37th OPA Annual Conference

Sri Lanka's Sustained Economic Growth

Keynote Speech

26 August 2024

It gives me great pleasure to be joining you all today at this event and I extend my best wishes to the Organisation of Professional Associations of Sri Lanka (OPA) on the occasion of the Annual Conference themed 'Sri Lanka's Sustained Economic Growth'.

I think it is a very relevant and timely topic

- This gathering comes at a pivotal moment as Sri Lanka emerges from one of the most challenging economic crises in its post-independence history. Despite these hurdles, **the economy has regained its normalcy to a greater extent within a shorter period**. This progress is not by chance but is the result of coordinated, transparent, and robust measures undertaken by the Central Bank of Sri Lanka and the Government, supported by numerous public and private stakeholders even like OPA as well as international agencies and lenders and our creditors. A key driver of our progress has been restoration of macroeconomic stability, achieved through a sound monetary policy measure, strong fiscal consolidation measures and implementation of long-overdue structural reforms. These efforts have created a conducive environment for growth as we move forward. Consequently, the Sri Lankan economy broke a six-quarter streak of contractions in the second half of 2023 and has recorded positive growth since then. Leading indicators signal that this growth momentum is set to continue, underpinned by strong macroeconomic fundamentals.

- On the inflation front, inflation, which had peaked at an all-time high in September 2022 to 70 per cent, reverted to single digit levels within a year as a result of monetary policy tightening and inflation remained closer or below the targeted level since then. Considering the low inflation, well-anchored inflation expectations and moderation of external sector pressures, the Central Bank began its **monetary policy easing** in mid of 2023 with a view to supporting the economy reaching its potential. The Central Bank's monetary policy stance continues to be accommodative aligning with softened inflationary pressures. As per the current projections based on available information at present the inflation is expected to be well below the target of 5% until first quarter of 2025 before stabilising around the targeted level later in 2025. Though, it is technically inflation target miss on the lower bound which is 3%, the economy could benefit from this extended period of low inflation as it is coming out of the deepest crisis, after recoding historic level of inflation. The **low inflation environment has been providing comfort and stability** to both livelihoods and business activity, contributing to a continued rebound in domestic economic activity as well seen so far. This favourable environment has alleviated a significant bottleneck previously faced by various economic sectors for them to conduct smooth business.

- Improved fiscal performance under consolidation efforts and turnaround in financial performance of key state-owned-business enterprises have enabled the banking sector to reduce its exposure to the government sector and allocate the freed-up resources for lending to the private sector. Under the current low interest rate environment, we observed a gradual pickup in private sector credit in the recent period and going forward, we expect there would be a notable expansion in lending to productive sectors, particularly those focused on exports, as well as to Small and Medium Enterprises (SMEs), which have long been the backbone of the economy.

- I wish to emphasise that the enactment of the Central Bank of Sri Lanka Act in September 2023 was a milestone achievement, enabling the **formal recognition of Flexible Inflation Targeting as the Central Bank's monetary policy framework,** complemented by a flexible exchange rate policy. Additionally, increasing the autonomy of the Central Bank has been accompanied by enhanced accountability towards the Parliament and the general public for the Central Bank's policy actions. The independence of the Central Bank has been reinforced by limiting monetary financing and ensuring independent decision making without the influence from the fiscal authorities, thereby strengthening both monetary policy formulation and governance and accountability.

- On the other hand, improvements on the external front, primarily driven by workers' remittances and tourism inflows and also exports, have resulted in a relatively stable exchange rate and enabled the Central Bank to rebuild gross official reserves. Moving forward, **the expected inflows from the services sector are expected to sustain this positive momentum in the external sector** and provide a buffer against external shocks. Under the flexible exchange rate regime, the Central Bank has allowed the exchange rate to be determined by the market forces and the Central Bank's interventions in the market is limited only to prevent undue substantial volatilities in the market and to rebuild the external buffers. The reserves which depleted to a very low level have now reached US dollars 5.7 billion with the gradual purchase of forex by the Central Bank. External sector stability supports the enhancement of market sentiments.

- On the fiscal front, positive impacts of fiscal policy reforms are becoming evident in the government's finances, marked by a significant increase in tax revenue collection, while the implementation of cost reflective pricing mechanisms has helped improve the financial performance of State-Owned Business Enterprises. **The Government's steadfast commitment to a revenue based fiscal consolidation path, in conjunction with the continued execution of the economic reform programme aligned with the IMF-EFF arrangement**, is expected to continue. Since most of the tax policy reforms are frontloaded in this reform process, the revenue enhancement in the forthcoming period would be more focused on improving tax administration and widening the tax net rather than increasing taxes.

- Key pieces of legislations related to public financial management, public debt management, and anti-corruption have been enacted recently, which are pivotal to strengthen prudent management of public finance and debt, transparency and accountability. In addition, reforms in state-owned business enterprises (SOBEs) and divestment of non-strategic investments would reduce the burden of SOBEs on the government budget. Alongside the successful external debt restructuring process, these measures are expected to facilitate the achievement of medium-term fiscal targets and ultimately restoring long term fiscal sustainability which is prerequisite for medium term growth. Enhanced fiscal discipline along with the improved financial performance of the key State-Owned Enterprises (SOEs) would help to free up more funds available in the banking system towards productive purposes of the private sector.

- The financial sector, which endured difficult macroeconomic conditions in recent years, remained resilient amidst the crisis owing to proactive and prudent regulatory actions of the Central Bank and the compliance and crisis preparedness of the financial institutions. Central Bank provided regulatory guidance to the banks and non-bank financial institutions during the crisis time to ensure their resilience with adequate capital and liquidity. An Asset Quality Review was conducted as part of the bank diagnostic exercise and the Central Bank developed a roadmap to address issues related to capital and foreign currency shortfalls based on the AQR, expected impact of debt restructuring and forward-looking stress testing. On that basis we expect the **financial sector's resilience to improve further** as macroeconomic vulnerabilities dissipate in the upcoming period. Also, an array of structural, legal, and policy level reforms and innovations will continue to be mobilised to ensure the stability of the financial system.

- As you all know, the **ongoing reform agenda comprises measures that are expected to augment the resilience and stability of the economy which is needed for the long-term economic growth. Maintaining macroeconomic stability is a pre-requisite to** ensure sustained growth trajectory in the medium to long term. Although these reforms are painful in the short term, it is crucial for all stakeholders to remain committed and ensure the swift implementation of these long overdue reforms to set the economy on a path towards sustained, inclusive, and sustainable growth. Despite all such efforts, any political or social uncertainties or reversals of hard-earned achievements that exert significant pressure on the reform agenda could lead to a deviation from the intended policy trajectory, potentially resulting in adverse and irreversible impacts on the economy and recurrence of the economic and social crisis that we experienced in the past two years.

- At the same time, policies for macroeconomic stability itself would not be sufficient to propel the economy to a high growth path that would take Sri Lanka to an advance country status within a short time. With the current sovereign debt crisis, the Government does not have any fiscal space to drive the economic growth through higher spending or lower taxes as in the past, since reinstating fiscal and debt sustainability is the need of the hour at present and for the future. Therefore, going forward, the growth should be driven by the private sector and the Government's role would be to **create a facilitating and conducive environment for the private sector** to thrive.

- Sri Lanka's growth potential has been constrained in the past due to **structural issues in the factor markets and these issues need to be addressed expeditiously** in tandem with the current reform programme. The issues related to skill mismatch in the labour force, stringent labour laws, archaic laws related to land markets have prevented efficient resource allocation in both labour and land markets. Given the looming challenge of aging population, the education system should be reformed to produce a more efficient labour force who can easily adapt to the dynamic needs of the industries in order to sustain the growth in the long run. In addition, special policy focus is needed to address the issue of low female labour force participation to harness the under-utilised labour force for productive purposes, thereby expanding the growth potential of the country. In addition, policy initiatives such as development banking, business incubators and credit registry would enable the SME sector and innovators to access the financial markets at competitive rates to expand their businesses.

- Apart from the current reform agenda, **Sri Lanka needs to embrace digital transformation** through initiatives to foster a knowledge-based economy. Expanding digital services, including banking, payments, and e-government, will boost efficiency, productivity, and financial inclusion. This transformation will also streamline government operations, reduce corruption, and improve transparency and accountability, addressing issues like tax evasion, the large and vulnerable informal economy, and growing inequalities. Further, improved access to digital technologies and data will drive innovation, attract foreign investment, and strengthen global competitiveness of our businesses. For this transformation to succeed, a supportive regulatory environment and active participation from the private sector are essential in bridging the digital divide and fostering long term economic development.

- **The Sustainable Development Goals (SDGs) are integral to Sri Lanka's sustained growth in the long term,** by addressing critical issues in key sectors such as health, education, poverty reduction, and infrastructure development. Sri Lanka's progress under specific SDGs is commendable, with achievements such as reduced maternal mortality, high literacy rates, and strengthened social safety nets. However, to ensure continued progress and avoid any reversals of these gains, Sri Lanka should focus on reinforcing development strategies that emphasise social protection networks, food security, and health and education reforms. Aligning these efforts with international frameworks and addressing regional disparities will be essential for achieving resilient, long term economic stability and growth.

- I wish to take this opportunity to emphasise the need for fostering as I already mentioned the **transition of Sri Lanka's economy towards a green economy,** as highlighted in international agreements. Given the country's environmental vulnerabilities as an island nation and escalating global challenges, advancing green initiatives is essential. Greening the industrial activities would be imperative, going forward, especially for our export sector, as there is a growing recognition for sustainable production by the importing countries. Sri Lanka is making progress through efforts to achieve 70 per cent of electricity from renewable sources, promote green financing aligned with the Central Bank's Sustainable Finance Roadmap, and implement conservation programmes with local and international partners. Supporting the development of environmentally sustainable businesses, advancing clean technologies, and expanding access to green financing are crucial strategies for fostering an economy that is resilient, resource efficient, and sustainable.

Conclusion

Sri Lanka has rebounded faster than expected from the economic crisis. However, building a stronger, more resilient economy requires a collective effort. Sustained growth depends on consistent reforms, targeted policies, and addressing grassroot level challenges. Events like this provide valuable platforms for discussing these gaps and identifying collective and effective strategies amid ongoing macroeconomic developments. To ensure the success of these efforts, it is imperative that professionals across various fields actively engage in creating a resilient and prosperous future for Sri Lanka. I extend my heartfelt wishes to the OPA and look forward to our joint efforts in achieving sustained economic growth.

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