

SRI LANKA

Economic Brief

Government Finance

	Jan-Mar 2009 Rs. bn	Jan-Mar 2010 Rs. bn	Change %
Non-tax revenue	11.1	32.7	194.6
Tax revenue	133.5	150	12.35
Grants	3.5	1.2	-65.7
Total revenue & grants (1)	148.1	183.9	24.17
Recurrent expenditure	243.7	247.5	1.55
Capital expenditure	58.4	58.1	-0.51
Total expenditure (2)	302.2	305.6	1.12
Deficit (1-2)	-154.1	-121.7	-21.02
Estimated GDP	4,825	5,445	-
Deficit as a % of GDP	3.19 %	2.23%	-

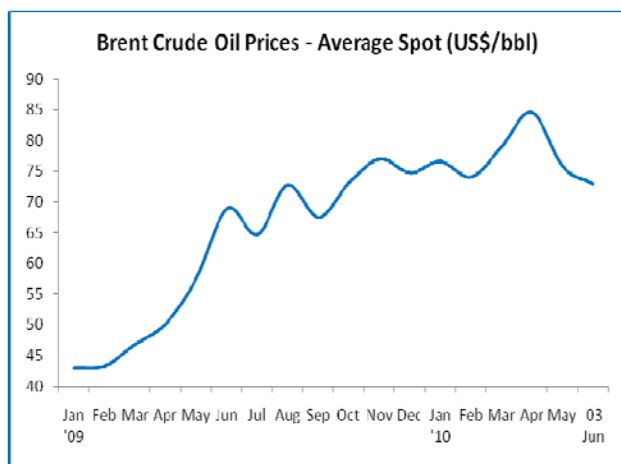
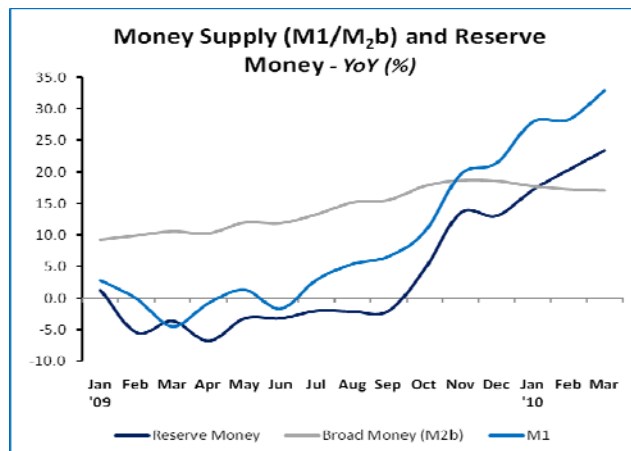
Inflation

Rate of Inflation (CCPI & CCPI Core)

	Jun '09	Jul	Aug	Sep	Oct	Nov	Dec	Jan '10	Feb	Mar	Apr	May
Point to Point												
CCPI	0.9	1.1	0.9	0.7	1.4	2.8	4.8	6.5	6.9	6.3	5.8	5.3
CCPI (Core)	7.7	6.0	6.4	5.4	5.1	5.1	5.9	7.9	8.0	6.7	6.4	6.5
Annual Average												
CCPI	12.5	10.4	8.5	6.6	5.2	4.1	3.4	3.1	3.1	3.2	3.4	3.6
CCPI (Core)	15.2	14.2	13.2	12.1	11.0	9.9	9.2	8.6	8.1	7.5	7.0	6.4

The rate of inflation (as measured by the CCPI annual average change) which reached single digits in August 2009 (8.5%), continued to record single digits thereafter and recorded 3.6% in May, 2010.

However, we can see a build-up in inflationary pressure when considering the annual changes of money supply indicators (particularly M1) and reserve money (please see graph). Two other areas that need to be watched will be how the government will manage its budget deficit, and the price of oil, since Sri Lanka is entirely dependent on imports for her oil requirement.



The Central Bank has upped its GDP growth forecast for 2010 to 7% from its earlier forecast of 6.5%, in view of increased construction and infrastructure development coupled with gains in agricultural and industrial output.

It will be interesting to see how the government will balance inflation and growth, now that it has committed to a higher GDP growth figure. An enhanced growth drive (as evidenced by the import duty cuts) will also have its negative fallouts by way of an increase in inflationary pressure.

Private Sector Credit Demand

After posting y-o-y declines since April, 2009, latest data from the CBSL show that private sector credit demand had entered positive territory with a 0.1 % y-o-y gain recorded for March, 2010. Although it is a marginal gain, low interest rates and single digit rates of inflation combined with political stability and peace provide a conducive setting for further gains in private sector credit demand in the coming months.

External Developments

The burgeoning trade deficit is a cause for concern. In 1Q, 2010 exports had recorded a growth of 7.1% (compared to the corresponding quarter of 2009), whereas imports had recorded a much higher growth rate of 39.5%. Hence, the trade deficit had further aggravated by 119.7% in 1Q, 2009 to record USD 1,461Mn. However, a 14% increase in remittance inflows and a 68.8% increase in earnings from tourism have helped to mitigate this adverse outcome. Remittance inflows and earnings from tourism had totaled USD 1,065.5Mn in 1Q, 2010 which is 73% of the trade deficit.

The Euro which had been falling against the LKR since November, 2009 had traded at around Rs.135.76 on 9th June, 2010, and this represents a depreciation of around 20% against a figure of Rs.160 for a euro a year ago. This depreciation of the euro against the LKR is a cause for concern, because the European Union is our biggest export destination and this would mean that our exporters would earn less rupees from each euro.

The LKR had recorded a slight appreciation against the US dollar in recent times. However, with a widening trade deficit and mounting inflationary pressure we expect the LKR to begin depreciating against the US dollar towards the latter part of 2010.

Gross official reserves which had recorded USD 5,096.5Mn as at end Dec., 2009 had increased to USD 5,192 Mn as at end March, 2010 recording an increase of 1.9%.

Import Duty Reductions

The government of Sri Lanka (GOSL) announced import duty reductions in relation to motor cars and certain other types of vehicles as well as for electrical items, wristwatches and raw materials.

Implications of import duty reductions

- ▶ Motor vehicle sales which had dried up are expected to pick up aggressively over the second half of 2010 boosting government revenue on the positive side and widening the trade deficit through an increase in vehicle imports and enhanced fuel consumption on the negative side.
- ▶ Leasing businesses, for which motor vehicle leases account for as much as 90% of business volume, are likely to face some short term stress in its assets as the value of collateral on leased vehicles drop. However an increase in new business volume would more than compensate for this in the medium term.
- ▶ The general insurance business would benefit from pickup in new vehicle registrations, although the sector would be affected in short term by lower motor premiums on insurance renewals as a result of the decline in motor vehicle prices.
- ▶ Banks would also benefit from increased trade finance activity while an expected increase in imports could create moderate volatility on exchange rates.
- ▶ The reduction in raw materials is expected to encourage industrial exports and be an incentive for development of new industrial exports while also encouraging industries with higher value addition.

The impact of the import duty reductions on the prices of a selection of cars (taken here as a sample) can be seen from the table below:

Car Prices - All prices in Rs. Mn. as @ 11.06.10

	Brand	Engine capacity	Earlier price (1)	New price (2)	Total reduction of price(1)-(2)	
Brand New	Yaris	1300cc	5.95	4.45	1.5	
	Corolla	1600cc	6.95	5.625	1.325	
	Camry	1800cc	15.5	10.28	5.22	
	NISSAN SUNNY					
	Ex-Saloon	1300cc	4.85	4.00	0.85	
	Super Saloon	1300cc	5.89	4.45	1.44	
	Super Saloon	1500cc	6.70	5.30	1.40	
	TIIDA	1600cc	n/a	5.55	-	
	SUZUKI MARUTI					
	Maruti (BASIC)	800cc	1.310	0.975	0.335	
	Maruti (SPORT)	800cc	1.365	1.025	0.340	
	ALTO (BASIC)	800cc	1.695	1.235	0.460	
	ALTO (SPORT)	800cc	1.790	1.325	0.465	
	SUZUKI SWIFT	1500cc	4.8	3.56	1.24	
	SUZUKI SX4	1600cc	6.6	4.65	1.95	
	DZIRE (INDIAN)	1200cc	3.7	2.7	1.0	
	Honda City	1500cc	6.8	5.0	1.8	
	Honda Civic	1600cc	7.8	6.1	1.7	
Honda Accord	2400cc	15.5	11.2	4.3		
Honda CR-V	2000cc	14.2	10.2	4.0		
DAIHATSU TERIOS	1500cc	7.70	5.50	2.2		
Re-condition	Honda FITARIA	1300cc	n/a	2.6	-	
	Toyota VITZ	1000cc	3.4	2.5	0.9	
	TOYOTA PREMIO	1500cc	n/a	4.0	-	
	TOYOTA BELTA	1000cc	n/a	3.0	-	
	TOYOTA (NZZ - 260)	1500cc	n/a	5.0	-	
	Nissan Blue Bird	1500cc	5.8	4.7	1.1	
	Honda Airwave	1500cc	4.6	3.5	1.1	

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Shan Fernando
 Research & Development Unit
 Commercial Bank of Ceylon PLC
 + 94 11 2486595
 shanthikumar_fernando@combank.net