

**Sector  
Highlight**

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**The likely impact on Cambodia  
of the tightening liquidity in global markets  
and the sharp decline of oil and commodity prices**

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To those sitting in Cambodia, for which revised consensus '08 GDP forecasts remain a healthy 6.5 percent, the turmoil in American and European financial markets seems a distant event. The comparable meltdowns in Asian markets seem closer to home, but still somewhat remote. Below we discuss the impact that Cambodia will feel from the global liquidity crunch and falling commodity prices.

### **1. Falling oil and commodity prices are positive for Cambodia**

The benefit of cheaper oil is already being felt amongst Cambodian consumers and businesses. The frugal Cambodian authorities provide minimal subsidies for oil, thus savings are being quickly passed on to consumers and businesses. Heated inflation figures of CPI rising 20-30% YoY now seem a distant memory, and upcoming monthly figures are likely to be modest and re-assuring. As most of Cambodia's foods and raw materials are imported, softening commodity prices will likewise result in cheaper prices. Cambodian farmers and exporters are not enjoying the unusually high market prices that occurred in mid 2008, so not everyone benefits from the slump in commodities. However at Leopard we're encouraged to see that many investors of all sizes are still interested in funding large scale agriculture projects in Cambodia. They now see Cambodia's abundant but under-utilized farm land as a good opportunity to expand production of food and other needed raw materials. Missions from numerous governments have visited Cambodia to enquire about huge farm deals and long term supply contracts that ensure their food security. As mentioned below, if the price of Cambodian farm land or long term farm leases softens in the short term, this will be a good opportunity to invest for the long term.

### **2. The impact of global liquidity concerns is less obvious, but likely**

As liquidity in global financial markets tightens, Cambodia's economy will be spared the more immediate and obvious problems facing some economies, but there will be some follow on effects. With no stockmarket at present, Cambodian investors will not suffer from the hardship of "wealth destruction" and thus the global turmoil should not cause domestic consumption to decline significantly. Cambodia also has virtually no interbank market, thus domestic short term lending rates have not jumped. Moreover, healthy banks are safe from the "contagion effect" that might otherwise be caused by interbank loans to weaker banks.

Like their counterparts elsewhere, Cambodian businessmen will find it more difficult to obtain loans in late 2008 and 2009 and interest costs will firm. The reason for this is not likely be a shortage of funding, but instead, growing prudence and caution amongst local bankers. Currently the banking system has ample liquidity as banks are flush with deposits and commercial lending rates are reasonable as indicated by a US dollar prime rate of 8-9%. However one area to watch will be the movement of foreign deposits and inward remittances to Cambodia. These sources contributed a significant portion of deposit growth in recent years (rising 38% per annum in 2006 and 2007). It is likely that the global slowdown could reduce funding from these groups in the near term. Cambodian banks and companies are isolated from a potential rise in global lending rates as they have very

limited offshore borrowing. Total private sector loans were only 19% of GDP at the end of 2007, thus Cambodia Inc. enjoys much a lower leverage compared to its peers throughout Asia.

### **3. A slowdown in investment and growth is likely**

Cambodia will likely see a slowdown in investment due to the global credit crunch, particularly in the construction of high profile property projects and perhaps a delay in some infrastructure works. Foreign investment and foreign aid funds a large portion of property and infrastructure projects. As foreign property developers find it more difficult to obtain funding at home, they may be choose to delay or cancel projects in far away Cambodia. On a positive note, many badly needed infrastructure works will go forward without delay, particularly those which are funded by the multilateral groups such as the ADB, IFC etc. However some projects which are funded by single nation donors (usually smaller but also important road or bridge projects) may get reviewed by the donor governments and face possible delay or cancellation.

Signs are already emerging of a slowdown in the property market. Property agents and local newspapers report that prices are softening and that the foreigners are beginning to delay their projects. Some property investors fear that foreigners will sell their half finished projects to meet funding requirements at home.

### **4. A near term slowdown is likely to be positive for longer term growth**

Many economy watchers (including Leopard) feel that if growth and investment slows to modest rates in 4Q 2008 and in the first half of 2009, that this is likely to be a positive development. After posting 10.5% annual GDP growth in the 2003-2007 period, a soft landing would likely be in the best interests of the longer term economy and would allow the excesses of the past several years to be corrected. Notable examples are that loan growth expanded nearly 100% YoY in 1Q 2008 and Phnom Penh properties had doubled or trebled in price in the past few years.

For Leopard Cambodia Fund and other investors with cash in hand, the next 6-9 months should be a very good time to invest in Cambodian companies and fixed assets. Some potential acquirers are likely to be cash strapped or increasingly cautious, leading them to delay their acquisitions and investments. This creates buying opportunities for the remaining buyers. We also believe that the pricing of deals is likely to improve further as company owners will lower their expectations, due to tightening supplies of loans and the sobering impact of a slowing economy.

There are few sources of long term capital in Cambodia, and the on going liquidity crisis will force some suppliers of capital to overlook Cambodia in the near term. Many of the rival buyers that Leopard have come up against in our deals have been Asian investment banks or Asian investment funds who have been using their 'discretionary' funds to acquire Cambodian assets or stakes in Cambodian companies. For many of these groups discretionary funds will now be largely unavailable or directed toward opportunities at home or in more traditional markets. We have even encountered large hedge funds dabbling in the Cambodian market in anticipation of big returns. The meltdown of worldwide stockmarkets and tightening liquidity will likely force these non-traditional investors to overlook the country and attend to concerns in their home markets. This leaves more opportunities for Cambodian specialists, such as Leopard.