



INTERNATIONAL MONETARY FUND

OFFICE OF THE RESIDENT REPRESENTATIVE IN CAMBODIA
22-24, Preah Norodom Boulevard, Phnom Penh.

Phnom Penh, March 20, 2014

Mr. Eric Sidgwick
Country Director
Asian Development Bank
Cambodia

Dear Mr. Sidgwick:

I refer to Mr. Nugent's letter of March 17, 2014 to the Director of the Asia and Pacific Department of the IMF requesting an Assessment Letter for the ADB's Technical and Vocational Education and Training Sector Development Program (the Program) for the Royal Government of Cambodia.

I have consulted with the Headquarters and they informed me that the IMF Press Release issued on February 4, 2014 can be used as an alternative to an Assessment Letter. Please find attached a copy of the Press Release.

With warm regards,

A handwritten signature in black ink, appearing to read "Faisal Ahmed".

Faisal Ahmed
Resident Representative
Cambodia

cc: Mr. Rhee
Mr. Nelmes
Ms. Karasulu

ASIAN DEVELOPMENT BANK
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CAMBODIA RESIDENT MISSION



International
Monetary Fund

IMF Executive Board Concludes 2013 Article IV Consultation with Cambodia

Press Release No. 14/34
February 4, 2014

On January 27, 2014, the Executive Board of the International Monetary Fund (IMF) concluded the 2013 Article IV consultation¹ with Cambodia, and considered and endorsed the staff appraisal without a meeting.²

Economic activity remained strong in 2013 driven by robust exports, with garment exports helped by preferential access to European Union, and tourism with more diversified destinations. Real estate and construction also expanded rapidly supported by fast credit growth. Foreign direct investment (FDI) remained strong partly driven by factories relocating from China and Vietnam. Nonetheless, staff estimates real GDP growth to remain at 7 percent in 2013 due to the sluggish global economic recovery, the recent floods, and the slowdown in economic activity during the election period.

Private sector credit has been growing by about 30 percent (year-on-year) on average in the last three years driven mainly by ample liquidity, including bank funding from abroad, and heightened competition in the banking system. In the process, the loan-to-deposit (LTD) ratio trended upwards to over 100 percent and credit-to-GDP ratio nearly doubled to 40 percent diverging from past trends of sustainable financial deepening. The National Bank of Cambodia raised the reserve requirements on foreign currency deposits in September 2012 by ½ percentage points (ppt) to 12½ percent, but bank funding from abroad is not subject to any prudential limits. Notwithstanding the rapid credit growth, inflationary pressures eased due to moderating commodity prices. As a result headline inflation is estimated to average around 3 percent in 2013 once the impact of the recent floods on food prices subsides.

The current account deficit including official transfers is expected to stay flat at around 8½ percent of GDP in 2013 owing to strong but moderating imports, and remain fully financed by FDI and official loans. The deficit is projected to decline to 5½ percent of GDP over the medium term with improved competitiveness and diversification of exports, and

lower imports after the completion of large power projects. Gross official reserves stood at US\$3.6 billion in November, about 3½ months of prospective imports, and this reserve coverage appears to be adequate considering the long-term nature of Cambodia's external debt, although the high degree of dollarization would suggest that a higher level of reserves may be warranted. Consistent with this stable external position, the real effective exchange rate has remained stable since the 2008 global financial crisis.

Fiscal consolidation remained broadly on track. Buoyant domestic demand and revenue collection efforts improved revenue performance, while domestically-funded spending has been in line with the budget. As a result, the fiscal deficit, excluding grants, is expected to narrow further by about ½ ppt of GDP in 2013, leaving the stock of government deposits, the only fiscal buffers, at around 4¾ percent of GDP.

Executive Board Assessment

In concluding the 2013 Article IV consultation with Cambodia, Executive Directors endorsed staff's appraisal, as follows:

Economic activity remains strong driven by robust exports, tourism, and construction despite recent floods and some slowdown during the election. Growth is projected to pick up to 7¼ percent in 2014 and reach 7½ percent over the medium term along with global recovery, improvements in infrastructure, competitiveness, and investment climate. Inflation is expected to remain low in 2013–14 due to stable food and fuel prices. The external position is stable notwithstanding a declining reserve coverage of foreign currency deposits, and the real effective exchange rate appears to be in line with fundamentals.

The U.S. tapering and slow European growth could expose Cambodia's favorable outlook to downside risks. On the domestic side, rapid credit growth and emerging risks in a fast changing financial landscape could undermine financial stability; extreme weather conditions could affect agriculture and growth, and labor market instability could disrupt garment production and exports. Should these downside risks materialize, low fiscal buffers would require any additional expenditure to be allocated to high-impact development spending.

The progress made by the authorities in implementing past Article IV recommendations is welcome. They have improved revenue collection, formulated a revenue mobilization strategy (RMS), and strengthened public financial management (PFM), including improving the monitoring of contingent liabilities. They have also introduced negotiable certificates of deposit (NCDs) to help develop the interbank market, improved financial supervisory capacity, and established an initial memorandum of understanding (MoU) to establish a financial crisis management framework. Continuous progress in many of these areas remains necessary and is reflected in the priorities of this Article IV consultation.

The strong fiscal performance has continued, driven by

substantial improvement in revenue collection and prudent spending. Fiscal consolidation should continue to rebuild government deposits—the only fiscal buffers—in view of the expected decline in grants, to maintain long-term fiscal and debt sustainability, including by making the planned wage increases in 2014 a part of a broader civil service reform. Successful implementation of RMS strategy and careful management of contingent liabilities are needed to rebuild and safeguard the fiscal space. Continuing with PFM reforms remains important to improve fiscal accountability and transparency.

Rapid credit growth, increasing foreign bank financing and the buoyancy of the real estate and construction sectors pose substantial macro financial risks especially in light of high dollarization, which limits monetary policy effectiveness and lender-of-last-resort capacity. Steps on multiple fronts are required to contain credit growth and safeguard financial stability. Strengthening liquidity supervision and redefining the liquid asset ratio (LAR) to better capture banks' true liquidity conditions will improve their resilience to shocks. Fully enforcing the reserve requirements to include foreign funds in the reserve base would help contain credit growth. Should this fail to slow credit growth macro prudential measures such as loan-to-value ratios (LTVs) and LTDs could be considered. Better monitoring of real estate developments, by collecting more data including on developer financing, is also needed to contain risks. Finally, the introduction of NCDs is a welcome first step toward market-based monetary operations. Going forward establishing an interbank and foreign exchange market would be needed to begin addressing dollarization, including by allowing more exchange rate flexibility.

The transition to risk-based supervision and the rapid expansion of the banking system continued to put additional burden on the supervisory capacity, and in this context, the 2010 FSAP recommendation of imposing a moratorium on new bank licenses remains appropriate. In view of the limited resources, focusing on key emerging risks would improve the supervisory effectiveness. Strengthening the financial crisis management framework is critical in managing systemic risks and minimizing potential fiscal costs. The signing of an initial MoU between supervisory agencies is welcome, and should be used to enhance cooperation at the policy and technical levels, and expedite preparation of a second MoU on crisis resolution.

Cambodia has made good progress in achieving the Millennium Development Goals and reduced poverty substantially. Continued improvements in human capital, including through education and training, infrastructure, and business climate are needed to promote inclusive and sustainable growth and further reduce poverty and income inequality. Plans to reduce regulatory impediments to doing business are welcome, while improving education outcomes to catch up with peers would take longer term efforts. Given the budgetary constraints, the near term priority would be improving efficiency and reallocating spending within the budget envelope. New initiatives, such as establishing a national training fund, could

be considered over the medium term following the successful implementation of PFM reforms.

Good faith efforts to resolve external arrears are welcome and should continue.

Cambodia: Selected Economic Indicators, 2010-14

	2010	2011	2012	2013	2014
			Est.	Proj.	
GDP in constant prices (annual percent change)	6.1	7.1	7.3	7.0	7.2
(Excluding agriculture)	6.9	8.6	8.4	8.6	8.3
Inflation (end-year)	3.1	4.9	2.5	4.1	3.0
(Annual average)	4.0	5.5	2.9	2.9	3.4
Saving and investment balance (in percent of GDP)					
Gross national saving	13.4	13.9	14.8	14.9	13.1
Gross fixed investment	17.3	22.0	23.5	23.5	21.5
Money and credit (annual percent change)					
Broad money	20.0	21.4	20.9	17.7	23.7
Private sector credit	23.4	31.2	28.0	28.0	24.0
Public finance (in percent of GDP)					
Revenue	17.0	15.6	16.9	17.1	17.4
Expenditure	19.9	19.6	20.7	20.1	20.2
Net lending (+)/borrowing(-)	-2.8	-4.1	-3.8	-3.0	-2.8
Balance of payments (in millions of dollars, unless otherwise indicated)					
Exports, f.o.b.	3,884	5,219	6,016	6,992	8,002
Imports, f.o.b. 1/	-5,466	-7,260	-8,426	-9,789	-11,135
Current account (including official transfers)	-441	-1,040	-1,233	-1,339	-1,430
(In percent of GDP)	-3.9	-8.1	-8.7	-8.6	-8.4
Gross official reserves 2/	2,653	3,032	3,463	3,824	4,327
(In months of prospective imports)	3.7	3.6	3.6	3.6	3.7
External debt (in millions of dollars, unless otherwise					

indicated)

Public external debt 3/	3,337	3,841	4,486	5,052	5,559
(In percent of GDP)	28.7	29.7	31.6	32.8	33.1
Memorandum items:					
Nominal GDP (in billions of riels)	47,102	52,154	56,711	62,559	69,195
(In millions of U.S. dollars)	11,255	12,890	14,118
Exchange rate (riels per dollar; period average)	4,185	4,046	4,017

Sources: Cambodian authorities; and IMF staff estimates and projections.

1/ From 2011, includes large power sector projects.

2/ Excludes unrestricted foreign currency deposits held as reserves at the National Bank of Cambodia; starting in 2009,

includes the new SDR allocations made by the IMF.

3/ Debt owed to the Russian Federation is valued at 0.6 rubles per U.S. dollar with the standard 70 percent discount.

¹ Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. A staff team visits the country, collects economic and financial information, and discusses with officials the country's economic developments and policies. On return to headquarters, the staff prepares a report, which forms the basis for discussion by the Executive Board.

² Article IV consultations are concluded without a Board meeting when the following conditions apply: (i) there are no acute or significant risks, or general policy issues requiring Board discussion; (ii) policies or circumstances are unlikely to have significant regional or global impact; (iii) in the event a parallel program review is being completed, it is also being completed on a lapse-of-time basis; and (iv) the use of Fund resources is not under discussion or anticipated.

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