

Monthly Economic Update (MEU)

April 2024

**Economic Intelligence Unit
The Ceylon Chamber of Commerce**

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Highlights

Sri Lankan Economy

The World Bank and ADB Anticipates a further Economic Stabilization

According to the latest reports published by the World Bank and the Asian Development Bank, the growth of the Sri Lankan economy is expected to turn positive in 2024 and remain moderately positive over the medium term, limited by the scarring effects of the crisis, lower real incomes amidst higher taxes, and higher migration of skilled workers. However, as per the ADB forecasts, Sri Lanka ranked among the two countries with the slowest economic growth expectations in the South Asian Region.

Sri Lanka had Discussions with its International Bondholders

The GoSL recently concluded initial discussions with the Steering Committee of its International Sovereign Bondholders, but failed to reach an agreement on debt restructuring terms during the designated Restricted Period. These negotiations included a detailed two-day meeting in London, where both parties exchanged proposals focusing on the conditions and structures of Macro-Linked Bonds. Despite some concessions regarding the bond structure, the discussions concluded without reaching a consensus. Nonetheless, Sri Lanka remains optimistic, planning to continue engaging in discussions in hopes of reaching an agreement aligned with IMF recommendations before the upcoming review.

External Sector is Continued to Recover

In February 2024, Sri Lanka saw increased import spending and export earnings. However, the rise in imports outpaced that of exports, leading to a widening trade deficit. Import expenditure notably decreased from the previous month, mainly due to lower fuel imports. The services sector saw significant net inflows from tourism, sea transport, air transport, and computer/IT/BPO-related services. Tourism surpassed 700,000 arrivals within 14 weeks, with revenue reaching 25% of the yearly target by March. Remittances surged to their highest level in nearly three years in March.

Inflation Declined in March

The overall rate of inflation as measured by the year-on-year changes in the Colombo Consumer Price Index (CCPI), decelerated to 0.9% in March 2024, from 5.9% recorded in February 2024. The year-on-year inflation of Food group increased to 3.8% in March from 3.5% in February 2024, and the Non-food group inflation decreased to 0.5% in March from 7% in February 2024.

Government Unveiled “National Digital Economy Strategy”

The Government has introduced "Digital Sri Lanka 2030," a strategy focusing on innovation, inclusion, and sustainable growth. It outlines actions across six areas and emphasizes core principles and critical enablers for implementation. The goal is to develop a vibrant digital ecosystem for a socially inclusive, export-oriented, and green economy.

Global Economy

ADB Expects a 4.9% Growth for Developing Asia

Economic resilience in Asia and the Pacific persists, fueled by robust domestic demand, improving semiconductor exports, and ongoing recovery in tourism. The ADB anticipates that the economies of developing Asia will expand by 4.9% this year, with a similar growth rate projected for next year. The acceleration in growth within South Asia and Southeast Asia will compensate for slower growth in other parts of the region.

Gold and Oil Markets at Risk due to Tensions in the Middle East

Iran launched its first direct attack on Israeli territory on April 13th, retaliating against the killing of a senior officer in Syria. Subsequent incidents, including a drone attack in Iran attributed to Israel and an explosion in an Iraqi military base, have heightened tensions, impacting global gold and oil markets. Geopolitical uncertainties have led to record-high gold prices, while oil prices surged briefly amid fears of Iranian retaliation, but later stabilized as concerns eased.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

4.5% in Q4-2023
-2.3% in 2023 (Full Year)

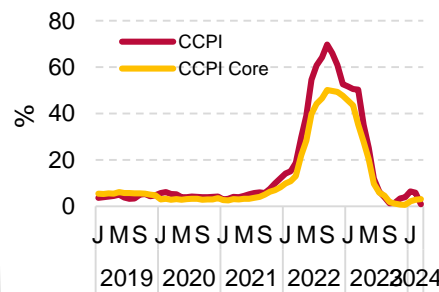
Movement of Purchasing Managers' Index-Mar 2024

Manufacturing PMI **62.5**
 Services PMI **67.7**

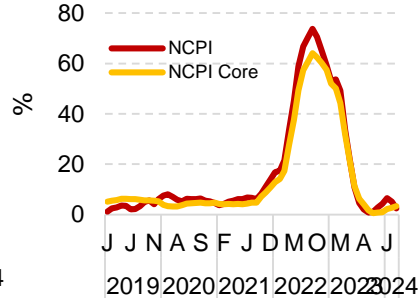
Indexes shows a further improvement in both Manufacturing and Services activities.

Inflation

CCPI Inflation (%) - Base 2021

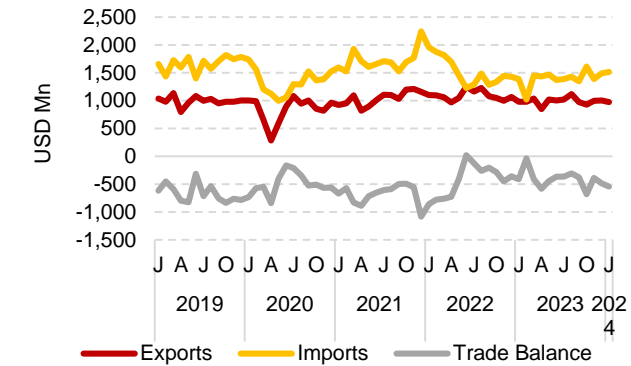


NCPI Inflation (%) - Base 2021



External Sector

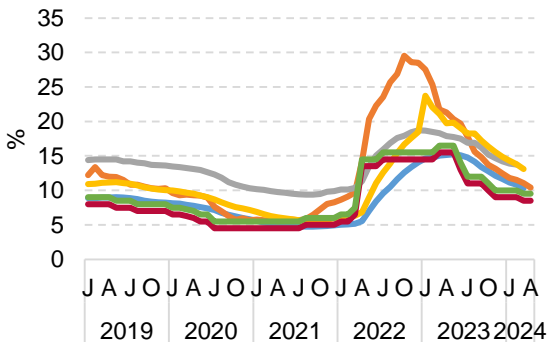
Merchandise Trade



Tourism

Feb. 2024	Mar. 2024
Exports 7.9% ↓	Arrivals 67% ↑
Imports 35% ↑	Earnings 71% ↑
Workers' Remittances	
Mar. 2024 1% ↑	

Interest Rates



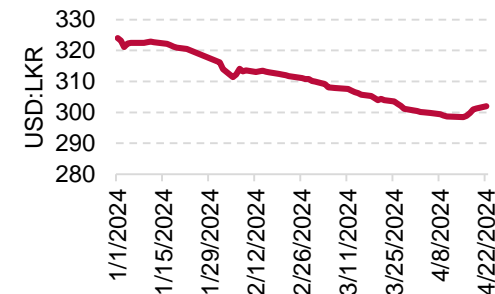
AWDR
 AWPR
 AWLR
 AWFDR
 SDFR (Repo)
 SLFR (Rev.Repo)

SDFR: 8.50%
SLFR: 9.50%

Growth in Credit to Private Sector

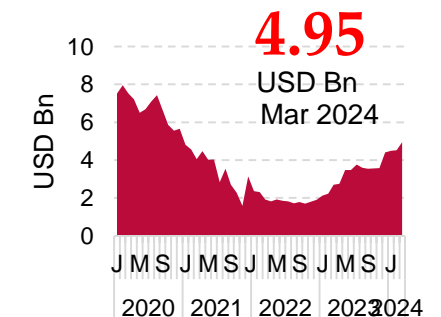
Feb 2024
0.9%

Exchange Rate



Appreciation of LKR thus far 2024
7.3%

Official Reserves



KEY INSIGHTS

Sri Lankan Economy

The World Bank and ADB Anticipate Further Economic Stabilization

Growth: According to the latest reports published by the World Bank and the Asian Development Bank, the growth of the Sri Lankan economy is expected to turn positive in 2024 and remain moderately positive over the medium term, limited by the scarring effects of the crisis, lower real incomes amidst higher taxes, and higher migration of skilled workers. However, as per the ADB forecasts, Sri Lanka ranked among the two countries with the slowest economic growth expectations in the South Asian Region.

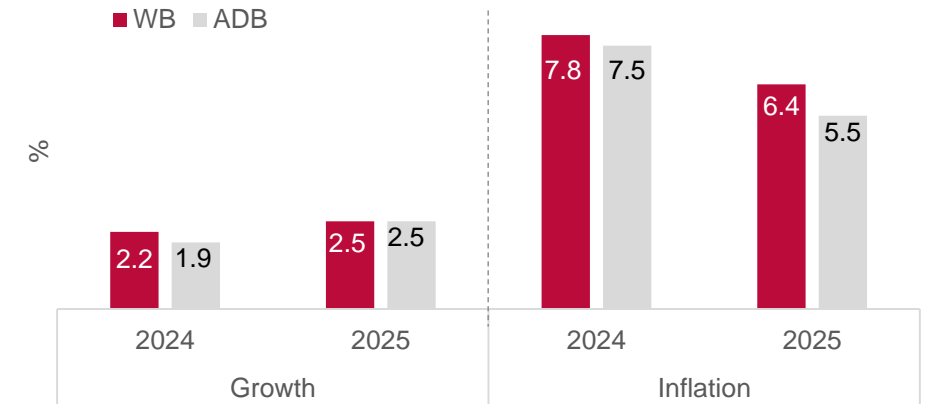
Inflation: Inflation is likely to rise moderately in the near term- due to new revenue measures and the waning of favorable base effects, and remain benign in the medium term as demand continues to be subdued.

Fiscal and External Sectors: The current account is expected to record a slight surplus, attributed to restrained import growth and the resurgence of tourism and remittances inflows. Nevertheless, the substantial interest payments will maintain the fiscal deficit at heightened levels throughout the year.

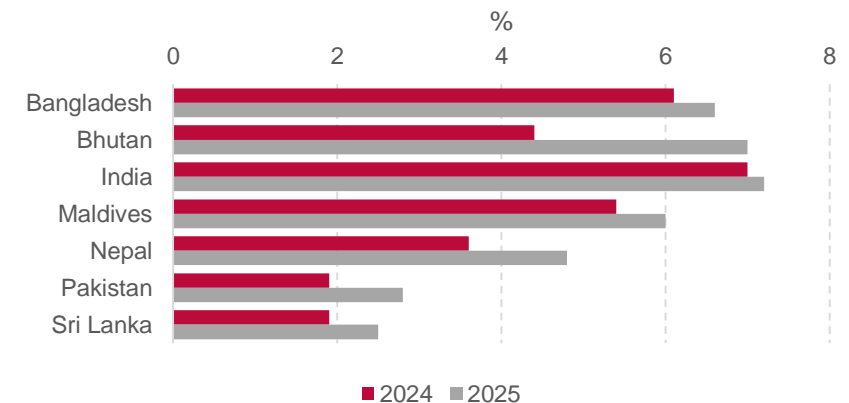
Poverty: Despite a modest economic rebound, it is anticipated that the adverse effect of the crisis will persist, with poverty rates forecasted to exceed 22% until 2026. Household finances are expected to remain under pressure due to the implementation of cost-based utility tariffs and additional revenue measures, essential for macroeconomic stability.

Risks: A sufficiently deep debt restructuring is required to restore country's debt sustainability and regain access to international financial markets. Thus, a protracted or insufficiently deep debt restructuring remains a key risk to the outlook. Other down side risks include reform fatigue or reversal linked to elections, continued financial sector stability and intermediation risks, and a weaker recovery linked to the scarring effects of the crisis. On the upside, a strong and sustained implementation of the structural reform program could boost confidence and attract fresh capital inflows. Better than expected tourism and remittances could also provide an upside, says the World Bank.

Growth and Inflation Forecasts by the WB and ADB



Sri Lanka ranked among the two countries with the slowest economic growth expectations in the South Asian region.



KEY INSIGHTS

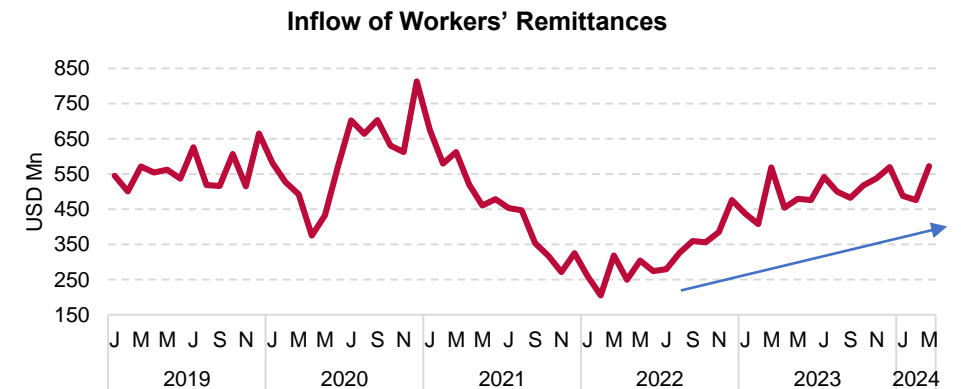
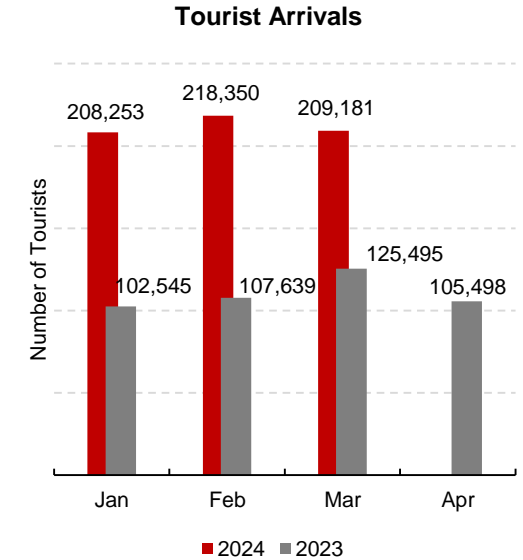
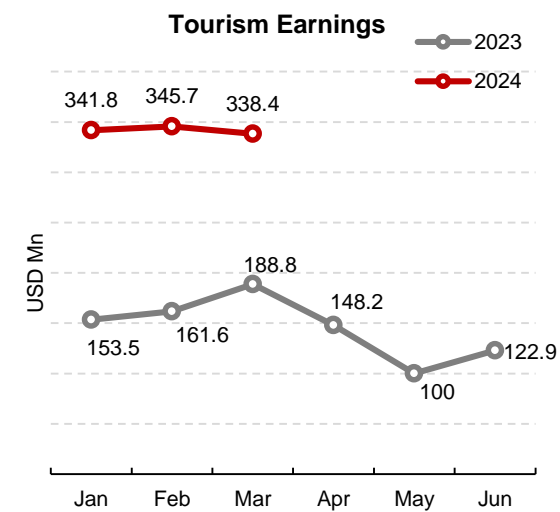
Sri Lankan Economy

Sri Lanka's Booming Tourism and Remittances Growth

Sri Lanka has surpassed the 700,000-tourist arrival milestone within the first 14 weeks of the year 2024, nearly halving the time taken to achieve this feat in 2023. According to provisional data from the Sri Lanka Tourism Development Authority, the country welcomed a total of 729,753 international visitors from January 01 to April 18. As of April 18th, Sri Lanka has reached 30% of its target number of tourists for 2024, set at 2.4 million. Regarding tourism revenue, figures reported until the end of March reached USD 1,026 million, with USD 338 million in March alone. This indicates that Sri Lanka has attained 25% of the USD 4 billion revenue goal set for the year within the first quarter.

The Sri Lankan Department of Immigration and Emigration introduced its new e-visa system on April 17th, replacing the current ETA (Electronic Travel Authorization) method, marking a significant advancement in visa services. Furthermore, the president has emphasized the need to develop the Pekoe Trail to enhance the tourist experience and boost tourism in the central highlands. The Trail spans over 300km through the central highlands of Sri Lanka; it starts from Kandy, and extends towards Hatton and Haputale and Nuwara Eliya. Constructed during the British colonial era to facilitate the transportation of tea from plantations to factories, the Pekoe Trail holds significant historical value. The European Union (EU) and the United States Agency for International Development (USAID) have extended their support to the Pekoe Trail project.

In March, remittances increased to USD 572 million, while the cumulative figure for the first quarter of 2024 amounted to USD 1,536 million, compared to USD 1,413 million in 2023. Remittances typically surge in March ahead of traditional New Year holidays and Ramadhan celebrations. In March 2024, remittances experienced their highest inflow in nearly three years, dating back to February 2021. Surge in the first quarter can be attributed to a significant number of remitters moving to formal remitting channels as CBSL clamped down on informal money exchangers who were offering significant premiums.



KEY INSIGHTS

Sri Lankan Economy

Governance- Linked Bonds Mooted in External Debt Restructuring Negotiations

Governance-Linked Bonds (GLBs) were brought to the forefront during discussions in London between the Government of Sri Lanka and external commercial creditors of its International Sovereign Bonds. The concept GLBs represents an innovative financial instrument designed to incentivize and reward governance reforms in the issuing country. The fundamental structure of a GLB entails a reduction in coupon (interest rate) triggered by the achievement of specific governance milestones within a prescribed timeframe. This mechanism offers the country a transparent and publicly visible financial incentive to enact a series of measures aimed at enhancing financial governance and combating corruption. These features tend to generate strong public interest as well as political competition and accountability for achieving those governance improvements. This is particularly important as Sri Lanka anticipates holding elections in the final quarter of 2024.

In contrast to Macro-Linked Bonds (MLBs), which are tied to specific macroeconomic indicators like inflation rates, GDP growth, or interest rates, GLBs present distinct advantages. While MLBs may increase coupon payments with higher GDP growth rates (if the MLB is based on GDP), GLBs function differently: meeting governance targets results in coupon reductions. This incentivises the country performance by tying it to lower debt-servicing costs, as opposed to the higher costs associated with MLBs. GLBs offer a win-win scenario for both bondholders and issuers. By incentivizing political leadership to enact governance reforms through the promise of interest rate reductions, GLBs mitigate risk for bondholders concerned about potential future governance challenges.

This reduction in risk enhances the bond's secondary market value, surpassing the benefits of MLBs, where the risk associated with inadequate governance remains elevated. In this dynamic, the country benefits twofold: firstly, by enhancing governance practices and thereby triggering interest rate reductions (coupon step-down), thus reducing debt-servicing costs. Secondly, it enjoys anticipated synergies stemming from improved governance, further bolstering its overall financial health.

The suggestion of GLBs was proposed by the external commercial creditors, to which Sri Lanka expressed openness, pending receipt of further details regarding the proposal. Subsequently, on April 3rd, 2024, Sri Lanka's advisors received further information on the potential structure of a GLBs. The proposed framework encompasses two key performance indicators (KPIs), both quantitative and qualitative. The coupon step-down is contingent upon the successful attainment of **both** KPIs.

The qualitative KPI includes a specific target for government tax revenue-to-GDP ratio. The suggested target, proposed by external creditors, align with those outlined in the IMF program, aiming for a tax revenue-to-GDP ratio of 14.0% in 2026 and 14.1% in 2027. Moreover, qualitative targets include select reforms outlined within the current IMF program. Notably emphasized reforms encompass the public disclosure of procurement contracts exceeding Rs. 1 billion and the publication of information pertaining to tax exemptions. Both these KPIs would be reviewed by external parties (for example Moody's ESG Solutions, Sustainalytics). The adjustment date for the coupon step-down is potentially slated for June 2028, contingent upon the successful achievement of both quantitative and qualitative targets. Sri Lanka has also been encouraged to propose its own governance targets, accompanied by respective measurement and verification methods. This affords Sri Lanka the chance to integrate long-term macroeconomic objectives, thereby fostering policy consistency—a long standing issue in Sri Lanka that needs to be confronted.

KEY INSIGHTS

Global Economy

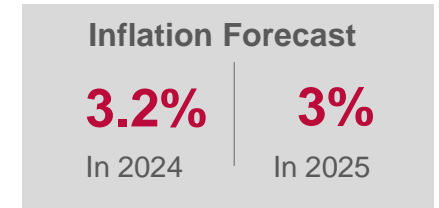
ADB Expects a 4.9% Growth for Developing Asia

Growth: Economic resilience in Asia and the Pacific persists, fueled by robust domestic demand, improving semiconductor exports, and ongoing recovery in tourism. The Asian Development Bank (ADB) anticipates that the economies of developing Asia will expand by 4.9% this year, with a similar growth rate projected for next year. The acceleration in growth within South Asia and Southeast Asia will compensate for slower growth in other parts of the region.

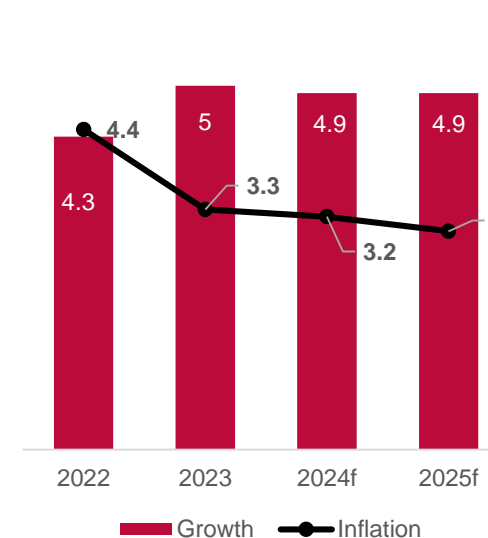
Risks: However, there are notable risks on the horizon. Escalating conflicts and geopolitical tensions have the potential to disrupt supply chains and impact commodity prices. Uncertainty surrounding U.S. monetary policy and further weaknesses in the property market, particularly in the People's Republic of China, could pose challenges. Additionally, extreme weather events may present further obstacles for the region.

Inflation: Inflation across developing Asia and the Pacific continues to moderate, with global food and fuel prices receding from elevated levels following Russia's invasion of Ukraine. ADB anticipates inflation in the region to decrease to 3.2% this year and 3% in 2025, though challenges persist. Excluding the People's Republic of China, inflation remains higher than pre-pandemic levels. Rice prices, in particular, have remained elevated due to adverse weather conditions and export restrictions imposed by some major rice-producing countries. Furthermore, disruptions in the supply chain could continue to impact prices. Recent attacks on ships, such as those in the Red Sea, have resulted in higher shipping costs as vessels opt for longer routes between Asia and Europe.

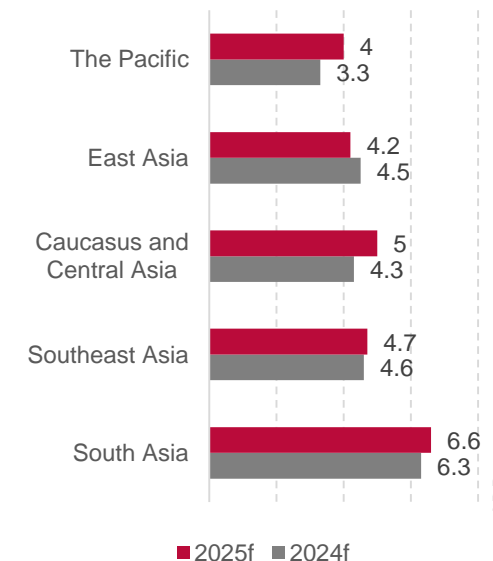
For Policy Makers: To bolster resilience, policymakers should intensify efforts to promote trade, cross-border investment, and competitive supply networks. Preserving food security for vulnerable populations is imperative. Policymakers in the region must closely monitor inflation and reinforce social safety nets to mitigate adverse effects.



Growth and Inflation Forecasts for Developing Asia



Growth Forecasts for Sub-Regions



KEY INSIGHTS

Global Economy

Gold and Oil Markets at Risk due to Tensions in the Middle East

On April 13th, Iran launched explosive drones and fired missiles at Israel, marking its first direct attack on Israeli territory. This retaliatory strike came in response to the killing of a senior officer in Iran's embassy in Syria on April 1st. Additionally, on April 19th and 20th, there were further incidents—a mini drone attack in Iran attributed to Israel and an explosion in a military base in Iraq, the perpetrator of which remains unidentified. These tit-for-tat retaliatory measures have significantly unsettled global gold and oil markets.

The escalation of geopolitical tensions in the Middle East has led to a surge in gold prices worldwide, reaching unprecedented highs. According to the London Stock Exchange Group (LSEG), spot gold prices soared to USD 2,431.29 per Troy ounce on April 12th, marking a historic peak for the precious metal. Everett Millman, Chief Market Analyst at Gainesville Coins in the US, remarked to Reuters, "When there are geopolitical tensions, the natural response is for investors to flee to gold, which is happening now. If the conflict further escalates, prices could exceed USD 2,500 - USD 2,600, and if there is a ceasefire, they could decline to USD 2,200."

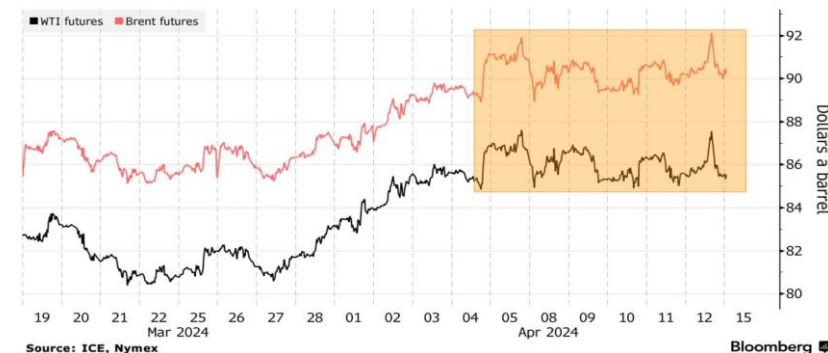
Conversely, oil prices experienced a surge as well, with Brent crude oil prices climbing to USD 92.18 per barrel on April 12th, the highest since October 2023, amid concerns of potential Iranian retaliation. However, this price hike was short-lived, as Iranian state media downplayed the damage from the April 19th attacks. Subsequently, oil markets exhibited resilience, reflecting investors' confidence that the situation would not escalate into a broader conflict in the Middle East.

Spot gold price in USD per oz



Published April 19, 2024 at 4:21 PM GMT

Global Oil Prices



Source: ICE, Nymex

Bloomberg

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.

Asia's Rebounding Semiconductor Sector

According to a report by McKinsey Research, in 2021, the semiconductor industry's total value approached USD 600 billion, with primary applications revolving around computing, data storage, and wireless communication. Forecasts indicate that this industry is poised to soar to a monumental USD 1 trillion by 2030, signifying a paradigm shift in global technological landscapes. Traditionally relegated to computing and data storage sectors, semiconductors have expanded their reach across a spectrum of industries. The motor vehicle industry has emerged as a significant consumer of semiconductors, alongside industries such as, consumer electronics, and wired communication. This diversification underscores the pivotal role of semiconductors as indispensable components driving innovation and efficiency across various sectors.

Rising Exports from Asia

High-income and developing economies in East Asia and Southeast Asia jointly wield an overwhelming share of over 80% in global semiconductor manufacturing. This concentration renders the world heavily reliant on the region's semiconductor exports, while simultaneously tethering the region's economic fortunes to the global appetite for semiconductor products.

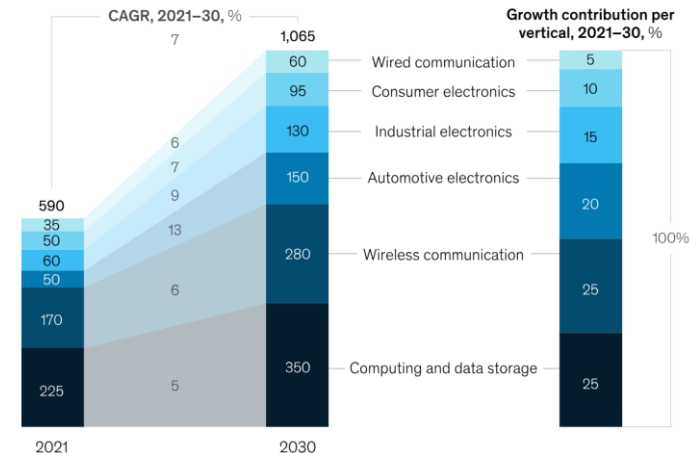
Semiconductor exports from Asia have experienced an upward trajectory, propelled by the increase in global demand for microprocessors and memory chips. Following a sharp contraction at the close of 2022, exports from Asia's primary semiconductor manufacturing hubs rebounded throughout 2023. Notably, exports in the final quarter of the year surged by approximately 15% compared to the first quarter, mirroring the growth trajectory of other electrical machinery equipment. While nominal exports of semiconductors approached mid-2022 record highs by the end of 2023, exports of other electrical machinery lagged significantly behind the peaks witnessed during the COVID-19 pandemic. The upswing in semiconductor exports was predominantly driven by heightened demand for specific semiconductor categories, notably microprocessors and memory chips. This subset witnessed a remarkable uptick, with exports growing nearly 25% from the first to the last quarter of 2023.

AI Boom: Catalyst for Semiconductor Demand Surge

The burgeoning AI sector is emerging as a major catalyst for the exponential growth in demand for advanced microprocessors and memory chips. Advanced microprocessors, encompassing graphics processing units (GPUs) and central processing units (CPUs), play a pivotal role in executing complex AI algorithms and computations. The introduction of ChatGPT, a free-to-use AI language model, in November 2022 ignited a global race to develop novel AI models. This unprecedented surge in AI model development has substantially escalated the demand for microchips, thereby bolstering the profitability and equity valuations of companies in the upstream semiconductor value chain. Notably, industry giants like NVIDIA and Advanced Micro Devices (AMD) have witnessed a surge in shipments from Asia, indicative of the heightened demand for their products.

The overall growth in the global semiconductor market is driven by the automotive, data storage, and wireless industries.

Global semiconductor market value by vertical, indicative, \$ billion



Evolving Landscape cont'd

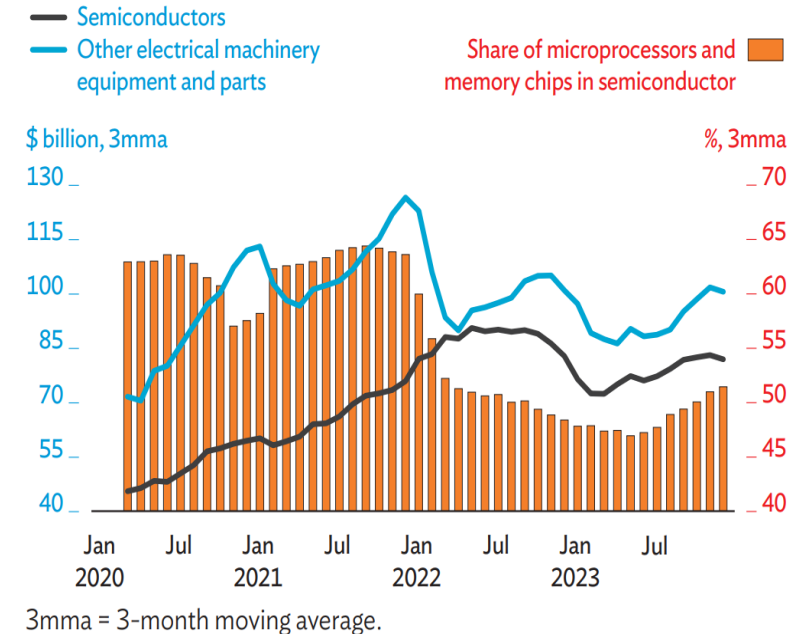
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Asia's Rebounding Semiconductor Sector

Can Sri Lanka Ride the Indian Semiconductor Wave?

Sri Lanka's northern neighbor, India, unveiled the USD 10 billion Semicon India Program in December 2021, dedicated to fostering the development of the semiconductor and display manufacturing ecosystem within its borders. This ambitious initiative includes a sub-scheme aimed at bridging the gap between design and industry, catering specifically to 100 domestic companies, startups, and micro, small, and medium enterprises (MSMEs) poised to become pivotal players in India's burgeoning semiconductor industry. Complementing these local endeavors, several global tech giants such as Micron Technology, Samsung, and Intel have already established production branches in India. The semiconductor industry in India recorded a value of USD 7.76 billion in 2023, with plans to bolster this figure to USD 10.68 billion by 2027.

The semiconductor industry presents a significant market opportunity for Sri Lanka, which has yet to establish a presence in this sector. With traditional exports like tea, rubber, and coconut reaching saturation points and the apparel industry facing various challenges, diversifying the export basket becomes imperative for sustained economic growth. Semiconductors emerge as a promising addition to Sri Lanka's export portfolio, albeit the country lacks the technology for independent manufacturing. Collaborating with countries possessing semiconductor manufacturing capabilities, particularly India, presents a viable solution. Viewing India as a collaborative partner rather than a competitive threat opens doors to mutually beneficial arrangements. Such partnerships offer a 'win-win' scenario, allowing Sri Lanka to contribute microchip wafers or participate in specific manufacturing processes, leveraging its skilled labour force.



Datasheet

Latest Available data

External Trade (USD Mn)	Feb-2024	Month Ago	Year Ago
Exports	1,059	971	982
Agricultural Exports	222	196	201
Industrial Exports	834	771	777
Imports	1,378	1,512	1,021
Consumer Goods	250	281	202
Intermediate Goods	840	981	638
Investment Goods	286	249	181
Trade Balance	-319	-541	-39
Tourist Arrivals (No.)	209,181 (Mar 2024)	218,350	125,495
Tourism Earnings	338 (Mar 2024)	346	189
Workers' Remittances	572 (Mar 2024)	476	568
Inflation (%)	Mar 2024	Month Ago	
CCPI (2021 base)			
Headline	0.9	5.9	
Core	3.1	2.8	
NCPI (2021 base)			
Headline	2.5	5.1	
Core	3.4	2.7	
Interest Rates (%)		Month Ago	Year Ago
AWPR	10.41 (Apr)	11.04 (Mar)	21.45
AWLR	13.74 (Feb)	13.88 (Jan)	18.50
AWDR	10.30(Mar)	10.80 (Feb)	15.06
AWFDR	13.10 (Mar)	13.77 (Feb)	19.80
SDFR	8.50	8.50	15.50
SLFR	9.50	9.50	16.50
Growth in Credit to Private Sector	0.9 (Feb)	0.0 (Jan)	2.9
Fiscal Sector (LKR Bn)		2023 (Jan-Nov)	Year Ago
Revenue and Grants		2,771	1,809
Expenditure and Net Lending		4,791	3,411

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