

Optimism Pervades the Economy

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In June much of the economic discourse in Sri Lanka was on post-war economic recovery. This was in the context of the continuing financial crisis and recession in the global economy. The price of oil in the global market topped \$70 in the middle of the month before falling to the sixty dollar range. Analysts have expressed concern that inflation and unsustainable fiscal deficits would jeopardize the recovery of the global economy. The IMF and the World Bank projected that the recovery that they expect to see in the last quarter of 2009 would be “fragile” and that no real positive movement in the global economy would be seen until 2010.

An ILO sponsored study reported that in Sri Lanka close to 200,000 jobs were lost in manufacturing and construction and a roughly equal number were created in agriculture and services. The job losses in manufacturing can be attributed to weak exports.

In the first quarter of 2009 the Sri Lankan economy grew by 1.9%. However, the Central Bank revised upwards its growth forecast for the year from 2.2% to 4.0%. The end of the war that has opened up the north and east to normal economic activity was one reason for this optimism. The government, for example, lifted restrictions on fishing first in the East and later in the North. The A9 road that connects Jaffna to the South was opened for private trade. The Board of Investment (BOI) announced that it would shortly open a branch office in Jaffna. Most notably business confidence has improved vastly. The LMD-Nielsen Business Confidence Index rose by 72 basis points in June to 161 that is only a little below its all-time high of 172 in December 2002.

The government urged the EU countries to revise their respective travel advisories. The tourist trade welcomed Britain’s revision of its travel advisory but was disappointed that the US thought it fit to issue an advisory that continued to warn Americans of the risk of travel to Sri Lanka. Sri Lanka is also demanding that the war risk premium in reinsurance that affects exports and imports be scrapped that will save the country an estimated Rs 20 billion annually.

The IT industry also has expressed optimism. The country has moved up in the global IT Network Readiness Index from 86th position out of 122 countries in 2006/07 to 72nd position out of 134 in 2008/09.

Inflation that had been hovering around an annual rate of about 3% in the last three months dropped to a record low of 0.9% in June. This makes monetary policy management that much easier. The Central Bank reduced its Purchase Rate and Reverse Purchase Rate by 50 basis points

each and the nation's largest commercial bank, Bank of Ceylon, cuts its lending rate by 2 percentage points. However, the increase in petrol and diesel prices in early July will have an impact of consumer prices in the coming weeks.

The major immediate challenge facing the Sri Lankan economy is the payments gap. The IMF is yet to decide on the IMF standby loan of \$1.9b. President Rajapakse publicly stated that the government won't bow to political pressure from western countries to get the loan. US which is suspected of exerting pressure on the IMF to delay the loan has denied any such maneuver. The government asserts that there are no technical issues that stand in the way of the IMF giving the loan to Sri Lanka. What we do know is that the IMF loan will be strongly conditional and that the "Letter of Intent" that President Rajapakse will have to sign as Finance Minister will include commitments on fiscal reforms, privatization and related economic management issues that are not politically palatable especially with the prospects of parliamentary and presidential elections in 2010. Moreover, the IMF is also likely to insist on financial governance reform in the central bank itself in the light of the recent troubles concerning Golden Key.

The Central Bank has of late been asserting that Sri Lanka's foreign reserves have risen to a level that would finance about six weeks of imports and that the country is no longer in urgent need of the IMF money. The economic slowdown in Sri Lanka has caused a reduction in imports easing pressure on the balance of payments. The government also expected India to step in with additional assistance. India's stake in this issue is not the IMF but China that has become a major donor to Sri Lanka. India promised \$100m in loan funds but to enter the big league the amount will have to be at least ten times that amount. But Indian money will come only with its own conditionalities and those will not be economic but political such as the treatment of the IDPs and a lasting political solution to the ethnic issue.

The Supreme Court found that the privatization of the Sri Lanka Insurance Corporation had been done unlawfully and ordered its return to public ownership. This has been hailed as a victory for good economic governance. However, the court did not order sanctions against those who were believed to be culpable for the illegal act.

The Chairman of the Colombo Stock Exchange (CSE) in his annual review noted that the CSE has to rectify some major structural defects including high transactions cost and lack of traded products. The CSE is one of the most expensive exchanges in the world.

The Asian Development Bank signed a loan agreement with the government to provide \$160m for a \$188m project to develop the power sector over the period 2009-13. This money will be tied to the reform of the CEB that is currently running at a loss.

Dr. Samarasinghe writes a monthly report on the Sri Lankan economy for the Rapid Context Assessment (RCA) of the Consortium of Humanitarian Agencies

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