

# ACCELERATING GROWTH, MANAGING MACRO RISKS

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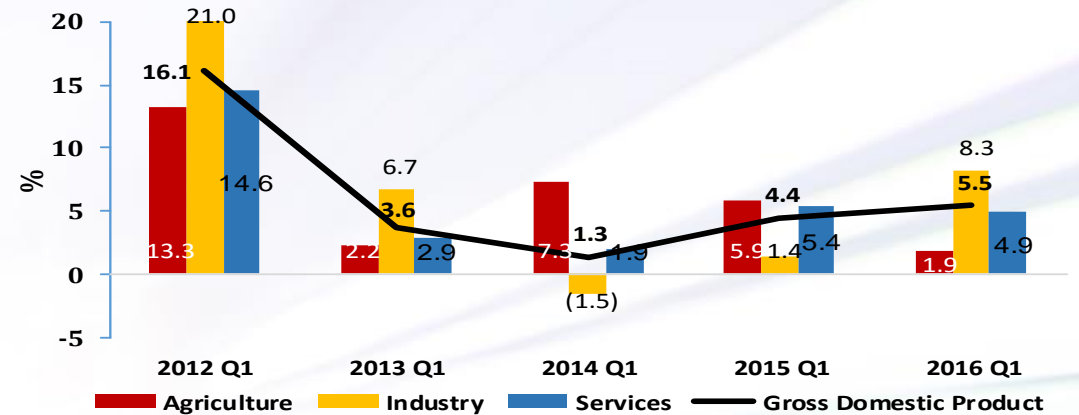
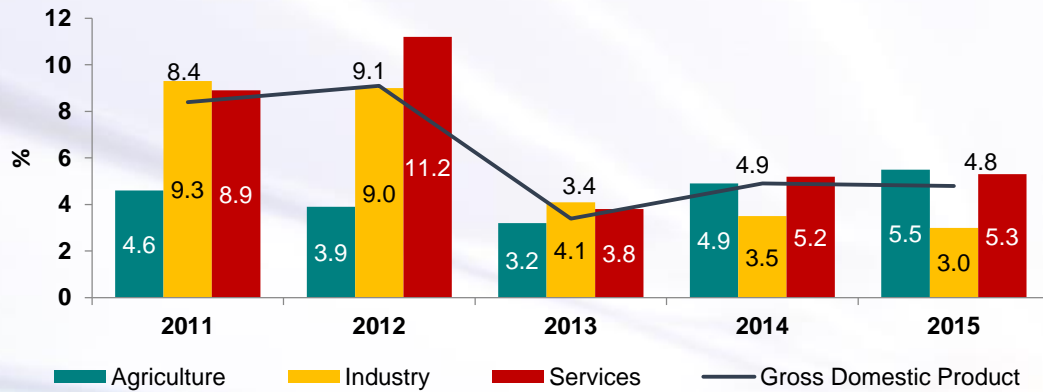


2 AUGUST 2016

**The Sri Lankan economy had recorded steady progress amidst global and domestic challenges over the past few years**

# Positive Growth Momentum Averaging 6.1% since 2011

GDP and Sectoral Performance: Growth Rates



Note: Data are based on the revised GDP estimates (base year 2010) Source: DCS

Sri Lankan economy grew by 4.8% in 2015

Agriculture Growth: 5.5%  
 Industrial Growth: 3.0 %  
 Services Growth: 5.3%

In 2016, Q1 Sri Lankan economy grew by 5.5%

Agriculture Growth: 1.9%  
 Industrial Growth: 8.3 %  
 Services Growth: 4.9%

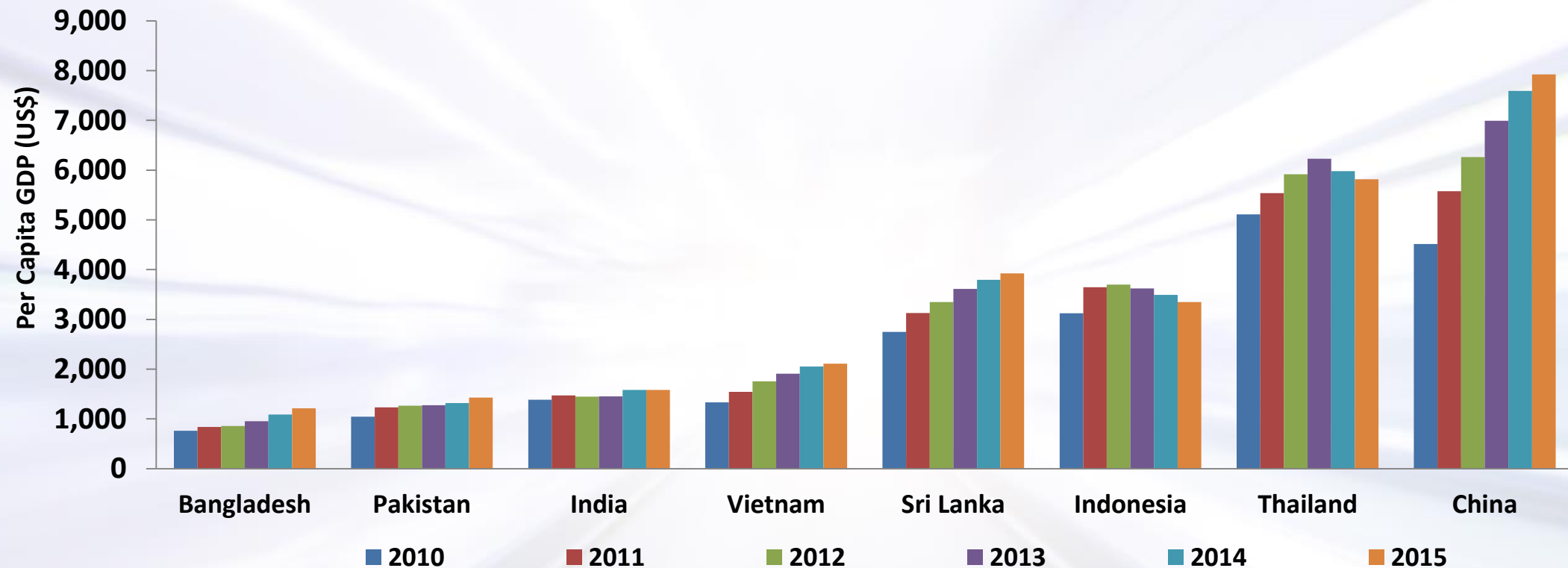
- An overheating economy grew by 8.5% in 2010-2012
- It has averaged to 4.3% in 2013-2015
- Reinforces need for structural reforms.

# Per Capita GDP Rose Steadily



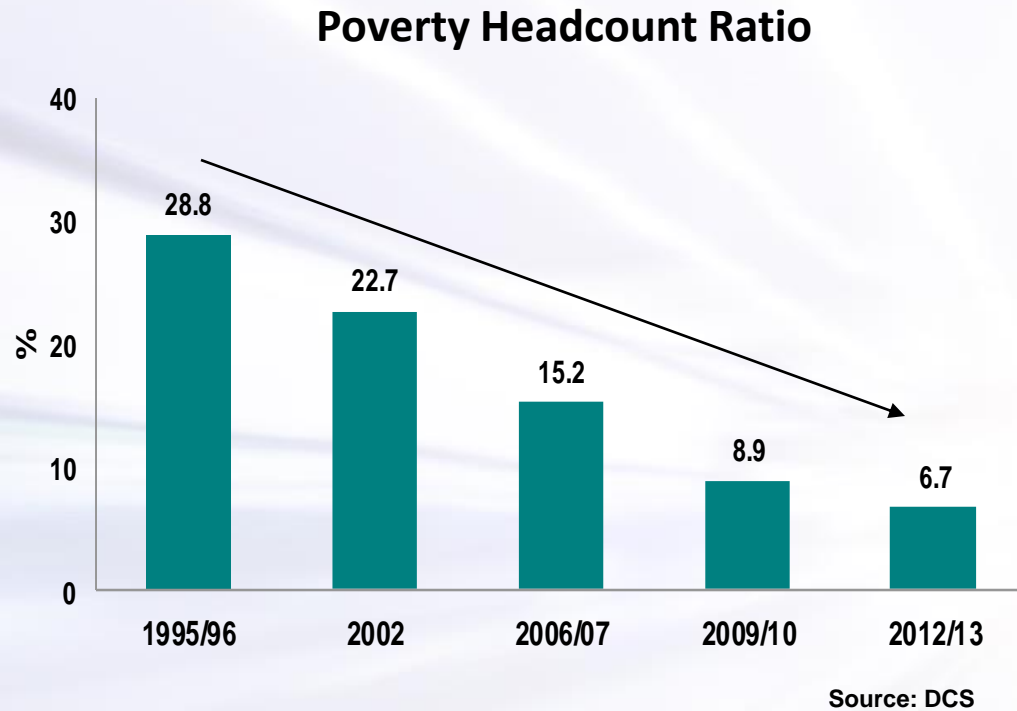
Country is gradually moving to upper middle income status

# GDP per Capita Growth of Selected Economies



Sri Lanka has always been ahead of the South Asian peers but has fallen behind a number of East and South East Asian countries after being 2nd to Japan in Asia at independence

# Improvement in Poverty Headcount Ratio



Sector	Poverty HCR	
	2009/10	2012/2013
Sri Lanka	8.9	6.7
Urban	5.3	2.1
Rural	9.4	7.6
Estate	11.4	10.9

Source: DCS

Significant poverty reduction across all sectors.

According to World Bank, Sri Lanka's poverty headcount ratio at \$1.90 a day (2011 PPP) is 1.7 per cent in 2012 while the country's poverty headcount ratio at \$3.10 a day (2011 PPP) is 14 per cent in 2012.

# From Western Province Dominance to the Periphery

Province	Provincial Share of GDP (%)		
	2013	2014	2015
Western	42.2	41.7	41.2
Central	10.5	10.3	10.3
Southern	10.1	10.5	10.4
Northern	3.4	3.3	3.5
Eastern	5.7	5.8	6.1
North Western	10.9	11.1	10.8
North Central	5.1	5.2	5.5
Uva	5.2	5.3	5.3
Sabaragamuwa	7.0	6.8	7.0

The dominance of the Western Province is diminishing, while the contribution from other provinces to GDP is gradually rising.

Government's area development plans should contribute to regionally balanced progress.

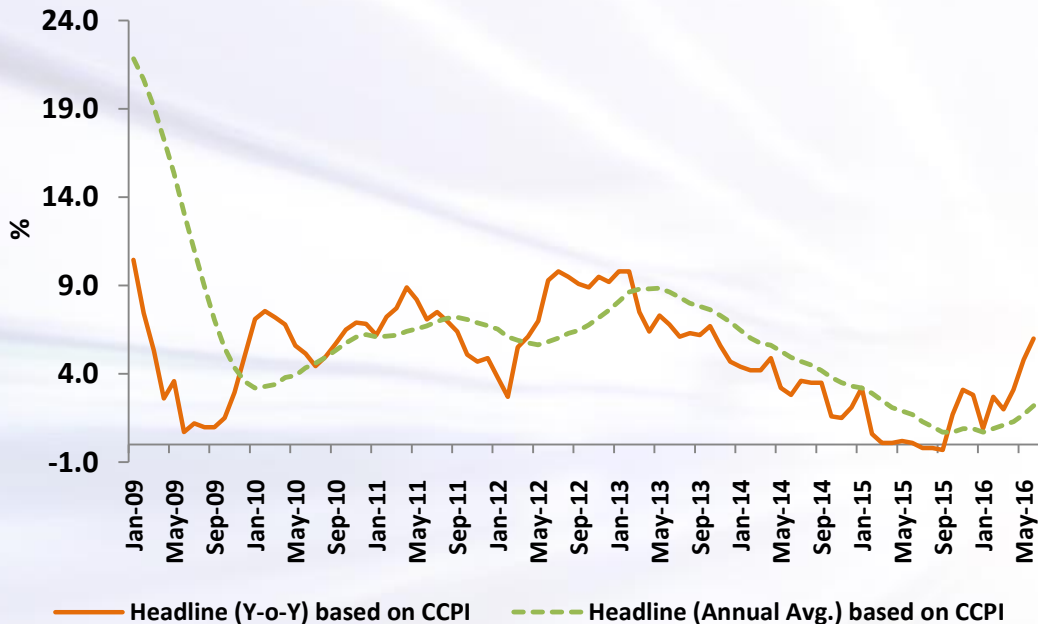
# Macroeconomic Stability is the Cornerstone for Sustainable Growth

1. Low and Stable Inflation
2. Sustained Low Unemployment
3. Continued Efforts towards Fiscal Consolidation
4. Positive Developments in the External Sector
5. Prudent Monetary Policy Measures
6. Stable Financial System

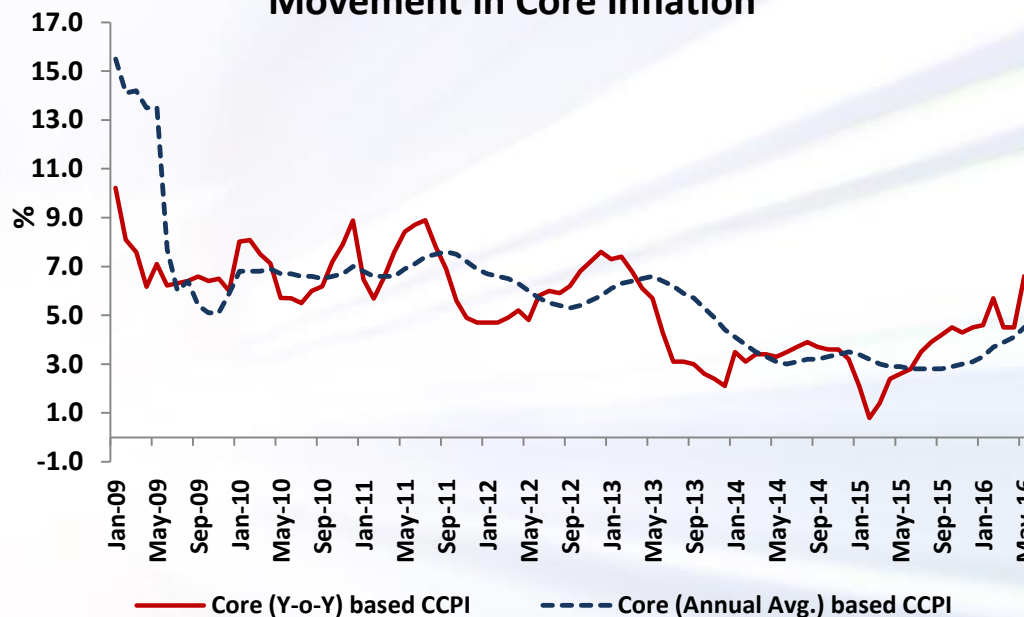


# Low and Stable Inflation Environment Continued Supporting the Economy

**Movement in Headline Inflation**



**Movement in Core Inflation**



Inflation is expected to remain in mid-single digits in the medium term with the prudent and timely monetary policy measures.

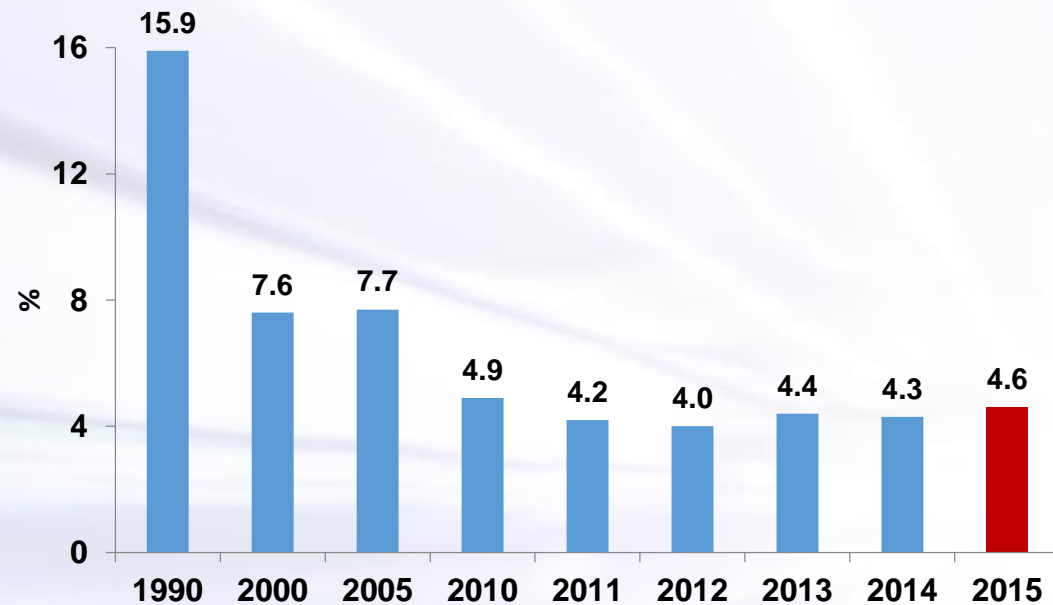
**Risks to be managed :**

Average inflation forecast for Asia is 2.5 % in 2016.

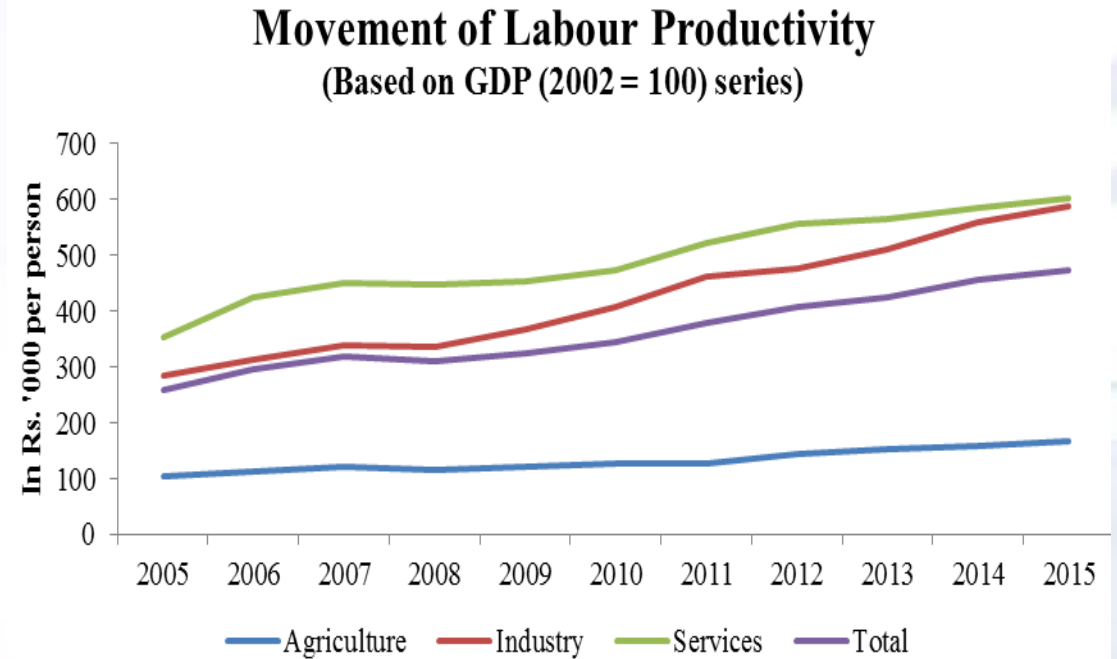
Very low inflation in major export markets; USA (1.0%) and Europe (0.1%) in June 2016.

Hence there are competitiveness pressures.

# Sustained Low Unemployment Rate



Sources: DCS, CBSL



## Risks to be managed :

Nearly 400,000 people were absorbed into the Public Service in 2005-2015. This cannot be sustained due to lack of fiscal space. Alternative employment must be generated in the private sector.

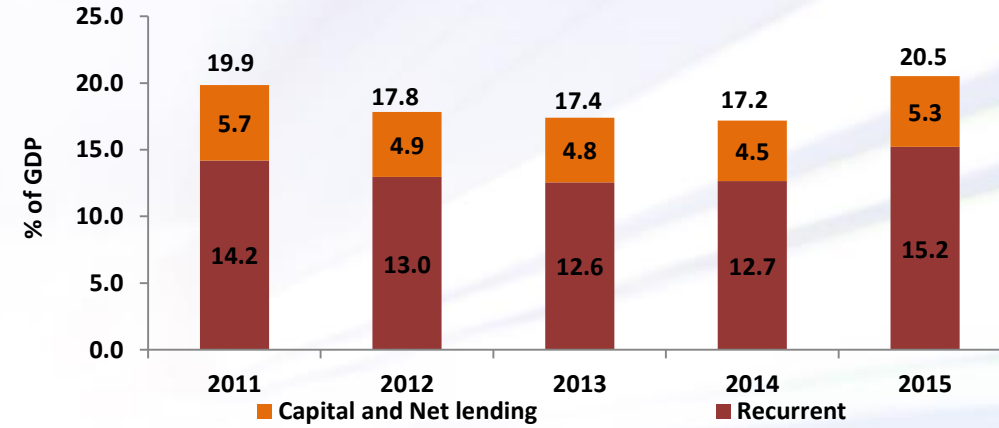
There are around 1.8Mn temporary migrants with a substantial share in the Middle East where there are high geopolitical risks and uncertainties.

# Fiscal Consolidation is Essential to Reduce the Pressure on the Budget Deficit and Government Debt

### Government Revenue



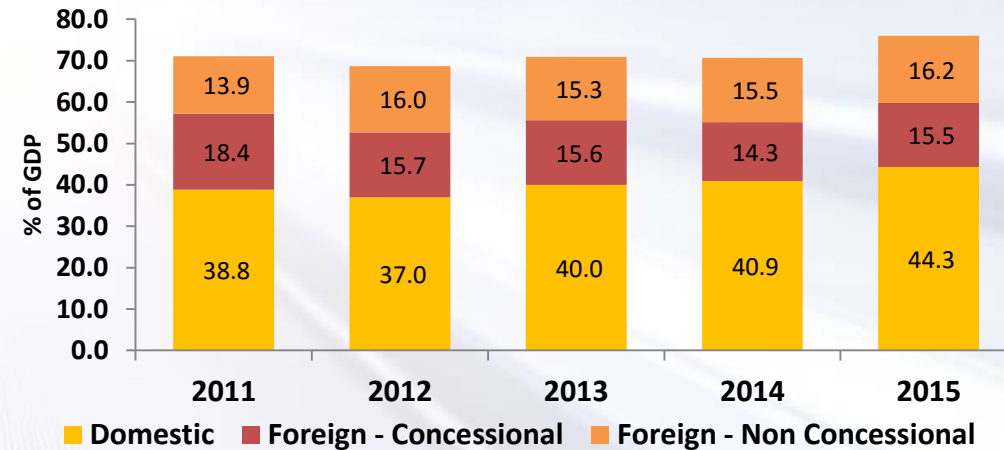
### Government Expenditure



### Budget Deficit

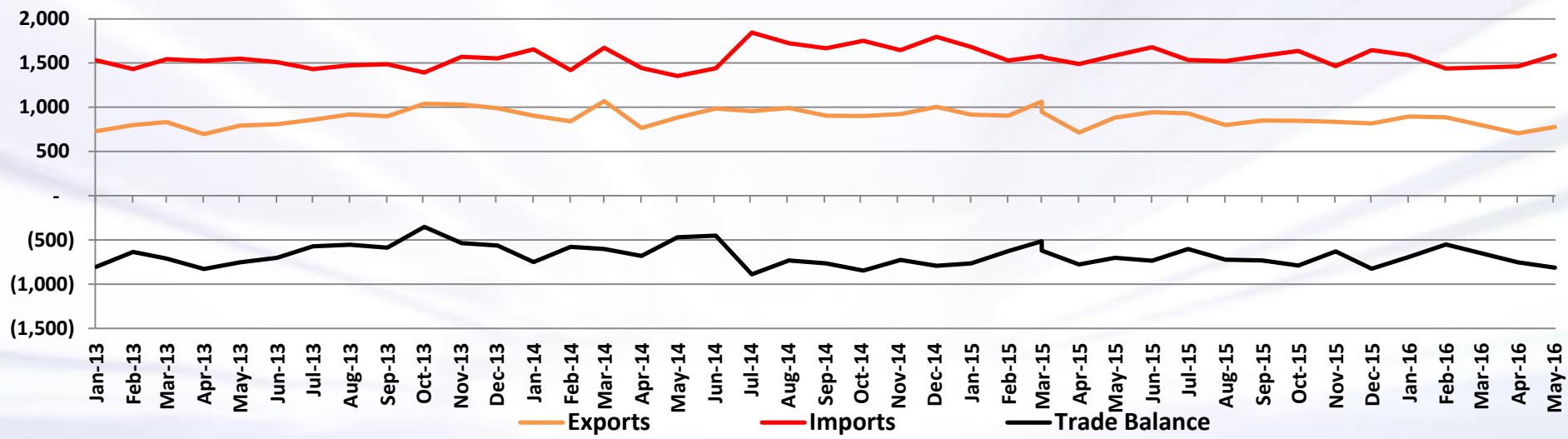


### Government Debt



Risks to be Managed : Greater reliance on external commercial debt since graduation to **Middle Income Emerging Market (MIEM) status**. Increases premium attached to prudent fiscal management with greater exposure to rating agencies and international capital markets.

# External Trade Plays a Paramount Role in Strengthening the External Sector Performance



Exports as % of GDP

Country	2000	2005	2010	2015
Sri Lanka	33.8	26.0	15.2	12.8
Vietnam	43.1	56.3	62.3	83.7
Malaysia	104.7	98.7	77.9	67.5
Thailand	54.6	58.6	56.7	54.2
Singapore	143.8	180.2	148.8	119.7

Focused attention is required to;

- Increase earnings from exports while curtailing import expenditure on consumer durables.
- Minimize risks stemming from product and market concentration – need for diversification.

# Tourism Industry has become the Third Largest Foreign Exchange Earner in Sri Lanka

Tourist Arrivals and Earnings

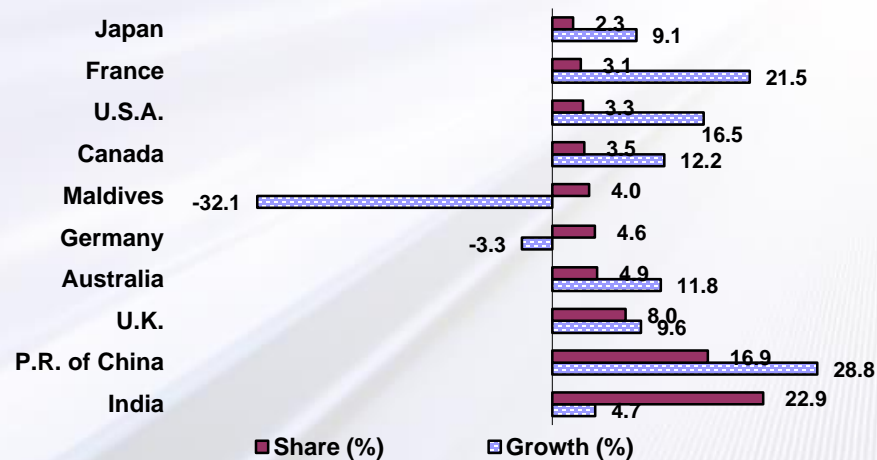


Source: CBSL/SLTDA

Earnings from tourism is 3.6% of GDP in 2015

According to the Sri Lanka Tourism Promotions Bureau, the target arrivals for 2020 is 4.5 million arrivals and a US dollars 10 billion receipts from tourism

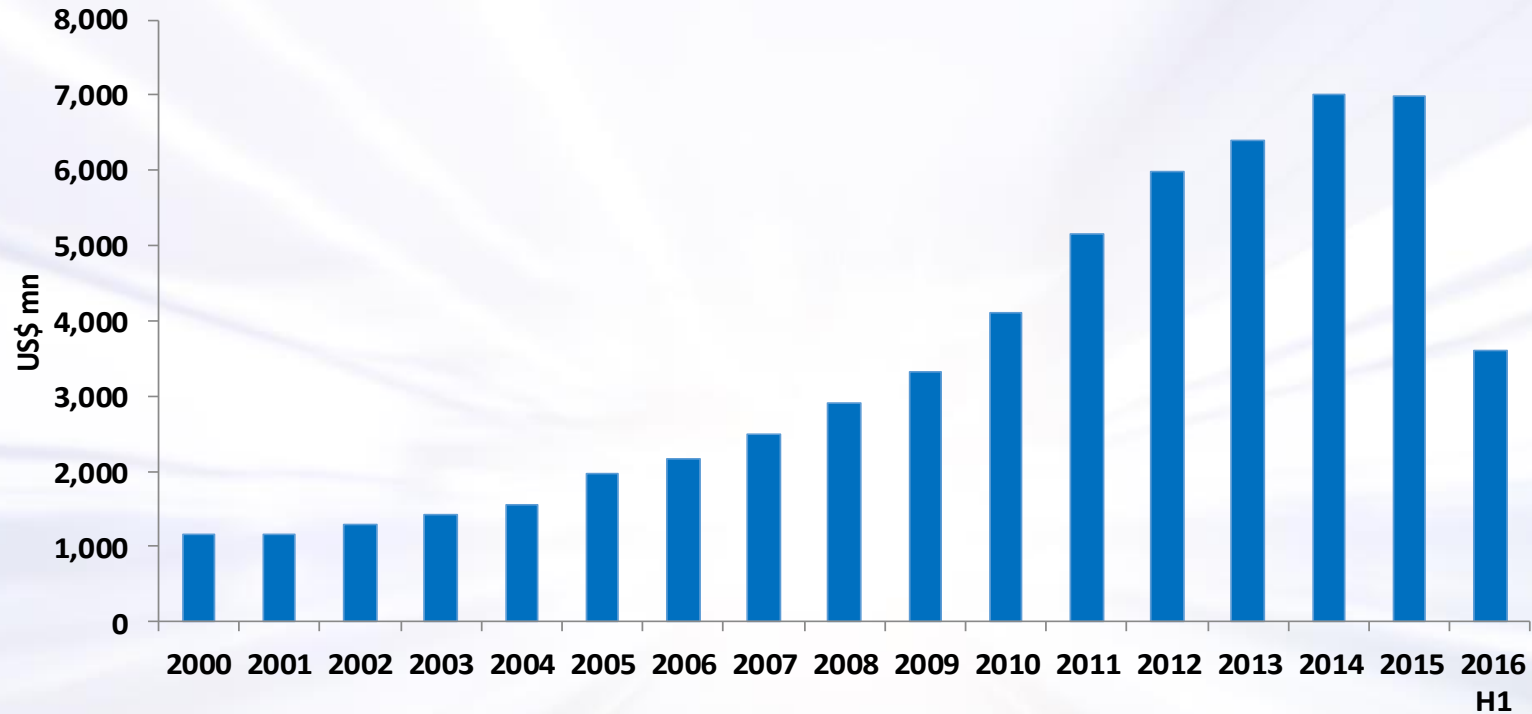
Growth and Share of Top Ten Source Markets - June 2016



Source: SLTDA

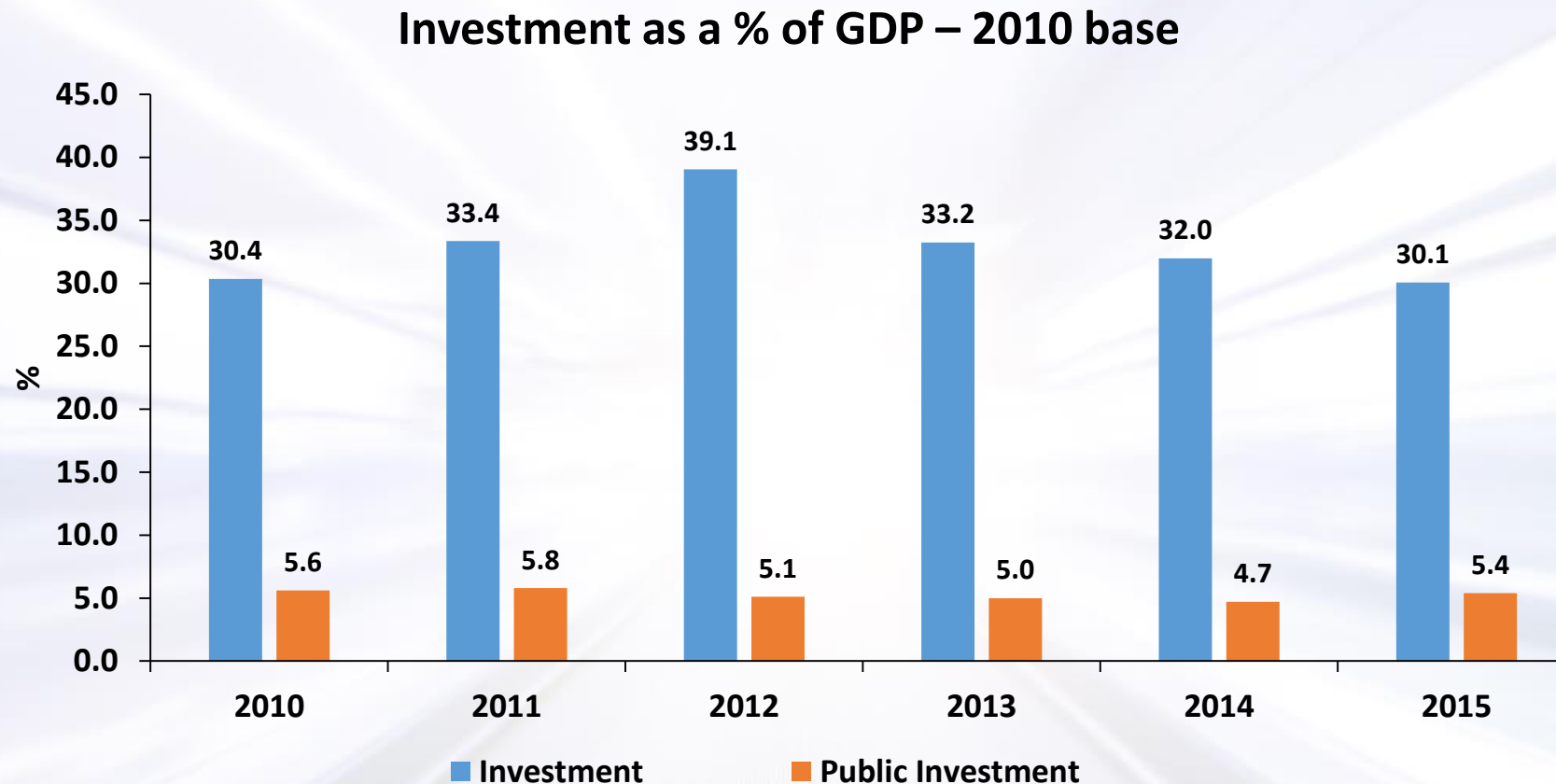
In order to meet this target a well-focused strategy is necessary to address challenges such as inadequacy of hotel rooms, requirement of skilled labour, attracting more tourists particularly from high end, well designed promotion strategy, etc.

## Workers' Remittances as a % of GDP is 8.5



- The decline in worker's remittances in 2015 was mainly due to prevailing geo-political uncertainty in the Middle Eastern region. However, there has been some recovery in the first half of 2016.
- Several policy measures to discourage departures of house-maids and unskilled workers contributed to change the composition of labor migration from unskilled labor to skilled labor migration.

# Investment from 2010 to 2015



Conditions must be created to achieve an investment ratio of 35% of GDP through improved domestic resource utilization and non-debt creating foreign inflows (especially FDI)

# Foremost Attention is Needed to Boost FDI

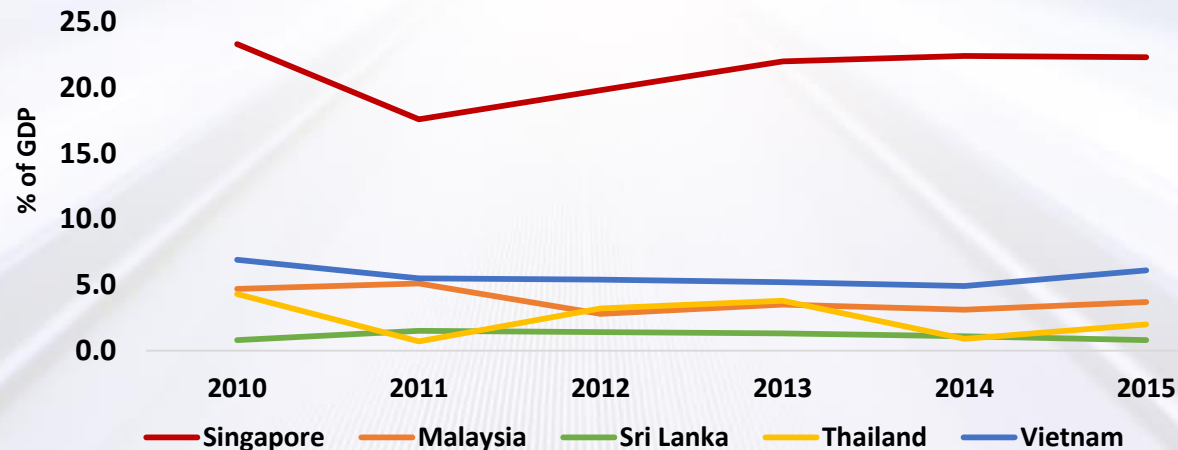
## Foreign Investments



Company	2015	2016 Q1
Housing Property Development & Shop Office	212	13
Hotels & Restaurant	182	38
Telecommunications	139	53
Rubber Products	60	24
Port Container Terminals	51	1
Fuel, Gas, Petroleum and other	47	-
Fabricated Metal, Machinery & Transport Eq.	46	3
Textile, Wearing Apparel & Leather Prod.	45	4
Food, Beverages & Tobacco	43	5
Others	336	24
<b>Total</b>	<b>1,161</b>	<b>165</b>

Sources: BOI  
CBSL

## Foreign Direct Investment, Net Inflows

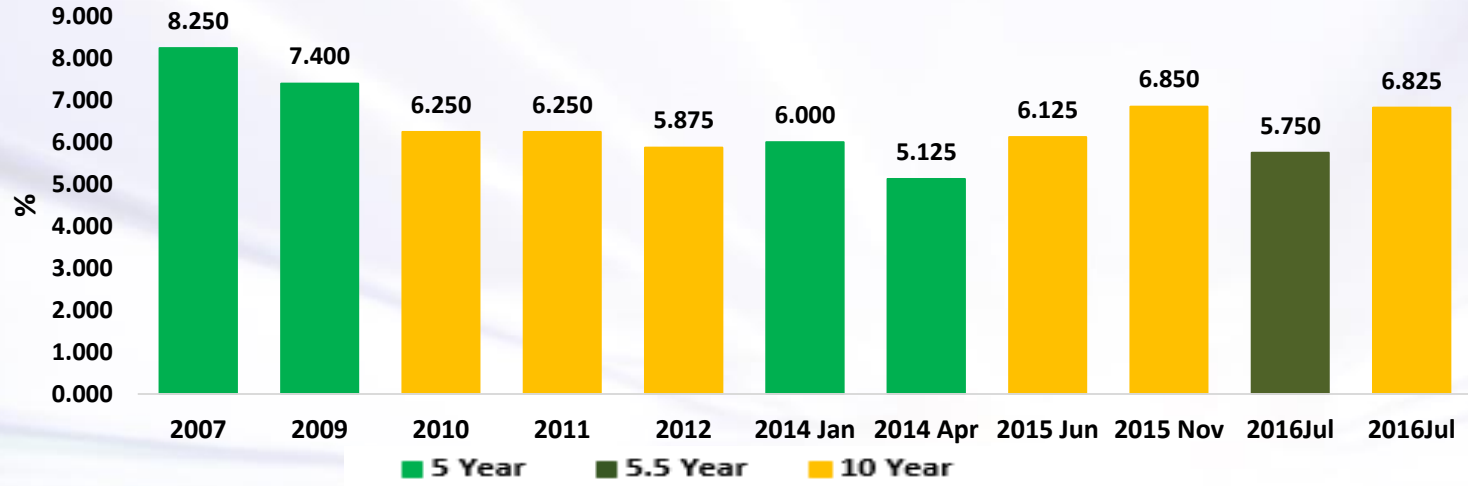


Source: World Bank



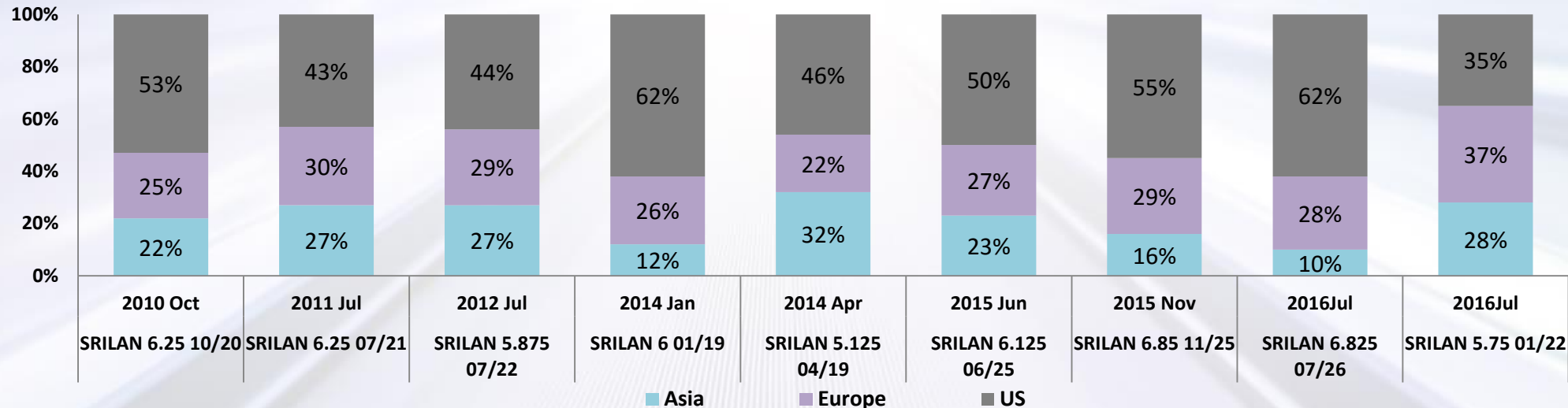
# The 10<sup>th</sup> Sovereign Bond Issue

Sovereign Bond Issues – Tenors and Coupon Rate (%)



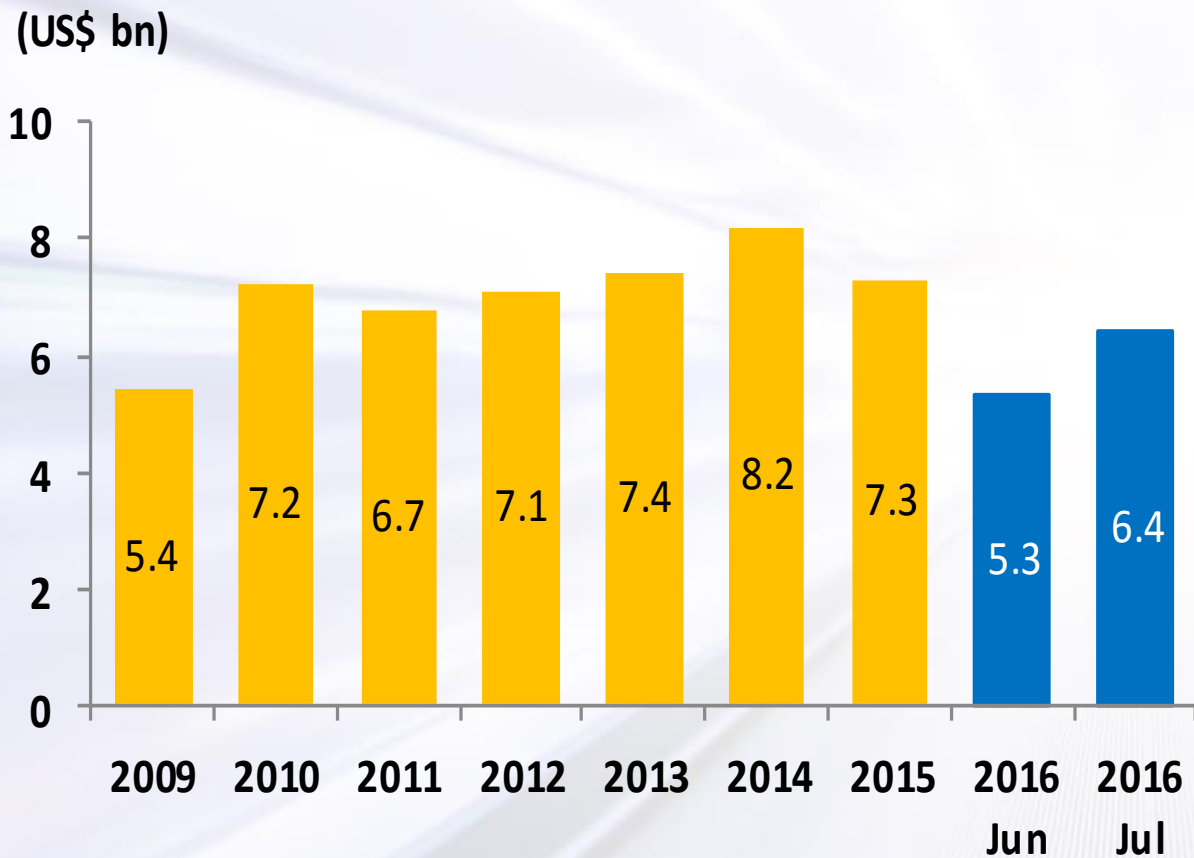
Recent sovereign bond issuances have attracted highly diverse investor interest from across the globe.

Sovereign Bond Issues - Investor Mix



# The Gross Official Reserves Declined to USD 5.3 bn, but Improved Thereafter

## Foreign Exchange Reserves

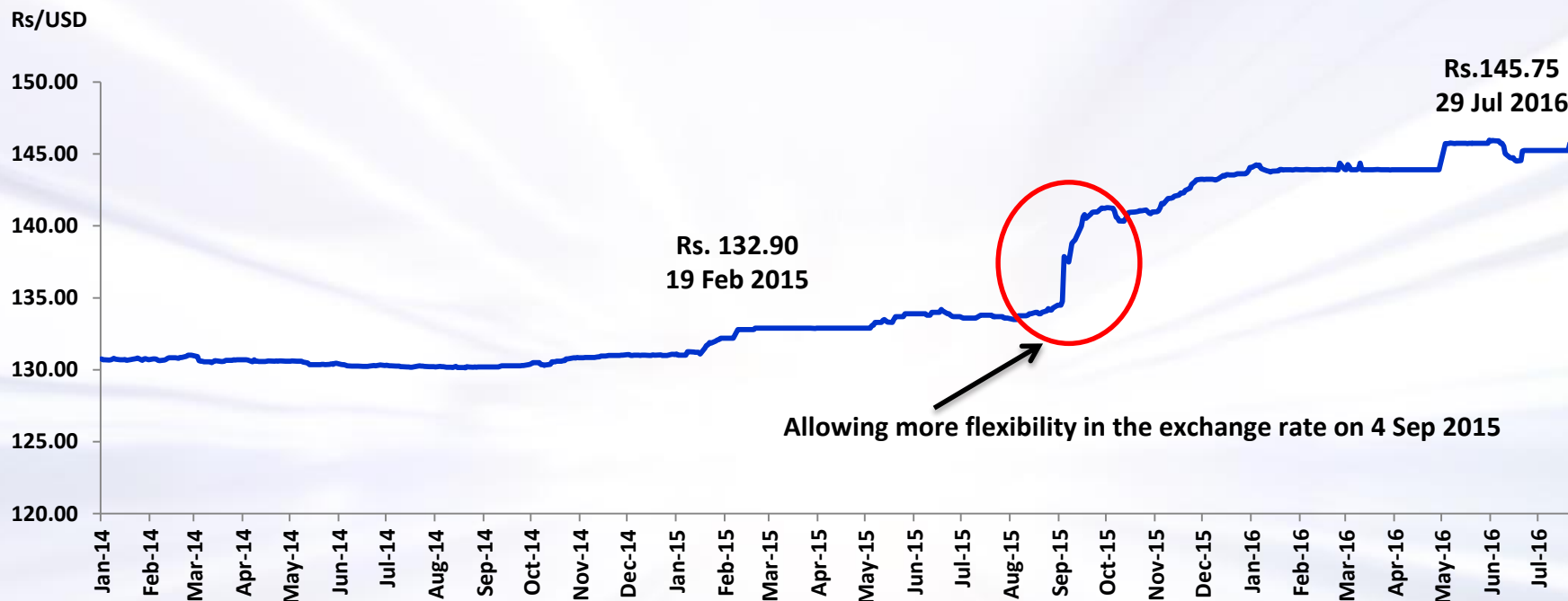


The Gross Official Reserve (GOR) position is estimated to have improved significantly with the 10<sup>th</sup> International Sovereign Bond (ISB) of US dollars 1.5 billion and the syndicated loan of US dollars 300 million issued in early July. GOR amounted to US \$ 6.4 bn as at end July 2016.

### Risks to be managed :

- Net reserves need to improve.
- Shift from borrowed to earned reserves.

# The Rupee has Depreciated Against the US Dollar by 1.2 % During 2016



Source: CBSL

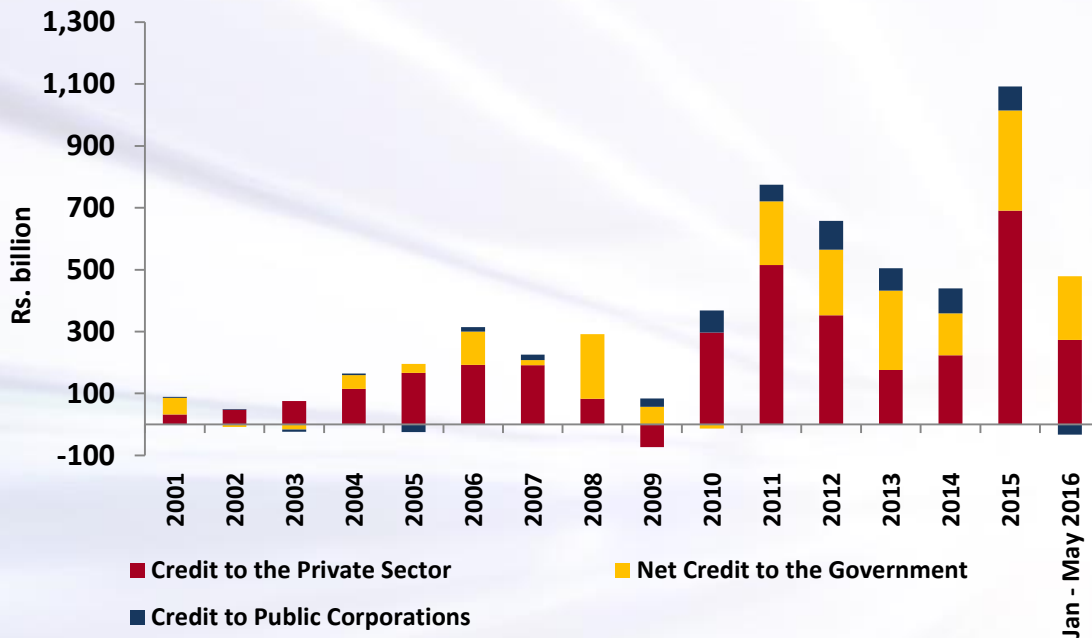
Substantial pressure on the domestic foreign exchange market has been witnessed due to:

- lower than expected inflows to the current and financial accounts
- foreign exchange outflows on account of increased imports and debt service payments

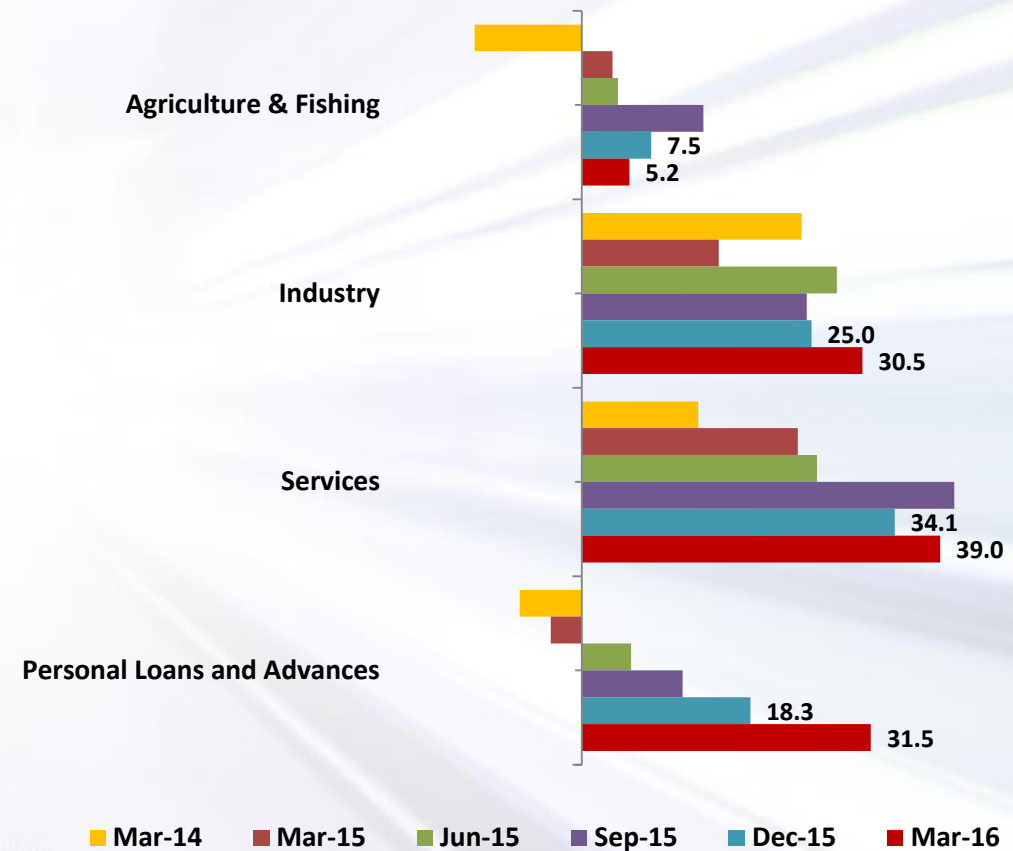
Recent dual-tranche bond issue, foreign inflows into Government Securities and syndicated loan have reduced the pressure.

# Domestic Credit is Skewed Towards the Private Sector

Annual Increase in Domestic Credit



Year-on-Year Growth of Private Sector Credit to Key Sectors (%)

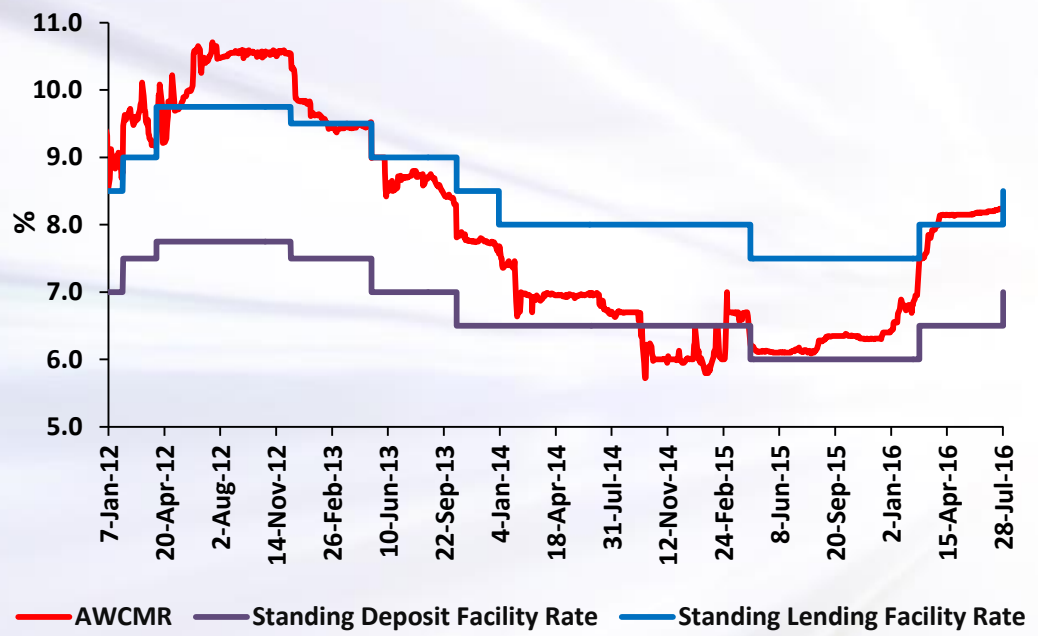


**Risks to be managed :**

- Private sector credit growth persistently high, around 28% during May, June 2016.
- Net Credit to the government from the banking sector is also higher than envisaged
- Key public corporations have repaid to the banking sector, but the risk of future borrowing cannot be ruled out

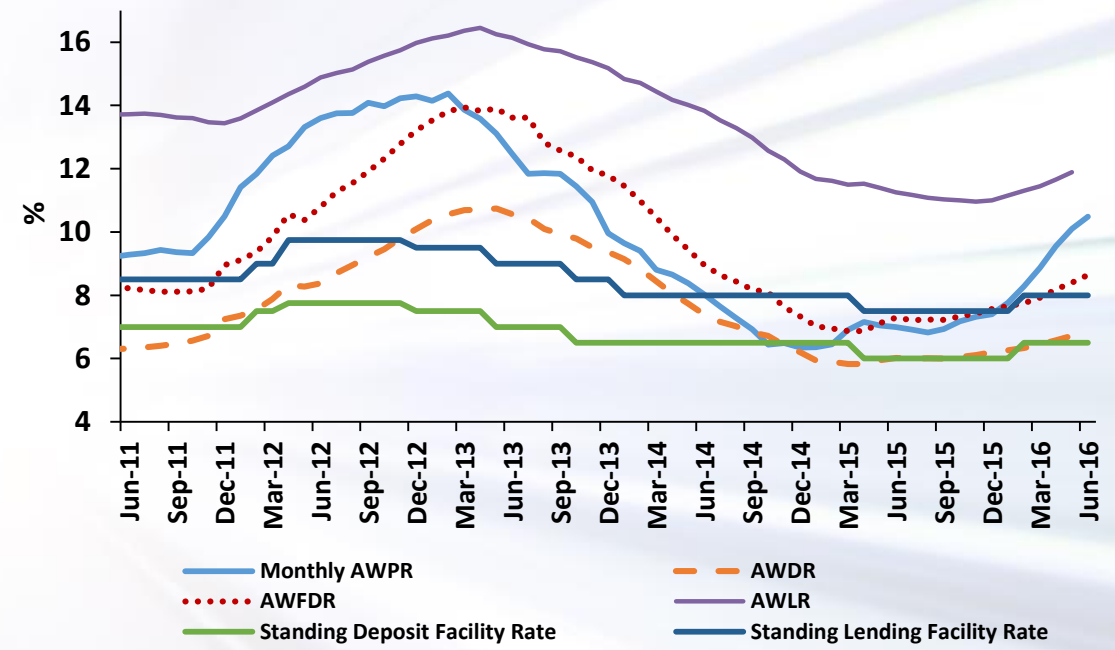
# Interest Rates Help the Economy Strike a Balance Between Sustainable Growth and Inflation

Policy Interest Rates and Call Money Rates



Source: CBSL

Policy Rates and Deposit and Lending Rates

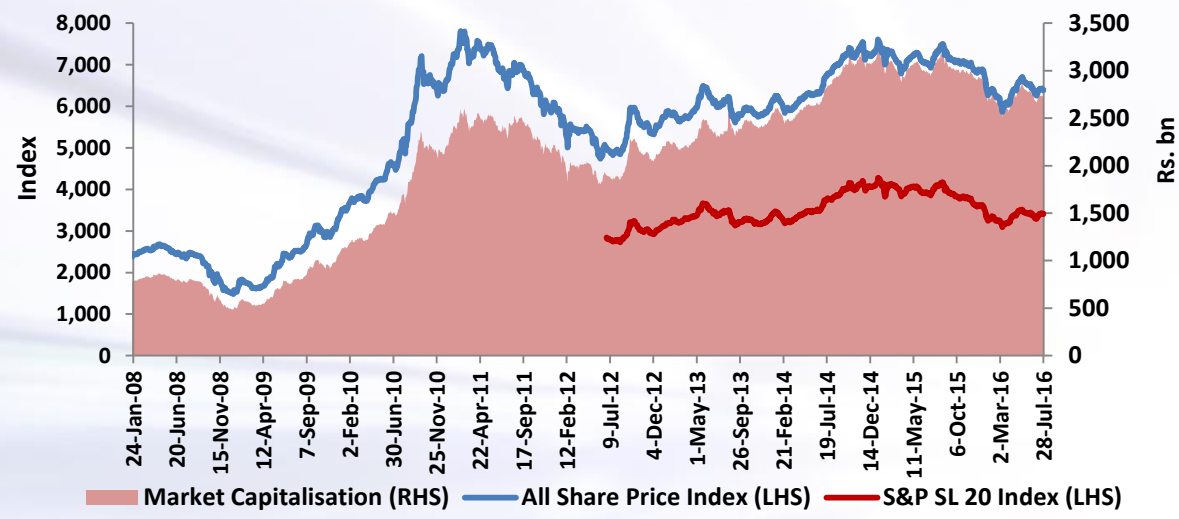


Source: CBSL

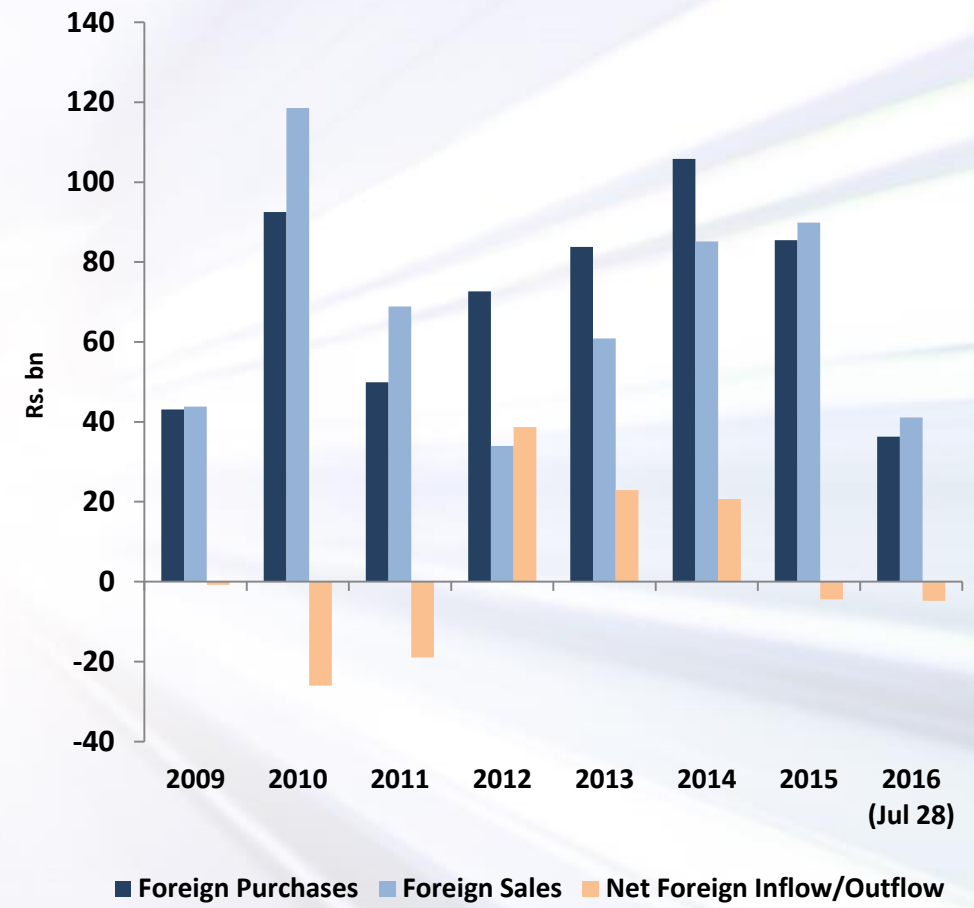
- Risks to be managed :**
- Monetary policy decisions in a forward looking manner.
  - Sound fiscal/monetary coordination.

# Domestic Capital Market Needs to be Further Strengthened

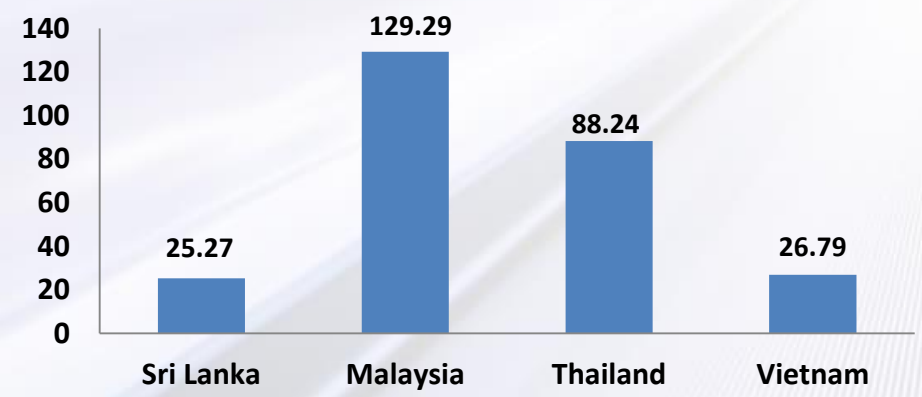
Growth of the Stock Market (CSE)



Foreign performance at the CSE



Market cap as a % of GDP



# Accelerate Economic Growth, while Managing Associated Risks

## Development Vision :

**Competitive social market economy with an inclusive and sustainable growth model which delivers shared prosperity.**

## Growth Drivers :

**Private sector with exports and FDI as key pillars**

- Fiscal consolidation needs much attention
- Trade policy and trade facilitation needs to be strengthened
- Investment climate needs to be improved to attract FDI and portfolio investment
- Challenges in the labour market also needs to be addressed
- Stability of the financial system needs to be ensured
- Inclusivity and environmental sustainability should not be forgotten

## Fiscal Consolidation, which is Already Underway, Needs to be Continued

- Enhancing revenue mobilization
- Rationalizing government expenditure
- Implementing prudent debt management policies
- Restructuring state owned enterprises

### Managing Risks:

Low government debt levels and sustainable fiscal balances provide fiscal space to address large, adverse shocks to the economy



# Trade Policy and Trade Facilitation Need to be Strengthened to Increase Exports and Reduce Transaction Costs for Imports

- Diversifying the export base and export markets
- Promoting global integration by strengthening bilateral and regional trade and investment relations
  - Following trade deals are under negotiation
    - The current FTA in goods with India is being deepened and broadened
    - Comprehensive FTAs are being negotiated with China and Singapore
    - Proposed plan for increasing trade and investment with the US, Sri Lanka's largest export market, will be launched later this year
    - Application has been made for EU GSP plus restoration.
- Leveraging preferential access to a market about 3Bn people (trade-investment nexus)
- Enhancing trade facilitation - easy documentation, single window system, export finance, guarantees, and insurance
- Further rationalization of trade and tariff policies

## Managing Risks:

- Trade openness tends to boost growth, but exposes countries to external shocks

Therefore,

- Policy makers need to consider policy options available to absorb external shocks (terms of trade and/or capital flow)
- Above all need to reduce vulnerability by reducing twin deficits ( budget and the current account of BOP)

# Investment Climate Needs to be Enhanced to Attract the FDI and Portfolio Investment

- Need of attracting targeted investments
- Review of the investment laws
- One stop shop at the Board of Investment (BOI)
- Improving Doing Business Index

## Managing Risks:

- Even though financial openness confers benefits, foreign financial shocks can be sizeable

Therefore,

- Need to build up earned external reserves as a buffer against exogenous shocks in an uncertain world

## Challenges in the Labour Market also Need to be Addressed

- with emphasis on enhancing productivity and changing population dynamics
  - Key challenge is to change incentive structure to move human resources from lower to higher productivity sectors.
- bridging the gap between tertiary education and industry expectations.
  - Industry in higher productivity areas complain of labour scarcity.

New economic activities and the expansion of existing economic activities, **particularly in the private sector**, are required to absorb additional new labour into the labour force.

# Financial Deepening is Necessary, but Stability of the Financial System Needs to be Ensured

- Promoting financial inclusion
- Looking for cutting-edge technological solutions from the globe in order to have efficient and cost-effective transactions
- Strengthening Macro prudential policies
- Enhancing the supervision of the financial institutions

# Achieving Regional Balance in the Development Process

## Regionally balanced growth

- Western Region Megapolis Plan
- Hambantota (China)- Including debt-equity Swaps
- Master Plan for Trincomalee (Singapore)
- Master Plan for Kandy (Japan)
- Wayamba development
- Industrial, agricultural and fisheries zones

## In summary,

- Short term solutions (including accommodative monetary policy and debt driven public and private spending) for long term issues (including higher budget deficits and structural issues) have proven to be costly and unsustainable in terms of the macroeconomic balance.
- A number of macro concerns need to be addressed urgently.
  - These include strengthening fiscal consolidation, attracting FDIs and boosting exports.
- In the meantime, the remaining structural issues also must be addressed with a medium term focus in order to facilitate sustainable and inclusive growth.

**Thank You**