

Risks and Challenges for the Sri Lankan Economy

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Sri Lankan economy is at a crossroads due to:

- State led economic growth is losing steam due to growing scarcity of resources
- External sector vulnerability due to the end of the bonus cycle arising from:
 - Low energy prices
 - Globally low interest rates
 - Difficulties in market access
- Change in policy after the election of the new government

Government budgetary position

- Popular expenditure programmes and rising government expenditure
- Falling revenue and failure to realise the revenue proposed in the budget
- Increased budget deficit and difficulties in financing the budget
- Domestic financing difficulties despite the huge excess market liquidity

Budget at a glance

	2013	2014 E	2014 P	2015 E
<i>As a percentage of GDP</i>				
Total Revenue and Grants	13.3	14.8	12.3	13.6
Total Revenue	13.1	14.5	12.2	13.3
Tax Revenue (a)	11.6	12.8	10.7	11.8
Non Tax Revenue	1.5	1.6	1.5	1.5
Grants	0.2	0.3	0.1	0.3
Expenditure and Lending Minus Repayments	19.2	20.0	18.3	18.0
Recurrent	13.9	13.4	13.5	13.7
Capital and Net Lending	5.4	6.6	4.8	4.3
o/w Public Investment	5.5	6.7	5.0	4.3
Current Account Surplus (+)/Deficit (-)	-0.8	1.1	-1.3	-0.4
Primary Account Surplus (+)/Deficit (-)	-0.8	-0.8	-1.6	-0.7
Overall Fiscal Surplus (+)/Deficit (-)	-5.9	-5.2	-6.0	-4.4

Source: CB AR 2014

Funding problems for state led projects

- Need for renegotiating with lenders for long term investment funding and the delay in signing of contracts
- Political uncertainty contributing to effective loan negotiation
- Election fever until end of August and uncertainty associated about the outcome of the elections

Can the current monetary policy prevail?

- Excess market liquidity of Rs 250 billion on a daily basis
- Siphoning off liquidity through standard deposit mechanism at 6% rate of interest
- Interest out-payment to banks
 - Rs 17.7 billion in 2014
 - Rs 15 billion estimated to be in 2015
- Loss situation in Central Bank eroding its capital base

Losses in the Central Bank

- Losses in foreign operations in 2013 amounting to Rs 39 billion
- Losses in both foreign and domestic operations in 2014 amounting to Rs 22 billion
- Erosion of the capital base from Rs 182 billion as at end of 2012 to Rs 81 billion as at end of 2014
- Declining capital base as a percent of domestic assets from 45% in 2013 to 19% in 2014

Implications

- Monetary policy mechanism has to be changed from standard deposit accepting system to previous system
- No more rate cuts
- Falling foreign reserves and the consequential pressure on the exchange rate
- Pressure on the balance of payments and need for going for IMF support

Government's External Debt

Item	US\$ million (End period position)	
	2013(a)	2014(b)
General Government	22,290	24,051
Short term	507	399
Debt securities	507	399
Treasury bills (c)	507	399
Long term	21,783	23,651
Debt Securities	5,968	7,890
Treasury bonds (c)	2,483	2,603
International sovereign bonds (d)	3,485	5,287
Loans	15,814	15,762
Non-concessionary/commercial share of debt	29%	34%

Source: CB AR 2014

External Debt Servicing

4. Debt Service Ratio	2010	2011	2012	2013	2014
4.1 As a percentage of 2 above					
(i) Overall Ratio	16.7	13.2	19.7	23.5	20.2
(ii) Excluding IMF transactions	16.2	13.0	19.0	20.3	15.8
4.2 As a percentage of 3 above					
(i) Overall ratio	11.9	9.3	13.5	16.4	14.1
(ii) Excluding IMF transactions	11.5	9.2	13.1	14.1	11.1
5. Government Debt Service Payments					
5.1 Government debt service payments (c)	1,219	1,474	2,191	2,386	2,172
5.2 As a percentage of 1 above	65.8	82.0	82.0	67.4	64.1

Exchange rate movements

Effective Exchange Rate Indices(b) (c) (2010=100)	End Year Index			Annual Average Index		
	2012	2013	2014	2012	2013	2014
NEER 24-currencies	90.33	90.97	96.44	90.44	91.39	91.99
REER 24-currencies	97.85	100.31	106.30	95.80	100.61	101.94

The End