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# MACROECONOMIC AND SECTORAL EFFECTS: Long-Term Constraint and Transition to the New Normal

SEAN MONORITH



Working Paper on COVID-19 Series No. 03  
MARCH 2023



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# **Macroeconomic and Sectoral Effects: Long-term Constraint and Transition to the New Normal**

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**CDRI – Cambodia Development Resource Institute**

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ISBN-13: 978-9924-500-44-5

**Citation:**

Sean Monorith. 2023. *Macroeconomic and Sectoral Effects: Long-term Constraint and Transition to the New Normal*. CDRI Working Paper on COVID-19 Series No. 03. Phnom Penh: CDRI.

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## Table of Contents

List of box, figures and tables .....	ii
Acknowledgements .....	iii
Acronyms and abbreviations .....	iii
Executive summary.....	iv
1. An overview of the pre-pandemic macroeconomic situation .....	1
2. Macroeconomic performance and Covid-19 shock .....	2
2.1. Potential transmission channel.....	2
2.2. Macroeconomic impact .....	3
2.2.1. Industry .....	6
2.2.2. Social impact.....	11
2.2.3. Financial sector .....	13
2.2.4. Fiscal performance .....	14
2.2.5. Government responses to the pandemic.....	16
3. Cambodia in the post-pandemic and policy direction .....	17
3.1. Post-pandemic recovery plan .....	17
3.2. Medium- and Long-term Policy Direction .....	19
4. Conclusion .....	20
References .....	21

## List of box, figures and tables

Box	1: Cambodia’s Selected High-Frequency Indicators.....	5
Figure	1: Potential transmission channel Impact of Covid-19 on Cambodia’s economy .....	2
Figure	2: Contribution to growth of GDP by sector (2015-2021).....	4
Figure	3: International Tourists .....	6
Figure	4: Domestic Tourists.....	6
Figure	5: Contribution to growth of garment export by destination.....	8
Figure	6: Growth of garment material imports.....	8
Figure	7: Project approvals by types of construction .....	9
Figure	8: Import of construction material .....	9
Figure	9: Average quoted sale price .....	10
Figure	10: Average quoted rental price .....	10
Figure	11: Number of residential properties sold (unit).....	10
Figure	12: People’s mobility to retail.....	10
Figure	13: Average rental price of retail mall space in Phnom Penh .....	10
Figure	14: Unemployment and poverty rate (2010-2020) .....	12
Figure	15: Current revenue performance .....	15
Figure	16: Fiscal position .....	15
Figure	17: External public debt.....	16
Figure	18: Real GDP projection (before and after Covid-19).....	17
Figure	19: Three-pronged approaches of post-pandemic recovery plan .....	18
Table	1: Credits provided by financial institutions .....	14
Table	2: Financial soundness indicators .....	14
Table	3: Intervention package budget (2020-2023) .....	18

## Acknowledgements

This research on the macroeconomic and sectoral effects of the Covid-19 pandemic is part of a project titled Strengthening Cambodia's Post-Pandemic Recovery and Competitiveness Pathways funded by the Swedish International Development Agency (Sida). The author is profoundly thankful to Sida for supporting this research. The author is grateful to Mrs Sem Sophea, Deputy Director General of the General Department of Policy, Ministry of Economy and Finance, for her valuable contributions to the enhancement of this research report. Lastly, the author would like to thank individuals whose names are not listed here but who directly and indirectly provided assistance for this research report.

## Acronyms and abbreviations

GDP	Gross domestic product
CSPPro	Census and Survey Processing System
UNIDO	United Nations Industrial Development Organisation
VAT	Value-added tax
ARDB	Agricultural and Rural Development Bank
CCB	Capital Conservation Buffer
CRA	Cambodia Restaurant Association
FDI	Foreign Direct Investment
FTA	Free Trade Agreement
GDP	Gross Domestic product
MEF	Ministry of Economy and Finance
MFI	Microfinance Institution
MLMUC	Ministry of Land Management and Urbanization and Construction
MLVT	Ministry of Labour and Vocational Training
MoT	Ministry of Tourism
NBC	National Bank of Cambodia
NPL	Non-Performing Loan
PPAP	Phnom Penh Autonomous Port
PPP	Public Private Project
RGC	Royal Government of Cambodia
RMS	Revenue Mobilization Strategy
SME	Small Medium Enterprise

## **Executive summary**

Cambodia's economy has made significant progress over the decades. However, the smooth and robust developments were significantly disturbed in 2020 with the arrival of the global Covid-19 pandemic. Globally, both internal and external demands, FDI flows, the movement of goods, and travel were all severely impacted by governments increasingly imposing lockdowns and other restrictions to contain the spread of the unprecedented and deadly disease.

From an economic standpoint, sectors that are high-contact including tourism, textile and apparel, construction, and real estate as well as other service-related sectors, suffered severely due to the pandemic. The GDP growth has plunged to a 20-year historic low of -3.1% in 2020 compared to the average of 7% growth rate over the same period. Many businesses were forced to suspend operations or shut down while many employees were either laid off or had to work fewer hours. As a result, the unemployment rate rose to 2.4% in 2020, which is a significant departure from the unemployment rate over the past decade (between 0.1% and 0.3%). As many as 83% of households reported having received less income during the peak of the impact, and the poverty rate surged to 17.8% in 2020 after having dropped to less than 10% before the pandemic.

However, the economic impacts could have been much more severe, causing more scarring, had it not been for interventions from the government and central bank that implemented fiscal policy, monetary policy, and other unprecedented measures to counteract the pandemic's impact. In fact, fiscal deficit was widened significantly both in 2020 and 2021 because of higher fiscal spending and lower revenue generation due to tax relief measures helping businesses stay afloat and individuals maintain their livelihood. The monetary measures implanted included the maintenance of the capital conservation buffer at 50%, loan restructuring, and other flexible measures were introduced to help relieve the impacts of pandemic. Even though the initial shock of Covid-19 gradually faded out, its social and economic impacts are long-lasting. Therefore, further policy developments will play a crucial role in bringing Cambodia's economic growth back to its potential.

The following sections will briefly discuss Cambodia's macroeconomic performance before the Covid-19 pandemic, and then describe the impacts of Covid-19 on various aspects including economic sectors, society, financial sector and fiscal position. Finally, the chapter concludes with a description of policy directions put forth by the Royal Government of Cambodia (RGC) both during and after the pandemic.



## 1. An overview of the pre-pandemic macroeconomic situation

Over the last two decades, Cambodia has achieved a remarkably high and stable economic growth with an average annual growth of 7.7% (2000-2019) [1]. The country's robust growth was underpinned by a strong performance of manufacturing exports, mainly garment products, that emerged in the mid-1990s after the restoration of peace and the resumption of normalized political and economic relations with the global community. The United States (US) and the European Union (EU) have been the largest garment export market destinations accounting for 32% and 31% of Cambodia's garment exports in 2019, respectively. Taking advantage of political and macroeconomic stability, Cambodia has become one of the most attractive places for foreign direct investment (FDI). In 2019, foreign investment capital accumulated to almost \$3.4 billion, which was approximately 4 times that of 2010 [2]. The majority of FDI came from China, which accounted for 50% of the total FDI<sup>1</sup> of which investment in manufacturing accounted for 21%<sup>2</sup>. Besides stimulating the manufacturing sector, FDI has also played a significant role in promoting both the construction and real estate sectors, which accounted for 15% of total FDI and are two of the key growth drivers largely financed by the influx of foreign capital. Additionally, Cambodia has also benefited from its robust tourism sector, with its abundant natural resources and historical heritage, and has received around 6.6 million international tourists that generated almost US\$ 5 billion in revenue in 2019 [3].

Alongside remarkable economic growth, socioeconomic metrics, like the poverty rate, income inequality, and living conditions, have also significantly improved over the last two decades. In 2019, the textile and apparel sector alone employed more than 700,000 workers [4], and the tourism sector also created more than 620,000 jobs, both directly and indirectly [5]. Given the long-standing economic growth and rise in decent employment, living conditions have significantly improved. The average household's monthly disposable income substantially increased from KHR 871 thousand (\$218) in 2011 to KHR 1,947 thousand (\$486) in 2017<sup>3</sup>. As a result, the poverty rate has noticeably reduced over the last decade from 53.2% in 2004 down to 9.4% in 2017. The unemployment rate has been relatively low compared to countries in the macro-region with just 0.1% of the total labour force unemployed in 2017 [6].

Cambodia's strong fiscal performance has also substantially benefited from the effective implementation of the Revenue Mobilization Strategy (RMS) 2014-2018 and on-going structural reforms. Specifically, revenue collection surged from 16.4% of GDP (KHR 11,028 billion) to 25.1% of GDP (KHR 27,609 billion), which was roughly 8.7%

---

1 China here includes China mainland, Hong Kong Special Administrative Region, Macao Special Administrative Region, and Taiwan

2 Manufacturing here includes beverages, footwear, garments, bags, packaging, petroleum, tobacco, wood processing, solar manufacturing, food processing and other manufacturing

3 Exchange rate is 4000 Khmer Riel/USD

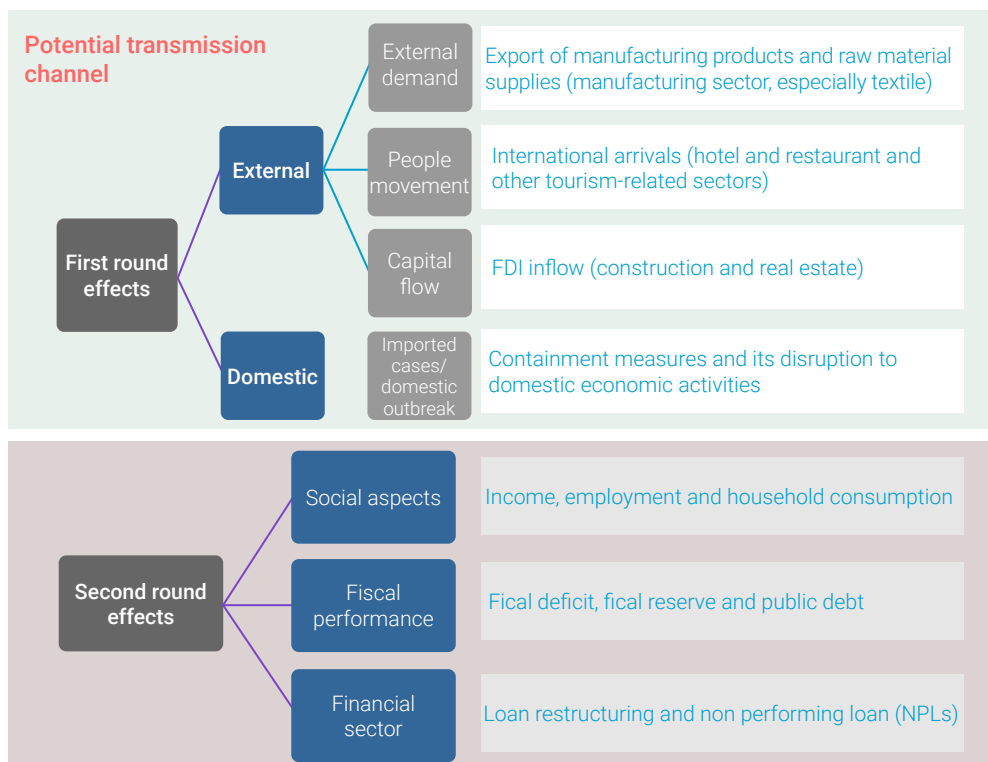
increase between 2014 and 2019. In line with revenue collection, expenditure has also consistently increased due to both the implementation of public administration reform programs and efforts to sustain high economic growth. Government expenditure, including current and capital expenditure, surged from 21.1% of GDP (KHR 14,215 billion) to 26.1% of GDP (KHR 28,677 billion) between 2014 and 2019. The overall fiscal deficit was approximately 3.2% of GDP on average during this period.

## 2. Macroeconomic performance and Covid-19 shock

### 2.1. Potential transmission channel

Being a small and open economy, Cambodia has been hit on several fronts by the pandemic. The effects of Covid-19 have been diffused largely through a few key transmission channels in the first-round effects: external demand (export and import), tourism, and FDI. In addition to the impacts on economic sectors, the pandemic has also created second-round effects, namely impacts on society, fiscal performance, and financial sector.

Figure 1: Potential transmission channel Impact of Covid-19 on Cambodia’s economy



Source: Author’s diagram

The unprecedented drop in external demand has strongly affected Cambodia's exports, particularly textile and apparel products, including garments, footwear, shoes, and bags. In addition, since Cambodia is also an importer of production materials, the supply chain disruptions caused by the pandemic have also affected the country's imports (intermediate goods for production). As a result, the collapse of global trade, especially in 2020, significantly dampened Cambodia's outlook in both direct and indirect channels.

The sudden drop in people's movement caused by the measures governments took during the pandemic has also affected Cambodia's tourism sector. Cambodia has been heavily reliant on tourists from East Asia, especially China which accounted for 36% of international arrivals in 2019. Furthermore, other tourism-related sectors, like transport and other services have also fundamentally suffered.

The outbreak of Covid-19 has darkened the investment sentiment around the globe causing slower FDI inflows. The construction sector, largely financed by FDI, was significantly impacted especially in 2020. The China region, which includes Hong Kong SAR, China, Taiwan, and China MSAR, accounted for almost 50% of total FDI inflows into Cambodia in 2019. The majority of Chinese FDI has been centered on construction.

Along with the potential impacts on key sectors, restrictions imposed in 2020 and particularly in the aftermath of the 20<sup>th</sup> February 2021 event (when the government initiated a complete lockdown in Phnom Penh, partial lockdown in other provinces, and a curfew among other administrative measures), have also put pressure on domestic economic activities, including wholesale and retail activities as well as real estate, transportation, and other local businesses.

The negative economic impact of government restrictions on key industrial sectors, especially tourism and textiles and apparel, has caused negative social effects as well, particularly regarding employment and consumption. Vulnerable groups, including poor and near-poor families, have been severely impacted. The sudden drop in income has since led to a feedback loop within the financial sector through debt repayment (macro-financial linkages). In addition, the collapse of industry also affected fiscal balance resulting in revenue shortfalls and expenditure pressures.

## **2.2. Macroeconomic impact**

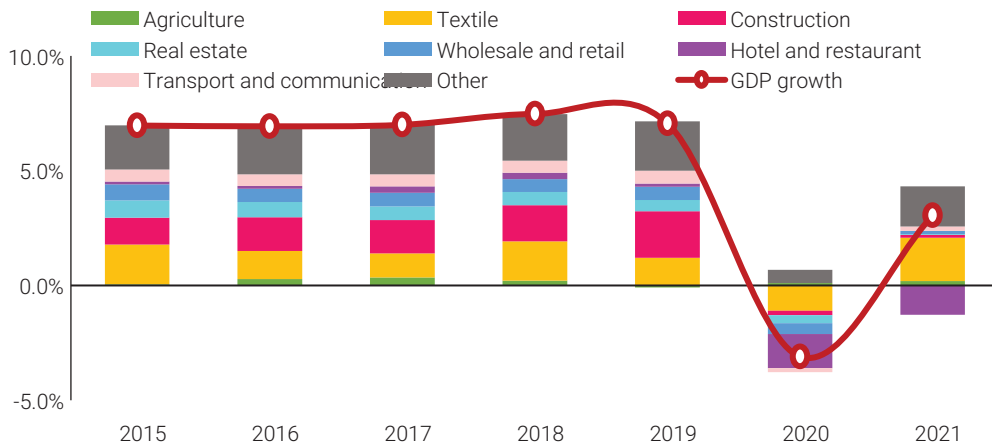
The Covid-19 shock curbed Cambodia's path of growth as potential opportunities were severely disrupted. As a result, in 2020, the economic growth rate has plunged to an historic low of -3.1% from its prior average of 7% (see Figure 2). Most of the disruption was due to the external environment, namely global supply disruptions including material supplies, an unprecedented drop in global demand, and a sharp decline in people's movement and investment propensity. In 2020, total merchandise exports dropped by 1.1% amounting to US\$ 14.2 billion (down from US\$ 14.4 billion in 2019)

#### 4 | Macroeconomic and Sectoral Effects: Long-term Constraint and Transition to the New Normal

mainly due to an unprecedented decline in garment exports. In addition, total imports declined by 10.0% and amounted to US\$ 18.1 billion—a significant drop from US\$ 20.1 billion in 2019—mainly due to low supplies of intermediate goods and durable goods caused by the supply chain disruption<sup>4</sup>. Compared to 2019 where FDI amounted to US\$ 3.62 billion, FDI dropped by 1.0% amounting to US\$ 3.62 billion and reflecting a loss of investment confidence. Travel also slowed due to the fear of catching and/or spreading the virus by traveling and the containment measures imposed by governments around the world. International arrivals to Cambodia dropped by 80.2% (see Box 1). As a result, key externally driven sectors such as textiles, construction, real estate, and tourism all witnessed negative growth.

In 2021, the economy gradually rebounded with a growth rate of 3.0%. Despite showing signs of recovery, the economy was still dampened by the prolonged pandemic effects largely caused by a domestic outbreak and the emergence of the new Covid-19 variants, Delta and Omicron. The tighter health and administrative measures continued to disrupt domestic economic activities, especially tourism-related sectors which include transportation as well as wholesale and retail trade (see Box 1). However, the situation external to Cambodia's economy has recovered faster than initially expected and has encouraged the rebound of the manufacturing sector.

Figure 2: Contribution to growth of GDP by sector (2015-2021)

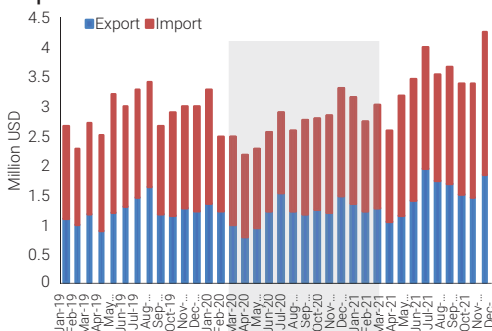


Source: National Institute of Statistics (NIS)

<sup>4</sup> Intermediate goods consist of construction materials and garment materials. Durable goods here mostly cover total vehicle imports, such as motorcycle, car, bus, truck and other vehicles.

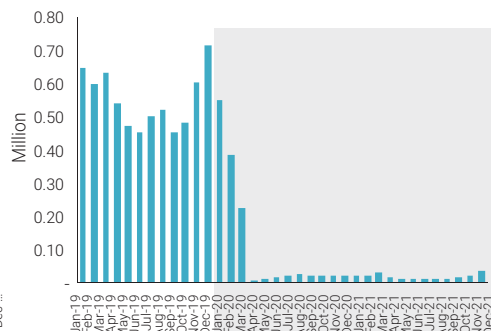
### Box 1: Cambodia's Selected High-Frequency Indicators

**Figure A: Total merchandise exports and imports**



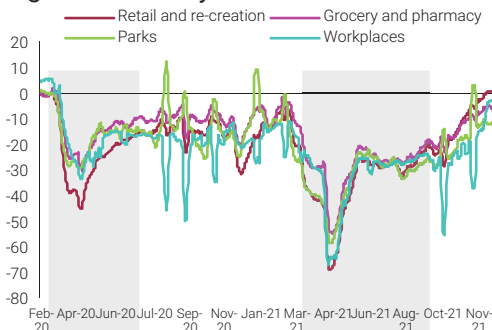
Source: Ministry of Economy and Finance (MEF)

**Figure B: Number of international arrivals**



Source: Ministry of Tourism (MoT)

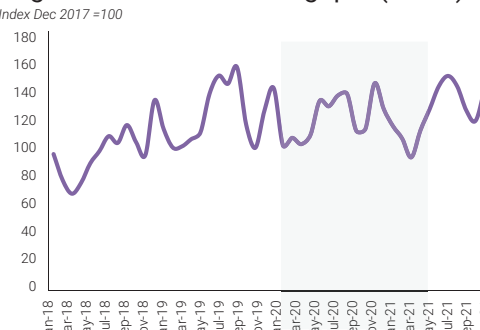
**Figure C: Mobility tracker for Cambodia**



Source: Google mobility data

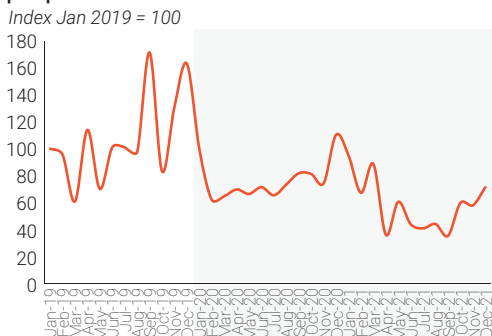
Note: The data in the negative territory indicates a drop in people's movement compared to Baseline (0). The baseline day is the median value from the 5-week period Jan 3 – Feb 6, 2020, pre-Covid-19 period.

**Figure D: Container throughput (PPAP)**



Source: Phnom Penh Autonomous Port (PPAP) and Calculation

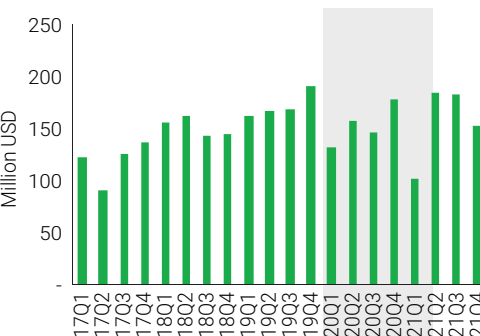
**Figure E: Number of residential properties sold**



Source: Regulator of Real Estate Business and Pawnshop and calculation

Note: Residential sold here includes a flat, a villa, and a condominium. Residential sold is covered only projects that have been licensed by the regulator.

**Figure F: FDI inflow to construction and real estate sector**



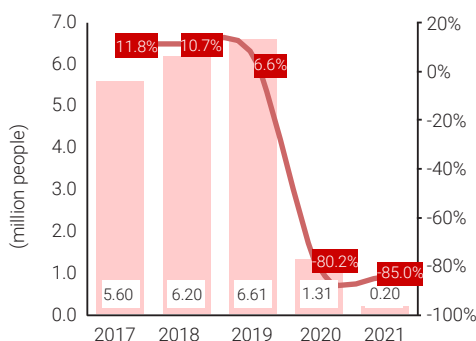
Source: National Bank of Cambodia (NBC)

## 2.2.1. Industry

### Tourism sector

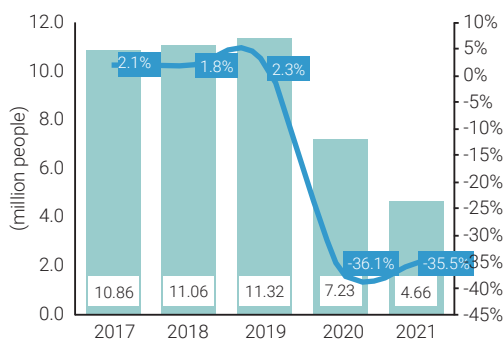
The tourism sector has been one of the hardest hit sectors. Globally, Covid-19 has had a catastrophic effect on the tourism sectors of developing countries like Cambodia. In 2020, due to the worldwide spread of Covid-19, international tourist arrivals in Cambodia declined dramatically by 80.2% in 2020 almost coming to a halt in April 2020, which represents a drastic change compared to 2019 when the growth rate was 6.6% (see Figure 3). Meanwhile, domestic tourism also experienced negative growth of 36.1% due to travel restrictions to curb the spread of Covid-19 as well as the decline of tourists' traveling confidence, and this was a marked contrast to the increase of 2.3% in 2019 (see Figure 4).

Figure 3: International Tourists



Source: Ministry of Tourism (MoT)

Figure 4: Domestic Tourists



Source: Ministry of Tourism (MoT)

Since international travel stopped almost entirely in March 2020, many small businesses permanently shut down because they could not sustain their operations. According to the Ministry of Tourism, it was estimated that Cambodia experienced a loss of tourism revenues totaling roughly US\$ 3 billion. Additionally, approximately 51,000 jobs disappeared in 2020 as almost 3,000 tourism-related businesses were shut down or temporarily closed due to the Covid-19 crisis, which resulted in 50,000 unemployed workers and put more than 30,000 jobs in related sectors at risk [7]. Even though the Covid-19 situation began to stabilize by early August 2020, tourism and related sectors continued to be impacted. As discussed above, the volatility of the pandemic created a highly uncertain environment where wages, guaranteed employment, and household savings continued to drop as numerous hospitality firms closed one after another.

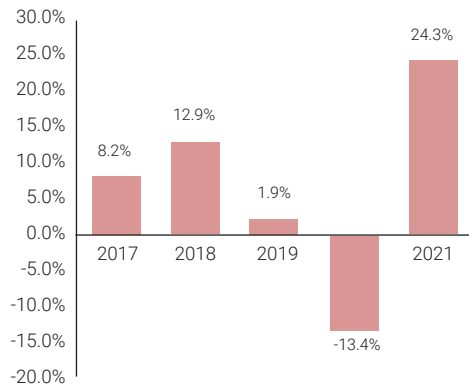
In February 2021, Covid-19 cases began to rise rapidly again, and so the recovery of the tourism sector became even more challenging and unpredictable. Compared to 2020, international tourist arrivals in Cambodia in 2021 fell by 85.0% indicating an

even more severe impact than in 2020 (Figure 3). The 20 February 2021 Covid-19 outbreak took a heavy toll on the country as it was already facing struggles in tourism and related businesses. As the Delta variant emerged in April 2021 and continued to spread, the government had to make a hard decision to institute nationwide lockdowns including bans on inter-provincial travel, public gatherings, and in-person attendance of all educational institutions. All visa exemptions and visas on arrival were suspended. The plummeting number of international tourists indicated the escalation of Covid-19 situation in the country as the number of community infections rose from less than 500 cases in January 2021 to more than 50,000 cases by June 2021. In 2021, there were only 196,000 international tourist arrivals. However, despite the restrictions, domestic tourism has maintained a reasonable rate in both 2020 and 2021. Although domestic tourism is expected to recover faster than international tourism, it may still take several years to rebound to its pre-pandemic levels due to the scarring effect. As the pandemic drags on, temporary job losses in tourism-related businesses have gradually become permanent and household incomes have declined. In addition, according to data from Ministry of Labour and Vocational Training (MLVT) as of July 2022, 235 enterprises employing around 26,925 workers (11,697 females) in the tourism sector had their contracts suspended.

### *Textile and apparel sector*

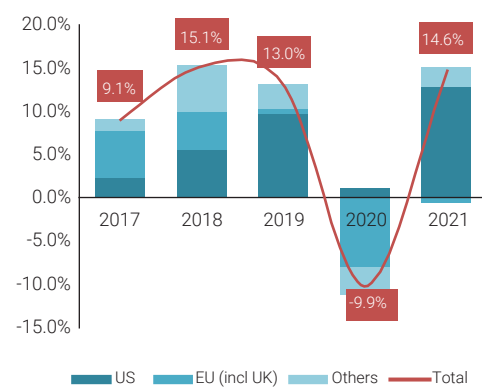
The textile and apparel sector has been one of the highest contributors to the Cambodian economy over the last 20 years. Growth of this sector has been consistently robust in the last 10 years. However, the momentum was suddenly halted in 2020 as global economies struggled to deal with the emergence of Covid-19. Impacts from the global Covid-19 pandemic on this sector could be divided into 2 stages. The first stage was the result of the full lockdown in China – Cambodia’s largest garment material supplier – in early 2020 leading to garment supply disruption globally. The second stage hit when purchase orders were canceled by main export destinations, like the EU and US, especially between April and June. In fact, annual garment exports and garment material imports decreased by 9.9% and 13.4%, respectively, in 2020 (see Figures 5 and 6). Garment exports to the EU witnessed the sharpest decline of 20.0% in 2020 compared to a growth of 2.1% in 2019. Meanwhile, garment exports to the US, although maintaining a positive growth, experienced notably decelerated growth at 3.6% compared to 36.4% in 2019. As a result of the impact on the garment sector, the Ministry of Labour and Vocational Training has recorded 562 requests to suspend factory operation since 2020, which adversely affected a total of 395,700 employees (of which 327,996 or 82.9% are female employees).

Figure 5: Contribution to growth of garment export by destination



Source: Ministry of Economy and Finance (MEF)

Figure 6: Growth of garment material imports



Source: Ministry of Economy and Finance (MEF)

However, the sector quickly picked up its pace of growth due to the strong recovery in external demands. Not only did the US market relocate manufacturing orders to Cambodia from Myanmar due to political unrest and Vietnam due to a Covid-19 community outbreak but Cambodian factories were also quick to normalize domestic factory operations to meet the increased demand without any further domestic Covid-19 outbreaks thanks to the high vaccination rate among garment workers.

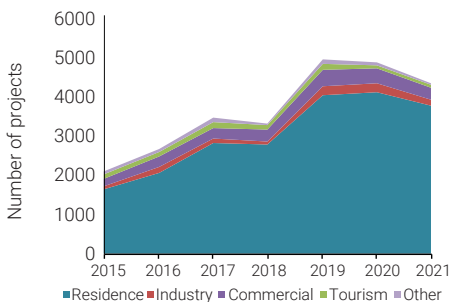
### ***Construction and real estate sector***

Over the last decade, the construction and real estate sectors have grown rapidly largely financed by foreign capital inflow, particularly Chinese investment. Growth of these two sectors has been robust in the last few years prior to the pandemic, and has been driven by the construction of buildings related to commercial, industrial, and tourism activities as well as residential buildings (condominium, service apartments, and landed property). However, Covid-19 has derailed its growth and affected the sector through an unprecedented decline in investor confidence and market demand. The number of approved projects in 2020 noticeably declined from 4,919 projects in 2019 to 4,841 projects in 2020 [8]. Approved projects in the tourism and commercial sectors also dropped between 2019 and 2020 with tourism seeing a drop from 154 projects to 95 projects and the number of commercial projects approved down from 403 projects to 365 projects in that timeframe (see Figure 7). Many construction activities including condominiums, hotels, and other commercial-related projects, particularly in Sihanoukville province, were halted as Chinese investors left in late 2019 and even more in 2020 due to the pandemic [9]. More than 1,000 construction sites were suspended in 2020. The overwhelming majority of those suspended projects (90%) were foreign-invested construction sites and the remaining 10% were Cambodian-owned construction sites [10]. As a result of the decline in project approvals, increased



number of suspended construction sites, and supply chain disruptions, imports of construction materials, namely construction equipment and steel, dropped by 13.5% and 48.5%, respectively, in 2020 (see Figure 8).

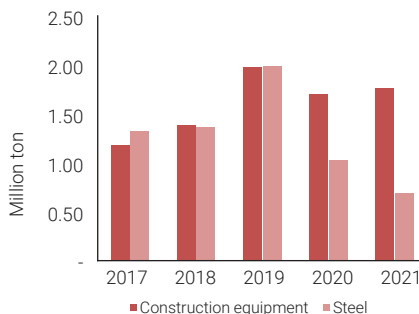
**Figure 7: Project approvals by types of construction**



Source: Ministry of Land Management and Urbanization and Construction (MLMUC)

Note: Construction equipment consists of equipment for residents such as roof tile, bathtub, door frame, and mirror, etc.

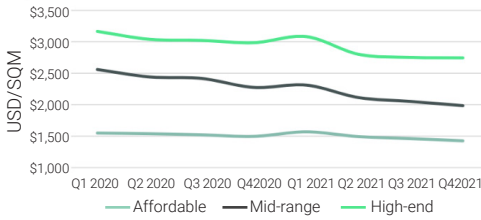
**Figure 8: Import of construction material**



Source: Ministry of Economy and Finance (MEF)

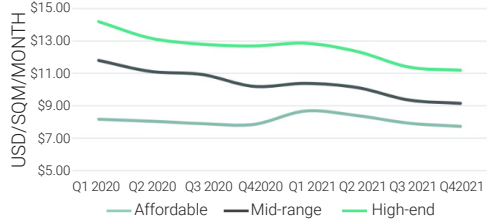
In tandem with the construction sector, the real estate sector has also suffered, especially in 2020 due to noticeable disruptions of market demand brought about by Covid-19. Transactions (purchase, sale, and rent of properties) activities suddenly contracted particularly in investments. All segments of the real estate market were negatively affected, including condominiums, serviced apartments, landed properties, and retail activities. Among those, condominiums and serviced apartments are among the hardest hit segments given their high dependence on foreign investment (supply side), which has largely been driven by Chinese investors, and foreign buyers (demand side). The threat of Covid-19 and related travel restrictions have warded off substantial investments and potential buyers, especially foreigners [11]. Overall transaction volume in the condominium market is believed to fall between 15% and 20% in 2020 compared to the pre-pandemic period [12] and has continued to plummet in 2021. The average quoted sale and rental prices of condominiums across all ranges declined in 2020 and 2021 reflecting the significant drop in demand (see Figure 9 and 10). In particular, the number of condominiums sold declined by 26.5%, down from 8,238 units in 2019 to 6,058 units in 2020. In addition, transaction activities for landed property also declined indicating the reduction in both income and demand. In fact, the number of houses sold dropped by 77.7% from 4,684 units in 2019 to 1,043 units in 2020 (see Figure 11).

Figure 9: Average quoted sale price



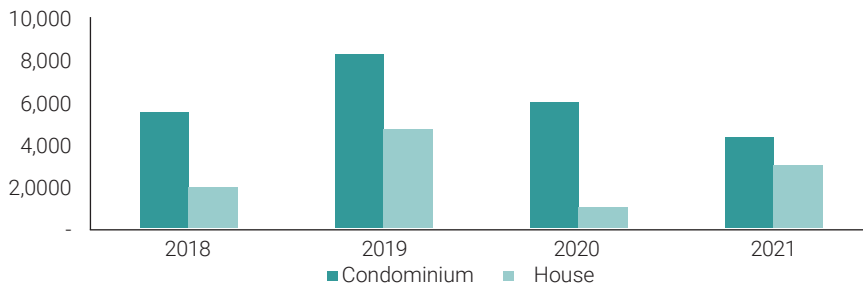
Source: CBRE

Figure 10: Average quoted rental price



Source: CBRE

Figure 11: Number of residential properties sold (unit)

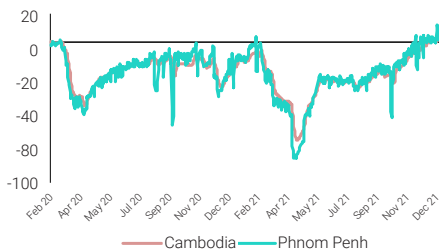


Source: Knight Frank

Note: Houses refer to landed property (Borey)

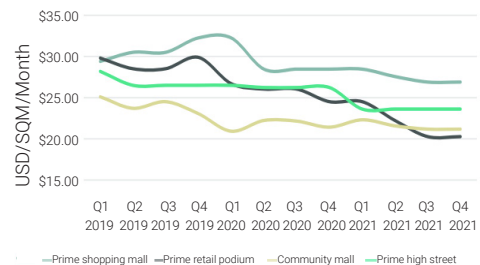
Retail mall activities were also hard-hit by the pandemic largely due to the restrictions on people’s mobility caused by a spike in Covid-19 cases and subsequent containment measures, including lockdown and curfew, from March to May 2020 and April to May 2021 (see Figure 12). In the CBRE’s survey, most of respondents (retailers) reported a contraction in sales of 32% from pre-pandemic levels during Q1 and Q2 2020. Based on a micro survey done by the CBRE, about 48% of respondents (retail shop) closed or partly closed their businesses amid the pandemic [13]. The sudden closures of retail businesses caused the average rental price of malls as well as the occupancy rate for all types of retail in Phnom Penh to decline (see Figure 13).

Figure 12: People’s mobility to retail



Source: Google mobility data

Figure 13: Average rental price of retail mall space in Phnom Penh



Source: CBRE

### ***Other related service sectors***

During the domestic outbreak, named the 20<sup>th</sup> February 2021 incident, the government-imposed containment measures including curfew and lockdown in Phnom Penh and other provinces to curb virus transmission. Therefore, certain sectors, including wholesale and retail trade, transportation, and logistics as well as other related service sectors were severely impacted.

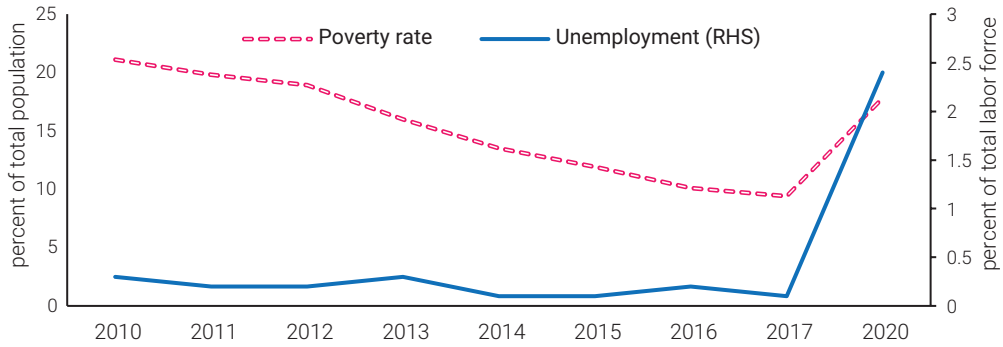
Based on Cambodia Restaurant Association (CRA), sales in the restaurant industry have been decimated by the pandemic, dropping roughly 50% in 2020 and further declining by 60% in 2021. This unprecedented decline in sales clearly demonstrates a lack of consumer demand amid the pandemic and containment measures, including lockdown and curfew, which strongly affected people's movement [14]. In addition to demand, supply was also severely disrupted as some businesses were forced to shut down, particularly during the lockdown. In Phnom Penh, food-related businesses, such as restaurants and street vendors, without takeout services were adversely affected during the lockdown period between 15 April 2021 and 6 May 2021. Even though most restrictions, including bans on inter-provincial and city travel were later lifted, some remained in place, like temporary closures of government-run and unregulated markets as well as the zone restriction system (where all movement was restricted within a particular neighbourhood, or zone, depending on the colour code given) [17].

The transportation and logistics sectors in Cambodia were also incredibly impacted particularly in 2020 and early 2021. The unprecedented drop in both of their supporting sectors (textile and apparel, construction, and tourism activities) were undeniably disrupted. Given the steep rise in the Covid-19 pandemic globally and domestically, 30% of logistics businesses in Cambodia suspended their operations in 2020 [18]. Although some logistics companies continued to operate, the majority of them were also affected by higher shipping costs and container shortages. To some extent, this discouraged the performance of the overall sector. Imports of jet fuel (by volume) declined by 60% and 48.2% in 2020 and 2021, respectively. In addition, air cargo traffic through Cambodia's three international airports dropped by 30% in 2020 [19], reflecting a decline in the transport of goods and economic activities.

#### ***2.2.2. Social impact***

Besides the economic impacts, Covid-19 has also had undesirable affects on society, including a rise in unemployment and decline in income. As already pointed out, one of the most notable impacts from the Covid-19 crisis has been on employment. Lockdown and various restriction measures to curb domestic outbreak led to disturbances in business operations, which in turn forced these businesses, especially high-contact industries, to cut down on their workforce. Evidently, the low unemployment rate of Cambodia (ranging between 0.1% and 0.3% over the past 10 years) jumped to 2.4% after the pandemic hit in 2020 (see Figure 14) with a higher rate for women (3.7%) than men (1.1%) according to the Cambodia Socio-Economic Survey Report 2019-2020.

Figure 14: Unemployment and poverty rate (2010-2020)



Source: Ministry of Planning (MoP)

Given the detrimental impact of the pandemic on business operations and employment, household income also severely declined. One way the negative impacts of the pandemic is measured at the household level is through income. As a result, the World Bank in collaboration with the National Institute of Statistics of the Ministry of Planning conducted five rounds of the High Frequency Phone Survey. At the early stage of the pandemic, or in Round 1 (May-June 2020), 83% of households reported having received less income. However, there were signs of improvement as fewer households reported experiencing declines in the rounds that followed. In fact, 63% of households reporting reduced income in Round 2 (August-September 2020), 51% in Round 3 (October-November 2020), 48% in Round 4 (December 2020-January 2021), and, finally, 45% of households reported reductions in their income in Round 5 (March 2021). In addition, the results also indicated that the reduction in income was felt most acutely by households relying on family business unrelated to farming or that were relying on non-labour income, such as remittances or assistance from other family members. Rural and urban household incomes were affected differently. Urban households experienced greater reductions in income from properties while rural households experienced greater reductions in remittances. Furthermore, based on the micro survey done by World Vision International, almost three-fourths of the respondents reported to have lost their main source of income or had it reduced [15]<sup>5</sup>. Their finding coincides with another micro survey conducted by Indochina Research that found the monthly average income of households reported a decline in 2020 compared to pre-pandemic levels and kept decreasing from that point during 2021 [16]<sup>6</sup>.

Increased unemployment as well as income losses resulting from the Covid-19 pandemic in turn contributed to a rise in the poverty rate. Over the last few decades, tremendous efforts from all relevant stakeholders were made to increase people's

5 The survey was conducted from 29 May to 9 April 2021. The assessment was completed with 621 heads of households from three provinces and Phnom Penh

6 The survey was conducted from 23 October-05 November 2021, completed with 1,500 households in 10 provinces in Cambodia

living standard and reduce the poverty rate within the country. In fact, the poverty rate continually dropped from around 47.0% in 2007 to 22.9% in 2009 and then to 9.4% in 2017. However, the poverty rate shot up back to 17.8% in 2020 (see Figure 15) according to the latest Cambodia Socio-Economic Survey Report 2019-20, which utilized the newly redefined poverty line. Even so, the poverty rate varies noticeably depending upon the region. It is the highest in rural areas at 22.8%, 12.6% in provincial urban area besides, and is at its lowest rate in Phnom Penh at 4.2%.

### ***2.2.3. Financial sector***

The contraction of the real economy, namely tourism, textile and apparel, construction, and real estate, has caused a feedback loop to the financial economy. Corporate suspensions and/or bankruptcies along with income losses due to high uncertainties, especially in 2020, have negatively impacted debt repayment capacity as well as the soundness of the overall financial economy. Households and firms were struggling to pay their scheduled debts. Banks and MFIs were even more cautious in issuing new loans. Facing the high level of uncertainty, the NBC has closely monitored the risks of the financial system, especially the liquidity, capital, and credit quality conditions of banks and financial institutions. In order to mitigate those risks and maintain financial stability, the NBC has introduced macroprudential and other measures, such as i) allowing banks and financial institutions to maintain their capital conservation buffer (CCB) at 50%; ii) allowing banks and financial institutions to restructure loans for clients affected by the Covid-19 outbreak and floods; iii) allowing banks and financial institutions to temporarily recognize audited quarterly profits in the calculation of net worth; iv) providing favourable processing fees and/or penalties exemption, such as actively continuing to issue loans to priority sectors, no credit processing fees and removal of other penalties; and v) requiring no fees for credit history checks in the credit information sharing system [20].

Additionally, loan restructuring has been introduced to lessen the financial burden of households and firms. Priority in loan restructuring has been given to four key sectors, including tourism, textiles and apparel, construction, and transportation. By the end of 2021, the total amount of restructured loans reached around US\$ 5 billion, or 10% of total private debt. According to a confidential stress test performed by NBC in mid-2021, in the event that 50% of restructured loans (US\$ 2.7 billion) turn into non-performing loans (NPL), financial institutions' solvency ratios would be below a threshold set by NBC thereby putting the banking sector's performance at high risk.

Furthermore, the growth of new loans slowed in 2020 and 2021 as financial institutions became more cautious in the face of highly uncertain situations. In fact, the total credit at both banks and MFIs experienced a slowdown from 28.5% in 2019 to 16.1% in 2020 as shown in Table 1. Notably, credits issued by MFIs declined by 6.2% in 2020 due to precautions taken by financial institutions during uncertainties (supply side) and the weakening demand amid the slowdown in economic activity (demand side).

**Table 1: Credits provided by financial institutions**

Financial Institution	2017	2018	2019	2020	2021
Banks	19.7%	24.1%	27.0%	22.2%	25.2%
MFIs	36.1%	26.6%	34.6%	-6.2%	15.2%
Total credit	22.7%	24.6%	28.5%	16.1%	23.5%

Source: National Bank of Cambodia

However, despite the Covid-19 shock, the financial economy overall has remained stable, which is reflected by the key prudential ratios (see Table 2). In fact, as of 2021, the liquidity coverage ratio was 150%–160%, which is far above its minimum requirement (100%), indicating a liquidity surplus in the banking system. In addition, the solvency ratio has remained high at 23% compared to its minimum requirement of 15%. Finally, NPLs were still low at around 2% as debt repayment was not yet severely disrupted.

**Table 2: Financial soundness indicators**

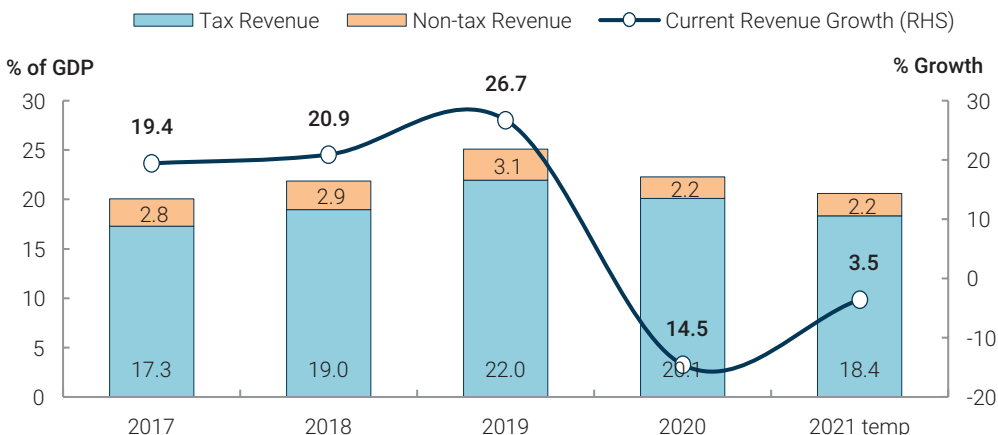
Commercial banks' prudential ratios	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Liquidity coverage ratio (requirement: 100%)	139.5%	158.8%	155.7%	162.4%	151.6%	154.0%
Solvency ratio (requirement: 15%)	23.8%	24.2%	24.0%	23.6%	23.1%	22.3%
NPLs	2.4%	2.2%	2.0%	2.6%	2.0%	2.2%
MFIs prudential ratios	Dec-17	Dec-18	Dec-19	Dec-20	Dec-21	Dec-22
Liquidity coverage ratio (requirement: 100%)	208.2%	213.6%	178.1%	240.4%	160.1%	133.7%
Solvency ratio (requirement: 15%)	20.7%	19.8%	18.9%	22.4%	21.5%	20.0%
NPLs	1.6%	1.3%	0.8%	1.8%	2.4%	2.3%

Source: National Bank of Cambodia

### 2.2.4. Fiscal performance

The collapse of industry sectors has sequentially affected fiscal performance. Revenue collection encountered significant setbacks for two consecutive years in 2020 and 2021. For instance, the revenue collection dropped by 14.5% and 3.5%, respectively in 2020 and 2021 due to the decline in economic activities as well as the imposition of strict administrative measures to minimize the spread of Covid-19 during the community outbreak at the beginning of 2021 (see Figure 15).

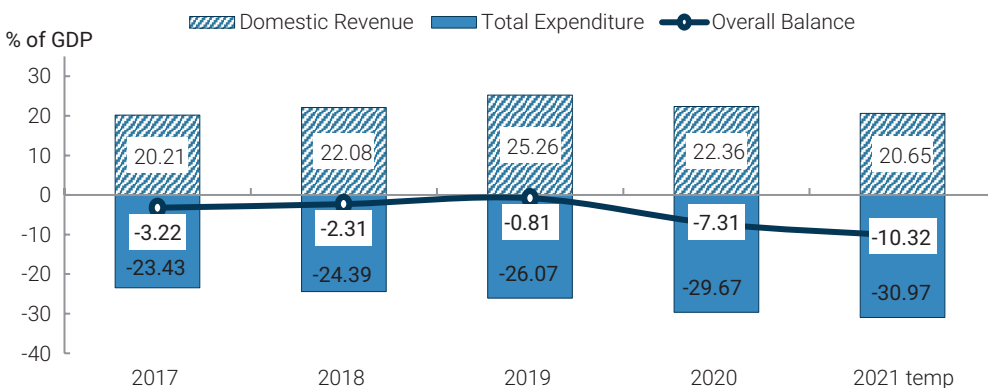
Figure 15: Current revenue performance



Source: FMIS (18 July 2022) for 2021 temp

Despite the revenue shortfall, expenditure pressures increased in both years to cushion the adverse socioeconomic impacts of the Covid-19. The Royal Government of Cambodia launched a strategic flexible fiscal policy aimed at timely responses to the crisis and maintaining Cambodia’s socioeconomic stability. In order to combat the continued decline in domestic revenue collection, the government rationalized non-essential spending to reserve limited national resources so that a substantial intervention package totalling US\$ 2,172 million could be implemented in 2020 and 2021. As a result of this aggressive intervention, there was a steep increase in the budget deficit in 2021 that widened to 10.3% of GDP (see Figure 16).

Figure 16: Fiscal position

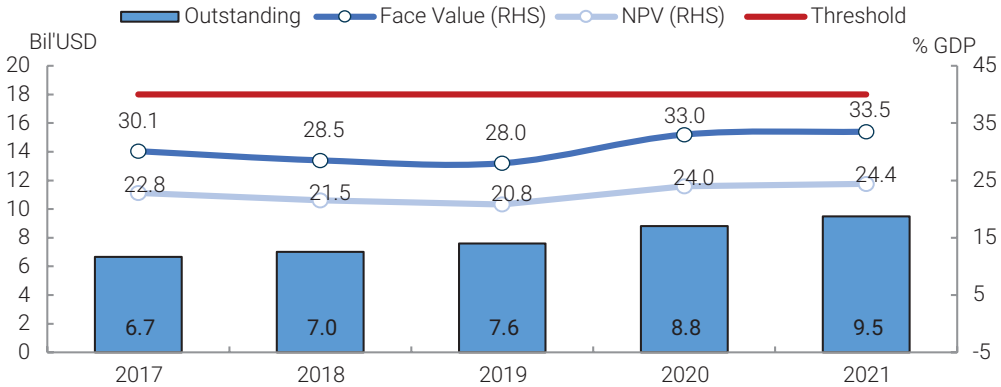


Source: FMIS (18 July 2022) for 2021 temp

Despite the increase in fiscal pressure, the country’s public debt situation has remained sustainable and low risk. In particular, the present value of total public debt to GDP ratio in 2020 and 2021 is around 24% of GDP which is below the threshold of 40% of

GDP (see Figure 17). This means that Cambodia continues to have a reasonable fiscal space that can meet the needs for necessary public investments and socioeconomic development in all sectors in a sustainable and inclusive manner.

Figure 17: External public debt



Source: Cambodia Public Debt Statistical Bulletin, Vol. 14.

### 2.2.5. Government responses to the pandemic

Amid the uncertainties caused by the Covid-19 pandemic crisis, the Royal Government of Cambodia put forth policy guidelines that account for the following two main aspects:

- Stabilizing the economy, especially during the Covid-19 pandemic, by keeping businesses afloat and protecting people’s livelihood as well as fighting against Covid-19
- Bolstering economic growth by further accelerating economic diversification, improving competitiveness, and solving structural issues

The government has introduced 10 rounds of intervention measures aimed at reducing the negative impacts and ensuring the stability of the country’s socio-economic status, especially in key sectors and target groups like garment manufacturing, tourism, aviation, and poor and vulnerable families.

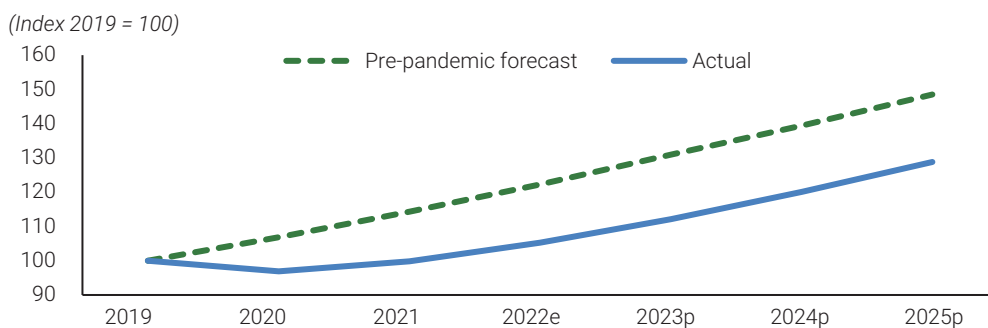
Overall, a large portion of the budget, amounting to US\$ 2,172 million, was utilized for various intervention packages in 2020 (US\$ 836 million) and 2021 (US\$ 1,336 million) focusing on public health spending and other crisis supports, such as cash transfers, cash for work, wage subsidies and skill training, and an economic recovery plan (see Table 3). These intervention packages have been made through 1) fiscal measures, like tax reliefs and wage subsidies; 2) financial assistance measures, such as credit guarantee schemes and risk sharing schemes; and 3) social assistance schemes, such as cash for work and cash transfers to the poor and vulnerable (see Table 3).



### 3. Cambodia in the post-pandemic and policy direction

With the leapfrogging vaccination rate, the country re-opening, and the adaptation of people and businesses to living in the new normal, Cambodia's economic growth is projected to return to its previous path of growth of 7% in the medium-term (2022-2025). Although the Covid-19 shock has gradually faded out, the socioeconomic impacts continue to be profound. The Covid-19 pandemic has exacerbated long-standing constraints on Cambodia's economy because of the scars left behind especially within the tourism sector. Despite a strong recovery, the pandemic will continue to impede output in the long term (see Figure 18). Therefore, policies supported by the government will play a significant role in bringing the economy back onto a growth path.

Figure 18: Real GDP projection (before and after Covid-19)



Source: National Institute of Statistic (NIS) and Ministry of Economy and Finance (MEF)

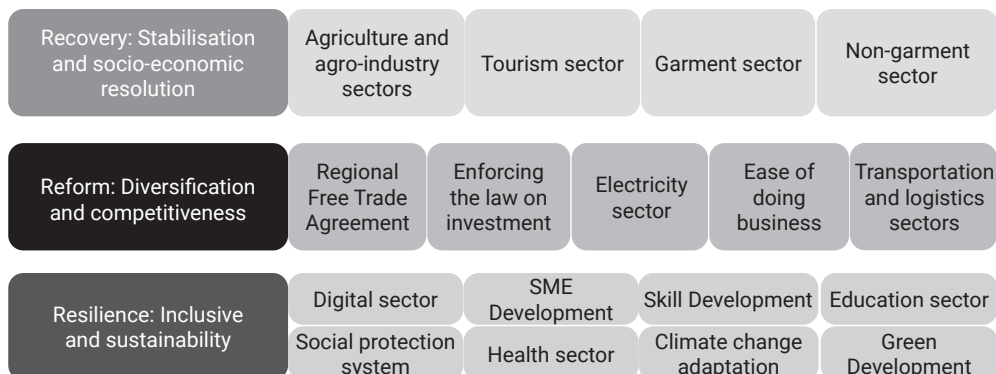
Note: "e" is an estimate and "p" is projection

#### 3.1. Post-pandemic recovery plan

In the short term, the Royal Government of Cambodia officially launched and implemented the "Strategic Framework and Programs for Economic Recovery in the Context of Living with Covid-19 in a New Normal 2021-2023" which focuses on the following three-pronged approach:

- **Recovery:** to ensure stabilization and socioeconomic restoration by strengthening public health and safety, providing financing to the private sector, effectively implementing fiscal policy, promoting key sectors, and implementing FTAs and PPP.
- **Reform:** to promote diversification and competitiveness by strengthening governance of General Department of Taxation and General Department of Customs and Excise, building up the electricity sector, improving the ease of doing business, and improving transportation and logistics capabilities.
- **Resilience:** to elevate inclusiveness and sustainability by promoting digitalization, enhancing SMEs, promoting skills development, strengthening social protection systems, and adopting green recovery.

Figure 19: Three-pronged approaches of post-pandemic recovery plan



Source: Strategic Framework and Programs for Economic Recovery in the Context of Living with COVID-19 in a New Normal 2021–2023

Table 3: Intervention package budget (2020-2023)

Interventions	Description	2020	2021	2022	2023
		Disbursed	Disbursed	Plan	Plan
<b>Public health and social intervention</b>					
- Health masterplan - Outbreak intervention and treatment	Scaling up health response by increasing prevention and detection facilities, clinical management and treatments as well as coordination and supporting system	36	699	300	100
Wage subsidy and skill training	Providing partial wage subsidies of \$40 per month and technical/soft skills training for furloughed workers in the tourism and garment industries	64	33	59	60
Cash for work	Providing jobs in rural areas through construction, upgrade, and maintenance of rural roads, drainage and small-scale irrigation	100	158	100	100
Cash transfer	Providing monthly cash grants to poor and vulnerable individuals that are registered in the government's IDPoor database	306	295	280	400
Near-poor program	Package for families living near poverty line	-	-	-	65
<b>Economic intervention</b>					
Financing through ARDB	Providing low-interest loans for working capital and investment in agricultural sector through capital injections to Agricultural and Rural Development Bank	50	-	-	-
Co-financing through SME bank	Co-financing with commercial banks by providing low-interest loans for working capital and investment in 6 targeted SME sectors through newly established SME bank	50	-	-	-
Credit guarantee fund	Providing capital to establish the Credit Guarantee Corporation of Cambodia which helps bear risk-sharing with businesses	200	-	-	-
SME financing facilities**	Reserving contingent funds to provide any necessary financing to SME sector	30	150	-	100
Economic recovery strategy	Implementing Strategic Framework and Programs for Economic Recovery in Cambodia	-	-	250	100
Digital and green infrastructure	Investment on new source of growth and development resilience against future shock	-	-	-	50
Economic diversification and competitiveness	Investment for widening economic base and promoting business environment	-	-	-	30
<b>Total intervention package</b>		<b>836</b>	<b>1,336</b>	<b>989</b>	<b>1,005</b>

Source: Ministry of Economy and Finance (MEF)

Ultimately, the above policy framework is aimed at addressing the following four key objectives:

- **Revive key sectors** of the economy that were affected by the Covid-19 crisis by addressing structural issues, eliminating specific barriers in those sectors, and harnessing potential sectors for economic growth.
- **Implement structural reform** with the aim of building a solid foundation for growth, diversification, and competitiveness.
- **Strengthen resilience** by preparing a response plan to ensure sustainability and inclusiveness of socioeconomic development.
- **Achieve macro-economic stability** by improving fiscal mechanisms, ensuring monetary stability, strengthening trade balance, and considering financing mechanisms.

Furthermore, the Royal Government of Cambodia (RGC) continues to accommodate social and economic recovery by implementing and planning government intervention packages for 2022 and 2023 that amount to US\$ 989 million and US\$ 1,005 billion, respectively (Table 4).

### 3.2. Medium- and Long-term Policy Direction

In the medium and long term, the RGC will concentrate on promoting structural and systematic reforms while also strengthening economic and social resilience. Each of these will enable the economy to become stronger and more responsive by specializing in the following four priorities [21]:

- **Strengthening public administration and leadership capacity** through state reform and enhancing ministry-institution's authority and responsibility to achieve clean, smart, and capable public administration.
- **Building economic resilience** by accelerating economic diversification and enhancing competitiveness by concentrating on improving the investment climate and facilitating trade; promoting digitalization in both the public and private sectors; and building high quality infrastructure, green infrastructure, and digital infrastructure.
- **Building social resilience** by concentrating on both quality and scope of health and social protection systems' development in order to respond to unexpected crises. Additionally, by developing human resources through empowering education quality and vocational training.
- **Building financial system resilience** by strengthening the financial system's capability to adapt and respond to volatile economic and social conditions and having a central role in sustaining overall economic activity. Building financial system resilience must be done through maintaining financial products diversification,

developing financial system infrastructure, particularly financial technology. In addition, strengthening the public financial system requires modernizing and reforming the tax system, the budget management system, and public debt management in order to be more effective and sustainable while also building state savings for intervention in times of crisis. Lastly, it is also important to strengthen the banking crisis monitoring and response systems. At the same time, building a financial safety net plays an important role in maintaining financial stability and strengthening financial resilience in response to future crises. Strengthening the financial safety net will contribute to improving macroeconomic and financial monitoring, strengthening crisis management, and encouraging cooperation to ensure financial stability and resilience.

#### **4. Conclusion**

Covid-19 has impacted the entirety of Cambodia's socio-economic landscape, including all economic sectors as well as fiscal capabilities, the financial sector, and society. Growth contracted in 2020 compared with the trajectory of the previous 20 years since many potential growth drivers were severely damaged. The tourism industry was one of the hardest hit sectors, and it is expected to take a longer time to recover to its pre-pandemic levels. The collapse of industries, both manufacturing and services, had an automatically negative effect on society as evidenced by rising unemployment, declines in income, and rising poverty. Additionally, the decline in the real economy and income has also had some impact on the financial sector, which was reflected in an increase in restructured loans. However, the financial sector has remained stable despite the contraction of production activities. Fiscal performance was also impacted as revenue collection declined and expenditure pressures increased alongside rising public debt. However, fiscal space has remained large and the public debt is still below the debt threshold. Although the shock of COVID-19 has gradually diminished over time, its effects on the economy are long-lasting.

In response, the Royal Government of Cambodia has introduced a total of 10 rounds of intervention measures to soften the pandemic's impact and ensure stability for citizens' livelihood and the economy, especially in key sectors such as textiles and apparel, tourism, and aviation. To bring growth back on track and rebuild society and the economy, the government has officially launched and implemented the "Strategic Framework and Programs for the Economic Recovery in the Context of Living with COVID-19 in a New Normal 2021–2023" that focuses on a three-pronged approach and will serve as the roadmap for supporting economic recovery and social development.

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