

End of War Brings Hope but Financial Problems Unresolved

S W R de A Samarasinghe

The economic numbers for the month of May are unexceptional. But the government's military victory over the LTTE has given hope for the economy. Investors in the Colombo stock market expressed their confidence by pushing up share prices by as much as 18% in the last two weeks of the month. The Central Bank claimed that after the war ended in the space of five short days foreign investors purchased government bonds worth about \$100 million. The annual rate of inflation moved up marginally from 2.9% in April to 3.3% in May but this was inconsequential. President Rajapakse spoke with great optimism about reconstruction of the north and east and more generally about winning the "economic war."

The rupee that has been allowed to float depreciated in late April and early May to drop below Rs 120 against the dollar. This was a necessary adjustment to correct for our relatively high rate of inflation in 2007-2008 compared to those of our main trading partners. But later it moved up to around Rs 115 and the Central Bank had to intervene to keep it from appreciating further that would have been detrimental to exporters. This appreciation was not related to economic fundamentals. It was the result of speculative buying and selling of the dollar.

Most of the economic signs were not propitious. The nation's foreign reserves were down to about seven weeks worth of imports. Standard and Poor (S&P) Ratings Services revised the outlook for Sri Lanka from stable to negative. This happened after the war ended. S&P justified its decision on the grounds that Sri Lanka's external liquidity was inadequate, the Rs 1.9b IMF loan was uncertain and the fiscal imbalance remains uncorrected. The US Secretary of State Hillary Clinton expressed some reservations in mid May about US supporting Sri Lanka's stand-by loan application to the IMF. At the time of this writing the publicly announced calendar of formal meetings of the IMF Executive Board up to June 8th 2009 does not have Sri Lanka on the agenda.

It was reported that the Central Bank had lost as much as Rs 5 billion in 2008 by trying to "diversify" its currency reserves. The Bank bet against the dollar and lost. The much talked about \$500m fifteen year loan from Libya has not come as yet. The Asian Development Bank has hinted that it may be able to frontload some of its project assistance to Sri Lanka and disburse a little more funds in 2009. The Central Bank is seeking currency swaps to tide over the shortage of external liquidity. Malaysia agreed to a \$200m swap in March. This would have

been partly self-serving because Malaysian companies that have substantial investments in Sri Lanka need to send back home their dividend and interest earnings.

Sri Lanka expects donor assistance to resettle the IDPs numbering over 250,000 and rebuild the north and east. In February the government launched the Committee for Action Plan (CHAP) under UN sponsorship with the goal of raising \$155m. This amount includes \$48m that had been pledged before the appeal was launched. But since then only about \$1.5m had been added to the total mount pledged. India has promised about \$8.5m and Norway (\$10m), UK (\$7.5m), and Japan (\$4.5m) have also pledged to help.

The rate of unemployment was reported to have fallen to a record low of a little over 5%. But a significant share of recent jobs is in the military and private security services. Sri Lanka has to resettle the IDPs, rebuild the infrastructure deficit especially in the north and east and create more productive employment. For this the government will have to attract both donor assistance as well as foreign direct investment. It is also essential to protect the markets in the west such as the GSP+ facility in EU. China has emerged as a major source of loan assistance for the country. However, the major markets for the country's products are in the west. Just now relations between Sri Lanka and some major western countries that have been critical of the war conduct on the part of both the LTTE as well as the Sri Lankan military remain strained.

Finally, a brief comment on the price of rice which is important for the household budget and is a politically sensitive issue as well. It was reported that the government has managed to collect only 37,000mt (26%) of the targeted 140,000mt of rice for its buffer stock. This is not because of a local production shortfall. The 2008 Yala and the 2009 Maha together have yielded about 2.7m tons, up 23% on the 2.2m tons in the previous year. Competition from private millers and inefficiency in government purchase appear to be the explanation. The current Yala crop is likely to below average because of the draught. However, world rice production is up and world price is down. Thus importing rice won't pose a problem provided the country has the necessary foreign exchange.

Dr. Samarasinghe writes a monthly report on the Sri Lankan economy for the Rapid Context Assessment (RCA) of the Consortium of Humanitarian Agencies (CHA), Colombo. This is an expanded version of that report. Global Vision thanks CHA for granting permission to reproduce the article.