

CAMBODIA ECONOMIC UPDATE



RESTRAINED RECOVERY

SPECIAL FOCUS

ADAPTING TO COVID-19 IN AN UNCERTAIN WORLD

NOVEMBER 2020



FOR SALE

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CAMBODIA ECONOMIC UPDATE

NOVEMBER 2020

RESTRAINED RECOVERY



WORLD BANK GROUP

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ABBREVIATIONS

ASEAN	Association of Southeast Asian Nations
CCFTA	Cambodia-China Free Trade Agreement
CEU	Cambodia Economic Update
CGT	capital gains tax
COVID-19	coronavirus disease
CR	Cambodian riel
EAP	East Asia and Pacific region
EC	European Commission
EMDEs	emerging markets and developing economies
EU	European Union
FDI	foreign direct investment
FTA	free trade agreement
GDCE	General Department of Customs and Excise
GDP	gross domestic product
GDT	General Department of Taxation
GMAC	Garment Manufacturers Association in Cambodia
GVA	gross value-added
IMF	International Monetary Fund
LPCO	Liquidity-Providing Collateralized Operation
NAFTA	North American Free Trade Agreement
PMI	Purchasing Managers' Index
UK	United Kingdom
U.S.	United States
US\$	United States dollar
YTD	year-to-date
y/y	year-on-year

EXECUTIVE SUMMARY

Recent developments

The COVID-19 pandemic has abruptly interrupted Cambodia's celebrated growth story. The country had averaged 7.7 percent real growth rate during the last two decades. In contrast, in 2020, Cambodia's economy is likely to contract by 2 percent, plunging the economy into a recession for the first time in three decades. The key growth drivers—construction, tourism, and merchandise exports—which together account for more than 70 percent of growth and 39 percent of total paid employment, have been severely affected.

The pandemic has effectively stalled the construction and real estate boom that relied heavily on foreign investment. Steel and cement imports in the first nine months of 2020 contracted by 41.4 percent and 38.1 percent (year-on-year [y/y]), respectively, as many large development projects were put on hold. Cambodia's exports of manufactured products which include garments, travel goods, footwear, bicycles, electrical parts, and vehicle parts and accessories fell by 2.5 percent during the first nine months of 2020. Thanks to travel restrictions and lockdowns, Cambodia's tourism and hospitality sector has collapsed, with international arrivals falling by 74.1 percent (y/y) during the first nine months of 2020.

Inflation remained subdued, thanks to low inflation in import partners and stable exchange rates. Headline inflation was 2.9 percent (y/y) in September 2020, down from 3.1 percent in the end of 2019. The riel-to U.S. dollar remained broadly stable at 4,100 in September 2020, compared to 4,075 in December 2019.

The current account deficit is expected to widen, but to be fully financed by foreign direct investment inflows. Imports have eased, reflecting shrinking domestic demand and the stalled construction boom. Passenger vehicles and motorcycles, Cambodia's key durable imports,

contracted by 34.1 percent and 39.5 percent, respectively, during the first nine months of 2020. Worker's remittance inflows declined by 4.6 percent, reaching US\$550 million during the first six months of 2020. Due largely to the widening trade deficit, the current account deficit is projected to reach 12.8 percent of GDP in 2020, up from 10 percent of GDP in 2019. It is expected to be fully financed by foreign direct investment (FDI) inflows. The gross international reserves position remained solid, increasing to US\$19.5 billion (about 10 months of imports) in June 2020, up from US\$18.7 billion at the end of 2019.

Broad money growth eased, largely due to the deceleration of foreign currency deposits. Given Cambodia's highly dollarized economy, foreign currency deposits account for more than 70 percent of broad money. Broad money grew at 12.3 percent (y/y) in June 2020, compared to 18.2 percent in 2019, as growth of foreign currency deposits fell, reflecting an easing of capital inflows. Growth of currency outside all depository corporations, however, remained strong, increasing at 28.0 percent (y/y) in June 2020, compared to 32.1 percent in 2019, as the central bank continued to promote the use of local currency. Growth of private sector deposits decelerated, falling to 10.7 percent (y/y) in June 2020, down from 16.4 percent in December 2019, likely reflecting sluggish economic activity that negatively impacts liquidity of the corporate sector (and households), thus constraining their ability to save. Despite monetary policy easing by the central bank, growth of depository corporation credit to the private sector eased, decelerating to 18.9 percent (y/y) in June 2020, down from 27.0 percent in 2019, as demand for credit weakened.

High-frequency phone surveys of households validated the adverse impact of the pandemic on employment. The share of respondents who were working declined from 82 percent before the COVID-19 outbreak to 71 percent in May 2020,

but remained relatively unchanged in August 2020. The pandemic continued to negatively affect non-farm business activities, but less severely compared to the onset of the pandemic. However, income losses remained widespread, though the declines in household income slowed following the launch of a new cash transfer program to assist poor and vulnerable households.

Government support to the affected population has been unprecedented, at up to 5 percent of GDP. A broad package of support includes health-related spending and income assistance, equity injections and loan guarantees, development spending, and tax relief. The government's large fiscal support program is expected to turn the budget from a surplus in 2019 into a deficit in 2020.

During the first eight months of 2020, the central government collected 14.3 trillion riels in revenue, a 14.2 percent (y/y) decline. The central government's outlays, however, expanded quickly, reaching 16.2 trillion riels, or a 21.5 percent (y/y) increase. This year's overall fiscal deficit is therefore projected to reach a record high of 6.2 trillion riels. This represents an overall fiscal deficit of 5.6 percent of GDP, compared to a fiscal surplus of 0.8 percent of GDP in 2019. About half of the deficit is expected to be financed by government savings, which stood at 20.2 percent of GDP at the end of 2019, while the remaining half is expected to be financed through official loans. The unprecedented expansion of social assistance will substantially (though not fully) mitigate the pandemic's impact on the poor and near-poor.

Outlook

With the easing of social distancing measures, Cambodia's domestic economic activity is gradually returning to normal. Domestic demand, including internal travel and tourism, is picking up. In October 2020, Cambodia and China signed the Cambodia-China Free Trade Agreement (CCFTA), which is expected to enter into force in 2021. In addition, the benefits of being a member of the Regional Comprehensive Economic Partnership (RCEP) —the largest free trade area in the world, which was signed in

November 2020—should begin to flow, starting in 2021. While actual FDI is expected to decline this year, there is some positive sign that FDI inflows are picking up and becoming more diversified.

As the global economic crisis caused by COVID-19 continues, the economy in 2020 is projected to contract by 2.0 percent, the sharpest decline in Cambodia's recent history. The partial withdrawal of the European Union's (EU's) "Everything But Arms" trade preferential treatment became effective on August 12, 2020, affecting approximately 20 percent of Cambodia's exports to the EU. The economy is projected to recover in 2021, growing at 4.0 percent.

Risks and challenges

Significant uncertainty remains in Cambodia's growth outlook. Downside risks include local COVID-19 outbreaks, a deeper and prolonged decline in tourist arrivals linked to a lingering global pandemic and the speed with which the vaccines become widely available, and the possibility of increased global trade tensions and protectionism. An overleveraged banking (and microfinance) sector also represents a risk to the country's financial stability. Given the unprecedentedly large government intervention, an extension of the social assistance scheme beyond the currently planned time frame would put significant pressure on the budget and further reduce the country's fiscal space.

Policy options

The most important policy goal must be to urgently regain jobs lost or suspended due to the pandemic. In this regard, full attention must be paid to boost investment in labor-intensive sectors to generate jobs. This can be done by taking advantages of the quick recovery of domestic demand for consumer goods, including foods and domestic services, mainly travel, hospitality, and healthcare. For example, ensuring the survival of firms and businesses that are likely to thrive in the post-COVID-19 period would provide relief to workers, facilitate a quick recovery, and boost growth. Similarly, boosting pro-poor and growth-enhancing public investment including cash-for-work projects will create jobs. Public investment

program initiatives to build physical infrastructure in the provincial towns of Sihanoukville and Siem Reap will improve the connectivity and underpin tourism sector development. Doing this will also facilitate the authorities shifting their intervention from emergency relief and social assistance in the form of cash transfers to livelihood support, targeting income generation and job creation.

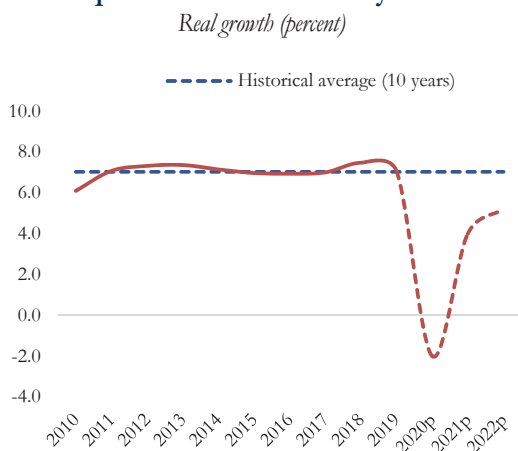
Looking ahead, it is essential to facilitate an expansion of domestic and foreign investment arising largely from recent bilateral and regional free trade agreements. In this regard, promptly introducing competitive investment law and incentive schemes together with the ease of doing business are particularly crucial. Immediate benefits of the CCFTA may come from exporting non-rice, high-value (raw and processed) agricultural products such as cassava, rubber, and soybean, as China has already provided quotas for Cambodia's milled rice and mango exports. Policy, technical, and financial support may therefore be provided to expand the production and quality of these products. In the medium term, nurturing integration of Cambodia's agroprocessing and manufacturing value chains into the regional value chains, initially with those in China, Vietnam, and Thailand, will be fundamental. Singapore, the Republic of Korea, China, and Japan—the largest investors in Vietnam (and Thailand)—are also main investors in Cambodia. Therefore, attracting them to integrate Cambodia into their regional (and global) production chains by improving connectivity, upgrading skilled labor, and reducing energy costs is a good first step. To this end, it is essential to further facilitate trade and investment (measured against the country's rankings in global competitiveness and doing business), while promoting small and medium-sized enterprises (which account for a majority of the economy and labor market) through entry and expansion of innovative businesses and to align and link them with the FDI sector.

It is imperative to continue to closely monitor vulnerabilities arising from a prolonged construction and property boom and the increase of credit provided to the construction and real estate sector. This is particularly crucial, if the pandemic lingers on and damage caused by recent floods turns out to be substantial. Such events will further diminish the ability of businesses and households to repay loans, putting the financial sector under increased stress. While the authorities have granted, as part of the COVID-19 response, an exemption of the ownership transfer tax for property valued at US\$70,000 or less, a 20 percent capital gains tax (CGT) will be effective in 2022. The CGT levies on a capital gain, the taxable income that results from the revenue received from the sale or transfer of capital. The CGT will likely dampen property speculation as it reduces speculative demand, helping stabilize Cambodia's property market, which was booming prior to the COVID-19 pandemic. With influx of FDI inflows targeting the construction and real estate sector, speculative demand rose quickly and has so far distorted Cambodia's housing market. In addition to collecting more revenue for the government, the CGT will likely help contain price volatility. More importantly, the CGT should help redirect investment from buy-and-hold property for capital gains to finance productive and tradable sectors that underpin job creation and boost exports.

It is critically important to develop a COVID-19 vaccine distribution infrastructure, while identifying potential COVID-19 vaccine availability and affordability. This is an important time to make sure that any upcoming vaccines will become available to Cambodia and will be distributed efficiently and fairly. Cooperation has been sought with regional countries developing COVID-19 vaccines such as China to ensure Cambodia has access to the COVID-19 vaccine when it is available.

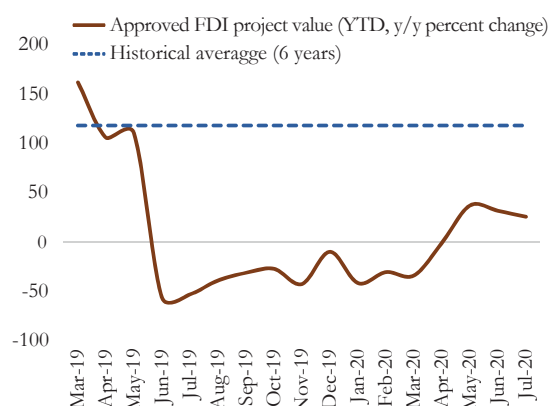
FIGURE ES.1. CAMBODIA'S RECENT DEVELOPMENTS AT A GLANCE

Real growth—hit hard by the pandemic—is expected to recover next year...



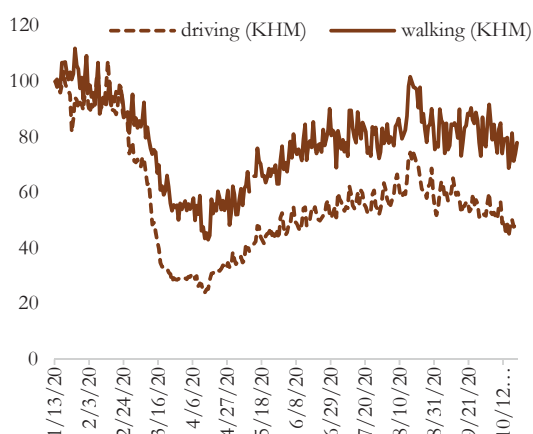
...as investment appetite is growing...

Approved FDI projects (YTD, y/y percent change)



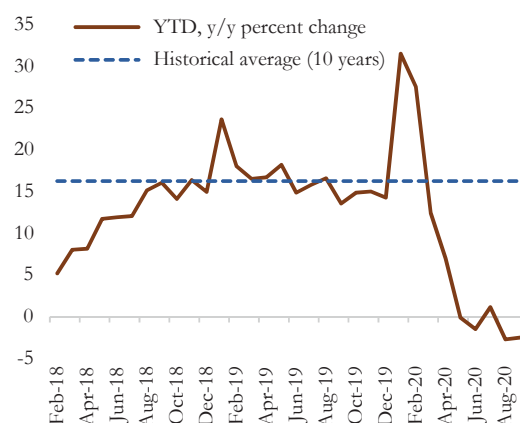
...while domestic activity is gradually recovering...

Cambodia's mobility trends index by Apple (percent)



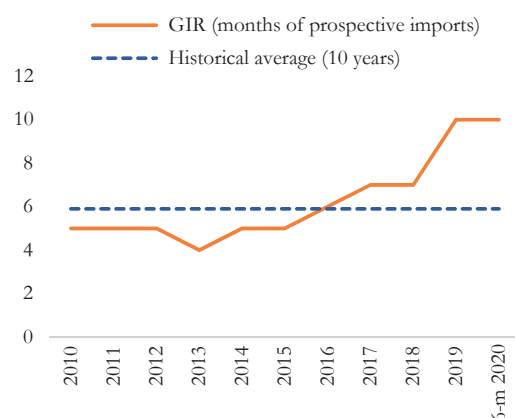
...although manufacturing exports have not improved yet.

(YTD, y/y percent change)



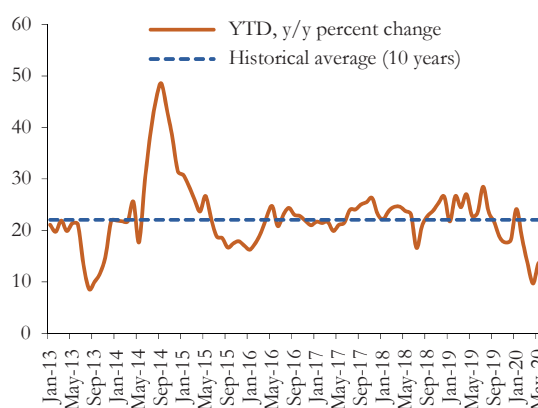
International reserves accumulation continued...

Gross international reserves (months of prospective imports)



...despite shrinking broad money growth.

Broad money liabilities (y/y percent change)



Sources: Cambodian authorities; World Bank staff estimates and projections.

Note: p = projection; y/y = year-on-year; YTD = year-to-date; RHS = right-hand scale; KHM = Cambodia.

Section I

Recent Economic Developments and Outlook



Recent Economic Developments and Outlook

Recent developments

Economic activity has picked up after being hit hard by the pandemic

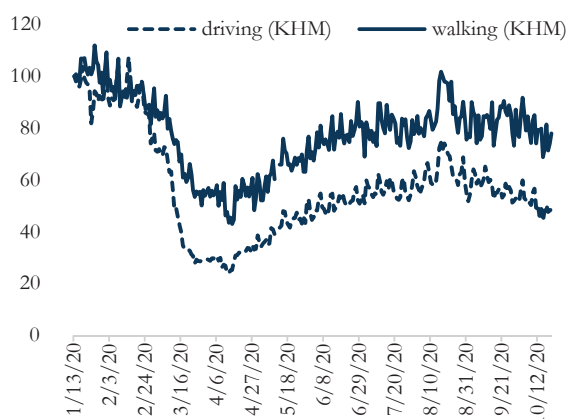
The Cambodian economy is gradually emerging from the severe shocks triggered by the global COVID-19 pandemic. Domestic economic activity is recovering, after lockdowns and travel restrictions were relaxed in May 2020, thanks to the authorities' efforts in controlling local outbreaks of the virus (figures 1 and 2). The negative impacts of the pandemic which caused sharp decelerations in most of Cambodia's main engines of growth in the first half of 2020 have stabilized, mitigated in part by revival of domestic economic activity, although external shocks continue. The value of approved projects in Cambodia's real sector financed by FDI which started to taper in mid-2019, coinciding with a ban on online gambling, has recovered since May 2020. There has been an initial shift in (approved) FDI projects from the tourism sector to the non-garment manufacturing sector. The downfall of the tourism sector has been partly offset by the return of domestic tourists. Construction activity and manufacturing exports, however, remained subdued.

So far, the country has avoided a health crisis thanks to swift action to detect and contain local outbreaks by the authorities. Schools and

colleges have been allowed to reopen since August 2020 but were closed again during the second and third weeks of November 2020. As of November 14, 2020, there were 302 confirmed cases of Coronavirus, of which 289 have fully recovered, and the rest are still being treated. The first confirmed case was found on January 27, 2020.¹

In the East Asia and Pacific (EAP) region, the efforts to contain the spread of the pandemic have led to a significant curtailment of economic activity.² These domestic difficulties were compounded by the pandemic-induced global recession which hit hardest those EAP economies that rely on trade and tourism (see box 1). Country outcomes were generally related to how efficiently the disease was contained and how exposed countries were to external shocks. EAP governments have on average committed nearly 5 percent of their GDP to improve health systems, help households smooth consumption, and support firms to avoid bankruptcy. Successful containment of the disease in some countries is leading to a revival of domestic economic activity. But the region's economy is heavily dependent on the rest of the world. Trade will see a revival as global economic activity gradually resumes, but tourism will remain subdued. Though short-term capital has returned to the region, global uncertainty still inhibits domestic and foreign investment.

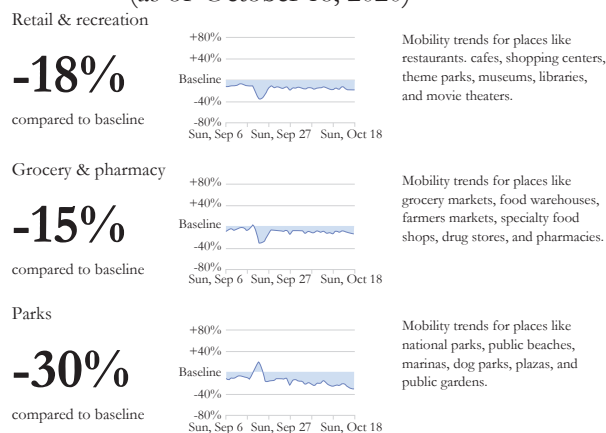
Figure 1: Cambodia's Apple mobility trends index (percent)



Source: Apple mobility trends, Apple.

Note: KHM = Cambodia.

Figure 2: Cambodia's Google Mobility Trends (as of October 18, 2020)



Source: Google Mobility Trends, Google.

¹ Ministry of Health press release, November 5, 2020.

² World Bank 2020a.

Global and regional economic developments, outlook, and risks¹

Following a collapse in the first half of 2020, global activity has begun to rebound following a gradual relaxation of lockdown measures, led by China (figure B1.1). The accelerating spread of COVID-19 in some regions, however, is weighing on the nascent recovery in activity. Global output is set to contract sharply in 2020, marking the deepest global recession since the Second World War (World Bank 2020). Global goods trade continues to recover, while trade in services is lagging. Manufacturing new export orders firmed to 51.7 points in September, compared to its nadir of 27.1 points in April (figure B1.2). International tourist arrivals remain more than 90 percent below last year's levels in many countries. The number of daily commercial flights recovered to about half of last year's levels by early August but showed no further increase in September and October.

The pandemic has taken a severe toll on East Asia and Pacific (EAP). Regional growth slowed to an estimated 0.9 percent this year—the lowest rate since 1967—reflecting the impact of pandemic-related disruptions, lockdowns, and travel restrictions. The depth of the shock on regional economies was uneven and reflected the varying severity of supply-side disruptions and the spillovers from the global recession. In China and Vietnam, which have kept new infections low, GDP is estimated to expand this year. The rest of the region will suffer significant output losses, with GDP contracting by an average of 4 percent.

Central banks around the world have aggressively eased monetary policy and provided liquidity support to avoid shortages in credit markets. The Federal Reserve cut its policy rates to close to zero. Capital outflows from emerging market and developing economies (EMDEs), which exceeded the worst period of the global financial crisis at the outset of the pandemic, have subsided. Though yields remain low, sovereign credit ratings have continued to deteriorate, reflecting increasing debt sustainability concerns. Commodity markets have been following diverging trends. Oil prices fell nearly 7 percent in September before stabilizing in October, with the price of Brent crude oil averaging US\$40 per barrel. Base metals prices continued to recover in October and are now nearly 6 percent higher than their pre-pandemic peak in January, led by copper. The increase in prices has been supported by the strengthening of global economic activity, particularly in China. Agricultural commodity prices increased by 6 percent in September and are now above their January levels.

Figure B1.1: Latest GDP growth data in selected countries

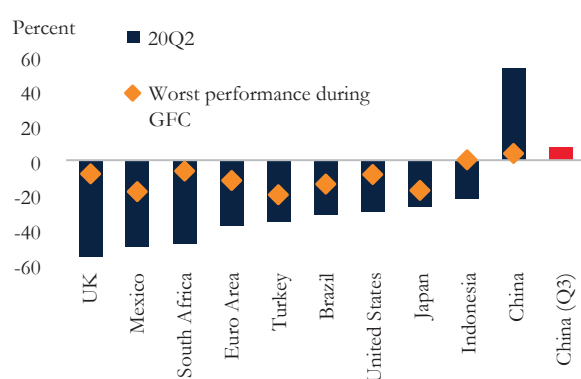
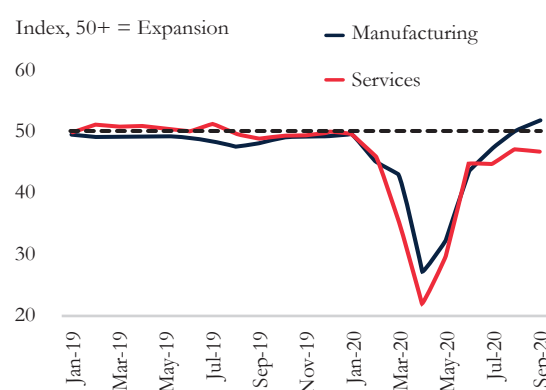


Figure B1.2: New export order subindex of Purchasing Managers' Index (PMI)



Source: Haver Analytics.

Note: The figure shows the quarter-on-quarter annualized growth rate for 2020 Q2 for selected countries. The red bar indicates the 2020 Q3 quarter-on-quarter nonannualized growth rate for China.

¹ This box was prepared by Ekaterine Vashakmadze, PG

Global and regional economic developments, outlook, and risks (cont'd)

Global outlook¹

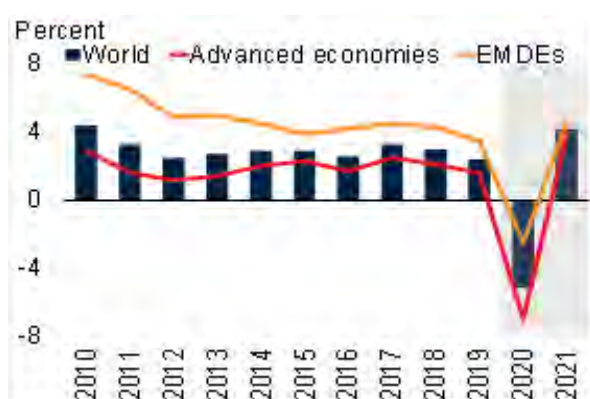
Global output is projected to contract by 5.2 percent this year, despite unprecedented policy support (figure B1.3; World Bank 2020). This reflects a widespread sudden stop of global activity in the first half of 2020, mirroring the national lockdowns implemented worldwide to contain the spread of the outbreak. Although a moderate recovery is envisioned in 2021, with global growth reaching 4.2 percent, output is not expected to return to its previously expected levels (figure B1.4). The strength and sustainability of a global growth rebound depend on the duration of the pandemic, and on the effectiveness of policy actions in preventing financial meltdowns, restoring global consumer and investor confidence, and resuming global travel.

Growth in the East Asia and Pacific region is projected to accelerate to 7.4 percent in 2021, led by a strong rebound in China. This is predicated on the rollout of an effective vaccine starting in early 2021 in major economies and somewhat later in smaller EMDEs. However, despite the subsiding of the pandemic and a recovery of domestic and global demand, regional activity is expected to remain somewhat below its pre-pandemic trend by late 2021, reflecting lasting scars caused by the pandemic. The recovery in the region excluding China is expected to be protracted and expand by 5.3 percent in 2021–22 on average, with significant cross-country variations.

Thus far, an extraordinary policy response has prevented the slowdown in activity from becoming a financial crisis. Nonetheless, financial conditions will remain fragile for many market participants. A prolonged disruption to economic activity could exacerbate financial stress, which could lead to widespread financial crises. There is high uncertainty around the global growth forecast. The global recession would be deeper than the baseline forecast if bringing the pandemic under control took longer than expected, or if financial stress triggered cascading defaults.

The pandemic is likely to have a durable impact through multiple channels, including lower investment and innovation, erosion of human capital, and retreat from global trade and supply chains. The long-term damage related to the pandemic will be particularly severe in economies that suffer financial crises, and in energy exporters, due to plunging oil prices. For example, in the average EMDE, over a five-year horizon, a recession combined with a financial crisis could lower potential output by almost 8 percent (World Bank 2020).

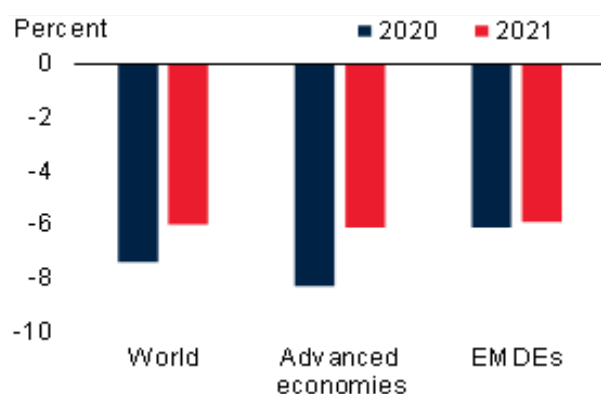
Figure B1.3: Global growth



Source: World Bank.

Note: Shaded area indicates forecasts. Aggregate growth rates calculated using constant 2010 U.S. dollar GDP weights. Data for 2019 are estimates. Aggregate growth rates calculated using GDP weights at 2010 prices and market exchange rates. EMDEs = emerging market and developing economies.

Figure B1.4: Level of output relative to January 2020 projections



Source: World Bank.

Note: Figure shows the percent difference between the level of output in the January and June 2020 editions of the World Bank's Global Economic Prospects. EMDEs = emerging market and developing economies.

¹ Draws on the World Bank's June 2020 Global Economic Prospects report. The updated global forecasts will be published in January 2021 Global Economic Prospects.

The COVID-19 pandemic has abruptly interrupted Cambodia's celebrated growth story. The country had averaged a 7.7 percent real growth rate during the last two decades. Cambodia's real growth reached 7.1 percent in 2019 (figure 3). In contrast, in 2020, the country's key growth drivers—construction, tourism, and merchandise exports—which together account for more than 70 percent of growth and 39 percent of total paid employment, have been severely affected.

Contraction of Cambodia's manufacturing exports has continued

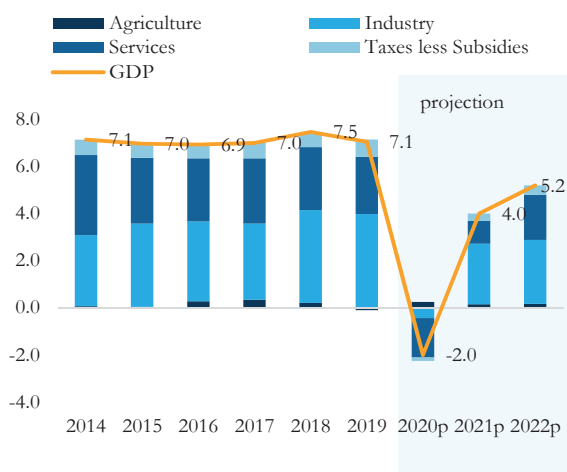
Cambodia's narrow export base continued to be hit by demand shocks, triggered by the pandemic. As the global COVID-19 outbreak lingers, the country's exports of manufactured products including garments, travel goods, footwear, bicycles, electrical parts, and vehicle parts and accessories fell by 2.5 percent (y/y) during the first nine months of 2020 (figure 4); total manufacturing exports declined to US\$8.48 billion from US\$8.69 during the same period the previous year. The immediate future of garment exports, which account for two-thirds of manufacturing exports, remains uncertain. The latest updates from the industry revealed that orders by international buyers in large part remain uncertain. A survey conducted by the Garment Manufacturers Association in Cambodia (GMAC)

in June 2020 revealed that only 40 percent of factories will have (either full or reduced) orders until the last quarter of 2020, while the rest have as yet received no orders. In addition, price trends for new orders in large part have been lower. Only 37 percent of the factories said buyers offered the same prices, while 45 percent of the factories said buyers offered lower prices. Buyers' payment terms for new orders seem hardened. Only 45 percent of the factories said they were offered the same payment terms, while 35 percent said they faced longer payment terms than before. In addition, the partial withdrawal of the EU's Everything But Arms preferential treatment, which has been effective since August 12, 2020, is affecting approximately 20 percent of Cambodia's exports to the EU.³ According to the GMAC, as of July 2020, 400 garment factories had suspended operation, laying off 150,000 workers.⁴ In June 2020, more than 13,600 factories (of which 1,200 were garment factories) were registered, with more than 1.37 million workers (of which 0.83 million were garment workers).

Despite the pandemic, manufacturing exports to the United States rose

Unlike its manufacturing exports to other major markets, Cambodia's exports to the U.S. market expanded. Exports of garments, travel goods, footwear and bicycle products to the U.S. market rose to US\$2.7 billion, expanding

Figure 3: Real GDP growth and contributions to real GDP growth (percent)



Source: Cambodian authorities and World Bank staff projections.
Note: p=projection.

Figure 4: Manufacturing exports (US\$ million)



Source: Cambodian authorities.

Note: RHS = right-hand scale; YTD = year to date; y/y = year on year.

³ For more details, please see <https://trade.ec.europa.eu/doclib/press/index.cfm?id=2113>.

⁴ Statement by the GMAC, July 8, 2020.

at 7.6 percent (y/y) in the first nine months of 2020 (figure 5). Disaggregating the U.S. market data shows that exports of garment, travel goods, footwear, and bicycle products grew at 5.0 percent, 8.0 percent, 4.1 percent, and 190.9 percent (y/y), respectively. In contrast, exports to the EU (excluding the UK) shrank to US\$2.1 billion, contracting by 19.8 percent (y/y), of which exports of garment, footwear, and travel goods products contracted by 22.4 percent, 14.6 percent, and 30.2 percent (y/y), respectively, while exports of bicycles marginally picked up, by 3.6 percent. Similarly, exports to other main destinations such as the United Kingdom and Japan also contracted, declining by 19.1 and 6.7 percent (y/y), respectively. The U.S. market is the largest, accounting for 36 percent of Cambodia's total exports of garment, travel goods, footwear, and bicycle products (figure 6). The EU market is second, covering 28 percent.

Exports of bicycles and electrical and vehicle parts expanded

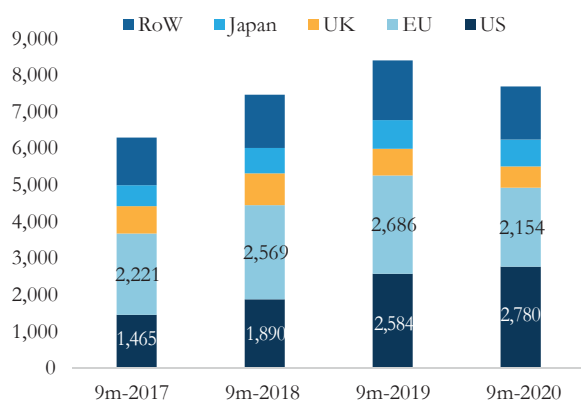
Demand shocks did not negatively impact all exported products. While garment, footwear, and travel goods products exported to all major markets (except the U.S.) declined, exports of bicycles surged, reaching US\$369 million, an increase of 31.6 percent (y/y) during the first

nine months of 2020. Exports of bicycles to the U.S., EU, and UK markets rose 190.9 percent, 3.6 percent, and 32.3 percent (y/y), respectively. Similarly, exports of electrical parts, and vehicle parts and accessories reached US\$456 million or a 14.4 percent year-on-year increase during the first nine months of 2020, of which 60 percent is destined for ASEAN members and Japan.

International arrivals have collapsed

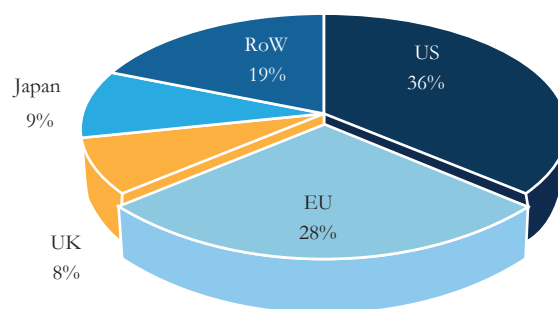
International arrivals contracted by 74.1 percent (y/y) in September 2020, thanks to international travel restrictions, as well as general avoidance of (international) travel globally (figure 7). During the first nine months of 2020, international arrivals reached only 1.25 million, down from 4.8 million during the same period last year. Siem Reap, Cambodia's most popular tourist destination, experienced a 74.6 percent (y/y) decline in international arrivals during the first half of 2020. The collapse of international arrivals has occurred in Thailand and Vietnam as well (figure 8). Tourism (including hospitality) is Cambodia's second-largest growth driver after the construction sector. According to the official estimates, Cambodia earned US\$4.9 billion in tourism receipts in 2019 and the country is projected to lose US\$3 billion in tourism receipts this year, thanks to the collapse of international

Figure 5: Exports of garments, footwear, travel goods and bicycles.
(US\$ million)



Source: Cambodian authorities.
Note: RoW = rest of world.

Figure 6: Cambodia's top export markets^a
(percent, 2020)



Source: Cambodian authorities.
Note: a. Denotes garment, footwear, travel goods, and bicycle products. RoW = rest of the world.

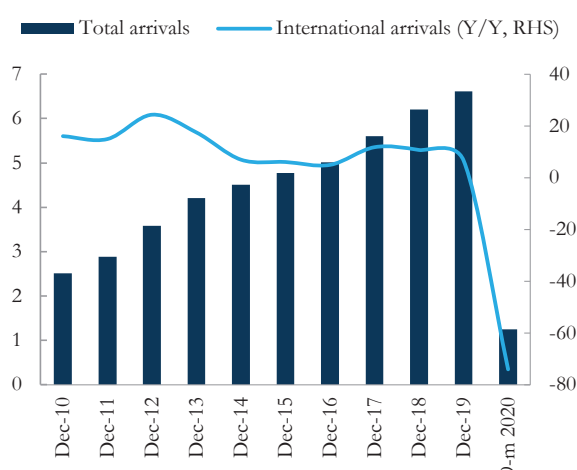
arrivals.⁵ It is notable that Cambodia's tourism sector has experienced relatively large foreign exchange "leakage".⁶ Leakage factors were earlier estimated to be around 40 percent for Cambodia, which indicates that a substantial part of destination expenditure is spent on imports, or Cambodia's supply capacity is too limited to meet additional and dispersed demand.⁷ As a result, income multiplier effects remain low and foreign exchange leakage high, resulting in suboptimal contributions to the country's economy.

Domestic tourists have supported a gradual recovery of the travel and tourism industry

With the lifting of internal lockdown measures, domestic travel and tourism activities have picked up. Thanks to the return of domestic tourists to the main destinations, Cambodia's tourism and travel sector has, since the second quarter of 2020, gradually recovered. There were 0.6 million and 1.11 million tourists, mostly domestic visitors, during October 29–November 1 and September 16–18, 2020, holiday periods, respectively, according to the Ministry of Tourism. The top three most visited destinations were coastal zones (Sihanoukville, Kampot, Kep, and Koh Kong provinces), Battambang zone (Battambang, Pursat, Banteay Meanchey,

and Palin provinces), and cultural zones (Siem Reap, Kompong Thom, Preah Vihear, and Oddar Meanchey provinces), which received 23.1 percent, 23.0 percent, and 17 percent, respectively. During an earlier Khmer New Year's holiday covering August 17–21, 2020, there were 1.5 million tourists, mostly domestic. However, the number of domestic visitors in 2020 remains much lower than the 11.3 million domestic tourists recorded in 2019. Unlike foreign tourists, who are interested most in Cambodia's cultural heritage in "cultural zones," especially the Angkor Temple Complex in Siem Reap, domestic tourists' most popular destination is coastal zones. In 2019, coastal zones captured 28.1 percent of total domestic tourists, while the capital city of Phnom Penh was next, accounting for 21.0 percent. Cultural zones, the Battambang zone, and the rest received 20.6 percent, 10.9 percent, and 19.4 percent, respectively. Given expected lingering negative impacts of the pandemic on international travel, the tourism (and hospitality) industry will be dependent almost entirely on domestic travel and tourism activity for the foreseeable future. The industry is currently adapting to the post-lockdown travel and tourism services demanded by domestic visitors.

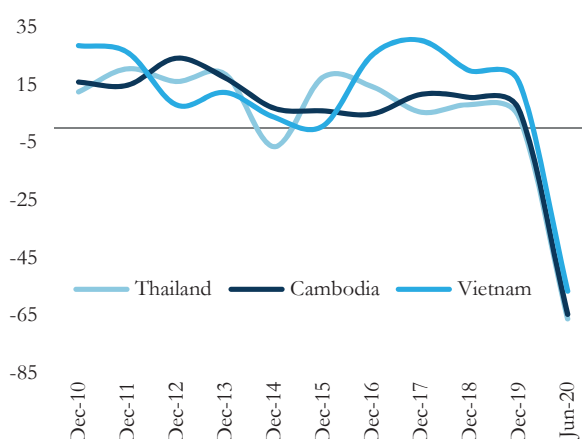
Figure 7: Cambodia's tourist arrivals
(millions of tourists and YTD, y/y percent change)



Source: Cambodian authorities.

Note: RHS = right-hand scale; y/y = year on year.

Figure 8: Tourist arrivals to Cambodia, Thailand, and Vietnam
(y/y percent change)



Source: Cambodian, Vietnamese, and Thai ministries of tourism.

⁵ Ministry of Tourism (2019), and statement dated November 6, 2020.

⁶ Leakage occurs when tourism-related goods, services, and labor are imported.

⁷ See Selected Issue on Maximizing Tourism Potential, October 2017 Cambodia Economic Update.

Cambodians are saving billions of dollars on outbound travel, thanks to travel restrictions

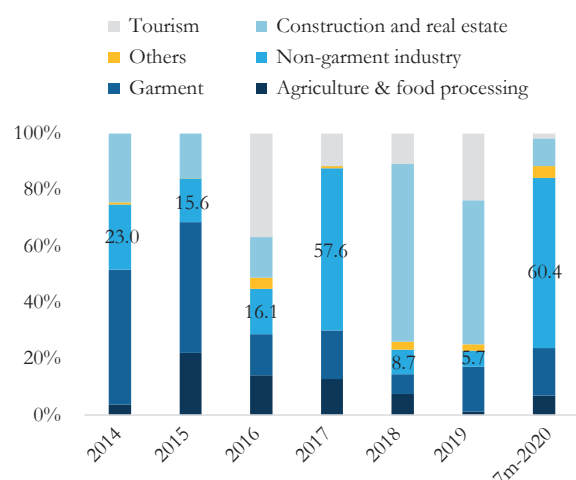
Pre-COVID-19 Cambodian outbound travelers are now enjoying in-country travel and tourism activity, thanks to international travel restrictions. There were 2.03 million Cambodian outbound visitors in 2019,⁸ of which one-third traveled by air to destinations around the world, while two-thirds traveled by land to neighboring Thailand, which received about a million Cambodian visitors, and Vietnam, which welcomed a quarter of a million Cambodian visitors. Cambodian visitors in Thailand alone spent US\$1.15 billion in 2019.⁹

FDI has picked up and shifted to non-garment manufacturing projects

While actual FDI inflows to both the financial and real sectors are expected to decline this year, there are positive signs that the inflows are returning and more diversified. During the first seven months of 2020, total approved project value financed by FDI in Cambodia's real sector rose to US\$1.4 billion, or a 25.8 percent year-on-year increase over the same period last year.¹⁰ Approved FDI project value tapered since mid-2019, coinciding with a ban on online gambling. Approved FDI project value contracted by 56.0 percent (y/y) in June 2019, after growing at 84.8 percent in 2018.

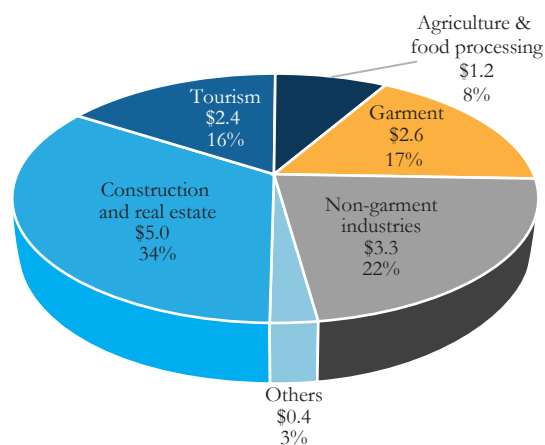
While China continues to account for the majority of (approved) project value financed by FDI, there has been a shift of approved FDI projects to finance non-garment manufacturing sectors at the expense of the tourism sector. Chinese FDI accounts for 56.3 percent of total (approved) FDI project value during the first seven months of 2020, up from 43.7 percent in 2019. Looking ahead toward post-COVID-19 opportunities, during the first seven months of 2020, the share of approved FDI project values going to non-garment manufacturing sectors rose to 60.4 percent (US\$878 million) (figure 9), up from 8.2 percent (US\$95 million) during the same period in 2019, likely indicating more realistic investment sentiment. Similarly, the share of approved FDI project values going to the agriculture sector increased to 6.9 percent (US\$100 million), up from 2.9 percent (US\$34 million) during the same period. Approved FDI project values going to the tourism sector plummeted to 1.8 percent (US\$26 million), down from 43.3 percent (US\$500 million), likely indicating the loss of investor appetite due to the recent collapse of the tourism sector. During the first seven months of 2020, 9.8 percent (US\$142 million) of approved FDI projects went to the construction and real estate sector, a marginal increase from 9.0 percent (US\$104 million) during the same period in 2019.

Figure 9: Approved FDI by main sector
(% of total)



Source: Cambodian authorities.

Figure 10: Approved FDI by sector
(US\$ billion, January 2014–July 2020)



Sources: Cambodian authorities.

⁸ Ministry of Tourism 2019.

⁹ Thailand's Ministry of Tourism and Sports (https://www.mots.go.th/more_news_new.php?cid=527).

¹⁰ According to the central bank, roughly one-third of FDI inflows goes to the financial sector.

During January 2014 to June 2020, the largest approved FDI values went to the construction and real estate sector, accounting for US\$5.0 billion, or one-third of the total approved FDI project value (figure 10). The second-largest approved FDI values went to non-garment industries, capturing US\$3.3 billion, or 22 percent of the total. The third-largest approved FDI values went to the traditional garment sector, which received US\$2.5 billion, or 17 percent of total approved FDI. An influx of FDI targeting the tourism sector emerged in 2016, coinciding with the short-lived introduction of online gambling, and becoming one of the major FDI inflow recipients, capturing US\$2.4 billion, or 16 percent of total approved FDI.

The diversification of FDI inflows is a good sign. Approved FDI in agriculture, agroindustry, and food processing are also receiving a boost. Those industries may be able to take advantage of the Cambodia-China Free Trade Agreement including relocation of supporting industries for Cambodia's rapidly expanding travel goods and footwear industry. However, challenges facing connectivity, skilled labor and energy costs remain a key bottleneck, preventing the expansion and deepening of Cambodia's participation in global and regional value chains.

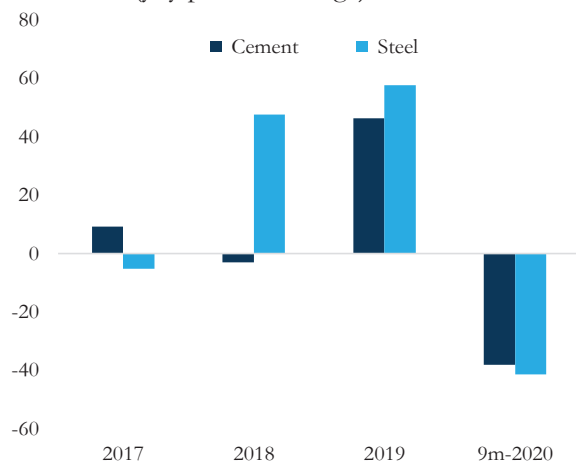
While it will likely boost trade, the CCFTA alone is not sufficient

The Cambodia-China Free Trade Agreement (CCFTA) is expected to attract FDI inflows to Cambodia. Sectors such as agriculture, agroprocessing, and manufacturing are well

positioned to export to the Chinese market and beyond (see box 2 for more discussion on the CCFTA). Cambodia's comparative advantages may include its underutilized and relatively cheap labor, and its abundant land suitable for production of primary and labor-intensive goods for exports, generating gains through specialization and economies of scale. This will potentially help Cambodia expand beyond the established pattern of production heavily dependent on garment and footwear, while promoting a more diversified economic structure.

However, the CCFTA alone may be insufficient to boost Cambodia's trade and economic performance. A key finding of the study of Mexican imports and exports by Garces-Díaz (2001) entitled "Was the North American Free Trade Agreement (NAFTA) Behind the Mexican Export Boom (1994–2000)?"¹¹ pointed to the really important institutional changes—the abandonment of an erratic trade policy in favor of the opening up of the economy following Mexico's adherence to the General Agreement on Tariffs and Trade (GATT) that allowed Mexican exporters to take advantage of the favorable external conditions, and the expansion of the U.S. economy. The study warned that countries should not indulge in unrealistic hopes when signing free trade agreements. Likewise, the assessment of U.S.–Mexico trade by the U.S. Congressional Budget Office (2003) concluded that NAFTA had a very modest effect on bilateral trade flows, and attributed the growth in Mexico's exports to the United States after 1994 to the real depreciation of the peso and the sustained expansion of the

Figure 11: Imports of basic construction materials
(y/y percent change)



Source: Cambodian authorities.

Figure 12: Approved construction permits
(y/y percent change)



Source: Cambodian authorities.

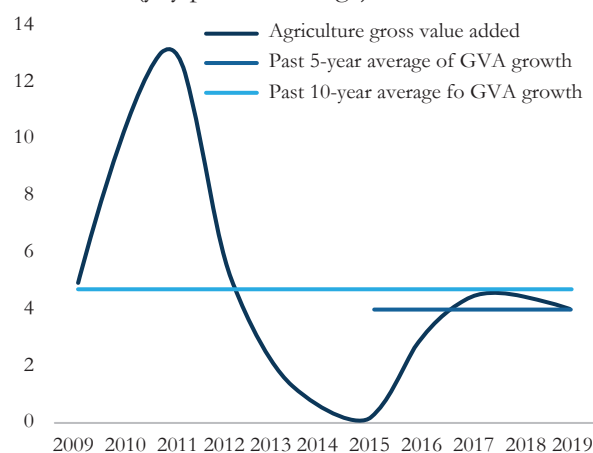
¹¹ Lederman, Maloney, and Servén 2003.

U.S. economy. A sharp shift in policy in the late 1980s that included market opening measures and economic reforms helped bring in a steady increase of FDI flows to Mexico.¹² NAFTA (and its investment provisions) may have encouraged U.S. FDI in Mexico by increasing investor confidence, but much of the growth may have occurred anyway because Mexico likely would have continued to liberalize its foreign investment laws with or without the agreement.

The construction sector remained subdued, with excess supply from the pre-crisis boom

Construction activity has remained weak since the first half of 2020. The value of steel, and cement imports in the first six months of 2020 contracted by 45.1 percent and 8.3 percent (y/y), respectively as some large development projects, especially high-rise commercial and residential buildings, were put on hold. As of September 2020, the sharp declines of steel and cement imports continued, contracting by 41.4 percent and 38.1 percent (y/y), respectively (figure 11). As the construction (and real estate) sector had been the largest engine of growth in recent years, subdued construction and real estate activity is damping real growth in the short term. The value of approved construction permits which skyrocketed last year, growing at 98.3 percent, contracted by 9.3 percent (y/y) in the first nine months of 2020 (figure 12), possibly reflecting declining investment appetite as the property market experienced overinvestment and excess supply from the pre-crisis boom.

Figure 13: Nominal agricultural gross value added (y/y percent change)



Source: Cambodian authorities.

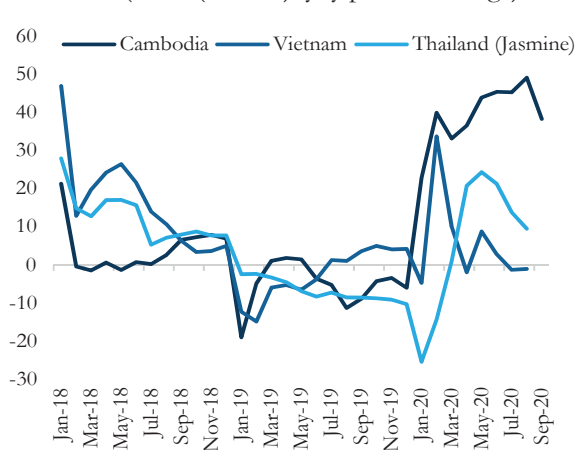
Increased attention is being paid to agriculture, the sector least affected by the pandemic

The agriculture sector is benefiting from increased labor availability laid off by the services and industry sectors. As discussed above, the CCFTA is expected to further boost trade and investment in Cambodia for exports to the Chinese market. In addition, advanced cultivation techniques and new seeds made possible by technology diffusion via FDI are helping boost productivity within major crops. In December 2019, the authorities introduced the 2019–25 Agriculture Sector Development Strategy, aiming at modernizing the agriculture sector, while targeting agricultural gross value-added (GVA) (in nominal terms) to increase by 4 percent per year, reaching 25,700 billion riels in 2023, up from 21,913 billion riels in 2018. Modernizing the agriculture sector is an important step toward accelerating the transformation of Cambodia's agriculture sector from subsistence farming to commercial agriculture. However, the GVA growth rate of 4 percent a year in nominal terms does not seem to be an ambitious target, given the fact that average agricultural GVA growth during the past 5-year and 10-year periods was 3.9 percent and 4.8 percent per year, respectively (figure 13).

Rice exports have rapidly increased, thanks to rising demand

During the first nine months of 2020, Cambodia's milled rice export (of which

Figure 14: Milled rice exports—regional comparisons (YTD (volume), y/y percent change)



Source: Cambodian authorities and Haver Analytics.
Note: For Thailand, only jasmine rice is included.

¹² Congressional Research Service 2020.

Cambodia – China Free Trade Agreement^a

The Cambodia-China Free Trade Agreement (CCFTA), signed on October 12, 2020, is expected to enter into force in early 2021. The CCFTA represents Cambodia's first comprehensive bilateral free trade agreement (FTA) with one of its most important trading partners. The CCFTA is also China's first bilateral FTA with a member of ASEAN. While CCFTA negotiations covered more than 10,800 tariff lines for Cambodia and about 9,530 tariff lines for China, they primarily focused on the tariff lines that were beyond what were offered under the (January 2010) ASEAN-China FTA. In this regard, an additional 340 tariff lines have been agreed (4 percent of total), covering mostly chapters 1 to 10 of Cambodia's ASEAN Harmonized Tariff Nomenclature (AHTN), ranging from live animals/animal products to meat, fish, and cereals (table B2.1).

After the CCFTA takes effect, about 98 percent of China's tariff lines and nearly 90 percent of Cambodia's tariff lines will reportedly go to zero tariff rates immediately. Key achievements also include simplification of export and import procedures, clear and transparent dispute resolution mechanisms, and e-commerce arrangements. Cambodia will reportedly open its services sector on research, education, and sea transport in the CCFTA beyond what is already open to China through Cambodia's World Trade Organization accession and ASEAN-China FTA. China will open its insurance, education, and marketing sectors, among others. China is currently the fourth-largest merchandise export market for Cambodia's unsophisticated agricultural and low domestic value-added products, capturing 6.8 percent of total merchandise exports (but represents only 0.05 percent of China's total imports), after the United States (29.8 percent), Japan (7.7 percent), and Germany (7.3 percent), amounting to about US\$1.01 billion. In 2019, Cambodia's imports from China amounted to US\$7.58 billion, making China Cambodia's largest import market, accounting for 37.4 percent of total imports.

Cambodia's exports to China are largely concentrated in unsophisticated agricultural products or products with low domestic value addition. Furskins and artificial fur are Cambodia's number one exported product, covering 25 percent (or US\$252.9 million) of total exports to China (table B2.2). However, Cambodia entirely imports US\$202.9 million worth of raw furskins, including heads, tails, and paws from Denmark. Similarly, articles of apparel and clothing accessories, knitted or crocheted (HS 61), captures 19.5 percent (or US\$197.4 million) of total exports to China, but the country entirely imports knitted or crocheted fabrics (HS60) worth US\$1.5 billion (out of US\$2.68 billion) from China for processing that mainly involves cut-make-trim. Milled rice is Cambodia's third-largest exported product to China, accounting for 15.4 percent (or US\$156.2 million). Cambodia has become increasingly reliant on Chinese investment flows, largely channeled to the construction and real estate sectors. Of Cambodia's total international arrivals of 6.6 million in 2019, more than a third (35.7 percent) arrived from China, of which almost half (44.3 percent) came for business purposes.

Trade agreements between countries that lower trade barriers on imported goods provide welfare gains to consumers from increases in variety, access to better-quality products, and lower prices, thus creating trade. As China's first bilateral FTA with any ASEAN country, the CCFTA also has potential to benefit Cambodia through trade diversion from other (ASEAN) countries. According to an official projection, Cambodia's exports to China are projected to increase by 25 percent, and Chinese exports will increase by 23 percent after the FTA goes into effect. The CCFTA could also make Cambodia a more attractive FDI destination aimed at the China market relative to neighboring countries. Materialization of the potential benefits will depend on various aspects of the CCFTA that are yet to be disclosed.

Table B2.1: Chapters 1 to 10 of Cambodia's Customs Tariff Schedule

1. Live animals.
2. Meat and edible meat offal
3. Fish and crustaceans, mollusk and other aquatic invertebrates
4. Dairy produce; bird's eggs; natural honey; edible products of animal origin, not elsewhere specified or included
5. Products of animal origin, not elsewhere specified or included
6. Live trees and other plants, bulbs, roots, and the like; cut flowers and ornamental foliage
7. Edible vegetables and certain root and tubers
8. Edible fruits and nuts; peel of citrus fruit or melon
9. Coffee, tea, mate and spices
10. Cereals

Source: Cambodian authorities.

Note: a. Prepared by the Cambodia Macroeconomics, Trade and Investment Global Practice team.

Table B2.2: Cambodia's top 7 exported products (HS4) to China and imported products from China

Cambodia's exports to China			Cambodia's imports from China		
HS4	Product label	Share (%)	HS4	Product label	Share (%)
4302	Furskins and artificial fur; manufactures thereof	25.0	6004/06	Knitted or crocheted fabrics	20.5
6103/04/09/10/11	Articles of apparel and clothing accessories, knitted or crocheted	19.5	5509/10/15	Man-made staple fibers	10.2
1006	Cereals	15.4	8413/19/28/29/51	Machinery, mechanical appliances, nuclear reactors, boilers; parts thereof	10.0
8501/04/17	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television...	7.4	8504/17/36/39/41/44	Electrical machinery and equipment and parts thereof; sound recorders and reproducers, television...	8.1
6203/04	Articles of apparel and clothing accessories, not knitted or crocheted	6.5	5208/09/11	Cotton	6.8
6403/04	Footwear, gaiters and the like; parts of such articles	5.1	7304/08/18/26	Articles of iron or steel	4.8
7401/02	Copper and articles thereof	3.3	3921/23/26	Plastics and articles thereof	4.4
Total top seven exported items		82.2	Total top seven imported items		86.3

Source: UN Comtrade.

fragrant rice accounts for about 80 percent) surged, rising 38.3 percent y/y, reaching 0.48 million metric tons (figure 14). China is the largest market, capturing 35.5 percent of Cambodia's milled rice exports, and the EU market is second, accounting for a third of total milled rice exports. Despite the imposition of EU safeguard measures on Cambodia's milled rice exports, exports to the EU market (including the UK) reached 150,000 metric tons, reflecting a 25 percent year-on-year increase (of which more than a third was imported by France alone) during the first eight months of 2020. Public, private, and foreign direct investment inflows into agriculture have been boosted as attention has increasingly been paid to develop and diversify the agriculture sector. In addition to its traditional rice, cassava and rubber products, Cambodia's exports of emerging agricultural products such as bananas and mangos are showing promising signs.

Rice cultivation has accelerated

During the first seven months of 2020, rainy season rice cultivated area rose to 2.28 million hectares, or a 7.2 percent (y/y) increase, thanks to better weather conditions.¹³ Dry season rice harvesting also increased, reaching 0.26 million metric tons, or a 38.8 percent y/y increase.¹⁴ Dry season rice yield in 2020, however, declined to 4.2 metric tons per hectare, down from 4.4 metric ton per hectare in 2019. Performance of production and exports of other agricultural commodities, however, is mixed. During the first seven months of 2020, rubber production decreased to 100,000 metric tons, or a 10.9 percent decline. In addition, flooding occurred in October that caused loss of human life, destruction of crops, damage to property, physical infrastructure, and more.

Crop production, especially rice, continues to account for the majority (60 percent) of agricultural GDP. Cambodia has been relatively less successful in diversifying agricultural products to higher-value-added crops, fisheries, and livestock due largely to relatively slow adoption of modern agricultural technology, including input use and irrigation.¹⁵

The pandemic has hurt domestic demand and dampened consumption

Weak consumer sentiment held back domestic demand, which dampened imports. Imports of consumable and durable goods contracted in the first nine months of 2020. Passenger vehicles and motorcycles, Cambodia's key durable imports, contracted by 34.1 percent and 39.5 percent (y/y), respectively, while imports of gasoline and diesel were almost flat, rising at 0.3 percent and 2.7 percent, respectively. Imports of foodstuff and electronics (mobile phones and televisions) dipped by 16.8 percent and 45.9 percent, respectively. As the decline in exports more than offset that of imports, the trade deficit is expected to widen. Worker's remittances (inflows) declined by 4.6 percent, reaching US\$550 million during the first six months of 2020. As a result, the current account deficit is projected to reach 12.8 percent of GDP in 2020, up from 10 percent of GDP in 2019, which is expected to be financed by FDI inflows.

Accumulation of foreign reserves continued

Cambodia's external position remained broadly stable, while its accumulation of international reserves continued. Gross international reserves (which are equal to net international reserves, given that Cambodia does not borrow from the International Monetary Fund [IMF]) rose further, reaching US\$19.5 billion in June 2020, or 21.7 percent growth (y/y) (figure 15), equivalent to about 10 months of prospective imports. Foreign exchange reserves, which constitute the majority of Cambodia's gross international reserves (and the value of gold reserves) expanded during first half of 2020, thanks to continued capital inflows (see more discussion on broad money below). As illustrated in figure 15, during the past decade, there were two episodes that significantly dampened international reserves growth. First, the country's international reserves growth decelerated markedly to 2.3 percent (y/y) in July 2009 as the economy was severely hit by the 2008–09 global financial crisis. Second, international reserves growth contracted by 7.7 percent (y/y) in September 2013, triggered by political uncertainty after the 2013 general elections. Regional comparisons show that Cambodia sustained a stronger accumulation of foreign reserves than other ASEAN countries. The

¹³ Weather forecast for 2020, April 14, 2020 and weekly weather announcements, Ministry of Water and Meteorology,

¹⁴ July 2020 monthly report on agricultural production, August 4, 2020, Ministry of Agriculture, Forestry and Fisheries.

¹⁵ See World Bank 2015a.

year-on-year growth rate of Cambodia's foreign reserves grew faster than those of Thailand, the Philippines, and Indonesia (figure 16).

Inflation remained subdued thanks to low inflation in import partners and stable exchange rates

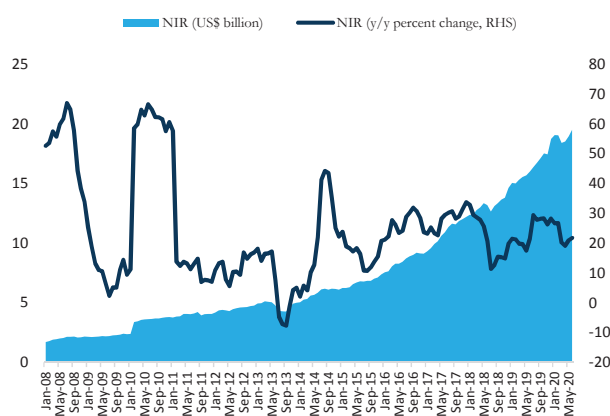
Headline inflation remained subdued at 2.9 percent (y/y) in September 2020, down from 3.1 percent at the end of 2019. The increase in the food sub-indexes was largely offset by the decline in the transports (and telecommunication) sub-indexes (figure 17). Rising food prices, in particular pork, beef, and fish were caused by increased demand and disrupted supply, thanks to the pandemic. According to the “Food Price Outlook 2020” published by United States Department of Agriculture, prices have been relatively slow to retreat from the highs reached as a result of the pandemic. Prices of petroleum products, however, tumbled with travel restrictions. By September 2020, the food and non-alcoholic beverage sub-index of Cambodia's inflation basket rose further to 4.6 percent (y/y), compared with 3.4 percent in December 2019. During the same period, the housing and utilities sub-index eased, declining to 1.2 percent, down from 1.6 percent, while the transport and telecommunication sub-index retreated into negative territory, contracting by 4.5 percent, down from 1.7 percent.

Subdued inflation in Cambodia's main import partners and stable exchange rates helped contain domestic price pressures. Two main

factors influence domestic prices in Cambodia. First, Cambodia is an importer of goods, especially consumer goods including foodstuff from its neighbors, Vietnam, Thailand and China. Therefore, rising inflation in the country's main import partners, often results in increased inflationary pressure (imported inflation) at home. Subdued inflation in its main import partners helped tame its domestic price pressures. Second, nominal values of the Cambodian riel vis-à-vis the U.S. dollar, Thai baht, Vietnamese dong, and Chinese yuan affect inflation in Cambodia as domestic suppliers and traders peg against depreciation of the Cambodian riel. Inflation rises when the riel depreciates. Thus, broadly stable Cambodian riel to U.S. dollar, Vietnamese dong, Thai baht and Chinese yuan exchange rates help anchor domestic inflation. Inflation in Vietnam was subdued at about 3.2 percent y/y in August 2020 due to low food prices and weak demand.¹⁶ In Thailand, inflation retreated into negative territory, contracting by 0.5 percent in August 2020 due to lower energy and public utility prices. In China, headline inflation was 2.4 percent (y/y) in August 2020, down from 4.0 percent in March 2020 as food inflation eased. The economy is highly dollarized. So, devaluation of local currency which often causes inflation to rise is not feasible in any circumstances in Cambodia as it will drive the economy to full dollarization.

The riel marginally appreciated against the Thai baht, but depreciated against the U.S. dollar, Chinese yuan, and Vietnamese dong.

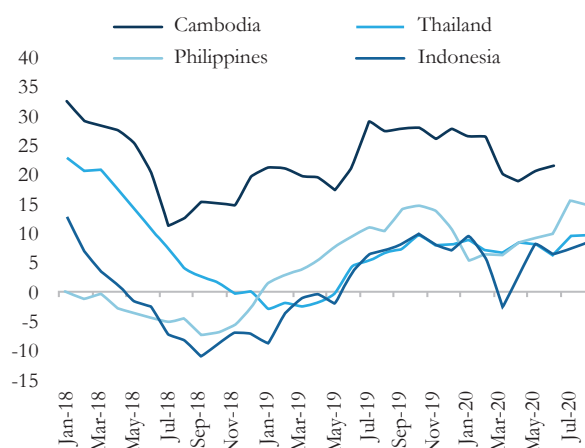
Figure 15: Cambodia's international reserves
(US\$ billion)



Source: Cambodian authorities.

Note: NIR = net international reserves; RHS = right-hand scale.

Figure 16: International reserves – regional comparisons
(y/y percent change)



Source: Cambodian authorities and Haver Analytics.

¹⁶ World Bank 2020a.

The riel-to-baht exchange rate appreciated to 130.5 at the end of September 2020, compared to 136.0 in December 2019. However, the riel-to-U.S. dollar, the riel-to-yuan and the riel-to-dong exchange rates depreciated to 4,095, 602, and 0.177, from 4,075, 583, and 0.176, respectively (figure 18).

Poverty is estimated to increase

The economic and social costs of the pandemic are being felt widely. A high-frequency phone survey of households shows the negative impacts of the pandemic on employment. The share of respondents who were working declined from 82 percent before the COVID-19 outbreak to 71 percent in May 2020, but remained relatively unchanged in August 2020. The pandemic continued to negatively affect non-farm business activities but less severely compared to the onset of the pandemic. However, income losses remained widespread, though the declines in household income slowed following the launch of a new cash transfer program to assist poor and vulnerable households (see box 3). Firms are also facing economic hardship (see Special Focus, below). In early June, the Ministry of Planning announced that 560,000 households (2.3 million people) were eligible for cash transfers during the COVID-19. As of October, more than 640,000 households (2.6 million people) have received the cash subsidies – implying that at least 80,000

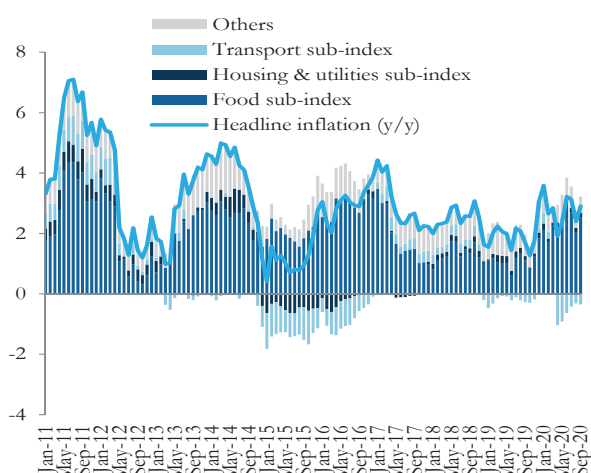
households have been identified as new poor between June and October.¹⁷

The central bank has eased monetary policy

To support market liquidity during the COVID-19 pandemic, the central bank reduced the reserve requirement ratios. The ratios were reduced to 7 percent for both local currency and foreign currency deposits, down from 8 percent for local currency and 12.5 percent for foreign currency deposits, respectively, for six months starting in April 2020. The central bank has reduced interest rates by 0.5 percentage point for all Liquidity-Providing Collateralized Operation (LPCO) maturities since March 2020. Through the LPCO facility, the central bank influences riel interest rates, while it cannot influence US dollar interest rates due to the highly dollarized economy. As a result, actual average interests of the LPCO facility declined to 2.66 percent, 3.08 percent, and 3.25 percent for 91 days, 182 days, and 364 days, respectively down from 2.94 percent, 3.2 percent, and 3.43 percent in 2019, respectively.¹⁸ The central bank also postponed full implementation of the Capital Conservative Buffer to maintain the 50 percent current requirement.¹⁹ In March 2020, the central bank issued a directive to all banks and financial institutions to restructure loans in order to maintain financial stability, while easing the burden of debtors facing major

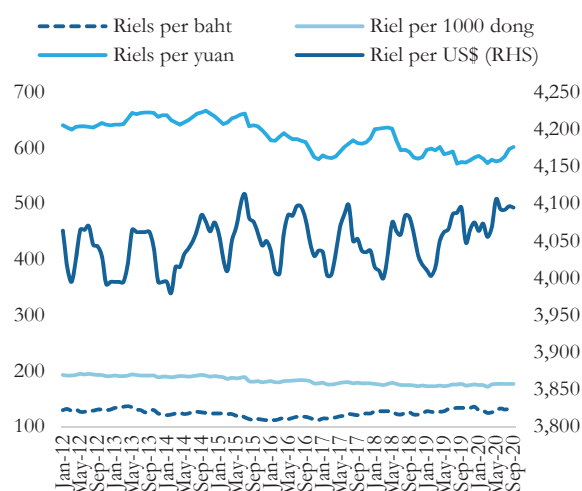
Figure 17: Inflation (consumer price index)

Contributions to 12-month inflation (percent)



Source: Cambodian authorities.

Figure 18: Nominal exchange rates



Source: Cambodian authorities.

Note: RHS = right-hand scale.

¹⁷ Presentation by the Ministry of Social Affairs, Veterans and Youth Rehabilitation on October 22, 2020.

¹⁸ Semi-Annual Report, National Bank of Cambodia, June 2020.

¹⁹ The capital conservation buffer is designed to ensure that institutions build capital buffers under normal financial situations that can be drawn down when losses occur. See the Prakas dated February 22, 2018 and the 2020 Semi-Annual Report, the National Bank of Cambodia.

revenue declines caused by the pandemic.²⁰ As of July 2020, the microfinance sector restructured US\$1.2 billion in loans with a quarter of a million borrowers affected by the COVID-19 pandemic, according to the microfinance association.²¹ As of June 2020, the microfinance sector had 2.1 million loans, amounting to US\$7.3 billion.²²

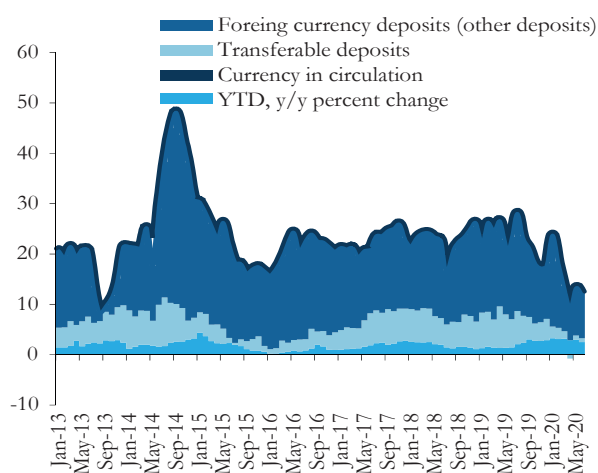
Broad money growth decelerated substantially as foreign currency deposits slowed

Reflecting a slowdown in capital inflows, growth of foreign currency deposit decelerated, resulting in the easing of broad money growth. Broad money growth significantly eased to 12.3 percent (y/y) in June 2020, down from 18.2 percent by the end of 2019 (and 24.0 percent in 2018) (figure 19). The contribution of foreign currency deposits (classified under “other deposits”) to broad money growth shrank, hitting an 8.5-year low, declining to 9.0 percentage points, down from 11.0 percentage points in 2019 (and 20.0 percentage points in 2018). The contribution of riels in circulation to broad money growth, however, remained at 2.5 percentage points, marginally declining from 2.8 percentage points, thanks to the central bank’s policy to promote the use of the local currency.

Deposit and credit growth declined as

Figure 19: Broad money

Contribution to broad money growth (percentage point)



Source: Cambodian authorities.

economic activity weakened

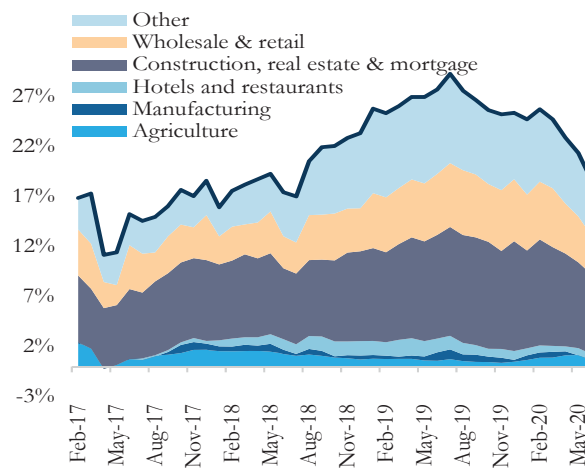
Growth of deposits at depository corporations (banks and microfinance deposit-taking institutions) decelerated as economic activity slowed. Deposits grew at 10.7 percent (y/y) in June 2020, down from 16.4 percent in 2019 (and 28.9 percent in 2018). As interest rates on deposits remained broadly stable, slow deposit growth likely reflects sluggish economic activity that negatively impacts liquidity of the corporate sector (and households), thus constraining their ability to save (see box 3 and Special Focus). Weak demand for credit further slowed depository corporation credits to businesses. Credit growth declined to a two-and-a-half-year low of 18.9 percent y/y in June 2020, down from 27.0 percent in 2019.

Domestic credit for construction activity eased, but credit to agricultural activity rose

Domestic credit financing the construction and real estate sector decelerated as the construction boom has stalled. In June 2020, the contribution of construction, real estate, and mortgage loans to credit growth hit a 2.5-year low, dropping to 8 percentage points (US\$8.1 outstanding credits), down from its peak of 11.0 percentage points in 2019 (figure 20), according to the central bank’s data on bank credit classified

Figure 20: Depository corporation credits

(Contribution to credit growth (percentage point))



Source: Cambodian authorities.

²⁰ See Instruction Circular dated March 27, 2020, the National Bank of Cambodia. “Renegotiated loan” or “Restructured Loan” means any loan that has been rescheduled or refinanced in accordance with an agreement setting forth a new repayment schedule on a periodic basis occasioned by weaknesses in the borrower’s financial condition and/or inability to repay the loan as originally agreed.

²¹ Media interview with the president of the microfinance association, August 31, 2020.

²² Semi-Annual Report of the National Bank of Cambodia, June 2020.

Impacts of COVID-19 on households – results from the High-Frequency Phone Survey of Households^a

COVID-19, a respiratory disease caused by a novel Coronavirus detected in 2019, became a pandemic in early March 2020. Cambodia confirmed its first case of Coronavirus on January 27, 2020, and Cambodia has thus far contained the spread of the virus. As of October 25, 2020, there were 287 confirmed cases and zero reported deaths according to the World Health Organization. Cambodia took various measures to curb the spread of the virus that causes COVID-19. These included advising citizens to stay at home, physically distance and reduce unnecessary travel; closing schools; banning mass gatherings; restrictions on international travel; health screening at airports; and closing its borders.

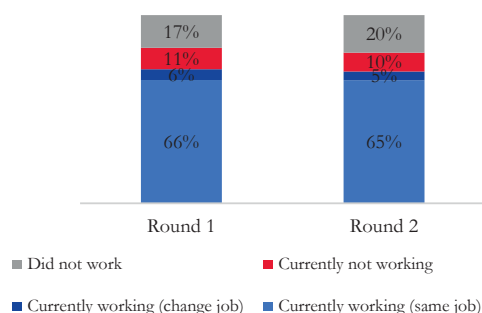
COVID-19 has not only been a health emergency; it has also affected the global economy and financial markets, and its impacts have reverberated through domestic economies. While Cambodia has avoided a health crisis so far, the immediate economic cost is significant. The World Bank is projecting a negative growth of 2.0 percent for Cambodia in 2020 due to COVID-19 and for poverty in the region to increase for the first time in 20 years.

Governments more than ever need timely and reliable data to monitor and mitigate the social and economic impacts of the crisis on the poor and vulnerable. To monitor the socioeconomic impacts of the COVID-19 pandemic and inform policy responses, the World Bank designed and conducted a nationally representative High-Frequency Phone Survey (HFPS) of households in Cambodia. The survey covers important and relevant topics, including knowledge of COVID-19 and adoption of preventive behavior, economic activity and income sources, access to basic goods and services, exposure to shocks and coping mechanisms, and access to social assistance.

Employment remained steady between May and August following an initial shock due to the COVID-19 pandemic. While the share of respondents who were working declined sharply from 82 percent before the COVID-19 outbreak to 71 percent in May under round 1 (figure B3.1), it remained relatively unchanged in August under round 2 at 70 percent. Most respondents remained within the same sector of employment. Only 5 percent of the respondents switched jobs, largely moving from the industry sector into the agriculture sector. The share of respondents who stopped working remained around 10 percent between the two rounds. Among those who stopped working, around 32 percent reported that it was due to seasonality in employment and 21 percent reported it was due to illness.^b The COVID-19-related reasons mostly cited in May such as business closures or temporary layoffs had largely disappeared.

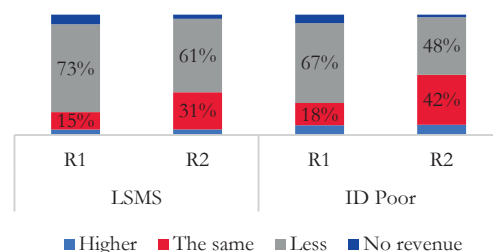
COVID-19 continues to negatively affect non-farm business activities albeit less severely compared to the onset of the pandemic (figure B3.2). The share of non-farm household businesses reporting less or no revenues declined. Four in 5 households reported earning less or no revenues in April compared to March, while about 3 in 5 households did so in July compared to June. Household businesses reporting that their revenues remained the same doubled, reaching 31 percent in July. Similar trends are observed among IDPoor households although at different magnitudes. The share of households operating a non-farm family business remained relatively unchanged. About one-third (32 to 34 percent) of households in the Living Standards Measurement Study (LSMS) sample operated non-farm family businesses during May–August, and around 16 to 19 percent of the households belonging to the identification of Poor (IDPoor) program did so during June–August. Most of the businesses were in retail sales. Nearly 80 percent of the businesses operating in August were retail sales, compared to 67 percent in May.

Figure B3.1: Respondent working in the last 7 days



Note: a. This box was prepared by Wendy Karamba and Kimsun Tong.

Figure B3.2: Non-farm business households reporting changes in sales revenues



Note: ID Poor = National Identification of Poor Households program; LSMS = Living Standards Measurement Study; R1 = round 1; R2 = round 2.

Impacts of COVID-19 on households – results from the High-Frequency Phone Survey of Households (cont'd)

Weak consumer demand continues to drive the loss or lack of revenues for non-farm family businesses. Among household businesses reporting less or no revenue, about 88 percent reported having fewer or no customers. Lower demand is equally affecting all household businesses across urban and rural areas and among households in the bottom 40 and top 60 percent.

Most migrants have lost jobs or wages because of the COVID-19 pandemic (figure B3.3). Pre-COVID-19, 3 in 10 households had a migrant. Since the COVID-19 outbreak, migrants have remained at their destination for 2 in 10 households, while migrants have returned home for 1 in 10 households. Among households whose members are currently away, 80 percent had migrant workers working as wage employees. More than 60 percent of migrant households reported declines in the migrant's income. About 60 percent of migrant households reported that the income of their migrant members had declined by 47 percent since the COVID-19 outbreak, which in turn reduced the amount of remittances received. ID Poor households reported that the income of their migrant members had declined by 42 percent compared to the pre-COVID-19 outbreak.

Among the 1 in 10 return migrant households, most had a migrant return home because of factory closures (36 percent) and lack of work (24 percent). One-third (34 percent) of the return migrant households had a returnee who was currently out of work, but the estimate for the ID Poor households was half that. The other third (29 percent) of the returnees were engaged in family farm activity, while 16 percent worked as wage employees. Conversely, only 16 percent of the return migrant households from ID Poor households engaged in family farm activity, while 58 percent worked as wage employees (probably because poor households are likely to own only small parcels of agricultural land).

Wage and job losses among migrants have had an adverse impact on remittance flows, which are an important source of income for rural households (figure B3.4). Over 70 percent of migrant households had received remittances since March. However, migrant households received a median US\$50 per month, which was lower than the pre-COVID-19 outbreak. ID Poor households had only received US\$30 since the onset of the pandemic. The survey did not inquire about the magnitude of the change.

Figure B3.3: Migrant households reporting changes in income since mid-March (% of households)



Note: LSMS = Living Standards Measurement Study.

Note: ID poor = National Identification of Poor Households program.

Figure B3.4: Migrant households reporting changes in remittances since mid-March (% of households)



Note: LSMS = Living Standards Measurement Study.

Note: ID poor = National Identification of Poor Households program.

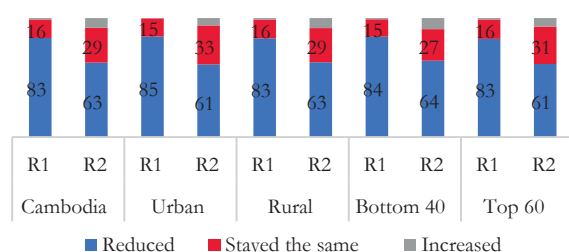
Impacts of COVID-19 on households – results from the High-Frequency Phone Survey of Households (cont'd)

Income losses remain widespread, although the decline in household income has slowed since May due to few disruptions to work activities and increased government assistance (figure B3.5). About 3 in 5 households reported a decline in household income in round 2 compared to 4 in 5 households in round 1. The observed decline in income has slowed for income from all sources, but most prominently for income from farming. Only 32 percent of households that derive their livelihoods from farming, livestock, or fishing reported that their income declined in round 2, which is a 30-percentage-point reduction since round 1. The share of households reporting a decline in income from wage employment and non-farm family businesses also fell by 13 to 14 percentage points. Remittances and assistance from family have not deteriorated further, as the share of households reporting a decline fell 17 and 44 percentage points, respectively, from about 75 percent. The share of households reporting an increase in assistance from government and nongovernmental organizations increased tenfold between May and August, from 4 percent to 42 percent.

Markets remained functional and able to supply basic necessities despite the COVID-19 pandemic. Virtually all households regardless of poverty status and area of residence were able to buy rice, fish or meat, and vegetables or fruit in both May and August when they sought these staples. Similarly, 99 percent of the households that tried to purchase medicine were able to do so in both periods (figure B3.6). Among households that needed medical treatment, virtually all of them were able to access medical services. Female respondents were more likely to report they needed medical treatment for themselves or other household members than male respondents.

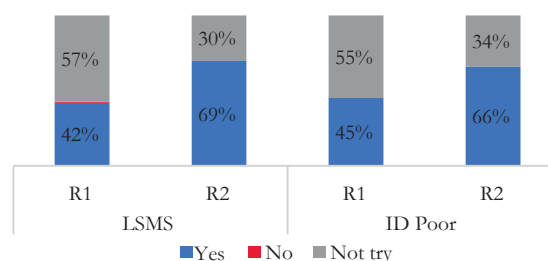
Children's engagement in learning activities is rising following initial disruptions brought about by the COVID-19 outbreak. On March 16, 2020, the Ministry of Education, Youth and Sport (MoEYS) directed the closure of all public and private schools and required students to study remotely. Households largely relied on television or radio programs to complement learning at home. Since September 7, 2020, schools have partially reopened and must follow standards recommended by the MoEYS to prevent the spread of COVID-19 including hygiene practices, social distancing, temperature screening, and use of masks. At the time of the survey, a partial reopening had not yet been implemented. Instead, greater adaptations of households and alternatives from schools offered more opportunities for learning at home. The share of households with children aged 6-17 who had been in school engaged in learning activities rose from 63 percent to 75 percent. Despite this improvement, 1 in 4 households with children continue to have few opportunities to learn during school closures.

Figure B3.5: Changes in household income between May and August, 2020



Note: R1 = round 1; R2 = round 2.

Figure B3.6: Household able to buy medicine in the last 7 days



Note: ID Poor = National Identification of Poor Households program; LSMS = Living Standards Measurement Study; R1 = round 1; R2 = round 2.

by business undertaking. Similarly, reflecting sluggish domestic business and sales activity, the contributions of the retail and wholesale, and manufacturing sectors to domestic credit growth shrank to 3.9 percentage points (US\$7.0 billion outstanding credits) and -0.3 percentage point (US\$1.1 billion outstanding credits) in June 2020, down from 6.6 percentage points, and 0.2 percentage point in December 2019, respectively.

Agricultural lending rose, boosted by rising demand for agricultural products during the pandemic. The contribution of agricultural lending to credit growth rose 1.0 percentage point (US\$2.0 billion outstanding credits) in June 2020, up from 0.5 percentage point in December 2019, despite the overall decline in domestic credit growth. The contribution of the hotel and restaurant sector to domestic credit growth also edged up to 0.6 percentage point (US\$1.2 billion outstanding credits), from 0.4 percentage point during the same period. In June 2020, the reported nonperforming loan ratios remained low at 2.2 percent and 0.9 percent for the banking sector and microfinance sectors, respectively.²³ As of July 2020, the microfinance association reported nonperforming loans of 2.5 percent. In 2019, the reported nonperforming loan ratios were 2.2 percent and 1.1 percent for the banking sector and microfinance sectors, respectively.

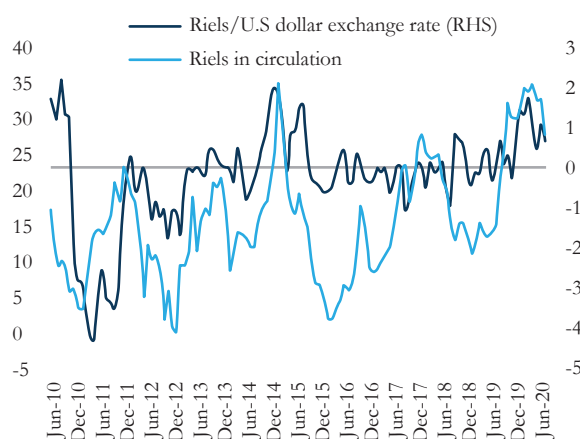
As the central bank continued to inject riels into the economy, high-powered money in

circulation rose further (figure 21). Consequently, pressure on the exchange rate has increased, likely reflecting a slowdown in capital inflows and the decline in Cambodia's foreign exchange earnings caused by the downturn in the tourism and export sectors, thus reducing the central bank's ability to further accumulate foreign reserves.

During the first half of 2020, the central bank purchased US\$17 million by injecting 69 billion riels into the foreign exchange market. The amount of U.S. dollars purchased represents a 99 percent decline (y/y), likely due to the shrinking supply of U.S. dollars in the foreign exchange market. During the same period, the central bank's U.S. dollar purchase from government agencies increased, reaching US\$192.3 million, or 25 percent (y/y). The central bank intervened in the foreign exchange market to maintain the riel versus U.S. dollar exchange rate, which is one of its key policy tools, aiming at achieving price stability.²⁴

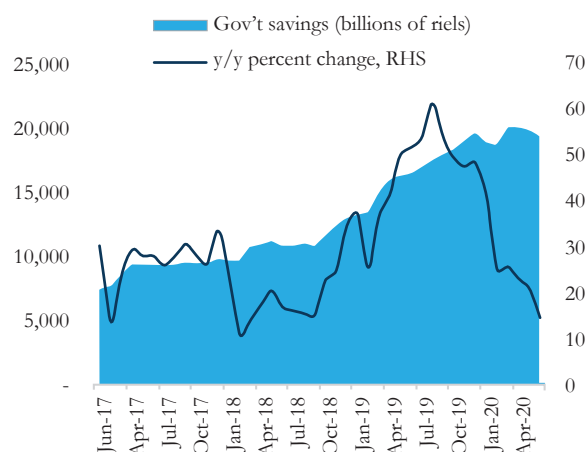
As the central bank cannot influence interest rates of U.S. denominated loans and deposits,²⁵ their interest rates remained broadly stable, despite monetary policy easing. The weighted average of the 12-month U.S. dollar certificate of deposit rates stood at 4.39 percent per year in June 2020, compared to 4.34 percent in December 2019. Similarly, the weighted average of the 12-month U.S. dollar lending rates remained broadly unaffected at 9.44 percent per year in June 2020, compared to 9.51 percent in December 2019.

Figure 21: Riel in circulation and riel versus U.S. dollar exchange rate
(y/y, percent change)



Sources: Cambodian authorities.
Note: RHS = right-hand scale.

Figure 22: Government savings
(billions of riels)



Sources: Cambodian authorities.
Note: RHS = right-hand scale.

²³ Semi-Annual Report, National Bank of Cambodia, June 2020.

²⁴ See https://www.nbc.org.kh/english/monetary_policy/exchange_rate_policy.php

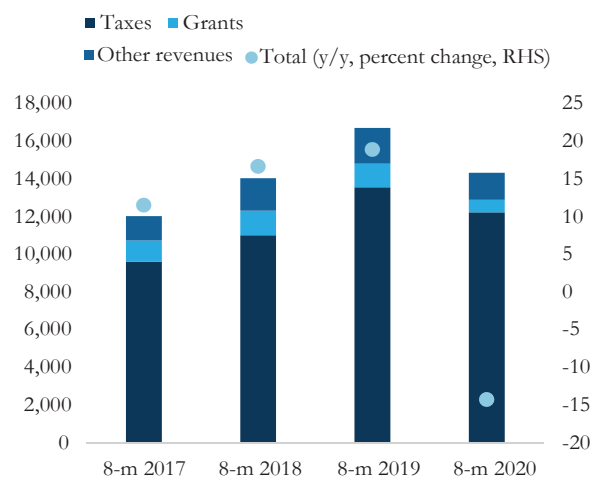
²⁵ However, the central bank introduced a lending rate cap at 18 percent per annum in March 2017. See Prakas number B7-017-109 PK dated March 13, 2017.

Government response to the pandemic is unprecedented

Government intervention to mitigate the negative impacts of the pandemic is unprecedented, amounting up to 5 percent of GDP. A broad package of support includes health-related spending and income assistance, equity injections and loan guarantees, and development spending and tax relief. The government's large fiscal support program is projected to turn the budget from a surplus achieved in 2019 (and 2018) into a large deficit in 2020. To close the gap between revenue collection and financing requirements, the authorities are dipping into government savings deposited in the banking system. While remaining solid, as of June 2020, growth of government deposits eased, decelerating to 14.5 percent (y/y) in June 2020, down from 48.4 percent in December 2019 (figure 22), due to a slowdown in revenue collection. In addition, large components of the government's intervention did not begin until late June 2020.

Thanks largely to successes in its public financial management reform program undertaken since 2005, Cambodia has managed to greatly boost revenue collection. As a result, Cambodia has built up relatively large fiscal space in the form of government savings, while continuing to maintain prudent fiscal management and stable macroeconomic performance. At the end of June 2020, government deposits stood at 17.3 percent of GDP (or 19.3 trillion riels).

Figure 23: Central government revenue
(billions of riels)

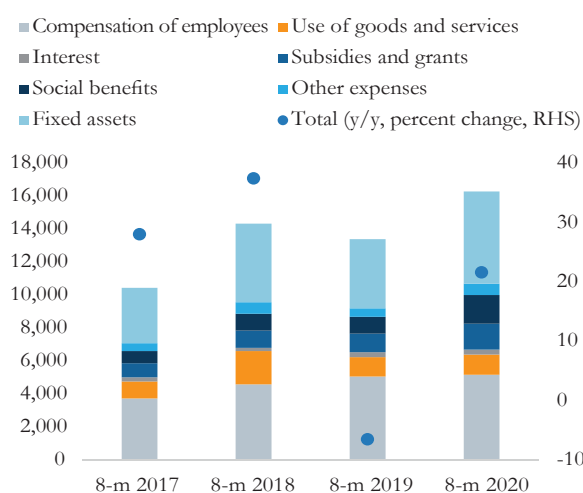


Source: Cambodian authorities.
Note: RHS = right-hand scale.

Revenue collection declined in 2020 thanks to the slowdown in domestic economic activity and sluggish imports, caused by the pandemic. During the first eight months of 2020, central government revenue reached 14.3 trillion riels, or a 14.2 percent y/y decline (figure 23).²⁶ Of the 14.2 percent contraction, the declines of tax revenue, other revenues (mainly non-tax revenue), and grants accounted for 7.9 percentage points, 2.9 percentage points, and 3.5 percentage points, respectively. Tax revenue, which includes taxes on goods and services; taxes on profits, income, and capital gains; and taxes on international trade, accounts for 85.4 percent of total revenue, while the other revenues and grants accounted for 4.6 percent and 10.0 percent, respectively.

The decline in tax revenue is caused largely by weaknesses of taxes on goods services (60 percent of total tax revenue) which shrank by 18.0 percent (y/y) during the first eight months of 2020. With shrinking imports, revenues from the value-added tax, excises, and import duties collected by the General Department of Customs and Excises (GDCE), the largest revenue agency, declined by 23.1 percent (y/y) during the first eight months of 2020. In contrast, boosted mainly by ballooned (profit) taxes filed in April 2020, revenue collected by the General Department of Taxation (GDT), the second-largest revenue agency grew at 10.8 percent (y/y) during the same period. Nevertheless, domestic collection has been deteriorating steadily toward the end

Figure 24: Central government expenditure
(billions of riels)



Source: Cambodian authorities.
Note: RHS = right-hand scale.

²⁶ Ministry of Economy and Finance August 2020 government finance statistics.

of the year. Total collection by both the GDCE and GDT accounts for about 90 percent of total domestic revenues.

In contrast, central government expenditure accelerated, rising to 16.2 trillion riels or 21.5 percent (y/y) (figure 24) during the same period, boosted largely by rising government intervention in response to the pandemic. Of the 21.5 percent expansion, the increase of fixed assets (capital spending) contributed the largest, accounting for half (or 10.5 percentage points) of the total expenditure increase. Spending on social benefits, subsidies and grants (to subnational levels) combined, is second, capturing 8.7 percentage points of the total increase. Employee compensation, which was growing rapidly during the past several years, has finally eased and contributed only 0.8 percentage point of the increase. The authorities' target of having a minimum civil servant's monthly wage of at least 1 million riels has been met or exceeded. In addition, responding to the pandemic requires a substantial increase in public outlays, reducing the authorities' fiscal space for raising civil servants' wages much further.

Spending on social benefits quickly rose thanks to new government policy intervention.

Reflecting rising government intervention, central government spending on social benefits reached 1,737.8 billion riels (equivalent to US\$424.3 million) during the first eight months of 2020, or a 70.0 percent year-on-year increase. Spending on social benefits which mainly include social security

and social assistance contributed a quarter (or 5.4 percentage points) of the total expenditure increase during the first eight months of 2020.

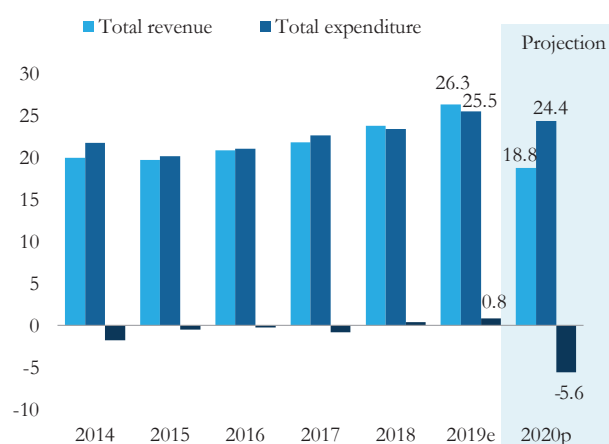
The fiscal deficit is projected to widen to 5.6 percent of GDP in 2020

In 2020, revenue collection is expected to reach only 18.8 percent of GDP, well below the estimated collection of 26.3 percent of GDP in 2019. Boosted by government intervention, outlays are rising and expected to reach 24.4 percent of GDP in 2020, lower than the estimated disbursement of 25.5 percent of GDP in 2019. As a result, the overall fiscal deficit (including grants) is projected to widen to 5.6 percent of GDP in 2020 (figure 25). Thanks to continued large foreign financing by development partners, domestic financing is expected to account for about half of the projected total financing requirement, lessening the need to drawdown on government deposits. Of the 5.6 percent of GDP financing need, foreign financing (official loans) is projected to account for 3.0 percent of GDP, while domestic financing (and debt amortization), a drawdown of government deposits, accounts for the remaining 2.6 percent of GDP (figure 26).

Cambodia's fiscal support is the fourth largest in the region

Cambodia's total fiscal support of 5 percent of GDP is the fourth largest among developing East Asia and Pacific economies, behind only Thailand, Mongolia, and Malaysia

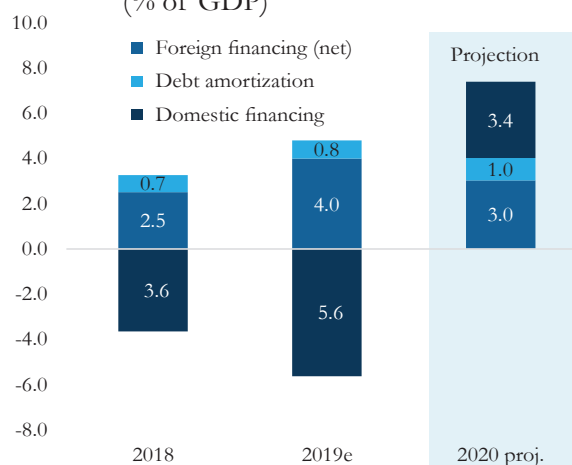
Figure 25: General government operations
(% of GDP)



Sources: Budget Settlement Laws; and World Bank staff estimates and projections.

Note: e = estimates; p/proj. = projections.

Figure 26: General government surplus/deficit and financing
(% of GDP)



Sources: Budget Settlement Laws; and World Bank staff estimates and projections.

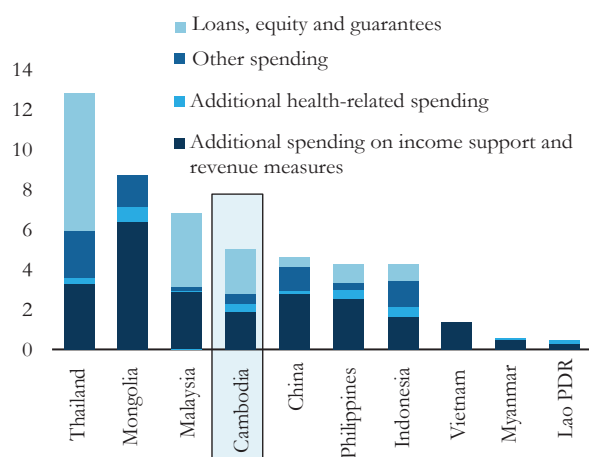
Note: e = estimates; proj. = projections.

(figure 27). Despite being the poorest country in the region, the size of Cambodia's total policy support, which is larger than those of its wealthier neighbors including Indonesia, the Philippines and Vietnam, is a promising sign. Of the total 5 percent government intervention, direct fiscal support (income and revenue support to affected households and firms, and public health support) accounts for 2.8 percent of GDP, while loan, equity and guarantee support captures the rest. The intervention has helped ease the economic and social distress caused by the pandemic.

Cambodia has been able to quickly scale up and deepen the nascent cash transfer program that was in place in the pre-COVID-19 period.

The large cash transfer program for poor and vulnerable households identified under the Identification of Poor Households Program (ID Poor) has been introduced. Starting on June 24, 2020, the program, costing between US\$25 million and US\$30 million a month, reached large numbers of households: 580,838, 598,512, and 644,655 households for the first, second, and third months of intervention, respectively.²⁷ For the fourth month of intervention, starting on September 25, 2020, the authorities budgeted 125.1 trillion riels, equivalent to US\$30.53 million, targeting 689,973 households. However, an extension of the social assistance scheme beyond the currently planned timeframe would put significant pressure on the budget.

Figure 27: Fiscal support – regional comparisons
(percent of GDP)



Source: World Bank 2020a.

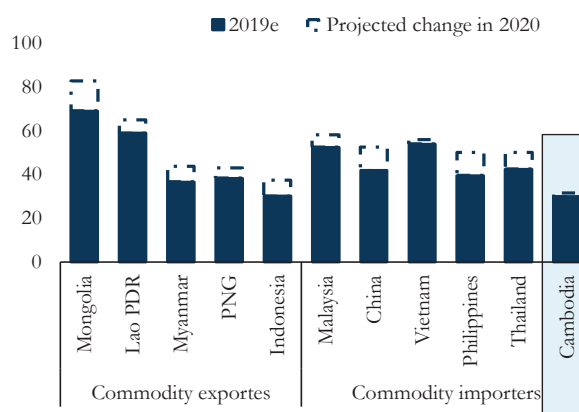
Public debt is expected to rise, but risk of debt distress remains low

Cambodia's public debt-to-GDP ratio is projected to marginally increase to about 31.6 percent of GDP in 2020 (figure 28). The increase is to finance the country's widening overall fiscal deficit in the short term (see Annex). Although the debt sustainability analysis conducted in 2019 using the joint IMF/World Bank Debt Sustainability Framework for Low-Income Countries (LIC-DSF) showed that Cambodia remained at low risk of external debt distress,²⁸ the baseline has changed. With the fiscal deficit estimated at 5.6 percent of GDP in 2020 and 6.1 percent of GDP in 2021, financing needs from abroad will increase, while the exchange rate is coming under pressure.

Credit to construction, real estate activities, and mortgages grew quickly, averaging 32.1 percent per year during 2009–19.

The share of credit to construction, real estate activities, and mortgages in total domestic credit rose to 31.1 percent in 2019, up from 18.8 percent in 2009. While decelerating to a 23.1 percent year-on-year increase in August 2020, down from 39.4 percent at the end of 2019, outstanding domestic credit financing construction, real estate activities, and mortgages reached 34.6 billion riels (US\$8.17 billion). Disaggregating the outstanding credit data shows that mortgage financing was the largest, accounting for 14.2 billion riels (US\$3.5 billion).

Figure 28: Government debt - regional comparisons
(percent of GDP)



Source: World Bank 2020a and World Bank staff projections.

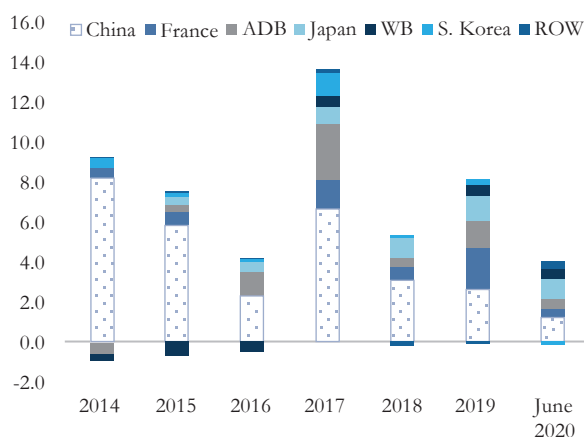
²⁷ Media announcement, September 29, 2020, General Secretariat, Council for Social Protection, Ministry of Economy and Finance.

²⁸ IMF staff report for the 2019 Article IV consultation - Debt Sustainability Analysis. <https://www.imf.org/en/Publications/CR/Issues/2019/12/23/Cambodia-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-48912>.

Construction financing is next, accounting for 10.5 billion riels (US\$2.6 billion), followed by real estate financing, which amounted to 9.8 billion riels (US\$2.4 billion) in August 2020. There is consensus that booms and busts in asset prices can contribute to financial sector distress and macroeconomic imbalances.²⁹ The pandemic has constrained the ability of households to repay loans, in particular mortgage loans, which are mostly denominated in U.S. dollars. So far, financial stability has been maintained, thanks in part to pre-emptive containment of risks arising from borrowers who have difficulty repaying their loans. Interest rates remained unchanged. While under pressure, the value of the riel to U.S. dollar remained broadly stable. Accumulation of foreign reserves continued, and gross international reserves can now cover up to 10 months of prospective imports. This has helped anchor market confidence in local currency and in the economy.

By June 2020, Cambodia had a total outstanding public debt of US\$7.9 billion,³⁰ all of which is external (and in foreign currencies). Borrowing has been largely for public investment in physical infrastructure, which accounts for 87.0 percent of the total. The weighted average grant element of Cambodia's public debt improved, reaching 55.8 percent in the first half of 2020, compared to 51.6 percent in 2019 and 43.7 percent in 2018. U.S. dollar outstanding debt is the largest, accounting for 43.5 percent of the total. Special drawing rights (SDR) outstanding debt is

Figure 29: Contribution to Cambodia's debt stock growth
(percentage point)



Source: Cambodian authorities.

Note: ADB = Asian Development Bank; WB=World Bank; ROW=Rest of the World.

²⁹ IMF 2001

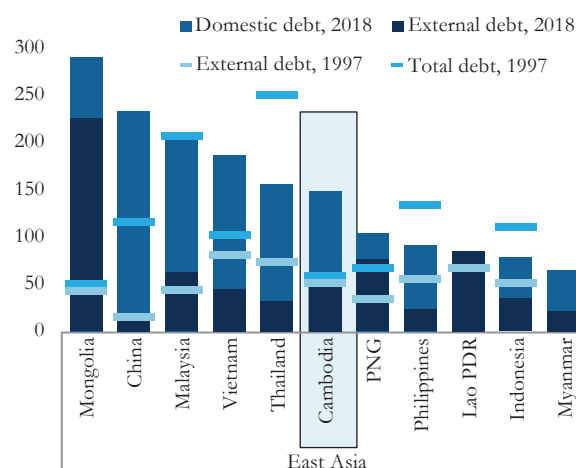
³⁰ Cambodia Public Debt Statistical Bulletin, Vol. 10, September 2020, Ministry of Economy and Finance.

second, capturing 25.7 percent. While China is the largest creditor with a total outstanding debt of US\$3.7 billion (or 46.8 percent of the total), debt denominated in Chinese yuan covered less than 15 percent of total debt stock. The second- and third-largest creditors are the Asian Development Bank and the World Bank, accounting for 18.6 percent and 7.9 percent of total outstanding debt, respectively, followed by Japan, Korea (the Republic of), and France. In June 2020, the top six creditors accounted for 89 percent of Cambodia's total debt stock.

Cambodia's public debt stock growth decelerated, but its private sector debt rose

Cambodia's debt stock growth decelerated toward 2019 as outstanding debts owed to China, the Asian Development Bank, and Korea eased. Growth of Cambodia's public debt stock peaked in 2017 with a 13.8 percent increase that year, due largely to a sharp increase in Chinese loans (figure 29). Chinese loans contributed the largest, accounting for 6.7 percentage points of the total outstanding debt increase in 2017. Loans from the Asian Development Bank (ADB) were next, accounting for 2.9 percentage points, while loans from France and Korea contributed 1.4 percentage points and 1.2 percentage points, respectively. However, debt stock growth has decelerated since, growing at 8.2 percent in 2019 as contributions of outstanding loans owed to China, the ADB, and Korea declined to 2.7

Figure 30: Levels of debt - regional comparisons
(percent of GDP)



Source: Institute of International Finance, World Bank.

percentage points, 1.5 percentage point, and 0.3 percentage point, respectively. However, as discussed above, public debt is projected to again increase to finance a widening fiscal deficit caused by the pandemic.

Cambodia's private debt has been rising. The country's private debt has substantially increased during the past two decades. It is estimated that the country's total debt stood at 148.4 percent of GDP in 2018, from 58.3 percent of GDP in 1997. Cambodia's external and domestic debts were estimated to increase to 62.7 percent of GDP and 85.7 percent of GDP in 2018, up from 51.4 percent of GDP and 6.9 percent of GDP, respectively.³¹ In the East Asia region, Cambodia's total debt is among the top six countries, after Mongolia, China, Malaysia, Vietnam, and Thailand (figure 30).

Outlook

The economy is projected to contract by 2.0 percent in 2020 and recover in 2021, growing at 4.0 percent (table 1). This is in line with potential growth in the EAP region, which is expected to decline in the next decade by almost 2 percentage points, from 7.6 percent in the last decade (2010–19) to 5.7 percent on average (over 2020–30) regardless of the effects of COVID-19, assuming that each underlying component of potential growth (investment, human capital, and labor force participation rate) follows the historical trend.³² With the easing of social distancing measures, Cambodia's domestic economic activity has been gradually returning to normalcy. Domestic demand, including domestic travel and tourism, is picking up. The recent signing of the Cambodia-China Free Trade Agreement (CCFTA) and the likelihood that the CCFTA will enter into force in 2021 will help further promote domestic investment and regional trade. In addition, the benefits of being a member of the Regional Comprehensive Economic Partnership (RCEP)—the largest free trade area in the world that was signed in November 2020—should begin to flow, starting in 2021.

Domestically, the projections assume no significant long-term adverse impacts of the pandemic on the corporate or banking sector

or on the balance of payments. It is assumed that market confidence has been gradually restored as the outbreak is under control and FDI inflows have steadily returned. Private consumption is assumed to decline moderately, thanks to government fiscal direct support, amounting to 2.8 percent of GDP. Gross fixed investment remains relatively robust in this scenario as on-going construction projects are completed with the return of FDI inflows, while public investment rises. Exports contraction is projected to be relatively large but to quickly recover in 2021 (and 2022). Imports contraction is moderate as consumption has held up, thanks largely to the relatively large government invention. Agricultural growth is assumed to accelerate fairly quickly as rice production rises, while diversification of other export crops and livestock and fisheries gradually progresses. The industry sector is expected to moderately decline. The contraction of garment, footwear and travel goods manufacturing is expected to be partly offset by the expansion of other manufacturing.

Externally, the projections assume gradual recovery of international and regional trade with increased access to external markets including the Chinese market. Cambodia's underutilized and relatively cheap labor, and abundant land, can focus on primary and labor-intensive goods for export.

Table 1: The macro outlook

	2020	2021	2022
GDP Growth	-2.0	4.0	5.2
By expenditure			
Private Consumption	-1.4	3.4	4.7
Government Consumption	6.7	8.6	5.8
Gross Fixed Capital Investment	6.3	6.1	7.1
Exports, Goods and Services	-12.6	5.4	5.4
Imports, Goods and Services	-8.9	5.5	5.4
By production			
Agriculture	1.5	0.9	1.0
Industry	-1.2	6.9	7.1
Services	-4.3	2.6	5.1

Source: World Bank staff projections.

³¹ October 2020 East Asia and Pacific Economic Update, the World Bank.

³² October 2020 East Asia and Pacific Economic Update, the World Bank.

Diversification of FDI is a good sign

The increase in approved FDI project values to non-garment industries and agriculture is encouraging. During the first seven months of 2020, approved FDI project values for non-garment manufacturing sectors rose to US\$878 million, up from US\$95 million during the same period in 2019, while FDI going to the agriculture sector (including the agroprocessing industry) increased to US\$100 million, up from US\$34 million during the same period. The newly emerging non-garment sectors include energy, travel goods, footwear, furniture, building materials, metal, plastic, leather processing, packaging, decorative products, telecommunications, mechanic assembly, electronics, vehicle accessories, and beverages. If appropriately nurtured, it will underpin the authorities' efforts to diversify Cambodia's manufacturing sector.

Risks and challenges

Significant uncertainty remains in Cambodia's growth outlook. The economy is small, open, narrowly based, and heavily dependent on capital inflows, mainly foreign investment, and external trade. Globally, growing tensions among international powers and the erosion of multilateral disciplines are generating uncertainty that hurt trade and investment flows. Domestically, an extension of the social assistance scheme beyond the currently planned time frame would put significant pressure on the budget, while not extending it will hurt the poor and lower domestic demand. Downside risks include a second wave of the COVID-19 outbreak, and a deeper and prolonged decline in tourist arrivals linked to a lingering global outbreak and the speed with which a vaccine becomes widely available. The partial withdrawal of the EU's "Everything But Arms" trade preferential treatment began on August 12, 2020, affecting approximately 20 percent of Cambodia's exports to the EU.

While the containment of financial risks triggered by the pandemic has helped maintain stability in the banking and microfinance sector, the risks accumulated by an overleveraged

financial sector remain. As discussed, private debt has risen significantly, and vulnerabilities, including high credit concentration, related party lending risks, lack of consolidated cross-border supervision, and gaps in implementation of risk-based supervision, remain.³³

Although it is too early to ascertain the consequences, flooding that occurred in October 2020, has caused loss of human life, destruction of crops, damage to property and physical infrastructure. As of October 22, 2020, the floods have claimed 39 lives, affected 120,785 households (483,140 people), 115,354 homes (63 homes damaged), 232,551 hectares of cultivated rice, and 83,918 hectares of other crops, according to the National Committee for Disaster Management. However, it is not known yet how much of the affected cultivated area of rice and other crops are permanently damaged.

A medium-term strategy for the garment, footwear, and travel goods sector is being developed

A 2020–25 garment, footwear, and travel goods sector strategy serving as a roadmap and aiming at strengthening the sector's value addition and competitiveness is being developed.³⁴ The strategy is being designed to target skills upgrades and career paths for factory workers, promote high value-added domestic and foreign investment, attract the sector's supporting industries, and diversify export markets. Establishing the strategy is seen as increased attention by the authorities to move this important sector up in regional and global value chains in garment production as envisaged in Cambodia's 2015–25 Industry Development Policy. It is not known yet whether government intervention in the forms of competitive energy costs, technological upgrades, and upstream textile industry promotion will be forthcoming. Cambodia's well-established garment sector is a labor-intensive and export-oriented. However, the manufacturing sector remains largely engaged in the "cut-make-trim" process, the lowest value-added section of the entire value chain for decades.³⁵

³³ Staff report for the 2019 Article IV consultation, IMF (<https://www.imf.org/en/Publications/CR/Issues/2019/12/23/Cambodia-2019-Article-IV-Consultation-Press-Release-Staff-Report-and-Statement-by-the-48912>).

³⁴ Announcement dated July 28, 2020, Ministry of Economy and Finance.

³⁵ Economic impact of the EU's suspension of its trade preferences on Cambodia, Research Intelligence, June 2019. In CMT manufacturing, apparel buyer pays the manufacturers for the cut-make-trim process. Pre-production process like the order processing, product development, pattern making and pattern grading, and post-production process such as shipping of goods are handled by the buyer.

In an effort to maintain external competitiveness, decisions have been made to freeze the monthly minimum wage and to shorten the paid holiday list in 2021. The minimum wage for the garment and footwear industry has largely been frozen at US\$192 per month for 2021.³⁶ The new minimum wage for 2021 will be an increase of only US\$2, or 1.1 percent from this year's wage. Prior to 2020, the minimum wage grew quickly, averaging 13.2 percent per year during 2013–20. Similarly, paid (official) holidays in 2021 have been cut further to 21 days, down from 23 days in 2020. Prior to 2020, paid public holidays were as many as 28 days a year.

A 2020–25 tourism sector roadmap and a 2020–35 Siem Reap masterplan are being developed

A 2020–25 roadmap to restore and develop the tourism sector is being finalized and will consist of three stages: resilient and restart (2020–21), recovery (2021–22), and relaunch (2023–25).³⁷ The 2020–25 roadmap, targeting seven million international arrivals, is broadly underpinned by Cambodia's comparative advantage in tourism. However, successfully implementing the roadmap will likely require resources. In the foreseeable future, financing by the private sector, especially FDI, is unlikely to be forthcoming due to the collapse of the tourism sector (see the discussion on approved FDI projects below). Unless the public sector is willing to boost public investment in the tourism sector, the roadmap to jumpstart the sector will likely face resource constraints.

Linking with the Siem Reap physical infrastructure development plan, the Siem Reap tourism development masterplan will aim at strategically developing Siem Reap as a tourist destination priority. This includes a Siem Reap tourism investment strategy, covering infrastructure development and connectivity, marketing, environmental protection and human resource development. In addition, destination management organizations are being established

covering six destinations within Siem Reap province. In September 2020, the government approved an allocation of US\$150 million to develop physical infrastructure, consisting of 38 roads in Siem Reap to be ready by the end of 2021.³⁸ A similar public investment project, amounting to US\$ 300 million to build 34 roads with a total length of 82.5 kilometers, was approved in 2019 to develop physical infrastructure in the seaside province of Sihanoukville. The project was almost completed.³⁹

Policy options

The most important policy goal must be to urgently regain jobs lost and suspended due to the pandemic. In this regard, full attention must be paid to boost investment in labor-intensive sectors to generate jobs. This can be done by taking advantage of the quick recovery of domestic demand for consumer goods, including foods and domestic services, mainly travel, hospitality, and healthcare. For example, ensuring the survival of firms and businesses that are likely to thrive in the post-COVID-19 period would provide relief to workers, facilitate a quick recovery, and boost growth. Similarly, boosting pro-poor and growth-enhancing public investment, including cash-for-work projects, will create jobs. Public investment program initiatives to build physical infrastructure in Sihanoukville and Siem Reap provincial towns will improve the connectivity and underpin tourism sector development. Doing this will also facilitate the authorities shifting their intervention from emergency relief and social assistance in the form of cash transfers to livelihood support, targeting income generation and job creation.

Looking ahead, it is essential to facilitate an expansion of domestic and foreign investment arising largely from recent bilateral and regional free trade agreements. In this regard, promptly introducing competitive investment law and incentive schemes together with ease of doing business is particularly crucial. Immediate benefits of the CCFTA may come from exporting non-rice, high-value (raw and processed) agricultural

³⁶ Announcement dated September 10, 2020, Ministry of Labor and Vocational Training.

³⁷ Statement dated November 6, 2020, Ministry of Tourism.

³⁸ See a letter dated September 4, 2020 from Siem Reap provincial governor to the prime minister.

³⁹ See news release dated July 17, 2020 by National Committee for Managing and Developing Cambodian beaches.

products such as cassava, rubber, and soybean, as China has already provided quotas for Cambodia's milled rice and mango exports. Policy, technical, and financial support may therefore be provided to expand the production and quality of these potential products. In the medium term, nurturing integration of Cambodia's agroprocessing and manufacturing value chains into the regional value chains, initially with those in China, Vietnam, and Thailand, will be fundamental. This may follow the "flying geese paradigm" of economic integration.⁴⁰ Singapore, Korea, China, and Japan—the largest investors in Vietnam (and Thailand)—are also main investors in Cambodia. Therefore, attracting them to integrate Cambodia into their regional (and global) production chains by improving connectivity, upgrading skilled labor, and reducing energy costs is a good first step. To this end, it is essential to further facilitate trade and investment (measured against the country's rankings in global competitiveness and doing business), while promoting small and medium-sized enterprises (which account for a majority of the economy and labor market) through entry and expansion of innovative businesses and to align and link them with the FDI sector.

It is imperative to continue to closely monitor vulnerabilities arising from a prolonged construction and property boom and the increase of credit provided to the construction and real estate sectors. This is particularly crucial if the pandemic lingers and damage caused by recent floods turns out to be substantial. Such events will further diminish the ability of businesses and households to repay

loans, putting the financial sector under increased stress. While the authorities have granted, as part of the COVID-19 response, an exemption of the ownership transfer tax for property valued at US\$70,000 or less,⁴¹ a 20 percent capital gains tax (CGT) will be effective in 2022.⁴² The CGT is levied on a capital gain as the taxable income that results from the revenue received from the sale or transfer of capital (less allowable expenses). The CGT will likely dampen property speculation as it reduces speculative demand, helping stabilize Cambodia's property market, which was booming before the COVID-19 pandemic. With FDI inflows targeting the construction and real estate sectors, speculative demand rose quickly and has so far distorted Cambodia's housing market. In addition to collecting more revenue for the government, the CGT will likely help contain the price volatility of Cambodia's property market during the post-COVID-19 period. More importantly, the CGT should help redirect investment from buy-and-hold property for capital gains to finance productive and tradable sectors that underpin job creation and boost exports.

It is critically important to develop a COVID-19 vaccine distribution infrastructure, while identifying potential COVID-19 vaccine availability and affordability. This is an important time to make sure that any upcoming vaccines will become available to Cambodia and will be distributed efficiently and fairly. Cooperation has been sought with regional countries developing COVID-19 vaccines such as China to ensure Cambodia has access to the COVID-19 vaccine when it is available.

⁴⁰ The division of labor in the Pacific region has aptly been called the "flying geese paradigm" of development.

⁴¹ Letter 1313, Ministry of Economy and Finance, February 25, 2020.

⁴² Prakas 346, signed April 1, 2020, Ministry of Economy and Finance. The implementation of CGT, however, has been postponed until 2022, according to a GDT letter dated October 22, 2020.





Special Focus:

Adapting to COVID-19 in an
Uncertain World

Special Focus: Adapting to COVID-19 in an Uncertain World⁴³

1. Introduction

The COVID-19 pandemic has triggered what is likely to be the worst global recession since the Great Depression.⁴⁴ The pandemic and efforts to contain its spread have led to significant curtailment of economic activity around the world. Many emerging market and developing economies are experiencing domestic outbreaks of COVID-19 and suffering from international spillovers transmitted through trade and investment channels. In Cambodia, the local COVID-19 outbreak has been broadly under control, resulting in a relatively short period of business closure in a limited number of sectors that presented a high risk of COVID-19 transmission, followed in July by increased mobility and gradual restoration of normal life. But economic activity remains weak, as the global demand shock has become the main issue alongside heightened uncertainty.

Cambodia has been significantly affected by COVID-19, and the economic and social costs of the pandemic are expected to be large. Impacts of COVID-19 on the real economy include disruptions in labor supply, consumer demand, global trade through global and local supply chains, travel and tourism, as well as sharp disruptions in access to capital and finance amplified by plummeting confidence of investors. Cambodia's key growth drivers, namely the merchandise export, tourism and construction sectors, have been particularly affected. COVID-19 has effectively stalled the construction and real estate boom that relies heavily on foreign investment. Due to travel restrictions and lockdowns, Cambodia's international tourism and hospitality sector has collapsed. Global supply and demand shocks have led to contractions in garment and footwear

exports, Cambodia's key merchandise export sector. Together, tourism, garment and footwear, and construction sectors contribute more than a third of all paid employment.⁴⁵

The Royal Government of Cambodia has responded with a variety of policy measures.

To help monitor the impact of the COVID-19 pandemic and inform policy responses, the World Bank designed and conducted a Business Pulse Survey of firms in Cambodia (see box S1). Using findings of the survey from June and September, this special focus explores the impact that the COVID-19 pandemic is having on firms in Cambodia relative to the East Asia and Pacific (EAP) region and offers policy recommendations to support firm relief and recovery. While the results show marked signs of improvement in firm closures and sales, the impact is still being felt widely. Firms continue to face substantial hardship through a variety of channels, with a long road to recovery ahead.

2. Firms are reopening, but sales continue to be impacted

The global COVID-19 pandemic has prompted governments around the world to take measures to reduce the spread of the virus. Lockdowns have mandated non-essential businesses to close or significantly reduce in-person operations, but even in the absence of mandatory closures revenue and businesses' operations have faced severe consequences of large negative labor and consumer demand shocks. Like other countries in the region, in early-April Cambodia ordered closures of a range of businesses that presented a high risk of COVID-19 transmission, such as gyms and fitness centers, health spas, cinemas, casinos, Karaoke bars, and entertainment clubs. With limited local

⁴³ This special focus was prepared by Sarah Hebous, Claire H. Hollweg, Philippe de Meneval, and Trang Thu Tran with valuable inputs from Wendy Cunningham and Maheshwor Shrestha. The authors thank Deepak Mishra for thoughtful suggestions.

⁴⁴ World Bank (2020b).

⁴⁵ World Bank (2020a).

World Bank's Business Pulse Survey—Cambodia and globally

The World Bank commissioned firm surveys to understand the impact of the global COVID-19 pandemic on businesses in countries around the world. The questionnaire encompasses questions about the firms' operational status, the channels affecting operations, access to finance, access to support policies, and adjustment mechanisms used by firms.

These business pulse surveys (BPS) have been thus far conducted in more than 40 countries globally with ongoing collection of follow-up rounds. In the EAP region, BPS surveys have been conducted in Cambodia, Indonesia, Myanmar, Malaysia, the Philippines, and Vietnam. The BPS surveys are conducted via short phone interviews, including in Cambodia.

In Cambodia, a first round of data collection took place between June 18 and July 8, 2020, and a second round of interviews was conducted between September 3 and

September 29, 2020. Additional rounds of follow-up surveys are planned over the next 6 months. Throughout this note, results from the first round are referred to as June results and results from the second round as September results.

The sample of interviewed firms consists of 537 firms in June and 518 firms in September, with a panel of 419 firms, covering firms across all size groups¹ in manufacturing or services² and from five provinces in Cambodia (Battambang, Kampong Cham, Kandal, Phnom Penh, and Siem Reap). The survey was unable to identify the cause of attrition between the June and September rounds (e.g. if a firm had closed permanently or was uncontactable for other reasons). The vast majority of firms in the sample (94%) are registered with at least one governmental authority, with around 90% of micro firms being registered with some authorities.³ Around 28% of surveyed firms are female-owned.



¹ In Cambodia, firms are classified as micro if they have less than 10 employees. Firms with 10-50 employees are classified as small, 51-100 medium and more than 100 employees large. Robustness checks were made for extremely small businesses with three employees or less as well as female- versus male-owned and results hold qualitatively.

² Sectors include: agro-industry/food processing; textile, garment, clothing; electrical products; other manufacturing; construction or utilities; retail or wholesale; transportation and storage; accommodation or food services; information and communication; financial activities or real estate; education; health; and other services. The survey is not representative at the sectoral level.

³ The questionnaire asks if the firm was formally registered with any government authority at present: national business registration, sector license, local registration, tax registration, social security registration, other.

COVID-19 outbreak, many of these restrictions were lifted in July and August conditional that additional health precautions be put in place.

Consistent with the return of domestic economic activity, the findings of the BPS show that firms have continued re-opening their businesses since June. The share of firms that were open has risen from an already high share of 81% in June to 89% in September (figure S1, panel a). In September, 8% of firms remained temporarily closed due to the pandemic, compared to 16% in June. The decision to remain closed is at the firm's discretion as there are currently no mandated closure restrictions in place.⁴⁶ At the same time, the share of firms that are permanently closed due to the COVID-19 pandemic remains stable at 2%.⁴⁷

Re-opening progress has not been uniform across sectors. While more than 90% of businesses were open in sectors such as manufacturing, construction, utilities, wholesale and retail trade, financial activities and health in June, businesses in other sectors were very

limited in their ability to operate. For example, only 55% and 60% of firms in accommodation and food services and transportation and storage, respectively, were open in June. With 80% and 83% of firms in these sectors open in September, they have caught up considerable but are still below average.⁴⁸ The education sector had the lowest share of open firms in September, only 64%.

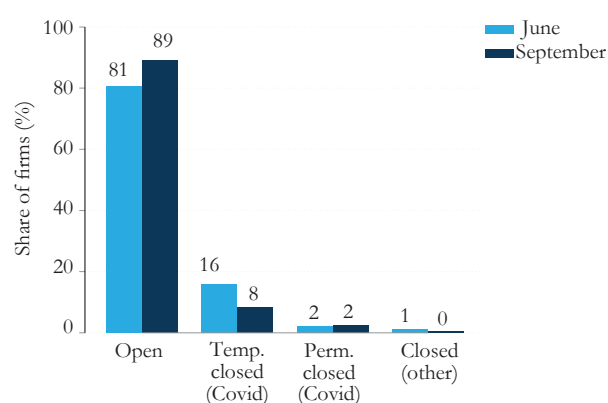
Revenues improved but continue to be significantly affected by the COVID-19 shock.

Although the majority of businesses have been open, most businesses continue to experience a large, negative impact on sales. The share of firms reporting a decline in sales in the past 30 days has decreased from its June level of 87% but remains high at 71% in September (figure S1, panel b). In June, firms reported an average decline of sales of 49%. In September, the average change in sales is less severe, but still negative at -30%.

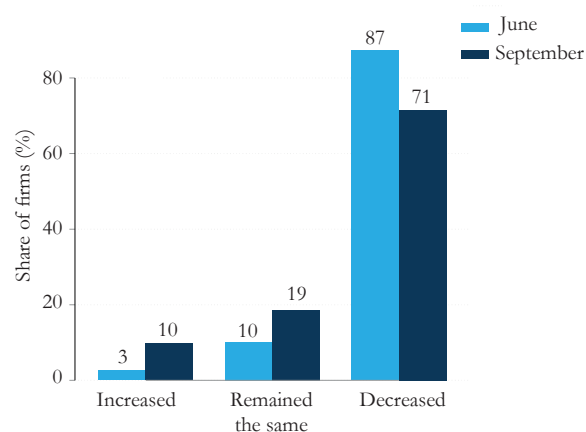
With further reopening, the rate of sales recovery in Cambodia is overall better than other countries in East Asia and may improve

Figure S1: Despite progress on re-opening, impact on sales continues to be high

a. Operational status in June and September



b. Impact on sales in June and September



Note: Businesses were asked to indicate what happened to sales during the 30 days prior to the interview.

⁴⁶ Karaoke bars have been allowed to reopen but under a different business license as a restaurant. See <https://www.thestar.com.my/aseanplus/aseanplus-news/2020/07/07/phnom-penh-karaoke-bars-to-reopen-as-cambodia-controls-COVID-19>.

⁴⁷ This number may be underreported, as the survey was unable to identify the cause of attrition between the June and September rounds (e.g. whether a firm had closed permanently or was uncontactable for other reasons).

⁴⁸ As an alternative to categorizing businesses into 13 sectors information on the main product or service can be used to classify businesses. The tourism industry can be linked to 12 products and services (selling souvenirs, entertainment, tourism services, taxi, translation services, drink services, massage, transportation, accommodation services, food services, tickets, wedding venues). The share of open firms in this industry has been 51% in June and 74% in September.

faster provided the COVID-19 pandemic remains under control without further lockdown. An additional 8% of businesses have opened between June and September in Cambodia, comparable to an increase of 9% between May and August in Myanmar (figure S2). Remarkably, while the initial revenue shock in June was higher and the share of closed businesses in September stayed significantly higher than in Vietnam, revenues for Cambodian firms in September have recovered more quickly. The average sales drop in September for Cambodian firms was 30% compared to 36% in Vietnam. One possible explanation is that sampled firms in Vietnam are more dependent on external demand, which has not been improved by domestic reopening alone.

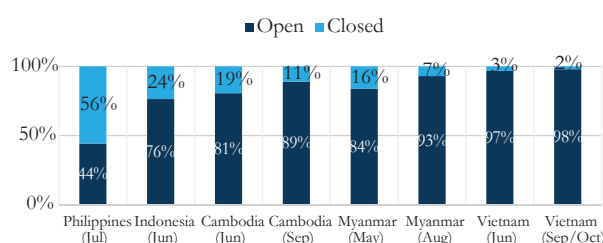
Firms in Cambodia expect the impact of the COVID-19 pandemic to further weaken over

the next six months. According to September results, firms' expectations for future sales was on average -10%, although with many respondents expecting close to no change in sales (figure S3). In comparison, in June firms expected the change in sales to be -28% on average during the following six months. In fact, firms' expectations of the future change in sales in June accurately captured the actual average change in September (-30%).

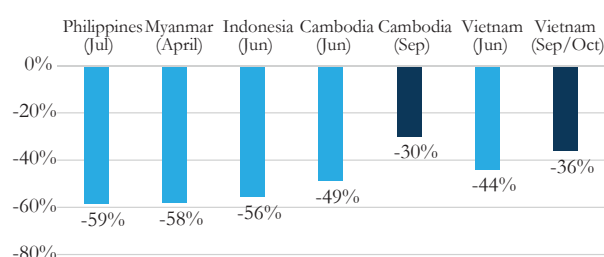
It is important to note however that micro, small and medium sized firms (MSMEs) in Cambodia, and across the EAP region, have been more affected by the COVID-19 pandemic. The impact on sales has been significantly higher for MSMEs than it has been for large firms (figure S4). In June, MSMEs reported an average decrease in sales of 47-56% compared

Figure S2: Firms' operational status is on par and sales recovery is faster than in East Asia

a. Operational status

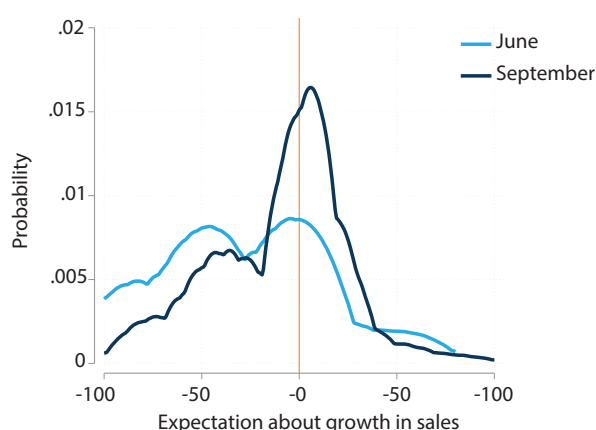


b. Impact on sales



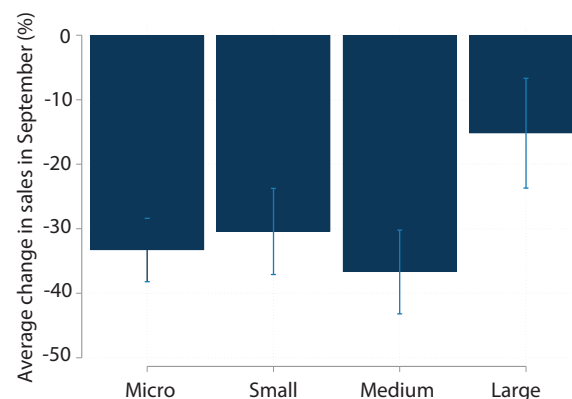
Note: The survey was conducted in June for Cambodia, Indonesia, Vietnam, and July for the Philippines. Monthly sales refer to firm sales in the last 30 days prior to the survey (Cambodia, Indonesia and Vietnam). In the case of the Philippines, the change is between July and April, when Enhanced Community Quarantine (ECQ) was adopted.

Figure S3: Expectations for future six months improving, but still negative on average



Note: Businesses were asked to indicate what they expect to happen to sales over the next 6 months. The response rate for this question was 56% in June and 63% in September.

Figure S4: High impact on sales for MSMEs



to 35% for large firms while in September the decrease was 30-37% for MSMEs and under 15% for large firms. This finding is consistent across the EAP region, where monthly sales of SMEs have fallen by 24% more in Indonesia, 9% in Philippines, and 7% in Myanmar.⁴⁹ This may reflect fewer coping mechanisms for MSMEs than larger firms (discussed below).

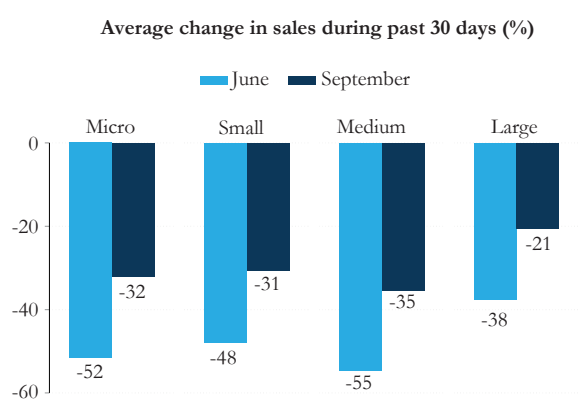
While COVID-19 has had a significantly larger impact on sales for MSMEs in Cambodia, recovery is happening across all firm sizes and sectors, unlike in Vietnam where recovery is mainly driven by large firms in wholesale/retail sectors. Results between the June and September survey rounds in Cambodia suggest that large firms have recovered only slightly faster on average than MSMEs: the impact on sales improved by 45% between June and September for large firms, compared to about 40% for MSMEs (figure S5, panel a). This is in contrast to Vietnam, where the drop in sales in September/October for

small firms has only slightly improved compared to June (by 11%) but has improved significantly for large firms (by 41%) (figure S5, panel b). Similarly, on average, only wholesale/retail activities have recovered significantly in Vietnam (figure S5, panel d) whereas the revenue loss for firms across four broad sectors in Cambodia has improved by between 15 to 23 percentage points (figure S5, panel c).

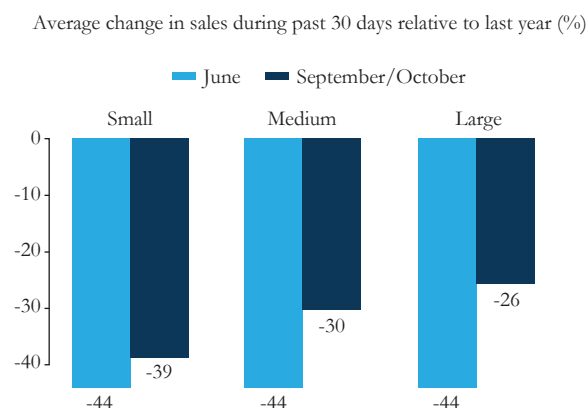
The impact of the COVID-19 pandemic is being felt unevenly across Cambodia. The impact on firms in the Siem Reap province is larger, and their recovery is slower, than in other provinces. In June, only a little more than half of businesses in Siem Reap (57%) were open, compared to for example 88% in Phnom Penh, but the region has largely caught up on reopening in September (80% of businesses reported being open). However, the impact on sales remains comparably high. Across regions, the average decrease in sales in September is the highest in

Figure S5: Recovery appears more even across firm sizes and sectors in Cambodia than in Vietnam

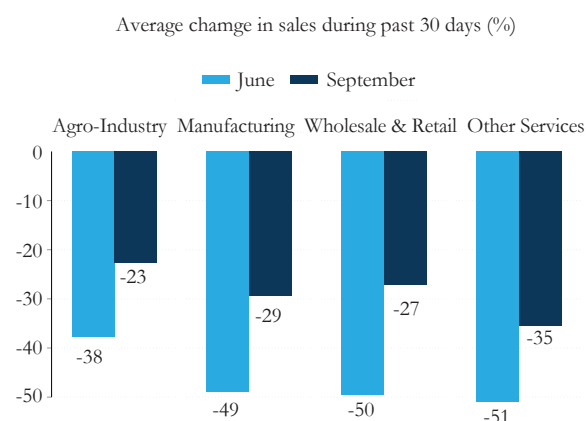
a. Cambodia by firm size



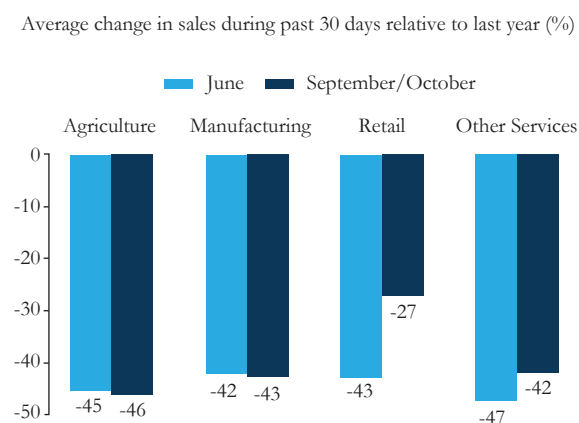
b. Vietnam by firm size



c. Cambodia by sector



d. Vietnam by sector



⁴⁹ World Bank (2020).

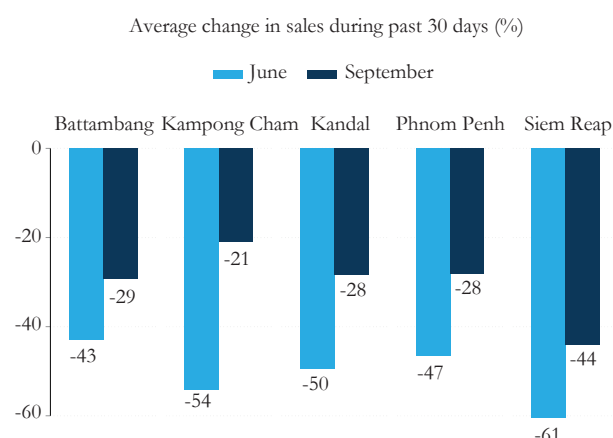
Siem Reap reaching more than 40%, whereas in other Cambodian regions it is around 20-30% (figure S6). Sales recovery has also been slower in Siem Reap than in Phnom Penh, for example (28% versus 41%). This reflects the severity of the global demand shock of tourism—where international arrivals to Cambodia have fallen by 71.9% (year-on-year) during the first eight months of 2020—and Siem Reap’s high dependence on the tourism sector, as home to the famous ruins of Angkor Wat temple complex.

3. Firms face continued operational risks, particularly financing

Beyond closures, firms’ operations can be affected through other channels. These include availability of personnel due to changed circumstances; availability, increased costs or lower quality of inputs due to supply shock-related delays; and access to financing. When firms are faced with large cash flow shortages, the availability of financial services payment deferrals, timely payment, and supplier credit become crucial for firms to continue their operations.

The COVID-19 pandemic continues to affect firms in Cambodia through these various channels. Based on the survey results, a significant share of firms in September reported: i) a shortage in the supply of financial services that are normally available (43%); ii) a decrease in availability of inputs (27%); and iii) a shortage of supplier credit and payment deferrals (22%)—although there has been a slight improvement in these indicators compared to June (figure S7).

Figure S6: Tourism-dependent province of Siem Reap has been hit hardest



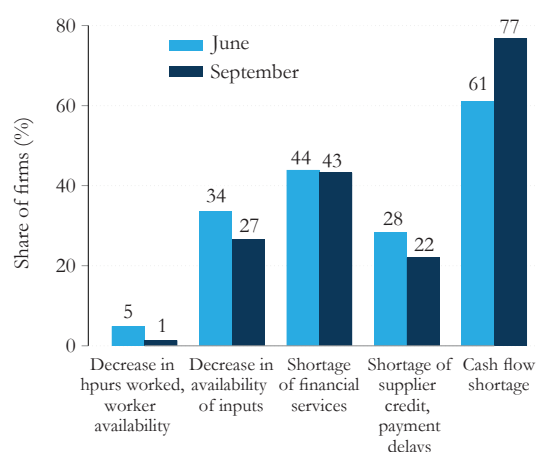
For example, in June 34% of firms reported decreased availability of inputs, compared to 27% in September.

Reduced cash flow is increasingly affecting firms and is expected to worsen in the next months. After months of below normal sales, the share of firms that reports a shortage of cash flow to the extent that it cannot carry out regular operations has risen from 61% in June to a worrying 77% in September. This share is equally high for firms across all size groups as well as for male- and female-owned firms. The share of firms expecting cash flow shortages in the next 6 months has also risen, from 56% in June to 71% in September.

Firms’ risk of falling into arrears—that is, unable to meet payment obligations on time—similarly remains high. Nevertheless, the share of Cambodian firms at risk of falling in arrears in September has reduced. About 34% of firms in June and 25% in September expected to fall in arrears in the next 6 months. This improvement is in line with resumption of business activities and improvement in revenue observed above. Although improving compared to June, the risk of falling into arrears is higher for micro and smaller firms. For example, 29% of micro and small firms reported being in danger of falling into arrears in September, compared to 20% for larger firms.

Cambodian firms are in a comparable position to firms in other countries in the region with regard to risk of default. The share of firms that expected to fall into arrears in Cambodia (34% in

Figure S7: Increasing pressure on cash flow



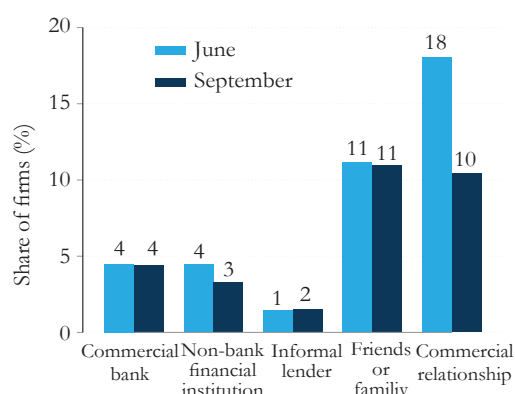
June) was significantly higher than in Indonesia (16% in June), but is similar to Myanmar (36% in May) and below that in Vietnam (48% in June) (table S1).

Table S1: Firms' financial situation in Cambodia is comparable to East Asia

Country	Already in arrears or expected to fall into arrears in the next 6 months
Vietnam (Jun)	48%
Vietnam (Sep/Oct)	43%
Indonesia (Jun)	16%
Cambodia (Jun)	34%
Cambodia (Sep)	25%
Myanmar (May)	36%
Myanmar (Aug)	40%

Formal financial institutions so far have only played a relatively minor role in easing firms' cash flow shortages in Cambodia. Additional financing needed to cope with the COVID-19 impact came mainly from suppliers' credit and payment delays in June, when firms relied on these commercial relationships more than on other forms of financing (18% of firms reported these

Figure S8: Persisting reliance on family and friends as main mechanism to ease cash flow shortages



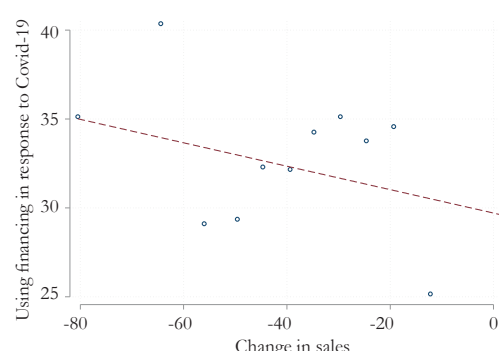
Note: Firms were asked to indicate the main mechanism used to deal with cash flow shortages since the outbreak of COVID-19. Multiple answers were possible. Commercial relationships combine supplier credit and payment delays.

as the main mechanism used to deal with cash flow shortages). This had changed by September, when this share is almost halved (to 10%) (figure S8). Firms do, however, continue to rely on family and friends to bridge cash flow shortages amidst the pandemic (11%), which has remained a stable source of emergency finance.

Moreover, the share of firms using some sort of financing to deal with cash flow shortages has fallen. This decrease—from 34% in June to 26% in September—is mainly driven by the decrease in firms' use of their commercial relationships in the form of supplier credit or payment deferrals mentioned above. While the survey cannot give a definitive answer as to whether this decrease is driven by changes in demand or access to funding, the results show a negative relationship between firms' use of financing in response to COVID-19 and reported changes to sales (figure S9).⁵⁰ That is, firms with a more severe shock to sales are more likely to use financing to ease cash flow shortages.

Overall, larger firms in Cambodia are less likely to use financing and less likely to be in danger of falling in arrears, which is decreasing with firm size. Over half of micro firms are currently using some sort of financing (54%), while this is true for only about a quarter of large firms

Figure S9: Firms with more severe shock to sales are more likely to use financing to ease cash flow shortages



Note: This figure is a binned scatterplot: Dividing the change in sales into 12 bins and plotting the average of change in sales and likelihood of using financing in response to COVID-19 in each bin, controlling for firm fixed effects. It uses the panel of firms who responded in round 1 and round 2.

⁵⁰ While firms' indication of shortages in supplier credit and payment delays might also help in explaining the decrease in usage, it is worth noting that firms using these commercial relationships are also more likely to indicate a shortage, thereof perhaps reflecting perceived difficulties in the process.

(27%) (figure S10). Across all size groups, the use of financing and danger of falling in arrears has fallen slightly between June and September but is still high, especially for micro firms. In June, the share of firms in danger of falling in arrears was ranging from 27% for medium firms to 38% for small firms. By September, it has fallen to 16% for medium firms to 29% for micro and small firms.

4. Firms' coping mechanisms to the shock

Globally, in the face of limited ability to operate and generate revenue, firms are being forced to reduce costs by making adjustments to employment. Firms can make adjustments on the intensive margin by granting leave of absence or reducing wages or working hours, or on the extensive margin by letting go of employees.

In Cambodia, firms have been adjusting by laying off workers and reducing hours or wages. The share of firms laying off workers has

Figure S10: Likelihood of using financing and danger of falling in arrears decreasing with firm size

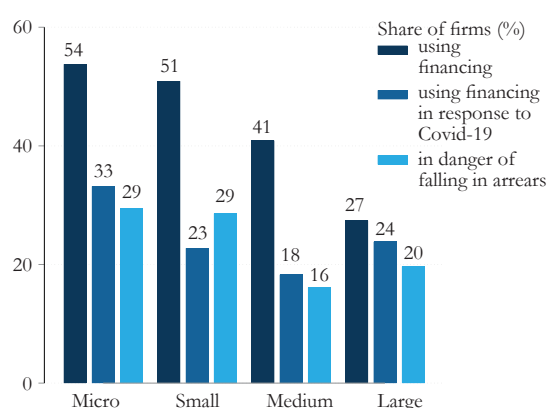
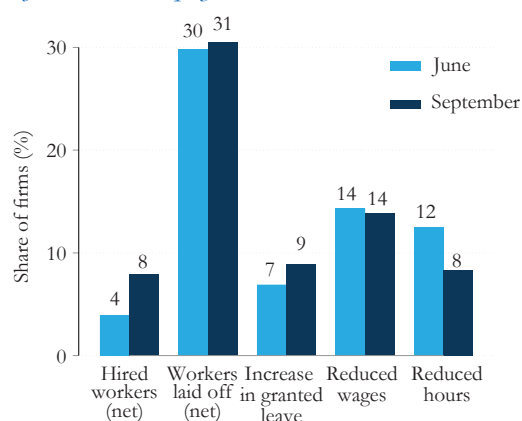


Figure S11: Persisting reliance on family and friends as main mechanism to ease cash flow shortages

a. Adjustments to employment



Note: Firms were asked to report what happened to employment in the 30 days prior to interview.

⁵¹ http://www.xinhuanet.com/english/2020-07/01/c_139180683.htm

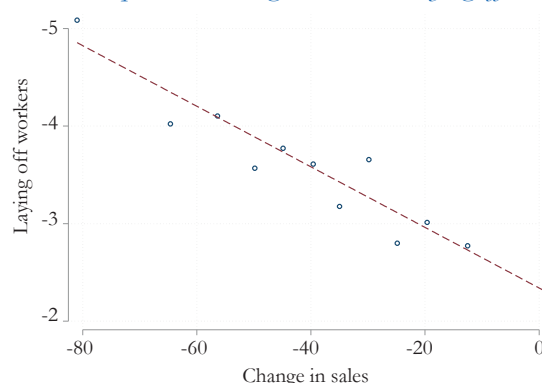
been and continues to be high. About 30% of firms reported reducing the number of employees in the previous 30 days in June and 31% of firms reduced the number of employees in the previous 30 days in September (figure S11, panel a). In comparison, in September, the shares of firms reducing hours or wages were lower than in June at 8-14%.

The decision to implement more permanent measures such as laying off employees compared to more temporary measures such as reducing hours or wages or granting leave of absence can be driven by different factors.

It may reflect firms' perception of the duration of the pandemic and changed circumstances or the severity of liquidity constraints. The latter is indicated by a strong negative relationship between the likelihood of laying off workers and changes to sales (figure S11, panel b). It may also reflect on the flexibility of labor laws and the easiness to hire or fire employees across countries.

The ability of firms to retain workers may also reflect government policy, which in Cambodia focused on providing unemployment benefits for suspended workers. In addition to tourism, the garment, travel goods and footwear sector has also been hit hard by the COVID-19 shock, with exports contracting by 11.5% by August 2020 (year-on-year). The sector employs close to one million workers in Cambodia. In July 2020, about 400 garments, footwear and travel goods factories had suspended their operations, affecting 150,000 workers.⁵¹ As part of a package of emergency intervention measures to manage the impact in

b. Relationship between change in sales and laying off workers



Note: This figure is a binned scatterplot: Dividing the change in sales into 12 bins and plotting the average of change in sales and likelihood of laying off workers in each bin, controlling for firm fixed effects. It uses the panel of firms who responded in round 1 and round 2.

affected sectors and to ensure economic and social stability, the Royal Government of Cambodia introduced unemployment benefits for suspended workers in garment/footwear/travel goods sector of \$70 per month. Of this, \$40 is to be paid by the government and \$30 is paid by the factory.

These findings of the impact of the COVID-19 pandemic on firms are consistent with the results of a high-frequency household survey undertaken in parallel by the World Bank. A survey of households in Cambodia undertaken in May and August of 2020 shows that the share of respondents who were working declined sharply from 82% before the COVID-19 outbreak to 71% in May, and remained relatively unchanged in August at 70% (see box 3 above). The household survey also showed that COVID-19 continues to negatively affect informal non-farm business activities—an important part of Cambodia's economy (see box S2)—albeit less severely compared to the onset of the pandemic. Four in 5 households reported earning less or no revenues in April compared to March, while about 3 in 5

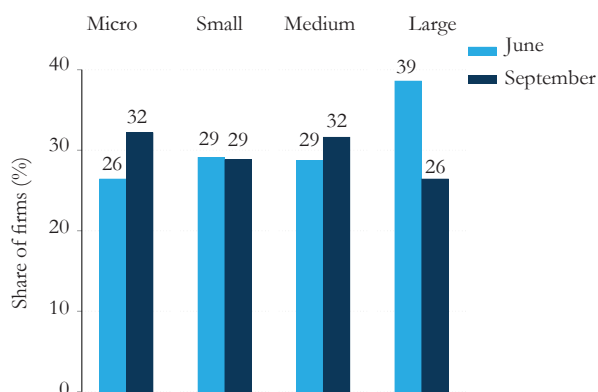
households did so in July compared to June.

There are considerable differences in adjustments to employment across firm sizes—with large firms more likely to lay off workers and MSMEs more likely to reduce working hours or wages or grant leave of absence. In June, 39% of large firms reported laying off workers compared to 26–29% of MSMEs (figure S12, panel a). At the same time, while 25–28% of MSMEs made adjustments at the intensive margin by reducing hours or wages or granting leave of absence, only 15% of large firms did so (figure S12, panel b). By September, these differences had levelled out.

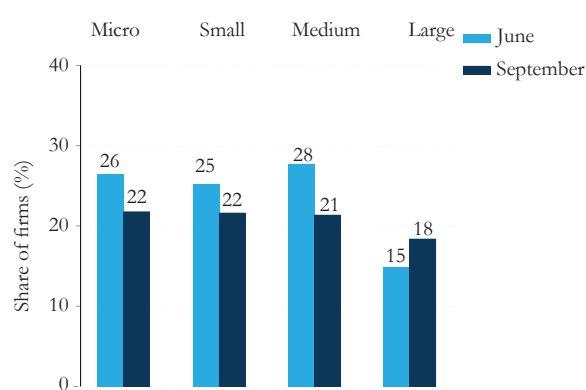
Compared to other countries in the region, employment adjustments in Cambodia have continued to be dominated by the extensive margin (laying off workers) despite improvements in both real and expected revenue shocks. The share of firms that laid off workers in Cambodia in both June and September is only lower than that in the Philippines (figure S13),

Figure S12: Large firms more likely to make adjustments to employment at the extensive margin

a. Adjustments at extensive margin

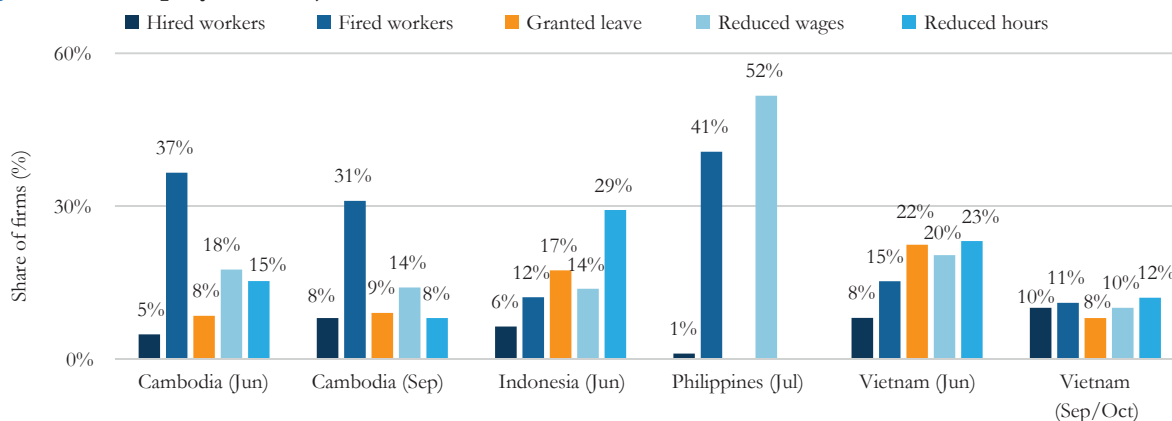


b. Adjustments at intensive margin



Note: Combined indicator of firms using at least one of the following adjustment mechanisms: increase in granting leave of absence, increase in reduced wages, increase in reduced hours.

Figure S13: Employment adjustments differ from firms in East Asia



Note: Employment adjustments refer to the last 30 days prior to the survey (Cambodia, Indonesia and Vietnam). In the case of the Philippines, the change is between July and April, when Enhanced Community Quarantine (ECQ) was adopted.

Importance of non-farm household enterprises in Cambodia

One in 5 Cambodians work in a non-farm household enterprise (nf-HHE). They are the one-man grocery vendors, the tailor shops, women selling grilled meats at the street markets, and motorcycle repair shops by the roads. They are not employees since they work for themselves or family members and they are not growth-oriented firms that are the hoped-for engine of Cambodian growth.

Non-farm household enterprises are a crucial part of the Cambodian economy and labor market. The 1.4 million non-farm micro family businesses provide a range of goods and services that keep the domestic economy moving. They are also the main source of income for 17% of the work force in an economy that is slowly transitioning to modernity.

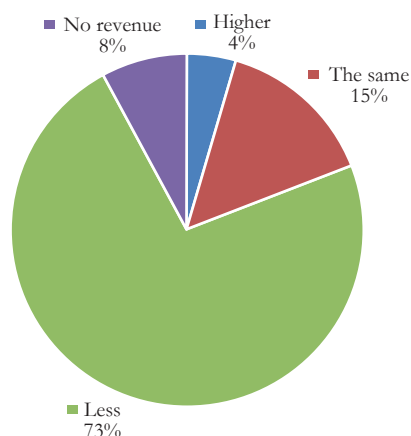
Non-farm household enterprises are found across the country. More than half of urban households own a nf-HHE, as do 23% of rural households. Given the high concentration of the population in rural areas, 60% of nf-HHEs are located in rural areas. They are more concentrated in economic corridors and in wealthier communities, where petty trade and services is the most vibrant.

Non-farm household enterprises are small, young, and concentrated in the retail sector. Half of nf-HHEs only employ the owner; another 51% employ at least one family member. Only 6% employ a non-family worker. Nearly half (47%) are in retail trade, with women owning two-thirds of these small businesses.¹ Another 14% are in the transport sector (20% in urban zones), which is dominated by men. And 14% are in manufacturing, with a slightly higher share in rural zones and among men. Most (96%) nf-HHEs were started by their current owner, and are quite young, with a mean age of 6.9 years and a median age of 4 years (30% are one year or younger). Though those in the manufacturing sector are over a decade old.

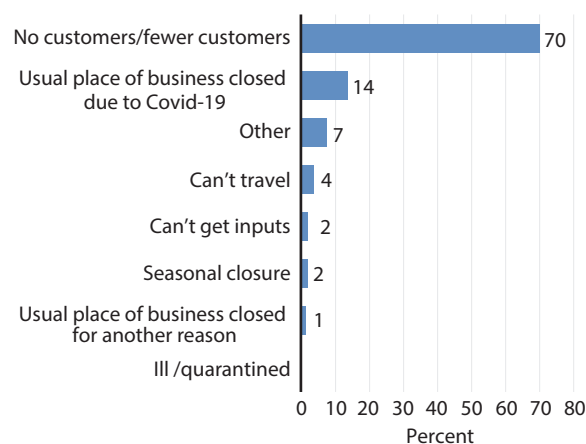
The COVID-19 crisis has highlighted the precarious situation of nf-HHE owners and their exclusion from the larger policy framework.² In May of 2020, 81% of nf-HHE owners reported a reduction in or no income over the previous month, as compared to 62% of family farmers and 63% of employees. Income losses were particularly strong among urban nf-HHE owners (89%), but rural nf-HHEs also disproportionately showed income losses (79%). The finding is consistent across gender of the respondent, education level of the household head, and socio-economic status of the household head. The income loss was attributed to lost customers (70%) and business closure (14%) and was more pronounced for service and industry sectors.

Non-farm family businesses have been seriously affected by the COVID-19 outbreak

a. Change in revenue from business sales compared to last month



b. Reasons for having less or no revenue



Source: Cunningham and Shrestha (2020).

¹ Enterprises that involve physically demanding activities such as transportation, construction, rice milling, repair work are mostly owned or managed by male. Only 38.3% of transportation related enterprises, 28.9% of enterprises engaged in repair and mechanic work, 41.9% construction related enterprises and 48.8% of rice mills are owned by females.

² The COVID-19 survey of households collects basic information about household experiences during the COVID-19 pandemic. The first (of five) survey wave was collected 11-26 May 2020. There were 700 respondents. The sample was slightly more rural (85%) than the general population (74% estimated from the CSES) but nationally representative for gender and poverty level (indicated by IDPoor status).

where firms experienced almost a 60% decline in sales between April and July, one of the highest rate of revenue loss in the region. Cambodia's trend also contrasts with Vietnam, whose firms were less likely to lay off workers, grant leave, or reduce wages and working hours in September/October than in June. The high share of firms firing workers in Cambodia would need to be investigated as it may be explained by a number of reasons, from firms perceiving the shock as more permanent, being less financially prepared to retain workers, less stringent labor regulations, or stronger bargaining power vis a vis the pool of available workers.

How well firms cope with the adverse shocks of the global COVID-19 pandemic will, among other factors, depend on their ability to make other types of adjustments to their business model. Firms may switch to different products or services that are in higher demand (for example, starting to produce medical products) or invest in digital solutions in order to facilitate a less

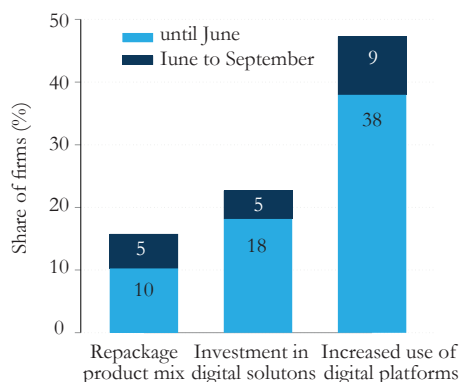
contact-intense environment for employees and customers (for example, through e-Commerce).

In Cambodia, firms' use of digital platforms to conduct business practices increased in response to COVID-19. The share of firms changing to a different product or service since the COVID-19 outbreak was 10% in June, with an additional 5% of firms by September (figure S14, panel a).⁵² By September, 23% of firms reported having made investment in digital solutions and almost half of firms (47%) stated that they had increased the use of digital platforms. While initially the uptake of digital solutions was high (38%), it has slowed down between June and September. Among firms who have increased the use of digital platforms, most did so for marketing and sales purposes (figure S14, panel b).

However, the use of digital solutions has not necessarily translated into significant changes in firms' business model. While the increased use

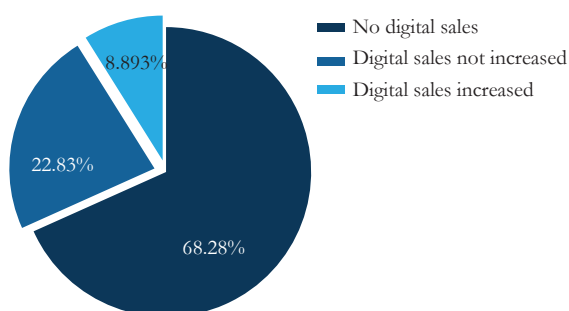
Figure S14: Almost half of firms have increased the use of digital platforms by September

a. Adjustment mechanisms

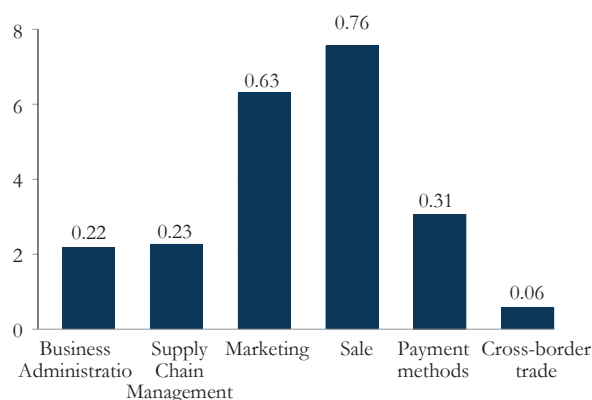


Note: Data from panel sample. Firms were asked to indicate adjustments since the outbreak of COVID-19. Firms making adjustments in September indicate additional adjustments after June. The total height of the bars is the cumulative share from both 1st round and 2nd round surveys.

c. Digital sales

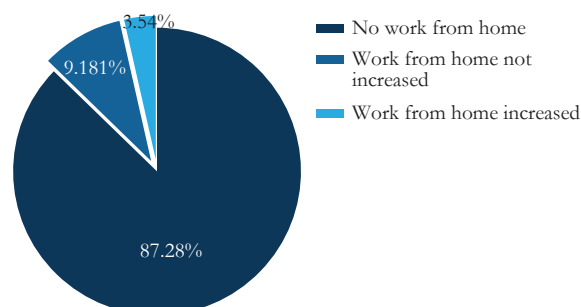


b. Use of digital platforms by business function (September)



Note: Bars represent shares of firms relative to firms who increased the use of digital solutions.

d. Remote work



⁵² The share of firms reporting having switched to new products/services in Cambodia in June is similar to that of firms in Indonesia and Vietnam, but much lower than those in Myanmar (26%) and Philippines (26%) in May and July, respectively.

of digital platforms is one of the key mechanisms to successfully navigate social distancing requirements, it is crucial to understand how well this increase has translated into changes in firms' operations. Around two third of firms report no digital sales, and among those that do report digital sales, the majority did not see an increase in digital sales (figure S14, panel c). Only around 12% of firms reported having at least part of their employees working from home and the majority of these did not increase the share of employees working from home (figure S14, panel d).

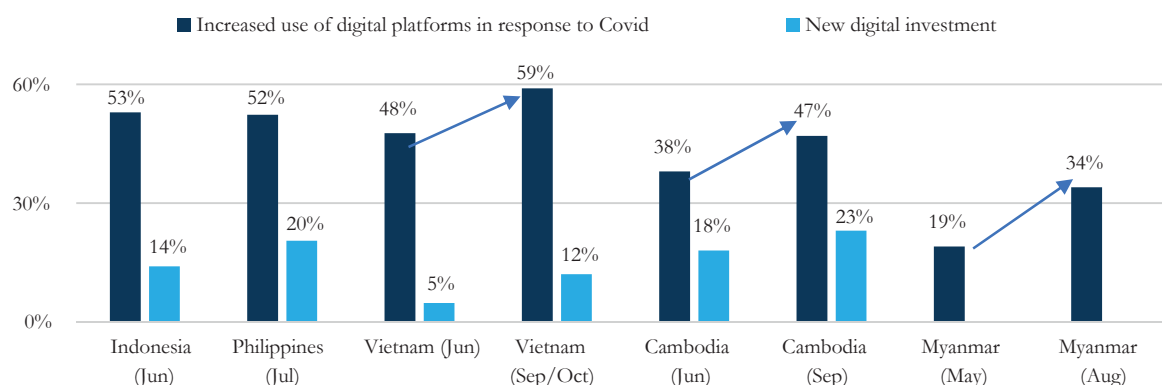
Relative to other countries in the region, Cambodian firms appear to be at a disadvantage in using digital platforms in response to the COVID-19 crisis. Despite an increase in adoption between June and September that has been observed throughout the region, Cambodia still has one of the lowest shares of firms having adopted or increased use of digital platforms, above only Myanmar (figure S15). At the same time, however, Cambodian firms are also more likely to have made a new investment in digital solutions—particularly services firms in wholesale and retail trade—than in most other countries with available data.⁵³ One possible explanation is that Cambodian firms were less digitally ready at baseline, and a substantial share needed to make new investments to start using digital solutions. This confirms earlier evidence of a nascent adoption of digital technologies by firms in Cambodia. For example, in Cambodia, only 24% of firms reported having a website or homepage in 2017, compared to the global median of 47%.⁵⁴

5. Needed policies reported by firms

A variety of policy options are being used by Governments to ease financial pressures on firms and support their ability to conduct their business in the prevailing environment. Options for support policies include subsidies (for salaries or fixed costs), payment deferrals or exemptions (rent, tax, social security), access to finance (investment grants, [subsidized] loans, credit guarantees), government purchases or trade reforms.

The Royal Government of Cambodia has similarly implemented a range of policies to support firms affected by the COVID-19 crisis, in addition to households and workers. These include tax relief for firms in the tourism and garment/footwear/travel goods manufacturing sectors (including exemption from paying healthcare contributions to the National Social Security Fund during operational suspensions); additional capital injection for the Rural Development Bank to support agroprocessing firms; establishment of a new SME Bank designed to support SMEs through co-financing and risk sharing with commercial banks; accelerating the implementation of the Entrepreneurship Development Fund through the establishment of its operational arm Khmer Enterprise and the provision of emergency grants to selected viable SMEs; measures to inject liquidity into the financial sector through the temporary lowering of capital and reserve requirements as well as regulatory forbearance; and measures to improve the ease of doing business and trade facilitation.

Figure S15: Digital adjustments to COVID-19 in East Asia



Note: The share of firms with increased use of digital platforms or making new digital investments in the 2nd round survey in Cambodia and Vietnam is the cumulative share from both 1st round and 2nd round surveys.

⁵³ In Cambodia, 7% of firms in agro-industry, 15% in manufacturing, 31% in wholesale and retail trade, and 27% in other services reported making a new investment in digital solutions in September. Services and agro-industry firms were also more likely to increase use of digital platforms: 55% for wholesale and retail trade, 57% for other services, and 54% for agro-industry compared to 25% for manufacturing.

⁵⁴ World Bank (2018).

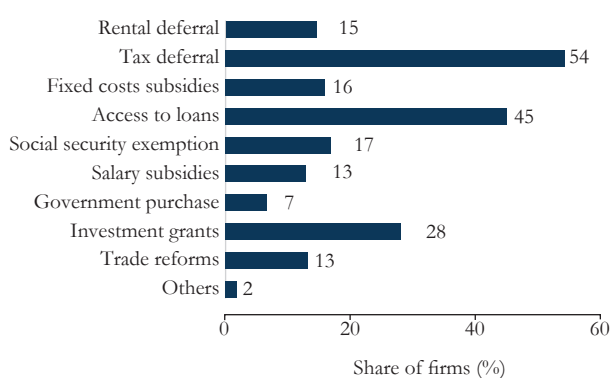
Tax deferrals continue to be the policy most needed by firms in Cambodia, with access to loans and subsidies being also flagged as needed. Fifty four percent of firms chose tax deferral as one of their three most needed policies in September (figure S16). Access to loans, investment grants, fixed cost subsidies and salary subsidies are also needed by significant shares of firms (45%, 28%, 16%, and 13% respectively). It is important to note that while firms across all size groups have expressed a growing need for investment grants, investment grants have not yet been offered as a support measure in reaction to COVID-19.⁵⁵ Other policy measures—such as trade reforms and government purchases—are less likely to be mentioned by firms.

There is a noted mismatch between policy need and the ability to access the policy measures. Tax deferral is the most needed as well as most applied for policy (21% of firms apply for tax deferrals). Demand for loans has diminished slightly in favor of subsidies and grants, but there is a noticeable widening gap between firms' demand versus

government supply in this respect. In September, only 3% of firms had applied for loans, while no firms had applied for investment grants (reflecting government policy towards these types of measures).

This gap is especially pronounced for smaller firms (figure S17). Tax deferrals are popular among all size groups (around 50% to 60% of firms express the need for tax deferrals) but application

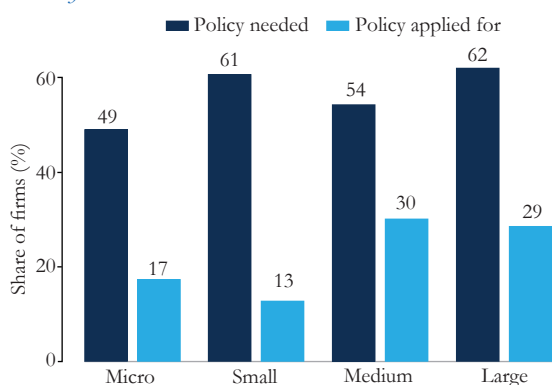
Figure S16: Tax deferral is most needed policy in September



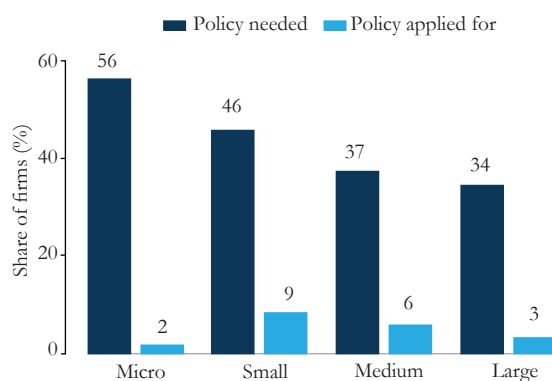
Note: Firms were presented with 10 options and asked to indicate up to 3 most needed policies.

Figure S17: Mismatch between policy need and access

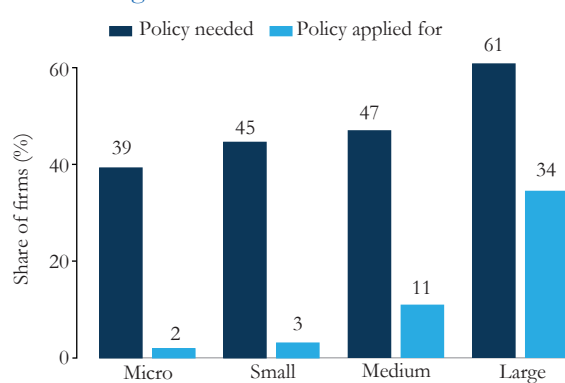
a. Tax deferral



c. Loans



b. Subsidies or grants



Note: This figure shows the total share of firms who were aware of or applied for or benefitted from support policies from the start of COVID-19 until September. It uses the panel of firms who responded to round 1 and round 2. Salaries and grants bundle fixed costs subsidies, salary subsidies, and investment grants.

⁵⁵ The Entrepreneurship Development Fund and its operational branch Khmer Enterprise have piloted two rounds of small grants to around 20 SMEs based on viable business plans that can include working capital and investment.

rates are much lower for micro and small firms (17% and 13%, respectively) than for medium and large firms (30% and 29%, respectively). Larger firms are more likely to need subsidies or grants in the form of fixed cost subsidies, salary subsidies, or investment grants (61% of firms) than MSMEs (39% to 47% of firms) but access is also much higher with 34% of large firms having applied for subsidies or grants but only 2% to 11% of MSMEs. Application rates for loans are low among all firm sizes (below 10%) but the need is higher for smaller firms. More than half of micro firms list loans as their most needed policy but only one third of large firms express the same need.

Access to support policies is similarly not homogeneous across types of firms. The likelihood of being aware of and having applied for support measures decreases with firm size (figure S18). Not only are MSMEs the hardest hit in terms of sales, they are all less likely to be aware of and benefit from government support policies compared to large firms. While 97% of large firms are aware of government measures and 60% have applied for at least one by September, these shares are at only 74% and 30%, respectively, for micro firms. This implies that two thirds of large firms who are aware of support measures have applied for them, but this true for 40% of micro firms.

The finding that access to government support decreases with firm size is not unique to Cambodia. However, unlike other countries in the region, Cambodia has not made improvements in access for MSMEs in the three months between June and September (table S2). For micro and small enterprises in particular, the share of firms applying for or benefitting from government assistance declined between June and September, from 21% to 9% for micro firms and 17% to 13% for small firms. This is in contrast to Myanmar, where overall access to government support has close to doubled between May and August, driven by a marked increase among micro and small sized firms. This is a cause of concerns given the more limited access to finance and higher default risk for MSMEs, as described above.

Table S2: Share of firms applied for or benefited from government assistance falling in Cambodia

Country	Large	Medium	Small	Micro	All firms
Cambodia (Jun)	40%	29%	17%	21%	25%
Cambodia (Sep)	20%	12%	13%	9%	13%
Myanmar (May)	30%	23%	20%	3%	10%
Myanmar (Sep)	34%	18%	24%	14%	17%

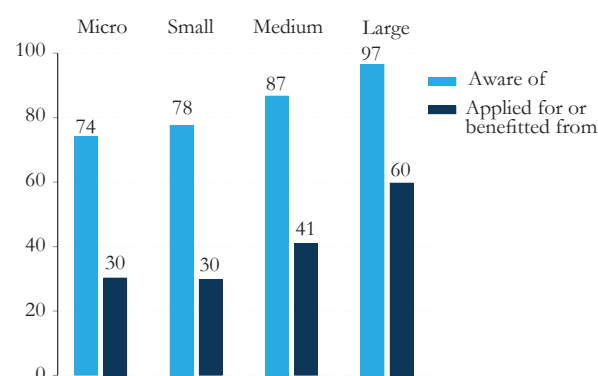
Note: This figure shows the total share of new firms who were aware of or applied for or benefitted from support policies from the start of COVID-19 until September. It uses the panel of firms who responded to round 1 and round 2. In Myanmar, micro are firms with 1-4 employees, small 5-9 employees, medium 20-99 employees, and large 100 or more employees.

An observed gender gap in access to policy measures in June seems to be closing. Female-owned firms were significantly less likely to be aware of or have applied for government measures than male-owned firms in June (21% versus 27%). By September, however, these differences had disappeared.

6. Policy recommendations

Overall, the business pulse survey shows that the economic and social costs of the

Figure S18: Large firms are more likely to be aware of and apply for support policy measures



Note: This figure shows the total share of firms who were aware of or applied for or benefitted from support policies from the start of COVID-19 until September. It uses the panel of firms who responded to round 1 and round 2.

COVID-19 pandemic are being felt widely by firms, and by MSMEs in particular. This is not surprising as MSMEs are the most impacted and can become even more vulnerable as time passes as they are less likely to have capacity to deal with supply shocks (e.g. resources to set up remote work and to adjust production planning) and demand shocks (e.g. less cash on hand to use as cushion). While the survey does not show that female-owned firms are more affected, female workers are more affected as they are over-represented in the informal sector, in the garment and in the tourism industry.

Policymakers will need to adapt the targeting and design of measures and ensure that small and micro firms' needs are adequately addressed. Policy measures must be sufficiently flexible to cover the various segments of firms and adapt their targeting to Cambodia's distribution of enterprises. It is particularly important as Cambodia has a "missing middle," with medium-sized enterprises making up only 1.3% of the roughly 500,000 enterprises covered by the 2011 Economic Census. Cambodian-owned enterprises have not been able to grow beyond micro- and small-sized into competitive medium- and large-sized enterprises, mainly due to a large productivity gap. The COVID-19 will likely further widen this gap unless the government focuses on improving productivity of entrepreneurs and small firms.

The survey also shows that the situation can evolve rapidly, for better or worse, which creates an additional challenge for policymakers in designing emergency and recovery programs. Responses to the Business Pulse Survey have varied significantly between July and September as the situation has improved markedly. At the same time, experience in neighboring countries also shows that the virus can spread again and lead to additional lockdowns that would have a dramatic impact on businesses. In addition, if the transition from crisis to recovery is confirmed, the focus of government policy will need to shift to support adjustments necessary to thrive in a changed world, support job creation and preserve growth-oriented enterprises. This may also involve managing financial restructurings, debt resolutions and bankruptcies. As there may also

be a change in consumer behavior, MSMEs may need support to adjust business models to the post-crisis economic environment, for example by making better use of fintech and e-commerce.

While certain trends may seem clear at present, considerable uncertainty remains about how the post-COVID-19 world will actually look. While the pandemic has accelerated some trends that were already in place (e.g. growing digitalization), there are questions about how long some impact will last (e.g. decline in demand for air travel, hospitality and tourism). Early discovery and widespread distribution of pharmaceutical treatments and/or vaccines for the Coronavirus would hasten global recovery. On the other hand, if a successful global recovery depends on sustained enforcement of mitigation measures across countries, in that case it would likely be more protracted and uneven, raising concerns about international logistics and supply chains.

In this uncertain environment, it becomes critical for the government to build the adequate framework and capacity of its policy delivery tools. Existing policy tools are not designed to deal with external shock such as the COVID-19 pandemic. Policymakers should innovate and adapt their delivery capacity and firm-level support programs to improve the survival chances of viable firms and accelerate the adaptation of firms and sectors with growth potential to the post-COVID-19 economic environment. This requires establishing institutions with transparent processes, effective governance and operational capacity.

Cambodia has started to set up and strengthen several key institutions and programs that can support private sector development. The RGC is notably accelerating the operationalization of several complementary support schemes for enterprises, facilitating access to loans and emergency grants, including notably: the Credit Guarantee Corporation of Cambodia (CGCC), the SME Co-Financing Scheme administered by the Small and Medium Enterprise Bank of Cambodia (SMEBC) and support provided to startups and SMEs by the Enterprise Development Fund and Khmer Enterprise, its operational arm.

Access to finance

Recent policy moves by the government focus on facilitating access to finance for large firms and SMEs.

The RGC has launched a SME Co-Financing Scheme which is administered by the recently established SMEBC. This program aims to provide credits with lower interest rates, equally co-financed by the SMEBC and commercial banks and microfinance institutions. As the SMEBC has been recently established, it has significant institutional building needs to achieve full operationalization. Its objective is to reduce the challenge of access to finance for SMEs, which was a challenge even before the COVID-19 impact due to high risks, collateral requirements, and absence of proper bookkeeping.

The RGC has also decided to establish CGCC.

The CGCC will aim to increase availability of credit to SMEs by reducing credit risks faced by financial institutions, especially in the context of the COVID-19 crisis. The key objective of CGCC is to unlock financing to SMEs through financial institutions by reducing high risk aversion, high collateral requirements and information asymmetries that financial institutions in Cambodia face in lending to SMEs. As part of Government's economic recovery program, the CGCC focus will be to support both SMEs survival during COVID-19 and their recovery and diversification during post-COVID-19 phase.

While policy measures facilitating access to finance are critical, the government must also be mindful that these types of measures may in practice primarily benefit the larger firms and the formal sector.

Support extended by the government in the form of credit injections through soft loans, for example, risks helping large or well-established medium-sized firms disproportionately since these firms can access credit from the banking system, unless governments enforce strict access criteria for SMEs, in particular those that have remained unbanked. To be sure, large firms also play an important role in generating high productivity employment, including in key sectors that typically are export-oriented. But it is important to acknowledge that government support to smooth SME's access to

finance remains important as the deterioration of firm's balance sheets increases the financial sector risk aversion when extending new credit.

Cash injections and incentives to SMEs

Small firms that do not have access to the traditional financial sector (unbanked SMEs) could benefit from grants and cost reductions.

Depending on country context, these can take the form of small cash injections or reprofiling grants. SMEs that have access to the financial sector and/or are integrated into the economy through value chains could benefit from export development or supplier development programs. Larger firms can be encouraged to support MSMEs along their supply chain, for example through incentivizing partnerships with domestic suppliers via a mix of matching grants, credit lines, credit guarantees and reduced or delayed import tariffs.

Looking forward, in the post-COVID-19 recovery environment, re-purposing production lines and modes of delivery, adapting to new markets, and investing in innovation will be greatly needed, but this involves substantial risk and investment.

To produce and export new products, to adapt to new market, or to do both, firms have to identify the right target market, product segment, and selling channel; adapt their products; launch marketing and selling campaign; hire new workers to be ready for the job; and obtain necessary quality and standards certification. These activities require significant investments with uncertain outcomes and thus are often not financed from traditional financing sources such as commercial banks.

Considering this challenge, several countries are implementing matching grant programs for firms to improve their productive capabilities and accelerate the process of economic recovery.

Under this type of program, firms identified as having viable investment plans can benefit from matching grants to reimburse part of the costs linked to investments. This includes both the soft (technical assistance on technical skills, managerial skills, compliance with international standards, etc.) and hard (procurement of machinery, equipment, etc.) recommendations of a business diagnostic. The matching grants

Social protection / policy for the non-farm household enterprise

Non-farm household enterprises are largely labor in the policy shadows, and the COVID-19 crisis has highlighted their exclusion from the larger policy framework. Three pillars of policy are necessary to nourish, grow, and protect the household entrepreneurs:

Nourish: Policies and interventions to improve productivity of the vast majority of household enterprises.

Not all businesses aspire to or have the ability to become a source of jobs for others. However, interventions can be targeted to increasing their productivity. Analysis shows potential success of interventions include those that teach higher-order socio-emotional skills, entrepreneurial mindset, better business practices, mobile and digital technologies for productive use, and of interventions that connect to markets and higher value chains.

Care needs to be taken to deliver the interventions in a manner and form suitable to the entrepreneurs. For instance, regular classroom-based training for several weeks may not be feasible as it leads to loss of income as well as time away from care and household activities that the business owners often multi-task from. Additional incentives may also be required to make training attractive to them.

Grow: To identify high growth potential entrepreneurs and help them grow.

There could be some potential entrepreneurs that could have the potential to grow rapidly if given appropriate financial and non-financial support. Many evaluations of micro-credit and related support programs have found that financial and non-financial support can really drive these ‘gung-ho’ entrepreneurs in a virtuous cycle of growth. However, these ‘gung-ho’ entrepreneurs are hard to identify ex-ante. Having an eco-system where capable microentrepreneurs can select into and compete for large cash grants and business development support could be one potential way.

Protect: Policies to provide adequate protection to the microentrepreneurs

COVID-19 has shown the vulnerability of these nf-HHE owners as they are one of the worst hit subgroups with their incomes plunging down. They do not have social insurance to protect them during difficult times; they typically would not qualify for social assistance as they are doing well under the normal circumstances. Policy options could be:

- Protection against idiosyncratic shocks: extending social insurance coverage to the informal sector; incentivizing nf-HHEs to participate in such a social insurance scheme;
- Protection against aggregate correlated shocks: expanding the social registry (IDP registry) to cover a greater share of people with detailed information on income and employment sources; introducing adaptive social protection programs that provides social assistance to those affected by large scale crisis (eg. nf-HHEs during COVID-19).

Source: Cunningham and Shrestha (2020).

phase of the program can be complemented by a match-making program in which firms can be connected with financial institutions in putting up their matching contribution.

Supporting micro-firms

Single owners and very small firms (i.e. less than 5 employees), which account for the majority of jobs, are usually best targeted through social protection, one-time grants, microfinance and Fintech solutions.⁵⁶ The informal sector dominates non-agricultural employment. The vast majority of informal businesses have few or no paid employees, low productivity, are not linked to the formal economy except through utility and rent payments and are highly dependent on social networks and community-based financing. One-time grants can be used but should not be contingent on formalization for tax purposes, in which case pickup would be limited. Leveraging fintech instruments or non-traditional marketplaces to provide liquidity to informal players and micro-small firms may provide new access to finance opportunities. (See box S3 for a discussion of policies that more broadly support development of the non-farm household enterprise sector.)

Bankruptcy, insolvency and the business environment

Finally, Cambodia could further accelerate the reform of its business environment. Cambodia lags behind peers in terms of the ease of doing business. Areas of particular room for improvement include enforcing contracts, resolving insolvency, dealing with construction permits, registering property, and protecting minority investors. The investment climate can also be strengthened further by ensuring investor protection. With the right incentives in place, this could also support the country to tap into foreign knowledge and facilitate productivity spillovers.

In order to effectively implement a cross-cutting business environment and investment climate reform agenda spanning multiple authorities and ministries, it will be crucial that a coordination mechanism is in place to ensure that all agencies are working together towards the same goals. Considering the urgency, it is also important that there is a designated reform champion with political leverage to ensure the reforms are implemented.

Revisiting the bankruptcy and insolvency procedures may become a priority. The deterioration of assets will increase the risk of insolvency for many firms, with negative implications on credit markets, supply chains, and worker productivity which will dissipate only gradually. The government can prepare for recovery by creating enabling environments to restructure debt and firms, including through strengthening insolvency and resolution and legal frameworks for corporate and consumer debt restructuring, and out-of-court conciliation and resolution measures. The latter will be particularly important to prevent a surge in insolvency, value-destroying liquidations and asset fire-sales, helping to preserve employment.

In conclusion, government policies to support firms can follow several options that are not mutually exclusive and can be implemented in phases. Options presented above cover a wide array of financing instruments, such as the provisions of soft loans, credit guarantees, small grants or matching grants for encouraging MSMEs survival and investment to adapt to the post-COVID-19 environment. They are conditioned by Cambodia's fiscal space to address the impact of the crisis on the private sector. They are also conditioned by the timing of the economic crisis and capacity of government and institutional stakeholders to deliver effectively the support program.

⁵⁶ This is a subset of micro firms in Cambodia, which is classified as less than 10 employees.

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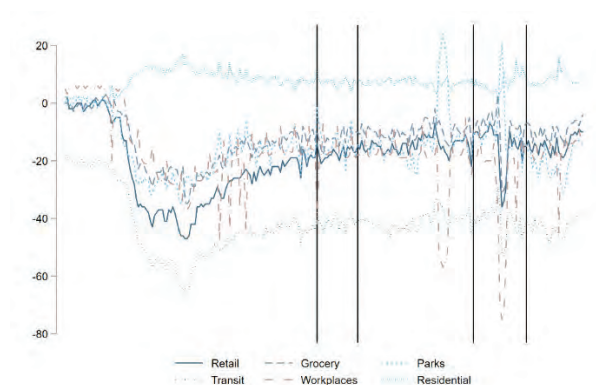
Appendix

Table A.S1: Sample distribution

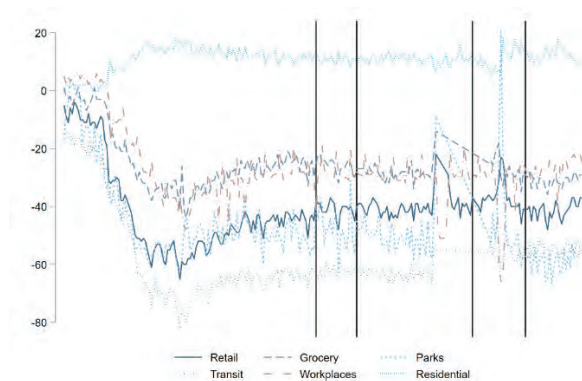
	Micro	Small	Medium	Large
Battambang	3.80%	2.66%	1.99%	0.85%
Kampong Cham	2.47%	1.99%	1.33%	0.95%
Kandal	1.71%	1.14%	0.85%	1.23%
Phnom Penh	23.06%	12.43%	12.24%	11.39%
Siem Reap	7.87%	4.36%	4.27%	3.42%

Figure A.S1: Google mobility trends in Siem Reap have not recovered compared to Cambodia

a. Cambodia



a. Siem Reap



Source: COVID-19 Community Mobility Reports.

Annex. Cambodia's key indicators

	2017	2018	2019e	2020p	2021f	2022f
Output and Economic Growth						
Real GDP growth, at constant market prices (annual %)	7.0	7.5	7.1	-2.0	4.0	5.2
Private Consumption	3.7	3.0	7.0	-1.4	3.4	4.7
Government Consumption	23.5	5.1	10.0	6.7	8.6	5.8
Gross Fixed Capital Investment	6.1	6.1	6.9	6.3	6.1	7.1
Exports, Goods and Services	5.3	5.3	7.8	-12.6	5.4	5.4
Imports, Goods and Services	4.1	4.1	6.0	-8.9	5.5	5.4
Real GDP growth, at constant factor prices (annual %)	6.8	7.4	6.8	-2.0	4.0	5.2
Agriculture	1.7	1.1	-0.5	1.5	0.9	1.0
Industry	9.7	11.6	11.3	-1.2	6.9	7.1
Services	7.0	6.8	6.2	-4.3	2.6	5.1
Money and Prices						
Inflation, consumer prices (annual %, period average)	3.3	3.1	3.2	3.0	2.5	2.5
Broad money (% of GDP)	88.2	100.7	107.7	111.6	126.1	145.0
Domestic bank credit to private sector (% of GDP)	86.4	99.4	114.2	123.3	132.0	140.0
Nominal Exchange Rate (local currency per US\$)	4,062	4,067	4,070	4,100	4,090	4,080
Nominal Effective Exchange Rate (annual %, incr = appr)	0.0	-0.8	1.1	-0.1	0.3	0.3
Real Effective Exchange Rate (annual %, incr = appr)	1.3	-3.4	-0.1	0.5	0.5	-0.1
Short-term interest rate (% p.a.)	11.7	9.7	9.5	9.3	9.0	9.0
Fiscal						
Revenue (% of GDP)	21.9	23.8	26.3	18.8	18.6	20.8
Expenditure (% of GDP)	22.7	23.4	25.5	24.4	24.6	24.4
Overall Fiscal Balance (% of GDP)	-0.8	0.4	0.8	-5.6	-6.1	-3.5
Primary Fiscal Balance (% of GDP)	-0.4	0.8	1.2	-5.1	-5.6	-3.0
General Government Debt (% of GDP)	30.3	30.0	29.0	31.6	32.0	32.7
External Accounts						
Exports, GNFS (nominal US\$, annual %)	9.4	12.3	9.5	-18.5	8.0	9.0
Imports, GNFS (nominal US\$, annual %)	7.8	9.3	9.0	-17.8	7.1	8.1
Current account balance (current US\$ millions)	-2,140.5	-2,180.1	-2,703.9	-3,477.2	-3,814.1	-3,890.5
Current account balance (% of GDP)	-9.7	-8.9	-10.0	-12.8	-13.1	-12.4
Foreign direct investment, net inflows (current US\$ millions)	2,673.1	3,088.8	3,561.0	2,092.1	3,040.8	2,981.3
Gross international reserves (US\$ million)	12,200.6	14,629.1	18,763.3	19,291.2	19,169.4	18,949.4
(prospective months of imports)	7.0	7.0	10.0	10.0	9.0	9.0
Memo: Nominal GDP (US\$ millions)	22,114.9	24,476.1	27,030.5	27,135.4	29,128.2	31,420.7
GDP per capita (US\$, nominal)	1,376.1	1,500.5	1,633.2	1,616.7	1,712.1	1,822.9
GNI per capita, Atlas method (current US\$)	1,230.0	1,380.0	1,480.0			

Sources: Cambodian authorities; and World Bank staff estimates and projections.

Note: e = estimates; f = forecast; p = projection. GNFS = Goods and Non-Factor Services.

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