

I. Introduction

1. This, the sixth Annual Report of the Monetary Board of the Central Bank of Ceylon, is issued in accordance with section 35 of the Monetary Law Act, No. 58 of 1949. This section provides that within three months after the end of the 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 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. In terms of section 22 of the Monetary Law Act and with the concurrence of the Minister of Finance, Dr. B. B. Das Gupta was appointed a Deputy Governor of the Central Bank with effect from 7th December, 1955, for the duration of the absence of Mr. D. W. Rajapatirana, Deputy Governor, abroad. Mr. D. W. Rajapatirana was designated Senior for this period in terms of section 24 of the Monetary Law Act. In terms of section 8 of the Monetary Law Act, Mr. G. de Soyza, Acting Permanent Secretary to the Ministry of Finance, functioned as official member of the Monetary Board in December, 1955, during the absence of Mr. L. J. de S. Seneviratne abroad.

3. Mr. D. C. Gunsekera, Acting Chief Accountant, was appointed Chief Accountant from August 1, 1955. Mr. W. Tennekoon, Chief Accountant, who was on duty with the International Bank for Reconstruction and Development, was appointed Director of Bank Supervision from the same date. Mr. P. M. Jayarajan, the officiating Director of Bank Supervision, continued to officiate until 5th December, 1955, when he was relieved by Mr. Tennekoon. Mr. Howard S. Lahman functioned as an Adviser up to July 29, 1955. Three staff officers of the Economic Research Department of the Central Bank continued during the year to devote their full time to work in the Planning Secretariat attached to the Cabinet Planning Committee.

4. The Bank's financial year is the calendar year. The following report is concerned primarily with the year 1955.

II. The Economic and Financial Situation

5. In the Annual Report of the Central Bank for 1954 mention was made of the remarkable economic and financial recovery which Ceylon achieved in that year. In general, 1955 was even a better year for the Ceylon economy than 1954. Because of the dominant role which foreign trade plays in Ceylon's economic activities, the terms of trade to a very great extent determine the level of real income. On the average the terms of trade showed about a 10·0 per cent increase in 1955 over 1954. This improvement, together with the very favourable position as regards Government's finances, was mainly responsible for a record balance of payments surplus estimated at Rs. 317·6 million. The external assets increased by Rs. 260 million.* In 1954 external assets increased by Rs. 288 million, but of this increase Rs. 63·3 million represented the proceeds of a loan floated in London. In 1955 Government's external borrowings were limited to withdrawals of Rs. 8·9 million from the I.B.R.D. loan negotiated in 1954. At the end of 1955 total external assets, at Rs. 1,155 million, were roughly equivalent to 79 per cent of the value of imports for that year.

*This figure does not take into account the increase (21·6 million) in Ceylon's credit balance with China under the Trade Agreement.

6. The improvement in the terms of trade was caused by an increase in export prices by 4.6 per cent and a fall in import prices by 5.6 per cent. The volume of exports increased 5.9 per cent. The volume of imports was 4.0 per cent higher. Consequently the value of exports increased by Rs. 131 million to Rs. 1,940 million in 1955 and the value of imports increased by Rs. 62 million to Rs. 1,460 million, yielding a trade surplus of Rs. 480 million. The trade surplus of 1955 was higher than the record trade surplus of Rs. 412 million obtained in 1954.

7. The increased expenditure on imports, which occurred in spite of the lower import prices, was the result mainly of the higher income which the private sector of the economy enjoyed in 1955. Not only was export income higher, but there is also evidence of an increase in the volume of production of goods for domestic consumption, particularly rice. On the other hand, while Government exerted a primary deflationary influence of Rs. 85 million on private income in 1954 by running a net cash operating surplus* of that amount, during 1955 the Government's net cash operating surplus was lower, being Rs. 28 million. The volume of imports in 1955 was high in contrast with the volume in 1954, which was abnormally low in relation to both national income as well as the level of imports in the preceding years.

8. The figures relating to foreign trade in 1955 give a very favourable impression of Ceylon's external financial position. The average and total figures relating to exports however conceal a situation that was not without its disturbing elements. Export values in 1955 were higher than in 1954 chiefly because of the very high prices obtained for tea exports during the first quarter of 1955. From the middle of March, however, tea prices declined drastically, the average f.o.b. price for June being Rs. 2.63 as compared with a price of Rs. 4.47 for February. During the latter part of 1955 there was a moderate recovery in tea prices, but although the year closed with prices at generally reasonable levels, there was considerable uncertainty regarding the future course of prices. The trend of prices of the three major coconut products was also unsatisfactory, being generally downward throughout the year. Rubber prices, on the other hand, generally improved during 1955.

9. Consequent on the very favourable trade surplus of 1955 the level of external banking assets increased by Rs. 217 million. Money supply, however, increased by only Rs. 116 million. The smaller increase in money supply was due predominantly to the contractionary influence exerted by the Government sector. The Government's financial operations restricted the expansion in money supply in two ways, (a) by the Government running a net cash operating surplus, and (b) through an increase in Government's indebtedness to the non-banking private sector.

10. The increase in money supply in 1955 did not have any inflationary consequences. The Colombo Consumers' Price Index was in fact, 0.3 per cent lower at the end of 1955 than at the end of 1954. The domestic group of this index, which is the best available measure of domestic inflation in Ceylon, increased 2.2 per cent during this period. The minimum wage rate index of Tea and Rubber estate workers showed a small decline (0.5 per cent) between the end of 1954 and the end of 1955, and their real wages were lower (0.2 per cent).

*Defined as the excess of revenue receipts over all payments excepting those resulting from Government's borrowing and lending operations.

11. The increase in money supply was not inflationary because it was held mainly by individual tea producers and companies, who could be regarded as having comparatively high average and marginal propensities to save. Two reasons can be adduced for this view ; (a) concentration of ownership is, on the whole, much greater in the case of tea than in rubber or coconut, and (b) foreign ownership is quite considerable in tea. A further factor responsible for the non-inflationary character of the expansion in money supply was the increase in the transactions demand for money caused both by the increase in the value of exports as well as the increase in domestic goods produced for home consumption. The increase in the volume of domestic goods, particularly rice, coming into the market is perhaps the main explanation for the increase in the currency circulation by Rs. 43 million during 1955.

12. In 1955 there was a moderate increase in the assets and liabilities of the commercial banks. Since the principal cause for this increase was the favourable balance of payments there was also an increase in commercial bank liquidity during the year. Total deposits rose from Rs. 795.6 million at the end of December, 1954, to Rs. 910.8 million at the end of December, 1955. Loans and overdrafts increased by Rs. 9.2 million, while bank holdings of commercial bills increased by Rs. 14.8 million. Over this period excess reserves increased by Rs. 22.5 million ; the increase in total liquid assets was Rs. 75.8 million.

13. According to estimates made by the Central Bank the value of gross national output in 1955 was Rs. 5,104 million. This represents an increase of roughly 7 per cent over 1954. The main causes for this rise were an increase in the value of net domestic exports (10 per cent) and an increase in the value of home-grown rice (11 per cent) due to an increase in the volume of output (13 per cent). Gross per head income in 1955 was Rs. 593 as compared with Rs. 572 for the previous year ; the figure for 1955 has been exceeded previously only in one year, *i.e.*, in 1951 when estimated gross per head income was Rs. 597.

III. Policies and Measures

14. As pointed out in the Annual Report for 1954, in countries greatly dependent on the export of agricultural commodities the prices of which fluctuate widely, fiscal measures are fundamental in keeping the economy on an even keel over a number of years. During periods of high export prices the Government should accumulate budget surpluses so that budget deficits can be run when export prices are unfavourable. This, of course, does not mean that in the long-run budget surpluses must exactly equal budget deficits ; such a policy of perfect budgetary balance may maintain the total spendable income relatively stable, but it may do so at an unnecessarily low level. Some expansion in the total public debt, consistent with the growth of the economy and the avoidance of inflationary pressure, is quite justifiable in any economy. In the case of export economies, however, budget deficits when incurred may also be financed from accumulated Government savings plus borrowings of money savings of the private sector. By this means total spendable income can be maintained at a relatively high and constant level, with an external financial situation that is always basically sound.