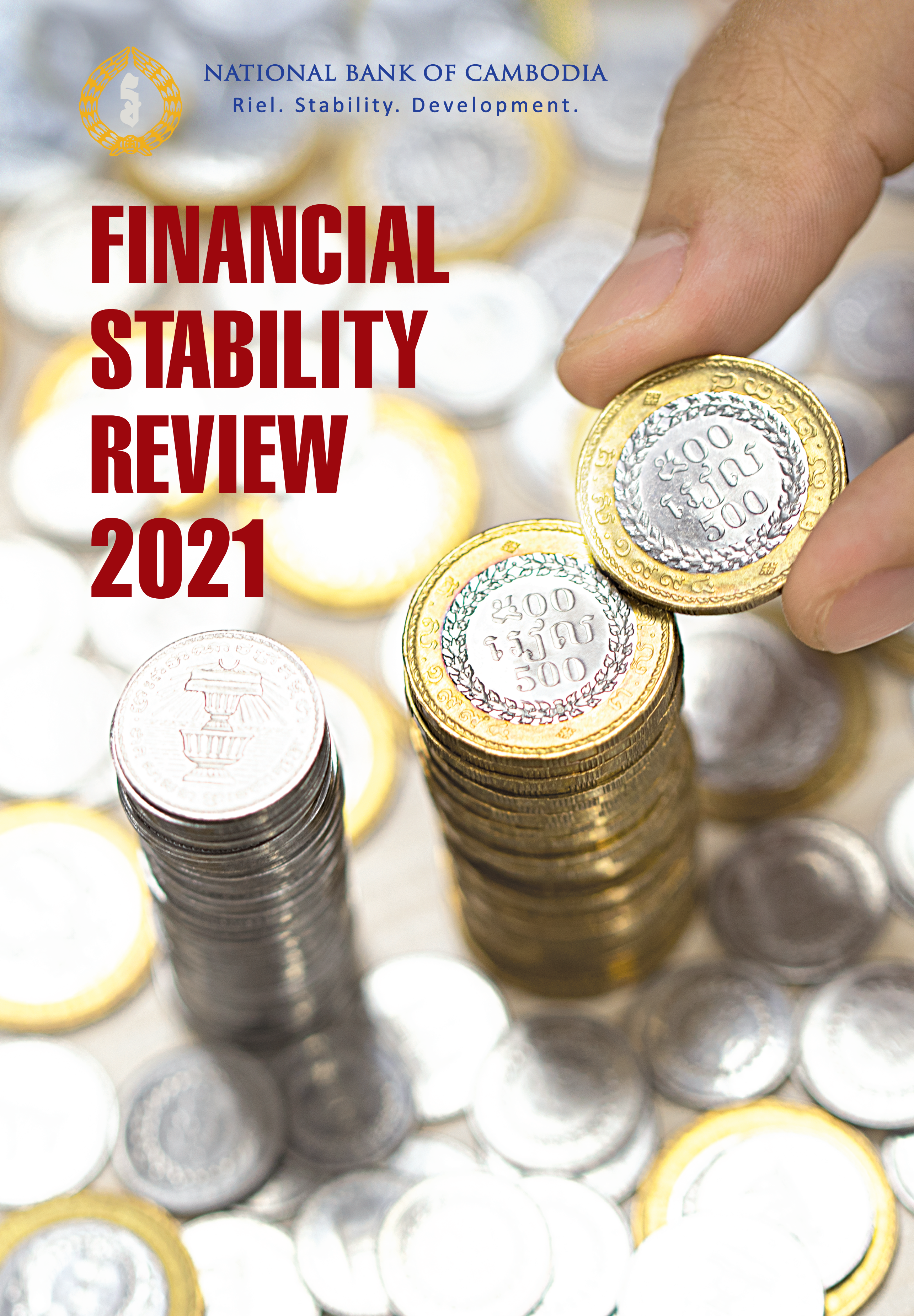
NATIONAL BANK OF CAMBODIA
Riel. Stability. Development.

FINANCIAL STABILITY REVIEW 2021



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Foreword

Both global and domestic economic activities rebounded in 2021 despite the emergence of new variants of COVID-19 and higher infection rates, though recovery has been uneven across countries and remains fragile. The relatively favorable global economic condition coupled with a successful domestic vaccination drive helped Cambodia post a V-shaped recovery, with the rate of economic growth shifting from −3.1 percent in 2020 to 3 percent in 2021. The upturn was underpinned by exports of garments and agriculture products and expansion in non-garment manufacturing as well as wholesale and retail trade; the tourism sector, however, contracted as international tourist arrivals plunged to −85 percent in 2021.

Encouragingly, a strong and resilient banking system, cushioned by NBC's policy support and regulatory forbearance measures, continued to play its critical intermediation role by providing necessary funding to businesses and households. Banks' key soundness indicators were robust, evident from their strong capital and liquidity buffers. Total assets of the banking system grew 18 percent to reach KHR281.5 trillion, equivalent to around 250 percent of the GDP in 2021. Credit growth was strong at 23.5 percent and broad-based, while asset quality remained healthy. NBC's restructuring policy for pandemic-affected borrowers allowed banks and MFIs to restructure loans worth USD4.9 billion, benefiting 310,746 accounts since the outbreak of COVID-19. However, with the prospects improving, NBC has started to gradually phase out some of the policy support measures.

Cambodia is fully open with no travel restrictions in place, thanks to high vaccination coverage and a negligible number of current infections. In terms of trade and investment, the country is set to gain from the Regional Comprehensive Economic Partnership, bilateral free trade agreements, and the introduction of a new law on investment. Nevertheless, the pandemic is not over yet, and risks of more virulent and transmissible variants remain. The Russia–Ukraine conflict and stringent lockdowns in China are also weighing on global growth. Inflation, which was already elevated amid supply–demand imbalances triggered by the pandemic, has soared further. As central banks in advanced countries strive to rein in inflation by hiking rates, emerging markets may face tighter financial conditions, larger capital outflows, and weaker domestic currencies.

As we learn to live with the pandemic, the world faces formidable challenges and an uncertain outlook. While navigating these challenging times, NBC will continue to closely monitor the developments in the Cambodian banking sector and the broader economy and will take any measures necessary to support domestic economic growth while preserving financial stability.

To keep the banking system sound and stable, NBC has steadily strengthened its capacity to identify, monitor, and mitigate any potential risks to financial stability. Accordingly, we have thoroughly revamped the Financial Stability Review (FSR), our flagship annual report primarily focusing on the performance and risk assessment of our bank-centric financial sector within the broader economic context. Through the publication of FSR 2021, we hope to offer better and deeper coverage of Cambodian financial institutions, markets, and payment systems as we endeavor to further promote transparency and help all stakeholders form a thorough understanding of the developments in our financial system.

Phnom Penh, June 10, 2022

Chea Chanto
Governor
National Bank of Cambodia

Executive Summary

The global economy recovered in 2021 but was uneven and continued to face several challenges. The global economy grew by 6.1 percent, yet growth rates diverged across income groups and regions. Advanced countries managed to rebound faster than emerging and developing countries as a result of higher vaccination rates and larger policy space. ASEAN economies achieved a growth rate of just 2.9 percent after being hit hard by escalating Delta waves. Besides the pandemic, several challenges put the strength of global and regional economic recovery under downside risks. Rising inflation, for instance, may cause a premature tightening of global financial conditions, adversely affecting the economic recovery process, particularly in developing countries.

Gradual global recovery revived Cambodia's economy, which heavily relied on external conditions. The Cambodian economy grew by 3 percent in 2021, mainly supported by impressive growth in exports of 25.1 percent (excluding gold), while the domestic economy, boosted by a high vaccination rate, progressively rebounded. Construction and real estate slowly recovered, while agriculture continued to grow at around 1.1 percent. Sectoral recovery, however, was uneven as tourism still struggled with international tourist arrivals in 2021 being down to −85 percent. The resurgence of COVID-19 cases in Cambodia and many other countries also weighed on investment sentiments, reflected in the declines of remittances and FDI inflow to −9.2 percent and −3.9 percent, respectively.

Fiscal and monetary conditions remained accommodative to boost economic recovery. The Royal Government of Cambodia has rolled out intervention measures equivalent to an accumulated amount of USD2.3 billion since the first intervention in 2020 to support poor households and businesses that were badly affected by the crisis. Monetary conditions also remained supportive to encourage credit flows to finance the economy amid the pandemic, while the loan restructuring policy was extended to lessen the burdens of households and firms.

Despite the accommodative policies, the government's debt distress was low, and inflation was still subdued. Government debt increased by 7.7 percent to 36.4 percent of the GDP, yet this ratio remained sustainable. Inflation was low at 2.9 percent, owing to the slower growth of food prices and core inflation, while sound control of the money supply and the stable exchange rate partly played a role as well.

The National Bank of Cambodia (NBC) actively intervened in the foreign exchange market to stabilize the exchange rate, and international reserves remained sufficient. NBC sold nearly USD600 million in 2021 to banks and money changers through auctions to stabilize the exchange rate that was under pressure due to the decline in tourism and remittance receipts coupled with other challenges faced by the country in its recovery process amid the lengthy pandemic. Thus, the exchange rate was KHR4,099 per USD on average, depreciating by approximately 1 percent compared to 2019. International reserves, while declining by 5 percent compared to 2020, still covered 8.3 months of prospective imports, which was higher than the 3-month minimum benchmark.

The banking system remained sound and resilient while steadily providing necessary funding to support economic recovery from the COVID-19-induced shock. Assets and deposits of the banking system grew by 18 percent and 17.7 percent, respectively, with credit posting an even stronger growth of 23.5 percent. Within the banking system, commercial banks accounted for over 85 percent of assets, followed by MDIs and MFIs.

Bank credit posted a robust growth and was broad-based. Bank credit recorded 26.4 percent growth to KHR155.3 trillion, mainly provided to retail trade, mortgages, wholesales, construction, and real estate. Asset quality remained healthy, in fact, slightly improving in 2021 as the NPL ratio slid to 1.8 percent.

Banks' liquidity and capital levels remained healthy. LCR was 151.6 percent, well above the regulatory requirement of 100 percent. Banks' capital adequacy level stood at 23 percent, well above the regulatory benchmark of 15 percent, reflecting banks' loss absorption capacity in case of unexpected shocks materializing. At the same time, banks' profitability remained healthy.

The microfinance sector continued to support households, agricultural activities, and SMEs, while credit quality remained sound. Credit growth accelerated to 26 percent in 2021 compared to 12.4 percent in 2020, mainly targeting households, trade, agriculture, and services. The NPL ratio slightly increased compared to 2020 yet remained healthy, as the ratio was just 2.4 percent in 2021.

Amid the pandemic, MDIs maintained healthy liquidity buffers to withstand potential stress events. MDIs' LCR at 160 percent at the end of 2021 was well above the regulatory requirement. Capital adequacy levels were also high, with ratios of 18.2 percent for MDIs and 40.7 percent for MFIs.

The non-bank financial sector continued to grow gradually. Amid the pandemic, Cambodia's equity markets welcomed an additional company in 2021, which was listed on the new CSX Growth Board for SMEs for the first time since the creation of the platform in 2015. Meanwhile, Cambodia's bond market became one of the important sources of financing in local currency for banks and financial institutions as well as private companies. At the end of 2021, bond market capitalization was recorded at KHR542.4 billion, of which KHR377.9 billion belonged to banks and financial institutions. The insurance sector's prospects were also positive, supported by premiums for both general and life insurance that increased by 10.2 percent to KHR1.2 trillion.

The development of payment and settlement systems over the last decade underpinned economic activities amid the pandemic. In line with market demands in Cambodia, characterized by a young population and high mobile phone and internet penetration, NBC has created an enabling environment and regulatory framework to encourage banks and financial institutions to introduce innovative digital payment services. As a result of the modernized payment system, the government could provide timely social assistance to affected workers and vulnerable households through digital transfers. Digital payments were also essential to keeping the wheels of business transactions turning amid tightened social distancing measures. It is worth noting that in 2021, the amount of retail electronic payments in both KHR and USD significantly expanded to equal 3.8 times the GDP with a YoY growth rate of 34.5 percent, while the number of e-wallet accounts surged to 13.6 million, accounting for more than 80 percent of the total population.

Outlook:

In 2022, Cambodia's economy is expected to continue its recovery process, though several downside risks remain. In line with the global and regional economic outlook, Cambodia's economy is expected to grow by around 5 percent, mainly supported by exports of manufacturing products, agriculture, transport, and communications. The recent free trade agreements with China and Korea and the Regional Comprehensive Economic Partnership (RCEP) are expected to attract more investments and further boost Cambodian exports. With the gradual easing of COVID-19-related restrictions due to a rapid vaccine rollout program (including booster doses), domestic economic activities will progressively rebound, as reflected in the Google mobility index. There have been signs of increased international arrivals and domestic tourists as well in the first quarter of 2022, which will support the recovery of the service sector after being contracted in the last two years. The construction and real estate sectors are also expected to recover gradually.

Nevertheless, Cambodia is facing several downside risks. First, despite the limited macroeconomic and financial linkages between Cambodia and Ukraine–Russia, the prolongation and escalation of the war may cause more damage to the global economy, particularly the European Union, which is one of Cambodia's main export destinations. At the same time, this crisis has weighed on global and regional economic recovery through the rise in international commodity prices, putting more upward pressures on currently high inflation in many countries. As Cambodia imports several food items and oil from abroad, inflation may be much higher than the previous year, which would put pressure on households' purchasing power. Second, China's recent economic slowdown due to its strict zero-COVID strategy has led to more frequent and wider-ranging lockdowns and the retrenchment of China's real estate sector, which may affect the economic recovery of Cambodia that heavily relies on Chinese investments and imported materials for the kingdom's export-oriented industry. Third, the tightening of global financial conditions as a consequence of persistent and soaring inflation since the second half of 2021 may affect the flow of capital into emerging and developing countries and decelerate the recovery momentum in the region as well as in Cambodia. Fourth, although the Omicron infection rate in Cambodia is low and its severity is weak, the threat from new variants remains as long as the global pandemic is not over. In addition, the continued wide spread of Omicron in the region may disrupt economic activities and have spillover effects on Cambodia's economy through remittances, tourism, investment, and export channels. Fifth, climate change poses a significant risk to the kingdom's agricultural production, which is vulnerable to extreme weather events.

Within this economic prospect, Cambodia's banking system, which has been robust amid the pandemic, is expected to continue to support economic recovery but with more emphasis on the balance between economic growth and financial stability going forward. Over the last two years, the banking system has played a key role in backing economic activities, including sustained credit growth and loan restructuring, and has weathered the pandemic pressures on the Cambodian economy. The banking system is also resilient, as reflected in a healthy capital position and liquidity and a low NPL ratio, partly supported by NBC's measures. With the current signs of recovery on the horizon, accommodative financial conditions can be reduced to avoid the build-up of risks to financial stability, although risks remain low so far.

Going forward, the banking system is subject to risks related to the uncertainties of COVID-19 evolution and the escalation of geopolitical tensions, which may elevate financial risks through the fall in economic activities, thus affecting firm and household incomes and causing debt accumulation. Meanwhile, the sluggish property market in China may affect the sentiment in the Cambodian real estate market and construction activities, imposing risks to the banking sector through the lending channel. A faster tightening of global financial conditions may have effects on MFIs that obtain some of their funds from abroad. For banks and MDIs, though the direct effects of the rise of global interest rates are limited because these institutions are largely funded through domestic deposits, the spillover effects from the real sector must be carefully monitored given that Cambodia is a small and open economy that may be vulnerable to changes in external conditions. NBC will continue to collaborate with all relevant authorities to closely track the evolution of economic conditions and the soundness of the banking system. NBC has already started phasing out some support measures, such as the loan restructuring facility, which is now restricted to fresh customers. Exiting from other policy support measures will also be considered to strengthen financial resilience and stability, but they will be phased out gradually in line with the evolution of outlook and risks to avoid stalling economic recovery.

I Macroeconomic Conditions and Stability

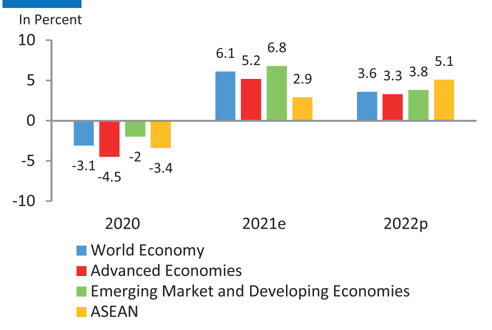
In 2021, the global economy rebounded, but the recovery was uneven due to the global supply chain disruption and surges in COVID-19 cases in many countries. The global growth has supported Cambodia's exports, while domestic economic activities, boosted by the rapid vaccine rollout, have also slowly picked up. As a result, Cambodia's economy grew by 3 percent, yet it was subject to significant challenges given that FDI inflows, tourism, and remittance receipts continued to be subdued, whereas imports accelerated. All of these factors contributed to narrowing the surplus of the balance of payments (BoP) and putting depreciation pressure on the KHR exchange rate. However, an adequate level of accumulated international reserves and timely intervention in the foreign exchange market by the National Bank of Cambodia (NBC) helped keep depreciation pressure under control. Additionally, accommodative financial conditions were maintained to boost economic recovery in line with the fiscal policy that also remained supportive. Despite the accommodative policies, inflation was below 3 percent, partly supported by sound control of the money supply and stable exchange rate, while Cambodia remained at low risk of external debt distress.

1.1. External Conditions

A. Global Economy

The global economy was on the recovery track, but it was uneven, and momentum weakened due to pandemic dynamics. Global economic growth rebounded from −3.1 percent in 2020 to 6.1 percent (Figure 1.1), largely on the strength of advanced countries because of their unprecedented monetary and fiscal policy support and high vaccination rates. Advanced economies registered a 5.2 percent growth in 2021, while emerging market and developing economies grew by 6.8 percent, partly lifted by China's strong growth of 8.1 percent. Global growth would have been higher if not for the recurrence of the Delta variant in the second half of the year. For ASEAN, recovery momentum was also interrupted as many countries retightened containment measures to curb the spread of COVID-19, dragging regional growth to recover by just 2.9 percent.

1.1 World Economic Outlook

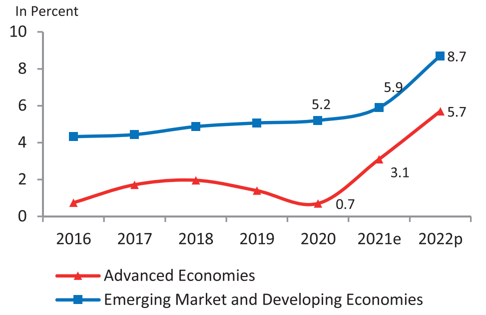


Source: WEO (April 2022) and AMRO (2021, 2022)

Global recovery was also under pressure from rising inflation and several key challenges besides the lengthy pandemic. The rise in shipping costs, commodity and food prices, supply chain bottlenecks, and a strong rebound in consumption pushed up inflation across many countries, particularly in advanced economies that experienced a jump in inflation from 0.7 percent in 2020 to 3.1 percent in 2021 (Figure 1.2). The inflationary spike, trade and geopolitical tensions, climate change, elevated public and private debts, rising poverty, and widening inequality, among other problems, made the road to recovery very challenging. However, it is worth noting that inflation in ASEAN stayed low at 2.5 percent in 2021 due to the slower recovery that kept the core inflation relatively lower, and the growth of food prices was also moderate.

High and persistent inflation worldwide may lead to a premature tightening of global financial conditions that had been accommodative in 2021. Most central banks, whether in advanced, emerging, or developing economies, kept their policy rates low to support economic recovery. However, rising inflationary pressure persuaded several central banks, notably in advanced countries, to start normalizing their monetary policy. Tightening monetary conditions imply higher costs to restore the economy, especially in developing countries where policy space is narrower. In any case, the global banking sector remained resilient with a solid capital position and continued to play a crucial role in supporting the flow of credit to finance the economy.

1.2 World Inflation

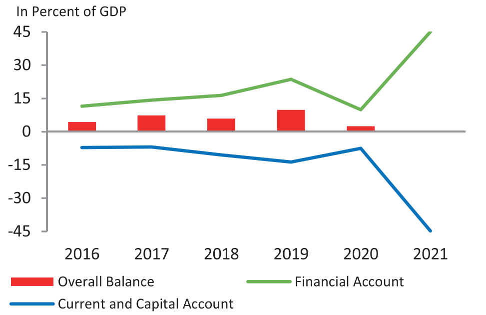


Source: WEO (April 2022)

B. Cambodia's Balance of Payments (BoP)

The overall balance surplus continued to narrow to just 0.3 percent of the GDP (Figure 1.3). In 2020, the surplus had already reduced to 2.5 percent of the GDP. In 2021, the current and capital account deficit increased to 44.8 percent of the GDP (7.5 percent of the GDP in 2020) after a significant rise in merchandise imports and a huge deficit in net services further put pressure on the overall balance. However, the financial account was still able to keep the overall balance positive, with a net incurrence of liability of 45.1 percent of the GDP on account of FDI and other investments.

1.3 Balance of Payments

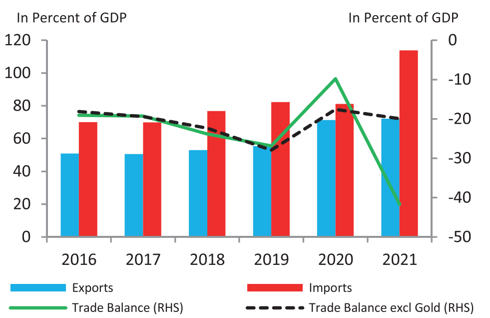


Source: NBC

B.1. Current Account

Global economic recovery boosted Cambodian exports, yet imports strongly increased, leading to a widening deficit in the trade balance. The deficit of merchandise goods equaled 41.7 percent of the GDP compared to 9.8 percent in 2020 (Figure 1.4). This was due to the rise in imports of goods by 45.9 percent, driven by a significant increase in imported gold (5 times), followed by construction materials and equipment (27.1 percent), garment materials (25.2 percent), petroleum (42 percent), and vehicles (5.2 percent). Meanwhile, exports grew by 5.1 percent (excluding gold, exports increased by 25.1 percent), aided by growing exports of garments[1] (15.4 percent), electrical parts (52 percent), bicycles (18.7 percent), and rubber (46.7 percent). It is worth highlighting that excluding the trade of gold,[2] the trade balance equaled −20 percent of the GDP in 2021, which was slightly higher than the deficit in 2020 (−17.6 percent).

1.4 Exports, Imports, and Trade Balance

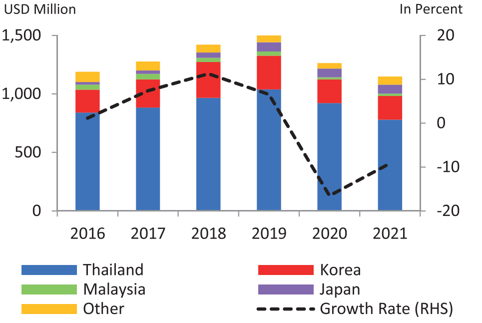


Source: General Department of Customs and Excise, NBC's staff calculation

[1] Including clothing, footwear, bags, and other textiles.
[2] Since 2020, international trade in gold has significantly emerged.

The prolonged pandemic duration in Cambodia and the region drove a huge deficit of net services, and remittances continued to decline. There were only 0.2 million visitors to Cambodia in 2021, declining to −85 percent. This led net services to register a deficit of USD1.4 billion (−5.4 percent of the GDP). At the same time, lower demand for migrant workers resulting from the COVID-19 outbreaks and stringent measures in host countries caused the number of Cambodian migrant workers to decrease from 1.2 million in 2020 to 1.1 million in 2021.[3] Remittances thus decreased by 9.2 percent to USD1.1 billion (Figure 1.5), mostly affected by the fall in remittances from Thailand (−15.4 percent), though remittance flows from Korea, Japan, and Malaysia grew by 1.1, 0.7, and 5.4 percent, respectively.

1.5 Remittances by Countries

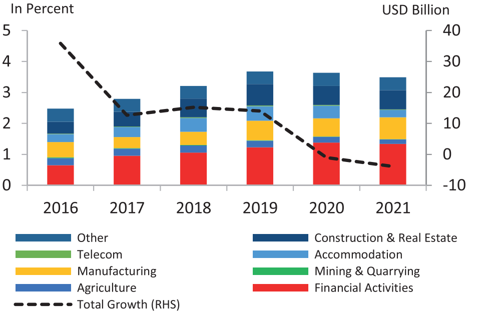


Source: NBC

B.2. Financial Account

FDI inflow was not seen to recover yet because of pandemic-related uncertainty. FDI inflow was recorded at USD3.5 billion in 2021, declining by 3.9 percent (Figure 1.6). A slowdown in banks' capital investment led FDI in the financial sector, which accounted for one-third of total FDI, to decline by 3 percent. FDI in the non-financial sector decreased by 4.4 percent, particularly in accommodations[4] (−43.7 percent), agriculture (−22.3 percent), and telecoms (−11.1 percent). However, other sectors recorded positive growth, such as manufacturing (21.3 percent) and construction and real estate (1.1 percent). The hydropower and energy sectors that represented 4.3 percent of total FDI inflow in 2021 remarkably increased by 2.6 times, showing the government's efforts to attract investments into this sector with the aim of lowering energy costs, which was a major barrier to accelerating the country's economic development for many years.

1.6 FDI Inflows by Sectors



Source: Council for the Development of Cambodia, NBC's staff calculation

[3] Ministry of Labour and Vocational Training and NBC's staff calculation.
[4] The sector includes hotels, restaurants, and casinos.

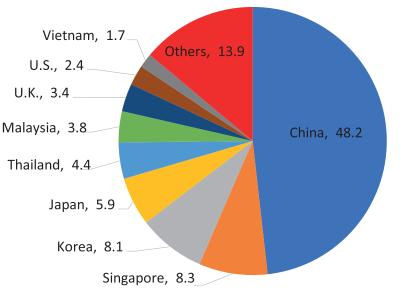
Asia was the main source of FDI inflows, with China at the top of the list. China remained the top foreign investor in Cambodia, accounting for nearly half of the total FDI inflow in 2021 (Figure 1.7). Investment from China mainly flowed into the manufacturing, finance, construction and real estate, and accommodation sectors. The other Asian contributors were Singapore (8.3 percent), Korea (8.1 percent), Japan (5.9 percent), Thailand (4.4 percent), and Malaysia (3.8 percent).

By the end of 2021, gross external debt[5] grew by 13.9 percent. Driven by the growth in private debts, the country's gross external debt reached USD20.1 billion, equivalent to 69.1 percent of the GDP (Figure 1.8). Indeed, the growth of deposit-taking corporations' gross external debt accelerated to 17.7 percent, reaching USD10.2 billion, of which USD5.8 billion was from long-term borrowing. The government's external debt, all long-term loans, also rose by 17.7 percent to USD9.5 billion.

C. Exchange Rate and International Reserves

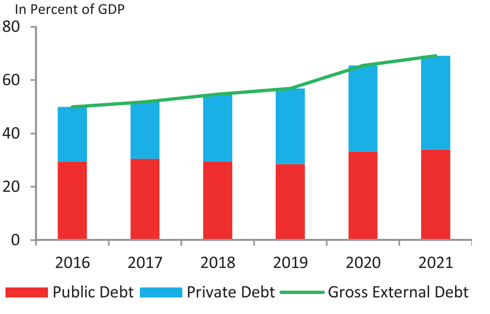
Challenges faced by the economy in its recovery process and the narrowed BoP surplus caused depreciation pressure on the KHR exchange rate, but the pressure was well under control. Exchange market pressure[6] (EMP) was within the band (Figure 1.9), supported by NBC's intervention in the foreign exchange market to stabilize the KHR exchange rate against the USD.

1.7 FDI Inflows by Country
(As of December 2021, in Percent)



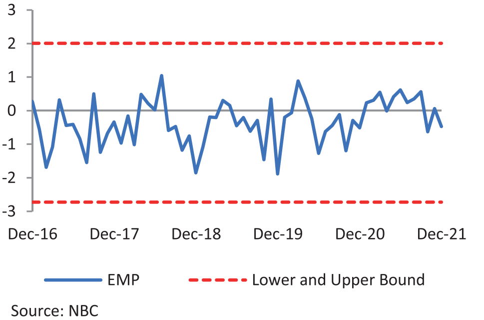
Source: Council for the Development of Cambodia, NBC's staff calculation

1.8 Composition of Gross External Debt



Source: General Department of Treasury

1.9 Exchange Market Presure Index



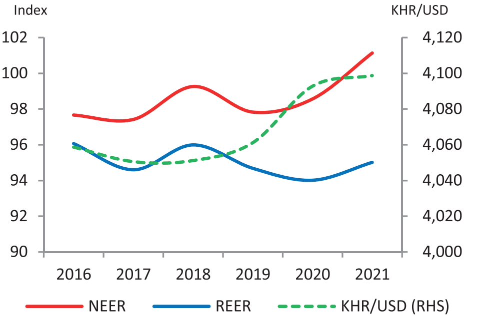
Source: NBC

[5] External debt covers external borrowing by the public sector (the government and central bank) and deposit-taking corporations only.
[6] The methodology to estimate EMP can be found on page 13 of the Financial Stability Review 2018.

Indeed, NBC sold nearly USD600 million to banks and money changers through auctions in 2021. This intervention contributed to keeping the exchange rate stable so that it hovered around KHR4,099 per USD on average, depreciating by approximately 1 percent compared to 2019. Meanwhile, the nominal effective exchange rate (NEER) against key trading partners also depreciated by 2.6 percent, yet higher inflation in Cambodia partly offset this depreciation, leading the real effective exchange rate (REER) to slightly depreciate by 1.1 percent (Figure 1.10), which is good for Cambodian trade competitiveness.

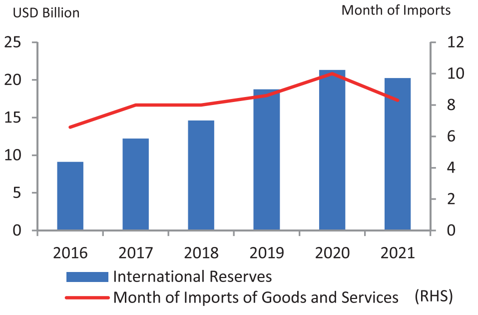
Despite NBC's intervention in the foreign exchange market, international reserves remained sufficient to maintain market confidence. International reserves equaled USD20.3 billion at the end of 2021, equivalent to 70 percent of the GDP. They decreased by 5 percent compared to 2020 but could cover 8.3 months of prospective imports (Figure 1.11), higher than the minimum benchmark of 3 months for developing countries. Using another adequacy matrix in comparison to broad money (M2), international reserves equaled 52 percent of M2, which was again higher than the benchmark of 20 percent. Nevertheless, in the context of high dollarization (reserves barely matched 62.7 percent of foreign currency deposits) and a stabilized exchange rate regime like the case of Cambodia, further accumulation of international reserves would be desirable to strengthen macroeconomic and financial resilience against acute shocks.

1.10 KHR Exchange Rates



Note: A higher index indicates the depreciation of the KHR exchange rate against key trading partners.
Source: NBC

1.11 International Reserves



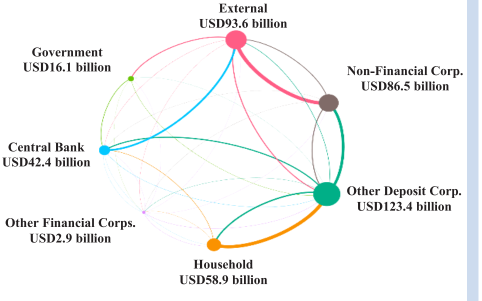
Source: NBC

Box: 1.1

Balance Sheet Analysis

Financial positions in 2021 increased despite COVID-19. The gross financial positions of all sectors from the perspective of assets and liabilities accumulated to USD423.8 billion, an increase of 9.2% compared to USD388 billion in 2020. During the period, ODCs played a more active role in collecting resources, typically from households, and providing the majority of funds to NFCs. In terms of net position, ODCs showed a net creditor of USD2 billion, an increase of 20 percent YoY from USD1.6 billion in 2020. ODCs received an inflow of funds from the rest of the sectors of USD60.7 billion, an increase of 15.6 percent YoY due to the higher influx from households (17.9 percent), external sectors (17.4 percent), and NFCs (10.5 percent), whereas claims on the rest of the sectors reached USD62.7 billion, an increase of 15.7 percent from USD54.2 billion in 2020. This was mainly due to an upsurge in the provision of funds to NFCs and households, most of which were in the form of loans.

A The Gross Financial Position of All Sectors in 2021

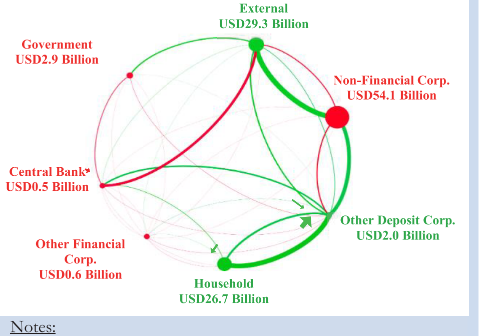


Notes:

- The size of the bubble represents the total assets and liabilities of each sector.
- The colored lines from each sector toward the other sectors represent the claims from those sectors.

External sectors and ODCs were the major sources of funds to NFCs. NFCs indicated a net debtor of USD54.1 billion, an increase of 13.3 percent due to the rise in the inflow of funds from external sectors (10.1 percent) in the form of FDI and borrowing from ODC (+13.1 percent). The fund's inflow from the rest of the sectors into the NFCs accumulated to USD70.3 billion, which was an increase of 10.9 percent YoY. With regard to claims from the rest of the sectors, NFCs recorded USD16.2 billion, a minimal increase of 3 percent.

B The Net Financial Position of All Sectors in 2021



Notes:

- The size of the bubble represents the relative size of the net financial position of each sector.
- The bubbles in red represent net debtors, while the green represent net creditors.
- The colored lines from each sector toward the other sectors represent the claims from those sectors.

The interconnectedness of external sectors with all sectors in Cambodia was also boosted after declining in previous years. External sector net claims were USD29.3 billion in Cambodia, an increase of 33.2 percent. The influx of funds from external sectors to the rest of the sectors accounted for USD61.4 billion, up by 10.9 percent, whereas outflows amounted to USD32.1 billion, decreasing by 16.2 percent. NFCs were the main recipients of funds from this sector, accounting for 67 percent of the total outflows from external sectors, while the inflow from NFCs to the external sectors contributed only 23 percent to total inflows.

1.2. Domestic Sector

A. Economic Growth

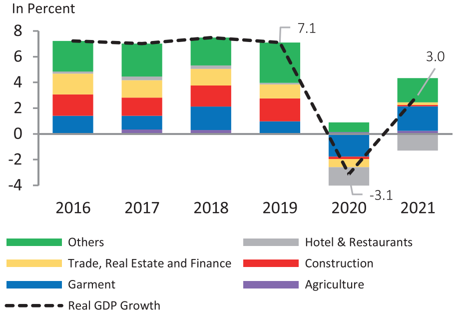
In line with the global economic recovery, Cambodia's economy in 2021 recorded a 3 percent growth rate (Figure 1.12)**.** This positive growth was supported by exports of garments and other manufacturing items, construction, agriculture, and wholesale and retail trade. However, the recovery was uneven as tourism continued to decline.

Fueled by improved external demand conditions, the manufacturing sector bounced back fast. Exports of garments (65.1 percent of total exports) increased by 15.4 percent, while exports of non-garment products climbed by 42 percent (excluding gold), particularly electrical parts, bicycles, and other agricultural products.

With strengthening domestic economic activities, the construction sector slightly recovered. Since the sectoral decline in 2010 due to the global financial crisis (GFC), construction activity has recorded a remarkable growth rate of 17.3 percent on average until it was shocked by the pandemic, leading the sector to decline by 1.8 percent in 2020. The sector slightly recovered with a growth rate of 1.1 percent in 2021 (Figure 1.13).

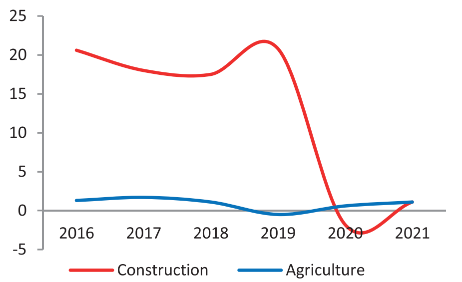
Agriculture continued to underpin economic recovery with a growth rate of 1.1 percent (Figure 1.13). This sector expanded as a result of additional investment, the government's supporting measures, favorable weather conditions, and increased labor availability. For instance, the cultivated area and rice yield during the wet season increased by 4 percent and 10.2 percent, respectively. However, aquaculture output, especially fish and shrimp farming, recorded a negative growth of −13 percent due to the fall in domestic demand and import competition.

1.12 Contribution to Growth



Source: NIS, NBC's staff calculation

1.13 Growth of Construction and Agricultural Sectors



Source: National Institution of Statistics, NBC's staff calculation

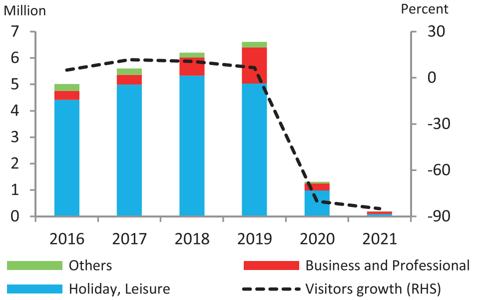
A resurgence of COVID-19 cases in Cambodia and the region struck the tourism industry severely. The number of international visitor arrivals further edged down to −85 percent (to 196,495 visitors) after it plummeted by 80.2 percent in 2020 (Figure 1.14), putting the tourism industry and related sectors under threat. However, the successful rollout of the vaccination campaign across the country, with around 90 percent of the total population being vaccinated by the end of 2021, has allowed the authorities to gradually relax travel restrictions since November 2021, which has helped bring back tourist activities, underpinned initially by a revival of domestic tourism.

In 2021, Thai tourists led international visitors in Cambodia, while China fell to the second rank. Between 2016 and 2020, Chinese tourists topped the list of foreign visitors to Cambodia with an average share of 27.3 percent, followed by Cambodia's neighboring countries: Vietnam (14.9 percent), Thailand (7.5 percent), and Lao PDR (6.9 percent). Due to China's stricter travel restrictions and reduction in long-distance traveling during the pandemic, Thailand overtook China and other countries to become Cambodia's largest tourist source with a share of 41.7 percent (Figure 1.15).

B. Construction and Real Estate

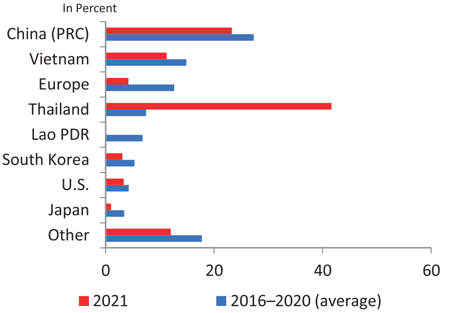
The development of construction and real estate has been highly leveraged over the last decade, requiring a closer look at potential risks to financial stability arising from the sector. Despite impressive economic growth before the pandemic, Cambodia's economic activities have relied on a few sectors, among which the share of construction and real estate has represented around one-fifth of the GDP. Given a high credit growth to the sector (see chapter 2), construction and real estate are key sectors to scrutinize.

1.14 Number of International Arrivals by Purpose of Visit



Source: Ministry of Tourism and Department of Migration, NBC's staff calculation

1.15 Share of tourist arrivals by country



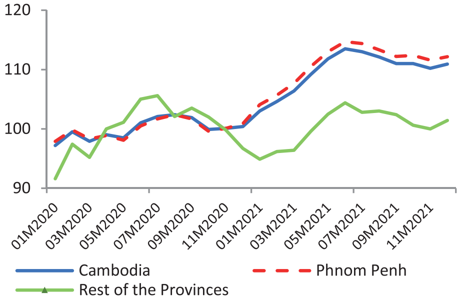
Source: Ministry of Tourism and Department of Migration, NBC's staff calculation

The residential property price index[7] (RPPI) has been compiled to monitor the residential property market conditions, and the results showed that this market was stable, both in Phnom Penh and the provinces (Figure 1.16)**.** Overall residential prices in 2021 increased by 10.9 percent compared to 2020, indicating that the housing market continued to be attractive to buyers despite the pandemic. The increase in overall prices may have been mainly due to the uninterrupted development of infrastructure to connect various areas in Cambodia and higher demands for the affordable and mid-priced segments in Phnom Penh's surrounding areas as a result of increasing people's mobility from provinces to work and study in the city.

Increasing imports of construction materials and equipment and FDI inflow to the sector were also signs of recovery in 2021. Imports of construction materials and equipment increased by 27.1 percent[8] after a contraction of −12.2 percent in 2020 (Figure 1.17), suggesting a restart of suspended construction projects. Meanwhile, FDI inflow to the construction and real estate sector slightly increased by 1.1 percent, turning from a negative rate of −10.6 percent in 2020.

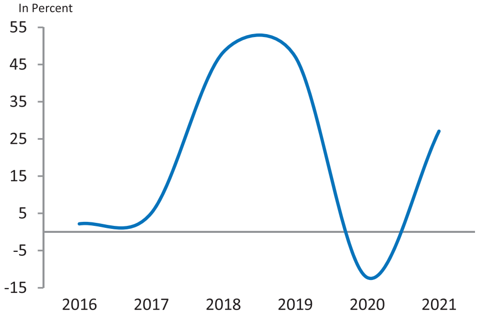
Going forward, however, the sector remains at risk because investors may still hold a wait-and-see position. Despite the sectoral recovery, the number of approved construction projects and their values fell by 11.2 percent and 31.2 percent, respectively (Figure 1.18), showing that investors might be still in a wait-and-see situation. Meanwhile, the market for condominiums remained sluggish, particularly the high-end and mid-range condominiums that rely on foreign buyers. NBC will keep working closely with other authorities to

1.16 **Cambodian RPPI Index**



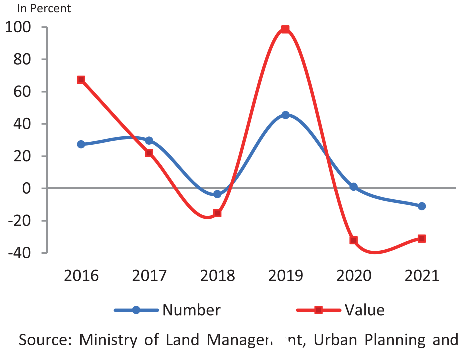
Note: 2020 is the base year index and equals 100.
Source: NBC

1.17 **Growth of Construction Materials and Equipment Imports**



Source: General Department of Customs and Excise, NBC's staff calculation

1.18 **Growth of Construction Projects**



Source: Ministry of Land Management, Urban Planning and Construction, NBC's staff calculation

[7] The methodology used to generate the RPPI index is the time-dummy hedonic method with 18-month rolling windows, which follows the IMF's RPPI Practical Compilation Guide published in 2020 (https://www.imf.org/en/Data/Statistics /RPPI-guide). The variables used in the regression model are date, property type, title, location (province or district), built area, land area, purchase price of property, number of floors, number of bedrooms, and width of house. All variables are taken from the credit transactions to buy residences from 67 commercial banks with around 1,000 monthly transactions.
[8] However, this high growth rate was also partly related to an increase in the price of imported construction materials and equipments.

monitor the evolving conditions in the sector and their implications on macroeconomic and financial stability.

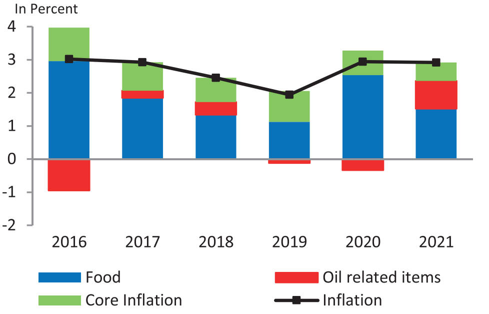
C. Inflation and Monetary Conditions

Headline inflation remained subdued at an average of 2.9 percent, owing to the slower growth of food prices and core inflation (Figure 1.19). Food prices and core inflation recorded slower growths of 2.7 percent and 1.6 percent, respectively (compared to 4.6 percent and 2.1 percent in 2020), driven by the slower demand as a result of stringent measures after the "February 20 community event", which saw the first widespread outbreak of COVID-19 in Cambodia. However, the prices of oil-related items significantly rose by 8.6 percent as a result of global recovery after declining by 3.2 percent in 2020.

Low and stable inflation resulted from the stable exchange rate and sound control of the money supply (M2). In 2021, M2 grew at 16.3 percent, in line with economic recovery without putting pressure on inflation (Figure 1.20). The growth of M2 was supported by the increases in deposits of 17.1 percent amid the pandemic (reflecting public confidence in the banking system) and currency in circulation of 8.3 percent.

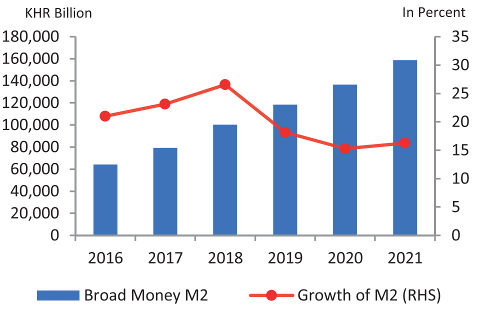
Financial conditions remained accommodative to support economic recovery. NBC maintained loose financial conditions to provide additional liquidity to the banking system at lower costs, including keeping the reserve requirement rates (RRR) at 7 percent for all currencies and reducing the minimum interest rate on the liquidity-providing collateralized operation (LPCO) by 0.5 percent for all maturities. In addition, to cushion the impacts of the pandemic on the economy and banking system, among other measures, NBC maintained the capital conservation buffer at 1.25 percent and authorized financial institutions to continue to restructure loans for households and firms.

1.19 Contribution to Headline Inflation



Source: NBC

1.20 Broad Money M2



Source: NBC

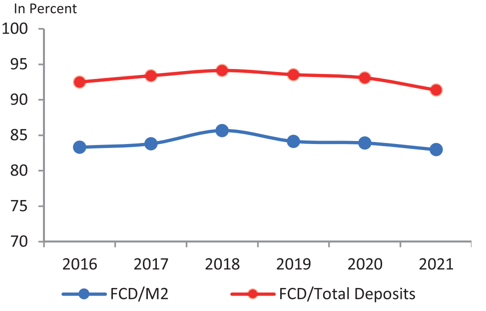
NBC would have more policy options to rebuild the economy if the level of dollarization is not high. A more riel-based economy will allow NBC to effectively implement monetary policy in response to economic shocks. Therefore, NBC has put efforts into gradually de-dollarizing the economy through the facilitation of KHR usage, regulation setting that aims to boost loans in KHR, and public awareness-raising of the role of the national currency in strengthening economic resilience. Those efforts have contributed to gradually decreasing financial dollarization, measured by the ratios of foreign currency deposits to M2 and total deposits. However, the level of dollarization was still above 80 percent (Figure 1.21), which limits NBC's role in influencing money supply and interest rates. Thus, policy coordination and active participation from the public and all stakeholders are necessary to further promote the use of the KHR.

D. Fiscal Sector

Lower revenue collection and continued fiscal support further widened the fiscal deficit and put more pressure on the government's financing (Figure 1.22). The fiscal position continued to widen, leading to a net borrowing of −5.3 percent of the GDP compared to −3.8 percent in 2020. This fiscal deficit prompted a drawdown of fiscal reserve and increased the government's debt.

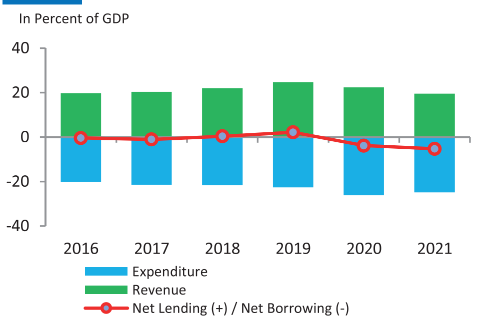
Revenue collection decreased as a result of slow economic recovery and tax relief measures. The government's revenue equaled KHR20.8 trillion, which continued to decline by 10.2 percent (Figure 1.23), with a slight improvement compared to 2020 (−15.1 percent). This was primarily due to the fall of tax collection by 4.2 percent, in which taxes on goods and services dropped by 9.6 percent and taxes on international trade and transactions by 3 percent, but the tax on income, profit, and capital gains increased by 2.6 percent. Meanwhile, grants that represented 5 percent of total revenue decreased by 49 percent.

1.21 Financial Dollarization



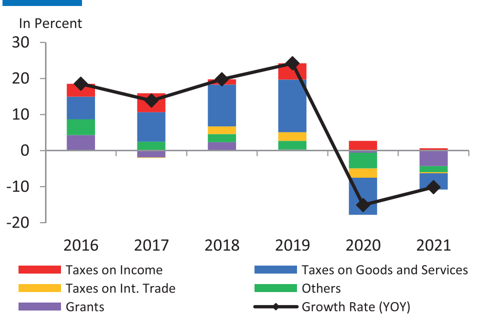
Source: NBC

1.22 Fiscal Balance



Source: Ministry of Economy and Finance

1.23 Contribution to Revenue Growth

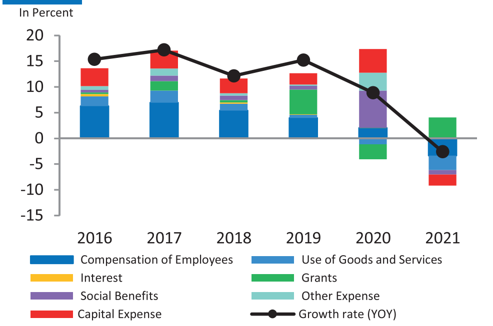


Source: Ministry of Economy and Finance

The Royal Government of Cambodia kept providing stimulus packages to protect the most vulnerable and support economic recovery. Nevertheless, despite increasing stimulus packages, overall expenditure, which equaled KHR26.4 trillion, declined by 2.6 percent (Figure 1.24) as a result of the government's efforts to rationalize its current spending, especially on wages (−10.9 percent) and the use of goods and services (−26.3 percent). At the same time, both capital expenditure and social benefits decreased by 6.7 percent. It should be noted that in 2020 and 2021, the government rolled out 10 rounds of intervention measures and spent USD2.3 billion to assist around 2 million poor and vulnerable households and support businesses strongly affected by the pandemic.

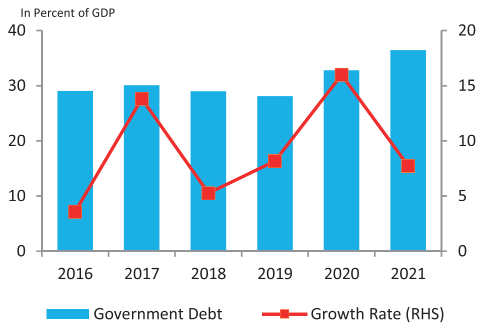
Despite increasing pressure on the government's financing, the risk of government debt distress was low. By the end of 2021, government debt increased by 7.7 percent to USD9.49 billion (36.4 percent of the GDP) (Figure 1.25). China was the largest creditor, sharing 42.7 percent of the total government debt, followed by multilateral loans (30.4 percent), Japan (9.2 percent), and Korea (5.3 percent) (Figure 1.26). According to the debt sustainability analysis of the Ministry of Economy and Finance (MEF), Cambodia's public debt remained at low risk. The presents value of public and publicly guaranteed debt in the GDP was 24.4 percent, much lower than the 40 percent threshold.

1.24 Contribution to Expenditure Growth



Source: Ministry of Economy and Finance

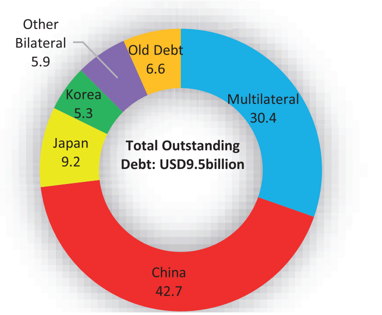
1.25 Government's Debt



Source: Ministry of Economy and Finance

1.26 Government Debt by Main Creditors

(in Percent, As of 2021)



Source: Ministry of Economy and Finance

Box 1.2

Government Policy Intervention to Help Local Businesses and Social Welfare Amid the COVID-19 Pandemic

To mitigate the impact of the COVID-19 pandemic on social and economic activities, the Royal Government of Cambodia spent USD2.3 billion in 2020–2021 with 10 rounds of relief measures. This intervention has contributed to keeping businesses afloat, stimulating economic growth, and providing minimum basic needs for 700,000 vulnerable households. The measures included:

- providing wage subsidies for garment workers of USD70 a month (Government: USD40, Employer: USD30) until the end of 2021
- exempting monthly taxes for hotels, guesthouses, restaurants, and travel agents in Kampot, Preah Sihanouk, Kep, Siem Reap, Phnom Penh, Bavet, and Poipet until the end of 2021
- exempting the minimum monthly tax duties of Cambodia Airlines from April to June 2021
- including value-added tax on basic food in the government tax burden for two years (1 Jan 2020–31 Dec 2021)
- exempting the obligation to make monthly contributions to the National Social Security Fund (NSSF) for occupational risk and healthcare schemes during any periods of business suspension
- exempting the minimum tax for all airline entities operating in Cambodia until the end of December 2021
- deferring civil aviation fee payments until the end of December 2021
- providing USD40 per month for suspended workers in hotels, guesthouses, restaurants, and travel agents until the end of 2021
- providing cash assistance for vulnerable households in lockdown areas
- providing tax holidays of six months to one year to factories that were severely impacted by the COVID-19 outbreak and the Everything But Arms (EBA) suspension
- exempting all license fees in the tourism sector for 2021
- providing tax exemptions and delays in comprehensive tax audits in 2020 to tourism agents and other companies in the tourism sector
- exempting the stamp tax on all residential properties with a value of less than USD70,000
- allocating funds in the form of low-interest loans to help SMEs in the agriculture and production sectors
- providing a special financing scheme for the Rural Development and Agriculture Bank to support agro-processing firms.
- establishing a credit guarantee scheme to ease working capital pressure
- reducing the withholding tax on loans provided by local and foreign lenders
- providing retraining and upskilling programs for laid-off workers in the tourism and garments sectors

II Banking System: Performance and Stability

The banking system remained sound and resilient while steadily providing necessary funding to support economic recovery from the COVID-19-induced shock. Assets and deposits of the banking system grew by 18 percent and 17.7 percent, respectively, with credit posting an even stronger growth of 23.5 percent. Within the banking system, commercial banks accounted for over 85 percent of assets, followed by deposit-taking microfinance institutions (MDIs) and non-deposit-taking microfinance institutions (MFIs). Bank credit posted a robust 26.4 percent growth to reach KHR155.3 trillion, mainly providing to retail trade, mortgages, wholesales, construction, and real estate. Asset quality remained healthy, slightly improving in 2021 in fact, as the non-performing loan ratio (NPLR) slid to 1.8 percent. Banks' liquidity and capital levels remained healthy at 151.6 percent and 23 percent, respectively, well above the regulatory requirement. At the same time, banks' profitability remained sustainable. For the microfinance sector, total assets grew at 7.3 percent and credit increased 26 percent, mainly to households, trade, agriculture and services. Amid the pandemic, credit quality in the microfinance sector remained sound with low NPLR, and liquidity remained ample, reflected by a liquidity coverage ratio (LCR) above the regulatory limit. The microfinance sector's profitability remained sustainable, which contributed to a strong capital adequacy ratio (CAR) registering at 18.2 percent for MDIs and 40.7 percent for MFIs. For specialized banks, credit growth dropped by 24.8 percent largely due to the decline in the number of institutions in operations. Specialized banks also provided credit to various sectors, including personal essentials, retail trade, mortgages, real estate, and others. NPLR for specialized banks was at 9.1 percent in 2021, while CAR exhibited at 37 percent.

2.1. Banking System Landscape

The Cambodian financial system remains bank-centric and is sizeable in terms of GDP. The banking system in Cambodia is dominated by commercial banks, as 54 banks with KHR241.8 trillion of total assets as of December 2021 account for around 85.3 percent of the domestic banking system.[9] MDIs distantly follow as the second major group with an 11.3 percent share in overall assets. Furthermore, 79 MFIs and 10 specialized banks, respectively, represent 1.8 percent and 0.9 percent of total banking system assets. The remaining 1 percent is represented by 18 leasing companies and 232 rural credit institutions.

Table 2.1: Cambodia: Structure of the Banking System (As of December 2021)

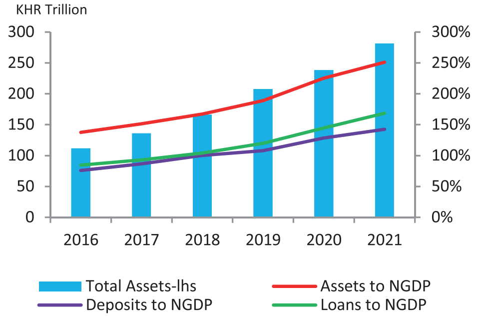
Institutions	Number	Assets (KHR, trillion)	Share (% of total assets)
Commercial Banks	54	241.8	85.3%
MDIs	5	31.9	11.3%
MFIs	79	5.1	1.8%
Specialized Banks	10	2.6	0.9%
Leasing Companies	17	1.8	0.7%
Rural Credit Banks	232	0.24	0.09%

Source: NBC

[9] The banking system is somewhat broadly defined here to include commercial banks, MDIs, MFIs, specialized banks, leasing companies, and rural credit banks in line with the regulatory ambit of the National Bank of Cambodia. As we cover later in Chapter 3, the share of the non-bank finance sector (primarily insurance firms) is negligible, and both equity and bond markets are still at an early stage of development.

By the end of 2021, the total assets of the banking sector[10] reached KHR281.5 trillion, posting an annual YoY growth of 18 percent. The banking sector appeared sizeable in terms of domestic output level at almost 251 percent of the nominal GDP of 2021. On the other hand, the total loans and deposits of the banking sector were 169 percent and 143 percent, respectively, of the nominal GDP (Figure 2.1). Intermediation ratios, measured in terms of key banking variables relative to the GDP, saw particularly stronger growth in 2020–21 in part because GDP growth was much slower than its historical trend (−3.1 percent in 2020. Moreover, with loan growth outpacing the rise in deposits, the gap between the two widened, resulting in somewhat greater reliance of some financial institutions on non-core funding.

2.1 Banking System in Cambodia

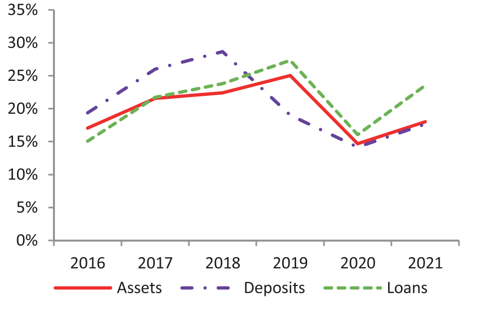


Source: NBC

In general, banks' contributions in financial intermediation supported the cause of financial inclusion in Cambodia. Recent estimates by NBC indicate that around 70% of Cambodians now have access to financial services, benefiting from some or all of the four key financial products, i.e., loans, deposits, money transfers, and digital payments.

Growth in banking sector assets and deposits recovered in 2021 after the slowdown in 2020, with loans posting particularly strong growth. The assets, deposits, and loans of the banking sector registered YoY growth of 18, 17.7, and 23.5 percent, respectively, in 2021, exhibiting a return toward their historical trends after witnessing comparatively subdued paces in 2020, the first year of the pandemic-induced economic contraction (Figure 2.2). Credit growth was particularly robust, similar to the pace in 2019 but higher than that of the 2016–17 period. By contrast, recovery in the growth rates of both assets and deposits was relatively moderate.

2.2 Banking System in Cambodia (YoY Growth)

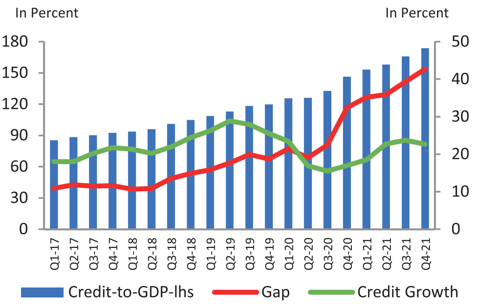


Source: NBC

[10] In Figures 2.1 to 2.3, the banking sector includes commercial banks, MDIs, and MFIs. Other institutions (like specialized banks, leasing companies, and rural credit banks) are not included here due to data limitations.

On the back of stronger credit growth[11] in 2021, the credit-to-GDP ratio surged to 174 percent, a historically high level (Figure 2.3). As a result, the credit-to-GDP gap[12] continued its steep upward climb, reaching 42.7 percent. While an increasingly large gap warrants closer monitoring, the sharp uptick in the gap, particularly in 2020, may in part be explained by the pandemic-driven contraction in Cambodia's GDP. Moreover, the rapid pace of credit off-take can be attributed to an extent to growing financial deepening as banks expand their outreach and, in turn, credit disbursement. Discussions on growth in bank credit may also consider banks' asset quality (as we examine later) as well as broader developments in the asset market and the debt servicing capacity of borrowers.

2.3 **Credit to GDP and Credit Growth**



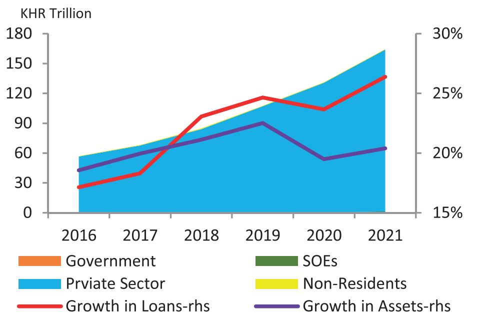
Source: NBC

2.2. Commercial Banks

A. Credit Intermediation and Credit Risk

Commercial banks extended almost their entire lending to the private sector, with the corporate sector being the lead recipient, followed by households. Bank credit to the private sector further picked up pace in 2021, growing by 26.4 percent YoY compared to its 23.7 percent increase a year earlier (Figure 2.4). Segregation in terms of lending to the public and private sectors reveals that almost all bank credit was received by the private sector, with the share of lending to the public sector confined to a paltry 0.8 percent in 2021. Moreover, within the public sector, all the financing was availed by state-owned enterprises (SOEs) as the Royal Government continued to make no fresh borrowings from the banking sector, a trend visible since 2016. This, in turn, meant that the private sector was virtually the sole recipient of bank credit, with banks playing their due role in facilitating private sector-led economic growth.

2.4 **Lending by Commercial Banks**



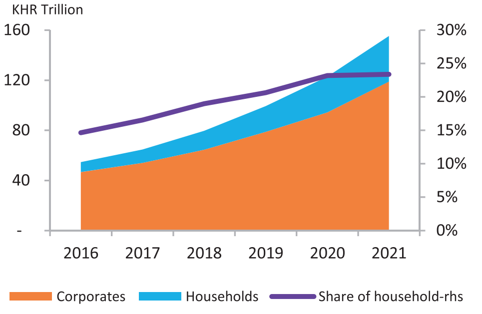
Source: NBC

[11] Credit here includes lending by commercial banks, MDIs, and MFIs.
[12] The gap is equal to the difference between the credit-to-GDP ratio and its long-term trend, measured by a one-sided HP filter with a smoothing parameter equal to 400,000.

Within the private sector, the bulk of the lending was availed by corporates, followed by households. Specifically, corporates (including businesses of all types and sizes) received KHR119 trillion of total credit in 2021 (76.6 percent of private sector credit), posting 26.1 percent growth. Meanwhile, total outstanding credit to households reached KHR36.3 trillion in 2021, accounting for 23.4 percent of bank credit to the private sector. The share of lending to households has steadily increased over the years, growing from 14.7 percent in 2016 to 23.4 percent in 2021 (Figure 2.5).

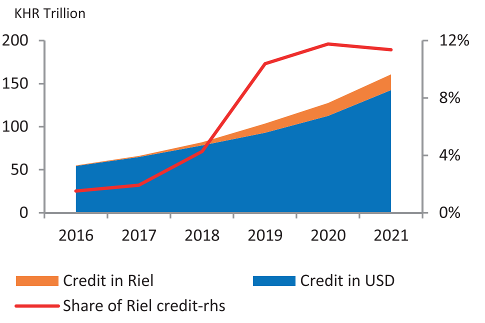
While banks' local currency lending stayed above NBC's required threshold of 10%, most lending continued to be in USD. A currency-wise breakdown of gross loans indicates that almost 88.6 percent of overall lending in 2021 was in USD, with the share of riel loans at around 11.4 percent (Figure 2.6). Aiming to promote the rielization of Cambodia's otherwise highly dollarized economy, NBC issued prakas requiring banks to allocate at least 10 percent of their total lending in riel in 2016. Consequently, the share of riel loans in overall credit gradually improved from 1.5 percent in 2016 to 11.4 percent in 2021, even if it somewhat tapered off compared to 2020. This shift toward the rielization of credit has been duly supported by NBC in terms of riel liquidity provision through its liquidity-providing collateralized operations.

2.5 Bank Credit to the Private Sector



Source: NBC

2.6 Bank Credit by Type of Currency

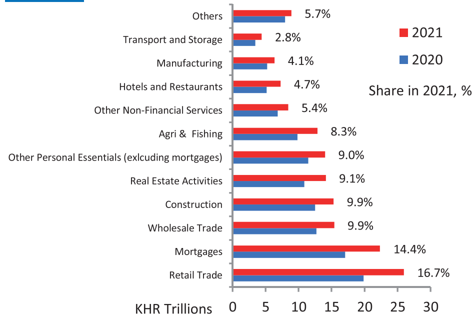


Source: NBC

Overall credit allocation across sectors appeared diversified, though half of the bank credit fell into two broad categories: mortgages, construction, and real estate loans, followed by retail and wholesale trade. Banks' credit allocation across different sectors reveals that retail trade was the single largest recipient with almost KHR26 trillion of outstanding gross loans in 2021, accounting for 16.7 percent of total bank credit during the same year (Figure 2.7). Personal mortgage loans, worth KHR22.3 trillion outstanding, represented the second major sector with a 14.4 percent share in total credit in 2021. Credit was somewhat equitably distributed in the next four sectors if ranked by size (wholesale trade, construction, real estate activities, and other personal loans, excluding mortgages), as each sector had a share of around 9 percent or slightly higher. Banks' credit exposure to hotels and restaurants, a sector hit especially hard by pandemic-related domestic lockdowns and the plunge in arrivals of international tourists, was relatively modest, standing at 4.7 percent of total outstanding loans in 2021.

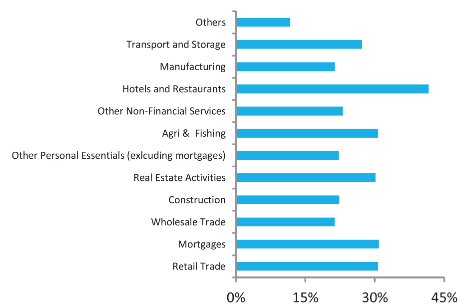
The pace of credit disbursement picked up across a broad range of sectors. After the slowdown in 2020, all major sectors posted stronger credit growth in 2021, with particularly robust growth in credit to hotels and restaurants (up by 41.6 percent YoY) albeit from a relatively lower base (Figure 2.8). This potentially reflects higher financing needs of a sector that continues to bear the brunt of the pandemic's devastating impact on economic activity. Other sectors like retail trade, mortgages, real estate activities, and agriculture all witnessed a YoY rise of around 30 percent or more in their respective borrowings. On the other hand, wholesale trade logged 21.3 percent growth, the slowest compared to other key sectors.

2.7 Bank Credit by Sector-Value & Share



Source: NBC

2.8 Bank Credit-Growth (YoY) in Sectoral Loans

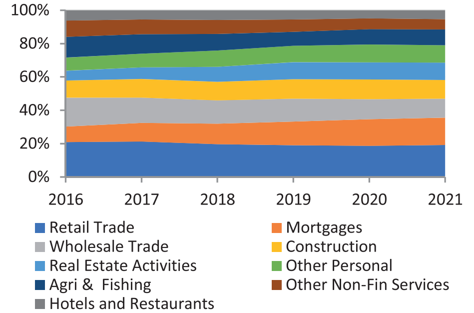


Source: NBC

The shares of households and real estate-related lending has increased over time. Given the differences in the pace and volume of credit to various sectors, the broader long-term trend in credit disbursement reflects some reallocation of credit, with a few sectors gaining shares over the years (Figure 2.9). Specifically, the share of household-related loans (both mortgages and other personal lending) and lending for real estate activities grew, while that of manufacturing and wholesale trade marginally declined. Since household loans, on average, are smaller in size and better diversified, banks' higher exposure to households should, in principle, improve the diversification of banks' credit portfolios provided that prudent lending practices are followed.

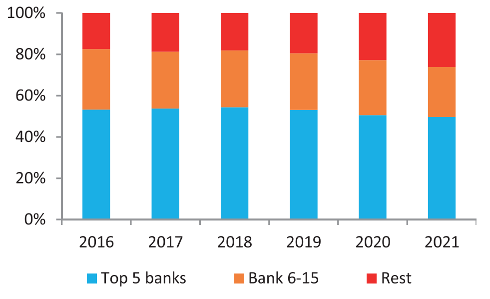
Yet the concentration in the provision of credit, if viewed in terms of the top five banks, marginally declined over time. The top five banks in 2021 accounted for almost half (49.7 percent) of the total credit extended to the private sector, with the share of the top three banks at 40.1 percent (Figure 2.10). Banks 6 to 15, ordered in terms of loan size, collectively provided 24.2 percent of total financing, while the remaining 39 banks had a 26.1 percent share in total gross loans in 2021. The share of the top five banks marginally came down in the last few years, as smaller banks were able to gain some ground in part because the number of banks also grew during the reference period. Moreover, structural changes seen in the banking sector, as evident from the growing digitalization of finance, may have also increased competition.

2.9 Bank Credit by Key Sectors



Source: NBC

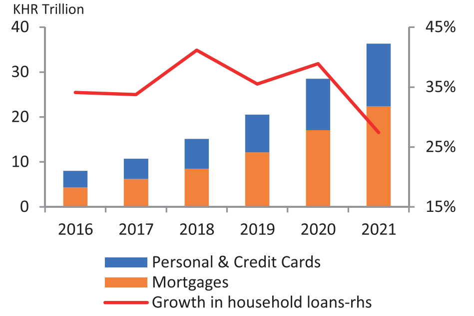
2.10 Share in Credit by Banks



Source: NBC

Growth in households' credit was primarily driven by mortgage loans. Banks' credit to households grew by 27.4 percent in 2021, expanding at a healthy rate but was still slower than the much higher pace (over 35 percent) observed during the last six years (Figure 2.11). Overall outstanding credit to households reached KHR36.3 trillion in 2021, making the household sector a major recipient of bank credit with a 23.2 percent share in terms of total loans outstanding. The breakdown of household loans indicates that around 61.5 percent of borrowing fell under the mortgage loans, which were provided to households and restricted to first-home ownership, while the rest (38.5 percent) were personal and credit card loans combined.

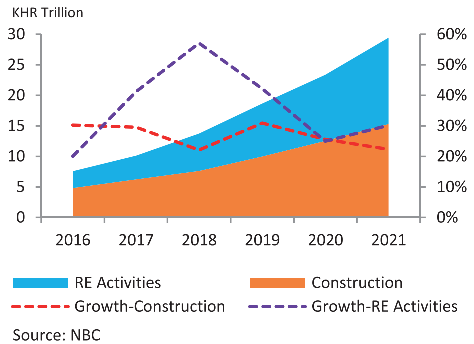
2.11 Bank Lending to Households



Source: NBC

Credit to real estate and construction accounted for almost one-fifth of banks' gross loans, further rising to over one-third if personal mortgages are added. Bank credit for real estate activities and the construction sector grew by 30 percent and 22.3 percent, respectively, in 2021 (Figure 2.12). In the last five years, growth in lending to real estate was routinely higher when compared to construction loans; consequently, the share of real estate loans grew from 38 percent to 48 percent during the same period within the total real estate and construction loans.

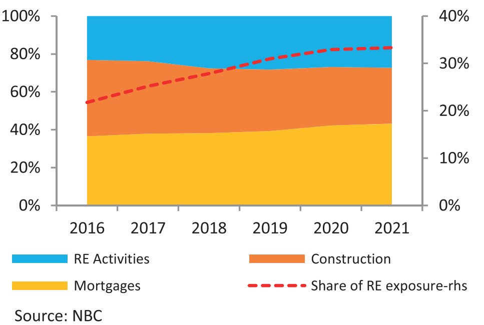
2.12 Lending to Real Estate & Construction



Source: NBC

One way to assess banks' overall real estate-related exposure is by combining their lending for the (a) real estate sector, (b) construction sector, and (c) personal mortgage loans to households. Adding up the lending under these three categories, banks' real estate-related exposure accounted for almost one-third of the entire loan portfolio (Figure 2.13). This exposure grew over the years from 22 percent in 2016 to 33 percent in 2021.

2.13 Banks' Overall Exposure to RE & Construction

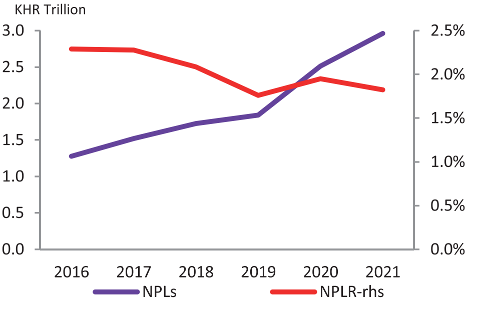


Source: NBC

Notwithstanding the size of banks' exposure to real estate-related sectors, the credit risk in all three subcomponents was well contained, as we highlight below. The risk profile of mortgage loans was different from banks' direct lending to the real estate and construction sectors, as the former portfolio consisted of smaller loans to a large number of households and thus was better diversified. The real estate market has remained resilient so far, even during the pandemic, with residential property prices increasing by 12.2 percent in 2021 *(see Figure 1.11 in Chapter 1)*. While the commercial property market possibly took a more serious hit during COVID-19 lockdowns, banks' exposure to this segment was limited to only 6 percent of their total lending to real estate activities. However, it remains to be seen how real estate prices will behave once the upcoming supply, in addition to the already lower occupancy rates in certain segments, reaches the market during the 2022–23 period.[13]

Strong credit growth coupled with NBC's regulatory forbearance measures helped keep the NPLR low. Commercial banks' overall non-performing loan ratio (NPLR), a key indicator of asset quality, declined in 2021 to 1.8 percent, similar to the pre-pandemic level and marginally better than the 1.9 percent observed in 2020 (Figure 2.14). Though the overall NPLs increased (by 18 percent) in 2021, robust credit growth helped bring the ratio down. Moreover, NBC's regulatory forbearance measures introduced since the outbreak of COVID-19 also enabled banks to restructure loans without changing their loan classifications, thus delaying NPL formation. For instance, banks restructured around 10.4 percent of their total loans on average between April 2020 and December 2021.[14]

2.14 Non-Performing Loans of Commercial Banks



Source: NBC

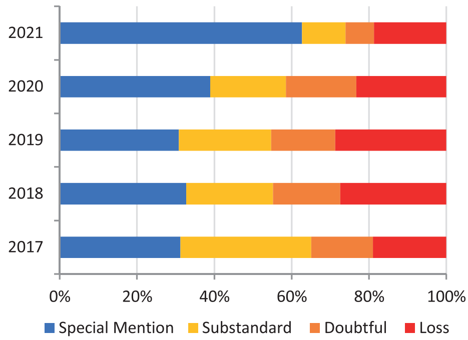
[13] Research by a local real estate firm, CBRE, suggests that the supply of condominiums is expected to double in the next two years. The supply of community malls and office space is also set to increase by over 20 percent during the same period. Higher supply, particularly if not met with sufficient demand, will weigh on prices as the occupancy rate, according to CBRE, is already lower than 70 percent in both segments.
[14] The ratio of restructured to total loans is somewhat similar for MDIs (10.9 percent), while it is relatively higher for other institutions, including MFIs, specalized banks, and leasing companies (14.9 percent).

In December 2021, NBC issued a circular on classification and provisioning requirements for restructured loans, requiring banks to treat loans deemed performing as viable and classifying such as "special mention" with 3 percent provisioning of the gross amount. Banks were further instructed to treat restructured loans that were non-viable as non-performing, classifying these loans as "loss" with 100 percent provisioning. Against that backdrop, the share of special mention loans surged in 2021 (Figure 2.15). The large share (63 percent) of special mention loans also indicated that banks deemed the majority of the restructured loans as viable. By contrast, the share of loans under the loss category was much smaller (19 percent). In general, the broader classification of NPLs suggested that the impact of pandemic-related economic slowdowns on banks' asset quality was somewhat contained.

NPLs by different sectors reveal that the agriculture, forestry and fishing sector had the largest size of NPLs outstanding in absolute terms (KHR577 billion), followed by retail trade (KHR423 billion) and construction (KHR271 billion) (Figure 2.16). In 2021, most sectors witnessed the addition of fresh NPLs, except for manufacturing, which recorded a decline of KHR75.8 billion. The hotel and restaurant sector experienced the highest increase in NPLs (KHR108 billion), followed by retail trade (KHR94 billion) and other personal essentials (KHR59.5 billion). Meanwhile, real estate activities and the construction sector observed only modest rises in NPLs at KHR10.5 billion and KHR28.4 billion, respectively.

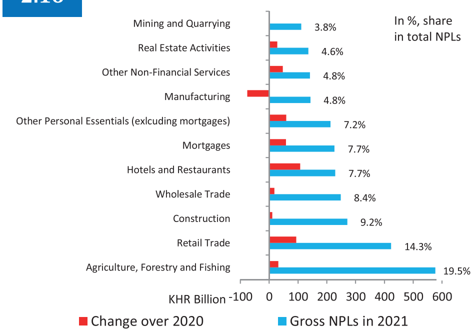
Sector-wise NPLRs reflected a converging trend in the infection ratio, though with some obvious dispersion across sectors. Unsurprisingly, the NPLR for the hotel and restaurant sector inched up from 2.4 percent in 2020 to 3.1 percent in 2021 as the sector continued to face a challenging operating environment amid the plunge in tourist arrivals and lockdowns through most of 2021

2.15 **Age-Wise classification of NPLs**



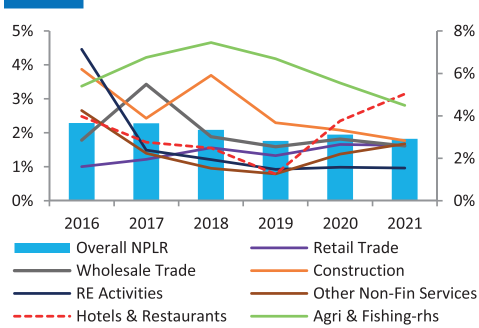
Source: NBC

2.16 **NPLs by Sector**



Source: NBC

2.17 **Gross NPLR- Major Business Sectors**



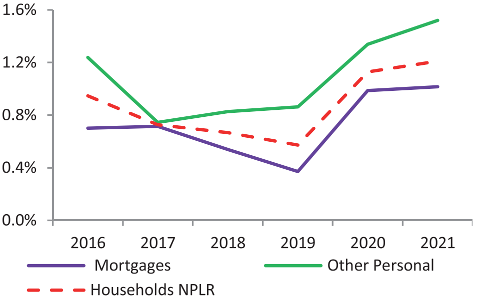
Source: NBC

(Figure 2.17). Other financial services also registered a pickup in NPLR. However, a number of sectors observed a decline in NPLR, including agriculture, construction, mining and quarrying, wholesale trade, and leasing activities, which, in turn, helped the overall NPLR to post a slight decline from 1.9 percent in 2020 to 1.8 percent in 2021. Among the various business segments, the NPLR for real estate activities remained fairly low at 1 percent for the second year in a row.

The NPLR for the two components of the household sector, (i.e., mortgages and other personal loans) remained low at 1 percent and 1.5 percent, respectively, though the latter witnessed some increase when compared to 1.3 percent in 2020 (Figures 2.18). As mortgages were around 62 percent of households' total credit, their larger share in credit and better asset quality helped keep the overall NPLR of households at a lower level of 1.2 percent.

Specific provisions significantly increased during the year, providing banks an additional cushion to withstand any potential deterioration in credit quality. In 2021, specific provisions reached KHR1.8 trillion on the back of KHR497 billion worth of additional specific provisions, the highest increase in absolute terms in the last five years (Figure 2.19). As a result, the specific provisions-to-NPL ratio reached 60 percent, the highest level in the recent past, notwithstanding the rise in NPLs as the economy continued to face pandemic-related slowdowns. The accumulation of provisions is encouraging, as it will help banks better manage any uptick in the NPLR once the regulatory support measures are fully withdrawn.

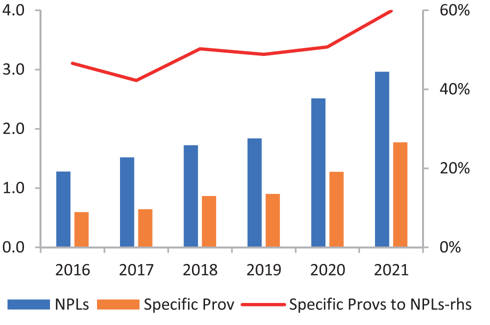
2.18 Gross NPLR - Household Sector



Source: NBC

2.19 NPLs and Provisions

KHR Trillion

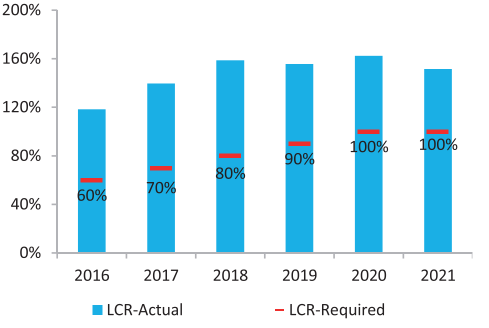


Source: NBC

B. Funding and Liquidity

Banks' liquidity levels remained healthy, notwithstanding a marginal decline in 2021. The liquidity coverage ratio (LCR), a measure to test whether banks hold sufficient high-quality liquid assets to survive 30-day severe liquidity stress, was first introduced by NBC in September 2016 with a minimum ratio set at 60 percent. The LCR was gradually phased in, reaching 100 percent in 2020, where it has stayed since, in line with the Basel III recommendations. The overall LCR of commercial banks of 151.6 percent in 2021 remained well above the required benchmark (100 percent), indicating healthy liquidity levels to face any short-term liquidity stress (Figure 2.20).

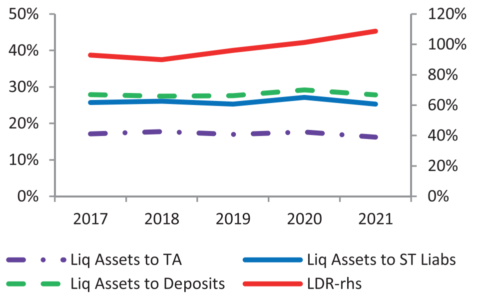
2.20 Banks' Liquidity Coverage Ratio



Source: NBC

Similar to the LCR, a marginal decline in liquidity was also experienced by banks when viewed in terms of traditional indicators. For instance, the ratio of liquid assets to total assets, an indication of available liquidity to meet expected and unexpected cash outflows, came down from 17.6 percent in 2020 to 16.2 percent in 2021 (Figure 2.21). Likewise, liquid assets to short-term liabilities, which reveal the extent to which banks can meet short-term withdrawals of funds without experiencing a liquidity squeeze, slid from 27.1 percent to 25.3 percent during the same period. Stronger growth in credit disbursement, compared to deposit mobilization, also led to an increase in the loan-to-deposit ratio, reaching 108.7 percent in 2021.

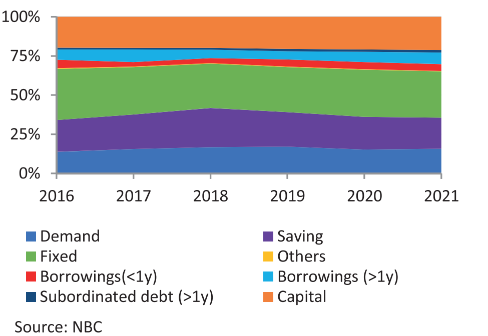
2.21 Commercial Banks-Liquidity Ratios



Source: NBC

In terms of banks' sources of funds, customer deposits represented around 65.5 percent, with borrowings (both short and long term) accounting for 13.3 percent and capital over 21 percent (Figure 2.22). With customer deposits accounting for around two-thirds of banks' sources of funds, the overall funding base appeared stable. A breakdown by types of deposits reveals that the highest share was fixed deposits (45.2 percent), followed by savings (30.5 percent) and demand deposits (24 percent). In 2021, overall customer deposits reached KHR142.9 trillion, posting 15.1 percent growth compared to 14.6 percent in 2020.

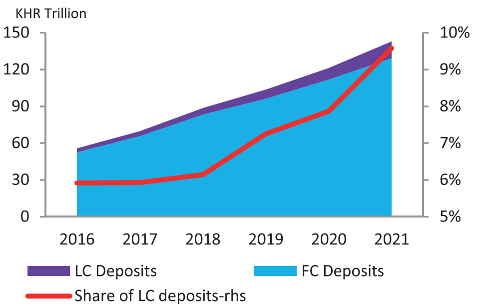
2.22 Banks' Sources of Funds



Source: NBC

The bulk of banking sector deposits, similar to loans, remained in USD. US dollar deposits continued to be the mainstream choice among customers, accounting for 91.4 percent of total deposits in 2021. While the share of riel deposits grew from 6.1 percent in 2018 to 9.6 percent in 2021, the degree of dollarization remains high (Figure 2.23). NBC's policy to require banks to lend at least 10 percent of their credit in riel has encouraged banks to raise more local currency deposits; however, the size of local currency loans in 2021 (KHR18.3 trillion) remained well above the local currency deposits that banks managed to collect (KHR13.7 trillion), necessitating continuous injection of riel liquidity by NBC through its LPCO arrangement.

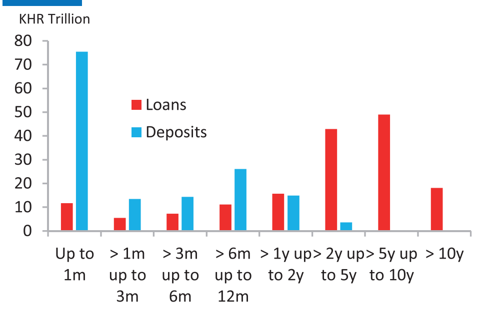
2.23 Customer Deposits



Source: NBC

The term structure of banks' loans and deposits in 2021 reveals that deposits in general were well above the loans for shorter maturities, while loans far outstripped deposits in maturities of two years and beyond (Figure 2.24). In fact, a certain degree of maturity mismatch is natural given banks' very function of maturity transformation where short-term liabilities are converted into longer-term assets. Nonetheless, if the scale of mismatch is too high, banks may face liquidity risk, particularly if they are more reliant on short-term, less stable non-core funding.

2.24 Loans and Deposits by Maturity Profile

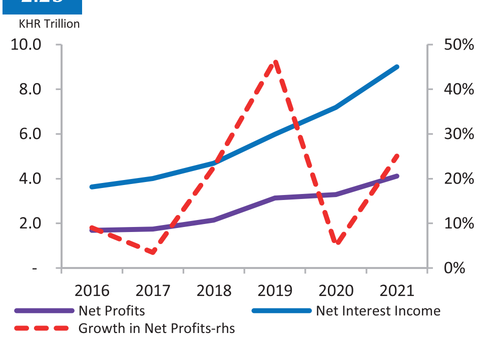


Source: NBC

C. Profitability and Solvency

Banks' net profits posted strong growth in 2021 after experiencing a relative slowdown in 2020, buoyed by higher income and comparatively slower rise in provisions and interest expenses. The profitability of commercial banks picked up pace in 2021, with net profits after tax registering 25 percent growth to reach KHR4.1 trillion (Figure 2.25). While NBC lifted the outright ban on dividend payments (which was introduced in 2020) in December 2021, the distribution of profits by banks was subjected to specific permission from NBC to ensure that banks first set aside the requisite provisions laid out in the NBC circular dated December 28, 2021.

2.25 Commercial Banks' Profitability



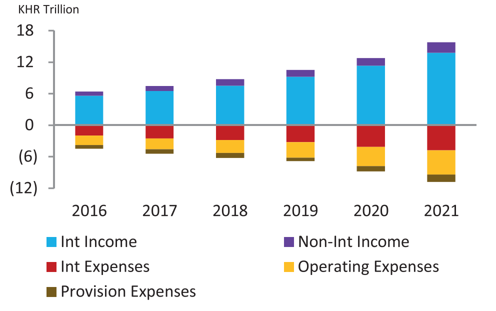
Source: NBC

Higher net profits were driven by both higher interest and non-interest income, with the latter posting particularly stronger growth in 2021; moreover, comparatively slower increases in interest and provision expenses also supported profitability (Figure 2.26). On the expenses side, while operating expenses grew faster in 2021, the pace of interest expenses was somewhat moderate. Additionally, net profits were duly supported by the relatively slower increase in provision expenses (34 percent in 2021) compared to the 61.5 percent rise in 2020 when banks first scrambled to set aside adadditional provisions in the midst of the initial COVID-19 shock. The gradual economic recovery and consequently diminished uncertainty regarding borrowers' debt servicing also helped keep provisioning needs in check.

Higher net profits of commercial banks, in turn, helped both average return on assets (ROA) and return on equity (ROE) post a modest recovery in 2021 (Figure 2.27). Specifically, ROE improved from 8.72 percent in 2020 to 8.95 percent in 2021; likewise, ROA also inched up by six basis points to reach 1.7 percent in 2021. The improvement in return ratios was on account of relatively stronger growth in net income (25 percent) compared to relatively slower growth in both average assets (20.4 percent) and equity (21.9 percent) of commercial banks.

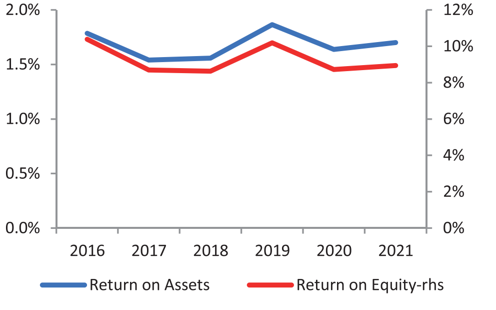
The operational efficiency of commercial banks, measured in terms of operating expense to gross operating income, marginally improved to 45.2 percent in 2021 (Figure 2.28). Operating expenses and gross operating income grew by almost similar levels, yet the larger size of the denominator (operating income) helped somewhat improve the efficiency ratio.

2.26 Commercial Banks-Income and Expenses



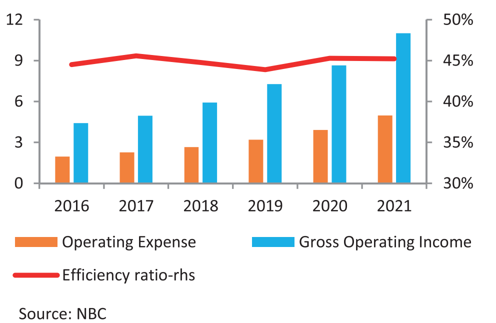
Source: NBC

2.27 Banks' Return on Assets & Equity



Source: NBC

2.28 Banks' Efficiency Ratio

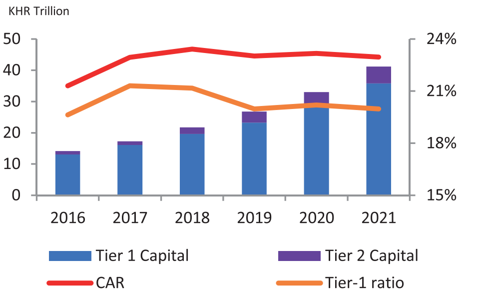


Source: NBC

Banks' capital adequacy remained at a comfortably high level and well above NBC's required benchmark. Commercial banks in Cambodia continued to maintain high capital levels, with banks' overall capital adequacy ratio (CAR) at 23 percent, slightly down from 23.2 percent in 2020 (Figure 2.29). This was driven by a relatively higher growth in risk-weighted assets (26 percent) in 2021 compared to capital (up 25 percent). Notwithstanding the marginal decline, banks' CAR, an indicator of their loss-absorbing capacity, was well above NBC's minimum regulatory requirement of 15 percent. In fact, even the Tier-1 capital ratio was around 20 percent, above the regulatory minimum required for overall capital. Moreover, the capital conservation buffer (CCB) has stayed at 1.25 percent in 2021 since it was halved from 2.5 percent in May 2020 as part of NBC's policy response to help banks withstand the COVID-19 shock. In December 2021, NBC allowed banks and other financial institutions to use the full amount (100 percent) of CCB while setting aside necessary provisions for restructured loans.

The breakdown of total capital reveals that while both Tier-1 and Tier-2 capital posted positive growth, the latter category witnessed a slightly higher increase (24.6 percent and 27 percent, respectively). As a result, the share of Tier-2 capital marginally increased to 13 percent of banks' overall capital, though the bulk (87 percent) was still represented by Tier 1. Banks' strong capital adequacy level, primarily supported by high-quality Tier-1 capital, continued to underpin the ability of the banking system to weather major stress scenarios, including the unprecedented pandemic-induced economic slowdown.

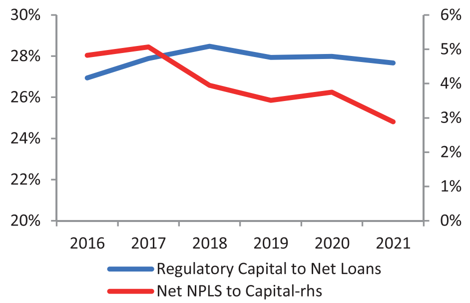
2.29 Banks' Capital Adequacy Ratio



Source: NBC

Thanks to strong capital adequacy levels and higher provisions, banks' net NPL-to-capital ratio, an indicator of the fraction of banks' equity that can be wiped out due to loan losses, steadily declined over the years, dropping to 2.9 percent in 2021 (Figure 2.30). Moreover, banks' regulatory capital-to-net loans ratio also declined further to 27.7 percent in 2021, reflecting the scale of the cushion banks would have in terms of their capital even if a sizeable chunk of their loans turned bad. Both indicators further supported the comfortable capital adequacy levels evident from the standard adequacy ratio.

2.30 Banks' Capital Adequacy

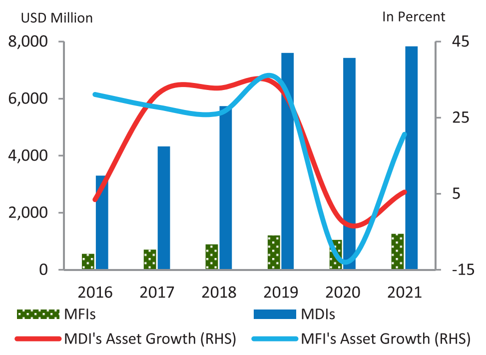


Source: NBC

2.3. Microfinance Institutions

Despite the pandemic, new institutions were granted licenses, which led to an expansion of the microfinance sector's assets.[15] At the end of 2021, total assets in the microfinance sector further grew by 7.3 percent to KHR37.1 trillion, compared to a decline to –3.7 percent in 2020, with MDIs covering 86.1 percent of total assets in the sector. MDIs' assets increased by 5.4 percent to KHR32 trillion, and MFIs' assets increased by 20.6 percent to KHR5.1 trillion (Figure 2.31).

2.31 Total Assets in Microfinance Sector

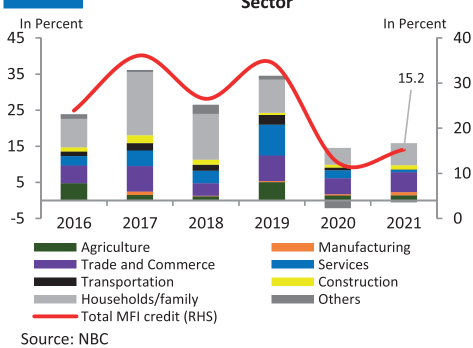


Source: NBC

A. Credit Performance

In light of the COVID-19 pandemic, the microfinance industry continued its prominent role, particularly in supporting financial inclusion, agriculture, and SMEs. Credit in the microfinance sector stood at KHR31.7 trillion, inching up 15.2 percent compared to 12.4 percent in 2020, mainly contributed by households (6.1 percent), trade and commerce (5.5 percent), agriculture (1.4 percent), services (0.7 percent) and others (1.5 percent) (Figure 2.32). Credit to households remained the largest share, accounting for 32.4 percent of the total microfinance sector's loans, followed by trade at 23 percent, agriculture at 18

2.32 MFI's Contribution to Credit Growth by Sector



Source: NBC

[15] As of December 2021, the total number of MDIs reported was five and MFIs was 75. In 2021, one MDI was transformed into a commercial bank.

percent, services at 14.5 percent, and others (Figures 2.33). The majority of institutions saw an increase in demand for credit, especially when the domestic economy started to re-open and there was more clarity about the market demand and business opportunities, predominantly for working capital purposes.

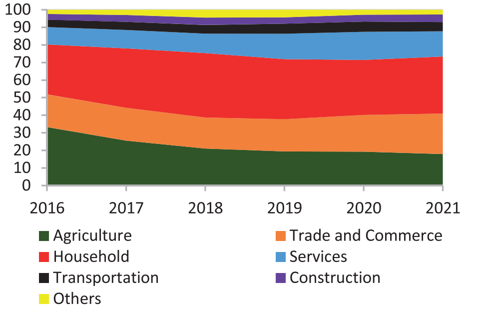
B. Credit quality

The microfinance sector was able to maintain its credit quality amid the pandemic. The NPL ratio for microfinance sectors increased over the course of 2021 from 1.8 percent in 2020 to 2.4 percent, but it remained low (Figure 2.34). However, the business disruption and employment and income losses due to lockdown and social distancing measures during COVID-19 may have put pressure on the payment capacities of many SMEs and households working in informal sectors. As part of its response, NBC allowed banks and financial institutions to restructure their loans until June 2022. Even though the credit portfolio remains sound, NBC will keep monitoring and has required banks and financial institutions to start assessing their portfolio early to avoid any cliff effect on their capital once the supportive measures are withdrawn.

C. Liquidity and Funding position

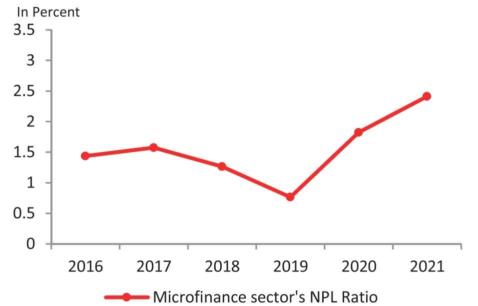
Amid the pandemic, MDIs maintained healthy liquidity buffers to withstand potential stress events, reflected by the aggregate LCR remaining well above the regulatory minimum with the supportive measures from NBC. MDIs' LCR was recorded at 160 percent, which was above the 100 percent threshold, although it decreased from 240.4 percent in 2020 (Figures 2.35). The drop in the LCR can be attributed to higher demand for credit as lockdowns were relaxed and economic activities resumed.

2.33 Share of MFI Credit by Sector



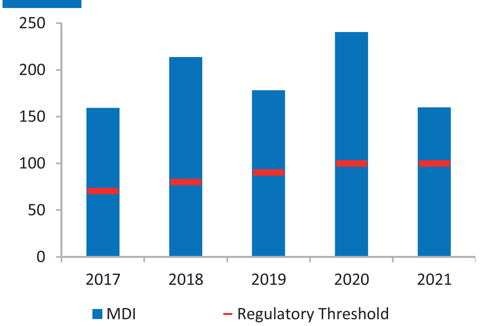
Source: NBC

2.34 Non-Performing Loan Ratio



Source: NBC

2.35 MDI's Liquidity Coverage Ratio



Source: NBC

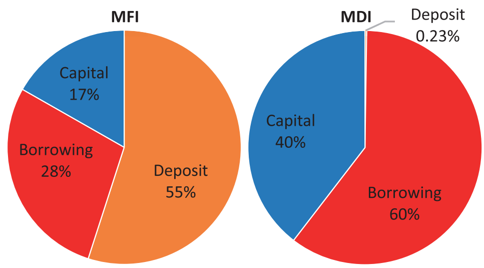
Regarding the funding structure, deposits played a key role in supporting the funding of MDIs, as they accounted for 55 percent of total funding, while borrowing and capital were 28 percent and 17 percent, respectively. For MFIs, funding was mainly from traditional sources, including bilateral and multilateral donors, banks and financial institutions (domestic and abroad), and investors; thus, their funding structure largely depended on borrowing and accounted for 60 percent, while capital was 40 percent (Figure 2.36).

As of 2021, the overall borrowing fund of the microfinance sector was KHR11.5 trillion, a 1.2 percent decrease compared to 2020. The share of long-term borrowing to total borrowing in the microfinance sector increased from 81.7 percent in 2020 to 86.3 percent in 2021. Short-term borrowing slightly decreased compared to the previous year as MDIs and MFIs sought out more stable funding as the economy went back to normal (Figure 2.37). The microfinance sector was able to obtain borrowing both locally and from abroad; local funds accounted for 27 percent. Compared to 2020, the locally borrowed funds declined by 6.1 percent to KHR3.1 trillion, while the foreign fund slightly decreased to KHR8.4 trillion. Funding from Europe increased by 15.9 percent from KHR2.8 trillion in 2020 to KHR3.2 trillion in 2021, accounting for 28 percent of foreign borrowing (Figure 2.38).

D. Profitability

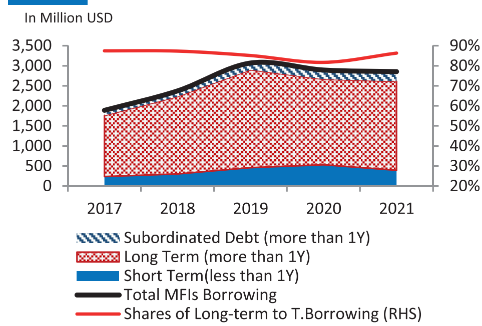
The overall microfinance sector's profitability remained healthy and sustainable, reflected by the pickup in credit demand as economic prospects improved. MDIs' net profit increased slightly, supported by net interest income, while operating expenses remained stable. Provision expense slightly increased, mainly due to the rise in precautionary provisioning as MDIs started to make early assessments of their restructuring loan portfolios, according to NBC's circular dated December 28, 2021 (Figure 2.39).

2.36 Funding Structure
(As of 2021)



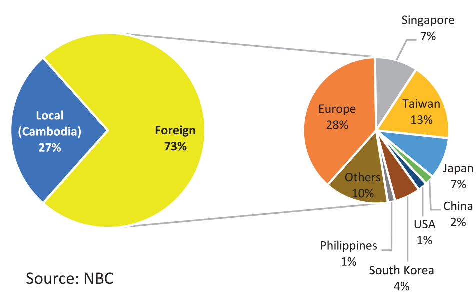
Source: NBC

2.37 Borrowing Fund in Microfinance Sector



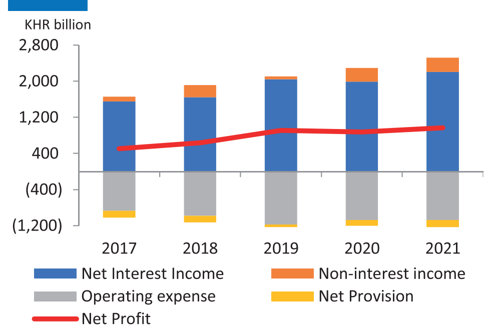
Source: NBC

2.38 MFI's Source of Borrowing by Countries
(As of 2021)



Source: NBC

2.39 MDIs' Profit Structure



Source: NBC

MFIs continued to have higher operating expenses, as they still depended on traditional operations. However, higher net interest income helped to offset this increase in expenses, leading to positive net profit. Similar to MDIs, MFIs' provision expenses also increased slightly (Figure 2.40).

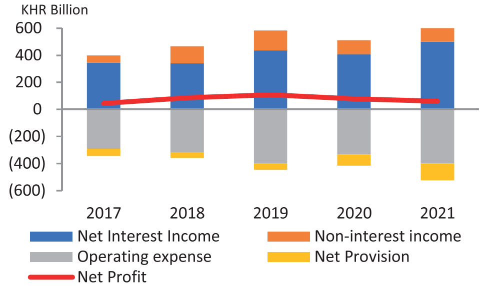
Average ROA for MDIs remained stable at around 3 percent, while MFIs exhibited a decline in ROA from 1.9 percent in 2020 to 1.2 percent in 2021. Furthermore, average ROE for MDIs showed a slight increase from 14.8 percent in 2020 to 15.9 percent in 2021, whereas MFIs demonstrated a fall from 4.5 percent to 3.1 percent (Figure 2.41).

MDIs' average efficiency ratio improved to 42.6 percent in 2021 from 46.8 percent in 2020, as MDIs were able to take advantage of the economies of scale and become more efficient with the use of FinTech, while that of MFIs remained higher at 64.8 percent, as they still depended on traditional operations (Figure 2.42).

E. Capital

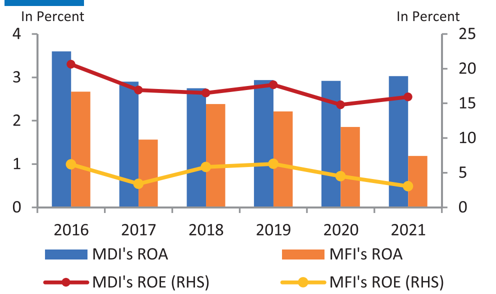
The microfinance sector continued to be resilient, as MDIs and MFIs were able to maintain capital levels higher than the regulatory threshold (15 percent). MDIs' CAR fell slightly from 19.8 percent in 2020 to 18.2 percent in 2021, but it was higher than pre-pandemic levels, while that of MFIs improved from 38.9 percent in 2020 to 40.7 percent in 2021 (Figure 2.43). The slight decrease in MDIs' CAR reflected the uptick in risk-weighted assets (12 percent compared to 2020) as credit demand increased.

2.40 MFIs' Profit Structure



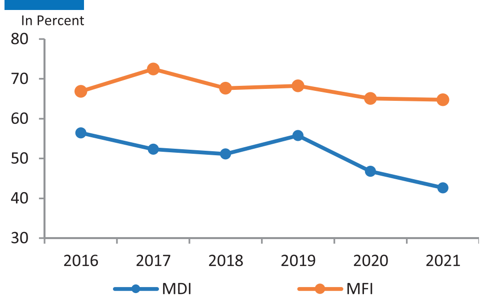
Source: NBC

2.41 Return on Asset and Equity



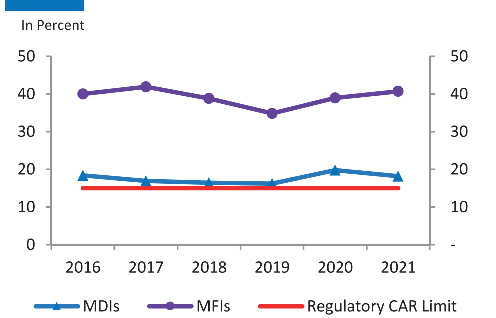
Source: NBC

2.42 Efficiency Ratio



Source: NBC

2.43 Capital Adequecy Ratio



Source: NBC

Box: 2.1

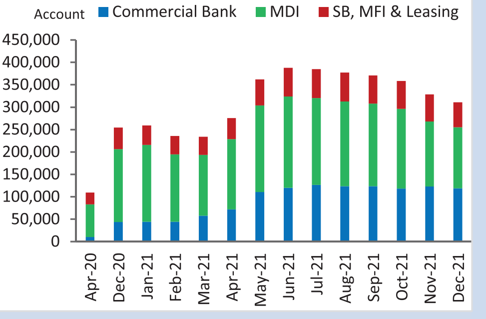
Loan Restructuring: Helping Alleviate the Burden of the People During the Pandemic

In March 2020, the first wave of COVID-19 began to spread in Cambodia. What followed was the slowdown of economic activities due to travel restrictions and social distancing, which affected borrowers' abilities to pay back their loans. In response to this rising issue, the National Bank of Cambodia issued the Circular on Loan Restructuring During the COVID-19 Outbreak on March 27, 2020, which aimed to help relieve the burden of borrowers facing revenue shortfalls and having difficulties in loan repayments. Initially, banking and financial institutions were instructed to restructure loans mainly for customers in four economic sectors: tourism, construction, garments, and transportation. However, as the pandemic raged on, loan restructuring was allowed for all sectors affected at the end of 2020.

In April 2020, the first month after the circular was introduced, 106,623 loan accounts in the banking system were restructured, equivalent to the amount of KHR6.1 trillion. The following months saw further increases in the number and amount of loan restructuring, reaching 254,302 accounts and KHR16.4 trillion, respectively, by the end of 2020 (Figures A & B).

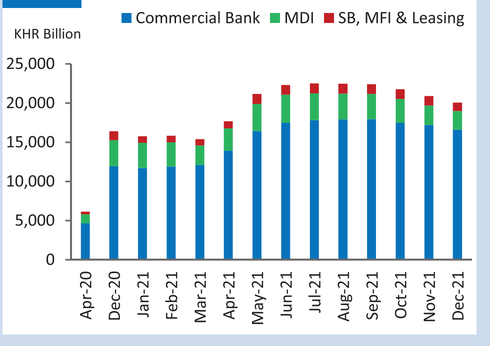
While COVID-19-related lockdowns and restrictions were imposed in 2020, it was only in the beginning of 2021 that Cambodia experienced a community outbreak, dubbed as the February 20 event. This wave resulted in stricter travel restrictions and a number of places being placed in quarantine as economic activities once again halted. Thus, the number of accounts and amount of loan restructuring increased further in the second quarter of 2021 and reached 388,084 accounts and KHR22.3 trillion, respectively, in June 2021. Loan restructuring continued in the third quarter, but it slowed down in the fourth quarter as the community outbreak was brought under control and economic activities resumed, thanks to the successful vaccination drive by the government. By the end of 2021, restructured loan accounts and the amount decreased to 310,746

A Number of Restructured Loan Accounts



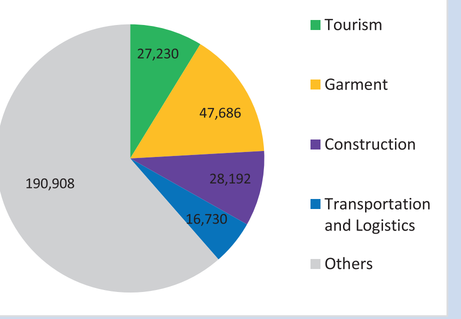
Source: NBC

B Amounts of Restructured Loan



Source: NBC

C Restructured Loan Accounts by Sector in 2021

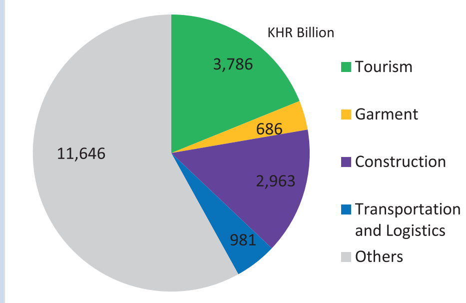


Source: NBC

accounts and KHR20.1 trillion. It should be highlighted that MDIs restructured the most loans—136,220 accounts as of 2021—while commercial banks restructured fewer loans, but the value was higher at KHR16.6 trillion.

Regarding the four prioritized sectors, by the end of 2021, banking and financial institutions had helped restructure 27,230 accounts for the tourism sector, 47,686 accounts for the garment sector, 28,192 accounts for the construction sector, 16,730 accounts for transportation and logistics, and 190,908 accounts for other sectors (Figure C). In terms of amount, restructured loans were recorded at KHR3.8 trillion in the tourism sector, KHR0.7 trillion in the garment sector, KHR3 trillion in the construction sector, KHR1 trillion in the transportation and logistics sector, and KHR11.7 trillion in other sectors (Figure D). Noticeably, the tourism sector was the single largest benefactor in terms of the restructured loan amount, although the garment sector recorded the largest number of restructured loan accounts.

D Restructured Loan Amounts by Sector in 2021

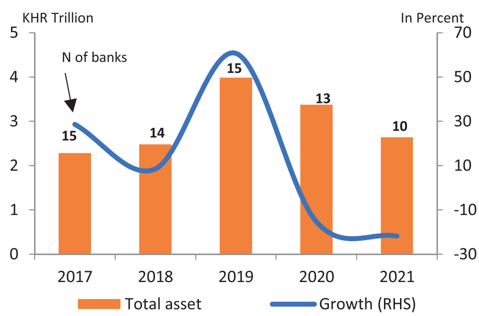


Source: NBC

2.4. Specialized Banks

Specialized banks are permitted by NBC to carry out one of three basic activities (lending, payments, and collecting deposits), as mentioned in the Law on Banking and Financial Institutions. Currently, specialized banks focus on facilitating financing to economic sectors based on their main interest and thus do not collect deposits or make payments. By the end of 2021, total assets of specialized banks was recorded at KHR 2.6 trillion, down by 21.8 percent compared to KHR 3.4 trillion in 2020 (Figure 2.44). The drop in total assets in 2021 was due to the voluntary liquidation of one specialized bank as well as the transformation of another specialized bank into a commercial bank.

2.44 Total Assets



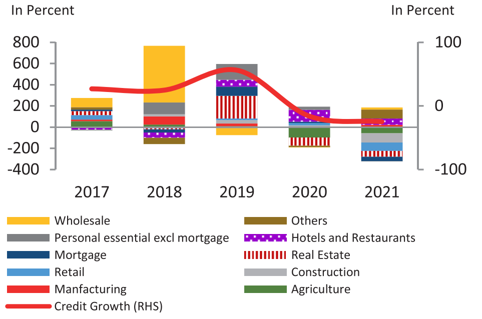
Source: NBC

Specialized banks provide credit to various sectors; in 2021, personal essentials (excluding mortgages) received 80 percent of the total loans, while retail sales and mortgages accounted for another 4 percent each. The share of loans to real estate was only 2 percent. In 2021, credit growth dropped by 24.8 percent largely due to the decline in the number of institutions in operation. However, key economic sectors experienced an increase in growth rate; credit to manufacturing, wholesale, and hotels and restaurants grew at 21.3 percent, 19.5 percent, and 59.6 percent, respectively, compared to negative growth in 2020, as the containment and travel restriction measures were gradually relaxed (Figure 2.45).

The average non-performing loan ratio for specialized banks rose recently from 6.5 percent in 2020 to 9.1 percent in 2021. This increase was partly due to NBC's policy to require banks and financial institutions to start provisioning for non-viable customers as a pre-emptive provisioning practice before the supporting measures expire.

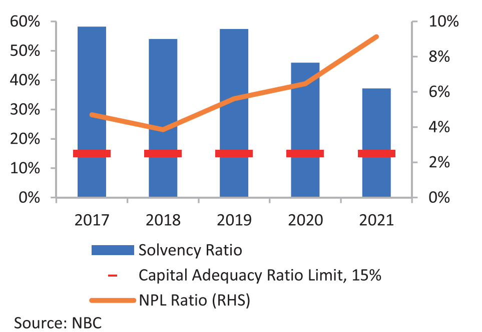
Despite the pandemic, specialized banks maintained strong capitalization levels with excess capital buffers above the minimum regulatory capital requirement of 15 percent. The capital adequacy ratio was around 37 percent in 2021, compared to 46 percent in 2020. Capital as a whole was adequate and provided banks with sufficient loss-absorption capacity to safeguard against any potential unexpected losses that could have materialized (Figures 2.46).

2.45 Credit Growth by Sector



Source: NBC

2.46 Solvency Ratio and NPL Ratio



Source: NBC

Box: 2.2

NBC's Supportive Measures During the Pandemic

The National Bank of Cambodia implemented a number of measures to provide additional liquidity to the banking system as well as to relieve the burden of borrowers. The initial measures were as follows:

i/-Maintain the implementation of prakas on the capital conservative buffer (CCB) at 1.25 percent from March 17, 2020.
ii/-Reduce the minimum interest rate on the LPCO by 0.50 percent for all maturities from March 17, 2020.
iii/-Reduce the interest rate on NCD for both KHR and USD at an appropriate level.
iv/-Reduce the RRR from 8 percent for KHR and 12.5 percent for foreign currencies to 7 percent for all currencies for a six-month period from April 2020 onward.
v/-Issue guidelines to financial institutions regarding loan restructuring for borrowers experiencing financial difficulties (but still performing) in priority sectors and others on March 27, 2020.
vi/-Recognize the quarterly audited net profit as included in the net worth calculation from April 13, 2020.
vii/-Restrict dividend payments to shareholders for audited profit in 2020.

As the economy started to recover gradually, NBC continued to implement the above-mentioned measures while also formulating the proper exit strategy that aimed to prevent moral hazards and ensure that the trend of banking system development was in line with the economic recovery. Thus, NBC put additional measures in place in 2021, such as

i/-requiring banking and financial institutions to make provisions based on their assessments of all loans restructured in line with the last circular issued on December 28, 2021
ii/allowing banking and financial institutions to restructure loans affected by COVID-19 until June 30, 2022; however, none of the customers that have already applied for restructuring since March 2020 could benefit from the new forbearance period
iii/-allowing banking and financial institutions to fully utilize their CCBs
iv/-restricting dividend payments to shareholders for audited profit in 2021 unless with permission from NBC
v/-maintaining the reserve requirement rate of 7 percent until further notice

III Non-Bank Finance

Cambodia's equity markets continued to develop with the addition of one company listed in the growth trading board for small and medium enterprises (SMEs) for the first time since this board's launch in 2015. Even though trading activity increased compared to the previous year, the Cambodia Securities Exchange (CSX) index plummeted along with market capitalization, mainly as a result of the addition of more than 17 million shares of ACLEDA Bank (ABC) being listed and available for trading on the platform. Meanwhile, Cambodia's bond market remained one of the important sources of financing for banks and financial institutions as well as private companies. The insurance sector's prospects also remained positive, supported by increases in premiums for both general and life insurance.

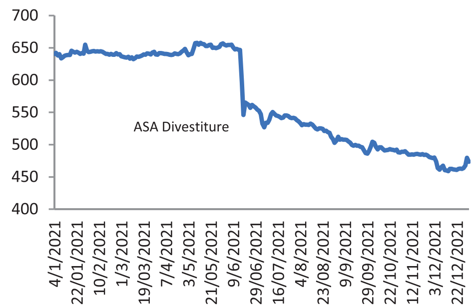
3.1. Asset Market

A. Equity Market

Both the CSX index and its market capitalization decreased significantly compared to the year before. At the end of 2021, the CSX index was 473.4, which was a reduction of 26.9 percent from 648 last year (Figure 3.1). This drop resulted from the decreases in the share prices of ABC and Sihanoukville Autonomous Port (PAS), which had negative yearly returns of −38.5 percent and −6.2 percent respectively.

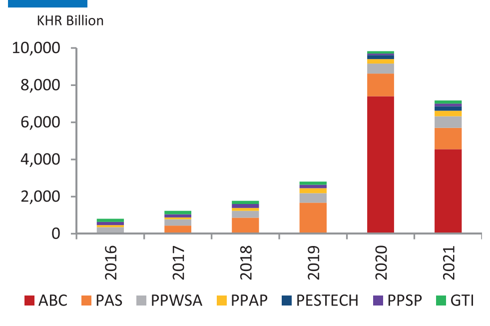
The market capitalization of the CSX has grown over the years as the market expanded with more companies being listed, but in 2021, it decreased following the trend of ABC. Market capitalization fell by 26.9 percent from KHR9.8 trillion in 2020 to KHR7.2 trillion, of which ABC contributed KHR4.6 trillion (63.5 percent of total market capitalization) (Figure 3.2).

3.1 Cambodia Securities Exchange Index



Source: CSX

3.2 Market Capitalization



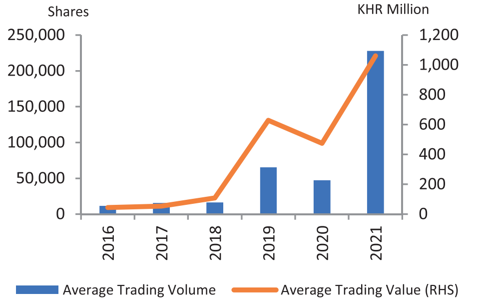
Source: CSX and NBC Staff's Calculation

Cambodia's equity market remained active amid the pandemic, as reflected by the significant increase in the number of daily trades. The CSX reported increases in average daily trading volume of 381.9 percent and average daily trading value of 123.9 percent from KHR473.9 million to KHR1.1 billion (Figure 3.3).

For the outlook, the equity market in Cambodia continues to expand and mature. More companies are expected to be listed on the CSX, which will provide both local and foreign investors with more options and diversification strategies. As a result, daily trading is expected to remain active. As for ABC's performance, its price is likely to gradually return to its initial price range before the ACLEDA Staff Association (ASA) divestment, hence bringing the CSX index back on its growth path.

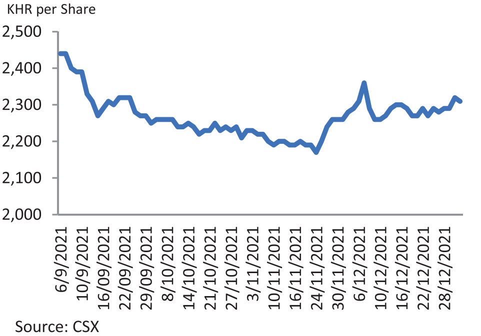
The growth board market opened up opportunities for SMEs to obtain additional financing, starting with the listing of DBD Engineering Plc. (DBDE). DBDE is a multifaceted engineering and construction company, which was listed on September 6, 2021. This company issued around 6.5 million shares at an IPO price of KHR2,380 per share. By the end of 2021, the price of DBDE stock settled at KHR2,310 per share (Figure 3.4). The success of DBDE's stock listing has attracted the attention of other SMEs to seek alternative financing options to expand their operations. Thus, more SMEs are expected to join the growth board, giving more options for investors with different risk appetites.

3.3 Average Trading Volume and Value



Source: CSX and NBC Staff's Calculation

3.4 DBDE Price

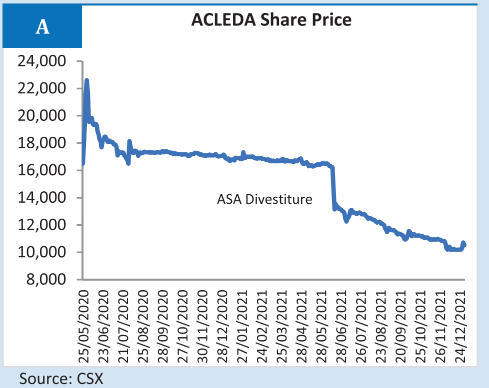


Source: CSX

Box: 3.1

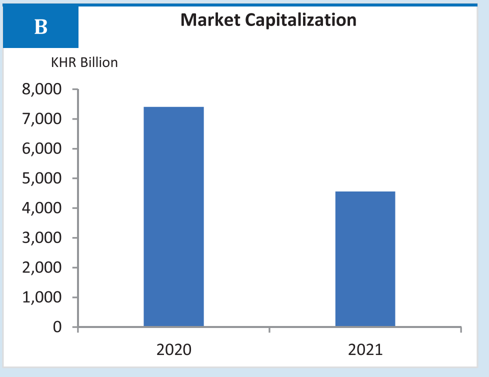
Stock Market Mover: ACLEDA Stock Performance

ACLEDA Bank Plc. was the first Cambodian bank to be listed on the CSX with its IPO on May 25, 2020; the IPO offering price was KHR16,200, and the closing price was KHR16,500. A total of 433,163,019 shares were listed, and 4,344,865 shares were issued on the CSX (Figure A). At the time, ABC dominated the CSX by becoming the major player as its market capitalization amounted to KHR7.1 trillion (75 percent of total market capitalization) and further increased to KHR7.4 trillion by the end of 2020 (Figure B). After that, the price of ABC fluctuated on average around KHR17,000 before the divestiture phenomenon.



Source: CSX

On June 15 2021, ACLEDA Bank announced that the ASA, which is an institutional stockholder, would divest 16.2 percent of its holding in the bank, making more than 17 million shares (equal to 4 percent of total outstanding ACLEDA Bank's shares) available for trading on the CSX. The move was made to enable ACLEDA's employees to trade the bank's shares on the exchange. The ASA is the second largest shareholder in the bank and was formed to serve as a holding company and vehicle to allow the staff of the bank and relevant investor(s) to participate in the long-term growth and appreciation in value of ABC.



Source: CSX

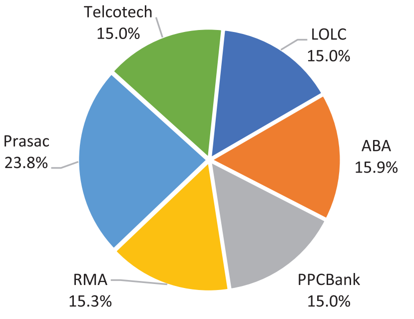
Before the divestment, the ASA held approximately 24.8 percent of ACLEDA Bank's shares, which was equivalent to 107,204,547 shares. After the divestiture, the ASA retained 89,878,026 shares or 20.8 percent of ABC, and the stock price began to fall due to the huge supply of ACLEDA stock in the market. By the end of 2021, ABC price had fallen by 35.1 percent compared to the price on the announcement date, from KHR16,220 per share to KHR10,520 per share (Figure A).

B. Bond Markets

The bond market continued its role as an alternative source of financing in local currency. At the end of 2021, market capitalization was recorded at KHR542.4 billion, of which KHR377.9 billion belonged to financial institutions (about 69.7 percent of total market capitalization) (Figure 3.5). This reflected the role of the bond market in providing additional long-term financing to the banking sector. Among the listed 3-year-maturity bonds, ABA took the first spot for offering the highest market yield at around 10 percent, whereas RMA offered the highest market yield at 5.5 percent for 5-year-maturity bonds (Figure 3.6).

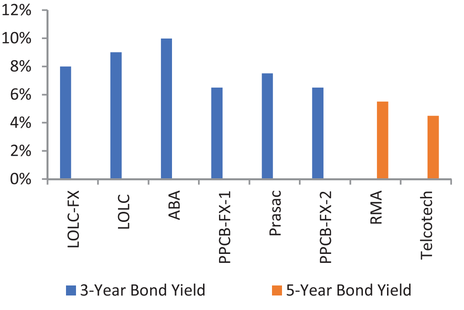
In 2021, Telcotech Ltd., a telecommunication company, was listed on the bond market. The company issued 800,000 5-year corporate bonds for KHR80 billion in local currency, with a 4.5 percent coupon to be paid semi-annually. By the end of 2021, there were two commercial banks, two microfinance institutions, one import–export company, and one telecommunication company listed on the bond market. Despite an increase in the number of issuers, the bond market remained less active in trading, as many investors preferred to hold their bonds until maturity. It is worth mentioning that the corporate bond issued by Hattha Bank, the first corporate bond issuer, reached maturity in November 2021.

3.5 Bond Market Capitalization by Company



Source: CSX and NBC Staff's Calculation

3.6 Bond Yields

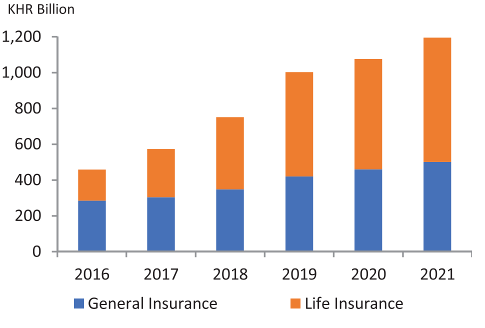


Source: CSX

3.2. Insurance Sector

The insurance sector experienced robust growth both in general and life insurance. Total gross premiums increased by 10.2 percent to KHR1.2 trillion in 2021 (Figure 3.7). Total claims paid increased by 12.1 percent to KHR164.7 billion, while the claim ratio (the percentage of insurance claims paid relative to insurance premiums earned) increased from 13.6 percent to 13.8 percent (Figure 3.8).

3.7 Insurance Premium

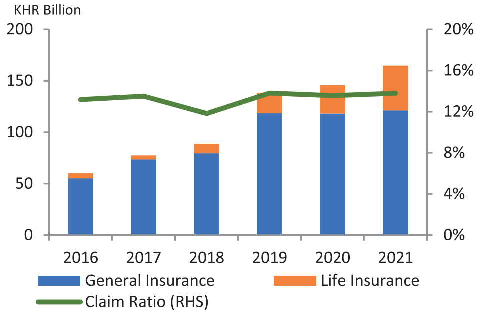


Source: Insurance Association of Cambodia

Premiums earned from the sale of life insurance increased by 11.8 percent to KHR693.7 billion, which was mainly driven by endowment policies (4.2 percent of total growth) and group life insurance (3.9 percent). Endowment policies covered the largest share of gross premiums for life insurance, accounting for 79.4 percent of total life premiums, followed by group product (12.5 percent) and term life (5.3 percent) (Figure 3.9). Furthermore, the number of new business policies increased by 3.8 percent from 133,648 to 138,662 policies, corresponding to an increase of 8.9 percent in renewal policies from 342,322 to 372,938 policies. The claim ratio increased from 4.5 percent to 6.3 percent as the claims paid in life insurance increased by 54.6 percent to KHR43.4 billion.

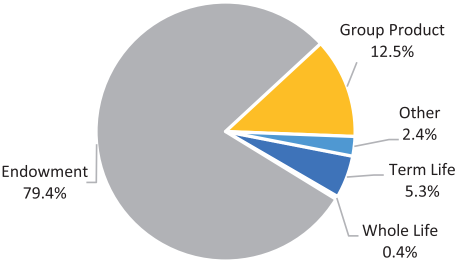
General insurance premiums increased by 8.2 percent to KHR501.5 billion, mainly contributed by medical (5.4 percent of total growth), miscellaneous (0.9 percent), and auto (0.8 percent). Moreover, property insurance accounted for the largest share of gross premiums for general insurance, accounting for 33.1 percent, followed by medical insurance (22.1 percent) and auto insurance (16.6 percent) (Figure 3.10). The claim ratio declined from 25.6 percent to 24.2 percent, and the claims paid in general insurance increased by 2 percent from KHR118 billion to KHR121.3 billion.

3.8 Insurance Claims Paid and Claim Ratio



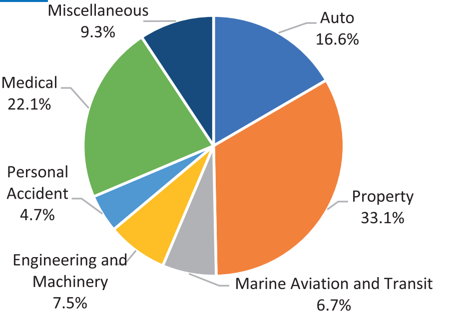
Source: Insurance Association of Cambodia, NBC Staff's Calculation

3.9 Shares of Life Insurance Premiums



Source: Insurance Association of Cambodia

3.10 Shares of General Insurance Premiums



Source: Insurance Association of Cambodia

IV Payment and Settlement Systems: Recent Development

Cambodia's payment and settlement systems have developed remarkably in recent years, and the use of electronic payment systems increased substantially during the pandemic. The large share of the young in the population, high mobile phone and internet penetration, and supportive regulatory framework encouraged banks and financial institutions to introduce innovative digital payment services with many agents nationwide have also markedly contributed to promoting financial inclusion. For instance, the value of retail electronic payments has steadily increased to almost four times of the GDP, and the number of e-wallet accounts has surged to 13.6 million, accounting for more than 80 percent of the total population.

Payment and settlement systems in Cambodia have developed remarkably in recent years, especially electronic payment systems, and the COVID-19 pandemic has accelerated the use of cashless transactions. In line with advancements in financial technology and the government's policy toward the digital economy, NBC encourages and supports innovation and provision of digital financial services to reduce costs, improve interoperability and promote financial inclusion. NBC has continuously developed payment and settlement systems for both wholesale and retail payments to support the country's rapidly expanding digital financial services, including the National Clearing System (NCS), Online Banking System (OBS), Fast Payment System (FAST), Cambodian Shared Switch (CSS), Retail Pay, and Bakong (Figure 4.1). Meanwhile, a Real-Time Gross Settlement (RTGS) system is being developed to facilitate large-value transactions in the financial system.

The use of electronic payment systems has increased substantially, reflecting growing adoption and confidence from the public. In 2021, the NCS settled a lower volume and value of checks for both KHR and USD but settled more electronic payment orders given the spread of COVID-19, and imposed stringent measures encouraged individuals and business firms to use and accept cashless payment systems. The timely introduction of new electronic payment systems by

4.1 NBC's Payment and Settlement Systems

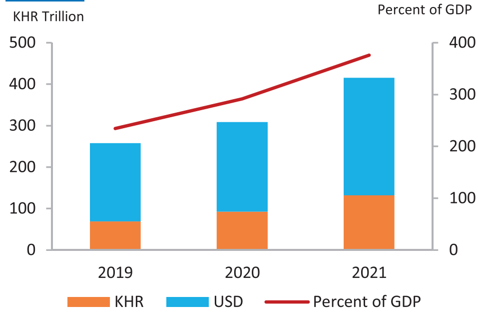
Source: NBC

NBC in recent years has provided efficient and convenient platforms for secure and smooth payment transactions amid the pandemic. For instance, the value of retail electronic payments,[16] including both KHR and USD, markedly expanded 34.5 percent to KHR415.5 trillion, equivalent to 3.8 times of the GDP (Figure 4.2).

Large share of young population, high mobile phone and internet penetration, and supportive regulatory framework have motivated banks and financial institutions, especially payment service institutions, to introduce innovative digital payment services with many agents nationwide. As of 2021, NBC has provided licenses to 30 payment service institutions and two banks and financial institutions to operate payment services that mainly focus on digital payment services through their mobile applications and agents (46,278 outlets), significantly contributing to financial inclusion. More than 13.6 million customers have registered for e-wallet accounts, while a large number of customers can directly walk into any agent network to conduct various transactions, such as bill payments and money transfers (106.2 million customers recorded in 2021), allowing the previously unbanked to access and use formal financial services at affordable costs (Figure 4.3). In 2021, the total value of online payments using e-wallet accounts expanded 17.3 percent to almost KHR200 trillion with 343.8 million transactions (Figure 4.4).

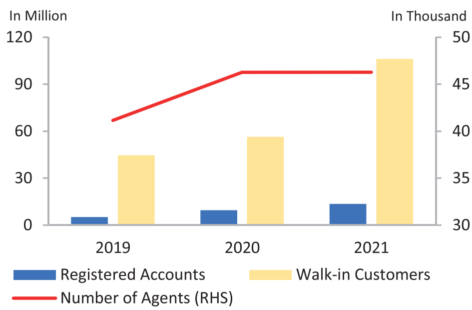
Advancements in financial technology and the rapid adoption among the public have also encouraged more banks and financial institutions to develop and provide internet and mobile banking services to enable customers to perform a wide range of digital banking operations, including loan repayments, fund transfers, bill payments, phone top-ups, payrolls, and balance inquiries. In

4.2 **Value of Retail Electronic Payment**



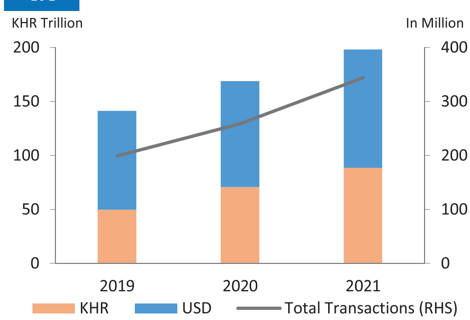
Source: NBC

4.3 **Number of Registered E-wallet Accounts, Walk-in Customers and Agents**



Source: NBC

4.4 **Value and Volume of E-wallet Transactions**



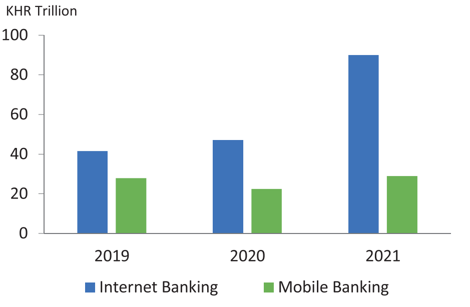
Source: NBC

[16] Retail electronic payments include both KHR and USD payment transactions through the e-wallets of banks and financial institutions and payment service institutions, internet banking, mobile banking, card payments, and Bakong.

2021, the value of internet banking almost doubled to KHR90.1 trillion with 4.4 million transactions and that of mobile banking increased 28.6 percent to KHR28.9 trillion with 254.1 million transactions (Figure 4.5).

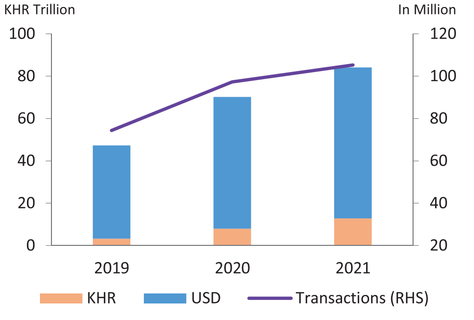
At the same time, the use of card payments has steadily increased as around 10.6 million cards have been issued. In 2021, the total value of card payments increased 20 percent to KHR84.1 trillion with 105.3 million transactions (Figure 4.6). To facilitate the increasing trend of card payments, banks and financial institutions installed 3,639 ATMs and 49,432 POS machines across the country. Meanwhile, QR code payments have also expanded notably in recent years, and NBC has introduced the KHQR code standard to facilitate interoperable QR code payments among banks and financial institutions as well as to enhance financial connectivity in the region. In 2021, the value of QR code payments increaseds 2.2 times to KHR953.9 billion with 4.4 million transactions (Figure 4.7).

4.5 Value of Internet and Mobile Banking Transactions



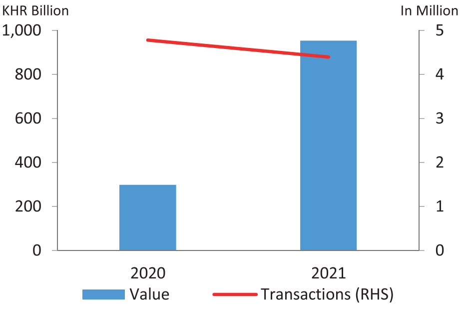
Source: NBC

4.6 Value and Volume of Card Payments



Source: NBC

4.7 Value and Transactions of QR Payments



Source: NBC

Box: 4.1

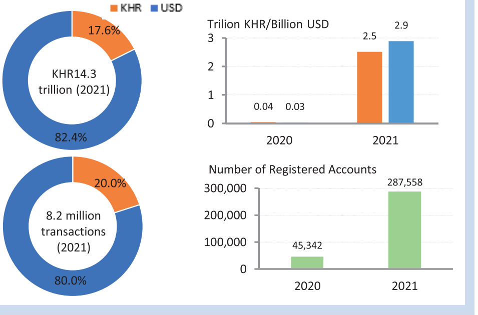
Bakong System Development

Bakong, a blockchain-based payment platform, was officially launched by NBC in October 2020. Using distributed ledger technology (DLT), Bakong is a backbone payment system that aims to enable interoperability among banks and financial institutions, enhance efficiency in payment systems, promote financial inclusion, and encourage the use of cashless payments in local currency.

This system has been recognized regionally and globally as the first central bank payment system using blockchain technology. In April 2021, the PwC CBDC global index ranked Cambodia's Bakong project first in Asia and second in the world for retail projects, just after the Bahamas' Sand Dollar. Moreover, in January 2022, the system won one of Asia Nikkei's Awards for Excellence in the 2021 Nikkei Superior Products and Services Awards for its innovative technology and impact on the country's economic and social development.

As of 2021, 55 banks and financial institutions have participated in this system, of which 27 members are officially connected, and another 28 institutions are studying and integrating with their own systems. Meanwhile, the number of registered accounts reached 287,558, though the number of people who can use this system indirectly through members' applications may be much higher. In 2021, the total value of transactions through Bakong was recorded at KHR14.3 trillion with 8.2 million transactions (Figure A).

A **Amount, Number of Transactions, and Registered Accounts in Bakong System**



Source: NBC

The introduction of Bakong and the KHQR code standard has enhanced interoperability among local banks and financial institutions as well as improved efficiency, promoted safety, and reduced costs. In addition, Bakong also facilitates cross-border payment transactions, as NBC launched a cross-border payment linkage with Maybank in August 2021 to enable Cambodian migrant workers in Malaysia to send remittances home at low costs. Going forward, NBC will enhance regional financial connectivity, particularly with ASEAN member states, to deepen regional integration and cooperation through cross-border payments to facilitate trade, e-commerce, tourism, and remittances as well as to promote financial inclusion. Furthermore, NBC is studying the use of the Bakong system for large-value payment to strengthen the efficiency and security of gross settlements in the Cambodian financial system in line with regional and global developments.