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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA

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Press Release

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The Annual Report of the Central Bank of Sri Lanka for the Year 2014

In terms of Section 35 of the Monetary Law Act No. 58 of 1949, the sixty fifth Annual Report of the Monetary Board of the Central Bank of Sri Lanka was submitted on 29 April 2015 to Hon. Ravi Karunanayake, the Minister of Finance by Mr. Arjuna Mahendran, the Governor of the Central Bank of Sri Lanka.

[Mr. Arjuna Mahendran, the Governor of the Central Bank of Sri Lanka presenting the Annual Report 2014 to Hon. Ravi Karunanayake, the Minister of Finance. Mr. B.D.W.A.Silva and Mr. P.Samarasiri, Deputy Governors of the Central Bank, Mr. C.P.A.Karunatilake, Assistant Governor of the Central Bank, and Mr. D.Kumaratunge, Acting Director of Economic Research of the Central Bank are also in the photo.]

An overview of the Sri Lankan economy in 2014 as reflected in the Annual Report is given below:

The growth momentum of the Sri Lankan economy continued, while inflation declined further to low single digit levels during the year. The economy that was initially projected to grow in real terms by 7.8 per cent, recorded a growth of 7.4 per cent in 2014, in comparison to the growth of 7.2 per cent in 2013. Amidst uneven developments in the global economy, continued domestic economic activity helped sustain the growth in the Industry and Services sectors, while adverse weather conditions dampened the performance of the Agriculture sector during the year. In nominal terms, GDP amounted to Rs. 9,785 billion (US dollars 74.9 billion) in 2014, compared to Rs. 8,674 billion (US dollars 67.2 billion) in 2013. Accordingly, GDP per capita increased to US dollars 3,625 in 2014 from US dollars 3,280 in the previous year. Inflation remained at single digit levels for the sixth consecutive year, with year-on-year and annual average inflation declining to 2.1 per cent and 3.3 per cent, respectively, by end 2014, from 4.7 per cent and 6.9 per cent, respectively, at end 2013. Prudent monetary policy as well as the considerable decline in global commodity prices in the second half of the year enabled the deceleration of inflation to low single digit levels during the year. In spite of the relatively relaxed monetary policy stance, the effect of declining pawning advances shrouded the pickup of credit obtained by the private sector, particularly in the first seven months of the year. In the absence of demand pressures on inflation, the Central Bank took measures to facilitate further credit disbursements by banks. However, these measures, along with volatile global conditions, caused some portfolio investment outflows and encouraged imports, increasing the pressure on the external sector and the exchange rate towards the latter part of the year. Overall, the trade deficit widened in nominal terms during the year, although inflows from trade in services and workers’ remittances supported the reduction of the deficit in the current account. This, together with other financial inflows, helped strengthen the balance of payments (BOP), and hence gross official reserves. Meanwhile, in the fiscal sector, despite the government’s announced commitment towards fiscal consolidation, the overall fiscal deficit increased to 6.0 per cent of GDP in 2014 from 5.9 per cent of GDP in the previous year, mainly as a result of the continued shortfall in revenue collection. Nevertheless, public debt as a percentage of GDP declined to 75.5 per cent by end 2014 from 78.3 per cent by end 2013. In the financial sector, the strengthened regulatory and supervisory framework, improved risk management capabilities and adequate buffers to mitigate risks, enabled financial institutions to remain resilient during the year.

Consumer price inflation, which has remained at single digit levels since early 2009 with prudent monetary management and improved supply conditions, declined further to low single digit levels in 2014, as a result of the passthrough of favourable international commodity price movements to domestic prices during the second half of the year. Year-on-year headline inflation, which was at 4.7 per cent by end 2013 declined to 2.1 per cent by end 2014. Downward adjustments in administratively determined energy prices and water tariffs lowered inflation during the last quarter of the year, although weather related disruptions to food supplies adversely affected price levels in some months. Meanwhile, year-on-year core inflation remained in a range of 3.1 per cent to 3.9 per cent throughout the year, reflecting subdued underlying demand pressures in the economy. Annual average headline and core inflation were 3.3 per cent and 3.5 per cent, respectively, in 2014, compared to 6.9 per cent and 4.4 per cent, respectively, in 2013. The efforts of the Central Bank to maintain inflation at single digit levels, along with the support of fiscal authorities, helped build up favourable inflation expectations in the economy.

The economy grew by 7.4 per cent in real terms in 2014 compared to the growth of 7.2 per cent in the previous year, while the unemployment rate remained low at 4.3 per cent during the year compared to 4.4 per cent in the previous year. The Services sector, which represents 57.6 per cent of GDP, grew by 6.5 per cent in 2014 compared to the growth of 6.4 per cent in 2013, with significant contribution from Wholesale and Retail Trade, Transport and Communication, and Banking, Insurance and Real Estate sub sectors. The share of the Industry sector within GDP increased further to 32.3 per cent, with a sectoral growth of 11.4 per cent in 2014 compared to 9.9 per cent in the previous year. The Construction sub sector recorded the highest contribution to the growth of the Industry sector, while Food, Beverages and Tobacco and Textile, Wearing Apparel and Leather sub sectors within Factory Industry, also made substantial contribution to growth. Meanwhile, affected by extreme weather conditions, the Agriculture sector, which represents 10.1 per cent of GDP, contributed only marginally to real GDP growth. The growth of the Agriculture sector was 0.3 per cent in 2014, compared to 4.7 per cent recorded in the previous year.

Addressing investment needs in economic and social infrastructure to facilitate sustained economic growth in post-conflict Sri Lanka continued to be a key priority in the government's development agenda. Several key infrastructure projects were completed during 2014. The construction work relating to a number of other mega infrastructure projects progressed during 2014. Meanwhile, several small scale rural road improvement programmes, irrigation projects, water supply projects, rural electrification projects, housing development programmes and city beautification projects continued during the year. Public investment on economic and social infrastructure development amounted to Rs. 442.4 billion (4.5 per cent of GDP) in 2014. The new government formed in January 2015, is in the process of reviewing the ongoing and proposed mega infrastructure projects to ensure their financial viability, environmental feasibility, equitability, and their overall contribution to the economy.

Sri Lanka's social indicators continued to improve, enabling the country to maintain its foremost position in terms of social developments amongst emerging markets and regional peers. Sri Lanka, the only country in South Asia in the 'high human development' category, reported an increase in the Human Development Index (HDI) to 0.750 in 2013 from 0.745 in 2012, thus raising its position to 73 in 2013 from 75 (revised) in the previous year. The government continued to offer free health and education services, while strengthening equitable access to and quality of these services. Government expenditure on health remained at 1.4 per cent of GDP in 2014, and health sector indicators reflected moderate improvement. In 2014, the number of persons per doctor in the public health service was 1,155 compared to 1,167 in the previous year while the number of hospital beds available per 1,000 persons was 3.7 in 2014 compared to 3.6 in 2013. Government expenditure on education as a percentage of GDP was 1.9 per cent. The school density in terms of the area covered by a school remained unchanged at 6.5 sq.km, while the student teacher ratio in the government education service also remained unchanged at 18. It must, however, be noted that the private sector involvement in the provision of these services has increased considerably in recent years, supplementing the services provided by the public sector. The level of electrification in the country improved further to 98 per cent in 2014 from 96 per cent recorded in 2013. Accessibility to safe drinking water improved to 89.7 per cent in 2012/13 as per the Household Income and Expenditure Survey (HIES), compared to 87.7 per cent in 2009/10. The country's telephone penetration including cellular phones continued to improve to 120 connections per 100 persons in 2014 from 112.4 in 2013. In terms of poverty indicators, as per the HIES, the poverty head count ratio (PHCR) in 2012/13 was 6.7 per cent compared to 8.9 per cent recorded in 2009/10. Many of these indicators stand well above the levels reported by peer economies, although continued efforts are necessary to fill the remaining gaps in economic and social infrastructure provision.

The external sector demonstrated its resilience in 2014 amidst headwinds originating from the global economic environment. In the global economy, the economic recovery in the US and the UK strengthened while expansionary policies in the Eurozone and Japan continued in order to support economic growth and to address deflationary pressures. Within emerging Asia, there were signs of some slowdown in the Chinese economy while the Indian economy continued to recover. Geopolitical uncertainties in the Middle East, the Ukraine crisis and the Ebola outbreak threatened global economic performance, while commodity prices including those of energy, declined sharply in the second half of the year. In the midst of these diverse global economic conditions, Sri Lanka's external sector imbalances narrowed to some extent. As a percentage of GDP, the deficit in the trade account improved to 11.1 per cent in 2014 from 11.3 per cent in 2013. However, in nominal terms, the trade deficit increased to US dollars 8.3 billion in 2014 from US dollars 7.6 billion in the previous year, as a result of a higher increase in the expenditure on imports compared to the increase in earnings from exports. With the considerable improvement in service exports as well as increased workers' remittances, the current account deficit narrowed to US dollars 2.0 billion in 2014 from the deficit of US dollars 2.5 billion in the previous year. As a percentage of GDP, the current account deficit was 2.7 per cent in 2014, a notable improvement from 3.8 per cent of GDP in 2013. Although some outflows were observed in the rupee denominated Government securities market towards the end of the year, other financial inflows, together with the improvement in the current account, helped improve the overall surplus of the BOP to US dollars 1,369 million in 2014 from US dollars 985 million in the previous year. Gross official reserves improved to US dollars 8.2 billion at end 2014 in comparison to US dollars 7.5 billion at end 2013. Gross official reserves as at end 2014 were equivalent to 5.1 months of import of goods, compared to 5.0 months at end 2013. The country's external debt stock improved as a percentage of GDP to 57.4 per cent in 2014 from 59.4 per cent in the previous year, although in nominal terms it increased to US dollars 43.0 billion at end 2014 from US dollars 39.9 billion at end 2013. Meanwhile, the Sri Lanka rupee, which remained broadly stable against the US dollar in the first nine months of the year, depreciated thereafter, to record an annual depreciation of 0.23 per cent in 2014. Real effective exchange rate indices, based on both 5-currency and 24-currency baskets, appreciated particularly during the last quarter of the year.

Some reversal in the fiscal consolidation process was observed during the year, with the overall fiscal deficit as a percentage of GDP increasing for the first time in the post conflict period. The government aimed to reduce the fiscal deficit to 5.2 per cent of GDP in 2014 from 5.9 per cent of GDP in the previous year. This was to be achieved by improving revenue to 14.5 per cent of GDP in 2014 from 13.1 per cent in 2013, and reducing recurrent expenditure to 13.4 per cent of GDP in 2014 from 13.9 per cent in 2013, while maintaining public investment at a high level of 6.7 per cent in 2014 compared to 5.5 per cent in 2013. However, contrary to expectations, the continued decline in revenue as a percentage of GDP led to an increase in the overall fiscal deficit to 6.0 per cent of GDP in 2014. Although unexpected expenditure due to extreme weather conditions added pressure on government finances, recurrent expenditure as a percentage of GDP remained broadly on target at 13.5 per cent, mainly as a result of the decline in interest cost of the government. A large deviation of public investment from the envisaged levels was observed due to rationalising the public investment programme in response to the revenue shortfall. Accordingly, public investment was 5.0 per cent of GDP in 2014. Meanwhile, the current account deficit as well as the primary deficit deteriorated to 1.3 per cent and 1.6 per cent of GDP, respectively, in 2014, in comparison to the deficit of 0.8 per cent of GDP recorded in both the current account and the primary account in 2013. In the meantime, with the increase in nominal GDP at a higher rate than the debt stock, the government debt to GDP ratio continued to improve, recording 75.5 per cent in 2014 compared to 78.3 per cent in 2013. As a percentage of GDP, domestic debt and foreign debt of the government stood at 43.7 per cent and 31.8 per cent, respectively, at end 2014.

Monetary expansion was in line with expectations during the year, enabling the continuation of the relatively relaxed monetary policy stance. Year-on-year broad money (M_{2b}) growth was 13.4 per cent at end 2014 compared to 16.7 per cent at end 2013. Net foreign assets (NFA) as well as net domestic assets (NDA) of commercial banks contributed positively to broad money growth in 2014. With NFA of the Central Bank improving mainly as a result of the net purchase of foreign exchange from the market and the purchase of a part of the proceeds from the International Sovereign Bond issuance, NFA of the banking system increased by Rs.

91.5 billion in 2014, compared to a reduction of Rs. 50.5 billion in 2013. Within NDA, the growth of credit to the private sector from commercial banks continued to decelerate in the first seven months of the year, prompting the Central Bank to take further steps to support the revival in credit flows to the private sector. Accordingly, a credit guarantee scheme for pawning advances was introduced in June 2014, and, in addition to the reduction in the Standing Lending Facility Rate (SLFR) of the Central Bank by 50 basis points on 02 January 2014, a temporary restriction was placed on the access to the Standing Deposit Facility (SLF) of the Central Bank in September 2014. These measures, along with regular discussions with lending institutions, led to a further decline in market lending rates, resulting in the growth of credit to the private sector picking up to 8.8 per cent by end year. In absolute terms, the overall increase in credit disbursements to the private sector amounted to Rs. 223.9 billion in 2014, in comparison to Rs. 175.9 billion in the previous year. According to the sectorwise classification of outstanding loans and advances granted to the private sector by commercial banks, credit disbursements to the Industry and Services sectors increased by Rs. 311.1 billion during the year, while credit to Agriculture and Fishing Category and Personal Loans and Advances declined, reflecting the impact of pawning advances. Meanwhile, with increased government reliance on domestic non bank and foreign sources to finance the overall fiscal deficit, the increase in net credit to the government (NCG) from the banking sector was limited to Rs. 134.6 billion during 2014 compared to the increase of Rs. 256.1 billion in the previous year. Bank borrowing by public corporations increased by Rs. 80.9 billion in 2014 compared to an increase of Rs. 72.6 billion in 2013. The upward adjustments to domestic energy prices in previous years, the decline in global petroleum prices in the second half of the year, and the addition of coal power generation capacity to the national grid, contained bank borrowing by key public corporations (net of deposits) to some extent, although borrowing by the Road Development Authority (RDA) and state owned fertiliser corporations increased. With the revival of private sector credit growth, the special SDF rate of 5 per cent was removed with effect from 02 March 2015. To address concerns over the behaviour of market interest rates inconsistent with inflation as well as the investment needs of the country, the Central Bank reduced the SDFR and SLFR by 50 basis points each to 6.00 per cent and 7.50 per cent, respectively, with effect from 15 April 2015.

The financial system remained stable during the year, and measures were taken to strengthen the financial sector further. The acceleration in credit growth in the second half of the year, the increase in investments, and the growth in other assets, resulted in total assets of licensed commercial banks (LCBs) and licensed specialised banks (LSBs) growing by 17.3 per cent in 2014 compared to 16.5 per cent in the previous year. Asset quality of banks improved, as a result of the decline in non performing loans in relation to the pawning portfolio. Liquid assets in the banking sector remained well above the stipulated levels. Capital of the banking sector was maintained at a healthy level, with total regulatory capital increasing by 22 per cent as a result of increased share capital, profits, and general and other reserves. Profits of the banking sector increased during the year. The number of banks, as well as bank branches and automated teller machines (ATMs) expanded during the year. Banking density, i.e., the number of bank branches per 100,000 persons, improved to 17.0 at end 2014 from 16.8 in the previous year. Meanwhile, the licensed finance companies (LFC) and specialised leasing companies (SLC) sector grew by 18.9 per cent in terms of total assets, compared to the growth of 20.3 per cent in the previous year. The low interest rate environment helped maintain non performing loans at a manageable level, while mergers and acquisitions during the year helped build up the resilience of the LFC and SLC sector. In relation to banking institutions as well as LFCs and SLCs, several prudential policy measures and regulations were introduced by the Central Bank during the year, with a view to enhancing their safety and soundness further. Performance of superannuation funds, insurance companies, primary dealers in Government securities, and unit trusts also improved during the year. In the meantime, financial markets remained liquid during the year. The performance of the Colombo Stock Exchange (CSE) improved considerably. The All Share Price Index (ASPI) increased by 23.4 per cent to 7,299 while market capitalisation, also increased to Rs. 3.1 trillion by end 2014. Activity in the corporate debt market remained high, although there was a slowdown compared to the takeoff observed in 2013. The national payment infrastructure operated smoothly, with several measures taken to enhance the efficiency and soundness of payment and settlement systems. Access to finance improved with continued provision of concessionary credit facilities to the agriculture and livestock sector as well as micro, small and medium scale enterprises (MSMEs).

Going forward, the Sri Lankan economy is projected to reach upper middle income levels in terms of per capita GDP, and sustain the favourable high growth and low inflation nexus in the medium term, supported by appropriate economic policies. The new government formed in January 2015, is expected to uphold policies of good governance and transparency, which would support a high growth path through improved investor sentiment and also lead to a more equitable distribution of benefits of economic growth. In addition to balancing the tradeoff between growth and equity, the new government faces the enormous task of articulating a coherent medium term policy framework, which addresses possible shortcomings of previously announced policies as well as the challenges already identified. Addressing such challenges would be essential to realise the projected growth path as envisaged in the medium term, enabling the economy to achieve its full potential while maintaining macroeconomic stability in a more equitable environment.