MONTHLY ECONOMIC UPDATE

April 2023

EIU | The Ceylon Chamber of Commerce

3 KEY INSIGHTS

- Trade deficit narrows sharply in February 2023; Tax Revenue doubles in Q1-2023
- PMI for Manufacturing returns back to positive territory, foreign inflows to government securities accelerates.
- Global Growth is expected to fall to 2.8% in 2023, risks to the outlook is heavily skewed downward: IMF

SRI LANKAN ECONOMY

ADB Forecasted a 3% contraction in 2023: Similar to the projections made by the IMF, ADB has projected a 3% contraction in the economy in 2023. 1.3% growth is expected for 2024.

Economic Outlook Improves: With the approval of the IMF EFF programme, the country's economic outlook has improved with an appreciating LKR, increasing foreign holdings to local securities, recovering tourism and rise in remittances inflows.

Trade Deficit Narrowed Significantly in February: Decline of imports by 45.5% and exports by 10.1% resulted in a significant drop in the trade deficit during February 2023. Tourism and remittances inflows registered a progressive growth.

Tax Revenue doubled in Q1-2023: According to the IRD, the tax revenue for the Q1-2023 has doubled to Rs.317 billion in comparison to the same period of last year. The new tax policy, a gradual improvement of the country's economic situation and enhanced efficiency of tax administration has been contributed to this progress. Collection of VAT picked up by 87% while corporate and non-corporate income tax collection increased by 47%.

PMI returned to positive territory in March: Due to increased manufacturing and business services due to the upcoming New Year season, both the Manufacturing and Services Purchasing Managers' Indices (PMI) recorded an expansion in comparison to the previous month. Manufacturing PMI was returned to positive territory for the first time since June 2022.

GLOBAL ECONOMY

2.8% Global Growth is Expected for 2023: As per the latest forecasted by the IMF, global growth is expected to fall from 3.4% in 2022 to 2.8% in 2023. Growth of advanced economies are expected to slow sharply meanwhile EMDEs are expected to reach a stronger growth, well above the global growth projections.

Global Oil Prices are declining: Oil prices fell more than 34% from their peak in June 2022 by the time they reached a 15-month low in March 2023 to USD 76.47 per barrel. Uneven demand recovery from China, fears on a bank turmoil, rising interest rates and tight credit conditions can be identified as key causes for this slowdown of prices.

MACROECONOMIC SNAPSHOT

Y-O-Y CHANGES

EXTERNAL TRADE

February 2023

Exports ↓ 10.1%

Imports ↓ 45.5%

Trade Deficit ↓ 95%

REMITTANCES & TOURISM

March 2023

Workers' Remittances ↑ 78%

Tourist Arrivals ↑ 18%

Tourism Earnings ↑ 3%

INFLATION

March 2023

CCPI 50.3% ↑

CCPI Core 39.1% ↑

NCPI 49.2% ↑

NCPI Core 44.2% ↑

CREDIT TO PRIVATE SECTOR

February 2023

3% ↓

KEY INTEREST RATES

SDFR (Apr):16.50%

SLFR (Apr): 15.50%

AWPR (Apr):21.45%

AWFDR (Mar): 19.80%

AWDR (Mar): 15.06%

AWLR (Feb): 18.05%

Data Sources: Central Bank, Sri Lanka
Department of Census and Statistics, Sri Lanka
Tourism Development Authority, Sri Lanka

FURTHER INSIGHTS- SRI LANKAN ECONOMY

Similar to IMF projections, ADB too forecasted a 3% Contraction for Sri Lanka in 2023

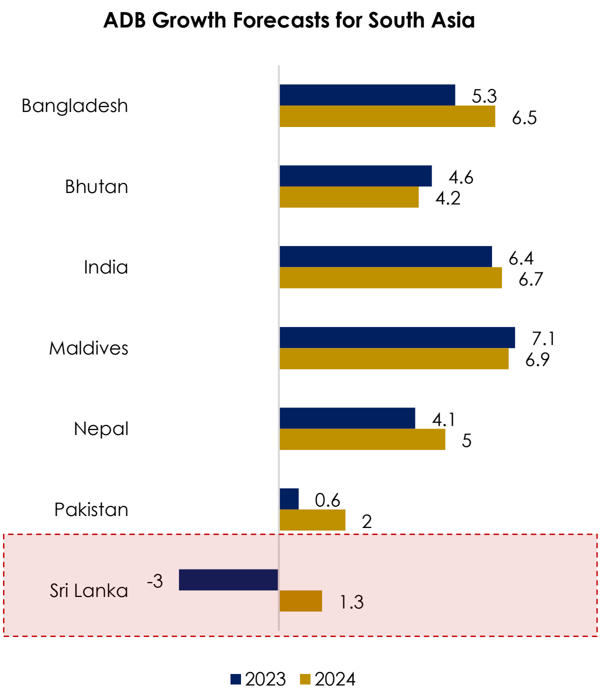
Historic back-to-back contraction in 2023 is likely to be followed by only tepid recovery in 2024, says the Asian Development Bank (ADB) in its latest Asian Development Update. Assuming that the conditions of the IMF programme are met, ADB forecasted a 3% contraction of the economy in 2023, similar to the expectations of the IMF. Going forward, in 2024, the economy is expected to grow by 1.3% in 2024 as the country's debt overhang wanes, where IMF forecasted a 1.5%.

As a result of tight fiscal policy, high interest rate environment and uncertain economic conditions; consumption and investments are expected to be weak in 2023. Inflation is forecast to ease in 2023 and return to single digits in 2024. Inflation is projected to average 24.6% in 2023 as fiscal tightening and double-digit interest rates weigh on domestic demand, supply side disruption eases, and moderating external pressures alleviate food shortages.

The fiscal deficit is expected to decline to the equivalent 7.9% of GDP in 2023 and the current account balance is forecast to improve as tourism and remittances continue to recover.

Report highlighted that the country's economic outlook is clouded by uncertainty concerning progress on debt restructuring, the timely implementation of measurers under the IMF programme, political developments as the country enters the electoral cycle that will likely test authorities' will to carry out reforms, and unpredictable weather patterns.

Risks to the outlook could also emanate from the financial sector which has a significant sovereign exposure and faces deteriorating credit quality. Other downside risks are a global slowdown that exceeds expectations, which would hit foreign exchange earnings, political instability, which could hit tourism or delay reforms; and a possible resurgence of the pandemic, the report stated.



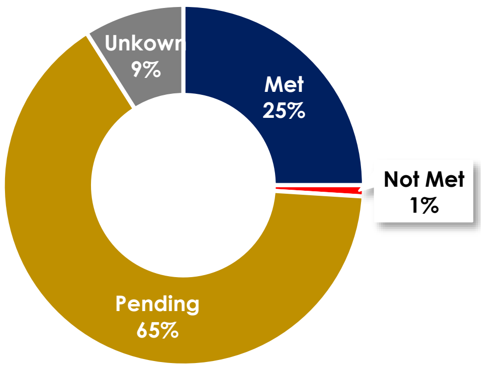
Considering the growth forecasts for South Asian region (except Afghanistan), Sri Lanka marks the only country with a projection of contraction in 2023.

Source: ADB, IMF

Progress of the IMF Programme and Debt Restructuring Process

As featured in our March Economic Update, the Extended Fund Facility (EFF) programme for Sri Lanka was recently approved by the IMF Board. Sri Lanka has already demonstrated a strong commitment to reforms. The government of Sri Lanka has already taken significant strides towards meeting the program's proposals, having met 25% of the targets set forth. These include all prior actions, removal of zero VAT on Tourism, Parliamentary approval of 2023 appropriation bill, cabinet approval on fiscal revenue measures and fuel pricing formula.

Progress of the IMF Programme as of 31st March 2023



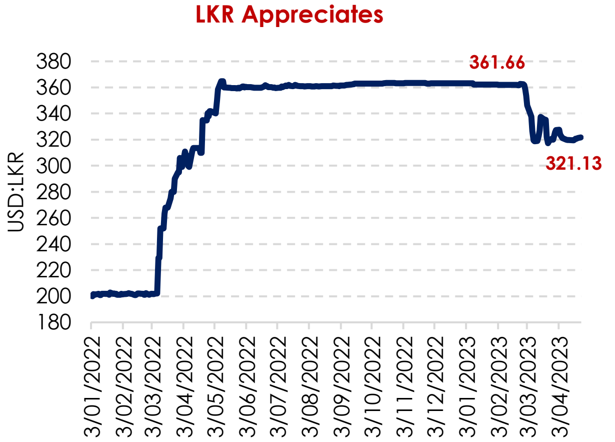
Moving forward, there are several pending actions to be completed in April, which include completing an asset quality review of selected banks, securing parliamentary approval on the new Central Bank Act, and increasing betting and gaming levies. However, there remains one outstanding item that was not met. That is the proposal pertains to the creation of an online fiscal transparency platform for publishing public procurement contracts, a list of firms receiving tax exemptions through BOI, and a list of individuals receiving tax exemptions on luxury vehicle imports.

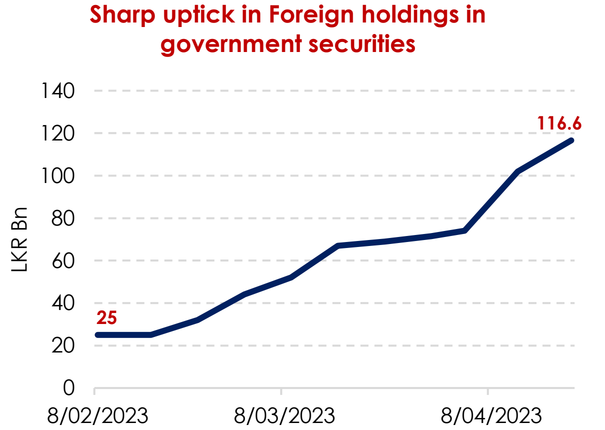
The rapid growth of Sri Lanka's public debt has reached unsustainable levels. Central Government and Guaranteed SOEs foreign currency debt together accounted for USD 45.5 Bn. Thus, the country is now in need of a comprehensive debt treatment to address this pressing issue. Sri Lanka is requesting a significant effort from its foreign currency creditors in this regard. Currently, USD 30.8 billion or 68% of FX debt is being considered for debt treatment, with official bilateral creditors accounting for 34% of the FX treatment perimeter or USD 10.6 billion, and private creditors making up the remaining 66% of the FX restructuring perimeter or USD 20.3 billion. On the other hand, USD 14.7 billion or 32% of FX debt is being considered for exclusion from the debt treatment perimeter, with multilateral creditors accounting for USD 11.5 billion, emergency assistance credit lines totaling USD 0.8 billion, bilateral swap lines amounting to USD 2.0 billion, and Ceylon Petroleum Corporation (CPC) and Ceylon Electricity Board (CEB) FX payables at USD 0.3 billion. The Sri Lankan authorities are also taking steps to explore options for a domestic debt operation that aims to provide liquidity relief while maintaining financial stability, and avoiding any further erosion of Sri Lanka's repayment capacity. To this end, only T-Bills held by the CBSL will be considered for treatment, with the goal of creating some fiscal space. It is important to note that a voluntary domestic debt optimization operation is being considered, with no coercion involved. The Sri Lankan government, in consultation with its advisors, will initiate discussions with major T-Bond holders to explore the various options available and to understand any constraints that may need to be addressed.

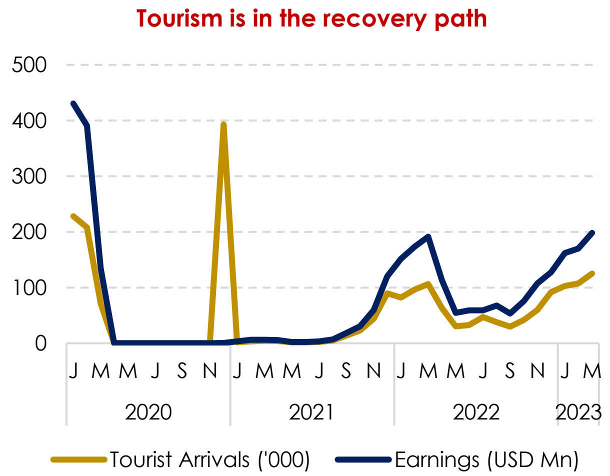
Source: Manthri.lk ([IMF Meter – Manthri.lk]) & MoF

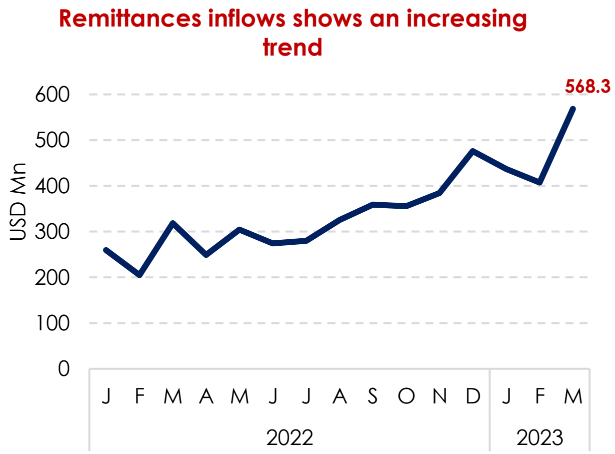
With the Approval of the IMF Programme, Country's Economic Outlook Improved

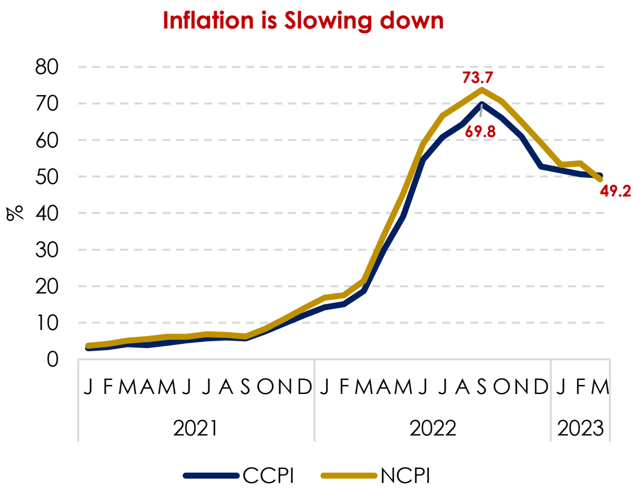
Approval of the EFF programme for Sri Lanka by the IMF Executive Board has contributed to relative improvement to Sri Lanka's economic outlook, as illustrated by below set of charts.

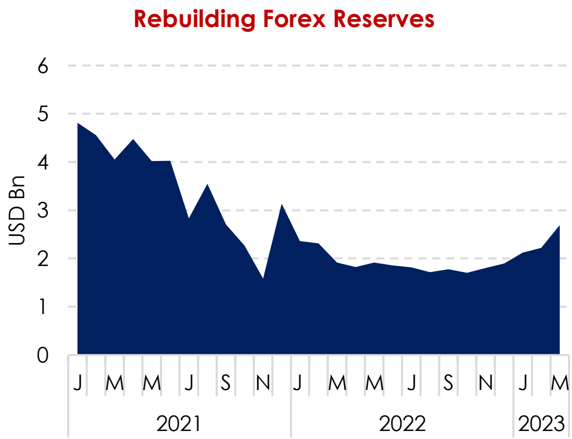












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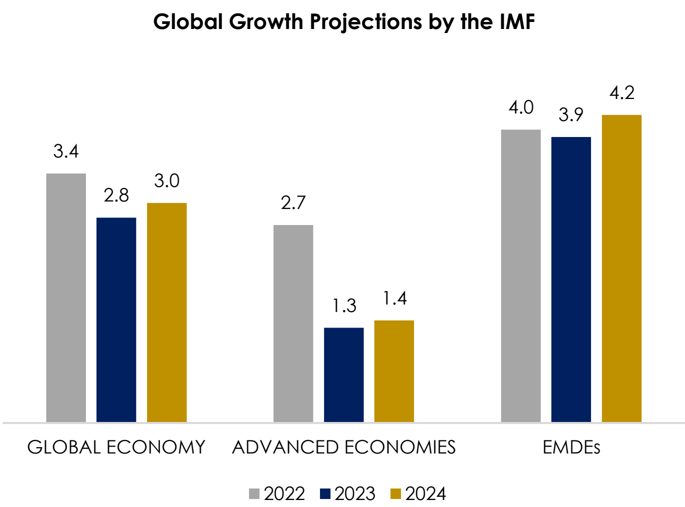
FURTHER INSIGHTS- GLOBAL ECONOMY

Global Growth is expected to Fall to 2.8% in 2023

The IMF has published its World Economic Outlook-April update earlier this month, releasing its latest growth forecasts for the global economy, Advanced Economies, and emerging market and developing economies (EMDEs). The IMF's baseline forecast assumes that recent financial sector stresses are contained, with global growth projected to fall from 3.4% in 2022 to 2.8% in 2023 before rising slowly and settling at 3.0% in the medium term.



According to the report, advanced economies are expected to see a sharp slowdown in growth, with projections for 2023 falling by half to 1.3%, before rising to 1.4% in 2024. The slowdown is expected to result in higher unemployment, with an average rise of 0.5 percentage points from 2022 to 2024. This is particularly due the euro area and the United Kingdom, where growth is expected to fall to 0.8% and -0.3% in 2023 respectively, before rebounding to 1.4% and 1.0% in 2024. This reflects the tight policy stances which are needed to bring down inflation and the fallout from the recent deterioration in financial conditions. Additionally, the ongoing war in Ukraine and growing geo-economic fragmentation are expected to have negative impacts on growth. The report notes that the outlook is anemic, with the lowest medium-term forecast in decades.

Meanwhile, EMDEs are expected to have stronger economic prospects, well above the global growth projections. The IMF predicts that EMDEs will experience a growth rate of 3.9% in 2023, which is expected to rise to 4.2% in 2024. It is worth noting that the economic prospects of EMDEs vary widely across regions.

Risks to the outlook are heavily skewed to the downside with the chances of a hard landing having risen sharply. Financial sector stress could amplify and contagion could take hold, weakening the real economy through a sharp deterioration in financing conditions and compelling central banks to reconsider their policy paths. Pockets of sovereign debt distress could, in the context of higher borrowing costs and lower growth, spread and become more systematic. The war in Ukraine could intensify and lead to more goods and energy price spikes, pushing up inflation. Fragmentation into geopolitical blocs has the scope to generate large output losses, including through its effects on foreign direct investments, the report explained.

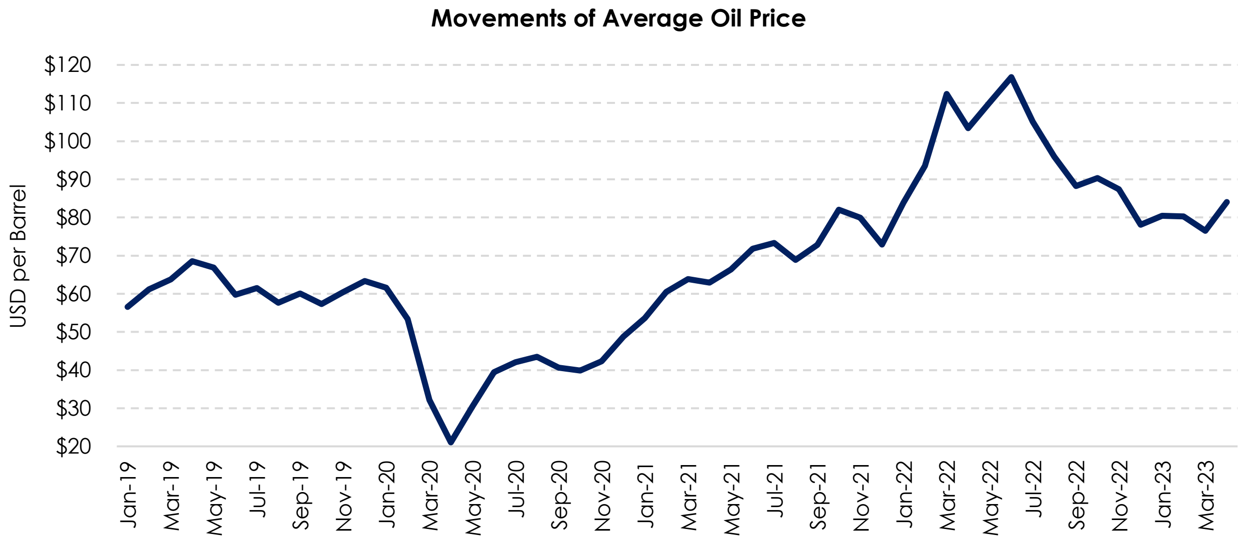
Source: IMF

Oil Prices Soared after OPEC's Surprise Output Cut

One of the most significant trends in recent months has been the downward movement of oil prices. Oil prices started the year at USD 83.92 per barrel in January 2022 and rose to a peak of USD 116.80 in June 2022, representing an increase of almost 39% over this period. However, prices began to decline in July 2022 and have continued to decrease since then. Oil prices fell more than 34% from their peak in June 2022 by the time they reached a 15-month low in March 2023 to USD 76.47 per barrel.

The recent decline in crude oil prices has been influenced by multiple factors. The uneven demand recovery from China, one of the world's largest consumers of crude oil, has impacted the market. Chinese exports had been declining in the past months due to the fall in global demand. Additionally, fears of a banking turmoil that could cause a recession have led to a fall in prices. The recent fallout in banks in the US and Europe, such as the failure of two US banks - Signature Bank and Silicon Valley Bank, and then Credit Suisse almost one after the other due to asset liability mismatch and large withdrawals, have triggered fears of a banking crisis. Furthermore, rising interest rates and tighter credit conditions in the banking sector may have an impact on crude oil investments, which have already been declining for several years as more incremental investments are directed toward green energy and green transactions energy transitions.

However, OPEC+ announced on April 2nd it was slashing output by 1.16 million barrels per day. The move was a "precautionary measure" to stabilize the oil market, following Russia's decision to trim oil production by 500,000 barrels per day until the end of 2023. Other member states, such as Saudi Arabia, UAE, Kuwait, Oman, Iraq, Algeria and Kazakhstan, also pledged respective cuts. The surprise cut could push oil prices toward the USD 100 mark again, and said it could also reverse the decline in inflation. Analysts says.



Source: World Bank, CNBC

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DASHBOARD

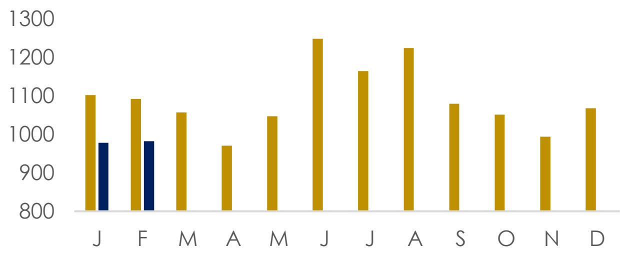
EXTERNAL SECTOR PERFORMANCE-FEBRUARY 2023

Legend: 2022 2023

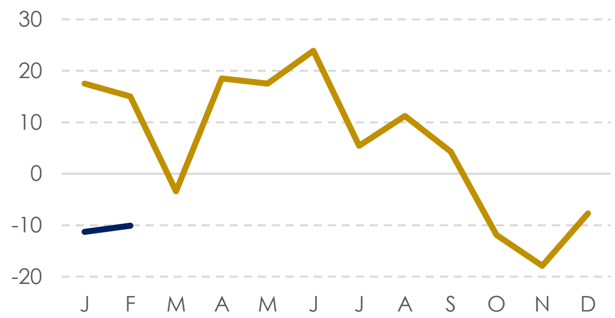
All the numbers are in USD Mn unless otherwise specified.

EXPORTS

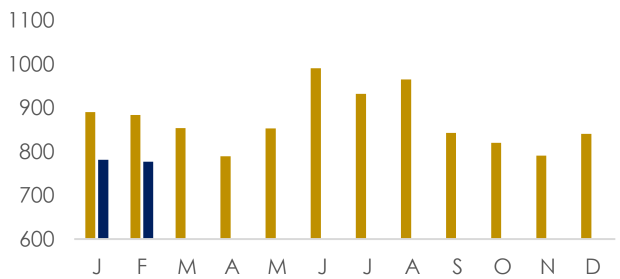
EXPORTS DROPPED BY 10.2% Y-O-Y



Y-o-Y % CHANGE IN EXPORTS



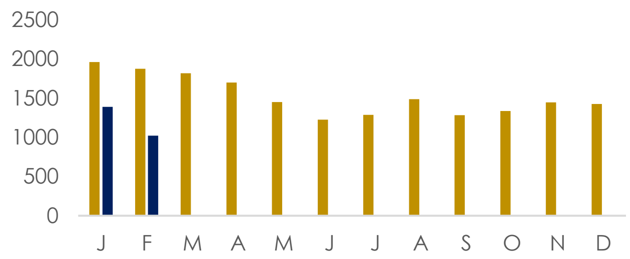
INDUSTRIAL EXPORTS DECLINED BY 12.1% Y-O-Y



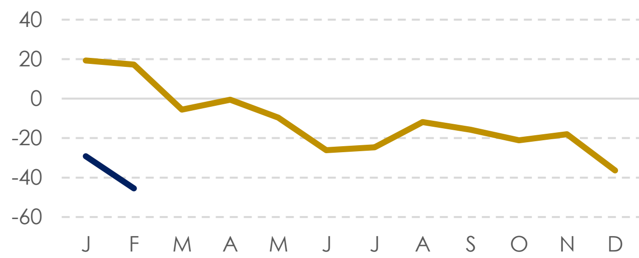
AGRICULTURAL EXPORTS DROPPED UP BY 0.4% Y-O-Y

IMPORTS

IMPORTS DECLINED BY 45.5% Y-O-Y

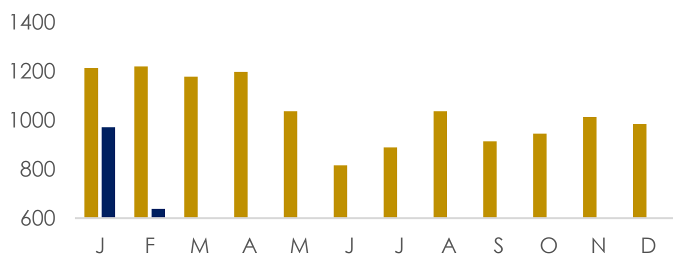


Y-o-Y % CHANGE IN IMPORTS

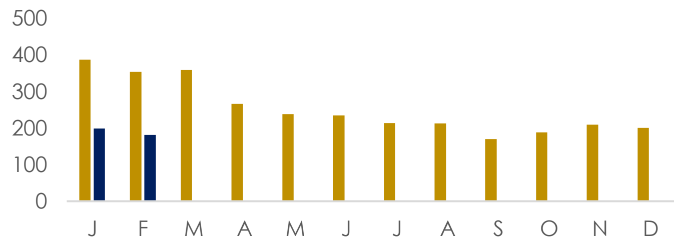


CONSUMER GOODS IMPORTS DROPPED BY 32.3% Y-O-Y

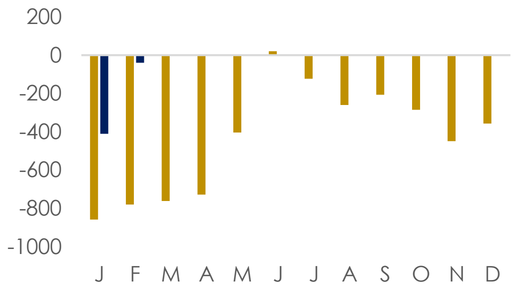
INTERMEDIATE GOODS DECLINED BY 47.7% Y-o-Y



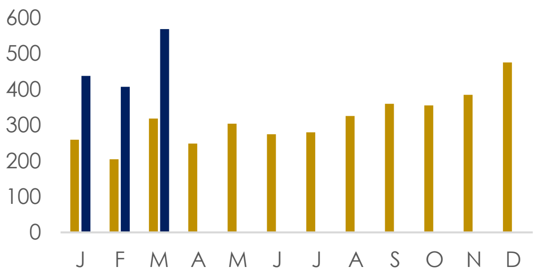
INVESTMENT GOODS DECLINED BY 48.9% Y-o-Y



TRADE DEFICIT NARROWED BY 95% Y-o-Y



WORKERS' REMITTANCES INCREASED BY 78% Y-o-Y (MAR-2023)

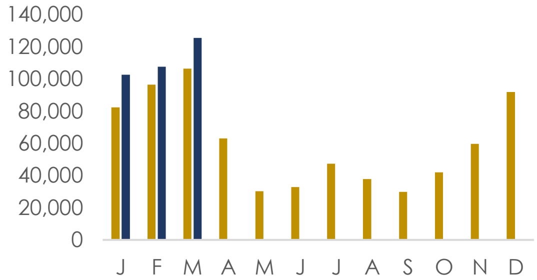


40%

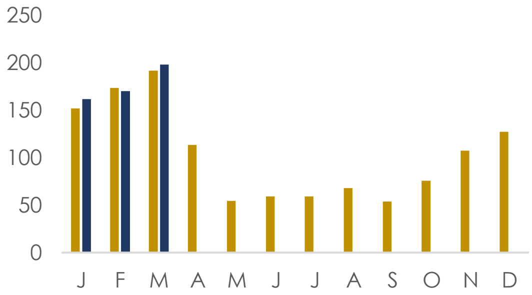
of the total import bill covered by Remittances

(Feb 2023)

18% INCREASE IN TOURIST ARRIVALS Y-o-Y (MAR-2023)



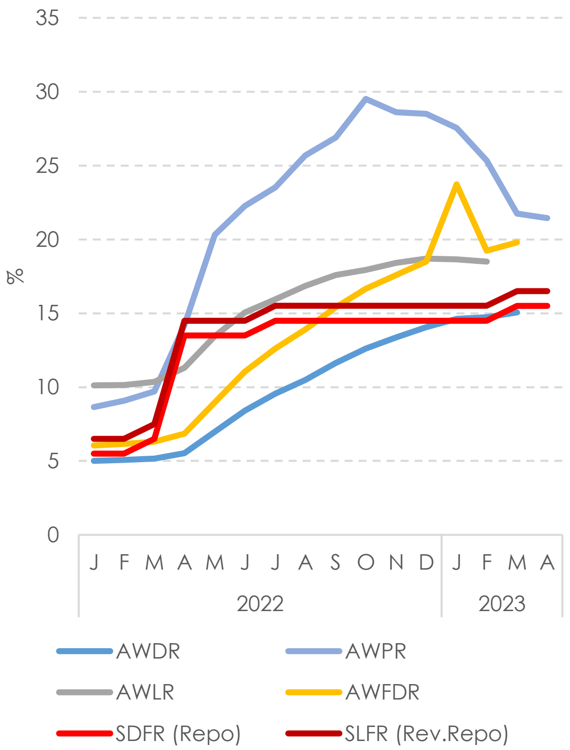
3% INCREASE IN TOURISM EARNINGS Y-o-Y (MAR-2023)



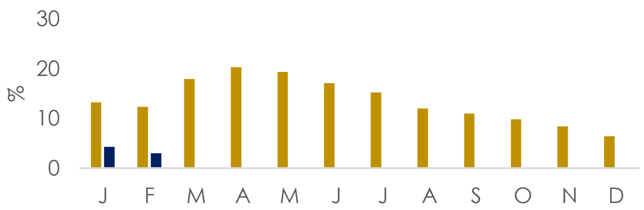
KEY INTEREST RATE INDICATORS

INTEREST RATES

Standing Deposit Facility Rate (SDFR): 15.50%
Standing Lending Facility Rate (SLFR): 16.50%

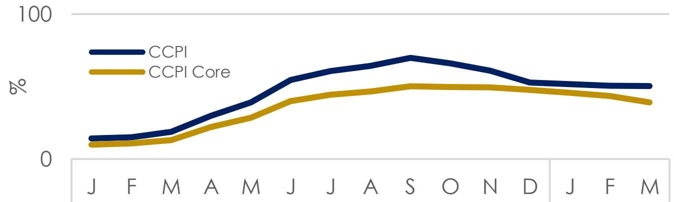


PRIVATE SECTOR CREDIT GROWTH



INFLATION: CCPI (BASE 2013) Y-o-Y

	Mar '23	Feb '23
CCPI:	50.3	50.6
CCPI Core:	39.1	43.6



INFLATION: NCPI (BASE 2013) Y-o-Y

	Mar '23	Feb '23
NCPI:	49.2	53.6
NCPI Core:	44.2	50.1