

Cambodia: 2008 Article IV Consultation—Staff Report; Staff Supplement; and Public Information Notice on the Executive Board Discussion

Under Article IV of the IMF's Articles of Agreement, the IMF holds bilateral discussions with members, usually every year. In the context of the 2008 Article IV consultation with Cambodia, the following documents have been released and are included in this package:

- The staff report for the 2008 Article IV consultation, prepared by a staff team of the IMF, following discussions that ended on November 7, 2008, with the officials of Cambodia on economic developments and policies. Based on information available at the time of these discussions, the staff report was completed on December 23, 2008. The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- A staff supplement on the joint IMF/World Bank debt sustainability analysis.
- A public information notice (PIN) summarizing the views of the Executive Board as expressed during its January 16, 2009 discussion of the staff report that concluded the Article IV consultation.

The document listed below has been or will be separately released.

Statistical Appendix

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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CAMBODIA

Staff Report for the 2008 Article IV Consultation

Prepared by the Staff Representatives for the 2008 Consultation with Cambodia

Approved by Jerald Schiff and Dominique Desruelle

December 23, 2008

- **The 2008 Article IV Consultation discussions were held in Phnom Penh October 23–November 7** with Minister of Economy and Finance Keat Chhon, National Bank of Cambodia Governor Chea Chanto, and other ministers and senior officials, and donor, private sector, NGO, and labor union representatives. The staff team comprised David Cowen (Head), John Nelmes (Resident Representative), R. Armando Morales, and Nombulelo Duma (all APD); Jung Yeon Kim (SPR); and Joong Beom Shin (FAD). Perry Warjiyo (Executive Director) also participated in discussions. Staff worked with the World Bank on a debt sustainability analysis (Appendix I), with the Asian Development Bank participating.
- **Past advice:** The IMF and authorities have generally agreed on the direction of policies, but the pace of reforms is lagging in several critical areas, notably monetary operations, banking supervision, and public financial management. In support of the government's reform agenda, extensive technical assistance has been provided in fiscal, money and banking, and statistical areas through long-term advisors, peripatetic experts, and staff visits.
- **Exchange system:** Cambodia accepted the obligations under Article VIII, Sections 2, 3, and 4 in January 2002, and has maintained an exchange system free of restrictions on the making of payments and transfers for current international transactions (Annex I).
- **Economic statistics:** The statistical framework is being upgraded, but weaknesses remain. Core economic data are adequate for surveillance purposes and delivered in a timely manner (Annex IV).
- **Safeguards assessment:** Staff welcomes the NBC's plans to request an update to the full assessment completed in March 2004, in view of the rapid rise in foreign reserves since then and ongoing efforts to strengthen internal controls.

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EXECUTIVE SUMMARY

The 2008 Article IV consultation discussions took place against the backdrop of rapidly deteriorating external conditions, with the global financial crisis adversely affecting Cambodia's economy. Growth is slowing, liquidity is tightening, and, as a result, banks' balance sheets are coming under strain. Competitiveness has eroded given the recent sharp real appreciation of the Cambodian riel and U.S. dollar. On the other hand, inflation pressures are easing as commodity prices fall and demand pressures moderate. However, external vulnerability, which had declined significantly in recent years, could be rising given the near-term outlook. Therefore, discussions focused on sound policy responses to better manage emerging risks and ensure stable domestic conditions.

The immediate risks to Cambodia arise from liquidity shortages among banks owing to a sharp slowing in external inflows and deposit growth. Over the past few years, these inflows have fueled rapid credit expansion, which has bolstered economic activity and contributed to a boom in the property sector. As conditions tighten, bank lending has moderated, construction activity has slowed, and property prices—after reaching historic peaks—appear to be declining. Some banks, including several large ones, could face a large deterioration in credit quality and a need for recapitalization, depending on the magnitude of the current slowdown and effectiveness of the policy response. Others have entered Cambodia recently with limited banking experience or large exposure to the property sector, making them especially vulnerable to external conditions and an economic slowdown.

On its part, the Royal Government of Cambodia has done a commendable job in recent years in pursuing stabilization efforts through a sound fiscal stance. As a result, the overall budget deficit has remained low, with revenue rising rapidly and expenditure appropriately restrained. To the government's credit, national elections in mid-2008, which were largely peaceful, and ongoing border tensions with Thailand have not exerted extraordinary pressures on the budget so far. At the same time, the lack of an operational framework and high degree of financial dollarization continue to constrain the National Bank of Cambodia's ability to manage domestic liquidity conditions. Combined with limited supervisory oversight and enforcement, recent conditions have contributed to heightened risks among banks.

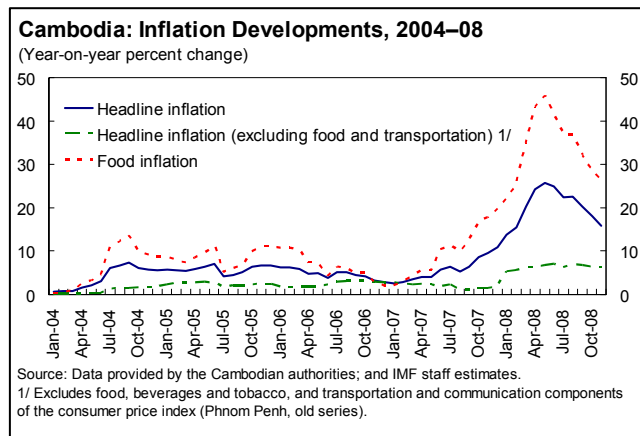
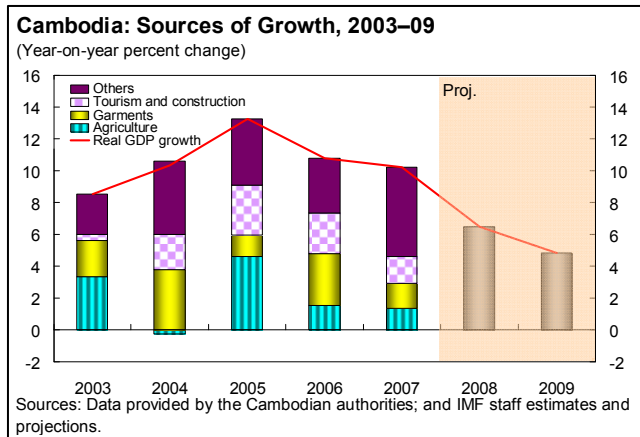
Going forward, the authorities agreed that credible policy actions are needed to maintain macroeconomic stability, improve bank soundness, and strengthen external competitiveness. Staff's main recommendations build on those made during earlier consultations, as well as address the near-term challenges posed by external conditions and policy weaknesses—notably on monetary operations and banking supervision. The authorities will need to implement decisive measures to manage risks faced by banks and reduce vulnerabilities to further shocks that could arise given Cambodia's openness and dependence on inflows.

I. MACROECONOMIC AND FINANCIAL DEVELOPMENTS

1. **Cambodia's exceptional growth performance the past five years is coming under increasing strain from the global financial crisis and weakening external demand** (Box 1). The economy has been particularly vulnerable to recent shocks given its narrow production base, concentration of exports by product and destination, and dependence on external inflows. As a result, economic activity is slowing in most sectors and liquidity conditions are tightening as funding sources dry up. Rapid credit expansion since 2007 combined with long-standing weaknesses in bank oversight and now falling property prices have heightened credit and solvency risk among a number of banks, including a few systemically important ones.

2. **Core macroeconomic developments are summarized as follows:**

- **Real GDP growth** is projected at 6½ percent in 2008, compared to 10¼ percent in 2007 (Table 1). Garment exports and tourism activity moderated as external demand weakened. Tourism has also been adversely affected by border tensions that emerged between Cambodia and Thailand in mid-2008. Agricultural growth is expected to be below-trend due to adverse weather. New construction activity—strong in the first half of the year—faltered, as foreign direct investment (FDI) slowed and credit growth decelerated.



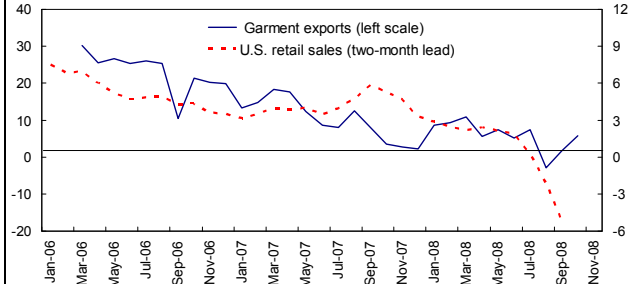
- **Inflation pressures** intensified in the second half of 2007 and first half of 2008 because of rising commodity prices, a weakening in the U.S. dollar against major currencies, and domestic demand pressures. As these factors reverse, headline inflation is expected to be around 15½ percent (y/y) in December 2008, compared to a peak of 26 percent in May 2008.
- The **current account deficit** rose sharply in 2008 due to high oil prices and strong non-oil imports. As a share of GDP, the deficit (including transfers) is projected at

Box 1. Cambodia: Effects of the Global Crisis

- **On the real side, garment export growth has fallen sharply in Cambodia, consistent with weak retail sales in the United States** (around three-quarters of the market). Garment sector employment (the largest source of formal employment) is also declining, down 6 percent (y/y) for the year ending July 2008, or to 330,000 workers. Near-term prospects for the sector are poor from both an output and employment perspective, because of demand concentration in the U.S. and competition abroad (see Box 4).
- **Tourist arrivals are also slowing given external conditions, with rising costs and regional instability also factors.** Growth was 3 percent (y/y) in the third quarter of 2008, compared to 17 percent in the same quarter last year. As a further indicator, ticket sales at Angkor Wat were up only ½ percent in the first eight months of 2008, compared to 36 percent for the same period in 2007. With the peak travel season now upon Cambodia, hotel operators are reporting a significant drop in forward bookings for this period compared to the previous year. A prolonged downturn could have serious fiscal implications, given the sector's contribution to domestic revenues, in particular the VAT.
- **Construction approvals were up 38 percent in the first nine months of 2008**, compared to 100 percent in the same period last year. Property prices in and around Phnom Penh are reportedly down as much as 25 percent from historic highs in mid-2008, after rising 50–100 percent in the preceding year. Since the global financial crisis hit, a few major urban projects have been scaled back or cancelled outright, as foreign investors (mainly from Korea) reassess their commitments in the face of tighter funding conditions abroad and weaker near-term prospects in Cambodia.
- **However, lower commodity prices have helped bring down inflation and temper the rise in the current account deficit.** Since the May 2008 peak, food and fuel prices are responsible for around 80 percent of the decline in headline inflation. In the event world oil prices had stayed at mid-year levels, the oil import bill for Cambodia would likely be around US\$210 million (2 percent of GDP) higher in 2008 than currently projected.

Cambodia: Garment Exports and U.S. Retail Sales Growth, 2006–08

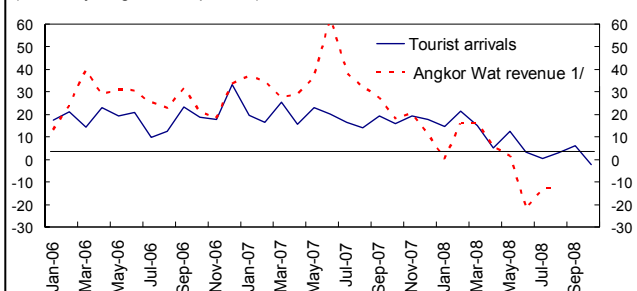
(Seasonally adjusted, 3-month moving average)



Sources: Data provided by the Cambodian authorities; U.S. Federal Reserve Bank; and IMF staff estimates.

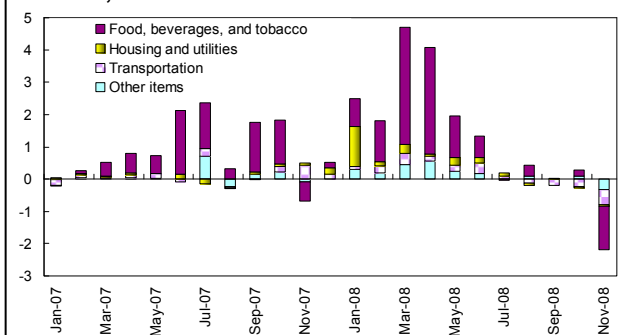
Cambodia: Total Tourist Arrivals and Angkor Wat Revenue, 2006–08

(Year-on-year growth, in percent)



Sources: Data provided by the Cambodian authorities; and IMF staff estimates. 1/ Revenue from ticket sales.

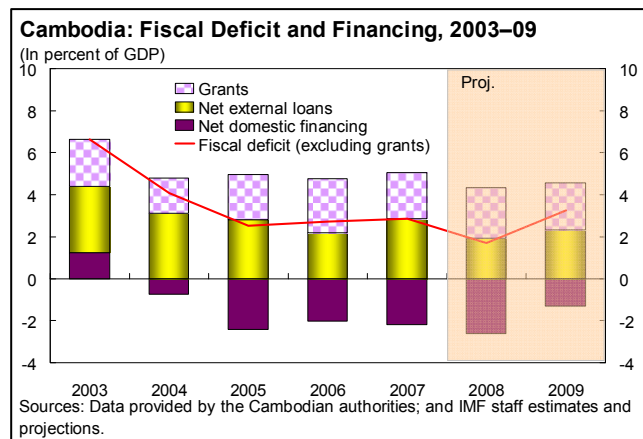
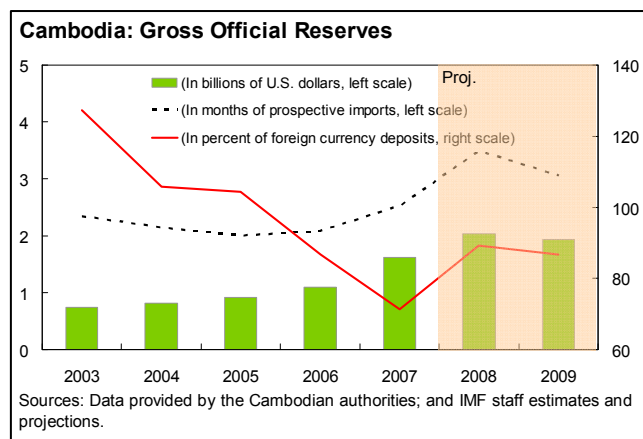
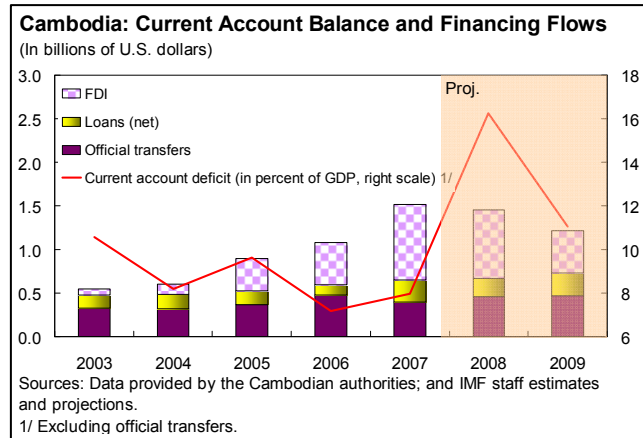
Cambodia: Contribution to Month-on-Month Headline Inflation, 2007–08



Sources: Data provided by the Cambodian authorities; and IMF staff estimates.

12 percent in 2008 compared to about 3½ percent in 2007 (Table 2). Notwithstanding recent developments, the overall external position for 2008 should improve on strong official inflows as well as private inflows earlier in the year, with **gross official reserves** projected at US\$2.0 billion (3.5 months of prospective imports) by year-end, compared to US\$1.6 billion (2.5 months) at end-2007.

3. **The fiscal stance continued to underpin the government's stabilization efforts in 2008.** The overall deficit is expected at around 1¾ percent of GDP, against an official target of 4¼ percent and an outturn of around 3 percent in 2007 (Table 3). Revenue continues to rise (including as a share of GDP), owing to a buoyant domestic economy and improved tax and customs administration, with a pilot of the ASYCUDA system launched and ad hoc tariff exemptions reduced. Current expenditure has been in line with planned allocations, including a mid-year fiscal package.¹ Capital expenditure is expected to be slightly higher than budgeted, but precise estimates of actual spending are hampered by weaknesses in recording payment orders and slow progress in budget integration.

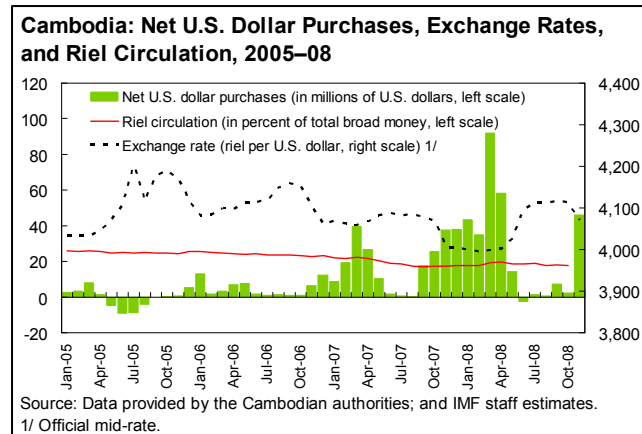
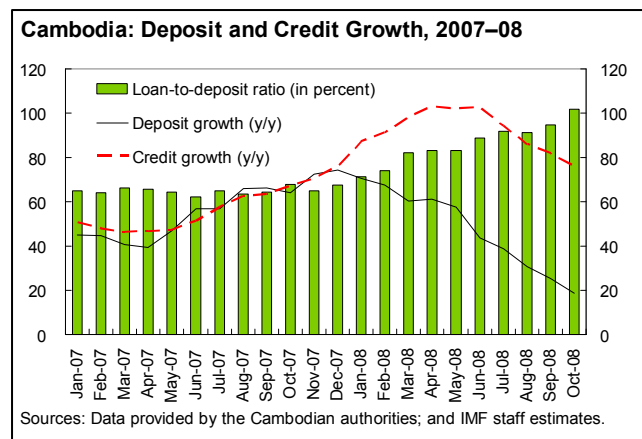
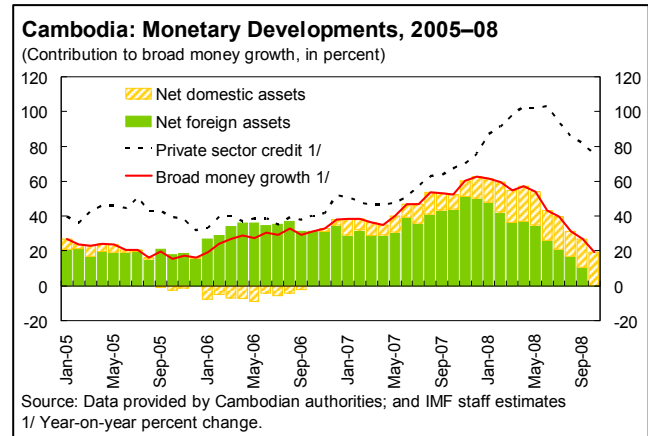


4. **Monetary conditions have tightened as external inflows slow and policy measures take hold.** Broad money growth is expected to decline from 63 percent at end-2007 to around 5 percent by end-2008 (Table 4). In response to excessively loose conditions in the first half of

¹ The main elements were new allowances for military personnel and salary supplements for civil servants. In addition, the package included direct subsidies to Electricité du Cambodge and subsidized loans to rice millers.

2008, the National Bank of Cambodia (NBC) doubled the reserve requirement on foreign currency deposits (FCDs) to 16 percent in June.² It also placed caps on banks' lending to the real estate sector. Credit growth, which exceeded 100 percent (y/y) in mid-2008, is expected to fall to around 60 percent by year-end. Despite recent global developments, the riel has remained generally stable against the U.S. dollar since mid-year. Lacking an effective interbank market, the NBC continued to use foreign exchange market intervention to inject riel liquidity necessary to meet transaction demand, with the effect of limiting riel strengthening.

5. **As noted, the banking system is under increasing strain.** The global financial crisis has exposed vulnerabilities among Cambodia's banks and is beginning to affect their financial soundness (Box 2 and Table 5). Liquidity shortages have arisen at some banks. In response, banks have been raising deposit rates, drawing excess reserves and, in few cases, borrowing from abroad (mainly from parent institutions).³ At the same time, loan rates have been sticky, suggesting bank spreads are narrowing and profits may be squeezed going forward. The number of banks has also increased rapidly during the past two years—by nearly 50 percent to 28 licensed institutions in late 2008, putting added pressure on the NBC's supervisory capacity.



² For riel deposits, the reserve requirement was kept at 8 percent, but few banks hold significant amounts.

³ As of end-October 2008, banks' excess reserves were 94 percent of required reserves, but down from 227 percent at end-June 2008, immediately following the latest hike in the reserve requirement on FCDs.

Box 2. Cambodia: Global Volatility and Bank Vulnerabilities

The global financial crisis has increased risks and exposed weaknesses in Cambodia's highly dollarized banking system. Liquidity risk is an upfront concern, compounded by a potentially volatile deposit base. Bank deposit growth (resident and nonresident) has slowed significantly in recent months, turning negative (month-on-month) since September 2008. Large withdrawals have reportedly been made by firms concentrated in the property sector, notably at Korean-owned banks. Combined with rapid credit growth, the loan-to-deposit ratio for commercial and specialized banks breached 100 percent for the first time in October 2008—up from 68 percent one year before. Currently, the nine largest banks control nearly 90 percent of deposits, with six having an average level of deposits in excess of US\$10,000. Credit risk may also be increasing as growth slows and property prices decline. Asset quality at some banks has been compromised by poor risk management and weak internal controls. Loan delinquencies appear on the rise, in particular in construction and real estate, and loan recoveries may face difficulties owing to a weak legal system and poor collateral quality. New banks with loans concentrated in the property sector and large banks with weak capital bases are especially vulnerable.

Financial soundness indicators (FSIs) show that banks remain well capitalized, hold sizable liquid assets, and have low nonperforming loans (NPLs), but the picture could be misleading (Table 5). First, rapid credit growth since 2007 may have masked emerging NPL problems. Second, banks' compliance with prudential regulations remains weak. Mid-year audits by the National Bank of Cambodia revealed NPLs (as a share of loans) higher by two percentage points than previously reported by banks. Third, the FSIs show a move toward more risky lending activities, as suggested by the sharp increase in large exposures in 2008, partly related to real estate, and a continuing rise in consumer loans, mainly mortgage lending. Regarding liquidity, the decline in the liquid asset ratio net of short-term liabilities in 2008 is partly due to the increasing reliance on short-term external financing, mainly by foreign banks from their overseas parents, in light of tighter liquidity conditions.

Sensitivity analysis performed on the nine largest banks reveals the following:

- **Credit risk:** Different assumptions were used for the quality of the banks' loan portfolio, with higher NPLs assumed for real estate and textile sector loans, followed by new loans (see table below). In the most benign scenario (1), average NPLs would increase by about 4 percentage points to 6.5 percent, bringing the risk-weighted capital-asset ratio (RWKA) below the regulatory minimum of 15 percent for four banks. In the most extreme scenario (3)—with average NPLs increasing to 13 percent—six banks fall below the RWKA required minimum, with the capital deficiency equivalent to 1.2 percent of GDP.

Liquidity risk: Different scenarios for a decline in deposits bring the average liquid asset to deposit ratios (LAD) to between 38–45 percent. However, a deposit reduction by 20 percent (Scenario 2) would take the LAD below 15 percent for a few banks (i.e. below required reserves). At a reduction by 25 percent, four banks would see their LAD decline below 20 percent, extremely low for a financial system lacking liquidity instruments and central bank facilities.

Risks may compound if the global financial environment deteriorates further. Deposit growth could slow more. Banks' access to external financing could also become restrictive, with foreign parents facing their own financial strain. In the event, banks in Cambodia might be unable or reluctant to renew credit lines, which could affect borrowers' capacity to repay.

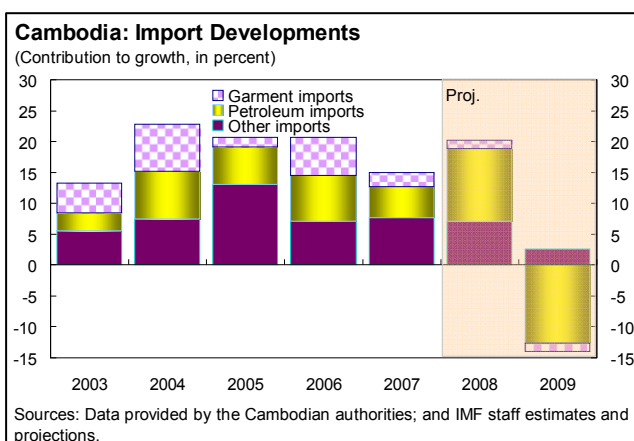
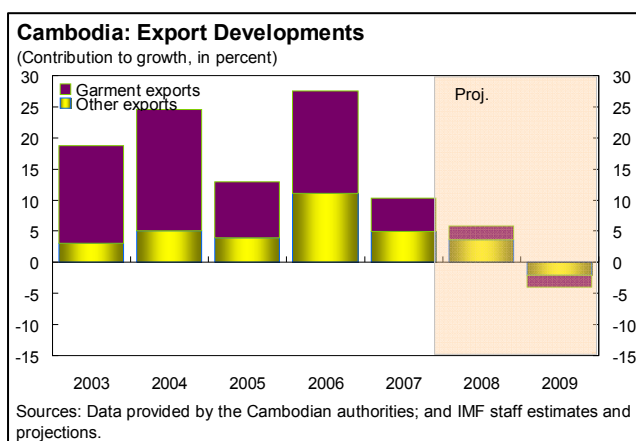
Cambodia: Sensitivity Analysis for the Nine Largest Commercial Banks											
(Number of banks, unless otherwise specified)											
	Credit Risk						Liquidity Risk				
	Risk-Weighted Capital-Asset Ratio (RWKA)						Liquid Assets to Total Deposits Ratio (LAD)				
	< 15	15 to 20	20 to 25	> 25	Average		< 15	15 to 20	20 to 50	> 50	Average
	Percent	Percent	Percent	Percent	NPLs	RWKA	Percent	Percent	Percent	Percent	LAD
Baseline	0	4	3	2	2.4	19.4	0	0	4	5	53.5
Scenario 1	4	2	2	1	6.5	16.4	0	1	5	3	45.3
Scenario 2	5	2	1	1	9.8	13.9	1	2	3	3	41.9
Scenario 3	6	2	0	1	13.1	11.2	3	1	2	3	38.0
	Credit Risk Scenarios					Liquidity Risk Scenarios					
	Additional NPLs (percent of loans)					Deposit reduction (in percent)					
	New	Real		Other							
	Loans	Estate	Textile								
Scenario 1	5	10	10	2.5		15					
Scenario 2	10	15	15	5		20					
Scenario 3	15	20	20	10		25					

Source: Cambodian banks' financial statements; and IMF staff estimates.

II. OUTLOOK AND RISKS

6. The near-term outlook for Cambodia points to a further slowing in economic activity in 2009, as the impact of negative external shocks becomes more pronounced.

- **Growth is projected at 4.8 percent in 2009.** While agricultural output is expected to pick up, garments and tourism would act as a significant drag given weak external conditions. Real estate and construction activity is expected to decelerate further, as investment becomes more constrained by inflows and credit.
- **Inflation should continue to fall, based on the IMF's latest commodity price outlook and moderating demand pressures.** Headline inflation is projected to decline to around 7½ percent (y/y) by end-2009. However, the lagged effects of high inflation in 2008 could still yield upward wage pressures.
- **The current account deficit is expected to decline to around 7 percent of GDP in 2009, but the overall external position will likely deteriorate.** Factors that drove the deficit higher in 2008 are expected to reverse and more than offset a sharp drop in export growth. Official inflows should remain strong, but FDI and other private inflows are expected to decline, likely resulting in a moderate deterioration in the overall external position in 2009. Based on this outlook, **gross official reserves would fall to around US\$1.9 billion** (3.1 months of imports) by end-2009.



7. **The balance of risks is clearly to the downside**, because of uncertainty about the length and depth of the global recession and its impact on trade and capital flows. Adding to pressures is a recent loss in competitiveness stemming from high domestic inflation coupled with U.S. dollar strength vis-à-vis most major currencies, leading to a sizable real appreciation. In the event of a sharper pullback in external demand or reversal in foreign inflows, with high dollarization, Cambodia could experience a pronounced liquidity contraction and possible large reserve loss, with limited policy options available to cushion the adjustment. A risk scenario such as this would put an even tighter squeeze on private credit availability, increase risks in the banking system, and raise external vulnerability.

8. **Medium-term prospects depend on maintaining macroeconomic and financial stability, improving governance and infrastructure, and taking other actions to strengthen competitiveness.** Under the current baseline, growth is projected to rise gradually to 7–7½ percent a year (Table 6), driven by FDI-promoted export opportunities, broader tourism development, and higher agricultural yields—each critical to sustained growth and poverty reduction, including meeting the Millennium Development Goals (Table 7).⁴ The current account deficit would narrow to 5–6 percent of GDP with further export diversification, even accounting for large investment-related imports. Under this scenario, the reserve cover would settle around 2½–3 months of imports. Underpinning stabilization efforts would be modest fiscal consolidation over the medium term, with the overall budget deficit narrowing to less than 2 percent of GDP by 2012.

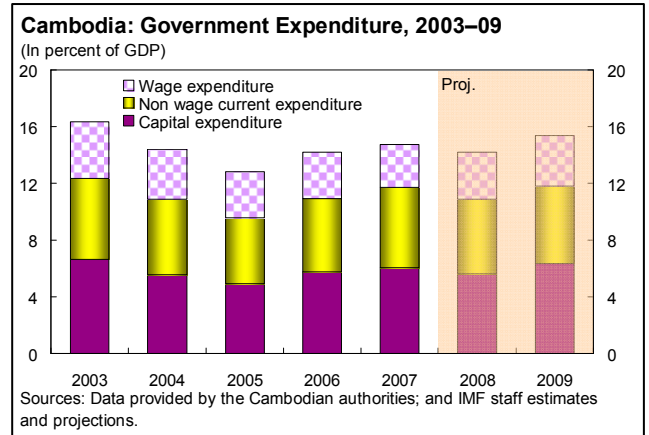
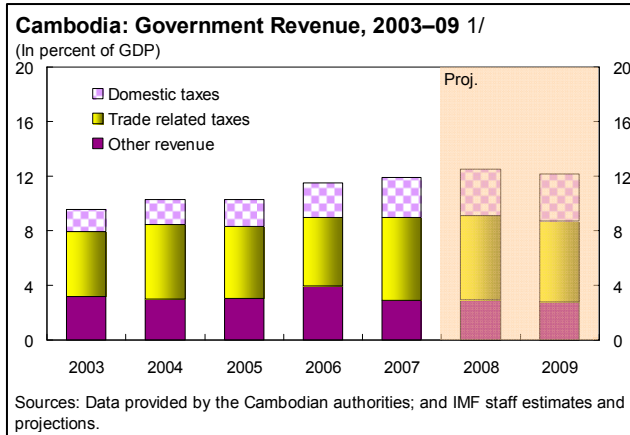
III. POLICY DISCUSSIONS

9. **Policy discussions centered on formulating effective responses to the sharp global slowdown.** Given recent developments, the policy focus has shifted quickly away from dealing with excessive inflation pressures to preventing a sharp economic downturn. The authorities recognized that sudden and rapid change in underlying macroeconomic and financial conditions required careful policy considerations, in particular to manage the impact of a weakening economy and external inflows on the banking sector. Staff urged quick and decisive action on all fronts to contain the impact of the global crisis through moderate fiscal easing, improved liquidity management, and measures to protect the banking system. The authorities generally concurred with these priorities.

A. Fiscal Policy

10. **In view of the near-term outlook, a countercyclical easing of fiscal policy is being targeted in 2009.** The authorities proposed a preliminary 2009 budget with an overall budget deficit of 4¼ percent of GDP. Staff indicated a deficit of around 3¼ percent of GDP in 2009 would provide an adequate fiscal impulse without undermining stabilization efforts (Box 3). The main difference is the revenue outlook. The authorities argued that revenue would decline more sharply (as a share of GDP) than staff envisaged, due mainly to lower expected automobile imports. Staff noted that even taking into account expected weaknesses in import growth and corporate profits, revenue would only be expected to decline by around ½ percent of GDP, absent any new measures. However, staff recognized that in the event of a sharper-than-expected growth slowdown, scope could remain for even further easing, in the form of

⁴ As with the 2007 Article IV consultation, the baseline scenario does not incorporate prospective oil production. Currently, Chevron Corporation is evaluating its test wells. Sector development also awaits improved legal certainty, in particular passage of the Petroleum Law and amendment of the Taxation Law.



select (temporary) tax relief and spending aimed at protecting the most vulnerable groups. In this case, caution was urged, taking into account limited implementation capacity, with a view to avoiding any serious recourse to domestic financing or weakening in the external position.⁵

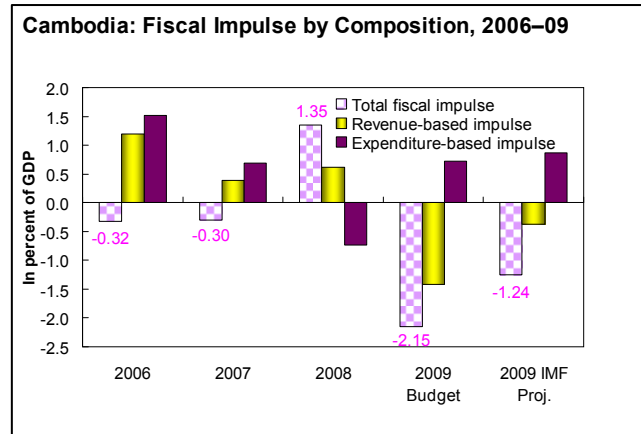
Box 3. Cambodia: 2009 Budget—Fiscal Impulse¹

Cambodia's 2009 draft budget is significantly more expansionary than recent outturns. This was also true for the 2008 budget, but the actual outturn is likely to be contractionary (consistent with the authorities' policy response to domestic inflation pressures).

The 2009 budget yields a fiscal impulse of 2¼ percentage point of GDP compared to the projected outturn for 2008.² The staff's 2009 outlook is also expansionary, but less so than the draft budget.

Under both the draft budget and staff projections for 2009, the stimulus effect would come from revenue and expenditure. For the

budget, the revenue impulse is more pronounced, mainly because of lower expected trade tax collections. Staff projections are already conservative here, with trade taxes as a share of retained imports expected to remain constant in 2009 despite further expected administrative improvements (imports exclude those for garment production and changes in oil prices—the latter due to the use of fixed reference prices on petroleum taxation). On the other hand, staff projections yield a slightly larger expenditure impulse than the 2009 budget, due mostly to higher capital spending coming from recently announced loans from China, partially offset by lower recurrent spending.



¹ The fiscal impulse measures the fiscal position net of the impact of output effect on the budget. For the revenue impulse: (+) contractionary (-) expansionary; for the expenditure impulse: (+) expansionary (-) contractionary.

² Cyclical components were extracted using trend GDP (calculated by the HP filter with a smoothing parameter of 6.25).

⁵The government issues no securities. Thus, any domestic financing would come as a reduction in deposits held in the banking system. As of end-October 2008, these deposits were equivalent to around 6½ percent of GDP.

11. Main policy recommendations focused on improving revenue performance, ensuring proper spending allocation, and strengthening public financial management (PFM).

- On revenue, staff argued that as conditions improve, new revenue measures should be considered, in keeping with the government’s medium-term revenue strategy. Additional revenue could come from a gradual rise in the reference price for petroleum taxation (unchanged since 2004), select increases in excises (mainly beer and cigarettes), and a broadening of the VAT base, including covering utilities—all in keeping with previous recommendations to improve tax efficiency. The authorities indicated tax increases, in particular on petroleum, remained politically sensitive, but that they planned to expand the VAT base in 2009 to cover electricity in line with their medium-term revenue strategy, which staff welcomed. Staff also continued to urge adoption of transparent fiscal regime for extractive industries, in the context of amending the Law on Taxation, which the authorities broadly agreed.
- On expenditure, staff noted that the large budgeted increase in nonwage recurrent spending should be oriented toward pro-poor social outlays (including locally-financed capital expenditure) to mitigate the impact of the projected growth slowdown.⁶ The authorities mostly agreed, but explained the final budget might need to accommodate higher military spending. Staff also noted concerns about rising government wage and administration costs, including those associated with a recently expanded cabinet, and urged further wage increases be linked to comprehensive civil service reform given still limited capacity and skill deficiencies.⁷ The authorities noted staff’s concerns, but cited the wage bill is lower as a share of GDP than neighboring countries and that cabinet-related expenses are needed to accommodate the political process.
- In line with IMF technical assistance (TA) recommendations, staff urged PFM reforms be accelerated, including tackling budget integration, particularly as it pertains to the recording of donor-financed capital spending. The authorities agreed that reform efforts had been slower than desired due to the elections and adoption of new procurement procedures, and reiterated their commitment to renew momentum.

B. Monetary and Exchange Rate Policy

12. The current monetary stance is seen as broadly appropriate, but conditions have tightened rapidly, bearing close watch. Staff recommended that as credit growth decreases and inflation pressures subside, a moderate cut in the reserve requirement on FCDs would be justified. Under the current baseline, broad money is expected to increase by only around

⁶ The government has indicated it will use Multilateral Debt Relief Initiative (MDRI) proceeds to address rural infrastructure gaps.

⁷ Under the PFM reform program, the Merit-Based Pay Initiative was launched in 2005 on a pilot basis at the Ministry of Economy and Finance; it is now being extended to donor-financed activities in other ministries.

2½ percent in 2009, with weak inflows significantly constraining liquidity growth. As a result and also reflecting demand conditions, private sector credit growth is expected to expand by only 10 percent (y/y) in 2009. Staff and authorities agreed temporary liquidity shortages could arise in individual banks over the near term, but that these would be better handled through improved liquidity operations rather than through general policy easing.

13. **With strains already emerging, discussions focused on need to strengthen liquidity management at the NBC and reduce liquidity risk among banks.** Staff and the authorities recognized an effective policy response continues to be constrained by an underdeveloped operational framework, lack of instruments, and weak banking sector, with dollarization limiting available options. The authorities concurred immediate priority should be placed on (i) improving the liquidity monitoring framework through more frequent reporting of banks' liquidity position to better understand factors driving their reserves at the NBC; and (ii) developing an overdraft facility to address temporary liquidity shortages, with new regulations being formulated, including on acceptable collateral. With government securities nonexistent, staff cautioned the need under this facility to assess carefully any assets banks pledge as collateral. The authorities also agreed improvements are needed in the required reserve system—mainly reducing the maintenance period from 28 to 14 days, so banks can better manage their own liquidity needs.

14. **Staff recommended steps be taken over the medium term toward greater exchange rate flexibility.** In the past, the exchange rate served as a useful nominal anchor, given Cambodia's low level of financial development, ongoing need to improve bank soundness, and until recently, moderate imported inflation. Staff noted that greater flexibility could help deepen the foreign exchange market and facilitate an orderly progression toward de-dollarization, supported by more effective monetary controls. The authorities agreed on a more flexible exchange rate regime as a medium-term policy objective, but for now viewed the heavily managed float vis-à-vis the U.S. dollar as appropriate. Staff urged that intervention be limited to smoothing short-term volatility, so as to maintain adequate reserves in the event of a further sharp deterioration in external conditions or the NBC were called to act as lender of last resort.

C. Banking Sector Issues

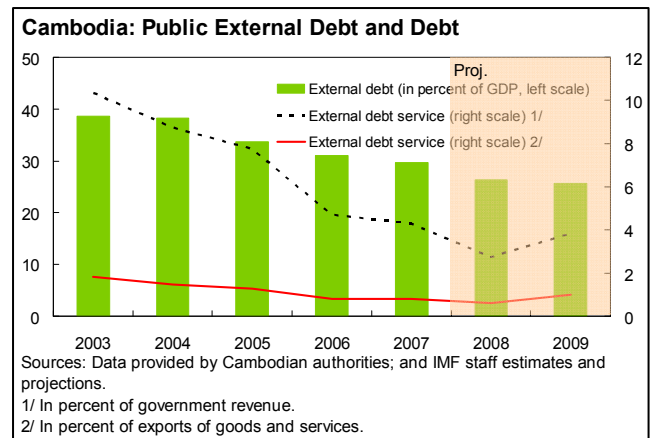
15. **Excessive credit growth, regulatory forbearance, and now tighter funding conditions have heightened risks to the banking sector.** Staff urged much closer monitoring by the NBC of banks' compliance with prudential regulations to prevent systemic problems. The NBC continues to improve supervisory capacity, with plans in 2009 for more intensive on- and off-site monitoring. However, enforcement remains weak, in particular dealing effectively with capital adequacy and loan provisioning. Staff also noted that bank licensing procedures need to be strengthened, with new entry reserved to those entities with a significant banking background. To this end, the NBC was urged to ensure close coordination between its recently established Financial Intelligence Unit and Banking Supervision Department to

ensure new and existing banks complied fully with anti-money laundering guidelines. Finally, staff welcomed the updating of fit-and-proper rules.

16. **To safeguard against risks, staff urged the NBC take quick and forceful action in several critical areas.** First, loan classification standards should be revised to force banks to take into account borrowers' ability to repay and underlying risks. Closer monitoring of large exposure loans is also necessary, and higher risk weights should be attached to more risky types of lending, including to the real estate sector (in place of sector lending caps). Second, new minimum capital requirements established to take effect in 2010 should be brought forward for banks facing elevated solvency risk.⁸ Third, given limited resources, bank supervisors should prioritize their inspections and coordinate with external auditors, focusing on those banks with a history of lax adherence to prudential regulations and on the large systemically-important banks. Finally, banking resolution plans should be formulated facilitating bank consolidation, if necessary; designating a clear role for the NBC as lender of last resort; and providing a credible settlement mechanism, for which the authorities requested IMF TA. They also indicated interest in pursuing a Financial Sector Assessment Program (FSAP) to ensure proper oversight of the financial sector.

D. Competitiveness and Sustainability

17. **Competitiveness will be tested, in particular over the near term, given recent developments.** An exchange rate assessment reveals that the riel is overvalued in the range of 11–13 percent (Box 4). The government's policy framework presented to the new National Assembly in September 2008 places increasing competitiveness at its core.⁹ Staff encouraged efforts to improve trade facilitation, including further streamlining customs clearance and improving port and border infrastructure. The authorities indicated they are seeking continued dialogue with the European Union to relax the restriction on local input content on garment from 45 to 25 percent, which by their estimates could boost the EU's share of garment exports by 10 percentage points. Cambodia also continues to seek preferential



⁸ The minimum capital requirement has been tripled to CR 150 million or around US\$37 million. It applies to all commercial banks, except foreign subsidiaries of investment-grade banks. As of November 2008, 10 of the 20 banks to which the new requirement will apply were already in compliance.

⁹ The government's "Rectangular Strategy" seeks to (i) raise agriculture productivity through output diversification and land reform; (ii) expand and improve infrastructure, concentrating on water and transport; (iii) encourage private sector development, focusing on small-to-medium scale enterprises, and (iv) build human capacity, in particular in education and health services.

treatment for garment exports to the United States by taking advantage of its low income country status.

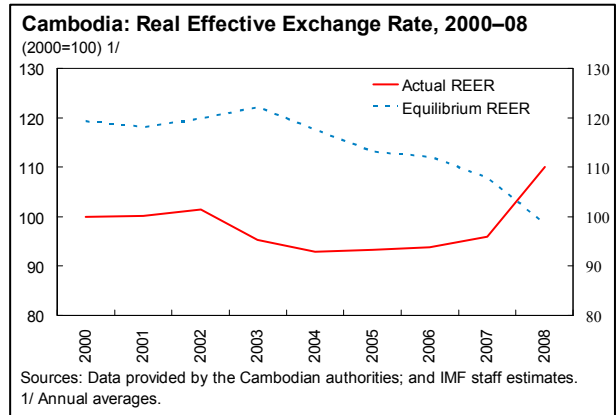
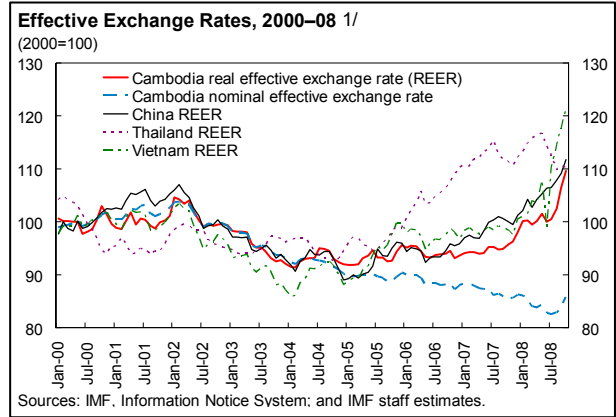
Box 4. Cambodia: Exchange Rate Assessment and External Stability

Based on the CGER-type assessments, Cambodia’s current exchange rate appears overvalued in the range of 11–13 percent. However, these are broad estimates and should be interpreted cautiously, as structural changes in the economy and weak macroeconomic data complicate the analysis. For the garment industry, the U.S. dollar-Cambodian riel exchange rate per se may be less of a factor than external demand conditions, given mostly U.S. dollar-denominated costs. Nevertheless, an overvalued riel could hurt some producers, as well as the tourism industry, combined with other factors constraining competitiveness.

The main findings of this assessment are summarized as follows:

- **Macroeconomic balance approach:** The current account (CA) norm is estimated at minus 4 percent of GDP and the underlying CA at minus 7 percent of GDP. This implies that a riel depreciation of about 13 percent is needed to close output gaps with partner countries and allow lagged effects of past exchange rates to be fully realized.
- **Equilibrium REER approach:** Cambodia’s equilibrium exchange rate has depreciated in recent years largely due to a deterioration in its terms of trade. However, with the recent REER appreciation, the riel appears overvalued at around 11 percent.

The need to improve productivity is more important than ever. Greater regional competition in garment exports, rising local wages (in dollars), and higher material costs portend difficulties ahead, including further loss in market share.¹ Moreover, global business climate indicators tend to rank Cambodia at the lower end. Better infrastructure (notably roads and electricity), a more skilled workforce, and less burdensome business regulation, along with maintenance of a stable macroeconomic environment, would address the major impediments to improving competitiveness.



Assessment of Business Climate			
	2008	2009 Doing	2007–08
	CPI 1/	Business 2/	GCI 3/
Countries	Rank	Rank	Rank
Singapore	4	1	7
China	72	83	34
Thailand	84	13	28
Vietnam	123	92	48
Cambodia	162	135	110
Total	180	181	122

Sources: Transparency International, World Bank, and World Economic Forum.
 1/ Corruption Perception Index by Transparency International.
 2/ By the IFC.
 3/ Global Competitiveness Index by the World Economic Forum.

¹ Since 2006, Cambodia’s share of U.S. garment imports has risen by 0.3 percentage points to 2.6 percent (for the year ending September 2008). During the same period, the share of imports from Vietnam and China increased from 3.6 to 5.8 percent and from 29.0 to 34.4 percent, respectively (based U.S. Department of Commerce data).

18. **Debt Sustainability Analysis (DSA):** Given longer-term prospects, Cambodia currently faces a moderate risk of external debt distress. In the DSA, no thresholds are breached under the baseline scenario and standard stress tests and alternative scenarios, except one bound tests (Appendix I). However, this benign outlook is subject to substantial downside risk, as shown in the DSA, in the event of a prolonged economic downturn, but the likelihood of debt distress remains moderate. Under the baseline scenario, the public external debt (projected at 27 percent of GDP at end-2008) should decline steadily over the medium term. The debt service-to-exports ratio is expected to stay below 3 percent. These results presume that external borrowing would gradually move toward less concessional terms and no resolution of external debt arrears with either the Russian Federation or United States takes place.

IV. STAFF APPRAISAL

19. **Cambodia is facing its most challenging macroeconomic and financial conditions this decade.** External shocks have been magnified by the concentration of economic activity, dependence on external inflows, and weaknesses in the banking system. The Cambodian authorities have swiftly recognized the serious challenges that lie ahead and agree on the necessity of a clear and timely policy response to manage the risks and avoid an even deeper downturn.

20. **Fiscal policy is expected to continue to underpin stabilization efforts, with a more expansionary stance in 2009 appropriate.** The government is to be commended for strong budget performance so far in 2008, especially given potential pressures arising from national elections, border security issues, and a weakening economy. Moderate fiscal easing in 2009 could help mitigate the impact of an expected growth slowdown, focused on higher pro-poor social and infrastructure outlays. However, continued efforts are needed to strengthen revenue administration and, as conditions permit, broaden the tax base. More control should also be exercised over the government's wage bill, with future increases linked to comprehensive civil service reform. Recognizing security concerns, military spending should avoid crowding out other essential spending. Concerted efforts are also needed to strengthen PFM, in particular on improving Treasury management and budget coordination and integration, including the recording of donor inflows. Finally, to maximize public gain, future oil and mineral production should be guided by a transparent fiscal regime.

21. **The current monetary stance is broadly appropriate, but conditions require close watch to avoid excessive tightening and aggravating risks to banking system.** As credit growth drops and inflation pressures subside, moderate easing could be justified. However, further steps are needed to improve policy effectiveness along the lines of longstanding IMF TA recommendations. Sound monetary operations at the NBC also hinge on better internal coordination to ensure policy consistency. A more developed framework will be needed in the years ahead, with a new nominal anchor that relies more on market-based instruments and prioritizes greater inflation control.

22. **A clear strategy must be put in place to manage liquidity risk.** Upfront action should be taken to strengthen the liquidity management framework to deal with potential pressures. The NBC's recent moves toward putting in place an overdraft facility is a critical step in this direction, but caution will need to be exercised in assessing eligible collateral and distinguishing liquidity from solvency pressures facing banks. In providing any liquidity support, the NBC should consider potential risks to its own balance sheet in the event banks are unable to repay, since reserve losses could further undermine confidence and increase external vulnerability. Staff urges equally swift measures be enacted to improve the required reserve system.

23. **Beyond immediate actions to contain liquidity risk, swift and comprehensive measures are needed to improve banking soundness, including on solvency issues.** The NBC continues to strengthen the prudential framework, but more systematic efforts are needed in supervising banks and enforcing regulations, given the likelihood nonperforming loans will rise as the economy further slows. The authorities should also develop banking resolution plans, in view of solvency risk faced by some banks, and strengthen bank licensing procedures. New minimum capital requirements should be brought forward, with those banks facing heightened solvency risks required to be in compliance immediately. An FSAP could help identify other vulnerabilities to the financial system and prioritize further policy actions.

24. **In light of recent developments, more efforts are needed to improve external competitiveness.** The exchange rate assessment points to an overvaluation of the riel. However, with a highly dollarized economy, exchange rate adjustment would play a limited role in resolving imbalances. On the other hand, competition gains should arise from maintaining a stable macroeconomic environment, along with taking steps to develop a more skilled workforce, improve public services and infrastructure, and streamline business regulation.

25. **Risk of external debt distress is moderate, but could become more pronounced with a prolonged downturn.** In light of this possibility and given a large external borrowing requirement, prudent debt management remains essential, with Cambodia expected continue to borrow on largely concessional terms in the foreseeable future. The authorities are also encouraged to continue seeking agreements to resolve outstanding debt obligations with the Russian Federation and United States.

26. **If the need were to arise and understandings could be reached on outstanding debt arrears, staff would support a request for a new PRGF arrangement.** Any such arrangement would need to be underpinned by a strong reform agenda aimed at strengthening competitiveness, reducing vulnerabilities, and ensuring a viable external position. Under any circumstances, staff urge the authorities to carry on their reform efforts, which the IMF will continue to support through intensive TA and policy dialogue.

27. It is recommended that Cambodia remain on the 12-month consultation cycle.

Table 1. Cambodia: Selected Economic Indicators, 2005–09

Nominal GDP (2007):	\$8.69 billion	GDP per capita (2007):		\$649		
Population (2007):	13.4 million	Poverty rate (2005):		35 percent		
Main exports (2007):	Garments (73.7 percent of total)	Fund Quota:		SDR 87.5 million		
	2005	2006	2007	2008	2008	2009
			Est.	Latest 1/	Proj.	Proj.
Output and prices (annual percent change)						
GDP in constant prices	13.3	10.8	10.2	...	6.5	4.8
(excluding agriculture)	8.1	17.3	12.2	...	8.1	5.3
Real agricultural output	15.7	5.5	5.0	...	2.0	3.5
GDP deflator	6.1	4.6	6.5	...	15.3	8.0
CPI Inflation (end-year) - Phnom Penh, old	6.7	2.8	10.8	15.7	15.5	7.4
(Annual average)	5.8	4.7	5.9	19.5	20.0	8.2
Saving and investment balance (in percent of GDP)						
Gross national saving	14.6	19.9	17.4	...	9.1	11.9
Government saving	1.9	1.8	2.9	...	3.4	2.7
Private saving	12.7	18.1	14.5	...	5.7	9.2
Gross fixed investment	18.5	20.6	20.8	...	21.0	19.0
Government investment	4.9	5.7	6.1	...	5.6	6.3
Non-budgetary grant-financed investment	3.0	3.6	2.4	...	1.9	1.7
Private investment	10.5	11.2	12.3	...	13.5	11.0
Money and credit (annual percent change, unless otherwise indicated)						
Broad money	16.1	38.2	62.9	19.5	4.9	2.6
Net credit to the government 2/	-4.9	-10.6	-12.4	-11.1	-9.5	-5.1
Private sector credit	31.8	51.6	76.0	75.5	60.0	10.0
Velocity of money 3/	5.4	4.9	3.9	3.5	3.6	4.0
Public finance (in percent of GDP)						
Revenue 4/	10.3	11.5	11.9	10.5	12.5	12.1
Of which: Tax revenue	7.6	7.9	9.5	8.6	10.1	9.9
Expenditure	12.8	14.2	14.7	11.1	14.2	15.4
Current expenditure	7.9	8.5	8.7	6.8	8.6	9.1
Capital expenditure 5/	4.9	5.7	6.1	4.3	5.6	6.3
Overall budget balance (excluding grants)	-2.5	-2.7	-2.9	-0.6	-1.7	-3.2
Foreign financing, net	4.9	4.8	5.0	3.4	4.3	4.6
Domestic financing, net 6/	-2.4	-2.0	-2.2	-2.8	-2.6	-1.3
Balance of payments (in millions of dollars, unless otherwise indicated)						
Exports, f.o.b.	2,910	3,694	4,089	...	4,363	4,197
(Annual percent change)	12.4	26.9	10.7	...	6.7	-3.8
Imports, f.o.b.	-3,904	-4,727	-5,419	...	-6,523	-5,798
(Annual percent change)	19.4	21.1	14.6	...	20.4	-11.1
Current account (including official transfers)	-240	-47	-296	...	-1,268	-845
(In percent of GDP)	-3.8	-0.6	-3.4	...	-11.9	-7.1
Gross official reserves 7/	915	1,097	1,616	2,093	2,033	1,933
(In months of prospective imports)	2.0	2.1	2.5	3.6	3.5	3.1
External debt (in millions of dollars, unless otherwise indicated)						
Public external debt 8/ 9/	2,120	2,254	2,582	...	2,809	3,087
(In percent of GDP)	35.0	31.0	29.7	...	26.8	26.0
Public debt service (cash basis)	28	28	36	...	28	46
(In percent of exports of goods and services)	0.7	0.6	0.6	...	0.5	0.8
Memorandum items:						
Nominal GDP (in billions of riels)	25,754	29,849	35,039	...	42,999	48,691
(In millions of U.S. dollars)	6,286	7,264	8,690	...	...	...
Exchange rate (riels per dollar; period average)	4,097	4,109	4,032	4,064	...	...

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ CPI is as of November; money and credit is as of end-October; public finance is as of end-October; and gross official reserves are as of December 5, 2008. The exchange rate is the year-to-date average through December 21, 2008.

2/ Contribution to broad money growth.

3/ Ratio of nominal GDP to the average stock of broad money.

4/ In 2006, includes transfer from the IMF of Multilateral Debt Relief Initiative (MDRI) proceeds as capital revenue.

5/ In 2005, includes repayment of arrears.

6/ Includes funds in transit and payment orders in excess of cash released.

7/ Excludes unrestricted foreign currency deposits held as reserves at NBC and valuation changes.

8/ From 2006, includes the impact of debt forgiveness from the IMF under the MDRI.

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

Table 2. Cambodia: Balance of Payments, 2005–09

(In millions of U.S. dollars, unless otherwise specified)

	2005	2006	2007	2008	2009
			Est.	Projection	
Current account (including official transfers)	-240	-47	-296	-1,268	-845
(Excluding official transfers)	-606	-522	-694	-1,725	-1,311
Trade balance	-993	-1,034	-1,330	-2,160	-1,601
Exports, f.o.b.	2,910	3,694	4,089	4,363	4,197
<i>Of which:</i> Garments	2,206	2,663	2,840	2,938	2,857
Imports, f.o.b.	-3,904	-4,727	-5,419	-6,523	-5,798
<i>Of which:</i> Garments sector	-1,106	-1,298	-1,376	-1,473	-1,393
Petroleum	-841	-1,123	-1,347	-1,981	-1,172
Services and income (net)	179	197	259	85	-35
Services (net)	483	516	644	488	346
<i>Of which:</i> Tourism (credit)	840	963	1,149	1,212	1,086
Income (net)	-304	-319	-384	-403	-380
Private transfers (net)	209	315	377	350	325
Official transfers (net)	365	475	398	457	466
Capital and financial account	305	240	724	1,648	715
Medium- and long-term loans (net)	170	118	251	196	253
Disbursements	177	132	269	221	288
Amortization	-7	-14	-19	-25	-35
Capital transfers 1/	0	76	0	0	0
Foreign direct investment	375	483	866	785	488
Net foreign assets of deposit money banks (change, + decrease) 2/	-16	-181	-384	806	8
Errors and omissions 3/	-224	-257	-9	-139	-34
Overall balance	65	193	427	379	-130
Financing	-65	-193	-427	-379	130
Change in gross official reserves 4/	-77	-138	-447	-400	110
Use of IMF credit	-9	-82	0	0	0
Purchases/disbursements	0	0	0	0	0
Repurchases/repayments 5/	9	82	0	0	0
Debt restructuring 5/	0	6	0	0	0
Accumulation of arrears	22	21	20	21	19
Memorandum items:					
Current account balance (in percent of GDP)					
Excluding official transfers	-9.6	-7.2	-8.0	-16.3	-11.0
Including official transfers	-3.8	-0.6	-3.4	-11.9	-7.1
Trade balance (in percent of GDP)	-15.8	-14.2	-15.3	-20.4	-13.5
Gross official reserves	915	1,097	1,616	2,033	1,933
(In months of prospective imports)	2.0	2.1	2.5	3.5	3.1
(In percent of commercial banks' foreign currency deposits)	105.0	85.7	70.8	90.2	86.6
Net official international reserves	834	1,097	1,616	2,033	1,933
Public external debt 6/	2,120	2,254	2,582	2,809	3,087
(In percent of GDP)	35.0	31.0	29.7	26.8	26.0
(NPV in percent of GDP)	24.2	23.1	24.2	26.7	24.5
Public external debt service (Including IMF, cash basis)	28	28	36	28	46

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ Debt forgiveness from the IMF of debt incurred before 2005 under the MDRI.

2/ Includes unrestricted foreign currency deposits held as reserves at the NBC.

3/ Includes unidentified short-term flows.

4/ Excludes unrestricted foreign currency deposits held as reserves at NBC and valuation changes.

5/ Reflects the impact of MDRI debt forgiveness.

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

Table 3. Cambodia: General Government Operations, 2005–09

	2005	2006	2007	2008		2009	
			Est.	Budget	Staff Proj.	Budget	Staff Proj.
	(In billions of riels)						
Total revenue	2,653	3,431	4,165	4,109	5,377	5,397	5,907
<i>Of which</i> : Central government	2,559	3,240	3,962	3,957	5,122	5,105	5,604
Tax revenue	1,948	2,372	3,343	3,241	4,357	4,342	4,834
Direct taxes	222	331	480	486	687	746	797
Indirect taxes	1,647	1,920	2,676	2,624	3,433	3,324	3,755
<i>Of which</i> : Trade tax	573	644	903	858	1,082	1,032	1,153
Provincial taxes	79	121	187	131	237	272	282
Nontax revenue	578	681	705	710	796	871	889
Capital revenue 1/	127	377	117	157	223	183	183
<i>Of which</i> : MDRI capital transfer 2/	0	341	0	0	0	0	0
Total expenditure	3,303	4,244	5,164	5,680	6,111	7,417	7,487
Current expenditure	2,032	2,527	3,043	3,569	3,699	4,658	4,408
Wages	835	975	1,058	1,242	1,436	1,730	1,730
Nonwage	1,066	1,372	1,766	2,120	2,057	2,572	2,322
<i>Of which</i> : Interest payments	55	50	70	75	56	100	100
Provincial expenditure	130	180	220	207	207	357	357
Capital expenditure	1,272	1,716	2,121	2,111	2,412	2,759	3,079
Locally financed	315	381	436	709	630	966	966
From MDRI capital transfer	0	0	2	2	83	92	92
Externally financed 3/	956	1,336	1,682	1,400	1,699	1,700	2,021
Current balance	494	526	1,004	383	1,454	555	1,315
Overall balance (excluding grants)	-650	-813	-1,000	-1,571	-734	-2,020	-1,581
Financing	650	813	1,000	1,571	734	2,020	1,581
Foreign (net)	1,275	1,418	1,768	1,501	1,861	1,895	2,216
Disbursements	1,312	1,474	1,870	1,621	1,981	2,035	2,356
Grants	551	761	764	883	1,030	1,078	1,078
Loans	761	712	1,106	738	951	957	1,278
Amortization	-38	-55	-102	-120	-120	-140	-140
Domestic (net)	-624	-606	-768	70	-1,127	125	-635
Bank financing (net)	-212	-532	-863	120	-1,077	155	-605
Other	-412	-74	94	-50	-50	-30	-30
	(In percent of GDP)						
Total revenue	10.3	11.5	11.9	10.9	12.5	11.1	12.1
<i>Of which</i> : Central government	9.9	10.9	11.3	10.5	11.9	10.5	11.5
Tax revenue	7.6	7.9	9.5	8.6	10.1	9.0	9.9
Nontax revenue	2.2	2.3	2.0	1.9	1.9	1.8	1.8
Capital revenue 1/	0.5	1.3	0.3	0.4	0.5	0.4	0.4
Total expenditure	12.8	14.2	14.7	15.1	14.2	15.3	15.4
Current expenditure	7.9	8.5	8.7	9.5	8.6	9.6	9.1
<i>Of which</i> : Wages	3.2	3.3	3.0	3.3	3.3	3.6	3.6
Nonwage	4.1	4.6	5.0	5.6	4.8	5.3	4.8
Capital expenditure 3/	4.9	5.7	6.1	5.6	5.6	5.7	6.3
Current balance	1.9	1.8	2.9	1.0	3.4	1.1	2.7
Overall balance (excluding grants)	-2.5	-2.7	-2.9	-4.2	-1.7	-4.2	-3.2
Financing (net)	2.5	2.7	2.9	4.2	1.7	4.2	3.2
Foreign	4.9	4.8	5.0	4.0	4.3	3.9	4.6
Disbursements	5.1	4.9	5.3	4.3	4.6	4.2	4.8
Grants	2.1	2.5	2.2	2.3	2.4	2.2	2.2
Loans	3.0	2.4	3.2	2.0	2.2	2.0	2.6
Amortization	-0.1	-0.2	-0.3	-0.3	-0.3	-0.3	-0.3
Domestic	-2.4	-2.0	-2.2	0.2	-2.6	0.3	-1.3
Bank financing (net)	-0.8	-1.8	-2.5	0.3	-2.5	0.3	-1.2
Other	-1.6	-0.2	0.3	-0.1	-0.1	-0.1	-0.1
Memorandum items:							
Social spending (in percent of GDP)	2.9	2.8	2.4	...	2.4	...	2.4
Overall balance (including grants, in percent of GDP)	-0.4	-0.2	-0.7	-1.8	0.7	-1.9	-1.0
GDP (in billions of riels)	25,754	29,849	35,039	37,694	42,999	48,446	48,691

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ Capital revenue includes privatization proceeds.

2/ The full amount of MDRI proceeds (CR 341 billion) was recorded as capital revenue in 2006. In subsequent years, spending under MDRI has been recorded as capital expenditure.

3/ Capital expenditure (externally financed) includes a statistical discrepancy, reflecting the difference between actual and recorded disbursements.

Table 4. Cambodia: Monetary Survey, 2006–09

	2006	2007	2008				2009	
	Dec.	Dec.	March	June	Sept.	Oct.	Dec. Proj.	Dec. Proj.
	(In billions of riels)							
Net foreign assets	7,224	10,735	10,911	11,353	10,809	9,864	9,393	8,942
National Bank of Cambodia (NBC)	5,729	8,579	9,706	10,783	11,187	10,385	9,976	9,156
Foreign assets	5,729	8,579	9,706	10,783	11,187	10,385	9,976	9,156
Foreign liabilities	0	0	0	0	0	0	0	0
Deposit money banks (DMBs)	1,496	2,156	1,205	570	-378	-521	-583	-214
Foreign assets	1,921	3,311	2,597	2,314	2,415	1,989	1,700	1,454
Foreign liabilities	426	1,156	1,391	1,744	2,792	2,510	2,283	1,668
Net domestic assets	-282	576	1,136	1,345	1,748	2,017	2,473	3,238
Domestic credit	2,676	4,570	5,650	6,527	7,128	7,196	7,323	7,738
Government (net)	-953	-1,816	-2,400	-2,678	-2,653	-2,747	-2,894	-3,500
NBC	-807	-1,632	-2,187	-2,435	-2,405	-2,474	-2,655	-3,261
DMBs	-146	-184	-213	-244	-248	-274	-239	-239
Private sector	3,628	6,385	8,049	9,205	9,780	9,943	10,216	11,237
Other items (net)	-2,959	-3,994	-4,514	-5,182	-5,380	-5,179	-4,850	-4,500
Broad money	6,942	11,311	12,047	12,698	12,557	11,881	11,865	12,180
Narrow money	1,658	2,052	2,389	2,467	2,335	2,212	2,458	2,840
Currency in circulation	1,600	1,990	2,324	2,349	2,259	2,127	2,388	2,770
Demand deposits	58	62	65	118	76	85	70	70
Quasi-money	5,285	9,259	9,658	10,231	10,223	9,669	9,408	9,340
Time deposits	89	121	126	150	181	167	166	192
Foreign currency deposits	5,196	9,138	9,532	10,081	10,042	9,501	9,242	9,148
	(12-month percentage change)							
Net foreign assets	31.9	48.6	35.4	25.5	10.7	0.3	-12.5	-4.8
Private sector credit	51.6	76.0	98.0	102.9	82.0	75.5	60.0	10.0
Broad money	38.2	62.9	54.6	43.1	26.7	19.5	4.9	2.6
Of which: Currency in circulation	24.8	24.4	34.1	41.1	34.5	23.1	20.0	16.0
Foreign currency deposits	44.8	75.9	61.4	43.4	24.7	18.3	1.1	-1.0
	(Contribution to year-on-year growth of broad money, in percentage points)							
Net foreign assets	34.8	50.6	36.6	26.0	10.5	0.3	-11.9	-3.8
Net domestic assets	25.8	12.4	18.0	17.1	16.2	19.2	16.8	6.4
Domestic credit	14.0	-17.4	35.4	38.2	33.3	31.9	24.3	8.2
Government (net)	-10.6	-12.4	-15.7	-14.4	-11.2	-11.1	-9.5	-5.1
Private sector	24.6	39.7	51.1	52.6	44.5	43.0	33.9	8.6
Other items (net)	-10.7	-14.9	-17.4	-21.1	-17.1	-12.7	-7.6	2.9
Memorandum items:								
Foreign currency deposits (in millions of U.S. dollars)	1,279	2,283	2,384	2,461	2,440	2,309	2,254	2,231
(In percent of broad money)	74.8	80.8	79.1	79.4	80.0	80.0	77.9	75.1
Riel component of broad money	1,746	2,173	2,515	2,617	2,515	2,379	2,623	3,032
(In percent of broad money)	25.2	19.2	20.9	20.6	20.0	20.0	22.1	24.9
Credit to the private sector (in millions of U.S. dollars)	893	1,595	2,013	2,247	2,376	2,417	2,491	2,741
(In percent of GDP)	12.2	18.2	19.2	21.4	22.7	23.0	23.8	23.1
Loan-to-deposit ratio (in percent) 1/	67.1	67.4	82.0	88.7	94.6	101.7	106.1	104.4
Velocity 2/	4.9	3.9	3.6	3.5	3.5	3.5	3.6	4.0
Money multiplier (broad money/reserve money)	2.1	2.2	2.2	2.1	1.9	2.0	2.0	2.0
Reserve money (12-month percent change)	28.3	48.6	52.2	53.1	52.9	39.4	16.3	2.7

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ Foreign currency loans and deposits only.

2/ The ratio of nominal GDP to the year-to-date average stock of broad money.

Table 5. Cambodia: Financial Soundness Indicators, 2006–08

	2006	2007		2008	
	Dec.	June	Dec.	June	Sept.
Number of banks	20	21	24	25	28
Commercial banks	15	16	17	20	22
<i>Of which</i> : State-owned banks	1	1	1	1	1
Specialized banks 1/	5	5	7	5	6
Bank concentration—number of banks accounting for:					
25 percent of banks' total assets	2	2	2	2	2
75 percent of banks' total assets	7	7	6	7	6
Capital adequacy (in percent)					
Regulatory capital to risk-weighted assets	26.5	26.8	23.6	25.6	25.6
Capital to assets	20.0	18.1	17.0	19.4	19.5
Nonperforming loans net of provisions to capital	19.4	11.9	8.2	5.3	4.9
Asset quality (in percent)					
Non-performing loans to regulatory total loans	9.9	5.9	3.4	2.6	2.7
Large exposures to capital	60.4	10.6	7.3	43.4	38.7
Sectoral distribution of loans (in percent of total loans)					
Real estate	8.6	9.1	7.9	7.0	7.6
Construction	7.7	10.5	10.2	7.0	6.8
Consumer	10.2	14.3	19.7	20.3	21.5
Earnings and profitability (in percent)					
Return on assets	2.8	3.5	2.8	3.4	3.1
Return on equity	14.2	19.3	16.6	17.6	15.8
Liquidity (in percent)					
Liquid assets ratio 2/	41.7	43.1	48.4	37.7	38.6
Liquid assets to total deposits	56.6	56.9	65.6	55.0	60.9
Liquid assets ratio net of short-term liabilities	49.4	50.2	43.5	30.4	27.8
Loan-to-deposit ratio 3/	60.5	56.9	62.7	82.4	85.5
Foreign exchange exposure (in percent)					
Foreign currency deposits to total deposits	97.2	97.2	97.7	98.2	98.2
Foreign currency loans to total loans	96.7	97.3	97.6	97.1	96.9
Memorandum item:					
Banks' assets (in percent of GDP)	26.0	31.2	38.4	40.9	43.1

Sources: National Bank of Cambodia; and IMF staff estimates.

1/ Specialized banks are lending institutions that do not take deposits and are subject to lower capital requirements than commercial banks.

2/ Net of gross interbank transactions with resident banks.

3/ Commercial banks only.

Table 6. Cambodia: Medium-Term Macroeconomic Framework, 2006–14

	2006	2007	2008	2009	2010	2011	2012	2013	2014
		Est.				Proj.			
Output and prices (percent change)									
GDP in constant prices	10.8	10.2	6.5	4.8	6.0	6.6	7.1	7.4	7.6
GDP deflator	4.6	6.5	15.3	8.0	3.7	4.5	4.6	4.1	4.1
Consumer prices (end-year)	2.8	10.8	15.5	7.4	4.3	4.3	4.3	4.3	4.3
Saving and investment balance (in percent of GDP)									
Gross national saving	13.4	12.8	4.7	8.0	9.4	11.1	12.4	13.6	15.4
Government saving	1.8	2.9	3.4	2.7	3.2	3.5	3.7	3.7	3.6
Private saving	11.6	9.9	1.4	5.3	6.1	7.6	8.7	9.9	11.8
Gross fixed investment	20.6	20.8	21.0	19.0	20.0	20.5	21.0	21.5	22.5
Government investment	5.7	6.1	5.6	6.3	6.3	6.2	5.9	5.7	5.6
Non-budgetary grant-financed investment	3.6	2.4	1.9	1.7	1.7	1.2	0.8	0.6	0.4
Private investment	11.2	12.3	13.5	11.0	12.0	13.1	14.3	15.2	16.5
Public finance (in percent of GDP)									
Revenue 1/	11.5	11.9	12.5	12.1	12.5	12.9	13.4	13.5	13.6
Of which: Tax revenue	7.9	9.5	10.1	9.9	10.3	10.7	11.1	11.3	11.3
Expenditure	14.2	14.7	14.2	15.4	15.2	15.2	15.2	15.2	15.2
Current	8.5	8.7	8.6	9.1	8.9	9.1	9.3	9.5	9.6
Capital	5.7	6.1	5.6	6.3	6.3	6.2	5.9	5.7	5.6
Current balance	1.8	2.9	3.4	2.7	3.2	3.5	3.7	3.7	3.6
Primary balance (including grants)	0.0	-0.5	0.8	-0.8	-0.5	-0.1	0.5	0.6	0.5
Overall balance (excluding grants)	-2.7	-2.9	-1.7	-3.2	-2.7	-2.3	-1.8	-1.7	-1.6
(Including grants)	-0.2	-0.7	0.7	-1.0	-0.7	-0.2	0.3	0.4	0.4
External financing, net (including grants)	4.8	5.0	4.3	4.6	4.3	4.1	3.7	3.5	3.2
Domestic financing, net	-2.0	-2.2	-2.6	-1.3	-1.6	-1.8	-1.9	-1.8	-1.6
Balance of payments (in percent of GDP, unless otherwise indicated)									
Exports (percent change) 1/	27.6	9.5	6.5	-4.0	7.4	9.9	10.4	10.8	10.7
Imports (percent change) 2/	20.9	14.0	21.8	-11.4	9.7	10.3	10.7	10.5	10.5
Current account balance (including transfers)	-0.6	-3.4	-11.9	-7.1	-7.0	-6.1	-5.7	-5.3	-4.7
(Excluding transfers)	-7.2	-8.0	-16.3	-11.0	-10.6	-9.4	-8.6	-7.9	-7.1
Foreign direct investment (in millions of U.S. dollars)	483	866	785	488	551	623	710	817	947
Net official capital flows 3/	7.1	7.5	6.1	6.1	5.7	5.1	4.4	3.9	3.5
Overall balance	2.7	4.9	3.6	-1.1	-0.2	0.1	0.6	0.9	1.4
Gross official reserves (in millions of U.S. dollars)									
(In months of imports of goods and services)	1,097	1,616	2,033	1,933	1,925	1,958	2,074	2,255	2,564
	2.1	2.5	3.5	3.1	2.8	2.5	2.4	2.4	2.5
External public debt (in millions of U.S. dollars) 4/ 5/									
(In percent of GDP)	2,254	2,582	2,809	3,087	3,379	3,677	3,945	4,211	4,492
	31.1	29.7	26.8	26.0	25.9	25.3	24.2	23.2	22.1
External public debt/service ratio (accrual basis) 6/									
(Cash basis) 7/	1.1	1.0	0.8	1.2	1.3	1.3	1.2	1.3	1.4
	0.6	0.7	0.5	0.8	1.0	1.0	1.0	1.1	1.3

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ Excludes re-exported goods.

2/ Excludes imported goods for re-export.

3/ Net official disbursements, exceptional financing, and official transfers.

4/ From 2006, includes the impact of debt forgiveness from the IMF under the MDRI.

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

6/ As a percent of domestic exports of goods and services.

7/ Excludes the accumulation of arrears on debt owed to the Russian Federation and United States.

Table 7. Cambodia: Millennium Development Goals

	1990	1995	2000	2002	2003	2004	2005	2006	2007	2015
	MDG Target									
Goal 1: Eradicate extreme poverty and hunger										
Percentage share of income or consumption held by poorest 20 percent	...	8.5	...	...	...	...	7	...	...	11.0
Population below minimum level of dietary energy consumption (percent)	...	...	...	33	...	...	...	...	...	20.5
Poverty headcount, national (percent of population)	...	47	...	...	...	...	35	...	...	19.5
Prevalence of underweight in children (under five years of age)	...	...	45	...	...	...	...	...	...	26.2
Goal 2: Achieve universal primary education										
Net primary enrollment (percent of relevant age group)	67	...	85	93	...	...	91	...	96	100
Primary completion rate, total (percent of relevant age group)	...	...	55	55	54	57	55	...	87	100
Proportion of pupils starting grade 1 who reach grade 5	...	...	63	61	60	63	62	...	...	100
Youth literacy rate (percent of ages 15–24)	73	76	79	80	...	83	...	...	...	100
Goal 3: Promote gender equality and empower women										
Proportion of seats held by women in national parliament (percent)	...	...	8	7	7	10	10	10	10	30
Ratio of girls to boys in primary and secondary education (percent)	73	...	82	85	86	87	90	89	93	100
Ratio of young literate females to males (percent ages 15–24)	81	84	89	90	...	90	90	...	...	100
Share of women employed in the nonagricultural sector (percent)	41	46	52	53	...	53	...	...	...	...
Goal 4: Reduce child mortality										
Immunization, measles (percent of children ages 12–23 months)	34	62	65	52	65	80	79	78	78	90
Infant mortality rate (per 1,000 live births)	84	89	78	...	...	...	67	65	65	50
Under 5 mortality rate (per 1,000)	116	123	104	...	...	...	85	82	82	38.3
Goal 5: Improve maternal health										
Births attended by skilled health staff (percent of total)	...	...	32	...	...	...	44	...	44	80
Maternal mortality ratio (modeled estimate, per 100,000 live births)	...	...	450	...	...	...	540	...	540	250
Goal 6: Combat HIV/AIDS, malaria, and other diseases										
Incidence of tuberculosis (per 100,000 people)	577	549	530	520	515	510	505	500	500	...
Prevalence of HIV, total (percent of population 15–49)	...	...	...	...	3	3	2	...	1	...
Goal 7: Ensure environmental sustainability										
Access to an improved water source (percent of population)	...	...	...	34	...	...	...	65	65	...
Access to improved sanitation (percent of population)	...	...	...	16	...	...	...	28	28	...
Nationally protected areas (percent of total land area)	...	...	...	...	19	24	...	...	...	...
Goal 8: Develop a global partnership for development										
Aid per capita (current U.S. dollars)	4	50	31	37	38	35	39	37	37	...
Fixed line and mobile phone subscribers (per 100 people)	0	2	1	3	4	7	8	12	18	...
Internet users (per 1,000 people)	...	...	6	30	35	41	44	66	70	...
Personal computers (per 1,000 people)	...	0	1	2	2	2	...	...	...	...
Total debt service (percent of exports of goods and services)	...	1	2	1	1	1	1	1	1	...
Goal 9: De-mining, UXO and assistance										
Annual numbers of civilian casualties recorded	...	1,691	...	...	...	...	797	...	...	0
Percentage of suspected contaminated areas cleared	...	10	...	...	...	...	50	...	...	100
Other										
Fertility rate, total (births per woman)	6	...	4	4	4	3	3	3	3	...
GNI per capita, Atlas method (current U.S. dollars)	...	280	280	300	340	380	440	490	540	...
GNI, Atlas method (current, in billions of U.S. dollars)	...	3.1	3.6	4.0	4.5	5.3	6.2	7.0	7.9	...
Gross capital formation (percent of GDP)	8	15	17	20	22	18	20	21	22	...
Life expectancy at birth, total (years)	50	...	...	54	54	54	58	59	59	...
Literacy rate, adult total (percent of people ages 15 and above)	62	64	68	69	...	74	...	...	...	...
Population, total (millions)	9.6	11.2	12.7	13.2	13.4	13.6	14.0	14.2	13.4	...
Trade (percent of GDP)	19	80	114	127	133	146	137	134	145	...

Sources: World Bank database, *World Development Indicators*, and *Poverty Assessment* (2006); UN Human Development Indicators Report (2003); Cambodia MDG 2005 update; and IMF staff estimates.

INTERNATIONAL MONETARY FUND AND
INTERNATIONAL DEVELOPMENT ASSOCIATION

CAMBODIA

Joint IMF/World Bank Debt Sustainability Analysis 2008¹

Prepared by the staffs of the International Monetary Fund and
the International Development Association

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This document presents the joint IMF-World Bank debt sustainability analysis (DSA) for Cambodia using the Debt Sustainability Framework for Low-Income Countries (LIC).² It shows that external debt burden indicators do not breach the relevant policy-dependent indicative thresholds under the baseline scenario. However, given recent global developments and Cambodia's vulnerability to external shocks, there are considerable downside risks to the baseline scenario. An assessment of the impact of various exogenous shocks on the sustainability of external and public sector debt shows Cambodia would face a moderate risk of debt distress.³

I. INTRODUCTION

1. **Cambodia's DSA indicates that the risk of debt distress remains moderate.** At end-September 2008, the total value of its external public debt was US\$2.8 billion

¹ This DSA was prepared jointly by the IMF and World Bank. The staffs also consulted with the Asian Development Bank. The debt data underlying this exercise were provided by the Cambodian authorities and donor partners.

² See "Debt Sustainability in Low-Income Countries: Proposal for an Operational Framework and Policy Implications" (<http://www.imf.org/external/np/pdr/sustain/2004/020304.htm> and IDA/SECM2004/0035, 2/3/04) and "Debt Sustainability in Low-Income Countries: Further Considerations on an Operational Framework, Policy Implications" (<http://www.imf.org/external/np/pdr/sustain/2004/091004.htm> and IDA/SECM2004/0629, 9/10/04) and "Applying the Debt Sustainability Framework for Low-Income Countries Post Debt Relief," (www.imf.org/external/np/pp/eng/2006/110606.pdf and IDA/SecM2006-0564, 8/11/06).

³ The low income country debt sustainability framework (LIC DSF) recognizes that better policies and institutions allow countries to manage higher levels of debt, and thus the threshold levels are policy dependent. Cambodia's policies and institutions, as measured by the World Bank's Country Policy and Institutional Assessment (CPIA), averaged 3.17 percent over the past three years, placing it as a "weak performer." The relevant indicative thresholds for this category are: 30 percent for the NPV of debt-to-GDP ratio, 100 percent for the NPV of debt-to-exports ratio, 200 percent for the NPV of debt-to-revenue ratio, 15 percent for the debt service-to-exports ratio, and 25 percent for the debt service-to-revenue ratio. These thresholds are applicable to public and publicly guaranteed external debt.

(27 percent of GDP) and domestic debt was US\$0.1 billion ($\frac{3}{4}$ percent of GDP), one-third of which was denominated in foreign currency.⁴ Under the baseline scenario and standard alternative scenarios and stress tests, all debt burden indicators are well below the relevant policy-dependent indicative thresholds with one exception—the net present value (NPV) of debt-to-revenue ratio, which exceeds the threshold over brief periods in the standard tests. This finding represents a modest improvement from the last DSA conducted during the IMF’s 2007 Article IV consultation, in which thresholds were breached for two indicators.⁵ However, in view of recent developments and Cambodia’s vulnerability to external shocks, staffs have analyzed a few additional scenarios. They show that in the event of a prolonged economic downturn, debt burden indicators would breach the indicative thresholds over extended periods.

II. BACKGROUND AND ASSUMPTIONS

2. **The main underlying macroeconomic assumptions are presented in Box 1.** They reflect Cambodia’s continued pursuit of sound macroeconomic and financial policies and structural reforms in support of growth and poverty reduction and low external vulnerability. Growth prospects are predicated on implementation of necessary banking, fiscal, and regulatory reforms and improvements to public infrastructure and services, helping to raise productivity and strengthen competitiveness. However, the development of extractive industries is not factored into the baseline, given uncertainties about the timing and impact of new oil and mineral production. Resources development could create considerable fiscal space, but also pose challenges for macroeconomic management.

3. **Cambodia remains in arrears to the Russian Federation and the United States.** Following a Paris Club agreement in 1995, Cambodia concluded agreements with France, Germany, Italy, and Japan. Negotiations of outstanding debt obligations with the Russian Federation and the United States are still ongoing, with their status unchanged since the last DSA. Currently, Cambodia is not servicing its debt with either of these creditors, but is making efforts to conclude agreements with each under the framework of the Paris Club. Since prospects for resolution are unclear, the current DSA assumes no restructuring in its baseline, with arrears continuing to build up throughout the projection period. In measuring debt levels, the DSA incorporates the negotiated debt stock for the Russian Federation (US\$457 million) and the agreed amount of total principal due for the United States (US\$162 million).⁶

⁴ Cambodia received debt relief from the IMF under the Multilateral Debt Relief Initiative (MDRI) of SDR57 million (US\$82 million) in January 2006, as outlined in the decision of the Executive Board.

⁵ See Cambodia—Staff Report for the 2007 Article IV Consultation, Joint IMF/World Bank Debt Sustainability Analysis 2007, IMF Country Report No. 07/290 (August 2007).

⁶ For this DSA, staffs continue to apply the standard 70 percent discount to the nominal value of debt owed to the Russian Federation.

Box 1: Main Assumptions for the Baseline Scenario (2008–28)

- **Real GDP growth** is projected to average slightly under 6 percent a year in 2008–10 compared with an average of 11 percent over the previous five years. The slowdown is due to some catch-up effects earlier on and less benign global conditions more recently, including spillover effects from the global financial crisis and weak external demand. Growth is expected to rise thereafter to around 7½ percent by 2014 as global and domestic conditions improve. Important drivers of future growth will be new export opportunities in light manufactures and agribusiness, as well as more expansive tourism activity. The construction and infrastructure sectors are also expected to be major contributors. These activities would depend on an improved investment climate as well as a recovery in foreign direct investment (FDI) starting in 2010, following an expected reduction in 2009 by around one-third from the previous year's level owing to global conditions. Over the longer term, growth is projected to be sustained in the range of 6–7 percent a year, supported by export growth and assuming maintenance of macroeconomic stability.
- **The external current account deficit** (including official transfers) is projected to decline in 2009 to 8 percent of GDP, compared to 12 percent in 2008, mainly due to lower oil prices and non-oil import growth, which more than offset low expected growth in garment exports and tourism services. Over the medium term, garment exports will continue to underpin export performance. Tourism growth should also strengthen as global conditions improve and given promotion efforts. Over the longer term, the current account deficit is expected to settle in the range of 5–6 percent of GDP a year. Official assistance (grants and loans) would decline gradually as a share of GDP, while FDI and other private inflows would rise. The baseline scenario also assumes an increasing but moderate level of external borrowing would be on less concessional terms, including from some bilateral creditors. With FDI and other private inflows expected to decline, the **overall external position** would weaken somewhat in 2009. Thereafter, gross official reserves would begin to build up slowly again in U.S. dollar terms, with the import coverage in the range of 2½–3 months from 2014 onward.
- **Macroeconomic stability** is underpinned by a moderate fiscal stance. Given weak global conditions, modest countercyclical easing is likely in 2009, with the **overall fiscal deficit** (excluding grants) expected to rise to around 3¼ percent of GDP in 2009 compared to a projected 1¼ percent in 2008. Thereafter, the deficit would be expected to decline gradually to under 2 percent by 2012, mostly financed externally. Revenue would rise over the medium term by about ¾ percentage point to around 13¼ percent of GDP by 2012 on increased tax buoyancy and a broadening of the tax base, with more moderate increases thereafter. **Grants** are projected to decline as a share of GDP from around 2¼ percent in recent years to 1½ percent in the outer years. **Expenditure** would stay around 15¼ percent of GDP over the medium term, but then rise gradually owing mainly to higher locally-financed capital spending.

4. **Cambodia received several speculative-grade sovereign credit ratings in 2007, which could provide an opportunity for commercial borrowing.** No plans have been announced and prospects appear remote at this time. However, bonds could be issued to finance infrastructure development, possibly for the oil sector. Several build-operate-transfer (BOT) projects have been signed with firms from China, but possible contingent liabilities arising from these types of contracts are not incorporated in this DSA. Greater transparency is needed in this area to facilitate the monitoring of these liabilities and mitigation of any associated fiscal risks.

III. EXTERNAL DEBT SUSTAINABILITY

5. **All external debt indicators remain below the policy-dependent debt burden thresholds under the baseline scenario, but one threshold is breached under the most extreme standard stress test.** The main results of the external DSA are as follows:

- The NPV of external debt as a share of GDP is expected to remain below the 30 percent indicative threshold over period covered (Table 1a). Under the most extreme stress test—a one-time 30 percent nominal depreciation of the Cambodian riel vis-à-vis the U.S. dollar relative to the 2008 baseline—the NPV of debt-to-GDP ratio would increase by about 7 percentage points to 27 percent by end-2009, but still remain well below the indicative threshold over the projection period (Figure 1 and Table 1b).
- The NPV of external debt-to-revenue ratio remains below the threshold for all years in the baseline scenario, declining from 162 percent in 2008 to 128 percent by 2013, and further decreasing over the long term. Debt service stays under 2 percent of exports throughout the entire projection period, as existing debts are highly concessional.
- However, under the one-time 30 percent riel depreciation, the NPV of debt-to-revenue ratio does exceed the 200 percent threshold during the period 2009–11, and then falls below the indicative threshold for the rest of the projection period.

	DSA Thresholds	Cambodia	
		2007	2008–28 ^{1/}
NPV of debt in percent of:			
GDP	30	23	16
Exports	100	35	33
Government revenue	200	191	111
Debt service in percent of:			
Exports	15	1	1
Government revenue	25	4	4
Sources: Cambodian authorities; and staffs' estimates and projections.			
^{1/} Period average under the baseline scenario.			

6. **In staffs' view, Cambodia faces a moderate risk of debt distress.** This assessment is based on the standard alternative scenarios and bound tests of the DSA, which are predicated on strong past performance.⁷ However, it also takes into account current global conditions and the possibility of a prolonged economic downturn. As an illustrative exercise, a few additional alternative scenarios are examined, based on different assumptions from the baseline. They are (i) lower annual real GDP growth (4½ percent over the medium term) and smaller FDI inflows (the average of 2000–04 level as a share of GDP); and (ii) smaller FDI flows and higher borrowing costs (an average nominal interest rate of 6 percent on new loans) (Figure 2 and 3). The latter scenario presumes low FDI would be indicative of a persistence of a weak business and investment climate, with a lack of reforms and the resulting financing gap necessitating that Cambodia resort to more costly borrowing. The results indicate that the NPV of external debt as a share of GDP breaches the indicative thresholds under both scenarios, and with (ii) remains well above the threshold at the end of the projection period.

⁷ Because of double-digit growth in recent years, the standard alternative scenarios and stress tests based on average past performance show a continued decline in debt and debt service levels. However, in view of the sharp downturn in global economic activity in the second half of 2008 and uncertain prospects about the degree and timing of a recovery, past performance may not be instructive of future trends.

IV. PUBLIC DEBT SUSTAINABILITY

7. **Given that most public debt is external, the overall public and external debt dynamics are very similar.** The nominal stock of public debt, equivalent to 30½ percent of GDP at end-2007, is expected to decline to 27½ percent by end-2008 (Figure 4 and Table 2a). The NPV of public sector debt-to-GDP ratio would fall steadily from 21 percent in 2008 to 12 percent by 2028. The NPV of public debt-to-revenue ratio, which is projected to be 142 percent in 2008, would decline to 70 percent by 2028. The debt-service-to-revenue ratio remains low in most scenarios for the entire projection period because of the concessionality of the existing debts. However under the standard alternative scenarios and bound tests, public debt ratios are particularly sensitive to a real exchange rate depreciation. A one-time 30 percent riel depreciation relative to the 2008 baseline would raise the NPV of public debt-to-GDP and the public debt-to-revenue ratios by around 8 and 51 percentage points, respectively, by end-2009, but eventually decline over the projection period.

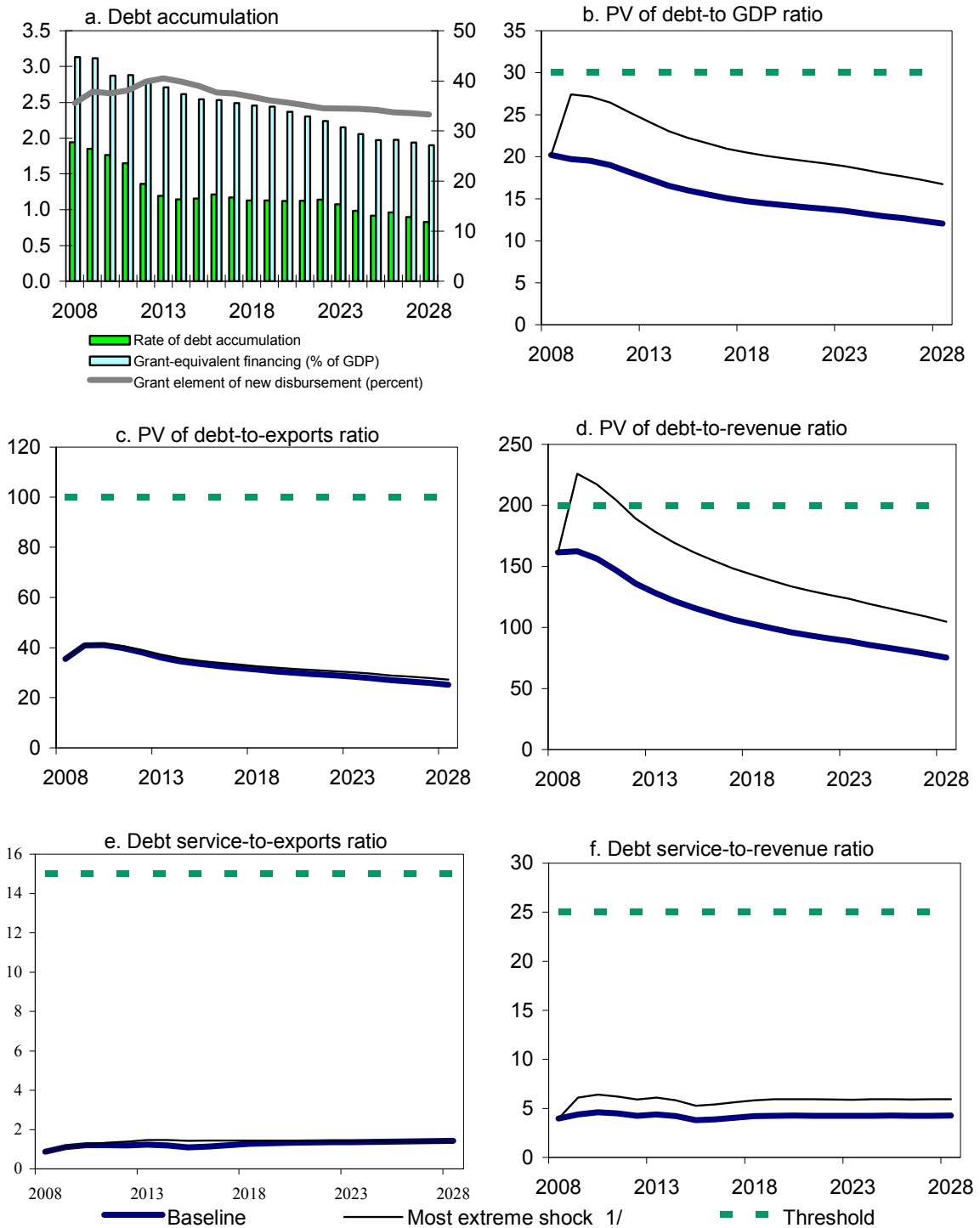
8. **The DSA does not account for possible contingent liabilities, notably those arising from large infrastructure investment.** More careful assessment is needed of plans in this area, including examination of BOT contracts for possible guarantees offered. The authorities will need to monitor commitments closely and transparently, including developing and maintaining an inventory of all concessions granted, in particular for infrastructure, and building and improving capacity to analyze the impact of contingent liabilities on debt sustainability, should they arise.

V. CONCLUSION

9. **Staffs conclude that Cambodia faces a moderate risk of debt distress.** No thresholds are breached under the baseline scenario and standard stress tests and alternative scenarios, except one bound test. However, this benign outlook is subject to substantial downside risks, as it rests on a pick up in the pace of economic activity from 2010 onward, notably economic growth and external inflows. Additional scenarios reflecting a prolonged downturn in global economic activity indicate that external debt could exceed indicative thresholds for extended periods. This outlook could be further weakened in the event actual liabilities arise from contingent obligations, mainly those entered for infrastructure development, which further underscores the rationale for the designation of risk.

10. **Given uncertainty about near-to medium-term prospects, staffs urge the Royal Government of Cambodia continue pursuing a sound strategy for public debt management.** Careful consideration is needed in possibly contracting less concessional loans, as they could impair sustainability, in particular if the revenue base remains low and institutions weak. Stronger capacity in debt management is an essential pre-requisite for this type of borrowing. To this end, a full accounting of all commitments, including from newly emerging creditors, and better monitoring of contingent liabilities will be necessary to ensure debt sustainability. Staffs also encourage the authorities to continue seeking agreements to resolve outstanding arrears.

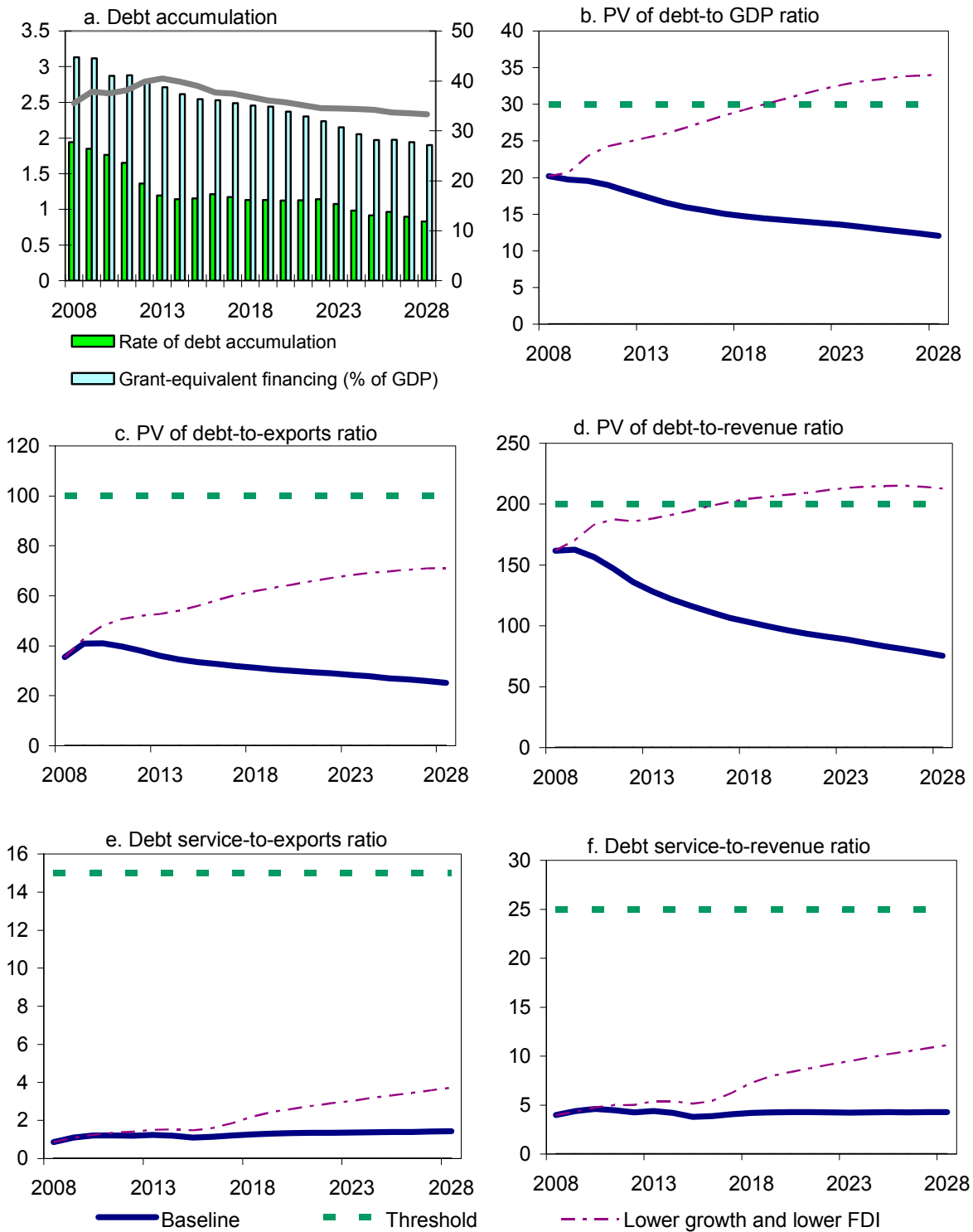
Figure 1. Cambodia: Indicators of Public and Publicly Guaranteed External Debt under Baseline and Alternative Scenarios, 2008–28 1/



Source: Staffs' projections and simulations.

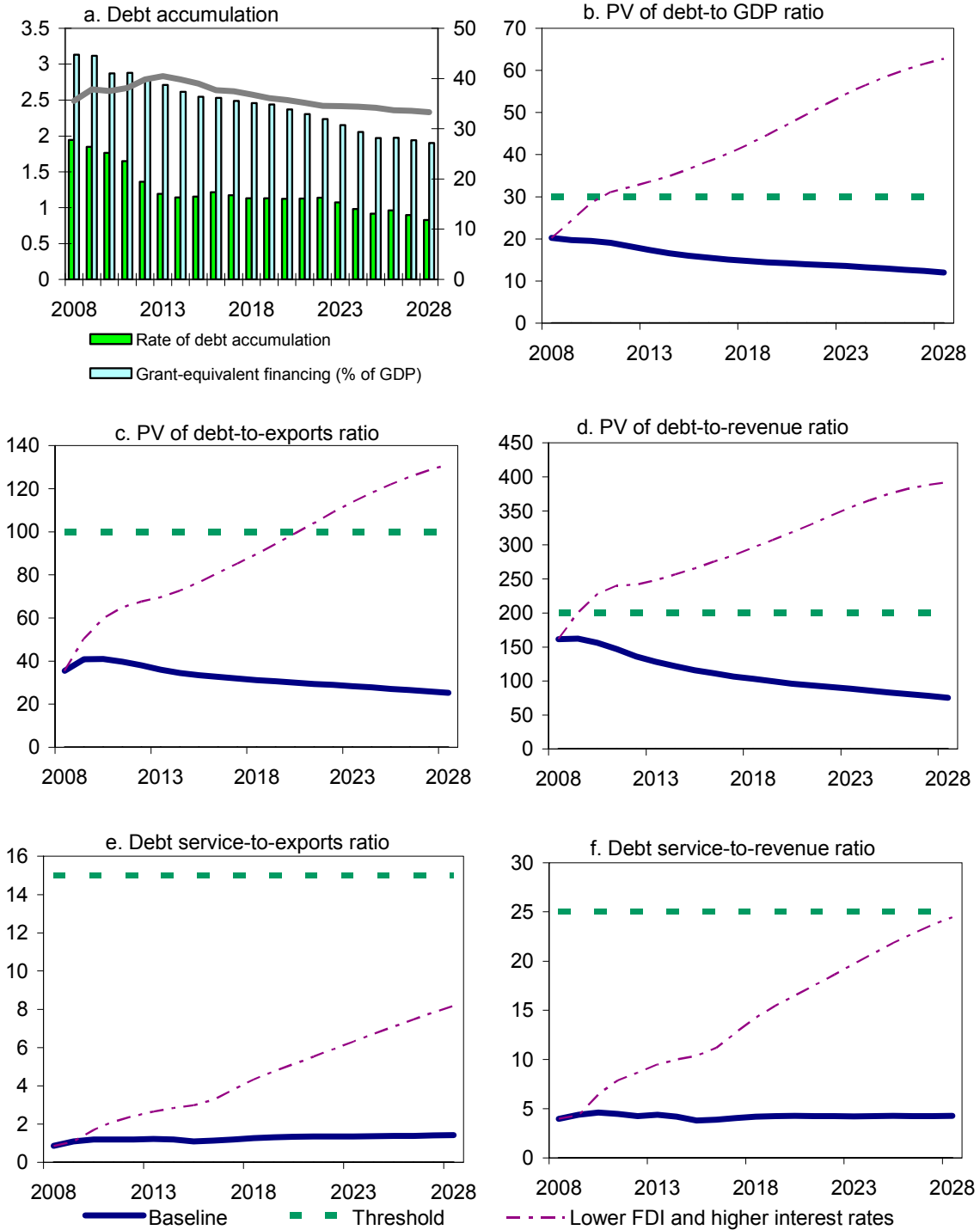
1/ The most extreme stress test is the test that yields the highest ratio in 2018. In figure b. it corresponds to a one-time depreciation shock; in c. to a terms shock; in d. to a one-time depreciation shock; in e. to a terms shock; and in f. to a one-time depreciation shock.

Figure 2. Cambodia: Indicators of Public and Publicly-Guaranteed External Debt under the Alternative Scenario of Lower GDP Growth and Lower FDI, 2008–28



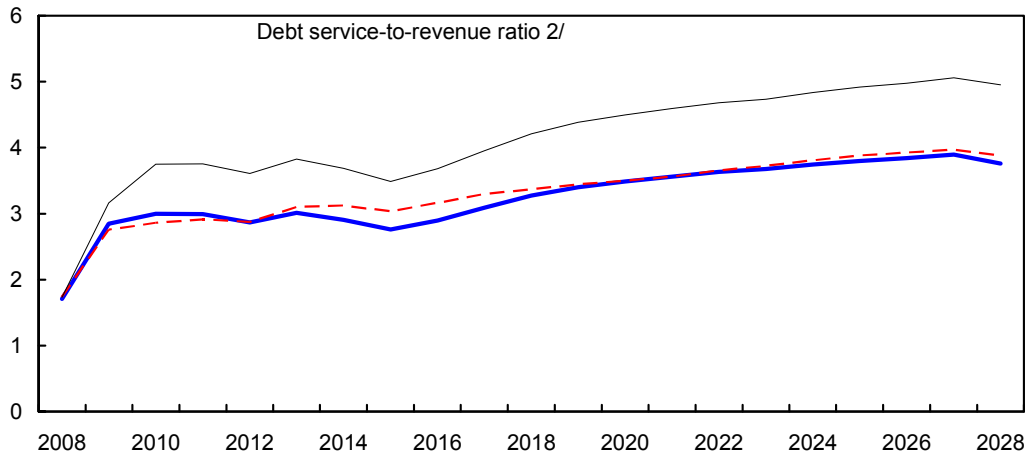
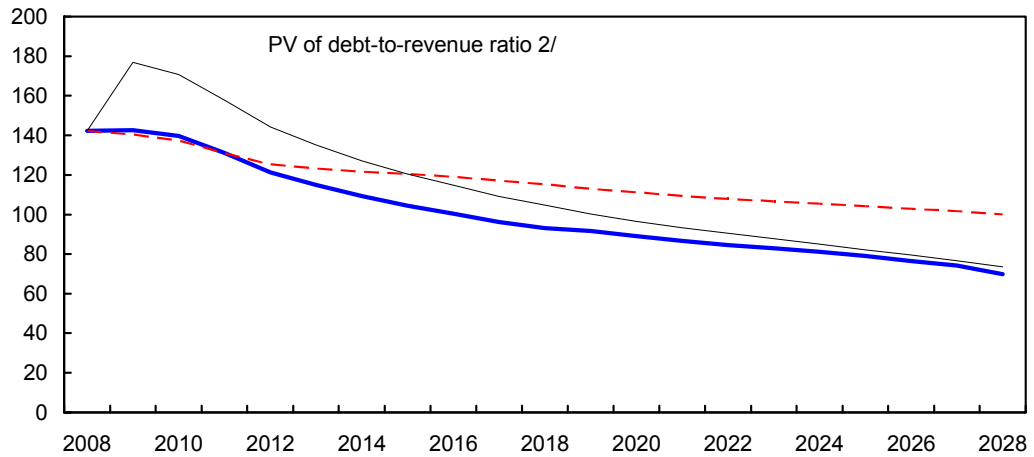
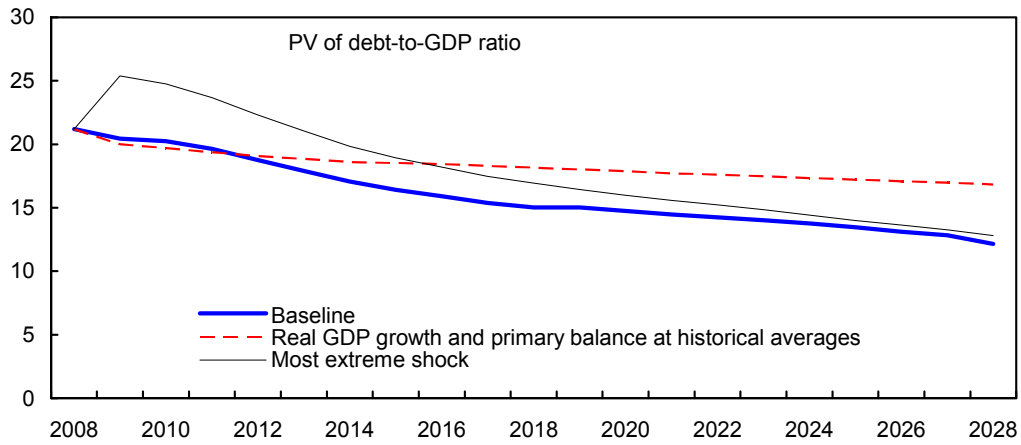
Source: Staffs' projections and simulations.

Figure 3. Cambodia: Indicators of Public and Publicly-Guaranteed External Debt under the Combined Scenario of Lower FDI and Higher Interest Rates, 2008–28



Source: Staffs' projections and simulations.

Figure 4. Cambodia: Indicators of Public Debt under Baseline and Alternative Scenarios, 2008–28 1/



Source: Staffs' projections and simulations.

1/ The most extreme stress test is the test that yields the highest ratio in 2018. For the first two charts, it is the 10 percent of GDP increase in other debt creating flows. For the third chart, it is the one-time 30 percent real depreciation in 2009.

2/ Revenue is defined as inclusive of grants.

Table 1a. Cambodia: External Debt Sustainability Framework, Baseline Scenario, 2005–28 1/
(In percent of GDP, unless otherwise indicated)

	Actual			Historical Average	Standard Deviation	Projections						2008-13		2014-28		
	2005	2006	2007			2008	2009	2010	2011	2012	2013	Average	2018	2028	Average	
External debt (nominal) 1/	35.0	31.1	29.7			26.8	26.0	25.9	25.3	24.2	23.2		20.0	16.0		
Of which: Public and publicly guaranteed (PPG)	35.0	31.1	29.7			26.8	26.0	25.9	25.3	24.2	23.2		19.5	15.8		
Change in external debt	-4.5	-4.0	-1.4			-2.9	-0.8	-0.1	-0.6	-1.1	-1.0		-0.5	-0.5		
Identified net debt-creating flows	-8.1	-10.7	-11.7			3.0	1.8	1.3	0.3	-0.3	-0.8		-1.2	-1.8		
Non-interest current account deficit	3.5	0.3	3.1	2.2	1.2	11.6	6.8	6.6	5.8	5.4	5.0		5.1	4.7	5.2	
Deficit in balance of goods and services	8.1	7.1	7.9			15.8	10.6	10.5	9.5	8.8	8.3		7.4	5.9		
Exports	64.1	68.7	64.8			56.9	48.3	47.7	47.8	47.8	48.2		47.2	47.8		
Imports	72.2	75.8	72.7			72.7	58.8	58.2	57.3	56.6	56.5		54.6	53.7		
Net current transfers (negative = inflow)	-9.1	-10.9	-8.9	-10.3	1.2	-7.6	-6.7	-6.5	-6.2	-6.0	-5.8		-4.6	-2.5	-3.8	
Of which: Official	-5.8	-6.5	-4.6			-4.3	-3.9	-3.6	-3.3	-2.9	-2.6		-1.5	-0.4		
Other current account flows (negative = net inflow)	4.5	4.0	4.1			3.4	2.9	2.6	2.6	2.5	2.5		2.3	1.2		
Net FDI (negative = inflow)	-6.0	-6.7	-10.0	-4.6	2.7	-7.4	-4.1	-4.2	-4.3	-4.4	-4.5		-5.3	-5.8	-5.5	
Endogenous debt dynamics 2/	-5.7	-4.3	-4.8			-1.2	-0.8	-1.1	-1.2	-1.3	-1.3		-1.0	-0.7		
Contribution from nominal interest rate	0.3	0.4	0.3			0.4	0.3	0.3	0.3	0.3	0.3		0.3	0.3		
Contribution from real GDP growth	-4.4	-3.3	-2.6			-1.6	-1.2	-1.4	-1.5	-1.6	-1.6		-1.3	-1.0		
Contribution from price and exchange rate changes	-1.6	-1.4	-2.4			...	...	...	...	...	...		...	...
Residual (3-4) 3/	3.6	6.7	10.3			-5.9	-2.6	-1.4	-0.9	-0.8	-0.2		0.7	1.3		
Of which: Exceptional financing	-0.3	1.1	-0.2			0.0	-0.2	-0.1	-0.1	-0.1	-0.1		0.0	0.0		
PV of external debt 4/	30.1	27.5	22.7			20.2	19.7	19.5	19.0	18.2	17.4		15.2	12.2		
In percent of exports	47.0	40.0	35.0			35.5	40.8	41.0	39.7	38.1	36.0		32.1	25.6		
PV of PPG external debt	30.1	27.5	22.7			20.2	19.7	19.5	19.0	18.2	17.4		14.7	12.0		
In percent of exports	47.0	40.0	35.0			35.5	40.8	41.0	39.7	38.1	36.0		31.2	25.2		
In percent of government revenues	292.4	239.0	191.2			161.6	162.5	156.3	146.9	135.9	128.3		103.0	75.3		
Debt service-to-exports ratio (in percent)	0.9	0.9	0.9			0.9	1.1	1.2	1.2	1.2	1.2		1.3	1.4		
PPG debt service-to-exports ratio (in percent)	0.9	0.9	0.9			0.9	1.1	1.2	1.2	1.2	1.2		1.3	1.4		
PPG debt service-to-revenue ratio (in percent)	5.3	5.3	4.9			4.0	4.4	4.6	4.5	4.2	4.4		4.2	4.3		
Total gross financing need (Billions of U.S. dollars)	-0.1	-0.4	-0.5			0.5	0.4	0.4	0.3	0.3	0.2		0.1	-0.3		
Non-interest current account deficit that stabilizes debt ratio	8.0	4.3	4.5			14.5	7.6	6.7	6.4	6.4	6.0		5.6	5.2		
Key macroeconomic assumptions																
Real GDP growth (in percent)	13.3	10.8	10.2	9.6	2.0	6.5	4.8	6.0	6.6	7.1	7.4	6.4	6.7	6.5	6.7	
GDP deflator in US dollar terms (change in percent)	4.1	4.3	8.6	3.2	2.9	14.7	6.7	3.7	4.5	4.6	4.0	6.4	3.0	3.1	3.1	
Effective interest rate (percent) 5/	1.0	1.2	1.1	1.1	0.1	1.5	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.5	
Growth of exports of G&S (US dollar terms, in percent)	18.7	23.9	12.9	17.6	6.5	7.2	-5.2	8.6	11.8	11.9	12.6	7.8	10.0	9.6	10.0	
Growth of imports of G&S (US dollar terms, in percent)	20.0	21.3	14.8	15.9	5.3	22.0	-9.4	8.8	9.7	10.6	11.4	8.8	9.7	9.4	9.7	
Grant element of new public sector borrowing (in percent)	...	...	...	...	...	35.6	37.9	37.5	38.1	39.8	40.5	38.2	36.8	33.3	35.7
Government revenues (excluding grants, in percent of GDP)	10.3	11.5	11.9	...	...	12.5	12.1	12.5	12.9	13.4	13.5	...	14.3	16.0	14.9
Aid flows (in billions of U.S. dollars) 7/	0.3	0.3	0.4			0.3	0.3	0.3	0.3	0.3	0.4		0.6	1.1		
Of which: Grants	0.1	0.2	0.2			0.3	0.3	0.3	0.3	0.3	0.4		0.6	1.1		
Of which: Concessional loans	0.2	0.1	0.3			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0		
Grant-equivalent financing (in percent of GDP) 8/	...	...	...			3.1	3.1	2.9	2.9	2.8	2.7		2.5	1.9	2.3
Grant-equivalent financing (in percent of external financing) 8/	...	...	...			70.1	67.8	66.1	68.0	72.0	73.3		70.4	67.4	69.0
Memorandum items:																
Nominal GDP (billions of U.S. dollars)	6.3	7.3	8.7			10.6	11.9	13.1	14.5	16.3	18.2		30.4	76.5		
Nominal dollar GDP growth	17.9	15.6	19.6			22.1	11.9	9.9	11.5	12.0	11.6	13.2	9.9	9.7	10.0	
PV of PPG external debt (in billions of U.S. dollars)			2.0			2.1	2.3	2.5	2.8	3.0	3.2		4.5	9.2		
(PVt-PVt-1)/GDPT-1 (in percent)						1.9	1.8	1.8	1.7	1.4	1.2	1.6	1.1	0.8	1.1	

Sources: Cambodian authorities; and staffs' estimates and projections.

1/ Includes both public and private sector external debt.

2/ Derived as $[r - g - r(1+g)] / (1+g+r+gr)$ times previous period debt ratio, with r = nominal interest rate; g = real GDP growth rate, and r = growth rate of GDP deflator in U.S. dollar terms.

3/ Includes exceptional financing (i.e., changes in arrears and debt relief); changes in gross foreign assets; and valuation adjustments. For projections also includes contribution from price and exchange rate changes.

4/ Assumes that PV of private sector debt is equivalent to its face value.

5/ Current-year interest payments divided by previous period debt stock.

6/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

7/ Defined as grants, concessional loans, and debt relief.

8/ Grant-equivalent financing includes grants provided directly to the government and through new borrowing (difference between the face value and the PV of new debt).

Table 1b. Cambodia: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2008–28
(In percent)

	Projections							2018	2028
	2008	2009	2010	2011	2012	2013			
PV of debt-to GDP ratio									
Baseline	20	20	20	19	18	17	15	12	
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008–28 1/	20	16	13	10	7	5	..	..
A2. New Public Sector loans on less favorable terms in 2008–28 2/	20	20	20	19	19	18	15	13	
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	20	19	19	18	17	17	14	12	
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	20	14	8	9	8	8	9	10	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–10	20	21	21	21	20	19	16	13	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–10 4/	20	20	19	19	18	17	15	12	
B5. Combination of B1-B4 using one-half standard deviation shocks	20	12	3	3	3	4	6	10	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	20	27	27	26	25	24	20	17	
PV of debt-to-exports ratio									
Baseline	35	41	41	40	38	36	31	25	
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008–28 1/	35	33	26	20	15	11	..	..
A2. New Public Sector loans on less favorable terms in 2008–28 2/	35	41	42	41	39	37	33	27	
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	35	41	41	40	38	36	31	25	
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	35	25	15	15	15	14	15	18	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–10	35	41	41	40	38	36	31	25	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–10 4/	35	41	40	39	37	35	31	25	
B5. Combination of B1-B4 using one-half standard deviation shocks	35	21	4	5	6	6	9	16	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	35	41	41	40	38	36	31	25	
PV of debt-to-revenue ratio									
Baseline	162	162	156	147	136	128	103	75	
A. Alternative Scenarios									
A1. Key variables at their historical averages in 2008–28 1/	162	133	101	75	54	38	..	..
A2. New Public Sector loans on less favorable terms in 2008–28 2/	162	164	159	150	140	132	108	81	
B. Bound Tests									
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	162	158	150	141	131	123	99	72	
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	162	118	67	66	63	62	61	65	
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–10	162	173	172	161	149	141	113	83	
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–10 4/	162	161	154	145	134	126	102	75	
B5. Combination of B1-B4 using one-half standard deviation shocks	162	100	20	24	26	27	39	61	
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	162	226	217	204	189	178	143	105	

Table 1b. Cambodia: Sensitivity Analysis for Key Indicators of Public and Publicly-Guaranteed External Debt, 2008–28 (Concluded)
(In percent)

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
Debt service-to-exports ratio								
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–28 1/	1	1	1	1	1	1	0	...
A2. New Public Sector loans on less favorable terms in 2008–28 2/	1	1	1	1	1	1	1	1
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	1	1	1	1	1	1	1	1
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	1	1	1	1	1	1	0	1
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–10	1	1	1	1	1	1	1	1
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–10 4/	1	1	1	1	1	1	1	1
B5. Combination of B1–B4 using one-half standard deviation shocks	1	1	1	0	0	0	0	1
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	1	1	1	1	1	1	1	1
Debt service-to-revenue ratio								
A. Alternative Scenarios								
A1. Key variables at their historical averages in 2008–28 1/	4	4	4	3	3	2	...	...
A2. New Public Sector loans on less favorable terms in 2008–28 2/	4	4	5	5	5	5	5	4
B. Bound Tests								
B1. Real GDP growth at historical average minus one standard deviation in 2009–10	4	4	4	4	4	4	4	4
B2. Export value growth at historical average minus one standard deviation in 2009–10 3/	4	4	4	2	2	3	0	3
B3. US dollar GDP deflator at historical average minus one standard deviation in 2009–10	4	5	5	5	5	5	5	5
B4. Net non-debt creating flows at historical average minus one standard deviation in 2009–10 4/	4	4	5	4	4	4	4	4
B5. Combination of B1–B4 using one-half standard deviation shocks	4	4	3	1	1	2	...	...
B6. One-time 30 percent nominal depreciation relative to the baseline in 2009 5/	4	6	6	6	6	6	6	6
Memorandum item:								
Grant element assumed on residual financing (i.e., financing required above baseline) 6/	35	35	35	35	35	35	35	35

Source: Staffs' projections and simulations.

1/ Variables include real GDP growth, growth of GDP deflator (in US dollar terms), non-interest current account in percent of GDP and non-debt creating flows.

Due to large swings in GDP, deflator and current account in 2008, compared to historical average, debt falls sharply under this scenario.

2/ Assumes that the interest rate on new borrowing is by 2 percentage points higher than in the baseline, while grace and maturity periods are the same as in the baseline.

3/ Exports values are assumed to remain permanently at the lower level, but the current account as a share of GDP is assumed to return to its baseline level after the shock (implicitly assuming an offsetting adjustment in import levels).

4/ Includes official and private transfers and FDI.

5/ Depreciation is defined as percentage decline in dollar/local currency rate, such that it never exceeds 100 percent.

6/ Applies to all stress scenarios except for A2 (less favorable financing) in which the terms on all new financing are as specified in footnote 2.

Table 2a. Cambodia: Public Sector Debt Sustainability Framework, Baseline Scenario, 2005–28
(In percent of GDP, unless otherwise indicated)

	Actual			Average	Standard Deviation	Estimate					Projections				
	2005	2006	2007			2008	2009	2010	2011	2012	2013	2008-13 Average	2018	2028	
Public sector debt 1/	37.2	32.8	30.6			27.5	26.7	26.6	25.9	24.8	23.7		19.8	15.9	
<i>Of which: Foreign-currency denominated</i>	35.0	31.1	29.7			26.8	26.0	25.9	25.3	24.2	23.2		19.5	15.8	
Change in public sector debt	-5.5	-4.4	-2.2			-3.1	-0.8	-0.1	-0.7	-1.1	-1.1		-0.5	-0.5	
Identified debt-creating flows	-6.0	-6.3	-4.5			-5.5	-2.1	-1.6	-2.4	-3.0	-2.8		-1.8	-2.0	
Primary deficit	0.2	0.0	0.5	1.9	1.5	-0.8	0.8	0.5	0.1	-0.5	-0.6	-0.1	-0.3	-0.8	
Revenue and grants	12.4	14.0	14.1			14.9	14.3	14.5	15.0	15.5	15.6		16.2	17.4	
<i>Of which: Grants</i>	2.1	2.5	2.2			2.4	2.2	2.0	2.0	2.1	2.0		1.9	1.4	
Primary (noninterest) expenditure	12.6	14.0	14.5			14.1	15.2	15.0	15.0	15.0	15.0		15.9	16.6	
Automatic debt dynamics	-6.1	-5.2	-4.9			-4.7	-2.9	-2.1	-2.4	-2.5	-2.2		-1.6	-1.2	
Contribution from interest rate/growth differential	-6.8	-4.7	-4.6			-5.3	-2.9	-2.1	-2.4	-2.5	-2.3		-1.6	-1.2	
<i>Of which: Contribution from average real interest rate</i>	-1.8	-1.1	-1.5			-3.4	-1.6	-0.6	-0.8	-0.7	-0.6		-0.3	-0.3	
<i>Of which: Contribution from real GDP growth</i>	-5.0	-3.6	-3.0			-1.9	-1.3	-1.5	-1.7	-1.7	-1.7		-1.3	-1.0	
Contribution from real exchange rate depreciation	0.7	-0.4	-0.4			0.6	0.0	0.0	0.0	0.0	0.1		...	...
Other identified debt-creating flows	0.0	-1.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Privatization receipts (negative)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Recognition of implicit or contingent liabilities	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Debt relief (HIPC and other)	0.0	-1.1	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Other (specify, e.g. bank recapitalization)	0.0	0.0	0.0			0.0	0.0	0.0	0.0	0.0	0.0		0.0	0.0	
Residual, including asset changes	0.5	1.9	2.3			2.4	1.3	1.4	1.7	1.8	1.7		1.3	1.6	
Other Sustainability Indicators															
PV of public sector debt	27.0	24.8	23.7			21.2	20.5	20.3	19.6	18.8	17.9		15.0	12.2	
<i>Of which: Foreign-currency denominated</i>	23.8	22.6	22.7			20.4	19.7	19.5	19.0	18.2	17.4		14.7	12.1	
<i>Of which: External</i>	23.8	22.6	22.6			20.4	19.7	19.5	19.0	18.2	17.4		14.7	12.1	
PV of contingent liabilities (not included in public sector debt)	...	...	...			...	...	...	...	...	...		...	...
Gross financing need 2/	2.7	0.6	0.4			1.0	-0.6	1.2	1.0	0.5	0.0		0.2	-0.1	
PV of public sector debt-to-revenue and grants ratio (in percent)	217.0	176.6	168.5			142.2	142.6	139.7	131.1	121.3	115.0		93.1	69.8	
PV of public sector debt-to-revenue ratio (in percent)	262.1	215.7	199.4			169.5	168.6	162.0	151.8	140.2	132.3		105.1	76.1	
<i>Of which: External 3/</i>	231.1	196.6	189.8			163.5	162.5	156.3	146.9	135.9	128.5		103.1	75.5	
Debt service-to-revenue and grants ratio (in percent) 4/	3.5	3.0	3.5			1.7	2.8	3.0	3.0	2.9	3.0		3.3	3.8	
Debt service-to-revenue ratio (in percent) 4/	4.2	3.7	4.1			2.0	3.4	3.5	3.5	3.3	3.5		3.7	4.1	
Primary deficit that stabilizes the debt-to-GDP ratio	5.7	4.4	2.7			2.3	1.6	0.6	0.7	0.6	0.5		0.2	-0.4	
Key macroeconomic and fiscal assumptions															
Real GDP growth (in percent)	13.3	10.8	10.2	9.6	2.0	6.5	4.8	6.0	6.6	7.1	7.4	6.4	6.7	6.5	6.7
Average nominal interest rate on forex debt (in percent)	1.0	1.2	1.1	1.1	0.1	1.5	1.4	1.4	1.4	1.4	1.4	1.4	1.4	1.7	1.5
Real exchange rate depreciation (in percent, + indicates depreci)	4.0	-1.0	-3.3	1.0	2.5	2.9
Inflation rate (GDP deflator, in percent)	4.1	4.3	8.6	3.2	2.9	14.7	6.7	3.7	4.5	4.6	4.0	6.4	3.0	3.1	3.1
Growth of real primary spending (deflated by GDP deflator, in pe	0.0	0.2	0.1	0.1	0.1	0.0	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Grant element of new external borrowing (in percent)	35.6	37.9	37.5	38.1	39.8	40.5	38.2	36.8	33.3	...

Sources: Cambodian authorities; and staffs' estimates and projections.

1/ General government debt (in gross terms).

2/ Gross financing need is defined as the primary deficit plus debt service plus the stock of short-term debt at the end of the last period.

3/ Revenues excluding grants.

4/ Debt service is defined as the sum of interest and amortization of medium and long-term debt.

5/ Historical averages and standard deviations are generally derived over the past 10 years, subject to data availability.

Table 2b. Cambodia: Sensitivity Analysis for Key Indicators of Public Debt 2008–28

	Projections							
	2008	2009	2010	2011	2012	2013	2018	2028
PV of debt-to-GDP ratio								
Baseline	21	20	20	20	19	18	15	12
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	21	20	20	19	19	19	18	17
A2. Primary balance is unchanged from 2008	21	19	19	18	17	16	12	10
A3. Permanently lower GDP growth 1/	21	20	20	20	19	18	16	18
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009–10	21	20	19	18	17	16	12	8
B2. Primary balance is at historical average minus one standard deviations in 2009–10	21	22	23	22	21	19	16	12
B3. Combination of B1-B2 using one half standard deviation shocks	21	21	21	20	18	17	12	7
B4. One-time 30 percent real depreciation in 2009	21	28	27	25	23	21	16	11
B5. 10 percent of GDP increase in other debt-creating flows in 2009	21	25	25	24	22	21	17	13
PV of debt-to-revenue ratio 2/								
Baseline	142	143	140	131	121	115	93	70
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	142	140	137	131	125	123	115	100
A2. Primary balance is unchanged from 2008	142	136	128	117	107	100	76	55
A3. Permanently lower GDP growth 1/	142	142	140	131	122	116	100	100
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009–10	142	138	131	120	109	101	74	46
B2. Primary balance is at historical average minus one standard deviations in 2009–10	142	151	157	145	133	125	98	71
B3. Combination of B1-B2 using one half standard deviation shocks	142	144	145	132	118	109	76	40
B4. One-time 30 percent real depreciation in 2009	142	194	183	166	149	137	99	65
B5. 10 percent of GDP increase in other debt-creating flows in 2009	142	177	171	158	144	135	105	74
Debt service-to-revenue ratio 2/								
Baseline	2	3	3	3	3	3	3	4
A. Alternative scenarios								
A1. Real GDP growth and primary balance are at historical averages	2	3	3	3	3	3	3	4
A2. Primary balance is unchanged from 2008	2	3	3	3	3	3	3	3
A3. Permanently lower GDP growth 1/	2	3	3	3	3	3	4	5
B. Bound tests								
B1. Real GDP growth is at historical average minus one standard deviations in 2009–10	2	3	3	3	3	3	3	3
B2. Primary balance is at historical average minus one standard deviations in 2009–10	2	3	3	3	3	3	3	4
B3. Combination of B1-B2 using one half standard deviation shocks	2	3	3	3	3	3	3	3
B4. One-time 30 percent real depreciation in 2009	2	3	4	4	4	4	4	5
B5. 10 percent of GDP increase in other debt-creating flows in 2009	2	3	3	4	4	4	3	4

Source: Staffs' projections and simulations.

1/ Assumes that real GDP growth is at baseline minus one standard deviation divided by the length of the projection period.

2/ Revenue is defined as inclusive of grants.

INTERNATIONAL MONETARY FUND

CAMBODIA

Staff Report for the 2008 Article IV Consultation—Informational Annexes

Prepared by the Asia and Pacific Department
(In Consultation with Other Departments)

December 23, 2008

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ANNEX I. CAMBODIA: FUND RELATIONS

As of November 30, 2008

I. Membership Status: Joined: 12/31/1969; Article VIII

II. General Resources Account:	SDR Million	Percent Quota
Quota	87.50	100.00
Fund Holdings of Currency	87.50	100.00
III. SDR Department:	SDR Million	Percent Allocation
Net cumulative allocation	15.42	100.00
Holdings	0.07	0.47
IV. Outstanding Purchases and Loans:	SDR Million	Percent Quota
PRGF arrangements	0	0

V. Financial Arrangements:

<u>Type</u>	<u>Approval Date</u>	<u>Expiration Date</u>	<u>Amount Approved (SDR Million)</u>	<u>Amount Drawn (SDR Million)</u>
ESAF/PRGF	10/22/1999	03/05/2003	58.50	58.50
ESAF	05/06/1994	08/31/1997	84.00	42.00

VI. Projected Obligations to Fund: (SDR Million; based on existing use of resources and present holdings of SDRs)

	<u>Forthcoming</u>				
	<u>2008</u>	<u>2009</u>	<u>2010</u>	<u>2011</u>	<u>2012</u>
Principal	0.00	0.00	0.00	0.00	0.00
Charges/Interest	<u>0.00</u>	<u>0.16</u>	<u>0.16</u>	<u>0.16</u>	<u>0.16</u>
Total	0.00	0.16	0.16	0.16	0.16

VII. Multilateral Debt Relief Initiative:

As part of the Multilateral Debt Relief Initiative (MDRI), the IMF Executive Board on January 5, 2006 approved relief on 100 percent of debt incurred by Cambodia to the IMF before January 1, 2005. This resulted in the forgiving of all of Cambodia's outstanding debt to the IMF, a total of SDR 56.8 million (about US\$82 million). The authorities intend to spend the resources over a number of years, initially on rural irrigation projects. The National Bank of Cambodia (NBC) transferred the full MDRI proceeds to the Ministry of Economy and Finance effective March 2006.

VIII. Safeguards Assessment:

Under the IMF's safeguard assessment policy, the NBC was subject to a full safeguard assessment with respect to a possible successor PRGF Arrangement. A previous safeguards assessment of the NBC was completed on March 24, 2004; it identified certain weaknesses, mostly in the area of internal audit and control and made appropriate recommendations.

IX. Exchange Rate Arrangement and Payments System:

Cambodia officially follows a managed float with no pre-announced exchange rate path. The official exchange rate, which is expressed in riels per U.S. dollar, applies to all official external transactions conducted by the central government and state enterprises and is used for accounting purposes by the NBC. It is determined by the foreign exchange market, with the official rate adjusted to be within 1 percent of the market rate on a daily basis.

Cambodia accepted the obligations of Article VIII, Sections 2, 3, and 4 on January 1, 2002, and maintains an exchange system that is free of restrictions on the making of payments and transfers for current international transactions.

X. Article IV Consultation:

Cambodia is subject to the provisions on consultation cycles approved on July 15, 2002. The last Article IV consultation discussions were held in Phnom Penh during May 21–June 5, 2007. The Executive Board discussed the staff report (Country Report No. 07/290) and concluded the consultation on July 25, 2007.

XI. Technical Assistance:

Technical assistance is currently focused on bank supervision, monetary operations, public financial management, customs administration, and macro-financial statistics. Delivery is through a resident advisor at the NBC, peripatetic experts, and short-term visits from headquarters.

XI. Resident Representative:

The resident representative office was closed in October 1997 and re-opened in October 1999. Mr. John Nelmes, the current Resident Representative, assumed the post in November 2005.

ANNEX II. CAMBODIA: RELATIONS WITH THE WORLD BANK GROUP¹ (As of November 2008)

I. OVERVIEW

The World Bank Group's 2005–08 Country Assistance Strategy (CAS) stresses the need to improve governance in order to maximize the impact of development efforts. The CAS activities are intended to contribute to six objectives, which are clustered under two over-arching pillars. In May 2008, the CAS period was extended until 2011 so that the World Bank and other development partners could better align their support around the next National Strategic Development Plan (NSDP). The approach and objectives of the original CAS will be maintained throughout the extended CAS period.

Activities under Pillar 1 are intended to help implement improvements in governance that are needed if Cambodia is to meet the Cambodia Millennium Development Goals (CMDGs). To this end, the CAS establishes four objectives: (i) promote private sector development for poverty reduction; (ii) improve natural resources management; (iii) improve service delivery and public financial management; and (iv) support decentralization and promote citizens' partnerships for better governance. These four objectives were chosen because of their importance for growth and poverty reduction and the strong ownership and leadership from the Royal Government of Cambodia (RGC). The selection was also informed by lessons from successes and failures in past strategies, and by the comparative advantage of development partners.

Pillar 2 of the CAS allocates World Bank resources to supporting the strategy development and investments needed to attain the CMDGs. To these ends the CAS has two other objectives. First, the Bank will encourage the emergence of poverty-focused approaches in the formulation and implementation of public policy by supporting the NSDP 2006–10. Second, where there are clear gaps in critical infrastructure and human development sub-sectors, the Bank will support the emergence of a nationally-owned vision and strategy through the provision of analytical and investment services.

II. PILLAR 1: REMOVING THE GOVERNANCE CONSTRAINTS TO ATTAINING THE CMDGS

A. Private Sector Development (PSD)

Country Progress: Progress in this area has been mixed. On the trade facilitation front, there has been steady movement towards a customs automation program (ASYCUDA), with adoption of the Single Administrative Document (SAD) import/export declaration format and a pilot test of the automated customs procedures, commencing in Sihanoukville in May 2008 and

¹ Prepared by World Bank staff.

with a nationwide roll-out scheduled in 2009. The Law on Customs, which is instrumental to customs reforms and to the implementation of ASYCUDA, was passed by the National Assembly in 2007. A risk management strategy has been adopted and is being implemented. Some progress has also been made in developing Special Economic Zones. With respect to improving the legal framework for investment and private sector development, the Law on Commercial Arbitration and the Law on Concessions were passed by the National Assembly in March 2006 and September 2007, respectively, but implementation of these laws has lagged.

Role of the World Bank Group: The focus of the Bank's PSD program in Cambodia is on supporting investment climate development through trade facilitation and improving the legal framework for investment. Policy reforms in both of these areas have been supported through the first of a series of Poverty Reduction and Growth Operations (PRGO) approved in July 2007. The 2005 Trade Facilitation and Competitiveness Project is helping improve Cambodia's competitiveness by streamlining import/export formalities and reducing the costs of trade-related activities. The IFC's Mekong Private Sector Development Facility (MPDF) prepared the Cambodian Provincial Business Environment Scorecards in ten provinces, and the Bank has recently started a new Investment Climate Assessment (ICA) to monitor results since the 2004 ICA, identify new issues, and design future support. The Bank has also led the Technical Working Group (TWG) on PSD, supported the Government/Private Sector Forum, and participated actively in the dialogue on private sector issues with the RGC, donors, and the private sector.

B. Natural Resources Management (NRM)

Country Progress: Progress in this area has been satisfactory, but a number of concerns remain. Sub-decrees on State Land Management and on Economic Land Concessions (ELCs) have been adopted, including provisions for reviewing and cancelling nonperforming economic land concessions and assigning the land for use as social land concessions for the poor. The RGC has distributed more than 800,000 titles and has also started a dialogue on titling of communally-owned land by indigenous people. Actions were also taken to strengthen systems for forestry management, including community based forest activities, with the RGC recently issuing a new Protected Areas Law to provide greater clarity on institutional roles, responsibilities, and obligations. However, transparency in the issuance of ELCs still needs to be improved, and the social land concessions program needs to be accelerated. Implementation of the laws governing access and title to natural resources has also been slow, and governance weaknesses in the forestry sector are still a major concern to all stakeholders.

Role of the World Bank Group: To better integrate the Bank's efforts across land, forestry, and biodiversity conservation, the Bank has developed a natural resources management framework that seeks to summarize the main challenges and required actions to move the overall agenda forward. The Bank has used this framework in its engagement with the TWGs on land, agriculture, poverty, environment, and water. Policy reforms in NRM are being

supported through additional analytical and advisory activities (AAA), including an agrarian structures study and an environment monitor, the PRGO, and a range of investment and technical support operations. Of particular importance are the Land Management and Administration Project (LMAP), which has supported notable progress on land titling, and the Biodiversity and Protected Areas Management Project, which has successfully piloted measures for ensuring sound management of protected areas. However, irregularities in the implementation of both of these projects as well as three other projects (the Forest Concession Management and Control Pilot Project, Flood Emergency Rehabilitation Project, and Agricultural Productivity Improvement Project) have resulted in delays. A Japan Social Development Fund Grant has been mobilized to foster NGO, local community, and RGC capacity to expand community forestry activities. Finally, in 2008, the Land Allocation for Social and Economic Development project was adopted to support the implementation of the RGC's Social Land Concession strategy.

C. Public Financial Management (PFM)

Country Progress: Progress in this area has been satisfactory. Good progress has been made in implementing improved arrangements for budget formulation, budget classification, cash and bank account management, financial control, and transaction management. Procurement responsibility has been increasingly deconcentrated to line agencies, and an improved procurement sub-decree and the supporting implementing regulations have been adopted, incorporating numerous measures for increasing competition, transparency, and accountability in the procurement process. This has contributed to a strengthening of the overall PFM system, with the latest indicators showing aggregate actual expenditures to be within 5 percent of the budget, revenues continuing to grow, and arrears being largely eliminated. An innovative merit-based pay initiative (MBPI) was implemented in the Ministry of Economy and Finance to tackle the issues of civil service incentives, performance, and capacity. This system is now being extended progressively to all development partner-financed strategic reforms with a view to eliminating current distortionary salary supplement schemes, harmonizing RGC and partner approaches to incentives, and beginning to address the broader needs for civil service reform.

Role of World Bank Group: The Bank has worked closely with the RGC and helped coordinate the 13 development partners in the TWG on PFM in the design and implementation of the RGC's PFM Reform Program (PFMRP). The Bank has also supported the program through the PRGO as well as the PFM Accountability Project. The PFMRP is the first operation to support a sector-wide approach in Cambodia and has been recognized as a model of aid effectiveness globally. The Bank has also initiated a dialogue on oil revenue management, engaged civil society in the dialogue on PFM, and assisted the RGC in adopting and extending the MBPI. AAA on public expenditure tracking surveys (PETS) in education and health sectors as well as civil service reform for teachers have been completed, and grants from trust funds are supporting strengthened National Assembly oversight of the budget.

D. Decentralization and Accountability

Country Progress: Progress in this area has been considerable. In line with the goal of decentralizing resources to local government units, average funds to commune/sangkat are projected to double by 2010. A second round of commune/sangkat council elections in 2007 has strengthened the foundation for enhanced accountability at the local level. The Ministry of Interior has successfully piloted “One Window Service” and a District Ombudsman’s office to enhance local governance. After some delay, the National Assembly adopted the Organic Laws on Decentralization and Deconcentration in April 2008. However, progress on improving access to information, including drafting of an access to information law, has been delayed, and civil society involvement in policy-making processes is developing slowly, as there is still insufficient constructive engagement with the RGC.

Role of the World Bank Group: The Bank has provided substantial support for decentralization through the Rural Investment and Local Governance Project. The Bank has also conducted a series of studies on justice for the poor as well as a village level and dispute resolution study. In addition, it has provided advice through the TWG on the RGC’s decentralization policy and strategy and mobilized grant finance to support government-civil society consultations on the decentralization strategy as well as to build the capacity of civil society on social accountability.

III. PILLAR 2: SUPPORTING STRATEGY AND INVESTMENTS TO ATTAIN THE CMDGs

A. Formulation and Implementation of the NSDP, 2006–10

Country Progress: Progress toward this objective has been impressive. The RGC adopted the NSDP in 2006, replacing previous donor-driven plans with a single national development strategy. The TWG for Planning and Poverty Reduction provides a forum for regular dialogue between the RGC, development partners, and civil society on the implementation of the NSDP. Over the last two years, the Ministry of Planning (MoP) has developed (with support from the TWG) a strategic plan to refocus the ministry and help build its capacity to coordinate the implementation, monitoring, and evaluation of the NSDP. The TWG has also provided a forum for shifting external support towards a ministry-wide, program-based approach, by which development partners supporting the MoP will coordinate their assistance with the NSDP. On gender equality, improvements have also been made, including an increase in female’s representation in commune councils from 8 percent to 15 percent following the 2007 elections.

Role of the World Bank Group: The Bank, together in other development partners, has provided technical and financial support to the MoP in the formulation and implementation of the NSDP, with the Bank and UNDP serving as development partner co-facilitators of the TWG. In addition to direct support to RGC institutions and processes related to the NSDP, the Bank has helped to improve the knowledge base for policymakers and other stakeholders

through the 2006 Poverty Assessment and the 2007 Sharing Growth: Equity and Development Report. The Bank has also provided support to the Ministry of Womens' and Veterans' Affairs through an Institutional Development Fund grant, which funded a Gender Budgeting Project, as well as a number of smaller stand-alone grants for various outreach, training, and advocacy activities, including study tours for women in leadership, a regional workshop on mainstreaming gender in aid effectiveness, and local-level dissemination activities.

B. Analytical and Investment Support for Achieving the CMDGs—Human Development and Infrastructure

Country Progress: Progress towards CAS outcomes has been impressive. In both the social and infrastructure sectors, significant progress has been made towards government-owned strategies around which donors can coordinate their financial and technical support. Improvements have also been made in most human development outcomes such as the infant mortality rate, fertility rate, HIV prevalence rates, and school enrollment rates. There has been greater access to and utilization of health, education, and infrastructure services, and better targeting of health and education subsidies. More resources have been allocated to interventions in priority sectors, such as to reducing child and maternal mortality. Access to education and health, including by disadvantaged/vulnerable communities, has expanded, and the perception of service delivery in health and education among users of these services has improved. Nevertheless, other indicators such as maternal mortality or drop-out rates are lagging.

Role of the World Bank Group: The Bank has continued to provide support for the development and implementation of effective strategies in the social sectors through the ongoing Health Sector Support and Education Sector Support Projects, as well as through participation in the TWGs. In the health sector, a major step toward a sector-wide approach was taken in 2008 to support the new RGC health sector strategy in partnership with AusAid, DFID, France, UNFPA, and UNICEF. In the education sector, support from the Education For All Fast Track Initiative Catalytic Fund was approved in 2008. As mentioned previously, the Bank has also undertaken PETS in health and education to promote PFM reforms in these sectors, and has supported additional analytical work in education.

In infrastructure, the Bank has helped in the development of sub-sector strategies through a range of AAA (Energy Sector Strategy Review, Transport Sector Update, Implementation Strategy for Urban Water Supply Policy, and briefing notes on oil and gas sector policy issues) as well as through participation in the TWGs. The Bank has also engaged in a number of investment projects that have had a high development impact for the intended beneficiaries. However, the temporary suspension of two such projects—the Provincial and Rural Infrastructure Project (PRIP) and the Provincial and Peri-Urban Water and Sanitation Project (PPUWSP)—has delayed somewhat the anticipated results.

IV. LENDING OPERATIONS AND NON-LENDING INSTRUMENTS

Proactive portfolio management continues to be a very high priority for the World Bank Group. Following the 2004–05 Fiduciary Review (carried out in partnership with the RGC), the World Bank's Institutional Integrity Department (INT) undertook separate investigations in 2005–06. The INT investigations substantiated allegations of corruption, collusion, and fraudulent practices on several contracts under seven projects for which “misprocurement” was declared in June 2006. As a result, the Bank temporarily suspended disbursements under three projects (LMAP, PRIP and PPUWSP) and established action plans for the concerned government agencies to execute in order to lift the suspensions.² These action plans were completed in January 2007, and the Bank lifted the suspensions on all three projects in February 2007.

The RGC and the World Bank have established a number of preventive and oversight measures to mitigate fiduciary risks in Bank-financed projects. One important measure has been the use of anti-corruption action plans knowing Good Governance Frameworks (GGFs). The GGFs—adopted for all on-going and future Bank-financed projects—include measures to strengthen procurement procedures, financial management processes, staff conduct, complaint mechanisms, disclosure, and internal controls. Although the GGFs have been in place for less than a year, early implementation reviews indicate an increasing level of implementation during this initial period. Another important measure is the use of an International Procurement Agent (IPA) since December 2007 for all ongoing and future Bank-financed projects. This action is evidence of the RGC's commitment to ensuring the integrity of the procurement process and to breaking established collusive and cartel arrangements. Finally, the Bank is also providing technical support to the RGC to reinforce its own ability to identify and remedy fraud and corruption problems.

The disbursement ratio in FY08—at 16.1 percent—was low mainly due to the after-effects of the project suspension and the delay in engagement of the IPA.

Non-lending instruments and operations (credits and grants) are described in Tables 1 and 2.

² Suspension is a remedial measure available under all World Bank legal agreements. It can be exercised by the Bank in a number of situations, including when the Borrower is not fulfilling its obligations under the legal agreement. Suspension entails a temporary freeze on the Bank's financing of implementation, but does not mean that the Bank withdraws from the project. Rather, the Bank steps up its supervision, dialogue, and other activities to help the government in its efforts to meet the conditions for lifting the suspension.

Table 1. Active IDA Projects

(As of November 24, 2008)

Project	Committed (USD)	Approval Date	Undisbursed Balance (USD)
Road Asset Management Project	30,000,000.00	20-May-08	26,937,600.00
Cambodia Second Health Sector Support Program	30,000,000.00	19-Jun-08	27,232,000.00
Land Allocation for Social and Economic Development	11,500,000.00	20-May-08	9,373,860.00
Avian and Human Influenza Control and Preparedness Emergency Project	6,000,000.00	24-Mar-08	5,072,174.18
GMS Power Trade (Cambodia) Project	18,500,000.00	05-Jun-07	18,105,600.00
First Poverty Reduction and Growth Operation	15,000,000.00	17-Jul-07	0.00
Cambodia Public Financial Management and Accountability	14,000,000.00	27-Jun-06	12,879,938.18
Cambodia Trade Facilitation and Competitiveness	10,000,000.00	02-Jun-05	6,601,368.32
Cambodia Education Sector Support	28,000,000.00	12-May-05	11,429,930.35
Rural Electrification and Transmission Project	40,000,000.00	16-Dec-03	30,872,894.14
Provincial and Rural Infrastructure Project	20,000,000.00	11-Sep-03	6,379,572.93
Provincial and Peri-Urban Water and Sanitation Project	19,900,000.00	22-Apr-03	8,455,017.85
Rural Investment And Local Governance Project	36,250,000.00	26-Jul-07	28,362,619.71
Rural Investment And Local Governance Project	22,000,000.00	22-Apr-03	360,093.53
Health Sector Support Project	27,000,000.00	19-Dec-02	9,455,659.11
Economic and Public Sector Capacity Building Project	5,500,000.00	25-Jun-02	4,828,908.20
Land Management and Administration Project	24,300,000.00	26-Feb-02	11,080,079.50

Table 2. World Bank's Main Non-Lending Services

(Recently completed and ongoing)

Issue	Instruments
Environment	Cambodia Environment Monitor (2008), Natural Resource Management and Forestry (2008).
Gender	Cambodia Gender Assessment (2008).
Human Development	Demand Side Incentives in Education Impact Evaluation (ongoing), Civil Service Reform for Teachers (ongoing), Social Protection Policy Note (2006), Safeguards Research (2006), Child Labor Study (2006), Health Sector Study, Education Fast Track Initiative (2008).
Infrastructure	Urban Water and Sanitation Strategy (2006); Oil and Gas Sector Policy (2008).
Legal and Judicial Reform	Justice for the Poor Phase One Study (2006); Justice for the Poor Phase Two (2008).
Poverty Reduction and Economics	Poverty Reduction Strategy Trust Funds (ongoing), Moving Out of Poverty Study (2007), National Poverty Assessment (2006), Cambodia Equity Report (2007), and Sources of Growth (2008).
Private Sector Development and Trade	PPIAF Grant to develop an interim regulatory framework (ongoing). FIAS report on FDI (2001), Integration and Competitiveness Study (2002), Investment Climate Assessment (2008).
Public Financial Management	Grant to assist the National Audit Authority (ongoing), IFAPER (2003), Country Procurement Assessment Report (2004), Fiduciary Review (2005), Public Expenditure Tracking Survey—Education (2005), Public Expenditure Tracking Survey—Health (2007), ROSC on private sector accounting (2007).
Rural and Agriculture	PSIA on Social Land Concessions (2004), Rural Sector Strategy Note (2005), Land Taxation and Valuation Study (2005), and Land Policy and Strategy (2007), Cambodia Agrarian Structure (2008).

ANNEX III. CAMBODIA: RELATIONS WITH THE ASIAN DEVELOPMENT BANK
(As of September 2008)

From 1992 through August 31, 2008, the Asian Development Bank (AsDB) approved \$1,032.1 million in low-interest loans (including \$86.8 million in grants in 2005, 2006, and 2007) to Cambodia to finance 39 projects and 9 structural reform programs. To date, 23 loan projects for a total of \$563.9 million have been completed:

- (i) Special Rehabilitation Assistance Project [approved in 1992];
- (ii) Power Rehabilitation Project [approved in 1994];
- (iii) Basic Skills Project [approved in 1995];
- (iv) Rural Infrastructure Improvement Project [approved in 1995];
- (v) Basic Education Text Book Project [approved in 1996];
- (vi) Agriculture Sector Program [approved in 1996];
- (vii) Basic Health Services Project [approved in 1996];
- (viii) Phnom Penh Water Supply and Drainage Project [approved in 1996];
- (ix) Siem Reap Airport Project [approved in 1996];
- (x) Greater Mekong Sub-region: Phnom Penh to Ho Chi Minh City Highway Project [approved in 1998];
- (xi) Primary Roads Restoration Project [approved in 1999];
- (xii) Provincial Towns Improvement Project [approved in 1999];
- (xiii) Provincial Power Supply Project [approved in 2000];
- (xiv) Emergency Flood Rehabilitation Project [approved in 2000];
- (xv) Rural Credit and Savings Project [approved in 2000];
- (xvi) Financial Sector Program, Subprogram I [approved in 2001];
- (xvii) Education Sector Development Program [approved in 2001];
- (xviii) Financial Sector Program, Subprogram II [approved in 2002];
- (xix) Commune Council Development Project [approved in 2002];
- (xx) Provincial Towns Improvement Project, Supplementary [approved in 2002];
- (xxi) Second Education Sector Development Program II [approved in 2004];
- (xxii) Financial Sector Program, Subprogram III [approved in 2005]; and
- (xxiii) Second Financial Sector Program [approved in 2007].

The sector composition and loan/grant amounts of the remaining active portfolio as of August 31, 2008 is as follows: agriculture and natural resources (\$73.6 million); education (\$70.1 million); energy (\$64.3 million); finance (\$0.0 million); health, nutrition, and social protection (\$29.0 million); industry and trade (\$35.6 million); law, economic management, and public policy (\$7.8 million); multi-sector (\$63.2 million); transport and communication (\$105.0 million); and water supply, sanitation, and waste management (\$18.0 million).

AsDB's overarching goal in Cambodia is sustainable poverty reduction. The AsDB's Country Strategy and Program (CSP 2005–09) midterm review (MTR), finalized in August

2007, concluded that the strategic thrust of the AsDB in Cambodia remains appropriately targeted on poverty reduction through broad-based private sector-led growth, inclusive social development, and stronger governance for sustainable development. The AsDB's proposed Country Operations Business Plan 2008–10 (COBP) will strongly focus on the priority areas of agricultural and rural development, private sector development, governance and capacity development, and the Greater Mekang Sub-region (GMS). In the near term, interventions would mostly center around the Tonle Sap basin area and be geared to improving the management of water resources and irrigation assets, as well as that of flood and drought risk and mitigation; expanding the connectivity internally between rural roads and the provincial and national network and externally with emerging subregional transport corridors; fostering the development of smallholder agricultural producers; and widening access for the poorest to rural water supply and sanitation while strengthening local community management capacity.

In the area of private sector development, the AsDB would support improvements in competitiveness by helping reduce border-related costs and distortions; enhancing domestic and external trade facilitation, including through promoting compliance with sanitary and phytosanitary standards; and fostering improved and cheaper access to information and communication technology. Later interventions would be more focused on improving the trade facilitation and logistics links to the GMS as systems and procedures become more developed and integrated. Supporting financial sector interventions would be aimed at improving financial intermediation, including the outreach of microfinance institutions (MFIs) and reducing the cost of finance in rural areas; enhancing the resilience of the financial sector; promoting good governance; and improving financial sector efficiency. Education-related interventions would be aimed at enhancing technical and vocational education training to achieve a closer match between the skills of a rapidly growing and young rural labor force and emerging employment opportunities. There will also be a gradual increase in private sector operations, beginning with interventions to expand trade and access to rural finance, including proposed non-recourse interventions by ASDB's private sector department to guarantee trade financing and extend MFI reach in rural areas. Other infrastructure loans or investment opportunities are being sought, including in the areas of thermal and hydropower.

With respect to governance and capacity building, the COBP proposes a long-term programmatic approach to public financial management (PFM) reform with interventions in 2008 and 2010 to underpin rolling out of PFM to rural development line ministries. At the decentralized level, it will be backed by a credible independent enforcement of accountability oversight in the form of the National Audit Authority. The COBP also proposes a sequence of interventions to support local accountability through particular projects and capacity building ahead of support for fiscal decentralization.

AsDB: Loan/Grant Commitments and Disbursements to Cambodia, 1992–2008
(In millions of U.S. dollars, as of August 31, 2008)

		Loan/Grant Approvals	Contract Awards/ Commitment	Disbursements
1	1992	67.7	0.0	0.0
2	1993	0.0	4.4	5.4
3	1994	28.2	35.9	12.2
4	1995	45.1	28.1	35.9
5	1996	105.0	15.3	32.1
6	1997	0.0	41.5	10.7
7	1998	40.0	29.1	29.3
8	1999	88.0	17.0	26.2
9	2000	109.6	114.4	50.8
10	2001	75.2	40.7	48.3
11	2002	116.5	64.4	78.9
12	2003	98.3	61.9	73.3
13	2004	65.0	62.4	76.7
14	2005	52.0 ¹	96.4	84.5
15	2006	69.8 ²	44.7	55.8
16	2007	72.1 ³	85.7	62.1
17	2008	84.4 ⁴	107.7 ⁵	96.3 ⁵
18	2009 (Projected)	114.0 ⁶		
TOTAL:		1,210.9	849.7	778.5

¹ \$10 million loans and \$42 million grants approved in 2005.

² \$62 million loans and \$7.8 million grants approved in 2006.

³ \$35 million loans (including \$8 million to private sector) and \$37 million grants approved in 2007.

⁴ \$46.8 million loans and \$31.6 million grants to be approved by end-2008.

⁵ Projections for 2008.

⁶ \$63 million loans and \$51 million grants expected for approval in 2009.

ANNEX IV. CAMBODIA: STATISTICAL ISSUES

1. Data provision is broadly adequate for surveillance. However, national accounts, price indices, government finance, balance of payments statistics, and external debt have various shortcomings that hamper analysis. Greater use of direct surveys is needed in the compilation of national accounts, BOP, and employment data, including enterprise surveys.
2. Extensive technical assistance from the IMF, UNDP, Asian Development Bank, and World Bank, as well as from bilateral partners (namely Japan and Sweden), has contributed to substantial improvements in macroeconomic statistics. The IMF provided a long-term multisector statistics advisor at the National Institute of Statistics during the period October 2001–January 2008 (with a one-year interruption) to assist the authorities in upgrading macroeconomic and financial statistics.
3. Metadata have been posted on the IMF’s Dissemination Standards Bulletin Board since March 2002. Cambodia also began participation in the IMF’s General Data Dissemination System (GDDS). The country’s GDDS metadata were last updated in August 2007.

National accounts and price statistics

4. Recent efforts have been made to improve the consistency of national accounts statistics with the United Nations’ *System of National Accounts 1993*, to expand the range of annual national account aggregates, and to produce a quarterly national accounts series (starting in June 2005). However, the quality of GDP estimates remains hampered by the lack of comprehensive and reliable source data on a production and expenditure basis, in part stemming from the need to improve data collection techniques.
5. A new CPI series was compiled starting in October 2006. Data were published through January 2008, but thereafter halted given the authorities’ view that a much higher level of inflation from the new CPI was attributable to methodological weaknesses. The authorities have reverted to the old CPI series that has a narrower geographical coverage (limited to Phnom Penh and surrounding areas as opposed the new series’ all-Cambodia index). They are seeking assistance from Statistics Sweden on a nationwide CPI, following up on earlier work done by the IMF advisor. A quarterly producer price index (PPI) was developed, with support from the IMF and financing from the AsDB. It led to the release of an experimental PPI in April 2005. However, compilation of the PPI has been discontinued owing to resource constraints.

Government finance statistics

6. Progress had been made recently in strengthening the reporting and compilation of government finance statistics (GFS), but gaps remain the coverage under new methodologies. With the support of an IMF Treasury advisor and the above-mentioned statistical advisor, the

authorities began implementing in 2007 a reform of the government accounting system and budgetary nomenclature based on the *Government Finance Statistics Manual (GSFM) 2001*. In addition, several recent STA missions have assisted with improving GFS compilation procedures within the *GSFM 2001* framework. The latest was in April 2008, which assessed progress and assisted with establishing a bridge between the government's new chart of accounts (COA) and the *GSFM 2001* classifications so that accounting records can be used as source data in compiling GFS. Currently, however, the new COA has not been implemented widely, limiting its use and coverage. Since 2005, the authorities have provided quarterly fiscal data for publication in *International Finance Statistics* and annual data for publication in the *Government Finance Statistics Yearbook*.

Monetary and financial statistics

7. The National Bank of Cambodia (NBC) compiles the sectoral balance sheet and the survey for central bank and other depository institutions in accordance with the methodology recommended in the IMF's *Monetary and Financial Statistics Manual*. Since August 2005, the NBC has reported monthly monetary and financial statistics to the IMF using the standardized report forms with about five-week lag. The NBC also began compiling and publishing financial soundness indicators in 2005 in its annual supervisory report, but as these data may partly rely on unaudited financial accounts, considerable scope remains for improving their accuracy and reliability.

External sector statistics

8. Despite recent improvements, more work is needed to improve balance of payments statistics. Customs data have substantial coverage and valuation problems arising from the use of reference prices and limited recording of non-dutiable imports, underreporting of re-exports, and weaknesses in customs controls. Enterprise transactions, such as payment for imported services, income payments, and portfolio investment abroad are excluded or underreported. Foreign direct investment, which is believed to be large, relies excessively on approvals data. Regarding external debt statistics, gross external debt data are provided by the Ministry of Economy and Finance, but gaps exist in the data, in particular public and publicly-guaranteed debt by maturity, the external debt service schedule, and timely information on disbursements by bilateral donors.

Cambodia: Table of Common Indicators Required for Surveillance
(As of December 19, 2008)

	Date of latest Observation	Date Received	Frequency of Data ⁶	Frequency of Reporting ⁶	Frequency of Publication ⁶
Exchange Rates	Dec. 2008	Dec. 2008	D	D	W
International Reserve Assets and Reserve Liabilities of the Monetary Authorities ¹	Nov. 2008	Dec. 2008	Biweekly	Biweekly, 2 week lag	N/A
Reserve/Base Money	Oct. 2008	Dec. 2008	M	M, 4–6 week delay	M
Broad Money	Oct. 2008	Dec. 2008	M	M, 4–6 week delay	M
Central Bank Balance Sheet	Oct. 2008	Dec. 2008	M	M, 4–6 week delay	M
Consolidated Balance Sheet of the Banking System	Oct. 2008	Dec. 2008	M	M, 4–6 week delay	M
Interest Rates ²	Oct. 2008	Dec. 2008	M	M, 4–6 week lag	M
Consumer Price Index	Nov. 2008	Dec. 2008	M	M, 2–4 week lag	M
Revenue, Expenditure, Balance and Composition of Financing ³ –General Government ⁴	Oct. 2008	Dec. 2008	M	M, 4–6 week lag	M
Revenue, Expenditure, Balance and Composition of Financing ³ –Central Government	Oct. 2008	Dec. 2008	M	M, 4–6 week lag	M
Stocks of Central Government and Central Government-Guaranteed Debt ⁵	Sep. 2008	Nov. 2008	Q	Q, 2–3 month lag	M
External Current Account Balance	Q3, 2008	Dec. 2008	Q	Q, 2 month lag	Q
Exports and Imports of Goods and Services	Q3, 2008	Dec. 2008	Q	Q, 2 month lag	Q
GDP/GNP	Q3, 2008	Nov. 2008	Q	Q, 2 month lag	Q
Gross External Debt	Sep. 2008	Oct. 2008	M	M, 1–2 month lag	A
International Investment Position ⁶	Sep. 2008	Nov. 2008	Q	Q, 2–3 month lag	M

¹ Includes reserve assets pledged or otherwise encumbered as well as net derivative positions.

² Both market-based and officially-determined, including discount rates, money market rates, rates on treasury bills, notes and bonds.

³ Foreign, domestic bank, and domestic nonbank financing.

⁴ The general government consists of the central government (budgetary funds, extra budgetary funds, and social security funds) and state and local governments.

⁵ Including currency and maturity composition.

⁶ Includes external gross financial asset and liability positions vis-à-vis nonresidents.

⁷ Daily (D), Weekly (W), Monthly (M), Quarterly (Q), Annually (A), Irregular (I); and Not Available (N/A).



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IMF Executive Board Concludes 2008 Article IV Consultation with Cambodia

On January 16, 2009, the Executive Board of the International Monetary Fund (IMF) concluded the Article IV consultation with Cambodia.¹

Background

Cambodia's economy has performed well in recent years, owing to a stable macroeconomic environment and double-digit growth. However, in 2008, conditions became less settled, owing to spillover effects from the global financial crisis and weakening external demand. Cambodia has been particularly vulnerable to recent shocks given its narrow production base, concentration of exports by product and destination, and dependence on external inflows. As a result, economic activity is slowing in most sectors and liquidity conditions are tightening. Rapid credit expansion since 2007 combined with weaknesses in bank supervision have heightened risks faced by a number of banks, including a few systemically important ones. On a positive note, inflation pressures, which were intensifying until mid-2008, has decreased owing mainly to the fall in commodity prices.

Real GDP growth is projected at 6½ percent in 2008 and 4¾ percent in 2009, compared to 10¼ percent in 2007. In 2008, garment exports and tourism activity moderated as external demand weakened. Agricultural growth was likely below-trend due to adverse weather. Construction activity—strong in the first half of the year—also faltered, as foreign direct investment slowed and credit growth decelerated. While agricultural output should pick up in 2009, garments and tourism are expected to act as significant drag on growth given weak external conditions. Real estate and construction activity will also likely slow further, as investment becomes more constrained by inflows and credit. Headline inflation is projected to moderate to 15½ percent (year-on-year) in December 2008 and 7½ percent (y/y) by end-

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. At the conclusion of the discussion, the Managing Director, as Chairman of the Board, summarizes the views of Executive Directors, and this summary is transmitted to the country's authorities.

2009 on lower commodity prices and easing demand pressures. The current account deficit rose sharply in 2008 due to high oil prices and strong non-oil imports, but with these factors now reversing, the deficit in 2009 is projected to narrow. Nonetheless, the overall external position, which improved in 2008, could weaken in 2009 given decreasing private inflows. Gross official reserves, projected at US\$2.0 billion (3.5 months of prospective imports), would fall to around US\$1.9 billion (3.1 months of imports) by end-2009.

The fiscal stance continued to underpin stabilization efforts in 2008. The overall deficit is expected at around 1¾ percent of GDP, against an official target of 4¼ percent and an outturn of around 3 percent in 2007. Revenue performance was strong, in part due to improved tax and customs administration, and expenditure remained appropriately constrained. However, public financial management reforms lagged, in particular budget integration. Given the near-term outlook, the 2009 budget has a deficit target of 4¼ percent of GDP, leaving scope for countercyclical fiscal easing.

Monetary conditions, lax in the first half of 2008, have tightened as external inflows slow and policy measures take hold—mainly a doubling of the reserve requirement on foreign currency deposits to 16 percent in June. Credit growth, which exceeded 100 percent (y/y) in mid-2008, is expected to fall to around 60 percent by year-end, with growth likely to be significantly lower in 2009 as liquidity remains tight. However, liquidity management remains constrained by the lack of an operational framework at the National Bank of Cambodia (NBC), although gradual steps are being taken to address this weakness. Despite recent global developments, the riel was relatively stable against the U.S. dollar in 2008, as transaction demand for riel balances stayed strong with inflation high.

With the banking system under increased strain, tighter monitoring is required by the NBC of banks' compliance with prudential regulations to prevent systemic problems. The NBC continues to improve its supervisory capacity, but enforcement remains weak, in particular in dealing effectively with capital adequacy and loan provisioning. New minimum capital requirements have been approved for 2010. In addition, steps are being taken to strengthen loan classification standards and improve bank licensing procedures. Bank resolution plans are also being formulated to provide a solid framework for dealing effectively with troubled banks.

Over the near term, the balance of risk is to the downside, because of uncertainty about the length and depth of the global recession and its impact on external inflows. Adding to pressures is a recent loss in competitiveness stemming from high domestic inflation coupled with U.S. dollar strength vis-à-vis most major currencies, leading to a sharp real appreciation. Medium-term prospects for Cambodia will depend on maintaining macroeconomic and financial stability, improving governance and infrastructure, and taking other actions to strengthen competitiveness, including addressing skill deficiencies and streamlining business regulation.

Executive Board Assessment

Executive Directors commended the Cambodian authorities for maintaining sound macroeconomic policies, including strong budget performance, against the backdrop of an increasingly difficult external environment. Directors noted that the global economic downturn and financial crisis pose serious challenges to Cambodia, with potential adverse effects on economic activity, capital inflows, and the banking system. They welcomed the authorities' recognition of the need for a timely and decisive policy response. This will need to involve supportive fiscal and monetary policies, as well as improvements in financial sector oversight, public services delivery, and external competitiveness, aimed at reducing vulnerabilities and sustaining growth and poverty reduction.

Directors considered the modest easing of fiscal policy envisaged for 2009 as broadly appropriate, and recommended that the increase in government spending be focused on pro-poor social and infrastructure outlays. They encouraged the authorities to continue to strengthen revenue administration and, as conditions permit, broaden the tax base, building on recent improvements. Greater control over the government's wage bill could be exercised by linking future increases to comprehensive civil service reform. Directors also called for concerted efforts to strengthen public financial management by improving Treasury operations and budget coordination and integration, as well as a transparent fiscal regime for extractive industries.

Directors supported the current monetary policy stance, and saw room for a moderate easing as credit growth drops and aggregate demand pressures ease. They encouraged the authorities to make further efforts to increase policy effectiveness in the context of high dollarization, building on the Fund's technical assistance recommendations, and to work toward a more developed monetary framework. Directors saw the adoption of a clear strategy to manage liquidity risk as an immediate priority. In this context, they welcomed steps to develop a sound, transparent overdraft facility, but stressed the need for caution in designating eligible collateral. Efforts should also continue to improve the required reserve system.

Directors stressed the need for comprehensive measures to improve banking soundness, notably in the areas of supervision, enforcement of regulations, and bank licensing procedures. They commended the NBC for taking further steps to strengthen the prudential framework and capital requirements. Directors also stressed the importance of formulating banking resolution plans should the need arise, with a view to containing fiscal risk. They welcomed the authorities' intent to participate in the Financial Sector Assessment Program (FSAP) in early 2010.

Directors took note of the staff's assessment that the real effective exchange rate appears overvalued. They generally considered that the present exchange rate regime continues to provide an appropriate nominal anchor, given the high degree of dollarization and the stage of financial development. Directors agreed that greater exchange rate flexibility is the appropriate medium-term objective. In the meantime, external competitiveness should be safeguarded by maintaining a stable macroeconomic environment, along with steps to develop a more skilled workforce, improve public services and infrastructure, and streamline business regulations.

Directors encouraged the authorities to continue pursuing a prudent debt management strategy, given the moderate risk of external debt distress and uncertainty about near-term prospects. Consistent with this strategy, Cambodia should continue to borrow largely on concessional terms in the foreseeable future.

Directors encouraged the authorities to continue efforts to resolve outstanding arrears with official creditors, noting that a successful resolution could pave the way for consideration of a Poverty Reduction and Growth Facility (PRGF)-supported arrangement should the authorities request it. They welcomed the authorities' commitment to remain closely engaged with the Fund and Cambodia's development partners, in support of the country's reform agenda.

Public Information Notices (Pins) form part of the IMF's efforts to promote transparency of the IMF's views and analysis of economic developments and policies. With the consent of the country (or countries) concerned, PINs are issued after Executive Board discussions of Article IV consultations with member countries, of its surveillance of developments at the regional level, of post-program monitoring, and of ex post assessments of member countries with longer-term program engagements. PINs are also issued after Executive Board discussions of general policy matters, unless otherwise decided by the Executive Board in a particular case. The [staff report](#) (use the free [Adobe Acrobat Reader](#) to view this pdf file) for the 2008 Article IV Consultation with Cambodia is also available.

Cambodia: Selected Economic Indicators, 2005–09

(Annual percent change, unless otherwise indicated)

	2005	2006	<u>2007</u> Est.	<u>2008</u> Proj.	<u>2009</u> Proj.
Gross domestic product (GDP) at constant prices	13.3	10.8	10.2	6.5	4.8
Inflation (consumer price index, end-year)	6.7	2.8	10.8	15.5	7.4
(annual average)	5.8	4.7	5.9	20.0	8.2
Saving and investment (in percent of GDP)					
Gross national saving	14.6	19.9	17.4	9.1	11.9
Gross fixed investment	18.5	20.6	20.8	21.0	19.0
<i>Of which: Government investment</i>	4.9	5.7	6.1	5.6	6.3
Public finances (in percent of GDP)					
Revenue 2/	10.3	11.5	11.9	12.5	12.1
Expenditure	12.8	14.2	14.7	14.2	15.4
Overall budget balance (- deficit) 1/	-2.5	-2.7	-2.9	-1.7	-3.2
Foreign financing (net)	4.9	4.8	5.0	4.3	4.6
Domestic financing (net) 2/	-2.4	-2.0	-2.2	-2.6	-1.3
Broad money	16.1	38.2	62.9	4.9	2.6
Private sector credit	31.8	51.6	76.0	60.0	10.0
Balance of payments					
Exports (in millions of U.S. dollars)	2,910	3,694	4,089	4,363	4,197
Imports (in millions of U.S. dollars)	3,904	4,727	5,419	6,523	5,798
Current account balance (in percent of GDP, - deficit)	-3.8	-0.6	-3.4	-11.9	-7.1
Gross official reserves (in millions of U.S. dollars) 3/	915	1,097	1,616	2,033	1,933
(In months of months of prospective imports)	2.0	2.1	2.5	3.5	3.1
Public external debt (in millions of U.S. dollars) 4/ 5/	2,120	2,254	2,582	2,809	3,087
(In percent of GDP)	35.0	31.0	29.7	26.8	26.0
Memorandum items:					
Nominal GDP (in billions of riels)	25,754	29,849	35,039	42,999	48,691
(In millions of U.S. dollars)	6,286	7,264	8,690	...	...
Exchange rate (riels per dollar, end of period)	4,097	4,109	4,032	...	...

Sources: Data provided by the Cambodian authorities; and IMF staff estimates and projections.

1/ In 2006, includes transfer of the Multilateral Debt Relief Initiative (MDRI) proceeds as capital revenue.

2/ Includes funds in transit and payment orders in excess of cash released.

3/ Excludes unrestricted foreign currency deposits held as reserves at the National Bank of Cambodia and valuation changes.

4/ From 2006, includes the impact of debt forgiveness from the IMF under the MDRI.

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