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## Building on Asia's momentum

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Asia is well positioned to capitalise on largely favourable global trends and enjoy steady growth in 2014-15. With vigilance and further reforms, the region should remain resilient to global risks and continue to be a dynamic force driving the strengthening global recovery.

Given Cambodia's growing regional integration, this is good news and would allow more space to focus on policies to further boost the resilience of the economy to shocks.

How did we arrive at these conclusions in our latest Regional Economic Outlook report? First, global activity has been firming up, and this will help Asia's exports. Growth momentum has gathered steam in the United States and the euro area, thanks to a reduction in fiscal tightening and still accommodative monetary conditions. And while some large emerging market economies have slowed, overall growth in emerging markets has picked up. Stock markets across most of the globe have reflected those trends and many have reached all-time highs.

Second, the largest economies in the region are also doing relatively well, despite some challenges. In China, the unveiling of the government's reform agenda has boosted sentiment, and growth should moderate only slightly to 7.5 per cent in 2014. Meanwhile, Abenomics has lifted confidence and inflation in Japan, and growth there should remain above trend at 1.4 per cent in 2014. This favourable external environment is benefiting the rest of the region, together with strong employment and credit growth in many economies. The overall outlook for Asia is one of steady, robust growth of about 5.5 per cent in 2014-15. No longer as stellar as a few years ago, but still enviable by international standards.

Third, external risks have receded in emerging Asia, including when compared with some emerging economies in other regions. Asia's emerging markets moved swiftly to address vulnerabilities following last year's market turbulence and now have stronger macroeconomic fundamentals.

So far, so good for Asia, but this outlook assumes that risk factors remain dormant. An unexpected tightening of global liquidity would affect the region. Domestic vulnerabilities could magnify the impact – as interest rates rise, vulnerabilities stemming from pockets of high corporate leverage and household indebtedness would come to the fore. In addition,

economies with weaker fundamentals would be hard hit, similar to what happened a year ago when markets abruptly revised their expectations of future US monetary policy. Asia is also facing risks originating from within the region. These include a sharper than envisaged slowdown and financial sector vulnerabilities in China, a waning impact of Abenomics, and political tensions and uncertainty.

A continuation of the recent macro-economic and structural policy momentum would help keep risks at bay, maintain investor confidence and sustain the region's growth leadership.

Progress on structural reforms is critical. The agenda varies across the region, involving vigorous implementation of the government's reform blueprint to put growth on a more sustainable path in China; further product and labour market reforms to prevent deflation and low growth from returning in Japan; and lifting regulatory impediments, boosting infrastructure and continuing to promote trade and financial integration in many emerging, frontier and developing economies, as well as in Pacific island countries and small states.

What does this regional outlook mean for Cambodia?

If we take a longer view, growth in Cambodia has been impressive but volatile relative to its peers, partly reflecting its open economy and concentrated production base. IMF research has shown that external shocks can explain more than half of Cambodia's growth variation, a trend that is expected to become more important as its integration with the global economy, and with emerging Asia in particular, expands.

Through trade, investment and financial channels, the economy is now more exposed to external shocks. We therefore need to be more vigilant about risks.

The good news is that, with Asia rebalancing and consumption playing a larger role in the region, including China, new sources of foreign direct investment and market access for Cambodia are opening up. In this context, the regional integration in 2015 will also provide opportunities.

The policy challenge now is how best to leverage these regional trends with domestic reforms to improve the quality of growth and build resiliency against shocks. This is essential to create more and better-quality jobs for Cambodia's youth in the years ahead.

In our latest country report, published in January, and in the book *Cambodia: Entering a New Phase of Growth*, published in February, we highlight the financial, monetary and fiscal measures that could lay the foundations for a more resilient Cambodia.

Given the rapid growth of Cambodia's banking system and microfinance institutions, it is important to ensure that financial deepening can continue without compromising financial

stability. That will require moderating credit growth and managing financial deepening, better risk management and continuous upgrading of supervision and regulation. Because of limited monetary control due to high dollarisation, monetary policy will need additional support from strong supervision and macro-prudential policies to moderate risk buildup in the system.

On fiscal measures, implementing the government's revenue mobilisation strategy, managing contingent liabilities related to public-private partnership projects and continuing to reform public financial management are critical to rebuilding and safeguarding the fiscal space. The strong performance of tax collection in recent years is a good start, but more is needed. Continued improvement in revenue collection and expenditure efficiency would support Cambodia's development needs, especially in health, education and infrastructure, and make growth more inclusive.

As Asia's momentum is on course to continue, Cambodia is well placed to take advantage of regional trends and navigate the associated risks to create more and better jobs for an inclusive society.

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