

# State of the Economy



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24 October 2017



# Outline

- **Economic Growth**
- **Macroeconomic Policy Reforms**
- **Macroeconomic Policy Direction**
- **Policy Direction in the Real Sector and Growth Drivers**
- **Way forward**

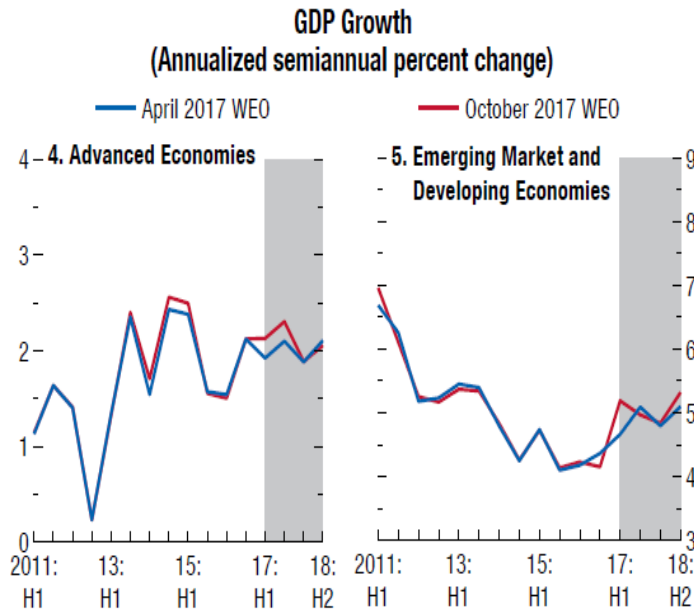


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# World economic growth estimated at 3.6% in 2017 and is expected to rise to 3.7% in 2018 ...



	Year-on-Year growth (Projections)					
	2017			2018		
	WEO Apr '17	WEO Oct '17	Change	WEO Apr '17	WEO Oct '17	Change
<b>World Output</b>	3.5	3.6	0.1	3.6	3.7	0.1
<b>Advanced Economies</b>	2.0	2.2	0.2	2.0	2.0	0.0
United States	2.3	2.2	-0.1	2.5	2.3	-0.2
Euro Area	1.7	2.1	0.4	1.6	1.9	0.3
Japan	1.2	1.5	0.3	0.6	0.7	0.1
United Kingdom	2.0	1.7	-0.3	1.5	1.5	0.0
<b>Emerging Market Economies</b>	4.5	4.6	0.1	4.8	4.9	0.1
Russia	1.4	1.8	0.4	1.4	1.6	0.2
China	6.6	6.8	0.2	6.2	6.5	0.3
India	7.2	6.7	-0.5	7.4	7.7	-0.3
Brazil	0.2	0.7	0.5	1.7	1.5	-0.2
ASEAN	5.0	5.2	0.2	5.2	5.2	0.0

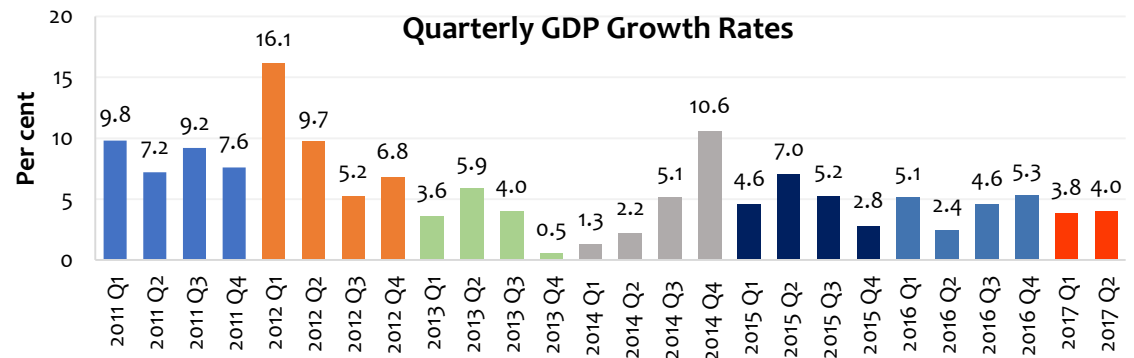
World Economic Outlook (October 2017)

- The Euro area, Japan, emerging Asia, emerging Europe and Russia growth in H1 of 2017 were better than expected and offset the downward revision for the US, UK and India

# The Sri Lankan economy would grow by 4.0 - 4.5% in 2017 ...

- ❑ The Sri Lankan economy grew by 4.0% during the second quarter of 2017 compared to 3.8% in the first quarter
- ❑ Growth in the first half of 2017 was 3.9%:
  - **Agriculture** activities were affected by extreme weather conditions
  - **Industry** activities were driven by the expansion in **construction** (12.8%), and **mining and quarrying** (18.1%)
  - **Services** activities were supported by the **wholesale and retail trade** (4.2%) and **financial services** (15.8%)

Economic Activity	Growth Rates (%)							
	2016					2017		
	Q1	Q2	Q3	Q4	Annual	Q1	Q2	H1
Agriculture, Forestry and Fishing	-0.2	-5.7	-2.0	-8.4	-4.2	-3.2	-2.9	-3.1
Industries	9.1	2.0	5.9	9.2	6.7	6.3	5.2	5.8
Services	3.7	3.6	4.8	4.6	4.2	3.5	4.5	4.0
<b>GDP</b>	<b>5.1</b>	<b>2.4</b>	<b>4.6</b>	<b>5.3</b>	<b>4.4</b>	<b>3.8</b>	<b>4.0</b>	<b>3.9</b>



Although disruptions to near term growth prospects continue, forward looking indicators show improved medium term prospects, which are likely to be realised with the envisaged structural reforms and expected inflows of foreign investments

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# Macroeconomic stabilisation of economy broadly on track

- **Government's macroeconomic policy strategy rests on three key pillars...**

## **Fiscal Policy Reforms**

- Lowering the budget deficit
- Rationalisation of expenditure
- Higher government revenues
- Reforms to SOEs
- Stronger public financial management

## **Monetary Policy Reforms**

- Moving towards a flexible inflation targeting (FIT) framework
- Low inflation will be a priority
- Flexible exchange rate policy

## **Trade and Investment Policy Reforms**

- Enhance exports
- Further liberalisation of trade
- Increasing FDIs
- Rebuild foreign exchange reserves

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# Fiscal consolidation is on track...

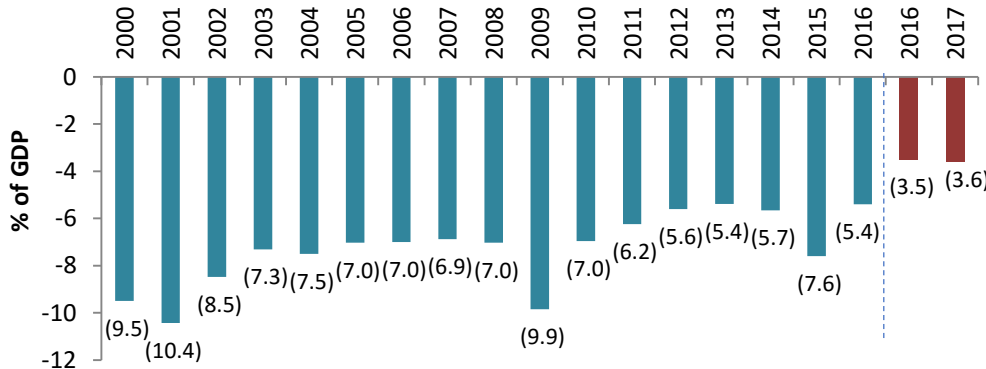
2017

- During the first seven months of 2017, overall budget deficit (as a % of estimated GDP) was 3.6%
  - Government revenue (as a % of estimated GDP) increased to 7.8% from 7.0% in the corresponding period in 2016
  - Government expenditure (as a % of estimated GDP) increased to 11.5% from 10.2% in the corresponding period in 2016

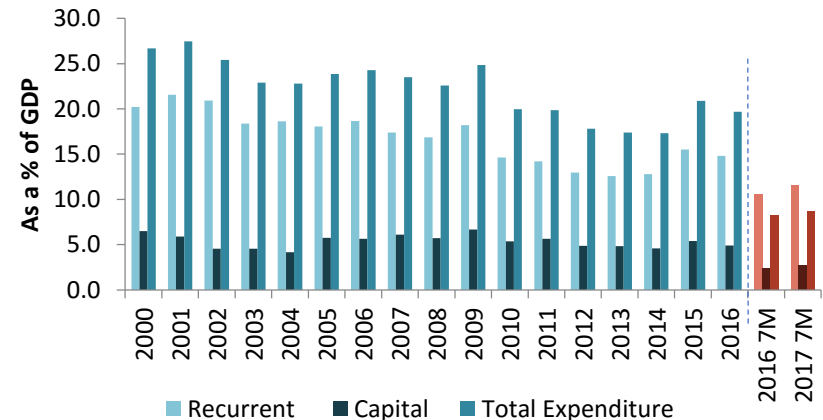
**Government Revenue**



**Budget Deficit**



**Government Expenditure**

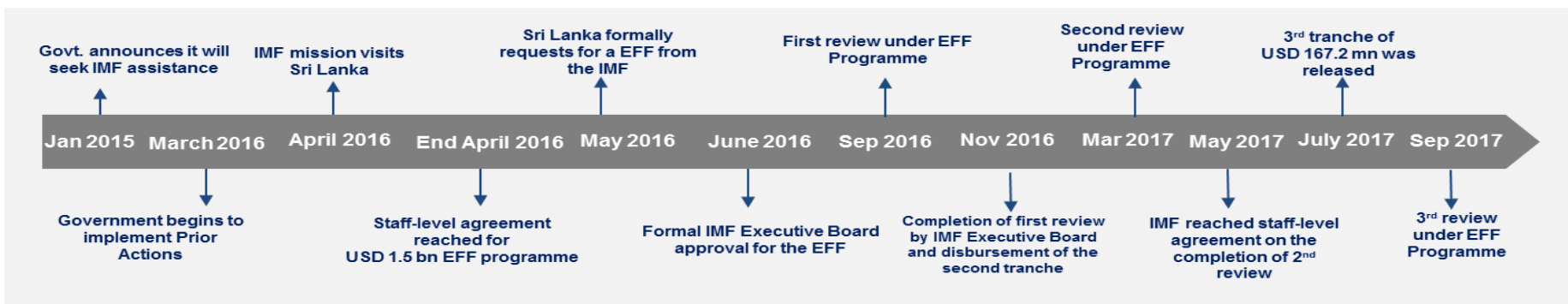


# Broad-based reforms under the IMF-EFF arrangement will complement the efforts of the government...

- Sri Lanka obtained a three year Extended Fund Facility of USD 1.5 bn from the IMF to support the BOP position and the government's economic reform agenda
- The IMF team reached a staff-level agreement with the Sri Lankan authorities on the third review
- The EFF Programme is expected to strengthen the economy by facilitating financial inflows in the period ahead while supporting medium term growth

Key Tenets of the Programme	
Fiscal Consolidation	<ul style="list-style-type: none"> <li>▪ Fiscal consolidation is expected to lead to a surplus position in the primary balance by 2018</li> </ul>
Net International Reserves	<ul style="list-style-type: none"> <li>▪ Accumulation of reserves for BOP support is a cornerstone of the programme</li> </ul>
Inflation	<ul style="list-style-type: none"> <li>▪ Maintaining inflation at mid single digits, while moving towards FIT framework</li> </ul>
Structural Reforms	<ul style="list-style-type: none"> <li>▪ Structural reforms mainly concentrate on the fiscal sector</li> </ul>

Timeline view of Sri Lanka's Recent Engagement with IMF



# Three Pronged Effort to Improve Government Revenue

## Tax Policy

### □ Revision of Tax Rates

- Increasing VAT rate to 15% from 11%
- Increasing WHT to 5% from 2%
- Reintroduced Capital Gain Tax
- Revision of excise duty on motor vehicles

### □ Redrafting Tax Laws

- Introduction of new Inland Revenue Act

### □ Simplification of Taxes

- Personal income tax rates structure revised by introducing rates from 4% to 24% having equal tax slabs of Rs. 600,000 each
- Introduction of three 3-tier tax structure for Corporate Sector (14%, 28% and 40%)
- Introduction of three band tariff structure (0, 15 and 30)

### □ Broadening the Tax Base

- Reducing the threshold of liable turnover of VAT and NBT to Rs. 3 mn per quarter from Rs. 3.75 mn per quarter
- Reducing the quarterly turnover of Rs. 100 mn applicable for the imposition of VAT on wholesale or retail trade to Rs. 12.5 mn
- ESC threshold was reduced to Rs. 12.5 mn per quarter from Rs. 50 mn per quarter
- Removal of selected exemptions granted on income tax, VAT and NBT

## Tax Administration

- Introduction of ICT into tax administration: Revenue Administration Management Information System (**RAMIS**)
- Introduction of Taxpayer Identification Number (TIN)
- Effective tax audit, tax consultation and taxpayer services
- Establishment of a Tax Appeals Commission
- Establishment of a Single Window System commenced at SLC to provide all necessary permissions, clearances and approvals
- Installing new scanning machines in order to eliminate leakages
- A 24-hour fully automated operational system to process export documents
- Operating CCTV systems in all customs bonding areas to ensure transparency

## Institutional Support

- Appointing a Committee constituting members from both the private and public sectors to oversee budget implementation and execution (particularly the revenue performance)

# Expenditure and Public Financial Management Initiatives are also being strengthened...

## Three Key Areas of Action

### Rationalisation/Prioritisation of Expenditures

- Better targeting the welfare expenditure to protect the most vulnerable sectors (Welfare Benefits Act)
- Rigorous monitoring of expenditure of a current nature
- Prioritisation public investments
- A new system to improve expenditure management and also cadre management
- Improving accountability in public sector, particularly in public procurement

### Institutional Support

- Automating activities at MOF through the Integrated Treasury Management Information System (**ITMIS**)
- Presenting quarterly expenditure and income outcomes to Parliament within one month of any quarter
- Aligning expenditures in line with revenue shortfalls with the approval of the Parliament
- A budget review and implementation committee was established in the MoF to monitor the progress of projects and programmes implemented under the Annual Budget

### Public Financial management

- Public Finance Act is being drafted to introduce certain enabling provisions and principles to current practices in the areas of budget formulation, public debt management, financial management and financial reporting
- National pension bill to be drafted in order to introduce a contributory pension fund for public servants



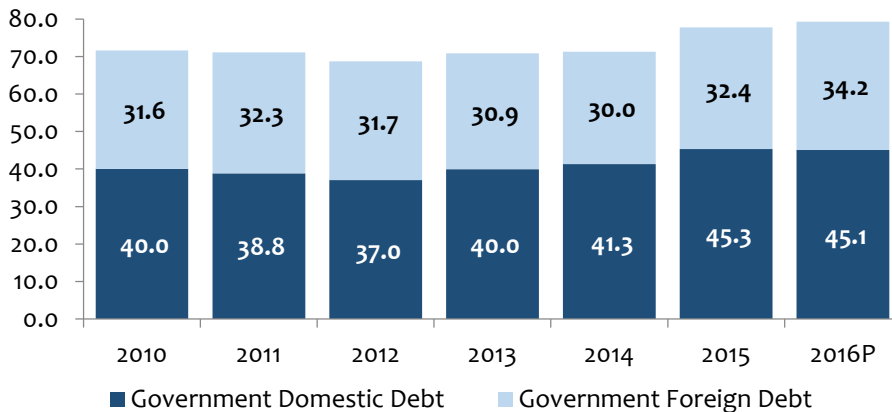
# Debt Management strategy on track...

## Recent measures taken to improve debt management and develop the market

- **New Primary Issuance System for Treasury Bonds was introduced**
  - This will further enhance the efficiency and transparency of the domestic borrowings of the Government
- **Publishing a quarterly auction calendar with more information**

- **Bloomberg e-Trading Platform is extended for repurchase transactions and reporting**
- **Publishing of primary auction guidelines for Treasury Bonds**
- **Drafting a Act to facilitate active debt management initiatives such as buy-backs, switching and swap arrangements**
- **Establish a distinct Electronic Trading Platform and Central Counter Party arrangements for government securities market**
- **Facilitating the Euroclearing of Government securities**
- **Increased information sharing with Primary Dealers and investors through Pre-bid Meetings**

Debt to GDP ratio is moderating though marginally increased in recent years



Source: CBSL

The Government is expected to introduce a new Liability Management Act in the near future

# In view of the developments mainly on the inflation front and monetary aggregates, the Central Bank pursued a tight monetary stance ...

## Monetary Tightening (commenced at end 2015)

30 Dec 2015

SRR was increased by 1.5 percentage points

SRR was increased to reduce excess liquidity and raise market interest rates: (7.5%)

19 Feb 2016

SDFR and SLFR increased by 50 bps

Policy rates were increased to contain high credit and money growth (6.5% & 8.0%)

28 Jul 2016

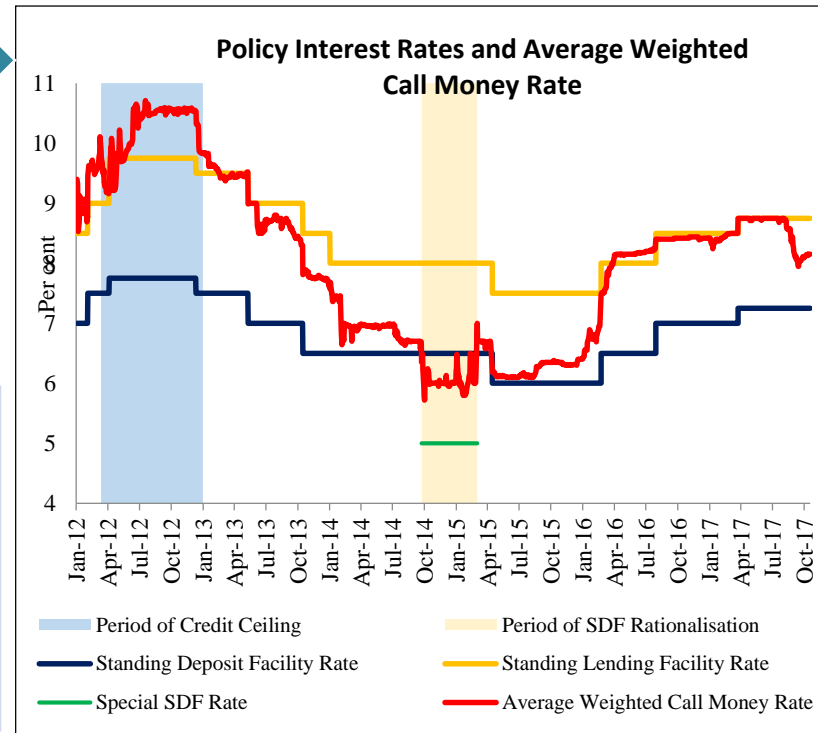
SDFR and SLFR increased by 50 bps

Policy rates increased to curtail credit to the private sector and the rising trend in inflation (7.0% & 8.5%)

24 Mar 2017

SDFR and SLFR increased by 25 bps

Deceleration of Monetary and credit was somewhat below expectations (7.25% & 8.75%)

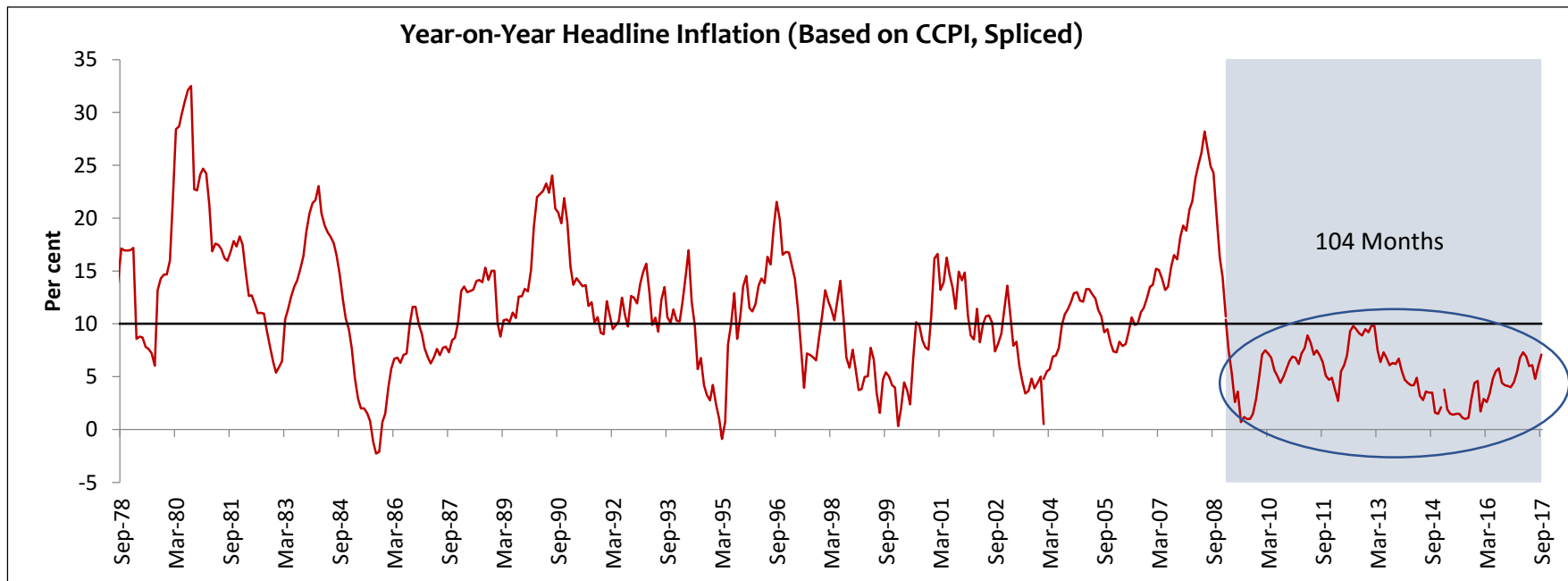


- Macroprudential measures have also complemented monetary policy actions
- Growth of credit to the private sector has decelerated in response to series of policy measures while inflation and inflation expectations remain subdued

# Monetary policy strategy for the medium term is to adopt flexible inflation targeting (FIT) while maintaining low and stable inflation...

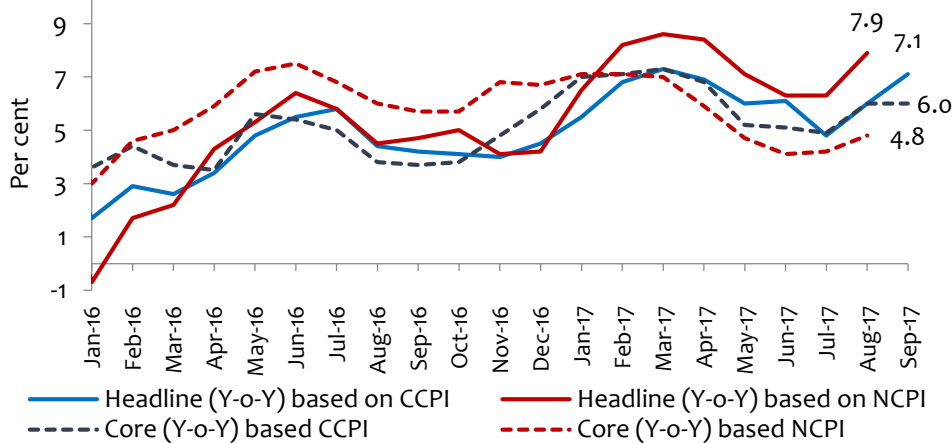
## Medium term strategy for monetary policy was announced in Road Map 2017

- The Central Bank will follow an increasingly forward looking approach in the conduct of monetary policy
- **Communication policy** and **transparency** will be continuously enhanced through the announcement of the medium term policy framework with the desired inflation path
- **Technical capabilities**, particularly with regard to macroeconomic modelling and forecasting will continue to be strengthened

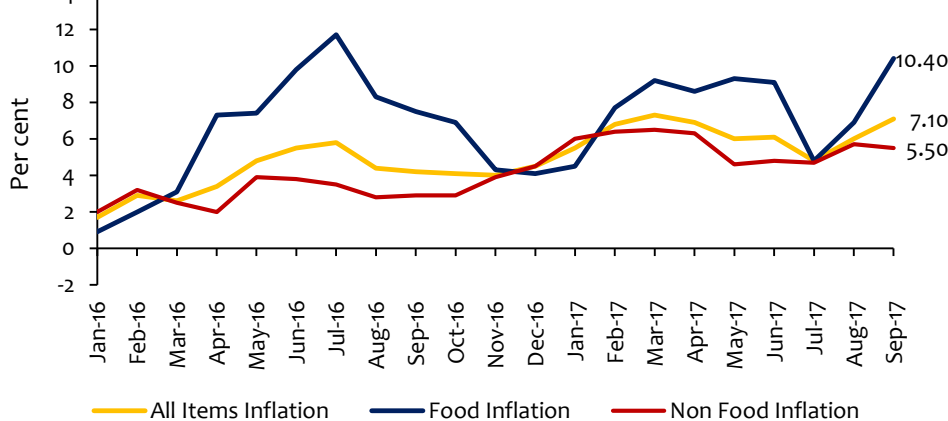


# Recent increase in inflation was mainly due to price increases in volatile food

Movements in Headline and Core Inflation (y-o-y)



Colombo Consumers' Price Index CCPI (Base: 2013=100)  
Inflation - Food and Non Food



Headline Inflation (%)

	Sep-16	Dec-16	Jun-17	Jul-17	Aug-17	Sep-17
based on CCPI (2013=100)						
Y-o-Y	4.2	4.5	6.1	4.8	6.0	7.1
Annual average	3.9	4.0	5.5	5.4	5.5	5.8
based on NCPI (2013=100)						
Y-o-Y	4.7	4.2	6.3	6.3	7.9	-
Annual average	3.8	4.0	6.1	6.2	6.5	-

Core Inflation (%)

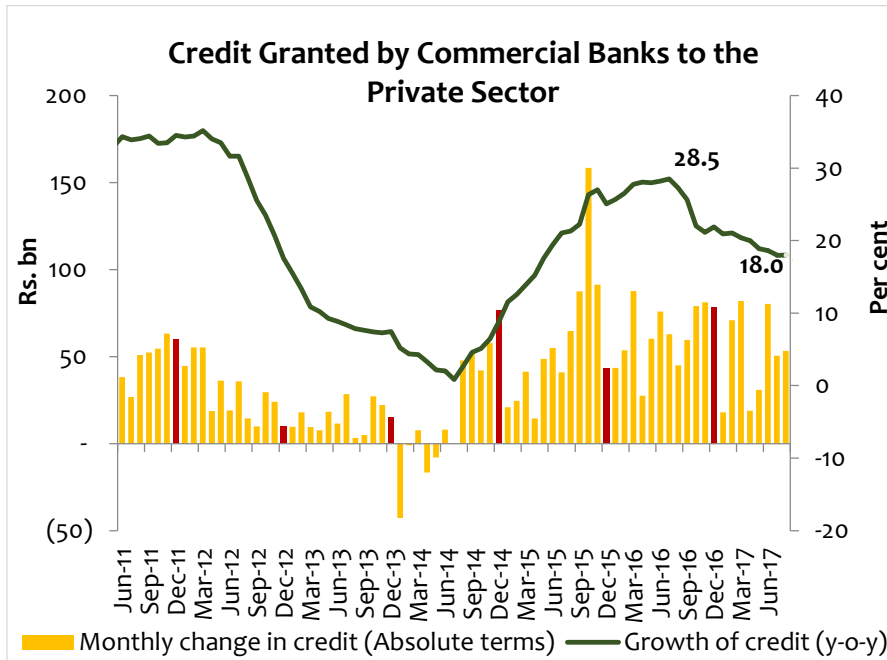
	Sep-16	Dec-16	Jun-17	Jul-17	Aug-17	Sep-17
based on CCPI (2013=100)						
Y-o-Y	3.7	5.8	5.1	4.9	6.0	6.0
Annual average	4.8	4.4	5.5	5.4	5.6	5.8
based on NCPI (2013=100)						
Y-o-Y	5.7	6.7	4.1	4.2	4.8	-
Annual average	5.7	5.9	6.1	5.9	5.8	-

Inflation is expected to decline to the desired level of 4–6% by end 2017



# Growth of credit to the private sector is on a declining trend...

- Y-o-y growth of credit to the private sector decelerated to 18.0% in August 2017 compared to a growth of 18.6% in June 2017
- The cumulative expansion in private sector credit during the first eight months of 2017 was Rs. 404.6 bn compared to Rs. 456.3 bn in the corresponding period of 2016

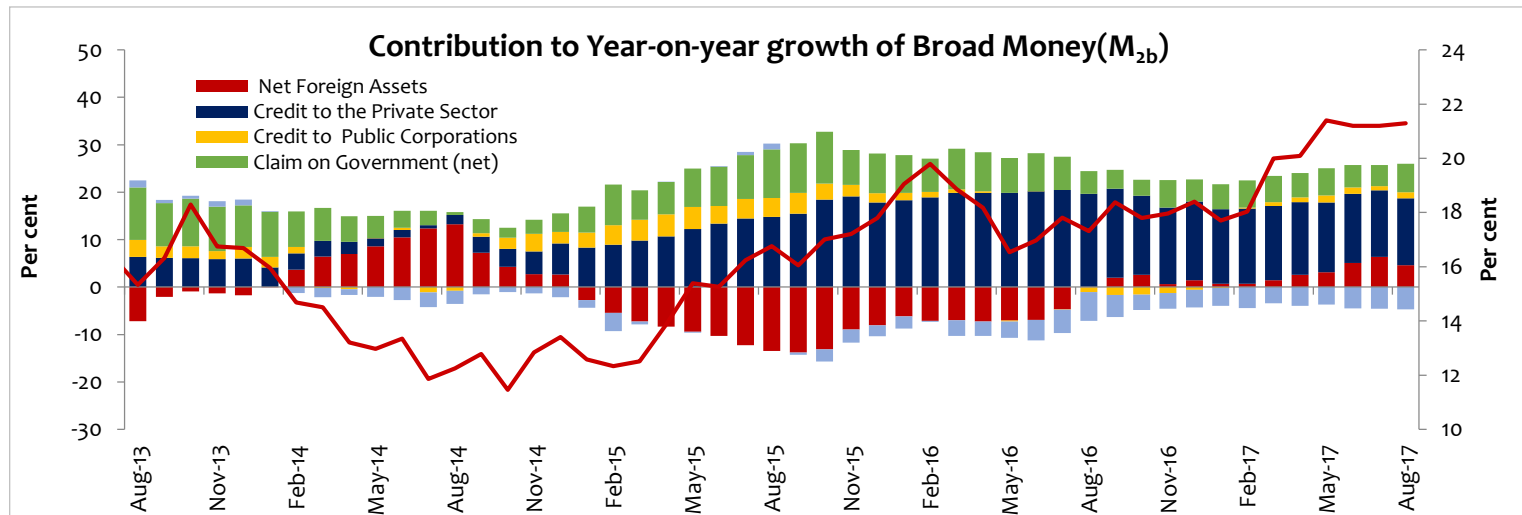


	Rs. bn					
	2012	2013	2014	2015	2016	2017
January	44.6	9.7	-42.8	21.0	43.6	17.9
February	55.3	18.0	-0.9	24.5	53.7	70.9
March	55.3	9.5	7.6	41.4	87.7	82.0
April	18.7	7.6	-16.6	14.5	27.4	18.9
May	36.1	18.3	-7.9	48.6	60.2	30.9
June	19.0	11.4	8.0	55.0	75.8	80.3
July	35.7	28.5	0.2	40.9	62.9	50.5
August	14.5	3.2	47.7	64.7	45.0	53.2
September	9.8	4.9	52.3	87.5	59.5	
October	29.5	27.2	42.0	158.4	79.0	
November	24.1	22.2	57.8	91.4	81.3	
December	9.9	15.4	76.5	43.6	78.7	
<b>Total</b>	<b>352.6</b>	<b>175.9</b>	<b>223.9</b>	<b>691.4</b>	<b>754.9</b>	

**At the current pace of expansion, the year-on-year growth of credit to the private sector by commercial banks is expected to decelerate to around 15-16% by end 2017**

## Monetary expansion continued at high levels...

- In August 2017,  $M_{2b}$  grew by 21.3%, y-o-y, also driven by NFA
  - The cumulative expansion in NFA during the first eight months of 2017 was Rs. 181.1 bn
- Within domestic credit;
  - NCG from the banking system amounted to Rs. 265.4 bn so far in 2017 compared to Rs. 212.6 bn increase in 2016
    - NCG by the Central Bank contracted by Rs. 119.5 bn thus far in 2017 (in contrast to the increase of Rs. 166.6 bn in the corresponding period of 2016)
- The increase in credit to SOEs on a cumulative basis was limited to Rs. 7.8 bn during the first eight months of 2017. In 2016, the contraction was Rs. 27.9 bn

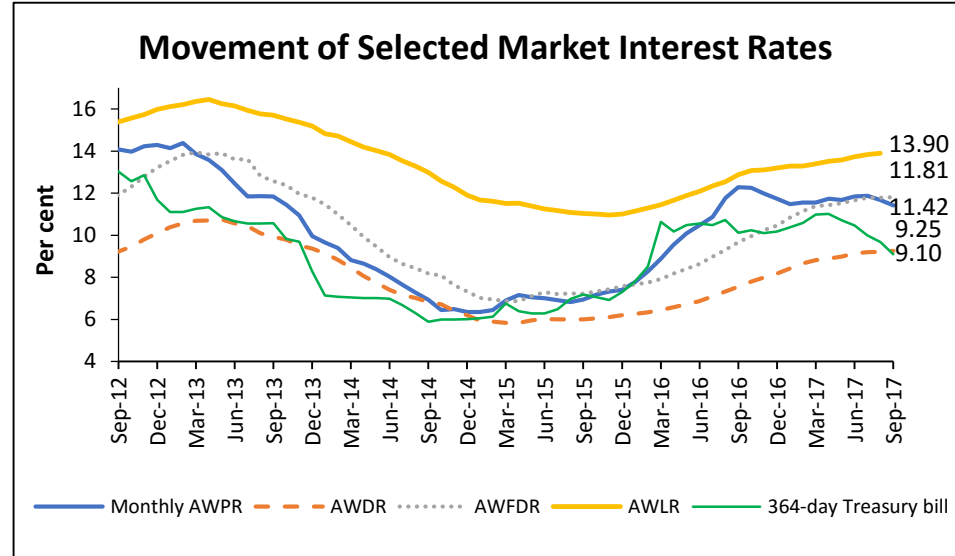
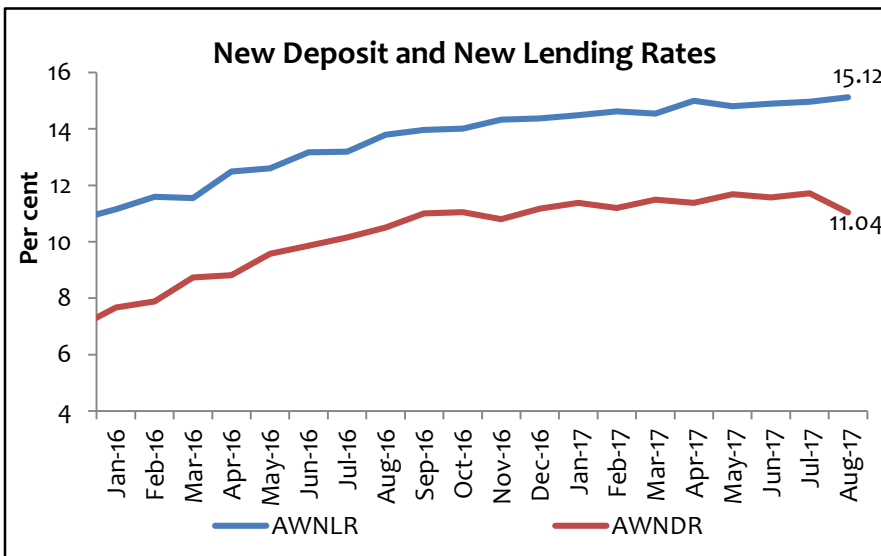
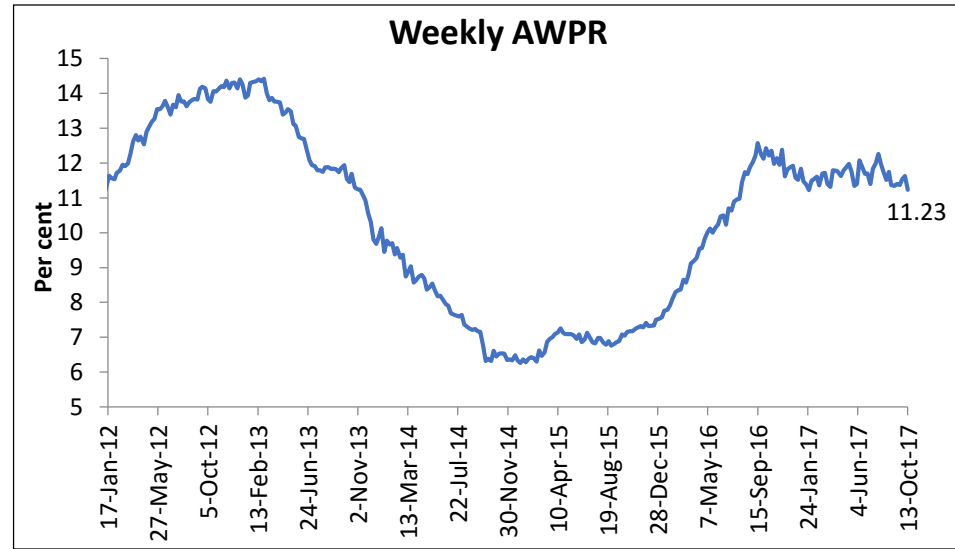
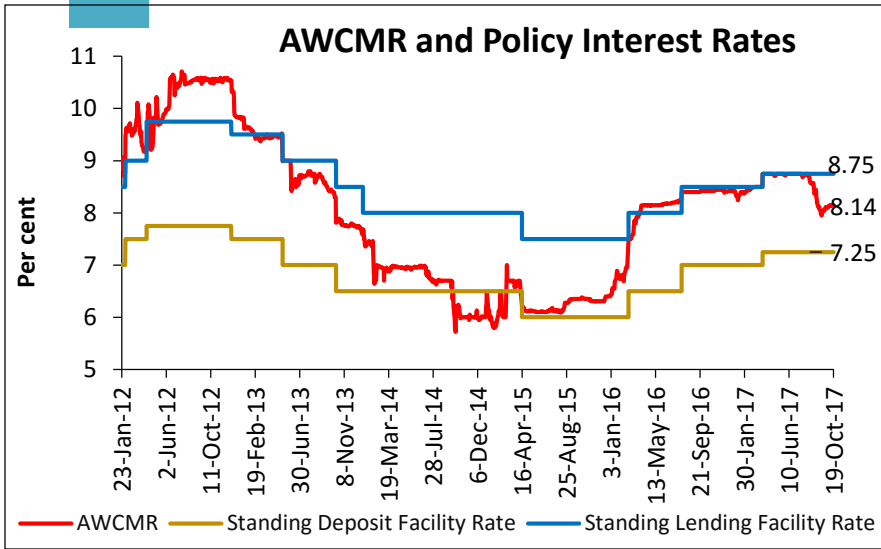


# Market interest rates have adjusted upwards in response to the tight monetary policy stance ...

## Adjustments in Interest Rates

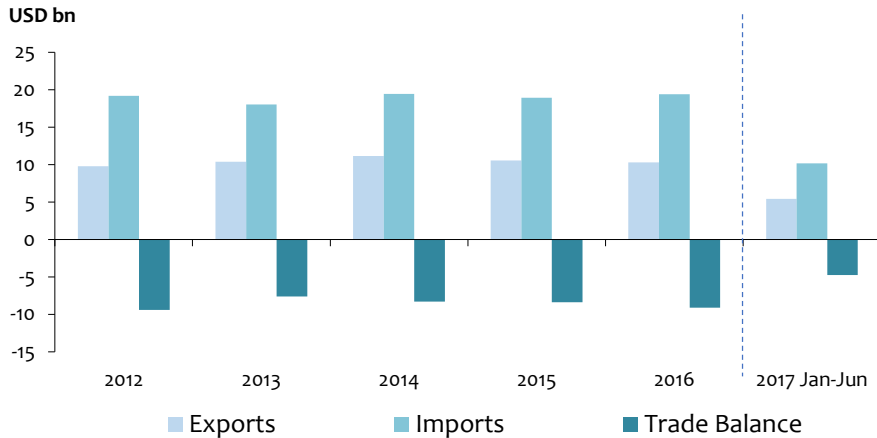
Interest Rates	2016 (100 bps change in policy rates and 1.5pp SRR adjustment)	2017 H1/or up to the peak (25 bps change in policy rates)	So far in 2017 (25 bps change in policy rates)
	bps Change	bps Change	bps Change
<b>AWCMR</b>	202	33 (up to the peak on 24.03.17)	-28
<b>Weekly AWPR</b>	399	74 (up to the peak on 28.7.17)	-29
<b>Monthly AWPR</b>	433	15 (up to the peak in July'17)	-31
<b>AWLR</b>	220	53	70
<b>AWNLR</b>	358	53	75
<b>AWDR</b>	197	96	108
<b>AWNDR</b>	421	55 (up to the peak in July'17)	-13
<b>AWFDR</b>	289	120	135
<b>T-bills</b>			
<b>91-Day</b>	227	101 (up to the peak on 19.04.17)	7
<b>182-Day</b>	280	116 (up to the peak on 19.04.17)	-51
<b>364-Day</b>	287	94 (up to the peak on 19.04.17)	-71

# Market interest rates have adjusted upwards in response to the tight monetary policy stance ...

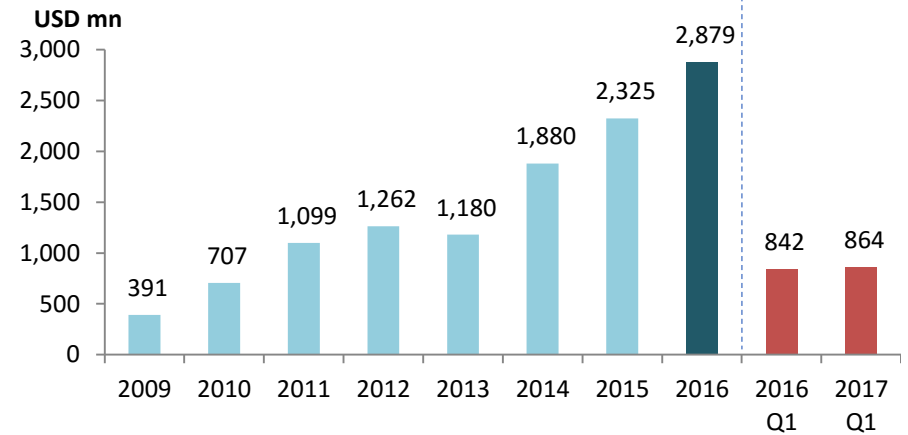


# Despite several challenges, the external sector has shown signs of improvement...

## Exports & Import have resulted in trade deficit



## Surplus in Services Account has continued to increase



## Current Account Deficit has been on a declining trend

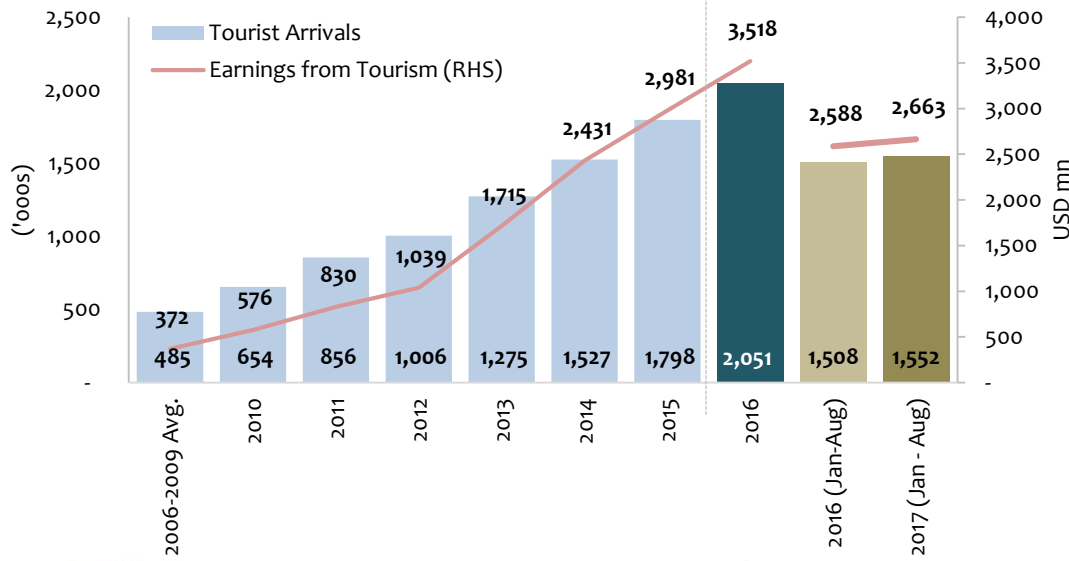


However, the effect of the drought has dampened the recent performance of the trade account and the current account

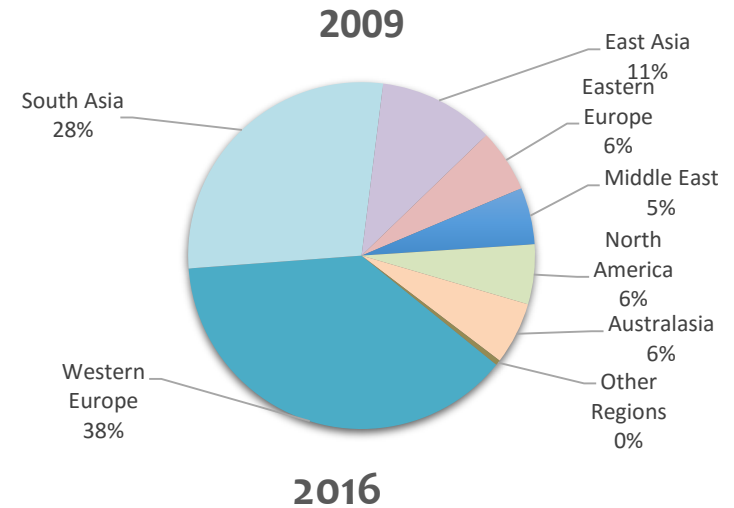
Source: CBSL

# Robust growth in tourism since 2009 has continued to be a key driver of growth...

## Strong growth in tourist arrivals and earnings



## Tourist Arrivals by Region

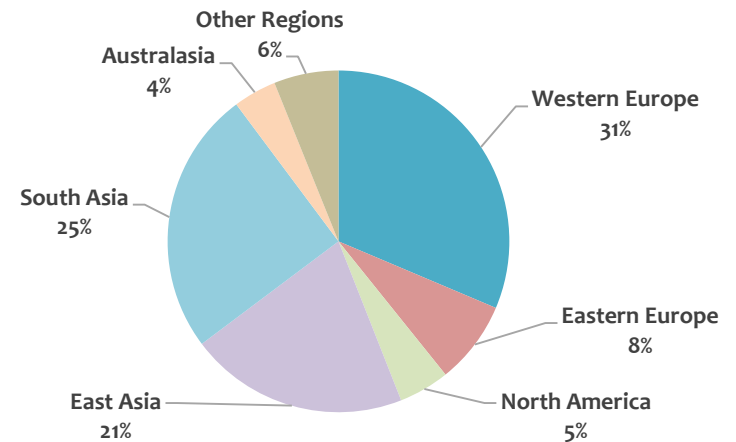


“One of the 20 hottest luxury tourism destinations in 2017”

- **Bloomberg**

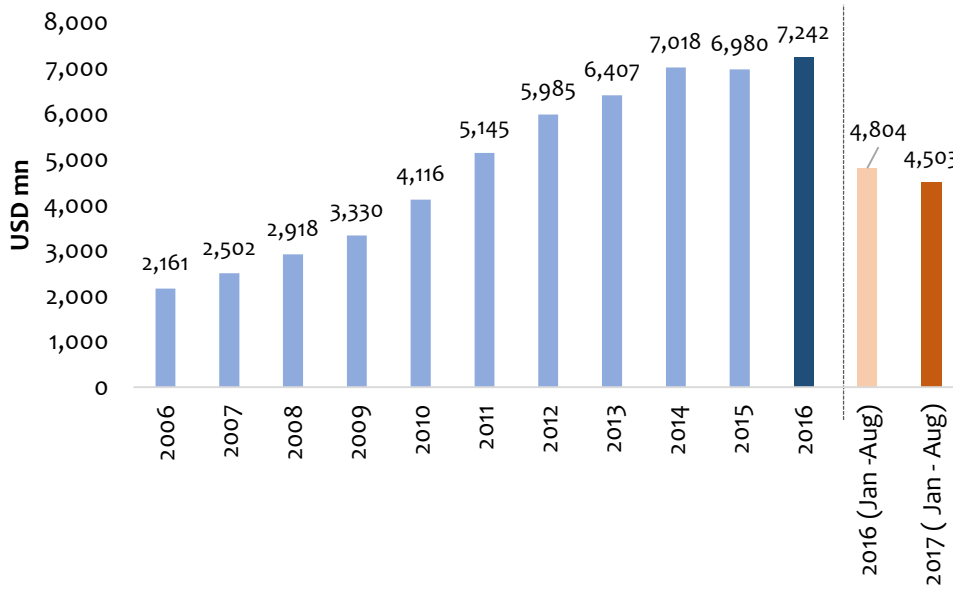
“The World's most extraordinary places to add to your travel wish list”

- **Dream Trips 2016**

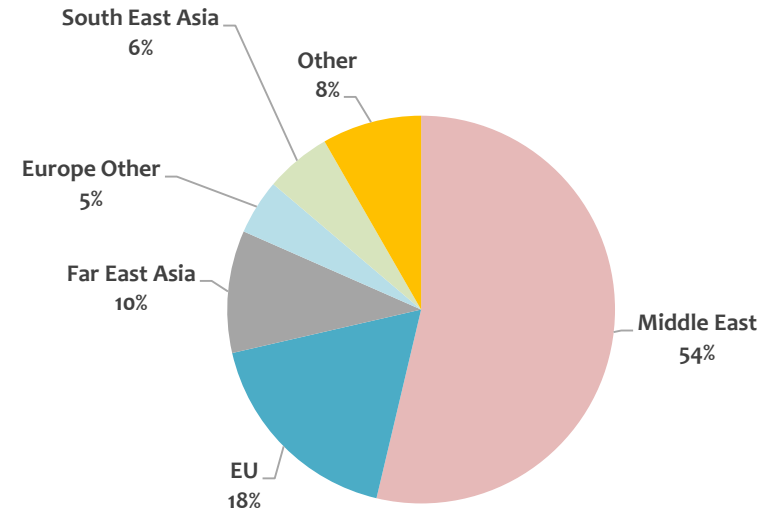


# Workers' remittances have also contributed to growth...

Workers' remittances

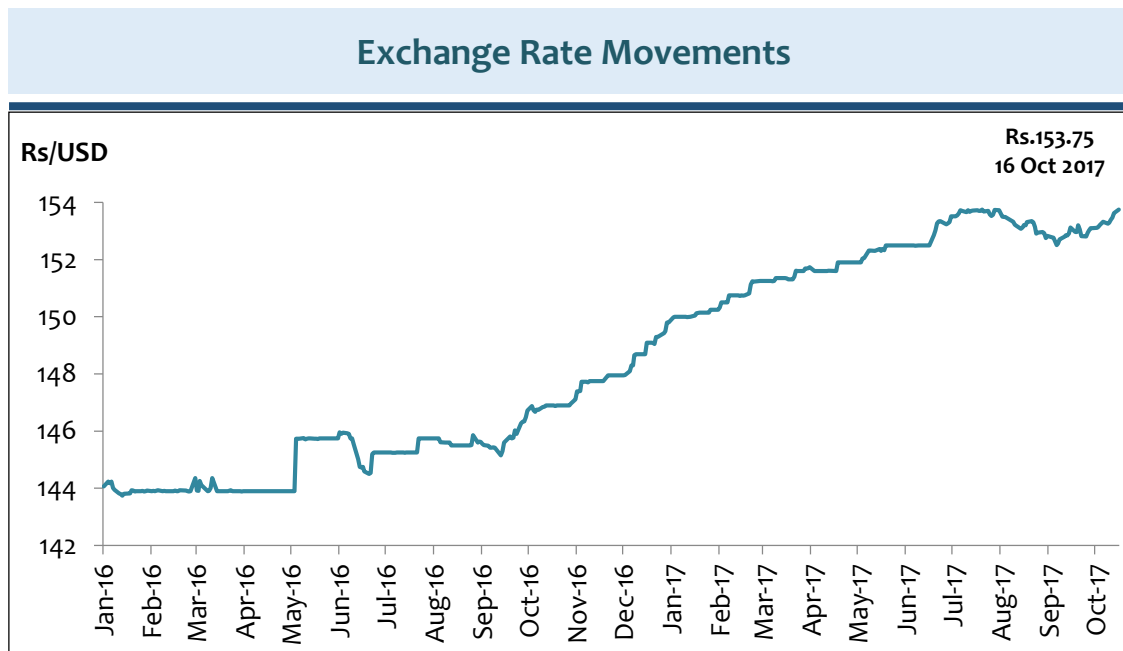


Origin of Remittances  
2016



# Increased flexibility in the determination of the exchange rate has complemented the conduct of monetary policy...

- As announced in the Road Map 2017, a market-based exchange rate system is in place as part of the macroeconomic policy framework of the country
- In ensuring external competitiveness, CBSL would closely monitor the developments of Real Effective Exchange Rates



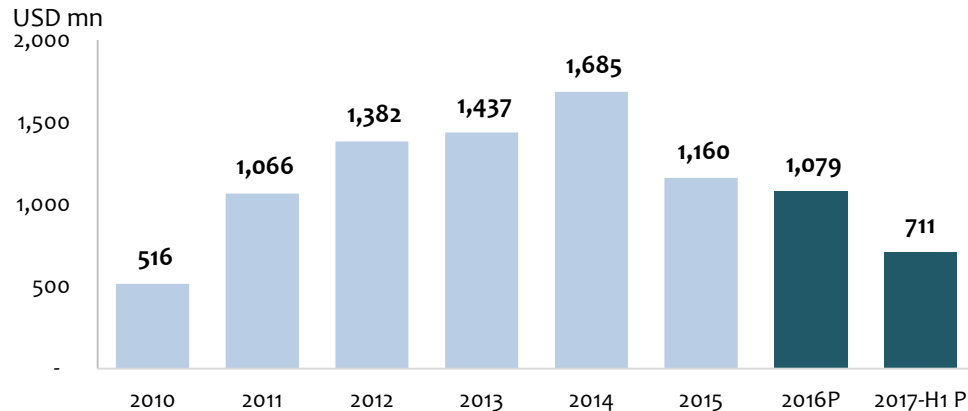
- The Central Bank purchased over USD 1.1 bn on a net basis from the forex market by end September 2017
- Gross official reserves, which stood at USD 6.0 bn at end 2016, increased to around USD 7.3 bn by end September 2017

With the improved foreign exchange inflows to the country, the pressure on the exchange rate appears to have eased



# Improved external relationships will strengthen Sri Lanka's investment climate for FDI...

## FDI to Improve with Investor Friendly Policies



## Budget 2017 Incentives for FDI

### Policies Proposed in the 2017 Budget to promote FDI

- Specific concessions granted to large scale industries with investments over USD 100 Mn
- **Income tax rebate to exporters: In the event profits from exports increase by 15% or more from the previous year**
- Accelerated depreciation allowances for investments in underdeveloped provinces (Uva, Eastern and Northern Provinces)
- **Benefits to specific investments that has more than 40% value addition and create more than 500 employment opportunities**

## Actions taken to promote FDI

- Agency for Development to fast track, streamline and attract investments
- **Board of Investment (BOI) approval process being restructured to grant approval within 14 days**
- Establishment of one stop shop at BOI to provide a total solution to investors
- With the new Foreign exchange bill, capital controls would be gradually eased which would also boost FDI

## ONE STOP SHOP

*Ease of doing business facilitation centre*

### Provided Services:

- Company Registration
- Resident Visa processing for BOI Investors
- Inland Revenue functions
- Customs functions
- Environment concurrence for expediting environmental clearances
- Utility issues
- Assistance in finding suitable land for BOI projects
- Attending to queries of new investors and existing BOI enterprises

Source : Doing Business 2016 - World Bank / IFC

# Banking sector showed continued stability and growth and is expected undergo significant changes in the medium term...

Cross-border expansion of banking operations

Greater focus on fee-based business and new product development

Improvements in risk management standards, cyber security & capital planning

Strengthened resilience through higher levels of capital and liquidity

Greater reliance on IT-based solutions on every business aspect

Continuous capacity development in the banking sector

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# Infrastructure is in place to reap benefits from Sri Lanka's strategic location...

## ❑ Regional Trading Hub

Sri Lanka is strategically located at the **CROSS ROADS** of both east and west **SEA ROUTES** and serves as the **POINT OF ENTRY** to South Asia

### Colombo Port

World Container Port Ranking (World Shipping Council)

- ❑ No. **1 in South Asia** & **28 in the World**
- ❑ Minimum deviation from shipping lines
- ❑ Fully **equipped berths** for late container vessels
- ❑ Total container throughput **5.7 mn TEUs** in 2016
- ❑ Transshipment **container 76%**



- ❑ Fast turnaround and round the clock service
- ❑ Excellent **FEEDER NETWORK**



### Colombo Airport



- ❑ Passenger movement – **9.5 mn / per annum** in 2016
  - ❑ With the second terminal, capacity of BIA will increase to 15 mn passengers per annum
- ❑ Cargo movement - **250,000 tonnes / per annum** in 2016

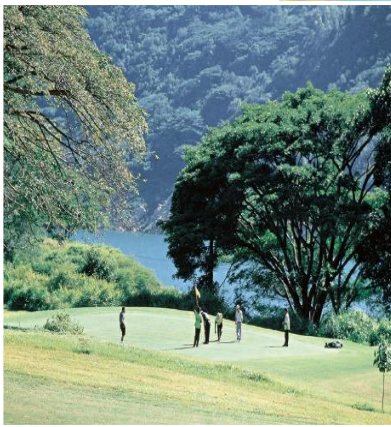




# Key projects will transform the economy and accelerate growth...

## Western Region Megapolis Plan

Under the Western Region Megapolis project, **Colombo** will be home to state-of-the-art technologies and infrastructure and a haven for investment in South Asia



## The Colombo Financial City

The establishment of Colombo Financial City will position **Sri Lanka** as one of **Asia's** foremost commercial centres in the field of logistical, technological and financial services



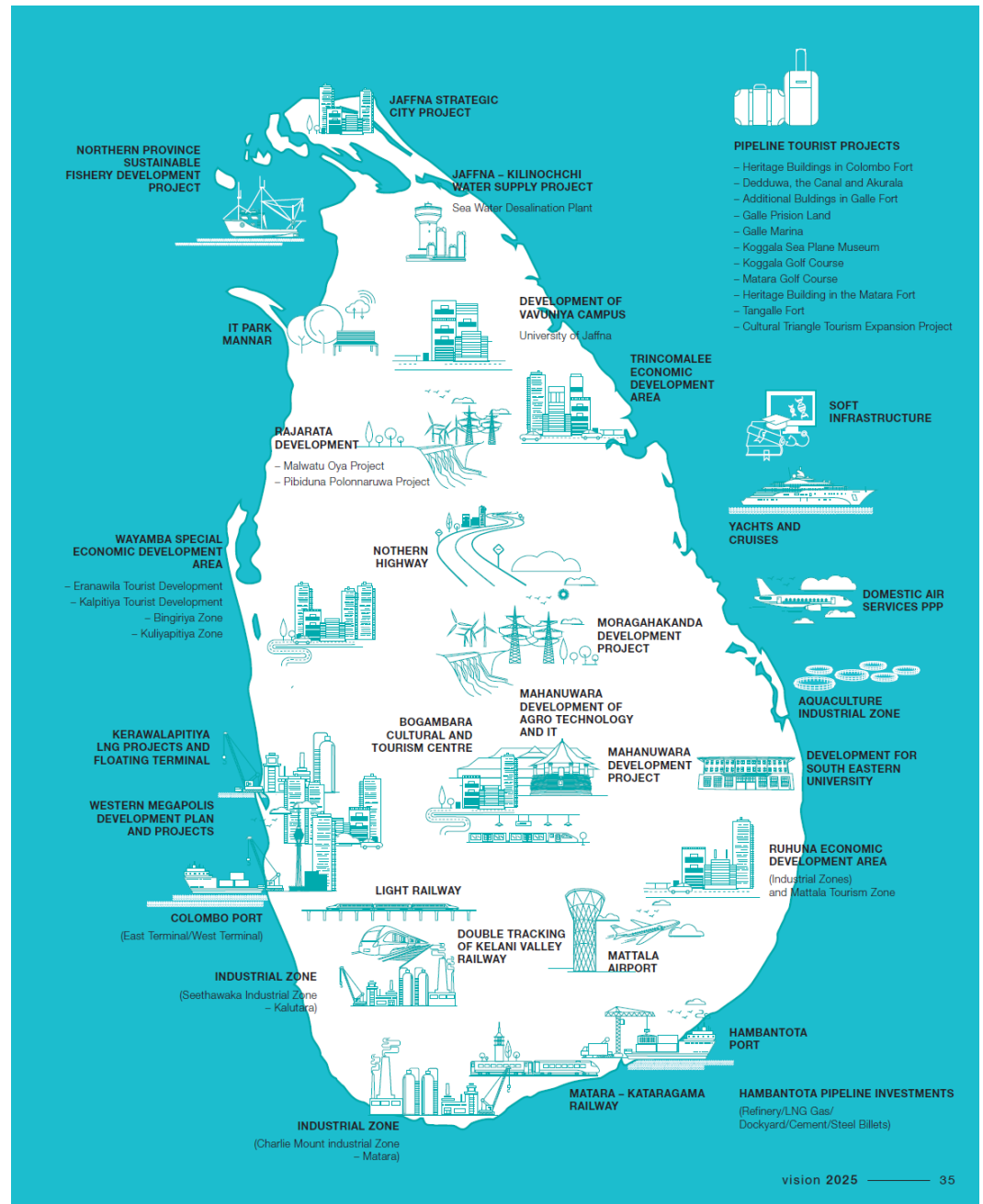
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- **Way forward**



Government has unveiled its medium term vision with a comprehensive development strategy...

- Large scale projects, with the participation of domestic and foreign private sector, are envisaged to drive broad-based and inclusive growth





**Transforming Sri Lanka into the hub of the Indian Ocean, with a knowledge-based, highly competitive, social-market economy**

**Within this broader vision, a 3-year Economic Delivery Programme will be implemented to:**

- **Raise per capita income to USD 5,000 by 2020**
- **Create one million new jobs**
- **Increase FDI to USD 5 billion per year**
- **Double exports to USD 20 billion per year**



**These intermediate targets lay the foundation for Sri Lanka to become a higher income country by 2025**



# Government's new approach to growth is structured on a knowledge-based, highly competitive, social market economy model...

Incentivising domestic and foreign investment

Revamping trade policy to enable an export-driven economy

Facilitating services expansion

Undertaking major reforms in land, labour, and capital markets

Supporting inclusive growth through improving the provision of social goods and infrastructural development

Developing strategies to become a digitally empowered economy

Establishing an integrated and efficient social protection system

Ensuring prosperity for future generations through adherence to the UN sustainable development goals

Ensuring the development of lagging regions

Strengthening monitoring and coordination of the implementation of the growth strategy

Key  
features of  
the growth  
framework



~ THANK YOU ~

