

3. Prices and Inflation

Inflation, the rate of increase in the price level, has declined from the latter part of 1998. That trend reversed after May 2000 with the adjustment in administered prices in response to increases in international prices. Yet, annual inflation remained at a moderate level.

- ▲ The annual average inflation measured by the increase in the Colombo Consumers' Price Index (CCPI) was 6.2 per cent in 2000 compared to 4.7 per cent in 1999.
- ▲ An alternative measure of inflation, the change in the Gross Domestic Product (GDP) deflator, has been estimated at 6.7 per cent in 2000, compared to 4.4 per cent in 1999. This was consistent with the trend in the CCPI.
- ▲ Rising import prices of oil and wheat, coupled with a depreciating currency, began to exert significant pressures on the public sector deficit. Hence, administered prices for these items could no longer be maintained at subsidised levels without adverse repercussions on the economy.
- ▲ Accordingly, administered prices for diesel, kerosene, wheat flour, bread, gas, electricity, bus fares and some other items had to be increased. These price revisions were followed by a series of price adjustments in many consumer and non-consumer items in the market.
- ▲ However, increases in domestic supplies contributed to contain price increases. Production of many agriculture products improved during the year. Similarly, tight monetary policy prevented the emergence of demand pull inflationary pressures in the economy.
- ▲ Despite a series of corrective administrative price increases the annual inflation rate in 2001 is expected to remain at a single digit level with the adoption of appropriate monetary and fiscal policy measures.

Inflation Rate (12 month moving average)

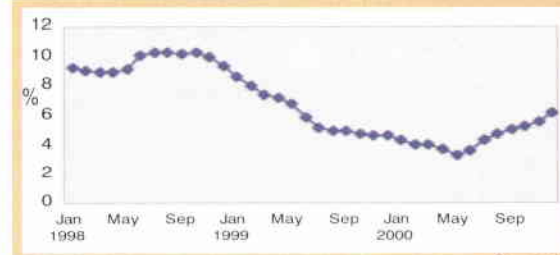


Chart 3.1