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# Why Credit Outstandings in Cambodia will be Closer to \$30b than \$14b by 2020

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## Key Points

- GDP growth forecast to be 7%-8% over the outlook period, resulting in Nominal GDP growth of 11%-12%.
- Financial deepening will continue, with Credit Bureau forecasting 97% increase in consumer borrowers by 2020.
- This is likely to drive credit growth of at least 15%-20%, leading to credit outstandings of \$23b to \$30b by 2020.
- Bank/MFI capital levels will need to increase significantly.

There has been recent discussion about the likely amount of credit outstanding in Cambodia in 2020, following a forecast issued by the Cambodian Credit Bureau (CBC) that credit outstanding would be \$14.7b in 2020, up from \$5b at the end of 2013. While some felt this was about right, others felt it was too high.

We believe that it is far too low, and that credit outstandings will be at least \$22.5b, and possibly closer to \$30b, by 2020.

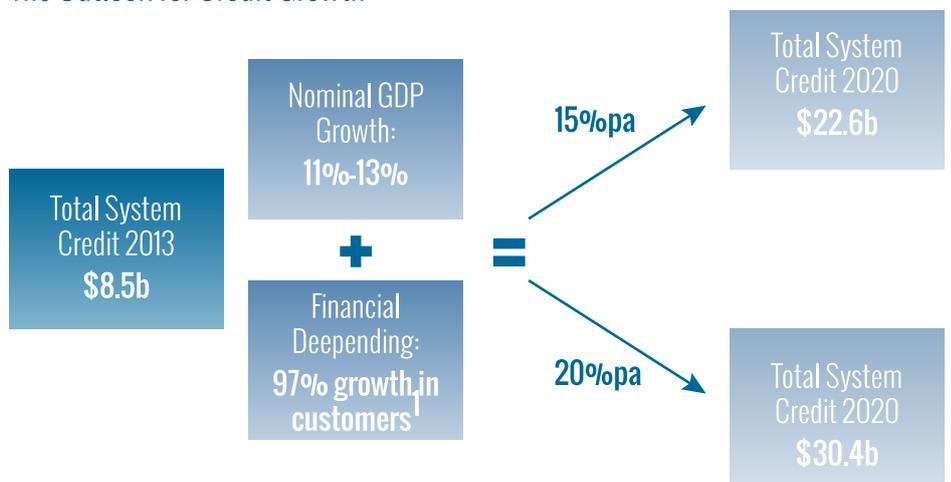
The CBCs credit growth estimate was for Consumer Credit, and was based on a linear function with credit growing at just under \$1.4b each year. Credit growth however is exponential, and to grow from \$5.0 to \$14.7b would imply annual growth of 16.6% pa.

To clarify the starting balance – at the end of 2013, total credit outstandings in Cambodia for Banks & MFIs amounted to \$8.5b. We estimate that less than 10% of this sum is consumer lending<sup>1</sup>, the remainder being for business purposes. Consumer lending was not \$5b at the end of 2013.

If however the CBC is correct regarding the credit growth rate of 16.6% for the

system overall, this would result in total credit outstandings of \$25b by 2020. Is this reasonable?

## The Outlook for Credit Growth



1 - Estimate by Cambodian Credit Bureau

## GDP Growth

Credit is measured in nominal terms, not real terms, therefore it should be compared to Nominal GDP growth rather than Real GDP growth.

The IMF estimates that Real GDP growth will average 7.3% out to 2018, with a GDP

1. Even Acleda, the largest & most consumer oriented bank, has < 20% of its portfolio in "consumer".



deflator of 3%<sup>2</sup>. This implies Nominal GDP growth of around 10.5%. We expect both GDP and the deflator to be slightly higher, resulting in Nominal GDP growth averaging at least 11% out to 2020<sup>3</sup>.

As a baseline, we would therefore expect credit growth in Cambodia to be at least 11%. If it is lower, it will imply that firms are deleveraging which would be counter-intuitive given the growth prospects on offer.

If we assume that firms will leverage up to take advantage of growth opportunities, as seems appropriate, then we can expect credit growth to be comfortably higher than Nominal GDP growth.

### Financial Deepening

The other key factor that will drive credit growth is “financial deepening”, which is particularly relevant for a country such as Cambodia where the overwhelming majority of the population are not yet in the formal financial system.

While there is no single measure for financial deepening, the proportion of the population with a bank account (or a loan), and the proportion of credit to GDP, are both indicators of financial deepening.

The CBC predicts the number of “consumer” borrowers will increase by 97% by 2020<sup>4</sup>, supported by demographic change, which implies a significant level of financial “deepening”.

2. IMF 2013 Article 4 Consultation

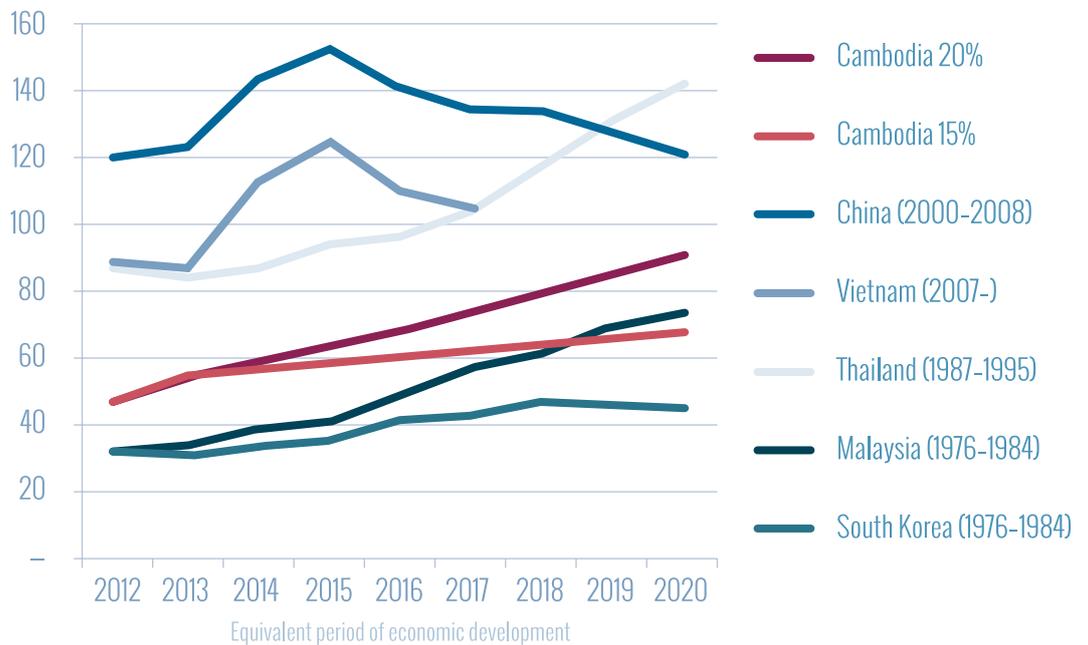
3. Even at 11%, Nominal GDP growth would be around 5% below that recorded by other “Asian Tigers” in the 7 years after reaching GDP per capita of \$1000

4. 2020 Outlook on Credit Demand, CBC, Sep 2014

### Outlook for Credit Growth

Based on the level of GDP growth and financial deepening, we believe that credit growth is likely to average at least 15%, and up to 20% out to 2020. This is broadly in line with the “rule of thumb” that credit growth in emerging markets is around double nominal GDP growth. It is also well below the 31% average credit growth rate of the past 6 years.

Credit / GDP %



This level of growth would result in total credit outstandings of up to \$30b by 2020, which some will decry as being wildly optimistic, and will point to an unsustainable and worrying rise in the Credit/GDP ratio.

However if we look at the experience of other Asian economies as they reached Cambodia’s current level of economic development (as measured by GDP per capita), we see that \$30b in credit by 2020 is within the bounds of peer experience, and that \$22.5b would be very much at the low end of peer experience.

The chart above plots the level of Credit to GDP for five other countries over the seven years

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after they reached GDP per capita of \$1000<sup>5</sup>. In the case of Cambodia, this was 2013.

If credit in Cambodia grows to \$30b by 2020, then in absolute terms Cambodia's Credit to GDP would be well below the levels of China, Thailand and Vietnam at their equivalent stage of economic development. In terms of the rate of increase, it will be broadly in line with the growth experienced by Malaysia, and less than that experienced by Thailand.

Cambodia's economic growth over the outlook period is expected to be amongst the highest in the world. In that context, it is not unreasonable to expect high credit growth.

Indeed, a recent research report by the Turkish Central Bank<sup>6</sup> found that an average of 15 percent annual credit growth would be reasonable and healthy in the medium-term for Turkey, despite being a lower growth economy than Cambodia.

There is one very significant and potentially negative caveat with this analysis, and that is "what will happen around the 2018 election"? We make no comment on that.

## How will it be funded?

A simplistic approach would be to note that "deposit growth has averaged more than 20% over the past 6 years, so why can't that continue?"

The more complex answer is that loans and deposits don't exist in isolation. When a bank makes a loan, that money doesn't simply disappear. It either comes back to the bank system as a deposit, or goes overseas via the current account or capital account.

So deposit growth in Cambodia will be heavily influenced by what happens with Cambodia's current account deficit, and how

that is financed. To the extent it continues to be financed by donor flows and capital investment, then deposit growth should remain robust.

If these are insufficient, banks will need to increase offshore wholesale borrowings, which may lead them to curtail their lending growth. This could result in credit growth at the lower end of the 15%-20% range, which would still result in a significant increase in overall credit outstandings.

## Implications for Public Policy

If credit is on track to grow to \$30b by 2020, the current level of minimum capital for banks will need to be revised upwards.

Any bank operating at the minimum level of \$37.5m will be limited to a market share of under 0.5%, which arguably makes them irrelevant, yet they will continue to absorb supervisory resources.

The National Bank of Cambodia (NBC) will need to consider increasing Minimum Capital, potentially to \$75m. Ideally this decision would be made prior to 2017 if not earlier, with a transition period to ensure banks have adequate time to reach the new minimum prior to 2020.

From a macro-prudential point of view, the NBC should also consider a Deposit to Loan Ratio (LDR) cap to minimize Cambodia's exposure to adverse capital flows which so damaged Thailand and Indonesia during the 97/98 Asia Crisis. At the end of 2013 this DLR stood at 104% for the bank sector overall, and the NBC should aim to keep it above 100%.

As a more general comment, the NBC will need to ensure that this lending growth is being directed towards productive assets, and not into unproductive property speculation. We rate the NBC as one of the most effective regulators in Cambodia, and have confidence that it will manage this issue carefully.

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5. World Bank

6. "In Search of a Reasonable Credit Growth Rate for Turkey", Central Bank of the Republic of Turkey



## Implications for Banks

On average, banks in 2020 will be three to four times bigger than they are today. This will present a significant management challenge in terms of building a suitably skilled workforce, building an appropriate risk management infrastructure, and ensuring they have a low cost, stable deposit base to fund their loan book.

The major challenge for banks though will be capital constraints. In order to support lending

growth of 20%, banks will need an ROE of at least 20%, or will need to find additional equity from shareholders. At the moment, with sector ROE just 11%, banks are well short of an ability to support credit growth organically, and will need to tap shareholders for new capital. To illustrate this, 20% credit growth in 2020 would amount to approximately \$5b in new loans, in turn requiring almost \$1b in new equity. If banks are still generating just 11% ROE, they will need to find around \$400m in new equity in 2020 alone.

## For further information

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