



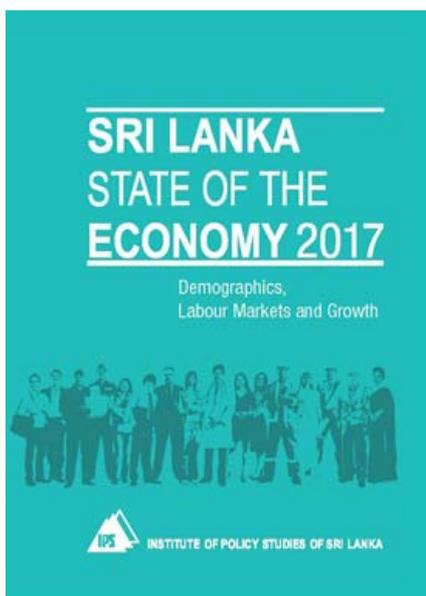
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# POLICYINSIGHTS

INSTITUTE OF POLICY STUDIES OF SRI LANKA

## INTERNATIONAL ENVIRONMENT

*From the IPS flagship publication 'Sri Lanka: State of the Economy 2017 Report'*



The year 2016 was dominated by uncertainty and pessimism on global political and economic fronts, with populist political rhetoric gaining firmer ground, resulting in the spread of nationalism and protectionism across much of the advanced world. The economic outlook for 2017 appears to be more favourable as both developed and developing economies are set to respond in a more determined fashion. The relatively more positive outlook, however, is underpinned by continuing uncertainty about policy outcomes associated with both the new US administration and the invoking of Article 50 by the UK to officially leave the EU (Brexit). In addition to these two key developments in international political economy, China is set to continue its domestic economic reform process, while commodity and oil prices are seeing a gradual increase with tighter financial conditions in emerging and developing economies.

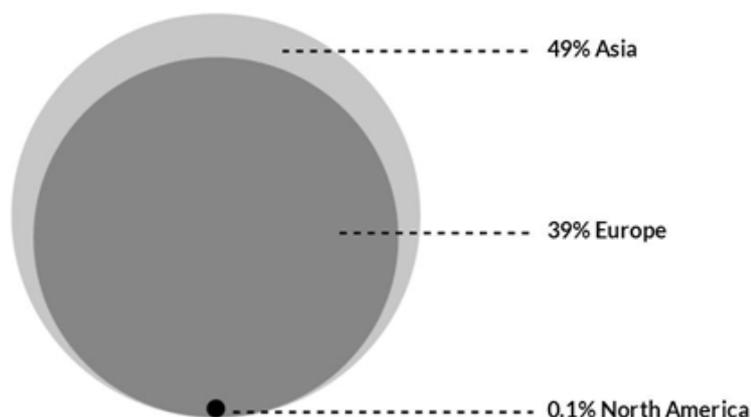
The world economy is projected to grow at 3.5 per cent in 2017, faster than both the growth rate of 2015 as well as the average growth of 3.38 per cent during the past five years. In addition to the cyclical recovery in manufacturing, the global economy is also expected to benefit from buoyant financial markets.

While emerging and developing economies are expected to headline global growth in 2017, performance among these countries is varied. China's growth trajectory remains strong due to continued policy support, albeit in the context of a major restructuring of the domestic economy. Its economy is expected to grow at 6.6 per cent in 2017 propelled by a government stimulus. Economic activity in India, on the other hand, slowed due to its initiative to demonetize the Indian economy and Brazil is still recovering from a deep recession. Meanwhile, commodity exporters continue to face challenges as commodity prices increase, but remain at low-levels.

### Global Investment Trends

Weak economic growth and lacklustre trade volumes also resulted in global FDI falling by 13 per cent in 2016, reaching approximately US\$ 1.52 trillion. However, having undergone considerable uncertainty during the previous year, the global economy is expected to rebound in 2017. Expected growth will thereby afford a greater scope for opportunities in trade, investment, and capital markets. Expectations of an economic recovery, however, are not a harbinger of political-economic stability. The growth of populist sentiment in the US and Europe in particular, threatens the prospects of a rejuvenated global economy. Continuing the trend in economic recovery since the recession, emerging economies will buttress most of the global economic gains. However, these same economies are especially vulnerable to external shocks emanating from advanced economies.

### CONTRIBUTION TO GROWTH OF IMPORTS



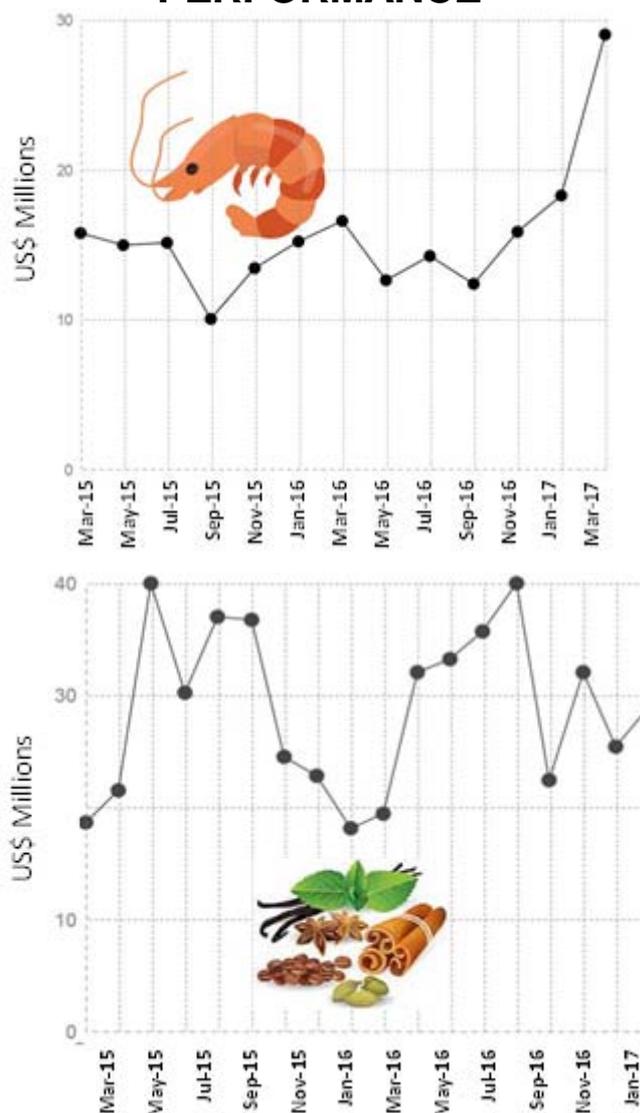
## Implications of External Environment Developments on Sri Lanka

Sri Lanka's merchandise export earnings contracted by 2.2 per cent in 2016 to an estimated US\$ 10.3 billion, while imports grew by 2.5 per cent to US\$ 19.4 billion. Thus, the trade deficit deteriorated further to 11.2 per cent of GDP from 10.4 per cent in 2015. The Textile and Garments (T&G) sector remains the flag bearer for Sri Lankan merchandise exports in international markets. The annual contributions from this sector amounted to approximately US\$ 4.9 billion. This amounts to 61.5 per cent of industrial exports and 47.3 per cent of aggregate merchandise exports. The T&G sector shows modest signs of recovery, with earnings expanding by 1.3 per cent in 2016.

Earnings from tea exports continue to be a significant foreign currency earner, garnering approximately US\$ 1.3 billion worth of revenue in 2016. Revenue has been receding in recent times (recent performance indicates a 5.3 per cent year-on-year contraction in exports) with the sector routinely hampered by international price volatility, instability in primary markets and incessant supply side constraints. Domestic tea production totalled 292 mn/kgs in 2016 which is the lowest yield since 2009. The deterioration of demand in primary international markets is also of particular concern for authorities. Therein, amidst domestic production issues, exporters also face a medium-term conundrum in that most of their significant markets face uncertain prospects.

A synoptic overview of Sri Lanka's external sector performance for 2016 indicates a protraction of the country's weak performance in exports and FDI. Annual export earnings contracted by 2.2 per cent to fall further to 12.7 per cent of GDP, while FDI inflows amounted to a modest 1.1 per cent of GDP. While such figures paint a sombre picture, an examination of composite data exhibits embryonic signs of rejuvenation. Prospects for a more sustainable trade balance have been bolstered by renewed optimism where

## SEA FOOD AND SPICE PRODUCTS EXPORT PERFORMANCE



domestic exporters will gain access to a larger and lucrative consumer base, thanks to ongoing bilateral negotiations with Asian and European partners. However, Sri Lanka should remain cognizant of fluctuations in commodity markets; the country remains highly susceptible to volatility in the prices crude oil, tea and natural rubber.

Sri Lanka's prospects for development are heavily contingent upon its ability to procure high value FDI. History paints a gloomy picture in this regard, with the country's magnitude of investment inflows significantly lower than regional competitors. While recent emphasis on attracting investments into domestic manufacturing sectors bears some promise, the relevant authorities need to ensure that supply

side irregularities are calibrated to ensure maximum results.

This Policy Insight is based on the comprehensive chapter on "International Environment" in the 'Sri Lanka: State of the Economy 2017 Report' - the flagship publication of the Institute of Policy Studies of Sri Lanka (IPS). The complete report can be purchased from the publications section of the IPS, located at 100/20, Independence Avenue, Colombo 7. For more information, contact the Publications Unit on 0112143107/ 0112143100.



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