I. Introduction

1. This is the third Annual Report of the Monetary Board of the Central Bank of Ceylon. It is issued in accordance with Section 35 of the Monetary Law Act, No. 58 of 1949, which provides that within three months after the end of each financial year—that is, by March 31—the Monetary Board shall submit to the Minister of Finance and shall publish an Annual Report on the condition of the Central Bank, 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 that prompted those policies and measures.

2. During the year Dr. Theodore Morgan was appointed a Deputy Governor and Mr. N. U. Jayawardena was designated Senior Deputy Governor. During two periods of temporary absence of both the Governor and Senior Deputy Governor from the Island, Dr. Morgan was designated by the Monetary Board as Senior Deputy Governor.

3. The Bank's financial year is the calendar year. The following report is concerned primarily with the year 1952.

II. The Basic Problems

4. The Ceylon economy passed through a difficult time in the year 1952 External assets fell by the largest amount on record, approximately Rs. 350 million or nearly 30 per cent.

5. The problems of 1950, those of a rapidly increasing money supply and a rising cost of living ; and of 1951, that of a continued rise in the cost of living, had disappeared. The essential economic problem in 1952 was adjustment of the Ceylon economy to the new conditions prevailing after the collapse of the Korean War boom. Thus the first three Annual Reports, by a series of coincidences, cover the different problems encountered in the three phases of a boom : first, that of monetary expansion and price inflation generated by export prices rising earlier and more rapidly than import prices in the upward phase of the boom ; second, that of damping the price inflation at the peak of the boom ; and third, that of deflationary adjustment to the squeeze on the economy when, in the collapse of the boom, export prices fell earlier and farther than import prices.

6. There were three main causes for the loss of external assets in 1952. The loss was initiated by falling export income, reinforced by rising import prices, and sustained and swollen by excessive expansion of the money supply to finance the heavy government budget deficit. These causes are analyzed in the paragraphs that follow.

7. Income from exports declined from Rs. 1,904 million in 1951 to Rs. 1,502 million in 1952, or by 21 per cent. The decline in value occurred in spite of a small increase in the physical quantity of total goods exported. Lower prices, therefore, were alone responsible for the lower value. The export price index fell by 22 per cent. Coconut products dropped nearly 38 per cent.