



NATIONAL BANK OF CAMBODIA

Riel Stability Development



The Importance of the Riel to Cambodia



National Bank of Cambodia Headquarters in Phnom Penh, Cambodia.

INTRODUCTION

The mission of the National Bank of Cambodia, the nation's central bank, is to determine and direct monetary policy aimed at maintaining price stability. Effective monetary policy is best conducted when the national currency is predominantly used. Since Cambodia is a highly dollarized economy, it is difficult for the central bank to successfully execute its mission as the NBC is limited in the number of policy instruments it can use to promote sustainable economic development.

Thus far, dollarization has positively contributed to Cambodia's economy, with an average of 8.5 percent growth over the last 15 years. This remarkable pace has been driven by foreign direct investment, exports, and rapid global trade integration. Yet, as Cambodia rises to middle-income status, high dollarization leaves the country vulnerable to external shocks and can threaten hard earned economic gains.

The national currency represents the monetary sovereignty and the strength of a nation. In order to achieve long term, sustainable and inclusive growth, Cambodia needs to be more independent from foreign currencies to exert greater control over its monetary and economic policy. Recognizing the importance of the local currency to achieve sustainable economic growth, the government has implemented a strategy to promote the use of the local currency through its Rectangular Strategy and its Financial Sector Development Strategy. For example, all taxes and utilities are obliged to be paid in the local currency, and maintaining the value of the riel through exchange rate stability. So far, the government and the NBC have not taken any administrative measures to enforce the use of riel as it could create a black market and capital flight from the country. The government and the NBC will continue to use moral persuasion methods and incentive based measures instead.

These strategies alone are not enough. The power to reshape the monetary landscape and move towards monetary independence depends on all Cambodian citizens. All Cambodians can work together to help achieve greater monetary sovereignty by using the riel more in our everyday lives; from obtaining loans in riel, to purchasing groceries at the market, to investing in your retirement. Every riel that is in the marketplace strengthens our economy and helps forge a stronger and sustainable economic future.

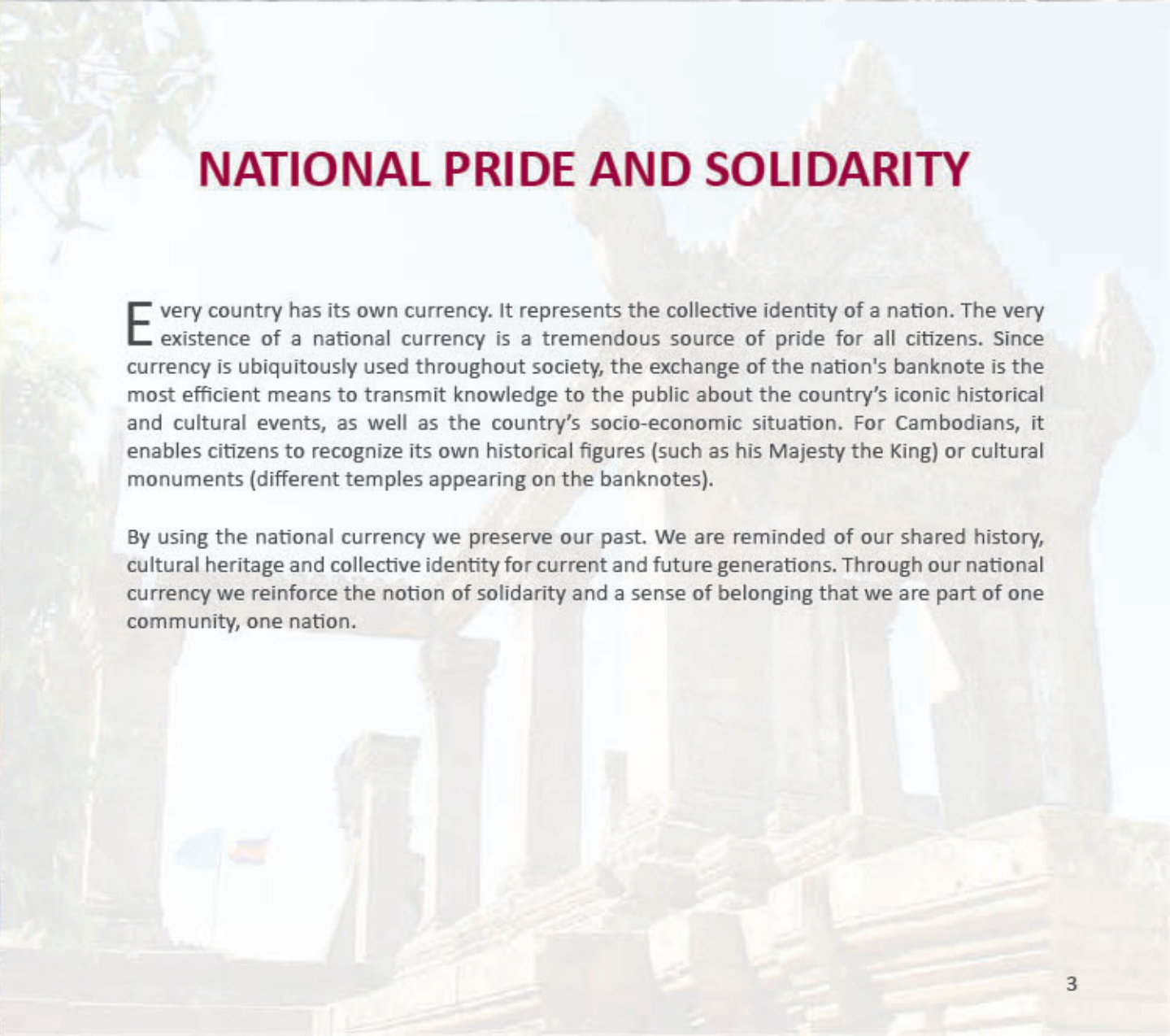
Here is why the riel matters to all of us.



NATIONAL PRIDE AND SOLIDARITY

Every country has its own currency. It represents the collective identity of a nation. The very existence of a national currency is a tremendous source of pride for all citizens. Since currency is ubiquitously used throughout society, the exchange of the nation's banknote is the most efficient means to transmit knowledge to the public about the country's iconic historical and cultural events, as well as the country's socio-economic situation. For Cambodians, it enables citizens to recognize its own historical figures (such as his Majesty the King) or cultural monuments (different temples appearing on the banknotes).

By using the national currency we preserve our past. We are reminded of our shared history, cultural heritage and collective identity for current and future generations. Through our national currency we reinforce the notion of solidarity and a sense of belonging that we are part of one community, one nation.





PROMOTE PRICE STABILITY

In theory, price stability is managed by adjusting money supply in the economy. As with any goods, an over-supply of money in circulation would diminish its value, leading to inflation. Similarly, an under-supply of money in circulation would increase its value, leading to deflation. Both currency depreciation and currency appreciation impact the value of goods on the market. High inflation negatively affects the livelihood of the population when goods become more expensive, while deflation could have a negative impact when investors don't see the value of their investments increasing overtime. If money supply is not well managed, macroeconomic instability could occur.

To maintain price stability the NBC must control money supply, by either absorbing money from the market or injecting it back into the market. In Cambodia, because of the high level of dollarization and the free movement of foreign currencies in the country (which is outside of the NBC's control) it is difficult for the central bank to assess the full extent of dollarization in the economy and use monetary policy to effectively control price stability.



REDUCE TRANSACTION COSTS

Using more than one currency in the economy increases the transaction costs both in terms of money and time. Currently goods and services are priced in different currencies depending on the origin of the products (local or imported), size of transactions (small or large) and type of markets (traditional or modern). As riels and dollars circulate simultaneously, buyers are subject to exchange rate risk depending on the currency they hold. The exchange rate is determined by the sellers, disregarding the market trend, and is generally set in their favor.

For example, a buyer needs to first exchange their local currency before paying to the seller, thus costs them time and money. On the other hand a seller wastes time and money when the price tags on their products are in a different currency that the buyer holds. They also face accounting difficulties when the currency they receive is different from the currency of their accounting system. For both sides, they face the exchange rate risk when one currency value moves against the other.

Using one national currency in all domestic economic transactions would help substantially reduce the costs for both buyers and sellers. In addition, it could facilitate and stimulate more transactions, which could be done faster and more efficiently as both sides won't have to encounter difficulties related to price and exchange rate differences.





PROMOTING TRADE

Cambodia relies heavily on exports and tourism for economic growth. In 2014, 61 percent of Cambodia's GDP came from these sectors. If Cambodia were to use the riel alone, the central bank can further promote exports by increasing price competitiveness through currency devaluation. Devaluation makes our goods cheaper on the international market, thereby enabling the country to increase exports. The power to devalue a currency lays with the central bank in consultation with the government and relevant policymakers.

For example, to produce a pair of jeans cost 4,000KHR. If the exchange rate is at 4,000KHR to 1USD, the trade partner would need 1USD to buy these jeans. If the riel were to depreciate to 4,200 KHR to 1USD, the exporter would only need 0.88 cents to buy the jeans, thus making it less expensive on the international market. The less expensive the product, the more consumers can purchase, leading to more buyers, creating more demand and more jobs for it to be produced in Cambodia.

However since production inputs—raw materials and worker salaries—are in U.S. dollars, a depreciation of the riel would have no effect on the export price thus leading to missing opportunities to boost exports. Similarly devaluation of a currency can attract more tourists to come to Cambodia and spend more, as our goods would be relatively less expensive. The loss of this important tool can significantly impede the country's economic development.



INCREASE INVESTMENTS & JOB CREATION

To promote domestic investments and job creation, many central banks, such as the U.S. Federal Reserve, adjust the central bank policy rate. The level of policy rate, set by the central bank, influences the banks' cost of funds and as a result the interest rate at which banks charge from households and investors. When the central bank lowers its policy rate, it signals to banks to lower their lending rate, thus making borrowing cheaper for investors and households. The central bank can also raise its policy rate if there is sign of the economy overheating, particularly in certain sectors, such as real estate to avoid a bubble.

This only works when everyone in the country uses the national currency. In the context of Cambodia, an overwhelming 90 percent of bank deposits and loans are in U.S. dollars. However, the NBC can only lend to banks in Khmer riels. This means that any policy rate the NBC sets would not affect banks' cost of funds. This is a significant disadvantage for Cambodia's households and investors who are now facing high funding costs because the central bank is not able to influence the lending rate.



PROMOTE INFRASTRUCTURE & SOCIAL WELFARE

Greater use of the local currency can allow the government to better manage its budget to meet the needs of investments in infrastructure and social welfare. Currently, the government collects revenues in riel, but spends for infrastructure and other development projects mostly in dollars. In the long run, this currency mismatch would greatly prevent the government from managing its budget at the optimum level.

In Cambodia, the government's fiscal policy is constrained by the substantial amount of foreign currencies in the economy. As such, it is limited in the amount it can borrow from the public to finance priority development projects such as roads, bridges, schools, hospitals, and other programs to reduce poverty. If the government wants to increase spending, it cannot borrow from the domestic market in foreign currencies because it would not only lead to higher demand for dollars in the economy, but also higher foreign exchange risk for the government.

Promoting the use of riel would play an important part in enhancing the government budget and reduce this fiscal restraint. If there were more riels on the market, the government could consider issuing riel-denominated securities to manage its budget, especially in financing the country's much needed development projects. Eventually, domestically mobilized financing could also reduce Cambodia's dependence on foreign debt.



FINANCIAL INCLUSION

According to the World Bank studies, there is a strong correlation between a country's economic development and its financial system development. Financial development is not only a vibrant banking industry but also implies an inclusive financial sector, where everyone in the country has access to formal and affordable financial services. In Cambodia, despite significant progress over the past decades, around 46 percent of the adult population has access to formal financial services and less than 23 percent have a bank account.

About 70 percent of Cambodia's population resides in rural areas where agricultural activities are the main source for their livelihood. The demand for the riel in these areas is especially high to help expand their businesses as well as to support their daily consumption. Currently, financial institutions operating in these areas receive a large portion of its funding in U.S. dollars by borrowing from foreign investors and local depositors in urban areas. In order to meet the demand for riels, those financial institutions often exchange their dollars into riels thus exposing them to foreign exchange risk. To compensate for such risks, financial institutions often charge a higher interest rate to borrow in riels, thus making loans in riels more expensive than in U.S. dollars.

For city dwellers large transactions are often conducted in U.S. dollars thus avoiding this foreign exchange risk. However, the rest of Cambodia's population (who have less access to foreign currencies) is subject to higher lending rates. Many may see this as a significant obstacle that prevents them from accessing formal financial services. Instead, they borrow through informal means from unscrupulous lenders who may take advantage of them. Expanding the use of riels in savings and other means of transactions would help reduce the cost of riel borrowing and further promote financial inclusion in rural areas in Cambodia. This could help to substantially contribute to economic growth in the rural areas, particularly in the agricultural sector, which constitute about 30 percent of GDP growth.



FOREIGN RESERVE ACCUMULATION

In a country where the national currency is exclusively used in the economy, foreign currencies that flow into the country must be converted into the national currency before conducting any domestic transactions. The role of the central bank is to absorb those foreign currencies in exchange for its national currency. If the riel were the only currency used in the economy, Cambodia could substantially increase its foreign reserve by accumulating every year the surplus of net inflows of foreign currencies to Cambodia.

Growing the foreign exchange reserve builds wealth for the country, enhancing confidence in the local currency and strengthens the foundation for macroeconomic stability. Adequate foreign exchange reserves also allows the central bank more room to intervene against volatile fluctuation of the currency as well as to manipulate it to achieve the desired outcome conducive for economic growth. Furthermore, foreign reserves accumulated over time is generally invested in various financial instruments to optimize reserves (in order of priority) for safety, liquidity and return. The more foreign reserves there are to invest, the more income it can generate. This income is then shared, as defined by the law, between the central bank (for its operating expenses) and the government, which can be invested back into the country for development. Thus far, foreign reserve accumulation in Cambodia, though adequate for the size of its economy, could be greatly improved, had the riel been used extensively in the country.





NBC staff member inspecting new U.S. dollar bills, Phnom Penh, Cambodia.

PREVENT COUNTERFEITING

As a cash based economy with wide use of the U.S. currency, Cambodia is an easy target to attract U.S. dollar counterfeiters because the general population and relevant authorities may not be familiar with the tactics, look and feel of a counterfeit foreign currency. In this regard, it is vital to encourage greater use of the local currency, which gradually reduces the degree of dollarization, thereby preventing counterfeiting of foreign currency in Cambodia. Less counterfeiting of foreign currency and increased use of the local currency enables more money to flow into the economy through the formal banking system.



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