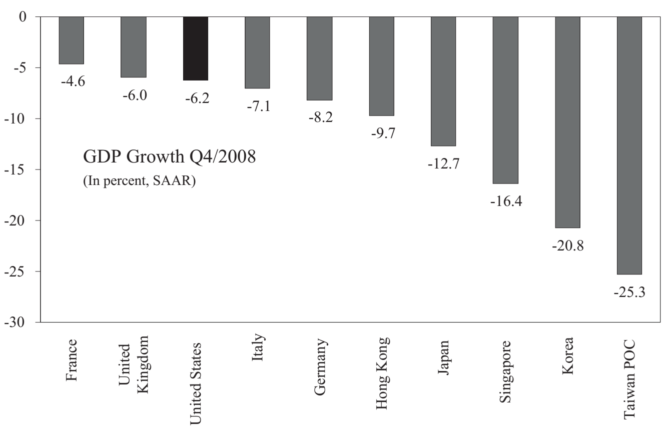
Global Crisis—Impact, Outlook and Policy Options for Cambodia

This article summarises the presentation by Mr John Nelmes[1] during session 1 of the 2009 Cambodia Outlook Conference.

The Crisis: Global Origins and Impact

The present meltdown has been dubbed as worse than the Great Depression. First and foremost, the impact has been so far-reaching and quick to spread that it left virtually no country unaffected. Set off in the United States, it soon spread to the other developed economies and, upon peaking in 2008, the rest of the globe. The shock has also been more severe and deep than the Great Depression. While it began from the subprime mortgage crisis, it soon contaminated other assets and spilled over into different sectors of the real economy, drying up credit and liquidity, slashing jobs and incomes and dissolving business and consumer confidence.

Figure 1: GDP Growth Q4/2008 *(In percent, SAAR)*



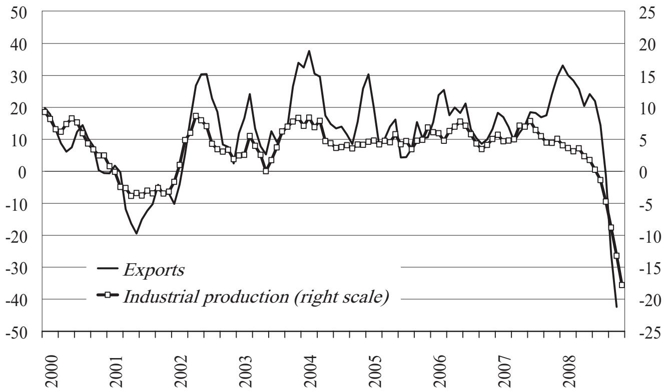
Source: Haver Analytics.

**SAAR (Seasonally Adjusted Annual Rate)*

The data provide a clear and concise picture of how global growth retreated dramatically as a consequence of the crisis. Combining them with the data presented in the IMF's January 2009 World Economic Update, a worsening economic performance worldwide becomes evident. Global output growth declined from 5.2 percent in 2007 to 3.4 percent in 2008, caused by a slowdown in all major regions and countries. Over the same period, output growth in the US declined by almost 1 percent, in the euro area by 1.6 percent, Japan by 2.7 percent to a negative 0.3 percent, China by 4 percent and the ASEAN-5 region by 0.9 percent. GDPs of advanced economies and newly industrialised economies all contracted in the last quarter of 2008 (Figure 1).

Industrial production and exports plummeted in 2008 (Figure 2). Business and consumer confidence have reached historical lows, prompting greater worries about impending conditions.

Figure 2: Global IP and Merchandise Exports
(3-month percent change of 3-mma, annualised)



Source: IMF, GDS database.

The Crisis: Impact in Cambodia

While shielded from the direct effects of the financial tumult by its insignificant exposure to the toxic subprime products, the Cambodian economy eventually got swept along by the crisis through the effects on its key growth areas. The fall in the country's economic growth to 6 percent (IMF estimate) in 2008, after an outstanding average growth of 10 percent in recent years, was induced by deceleration in the garment industry, tourism and construction. Cambodia's garment exports have been highly vulnerable to the external shock due to their heavy reliance on the US market. They have traditionally followed trends in US retail sales, and did so with the steep drop in sales starting in the middle of 2008. Year-on-year growth of garment export volumes neared 0 percent by January 2009.

1 Mr John Nelmes is the IMF resident representative in Cambodia.

A similar constriction in tourism was recorded, its year-on-year growth tumbling from a previous remarkable average of 25 percent to an estimated 9 percent in 2008. As the economies of its traditional tourist markets were afflicted by the crisis, tourist arrivals in Cambodia slowed, affecting revenues from Angkor Wat, overall tourist receipts, tax revenues and ordinary people's livelihoods. High inflation in 2008 and appreciation of the riel did not help, because they made the country a relatively more expensive tourist destination.

Figure 3: Cambodian Garment Exports and US Retail Sales *(Y/Y, in percent)*

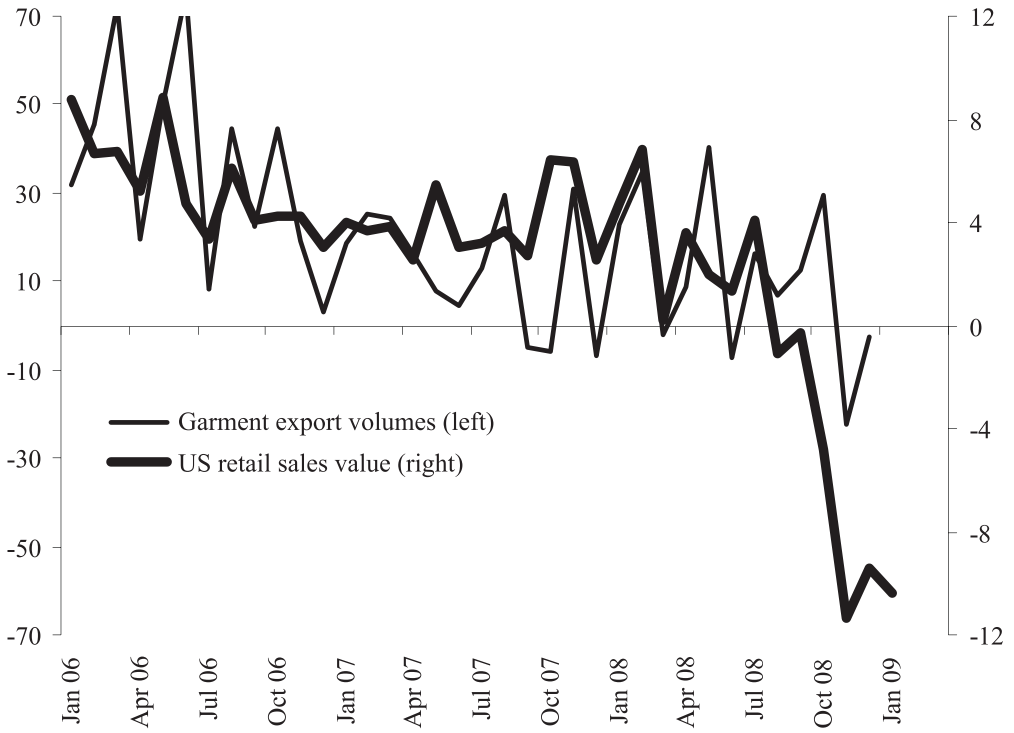
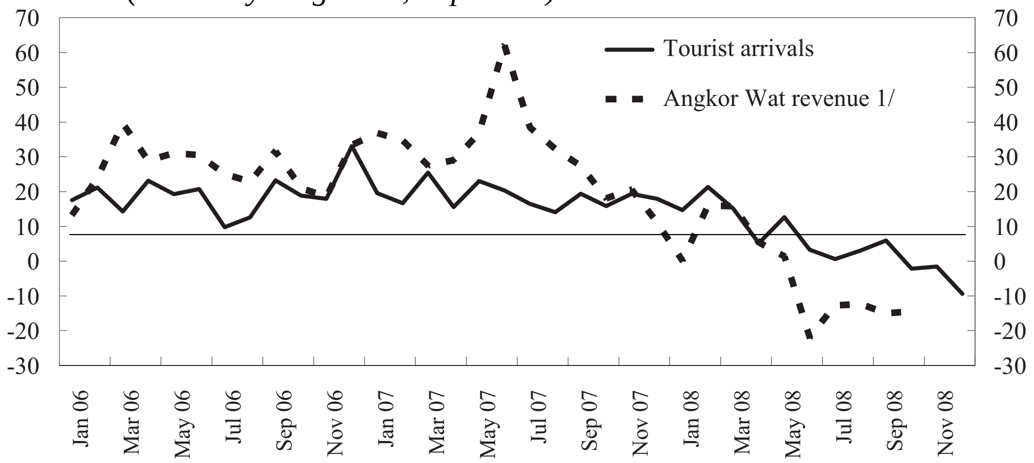


Figure 4: Cambodia: Total Tourist Arrivals and Angkor Wat Revenue, 2006–08 *(Year-on-year growth, in percent)*



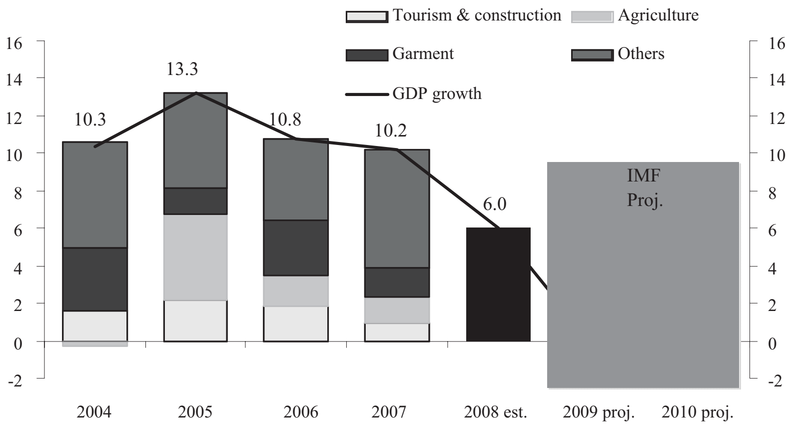
Sources: Data provided by the Cambodian authorities; and IMF staff estimates.
1/ Revenue from ticket sales.

Construction, another growth sector, has not fared any better. A key factor underpinning the lull in this sector is the cutback in foreign direct investment (FDI). This cutback was engendered by constrained financing conditions and higher aversion to risks. In Cambodia, construction activities are closely related to real estate development. Decreased external investments and the bursting of the domestic real estate bubble constituted a huge blow to the sector, which was booming only a year back. FDI in the last two quarters of 2008 declined.

Consistent with the above trends, domestic liquidity conditions have tightened. Broad money growth was near zero as of January 2009. Foreign currency deposits, which make up about 90 percent of total deposits on average, posted a mere 1 percent growth as of the end of 2008. This inevitably put a strain on the domestic banking system. The downturn in the real estate sector topped the banks' worries and forced restrictions in lending to the sector. After peaking at 100 percent in May 2008, year-on-year growth of private sector credit as a whole retreated to 45 percent in January 2009.

On a positive note, the positive performance of Cambodia's agriculture in 2008 helped to prop up the economy. Overall, the sector exhibited resilience although some of its key exportable crops took a serious blow from the crisis. To the benefit of consumers, the global meltdown put a brake on the escalation of prices triggered mainly by the food and energy crises of 2006 onwards. However, declining commodity prices cut producers' and exporters' profit margins, and lower world demand left them with unwanted produce. Still, prices in Cambodia remain higher than preceding average levels and, together with the stronger riel, put the country's competitiveness under pressure.

***Figure 5: Cambodia: Real GDP Growth** (Y/Y % change)*



The Crisis: Outlook and Potential Policies

There is no immediate end in sight for the downturn. Predictions for 2009 remain sombre and in fact have reflected increasing pessimism over the state of the global economy. Once projected to grow by 2.2 percent, world output this year is now predicted by the IMF to expand by a mere 0.5 percent. Similarly, the majority outlook for Cambodia has become gloomier. The earlier IMF projection of a 4.8 percent real GDP growth in 2009 was revised -0.5 percent (Figure 5). This bigger contraction was due to the persistence and deepening of the slowdown in garments, tourism and construction. He warned that US retail sales are predicted to contract by 10 percent this year, and Cambodia's garment exports are sure to suffer from this. Meanwhile, 2009 growth of tourism in Cambodia is placed at -0.5 percent. Agriculture, by contrast, is expected to continue its positive performance even though prevailing deflationary pressures do not bode well for this sector. A slow recovery is possible in 2010, but with downside risks.

Indeed, the road to recovery is difficult. Recommended is a strategy of moderated fiscal easing to provide relief to distressed sectors and sections of the population. A deficit of 4.75 percent of GDP is expected this year. For the expansionary budget to deliver on its purpose, however, spending priorities must be social safety nets and infrastructure. Also, it will not be wise to forego the hard-won gains made in revenue administration over the years.

Other remedial policies are further monetary easing (although the scope for this is limited) and development of monetary instruments that can facilitate interbank transactions. Recent actions to strengthen off-site and on-site bank supervision are commendable and must be carried on and improved. Perhaps most importantly, because the real antidote to the current and future crises may lie here, structural impediments to broader based growth and enhanced competitiveness must be dealt with.

Did you know that …

... as a result of the crisis, the United States, the euro zone and Japan have gone into synchronised recession for the first time since WWII? The US, the euro zone and Japan were all officially in recession by late 2008. Recession is usually understood as referring to at least two successive quarters of negative GDP growth.

Sources: CNN (2008), J. Menon in ADR 2008–2009

... as a result of the crisis, a country, Iceland, has technically gone bankrupt and several more are said to be in danger of being so? Since the middle of 2008, all three of Iceland's major banks have collapsed and the country's currency fell so sharply that it has become practically valueless. There is speculation that countries such as Switzerland and the United Kingdom could follow suit. Notwithstanding debates about whether a country can really go bankrupt, state bankruptcy is usually taken to mean that a country is no longer able to pay its external debt.

Sources: Economist (2008), Market Oracle (2009)