
Cambodia Risk Report

January 2022

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Table of Contents

1. Executive Summary	1
A. Positive Developments.....	3
B. Challenges	3
C. Graphic Summary of Perception Survey	5
2. Domestic Political Risks	7
3. Social Instability Risks.....	13
4. Institutional Quality, Accountability and Standards.....	17
5. Human Resource Risks.....	22
6. Physical Factors Affecting Country Risks.....	26
7. External Political Risks	31
8. Macroeconomic Situation	37
A. Overview	37
B. Tourism	40
C. Foreign trade.....	44
D. Balance of payments.....	46
E. Inflation	48
F. Monetary policy and the exchange rate	50
G. Fiscal policy	54
Appendix 1: Basic Macroeconomic Data	57
Appendix 2: Tourism Highlights	58
Appendix 3: The COVID-19 Situation through December 31, 2021.....	59
Appendix 4: Report Methodology.....	60
Appendix 5: Explanation of PERC's Country Risk Index.....	62
Appendix 6: About Political & Economic Risk Consultancy, Ltd.....	65

1. **Executive Summary**

The COVID-19 pandemic has severely disrupted the Cambodian economy, but the crisis has pushed down the overall level of socio-political risks. Four of the six major categories of socio-political risks are lower this year compared with 2020 and even more so compared with 2019. The population has rallied behind the government's policies to contain the virus. Those policies, especially the vaccination program, have been effective, raising confidence in the quality of the current government's policies, while reducing what limited appeal opposition parties still have among the local electorate.

Domestic political uncertainties have been further reduced by the high level of confidence in the outcomes of both the communal elections scheduled for 2022 and the national elections scheduled for 2023. There is little doubt that the ruling Cambodian People's Party (CPP), under Prime Minister Hun Sen, will retain power. Moreover, uncertainties regarding the succession have been reduced by Hun Sen's announcement, supported by the CPP, that his son, Hun Manet, will be his preferred successor when the time comes. This bodes well for political predictability not only for the next four or five years, but even longer. There are still transition risks, but these have been reduced by Hun Sen's clarification of what he wants to see happen upon his retirement and the time he now has to ensure that it does.

The likelihood of continuing political stability is not just a reflection of the strength of the current political leadership but also of the public's support for it and the lack of a credible political opposition. There is a widespread appreciation for how well the government has done in limiting the spread of COVID in the country, as well as the limited number of deaths arising from it, and there is much greater public confidence in the present government than in the opposition that it can protect the population from health risks, alleviate temporary economic hardships, and get the economy back on a high-growth path to which younger Cambodians have grown accustomed.

Dealing with the health care crisis has helped to strengthen important national institutions like the Ministry of Economy and Finance (MEF) and departments under it like the tax authorities. The ability of the MEF, in turn, to tighten its supervision of spending by other government departments has improved overall fiscal discipline in the

government and limited certain kinds of corruption. Moreover, while unnecessary spending has been reduced, the government has maintained strong spending on the country's physical infrastructure. The new roads, airport facilities, power, water, and other infrastructure being built should underpin the economy's recovery and help GDP growth get back above 4% in 2022 even if tourism continues to lag.

The country's education system has suffered a setback and progress in raising the level of young human talent has been delayed, but the contractions suffered by many industries, especially in services like hotels, have created a pool of experienced labor on which companies that survive the pandemic will be able to draw to gear up for the economic recovery as it materializes. That is already happening in the manufacturing sector. It will take longer for tourism to recover, and the number of foreign visitors to Cambodia might not return to pre-pandemic levels for another four years or so. However, the absolute number of tourists are less important to the dynamism of the economy than is the direction of change. After two years of declining foreign visitor numbers, there is likely to be a modest recovery in 2022 and a stronger one in 2023, and since the supply side of hotel rooms and other facilities has consolidated as much as it has, even a limited upturn in tourism inflows should have a big positive impact on establishments that have weathered the storm.

However, the pace of that recovery depends on factors that are beyond Cambodia's ability to control directly. That is why the one category of risk that has increased over the past year relates to external variables. The two biggest uncertainties here are, first, the speed that other countries, especially Mainland China and neighboring ASEAN countries, manage the threat of COVID enough to feel comfortable allowing their residents to travel abroad without having to go into quarantine upon returning home. Second, how US-China relations develop in the coming year and if their rivalry results in the US government trying to pressure other countries in how they conduct their relations with China. There is a risk that the US might adopt import penalties or take other punitive action against China as well as other countries in which China has a heavy factory presence and close diplomatic ties. That includes Cambodia. This risk arising from adverse changes in US policies is not a direct threat to Cambodia's tourism industry, but it would threaten Cambodia's manufacturing sector, which depends heavily on the US as a market.

A. Positive Developments

- The effective way the government has handled the COVID pandemic and rallied the population around its policies, especially its vaccination program, could change the entire narrative on Cambodia in a positive way. Cambodia now has a chance to be seen in a much more positive light by foreign investors and tourists for the stability and safety it offers.
- The Hun Sen government is taking steps to lay the ground for a smooth transition in which his eldest son will succeed him as prime minister. Such a succession would undoubtedly have its critics (mainly outside the country), and transition risks remain. However, they are less now than they were one year ago, and the public seems willing to accept this kind of transition.
- Cambodia's economic and diplomatic relations with Mainland China have continued to improve. If the Kingdom can keep COVID contained and coordinate its COVID tracing and monitoring policies with China, as it is trying to do, it should be one of the first countries in Southeast Asia that China starts relaxing restrictions so Mainlanders can visit more easily on business and for purposes of tourism.
- Foreign orders are strong, and many factories are running at capacity. COVID and other problems in neighboring Vietnam, Bangladesh and Myanmar have diverted more business to Cambodian factories, and this should help drive the economy in 2022.

B. Challenges

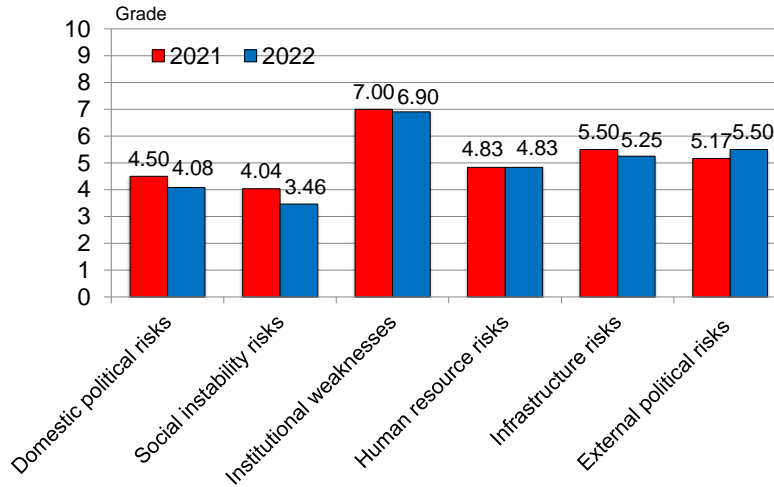
- Cambodia's extremely heavy reliance on China as a supplier (of goods, aid, tourists, and direct investment) and on the US as a market for its exports of goods entail downside risks that will have to be managed. Compounding the risks of having the economy so narrowly based is the delicate state of US-China relations that could evolve in ways that affect Cambodia adversely.
- The pandemic has highlighted the need for the government to do more to reach the informal economy or to bring the informal economy more into the formal economy. Relief efforts initially focused on the problems of companies and individuals working in the formal economy, but it soon became clear that the informal economy was

especially vulnerable and that it was not really an option to ignore the problems of unregistered workers and companies.

- Sharply rising freight rates and a shortage of containers will raise costs and result in delivery delays that could affect the timing of payments and push up prices. Locally, it could contribute to higher inflation in 2022, while affecting exporters' profits and cash flow.
- There is a need to speed up industrial diversification. The economy is still too dependent on garments and footwear. Developing new industries like electronics and spare parts manufacturing should reduce cyclical swings and broaden direct investment sources and export markets.
- The bursting of the Sihanoukville bubble just before the COVID pandemic hit highlights the need for better urban planning and forward thinking, stricter enforcement of building codes and other licensing requirements, and a more balanced development of supporting infrastructure.
- Managing the level of debt distress facing the banking and microfinance system is likely to be a growing challenge in 2022. The value of non-performing loans is likely to increase, as loan restructuring extends into 2022. This could weaken capital positions of the financial institutions, and reduce their ability to finance the recovery of the economy.

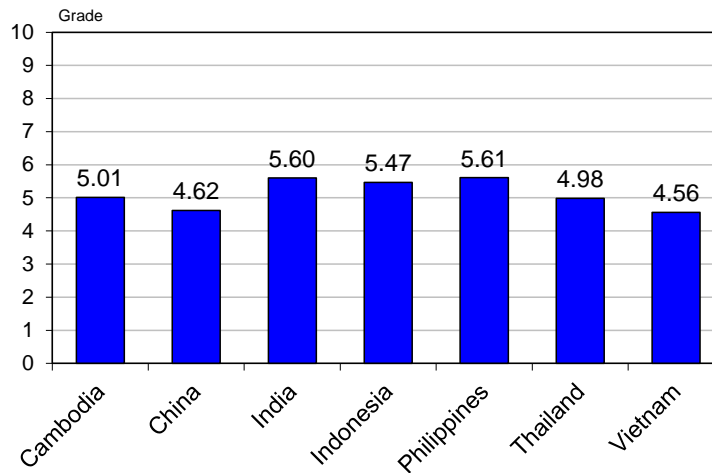
C. Graphic Summary of Perception Survey

Perceptions of Cambodia's Business Environment Risks



Grades range from zero to 10, with zero being the best grade possible and 10 the worst.

How Perceptions of Cambodian Socio-Political Risks Compare



Grades range from zero to 10, with zero being the best grade possible and 10 the worst.

Please refer to Appendices 4 and 5 for an explanation of PERC's country risk model and the specific grades used to compute the individual country risk indices.

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