Monthly Economic Update (MEU)

February 2024

Economic Intelligence Unit
The Ceylon Chamber of Commerce

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Highlights

Sri Lankan Economy

Monetary Policy Report Published under the New CBSL Act

The Central Bank of Sri Lanka (CBSL) released its first Monetary Policy Report this month under the new Central Bank of Sri Lanka Act, enacted on September 15, 2023. This report will be published biannually, covering recent inflation trends, sources, medium-term projections, and key risks, as per the new Act.

In 2023, the Trade Deficit Reached its Lowest Point for the First Time since 2010.

In 2023, the merchandise trade deficit reached its lowest level since 2010, driven by a more substantial contraction in import expenditure compared to export earnings, which recorded USD 4.9 billion. This marked a slight improvement from the previous year's deficit of USD 5.2 billion. This shift was primarily driven by contraction in both imports and exports of goods.

Sri Lanka Signed a Free Trade Agreement with Thailand to Bolster Economic Ties

Sri Lanka and Thailand signed the Free Trade Agreement (SLTFTA) on February 3, 2024, after negotiations started in 2018. With 14 chapters, the agreement is set to boost Sri Lanka's trade initiatives, deepen ties with ASEAN, and provide opportunities for diversification and FDI. Operational upon diplomatic notes exchange, it enhances competitiveness in the regional market.

LKR Appreciated further

The Sri Lankan Rupee (LKR) has experienced a 4% appreciation against the US Dollar (USD) thus far 2024. This upturn can be primarily attributed to reduced import expenditure and significant strides in the inflow of workers' remittances and earnings from tourism.

Sri Lankan Exporters Optimistic on Outlook 2024, despite challenging Global Outlook

The recently released fifth Export Barometer Survey by The Ceylon Chamber of Commerce showcases the resilience of Sri Lankan exporters despite a challenging global outlook. In a survey covering 2023 and forecasting 2024, exporters expressed confidence in their growth prospects.
To access the full report visit https://www.chamber.lk/trade-watch/backend/public/uploads/attachments/article/ExportBarometerSurveyJan2024_FindingsandInsightsReport_1708504488.pdf

Global Economy

IMF Predicts a 3.1% Growth in Global Economy in 2024

Latest IMF report projects global growth at 3.1% in 2024 and 3.2% in 2025, exceeding October 2023 forecasts by 0.2%. Resilient performance in US and key EMDEs, and fiscal support in China contribute. However, these figures lag behind the 3.8% historical average (2000–19) due to elevated central bank rates, inflation combat, reduced fiscal support amid high debt, and sluggish productivity growth.

Global trade is unlikely to meet the forecasted 3.3% growth due to increasing geopolitical tension.

The World Trade Organisation (WTO) predicts that global trade is likely to fall short of the initially forecasted 3.3% growth for 2024 due to various challenges, including slower economic growth and emerging risks such as the Red Sea attacks. The disruptions in global trade, exacerbated by attacks on ships and a longer shipping route along the southern tip of Africa, are contributing to delays and inflationary pressures.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

1.6% in Q3-2023

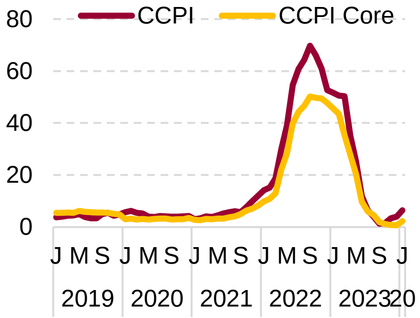
Movement of Purchasing Managers' Index-Jan 2024

Manufacturing PMI	55.6
Services PMI	60.1

Indexes shows an expansion in both Manufacturing and Services activities.

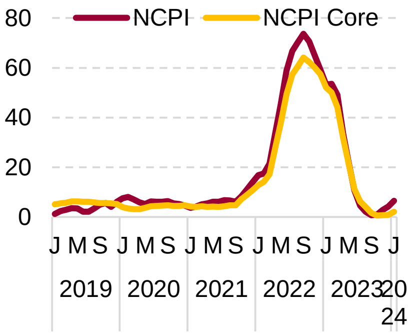
Inflation

CCPI Inflation (%)-*Base 2021*



Jan. 2024 — Headline **6.4%**, Core **2.2%**

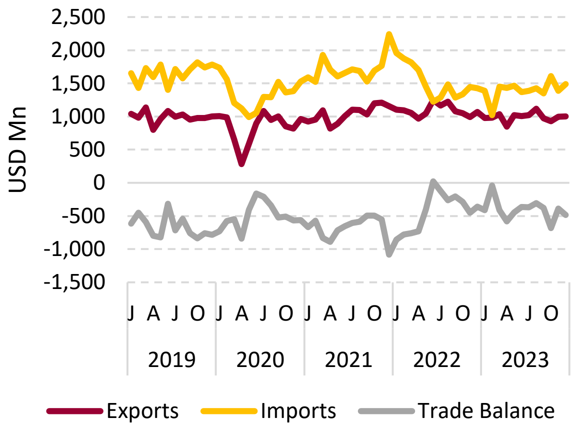
NCPI Inflation (%)-*Base 2021*



Jan. 2024 — Headline **6.5%**, Core **2.2%**

External Sector

Merchandise Trade



Dec. 2023

Exports **6.2%**

Imports **4.4%**

Tourism

Jan. 2024

Arrivals **103%**

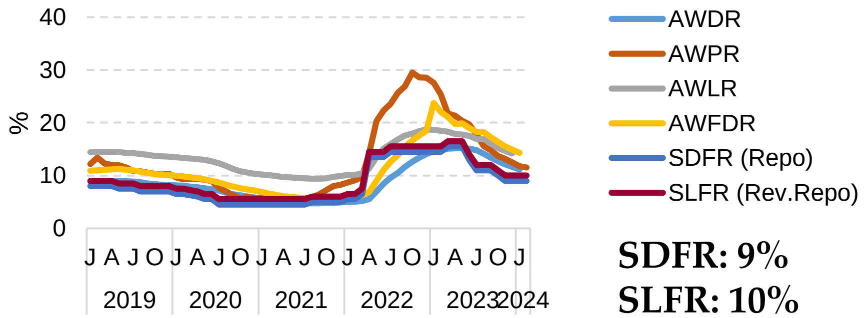
Earnings **111%**

Workers' Remittances

Jan. 2024

11%

Interest Rates



SDFR: 9%

SLFR: 10%

Growth in Credit to Private Sector

Dec 2023

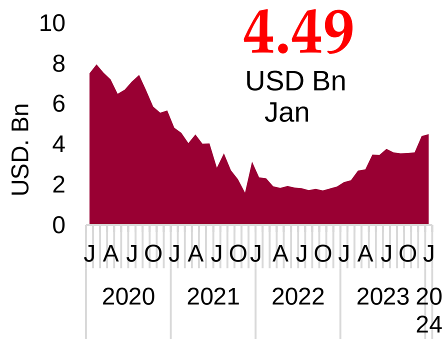
0.6%

Exchange Rate

Appreciation of LKR thus far 2024

4%

Official Reserves



KEY INSIGHTS
Sri Lankan Economy

Monetary Policy Report Published under the New CBSL Act

Central Bank of Sri Lanka (CBSL) released its first Monetary Policy Report this month under new Central Bank of Sri Lanka Act, No. 16 of 2023 which was enacted on 15th September 2023 (the previous monetary policy report that was released on July was under the previous Act). In keeping with new Act, the CBSL is expected to publish a report biannually, explaining recent movements in inflation, sources of inflation, and medium-term projections for inflation and key risks to such projections, as well as the implementation of monetary policy.

According to the latest forecasts, year-on-year headline inflation is anticipated to experience a short-lived acceleration from early 2024, driving quarterly average inflation levels during the year somewhat above the 5% target. The increase in headline inflation is primarily attributed to the price rises expected due to the increase in the VAT from 15% to 18% and the removal of certain exemptions. Headline inflation is expected to peak in Q3-2024, mainly on account of the unfavourable base effect stemming from sharp disinflation recorded in Q3-2023. However, the near-term surge in headline inflation is unlikely to persist due to subdued demand conditions, as the economy is projected to operate below its full capacity for an extended period.

Based on various indicators, survey findings, recent developments, and expert evaluations, the economy is expected to have grown at a higher pace in Q4-2023, following a mild expansion recorded for Q3-2023. However, the overall real gross domestic product (GDP) growth for 2023 is anticipated to be moderately negative, representing a milder contraction compared to the preceding year, while economic growth is expected to remain positive during 2024.

Figure 01: Projected Headline Inflation: (Quarterly, CCPI, Y-o-Y, %)

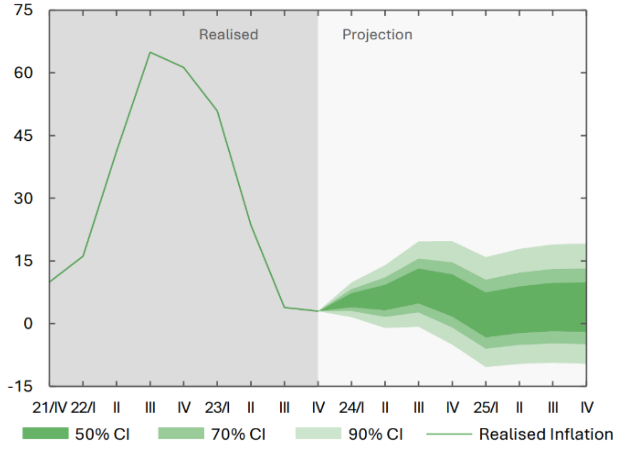
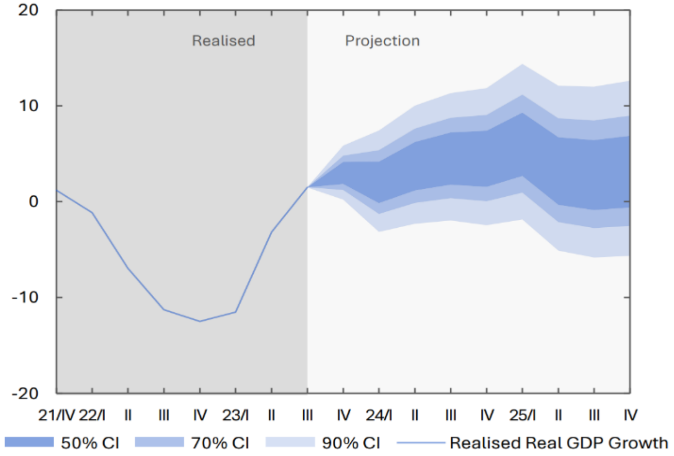


Figure 04: Projected Quarterly Real GDP Growth (Y-o-Y, %)



Data Source: CBSL

KEY INSIGHTS
Sri Lankan Economy

In 2023, the Trade Deficit Reached its Lowest Point for the First Time since 2010.

In 2023, the merchandise trade deficit reached its lowest level since 2010, driven by a more substantial contraction in import expenditure compared to export earnings, which recorded USD 4.9 billion. This marked a slight improvement from the previous year's deficit of USD 5.2 billion.

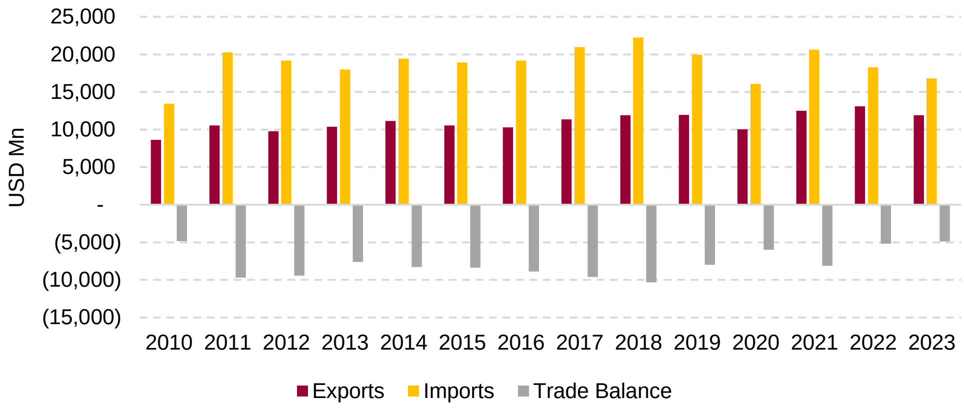
This shift was primarily driven by contraction in both imports and exports of goods. Exports experienced a decline of 9.1%, dropping from USD 13 billion to USD 12 billion, while imports fell by 8.1%, decreasing from USD 18 billion to USD 17 billion.

The decrease in imports was predominantly attributed to declines in intermediate and investment goods. Specifically, imports of textiles and textile articles decreased by USD 694 million, and imports of cereals and other intermediate goods such as plastics, rubber, paper, and fertilizer dropped by USD 716 million. Furthermore, imports of refined petroleum experienced a significant decline of USD 953 million. However, imports of crude oil and coal increased by USD 759 million, resulting in a net reduction of only USD 194 million in total fuel imports.

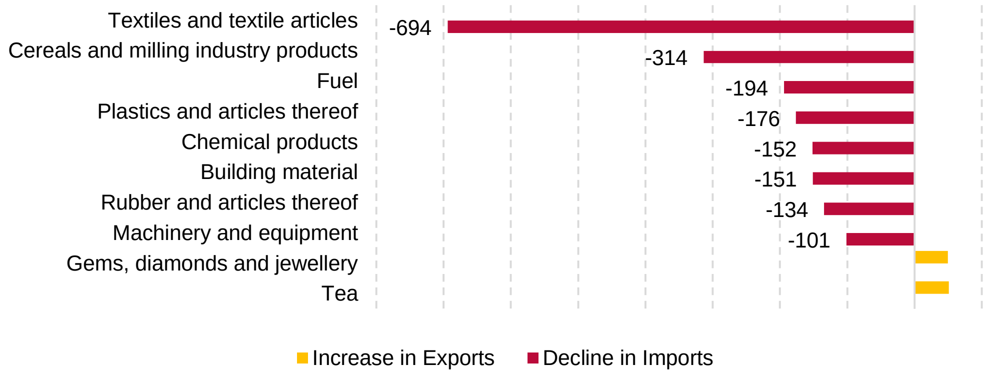
On the export front, the decline was mainly driven by a decrease in industrial exports amounting to USD 1.2 billion. Within this category, a notable decline was observed in the exports of textiles and garments. Despite these challenges, the export of tea emerged as a bright spot, experiencing a USD 50 million increase compared to 2022.

Overall, while the trade deficit narrowed slightly, challenges persist in balancing import and export dynamics, particularly in key sectors such as textiles and industrial exports. Efforts to address these challenges and capitalize on areas of growth, such as tea exports, remain crucial for sustaining a more balanced trade landscape.

External Trade Performance (2010-2023)



Major Contributory Factors for the Y-o-Y change in the Trade Deficit during 2023 (USD Mn)



Data Source: CBSL

KEY INSIGHTS
Global Economy

IMF Predicts a 3.1% Growth in Global Economy in 2024

According to the latest report by the International Monetary Fund (IMF) global growth is expected to reach 3.1% in 2024 and 3.2% in 2025, surpassing their forecast in October 2023 by 0.2 percentage points. This uptick is attributed to the resilient performance of the United States and several major Emerging Markets and Developing Economies (EMDEs), along with fiscal support in China. However, these projections fall below the historical average of 3.8% (2000–19), influenced by elevated central bank policy rates, combating inflation, reduced fiscal support amid high debt levels hampering economic activity, and sluggish underlying productivity growth.

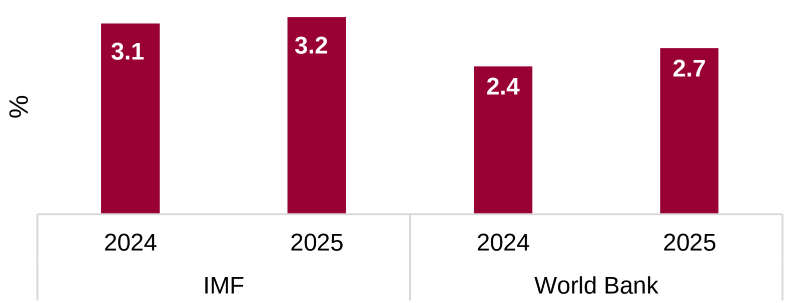
Global Inflation is declining more rapidly than expected, driven by the resolution of supply-side issues and restrictive monetary policy. Global headline inflation is projected to decrease to 5.8% in 2024 and further to 4.4% in 2025, with the latter revised downward.

The likelihood of a hard landing has diminished with disinflation and stable growth, and risks to global growth are generally balanced. Positive scenarios include faster disinflation, easing financial conditions, while looser fiscal policy may boost growth temporarily but at the risk of future challenges. Stronger structural reforms could enhance productivity with positive cross-border effects. Conversely, geopolitical shocks, persistent inflation, or disruptions in the property sector in China may prolong tight monetary conditions. Challenges may also arise from tax hikes, spending cuts, or unexpected events impacting growth adversely.

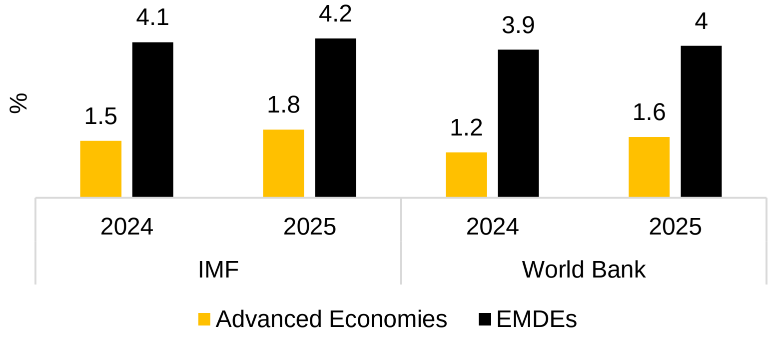
Policymakers face the immediate challenge of effectively managing inflation's descent to the target, adjusting monetary policy based on underlying dynamics. Simultaneously, with declining inflation and improved economic resilience, renewed attention to fiscal consolidation is essential. This aims to rebuild budgetary capacity, address future shocks, generate revenue for new priorities, and curb rising public debt. Targeted structural reforms can reinforce productivity growth and debt sustainability, accelerating progress toward higher income levels. Efficient multilateral coordination is crucial for debt resolution, preventing distress, creating room for necessary investments, and mitigating the impact of climate change.

IMF is more optimistic about global growth than the World Bank.

Global Growth Projections by the IMF and the WB



Growth Projections for Advanced Economies and EMDEs



Data Source: IMF

Detailed insights on growth projections by the World Bank are highlighted in our January Monthly Economic Update.

KEY INSIGHTS
Global Economy

Global trade is unlikely to meet the forecasted 3.3% growth due to increasing geopolitical tension.

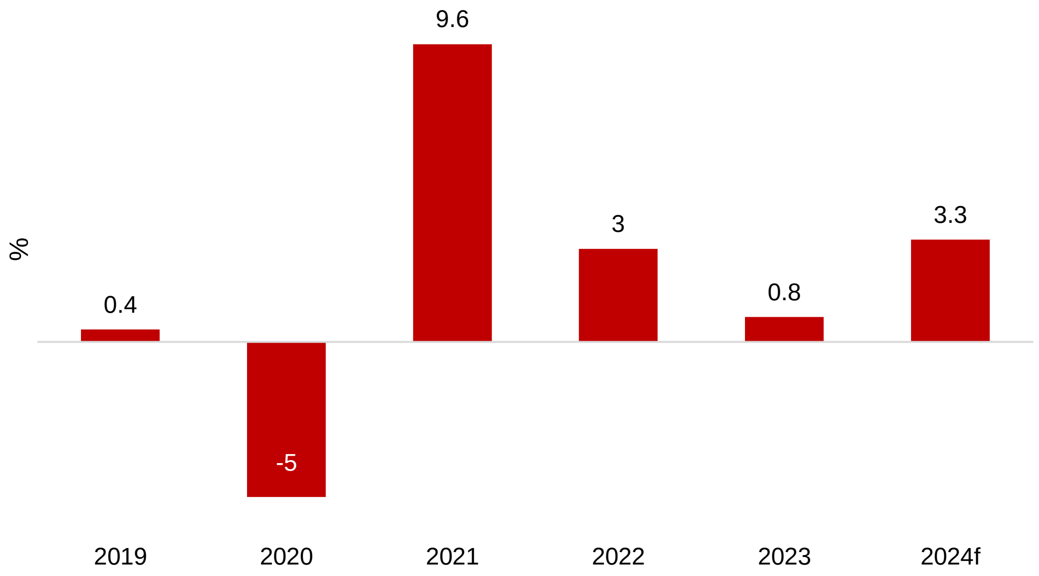
The World Trade Organisation (WTO) predicts that global trade is likely to fall short of the initially forecasted 3.3% growth for 2024 due to various challenges, including slower economic growth and emerging risks such as the Red Sea attacks. The disruptions in global trade, exacerbated by attacks on ships and a longer shipping route along the southern tip of Africa, are contributing to delays and inflationary pressures.

WTO highlighted the impact of geopolitical tensions and conflicts on global trade growth, noting that the multilateral trading system is currently under attack, especially amid US-China tensions and rising protectionist policies. Despite these challenges, she emphasized the resilience of the multilateral trading system, which still facilitates 75% of world trade on WTO terms.

While economic growth has held up better than expected, WTO acknowledged disparities, citing the World Bank's warning of the global economy's weakest five-year performance in thirty years. Developing countries, in particular, face challenges such as debt distress and high financing costs, impacting their economic prospects.

In contrast, as specified in the previous page, the IMF raised its global economic growth forecast, anticipating a soft landing in 2024. However, risks persist due to slow and uneven economic progress and increasing geopolitical uncertainties.

Global Merchandise Trade Volume Growth



Data Source: WTO

Evolving Landscape

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, 'Evolving Landscape' section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

Sri Lanka Signed a Free Trade Agreement with Thailand to Bolster Economic Ties

The negotiations for the Sri Lanka-Thailand Free Trade Agreement (SLTFTA) commenced in 2018, culminating in the signing of the agreement on February 3, 2024, following extensive discussions between the two nations. This comprehensive agreement, consisting of 14 chapters and accompanying annexes, is poised to become operational upon the exchange of diplomatic notes.

The SLTFTA represents a significant step forward for Sri Lanka, heralding a positive outlook for the country's trade initiatives and fostering deeper ties with economies within the Association of Southeast Asian Nations (ASEAN). Alongside the existing Singapore FTA, it opens avenues for Sri Lanka to diversify its export portfolio, attract Foreign Direct Investment (FDI), and seamlessly integrate into regional value chains within the ASEAN bloc. With its comprehensive coverage, the agreement presents ample opportunities for Sri Lankan businesses to leverage synergies across trade, investment, and services, thereby enhancing their competitiveness in the regional market.

Notably, the signing of the agreement has already sparked interest from Thailand, with delegations exploring potential investment opportunities in Sri Lanka. Presently, there are 10 commercial investment projects from Thailand operating in Sri Lanka, generating employment opportunities for over 600 individuals, according to government sources.

Under the Trade Liberalization Program, certain Sri Lankan products will enjoy preferential access to the Thai market, with reduced or zero customs duties. Key products such as tea, apparel, coconut and rubber products, fish and fishery products, and cinnamon are among those set to benefit, either within global quotas or without quota restrictions. These products, primarily value-added, hold significant export potential and are in high demand in the Thai market. Additionally, Sri Lanka will gain access to intermediary and industry inputs from Thailand, enhancing domestic production capacity and bolstering competitiveness across various sectors.

What are the key elements of the Tariff Liberalisation Program (TLP) under the SLFTA?

The TLP gives details on products that will be subject to an elimination of imports duty. Sri Lanka and Thailand have committed to a comprehensive Tariff Liberalisation Program spanning a 16-year time (refer the table below for more details).

- 80% of the HS Codes will undergo tariff liberalisation over 15 years in sequential stages.
- 5% of HS Codes will undergo partial liberalisation, with a single point removal at the onset of the 16th year from the date of the implementation.
- The remaining 15% of HS Codes, specified in Sri Lanka's Negative Schedule.

The tariff classification numbers used in the schedule for Thailand are based on the 2022 version of the ASEAN Harmonised Tariff Nomenclature (AHTN)1 where in the schedule for Sri Lanka is based on the 2022 version of the World Customs Organisation.

What are the Rules of Origin under SLTFTA?

This subject needs to be addressed by an understanding of the purpose of the Rules of Origin (ROO) criteria. ROO are the criteria that are used to determine the national source of a product. ROOs serve several purposes in the context of an FTA that goes beyond determining the qualifying criteria for products to be eligible for preferential duty claims.

ROOs are also used;

- for actioning trade remedy instruments such as anti-dumping duties and safeguard measures;
- for compiling trade statistics;
- for the application of labelling and marking requirements; and
- for government procurement

The Agreement's TLP will lower customs duty, but products must meet Rule of Origin Criteria to get duty concessions.

Evolving Landscape cont'd

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Sri Lanka Signed a Free Trade Agreement with Thailand to Bolster Economic Ties

Phase	Liberalisation Process	Thailand Offer		Sri Lanka Offer	
		No of HS Codes	%	No of HS Codes	%
1	Elimination of Customs Duties at the date of entry into force (EIF)	5,701	50	4,078	50
		9 (within WTO Quota)	0	0	0
2	Elimination of Customs Duties in 5 annual equal instalments (stage I: 1st - 5th year of the Agreement)	1,138	10	815	10
3	Elimination of Customs Duties in 5 annual equal instalments (stage II: 6th - 10th year of the Agreement)	1,128	10	815	10
4	Elimination of Customs Duties in 5 annual equal instalments (stage III: 11th - 15th year of the Agreement)	1,163	10	816	10
5	Reduction of Customs Duties by 50% of the applicable Customs Duties (at the onset of the 16th year)	567	5	409	5
6	Exclusion List/ Unbound / Not subject to TLP	1,708	15	1224	15
Total Tariff Lines		11,414	100	8,157	100

For more details, please click on the link to access the full trade brief compiled by our team.

Datasheet

Latest Available data

External Trade (USD Mn)	Dec-2023	Month Ago	Year Ago
Exports	1,002	999	1,068
Agricultural Exports	206	215	203
Industrial Exports	791	765	841
Imports	1,489	1,389	1,426
Consumer Goods	273	265	242
Intermediate Goods	948	868	984
Investment Goods	267	255	200
Trade Balance	-487	-390	-358
Tourist Arrivals (No.)	208,253 (Jan 2024)	210,352 (Dec)	102,545
Tourism Earnings	342 (Jan 2024)	269 (Dec)	154
Workers' Remittances	488 (Jan 2024)	568 (Dec)	438
Inflation (%)	**Jan 2024**	**Month Ago**	
CCPI (2021 base)			
Headline	6.4	4.0	
Core	2.2	0.6	
NCPI (2021 base)			
Headline	6.5	4.2	
Core	2.2	0.9	
Interest Rates (%)		**Month Ago**	**Year Ago**
AWPR	11.5 (Feb)	11.78 (Jan)	
AWLR	14.21 (Dec)	14.66 (Nov)	
AWDR	11.15 (Jan)	11.64 (Dec)	
AWFDR	14.28 (Jan)	14.88 (Dec)	
SDFR	9.00	9.00	
SLFR	10.00	10.00	
Growth in Credit to Private Sector	-0.6 (Dec)	-3.1	6.2
Fiscal Sector (LKR Bn)		**2023 (Jan-Nov)**	**Year Ago**
Revenue and Grants		2,771	1,809
Expenditure and Net Lending		4,791	3,411

Data Sources: CBSL, Department of Census and Statistics, Sri Lanka Tourism development Authority

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