted current surplus. The fiscal deficit has widened to 3.7 percent of GDP, lower than the budgeted 5.1 percent of GDP; current surplus is estimated to remain at a favorable level of 3.6 percent of GDP, which is higher than the budgeted 3 percent of GDP. Such better-than-planned fiscal performance is the result of buoyant revenue collection, disciplined expenditure amidst spending pressure, and sound debt management.

As a highly open and small economy, Cambodia shall remain mindful of some external risks even though the external environment, to a certain extent, remains favorable as reflected in a strong FDI inflow and investor confidence in Cambodia's overall economic performance. Those include the still-slow growth of the advanced economies, intensified regional competition including the expected EU-Vietnam Free Trade Agreement, the tightening of monetary and other trade policies, China's continued rebalancing including the risk from the rapid credit growth, and the tide of inward-looking policies, especially from the advanced economies, while the RGC is working to address challenges including: less-than-expected productivity growth, the lack of skilled labor, high electricity price and logistics cost and the high cost of doing business. In the context of the above-mentioned risks and challenges, the RGC has considered various policy actions to strengthen Cambodia's competitiveness and achieve the targeted economic growth.

[1] Particularly meat, fish and vegetable and sharp rise in transportation prices triggered by the rebound of international oil price.

I. Cambodia's Macroeconomic Performance

A. *External Outlook, Real Sector and Inflation*

1. External Economic Outlook

Global growth is projected to rise from 3.2 percent in 2016 to 3.6 percent in 2017 and 3.7 percent in 2018, with notable pickups in investment, trade, and industrial production, combined with strengthening business and consumer confidence. In advanced economies, the notable growth pickup in 2017 is broad based, with stronger activity in the United States and Canada, the euro area, and Japan.

Prospects for medium-term growth are more subdued, however, as demographic factors, and weak productivity can potentially undermine potential growth. In emerging market and developing economies, growth is projected to rise over this year and the next, supported by improved external factors—a benign global financial environment and a recovery in advanced economies. Growth in China and other parts of emerging Asia remains strong, and the still-difficult conditions faced by several commodity exporters show some signs of improvement.

Financial market sentiment has generally been strong, with continued gains in equity markets in both advanced and emerging market economies. Despite expectations of more robust global demand going forward, commodity prices have remained low, with oil prices reflecting stronger-than-anticipated supply. Global trade growth picked up in late 2016 and early 2017, reflecting a recovery in global demand and especially capital spending as a gradual recovery in investment by commodity exporters have boosted import growth. Consequently, global trade growth is projected to rebound to about 4.2 percent in 2017 and 4.0 percent in 2018. Still, it is subject to protectionism and cross-border investment flows.

Table 1: Projected Growth of Major Trading Partners

Growth (percent)	2016	2017e	2018p
World Output	3.2	3.6	3.7
Advanced Economies	1.7	2.2	2.0
USA	1.5	2.2	2.3
Euro Area	1.8	2.1	1.9
United Kingdom	1.8	1.7	1.5
Japan	1.0	1.5	0.7
Emerging Market and Developing Economies	4.3	4.6	4.9
ASEAN-5	4.9	5.2	5.2
China	6.7	6.8	6.5
World Trade Volume (Goods and Services)	2.4	4.2	4.0
Commodity Prices			
Oil	-15.7	17.4	-0.2
Non-oil commodities	-1.8	7.1	0.5

Source: WEO, October 2017

2. Cambodia's Economic Growth and Inflation

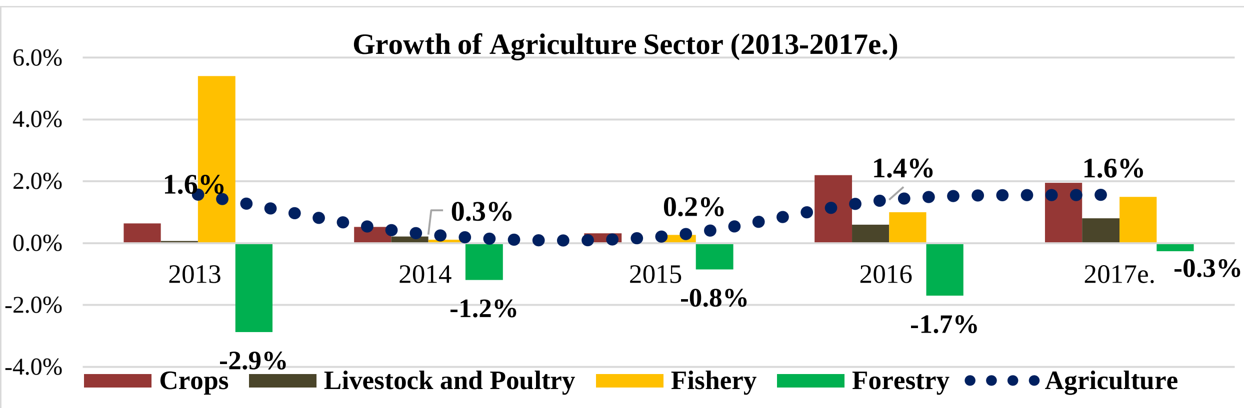
Cambodia's economy continues its growth at around 7 percent in 2017. It is reflected by strong export of non-garment industry, solid construction activities, tourism, trade, transport and communication and other services while garment and real estate continues a softer growth. Headline inflation remains stable at the rate of 3 percent in 2017, mainly attributed to the modest growth of food prices, particularly meat, fish and vegetable, although there was a sharp rise in transportation prices that was triggered by the rebound of international oil price. Core inflation, on the other hand, is estimated to rise to 2.17 percent, up from 1.60 percent in 2016, partly due to the rebound in oil price. Overall, Cambodia has achieved its forecasted growth rate in 2017 with the continued expansion of its economic base. Although the external environment, to a certain extent, remains favorable for Cambodia, it should take note of some external risks and continue to address challenges as to further promote growth and move in the right direction.

B. Real Sector

1. Agriculture

Agriculture is estimated to grow at 1.6 percent in 2017, up from 1.43 percent in 2016. This sector is supported by moderating-yet-strong growth of crops due to continuous increase of paddy rice production and rubber and pick-up growth of fishery. Livestock and poultry continue to be stagnant, affected by the drop of price of pigs[2] starting since beginning of the year.

Figure 1: Growth of Agriculture



Source: National Institute of Statistics (NIS), Ministry of Economy and Finance (2017e)

The growth of crops is estimated to be 2.0 percent in 2017, softer than that of 2016. Continued growth of paddy rice production and rubber has contributed to its expansion while the estimated drop in the production of subsidiary and industrial crops caused by the sharp drop of cassava's price have forced farmers to reduce cassava cultivation. With better rainfalls covering almost nationwide and improved irrigation schemes in some potential provinces such as Pursat, Battambang and Banteay Meanchey, despite the constraint of limited expansion of cultivated area, slower growth of productivity and production damage in some provinces caused by flood and draught, paddy rice production still managed to grow to 10.13 million tons in 2017, up from 9.95 million tons in 2016. Contributing to the growth of crops-sub sector, rubber production was estimated to be promising, roughly increasing from 145,000 tons in 2016 to 181,000 tons in 2017; thanks to the sharp increase of rubber's price—almost 50 percent as of mid-2017 compared

[2] *Based on consultations, team has concluded there is a pig dumping from Vietnam into Cambodia in 2017.*

to the corresponding period in 2016, which encouraged family-based farmers and commercial rubber plantation companies to increase harvesting for export.

Figure 2: Paddy Rice Production

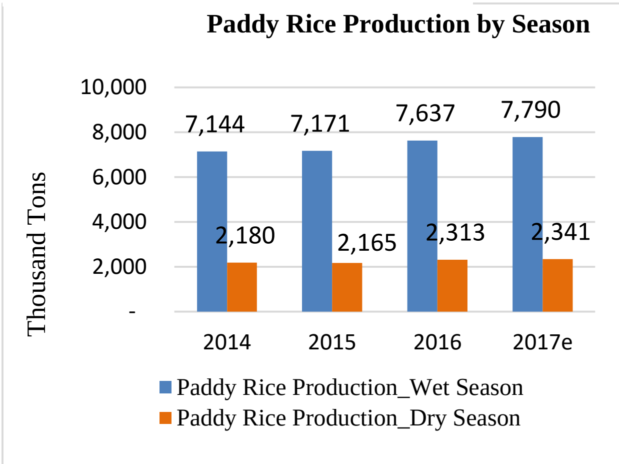
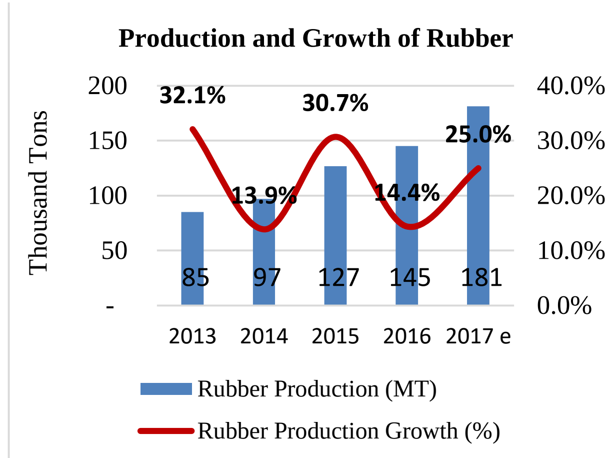


Figure 3: Growth of Rubber Production



Source: MAFF, MEF (2017e)

Fishery is estimated to grow at 1.5 percent in 2017, up from 1.0 percent in 2016, mainly driven by strong growth of inland fishery production due to the increase in water levels of around 1.5 meters compared to 2016 in Mekong River and Tunle Sap River, and continuous growth of investments in aquaculture. Based on consultation with the fishery administration at central and sub-national level, fishery production is estimated to increase from 6.8 percent in 2016 to 8.3 percent in 2017, in which the production of inland fishery and aquaculture grew around 7.0 percent and 18.0 percent, respectively.

Figure 4: Fishery Production

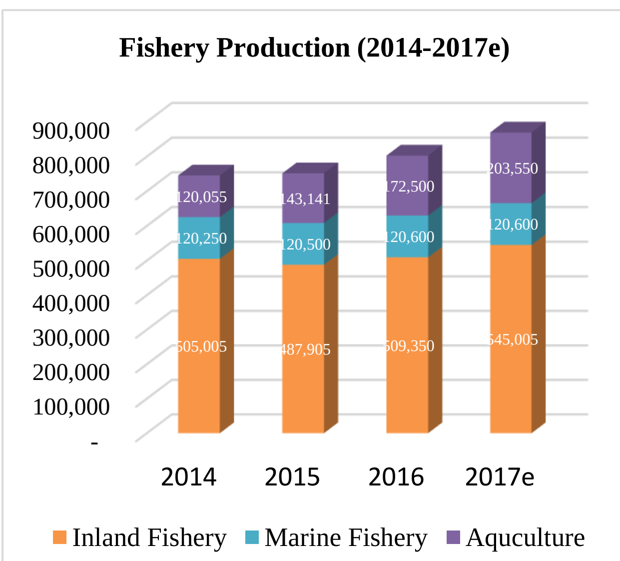
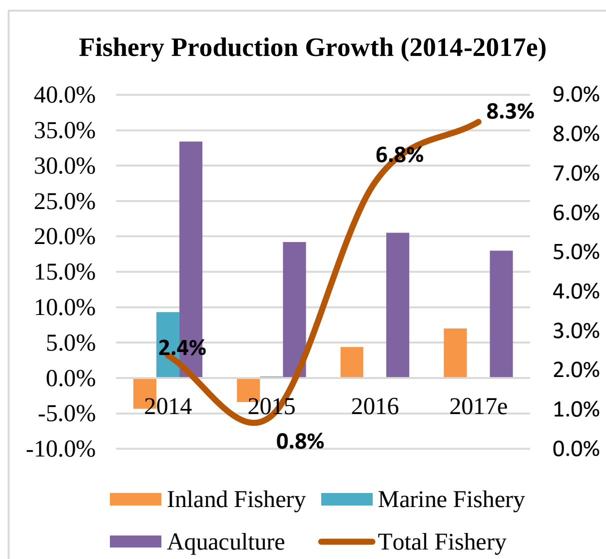


Figure 5: Fishery Production Growth



Source: MAFF, MEF (2017e)

Livestock and poultry sub-sector is estimated to grow 0.8 percent in 2017, up from 0.6 percent in 2016. In 2017, pig production is estimated to decline by -2.0 percent mainly caused by effect of declining prices, forcing many farmers to stop raising pigs or cutting production. However, the declining growth of pig production is offset by robust growth of poultry and cow production. Poultry production is estimated to have robust growth due to high demand for naturally farmed chicken and strong price, encouraging farmers to increase farming. Akin to the trend of poultry, cow production continues robust growth, resulting from the emergence of commercial cow farming.

Figure 6: Growth of Animal Production

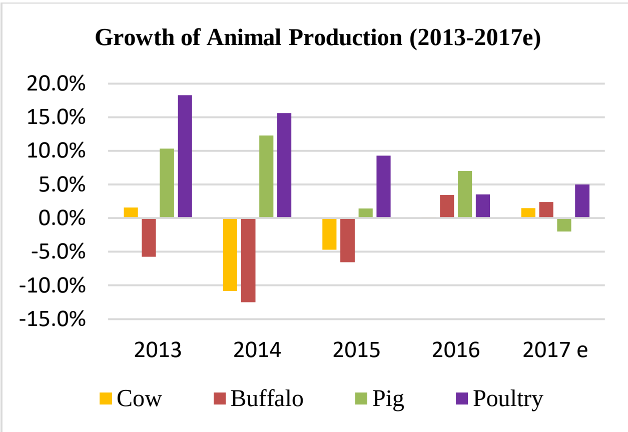
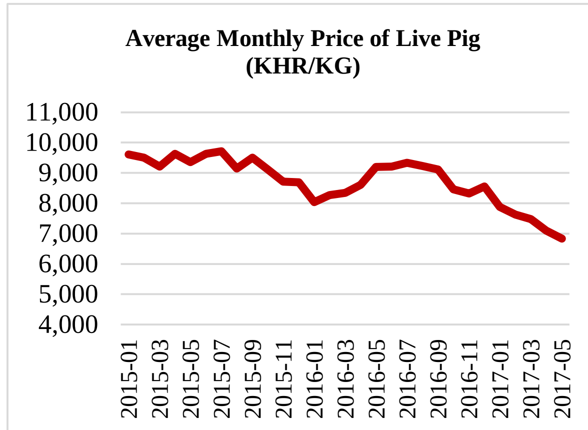


Figure 7: Monthly Price of Live Pig

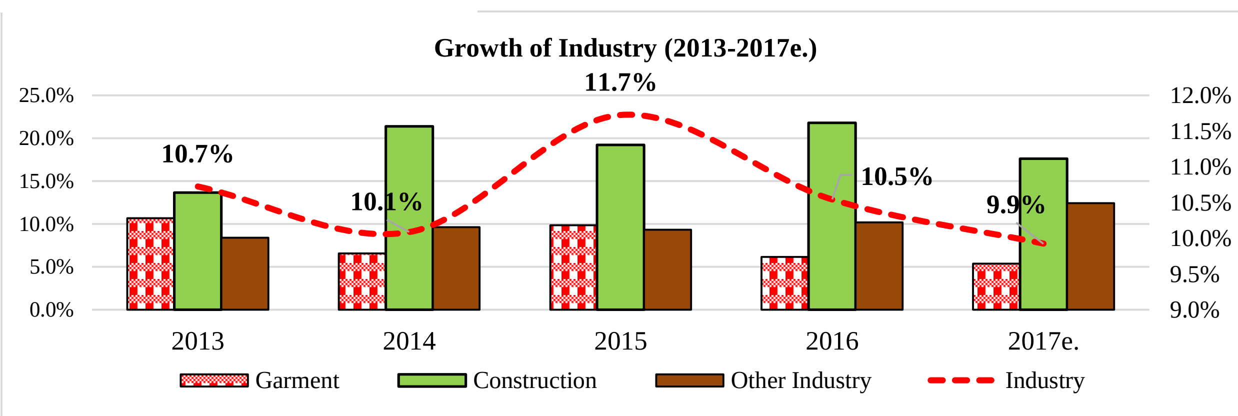


Source: MAFF, MEF (2017e)

2. Industry

Industry maintains a firm performance of around two-digit growth 9.93 percent in 2017. It is mainly driven by the accelerated growth of non-garment sector including food and beverage, electronic equipment, and spare parts etc, as well as a robust, although slightly decelerated growth of construction. This deceleration is due to softer growth of high-end housing market development, partly offset by a remarkable growth of low and medium-end housing which many people could afford to buy. Such a performance of other industry and the firm construction activities have partly offset the softer growth of garment in 2017.

Figure 8: Growth of Industry Sector



Source: NIS, MEF (2017e)

2.1 Garment

Garment production continues with a softer growth of 5.4 percent in 2017, down from 6.2 percent in 2016. The slower growth of garment was reflected by the softer growth of garment export value—from 8.4 percent in the first 10 months of 2016 to 7.9 percent in the same period of 2017 while the export volume (clothing's share 87 percent of total export value) has declined from 11.6 percent to 8.5 percent in the same corresponding period. Noticeably, the growth of garment export value to Europe (including UK) and Japan experienced a declining growth to 10.2 percent and 5.23 percent in 10 months of 2017, from 15.6 percent and 29.53 percent respectively in the corresponding period of 2016.

In 2018, garment sector is also projected to continue slower growth to around 5.0 percent. The minimum wage will increase to US $170 in 2018, similar to Vietnam's but well above Bangladesh and Laos', which has put pressure on Cambodia's garment export and its competitiveness, particularly since about 70 percent of the exporting-garment factories are still engaging with CMT deals, making the production cost sensitive to the price change. In other words, when price changes, through either increasing cost or decline of agreed prices, their profit margin will be inevitably impacted. In addition, the approach to risk diversification by the garment industry has also affected Cambodia's export performance, particularly as 2018 is the election year. Based on experience, buyers tend to be especially cautious before, during, and after the election; therefore, it might result in reduced order from parent companies. Any policy changes associated with the minimum wage hike could erode business confidence. It is therefore imperative to improve the stability and predictability of this sector.

Figure 9: Growth of Garment Export Value, 10M

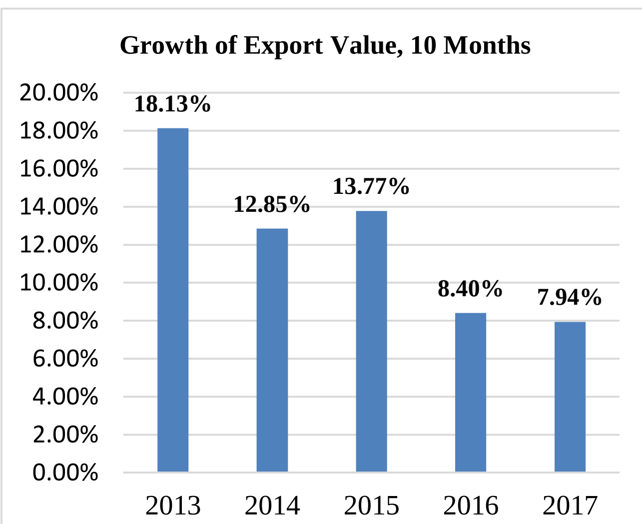
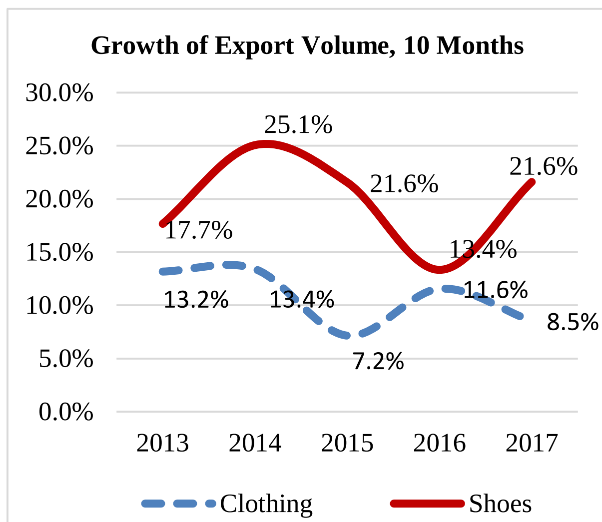


Figure 10: Growth of Garment Export Volume, 10M



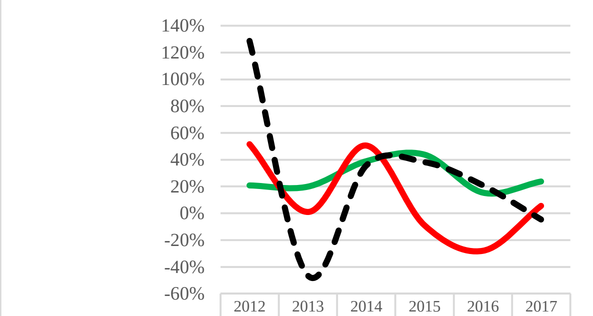
Source: General Department of Customs and Excise (GDCE)_

2.2. Construction

In 2017, construction activities continued strong growth of 17.6 percent despite being softer than that of 2016, largely supported by the housing market, especially the low-rise landed housing market and development projects rather than the high-end segments. For the first 10-month, the number of project approval has remained buoyant with its 6.2 billion project value compared to 4.9 billion of the 10-Month

2016[3]. The import quantity of construction equipment and cement have also witnessed a significant surge from 16 percent to 24 percent, and from -28 percent to 6 percent, respectively, supporting the robust growth of construction activities, both in and around Phnom Penh and other commercial hubs. Yet, steel import has dropped as some construction projects, which have begun several years ago, have reached a middle-phase or near completion stage. The 9-month of credit inflow to construction, on the other hand, ups by around 8 percentage points (9-month inflow 2017 over 2016 stock), signifying a continued confidence in the sector.

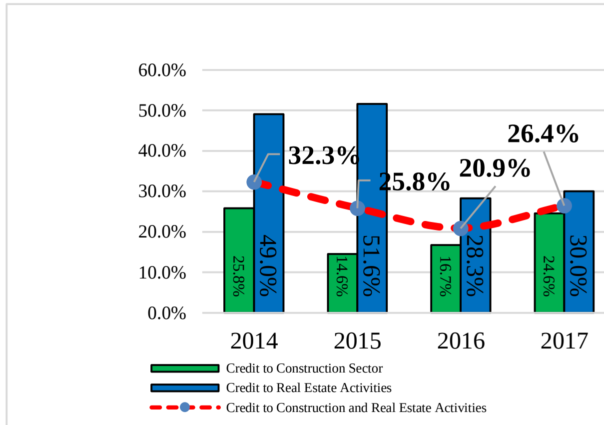
Figure 11: Growth of Import Quantity as of 10M



	2012	2013	2014	2015	2016	2017
Construction Equipment	21%	20%	39%	44%	16%	24%
Cement	52%	1%	51%	-9%	-28%	6%
Steel	129%	-46%	36%	38%	21%	-5%

Source: GDCE

Figure 12: Growth of Credit as of Q3



Source: National Bank of Cambodia (NBC)

The construction sub-sector is projected to remain solid yet further adjusted to softer growth of 16.7 percent in 2018. The construction and real estate market now is also visibly shifting toward mid-range affordable segments to accommodate more local buyers, while various types of commercial facilities and buildings continue to encourage a broad-based surge of construction activities, strengthening the health of the market. Some investors might be cautious and have a 'wait-and-see' attitude with their development plans in the election year, but the strong performance of the construction sector is expected to continue in the medium term, thanks to Cambodia's firm economic performance, the implementation of Affordable Housing Policy and the government's commitment to infrastructure development.

2.3. Other Industry

The performance of other industrial production in 2017 remains vibrant with a two-digit growth of 12.45 percent, higher than 2016's rate of 11.56 percent. The first eleven months of total value export of other manufacturing, which exclude garment and agriculture, has grown from 8.9 percent to 19.2 percent[4]. In addition, the beverage sector has progressively grown, resulting from the increasing demand of domestic consumption and increased domestic production. This trend has reflected in the reduction of the import quantity of beer, which declines from -29 percent to -23 percent and alcohol from 3 percent to -5 percent. Up to November 2017, 64 new factories were established including: 18 chemical rubber and plastic industry factories, 17 metal processing industry factories, 9 food beverage and tobacco factories (i.e. fruit juice, beverage, energy drink, beer and snack), and the rest are for other manufacturing factories. Moreover, 221

[3] Ministry of Land Management, Urban Planning and Construction

[4] According to the General Department of Custom and Excise (GDCE).

SMEs were newly set up to help boost domestic production to timely respond to the increasing domestic demand.

Energy production has also increased, reflecting in the expansion of electricity supply by local hydropower dams. This contributes to reducing the electricity supply imported from neighboring countries. Thus, it makes Cambodia's electricity more customer-oriented. As for electronics and auto parts sectors, Japanese investors have significantly contributed to boosting the growth. Japanese investors continue to embark on their new lines and full operation capacity. Moreover, the increasing price of international rubber supply has also contributed to revitalizing the rubber production in Cambodia.

(Put growth rate for each year in the graph below)

Figure 13: Number of Factories (non-garment)

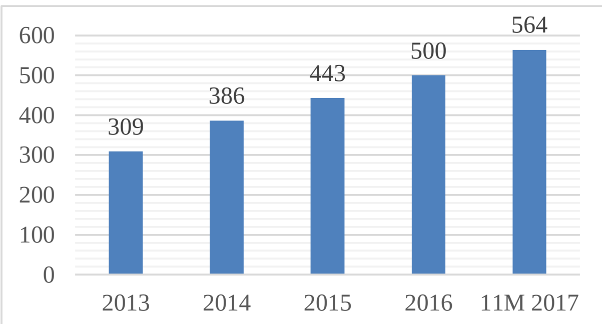
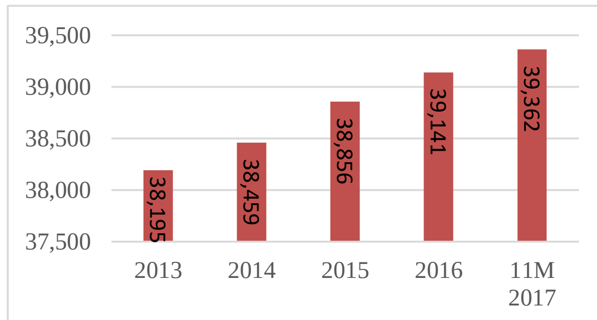


Figure 14: Number of SMEs



Source: Ministry of Industry and Handicraft

In 2018, growth of other industrial production is anticipated to moderate slightly to 11.92 percent but remains highly robust. The upcoming national election in 2018 is viewed as one of the reasons for dragging the growth of this sub-sector as investors are in wait-and-see mode. The production of spare parts and other electronic products are expected to face moderate growth without noticeable expansion. Additionally, the energy sector is also estimated to continue contributing to the growth of the other industry due to the domestic energy consumption both at the household and commercial levels. However, the food and beverage sector (F&B) is not likely to be affected because this sub-sector is highly inelastic[5].

3. Service

Growth in service sector is estimated to pick up to 7.1 percent in 2017, from a moderate-yet-strong growth of 6.8 percent in 2016. In 2017, the growth in service sector is mainly attributed to higher-than-expected growth in tourism sector, stronger wholesale and retail activities, stronger transport and communications, moderate-yet-solid growth of real estate and business, and strong growth of other services. In 2018, the sector is forecast to moderate a bit to 7.0 percent, with stronger performance of whole and retail trade and other services partially offsetting the slightly moderate growth of tourism, transport and communications, and real estate and business sectors.

[5] F&B continues to be consumed on a daily basis regardless of political situations

Table 2: Growth of Service Sector

Sector	2012	2013	2014	2015	2016	2017e
Service	**8.1**	**8.7**	**8.7**	**7.1**	**6.8**	**7.1**
Hotel and Restaurant	*12.5*	*13.8*	*6.1*	*2.4*	*2.6*	*4.8*
Trade	*6.2*	*8.0*	*8.7*	*7.7*	*6.4*	*6.9*
Transport & Communications	*6.1*	*8.9*	*7.7*	*8.0*	*7.7*	*7.9*
Real Estate & Business	*12.9*	*8.0*	*13.8*	*11.9*	*9.9*	*9.2*
Other Services	*6.6*	*7.3*	*8.0*	*5.6*	*6.6*	*6.6*

Source: NIS, MEF (2017e)

3.1. Tourism

Hotel and restaurant sector is estimated to grow by 4.8 percent in 2017, up from 2.6 percent in 2016. The sharp upturn in the sector is mainly attributed to faster-than-expected growth of international arrivals and the gradual return of high spending tourists as reflected in the increasing share of arrivals by air. Cambodia's international arrivals hit the highest record after 3 successive year of slowdown, with the growth rate of 10 percent for the first 10 months of 2017 compared to the same period in 2016 while international flight passengers have reached 61 percent of total arrivals. China has become the first leading market for the first time followed by Vietnam, Korea, Lao and Thailand. On the top of rapid growth in terms of number, the return of arrivals from countries which are considered as high spending tourists such as Russia and Japan has also put the Cambodian tourism sector in a better position. Better global economic environment is one of the main factors for the sharp rise in the number of arrivals. In addition, favorable domestic factors including increase in connectivity, international promotion and recognition, policy implementation from the authority (China Ready) also play an important role in the upsurge.

In 2018, the sector is forecast to grow marginally slower at 4.5 percent. It is largely due to the expected impact of national election, which more or less affect the sentiment of investors and tourist arrivals. However, the sector is likely to move up with the growth rate of 4.7 percent in 2019.

Table 3: Growth of Tourist Arrivals in 2017

Growth (%)	2013	2014	2015	2016	11M-2017	11M-2018
Total	**17.5%**	**7.0%**	**6.1%**	**5.0%**	**4.8%**	**11.4%**
China	38.7%	21.0%	24.0%	19.5%	16.9%	46.3%
Vietnam	11.9%	6.1%	9.1%	-2.8%	-2.3%	-14.3%
Lao	63.2%	1.4%	-3.6%	-8.9%	-10.1%	37.6%
Thailand	-6.9%	25.9%	25.2%	13.8%	13.4%	-3.9%
Korea	5.7%	-2.4%	-6.9%	-9.6%	-10.5%	-2.3%
USA	6.9%	3.5%	13.7%	9.7%	9.8%	7.8%
Japan	15.4%	4.3%	-10.4%	-0.9%	-0.7%	6.0%

Source: Ministry of Tourism

3.2. Wholesale and Retail Sector

Wholesale and retail trade is estimated to bounce back to a growth of 6.9 percent in 2017, from a slightly slower growth of 6.4 percent in 2016. That is likely resulted from the growth in income of the people, changing lifestyles of Cambodian people especially youth, fiscal expansion[6] and as new plans by various companies to increase domestic production, such as food and beverages, to help response to increase in domestic consumption**.** This higher growth is reflected by an increase in bank and MFI's credit to wholesale and retail trade activities by 10.6 percent (9-month flow 2017 over 2016 stock) compared with 7.2 percent (9-month flow 2016 over 2015 stock), a stronger growth of total import value of 10.6 percent (10 months 2017, YoY) compared with 5.6 percent (10 months 2016, YoY) and a stronger growth of total import value excluding import of garment materials of 10.5 percent (10 months 2017, YoY) compared with 5.3 percent (10 months 2016, YoY), as a result of strong growth in import of soft drinks, cooking oil, buses, tractors, generators, fertilizers, …, etc., though the value of production of for-domestic-consumption industry has slowed down to only 15 percent (10 months 2017, YoY) compared with 63 percent (10 months 2016, YoY).

In 2018, the sector is forecasted to grow even faster at 7.17 percent. In particular, it is expected that the increasing minimum wage of government officials and factory workers, more wholesale and retail stores to be operated such as AEON 2 and Makro amongst others, together with expansionary fiscal policy during the election year, assuming no major disruption before, during, and after the election, will help to further improve the sector in 2018.

Figure 15: Growth of Bank & MFI Credit, Q3

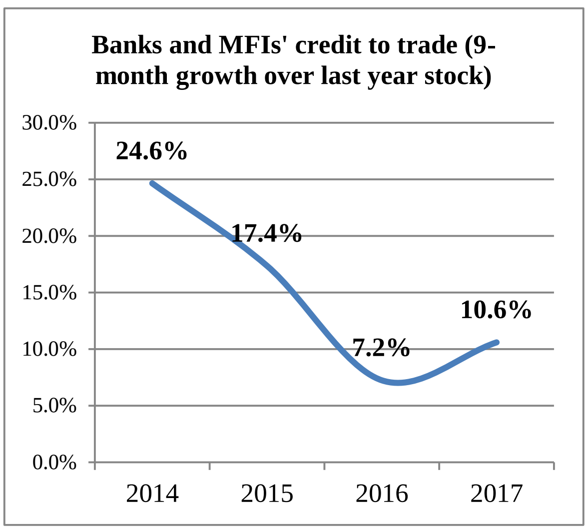
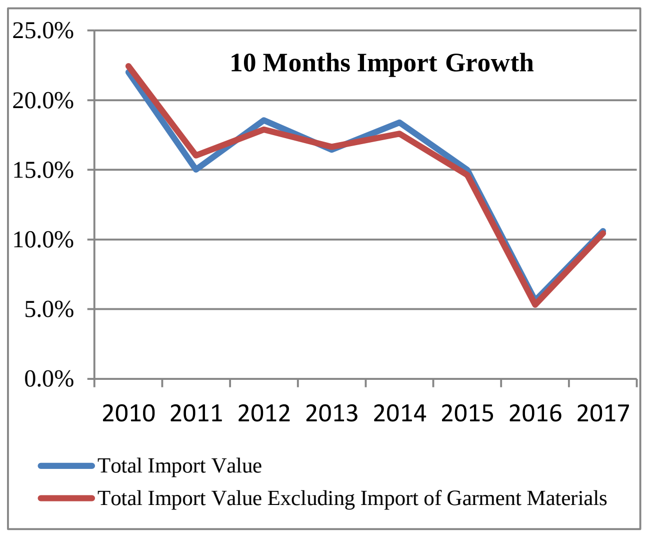


Figure 16: Growth of Import, 10 Months



Source: NBC

3.3. Transports and Telecommunication

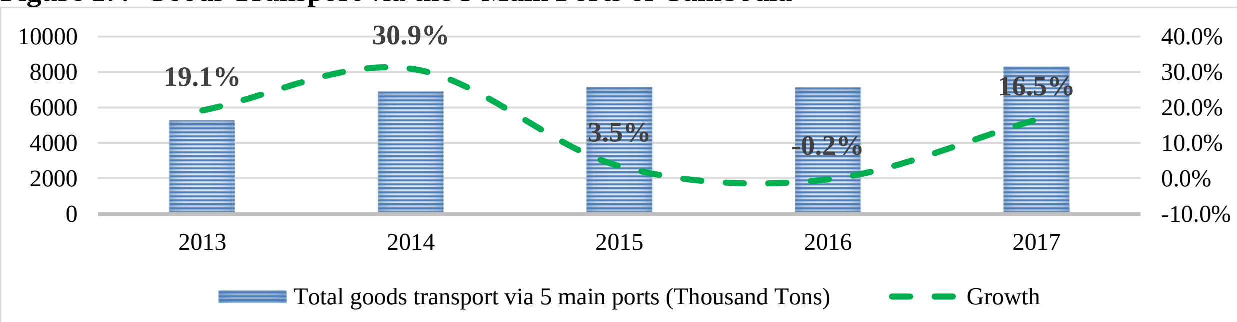
Transportation and communication sector performs better than expected in 2017 with the growth rate 7.9 percent compared to 7.7 percent in 2016. Growth remains robust for the transportation, supported mainly by trade activities and tourist arrival in 2017. According to the first 10-months data, the goods transported via the 5 main ports increased with two-digit growth rate. The expansion of direct flights between Cambodia and China has contributed to the arrival of international passengers, increasing about 25 percent from the previous year. Moreover, domestic

[6] Government has continued increased its consumption and spending in infrastructure development over the last several years.

flights have also recovered compared to last year, from -6 percent to 35 percent. In terms of petroleum import, it has indicated a substantial growth in volume, especially for aviation fuel. It has risen by about 56 percent while the gasoline import has increased by approximately 13 percent in the first ten-months of 2017. On the other hand, the postages activity has slightly declined compared to last year. The domestic postage has slower growth to about 16 percent in 2017 compared to 22 percent in 2016 while the international postage improved slightly from -1 percent to 3 percent in the same period.

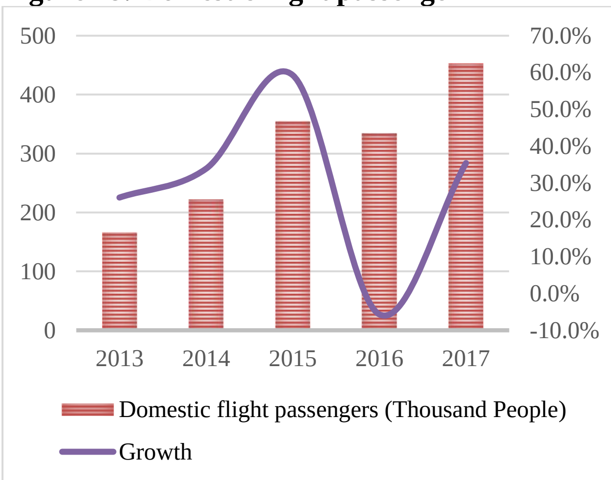
The sector is expected to face a slowdown in growth rate around 7.3 percent in 2018 and to rebound back in the medium term. As a supporting industry, transport and communication will be likely impacted by the slower growth of other sectors and as a result of the national election in 2018. Having said that, the economy is expected to pick up after the election.

Figure 17: Goods Transport via the 5 Main Ports of Cambodia



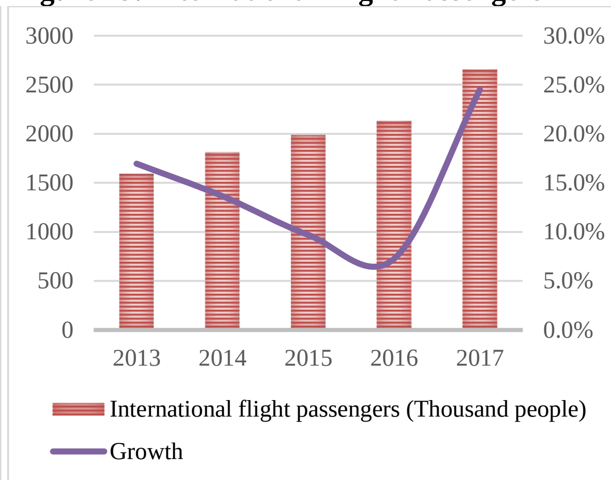
Source: ECOSOCC

Figure 18: Domestic flight passenger



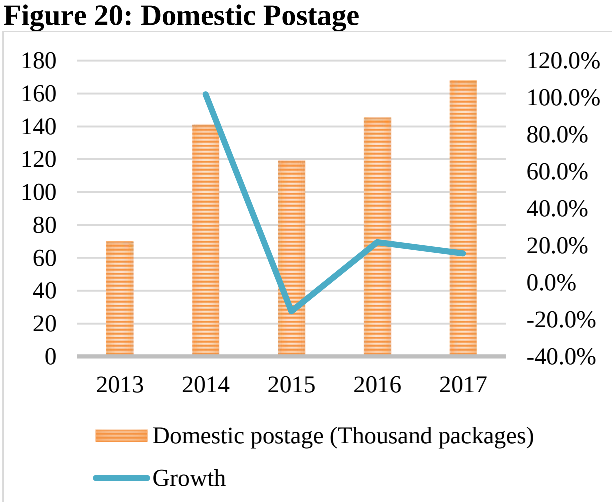
Source: ECOSOCC

Figure 19: International Flight Passengers



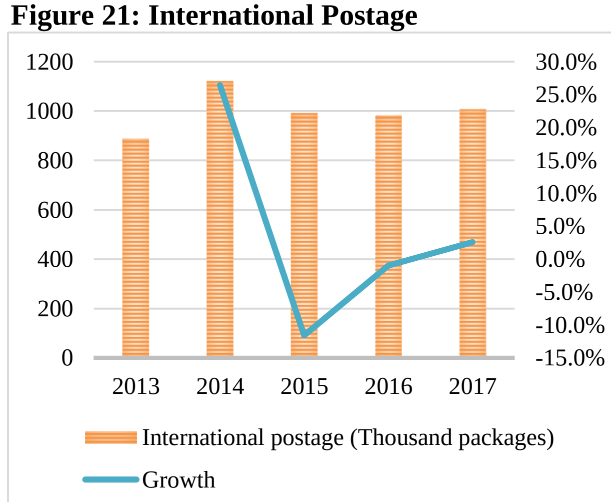
Source: Ministry of Tourism

Figure 20: Domestic Postage



Source: ECOSOCC

Figure 21: International Postage



Source: ECOSOCC

The growth momentum remains strong for the communication. Voice calls have been replaced by the data usage. The incoming and outgoing calls have been decreasing at a slower rate compared to the previous two years while this has been replaced by the substantial growth of the internet usage. The number of the mobile internet subscriber has risen sharply by about 32 percent in 2017.

3.4. Real Estate and Business

Real estate sector is estimated to undergo a moderate growth of 9.2 percent in 2017, from a moderate-yet-strong growth of 9.9 percent in 2016. That is likely to be a result of the wait-and-see strategy given the uncertain investment conditions in the upcoming election year. This moderate growth is reflected by marginally lower quoting prices of condominium units of about 1.0 percent across all grades compared to last year, while average rents of office spaces witnessed a marginal decrease of 0.5 percent with average quoting rents for Grade B offices fell by 1.4 percent, primarily as the result of some offices buildings reducing their rents to compete for occupancy with newly completed Grade-C buildings. Nevertheless, the growth is estimated to remain strong as investors generally feel less concerned and less cautious compared to past election periods, combined with a relatively strong growth of bank and MFI's credit to real estate activities of 30.0 percent (9-month flow 2017 over 2016 stock) compared with 28.3 percent (9-month flow 2016 over 2015 stock), the completion of many commercial facilities including the Exchange Square and Parkson, the launch of some affordable projects, and expansion plans of some developers, such as Piphub Thmey to supply 10,000 to 15,000 houses per year.

In 2018, the sector is forecast to face a slightly softer growth at 8.4 percent. This is mainly due to the wait-and-see attitude during the general election year but is partly offset by the increasing minimum wage of government officials and factory workers, affordable housing project being underway and finished, more wholesale and retail stores to be operated such as AEON 2 and Makro, together with development plans by various developers such as Piphub Thmey.

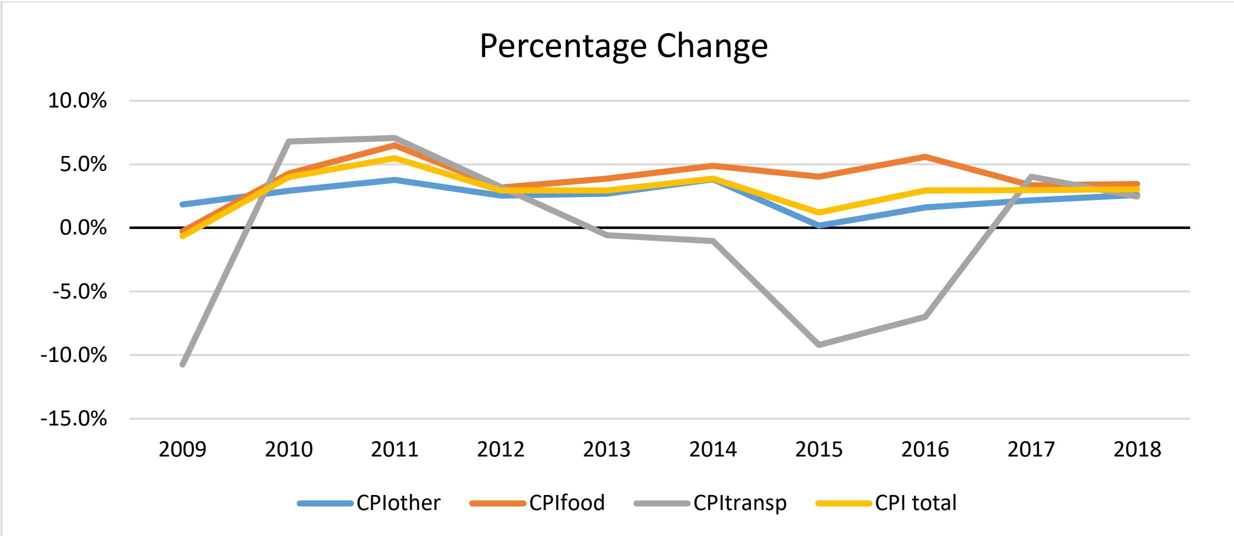
4. Inflation

Headline inflation is estimated to maintain stable at the rate of 3 percent in 2017, the same rate as last year. The stable inflation rate was mainly attributed to the modest growth of food prices, particularly meat, fish and vegetable, although there was a sharp rise in transportation prices triggered by the rebound of international oil price. The slower growth of food price is partly explained by the effect of imported inflation, especially the softer rise of food price in Vietnam. Core inflation[7], on the other hand, increased sharply to 2.17 percent, up from 1.60 percent in 2016, partly due to rebound in oil price. Core inflation normally has close correlation with the movement of food and oil prices, suggesting the importance of oil and food prices influencing on other goods and service in the economy.

In 2018, headline inflation is forecasted to fluctuate around 3 percent mainly due to the expected modest growth of food inflation and gradual increase of transportation inflation while core inflation is likely to rise by around 2 percent, in line with the movement of food and transportation prices. Furthermore, inflation expectations that might have resulted from the continuous increase in wage was also taken into account. The expected modest growth in food price is due to decision of the government in reducing tax duty for live animal (from 15 percent to 7 percent) and meat (from 35 percent to 15 percent) to be implemented from January 2018 and other planned measures aiming at stabilizing food prices in the economy.

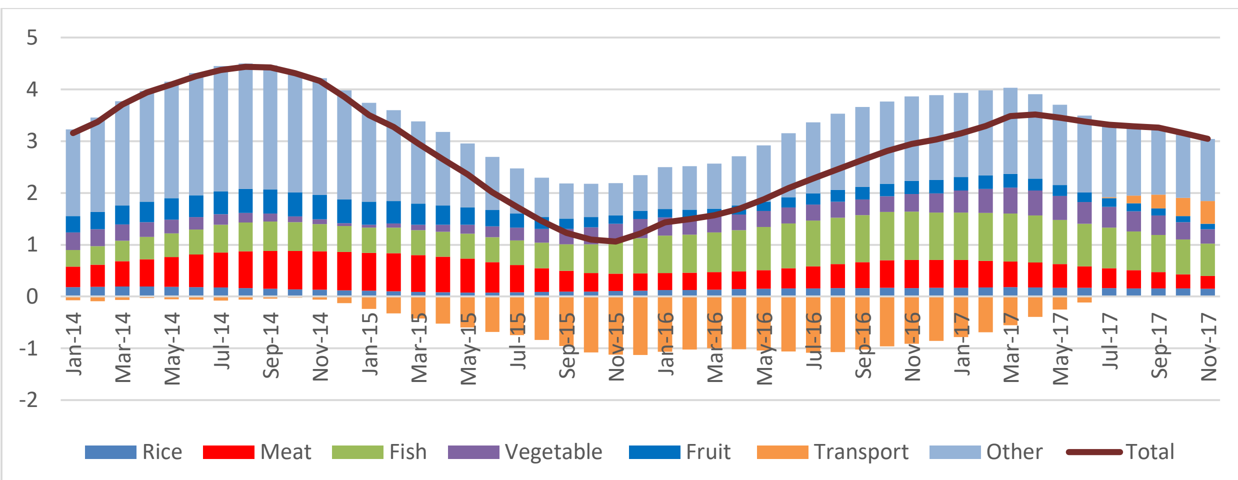
Figure 22: CPI inflation, year average, 2009-2018p

[7] Exclude food and transportation inflation.



Source: NIS, 2009-2016, MEF staff's estimation and forecast 2017-2021

Figure 23: Contribution to yearly average change of inflation



Source: NIS

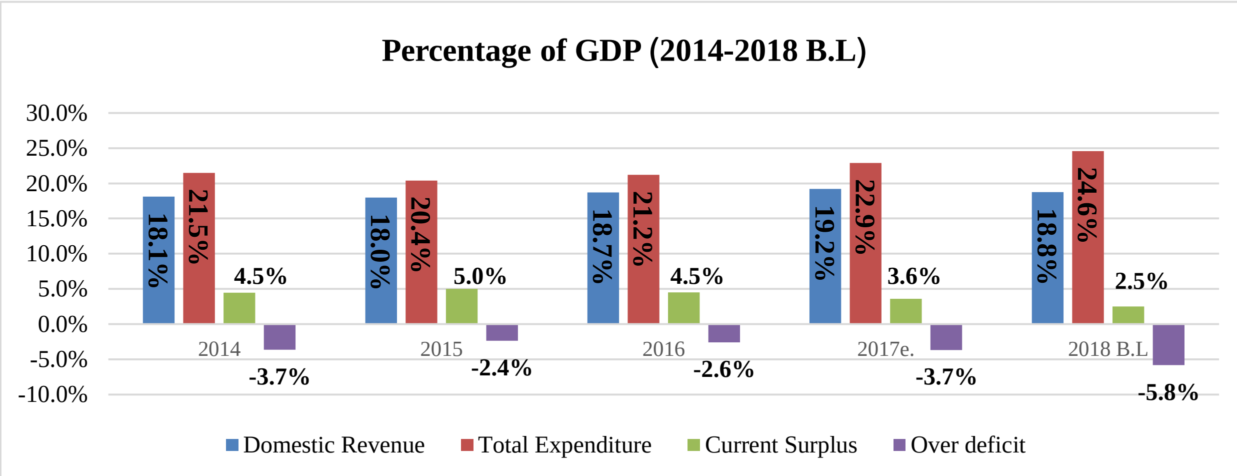
C. Fiscal Sector

1. Fiscal Performance 2017-2018

In 2017, estimated fiscal deficit has escalated, yet it is lower than that stated in the budget law, while the RGC continues to have a better-than budgeted current surplus. The fiscal deficit is to widen to 3.7 percent of GDP, lower than the budgeted 5.1 percent of GDP**;** current surplus is estimated to remain at a favorable level of 3.6 percent of GDP, which is higher than the budgeted 3 percent of GDP. Such better-than-planned fiscal performance is the result of buoyant revenue collection, disciplined expenditure amidst spending pressure, and sound debt management.

In 2018, RGC continues its expansionary expenditure policy. The total expenditure is planned at 24.6 percent of GDP and domestic revenue collection makes up 18.8 percent of GDP, driving the budgeted overall deficit to reach 5.8 percent of GDP.

Figure 24: Fiscal Position Overview as Percent of GDP (2014-2018B.L)



Source: Macroeconomic Framework, October 2017

2. Revenue Collection Performance 2017-2018 and 2018 Budget Law

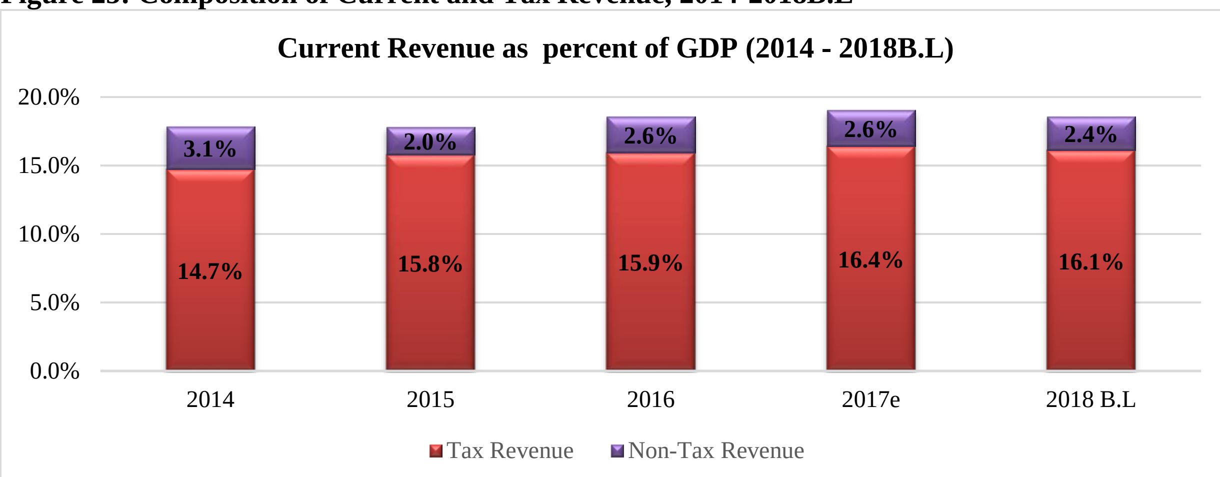
Owing to RGC's Revenue Mobilization Strategy (RMS) 2014-2018, the revenue collection remains buoyant in 2017, despite having a decelerated growth relative to last year's. The total domestic revenue is estimated to grow at a rate of 13 percent in 2017, scaling up to 19.2 percent of GDP, on top of the astounding growth rate of 15.2 percent in 2016. In 2017, the performance of current revenue is expected to grow at a rate of 12.9 percent over a 15.4 percent in growth rate in 2016. Such slower growth performance is indicative of the maturation of revenue cycle within the implementation of RMS timeframe. Meanwhile, current revenue collection is estimated to rise to 19 percent of GDP in 2017, up from 18.6 percent of GDP in 2016, an increase of 0.46 percentage point. In addition, when compared to the budget in 2017, current revenue collection is estimated to exceed the target by 0.63 percentage point of GDP.

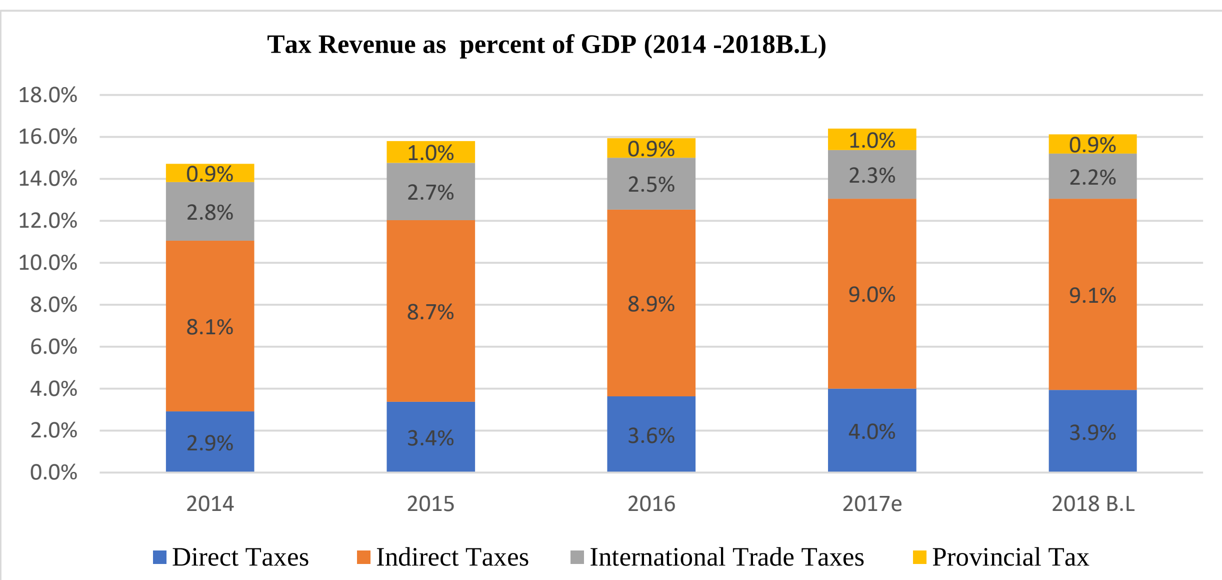
The momentum of tax revenue collection continues to be strong, driven by strong economic growth and sound business environment. Compared to a growth rate of 11.7 percentage in 2016, amounting to 15.9 percent of GDP, tax revenue collection is estimated to present a stronger growth rate of 13.3 percent in 2017, rising to an estimated 16.4 percent of GDP. Such impressive performance of 0.5 percentage point increase relative to GDP is attributable largely to direct and indirect taxes. In 2017, direct tax—taxes on income and property taxes—has increasingly become sizable, representing an estimated 4 percent of GDP up from 3.6 percent of GDP in 2016; thereby reflecting the growth of business activities and income among both firms and wage-earners. Indirect taxes—VAT and excise taxes—exhibits a slightly decelerated growth rate of 11.9 percent in 2017, achieving an estimated 9 percent of GDP, an uptick from 8.9 percent of GDP in 2016; thereby indicating favorably maintained patterns of consumption and importation of goods. In addition, to offset the revenue loss from the exemption of the registration tax among relatives in 2016, increasing collection effort coupled with better management have driven the performance of provincial tax collection, growing at a rate of 22.6 percent and proportional to 1 percent of GDP in 2017, a slight increase from 0.9 percent of GDP in 2016.

However, revenue from international trade tax has continued to grow at a much slower pace than GDP's despite having a slight pick-up in growth in 2017. Commitments to further economic integration initiatives, including regional economic blocs, and deeper integration in Free Trade Area (FTA) have gradually downsized revenue from international trade tax growing at a single digit of 3.2 percent in 2017, against 0.1 percent in 2016, justified largely by the rebound of global international trade. In proportion to GDP, revenue from international trade tax, however, has gradually become less significant, constituting merely an estimated 2.3 percent of GDP in 2017, down from 2.5 percent of GDP in 2016.

As for the non-tax revenue, continued improvement in management—recording and monitoring—has helped maintain the collection momentum. In 2017, non-tax revenue is estimated to register a growth rate of 10.4 percent, on top of the striking growth rate of 44.4 percent in 2016. This is due to the fact that in 2016 there was a reclassification of other taxes (including revenue from casino and export fee) into non-tax revenue, making the level of the latter inflated. Proportional to GDP, non-tax revenue has stayed at a level of 2.6 percent in 2016 and 2017.

Figure 25: Composition of Current and Tax Revenue, 2014-2018B.L





Source: Macroeconomic Framework, Oct 2017

Since 2018 is the last year of RMS 2014-2018 implementation, it is expected to bring about favorable revenue collection. Current revenue collection in 2018 is budgeted to exceed last year's budget, with an approximately 11.8 percent growth, driven largely by expectations that direct and indirect taxes continue to be sound, as the business environment and consumption momentum remains healthy. In term of GDP, current revenue is budgeted to stand at 18.5 percent, an uptick from budgeted 18.4 percent of GDP in 2017.

2.1. Expenditure Performance 2017-2018 and the 2018 Budget Law

In 2017, RGC continues to expand expenditure to maintain a sound economic environment and to actively promote living standards of government officials. Total expenditure is estimated to have YoY growth of 18.9 percent, standing at 22.9 percent of GDP**.** Due to wage hike policy for civil servants and armed force, coupled with the increasing spending in prioritized sectors *(education, vocational training systems, transports and logistics, agriculture, and social protection system*), current expenditure, on one hand, is expected to continue its upward trend with a growth rate of 21.7 percent. On the other hand, capital spending is estimated to moderately increase at a growth rate of 13.6 percent, reaching a level of 7.5 percent of GDP.

In 2017, expenditure performance shows a faster in-year disbursement, indicating a smoother budget operation. Total current expenditure is estimated to reach 12,708 Billion Riels (3.15 Billion USD), around 97.4 percent of B.L**.** The coverage of Program Budgeting (PB) has been extended, covering some more 11-line ministries where in-house spending entities have helped simplify and smoothen the spending procedures; thereby quickening the execution of proposed budget. This indicates an increase in the effectiveness of PB, accompanied by the implementation of the Financial Management Information System (FMIS).

Table 4: Components of Expenditure as Ratio to GDP, 2014-2018B.L

Ratio to GDP	2014	2015	2016	2017e	2018 BL
Total Expenditure	**21.5**	**20.4**	**21.2**	**22.9**	**24.6**
Current Expenditure	***13.1***	***12.8***	***14.0***	***15.4***	***16.1***
Wage	5.9	6.5	7.2	8.0	8.4
Non-Wage	7.2	6.4	6.8	7.4	7.7
Capital Expenditure	***8.4***	***7.6***	***7.2***	***7.5***	***8.5***

Source: Macroeconomic Framework, Oct 2017

In 2018, public expenditure is budgeted cautiously to sustain the desired economic growth and to continue supporting RGC's reform policies that are necessary for improving the efficiency of public service and goods delivery. To realize this outcome, total expenditure is planned to accommodate the wage hike policy of more than 1 million riels by 2018, to allocate funds towards social protection policy, to expand the stock of physical infrastructure, as well as to strengthen human resource development. In this regard, total expenditure is expected to increase by an impressive 1.7 percentage point of GDP, of which 60 percent goes to public investment and 24 percent is set for wage bill and social protection policy **(see Table 4)**. The rest (16 percent) is mainly targeted to facilitate the full implementation of PB that is expected to cover all line ministries by 2018 and to strengthen the implementation of FMIS.

Another prominent factor of the 2018 Budget is that it corresponds well to the RGC's policy of improving the livelihood of citizens via social protection programs. This includes providing: (1) healthcare system for workers both inside and outside the system; (2) maternity allowances for female workers; (3) fund support to ensure the sustainability of Kuntha Bophar hospital and good quality of services; (4) healthcare funds for public officials, retirees, and veterans; and last but not the least (5) budget support for the factory's workers.

Table 5: Public Wage

	2017	From Jan 2018	From April 2018
Civil Servant	853,500	914,450	1 014,450
Doctor	953,500	1 014,450	1 114,450
Teacher	953,500	1 014,450	1 114,450
Police	937,977	998,927	1 098,927
Militant	822,500	876,550	976,550

Source: Budget Law 2018, Ministry of Economy and Finance

3. Debt Management

Cambodia's public debt remains below threshold, as of 2017, posing very little to no concern to fiscal position of the country. By the end of 2017, public outstanding debt is at a level of 30.1 percent of GDP and debt service stands at 5.6 of current revenue. This debt is mainly used for public investment in infrastructure development (**around 86 percent**), which is considered as the backbone of economic development and plays an important role in sustaining economic growth. In 2017, public debt was disbursed at around 662 Million SDR, lower than the annual set ceiling of around 700 to 800 million SDR.

In 2018, the RGC is expanding the size of borrowing up to 1 billion SDR to sustain the desired economic growth and maintain macroeconomic stability. Despite commitments to borrow above the ceiling, based on the forecast and analysis of public debt and macroeconomic data, the five key debt ratios (*outstanding debt-GDP ratio, outstanding debt to export ratio, outstanding debt-domestic revenue ratio, service debt-export ratio and, service debt-domestic revenue ratio)* are all below the thresholds. In this sense, public debt of Cambodia in short term and medium term is still sustainable with low risks. Therefore, the current debt stress level is not at a risky stage and does not pose much concern. However, as the global economic situation and political aspects are unpredictable indicators, preparations to safeguard debt management is compulsory. Even though, key debt ratios remain sound with a minimal risk of distress, continued close monitoring and analysis of fiscal risks through further strengthening of capacity is needed to safeguard fiscal space and ensure financial sustainability.

The Debt Management Strategy 2015-2018 was created to secure the sustainability, effectiveness, and efficiency of Cambodia's public debt management. Holding a well-disciplined attitude of borrowing, RGC is strongly committed to four principles of public debt management such as: (1)- borrow in proper amount to balance with budget and economic situation, (2)- borrow high concessional loan, (3)- borrow for spending on the prioritized sectors to support growth and economic and production productivity, and (4)- use the debt within transparency, accountability, efficiency, and efficacy.

D. External Sector

1. Export

Growth of Cambodia's total merchandize exports in 2017 is estimated to substantially pick up to 17.5 percent, from a moderated growth of 9.2 percent in 2016, as a result of high export growth of non-garment products, and slightly moderated growth of garment export. The first 11-month export data shows a significant increase in non-garment and non-gold export, such as electronic components, bicycles, rubber, rice…etc., of 20.2 percent in 2017, compared to only 6.2 percent for the same period in 2016. At the same time, garment export has grown at a slightly lower rate of 7.2 percent in 2017, from 8.4 percent in 2016. This can be seen through the fall in garment export to major trading partners such as EU and Japan. Cambodia's garment export is still under pressure including gradual increase of minimum wage, weakening Cambodia's competitiveness against Vietnam, Myanmar and Bangladesh, buyer's hesitation in placing order due to the uncertainty of delivering products on time in the election year. However, it is noted gradual export diversification is observed, indicating a gradual export transition from garment to other products and from few destinations to many.

Cambodia's export has slowly yet steadily diversified over the years—from heavy garment export to other products export and concentrated US market to other markets. Since 2012, share of garment export has slowly narrowed down from 82.0 percent to 72.3 percent in 2017. Likewise, export destinations have been diversified over time from heavy concentration on US market to the rest such Japan, ASEAN and others. For instance, 36.7 percent of total export in 2012 was exported to US; however, this number dropped to only 21.6 percent in 2017, while share of export to other regions like Japan and EU has shown an increasing trend. EU has become Cambodia's major trading partner in exports, thanks to the "**Everything But Arms"** initiative.

Table 6: Growth of Export Compositions and Garment Export Destinations

	2012	2013	2014	2015	2016	2016(11M)	2017(11M)
Commodity Groups Export (Growth in percent)							
Garment	7.3	17.8	10.7	14.5	9.1	8.4	7.2
Others (excl. gold)	47.2	61.8	31.8	14.2	6.2	6.2	20.2
Garment Export by destinations (Growth in percent)							
EU	18.3	26.0	22.0	20.8	16.1	15.8	8.7
US	-4.7	6.0	-5.4	2.3	-8.5	-10.1	3.9
Japan	19.0	59.3	37.5	36.8	25.4	26.5	5.0
ASEAN	100.3	70.6	38.3	24.1	-4.8	-4.7	7.2
Others	17.0	19.5	12.4	14.2	15.3	14.8	8.7
Commodity Groups Export (Share in percent)							
Garment	82.0	77.1	73.5	73.7	73.1	73.1	72.3
Others (excl. gold)	17.7	22.9	26.0	25.9	25.0	24.9	27.7
Export by destinations (Share in percent)							
EU	32.1	33.4	34.1	37.9	38.8	38.6	38.7
US	36.7	31.4	26.7	23.9	20.9	20.8	21.6
Japan	3.5	4.8	5.7	6.8	8.2	8.3	7.6
ASEAN	7.2	9.3	11.7	11.1	10.3	10.4	9.7
Others	20.5	21.1	21.8	20.2	21.9	21.9	22.4

Source: Ministry of Economy and Finance, 2017.

2. Import

Import in 2017 is estimated to increase to 12.4 percent, from a moderated growth of 6.1 percent, due to higher growth of import of consumptions goods (food, beverages, medicines and cigarettes), vehicles, and other products, and moderate growth of import of construction and garment materials, although there is a huge decline in import value of petroleum products. Import in 2017 (first 11 months, YoY) of consumption goods showed a high growth around 19.8 percent in comparison to the 9.1 percent in the previous year, while growth of construction material import saw a relatively lower growth at around 11.4 percent as compared to 16.1 percent in 2016, illustrating moderate-yet-strong construction activities this year. Garment material import sees a further drop from 8.1 percent in 2016 to 5.5 percent in 2017 (11 months, YoY), indicating slower activities in this sector, driven by weakening Cambodia's competitiveness against competitors, fast rising minimum wage, and buyer's hesitation in placing order due to uncertainty in delivering products on time, pressured by the national election in 2018.

Table 7: Value of Import and its Compositions (Annual growth, percent)

Imported Commodity	2012	2013	2014	2015	2016	2016(11M)	2017(11
Consumption Goods	21.8	10.7	32.3	25.6	10.4	9.1	19.8
Construction materials	35.4	15.3	36.1	22.9	16.4	16.1	11.4
Garment materials	21.9	19.8	7.6	17.5	7.2	8.1	5.5
o.w: Garment materials (Tax Exemption)	*22.0*	*17.6*	*8.3*	*17.8*	*7.4*	*8.3*	*5.1*
Vehicles	36.1	2.1	24.5	33.2	-0.5	3.9	8.9
Petroleum products	12.6	5.7	5.9	10.7	9.9	9.5	-30.2
Others	11.8	24.5	24.4	6.1	1.9	1.2	26.9

Source: Ministry of Economy and Finance

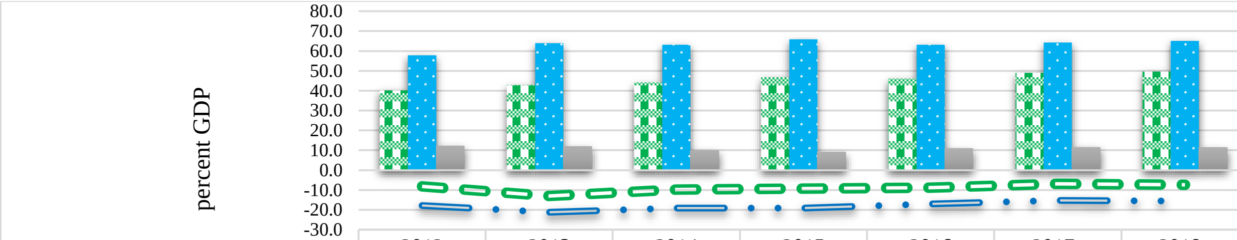
3. Trade and Current Account Balance

Trade balance in 2017 substantially improved due to a relatively stronger growth of export compared to import. With a high growth of 17.5 percent in 2017, export as a share of GDP is estimated to increase to 49.1 percent, up from 46.1 percent in 2016, due to stronger performance of non-garment export and strong-though-moderate growth of garment. Import as a share of GDP slightly increases to 64.3 percent in 2017, from 63.1 percent in 2016, as a result of higher wholesale and retail activities indicated by higher growth of import of consumption goods, though import of construction and garment materials have experienced slightly lower growth. As a result, trade deficit improved from -17.1 percent of GDP in 2016 to -15.2 percent in 2017.

Current account deficit was also on a convergence path by narrowing down from -8.9 percent of GDP in 2016 to an estimated -6.9 percent in 2017 due to improved trade balance, coupled with much higher net services as a result of higher number of tourist arrivals. Net services drastically grow by 17.2 percent in 2017, compared with the negative growth of -2.9 percent in 2016, driven mostly by much stronger growth in tourism, reflected by huge increase in the number of tourist arrivals. However, with a growth of 16.0 percent in 2017, deficit in net income becomes even wider, due to increasing reinvested earning and income on equity, estimated to be around -6.6 percent of GDP. Net current transfer as a share of GDP remains broadly stable at 4.4 percent in 2017k, compared with 4.5 percent in 2016, with increase in government transfer (ODA) offset by a slight decline in remittances.

Trade balance as a share of GDP in 2018 is expected to slightly worsen, as a result of a softer growth of export relative to import during the election year. As a share of GDP, trade balance in 2018 is expected to widen slightly to -15.5 percent from -15.2 percent in 2017, largely attributing to softer growth of export, especially garment export, combined with relatively stronger import growth partly induced by expansionary fiscal policy during the election year.

Figure 26: Trade and Current Account Balance



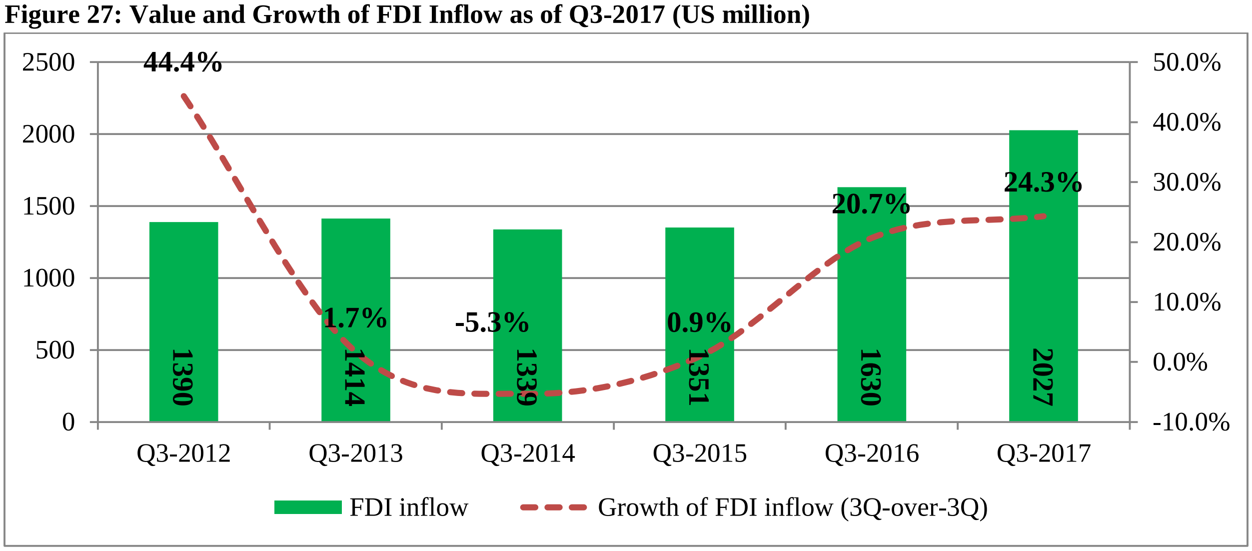
	2012	2013	2014	2015	2016	2017e	2018p
Goods Export fob	40.1	42.9	44.1	46.8	46.1	49.1	49.6
Goods Import fob	57.9	64.0	63.2	65.9	63.1	64.3	65.1
FDI	12.1	12.0	10.0	9.1	10.8	11.5	11.3
Trade Balance	-17.8	-21.1	-19.1	-19.2	-17.1	-15.2	-15.5
Current-Account Balance	-8.2	-13.0	-9.8	-9.4	-8.9	-6.9	-7.4

Source: National Bank of Cambodia, Ministry of Economy and Finance (2017-2018)

FDI has played a central role in Cambodia's economic development endeavors, particularly supporting economic growth, private sector development, and poverty reduction. As a highly open economy, Cambodia has received and is expected to attract an FDI inflow of roughly 10 percent of GDP per annum, particularly between 2013 and 2018.

Based on the data as of Q3-2017, FDI in 2017 has increased by USD 2,027 million, or about 24.3 percent, compared with only USD 1,630 million in the same period of 2016 (about 20.7 percent growth), largely driven by the investment in the financial activities (including banks and MFIs), which continues to experience a very high growth, and accounting for 33.0 percent of the total FDI inflow for the first three quarters of 2017. The FDI inflow into the manufacturing also remains strong as being the second biggest share (11 percent) of the FDI inflow by Q3-2017, and followed third by the investment in the accommodation **(see Table 8).**

Figure 27: Value and Growth of FDI Inflow as of Q3-2017 (US million)



Source: NBC, 2017

Table 8: Share of FDI Inflow as of Q3-2017

Share of FDI Inflow as of Q1-2017	2013	2014	2015	2016	Q3-2017
Agriculture	15.3%	16.9%	14.6%	10.3%	**8.5%**
Manufacturing	26.6%	30.5%	26.6%	16.6%	**11.1%**
Financial Activities	17.5%	19.1%	30.3%	28.2%	**33.0%**
Accommodation	6.0%	8.1%	9.7%	11.1%	**9.4%**
Other	34.6%	25.5%	18.9%	33.7%	**37.9%**

Source: NBC, 2017

Geographically, China (including Hong Kong and Taiwan) still tops the list of the FDI inflow in Q3-2017, accounting for over 40 percent of the total share. Noticeably, even the share of the Chinese mainland investors is by far the biggest, but its growth has been broadly stabilized while growth share of Hong Kong and Korea investment shown a faster pace, which might explain the potential surge of their investment and continued interest in the real estate market. The shares of other top investors as of Q3-2017 include Japan (8.9 percent), Singapore (8.2 percent), Korea (7.5 percent), Malaysia (5.9 percent), and the EU as a region (9.0 percent). In the case of the EU share of the FDI inflow, the United Kingdom (4.3 percent) and France (3.0 percent) contribute the biggest shares of the FDI from the EU.

In the context of the national elections in 2018, some investors as observed might take more cautious investment decisions, but the prospect of FDI inflow to Cambodia remains solid given the macroeconomic stability, double efforts in continuing the reform momentum and the improved prospect of external environment, particularly China's resilient growth and other Asian countries.

E. *Monetary Sector*

1. Broad money

Domestic monetary and financial condition remain supportive of economic activities. Money supply (M2) grew by 24 percent for the first 11 months in 2017, up from 20 percent in the correspondent period of 2016. The large expansion in M2 was driven by the increase in Foreign Currency Deposit (FCD) which was main component accounted for 83 percent of total M2, risen by 24 percent from 20 percent in the first 11 months of 2016. The surge in FCD suggests the continued increase in capital inflow into the country and confidence of investors in banking sector.

Table 9: Monetary Aggregate

	2013	2014	2015	2016	11-2016	11-2017
Liquidity M2 growth (percent)	14.6%	27.4%	15.4%	18.3%	20.3%	24.1%
Money	20.7%	27.1%	7.4%	7.5%	8.6%	28.3%
Quasi-money	13.6%	27.4%	16.8%	20.0%	22.1%	23.5%
Foreign Currency outside bank	13.4%	27.9%	16.0%	18.7%	20.5%	23.9%

Source: National Bank of Cambodia

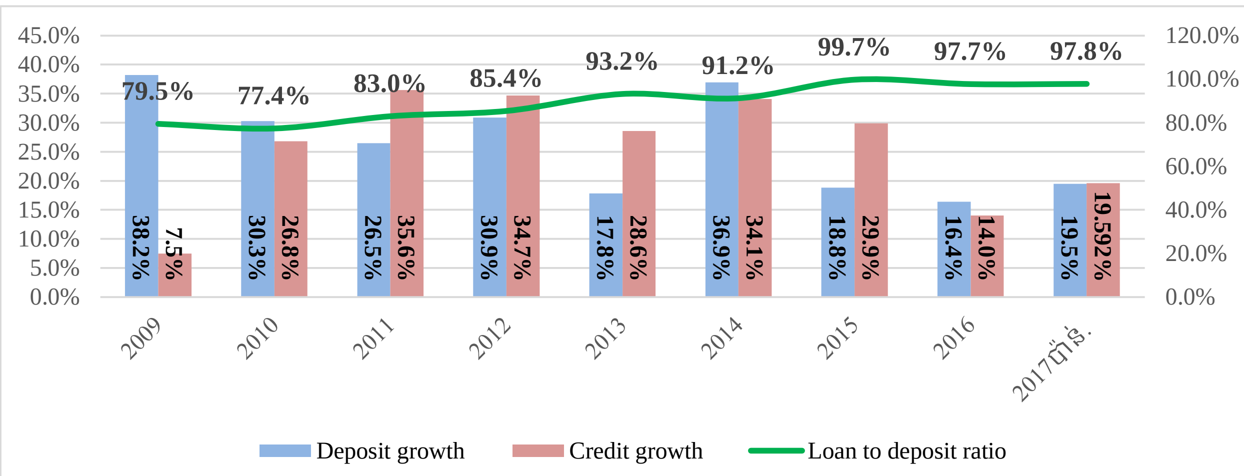
2. Credit

After a number of prudential measures introduced by NBC, growth of credit sees a remarkably decline from 30 percent in 2015 to 14 percent in 2016. However, the trend more or less went up again in 2017 and is estimated to increase by 19 percent in 2017. This was due to the increase in MFIs loan while bank loan maintains at the similar rate as last year. Meanwhile, financial risk is elevated with concentration of credit to real estate and construction related sector which is estimated to grow by 34 percent in 2017 compared to 28 percent in 2016.

Deposit, on the other hand, maintain at the favorable rate thanks to the increase public confidence in banking sectors. In 2017, deposit amount is estimated to rise by 19 percent, up from 16 percent in 2016 while majority of this amount is in US dollar.

Though the relatively stable growth of deposits, loan-to-deposit ratio remains high at the rate of almost 100 percent. The loan-to-deposit ratio (LTD) in total bank and MFIs stand at 98.0 percent 2017, pointing to financial sector's overleveraging and associated vulnerabilities. In the event of a spike in global financial market volatility, a reversal of foreign funding could lead to tightening of domestic liquidity conditions.

Figure 28: Growth of Credit, Deposit and Loan to Deposit Ratio



Source: National Bank of Cambodia

II. Risks, Challenges and Policy Options

As a highly open and small economy, Cambodia is facing some external risks, which can affect Cambodia's targeted economic growth and overall economic development. Those include the still-slow growth of the advanced economies, intensified regional competition including the expected EU-Vietnam Free Trade Agreement, the tightening of monetary and other trade policies, China's continued rebalancing including the risk from the rapid growth of credit growth, and the tide of inward-looking policies, especially from the advanced economies. In addition to the above external risks, Cambodia faces some challenges including: less-than-expected productivity growth, the lack of skilled labor, high electricity price and logistics cost and the complicated procedures and high cost of doing business which continue to be a bottleneck preventing Cambodia's trade potential, as a destination for additional quality investments, and the overall economic development endeavor.

In the context of the above-mentioned risks and challenges, the RGC has considered the following policy actions so as to strengthen Cambodia's competitiveness and achieve the targeted economic growth: (a) Fintalize the Master Plan for Transport and Logistics System by 2018, particularly to build a comprehensive and cost-competitive logistics system, aiming to promote competitivness and integrate into the regional and global production networks and markets; (b) Continue expanding and strengthening education, both soft and hard skills, and technology to promote skill development and know-how to attract high-quality investments, both foreign and domestic, particularly in response to Industrial Development Policy 2015-2025 and by leveraging the National TVET Policy 2017-2025; and (c) Accelerate institutional structural reforms, including the streamlining the procedures to reduce cost of doing business, and set out some sharp measures to ease the pressure on logistics and electricity prices.

With continued efforts to address the above challenges and prepare for the risks, Cambodia, going forward, is anticipated to move in the right direction. The Government is committed to further implementing IDP 2015-2025, particularly increasing value addition to garment, food and beverage, spare parts, electronics, other new industry products along with the strengthening of SMEs.