



# **State of the Economy** as reflected in **the Central Bank Annual Report - 2015**

**K. M. Mahinda Siriwardana**  
Director of Economic Research  
Central Bank of Sri Lanka

**10 May 2016**

# The Statutory Requirement

## Section 35 of the Monetary Law Act:

*...Within four months after the end of each financial year, the Monetary Board shall submit to the Minister in charge of the subject of Finance and shall publish an annual report on the condition of the Central Bank and a review of the policies and measures adopted by the Monetary Board during the financial year and an analysis of the economic and financial circumstances which prompted those policies and measures...*

## Contents of the Annual Report

- Part 1 -** The state of the economy, its performance, policies and issues
- Part 2 -** Accounts and operations of the Central Bank
- Part 3 -** Major administrative measures adopted by the Monetary Board in 2015
- Part 4 -** Major legislative enactments in 2015 relating to the functions and operations of the Central Bank and banking institutions in Sri Lanka

### Appendix Tables

### Special Appendix Tables

## Part 1:

# State of the Economy, Its Performance, Policies and Issues

<b>Chapter 1</b>	<b>Economic, Price and Financial System Stability, Outlook and Policies</b>
<b>Chapter 2</b>	<b>National Output, Expenditure and Income</b>
<b>Chapter 3</b>	<b>Economic and Social Infrastructure</b>
<b>Chapter 4</b>	<b>Prices, Wages, Employment and Productivity</b>
<b>Chapter 5</b>	<b>External Sector Developments and Policies</b>
<b>Chapter 6</b>	<b>Fiscal Policy and Government Finance</b>
<b>Chapter 7</b>	<b>Monetary Policy, Money, Credit and Interest Rates</b>
<b>Chapter 8</b>	<b>Financial Sector Developments and System Stability</b>



## Domestic and Global Environment in 2015...

- A slowdown in the growth of demand for traditional export markets impacting the export sector
- Strengthening US economy prompted short term capital outflows
- The slowing down of net financial inflows, including worker remittances
- The positive impact of lower international commodity prices
- Rebounded domestic consumption due to rise in incomes
- High money and credit growth and rising underlying inflationary pressures

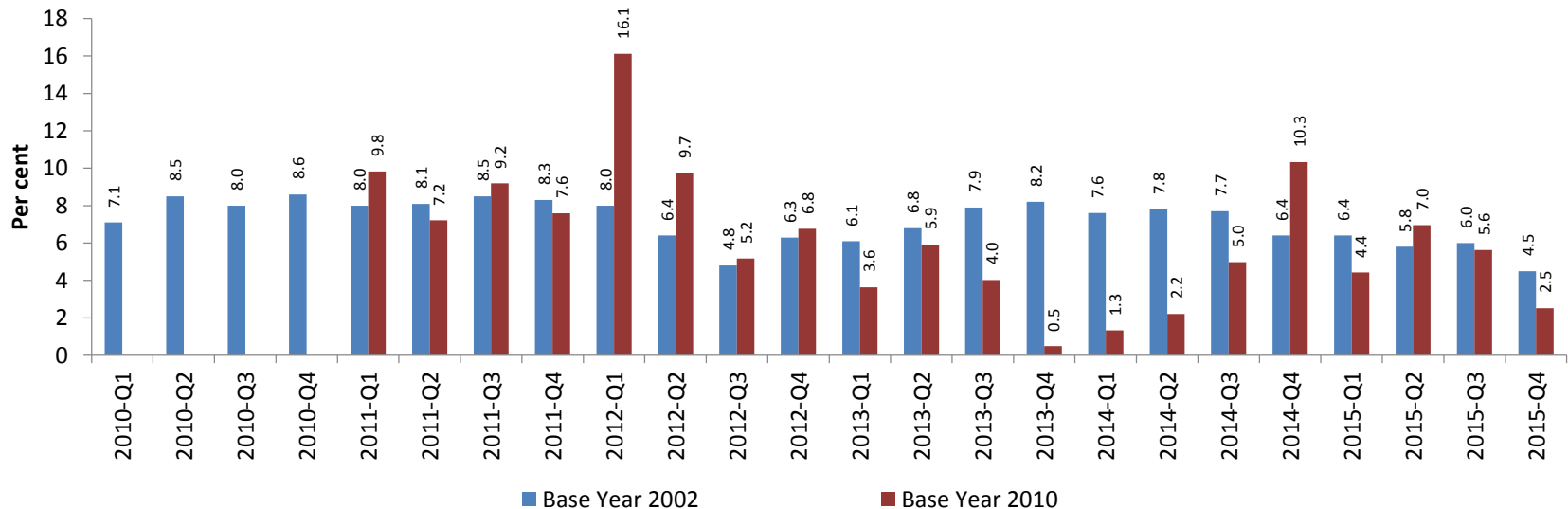
# Domestic and Global Environment in 2015

- Moderately successful efforts to reverse the downward trend in government revenue
- Overruns in the government expenditure with increased budget deficits
- Delay in the policy responses to volatile global economic conditions after the general election
- Central Bank policy actions to address adverse implications of growing demand pressures on price stability and financial system stability

# Sri Lankan economy grew by 4.8% during 2015 in real terms, compared to 4.9% in 2014...

- Department of Census and Statistics (DCS) revised the base year for national accounts statistics to 2010 from 2002.
- The United Nation's System of National Accounts (SNA) 2008 standard was adopted.
- This captures the changes in the economic structure of Sri Lanka over the past decade and introduces new economic activities such as IT programming consultancy and related activities, information services, and professional services, etc.

## Quarterly Real GDP Growth (Year-on-Year)



# Growth was broad-based with positive contributions by all major sectors...

## Services (GDP share 56.6%): 5.3%

- Financial Services Activities : 15.8%
- Real Estate Activities: 9.6%
- Transport Activities: 5.5%
- Wholesale and Retail Trade : 4.7%
- Education, Professional Services and Accommodation, Food and Beverage Services activities declined

Economic Activity	Annual Growth Rates (%)				
	2011	2012	2013	2014	2015
Services	8.9	11.2	3.8	5.2	5.3
Industries	9.3	9.0	4.1	3.5	3.0
Agriculture, Forestry and Fishing	4.6	3.9	3.2	4.9	5.5
GDP	8.4	9.1	3.4	4.9	4.8

## Industries (GDP share 26.2%): 3.0%

- Manufacturing activities grew by 4.7%, mainly contributed by manufacture of food, beverages and tobacco products, and other manufacturing and repair and installation of machinery and equipment, which grew by 5.6% and 16.4%, respectively
- Electricity, water and waste treatment activities contributed positively
- Construction, and mining and quarrying activities contracted by 0.9% each
- Manufacture of textiles, wearing apparel and leather related products recorded no growth

## Agriculture, Forestry and Fishing (GDP share 7.9%): 5.5%

- Growing of Vegetables and Rice increased by 24.9 % and 23.3%, respectively, while Fruits and Animal Production increased by 16.5% and 8.0%, respectively
- Fresh Water Fishing and Growing of Rubber contracted by 11.2% and 10.2%, respectively, while Growing of Tea contracted by 2.6%

# Accommodative policies and favourable weather conditions amidst challenges supported economic activity...

- **Monetary and fiscal policies were largely accommodative**
  - A low and stable inflation environment and low interest rates continued supporting the economy
  - Fiscal measures, such as increase in public sector salaries and downward revision of administrative prices of fuel, LP gas, bus fare, etc., also contributed positively to induce the demand
- **Agriculture largely benefitted from the favourable weather conditions**

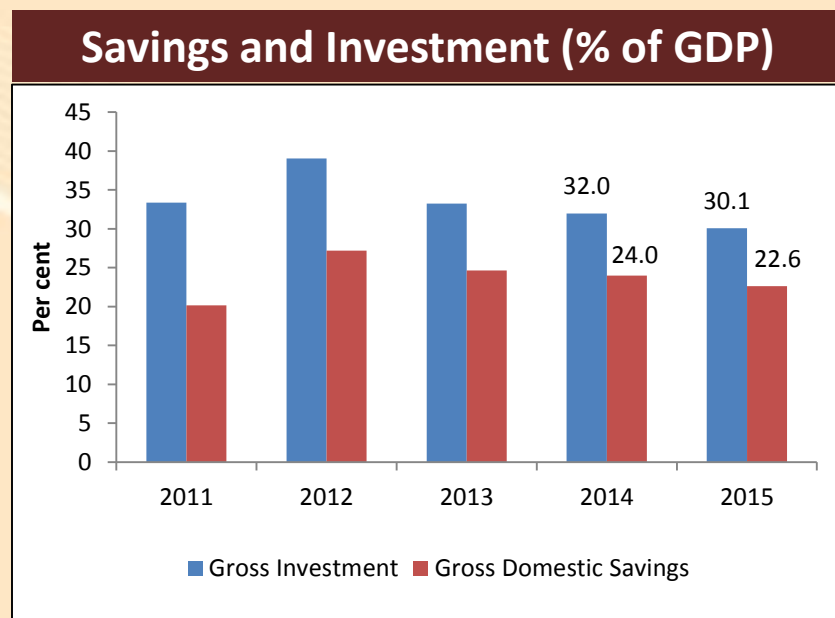


## Nevertheless, several domestic and global developments affected the economic activity...

- **Change in policy direction and attempts to re-evaluate large infrastructure projects affect the growth momentum and delayed possible capacity expansion in the economy.**
- **Slower than expected recovery in advanced economies, moderation in economic activities in China, and the economic distress in Russia and some Middle East countries dragged down the demand for exports.**
- **Spillovers from the subdued performance in the world economy weighed on domestic economic activities.**
- **A slowdown in the growth of demand in Sri Lanka's traditional export markets impacted the export sector.**

# Growth was largely driven by an increase in consumption with modest contribution of investments...

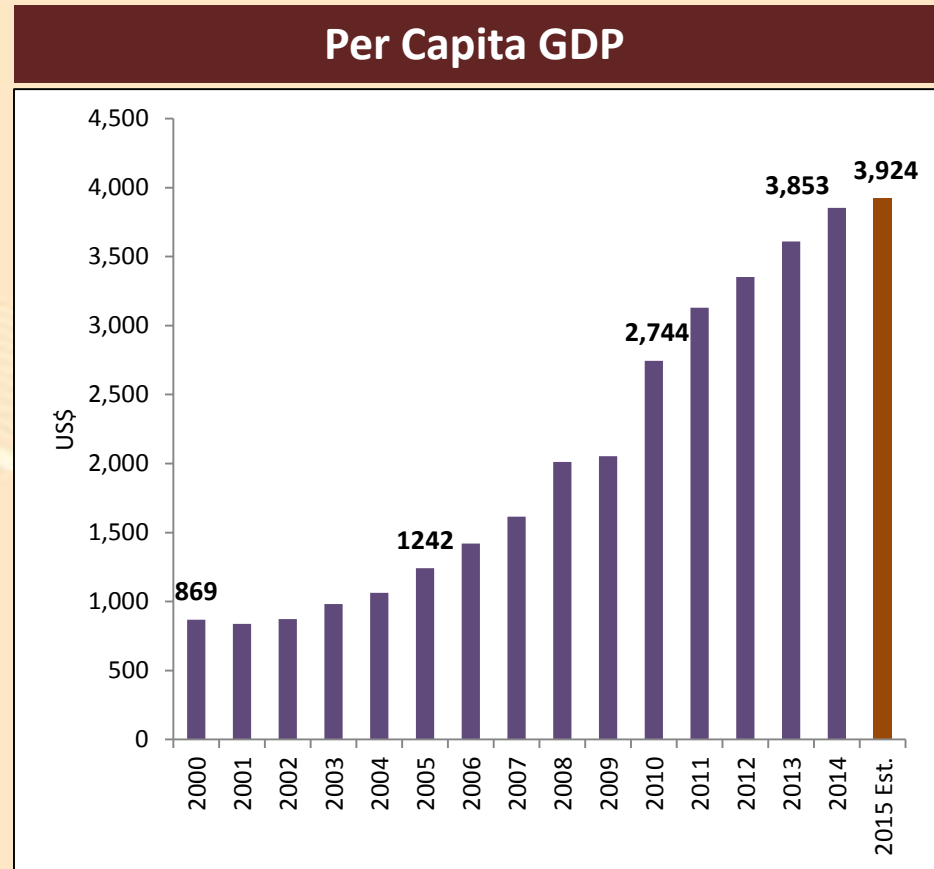
- Public consumption expenditure grew at a high rate (13.4%) reflecting the increase in salaries of public sector employees.
- Private consumption expenditure also grew (8.4%) due to the low interest rate environment and increased real wages.
- However, growth in investment activities decelerated to 0.6% from 4.8% in 2014.
- Domestic savings declined to 22.6% of GDP mainly due to an increase in government dissavings and the slowdown in private savings.



(a) The data is based on the base year 2010 GDP estimates of the Department of Census and Statistics

# GDP per capita increased to USD 3,924 in 2015 from USD 3,853 in 2014...

- GDP per capita was estimated at Rs. 533,398 for 2015 compared to Rs. 503,032 in 2014, recording a 6.0% growth in comparison to 7.9% in 2014.
- This was mainly attributable to the growth in nominal GDP (7.0%) in the midst of a fairly stable mid-year population growth level (0.9%).
- Country is gradually moving to upper middle income status.



# The low and stable inflation environment continued supporting the economy...

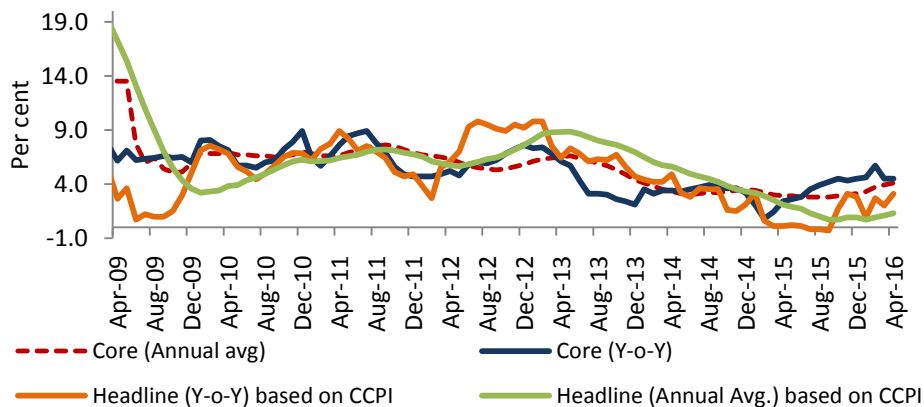
- Inflation remained low due to:**

- **Downward adjustment of administered prices**
- **Favourable supply side developments**
- **Well contained inflation expectations in the economy**
- **Relatively low international commodity prices including oil**

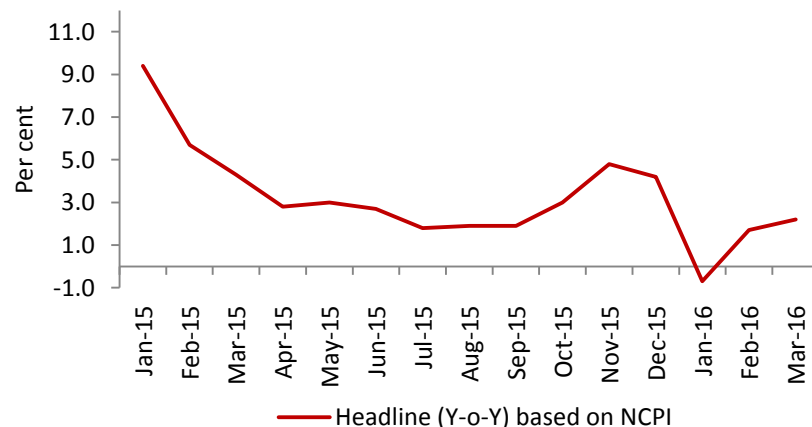
	Dec 2014	Dec 2015	Jan 2016	Feb 2016	Mar 2016	Apr 2016
Headline inflation (%) based on CCPI						
Y-o-Y	2.1	2.8	0.9	2.7	2.0	3.1
Annual average	3.3	0.9	0.7	0.9	1.1	1.3
Headline inflation (%) based on NCPI						
Y-o-Y	-	4.2	-0.7	1.7	2.2	-
Annual average	-	3.8	2.9	2.6	2.4	-
Core inflation (%) based on CCPI						
Y-o-Y	3.2	4.5	4.6	5.7	4.5	4.5
Annual average	3.5	3.1	3.3	3.7	3.9	4.1

## Movements in Inflation

CCPI (2006/2007 = 100)

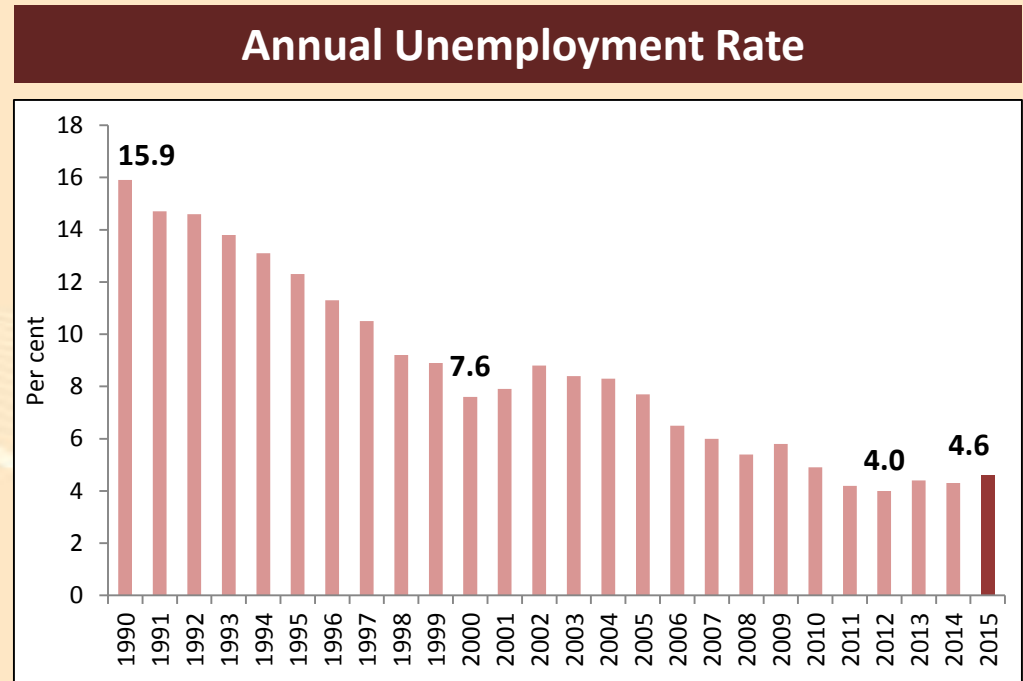


NCPI (2013 = 100)



# Unemployment rate increased to 4.6% during 2015, compared to 4.3% recorded in 2014...

- Female unemployment rate increased from 6.5% to 7.6%
- Male unemployment rate declined marginally from 3.1% to 3.0%
- Increase in unemployment among youth and those with GCE A/L qualifications and above was notable (from 8.1% in 2014 to 9.2% in 2015).



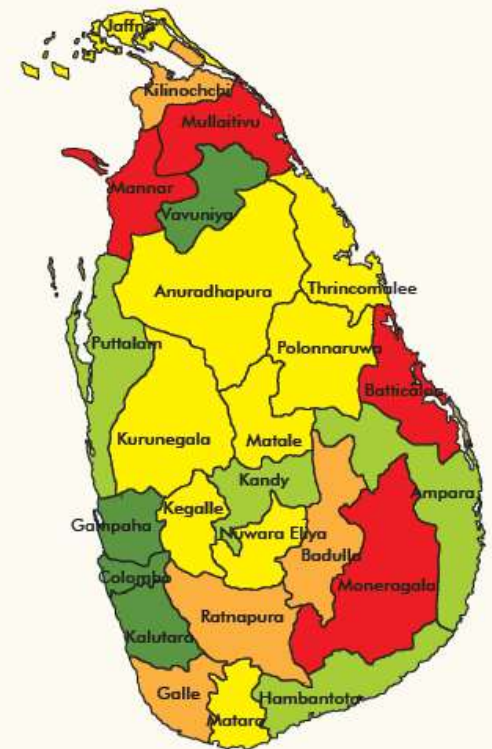
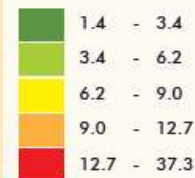
- Labour force participation rate (LFPR) increased to 53.8% from 53.3% with increased participation of rural sector females
- Although the LFPR increased, the new economic activities or the expansion of existing economic activities were not sufficient to absorb additional new labour into the labour force.

# Having achieved the MDG of halving poverty between 2000-2015, Sri Lanka now faces the challenge of addressing regional disparities and income inequality under SDGs...

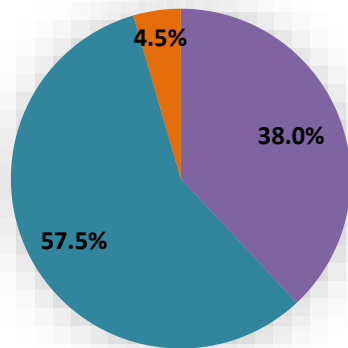
- It is needed to implement policies that will reach the extreme poor, especially in peripheral districts.
- As there is a legitimate right for the poor to have access to the socioeconomic infrastructure of the country, the government has the responsibility of addressing the issues on a systematic basis.

## Spatial Distribution of Poverty in Sri Lanka - 2012/13

Poverty Head Count Ratio



## Income Inequality - Share of Income



- Richest 10% of the Households
- Middle 70% of the Households
- Poorest 20% of the Households

# Improving economic and social infrastructure remained an integral part of the overall development drive...

- **Several key infrastructure projects were completed during the year.**
  - Phase II of the Outer Circular Highway (OCH)
  - Jaffna–Kankesanthurai and the Madhu – Thalaimannar sectors of the Northern railway line were opened to the public
  - Construction of phase I of the East Container Terminal (ECT) at port of Colombo
- **Number of infrastructure projects were initiated during the year.**
  - Central Expressway Project (CEP)
  - the ‘Google Loon Project’

However, in the absence of an efficient public transportation system, traffic volumes continued to exceed the capacity of roads.

# Improving economic and social infrastructure remained an integral part of the overall development drive...

- **Broad conceptual framework of the Western Region Megapolis Master Plan was drafted and the plan was unveiled in January 2016.**
- **Port City Project was permitted to recommence in first half of 2016.**
- **Lotus Tower project, Phase III of the OCH, the Extension of the Southern Expressway from Matara to Hambantota, Uma Oya Multipurpose Development project, Phase II of the Hambantota port and Road Sector Assistance Project II (Phase-II), progressed during the year.**

**Limitations in the fiscal space could constrain public investments required to expand and improve the quality of infrastructure.**

**Hence, funding of infrastructure investment projects in a number of countries has increasingly taken the form of equity financing, which is able to attract private capital for infrastructure investments.**



## Social indicators continued to improve with enhanced government investment on human development...

Indicator	2014	2015
Human Development Index (HDI)	0.752	0.757
HDI World Rank	74	73
Number of persons per doctor (Government health sector)	1,155	1,079
Number of hospital beds (Government health sector) available per 1,000 persons	3.7	3.7
School density (area covered by a school) (sq. km)	6.5	6.5
Student teacher ratio in Government schools	18	17
Level of electrification (%)	98	98.5
Telephone penetration (connections per 100 persons)	120.0	128.7
	2009/10	2012/13
Accessibility to safe drinking water (%)	87.7	89.7
Poverty headcount ratio (%)	8.9	6.7

- A healthier workforce with market oriented skills is necessary to sustain a high level of economic growth in the future.

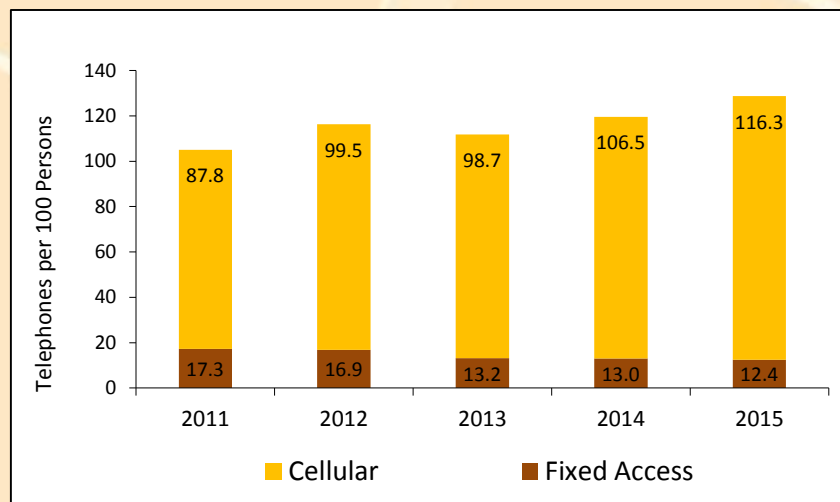
# Telecommunication sector continued to progress in line with the remarkable advancement and innovation in the global telecommunications technology...

- Telephone density increased to 128.7 in 2015 from 120.0 in 2014.
- Number of mobile telephone connections increased by 10.2%.



- Government and Google Inc. signed an agreement to initiate the 'Google Loon' project in July 2015, which will cover the entire Island with 4G internet.
- Successful implementation of the project will provide enhanced accessibility to high-speed, affordable internet across the Island.

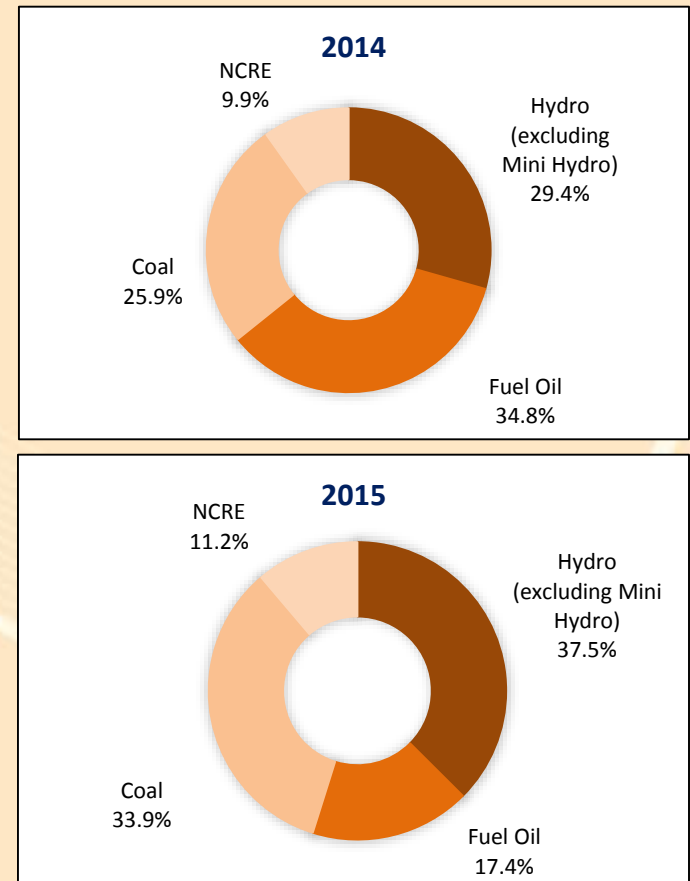
## Telephone Penetration



# Electricity generation mix has been significantly improved...

- Total electricity generation in 2015 increased by 5.9% to 13,090 GWh, from 12,357 GWh in 2014, facilitating the increased demand for energy
- Cumulative effect of increased hydro and coal power generation helped to lower fuel oil generation
- Electricity sales increased by 6.5% to 11,786 GWh in 2015 in comparison to the growth of 4.2% in 2014
- Optimal use of hydro and coal power sources through minimised overflows in reservoirs and appropriate timing of maintenance stoppages, is vital to further enhance the financial viability of the Ceylon Electricity Board.

## Electricity Generation Mix



# Road development continued to be a key policy priority of the government in 2015, while passenger transportation displayed some progress...

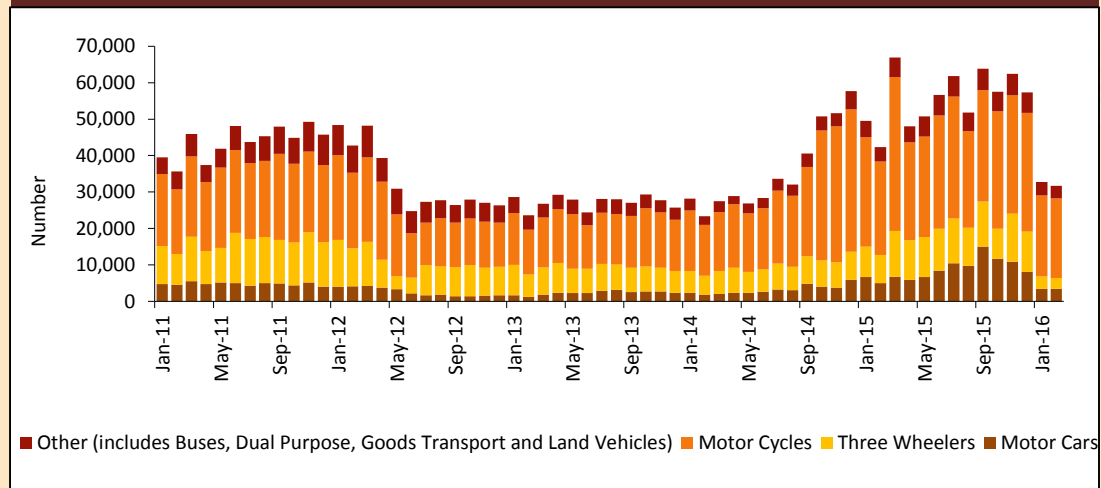
## Road Development

- Completion of extensions to the national expressway network continued while construction work of new expressways was initiated.
- Several road construction, rehabilitation and maintenance projects were in progress during 2015.
- A number of measures were taken to reduce traffic congestion in major cities and improve road safety.

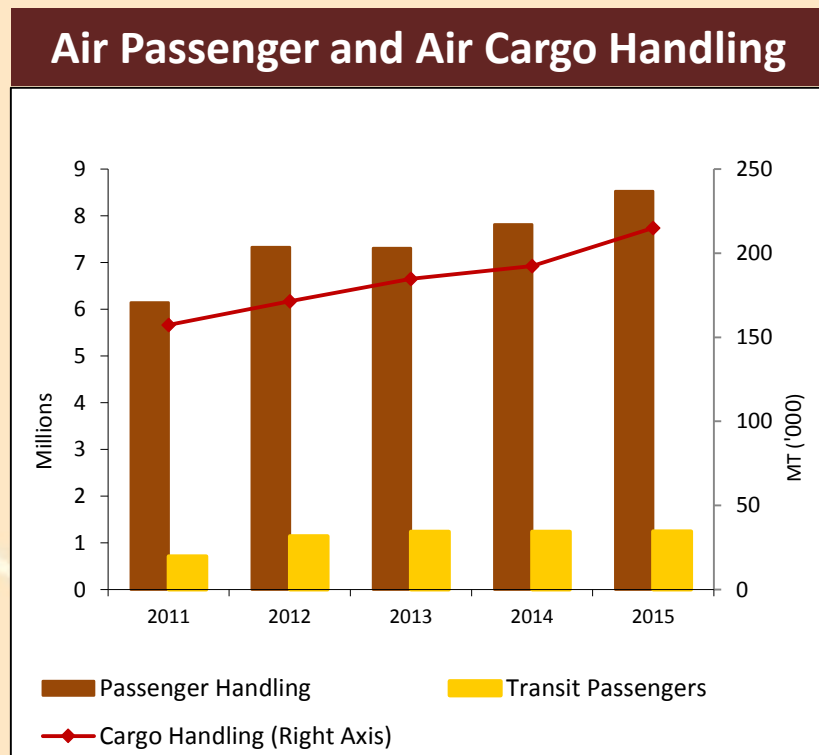
## Passenger Transportation

- Passenger kilometrage of SLTB and private buses increased by 19.6% and 6.1%, respectively, during the year.
- Rail passenger kilometrage increased by 8.3%.
- Registration of motor vehicles increased substantially during 2015 by 55.7%.

## New Registrations of Motor Vehicles



# Reflecting the increase in tourist arrivals, air passenger movements increased by 9.3% to 8.5 mn during 2015...

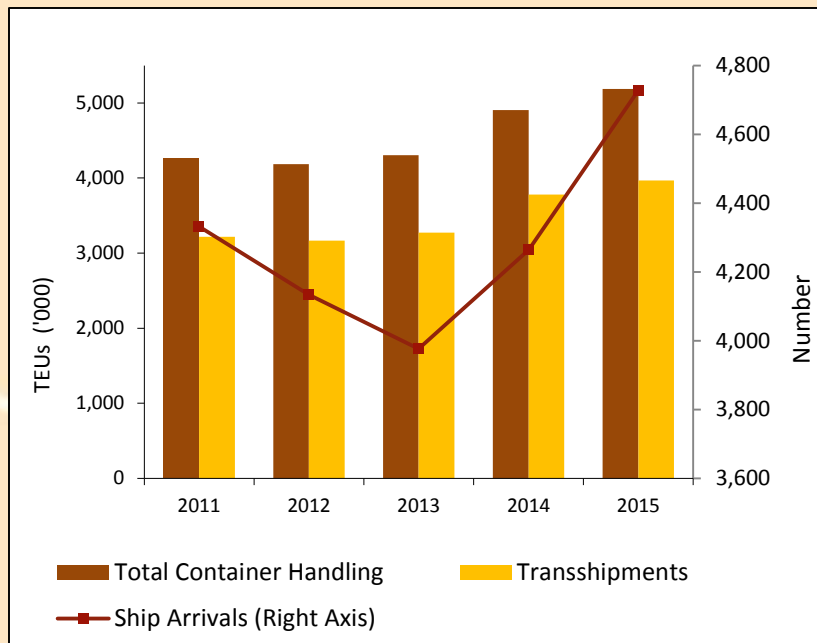


- Through Bandaranaike International Airport (BIA):
  - Transit passengers increased by 4.1% to 1.2 mn
  - Total volume of cargo handling increased by 11.8%
  - No. of aircraft handled increased by 4.6% to 57,823
- SriLankan Airlines (SLA) recorded an operating loss of Rs. 10.6 bn in 2015 compared to Rs. 29.0 bn in 2014

- Engineering designs of Phase 2 – Stage 2 of the BIA expansion project were mostly completed during 2015.

# Port of Colombo recorded its highest annual container throughput during the year...

## Container Handling, Transshipment Volume and Ship Arrivals



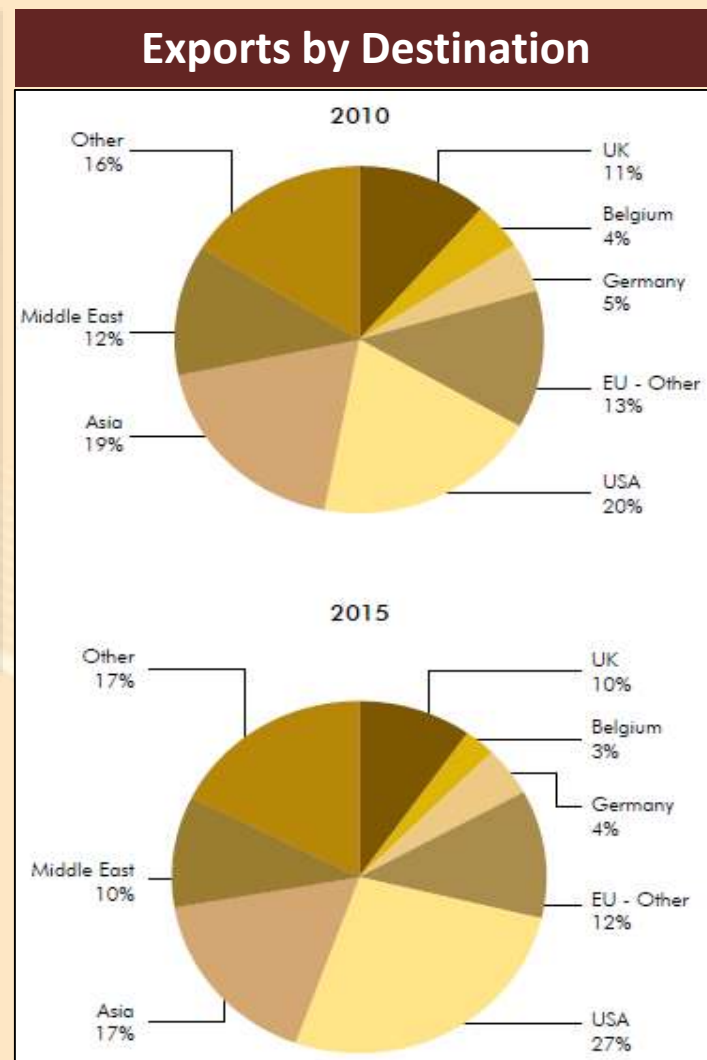
- Total container handling in 2015 increased by 5.7% to 5.2 mn TEUs from 4.9 mn TEUs in 2014
- Container ship arrivals to Colombo Port increased by 12.5%
- Total container handling of the Colombo International Container Terminal (CICT) grew substantially by 127.5%
- However, the performance of all other terminals deteriorated during the year

- Construction of Phase I of the East Container Terminal (ECT) at port of Colombo was completed in 2015.
- The construction of Phase II of the Hambantota port continued in 2015.

In the external sector, earnings from exports contracted by 5.6% in 2015 reflecting a decline across almost all major export categories...

Category	2014	2015 (a)	Y-o-Y
	Value	Value	Change
	(US\$ mn.)	(US\$ mn.)	%
<b>Agricultural Exports</b>	<b>2,793.9</b>	<b>2,481.5</b>	<b>-11.2</b>
Tea	1,628.3	1,340.5	-17.7
Rubber	45.3	26.1	-42.3
Spices	264.6	377.4	42.7
Sea Food	252.7	163.1	-35.5
<b>Industrial Exports</b>	<b>8,262.0</b>	<b>7,975.6</b>	<b>-3.5</b>
Textiles and Garments	4,929.9	4,820.2	-2.2
Rubber Products	889.8	761.2	-14.5
Transport Equipment	151.8	243.7	60.5
<b>Mineral Exports</b>	<b>59.5</b>	<b>28.4</b>	<b>-52.3</b>
<b>Total Exports</b>	<b>11,130.1</b>	<b>10,504.9</b>	<b>-5.6</b>

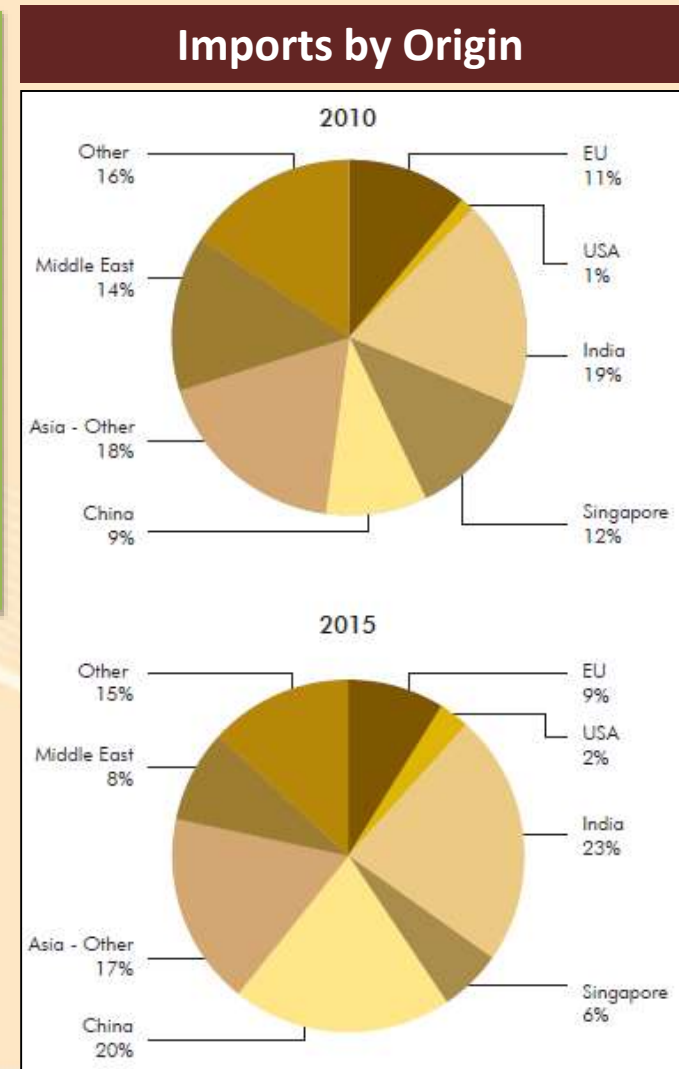
- Decline in international commodity prices, slower pace of growth in advanced economies, geopolitical uncertainties, and restrictions by the EU on fish imports contributed to the decline.



# Overall expenditure on imports declined by 2.5%, although expenditure on non-fuel imports increased significantly by 9.6%

Category	2014	2015 (a)	Y-o-Y
	Value	Value	Change
	(US\$ mn.)	(US\$ mn.)	%
<b>Consumer Goods</b>	<b>3,852.5</b>	<b>4,713.5</b>	<b>22.3</b>
Food and Beverages	1,633.7	1,627.8	-0.4
Vehicles	896.7	1,359.6	51.6
<b>Intermediate Goods</b>	<b>11,397.7</b>	<b>9,638.2</b>	<b>-15.4</b>
Fuel	4,597.3	2,699.6	-41.3
<b>Investment Goods</b>	<b>4,152.2</b>	<b>4,567.0</b>	<b>10.0</b>
Building Materials	1,308.9	1,352.0	3.3
Transport Equipment	707.3	930.9	31.6
<b>Total Imports</b>	<b>19,416.8</b>	<b>18,934.6</b>	<b>-2.5</b>

- Fuel import bill declined by USD 1.9 bn to USD 2.7 bn due to the significant decline in international oil prices.
- However, higher expenditure on importation of personal motor vehicles and other consumer durables contributed to the increase in non-fuel imports.





# Higher decline in exports resulted in the expansion of the trade deficit in 2015...

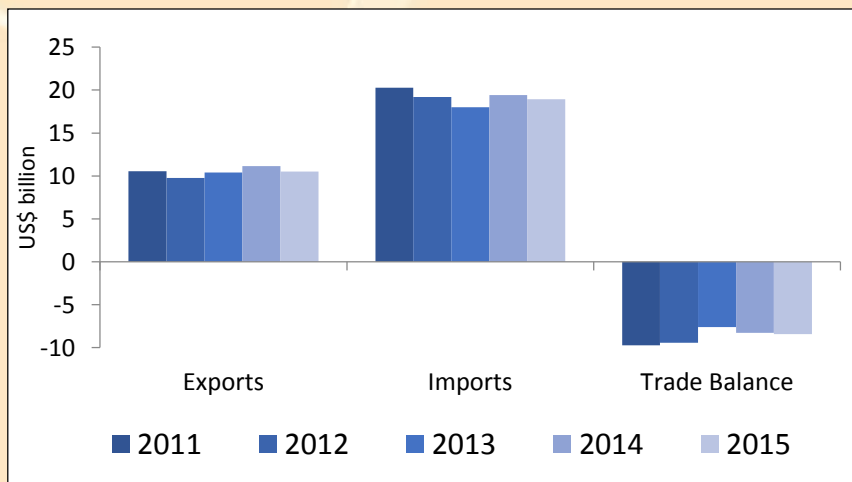
## Trade Deficit

- Trade deficit expanded marginally to USD 8,430 mn in 2015 from USD 8,287 mn recorded in 2014.
- However, as a percentage of GDP, the deficit in the trade balance decreased to 10.2% in 2015 from 10.4% in 2014.

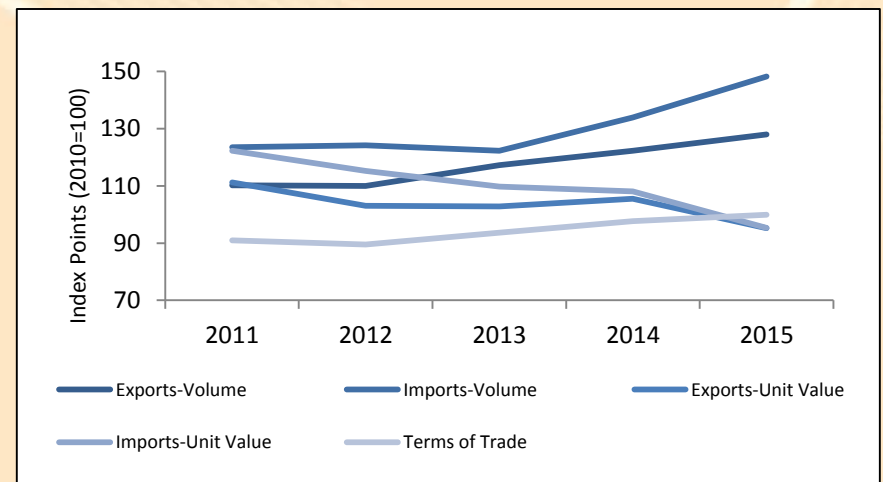
## Terms of Trade

- Significantly large decline recorded in import prices led by petroleum, in comparison to the reduction in export prices, led the terms of trade to improve by 2.3% in 2015.

## Exports, Imports and Trade Balance



## Terms of Trade and Trade Indices



# Earnings from tourism increased significantly even though workers' remittances witnessed a moderation...

## Tourist arrivals

- Tourist arrivals increased to 1.8 mn
- Tourist arrivals from all major regions, except Eastern Europe, increased
- Earnings from tourism increased by 22.6% to USD 2,981 mn

## Workers' Remittances

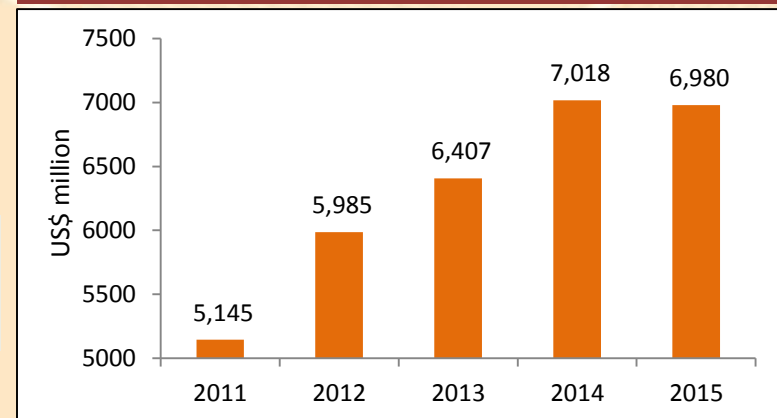
- Workers' remittances declined by 0.5% to USD 6,980 mn
- This was largely attributable to the fall in income of oil exporting countries in the Middle East

Labour migration under the skilled category, including professionals, had increased by 12.5 %

### Tourist Arrivals and Earnings from Tourism

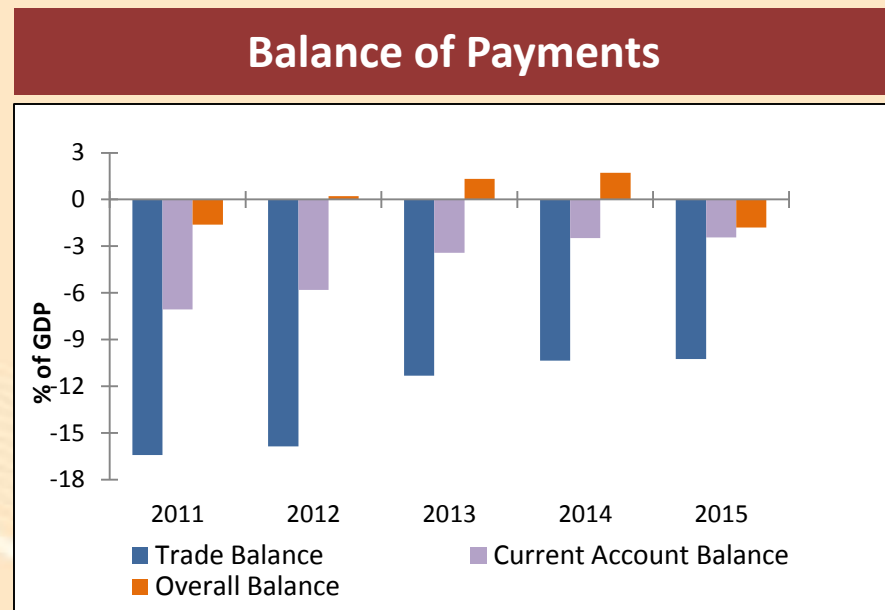


### Workers' Remittances



# External current account deficit in 2015 remained broadly unchanged compared to 2014 levels...

- Current account deficit remained largely unchanged as a result of the surpluses in the services and secondary income accounts
  - Merchandise trade and primary income deficits widened
  - However, services and secondary income accounts registered surpluses
  - Satisfactory performance in travel, transportation and telecommunications, computer and information services sub sectors witnessed

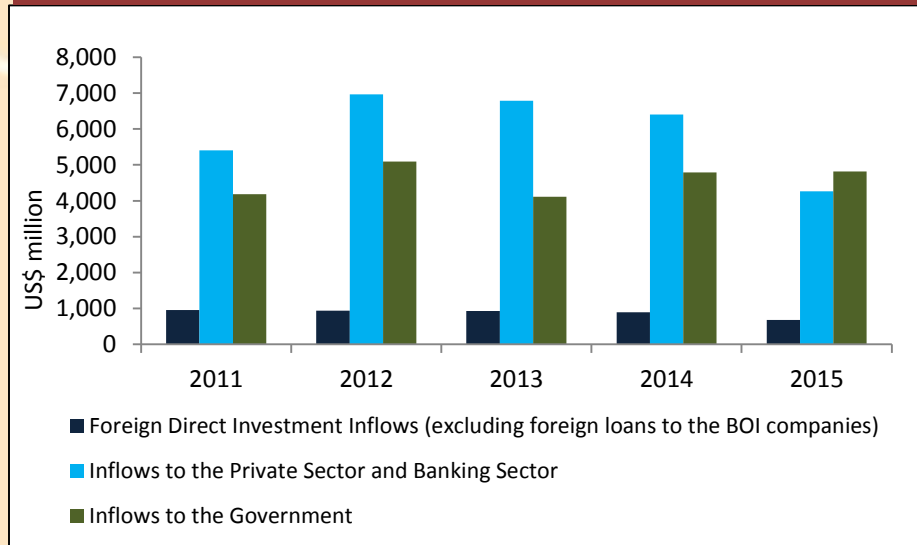


- Current account deficit amounted to USD 2,009 mn in 2015 compared to USD 1,998 mn recorded a year earlier.
- As a percentage of GDP, it narrowed slightly to 2.4% in 2015, compared to 2.5% in 2014.

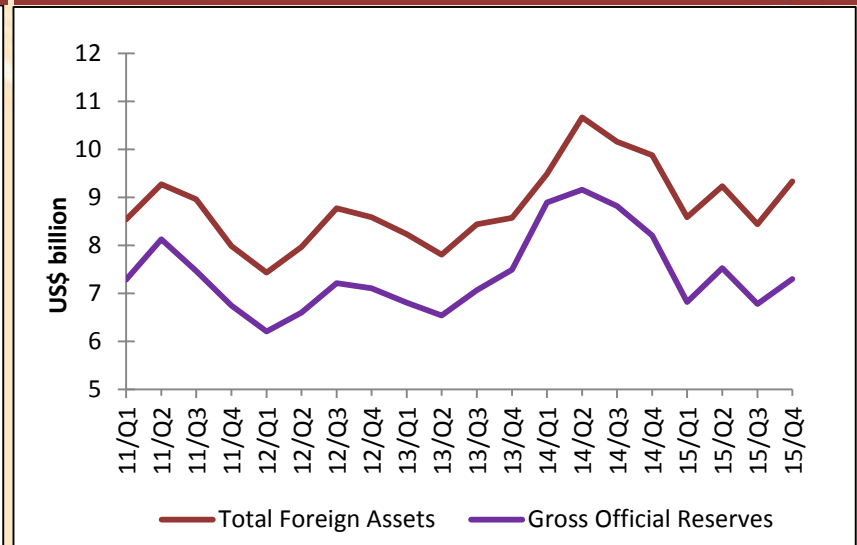
# The BOP deteriorated in 2015 largely due to lower than expected financial inflows and higher capital outflows...

- In 2015, the BOP recorded an overall deficit of USD 1,489 mn in comparison to the surplus of USD 1,369 mn recorded in 2014.
- Modest performance of the current account together with comparatively low level of inflows to the financial account and higher outflows contributed to the deterioration of the BOP.
- Gross official reserves declined to USD 7.3 bn (equivalent to 4.6 months of imports of goods) at end 2015 from USD 8.2 bn at end 2014.

## Inflows to the Financial Account

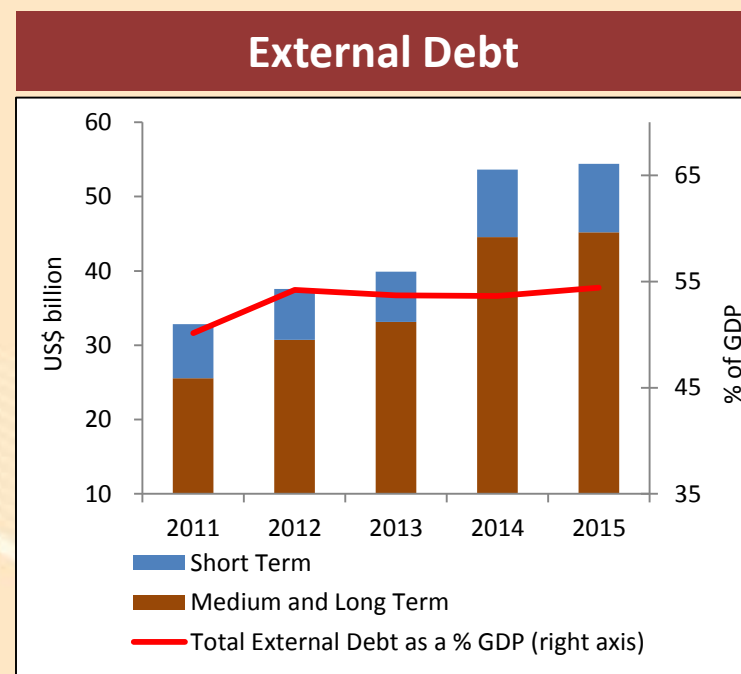


## Gross Official Reserves



# Total external debt increased marginally due to the moderate level of inflows on account of foreign loans, and substantial debt service payments...

- Total external debt stock amounted to USD 44.8 bn as at end 2015 compared to USD 42.9 bn as at end 2014.
- Total external debt increased to 54.4% of GDP as at end 2015, from 53.6% as at end 2014.
- Debt service payments on external debt obligations increased significantly to USD 4,684 mn.
- Ratio of debt service payments as a % of export of goods and services increased to 27.7%.

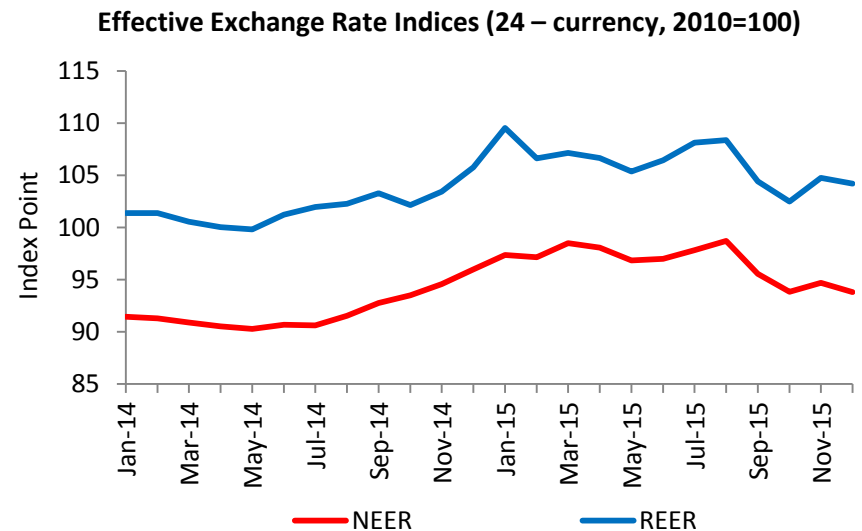
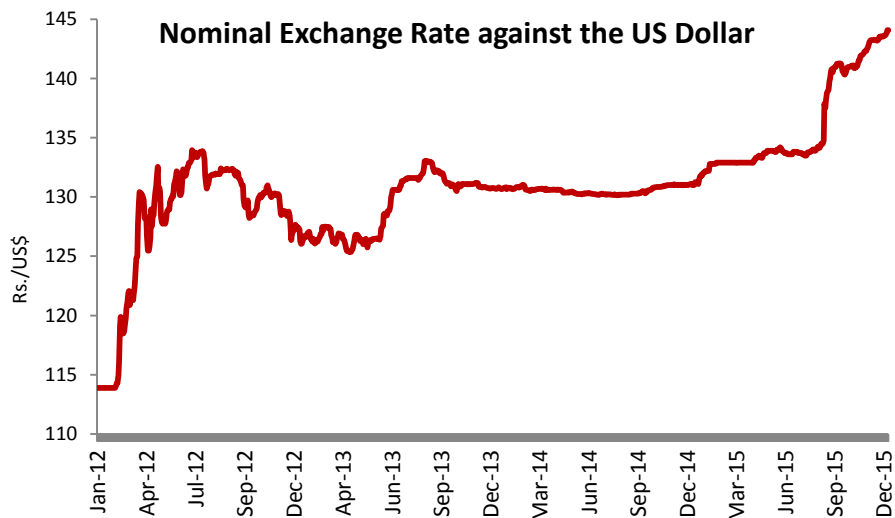


Inflow of non-debt creating financial flows (FDI and services exports) need to be increased significantly to compensate additional future borrowing requirements.

# Central Bank allowed greater flexibility in the determination of the exchange rate in September 2015...

- Sri Lankan rupee remained broadly stable during the first eight months of 2015, but depreciated thereafter to record an annual depreciation of 9%
- A substantial pressure on the domestic foreign exchange market was 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
  - reversal of foreign investments from the government securities market
- Effective exchange rate indices also depreciated during 2015, improving the country's external competitiveness

## Exchange Rate Movements



# Fiscal management in 2015 was extremely challenging due to various domestic and global developments...

- During the year, fiscal performance reflected the challenges faced by the government
  - Domestic challenges:
    - Uncertainty prevailed in the inter-election period
    - Slowdown in economic activity
  - External sector related issues:
    - Tightened international financial market conditions
    - Slowdown in foreign inflows
- A notable deviation from fiscal targets announced in January 2015 in the Interim Budget for 2015 was observed despite improvements in some areas

# The performance in the government finances reflects serious structural weaknesses in the government budget...

- As reflected in the sizable deficit (2.2%) in the revenue account (current account) of the budget, the country's revenue is not sufficient even to finance the maintenance expenditure of the government.
- Government is forced to recourse to borrowings even for its day-to-day operations.
- This weakness in the structure of the budget lessens the channeling of adequate expenditure for development needs.

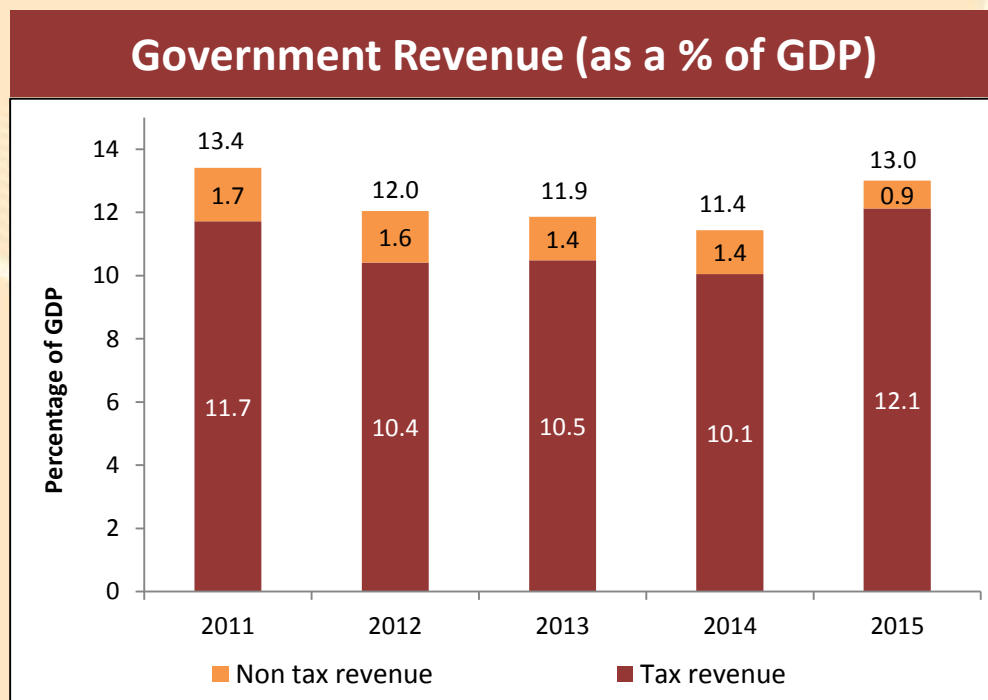
## Measures taken by the Government

- Redrafting of tax laws with technical assistance from the IMF to simplify the tax laws
- Improvements in tax administration, including the automation of revenue agencies:
  - Revenue Administration Management Information System (RAMIS) at Inland Revenue Department (IRD)
  - Single Window System (SWS) at Sri Lanka Customs
  - Integrated Treasury Management Information System (ITMIS) at the Ministry of Finance (MOF)
- Introducing the zero based budgeting system by the MOF
- Setting up of Budget Implementation and Monitoring Unit (BIMU) to ensure close monitoring of expenditure programmes



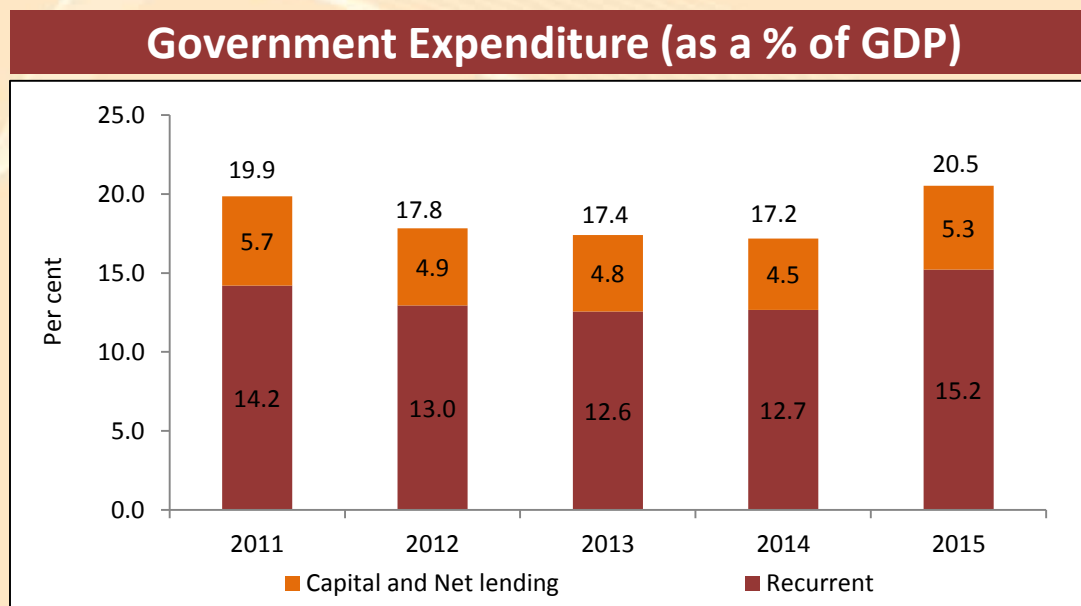
# Government revenue increased both in nominal terms and as a percentage of GDP in 2015...

- **Government revenue as a % of GDP increased to 13.0% in 2015 from 11.4% in 2014, although it remained lower than the Budgetary target of 13.3% for 2015:**
  - In nominal terms, total revenue increased by 21.7% to Rs.1,455 bn
  - Increased revenue collection from excise duties, income taxes and import duties
  - Non tax revenue declined due to the decline in profit and dividend transfers of SOBEs and declined interest and rent income



# Total expenditure increased reflecting a significant increase in both recurrent expenditure and public investment...

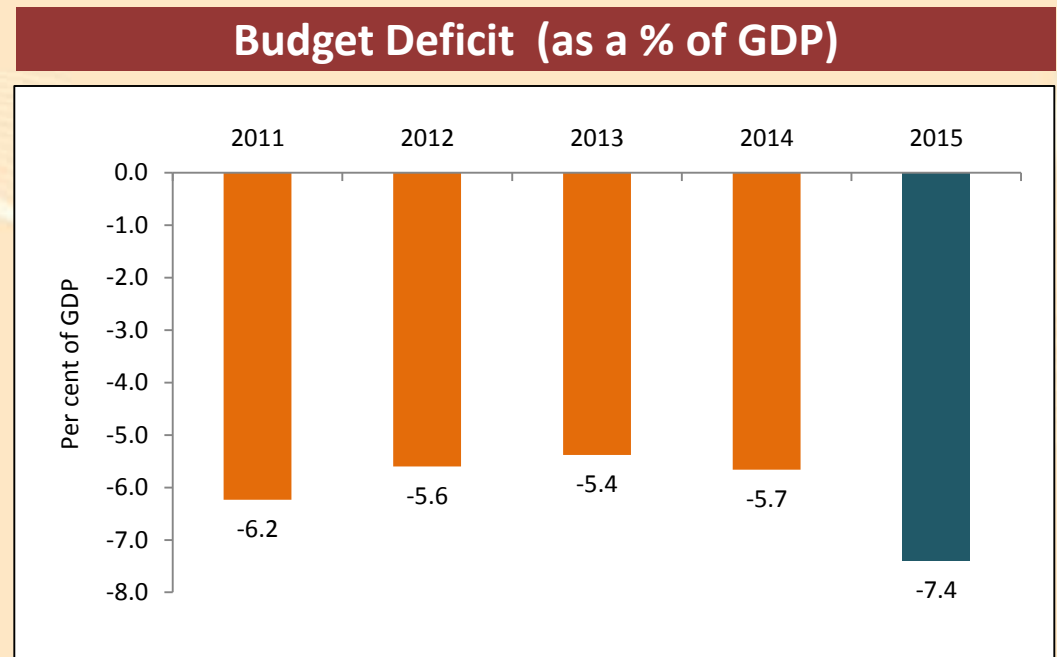
- Total expenditure and net lending increased by 27.5% to Rs.2,290 bn in 2015.
- Recurrent expenditure increased by 28.6% to Rs.1,702 bn, exceeding the budgetary target of Rs.1,552 bn.
- Expenditure overrun reflected the increased expenditure on salaries and wages, interest payments, current transfers and subsidies.
- Public investment increased by 23.9% to Rs. 602.8 bn in 2015.



# Key fiscal balances deviated from the annual targets...

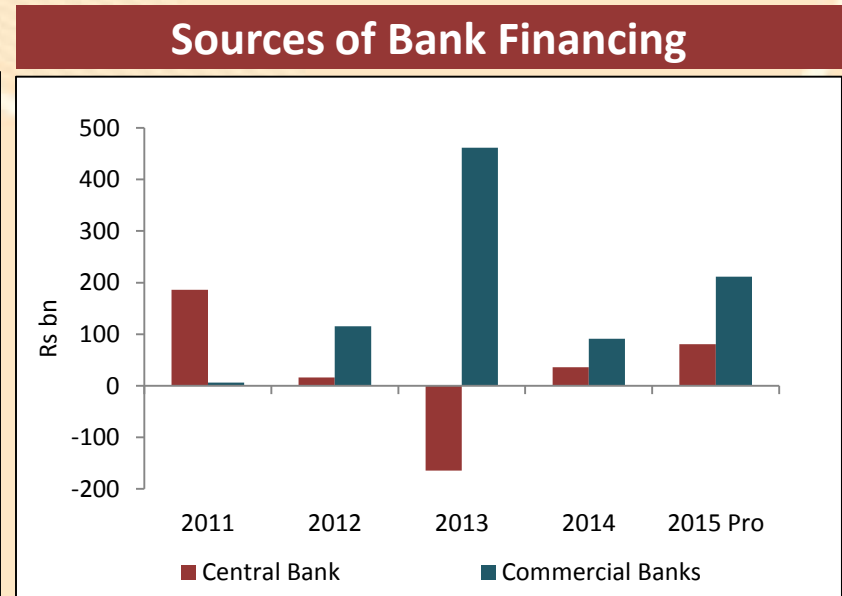
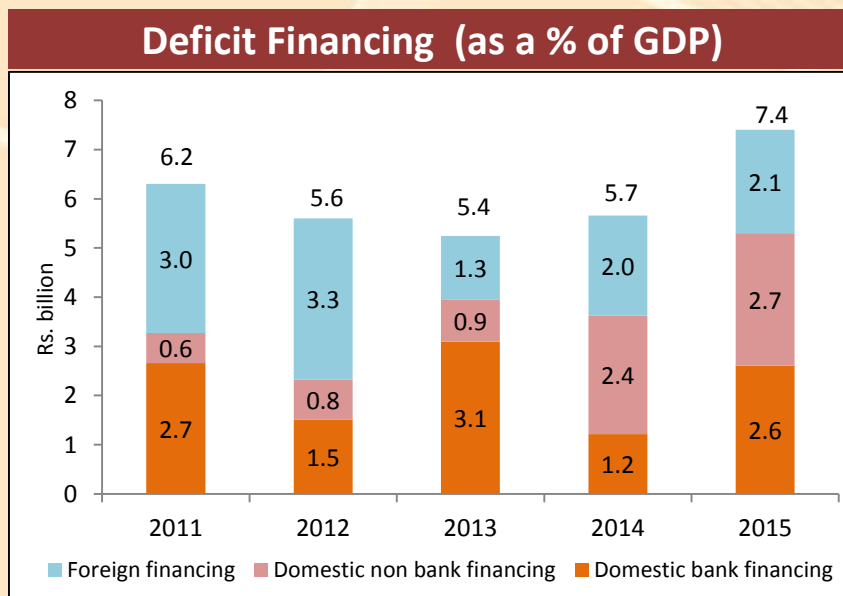
- Budget deficit increased to 7.4% of GDP in 2015 compared to 5.7% of GDP recorded in 2014 and the annual target of 4.4% of GDP envisaged in the Budget for 2015.

- Current account deficit, which indicates the government's dissaving, increased to 2.2% of GDP in 2015 from 1.2% of GDP in the previous year.
- Primary deficit, calculated excluding the interest payments from the overall deficit, increased to 2.9% of GDP.



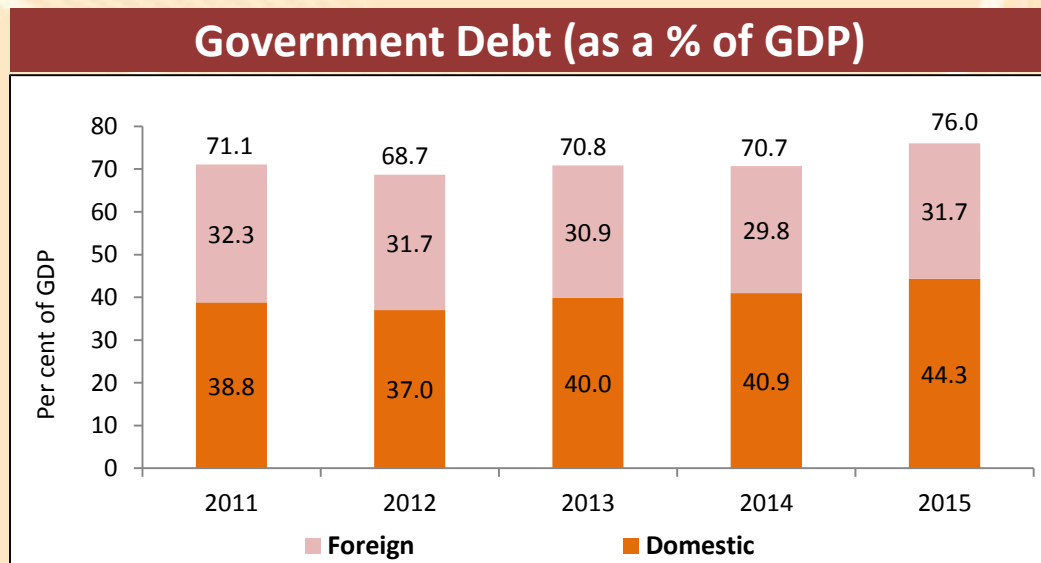
# In financing the budget deficit, the government relied mainly on domestic sources of financing...

- Net domestic financing increased from Rs. 379 bn in 2014 to Rs. 593 bn in 2015, a significant deviation from the annual estimate of Rs. 208 bn.
- Of the total net domestic financing, 50.8% was raised from the non-bank sector.
- Government borrowings from the banking sector also increased largely exceeding the annual estimate of Rs. 70 bn.



# Debt to GDP ratio increased reflecting a deterioration in fiscal sector performance, exchange rate depreciation and relatively low economic growth...

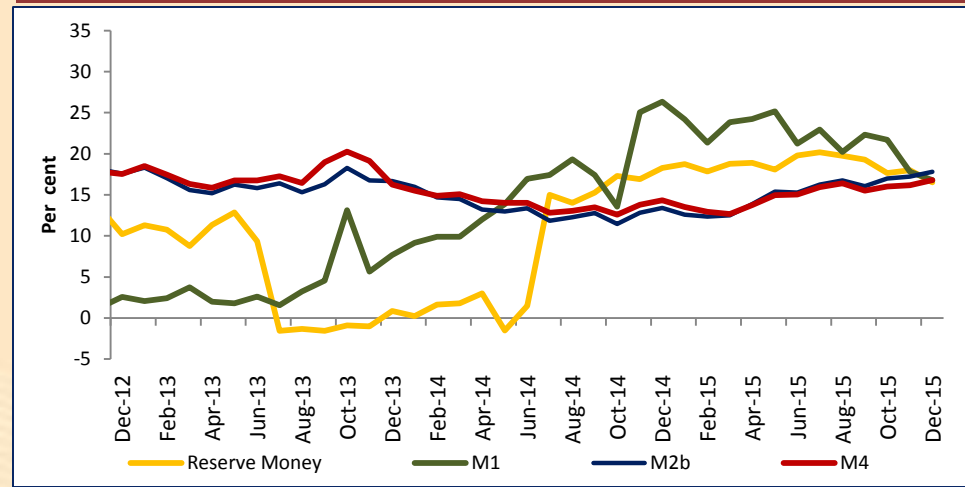
- Total government debt to GDP ratio increased to 76.0% at end 2015 from 70.7% at end 2014.
- In nominal terms, total outstanding government debt increased by 15.0% to Rs. 8,503 bn at end 2015.
- Increased level of borrowings, the significant depreciation of the rupee against major foreign currencies and relatively low economic growth contributed to this increase.
- Share of domestic debt in total government debt stood at 58.3% at end 2015.
- Average time to maturity of the domestic debt stock increased to 6.28 years by end 2015 from 5.75 years in the previous year, indicating the higher issuance of medium and long term government securities.



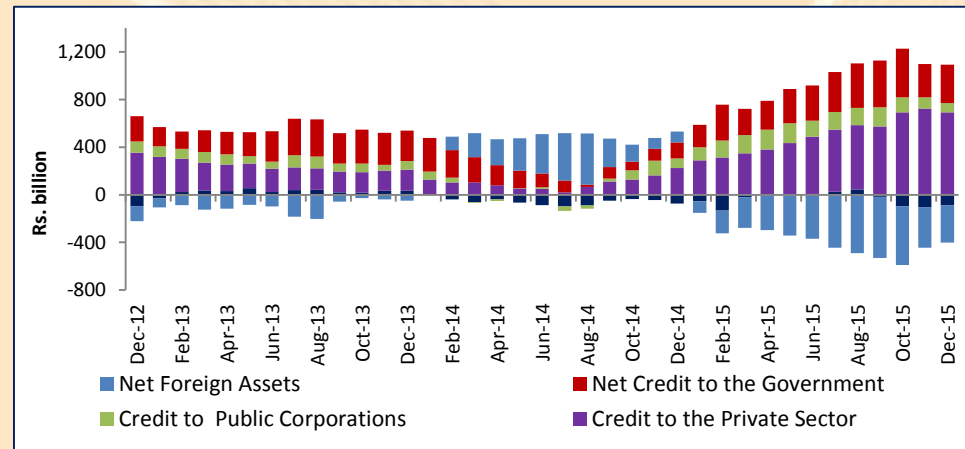
# Monetary aggregates increased at a higher than projected rate in 2015...

- Reserve money expanded at a relatively high pace during 2015
  - Continued expansion of reserve money was mainly due to the significant increase in currency in circulation
- Broad money ( $M_{2b}$ ) growth accelerated during 2015 beyond the projected levels
  - Monetary expansion was entirely due to the increase in net domestic assets (NDA)
  - Net foreign assets (NFA) of the banking system recorded a contraction

Year-on-Year Growth of Monetary Aggregates



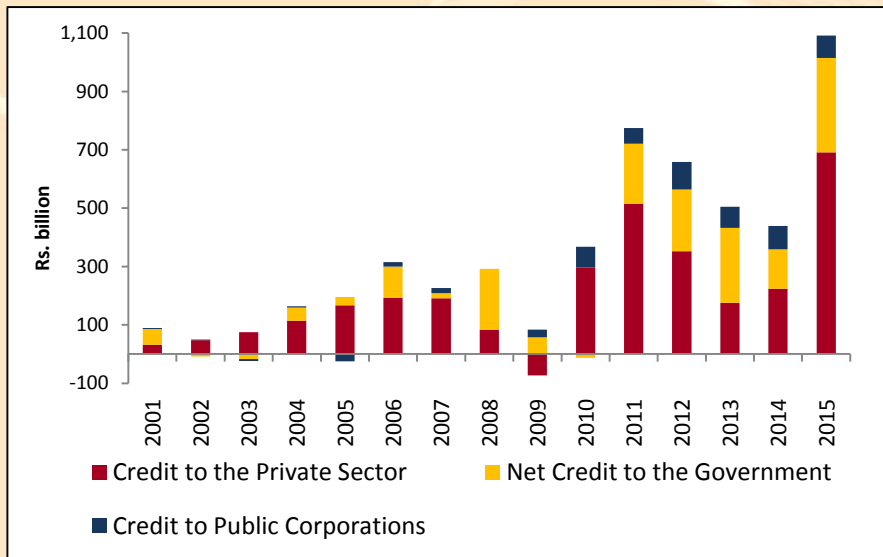
Contribution to Year-on-Year Change in Broad Money -  $M_{2b}$  (Assets Side)



# Monetary expansion reflects increased demand for domestic credit from both the public and private sectors...

- During 2015, domestic credit extended by the banking system expanded significantly due to increases in;
  - Net credit to the government (NCG)
  - Credit to public corporations
  - Credit to the private sector

Annual Increase in Domestic Credit

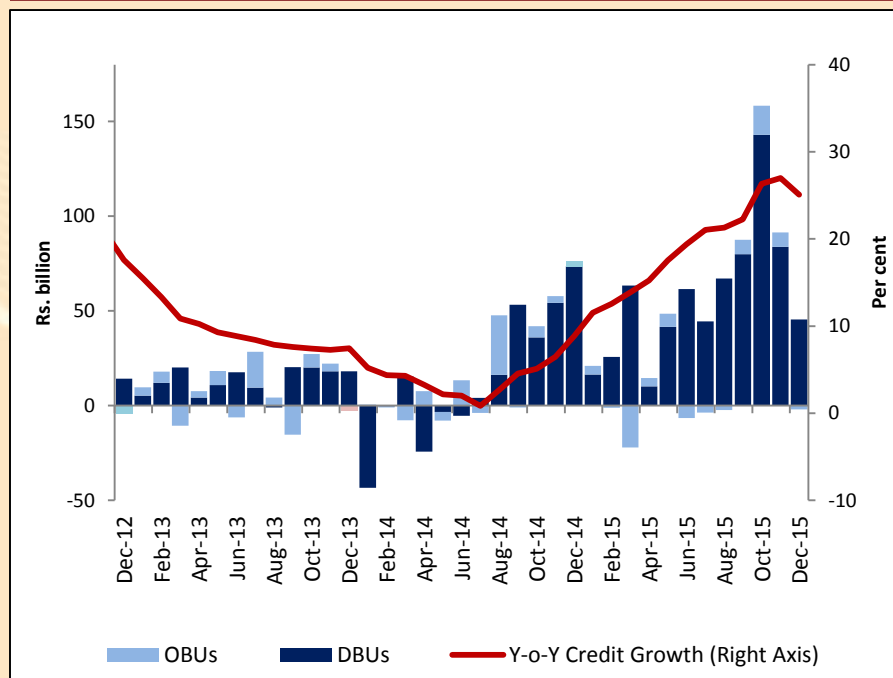


- NCG extended by the banking system increased substantially by Rs. 323.6 bn compared to the increase of Rs. 134.6 bn recorded in 2014.
- Increased reliance of the government on domestic financing amidst delays in the receipt of foreign financial flows led to an increase in NCG.
- Credit to public corporations increased by Rs. 76.9 bn in 2015 in comparison to the increase of Rs. 80.9 bn observed in 2014.

# In response to continued relaxed monetary conditions, credit extended to the private sector by commercial banks expanded substantially in 2015...

- Credit to the private sector, which bottomed out at 0.8% in July 2014, steadily expanded and recorded a growth of 25.1 % by end 2015.
- Expansion in credit to the private sector in absolute terms during 2015 was Rs. 691.4 bn.
- Sharp increase in credit to the private sector was due to low market lending rates and aggressive marketing campaigns by lending institutions.

Credit to the Private Sector by Commercial Banks

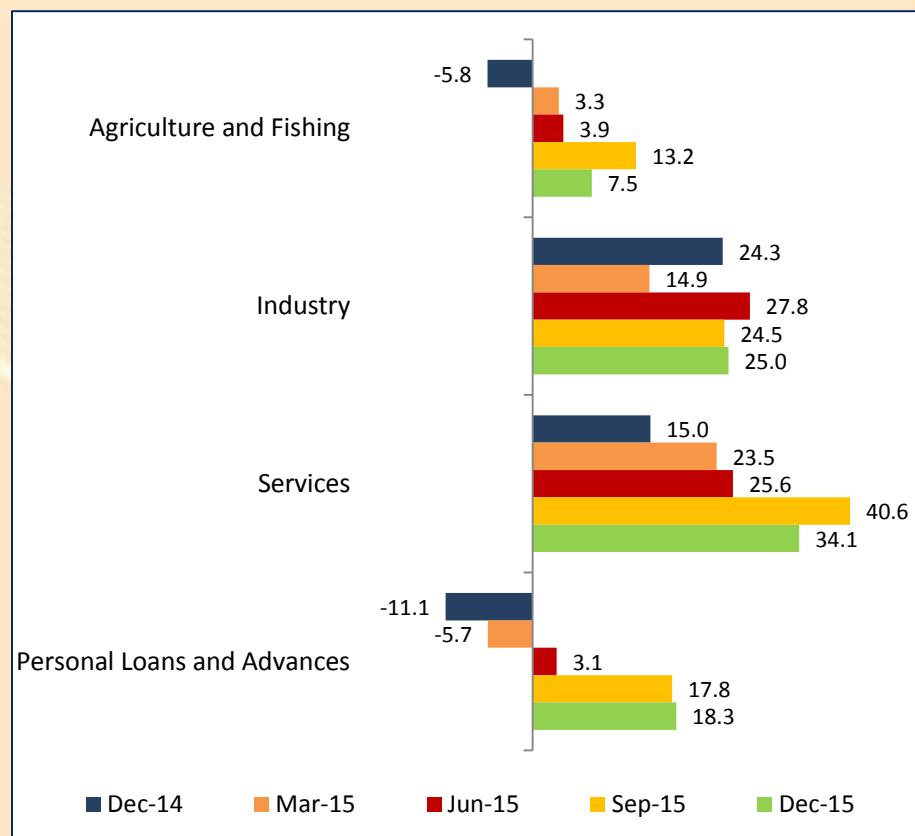




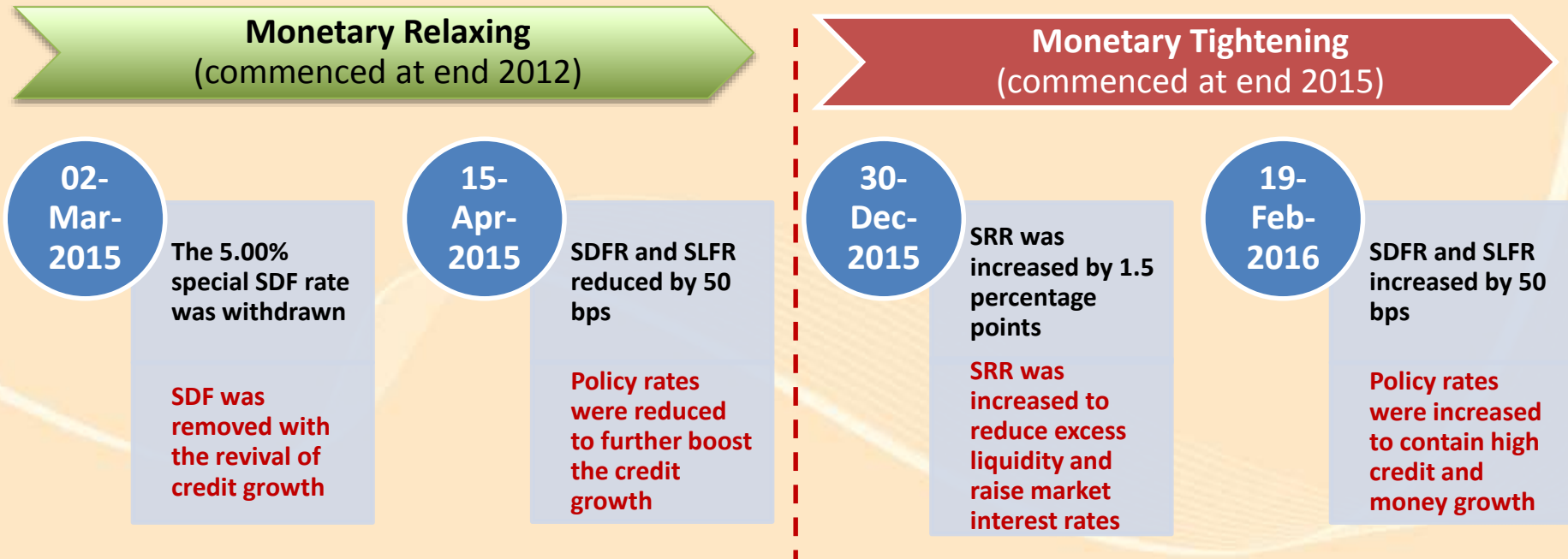
# Credit disbursed to all major sectors of the economy expanded during the year...

- Credit flows to the Services sector and the Industry sector expanded significantly by 34.1% and 25.0%, respectively.
- Compared to the contraction in 2014, a growth of 7.5% was observed in credit flows to the Agriculture and Fishing sector.
- Personal Loans and Advances (including loans for purchasing consumer durables, health and education services and pawning and credit card balances) increased by 18.3%.

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



Although a relaxed monetary policy stance was maintained in 2015, a gradual tightening was initiated towards end 2015 to pre-empt the emergence of excessive demand pressures...

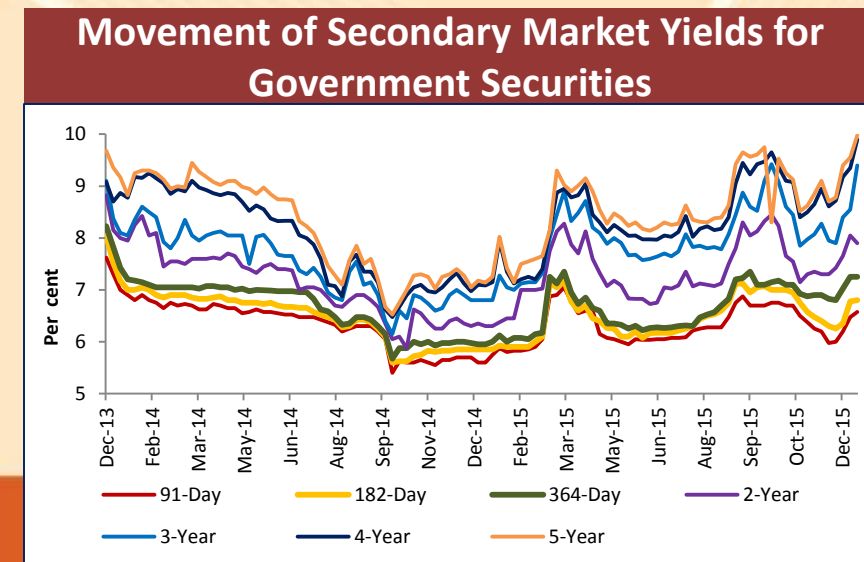
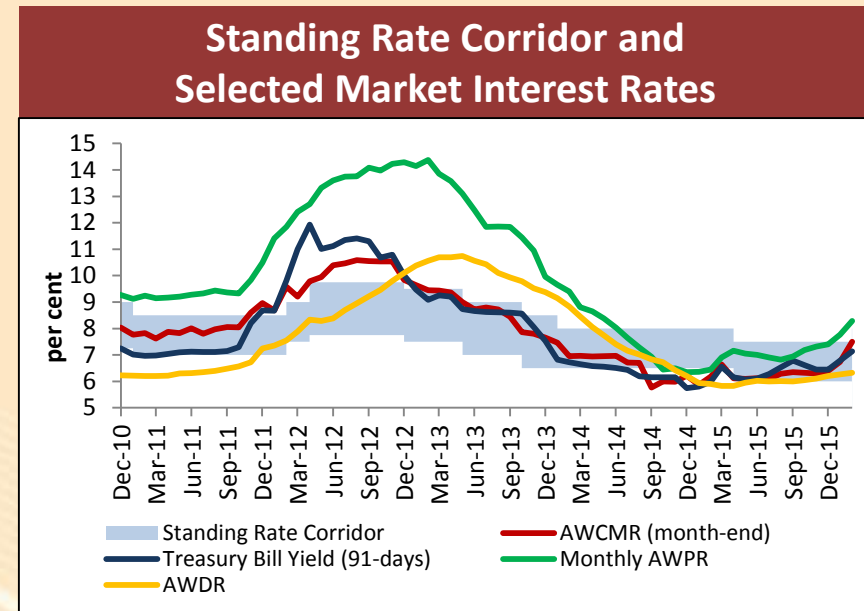


### Monetary policy measures were supported by external sector policies and macro-prudential measures

- Sep 2015: Exchange rate was allowed to be determined based on demand and supply conditions in the foreign exchange market
- Oct 2015: A minimum cash margin requirement of 100% was imposed against Letters of Credit opened with commercial banks for the importation of motor vehicles
- Dec 2015: A maximum Loan to Value (LTV) ratio of 70% was imposed in respect of loans and advances granted for the purpose of purchase or utilisation of motor vehicles by banks and financial institutions

# Market interest rates remained low during 2015 although some upward movements were witnessed intermittently...

- Interbank call money market rates responded to policy adjustments and changing liquidity conditions in the domestic money market.
- With the decline in market liquidity levels, a gradual upward adjustment in overnight interest rates was observed since August 2015
- Yield rates on government securities increased during 2015.
- Although most of the market interest rates remained low during the year, with the policy actions by the Central Banks, market rates trended upwards towards end 2015.



# In 2015, the financial sector expanded further reflecting the underlying economic performance and supportive prudential regulatory measures...

- A number of regulatory policies were introduced in 2015 to further strengthen the risk management and public confidence in the financial sector
- **Financial inclusion and infrastructure improved further in 2015:**
  - 6,583 banking outlets and 3,558 ATMs spread throughout the island.
  - Providing credit to promote high potential and promising SMEs was given priority in 2015.
  - The Central Bank continued to engage in activities promoting access to finance with a view to enhancing financial inclusiveness and balanced growth in the economy.

## Total Assets of the Financial System

	2014 (a)		2015 (b)	
	Rs. bn	Share (%)	Rs. bn	Share (%)
<b>Banking Sector</b>	<b>8,442</b>	<b>70.3</b>	<b>9,503</b>	<b>69.6</b>
Central Bank	1,471	12.2	1,426	10.4
Licensed Commercial Banks	5,884	49.0	6,974	51.1
Licensed Specialised Banks	1,087	9.1	1,103	8.1
<b>Other Deposit Taking Financial Institutions</b>	<b>857</b>	<b>7.1</b>	<b>1,042</b>	<b>7.6</b>
Licensed Finance Companies	743	6.2	915	6.7
Co-operative Rural Banks	103	0.8	116	0.8
Thrift and Credit Co-operative Societies	11	0.1	11	0.1
<b>Specialised Financial Institutions</b>	<b>441</b>	<b>3.7</b>	<b>544</b>	<b>4.0</b>
Specialised Leasing Companies	72	0.6	81	0.6
Primary Dealers	195	1.6	283	2.0
Stock Brokers	11	0.1	10	0.1
Unit Trusts / Unit Trust Management Companies	127	1.1	130	1.0
Market Intermediaries (c)	29	0.2	32	0.2
Venture Capital Companies	7	0.1	8	0.1
<b>Contractual Savings Institutions</b>	<b>2,275</b>	<b>18.9</b>	<b>2,573</b>	<b>18.8</b>
Insurance Companies	414	3.4	454	3.3
Employees' Provident Fund	1,487	12.4	1,665	12.2
Employees' Trust Fund	199	1.7	223	1.6
Approved Pension and Provident Funds	134	1.1	185	1.4
Public Service Provident Fund	41	0.3	46	0.3
<b>Total</b>	<b>12,015</b>	<b>100.0</b>	<b>13,662</b>	<b>100.0</b>

(a) Revised

Source: Central Bank of Sri Lanka

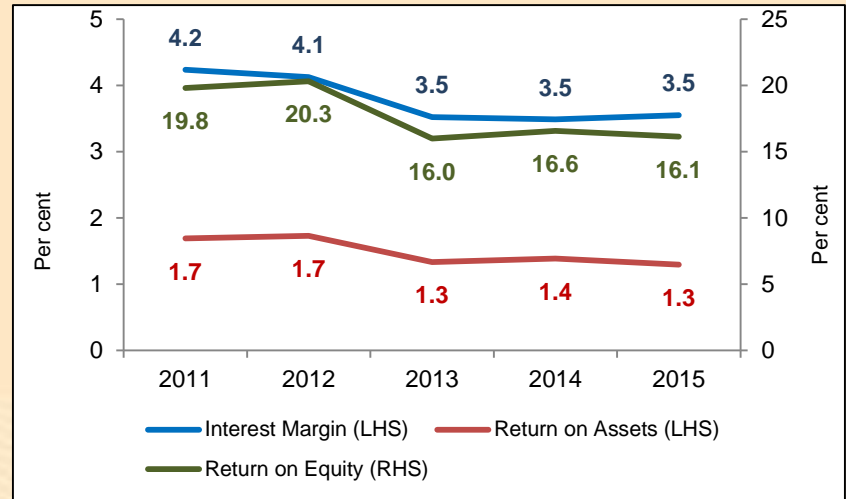
(b) Provisional

(c) Includes Underwriters, Investment Managers and Margin Providers.

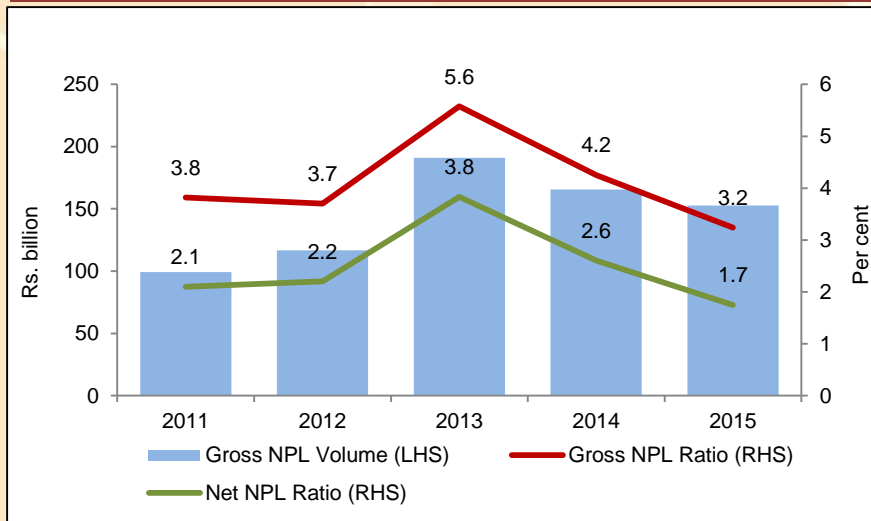
# Banking sector strengthened further while maintaining stability ...

- Banking sector total assets increased by 15.9% in 2015.
- Increased rupee lending activities of domestic banks, funded mainly through customer deposits, was the key of the asset growth.
- NPL ratio of the financial sector declined to 3.2% at the end of 2015 from 4.2% in 2014.

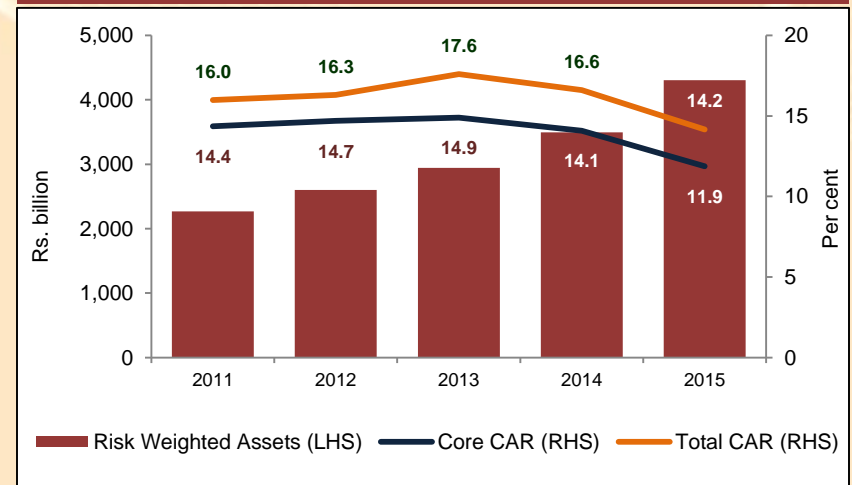
## Profitability Indicators of the Banking Sector



## Non-Performing Loans of the Banking Sector



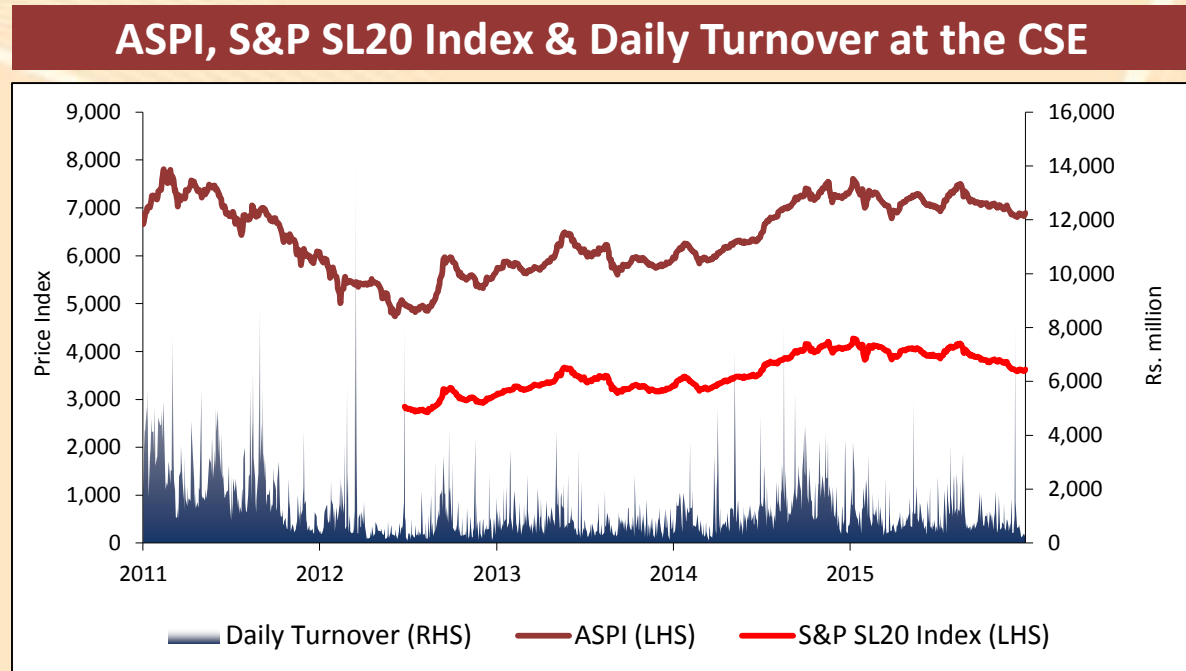
## Capital Adequacy Ratio of the Banking Sector



# Stock market recorded a sluggish performance with volatile movements in the price indices in 2015...

- Daily average turnover of the CSE declined by 25.1% to Rs. 1,060 mn in 2015 from Rs. 1,415 mn in 2014.
- All Share Price Index (ASPI) declined by 5.5% to 6,894 points.
- S&P SL20 Index declined by 11.3% to 3,626 points.

- Reversal of capital flows from emerging markets resulted in foreign outflows from the equity market during 2015.



# Key Highlights of the Economy in 2015...

## Real Sector and Inflation

- ✓ Sri Lanka economy grew by **4.8%**
- ✓ GDP amounted to **USD 82.3 bn**
- ✓ GDP per capita increased to **US\$ 3,924**
- ✓ Headline inflation fell further to **low-single digits**
- ✓ Core inflation increased gradually

## External Sector

- ✓ Trade deficit expanded to **US\$ 8,430 mn**
- ✓ Slowdown in the foreign exchange inflows and increased outflows from the government securities market **deteriorated the external position**
- ✓ Balance of Payments recorded an **overall deficit** of **US\$ 1,489 mn**
- ✓ Greater flexibility was allowed in the determination of the **exchange rate**

## Fiscal Sector

- ✓ Government revenue as well as **expenditure increased**
- ✓ Budget deficit rose to **7.4%** of GDP against the target of **4.4%** of GDP
- ✓ Central Government debt was recorded at **76.0%** of GDP

## Monetary Sector

- ✓ Credit to the private sector increased by **Rs. 691 bn (25.1% growth)**
- ✓ Net credit to government expanded by **Rs. 324 bn** exceeding the budgetary target
- ✓ Broad money growth accelerated to **17.8%**
- ✓ A gradual **tightening of monetary policy** was **commenced** from end 2015

## Financial Sector

- ✓ Financial system remained **stable**
- ✓ Business operations of the **banking sector expanded**
- ✓ Total assets and asset quality of the banking sector **improved**
- ✓ Capital of the banking sector was maintained at a **healthy level**

# In the medium term Sri Lanka's economy is projected to expand towards a higher growth trajectory with improved macroeconomic fundamentals ...

## Real Sector

- Sri Lanka's economy is projected to expand at a rate of 5.8% in 2016, and strengthen over the medium term to achieve a higher growth path of around 7%

## External Sector

- Positive developments in the domestic and global economies with recent policy initiatives are expected to result in a favourable outlook for the external sector

## Fiscal Sector

- With the strengthened fiscal consolidation process, the budget deficit is expected to be reduced to 3.5% of GDP by 2020, while the debt to GDP ratio is to be reduced to 60.0%

## Monetary Sector

- The conduct of monetary policy will focus on maintaining inflation in mid-single digit levels while facilitating the economy to realise its potential



# Medium Term Macroeconomic Framework: 2016-2019

Indicator	Unit	2014	2015 (provisional)	Projections			
				2016	2017	2018	2019
<b>Real Sector</b>							
<b>Real GDP Growth</b>	%	4.9	4.8	5.8	6.3	7.0	7.0
GDP at Market Prices	Rs.bn	10,448	11,183	12,307	13,614	15,155	16,863
<b>Annual Average Inflation</b>	%	3.3	0.9	4.0	4.0	4.0	4.0
Per Capita GDP	US\$	3,853	3,924	4,008	4,298	4,704	5,181
Total Investment	% of GDP	32.0	30.1	30.3	30.9	31.0	32.0
Domestic Savings	% of GDP	24.0	22.6	23.8	24.6	25.3	26.7
National Savings	% of GDP	29.5	27.8	28.1	29.1	29.5	30.6
<b>External Sector</b>							
Trade Gap	% of GDP	-10.4	-10.2	-9.5	-9.7	-9.7	-9.6
Exports	US\$ mn	11,130	10,505	10,853	11,542	12,057	12,589
Imports	US\$ mn	19,417	18,935	18,920	20,500	21,940	23,387
Current Account Balance	% of GDP	-2.5	-2.4	-2.1	-1.8	-1.5	-1.4
External Official Reserves	Months of Imports	5.1	4.6	4.0	4.2	4.5	4.6
<b>Fiscal Sector</b>							
Total Revenue and Grants	% of GDP	11.5	13.1	12.7	13.5	13.9	14.9
Expenditure and Net Lending	% of GDP	17.2	20.5	18.0	18.5	18.4	18.9
Current Account Balance	% of GDP	-1.2	-2.2	-1.4	-0.7	0.0	0.6
Overall Budget Deficit	% of GDP	-5.7	-7.4	-5.4	-5.0	-4.5	-4.0
Public Debt	% of GDP	70.7	76.0	74.0	70.0	66.0	63.0
<b>Monetary Sector (d)</b>							
Broad Money Growth (M <sub>2b</sub> )	%	13.4	17.8	9.0	10.5	11.5	11.5
Growth in Credit to the Private Sector	%	8.8	25.1	12.0	11.0	11.5	12.0

# Strong Need for Decisive Steps...

- The Annual Report 2015 highlights several issues and challenges faced by the Sri Lankan economy, especially structural vulnerabilities of the economy that had built up over time.
- Decisive steps are necessary to correct these vulnerabilities to ensure the country's progress along a high growth – low inflation path.
- It is expected that with appropriate policies, the economy will return to a high growth path in the medium term.

# Issues and Policies...(1)

## Improving fiscal performance through essential reforms

- Fiscal sector requires urgent attention of the government to implement reforms on highest priority basis to achieve the envisaged fiscal consolidation targets, thereby reducing pressure on the budget deficit and government debt, and strengthen medium term fiscal sustainability.

## Reforms in States Owned Enterprises (SOEs)

- Unavoidable reforms in SOEs should be undertaken based on a carefully thought strategy and implemented within the country's socio-economic and political context, while adequately explaining and educating the stakeholders and the general public on the rationale and potential medium to long-term consequences in the absence of those reforms.

## Introducing of a Robust Pricing Formula for Petroleum Products

- A robust pricing formula for domestic petroleum products is essential to ensure the commercial viability of the Ceylon Petroleum Corporation, while passing the effects of global oil price variations transparently to domestic users. This is also required for other SOEs as well.

# Issues and Policies...(2)

## Attracting Non-Debt Creating FDI and Long-term Financial Flows

- A concerted effort is required to overcome the challenge of attracting more non-debt creating foreign investment flows such as FDI and growth promoting long term financial flows to maintain the resilience of the external sector against various shocks.

## Strengthening External Sector Sustainability through External Trade

- Achieving a sustainable current account deficit, and establishing the external sector sustainability would depend on the performance of external trade, consistent with the development needs and external competitiveness of Sri Lankan products abroad.

## Optimal Utilisation of Trade Agreements and Arrangements

- For enhanced market access and export product diversification, exporters should utilise existing trade facilities optimally and take advantage of existing trade agreements.

# Issues and Policies...(3)

## Proactive Policies for Inclusive Growth

- Despite continued public investment in socioeconomic infrastructure, development challenges arising from the country's transition into a middle income economy have to be tackled through proactive policies, which are properly targeted and centred on creating an inclusive growth.

## Meeting High Quality Human Capital Needs

- With the structural transformation the country, effective measures are required to meet the growing demand for high quality human capital needs.

## Evolution of the Current Education System

- The evolution of the current education system into a demand driven one is essential to capitalise on the substantial investment that it has made in the education sector even prior to independence and to sustain its achievements.

# Issues and Policies...(4)

## Addressing the Issues in the Agriculture Sector

- The agriculture sector is saddled with major issues such as low productivity, lack of diversification, food insecurity and inefficiency in water management as well as the natural challenge of climate change and requires several corrective measures.

## Addressing the Issues in the Planation Sector

- Increasing cost of production, outdated machinery, low yields, old age of crops, low value addition and inadequate diversification remain key issues in the plantation sector and greater efforts are necessary from all stakeholders to make the plantation sector more profitable and sustainable.

## Promoting Public Private Partnerships (PPPs)

- In order to create an enabling socioeconomic infrastructure and lucrative livelihood opportunities amidst constraints on public resources, the government will have to actively consider innovative mechanisms, such as PPPs, to meet the rising funding gap.

# Issues and Policies...(5)

## Addressing the Chronic Kidney Disease of Unknown Origin

- Chronic Kidney Disease of Unknown Origin (CKDu) has been a serious health issue in Sri Lanka over the past two decades and it would be vital to adopt measures with a view to controlling the epidemic.

## Improvements of Public Transport

- Immediate improvements to public transport are needed to curb the economic loss caused by road traffic congestion.

## Development of Renewable Energy

- Ongoing changes in weather patterns and volatilities associated with fuel prices reiterate the need for strengthening of the national policy on renewable energy development, while undertaking initiatives to overcome barriers to increase the sustainability of low cost energy generation.

# Issues and Policies...(6)

## Sustainability of Pension and Superannuation Schemes

- With the acceleration of population ageing, there is a need to ensure the sustainability of the public sector pension scheme, while introducing market oriented pension and superannuation schemes that ensure a wider coverage of the labour force

## Enhancing Financial Deepening

- Financial deepening through the raising of efficiency of financial intermediation, introduction of a diverse range of financial products and services, and improving access to formal finance would be pivotal to the sustenance of the high growth momentum of the economy

## Exploiting the Potential of the Strategic Location

- The strategic position of the island of Sri Lanka in the Indian Ocean in the middle of the maritime silk route from China to Europe must be exploited to harness the potential of the country



# Box Articles in Annual Report 2015...(1)

## Fiscal Space for Stability and Resilience

- Given the government's borrowing constraints, fiscal space must be created through reforms in the tax and expenditure structures.
- Fiscal policy should aim at increasing the tax/GDP ratio, improving the efficiency of expenditure management, improving the performance of state owned enterprises (SOEs) and reforming labour markets.

## The Socioeconomic Challenges of Poverty, Income Inequality and Child Under-nutrition in Sri Lanka

- These three challenges, if not addressed, can severely undermine economic growth and result in social unrest.
- The government needs to continue its efforts to create a growth process where the entire populace can benefit - sharing prosperity through inclusive growth.

# Box Articles in Annual Report 2015...(2)

## Business Conditions Surveys as a Signal of Business Sentiment

- **Business Outlook Survey (BOS) and Purchasing Managers' Index (PMI) enable policy makers to gather real time information about the economy in a timely and more forward looking manner.**
- **BOS provides a snapshot of business sentiment regarding the ongoing and expected state of economic activities.**

## Renewable Energy for Electricity Generation

- **There has been a growing interest towards using renewable energy in both developed and developing countries, realising its sustainability, economic benefits and less adverse impact on the environment.**
- **Policy cohesion is required to inspire private sector and overcome the techno-economic barriers to reap benefits of renewable energy.**

# Box Articles in Annual Report 2015...(3)

## Non-state Sector Participation in Providing Higher Education in Sri Lanka

- Higher education has been well recognised as a priority in improving productivity and innovation to sustain high economic growth.
- The unprecedented demand for higher education in Sri Lanka necessitated a rethink of the existing model of providing higher education, given the limited fiscal space in the government budget.

## Sustainable Development Goals

- World leaders unveiled the new global Sustainable Development Goals (SDGs).
- Although Sri Lanka has already achieved some, out of the total number of 169 targets under SDGs, a strong collective effort of all stakeholders is required.

# Box Articles in Annual Report 2015...(4)

## A National Consumer Price Index for Sri Lanka

- The NCPI reflects more recent changes in the patterns of consumption and expenditure, as revealed by the Household Income and Expenditure Survey.
- NCPI provides a broader perspective on the economy's price trends and movements.

## Tourism Industry: Prospects and Challenges

- The tourism industry has been experiencing a rapid expansion and diversification, becoming the third largest foreign exchange earner in the country.
- As a growing industry, Sri Lankan tourism industry faces challenges including inadequacy of hotel rooms, requirement of skilled labour, and the need for an innovative approach with a well-focused strategy.

# Box Articles in Annual Report 2015...(5)

## Population Ageing: Challenges and the Way Forward

- Sri Lanka's population is the oldest in South Asia and is also one of the fastest ageing populations in the world.
- It is imperative to understand the needs of the elderly while uncovering ways and means by which they can actively contribute to the growth of the country.

## Modifications to the Monetary Policy Framework in Sri Lanka

- Several weaknesses that have been observed with regard to the monetary targeting framework in Sri Lanka, including the weakening relationship between money supply and inflation.
- In line with the global tendency, the Central Bank has also been improving its monetary policy framework and increasingly aligning it with a Flexible Inflation Targeting framework.

# Box Articles in Annual Report 2015...(6)

## Cyber Risk Management in Banks

- **Cyber risk refers to the risk of financial loss, operational disruption or reputational damage due to some kind of failure in IT systems.**
- **Individual banks as well as the Government and the Central Bank have been continuously implementing different cyber risk management procedures.**

## New Regulatory and Supervisory Approaches in Ensuring the Safety and Soundness of Banks

- **The bank regulators seek promoting the safety and soundness of banks and the banking system through regulation and supervision.**
- **The Global Financial Crisis and the subsequent European Crisis emphasized the need to factor in the build-up of risks and concentrations during economic booms and its subsequent effects during economic slowdowns.**
- **The Central Bank further strengthened macroprudential surveillance to identify any systemic risks by developing various indicators to help detect and assess systemic risks.**

# Box Articles in Annual Report 2015...(7)

## Main Findings of the Survey on Microcredit

- A survey on microcredit was conducted with the objective of understanding the developments in the microcredit sector and assessing the status of financial literacy and financial inclusion.
- Majority of microcredit loans were concentrated among females.
- The majority of the loans were used for business purposes and able to increase their profit/revenue.

## Implementation of a Risk-Based Approach to Anti Money Laundering and Countering the Financing of Terrorism

- Under the Risk-Based Approach (RBA), it is required to identify, assess and understand the Money Laundering and Terrorist Financing risks to which they are exposed and take Anti-Money Laundering / Countering Financing of Terrorism controlling measures in order to mitigate those risks effectively.
- The primary objective of the implementation of the RBA to AML/CFT is to protect financial systems being misused by criminals.

# Box Articles in Annual Report 2015...(8)

## Major Economic Policy Changes and Measures: 2015

- This includes major economic policy changes and measures implemented during 2015 as well as those that have been implemented during the first three months of 2016 and policy measures envisaged to be taken in the near future.
- Details of fiscal incentives granted for the development of the real sector are included in policy measures under the fiscal sector.

## New Risk Management Framework of the Central Bank of Sri Lanka

- The Central Bank follows 'Three Lines of Defense' risk management model under the new risk management framework.
  - 'First Line of Defense' - proper internal risk management systems and controls
  - 'Second Line of Defense' - assessing, monitoring, and reporting financial risks
  - 'Third Line of Defense' - the independent audit function of the Central Bank
- The new risk management system would help to create a risk management culture in the Central Bank.



**Thank You**