

MONTHLY ECONOMIC UPDATE

February 2023

EIU



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KEY INSIGHTS

Domestic Economic Activity is expected to recover towards the latter part of 2023: CBSL

Merchandise trade remained resilient during 2022, despite heightened challenges: 2022 data shows

The IMF projects a 2.9% growth for the world in 2023; inflation is expected to fall.

SRI LANKAN ECONOMY

Domestic Economic activity is expected to recover in latter part of 2023: The Central Bank of Sri Lanka (CBSL) is expecting a recovery of domestic economic activities during the latter part of 2023, considering the favorable developments in the economy.

Inflation continued to fall further: For the fourth consecutive month, the CCPI based inflation decelerated in January 2023. The CBSL is expecting this trend to continue and is projected to follow a faster disinflation path.

Merchandise trade remained resilient during 2022, despite heightened challenges: The merchandise trade deficit narrowed notably in 2022, to the lowest level since 2010, owing to an improvement in export earnings and significant compression of import expenditure as a result of the policy measures implemented in order to curtail non-urgent imports and foreign exchange liquidity constraints.

Mixed Performance in PMI: In January 2023, the Purchasing Managers' Index recorded mix performance, where Services activities showed a slight expansion, but the manufacturing activities remained deteriorated. However, expectations for next three months indicated an improvement, given the coming festive season.

Remittances inflows and Tourism performance gradually improving: Both remittances inflows and tourism arrivals showed a notable uptick during January 2023, and this helped easing excessive pressure in the domestic foreign exchange market.

GLOBAL ECONOMY

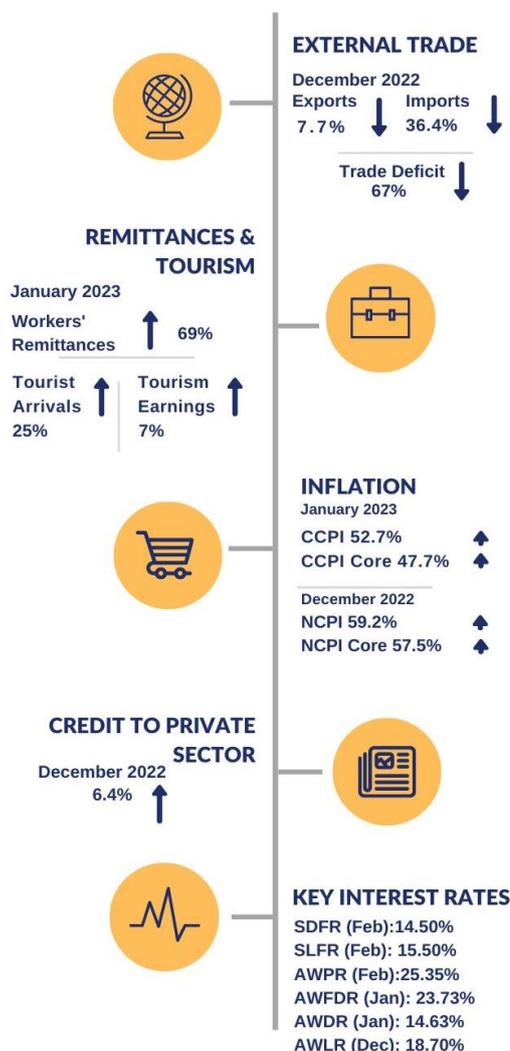
The IMF Projected a 2.9% growth for the World in 2023: Global growth is expected to fall to 2.9% in 2023 from 3.4% in 2022 and the decline is being driven by advanced economies, with EMDEs are expected to bottom out in 2022.

Global Inflation is expected to fall in 2023: As per the latest anticipations by the IMF, the global inflation is expected to decelerate to 6.6% in 2023 from 8.8% in 2022.

Energy Prices dropped in January: Energy prices registered an 8.9% drop in January 2023, led by natural gas in Europe and coal. However, non-energy prices gained slightly by 1.7%, where 0.4% increase recorded in food prices.

MACROECONOMIC SNAPSHOT

Y-O-Y CHANGES



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

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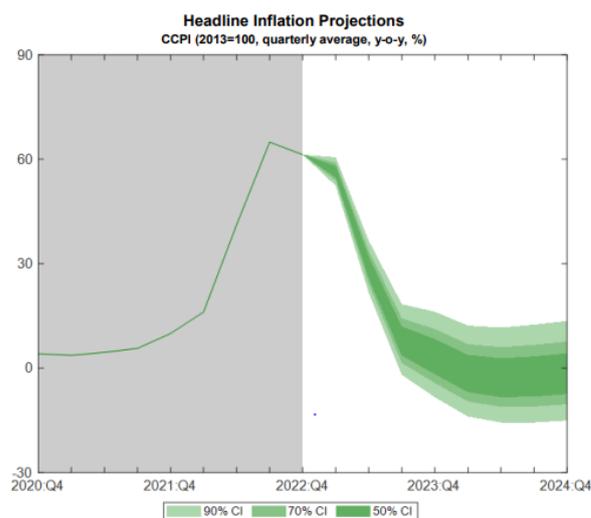
FURTHER INSIGHTS- SRI LANKAN ECONOMY

Domestic Economic Activity is expected to recover towards the latter part of 2023: CBSL

The economy is expected to make a gradual recovery during the year 2023 supported by the expected improvements in domestic supply conditions, underpinned by the timely implementation of corrective policy measures, says the CBSL by issuing the first Monetary Policy Review in 2023. In addition, the anticipated improvements in foreign exchange flows and the resultant enhancement in business and investor sentiment are expected to reinforce the expected recovery in the period ahead.

Gradual easing of excessive market interest rates, improved market liquidity conditions, improved investor sentiment on the anticipation of “financing assurance” from official creditors, led to a notable moderation in the yields on government securities recently, reflecting the easing of the high risk premia attached to government securities. Market deposit rates have also shown a notable moderation, and the CBSL is expected that, these developments pave the way for an easing of excessive market interest rates in the period ahead.

The inflation started to decelerate since October 2022. This trend is expected to continue in recent months and is projected to follow a faster disinflation path, supported by subdued aggregate demand resulting from tight monetary policies, expected improvements in domestic supply conditions, and the passthrough of easing global commodity prices to domestic prices, along with the favorable statistical base effect.



Source: Central Bank Staff Projections

Merchandise Trade Remained Resilient during 2022, despite heightened Challenges

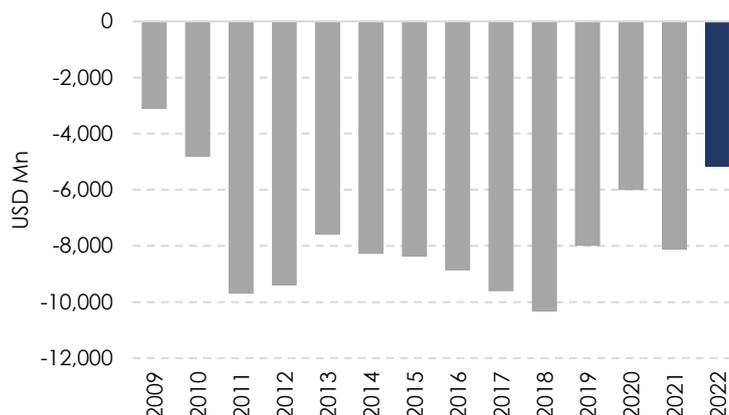
The merchandise trade deficit narrowed notably in 2022, to the lowest level since 2010, owing to an improvement in export earnings and significant compression of import expenditure as a result of the policy measures implemented in order to curtail non-urgent imports and foreign exchange liquidity constraints.

Accordingly, the trade deficit narrowed by 36% to USD 5 Bn in 2022, from USD 8 Bn recorded in 2021. Export performance remained notably robust despite the numerous challenges both at a local and global level. At the end of the year 2022, Sri Lanka recorded a 4.9% increase in export earnings compared to 2021, hitting a record high of USD 13 Billion. The Y-o-Y improvement in earnings in 2022 was driven by increased earnings from industrial exports (specifically, due to improvement in the Textiles and Garments, Gems, diamonds, jewellery, machinery and mechanical appliances and petroleum product groups). However, earnings from exports of rubber products, food, beverages and tobacco, transport equipment and plastics and articles declined during 2022. Though industrial exports saw a Y-o-Y increase, earnings in December 2022 reduced relative to December

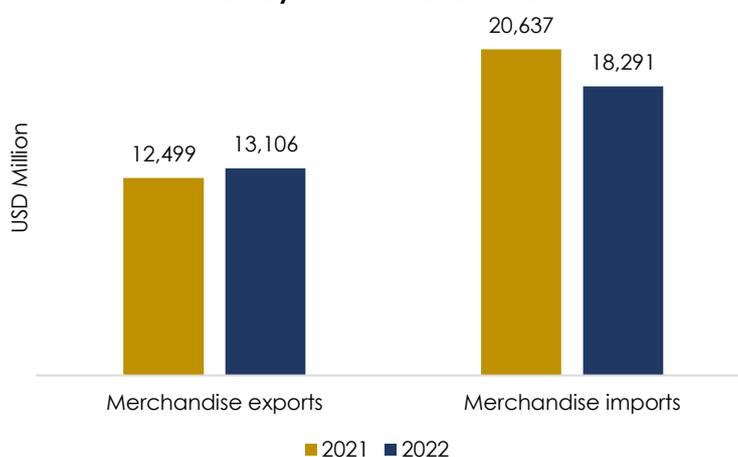
2021, mainly due to garment exports resulting from reduced spending capacity associated with the global slowdown, high inflation and recessionary concerns in the major export markets (the USA, the EU and the UK). The main export destinations remained among USA, EU, UK, and India. Both industrial exports and mineral exports contributed a 7.9% and 12.3% increase respectively, while agricultural exports fell by 5.9% compared to 2021. While industrial export earnings showed a Y-o-Y increase, compared to December 2021, industrial export earnings decreased by 8.3% due to the decrease in agricultural exports driven by negative growth of unmanufactured tobacco, spices and tea. The lag effect of the unavailability of required fertilizer and the decline in export volumes of pepper (under spices), compared to 2021, and is expected to have impacted these groups.

Total import expenditure in 2022 was USD 18 Bn and recorded a 11.4% Y-o-Y decline compared to 2021. This reduction was largely driven by the import restrictions imposed to overcome the forex crisis, the forex liquidity shortage in the banking system, and the substantial increase in import prices due to the sharp depreciation of the LKR. The main import sourcing countries were India, China, UAE, and Malaysia. The major groups of import products that impacted the reduction in expenditure are non-food consumer goods imports, driven by medical and pharmaceuticals, telecommunication devices and home appliances.

In 2022, Trade Deficit narrowed to the lowest level since 2010



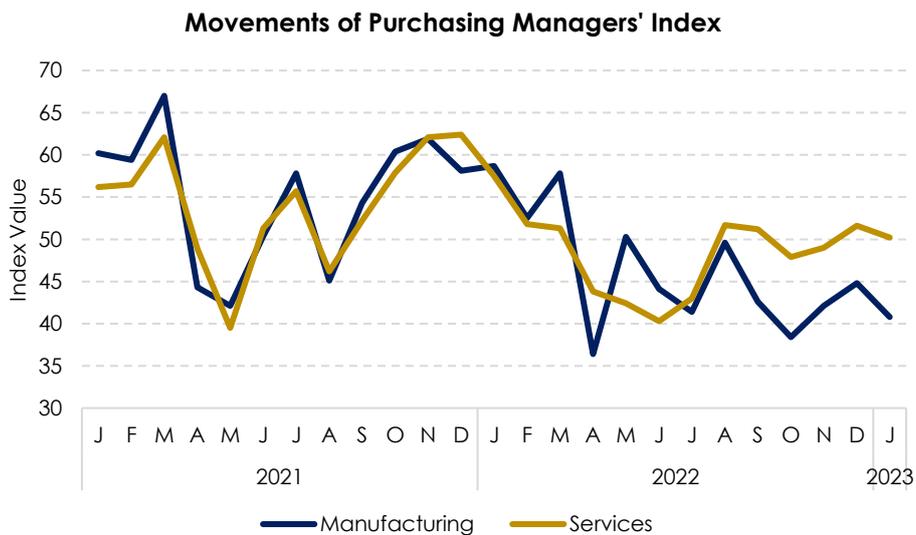
Summary of Merchandise Trade



Mix Performance in PMI during January 2023

In January 2023, the Purchasing Managers' Index recorded mix performance, where Services activities showed a slight expansion, but the manufacturing activities remained deteriorated. As per the CBSL, Manufacturing PMI signals a continued setback in manufacturing activities on a m-o-m basis in January 2023 and recorded an index value of 40.8, which is a decline of 4 index points from the previous month. This deterioration was driven by all sub-indices except Supplier's delivery time. Expectations for manufacturing activities for the next three months indicated an improvement, anticipating an increase in demand during the upcoming festive season, despite the decline in disposable income, the CBSL says.

Services PMI recorded an index value of 50.2 in January 2023, remaining slightly above the 50 threshold. This was underpinned by the improvements observed in New Business, Business Activities and Expectations for Activity sub-indices. Expectations for business activities for the next three months continued to improve amidst upcoming festive season. Positive sentiments on improvements in the economic conditions also lifted the expectations further. However, reduced purchasing power along with the new tax structure and electricity rate hike can be detrimental towards future business activities.



Data Source: CBSL

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FURTHER INSIGHTS- GLOBAL ECONOMY

2.9% Global Growth is expected for 2023, IMF

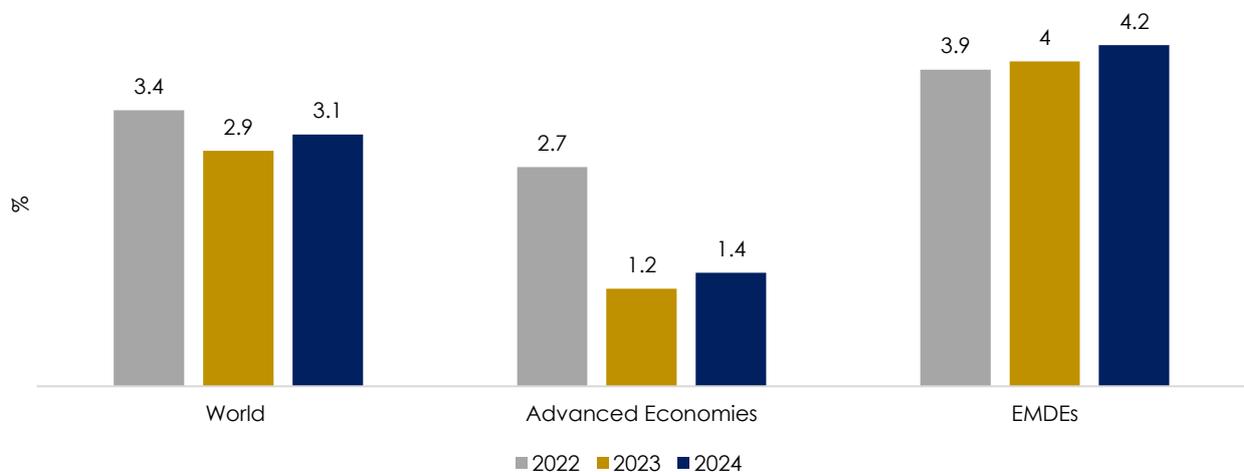
Global growth forecasts for 2023 and 2024 paint a mixed picture, with growth falling from 3.4 % in 2022 to 2.9 % in 2023 before rising to 3.1 % in 2024, as per the projections by the International Monetary Fund (IMF) in late January 2023. This is less than the historical average of 3.8 % between 2000 and 2019, and the decline in growth in 2023 is being driven by advanced economies, with emerging market and developing economies expected to bottom out in 2022. The forecast of low growth in 2023 reflects a rise in central bank rates to combat inflation and the ongoing war in Ukraine, while the expected pickup in 2024 reflects a gradual recovery from these factors.

For Advanced Economies, growth is expected to fall to 1.2% in 2023 and a slight rise of 1.4% in 2024. Growth in the United States is expected to fall from 2.0 % in 2022 to 1.4 % in 2023 and 1.0 % in 2024, according to the forecast. The 0.2 percentage point reduction for 2024 reflects the steeper path of Federal Reserve rate hikes, which are expected to peak at around 5.1 % in 2023. Despite these challenges, growth in the United States is expected to rebound in the second half of 2024, resulting in faster fourth-quarter growth in 2024 than in 2023.

The projected growth rates for emerging markets and developing economies (EMDEs) over the next two years (2023 and 2024) are modest, rising from 3.9% in 2022 to 4.0% in 2023 and 4.2% in 2024. However, roughly half of EMDEs are expected to grow slower in 2023 than in 2022.

Global inflation is expected to fall from 8.8% in 2022 to 6.6% in 2023 and 4.3% in 2024, still above pre-pandemic (2017-2019) levels of about 3.5%. The balance of risks to the global growth outlook remains tilted to the downside, with scope of lower growth and higher inflation, but adverse risks have moderated since last quarter of 2022.

Growth Projections by the IMF, in January 2023



Data Source: The IMF

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DASHBOARD

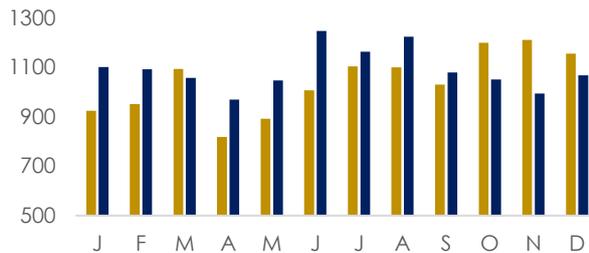
EXTERNAL SECTOR PERFORMANCE-DECEMBER 2022

Legend: ■ 2021 ■ 2022

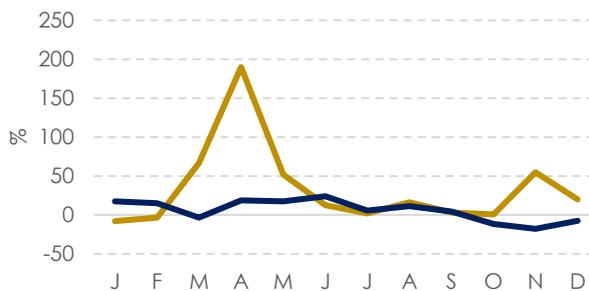
All the numbers are in USD Mn unless otherwise specified.

EXPORTS

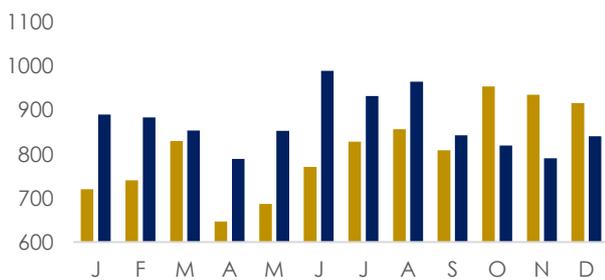
EXPORTS DROPPED BY 7.7% Y-O-Y



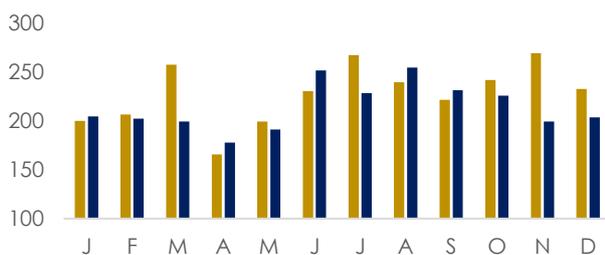
Y-o-Y % CHANGE IN EXPORTS



INDUSTRIAL EXPORTS DECLINED BY 8.3% Y-O-Y

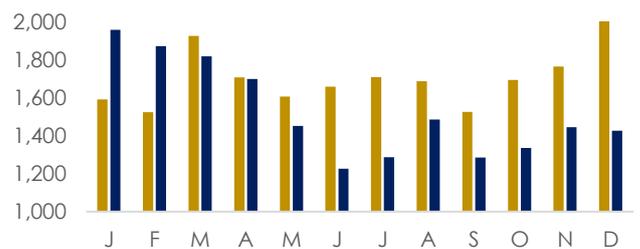


AGRICULTURAL EXPORTS DROPPED UP BY 12.4% Y-O-Y

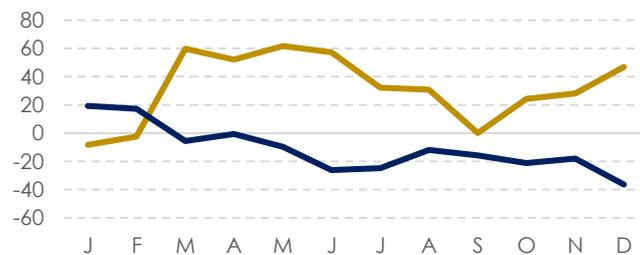


IMPORTS

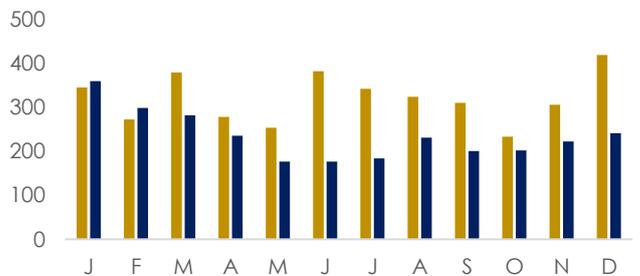
IMPORTS DECLINED BY 36.4% Y-O-Y



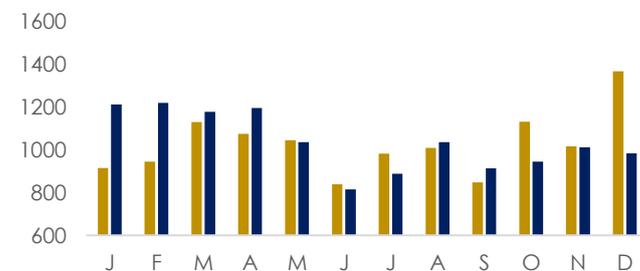
Y-o-Y % CHANGE IN IMPORTS



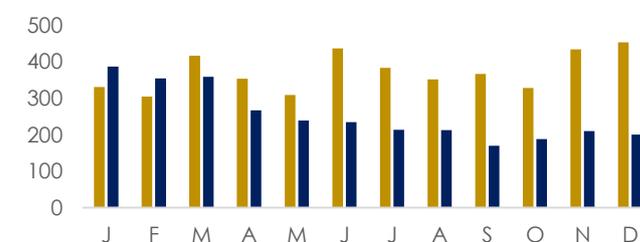
CONSUMER GOODS IMPORTS DROPPED BY 42.4% Y-O-Y



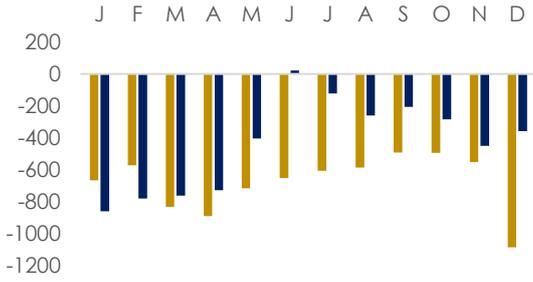
INTERMEDIATE GOODS DECLINED BY 28% Y-o-y



INVESTMENT GOODS DECLINED BY 52% Y-o-y



TRADE DEFICIT NARROWED BY 67% Y-o-Y



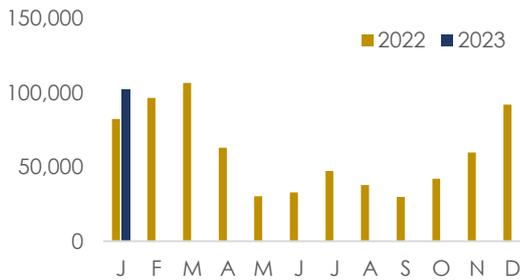
WORKERS' REMITTANCES INCREASED BY 69% Y-o-Y (Jan-2023)



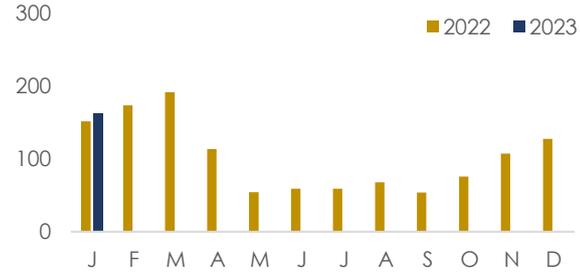
33%

of the total import bill covered by Remittances (Dec 2022)

25% INCREASE IN TOURIST ARRIVALS Y-o-Y (Jan-2023)



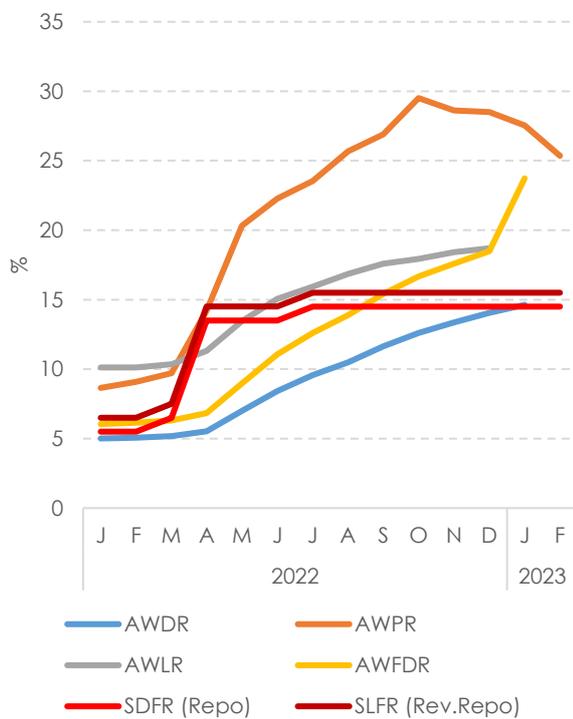
7% INCREASE IN TOURISM EARNINGS Y-o-Y (Jan-2023)



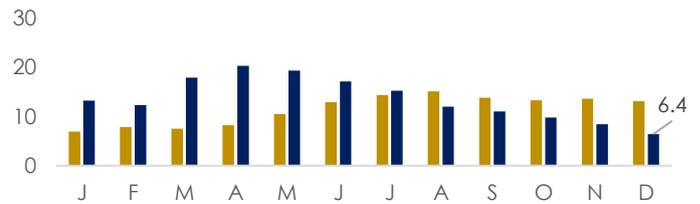
KEY INTEREST RATE INDICATORS

INTEREST RATES

Standing Deposit Facility Rate (SDFR): 14.50%
Standing Lending Facility Rate (SLFR): 15.50%

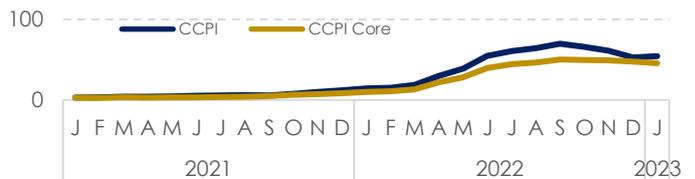


PRIVATE SECTOR CREDIT GROWTH



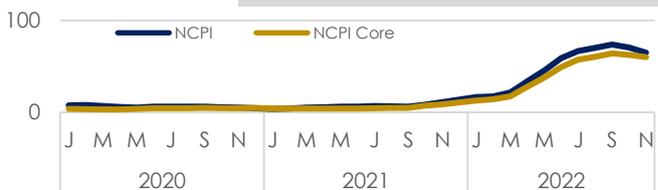
INFLATION: CCPI (BASE 2013) Y-o-Y

	Jan '23	Dec '22
CCPI:	54.2	52.7
CCPI Core:	45.6	47.7



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

	Dec '22	Nov '22
NCPI:	59.2	65.0
NCPI Core:	57.5	60.1



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