RECENT ECONOMIC DEVELOPMENTS

Highlights of 2016 and Prospects for 2017

CENTRAL BANK OF SRI LANKA

NOVEMBER 2016

Published by the Central Bank of Sri Lanka
30, Janadhipathi Mawatha
Colombo 01
Sri Lanka

Printed by: Lazergraphic (Pvt) Ltd.

ISBN 978-955-575-330-2

CONTENTS

KEY ECONOMIC INDICATORS

KEY ECONOMIC INDICATORS

	2012	2013	2014	2015 (a)	First Half (a) 2015	First Half (a) 2016
DEMOGRAPHY						
Mid-year population (‘000 persons) (b) (c)	20,424 (a)	20,579 (a)	20,771 (a)	20,966	-	-
Growth of mid-year population (per cent) (b)	0.7 (a)	0.8 (a)	0.9 (a)	0.9	-	-
Population density (persons per sq.km.) (b)	326 (a)	328 (a)	331 (a)	334	-	-
Labour force (‘000 persons) (d) (e) (f)	7,798 (a) (g)	8,034 (a) (g)	8,049 (a) (g)	8,214 (g)	8,223 (g)	8,256
Labour force participation rate (per cent) (e) (f)	52.5 (a) (g)	53.7 (a) (g)	53.2 (a) (g)	53.8 (g)	53.9 (g)	53.7
Unemployment rate (per cent of labour force) (e) (f)	4.0 (a) (g)	4.4 (a) (g)	4.3 (a) (g)	4.7 (g)	4.6 (g)	4.4
OUTPUT (h)						
GDP at current market price (Rs. billion)	8,732	9,592	10,448 (a)	11,183	5,432	5,926
GNI at current market price (Rs. billion)	8,578	9,366	10,212 (a) (i)	10,897 (i)	5,303	5,789
GDP at current market price (US$ billion)	68.4	74.3	80.0 (a)	82.3	40.9	41.0
GNI at current market price (US$ billion)	67.2	72.5	78.2 (a) (i)	80.2 (i)	39.9	40.1
Per capita GDP at market price (Rs.) (j)	427,559	466,112	503,032 (a)	533,398	-	-
Per capita GNI at market price (Rs.) (j)	419,975	455,126	491,667 (a) (i)	519,750 (i)	-	-
Per capita GDP at market price (US$) (j)	3,351	3,610	3,853 (a)	3,924	-	-
Per capita GNI at market price (US$) (j)	3,291	3,525	3,766 (a) (i)	3,823 (i)	-	-
REAL OUTPUT (percentage change) (h)						
GDP	9.1	3.4	4.9 (a)	4.8	5.7	3.9
Sectoral classification of GDP						
Agriculture	3.9	3.2	4.9 (a)	5.5	8.1	-2.5
Industry	9.0	4.1	3.5 (a)	3.0	2.5	5.2
Services	11.2	3.8	5.2 (a)	5.3	6.2	4.9
GNI	8.3	2.8	4.9 (a)	4.8	5.8	3.5
AGGREGATE DEMAND AND SAVINGS (per cent of GDP) (h)						
Consumption	72.8	75.4	76.0 (a)	77.4	76.0	74.3
Private	65.2	67.6	67.7 (a)	68.6	67.5	65.8
Government	7.6	7.8	8.3 (a)	8.8	8.5	8.5
Investment	39.1	33.2	32.0 (a)	30.1	31.5	33.0
Net exports of goods & services	-11.9	-8.6	-8.0 (a)	-7.4	-7.5	-7.3
Exports of goods & services	19.8	20.3	20.9 (a)	20.5	20.8	20.8
Imports of goods & services	31.7	28.9	28.9 (a)	28.0	28.3	28.1
Domestic savings	27.2	24.6	24.0 (a)	22.6	-	-
Net primary and secondary income from rest of the world	6.1	5.2	5.5 (a) (i)	5.0 (i)	-	-
National savings	33.3	29.9	29.5 (a) (i)	27.6 (i)	-	-
PRICES AND WAGES (percentage change)						
Colombo Consumers’ Price Index (2006/07=100) - annual average	7.6	6.9	3.3	0.9	1.7	2.2
Colombo Consumers’ Price Index (2006/07=100) - year-on-year (end period)	9.2	4.7	2.1	2.8	0.1	6.0
National Consumer Price Index (2013=100) - annual average	-	-	-	3.8	-	3.1
National Consumer Price Index (2013=100) - year-on-year (end period)	-	-	-	4.2	2.7	6.4
Producer’s Price Index (2013 Q4=100) - annual average	-	-	-	3.6	-	1.7
GDP deflator (h)	10.8	6.2	3.9 (a)	2.1	2.0	5.0
GNI deflator (h)	10.9	6.2	3.9 (a)	2.1	1.7	5.4
Nominal wage rate index for workers in wages boards trades (1978 Dec=100) - annual average	22.2	5.7	3.7	2.9	4.7	-
Nominal wage rate index for public sector employees (2012=100) - annual average	-	6.3	10.5	31.7	20.0	19.4
Nominal wage rate index for informal private sector employees (2012=100) - annual average	-	9.8	7.6	7.3	8.9	6.3
EXTERNAL TRADE						
Trade balance (US$ million)	-9,417	-7,609	-8,287	-8,430	-4,122	-4,213
Exports	9,774	10,394	11,130	10,505	5,424	5,108
Imports	19,190	18,003	19,417	18,935	9,547	9,321
Terms of trade (percentage change)	-1.5	4.6	4.3	2.3	7.0	2.8
Export unit value index (2010=100) (percentage change)	-7.3	-0.3	2.7	-9.8	-5.6	-4.7
Import unit value index (2010=100) (percentage change)	-5.8	-4.7	-1.5	-11.8	-11.7	-7.3
Export volume index (2010=100) (percentage change)	-0.2	6.7	4.3	4.6	5.5	-1.2
Import volume index (2010=100) (percentage change)	0.5	-1.5	9.5	10.6	20.4	5.4
EXTERNAL FINANCE (US$ million)						
Services and primary income account (net)	43	-572	72	228	134	272
Current private transfers (net)	5,339	5,619	6,199	6,167	3,017	3,142
Current official transfers (net)	53	21	28	27	18	4
Current account balance	-3,982	-2,541	-1,988	-2,009	-953	-795
Overall balance	151	985	1,369	-1,489	-792	-1,186

(a) Provisional
(b) As reported by the Registrar General’s Department
(c) Based on the final report of the Census of Population and Housing - 2012.
(d) Household population aged 15 years and above is considered for the calculation of labour force.
(e) Data covers the entire island.
(f) In July 2016, the Department of Census and Statistics published a re-weighted and revised labour force data series for 2011 onwards
(g) Revised
(h) Rebased GDP estimates (base year 2010) of the Department of Census and Statistics have been used.
(i) Revised based on latest Balance of Payments data.
(j) Estimates updated with latest population figures.

KEY ECONOMIC INDICATORS (Contd.)

	2012	2013	2014	2015 (a)	First Half (a)	
					2015	2016
Current account balance (per cent of GDP) (h) (k)	-5.8	-3.4	-2.5	-2.4	-	-
Total foreign assets (months of the same year imports) (l)	5.4	5.7	6.1	5.9	5.6	4.7
Gross official reserves (months of the same year imports)	4.4	5.0	5.1	4.6	4.5	3.4
Overall debt service ratio (m)						
As a percentage of export of goods and services	19.7	26.8	20.8	27.7	23.0	25.9
As a percentage of current receipts	13.5	18.7	14.5	19.5	16.3	18.1
Total external debt (per cent of GDP) (h) (k)	54.2	53.7	53.6	54.4	-	-
EXCHANGE RATES						
Annual average						
Rs/US$	127.60	129.11	130.56	135.94	132.93	144.47
Rs/SDR (n)	195.38	196.19	198.35	190.16	186.35	202.24
NEER (2010=100) (24-currency basket) (o)	90.44	91.39	91.99	96.61	97.49	92.65
REER (2010=100) (24-currency basket) (o) (p)	95.80	100.61	101.94	106.18	106.96	103.19
Year end						
Rs/US$	127.16	130.75	131.05	144.06	133.70	145.25
Rs/SDR (n)	195.31	201.36	189.86	199.63	188.04	203.18
GOVERNMENT FINANCE (per cent of GDP) (h)						
Revenue and grants	12.2	12.0	11.5	13.1	5.4	6.0
Revenue	12.0	11.9	11.4	13.0	5.4	6.0
o/w Tax revenue	10.4	10.5	10.1	12.1	4.9	5.6
Grants	0.2	0.2	0.1	0.1	…	…
Expenditure and net lending	17.8	17.4	17.2	20.5	8.9	8.7
Recurrent expenditure	13.0	12.6	12.7	15.2	6.8	6.8
Capital expenditure and net lending	4.9	4.8	4.5	5.3	2.1	1.9
Current account deficit (-) / surplus (+)	-0.9	-0.7	-1.2	-2.2	-1.4	-0.8
Primary deficit (-) / surplus (+)	-0.9	-0.8	-1.5	-2.9	-1.4	-0.3
Overall deficit (-) / surplus (+)	-5.6	-5.4	-5.7	-7.4	-3.6	-2.7
Deficit financing	5.6	5.4	5.7	7.4	3.6	2.7
Foreign	3.3	1.3	2.0	2.1	-0.4	-0.3
Domestic	2.3	4.1	3.6	5.3	3.9	3.0
Government debt	68.7	70.8	70.7	76.0	-	-
Foreign	31.7	30.9	29.8	31.7	-	-
Domestic	37.0	40.0	40.9	44.3	-	-
MONETARY AGGREGATES (year-on-year percentage change)						
Reserve money	10.2	0.9	18.3	16.5	19.8	24.5
Narrow money (M_1)	2.6	7.7	26.3	16.8	21.2	12.1
Broad money (M_{2b}) (q)	17.6	16.7	13.4	17.8	15.3	17.0
Net foreign assets of the banking system	-126.3	-195.5	119.8	-2,071.2	-225.6	139.4
Net domestic assets of the banking system	23.4	18.3	10.5	26.0	26.8	22.8
Domestic credit from the banking system to						
Government (net)	25.4	24.5	10.3	22.5	21.5	19.8
Public corporations	47.3	24.8	22.2	17.2	38.2	0.5
Private sector	17.6	7.5	8.8	25.1	19.4	28.2
Money multiplier for M_{2b} (end year)	6.05	7.00	6.71	6.78	6.81	6.40
Velocity of M_{2b} (average for the year) (h)	3.17	2.99	2.88	2.67	-	-
INTEREST RATES (per cent per annum at year end)						
Standing Deposit Facility Rate (SDFR) (r)	7.50	6.50	6.50	6.00	6.00	6.50
Standing Lending Facility Rate (SLFR) (r)	9.50	8.50	8.00	7.50	7.50	8.00
Money market rates						
Average weighted call money rate (AWCMR)	9.83	7.66	6.21	6.40	6.12	8.20
Treasury bill yields						
91-day	10.00	7.54	5.74	6.45	6.11	8.88
364-day	11.69	8.29	6.01	7.30	6.28	10.55
Deposit rates						
Commercial banks' average weighted deposit rate (AWDR)	10.10	9.37	6.20	6.20	6.02	6.87
Commercial banks' average weighted fixed deposit rate (AWFDR)	13.21	11.78	7.33	7.57	7.29	8.64
NSB savings rate	5.00	5.00	5.00	5.00	5.00	4.50
NSB 12-month fixed deposit rate	12.50	9.50	6.50	7.25	6.50	10.00
Lending rates						
Commercial banks' average weighted prime lending rate (AWPR)	14.40	10.13	6.26	7.53	7.00	10.70
Commercial banks' average weighted lending rate (AWLR)	15.98	15.18	11.91	11.00	11.25	12.09
CAPITAL MARKET						
All share price index (ASPI) (1985=100)	5,643.0	5,912.8	7,299.0	6,894.5	7,020.8	6,283.3
S&P SL20 index (2004 Dec=1,000) (s)	3,085.3	3,263.9	4,089.1	3,625.7	3,908.0	3,300.2
Value of shares traded (Rs. million)	213,827	200,468	340,917	253,251	122,985	87,378
Net purchases by non nationals (Rs. million)	38,661	22,783	21,217	-5,372	1,506	-6,374
Market capitalisation (Rs. billion)	2,167.6	2,459.9	3,104.9	2,938.0	2,983.0	2,677.6

(k) Based on GDP estimates in US dollars
(l) Excludes foreign assets in the form of direct investments abroad and trade credit and advances received
(m) Overall debt service ratios were reclassified to capture debt servicing of government: short-term debt (i.e. foreign holdings of Treasury bonds) in accordance with the External Debt Statistics Manual (2003) of the International Monetary Fund (IMF)
(n) Special Drawing Rights (SDR), the unit of account of the IMF
(o) Exchange rates have been defined in terms of indices so that the appreciation/depreciation of the rupee relative to other currencies is directly reflected by a rise/fall in the values of the effective exchange rate indices
(p) CCPI is used for the computation of the Real Effective Exchange Rate (REER). The REER is computed by adjusting the Nominal Effective Exchange Rate (NEER) for inflation differentials with the countries whose currencies are included in the basket
(q) Figures of 2015 include assets/ liabilities of DFCC Bank PLC, which merged with DFCC Vardhana Bank, with effect from 1 October 2015
(r) Repurchase rate and Reverse Repurchase rate were renamed as Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) respectively, with effect from 2 January 2014
(s) With effect from 1 January 2013, the MPI was replaced by a newly introduced index, namely S&P SL20 index. This index was introduced on 27 June 2012 and its base period is December 2004=1,000

1

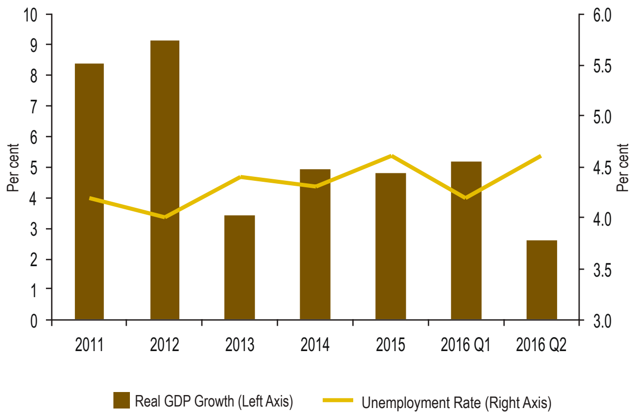
OVERVIEW

The growth in economic activity continued, with the Sri Lankan economy growing at the moderate rate of 3.9 per cent in real terms during the first half of 2016 following the annual growth of 4.8 per cent registered in 2015. The growth of the Services sector was supported by financial service activities, and wholesale and retail trade activities in addition to other personal services and public services. The Industry sector expansion was a result of higher value addition from construction and manufacturing activities. The Agriculture sector contracted due to adverse weather conditions, which also affected prices of domestic fresh food items in the first half of the year. In spite of the price pressures arising from these domestic supply side disruptions and the immediate impact of tax adjustments introduced by the government, consumer price inflation remained in single digits during the first nine months of the year. However, the upward trend in underlying inflation and average inflation during this period, along with high monetary and credit expansion and the possibility of a shortfall in government tax revenue collection required preemptive monetary policy measures from the Central Bank. Accordingly, the Central Bank tightened its monetary policy stance, first by raising the Statutory Reserve Ratio (SRR) and then by raising its main policy interest rates in two steps during the first nine months of the year. The tightening of monetary policy was also expected to support the reduction of the pressure on the external sector through the dampening of import intensive credit flows to the economy and discouraging portfolio capital outflows in the context of the normalisation of monetary policy in the United States of America. Nevertheless, external sector vulnerabilities persisted as a result of the weak recovery of the global economy and further uncertainties due to Brexit, as well as the inability of the Sri Lankan economy to attract sufficient non-debt creating long term capital flows. Meanwhile, the government and the Central Bank entered into an Extended Fund Facility (EFF) with the International Monetary Fund (IMF) with the intention of streamlining medium term fiscal performance, strengthening official international reserves and maintaining inflation at mid-single digit levels. In the fiscal sector, although some improvements were observed in the first half of 2016, lingering fiscal challenges as well as several structural weaknesses in the economy remain to be addressed. In relation to the financial sector, a continuation of its growth momentum was observed during the first eight months of 2016.

- **The economy grew by 3.9 per cent during the first half of 2016 in real terms, in comparison to 5.7 per cent growth recorded in the corresponding period of 2015.** This growth was mainly propelled by the continuous expansion in Services followed by the Industrial activities despite the contraction recorded in the Agriculture sector activities. Among the three major sectors, Services activities continued to be the dominant force in GDP growth, recording a 4.9 per cent increase during the first half of 2016. The sectoral performance was underpinned by the expansion in financial service activities, wholesale and retail trade activities and other personal services. Meanwhile, Industry related activities grew by 5.2 per cent during the first half of 2016, compared with the 2.5 per cent growth during the same period of 2015. The recovery in construction activities coupled with the positive performance of manufacturing activities mainly contributed to this growth. The other industrial activities too yielded positive results, albeit contributing marginally to growth. On the other hand, Agriculture activities contracted by 2.5 per cent during the first half of 2016, as opposed to the 8.1 per cent growth recorded in the corresponding period of 2015. The contraction recorded in growing of tea, rice, spices, rubber as well as fishing activities were the main contributory factors. In the meantime, taxes less subsidies on products of the economy had a dampening impact on the overall economic growth during the first half of the year, due to its contraction by 3.1 per cent during the period.

- **Although some increase in the unemployment rate was observed in the second quarter of 2016, the unemployment rate during the first half of 2016 was 4.4 per cent in comparison to 4.6 per cent in the first half of the previous year.** The decline in the unemployment rate among females to 6.7 per cent in the first half of 2016 compared to 7.5 per cent in the corresponding period of the previous year mainly contributed to the improvement in the first half of the year. Unemployment amongst males increased to 3.1 per cent in the first half of 2016 from 2.9 per cent in the corresponding period of the previous year. Youth unemployment (15-24 years) at 21.8 per cent during the period continued to remain high, although a marginal decline from the respective period of last year was observed. In terms of the level of education, the highest unemployment rate of 8.2 per cent was recorded amongst persons with GCE (Advanced Level) and higher levels of educational attainment, which however has improved from the 9.3 per cent recorded during the same period of 2015.

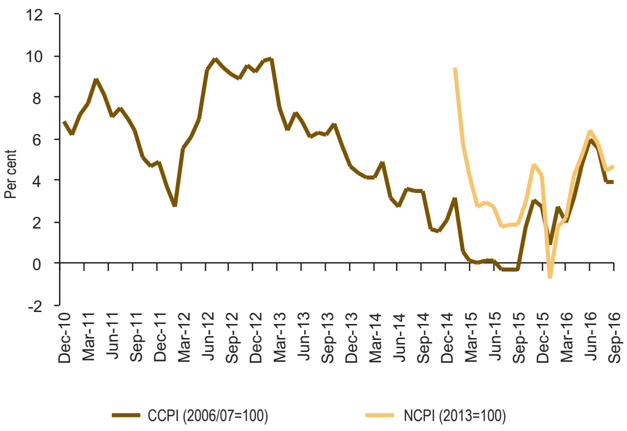
Chart 1.1 Real GDP Growth (a) and Unemplyment



(a) Based on revised GDP estimates (2010 base) of DCS

- **Consumer price inflation increased during the first half of 2016 and stabilised around mid-single digits thereafter while core inflation also indicated some stabilisation following an increasing trend.** Headline inflation, as measured by both the National Consumer Price Index (NCPI, 2013=100) and the Colombo Consumers' Price Index (CCPI, 2006/2007=100), registered an increase in the second quarter of 2016 reflecting the combined impact of domestic supply side disturbances, particularly due to adverse weather conditions, and the increase in the Value Added Tax (VAT)

Chart 1.2 Year-on-Year Inflation



rate as well as the removal of certain exemptions applicable on VAT and the Nation Building Tax (NBT). Nonetheless, inflation declined in the third quarter of 2016 mainly reflecting the impact of the normalisation in domestic supply conditions as well as the suspension of the implementation of changes to the government tax structure. Accordingly, on a year-on-year basis, NCPI based headline inflation, which increased to a peak of 6.4 per cent in June 2016, moderated to 4.7 per cent by September 2016. On an annual average basis, NCPI based headline inflation was 3.8 per cent in September 2016. Following a similar trend, CCPI based headline inflation also reached a peak of 6.0 per cent by June 2016 and gradually declined to 3.9 per cent in September 2016, while on an annual average basis, it stood at 3.4 per cent in September 2016. Meanwhile, core inflation, which measures the underlying inflationary pressures, continued its upward trend in the first half of 2016 reflecting the firming up of demand conditions in the economy, while it steepened towards the latter part of this period following the revisions made to the tax structure by the government. However, core inflation stabilised around mid-single digits in the third quarter of 2016, part of which could be attributed to the reversal of the changes made to the government tax structure. Accordingly, core inflation, based on NCPI, was 5.7 per cent in September 2016, year-on-year, compared to a peak level of 7.5 per cent recorded in June 2016 and 5.8 per cent recorded at end 2015. CCPI based core inflation, following a similar trend, was recorded at 4.2 per cent, year-on-year, in September 2016 in comparison to 4.5 per cent at end 2015.

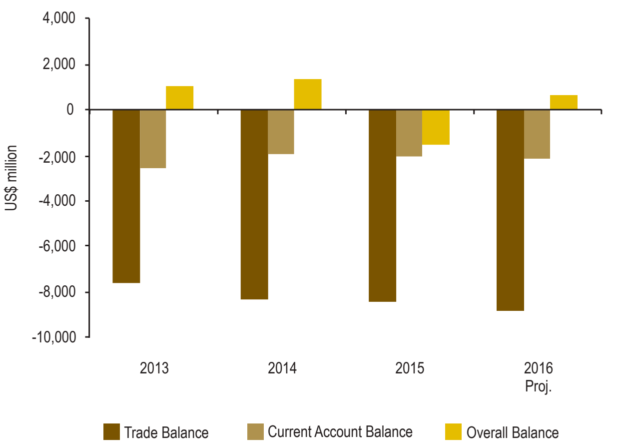
- **The external sector displayed a modest performance during the first half of 2016.** Both exports and imports contracted resulting in an expansion in the trade deficit during the first half of 2016. The services account recorded a surplus primarily due to the continuous growth in earnings from tourism while earnings from transportation and computer and information related services also recorded a moderate growth during the period. The deficit in the primary income account increased with lower inflows due to the decline in earnings from reserve assets as well as higher outflows on account of an increase in dividend payments by direct investment enterprises and interest payments on project loans by the government. The secondary income account continued to record a surplus despite a moderate growth in workers' remittances. With these developments, the current account deficit narrowed to US dollars 795 million in the first half of 2016 from the deficit of US dollars 953 million recorded during the corresponding period of 2015. In the financial account, limited FDI inflows, net outflows from the foreign investments in the Colombo Stock Exchange (CSE) together with the unwinding of foreign investments in government securities, on a net basis, resulted in an overall deficit in the BOP by end June 2016. Meanwhile, developments in the current and the financial accounts of BOP, along with the need to strengthen fiscal consolidation, prompted Sri Lanka to obtain a three year EFF of SDR 1.1 billion (approximately US dollars 1.5 billion) from the IMF to strengthen the external position of the country and to support the government's economic reform agenda. The EFF supported economic programme contributed to positive investor sentiments resulting in a reversal in the net outflow from the government securities market from April 2016 onwards. Inflows to the financial account were further supplemented by the proceeds from the dual-tranche International Sovereign Bond (ISB) issuance and the syndicated loan in July 2016, strengthening the external sector in the third quarter of 2016.

- **The deficit in the trade balance increased by 1.6 per cent, year-on-year, during the first eight months of 2016, as a result of the considerable reduction in exports compared to marginal decline in imports.** Continuing the sluggish performance recorded since the latter part of 2014, earnings from exports during the first eight months of 2016 declined by 4.1 per cent, year-on-year, to US dollars 6,865 million, while expenditure on imports decreased moderately by 1.6 per cent to US dollars 12,403 million. The substantial reduction in international commodity prices contributed significantly to the decline in both exports and imports. Despite the improvement recorded in earnings from textile and garment exports, lower earnings from transport equipment, petroleum products, tea, and spices exports contributed mainly to the decline in exports. Earnings from textiles and garments exports, increased by 3.6 per cent during the first eight months of 2016, as a result of the increase in exports to both traditional and non-traditional markets compared to the corresponding period in 2015. The decline in import expenditure was led by the significant decline recorded in the importation of fuel and motor vehicles. However, import expenditure on machinery and equipment, building materials, textile and textile articles, and gold increased considerably during the period. Accordingly, the trade deficit expanded to US dollars 5,538 million during the first eight months of 2016 from US dollars 5,449 million in the corresponding period of the previous year.

- **Sri Lanka's current account deficit moderated in the first half of 2016 by around 16.6 per cent from the corresponding period in 2015.** The improvement in the current account was a result of the increase in net inflows to the services account and the secondary income account. Alongside the increase in the deficit in the trade account, the primary income account also recorded a deficit of US dollars 955 million during the first half of 2016 compared to US dollars 925 million recorded a year earlier. Inflows to the primary income account declined marginally with a reduction in earnings from reserve assets during the period. Further, outflows from the primary income account by way of dividend payments increased while interest payments on portfolio investments declined with a significant reduction in outstanding Treasury bonds held by non residents during the period. The deficits in trade and primary income accounts were offset partially by the surplus in the services and the secondary income accounts. The improvement in services account was mainly driven by high inflows in travel and transport sub sectors while the surplus in the secondary income account recorded a moderate growth as a result of a lower than expected growth in workers' remittances. The services account of the BOP recorded a surplus of US dollars 1,228 million during the first half of 2016 compared to the surplus of US dollars 1,059 million in the corresponding period of 2015, with a higher contribution from travel and transport sub sectors. Other inflows to the services account remained moderate during the period, including net inflows on account of telecommunication, computer and information services. Net inflows to the secondary income account increased to US dollars 3,146 million in the first half of 2016 from US dollars 3,035 million in the corresponding period of 2015. Workers' remittances increased by 5.3 per cent during the first half of 2016 over the relatively low base recorded last year but remained subdued compared to the average annual growth of 13.6 per cent over the 2000-2014 period. The comparatively low growth in workers' remittances during the first half of 2016 could be partly attributed to the drop in income in oil exporting Middle Eastern countries with the decline of international oil prices, which resulted in reducing new recruitments and curtailing work hours such as over-time work. Reflecting these developments, the current account deficit moderated to US dollars 795 million in the first half of 2016 compared to the deficit of US dollars 953 million in the first half of 2015.

- **Both net incurrence of liabilities and net acquisition of financial assets declined significantly in the first half of 2016**. Higher net incurrence of liabilities relative to net acquisition of assets resulted in the overall net borrowings of the financial account amounting to US dollars 967 million in the first half of 2016 compared to US dollars 667 million in the corresponding period in 2015. Total net acquisition of financial assets declined by US dollars 1,882 million in the first half of 2016 in contrast to the increase of US dollars 419 million in the first half of 2015. Net incurrence of liabilities in the first half of 2016 decreased by US dollars 915 million compared to an increase in liabilities of US dollars 1,086 million in 2015. The slow recovery of the global economy and the increase in policy rates of the US Federal Reserve prompted continuous outflows of foreign investments, especially during the first four months of 2016. This also resulted in an outflow of foreign investments from the Colombo Stock Exchange and a significant outflow of foreign investments in the government securities market in the first half of 2016. External borrowings by the government for project loans also remained moderate during the period. Total contribution of the banking sector, corporate sector and State Owned Business Enterprises (SOBEs) to the financial account also remained modest. Further, trade credit and advances received by Sri Lankan enterprises, primarily by the Ceylon Petroleum Corporation, reduced during the first half of the year. Meanwhile, the Central Bank continued to repay the swap arrangement with the Reserve Bank of India (RBI) and the outstanding of the IMF-SBA while engaging in a new swap under the SAARCFINANCE arrangement. Further, inflows in the form of direct investments remained stagnant during the period, much in line with the low direct investment inflows in 2015. There were limited inflows as direct investments in the form of new projects, while ongoing key projects received only moderate levels of direct investments. In the backdrop of continuing pressure on the external sector in addition to the need for improving the fiscal sector, and effects of the unfavourable global economic environment, Sri Lanka entered into, a three year EFF from the IMF. The overall expectation of the EFF supported economic programme is to improve macroeconomic stability, bolster market confidence, enhance competitiveness and outward orientation while strengthening external sector resilience in a challenging global environment.

Chart 1.3 Balance of Payments

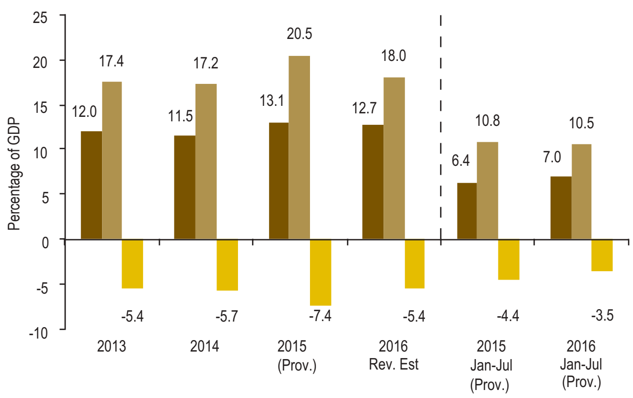


- **The level of gross official reserves of the country amounted to US dollars 6.5 billion by end September 2016.** The receipt of the first tranche of the IMF-EFF, proceeds from the issuance of the ISB of US dollars 1.5 billion, proceeds from syndicated loans of US dollars 700 million and rolling over of US dollars 400 million under the SAARCFINANCE currency swap arrangement contributed positively to the reserve level. Conversely, settlement of the RBI swap facility, foreign currency debt service payments, supply of liquidity to the domestic foreign exchange market and principal payments of IMF-SBA were the main drains on the reserves during the period. The country's gross official reserve level of US dollars 6.5 billion by the end of September 2016 is estimated to be equivalent to 4.1 months of imports.

- **Despite considerable depreciation pressure on the rupee during the first four months of 2016, the rupee remained relatively stable during the year up to September 2016.** Import expenditure, debt service payments and unwinding of investments in the government securities market exerted depreciation pressure on the rupee during the first four months of 2016 which necessitated the intervention of the Central Bank in the domestic foreign exchange market by supplying foreign currency liquidity. The gradual reversal in the outflows from the government securities market together with inflows from the IMF-EFF, the proceeds from the ISB and the syndicated loans reduced the depreciation pressure on the domestic currency gradually from May 2016 onwards. As such, the net supply of foreign exchange liquidity by the Central Bank was limited to US dollars 693 million during the first nine months of 2016. With all these developments, the Sri Lankan rupee recorded a depreciation of 1.8 per cent against the US dollar by the end of September 2016. Meanwhile, both the 5-currency and 24-currency Nominal Effective Exchange Rate (NEER) and Real Effective Exchange Rate (REER) indices depreciated during this period. The 5-currency REER and 24-currency REER indices depreciated by 0.06 per cent and 2.06 per cent, respectively, reflecting an improvement in country's external competitiveness.

- **The fiscal sector exhibited a favourable performance during the first seven months of 2016**. Government revenue as a percentage of estimated GDP increased to 7.0 per cent in the first seven months of 2016 in comparison to 6.4 per cent in the first seven months of 2015, reflecting an increase in tax revenue. The Value Added Tax (VAT), import duties, income taxes, Ports and Airports Development Levy (PAL), Cess, Special Commodity Levy (SCL) and other import related taxes contributed positively to the increase in tax revenue, while revenue from excise duties declined marginally during the period under consideration mainly due to the decline in revenue from excise duty on motor vehicles. Total expenditure and net lending as a percentage of estimated GDP declined marginally to 10.5 per cent during the first seven months of 2016 compared to 10.8 per cent recorded during the corresponding period in 2015, as a result of the decline in recurrent

Chart 1.4 Government Revenue, Expenditure and Overall Budget Deficit (as a percentage of GDP)



expenditure. Consequently, the overall budget deficit declined to 3.5 per cent of estimated GDP during the first seven months of 2016 from 4.4 per cent in the corresponding period in 2015, reflecting a significant improvement in the fiscal sector.

- **The overall budget deficit of Rs. 432.7 billion during the first seven months of the year was mainly financed through domestic sources.** However, net domestic financing declined by 24.8 per cent to Rs. 409.8 billion during the first seven months of 2016, compared to Rs. 545.2 billion in the corresponding period of 2015, owing to the low financing requirement of the government during the period under consideration compared to the same period in the previous year. Net foreign financing amounted to Rs. 22.9 billion in the first seven months of 2016 compared to the repayment of Rs. 41.8 billion in the corresponding period of 2015. This was mainly on account of the utilisation of the proceeds from the ISB and improved foreign holdings of Treasury bills despite the net repayment of foreign project loans and net outflows from foreign holdings of Treasury bonds.

- **The Central Bank tightened its monetary policy stance in several stages during the first nine months of the year with the view of containing the possible emergence of demand-driven inflationary pressures in the economy stemming from high credit growth and excessive monetary expansion.** In an environment of relaxed monetary conditions that prevailed in previous years, monetary aggregates grew at a higher than projected pace. Given the higher than expected domestic credit growth and risks relating to financial system stability, several macroprudential policy measures, such as imposing cash margins and maximum loan-to-value ratios, were introduced by the Central Bank in the last quarter of 2015 to contain credit flows to certain sectors, while allowing the exchange rate to be determined by market forces. At the same time, the Central Bank commenced tightening its monetary policy stance gradually by raising the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of commercial banks by 1.50

Table 1.1 Recent Monetary Policy Measures

Date	Measure
3-Feb-2012	Repurchase rate and Reverse Repurchase rate increased by 50 basis points to 7.50% and 9.00%, respectively.
9-Feb-2012	Greater flexibility in the determination of the exchange rate allowed.
12-Mar-2012	Direction issued to licensed banks to limit rupee denominated credit growth to 18% or Rs. 800 mn. Additional 5% (23% or Rs. 1 bn) allowed to banks that bridge the gap with funds raised abroad.
5-Apr-2012	Repurchase rate increased by 25 basis points to 7.75% and Reverse Repurchase rate increased by 75 basis points to 9.75%, respectively.
12-Dec-2012	Repurchase rate and Reverse Repurchase rate reduced by 25 basis points to 7.50% and 9.50%, respectively.
31-Dec-2012	Ceiling on rupee denominated credit growth allowed to expire.
10-May-2013	Repurchase rate and Reverse Repurchase rate reduced by 50 basis points to 7.00% and 9.00%, respectively.
26-Jun-2013	Statutory Reserve Requirement (SRR) reduced by 2 percentage points to 6% with effect from 1-Jul-2013.
15-Oct-2013	Repurchase rate and Reverse Repurchase rate reduced by 50 basis points to 6.50% and 8.50%, respectively.
2-Jan-2014	The Policy Rate Corridor was renamed as the Standing Rate Corridor (SRC), and the Repurchase rate and the Reverse Repurchase rate of the Central Bank were renamed as the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR), respectively. SLFR reduced by 50 basis points to 8.00%. The Standing Deposit Facility (SDF) was uncollateralised with effect from 1-Feb-2014.
23-Sep-2014	Access to the SDF of the Central Bank by OMO participants at 6.50% was rationalised to a maximum of three times per calendar month. Any deposits at the SDF window exceeding three times by an OMO participant was accepted at a special interest rate of 5.00% .
2-Mar-2015	The 5.00% special SDF rate was withdrawn.
15-Apr-2015	The SDFR and SLFR reduced by 50 basis points to 6.00% and 7.50%, respectively.
3-Sep-2015	The exchange rate was allowed to be determined based on demand and supply conditions in the foreign exchange market (a).
30-Dec-2015	SRR was increased by 1.50 percentage points to 7.50% to be effective from the reserve period commencing 16-Jan-2016.
19-Feb-2016	The SDFR and SLFR increased by 50 basis points to 6.50% and 8.00%, respectively.
28-Jul-2016	The SDFR and SLFR increased by 50 basis points to 7.00% and 8.50%, respectively.

Source: Central Bank of Sri Lanka

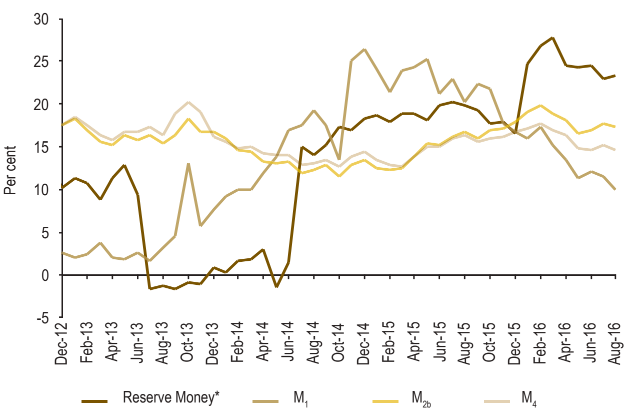
(a) In addition, the Central Bank imposed:
  i. a minimum cash margin requirement of 100% on 30 October 2015 against Letters of Credit (LC) opened with commercial banks for the importation of motor vehicles to be effective until 1 December 2015, and
  ii. a maximum Loan to Value (LTV) ratio of 70% in respect of loans and advances granted for the purpose of purchase or utilisation of motor vehicles by banks and financial institutions supervised by the Central Bank with effect from 1 December 2015, as a macro-prudential measure.

percentage points to 7.50 per cent, to be effective from January 2016. However, in spite of the upward adjustments observed in market interest rates following the increase in SRR, certain risks to macroeconomic stability continued to persist. Accordingly, the Central Bank further tightened its monetary policy stance by increasing its Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 50 basis points each, to 6.50 per cent and 8.00 per cent, respectively, in February 2016. Monetary tightening measures, coupled with declining levels of excess market liquidity, resulted in an increase in short term money market rates, while other market interest rates also started increasing gradually. However, amidst an increase in lending rates, credit disbursements to the private sector by commercial banks continued to grow unabated beyond the desired levels during the second quarter of 2016 as well. Therefore, considering the potential threats to price stability due to the sustained increase in credit and monetary aggregates amidst upward trending underlying inflation, the Central Bank tightened its monetary policy stance further in a forward looking manner by increasing SDFR and SLFR by 50 basis points each, to 7.00 per cent and 8.50 per cent, respectively, in July 2016.

- **Market interest rates moved upwards during the first nine months of 2016 reflecting transmission of the impact of tight monetary conditions in the economy.** Following the upward adjustment in SRR as well as the increase in policy interest rates in February 2016 and the subsequent decline in market liquidity levels, the Average Weighted Call Money Rate (AWCMR), which is the operating target variable under the present enhanced monetary policy framework, increased and hovered within the range of 8.15-8.24 per cent levels, while Open Market Operations (OMOs) conducted by the Central Bank helped stabilise money market rates. Following the policy rate hike in July 2016, the AWCMR increased further and remained at 8.42 per cent by end September 2016. Meanwhile, the Sri Lanka Inter Bank Offered Rates (SLIBOR) gradually increased in line with the AWCMR. Accordingly, by end September 2016, overnight and 12-months SLIBOR remained at 8.44 per cent and 11.98 per cent, respectively, compared to 6.40 per cent and 7.66 per cent, respectively, at end 2015. Following the increase in short term interest rates, lending rates and deposit rates of commercial banks have registered an upward adjustment thus far in 2016. Accordingly, the Average Weighted Lending Rate (AWLR), increased by 188 basis points to 12.88 per cent by end September 2016 from 11.00 per cent at end 2015. Similarly, the Average Weighted New Lending Rate (AWNLR) also increased to 13.97 per cent at end September 2016 from 10.79 per cent at end December 2015. Meanwhile, the weekly Average Weighted Prime Lending Rate (AWPR) increased substantially by 459 basis points to 12.12 per cent by end September 2016 compared to 7.53 per cent recorded at end 2015. Reflecting the increased funding costs of financial institutions, deposit rates also increased, albeit at a slower pace compared to lending rates. The Average Weighted Deposit Rate (AWDR) increased by 136 basis points to 7.56 per cent during the first nine months of the year while Average Weighted Fixed Deposit Rate (AWFDR) increased by 210 basis points to 9.67 per cent by end September 2016. Moreover, the Average Weighted New Deposit Rate (AWNDR), which captures the interest rates pertaining to all new interest bearing deposits, increased by 405 basis points to 11.01 per cent by end September 2016. Meanwhile, primary market Treasury bill yield rates witnessed a sharp increase during the first three months of the year and moderated thereafter. The government securities market experienced a net foreign inflow since the latter part of April 2016 reflecting positive sentiments following the announcement of the EFF programme of the IMF. This, coupled with the enhancements of government revenue collection and the receipt of long term financial flows from abroad, particularly with the successful issuance of Sri Lanka's tenth ISB, eased the pressure on yield rates to some extent. Although there was an upward adjustment in the yields immediately after the policy interest rate hike in July 2016, the yield rates indicated a gradual decline thereafter. Accordingly, 91-day, 182-day and 364-day Treasury bill yield rates were at 8.55 per cent, 9.39 per cent and 10.11 per cent respectively, by end September 2016 compared to 6.45 per cent, 6.83 per cent and 7.30 per cent respectively, reported at end 2015. Meanwhile, interest rates applicable on debt instruments issued by the corporate sector have also showed some upward adjustment thus far in 2016. In line with the movements in global interest rates, particularly interest rates in the United States, interest rates applicable to foreign currency deposits maintained at commercial banks increased marginally in 2016.

- **Reserve money, which represents the monetary base of the economy, recorded a notable growth of 23.3 per cent (year-on-year) by end August 2016, compared to 16.5 per cent at end 2015.** In absolute terms, reserve money increased

Chart 1.5 Year-on-Year Growth of Monetary Aggregates



*Sudden changes in reserve money growth in particular months are due to revisions to SRR.

substantially by Rs. 112.3 billion to Rs. 785.7 billion during the first eight months of the year. From the liability side, the increase in both currency in circulation and commercial banks' deposits with the Central Bank contributed to the expansion in reserve money. The significant expansion in commercial banks' deposits with the Central Bank during this period is mainly attributable to the increase in SRR applicable on all rupee deposit liabilities of commercial banks. On the assets side, the expansion in reserve money was entirely on account of the increase in net domestic assets (NDA) of the Central Bank, as net foreign assets (NFA) of the Central Bank declined during the first eight months of the year. NDA of the Central Bank, which increased by around Rs. 260 billion during the first seven months of the year, declined in August, thereby lessening the year-to-date expansion in NDA to Rs. 189.4 billion by end August 2016 compared to the increase of Rs. 207.3 billion recorded in the previous year. The expansion was largely on account of the substantial increase in the Central Bank's holdings of government securities (by around Rs. 133 billion), which led to an increase in net credit to the government (NCG) by the Central Bank by around Rs. 166.6 billion during the first eight months of the year. Nevertheless, a sharp contraction in Central Bank's holding of government securities of Rs. 59.3 billion was observed in the month of August 2016 on account of the maturing of Treasury bills. In addition, provisional advances to the government increased by Rs. 33.5 billion during the first eight months of the year. NDA of the Central Bank improved further following a notable decline in funds placed under the Standing Deposit Facility by Rs. 51.2 billion, which led to the contraction of other liabilities of the Central Bank by Rs. 26.3 billion during the period January-August 2016. Meanwhile, NFA of the Central Bank declined by Rs. 77.2 billion reflecting a decline in foreign currency reserves during this period.

- **Buttressed by the expansion in credit extended to the private sector and the government, the growth in broad money supply (M_{2b}) continued to remain high with an average growth of 18.1 per cent during the first eight months of 2016.** The year-on-year growth of broad money (M_{2b}) was 17.3 per cent in August 2016 compared to 17.8 per cent at end 2015. In spite of the contraction in lending to public corporations, NDA of the banking system has remained buoyant contributing to over 90 per cent of the expansion in broad money. The significant expansion in NDA was driven by the expansion in domestic credit flows directed towards the private sector and the government. Meanwhile, with NFA of commercial banks contributing positively as a result of increased foreign currency placements abroad and reduced foreign borrowings, NFA of the banking system increased by a moderate Rs. 16.6 billion, year-to-date, by end August 2016 following a contraction during the first half of the year.

- **During the first eight months of the year, NCG increased significantly by Rs. 178.4 billion due to credit disbursements to the government by both the Central Bank and commercial banks.** NCG by the Central Bank remained high and amounted to Rs. 166.6 billion, year-to-date, by end August 2016, compared to Rs. 80.3 billion recorded at end 2015. This increase was largely on account of purchases of Treasury bills by the Central Bank from the primary market, which led to an increase in the outstanding Treasury bill holdings by around Rs. 133 billion by end August 2016. Moreover, provisional advances to the government, which is the other key component of NCG, rose by Rs. 33.5 billion thus far during the year. Meanwhile, NCG by commercial banks increased only by Rs. 11.8 billion, year-to-date, by end August 2016; substantially lower than Rs. 243.3 billion recorded in 2015.

- **On the contrary, credit extended to public corporations from commercial banks declined by Rs. 81.5 billion during the first eight months of the year compared to the increase of Rs. 76.9 billion in 2015.** This was largely on account of partial loan settlements by the Ceylon Petroleum Corporation (CPC) amounting to around Rs. 97.5 billion, followed by net repayments by the Ceylon Electricity Board (CEB) and Sri Lanka Ports Authority (SLPA) amounting to Rs. 8.4 billion and Rs. 1.7 billion respectively, during the first eight months of the year. Nevertheless, SriLankan Airlines, Ceylon Fertilizer Corporation, Colombo Commercial Fertilizer and Ceylon Shipping Corporation have borrowed Rs. 5.6 billion, Rs. 4.0 billion, Rs. 3.4 billion and Rs. 3.4 billion respectively, on a net basis, thus far during the year.

- **Credit extended to the private sector expanded significantly during the first eight months of 2016**. The year-on-year growth of credit extended to the private sector peaked at 28.5 per cent in July 2016, and ended at 27.3 per cent in August 2016, compared to 25.1 per cent at end 2015, while the average growth of credit has remained high at 27.5 per cent thus far during 2016, compared to 16.6 per cent during the corresponding period of 2015. In absolute terms, credit obtained by the private sector increased by Rs. 456.3 billion during the first eight months of the year compared to the increase of Rs. 310.5 billion in the corresponding period of the previous year. As per the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, credit to all major sectors of the economy recorded notable rates of growth, year-on-year, by end June 2016. Year-on-year growth of credit to the Services and Industry sectors were high at 46.1 per cent and 29.6 per cent, respectively, by end June 2016, while credit in the form of Personal Loans and Advances grew by 23.3 per cent. Credit to the Agriculture and Fishing sectors was relatively low, with growth recording 8.9 per cent, year-on-year, by end June 2016. Security wise classification of advances indicated that credit against all major securities have increased thus far during the year. Nevertheless, credit extended by commercial banks in the form of leasing and hire purchase agreements increased only by around Rs. 18.0 billion, year-to-date, by end August 2016, compared to the increase of Rs. 65.6 billion during 2015, reflecting the impact of policy measures adopted by the Central Bank, alongside revisions to the tax structure made by the government, which caused a slowdown in demand for vehicle imports.

- **The growth momentum in the financial sector continued during the first eight months of 2016 with all major sectors remaining sound.** The banking system continued its accelerated growth in assets while maintaining capital and liquidity well above the regulatory minimum requirements. The asset quality of the banking system enhanced as shown by the historically lower level of non-performing loan (NPL) ratio and improvement of accessibility to banking facilities with the expansion of branch network and ATM facilities. High domestic demand for credit mainly from construction, financial and business service and consumption has led to the expansion in loans and advances, and the profitability of the banking system. On the other hand, non-bank financial institutions (NBFIs) sector sustained its growth momentum and stability with a diversified loan portfolio as a response to the tight fiscal and macro prudential policy measures. Profitability and asset base of other financial sub sectors, such as insurance, unit trust, primary dealers and superannuation funds also recorded positive growth during the reference period, though stock brokers' performance was subdued due to the poor performance of the Colombo Stock Exchange during this period. An upward pressure on money market interest rates was observed towards the latter part of the reference period resulting from the tight monetary policy stance of the CBSL and the liquidity shortage that prevailed in the money market. Yield rates of government securities in the secondary market too have increased and showed volatility during this period. Although liquidity shortage was observed in the domestic foreign exchange market during the first quarter of 2016, the liquidity position improved with foreign currency inflows to government securities and EFF approved by the IMF. While corporate debt securities market's growth momentum and investor base improved during the reference period, equity market's performance slowed down due to the foreign outflows and adverse investor sentiments connected to uncertainties over global economic outlook, exchange rate movements and political changes. Access to finance improved during this period as evident by several concessionary development credit schemes offered to micro, small and medium scale enterprises (MSME). The efficiency and safety of the national payment system were enhanced during this period and the national payment council has prepared a draft Road Map for the medium term development of payment systems.

International Economic Environment

- **The global economic outlook is projected to remain modest in 2016, while gradual recovery is expected in 2017, according to the IMF World Economic Outlook (WEO) – October 2016.** Global economic growth forecast has remained unchanged from July 2016 at 3.1 per cent for 2016 while gradually improving to 3.4 per cent in 2017. However, the 2016 growth projection for advanced economies was revised downwards from July 2016 in the backdrop of the lower than expected growth in the United States (US) particularly during the second quarter as well as increased uncertainty with the outcome of the

June vote in the United Kingdom (UK) to leave the European Union (Brexit). Meanwhile, the 2016 overall growth outlook for emerging market and developing economies improved marginally in comparison to the previous July estimates due to reduced concerns about China's short term growth prospects, firming of commodity prices and robust growth, particularly in India. During the medium term horizon, global growth outlook is forecast to gradually increase to 3.8 per cent by 2021 due to expected developments in emerging market and developing economies.

- **Growth outlook for advanced economies remains subdued during 2016 and 2017**. These economies are projected to grow by 1.6 per cent and 1.8 per cent during 2016 and 2017 respectively. The subdued outlook of advanced economies is partly attributable to the continuing impact of the global financial crisis and low productivity growth. Meanwhile, the Brexit vote is expected to have some negative repercussions, particularly in advanced European economies. The weaker than expected growth in the US economy during the first half of 2016 has contributed towards the muted growth in advanced economies. Although unemployment rate has declined, and housing market and consumer spending showed improvements in the US economy, the prolonged inventory correction cycle and weak business sentiments contributed towards the downward revision in economic growth. Accordingly, the IMF growth projection for the US economy is 1.6 per cent for 2016 followed by a 2.2 per cent growth in 2017. The growth outlook for the UK is projected at 1.8 per cent for 2016 and 1.1 per cent for 2017, assuming smooth post-Brexit transition. Meanwhile, the growth in the Euro area is projected to slowdown marginally during 2016-17 in comparison to 2015 in the backdrop of weaker investor confidence in the aftermath of the Brexit referendum. The loose monetary policy stance, modest fiscal consolidation in 2016 and recovery in oil prices would help maintain growth in the Euro region at 1.7 per cent and 1.5 per cent respectively, during 2016 and 2017, as per the IMF projections. The Japanese economy is projected to record a modest growth during 2016 and 2017, with projected growth rates of 0.5 per cent and 0.6 per cent respectively.

- **After five consecutive years of slow growth momentum, emerging market and developing economies are projected to perform better from 2016 onwards, although the economic outlook for these economies still remains weaker than in the past**. Economic growth in these economies is projected to increase to 4.2 per cent in 2016 and to 4.6 per cent in 2017. The relatively weak growth momentum is attributable to the slowdown in China, lower commodity prices, weak demand from advanced economies and geopolitical uncertainties in some countries. Economic growth in China is projected to slowdown from 6.9 per cent in 2015 to 6.6 per cent in 2016 and 6.2 per cent in 2017. This is mainly due to continued rebalancing of the Chinese economy from investment to consumption and from industry to services. Meanwhile, growth in India is projected to remain high among major economies with an expected growth of 7.6 per cent during 2016 and 2017. In Latin America and the Caribbean region, where several countries are in recession, a recovery in growth is expected in 2017 while the outlook for the Commonwealth of Independent States remains lacklustre. Meanwhile, the demographic transition in the emerging market and developing economies remains a major challenge to sustaining economic growth in such economies.

- **Global consumer price inflation is projected to remain diverse between advanced economies and emerging market and developing economies.** Inflation in advanced economies is expected to increase with the gradual rise in fuel prices and narrowing output gaps enabling central banks to reach their envisaged inflation targets by 2020. Accordingly, inflation in advanced economies is expected to rise to 0.8 per cent in 2016 and further to 1.7 per cent by 2017 in comparison to 0.3 per cent in 2015. Meanwhile, inflation in emerging market and developing economies is projected to moderate to 4.5 per cent in 2016 in comparison to 4.7 per cent in 2015 and further slowdown marginally to 4.4 per cent in 2017.

- **The growth in world trade volumes have remained at relatively modest levels during recent years.** As per the WEO, global trade volumes which recorded an average growth of 6.8 per cent during the period from 1998 – 2007, grew at a relatively modest level particularly from 2012 onwards. Continuing this trend, world trade volumes are forecast to grow by 2.3 per cent in 2016 while gradually recovering to 3.8 per cent during 2017. The main reason for the modest level of trade growth is attributed to the weakness in global economic activity, particularly in terms of investment. Meanwhile, the declining momentum of trade liberalisation and increasing trend in protectionism are also hampering the growth in world trade. However, global trade is expected to recover gradually from 2017 with a medium term growth projection of 4.3 per cent. This development is expected in the backdrop of increasing economic activity and investment in emerging market and developing economies.

Expected Developments

- **Sri Lanka's positive medium term macroeconomic outlook will depend on structural adjustments in the external and fiscal sectors and the implementation of sound macro-management policies.** In this backdrop, Sri Lanka's economic growth is likely to be around 5.0-5.5 per cent in 2016, and is expected to increase to 6.3 per cent in 2017 and to grow thereafter at an annual rate of 7 per cent or above. The growth momentum is expected to be supported by major contributions from growth in the trade of merchandise goods and services; especially in the areas of tourism, transport, telecommunication, ports and financial services. The higher growth potential is envisaged to be achieved mainly through productivity improvements supported by the adoption of new technology across production sectors as well as through the digitalisation of the economy, which would pave the way for increased market access and efficient information flow in the economy. The medium term growth outlook would also be supported through the consolidation of investment activities with the participation of both the public and private sectors. Foreign investments are expected to perform an enhanced role, particularly in areas where Sri Lanka has relative advantage, such as information technology related services and logistics. The planned establishment of the Colombo International Financial City, new opportunities under the Megapolis project and the proposed establishment of Special Economic Zones, particularly in Hambantota with the participation of Chinese investors, are among the key areas that would help generate growth over the medium term. Appropriate monetary and fiscal policy measures are also expected to create an environment conducive for investment. Inflation is expected to be maintained at around mid-single digit levels, while fiscal policy will continue to focus on strengthening the fiscal consolidation process. The rise in income levels from the expected developments in all sectors of the economy would help Sri Lanka to graduate to upper middle income status, and the per capita GDP is expected to rise to over US dollars 5,500 by 2020.

- **The external sector outlook is expected to improve gradually during the medium term, despite possible downside risks mainly stemming from the global environment.** Supported by appropriate policies to promote global market linkages and diversification, exports are projected to record an expansion during the period from 2017 while imports are expected to increase at a lower rate than exports. Inflows from services exports are projected to grow steadily, further strengthening the surplus in the services account of the BOP. The growth in services exports would come from the continued growth in tourist receipts and the increase in earnings from transportation services, and computer and information technology and related services. Meanwhile, receipts from workers' remittances are projected to improve gradually albeit at a moderate rate due to the decline in migration under unskilled category and better domestic labour market opportunities. As such, the current account deficit is expected to improve over the medium term and is expected to record a marginal deficit by 2020 with the improvement in the trade deficit and projected net inflows from services exports and workers' remittances. The financial account of the BOP is also projected to improve during the medium term with continued inflows to the government and the private sector. Inflows to the government are expected through project loans and issuance of government securities, including International Sovereign Bonds. Meanwhile, private sector inflows to the economy would mainly include receipts in the form of foreign direct investments. With these developments, gross official reserves are expected to rise to a comfortable level, strengthening the country's external sector stability.

- **The government's strong commitment towards fiscal consolidation is expected to enhance revenue collection and rationalise recurrent expenditure, thus resulting in an overall improvement in the fiscal sector during the medium term.** Policies taken towards strengthening the proper implementation of the proposed changes in the existing tax system by rationalising tax exemptions and improving tax compliance as well as tax administration would enhance government revenue to around 16 per cent of GDP in the medium term. This coupled with the rationalisation of recurrent expenditure would enable the government to allocate the required level of funds to maintain public investment at around 6 per cent of GDP in the medium term. Consequently, the budget deficit is expected to be around 3.5 per cent of GDP by 2020 while generating a surplus in the primary balance and current account balance during the medium term. The government debt is expected to fall below 68 per cent of GDP in the medium term. Further, planned fiscal reforms, including reforms to SOEs, are expected to address the structural weaknesses in the fiscal sector thus helping to improve the overall macroeconomic stability of the country.

- **The Central Bank will continue to follow an enhanced monetary policy framework with the view of moving towards a flexible inflation targeting (FIT) framework over the medium term to ensure price stability on a sustainable basis.** Under the ensuing FIT framework, the Central Bank would employ monetary policy to stabilise inflation around a targeted path and also to stabilise the real economy. Risks to macroeconomic stability due to demand pressures arising from high money and credit expansion are expected to moderate in the period ahead benefitting from the forward looking monetary policy measures of the Central Bank. Accordingly, in the medium term, inflation is projected to remain in mid-single digit levels of 4-6 per cent, which is also consistent with the inflation target bands stipulated under the IMF-EFF Programme. At the same time, with appropriate policies, monetary aggregates are expected to expand at a rate consistent with the expected nominal growth of the economy. The excessive expansion in credit to the private sector above the desired levels is also expected to decelerate to a level sufficient to facilitate the growth momentum of the economy. In addition, a gradual decline in credit to the public sector is anticipated along with the government's efforts to ensure long term fiscal consolidation and improved financial position of state owned enterprises, which are crucial for the effectiveness of monetary policy measures adopted by the Central Bank as well as to encourage greater private sector participation in economic activity.

- **Sri Lanka has the potential for a fresh leap of development leveraging its geographical location and strong relations with other nations to attract investment to foster stronger growth**. However, in order to accomplish this, an environment conducive for enhanced investments should be created by strengthening macroeconomic fundamentals and other related factors, including the doing business environment and structural reforms while putting in place a set of consistent policies that could support private sector led economic growth and people-centred development.

2

NATIONAL OUTPUT AND EXPENDITURE

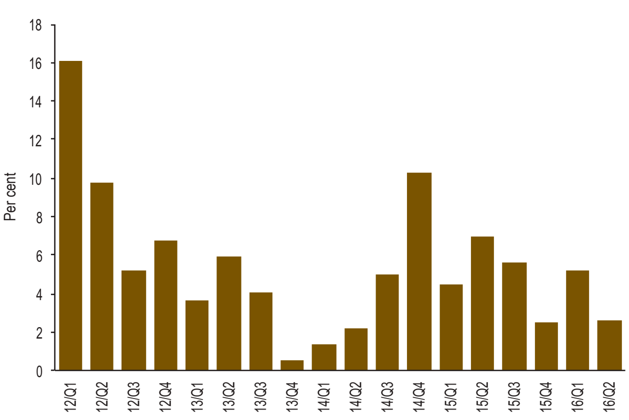
The economy grew by 3.9 per cent during the first half of 2016 amidst challenges on both the domestic and external fronts compared to the growth of 5.7 per cent recorded during the corresponding period of the previous year. On the domestic front, changes in policies, especially in fiscal policy measures intended to consolidate public finances, and adverse weather conditions dampened the growth momentum while lower than expected export demand impacted the external demand. Industry related activities propelled by the recovery in construction activities contributed to the growth in the first half of 2016. Contribution from Services activities to the growth in the first half of 2016 was mainly supported by the continued expansion in financial services activities. However, Agriculture activities contracted during this period. The early indicators of economic activities and the improved direction of business sentiment as reflected in surveys conducted by the Central Bank point to a rebound in overall economic activities in the second half of 2016. The public sector involvement in economic activities is expected to be modest in line with the commitment to fiscal consolidation while encouraging the private sector to take the lead in driving the economy. The Industry and Services activities are expected to lead the overall growth in the second half while Agriculture activities would continue to perform moderately. However, fiscal and monetary consolidation measures together with skilled labour shortages are expected to weigh on near term economic growth prospects as emphasised by market participants. On the external front, global growth is expected to remain subdued, which would in turn reduce the growth push emanating from external demand.

Developments in 2016

Output

- **The Gross Domestic Product (GDP) grew by 3.9 per cent during the first half of 2016 compared to 5.7 per cent growth recorded in the corresponding period of 2015.** This growth was mainly buoyed by expansion in Industry and Services related activities amidst the contraction recorded in Agriculture activities. Accordingly, Industry related economic activities grew by 5.2 per cent during the first half of 2016 mainly due to the considerable recovery in construction activities together with positive contribution from manufacturing activities. Services related activities grew by 4.9 per cent during the first half of the year. This growth was largely attributable to the expansion in financial service activities, wholesale and retail trade activities and other personal services. Meanwhile, Agriculture activities contracted by 2.5 per cent during the first half of 2016. The contraction in Agriculture activities was driven by decline in growing of tea, rice, rubber and spices, and fishing and forestry activities. In the meantime, taxes less subsidies on products of the economy contracted by 3.1 per cent during the first half of the year dampening the overall economic growth during the period.

Chart 2.1 Quarterly GDP Growth Rates (a)



(a) Based on the base year 2010 GDP estimates of the DCS

- **The economy is projected to grow around 5.5 per cent in 2016 compared to 4.8 per cent growth in 2015.** As reflected by leading economic indicators and business sentiment surveys conducted by the Central Bank, the expected growth would be mainly driven by Industry and Services activities while Agriculture activities would contribute marginally. Industry activities, bolstered by the recovery in construction activities along with the positive contribution from manufacturing activities, are expected to contribute significantly to economic growth. The major Services activities including financial, insurance and real estate, public services and other personal services, and wholesale and retail trade activities are expected to contribute positively towards the Services growth. The performance of Agriculture activities is expected to be modest during the year mainly due to subdued performance expected on account of growing of tea, rice and rubber.

Growth in Economic Activities

Agriculture, Forestry and Fishing

- **The Agriculture, Forestry and Fishing activities contracted by 2.5 per cent during the first half of 2016 against 8.1 per cent growth recorded in the corresponding period of 2015.** The adverse weather conditions that prevailed particularly during the second quarter of the year affected the growth in Agriculture activities. The contraction recorded in growing of rice, tea, rubber, spices, fishing activities, and forestry and logging activities dampened the growth in Agriculture activities. Further, growing of fruits and other beverage crops, and plant propagation and support activities to agriculture also contracted during the period. However, growing of oleaginous fruits, vegetables, cereals (except rice) and sugarcane, and animal production contributed positively towards the growth in Agriculture activities.

Production Trends and Institutional Support: Agriculture

Agriculture Production Index

- **The Agriculture Production Index (API), which measures the output of the Agriculture and Fisheries sector, declined by 3.2 per cent during the first half of 2016 compared to a 5.8 per cent growth recorded during the corresponding period of the previous year.** All sub indices contracted during the period, except paddy and coconut. The sub indices of paddy increased by 0.8 per cent due to the favourable weather conditions along with increased extent harvested while that of coconut increased by 1.8 per cent. Meanwhile, the tea subsector declined by 11.6 per cent while the rubber subsector declined by 4.9 per cent. The other crops subsector also declined in comparison to the previous year due to decline in vegetables and other field crops despite an increase in the fruits subsector. The livestock subsector also recorded a contraction of 3.3 per cent reflecting poor performance in its all sub categories while fisheries activities contracted owing to a significant decline in inland fish production.

Table 2.1 Agriculture Production Index (2007-2010 =100)

Item	2015 (a) First Half	2016 (b) First Half	Rate of Change (%)
Agriculture and Fisheries	**138.3**	**133.9**	**-3.2**
1 Agriculture	**135.0**	**131.9**	**-2.3**
1.1 Agriculture Crops	132.0	129.1	-2.2
Paddy	153.9	155.2	0.8
Tea	110.8	97.9	-11.6
Rubber	75.1	71.4	-4.9
Coconut	105.9	107.8	1.8
Other Crops	155.8	154.6	-0.8
Vegetables	164.6	150.4	-8.6
Fruits	152.8	155.7	1.9
Other Field Crops	173.9	167.8	-3.5
1.2 Livestock	158.5	153.2	-3.3
2 Fisheries	153.5	143.4	-6.6

(a) Revised
(b) Provisional

Source: Central Bank of Sri Lanka

Paddy

- **Paddy production in 2016 is expected to decline by 6.6 per cent to 4.5 million metric tons, following the bumper harvest recorded in 2015.** The paddy production in 2015/16 Maha season increased marginally by 0.9 per cent to 2.9 million metric tons over the corresponding period of the previous year, accounting for 64.5 per cent of the annual paddy production. The increased Maha production can be attributed to the favourable rainfall experienced during the latter part of 2015 along with increased extent harvested in major producing areas. The extent harvested during the 2015/16 Maha season increased by 12.7 per cent to 742,724 hectares. However, paddy yield per hectare during this season declined marginally by 0.3 per cent to 4,349 kg from 4,364 kg in the corresponding season last year, partly owing to the effect of blights and leaf-roll diseases in certain paddy producing areas. Meanwhile, it is expected that the paddy production during the 2016 Yala season would decline by around 18 per cent to 1.6 million metric tons over the 2015 Yala season, largely due to the severe tropical storm that caused widespread flooding and landslides during the second quarter of 2016, which delayed the paddy cultivation of the Yala season in major producing areas. The estimated annual paddy production of both the Maha and Yala seasons, equivalent to 2.9 million metric tons of rice, would be adequate to meet domestic rice demand for approximately 14 months. Meanwhile, the Paddy Marketing Board (PMB) purchased a stock of 131,000 metric tons of paddy from the 2015/16 Maha harvest compared to 160,000 metric tons in the 2014/15 Maha season and it is expected that around 120,000 metric tons of paddy will be procured from the 2016 Yala season. However, the PMB was able to purchase around 25,000 metric tons as at end of the Yala season due to higher demand from the private sector. The PMB should be further strengthened through modernising and expanding its storage capacity. This necessitates a carefully designed stock management programme which would help to determine the size, composition, location, and financing of the grain stocks in order to ensure remunerative prices for farmers while minimising losses incurred by the PMB. Meanwhile, the increased rice supply along with the upward revision in taxes on rice imports imposed during 2015 and early 2016 resulted in lower rice imports. Accordingly, the imported volume of rice declined by 94.3 per cent to 15,231 metric tons during the first half of 2016 from the corresponding period of the previous year.

- **Paddy prices in the open market remained low during the first half of the year supported by increased paddy supply and the reduction in the guaranteed paddy purchasing price.** As proposed in the budget 2016, the guaranteed purchasing price of paddy for Keeri Samba and Samba varieties were reduced to Rs. 50 per kg and Rs. 41 per kg, respectively, while Nadu and other varieties were reduced to Rs. 38 per kg with the view of stabilising rice prices in the domestic market. Despite a decline of 4.0 per cent in the average retail price of Nadu, the price of Samba increased by 3.1 per cent during the first half of the year as a result of increased paddy prices registered during the latter part of 2015.

Tea

- **The tea sector continuously experienced setbacks, owing to both local and global conditions.** The tea production recorded during the first half of 2016 was the lowest ever recorded since 2009. Tea production during the first half of 2016 declined by 11.1 per cent to 153.8 million kg due to unfavourable weather conditions and low demand from prime export destinations of Sri Lanka, which experienced economic setbacks owing to declining oil prices. Low grown tea production, which accounted for around 61 per cent of the total tea production, declined by 8.8 per cent to 93.5 million kg during the first half of 2016 while high grown and medium grown tea registered a decline of 14.2 per cent and 14.7 per cent, respectively. Although the smallholder tea sector continued to dominate the overall tea industry, its contribution to the total production declined to 60 per cent during the first half of the year from 73 per cent recorded for the year 2015. The National Fertiliser Subsidy scheme which

Chart 2.2 Paddy Production

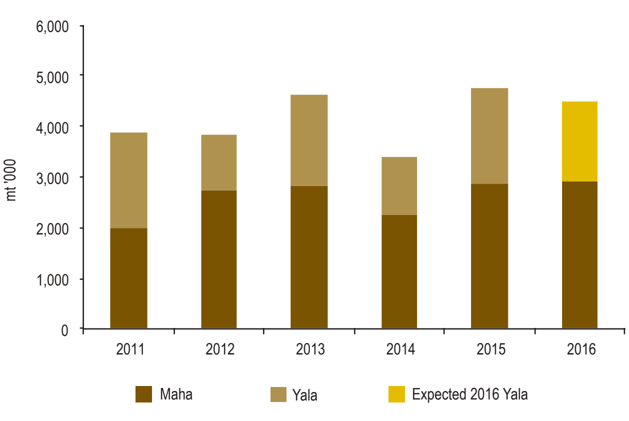
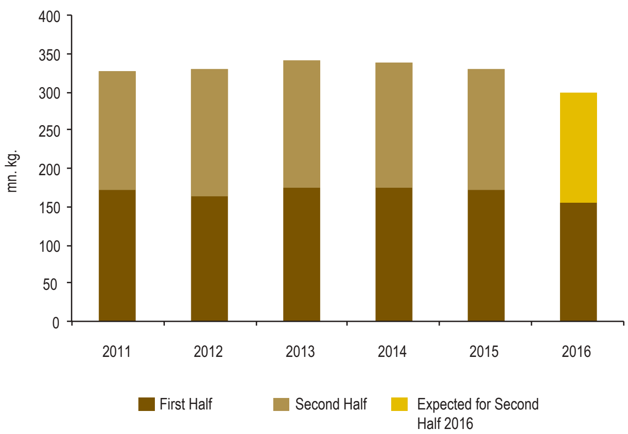


Chart 2.3 Tea Production



provides a cash subsidy of Rs. 15,000 per hectare was implemented for tea smallholders who own less than one hectare of tea, replacing the earlier subsidy scheme. The prevailing shortcomings in the tea sector should be overcome by improving the standard of tea leaf while improving estate fields and modernising tea factories. Further, proper implementation of good agriculture practices (GAP) and good manufacturing practices (GMP) throughout the supply chain are extremely important to maintain the quality of Ceylon tea in the global market.

- **Tea prices, which continuously declined since 2014, have shown a gradual improvement during the second quarter of 2016 underpinned by an improvement in the global demand**. Although the average tea price recorded at the Colombo Tea Auction (CTA) declined by 2.8 per cent, year-on-year, during the first quarter of 2016, tea prices started to rise registering an increase of 9.0 per cent during the second quarter of the year. Accordingly, the average price of tea during the first half of 2016 was Rs. 425.38 per kg registering an increase of 3.6 per cent over the corresponding period of the previous year. The highest increase in average tea prices at the CTA, on a year-on-year basis, was recorded for high grown tea (8.1 per cent), followed by medium grown tea (4.6 per cent) and low grown tea (1.2 per cent). Meanwhile, the export price of tea (FOB) also increased by 1.7 per cent to Rs. 609.88 per kg during the first half of 2016 from Rs. 599.03 per kg recorded during the corresponding period of 2015. Further, the average price received by smallholders for green leaf increased to Rs. 62.20 per kg during the first half of 2016 from Rs. 59.91 per kg during the corresponding period of 2015. Plummeting prices experienced in the last few years along with the increased cost of production highlights the necessity in undertaking immediate policy measures to bring the tea industry to a more sustainable footing.

Rubber

- **The low rubber prices experienced in both domestic and global markets continued to pose challenges to the local rubber industry**. Rubber production during the first half of 2016 remained at 47,894 metric tons witnessed a decline of 5.0 per cent for the fifth consecutive year. This was largely owing to the reduction of tapping days in response to lower prices mainly in the smallholder sector. As a result, growers shifted towards cultivating other crops including palm. During the first half of 2016, crepe rubber production declined by 27.0 per cent to 7,760 metric tons while sheet rubber production declined by 5.4 per cent to 23,947 metric tons compared to the corresponding period of the previous year. Meanwhile, the production of unspecified category, which accounts for around 34 per cent of the total rubber production of the country, registered a decline of 14.7 per cent to 16,187 metric tons compared to 18,981 metric tons recorded during the similar period of the previous year. Despite low commodity prices recorded in the global market, the natural rubber output of the world's major producing countries is estimated to record an increase of 1.3 per cent in 2016. On the supply front of the global rubber market, the extremely low rainfall in Thailand delayed the start of the tapping season weakening the availability of global rubber supplies. Meanwhile, according to international weather stations, a La-Nino phenomenon is expected at the end of 2016 which could bring an adverse impact on agriculture production during November/December periods in South East Asia. La-Nino may result in serious water logging in Malaysia, Thailand and Indonesia curtailing the production of many commodities, including natural rubber.

- **Rubber prices in the global market declined for the sixth consecutive year**. The declining trend in natural rubber prices in the global market was mainly due to the slowdown in global demand and the accumulation of stocks in major consuming countries, including China and Japan. Rubber prices in the domestic market also moved in line with global market prices. The average price of RSS1 at Rs. 229.59 per kg at the Colombo Rubber Auction during the first half of 2016 witnessed an 8.9 per cent decline over the first half average recorded in 2015. However, the price of latex rubber recorded an increase of 1.4 per cent to Rs. 280.56 per kg during this period. As world stockpiles of natural rubber have declined gradually in the recent period, it is expected that the demand for rubber from major consuming countries would surge in the period ahead and thereby escalate rubber prices during the latter part of 2016 and early 2017. As per the International Rubber Study Group, it is estimated that the total global rubber consumption would record a growth of 3.6 per cent in 2016 and 3.5 per cent in 2017. Although the rubber sector is a resource based, technologically sophisticated industry with global linkages, domestic rubber industry is yet to reach its full potential in capturing global markets. Therefore, appropriate steps should be undertaken to ensure its growth, competitiveness and sustainability. As the productivity of the domestic rubber sector is low at present, proactive measures should be taken to enhance the productivity of this sector while implementing good agricultural practices and productivity based subsidies. Further, as the rubber sector is currently experiencing a shortage of tappers, steps should be undertaken to introduce advanced technology to overcome existing weaknesses. Although the sector has shifted gradually to value addition, this transformation needs to be nurtured and managed to get optimum benefits. Therefore, steps should be taken to obtain maximum productivity from existing rubber farms while expanding the extent to sustain the comparative advantage of the industry by ensuring the availability of locally produced natural rubber for value addition. It is also imperative to provide necessary soft and hard infrastructure facilities along with policy and regulatory support to enable market expansion, and to attract new investments from the private sector.

Coconut

- **The coconut sector witnessed a marginal growth of 1.8 per cent during the first half of 2016 in comparison to a growth of 5.2 per cent recorded during the corresponding period of the previous year.** However, it is expected that weather related disturbances, largely drought conditions that prevailed during the first quarter of 2016, would adversely affect coconut production during the latter part of 2016 and early 2017. During the first half of 2016, the sub categories of the coconut sector registered a mixed performance. While the desiccated coconut (DC) production increased by 51.2 per cent to 24,361 metric tons from 16,108 metric tons, the production of coconut oil recorded a decline of 8.2 per cent, year-on-year, to 24,953 metric tons during the first half of 2016, against a growth of 16.7 per cent recorded in the corresponding period of the previous year. The coconut oil industry, which caters to around half of the country's edible oil requirement, has encountered challenges in the form of high cost of production and low profit margins and competition from the palm oil industry. The palm oil industry, which is a close substitute for coconut oil, enjoys enormous margins even after incurring import levies. However, imports of palm oil have witnessed a decline of 7.8 per cent, year-on-year, to 73,959 metric tons during the first half of 2016 in comparison to the corresponding period of the previous year. This was due to the increase in Special Commodity Levy (SCL) on palm oil imports during the latter part of 2015 and early part of 2016 as well as the availability of adequate domestic stocks. It is important to monitor whether the imported edible oil meets quality standards which would not impose any health hazards to consumers.

Meanwhile, virgin coconut production, which is extracted from fresh coconut milk obtained from matured kernel, showed a slow down during the first half of 2016 registering a decline of 6.9 per cent. However, the production of coconut cream, milk powder and liquid coconut milk registered a growth of 53.3 per cent to 21,477 metric tons in the first half of 2016 supported by emerging demand in the global market. Meanwile, the exports of king coconut during the first half of 2016 have increased by 42.9 per cent to 2,600 metric tons over the corresponding period of the last year.

- **The positive growth of major sub categories of the coconut sector resulted in low prices in major coconut based commodities**. The average retail price of fresh nuts recorded a decline of 12.1 per cent to Rs. 46.50 per nut while the average retail price of coconut oil (750 ml bottle) recorded a decline of 1.7 per cent to Rs. 207.70 during the first half of 2016. The declining trend in farm gate coconut nut prices was largely due to an increase in nut production and less utilisation of nuts for coconut oil production. Meanwhile, it is noted that the average price of DC at the Colombo Coconut Auction during the first half of 2016 declined by 22.0 per cent, year-on-year, to Rs. 255.35 per kg. The DC prices moved in line with international market prices where the average export prices of DC during the first half of 2016 decreased to US dollar 1.67 per kg from US dollar 2.76 per kg recorded during the same period of 2015.

Other Field Crops

- **The heavy rain and floods experienced during the 2015/16 Maha season has adversely affected major cultivated agriculture lands, nurseries and plants, and resulted in lower production of other field crops (OFCs).** Accordingly, production of OFCs at 259,509 metric tons registered a year-on-year decline of 7.4 per cent during the 2015/16 Maha season while the extent cultivated declined by 4.0 per cent to 101,594 hectares. Meanwhile, remunerative prices resulting from high SCL on OFC imports encouraged domestic farmers to increase production. SCL on imports of potatoes and big onions was increased in March 2016 while SCL on big onion imports was further increased by Rs. 15 per kg to Rs. 40 per kg in August 2016. Domestic production of OFCs, such as cowpea, kurakkan, maize, green gram, soya bean, gingerly, ground nuts, big onion, ginger and chillies, recorded an increase during the first half of 2016 while the production of black gram, red onion, sweet potatoes and potatoes declined in comparison to the corresponding period of the previous year. It is estimated that the present domestic supply conditions of OFCs such as maize, ground nuts and cowpea, which has surpassed domestic demand, would help industries producing animal feed in the market. Meanwhile, weather related disturbances during the second quarter of 2016 delayed OFC cultivation during the 2016 Yala season by more than one month. The combined outcome of drought, followed by floods, along with the lower extent of cultivated land is expected to have an adverse impact on the overall production of selected OFCs in 2016.

Vegetables

- **The combined outcome of diverse weather cycles consisting of rain, drought and flood has engendered a mixed performance in the vegetable sector during the first half of 2016.** Vegetable production during the 2015/16 Maha season registered a decline of 7.4 per cent, year-on-year, to 986,232 metric tons while the cultivated extent in major vegetable producing areas declined by 6.5 per cent to 76,332 hectares. Further, weather related disturbances during the early part of 2015/16 Maha season resulted in delaying vegetable cultivation thereby reducing the market supply and escalating vegetable prices. In addition, dry weather conditions experienced throughout February and March resulted in low water availability for agriculture activities and a slowing down of cultivation activities in the 2016 Yala season. Meanwhile, the inter-seasonal cultivation of vegetables, which is practiced during the months of March and April, was sluggish resulting from the dry weather conditions experienced prior to the commencement of the Yala season. The lower vegetable supply triggered by decreased extent under cultivation during the intermediate season resulted in increased prices for both upcountry and low country vegetable varieties. Meanwhile, dry weather conditions stimulated the process of ripening in selected vegetable varieties so that the harvesting interval shortened and a low quality supply reached the market resulting in low prices. Meanwhile, the market supply of high quality vegetables declined during May to mid-June 2016 leading to increased vegetable prices.

Sugar

- **Sugar production, which declined by 9.5 per cent during the first half of 2015, increased substantially by 112.2 per cent to 23,472 metric tons during the first half of 2016.** Considering the factory-wise performance, the Pelwatta factory, which accounted for the largest share of overall sugar production, recorded an output of 11,236 metric tons during the first half of 2016. The output at the Sevenagala and Gal Oya factories at 6,594 metric tons and 5,642 metric tons also recorded substantial increases of 45.6 per cent and 55.3 per cent, respectively, during this period. The cultivation of high yielding sugarcane varieties, access to proper irrigation systems and field maintenance, and the expansion in planting activities of out growers largely contributed to the increase in sugar production. It is expected that the total sugar production would increase by 30 per cent to 73,000 metric tons in 2016, which would be adequate to meet around 11 per cent of the national requirement. Therefore, the government should place a high priority on revitalising the sugarcane industry, considering the huge sum of money spent on sugar imports annually.

Fisheries

- **Fish production during the first half of 2016 declined by 6.5 per cent to 239,260 metric tons.** Both marine and inland fish production recorded a decline of 4.7 per cent and 21.3 per cent, respectively. In the marine fisheries sector, offshore fish production recorded a decline of 7.3 per cent. Meanwhile, production in the coastal and lagoon fishery subsector, which accounted for about 62 per cent of the fish production of the marine fishery sector, declined by 3.1 per cent. In the inland fishery sector, inland capture declined by 28.2 per cent to 18,560 metric tons. The substantial drop in the production of the inland fishery subsector was a result of the increased water level of major reservoirs leading to a reduction of fish netting areas. However, the production of shrimp farming and aquaculture increased significantly by 77.8 per cent and 69.2 per cent, respectively. With the lifting of the European Union (EU) ban for Sri Lankan sea food exports with effect from 21 June 2016, there was a huge demand from the EU for Sri Lankan fish varieties. The National Aquaculture Development Authority (NAQDA) conducted 151 raids during the first half of 2016 to improve the management of inland fisheries in perennial water bodies. Meanwhile, a pilot project to farm sea weeds was implemented in the Kilinochchi district with technical assistance from Vietnam, and during the first half of 2016, around 89 metric tons were harvested, involving around 1,000 people. Recognising the issue of lack of large fishing vessels, the government has decided to provide a

50 per cent grant for manufacturers of boats longer than 55 feet, enabling fishermen to catch the best quality fish which will receive high prices in the international market. However, the lack of new technology, research and management and conservation of resources are a few issues that should be addressed immediately.

Livestock

- **The livestock sector showed a mixed performance during the first half of 2016**. Milk production declined by 8.1 per cent, year-on-year, to 196 million litres during the first half of 2016 largely due to the lagged effect of the Foot and Mouth Disease epidemic that prevailed in 2014. Cattle milk production, which accounted for around 83 per cent of total milk production, declined by 6.2 per cent, year-on-year, to 163 million litres whilst buffalo milk production declined by 16.5 per cent to 32 million litres. It is expected that milk production would increase by around 3 per cent to 415 million litres in 2016, which would be sufficient to meet around 55 per cent of the total domestic demand. Meanwhile, egg production registered a decline of 3.7 per cent to 1,128 million, while poultry meat production recorded a marginal decline of 0.2 per cent to 81,140 metric tons during the first half of 2016. Lower imports of layer parent during 2014, resulted in reducing the number of layer day-old chicks (DOC) in 2015 leading to decelerate egg production in 2016. Meanwhile, during the first half of 2016 imports of layer parent and broiler parent increased significantly by 195.6 per cent and 181.3 per cent, respectively. The cost of production of eggs and chicken increased mainly due to price increase in feed ingredients, posing a challenge to the industry. However, the increase in the maximum retail price of chicken meat and fluctuations in the market price of eggs will compensate for the increase in the cost of production. Meanwhile, production of beef, pork and mutton declined by 6.0 per cent, 7.6 per cent and 1.5 per cent, respectively, during the first half of 2016.

Industries

- **Industry related economic activities recorded a substantial growth of 5.2 per cent during the first half of 2016 in comparison to 2.5 per cent growth recorded in the corresponding period of 2015.** Substantial recovery in construction activities and the positive contribution from the manufacturing activities led the Industrial growth. In the meantime, electricity, gas, steam and air conditioning supply activities, and sewerage, waste treatment and disposal activities grew significantly. Further, mining and quarrying activities recovered during the period while water collection, treatment and supply activities grew marginally during the first half of 2016.

- **Considerable recovery in construction activities provided impetus for the growth in the Industry activities.** Construction activities grew by 8.5 per cent during the period concerned against 2.8 per cent contraction recorded in the corresponding period of 2015. The growth in construction activities is reflected by the significant increase in cement availability by 22.9 per cent and the private sector credit of the commerical banks to the construction activities by 40.2 per cent during the first half of 2016 over the corresponding period of 2015. Further, building material imports also recorded a significant growth of 33.5 per cent during the period. Meanwhile, mining and quarrying activities grew by 1.5 per cent during the first half of 2016 recovering from 3.9 per cent contraction recorded in the corresponding period of 2015. Increase in gem output during the second quarter of the year and the rebound in construction activities during the first half of 2016 helped the recovery in mining and quarrying activities. Meanwhile, manufacturing activities, which is the largest segment within the Industry activities, slowed down to 3.9 per cent during the first half of the year compared to 5.4 per cent growth recorded in the corresponding period of 2015, due to the contraction in the second quarter largely on account of adverse weather related disruptions and the changes in government taxes thereby increasing the cost of production. Further, the lower demand from major export destinations also impacted the overall growth in manufacturing activities. The recorded growth was mainly attributable to the significant expansion in manufacturing of furniture, and coke and refined petroleum products which grew by 17.1 per cent and 37.0 per cent, respectively, during the first half of the year compared to 5.8 per cent and 5.3 per cent growth, respectively, recorded during the corresponding period of 2015. In the meantime, electricity, gas, steam and air conditioning supply activities, and sewerage, waste treatment and supply activities further expanded by 8.5 per cent and 21.0 per cent, respectively, during the first half of the year, in comparison to 6.8 per cent and 22.4 per cent growth, respectively, recorded in the corresponding period of 2015. However, water collection, treatment and supply activities decelerated to 1.0 per cent during the period compared to 3.2 per cent growth posted during the same period of 2015.

Production Trends and Institutional Support: Manufacturing Activities

- **Manufacturing activities provided the highest contribution to industry activities in the first half of 2016, accounting for around 60 per cent of total industry activities.** The Factory Industry Production Index (FIPI), which is computed covering 17 major manufacturing activities using the International Standard Industrial Classification (ISIC), Revision 4, provides an indication of the trends in the manufacturing sector performance of the economy [1].

Factory Industry Production Index

- **The Factory Industry Production Index (FIPI) registered a decline of 2.1 per cent during the first half of this year compared to the same period of 2015.** Weak global demand, mainly driven by low commodity prices, resulting in declined purchasing power of affected economies as well as other external volatilities, prevailed during this period. Further, supply side disturbances that occurred particularly during the second quarter due to adverse weather conditions and other catastrophes had a dampening impact on production. As a result, production of major subsectors such as food, wearing apparel, beverages, tobacco products, chemicals and chemical products, fabricated metal products, electrical equipment was affected. However, the output of textiles, other non-metallic mineral products, rubber and plastic products, refined petroleum products, leather and related products, basic metals, and machinery and equipment has improved during the period concerned.

- **The food products subsector, the largest subsector in FIPI, which grew by 0.3 per cent during the first quarter of 2016, declined by 4.2 per cent during the second quarter of the year, resulting in an overall decrease of 1.9 per cent during the first half of 2016.** The production of bakery products, vegetable and animal oils and processed and preserved meat products slowed during the period. These sectors were mainly affected by supply side disruptions that hampered the production process during the second quarter. However, dairy products, macaroni and

1. The weights in the FIPI are assigned for each industry using 2010 as the base year. Significant structural changes seen in the economy since then have resulted in new and emerging industries with relatively higher weights, while the significance of some of the existing industries in the sample has declined. This will be taken into account in the next revision to the FIPI.

Chart 2.4 Factory Industry Production Index (FIPI)

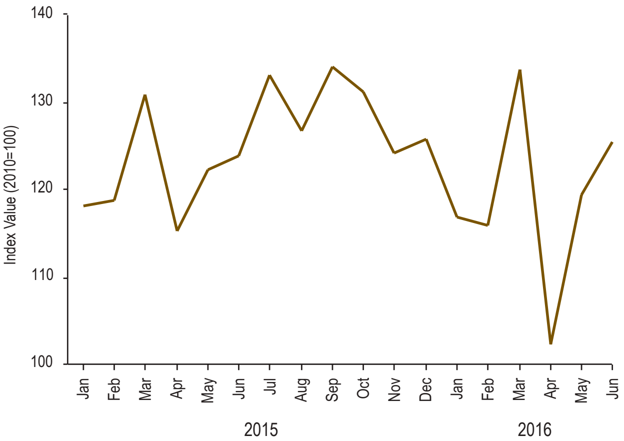
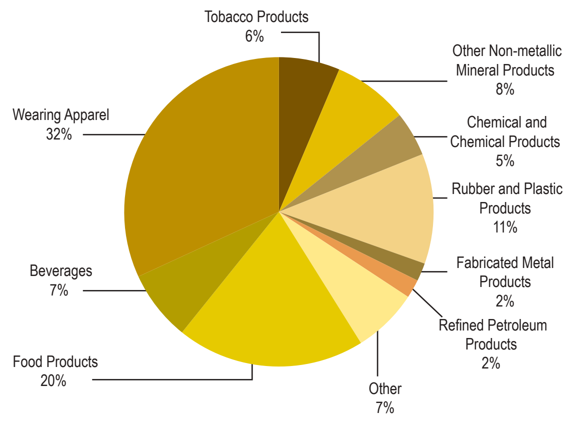


Chart 2.5 Composition of Factory Industry Production Index (FIPI) - First Half 2016



noodles, sugar, sugar confectionery products, prepared meals and dishes as well as prepared animal feed products reported an expansion in their output during the same period.

- **The beverages subsector declined by 10.4 per cent largely due to lower production of arrack as well as beer, the largest category in this subsector, along with a reduction in the production of malted milk products.** However, the soft drinks, mineral and bottled water subsector recorded an increase of 7.8 per cent when compared with the first half of the previous year. Further, the output of the tobacco products subsector also deteriorated by 3.2 per cent during the first half of 2016. Lower consumer demand coupled with an increase in prices in the earlier part of 2016 were the main contributory factors towards this contraction.

- **The wearing apparel subsector, which is the second largest subsector in FIPI experienced a setback during the first half of 2016 reporting a negative growth of 1.0 per cent.** Lower demand for selected categories of apparel exports, particularly from the U.S., was the key reason for the poor performance of this subsector. However, the apparel subsector is expected to rebound in the fourth quarter, supported by Sri Lanka's competitive strengths in terms of quality, lead time, reliability, social compliance etc. coupled with the country's brand identity. The expected regaining of GSP (+) facility in 2017 too will have a positive impact on the industry. However, given the increasing competition from other countries, continued efforts to explore new markets and product diversification to enhance the market share in existing markets and rationalisation of production costs for improved price competitiveness are essential for future growth of this subsector.

- **The chemicals and chemical products subsector also contracted by 18.9 per cent during the first half of 2016 largely due to lower fertiliser production.** The manufacturing of fertiliser declined during the reference period due to the impact of market adjustments during the transition from the previous scheme to the new fertiliser subsidy scheme. However, the production is expected to return to normalcy once the market is stabilised under the new fertiliser subsidy scheme. Meanwhile, the improved production of paints and varnishes contributed positively to the chemicals and chemical products subsector during the first half of 2016.

- **The subdued performance of the electrical equipment subsector was mainly due to the drop in demand for transformers from key export destinations such as Uganda and Jordan**. The subsector declined by about 8.4 per cent during the first half of 2016. However, the measures taken by the industry to access new international markets and product segments are expected to boost the industry in the future.

- **The fabricated metal products subsector, which mainly comprises ship building and repair activities, experienced a downturn with a decline in production by 38.7 per cent.** Downturn in the offshore oil drilling industry due to the drop in crude oil prices had an adverse impact on the ship building operations during the period, driven by the lower demand for oil drilling vessels. However, Sri Lanka's strategic location as the hub of the Indian Ocean continued to attract ship repair activities during the period under review.

- **The non-metallic mineral products subsector performed well during the first half of 2016**. The subsector performed favourably during both the first and second quarters registering an overall growth of 12.7 per cent for the first half of 2016, mainly induced by the growth momentum in the construction sector. Increased manufacturing of cement, which represents a major share of production of this subsector, was the key contributory factor towards this performance. Further, manufacturing of clay tiles and roofing sheets too expanded significantly, as a result of increased consumer demand. Manufacturing of porcelain and ceramic products recorded a marginal growth during the reference period amidst lower domestic and international demand. On the other hand, manufacturing of glass products declined slightly due to the reduction in production capacity of the single factory producing glass bottles in Sri Lanka.

- **The performance of the basic metals subsector was commendable during the first half of 2016, reporting a considerable growth of 43.3 per cent compared with the negative growth reported during the same period of 2015.** The increased production of steel products driven by the favourable performance of the construction sector contributed to high growth in the subsector.

- **The rubber and plastic products subsector showed a noteworthy performance during the first half of 2016, growing by 2.2 per cent as opposed to the adverse performance during the same period of 2015.** This subsector showed positive performance during both the first and second quarters of 2016. Increased production of pneumatic tyres or air tyres to cater to the both domestic market as well as international markets in Brazil, the USA etc, was the underlying reason for this growth. However, the production of solid tyres showed a marginal decline. Export demand for industrial and surgical gloves too expanded considerably with higher exports to markets in USA and Europe. The rubber based gloves industry is expected to maintain the growth momentum with the increasing regulations on occupational safety as well as emphasis on health and safety precautions globally.

- **The leather and related products subsector showed signs of recovery, reversing the negative performance reported since 2014.** A growth in production volumes was recorded during the first two quarters of 2016, resulting in an overall growth rate of 16.8 per cent during the first half of 2016. An increase in the demand for finished leather products and footwear was observed during the period.

- **The textile subsector showed a favourable performance during the first half of 2016 recording a growth of 5.7 per cent.** The higher production in this subsector was mainly driven by the domestic market demand for locally produced textiles. However, the absence of adequate facilities to dye and finish knitted fabric affects the growth in this industry.

- **The refined petroleum products subsector, which solely consists of production in the refinery of Ceylon Petroleum Corporation, grew by 32.2 per cent during the first half of 2016 compared with the negative performance during the same period in 2015.** The continued refinery process without disruption during the first half of 2016 as opposed to its closure for a few weeks during the same period in 2015 for repairs and maintenance, resulted in this increase. Hence, the growth in refined petroleum products reflects the base effect.

- **The industrial sector continued to receive the support of the government through the Ministries and other public sector institutions.** The regional development programme of the Ministry of Industry and Commerce (MIC), aimed at promoting industrial sector investments at regional level to promote regional industrialisation and employment, continued during the first half of 2016 as well. The majority of the infrastructure development activities relating to Trincomalee (Stage II) and Batticaloa industrial estates were completed. Development activities relating to Mannar Industrial Estate (IE) were completed and that of Welioya IE, which commenced in December 2015, continued further with the construction of 2 factory buildings. In line with the Budget 2016, MIC has commenced the initial work relating to 4 new IEs in Trincomalee, Raigama, Mahaoya and Hambantota. National Enterprise Development Authority (NEDA) continued to establish District and Regional Enterprises Forums at district and divisional secretariat level to create a proper mechanism for providing Business Development Services to the entrepreneurs. Under the "Regional Enterprise Development" program of NEDA, training was provided to selected new and existing entrepreneurs at regional level on entrepreneurship, technical, marketing and record keeping skills.

Services

- **The Services related economic activities expanded by 4.9 per cent during the first half of 2016 compared to 6.2 per cent growth recorded in the corresponding period of 2015.** The imposition of Value Added Tax (VAT) on some economic activities such as health care services and increase in VAT rates during the second quarter of 2016 had some impact on the overall growth in Services activities. The recorded growth in Services activities was largely supported by the continuous expansion in financial service activities. Further, wholesale and retail trade, other personal service activities, public services related activities, transportation activities, education services, real estate activities including ownership of dwellings, insurance activities and telecommunication services contributed positively to the overall growth in services related activities. However, professional services, and programming and broadcasting activities contracted during this period.

Wholesale and Retail Trade, Transportation and Storage, Accommodation and Food Service Activities

- **Wholesale and retail trade, transportation and storage, accommodation and food service activities, which accounts for the major share of the Services activities, grew by 3.4 per cent during the first half of the year compared to**

5.6 per cent growth recorded in the corresponding period of 2015. This growth was largely supported by the expansion in wholesale and retail trade activities which grew by 4.5 per cent during the first half of 2016 compared to 1.7 per cent growth recorded in the corresponding period of 2015. Further, transportation of goods and passengers including warehousing activities, and accommodation, food and beverage service activities grew by 2.1 per cent and 3.7 per cent, respectively, during the period compared to 11.4 per cent and 1.9 per cent growth, respectively, recorded in the corresponding period of 2015. Meanwhile, postal and courier activities grew marginally by 0.9 per cent during the first half of the year recovering from 6.6 per cent contraction recorded in the corresponding period of 2015.

Information and Communication

- **Information and communication activities continued to grow by 15.2 per cent in the first half of the year compared to 14.9 per cent growth recorded in the corresponding period of 2015.** The significant increase in telecommunication activities by 21.0 per cent during the first half of 2016 compared to 10.9 per cent growth recorded during the corresponding period of 2015 mainly contributed to this growth. However, IT programming, consultancy and related activities slowed down to 3.7 per cent during the period in comparison to 29.3 per cent growth observed in the corresponding period of 2015. In the meantime, programming and broadcasting activities and audio/ video production activities contracted by 2.4 per cent during this period against 6.0 per cent growth recorded during the first half of 2015.

Financial, Insurance and Real Estate Activities, including Ownership of Dwellings

- **Financial, insurance and real estate activities, including ownership of dwellings grew by 8.7 per cent during the first half of the year compared to 13.8 per cent growth posted in the corresponding period of 2015.** The recorded growth was mainly attributable to the continued expansion in financial service activities and auxiliary financial services which grew by 15.1 per cent during the first half of 2016 compared to 15.6 per cent growth recorded in the corresponding period of 2015. The continuous growth in gross loans and deposits of the banking sector by 17.3 per cent and the significant growth in private sector credit as per the Monetary Survey by 28.2 per cent by end June 2016 reflect the continuous expansion in financial services activities. Meanwhile, insurance, reinsurance and pension funding activities substantially grew by 13.4 per cent compared to 4.5 per cent growth recorded during the first half of 2015. However, real estate activities, including ownership of dwellings, slowed down to 1.8 per cent during the first half of 2016 in comparison to 13.3 per cent growth posted in the corresponding period of 2015, limiting the overall growth in the sub segment.

Professional Services and Other Personal Service Activities

- **Professional services and other personal service activities grew by 2.9 per cent during the first half of the year compared to 1.6 per cent growth recorded in the corresponding period of 2015.** This growth was buoyed by the continuous expansion in other personal service activities which grew by 4.4 per cent during this period compared to 3.0 per cent growth recorded in the corresponding period of 2015. Meanwhile, professional services further contracted by 5.4 per cent during the first half of the year compared to 5.2 per cent contraction recorded in the corresponding period of 2015.

Public Administration, Defence, Education, Human Health and Social Work Activities

- **Public administration, defence, education, human health and social work activities grew by 5.9 per cent during the first half of the year compared to 3.5 per cent growth recorded in the corresponding period of 2015.** Public administration, defence and compulsory social security activities expanded by 5.2 per cent during the first half of 2016 compared to 7.5 per cent growth posted in the corresponding period of 2015. Meanwhile, education services expanded by 8.1 per cent during the first half of the year recovering from 9.7 per cent contraction posted during the same period of 2015. Further, human health, residential care and social work activities grew by 5.2 per cent during the period compared to 9.3 per cent growth recorded in the corresponding period of 2015.

Expenditure

- **Gross Domestic Expenditure (GDE), which is the demand generated by the domestic economy grew by 8.9 per cent in nominal terms during the first half of 2016 compared to 8.5 per cent growth in the first half of 2015.** This was a combined effect of 14.2 per cent growth in investment expenditure and 6.7 per cent growth in consumption expenditure. Meanwhile, the net external demand witnessed a 6.0 per cent contraction during the first half of 2016. Accordingly, GDP, which is the sum of domestic and net external demand, grew by 9.1 per cent in nominal terms during the first half of 2016 compared to 7.8 per cent growth in the first half of 2015.

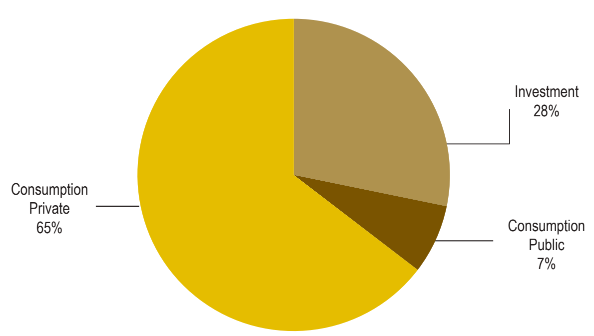
- **GDE is projected to grow by 9.7 per cent to Rs. 13,180 billion in nominal terms for the year 2016 compared to 6.5 per cent growth in 2015.** The growth is expected to be driven by the rebound in investment expenditure and the growth in consumption expenditure. The net external demand is expected to contract in 2016 in rupee terms against the marginal growth recorded in 2015, on account of the higher growth in expenditure on imports compared to exports expected during 2016. As a result, GDP at current market prices is envisaged to grow by 9.8 per cent to Rs. 12,275 billion in 2016 compared to 7.0 per cent growth in 2015.

Consumption

- **Consumption, the major expenditure component of the economy, is expected to grow by 9.3 per cent in nominal terms in 2016 to Rs. 9,460 billion compared to 8.9 per cent growth recorded in 2015.** The growth in consumption expenditure is expected to be driven by the private sector while the government consumption is expected to remain moderate during the rest of 2016.

- **Private consumption, the main contributor of consumption expenditure, is projected to grow by 11.0 per cent in 2016 compared to 8.4 per cent growth in 2015.** The growth in private

Chart 2.6 Composition of Domestic Demand - 2016 (a)



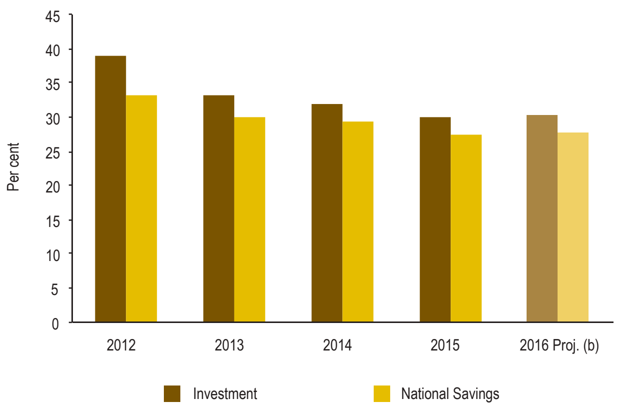
(a) CBSL projections based on the medium term macroeconomic framework consumption activities is supported by salary revision for the private sector employees in accordance with the Budgetary Relief Allowance of Workers Act and the legal provisions imposed related to the national minimum wages. The corresponding increase in private sector wages has been identified as a major reason for the increase in input cost by the survey participants of the business surveys conducted by the Central Bank. Nevertheless, gradual increase in interest rates in line with recent monetary policy measures, and the increase in indirect taxes and import duties are expected to moderate the potential growth in private consumption during the year. This was partly reflected by the contraction in import trade index of consumer goods during the first eight months of 2016.

- **In line with the commitment to fiscal consolidation, public consumption expenditure is expected to contract around 3.9 per cent during 2016 in comparison with 13.4 per cent growth recorded in 2015.** As per the budgetary estimates, the expenditure on salaries and wages, and goods and services, which together represents a considerable share of government recurrent expenditure, is expected to decline by 6.4 per cent during the year compared to 35.8 per cent growth recorded in 2015. In this regard, the public sector expenditure on salaries and wages is expected to increase by 5.0 per cent while the expenditure on other purchases of goods and services is expected to contract by 36.9 per cent during 2016.

Investment

- **Investment expenditure is projected to rebound by 10.6 per cent in 2016 to Rs. 3,719 billion in nominal terms compared to the marginal growth of 0.6 per cent recorded in 2015.** Private investment expenditure is expected

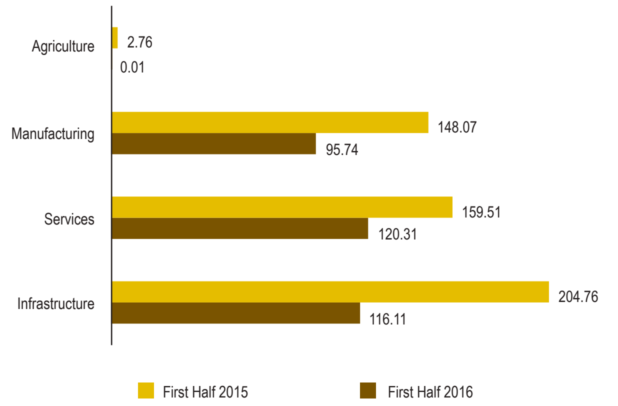
Chart 2.7 Investment and Savings as a Percentage of GDP (a)



(a) Based on the base year 2010 GDP estimates of the DCS
(b) CBSL projections based on the medium term macroeconomic framework

to contribute significantly towards this growth, while the government investment expenditure is expected to decline according to the annual budgetary estimates of the government. Construction activities showed a steady recovery during the first half of the year as reflected by the significant increase in cement availability and the importation of building materials during the period. Moreover, private sector credit for personal housing from commercial banks also increased by 41.7 per cent by end June 2016 over the corresponding period of the previous year. Meanwhile, as shown by the trade indices for the first eight months of the year, importation of machinery and equipment, and other investment goods categories also recorded a significant increase. These favourable developments are expected to continue throughout the year supporting investment growth in 2016. Accordingly, investment expenditure as a percentage of GDP is projected to increase to 30.3 per cent in 2016 compared to 30.1 per cent in 2015. However, labour market constraints and uncertainty arising from frequent changes in policy directions would dampen the possible investment drive of the economy, and remain as major impediments to sustain a higher pace of growth as highlighted by business surveys conducted by the Central Bank.

Chart 2.8 Foreign Direct Investment of BOI Enterprises* (US$ million)



* including loans

- **Inflows of Foreign Direct Investments (FDI), including loans to the Board of Investment (BOI) registered companies, in the first half of 2016 amounted to US dollars 332.2 million compared to US dollars 515.1 million in the first half of 2015, reflecting a year-on-year decline of 35.5 per cent.** FDI inflows relating to infrastructure projects, services and manufacturing sectors declined by 43.3 per cent, 24.6 per cent and 35.3 per cent respectively. Majority of FDI during the period was on account of services related projects representing around 36 per cent of total FDI (US dollars 120.3 million). FDI in the infrastructure sector amounted to around 35 per cent of total FDI inflows (US dollars 116.1 million) whereas FDI in the manufacturing sector amounted to US dollars 95.7 million representing about 29 per cent of total FDI during the first half of 2016.

Savings

- **Domestic savings as a percentage of GDP is expected to increase to 22.9 per cent in 2016 compared to 22.6 per cent in 2015.** According to the budgetary estimates, the government sector expects to reduce its dis-savings contributing to the improvement expected in domestic savings. Meanwhile, in rupee terms, net primary income from rest of the world is expected to contract at a slower rate while net current transfers from rest of the world is expected to grow at a reasonably higher rate in 2016 compared to 2015. Consequently, national savings is expected to be 27.8 per cent of the GDP compared to 27.6 per cent recorded in 2015.

Expected Developments

- **As projected under the medium term macroeconomic framework, the economy is expected to grow around 6.3 per cent in real terms in 2017.** The growth was expected to be broad-based and supported by all three major economic activities in the production front. The Agriculture activities are expected to rebound in 2017 provided that favourable weather conditions prevail. The Services and Industry activities are also expected to continue their positive growth momentum in 2017.

- **The Agriculture activities are expected to recover in 2017.** Though paddy production of 2016/17 Maha season would be affected by drought conditions experienced during the latter part of third quarter and early part of the fourth quarter of 2016, the production of 2017 Yala season would increase. It is expected that the gradual improvement of commodity prices in the global market would encourage domestic farmers, who are mainly cultivating export agricultural crops. Tea sector which was continuously experiencing setbacks owing to both local and global conditions is expected to recover supported by improved tea prices in the global market along with expected improvement in both Russian and the Middle Eastern economies. This has been gradually reflected in the domestic market where tea prices have started to escalate gradually in recent months which has provided impetus to the industry. Meanwhile, the rubber sector is expected to continue with the same trend in 2017 as well. However, this trend could be changed through implementing proper measures to enhance the productivity of the sector. Further, with a view to enhancing the value addition of rubber, common rubber processing centres should be established which would help to improve foreign exchange earnings. The increased cost of production in the local market and low international rubber prices led to higher imports of rubber from the global market. As a result, the local rubber industry will benefit from lower priced rubber source from the global market. Meanwhile, the increasing global demand for coconut based commodities produced by Sri Lanka will continue and it is expected that this trend would provide further impetus to the domestic coconut industry facilitating the higher growth of the sector in 2017. However, prevailed drought condition during the second half of 2016 may affect the production. The production of many field crops such as maize, kurakkan, soya beans, black gram and green gram is also expected to continue its growth trend supported by favourable weather conditions. Further, it is expected that the domestic dairy production would be sufficient to meet around 58 per cent of the local requirement in 2017 with continued government efforts on enhancing domestic milk production. Sugar production would meet up to around 14 per cent of the national requirement supported by new cultivation plan which would make sugarcane available throughout the year. The fishery sector, which experienced a sluggish trend owing to the ban on fish exports to the European market, will rebound to its growth potential in 2017 subsequent to the lifting of the EU ban. Further, new initiatives undertaken by the government in the recent past are also expected to provide further impetus to the robust growth of the fishery sector in 2017.

- **Industry related economic activities are expected to continue the positive growth momentum in 2017**. Manufacturing activities which represent a major share of Industry activities are expected to make a higher contribution towards accelerating the current growth momentum. However, weak global demand is expected to prevail, adversely affecting some of the major export oriented industries. Nevertheless, the measures taken towards the development of industrial and economic zones for export oriented industries envisaging higher levels of FDIs are expected to boost the manufacturing sector activities. Further, there are continued efforts to establish free trade agreements to boost export performance, while the contribution from Small and Medium Enterprises (SMEs) is expected to increase with the promotion of inclusive growth strategies. Improvement in investor confidence, mainly driven by economic and political stability and the commitment to provide a conducive environment is expected to enhance and stimulate investments in manufacturing activities. Meanwhile, construction activities are expected to contribute largely on account of large-scale construction projects such as Western Region Megapolis Project and Central Expressway Project together with the continuation of the Colombo International Financial City, Southern Expressway Extension Project-Matara to Hambantota and the Outer Circular Highway Project – Phase III. Private construction projects such as condominiums and other housing developments would also provide impetus to the construction growth. The mining and quarrying activities will also benefit from the expected growth in construction activities. Moreover, continuous expansion in the electrification and water distribution network is vital in providing adequate basic infrastructure to economic development. Going forward, continuous effort should be made to attract FDIs and to promote public private partnerships (PPP) which are key success factors in boosting the contribution from Industry related economic activities to the national economy.

- **Services activities would maintain their higher growth trajectory in 2017, supported by all the major economic activities within the segment**. The expected enhanced trade relationship with Sri Lanka's major trading partners would support the value added in the external trade. Conducive policy measures are required to unleash the potential in Services activities such as professional services, IT programming, telecommunication and financial services, to thrive as high value added activities that could be easily utilised in penetrating global markets. Initiatives need to be taken to address the skill mismatches in the economy to support the labour demand in Services activities in the economy. The necessity of these developments was emphasised repeatedly by the private sector respondents of the business sentiment surveys such as Business Outlook Survey and Purchasing Managers' Index Survey conducted by the Central Bank. Integrating the existing diverse transportation networks is also important and the introduction of high-tech transportation modes to the country is required; especially in public transportation which would reduce the unwarranted waste of time and other resources of the economy. Meanwhile, the hospitality industry which is driven by the post-conflict boom in the tourism industry is expected to gather momentum, further increasing its contribution. Moreover, already stagnant structural reforms in order to improve doing business climate need to be fast tracked.

- **Investment activities are expected to continue a positive growth momentum in 2017, accounting for 30.9 per cent of GDP, contributed by both government and private investment expenditure.** Continuation of ongoing and planned infrastructure development projects including Colombo International Financial City and expressway developments, together with the development projects proposed by the Western Region Megapolis Project would contribute positively to improve the investments of the economy. Further, private investment activities are expected to continue its growth momentum supported by construction projects of residential condominium, commercial buildings, hotels etc. to absorb the increasing demand for such activities.

- **Maintaining savings at a desirable level is vital in sustaining investments and economic growth**. In this regard, achieving and sustaining a positive level of government savings is important. Continuous effort for fiscal consolidation by developing prudent measures to improve government revenue while maintaining the smooth flow of business activities would contribute in improving domestic savings and the investment climate. As the country requires a high level of investments to avoid the middle income trap and to progress towards the high income levels, these improvements will support to taper the savings-investment gap, reducing reliance on external funding sources.

3

ECONOMIC AND SOCIAL INFRASTRUCTURE

The government continued to invest in the provisioning of economic and social infrastructure facilities during the first half of 2016. Most of the country's economic infrastructure, such as energy, transport, roads and ports, and social infrastructure, such as education and health, showed a positive growth performance during this period. The energy sector performed well, mainly due to low international oil prices. The government has taken several measures to drive the infrastructure development programmes. Initiatives are being taken to harness the potential of transforming Sri Lanka to a maritime economy, mainly by developing the Port of Colombo as the leading transshipment hub in South Asia with world-class terminals providing more services to regional shippers. The proposed Colombo Suburban Railway Project is expected to reduce vehicle traffic in Colombo and suburban areas. The Megapolis project launched by the government envisions a spatial transformation of the Western Region together with a much needed structural transformation of the economy. It will also facilitate the emergence of the main commercial city of the country as a regional aviation, port and financial hub. The government also continued to support improvements in the social infrastructure such as education and health. However, the sustainability of provisioning these infrastructure, either social or economic, may be hindered by the limited fiscal space available. Therefore, it is imperative to encourage the private sector to get involved in infrastructure provisioning by ensuring a conducive environment for private investments. Social infrastructure provisioning has always been designed to cater to the needs of the vulnerable groups in the country. However, as the country is moving towards the upper middle income status, the government needs to design policies to facilitate new perspectives on infrastructure provisioning to particularly match the needs and demands of the emerging middle class segment of the economy, while ensuring the provisioning of essential social infrastructure for the needy people in the country. Further, it is important to enhance the efficiency of existing soft infrastructure, which encompasses the rules and regulations governing the proper functioning and use of physical or hard infrastructure, in order to achieve higher economic, social and cultural standards in the country.

Developments in Economic Infrastructure

Communication Services

- **The telecommunication sector showed a moderate growth during the first half of 2016.** The number of mobile telephone connections increased by 5.6 per cent while fixed wireline telephone connections recorded a 2.4 per cent growth during the period from end June 2015 to end June 2016. Reflecting the trend of shifting to mobile connections, fixed wireless connections continued its declining trend, recording a drop of 6.9 per cent at the end of the first half of 2016, thereby causing a reduction in the total fixed telephone connections by 3.0 per cent during the period from end June 2015 to end June 2016. At the end of the period under review, the fixed telephone penetration (connections per 100 persons) and the mobile telephone penetration stood at 12.3 and 116.6, respectively. With regard to internet services, the total internet connections grew by 11.4 per cent during the period from end June 2015 to end June 2016, raising internet penetration (connections per 100 persons) to 20.0 per cent, in comparison to a 36.3 per cent growth recorded during the corresponding period in 2014/15. The growth in internet connections was largely supported by the accelerated growth of 26.5 per cent in fixed internet connections while mobile internet connections grew only by 8.5 per cent in comparison to a 42.8 per cent growth recorded during the corresponding period in 2014/15.

Chart 3.1 New Telephone Connections (Fixed Access and Cellular) and New Internet Connections Granted

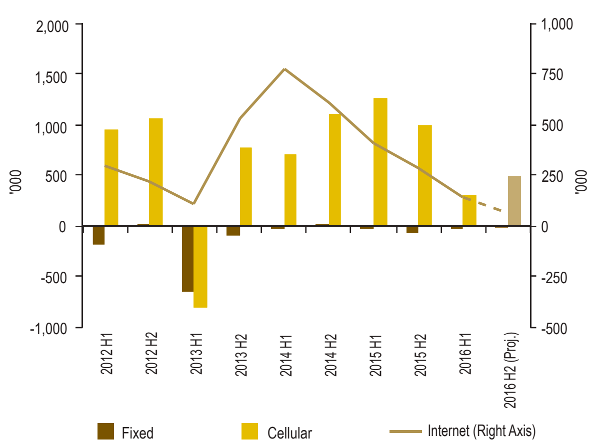


Table 3.1 Telecommunication Services

No. of Subscribers	End June 2015	End June 2016 (a)	Change %
Fixed Access Telephones ('000)	2,677	2,597	-3.0
Cellular Telephones ('000)	23,381	24,696	5.6
Internet Connections ('000) (b)	3,799	4,232	11.4
Total Telephone Penetration	124.28	128.89	3.7
Mobile Telephone Penetration	111.52	116.62	4.6

Sources: Telecommunications Regulatory Commission of Sri Lanka
Department of Census and Statistics

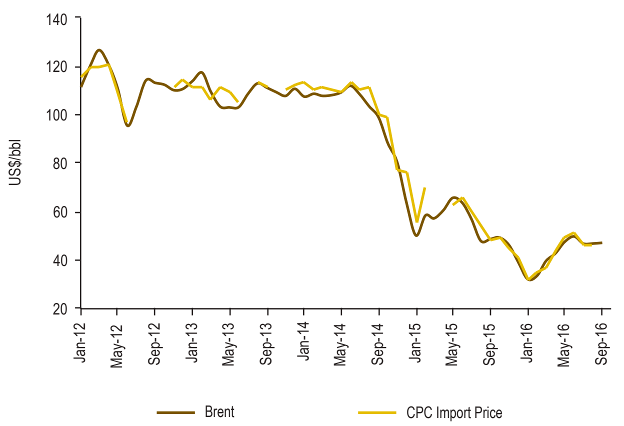
(a) Provisional
(b) Including mobile internet connections

- **The telecommunication industry has taken several initiatives to promote global connectivity.** The Sri Lanka Telecom Public Limited Company (SLT), gained full landing status of the optical fiber submarine cable SEA-ME-WE 5 (SMW5) that has been designed with the upgradable 100 gigabits per second (Gbps) technology while enabling a system capacity of 24 terabits per second (Tbps) bandwidth. The SMW5 will link South and East Asia, Middle East, Africa and Europe. Further, the envisaged full landing station in Matara will enable the establishment of a global point of presence (PoP) in Sri Lanka that would facilitate multi-regional high speed reliable data connectivity as the SMW5 connects to multiple PoPs while ensuring secure cross connection possibilities with other submarine cables. The Dialog Axiata PLC commissioned the Bay of Bengal Gateway (BBG) submarine cable landing facility in May 2016. The BBG connects India, Malaysia, United Arab Emirates (UAE) and Oman, thereby facilitating high speed data transmission together with the 100 Gbps technology and an initial system capacity of 6.4 Tbps bandwidth. Meanwhile, the initial testing of the 'Google Loon project', which will cover the entire island with 4G internet, was completed in the first quarter of 2016.

Petroleum

- **Crude oil prices in the international market registered an increasing trend during the first nine months of 2016.** The average international crude oil price (Brent) during the period under review stood at US dollars 43.08 per barrel compared to US dollars 56.62 per barrel in the corresponding period of 2015. Brent crude oil price fell to US dollars 28.09 per barrel on 21 January 2016, recording its lowest level since September 2003, on worries over a global supply glut mainly due to the expected increase in Iranian oil exports after the lifting of sanctions. However, an upward movement of international oil prices has been observed thereafter, mainly due to expectations that OPEC and non-OPEC producers would agree to freeze their output amidst global oversupply. This trend was further supported by the volatility in the US dollar and supply disruptions, particularly in Canada, Nigeria, Venezuela and Norway. However, during the month of July, prices followed a declining trend on concerns over global oil glut, market uncertainty over Britain's unexpected vote to exit the European Union, expectations on low growth in the demand for oil, and signs of an end to several supply disruptions. Thereafter, prices rose again on renewed speculation that some members of OPEC would try to restrain output. By late September 2016, OPEC agreed to limit its production to a range of 32.5 - 33.0 million barrels per day and the production levels for each member country will be decided at the next formal OPEC meeting in November. With these developments, the average price of crude oil imported by the Ceylon Petroleum Corporation (CPC) declined by 29.6 per cent to US dollars 43.44 per barrel during the first eight months of 2016 compared to US dollars 61.67 per barrel during the corresponding period of 2015.

Chart 3.2 Average Price of Crude Oil (Brent) in the International Market and Crude Oil Import Price of CPC

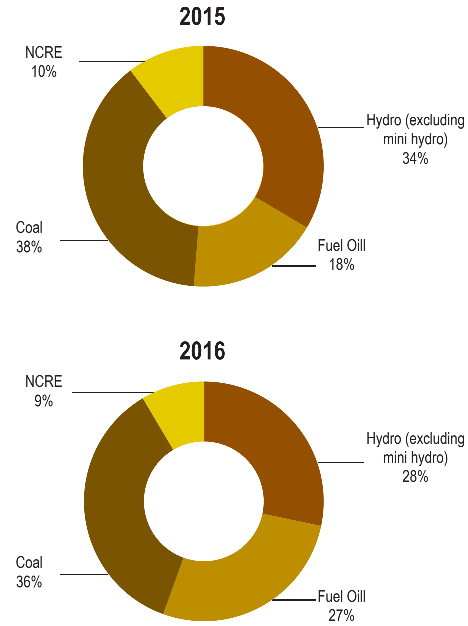


- **The increased domestic demand for petroleum continued.** Sales for the transport sector, the largest consumer of oil in Sri Lanka, increased substantially due to relatively low domestic petroleum prices and the increased number of vehicles in the country, while the sales for the power generation sector also increased substantially owing to greater fuel oil based power generation. During the first eight months of 2016, domestic sales of super diesel and auto diesel increased significantly by 44.3 per cent and 21.3 per cent, respectively. Further, domestic petrol sales recorded a 17.7 per cent growth during the period under review, reflecting the increased usage of private vehicles. Meanwhile, domestic kerosene sales also registered a 6.6 per cent growth during the first eight months of 2016 compared to the same period in 2015, even with the increased electrification in the country, and this could be due to lower prices encouraging the use of kerosene for fishery activities and cooking purposes, particularly in the rural and estate sectors.

Electricity

- **Electricity generation increased by 8.0 per cent to 9,375 GWh during the first eight months of 2016 from 8,678 GWh recorded during the corresponding period of 2015.** Hydropower generation (excluding mini hydro generation) during the first eight months of the year decreased by 8.8 per cent to 2,652 GWh due to the adverse weather conditions that prevailed. However, the share of hydropower in the total power generation increased gradually towards mid-year, supported by heavy rainfalls received during May 2016. Total coal power generation increased marginally by 1.4 per cent to 3,372 GWh during the first eight months of 2016 amidst the maintenance delays of the Norochcholai coal power plant. The cumulative effect of lower hydro and coal power generation resulted in a substantial increase in fuel oil based generation by 65.7 per cent to 2,552 GWh. Meanwhile, according to the Ceylon Electricity Board (CEB), generation of electricity through non-conventional renewable energy (NCRE) sources, including mini hydro generation, decreased by 11.6 per cent to 798 GWh. Accordingly, the share of hydro, coal, fuel oil and NCRE power generation during the first eight months of 2016 stood at 28 per cent, 36 per cent, 27 per cent and 9 per cent, respectively. Meanwhile, electricity consumption in the domestic, industrial, general purpose, government and hotel sectors increased by 9.8 per cent, 6.5 per cent, 11.8 per cent, 12.2 per cent and 17.1 per cent, respectively, during the first seven months of 2016, reflecting the increased demand due to the prevailing lower tariff. Thus, the total electricity sales increased

Chart 3.3 Electricity Generation Mix (Jan-Aug)



by 9.0 per cent to 7,349 GWh during the first seven months of 2016, from 6,741 GWh in the corresponding period of 2015. Further, the transmission and distribution losses, as a percentage of total generation, improved to 9.6 per cent during the first seven months of 2016, from 10.0 per cent recorded in 2015 and 17 per cent recorded in 2005.

- **The government has initiated a programme called "Ratama Eliyai - Andura Duralai", to provide electricity at concessional rates to low-income earners who cannot afford to light**

Table 3.2 Electricity Sales

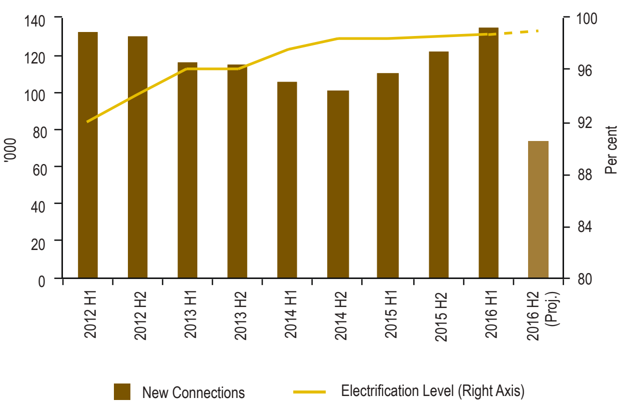
Item	2014	2015	2015 Jan - Jul	2016 Jan - Jul (a)	Change %
Total Sales by CEB (GWh)	11,063	11,786	6,741	7,349	9.0
Domestic	3,521	3,876	2,215	2,431	9.8
Religious	63	67	38	42	11.8
Industrial	3,498	3,608	2,056	2,190	6.5
General Purpose	2,194	2,324	1,333	1,489	11.8
Government	134	152	83	94	12.2
Hotel	192	205	120	140	17.1
Bulk Sales to LECO	1,352	1,446	833	899	7.9
Street Lighting	108	108	63	63	0.6

Source: Ceylon Electricity Board

(a) Provisional

up their households although the utility is accessible. Currently, the Colombo, Gampaha, Galle, Matara, Hambantota and Kandy districts have been 100 per cent electrified. However, this programme targets to achieve 100 per cent electrification in all the districts in the country. The CEB's efforts have helped the completion of 104 rural electrification schemes and several extensions covering all districts and electrifying 21,549 houses during the first half of the year. With this the level of electrification of the country has raised to 98.7 per cent by end June 2016 compared to 98.5 per cent at end 2015. In relation to the developments in NCRE generation, 9 mini hydro power projects were commissioned during the first half of 2016, adding approximately 13 MW to the national grid. In addition, there were 4 ongoing NCRE projects with a capacity of 6 MW collectively, by end June 2016. Meanwhile, the government launched a new community based power generation project called "Soorya Bala Sangramaya" in September 2016, with a view to transform every house to a micro power plant facilitating sustainable power generation in the country. The program is expected to establish solar power units in one million houses throughout the country by providing solar panels to households at a concessionary rate.

Chart 3.4 New Electricity Connections and Electrification Level



Road Development

- **Road development continued to be one of the main infrastructure development initiatives of the government in 2016.** The total length of national highways, including expressways, maintained by the Road Development Authority (RDA), remained unchanged at 12,380 km during January – June 2016. Approximately 4,662 bridges were maintained by the RDA during the same period. The total expenditure on maintenance, rehabilitation and development of roads and bridges during the first half of 2016 was around Rs. 38.4 billion in comparison to the Rs. 70.6 billion recorded during the corresponding period of 2015.

- **Construction work of extensions to the national expressway network continued during the first half of 2016.** Even though new major road development projects were not initiated during the first half of 2016, preparatory measures for already launched projects were undertaken. Loan agreements in respect of funding for the civil work of the Extension of the Southern Expressway Project (ESEP) from Matara to Hambantota with links to the Hambantota Sea Port and the Mattala International Airport were signed by the Government and the Exim Bank of China. The total length of the planned extension is 92 km and consists of 4 separate sections, namely, Matara to Beliatte (30 km), Beliatte to Wetiya (26 km), Wetiya to Andarawewa (15 km) and Mattala to Hambantota via Andarawewa (21 km). The civil contracts of the 4 sections were awarded to commence constructions. A economic feasibility study of the Central Expressway, from Kadawatha to Dambulla with Pothuhera-Galagedara and Meerigama-Ambepussa links, was carried out during the period. Meanwhile, engineering designs of Phase III of the Outer Circular Highway (OCH), which connects the Kadawatha interchange and

Kerawalapitiya interchange with a link to the Colombo-Katunayake Expressway were carried out by the RDA. The total length of this section is 9.6 km and the physical progress of this project stood at 9.9 per cent at end June 2016. Once completed, the OCH will link all expressways and a few major roads radiating from Colombo, thereby reducing traffic congestion within the Colombo Metropolitan Region. Meanwhile, the rehabilitation and improvement of roads and bridges continued during the first half of 2016.

- **Measures were taken continuously to reduce traffic congestion and improve road safety in major cities.** In this regard, installation of pelican crossings, installation of traffic signals, establishment of Advance Traffic Management System (ATMS) and scheduled construction of flyovers can be highlighted. The construction of a flyover at the Rajagiriya junction commenced in August 2016 and is expected to be completed by end 2018. At present, the ATMS project, which is funded by a grant from the Korea International Cooperation Agency (KOICA), is at its detailed design stage. The ATMS project aims at supporting the economic activity of Colombo Metropolitan Region by relieving traffic congestion, strengthening traffic safety and improving public transportation.

Road Passenger Transportation

- **The public passenger transportation by the Sri Lanka Transport Board (SLTB) improved marginally during the first half of 2016.** The total operated kilometerage of buses operated by the SLTB increased by 5.7 per cent to 222.8 million km while total passenger kilometerage also increased by 7.5 per cent to 7,780 million km during the first half of 2016 compared to the corresponding period of 2015. The operated average number of buses per day improved by 165 to 5,306 during the first six months. However, the total fleet of the SLTB declined by 269 to 7,778 during the first half of 2016, mainly due to the auctioning of unserviceable buses. Meanwhile, the average bus fleet owned by private operators increased to 20,329 as at end June 2016 compared to the bus fleet of 19,397 as at end 2015. Correspondingly, the operated average also increased to 18,359 by end June 2016 compared to 16,942 at end 2015. Even though the operated kilometerage of private buses declined by 4.8 per cent, the passenger kilometerage increased by 14.3 per cent, during the period under review.

- **The National Transport Commission (NTC) continued to provide Sisu Seriya and Gemi Seriya services in order to provide reliable, safe and cost effective services to school children and the rural mass.** The government has allocated Rs.600 million and Rs.23.5 million for Sisu Seriya and Gemi Seriya services, respectively, in year 2016. In addition, the NTC continues the Nisi Seriya project to provide reliable and safe transport services to passengers during late nights and early mornings. The NTC also continued to implement projects to provide a reliable, safe and comfortable private bus services for passengers during the first half of 2016. In line with the annual revision, bus fares increased by 6 per cent with effect from 01 August 2016.

- **The registration of new motor vehicles recorded a significant drop during the first nine months of 2016 compared to the corresponding period of 2015.** During this period, the total number of vehicles registered declined by 27.8 per cent to 355,155. Except for lorries, tractors and trailers, all other vehicle categories contributed to this decline. The registration of dual purpose vehicles and three wheelers declined by 34.3 per cent and 58.4 per cent, respectively, while the registration of motor cars declined by 55.7 per cent. New registration of buses was also declined by 38.4 per cent during

Table 3.3 New Registration of Motor Vehicles

Item	2014	2015	2015 Jan - Sep	2016 Jan - Sep (a)	Change %
New Registration of Motor Vehicles	429,556	668,907	491,632	355,155	(27.8)
Buses	3,851	4,140	3,264	2,011	(38.4)
Motor Cars	38,780	105,628	74,966	33,198	(55.7)
Cars Less than 1,000cc	5,781	60,641	38,922	17,256	(55.7)
Three Wheelers	79,038	129,547	96,987	40,314	(58.4)
Dual Purpose Vehicles	20,799	39,456	29,442	19,336	(34.3)
Motor Cycles	272,885	370,889	273,691	245,350	(10.4)
Goods Transport Vehicles	5,121	7,142	5,459	5,326	(2.4)
Land Vehicles	9,082	12,105	7,823	9,620	23.0

Source: Department of Motor Traffic

(a) Provisional

the period under review. The overall decline in vehicle registration during the first nine months of 2016 is largely driven by the upward tax revision on motor vehicle imports, depreciation of the rupee and the gradual increase in interest rates.

Rail Transportation

- **Passenger kilometrage by the Sri Lanka Railways (SLR) continued to increase during the first half of 2016.** During the period, rail passenger kilometrage increased by 2.1 per cent to 3.6 billion km, in comparison to 3.5 billion km recorded in the corresponding period of 2015, supported by prevailing relatively low tariffs, increasing road traffic in Colombo and the suburbs, and the expansion in railway services in the Northern Province. The goods kilometrage also increased by 3.7 per cent to 67.3 million MT km during the first half of 2016. Meanwhile, the SLR initiated and carried out several activities to improve the service quality and viability of the railway system. Rehabilitation of bridges under the financial assistance of Belgium, commencement of feasibility studies of the Colombo Suburban Railway Project under the technical and financial assistance of the Asian Development Bank (ADB), launch of coal transportation from Trincomalee to Norochcholai and the introduction of the rail bus service for Kandy – Peradeniya and Kelani Valley lines are several such initiatives that were carried out during the period.

Civil Aviation

- **The country's civil aviation sector showed a higher growth momentum during the first half of 2016.** Air passenger movements through the Bandaranaike International Airport (BIA) recorded a growth of 9.4 per cent to 4.5 million due to increased tourist arrivals during the first half of 2016. The transit passenger movements also increased by 2.3 per cent to 0.6 million during the first half of 2016 compared to the corresponding period of the previous year. Further, the total volume of cargo moved through the BIA increased by 26.5 per cent to 135,377 MT, while the total number of aircrafts handled at the BIA increased by 12.2 per cent to 31,651 during the first half of 2016. Meanwhile, the Mattala Rajapaksa International Airport (MRIA) handled only 670 aircraft during the first half of 2016 as the government suspended the regular operations of SriLankan Airlines (SLA) to the MRIA from February 2015. The MRIA handled only 1,652 passengers during the period under review. By end June 2016, 30 international airlines (including 5 charter airlines, SLA, Mihin Lanka (MLL) and 3 cargo airlines) served Sri Lanka, while 7 domestic airlines were also in operation. Meanwhile, the government issued directives to both the SLA and MLL to prepare business restructuring plans that would create alternative avenues in order to be economically viable in the medium term.

- **The second loan agreement for the construction work of the Phase II Stage 2 of the BIA expansion project was signed in March 2016 facilitating the balance funding requirement of the project.** This project includes a multi-level terminal with two pier passenger terminals, which is to be built with the safety requirements of an international airport, an inline baggage handling system and an access control system with surveillance cameras. Once the project is completed, the current capacity of 6 million passenger movements per annum is expected to increase to 15 million, while improving passenger convenience with the expansion of airport infrastructure and facilities. Meanwhile, the consultant and the project compnay have been choosen for the project named "Overlaying the runway and associated works at BIA" to improve the surface condition for the safe operation of aircrafts. The project includes the widening and overlaying of the existing runway, overlaying of the Northern part of the existing parallel taxiway, widening of existing taxiways, construction of new rapid exit taxiways and new bypass taxiways, installation of a new airfield ground lighting system, and modification of the existing apron of the aerodrome of the BIA. The project is scheduled to be completed by August 2017. As per the Airport and Aviation Services (Sri Lanka) Limited, it is proposed to have an 8 hour runway closure for aircraft operations on a daily basis for a period of three months commencing from 6th January 2017. This would affect about 10 per cent of the total flight movements of the BIA.

Port Services

- **The port sector performance continued to improve during the first nine months of 2016.** Total container handling at the Port of Colombo has increased by 9.4 per cent to 4,255,481 Twenty-foot Equivalent Container Units (TEUs) during the first nine months of 2016 compared to the corresponding period of the previous year. Total cargo handling recorded a growth of 11.5 per cent to 64.5 million MT during the first nine months of 2016 as against the corresponding period of 2015. During the first nine months of 2016, total container handling by the Sri Lanka Ports Authority (SLPA) showed a negative growth of 5.4 per cent when compared to the corresponding period of 2015. However, total container handling at the Colombo International Container Terminal (CICT) and South Asia Gateway Terminal (SAGT) grew by 27.7 per cent and 13.5 per cent, respectively, during the first nine months of 2016. Further, CICT handled mega container vessels that could not be operated either at the Jaya Container Terminal (JCT) of the SLPA or SAGT. Total vehicle handling at the Hambantota Port recorded a 2.6 per cent growth during the

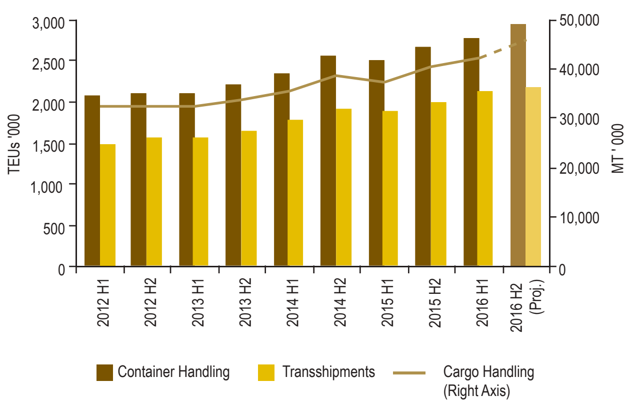
Table 3.4 Performance of Port Services

Item	2015 Jan - Sep	2016 Jan - Sep (a)	Change %
Total Cargo Handling (MT '000)	57,860	64,502	11.5
Total Container Handling (TEUs '000)	3,888	4,255	9.4
Transhipments (TEUs '000)	2,985	3,304	10.7

Source: Sri Lanka Ports Authority

(a) Provisional

Chart 3.5 Container Handling, Transshimpements and Cargo Handling



first nine months of 2016 mainly due to increased vehicle transhipments of around 39.3 per cent despite the domestic vehicle handling showed a decline of 56.0 per cent during the period under review.

- **The construction activities of some port projects have been completed and measures were taken to initiate the operational activities of those projects during the first half of 2016.** The ADB and SLPA signed a transaction advisory services agreement in February 2016 to develop the East Container Terminal (ECT) of the Colombo Port through a Public-Private Partnership (PPP). Further, the ADB has approved assistance to prepare a national port master plan for Sri Lanka covering all ports, including the restructuring of the SLPA. Further, it is expected that the construction work of the phase II of the Hambanthota Port project would be completed by April 2017.

Developments in Social Infrastructure

Health

- **The government has taken several initiatives to strengthen the primary healthcare network in the country.** The country's health indicators, such as maternal and infant mortality, and life expectancy, show a steady improvement over the recent past. The Maternal Mortality Ratio declined to 30/100,000 live births in 2015 from 32/100,000 reported in 2014 while child mortality rate is reported at 10 /1,000 live births in 2015. The improvement of these indicators is predominantly attributed to the Maternal and Child Care Programme implemented nationally as an integral component of the state healthcare system. Meanwhile, the neonatal mortality rate remained around 5-7/1,000 of live births over the recent past. Several initiatives are also being taken to improve the quality of maternal and newborn care services in hospitals.

- **The government continued its efforts to further improve the human resource and physical infrastructure base of the health sector during the first half of 2016.** In the government hospitals, there were 19,441 qualified doctors, a doctor for every 1,089 persons and 32,362 qualified nurses, and a nurse for every 654 persons by end June 2016. Further, there were 610 government hospitals with 76,949 beds in the country, which amounts to 3.6 beds for 1,000 persons by the end of June 2016. Several development projects were in progress in the health sector while several physical infrastructure development projects have also been completed during the first half of 2016. Accordingly, the construction of an accident services ward at the District General Hospital – Ratnapura was declared open while the construction and upgrading of 19 peripheral blood banks were completed. In addition, the construction of a state of the art cancer ward complex at the National Institute of Cancer, Maharagama was completed and the purchasing of equipment is currently in progress, while the construction of a ward complex at Vauniya Hospital was completed. Further, a construction of a epilepsy unit at the National Hospital of Sri Lanka and a clinical building and outdoor patient department (OPD) complex at District General Hospital – Kalutara, expansion of the OPD and clinic building at the National Eye Hospital in Colombo and programmes to develop the Dental Institute of Sri Lanka, District General Hospital – Hambantota and District General Hospital – Nuwara Eliya were in progress at the final stage. Meanwhile, there were 98 government Ayurvedic Hospitals with 4,845 beds, with 22,802 registered Ayurvedic physicians as at end June 2016.

- **Dengue outbreaks continue to remain one of the most challenging health issues in the country as a sustainable reduction in outbreaks has not been materialised over the last few**

years. During the first nine months of 2016, dengue cases increased substantially to 42,711 in comparison to the 21,261 cases reported during the corresponding period of 2015, with 10,636 dengue cases were reported in July 2016 itself. The increasing trend was mainly due to the inclement weather conditions, high temperatures, and heavy rains and floods. Of the total outbreaks, around 50 per cent were recorded from the Western Province where extensive urbanisation has created a perfect breeding ground for dengue mosquitoes. The Ministry of Health, Nutrition and Indigenous Medicine, in partnership with the Presidential Task Force, took several steps, such as carrying out mosquito control programmes, inspecting houses and institutions to eliminate breeding places, recruiting mosquito prevention field assistants to identify and eliminate mosquito breeding places, distributing mosquitocides among all regions, distributing hand held fogging machines and establishing controlling units covering all provinces of the country, for the prevention and control of dengue. In addition, with the outbreak of the Zika epidemic in several South American and Latin American countries, the Ministry of Health, Nutrition and Indigenous Medicine established a special screening facility at the BIA to detect those who may have infected by the Zika virus.

- **The private sector participation in providing healthcare facilities continued to grow during the period concerned.** There were 193 registered private hospitals with 6,028 beds in the country, including 17 Ayurvedic hospitals with 306 beds by end June 2016. Further, there are 472 registered medical and channelling centres, 878 registered medical laboratories, 1,937 full time and part time medical clinics that are in operation by end June 2016. Promising developments were observed in the private healthcare sector, alongside significant improvements that are taking place in the tourism industry, will provide an opportunity for Sri Lanka to promote medical tourism. However, the regulation and process of evaluation and the assessment of the quality of service delivery by the private health sector institutions needs to be strengthened, for the private health services to attract external demand.

Education

- **The general education sector showed a progress during the first half of 2016.** As per the Ministry of Education, the total number of schools in the country was 10,997 (excluding international schools) in 2015, out of which 10,144 were government schools. During the first half of 2016, the government recruited 490 teachers under two qualification categories, out of which 23 teachers were posted to national schools while the other 467 teachers were posted to provincial schools. Moreover the student net enrolment ratio (NER) of age group 5-16 (Grade 1-11) of the country stood at 96.26 per cent in 2015 with male and female student NERs of 96.75 per cent and 95.76 per cent, respectively. Schools' evaluation programme was continued under both internal and external evaluation systems during the first half of 2016 and under this, approximately 8,500 teachers were evaluated externally.

- **The Ministry of Education continued to engage in the development of infrastructure during the first half of 2016.** These developments consist of three types of projects. Project-1 focuses on the construction of Technological Laboratories in the selected secondary schools with the objective of enhancing the ICT literacy of students, school leavers as well as the community in the area. Under this, 1,005 technological laboratories are expected to be established in nine provinces, out of which, 991 laboratories have been completed by end June 2016. Among these, 840 laboratories were functioning well by the end of first half of 2016. Under Project-2, the construction of Technology Faculties (TFs) to facilitate the technology stream at GCE Advanced Levels in 251 secondary schools were carried out. At the end of the first half of 2016, the construction of 211 TFs were completed, out of which 78 TFs are currently functioning. Project-3 was based on the Development Programmes and Development Projects under the Budget 2016, including the establishment of teacher quarters and rest rooms in rural and regional schools, ensuring sanitation facilities in all schools by end 2016, upgrading 3,577 primary schools, 1,000 secondary schools' programme, development of 1,360 schools with GCE Advanced Levels and providing dental health facilities in schools.

- **Greater participation of non-state sector higher education institutions would be necessary to expand the availability of higher education facilities in Sri Lanka.** Given the capacity limitations in state universities, it is important to encourage and facilitate non-state higher educational institutions, including foreign universities and other institutions granting professional qualifications, to actively participate in the higher education sector of the country. At present, there are more than 70 non–state higher education institutions offering educational programmes in affiliation with foreign universities and higher education institutions. Among these, 16 have been recognised as "Degree Awarding Institutes" and another 19 are in review process. Review panels have been appointed to examine the capacity of these institutions to offer degree programmes, and nearly 07 institutional reviews are at the completion stage. By the end of the first half of 2016, approved institutions offered 85 degree programmes. Among these, 26 degree programmes were recognized during the first half of 2016, which consist of ten basic degrees, eight Master of Philosophy degrees and eight Doctor of Philosophy degrees. It should be noted that degree programmes offered by both public and private sector higher education institutes need to comply with the requirements of the relevant professional body. This issue is critical in particular in the case of degree programmes that produce professionals to the country. The Ministry of Higher Education and Highways (MOHEH) recommends the entry visa and residence visa for the foreign students who intend to follow higher studies in the Non - State Higher Education Institutions in Sri Lanka. During the first half of 2016, about 67 visa applications from 22 countries have been processed.

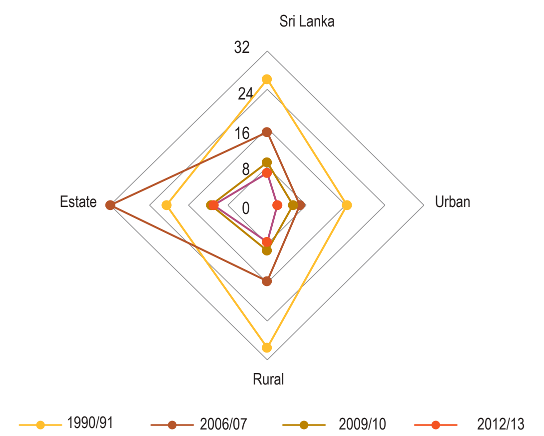
- **The technical and vocational education training sector performed well during the first half of 2016.** By end June 2016, 1,137 public, private and NGO sector vocational training centres that undertook 2,470 accredited courses were registered with the Technical and Vocational Education and Training (TVET) sector. Tertiary and Vocational Education Commission (TVEC) issued 22,539 National Vocational Qualification (NVQ) certificates during the first half of 2016. There were 117,321 students registered with public TVET institutions in 2015 and 84,552 students completed the training. Meanwhile, a large number of students registered and completed TVET courses in private sector institutions as well. During 2015, total recruitment in public and private vocational training institutions was 169,644.

Safety Nets and Poverty Alleviation

- **The incidence of poverty, measured by the poverty headcount ratio (PHCR), declined significantly in Sri Lanka during the last few years.** As per the Household Income and Expenditure Survey (HIES), conducted by the Department of Census and Statistics (DCS), the

PHCR declined from 8.9 per cent in 2009/10, to 6.7 per cent in 2012/13. In terms of the PHCR, approximately 1.3 million people were below the poverty line[1] in 2012/13 in comparison to 1.8 million people in 2009/10. However, poverty disparity still exists across the provinces and districts in the country. At the provincial level, the lowest PHCR of 2.0 per cent that reprecented 116,000 people was recorded in the Western province where as the Uva province recorded the highest level of 15.4 per cent, representing 190,000 people. At district levels, the lowest PHCR was reported in Colombo in contrast to the highest PHCR in the Mullaitivu district. Further, the poverty map prepared by the DCS and the Poverty Global Practice of the World Bank Group, based on data from Sri Lanka's 2012 Census of Population and Housing (CPH) and the 2012/13 HIES, highlights the presence of significant geographical disparities among poverty rates at the Divisional Secretariat (DS) level. While the presence of poverty in certain districts is low on an overall basis, some DSs possess pockets of poverty. Moreover, the PHCR of the estate sector, which is generally higher than those of urban and rural sectors, declined significantly to 10.9 per cent in 2012/13 from 30 per cent in 2002 mainly due to the decline in consumption poverty. As per the 2012/13 survey, the PHCR for rural and urban sectors estimated at 7.6 per cent and 2.1 per cent, respectively. However, Sri Lanka's poverty remained low by international standards. Based on the World Bank's criteria of measuring extreme poverty, i.e. US$ 1.90 a day [2011 Purchasing Power Parity (PPP)], the extreme poverty in Sri Lanka declined from 8.3 per cent in 2002 to less than 2 per cent in 2012 and is lower than many of Sri Lanka's peer economies. However, based on the World Bank's poverty line of US$ 3.10 per day (2011 PPP), Sri Lanka's poverty stood at 14.6 per cent in 2012.

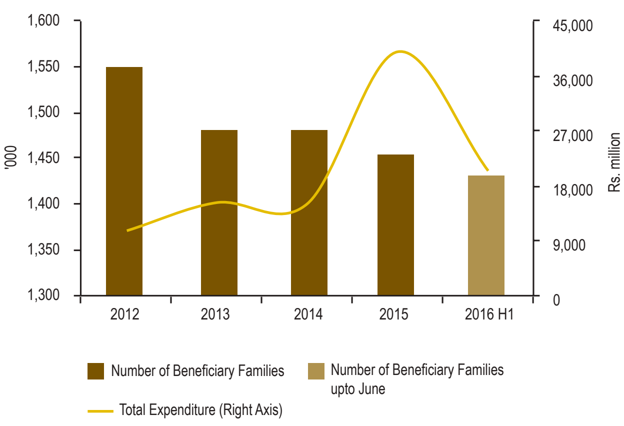
Chart 3.6 **Poverty Headcount Ratio (Per cent)**



- **All successive governments have implemented various poverty alleviation programmes during the past few decades.** Currently, the Samurdhi/ Divinaguma subsidy programme plays a major role as the foremost social safety net programme in the country. During the first half of 2016, Rs. 20.5 billion was granted under the Samurdhi/ Divinaguma subsidy programme, benefiting 1.43 million families in the country. The Samurdhi/Divinaguma Social Security Fund, which aims at reducing the vulnerability of the poor in case of emergency, also granted Rs. 221 million to 39,296 beneficiaries during the first half of 2016. Meanwhile, the Ministry of Women and Child Affairs disbursed Rs 1.6 billion and Rs. 9.2 million during the first half of 2016 to provide nutritional food packages for expectant mothers, and a glass of fresh milk for children between 2-5 years, to uplift the nutritional status among mothers and children in the country. In addition, the government continued to implement several other social assistance programmes such as the school food programme, Thriposha programme, disability and relief

1. Sri Lanka's official national poverty line defines a person as being poor in the 2012/13 Household Income and Expenditure Survey (HIES) if his or her real per capita consumption expenditure is less than Rs. 3,624 per month, which is equivalent to about US dollars 1.50, in 2005 purchasing power parity terms. Data from the HIES, conducted by the Department of Census and Statistics (DCS) once in three years, is used to calculate poverty using the Cost of Basic Needs (CBN) method. The latest HIES is for 2012/13.

Chart 3.7 Performance of the Samurdhi/Divineguma Subsidy Programme



assistance, elderly payment and disaster relief assistance, etc. during the first half of 2016 to uplift the livelihood of the poor. Meanwhile, the government declared the year 2017 as the "Year of Alleviating Poverty", recognising the need for a comprehensive approach to alleviate poverty in its all forms, in the march for achieving Sustainable Development Goals by 2030.

Expected Developments

- **Growing demand for electricity and delays in the completion of major power projects may affect uninterrupted power supply in the medium term.** At present, the total electricity generation capacity of the country is 3,970 MW. About 47 per cent of the total capacity is still fulfilled by hydropower and NCRE which varies with weather conditions. In this situation, if the dry weather condition prevails during the remaining period of the year, cost of generation would increase substantially affecting CEB's financial performances. Further, the supply of electricity during dry weather conditions is highly dependent on the 900 MW Norochcholei coal power plant. Therefore, unless the coal based power generation is sufficiently avalable, the supply shortage of electricity is unavoidable particularly during dry weather conditions. Hence, the national energy planning should be strengthened further as an ongoing process, to facilitate energy security of the country as well as to improve the financial viability of the CEB.

- **International oil prices show an increasing trend since October 2016 mainly due to the decision taken by the OPEC member countries to limit its production levels.** Based on the forecast provided by the US Energy Information Administration (EIA) the average Brent oil price would be around US dollars 42.5 per barrel by end 2016. Petroleum sales for the transport sector increased substantially due to relatively low domestic petroleum prices that prevailed during the first half of the year and this trend is expected to continue during the remaining period of 2016. Meanwhile, the petroleum sales for the power generation sector, which increased owing to greater fuel oil based power generation in the first half of 2016, may continue due to prevailing dry weather conditions. However, the CPC's overall financial position in 2016 is expected to improve, due to low international oil prices that have prevailed thus far during the year.

- **Recent developments in the tele communication sector are expected to bring down ground infrastructure costs of local telecommunication operators while enhancing accessibility to high-speed and affordable internet across the island.** This would in turn support to overcome the demand and supply side challenges, such as the promoting of e-business and e-learning, enhancing information and telecommunication literacy, enhancing infrastructure sharing and ensuring efficient frequency spectrums for latest technologies, which would be vital in the integration of all economic sectors with efficient internet services.

4

PRICES, WAGES, EMPLOYMENT AND PRODUCTIVITY

The general price level followed an overall increasing trend, with mixed movements during the first nine months of 2016. The movement of the general price level in terms of both the National Consumer Price Index (NCPI) and the Colombo Consumers' Price Index (CCPI) was largely in line with the price movements of the Food category. Inflation in the Non-food category also increased with the changes in government taxes in May 2016. The subsequent suspension of changes introduced to the government taxes moderated the impact from the Non-food category on inflation in recent months. Inflation, as measured by the year-on-year change in both the NCPI and the CCPI, followed an increasing trend during the period observed. The year-on-year producer price inflation also increased and largely followed the overall increasing trend of the Agriculture sub-index during the period. On the demand side, the expansion in credit to the private sector and the increase in wages in the economy exerted some pressure on the prices during the period. Both NCPI and CCPI core inflation exhibited an increasing trend during the period, signaling the demand pressure in the economy. Meanwhile, inflation expectations showed some degree of response to recent monetary and fiscal policy changes and broadly remained anchored. Wages in the public and the informal private sectors increased in both real and nominal terms. During this period several significant policy changes were introduced with respect to wages in the public and private sectors. The unemployment rate declined in the first half of 2016 compared to the corresponding period of the previous year. However, unemployment rates among youth, educationally qualified persons and females continued to remain high reflecting a structural issue in the labour market. Meanwhile, foreign employment continued to be one of the leading foreign exchange earners for the country although departures for foreign employment declined during the first half of 2016. On the productivity front, labour productivity as measured by value added (at 2010 prices) per hour worked increased moderately during the first half of 2016.

Developments in 2016

Prices

Movements in the General Price Level

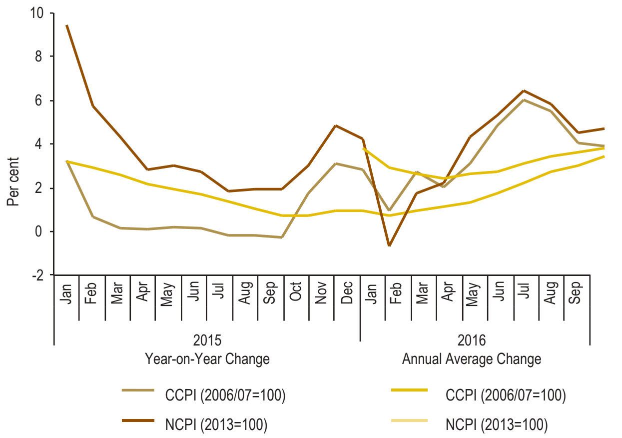
- **The general price level, as measured by the movements in both the NCPI (2013=100), and the CCPI (2006/07=100) followed an overall increasing trend, with mixed movements during the period observed.** Both price indices largely followed the movements of the Food category, which declined from January 2016 to March 2016, increased thereafter until July and subsequently declined until September 2016. The NCPI, which covers the price developments in the entire island, was 112.0 index points in January and increased to 113.5 index points in Septermber 2016. The CCPI which covers the price developments in the urban areas of the Colombo district, was 184.9 index points in January and increased to 188.5 index points in September 2016.

Headline Inflation

NCPI Inflation

- **Inflation as measured by the year-on-year change in the NCPI, followed an increasing trend during the first nine months of 2016.** Year-on-year NCPI inflation was negative in January 2016, due to the decline in food prices and the high base. Even though the food prices continued to decline during February and March 2016, year-on-year NCPI inflation increased from February 2016 onwards due to the low base in the corresponding period of 2015. Food prices started to increase from April 2016 due to seasonal demand and adverse weather conditions leading to a sharp increase in year-on-year NCPI inflation in April 2016. Thereafter, year-on-year

Chart 4.1 Movements of Headline Inflation (2015-2016)

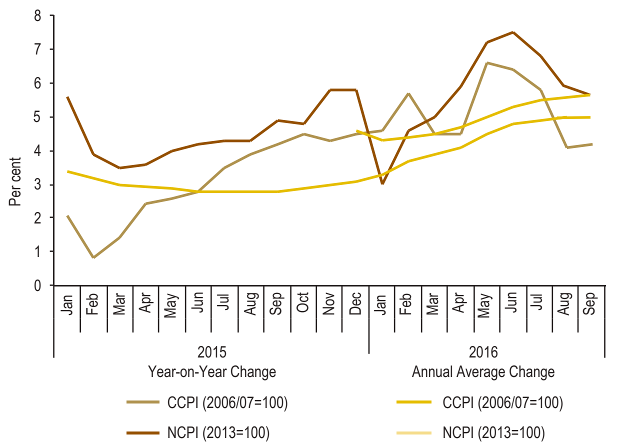


NCPI inflation increased further in May and June 2016 due to the impact of the continued increase in food prices and the increase in non-food prices resulting from the changes introduced to government taxes. Nevertheless, year-on-year NCPI inflation declined in July and August 2016 mainly due to the decline in food prices. Suspension of the change in taxes in July also had a marginal impact towards this decline. With the increase in both food and non-food prices, year-on-year NCPI inflation increased in September 2016. Meanwhile, annual average NCPI inflation declined during the first three months of 2016 and increased thereafter until September 2016.

CCPI Inflation

- **Inflation as measured by the year-on-year change in the CCPI moved on an increasing trend till June 2016 and declined thereafter.** Year-on-year CCPI inflation remained benign below mid-single digits during January to May 2016, but crossed the mid-single digit level in June 2016 due to the increase in both food and non-food prices and in July 2016 due to the base effect. With the sharp drop in prices in the Food category, year-on-year CCPI inflation

Chart 4.2 Movements of Core Inflation (2015-2016)



declined thereafter. Meanwhile, annual average CCPI inflation exhibited an increasing trend throughout the first nine months of 2016.

Core Inflation

- **Both NCPI and CCPI core inflation remained relatively high during the period, signaling the demand pressure in the economy.** Furthermore, subsequent to the changes in government taxes[1] in May 2016, prices of several key subgroups in the core basket increased, further increasing the upward pressure on prices. NCPI core inflation increased from 3.0 per cent in January 2016 to 5.7 per cent in September 2016 on year-on-year basis. Annual average core inflation moved on an increasing trend from 4.3 per cent in January 2016 to 5.7 per cent in September 2016. Year-on-year CCPI core inflation also moved from 4.6 per cent in January 2016 to 4.2 per cent in September 2016, exhibiting mixed movements. Meanwhile, annual average CCPI core inflation increased from 3.3 per cent in January to 5.0 per cent in September 2016, continuing the increasing trend that was observed from October 2015.

Supply Side Developments

Price Movements in the Food Category

- **Prices of food items with volatile prices (Volatile Food[2]) exhibited mixed movements, contributing largely towards the increase in food inflation during the period.** Prices of vegetables increased at a higher rate during the first nine months of 2016 compared to the corresponding period of the previous year largely due to adverse weather conditions. Prices of fresh fish also increased at a higher rate during this period compared to the same period of the previous year. This was due to a combination of factors including the shortage of supply to the domestic market caused by the increase in exports with the removal of the ban imposed by the European Union on fish imports from Sri Lanka. Adverse weather conditions that prevailed during April to May and the decline in production due to unsustainable fishing practices also contributed to the increase in fish prices. Nevertheless, rice prices recorded a modest decline during the first nine months of 2016 compared to the corresponding period of the previous year, contributing to moderate the pressure on volatile food prices.

- **Domestic prices of imported food items increased during the first nine months of 2016.** The increase was mainly due to the moderation of the declining trend of prices in the international markets and the weakening of the Rupee, as reflected by the changes in trade indices compiled by the Central Bank. The prices of sugar, dhal and wheat flour increased in the domestic market during the first nine months of 2016 compared to the same period of 2015. The price of a loaf of bread also increased, subsequent to the price increase in wheat flour.

1. Three main changes in government taxes were implemented in May
   i. The increase in the Value Added Tax (VAT) rate from 11 per cent to 15 per cent
   ii. The removal of the VAT exemption on certain goods and services
   iii. The removal of the Nation Building Tax (NBT) exemption on certain goods and services

2. Volatile Food includes rice, meat, fresh fish and sea food, coconuts, fresh fruits, vegetables, potatoes, onions and selected condiments.

The impact of the changes in government taxes in May 2016 on the increase in food prices was marginal.

Food Inflation

- **Year-on-year food inflation exhibited an overall increasing trend during the first nine months of 2016.** This increase could be largely attributed to the increase in Volatile Food prices while the prices of imported food also increased during the period. Food inflation remained benign during the first two months of 2016 due to the decline in Volatile Food prices, with improved supply conditions and the high base that prevailed in the corresponding period of 2015. From March 2016 onwards, food inflation increased until June 2016 due to continued weak domestic food supply conditions coupled with the low base effect. Food prices declined gradually with the arrival of the harvest to the market and food inflation began to subside from July 2016.

Price Movements in the Non-food Category

- **Price behaviour of sub groups in the Non-food category exhibited mixed directions.** Prices in Clothing and Footwear; Health; Communication; Recreation and Culture; and Education sub-groups recorded significant increases during first nine months of 2016 compared to the same period of the previous year. Increases in Health and Communication sub-groups could be largely attributed to the changes in government taxes implemented in May 2016. Meanwhile Furnishings, Household Equipment and Routine Household Maintenance; Transport; and Miscellaneous Goods and Services sub-groups recorded marginal increases. Nevertheless, Housing, Water, Electricity, Gas and other Fuels sub-group recorded a marginal decline. This was due to the downward revision of the administered prices of LP Gas and Kerosene on several occasions during the latter part of 2015. Meanwhile, bus fares were also revised upward by 6 per cent with effect from 01 August, 2016.

Non-food Inflation

- **Year-on-year non-food inflation moved on mixed directions during first nine months of 2016.** Non-food inflation increased in February 2016 mainly due to low non-food prices that prevailed during the same period of 2015. Thereafter, non-food inflation moderated until April 2016. Non-food inflation increased with the changes in government taxes in May 2016. This increase was prominent in items in the Health and Communication sub-groups. Nevertheless, subsequent to the suspension of the changes in government taxes in July, prices of items in Health and Communication categories declined.

Producer Price Inflation

- **Producer price inflation exhibited an overall increasing trend during the first half of 2016, albeit mostly remaining in the negative territory.** Producer price inflation is measured by the year-on-year change in the Producer's Price Index (PPI) (2013 Q4=100), which is compiled by the Department of Census and Statistics. The year-on-year changes in the Agriculture and Manufacturing sub-indices exhibited overall increasing trends with some volatility. Year-on-year producer price inflation largely followed the trend of the Agriculture sub-index during the period, which was also observed in consumer price inflation. Meanwhile, the year-on-year change in Electricity and Water (Utilities) sub-index moved on an increasing trend from January 2016 to April 2016 and declined thereafter where the decline in June 2016 was substantial. This decline in June 2016 was mainly due to the base effect where the cost of production increased with the high level of thermal power generation in the Production, Collection and Distribution of Electricity sub category.

Impact of Fiscal Policy Measures on Prices

- **There were several fiscal policy measures that exerted a direct impact on consumer prices during the period under review.** The Value Added Tax (VAT) rate was increased from 11 per cent to 15 per cent in May 2016. With this increase, the VAT exemptions for several sub categories in the consumer price index baskets including Health, Communication and Education were removed. This caused the prices in these sub categories to increase and this increase was observed in the relevant subgroups of Health and Communication subgroups of both the CCPI and the NCPI. However, subsequent to the Supreme Court interim order, the VAT increase was suspended in July 2016. Nevertheless, a full downward adjustment in prices was not observed in response to the suspension of the VAT increase. Meanwhile, to mitigate the effect of the increase in cost of living, the government announced ceiling prices for 16 essential food items through the Ministry of Industry and Commerce in mid July 2016. Moreover, the Special Commodity Levy (SCL) of several imported food commodities were revised on several occasions to balance supply side developments. SCL on imported commodities such as potatoes, red onions and big onions were increased to discourage imports during the harvesting seasons for the benefit of local farmers. Furthermore, the SCL on imported sugar was reduced substantially when the price ceiling was announced, to maintain prices in the retail market.

Demand Side Developments

- **The expansion in credit to the private sector and the increase in wages in the economy, leading to a rise in real incomes, particularly during 2015 and the early part of 2016 contributed to some degree of demand side pull on prices.** Credit to the private sector grew at higher rates in the past couple of years in response to the conducive monetary policy environment that prevailed since late 2012. Wages in the economy also increased at higher rates, particularly in the public sector during 2015. Wages in the informal private sector also followed the trend in public sector wages.

Inflation Expectations

- **Inflation expectations showed some degree of response to monetary and fiscal policy changes introduced during the first nine months of 2016.** Near term inflation expectations remained stable and low within the corporate sector surveyed during the year. Within the household sector, near term inflation expectations remained comparatively higher but at a stable level. Near term inflation expectations of both categories of respondents increased in response to the changes in government taxes in May 2016. The imposition of the ceiling price for 16 essential items in July 2016 had no significant effect on reducing inflation expectations, albeit stabilising expectations. Inflation expectations surveyed for 6 to 12 month periods ahead for the corporate sector continued a moderately increasing trend from the last quarter of 2015. Nevertheless, with the policy rate changes introduced in February 2016 and July 2016, corporate sector expectations on 12 months ahead inflation appear to have moderated.

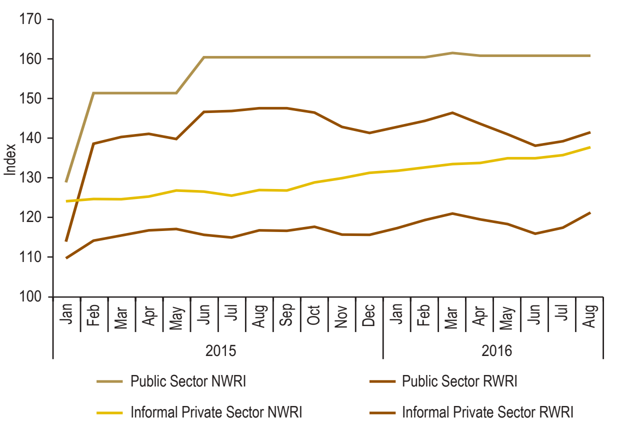
Wages

- **Wage pressures in the economy show signs of moderation subsequent to significant increases observed in wages during 2015 and the early part of 2016.** Growth in wages, amid low unemployment levels signal that the labour market is operating close to its potential. However, high rates of unemployment among youth and educationally qualified persons signal that there are some structural deficiencies in the labour market.

- **There were significant policy changes introduced with respect to wages in the public and private sectors during the period under review.** A new public sector salary circular[3] was issued to implement new salary scales and the addition of the Rs. 10,000/- interim allowance introduced in 2014 and 2015 to the basic salary in five phases starting from 01 January 2016. The actual changes in public sector wages were observed from March 2016. For the private sector, a National Minimum Wage[4] of Rs. 10,000/- was legalised with effect from 01 January 2016. Furthermore, the coverage of the workers eligible for the Budgetary Relief Allowance[5] was also expanded by increasing the ceiling from Rs. 20,000/- to Rs. 40,000/- in 2016.

- **The average nominal wage rate index of public sector (2012=100) employees increased by 5.8 per cent during the first eight months of 2016.** This increase in wages was due to the stepwise increase in the interim allowance to Rs. 10,000/- effected during the first eight months of 2015 and the inclusion of a portion of the interim allowance to the basic salary, which yielded a higher average wage index for the first

Chart 4.3 Movements in Nominal (NWRI) and Real (RWRI) Wage Rate Indices (2015-2016)



eight months of 2016 compared to the same period of 2015. Meanwhile, the real wages of public sector employees also increased by 2.0 per cent during the first eight months of 2016. It is noteworthy that nominal and real wages in the public sector grew by 31.8 per cent and 26.9 per cent respectively, during the corresponding period of 2015.

- **Wages of private sector employees increased during the first eight months of the year.** Nominal wages of informal private sector employees increased by 7.0 per cent during the first eight months of 2016 compared to the 7.9 per cent increase recorded during the same period of 2015, as measured by the informal private sector wage rate index (2012=100). Nominal wages of the three main economic activities namely; Agriculture, Industry and Services increased by 5.5 per cent, 7.8 per cent and 6.9 per cent respectively, during the first eight months of 2016. Meanwhile, real wages in the informal private sector increased by 3.2 per cent during the first eight months of 2016. Real wages of employees in Agriculture, Industry and Services activities increased by 1.7 per cent, 4.0 per cent and 3.1 per cent respectively, during the first eight months of 2016. Meanwhile, wages in the formal private sector also increased during the first half of the year, as revealed by

3. Public Administration Circular 03/2016
4. National Minimum Wage of Workers Act No 3 of 2016
5. Budgetary Relief Allowance of Workers Act No 4 of 2016

Table 4.1 Labour Force, Employment and Unemployment (a) (b)

Item	2015 (c)		2016	
	H1	Year	H1	Projections
Household Population, '000 (Age 15 years and above)	15,266	15,282	15,383	15,420
Labour Force, '000	8,223	8,214	8,256	8,172
Employed, '000	7,844	7,831	7,892	7,805
Unemployed, '000	379	383	364	368
Labour Force Participation Rate (% of Household Population)	53.9	53.8	53.7	53.0
Unemployment Rate (% of Labour Force)	4.6	4.7	4.4	4.5

(a) In July 2016, the Department of Census and Statistics published a re-weighted and revised labour force data series for 2011 onwards.
(b) Provisional
(c) Revised

Sources : Department of Census and Statistics
Central Bank of Sri Lanka

the Business Outlook Survey conducted by the Central Bank. This increase in wages was observed across all three economic activities.

Labour Market Trends

- **Labour market indicators signal an improvement in employment and persistent gaps in required skill levels.** Low unemployment rates with increasing wage pressures taken alone indicate that the labour market is operating close to its capacity. On the other hand, business sentiment surveys conducted by the Central Bank indicate that there is a persistent shortfall in the availability of both skilled and unskilled labour for private sector firms. Employers' intention to hire labour was mostly positive over the past couple of years, while the employment level existing in firms fell short of the desired level to carry out routine operations. These developments along with the high unemployment rates among youth and educationally qualified persons indicate that there is a structural issue in the domestic labour market.

Labour Force

- **According to the Quarterly Labour Force Survey (QLFS) conducted by the Department of Census and Statistics (DCS), covering the entire island, the labour force, which consists of the economically active population aged 15 years and above, increased by 0.4 per cent to 8.256 million persons in the first half of 2016, from 8.223 million in the corresponding period of 2015[6].** Increase in the labour force was mainly due to the increase of male entrants to the labour force. This increase in the economically active male population was due to increased participation in Urban and Rural sectors, while the economically active male population declined in the Estate sector. Female labour force participation in all three sectors, namely; Urban, Rural and Estate declined during the observed period.

- **The labour force participation rate (LFPR), which is the ratio of the labour force to the household population aged 15 years and above, decreased marginally to 53.7 per cent in the first half of 2016 compared to 53.9 per cent in the corresponding period of 2015.** The decrease was mainly due to the decrease in female LFPR from 36.4 per cent in the first half of 2015 to 35.7 per cent in the first half of 2016

6. Subsequent to the Census of Population and Housing conducted by the Department of Census and Statistics (DCS) in 2012 covering the entire island, the Labour Force Survey (LFS) estimates were re-weighted for the first time in Sri Lanka by the DCS, using rebased Mid-Year Population Estimate (MYPE) published by the Registrar General Department (RGO). The intention behind re-weighting was to keep LFS estimates in line with the latest population data as practiced by many other countries. The analysis is based on the said re-weighted LFS Estimates.

while male LFPR increased from 74.3 per cent in the first half of 2015 to 75.2 per cent in the first half of 2016.

Employment

- **The number of employed persons increased marginally by 0.6 per cent to 7.892 million in the first half of 2016 compared to 7.844 million in the corresponding period of 2015.** The increase in the number employed was mainly due to the 4.5 per cent increase in the number engaged in Industry activities and 4.1 per cent increase in the Services activities, compared to the first half of 2015. With the growth in Industry and Services sector activities during the first half of 2016, the capacity to absorb additional labour increased in these sectors. Nevertheless, the number employed in Agriculture activities declined by 8.1 per cent in the first half of 2016 compared to the same period of 2015, with the decline in the economic growth of agriculture related activities driven by adverse weather conditions. The Services sector continued to be the foremost employment generator accounting for a 46.6 per cent share of total employment. Agriculture and Industry sectors contributed to 26.8 per cent and 26.5 per cent of total employment, respectively.

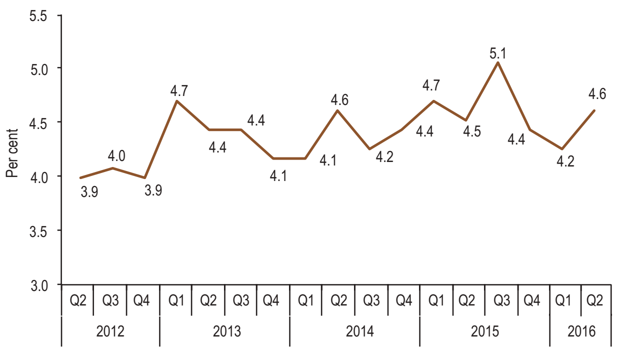
- **In terms of employment status, the number employed in the employer and private sector categories increased while those in the self-employed, public sector and contributing family worker categories declined.** The number employed in the private sector increased by 3.9 per cent, while the number of employers increased by 2.1 per cent in the first half of 2016 compared to the same period of the previous year. The self-employed and public sector employees categories declined by 1.1 and 2.4 per cent respectively. The number of contributing family workers declined by 3.8 per cent. This is due to the deceleration in economic activities in the Agriculture sector, in which the majority of persons considered under the contributing family worker category are employed. Except for contributing family workers, more than 50 per cent of the number employed in all other categories were engaged in Non-Agriculture related activities.

- **As per the Semi-annual Public Sector Employment Survey conducted by the Central Bank of Sri Lanka, public sector employment stood at 1.386 million as at the end of the first half of 2016.** The semi-government sector accounted for 17.4 per cent of the total public sector employment, while other types of government institutions accounted for the remaining 82.6 per cent. Ministries, departments and provincial councils accounted for 10.2 per cent, 40.2 per cent and 29.1 per cent of the total public sector employment respectively. District secretariats and divisional secretariats accounted for 3.1 per cent of the total public sector employment.

Unemployment

- **The unemployment rate declined to 4.4 per cent in the first half of 2016 compared to 4.6 per cent in the corresponding period of the previous year.** The total number of unemployed persons during the period under review was estimated at 0.364 million compared to 0.379 million recorded in the same period of the last year, recording a decline of 4.1 per cent. The male unemployment rate increased to 3.1 per cent during the period under review compared to 2.9 per cent in the same period of the previous year. The female unemployment rate in Sri Lanka continues to remain at high levels and is twice the male unemployment rate, amid comparatively low female LFPRs. This is due to the lack of opportunities to

Chart 4.4 Unemployment Rate (2012-2016)



work on a part-time basis or on flexible hours due to family commitments. Such options are rare in the Sri Lankan job market.

- **Notable disparities were observed across age wise unemployment rates.** Youth[7] unemployment continues to remain at a significantly high level of 21.8 per cent in the first half of 2016. Labour force participation by persons in this age group was substantial with over one million persons. The unemployment rate among persons in the 25-29 years age category was also 8.8 per cent. Nevertheless, age groups between 30-39 years and 40 years and above recorded relatively low unemployment rates of 2.4 per cent and 0.8 per cent respectively, during the first half of 2016.

- **In terms of education level, the highest unemployment rate of 8.2 per cent was reported among persons with GCE (A/L) and higher level of educational attainment.** It is pertinent to note that this group continuously records high unemployment rates of all categories. This can be attributed to issues of skills mismatch, variations in expected and actual remuneration packages, reluctance to accept employment opportunities which are considered to be unfitting with their social status and past breaks in the employment history. It could also be the preference to be employed in the public sector with conventional social security arrangements and other benefits rather than seeking an opportunity in the private sector. Meanwhile, the unemployment rate among persons with 6-10 years of schooling increased to 3.4 per cent from 3.3 per cent, while it declined to 5.8 per cent among those who have passed GCE (O/L) from 6.5 per cent in the same period of the previous year.

Foreign Employment

- **Foreign employment continued to be one of the main foreign exchange earners for the country despite a 10.2 per cent decline in departures for foreign employment observed during the first half of 2016, compared to the corresponding period of 2015.** The geo-political situation in the Middle East, the economic slowdown in major oil exporting countries and also the measures taken to streamline departures under the housemaid category by government authorities led to the decline in departures for foreign employment. Female departures declined by 12.3 per cent, while male departures declined by 9.0 per cent during the first half of 2016.

- **With regard to skill categories, worker departures under the Professional and Middle Level categories increased while departures for all other categories declined.** Compared to the first half of 2015, departures under the Middle Level category increased by 12.9 per cent, while departures under the Professional category increased by 7.6 per cent during the first half of 2016. Departures under Clerical and Related; and Housemaid categories declined by 21.7 per cent and 13.0 per cent respectively in the first half of 2016 compared to the same period of 2015. Measures taken to encourage departures under higher skill categories need to be further strengthened to sustain the growth in remittance inflows in future.

7. Age between 15-24 years

- **The Sri Lanka Bureau of Foreign Employment (SLBFE) issued licenses for 50 new foreign employment agencies and renewed 465 licenses of existing agencies during the first six months of 2016.** Nevertheless, the SLBFE statistics showed a considerable increase in the share of departures for foreign employment through private sources to 61.7 per cent during the first half of 2016 from 52.7 per cent in the previous year. If this trend continues, the process of monitoring, regulating the labour migration process and ensuring worker welfare would become a challenge in future.

- **Furthermore, the SLBFE continues to implement measures under the National Labour Migration Policy.** Measures were taken to combat human trafficking through setting up a Counter Human Trafficking Unit in 2016 and island wide awareness programmes are expected to be conducted by SLBFE. SLBFE conducted 122 raids on illegal recruitment activities during the first six months of 2016 and filed 197 court cases against illegal and licensed agencies which violated the law in order to ensure trustworthy foreign employment for Sri Lankan migrants.

Labour Relations

- **As per the statistics on strikes reported to the Labour Department, labour relations improved in terms of the number of man-days lost due to strikes, which declined by 25.5 per cent to 19,571 in the first half of 2016 from 26,258 in the corresponding period of 2015.** The number of strikes in private sector firms also declined from 22 to 12 during the period. The decline in the number of strikes were observed in both Plantation and other sectors. Nevertheless, workers involved in strikes increased from 5,257 to 7,418 in the first half of 2016 compared to the corresponding period of the previous year.

- **In order to enhance industrial harmony, a number of programmes were implemented by the Ministry of Labour and Trade Union Relations during the period under review.** Accordingly, the Ministry was continuously involved in activities to improve workplace co-operation and industrial peace in the private sector. Meanwhile, the National Minimum Wages of Workers' Act, No 3 of 2016 and the Budgetary Relief Allowance of Workers Act, No 4 of 2016 were passed in Parliament in March 2016.

Labour Productivity

- **As per the provisional National Accounts and Employment estimates, Labour productivity as measured by Value Added (in 2010 prices) per hour worked increased marginally by 0.6 per cent to reach Rs. 460.91 in the first half of 2016 compared to Rs. 458.00 in the corresponding period of 2015.** The Services sector exhibited the most efficient use of labour resources recording the highest productivity level of Rs. 556.84 per hour worked. The Industry sector recorded a productivity level of Rs. 497.34. The Agriculture sector registered the lowest productivity level of Rs. 179.29 per hour worked during the period observed.

Expected Developments

Prices

- **Inflation is expected to remain around mid-single digit levels during the remainder of 2016 and in the medium term.** Well anchored inflation expectations, the forward looking approach of monetary management and favourable domestic supply conditions are expected to help maintain the general price level at benign levels. Nevertheless, against such favourable developments, there is some degree of upward pressure on prices emanating from several factors. With the possible reversal of the declining trend in international prices of consumer goods and the weakening of the domestic currency, inflationary pressure caused by price movements of imported items could rise. Furthermore, if the suspension of the changes in government taxes is removed and the coverage of goods falling into the tax net is expanded, both food and non-food inflation will increase. Among the non-food categories, Health, Communication and utilities increased in May 2016 with changes introduced to the government taxes and declined with the suspension of the same measures. The possible weather related developments would also cause supply disruptions of fresh food items, particularly vegetables and fish, which could lead to an increase in volatile food inflation.

Wages and Productivity

- **The weakening of domestic currency will have a favourable impact on the export competitiveness through the low cost advantage while growth in real wages of the domestic labour market could counter the advantage.** Growth in real wages should be matched with growth in productivity over the long run to ensure cost competitiveness for producers. In order to cater to expanding access to international markets by domestic producers, production capacity and productivity have to be improved. Since production capacity cannot be expanded in the short term, the focus should be to improve productivity, particularly in the Agriculture sector. Hence, adjustments to wages need to be associated with productivity linked incentives to remain competitive in the international market.

Labour Force and Employment

- **Increase in LFPR among elderly persons (age 60 and above) points out active ageing, but it also signals, some degree of economic and social vulnerability.** Along with the higher life expectancy of Sri Lankans in comparison to regional peers, the widely accessible and quality medical facilities and declining fertility rates contribute towards an ageing population. Lack of adequate superannuation benefits and the psychological barriers to retire, push the ageing population in to the labour force. This is a positive trend in terms of the benefits of utilising their experience and expertise in economic activities, while keeping the elderly persons active and relieving the economic and social burden of their welfare. Nevertheless, this trend also points out the economic and social vulnerabilities of the elderly, which would aggravate with the imminent ageing population phenomenon burdening the working population in future.

- **The high level of unemployment among youth and females indicates the continuous availability of labour in the market for expansion in capacity utilisation, provided that adequate training and skill matching is available.** The education system of the country should offer more avenues along with entrepreneurship and technical and soft skills development with the intention of producing a quality workforce. Entrepreneurial skills can be developed among students since school age through projects during vacations to instil confidence in them. Lack of access to capital is also another issue to be solved in promoting young entrepreneurs. Although the educated youth are equipped with novel ideas, the capital constraints they face deter their ideas from materialising. Successful entrepreneurships will eventually increase the value addition in the economy, and also contribute to drain unemployment to a certain extent through the creation of multiple employment opportunities. Business startup assistance in financial and non-financial means would encourage new entrepreneurs to embark on their businesses with confidence. With the introduction of measures to discourage foreign employment under the housemaid category, the number of females seeking opportunities in the domestic labour market could increase. Female unemployment could be reduced if employers are willing to offer part-time or flexible working hour options and other often required amenities for female employees such as safe transport and accommodation.

- **There is a deficiency in the supply of both skilled and unskilled labour in the domestic market for the operation of private sector firms.** Employers have highlighted this issue continuously in the Business Outlook Survey conducted by the Central Bank. This issue has risen due to the continuous skills and perception mismatch between the demand and supply that has become embedded as a structural issue in the domestic labour market. To overcome this structural deficiency, the education system of the country needs to be modernised with a long term vision. Furthermore, encouraging the decentralisation of the operations of labour intensive firms to areas that have a relatively high labour supply would also contribute towards overcoming the labour supply deficiency issue.

- **The very high prevalence of chronic illnesses among persons who are in the age group of 15-59 years could lead to efficiency deteriorations in the economy in the long run.** According to the Self-Reported National Health Survey conducted by the DCS, the prevalence of chronic illnesses is high among the economically active population between 15-59 years of age. The health condition of economically active persons within the working age is important not only in one's personal perspective, but also in terms of the impact on the economy and the society at large. It is a known fact that many long-term health conditions occur during the working age, due to changes in lifestyle, low levels of physical activity and inadequate nutrition. Assessment of the health status among working age persons should be encouraged so that preventive treatments could be sought to mitigate the adverse economic and social impact of an unhealthy workforce.

5

EXTERNAL SECTOR DEVELOPMENTS

During the first half of 2016, the external sector experienced a mixed performance. The external trade account continued to be under pressure as the sluggish global economic activity and resultant lower global demand adversely affected exports, while the increase in consumer and investment imports more than offset the windfall from lower oil prices. As such, the deficit in the trade account widened by 2.2 per cent during the first half of 2016. The deficit of the primary income account also widened, albeit marginally, during this period. However, the surpluses recorded in the services and secondary income accounts, mainly due to the considerable expansion in earnings from tourism and continued workers' remittances, resulted in the narrowing of the external current account deficit to US dollars 795 million in the first half of 2016, from the deficit of US dollars 953 million recorded a year earlier.

Inflows to the financial account moderated during the first half of 2016. The slow recovery in the global economy amidst the increase in policy rates in December 2015 by the United States (US) Federal Reserve and the anticipation of a further rate hike resulted in an outflow of foreign investments from the government securities market and the Colombo Stock Exchange (CSE), particularly during the first four months of the year. A slowdown in exports and remittances, tepid foreign direct investment and a steady outflow of capital from the government securities market gave rise to an imbalance in the country's external sector, leading to a reduction in official reserves. This resulted in Sri Lanka entering into a three year programme of SDR 1.1 billion (approximately US dollars 1.5 billion) from the International Monetary Fund (IMF), under the Extended Fund Facility (EFF), to support the Balance of Payments (BOP) position and the government's economic reform agenda. The resultant improvement in investor sentiments generated by the country entering into the programme with the IMF and a delay in a further rate hike in the US led to a reversal in the outflow from the government securities market from April 2016. This, together with the proceeds of the International Sovereign Bond (ISB) and the syndicated loans, strengthened the financial account, thus improving gross official reserves of the country. Accordingly, gross official reserves stood at US dollars 6.5 billion, equivalent to 4.1 months of imports, as at end September 2016. Reflecting these developments, the overall balance of the BOP, which is the change in net international reserves, turned into a surplus of US dollars 243 million by end September 2016, from a deficit of US dollars 1,489 million by end 2015.

The external value of the Sri Lankan rupee remained relatively stable during the year up to end September, recording a depreciation of 1.8 per cent against the US dollar. On an aggregate basis, real effective exchange rate indices depreciated reflecting an improvement in the country's external competitiveness. Meanwhile, the Central Bank gradually turned into a buyer in the foreign exchange market since May 2016, thus replenishing the level of net international reserves, which is also a requirement under the IMF-EFF. However, increasing exports of both goods and services, and attracting non-debt creating financial inflows such as foreign direct investments are important requirements in reducing external sector imbalances and in achieving the envisaged macroeconomic targets over the medium-term.

Trade in Goods and Trade Balance

- **Both earnings from exports and expenditure on imports, which contracted in 2015, declined further during the first eight months of 2016.** However, overall trade deficit during the first eight months of 2016 expanded marginally by 1.6 per cent, year-on-year, due to the sharp decline in exports in comparison to imports. Accordingly, the deficit in the trade account during this period increased to US dollars 5,538 million from US dollars 5,449 million recorded during the same period of 2015.

- **Earnings from exports during the first eight months of 2016 declined by 4.1 per cent, year-on-year, to US dollars 6,865 million.** Agricultural exports followed by industrial exports contributed largely to this decline. The main factors that adversely affected Sri Lankan exports were geopolitical uncertainties and economic downturn that still prevails in Sri Lanka's major export destinations such as Russia and some of the Middle Eastern countries, restrictions imposed by the European Union for Sri Lankan fish exports until end June 2016, and substantial reduction in commodity prices in the international market.

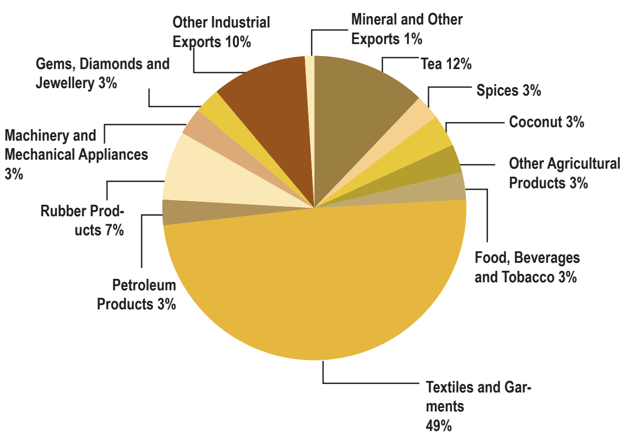
Chart 5.1 External Trade Performance

- **Earnings from agricultural exports declined significantly by 8.8 per cent, year-on-year, to US dollars 1,521 million during the first eight months of 2016, largely due to the decline in the prices of agricultural commodities in the world market.** Among agricultural exports, tea, spices and minor agricultural products contributed largely to this decline. Continuing the year-on-year declining trend, which began from the third quarter of 2014, export earnings from tea decreased by 7.3 per cent to US dollars 835 million during the first eight months of 2016, due to the combined outcome of a 2.1 per cent drop in tea export volumes and a 5.4 per cent reduction in the average export price of tea. The average export price of tea decreased to US dollars 4.23 per kilogram during the first eight months of 2016, from US dollars 4.47 per kilogram recorded in the corresponding period of 2015, as a result of weak demand from major tea importing countries. Earnings from spices, which recorded a robust growth in 2015, declined significantly by 22.1 per cent, year-on-year, in the first eight months of 2016, reflecting lower export volumes of cloves and pepper due to the lower harvest obtained so far this year, despite the significant improvement recorded in cinnamon exports. Earnings from minor agricultural exports declined by 21.8 per cent, year-on-year, during the first eight months of 2016, mainly due to the lower performance recorded in the export of arecanuts, cereals and betel leaves. However, earning from the exports of rubber grew by 17.2 per cent while earnings from coconut exports remained largely stable during the first eight months of 2016.

- **Earnings from industrial exports, which account for more than 75 per cent of the total exports, contracted by 2.6 per cent, year-on-year, to US dollars 5,315 million during the first eight months of 2016 mainly due to**

lower export earnings recorded for transport equipment and petroleum products. Export earnings from transport equipment declined by 63.2 per cent, year-on-year, during this period, mainly due to the base effect where a significantly higher level of exports recorded in the corresponding period of 2015, owing to the export of a dredger vessel that was imported in 2014 for the use of the Port City Development Project together with the export of two cruise ships to India and Australia. Export earnings from petroleum products, which mainly comprise bunker and aviation fuel, decreased significantly by 35.9 per cent, year-on-year, during the first eight months of 2016, partly due to the intense competition from major regional players such as India and Singapore. In addition, the poor performance in export earnings from gems, diamonds and jewellery, and rubber products also contributed significantly to the decline in industrial product exports. However, reversing the year-on-year declining trend, which began from the fourth quarter of 2014, earnings from textiles and garments exports, which accounted for 49 per cent of total export earnings, increased by 3.6 per cent during the first eight months of 2016. Garment exports to the traditional markets of EU and USA increased

Chart 5.2 Composition of Exports (January - August 2016)



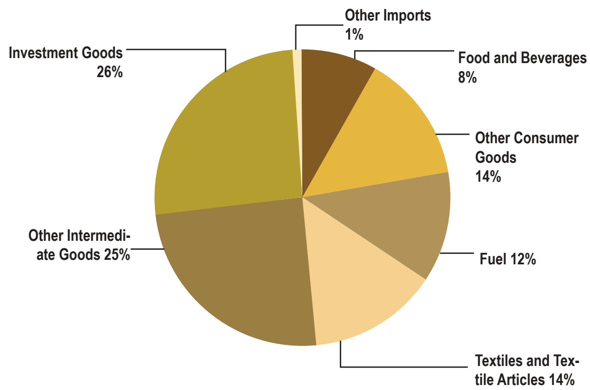
by 3.6 per cent and 1.7 per cent, respectively, while exports to non-traditional markets grew by 10.1 per cent during the period under review.

- **Expenditure on imports during the first eight months of 2016 declined by 1.6 per cent, year-on-year, to US dollars 12,403 million, despite the increase recorded in the expenditure on investment goods imports.** The substantial reduction recorded in commodity prices in the international market and policy measures adopted by the government to curtail vehicle imports largely contributed to the reduction in import expenditure. Expenditure on non-petroleum imports during this period, however, increased marginally by 1.2 per cent, year-on-year, to US dollars 10,902 million.

- **Expenditure on consumer goods imports reduced, reflecting the effect of policy measures adopted to manage import demand.** Imports of consumer goods, which accounted for about 23 per cent of total imports, declined by 10.1 per cent, year-on-year, to US dollars 2,825 million during the first eight months of 2016, reflecting reductions in import expenditure on both food and beverages, and consumer durables. Import expenditure on food and beverages declined by 7.6 per cent to US dollars 1,039 million, led by a reduction in the import expenditure on rice, followed by vegetables and dairy products. Expenditure on rice imports declined significantly by 94.4 per cent during the first eight months of 2016, reflecting the availability of rice in the local market due to the healthy paddy harvest in 2015 and the Maha season of 2016, as well as the impact of the increases in the import duty on rice in May 2015 and February 2016. With respect to consumer durable imports, import expenditure on personal motor vehicles decreased significantly by 39.5 per cent, year-on-year, to US dollars 547 million during the first eight months of 2016, mainly due to the increase in the import tariff applicable to motor vehicles, introduced by the government in the 2016 budget. Meanwhile, import expenditure on clothing and accessories, and printed materials and stationary also contributed towards reducing the import expenditure during the first eight months of 2016. However, expenditure on the importation of medical and pharmaceuticals, home appliances and household and furniture items, increased during the period under review.

- **Expenditure on the import of intermediate goods, which accounted for more than 50 per cent of total imports, declined by 2.1 per cent, year-on-year, to US dollars 6,309 million during the first eight months of 2016.** Lower expenditure incurred on fuel imports mainly contributed to this decline. Expenditure on fuel imports declined by 18.2 per cent, year-on-year, to US dollars 1,501 million during this period, mainly due to the reductions recorded in average import prices of all fuel categories despite the considerable increase in import volumes. As a result of the increase in the usage of motor vehicles and high level of thermal power generation due to adverse weather conditions, the volume of refined petroleum product imports increased by 11.6 per cent, while the crude oil import volume increased by 10.5 per cent. The average import price of crude oil was US dollars 43.44 per barrel during the first eight months of 2016 compared to US dollars 61.67 per barrel recorded in the corresponding period of 2015. Meanwhile, reflecting the year-on-year price reductions in the international market, import expenditure on base metals, fertiliser and wheat and maize dropped significantly by 23.4 per cent, 38.8 per cent and 23.2 per cent, respectively, during this period. However, in line with the high performance recorded in textiles and garments exports, import expenditure on textiles and textile articles increased by 14.0 per cent, year-on-year, to US dollars 1,765 million during the first eight months of 2016. Further, import expenditure on diamonds and precious stones and metals grew significantly by 128.0 per cent, year-on-year, mainly due to the substantial growth recorded in gold imports. Meanwhile, import expenditure on mineral products and vehicle and machinery parts also increased considerably during the period under review.

Chart 5.3 Composition of Imports (January - August 2016)

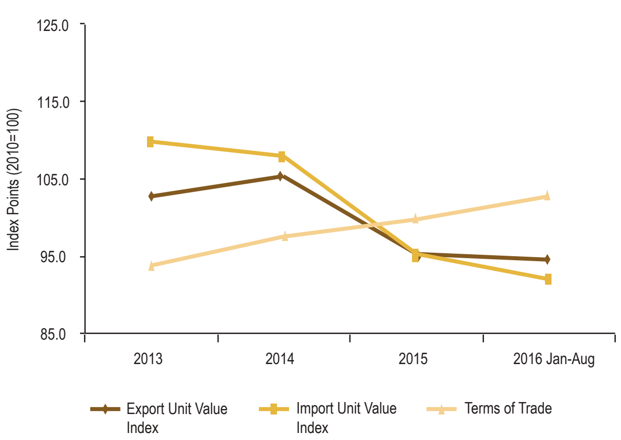


- **Signalling the possible favourable economic performance in the future, import expenditure on investment goods increased by 8.4 per cent to US dollars 3,260 million during the first eight months of 2016, despite the reduction in imports of transport equipment.** Import expenditure on machinery and equipment, and building materials increased substantially by 22.4 per cent and 21.4 per cent, year-on-year, respectively, during the first eight months of 2016. Imports expenditure on almost all sub categories of building materials as well as machinery and equipment, except engineering equipment, increased during the period concerned. However, reflecting the impact of policy measures adopted by the government to curtail vehicle imports, import expenditure on transport equipment declined significantly by 38.7 per cent, because of the decline in the imports of road vehicles, particularly, auto trishaws and buses.

Terms of Trade

- **The terms of trade for the first eight months of 2016, on average, increased to a more favourable level when compared to that of the corresponding period in 2015, owing to the sharper deterioration of import prices than export prices.** Reflecting the lower commodity prices in the international market particularly in fuel prices, the overall import price index declined by 5.9 per cent, year-on-year, to 92.0 index points during the first eight months of 2016. In addition, import price indices pertaining to base metals, wheat and maize, and cereals and milling industry products also contributed considerably to the decline in the overall import price index. Meanwhile, the overall export price index declined by 3.6 per cent, year-on-year, to 94.5 index points during the first eight months of 2016, as a result of the decline in prices of all major categories of exports. Accordingly, the terms of trade, improved by 2.4 per cent on

Chart 5.4 Terms of Trade and Trade Indices



average to 102.7 index points during the first eight months of 2016 in comparison to the corresponding period in 2015. However, the terms of trade, excluding oil-related products, declined by 1.6 per cent.

Trade in Services

- **The surplus in the services account continued to grow during the first half of 2016.** The services account of the BOP, which mainly consists of travel, transport and telecommunication, computer and information services, recorded a surplus of US dollars 1,228 million during the first half of 2016 compared to the surplus of US dollars 1,059 million in the corresponding period of 2015, with a higher contribution from the travel and transport sub sectors.

- **Gross inflows to the transportation sector continued to increase.** Gross earnings from transportation services, which consist of passenger fares, freight charges, and port and airport related activities, recorded a growth rate of 5.9 per cent to US dollars 1,118 million during the first half of the year. During this period, inflows on account of passenger fares increased by 9.8 per cent to US dollars 552 million, in line with the increased number of passengers traveling to Sri Lanka, mainly through SriLankan Airlines. Further, the increase in the number of destinations and frequency of flights, especially to the Middle East and the Far East, contributed towards the increased earnings in this sector. However, the downward revision of airfares by airlines operating in Sri Lanka, due to the fall in aviation fuel prices, dampened earnings from passenger fares. Meanwhile, inflows on account of freight and port and airport related activities increased by 2.3 per cent to US dollars 566 million, due to the improved performance in cargo and container handling and related services. The Sri Lanka Ports Authority (SLPA) has taken several steps to expand warehouse facilities at the Colombo Port, including the opening of a new warehouse centre in August 2016. With the opening of this warehouse centre, operation facilities of cargo and transhipment of cargo are expected to expand further. Meanwhile, Sri Lanka entered into a Memorandum of Understanding (MOU) with Singapore in June 2016 to develop the Trincomalee harbour as a port city, which will include an industrial zone. Further, the government has called for expression of interests from prospective investors to enhance operations of the Mattala Rajapaksa International Airport (MRIA), especially in warehousing, transhipment and refuelling, which would help in attracting both cargo and passenger airlines.

- **The Sri Lankan tourism industry has been experiencing rapid expansion and diversification, to become one of the largest and fastest-growing sectors of the post conflict economy.** The total tourist arrivals increased to 1,508,405 reflecting an impressive growth rate of 14.6 per cent, year-on-year, during the first nine months of 2016, led by increased arrivals from China and India. This reflects a 69 per cent achievement of the annual target of 2.2 million arrivals for 2016. Tourist arrivals from Western Europe dominated the arrivals with the highest contribution to the growth, mainly from the UK, Germany and France during the first nine months of 2016. Tourist arrivals from East Asia grew by 18.6 per cent, year-on-year, during the first nine months of 2016, led mainly by the 29.2 per cent growth of arrivals from China. Arrivals from Eastern Europe and the Middle-East showed a relatively low growth due to the possible deceleration in their income resulting from the significant decline in oil prices.

Chart 5.5 Tourist Arrivals and Earnings from Tourism

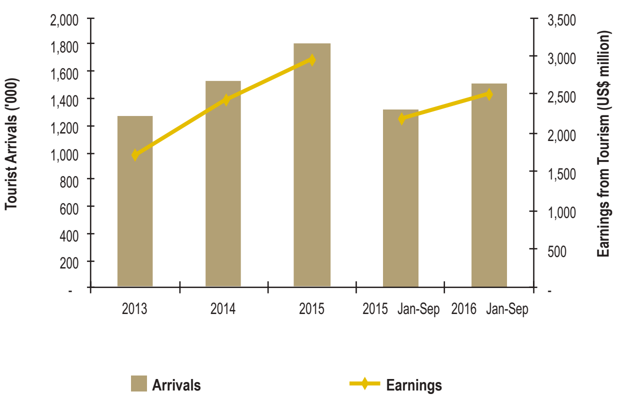
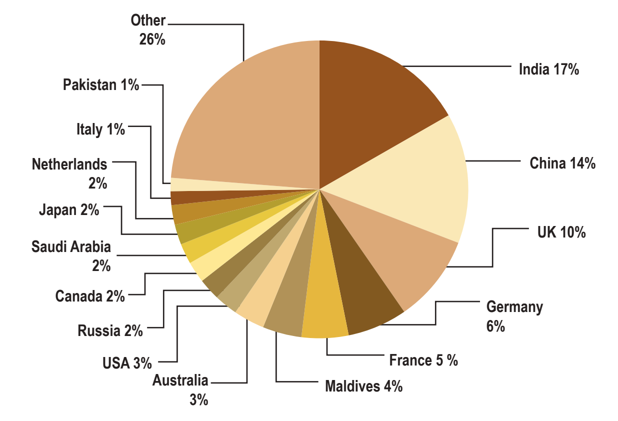


Chart 5.6 Tourist Arrivals by Country (January - September 2016)



- **Earnings from tourism continued to record a significant growth during the first nine months of 2016.** Accordingly, total earnings from tourism during the first three quarters of the year grew by 14.6 per cent, year-on-year, to US dollars 2,500 million, compared to the cumulative earnings of US dollars 2,181 million during the corresponding period of 2015. Tourist earnings are expected to increase during the latter part of the year with a higher number of tourist arrivals during the peak tourist season, supported by tourism promotional activities.

- **Investment in the tourism sector also expanded further during the first seven months of 2016.** The tourism sector has been experiencing an impressive growth after the restoration of peace in the country. As a result, investor confidence has grown immensely, which has led to investments from international hotel brands such as Shangri-La, Sheraton, Marriott, Grand Hyatt, Movenpick, RIU, ITC and Onyx. Meanwhile, proposals for 46 new hotel projects worth US dollars 439 million, with room capacity of 2,700, were received by the SLTDA during the first seven months of 2016. Further, 29 new hotel projects were given final approval to set up with an investment of US dollars 89 million by the SLTDA during this period. These new hotel projects will help the government to achieve its target of building 75,000 rooms to cater to the projected 4.5 million tourist arrivals by 2020.

- **Several measures were taken towards the advancement of the tourism industry during the first six months of 2016.** These measures aims at the gradual diversification of the tourism industry into niche markets and the development of non-traditional areas, such as MICE (Meetings, Incentives, Conferences and Exhibitions) tourism, cruise tourism, wedding tourism, film tourism, etc., also contributed towards the growth of the sector. A new classification for tourist hotels was introduced by the Sri Lanka Tourism Development Authority (SLTDA) in April 2016, under the Extraordinary Gazette No.1963/28, replacing the earlier classification presented in 1966. Under the new classification requirement, all tourist hotels registered with SLTDA are required to have a star classification, which will have to be reviewed every 3 years. Star classes are granted under classification standards based on a combination of mandatory requirements, minimum number of rooms and an additional point-based system on non-mandatory criteria. Further, as per the budget proposal for 2016, a programme for the absorption of the informal sector into the formal sector of tourism industry was launched. Under this programme, all the informal sector tourist establishments will be inspected and absorbed into the formal sector. Also, the SLTDA re-launched its "Tourism Mobile Service", which delivers various services such as hotel inspection, issuance of business licenses and, tourism training and conducted such services in areas of Arugam bay, Passikudah and Mannar with the financial support of the International Finance Corporation (IFC). Recognising the importance of tourism promotion in enhancing tourist arrivals to the country, the Sri Lanka Tourism Promotion Bureau (SLTPB) participated in 21 trade fairs and 7 road shows in countries with high tourism potential during the first half of 2016. Under the Visiting Journalists and Bloggers Programmes, 48 journalists and 6 bloggers were hosted during the period. Overall, there were 211 activities conducted, incurring Rs.359 million, during the first half of 2016 by the SLTPB, which will help to achieve the targeted tourist arrivals for 2016. As a result of targeted tourism promotion campaigns, Sri Lanka received further endorsements from world renowned tourism related magazines and organizations such as Dream Trips, Condenast traveller magazine of France, Fox news website and Association of British Travel Agents, etc

- **Earnings from telecommunication, computer and information services showed a steady growth during the first half of 2016.** Total earnings from the export of telecommunications, computer and information services amounted to US dollars 442 million in the first half of 2016 compared to the US dollars 410 million during the corresponding period of 2015. Following this trend, gross inflows from the export of software and Information Technology Enabled Services (ITES), such as Business Process Outsourcing (BPO) and Knowledge Process Outsourcing

(KPO), are also estimated to have increased. Accordingly, gross inflows to the computer and information services sub sector increased by 7.6 per cent to US dollars 373 million during the first half of 2016 compared to the US dollars 346 million recorded in the corresponding period of 2015. Sri Lanka is now emerging as a centre for Information Technology (IT), BPO and KPO services, expanding beyond traditional 'software development' to large scale IT processing centres in the areas of accounting, engineering, communication as well as KPOs in the fields of architecture and legal services.

Primary Income

- **The deficit in the primary income account increased marginally in the first half of 2016.** The primary income account deficit amounted to US dollars 955 million during this period compared to the US dollars 925 million recorded in the first half of 2015. The deficit in the primary income account is gradually increasing with the rise in interest payments for outstanding foreign liabilities, particularly of the government, and the lower interest income amidst the backdrop of low interest rates across the globe. Outflows on account of dividend payments increased with higher dividend payments by direct investment enterprises, indicating higher profits earned by these enterprises. However, interest payments on portfolio investments declined with a significant reduction in outstanding Treasury bonds held by non-residents during the period. Further, interest payments on project loans by the government increased while that on private sector and State Owned Business Enterprises (SOBEs) declined during the first half of 2016. Over the past few years, it is noted that the financial instrument mix used in government external financing has changed structurally with more of the government financing coming from the issuances of ISBs and Sri Lanka Development Bonds (SLDBs) compared to the traditional project loans. Meanwhile, inflows to the primary income account declined marginally during the period, with a reduction in earnings from investments in reserve assets.

Secondary Income

- **Surplus in the secondary income account, which comprises workers' remittances and government transfers, increased in the first half of 2016.** Net inflows to the secondary income account increased to US dollars 3,146 million in the first half of 2016 compared to US dollars 3,035 million in the corresponding period of 2015. During this period, workers' remittances increased by 5.3 per cent over the relatively low base recorded in 2015. The comparatively low growth in workers' remittances could be attributed to the drop in income in oil exporting Middle Eastern countries with the decline in international oil prices. Further, the reduction in labour migration under the skilled, semi-skilled and unskilled categories, including house-maids, during the year, by 10.5 per cent compared to the previous year, may also have contributed to the low growth in remittance inflows. Policy measures that have been taken to discourage unskilled female migrants have mainly contributed to the decline in labour migration under the unskilled category. However, based on the data provided by the Sri Lanka Bureau of Foreign Employment, labour migration under the professional category had increased by 7.6 per cent during the first half of the year, continuing the gradual compositional change in workers' remittances observed over the past few years. On a cumulative basis, workers' remittances up to August 2016 amounted to US dollars 4,804 million, registering a growth of 4.5 per cent over the corresponding period of 2015.

Current Account Balance

- **Sri Lanka's current account deficit narrowed in the first half of 2016 to US dollars 795 million, declining by around 16.6 per cent from the corresponding period of 2015.** The moderation in the current account was supported mainly by the services and secondary income accounts. Meanwhile, the trade deficit widened in the first half of 2016 on account of the decline in export earnings, mainly due to the subdued performance in the exports of transport equipment, petroleum products, tea and spices. However, a substantial increase in the trade deficit was largely abated by the decline in the import expenditure driven by the drop in the expenditure on fuel, transport equipment and personal motor vehicles, thereby resulting in the merchandise trade deficit recording a marginal increase of 2.2 per cent in the first half of 2016 over the corresponding period in 2015. The deficit in the primary income account also widened during the year up to end June. However, the deficits in the trade and primary income accounts were partially offset by the surplus in the services account, which was mainly driven by high inflows in the travel and transport sub sectors, and the surplus in the secondary income account, which mainly consist of workers' remittances. Overall, these developments resulted in the current account deficit moderating to US dollars 795 million in the first half of 2016 compared to a deficit of US dollars 953 million a year earlier.

Capital Account Balance

- **The capital account recorded a deficit in the first half of 2016.** During this period, capital grants to the government decreased with receipts of US dollars 8 million compared to US dollars 33 million in the first half of 2015. Consequently, the capital account recorded a net outflow of US dollars 2 million in the first half of 2016 in comparison to a net inflow of US dollars 29 million in the corresponding period of 2015.

Financial Account

- **Both net incurrence of liabilities and net acquisition of financial assets declined significantly in the first half of 2016.** Higher net incurrence of liabilities, relative to net acquisition of assets, resulted in net borrowings amounting to US dollars 967 million in the first half of 2016 compared to US dollars 667 million in the corresponding period in 2015.

- **The decline in the acquisition of assets during the first half of 2016 primarily reflected the significant decline in reserve assets.** The total net acquisition of financial assets declined by US dollars 1,882 million in the first half of 2016 compared to an increase of US dollars 419 million in the same period in 2015. The decline in the acquisition of assets during the first half of 2016 was primarily due to the significant decline in reserve assets. Meanwhile, currency and deposit assets of deposit-taking corporations also witnessed a reduction of US dollars 134 million during the period. Further, trade credit and advances given by Sri Lankan exporters to non-residents increased by US dollars 95 million during the first half of 2016.

- **Net incurrence of liabilities also recorded a reduction in the first half of 2016.** Foreign investor sentiments remained subdued with the slow recovery of the global economy and the increased policy rates of the US Federal Reserve, which prompted continuous outflows of foreign investments in government securities, as in other emerging economies, especially during the first four months of 2016. This resulted in a net outflow of foreign investments from the CSE of US dollars 45 million and a significant net outflow of US dollars 373 million of Treasury bonds, while receiving only a small net inflow of US dollars 2 million as foreign investment in Treasury bills in the first half of 2016. Meanwhile, external borrowings by the government for project loans increased with a net inflow of US dollars 354 million during the first half of 2016 compared to US dollars 147 million in the corresponding period in 2015. However, total contribution of the banking sector, corporate sector and SOBEs to the financial account remained modest during the first half of 2016, but foreign loans to deposit-taking corporations continued to remain high, with an inflow of US dollars 425 million in the first half of 2016 compared to US dollars 449 million a year earlier. Meanwhile, net loan inflows to the private sector and SOBEs amounted to US dollars 37 million compared to a net inflow of US dollars 79 million during the first half of 2015. Further, trade credits and advances received by Sri Lankan companies, primarily by Ceylon Petroleum Corporation, reduced by US dollars 45 million during the first half of the year.

- **The Central Bank continued to repay the IMF loan under the Stand by Arrangement (SBA) and engaged in swaps with the Reserve Bank of India (RBI) and under the SAARCFINANCE arrangement during the first half of 2016.** Repayments under the IMF-SBA facility amounted to US dollars 264 million during the first half of 2016. Meanwhile, Sri Lanka repaid the US dollars 1,100 million swap obtained from the RBI in March 2016. This was followed by a new swap under the SAARCFINANCE arrangement of US dollars 400 million and a swap arrangement of US dollars 700 million with the RBI. However, the US dollars 700 million swap facility obtained from the RBI was settled in June 2016 with the receipt of the first tranche of the IMF-EFF. The Central Bank also made net transactions on Asian Clearing Union (ACU) liabilities amounting to US dollars 34 million during the first half of 2016.

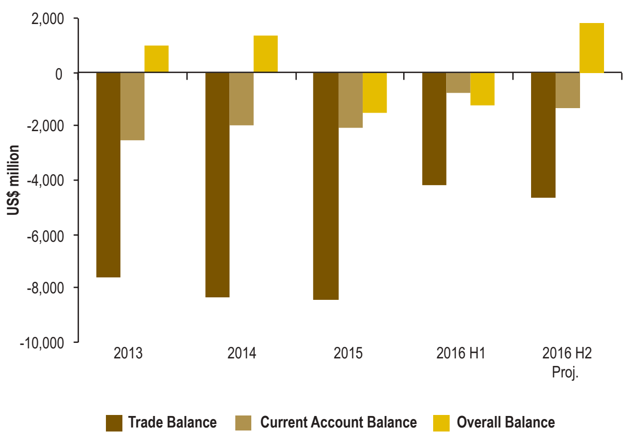
- **Inflows in the form of foreign direct investments (FDI) remained subdued during the first half of 2016.** Total FDI related inflows, which include foreign borrowings of BOI companies for investment purposes, declined to US dollars 336 million during the first half of 2016 compared to US dollars 534 million recorded during the corresponding period of 2015. Inflows from direct investment, excluding foreign borrowings of BOI companies, amounted to US dollars 216 million during the period, compared to US dollars 268 million recorded in the first half of 2015. There were limited inflows as direct investments in the form of new projects, while ongoing key projects also received only moderate levels of direct investments. Major direct investment inflows during the period were channelled to telecommunication, tourism and manufacturing sectors.

- **In the backdrop of continuing pressure on external sector stability and spillover effects of the unfavourable global economic environment, Sri Lanka obtained a three year EFF from the IMF in June 2016.** The overall objective of the EFF supported economic programme is to improve macroeconomic stability, bolster market confidence, enhance competitiveness and outward orientation while strengthening external sector resilience in a challenging global environment. The EFF of SDR 1.1 billion (approximately US dollars 1.5 billion) is aimed at improving Sri Lanka's BOP position and supporting the government's economic reform agenda. The first tranche of the EFF amounting to US dollars 169 million was disbursed in June 2016. The remaining amount is to be received in six tranches up to April 2019. The program is also aimed at restoring foreign investor confidence while attracting further development assistance from the World Bank, Asian Development Bank and other development partners. Sri Lanka successfully achieved the fiscal, monetary and net international reserve targets for June 2016 under the EFF and upon the review of the IMF, Sri Lanka is expected to receive the second tranche under the EFF program by November 2016.

Balance of Payments (BOP)

- **The BOP recorded a surplus of US dollars 243 million during the first nine months of 2016 compared to a deficit of US dollars 2.3 billion recorded during the corresponding period of 2015.** The BOP, which was in deficit until June 2016 even after the receipt of the first tranche of the IMF-EFF and the proceeds of the syndicated loan, turned to a surplus in the middle of July mainly due to the receipt of the proceeds of US dollars 1.5 billion of the 10th International Sovereign Bond issuance.

Chart 5.7 Balance of Payments



International Investment Position (IIP)

- **Both Sri Lanka's external asset position and liability position declined as at end June 2016 compared to the position as at end 2015.** The primary reason for the reduction in the stock position of assets is the significant decline in reserve assets during the period. The reserve asset position, which stood at US dollars 7,304 million as at end 2015, declined to US dollars 5,292 million as at end June 2016. Further, the outstanding position of trade credit and advances given by Sri Lankan exporters increased marginally, while the outstanding position of other accounts receivable of deposit-taking corporations remained at similar levels at end June 2016 compared to the position at the end of 2015. Meanwhile, asset positions of direct investments have also increased marginally during the period.

- **The total external liability position also declined moderately as at end June 2016 compared to end 2015.** The total external liability position declined from US dollars 53,586 million as at end 2015 to US dollars 53,283 million at end June 2016. The decline in the total liability position was due to a decline in the stock position of direct investments and portfolio investments. The stock position of direct investments declined by US dollars 73 million as a result of valuation losses, particularly of publicly listed companies. The total outstanding stock position of portfolio investments declined from US dollars 12,375 million at end 2015 to US dollars 11,839 million at end June 2016. This decline was primarily due to the outflow in government securities in the first half of 2016. Consequently, the outstanding debt securities reduced from US dollars 10,839 million at end 2015 to US dollars 10,706 million at end June 2016. The total outstanding position of foreign investments, classified as equity and investment fund shares, also reduced despite a moderate net inflow, mainly due to valuation losses on the equity of publicly listed companies.

- **The outstanding position of foreign loans, which is the largest component of the total liability position, increased during the first half of 2016.** The liability position of government project loans recorded a moderate expansion while the outstanding loan position of deposit taking corporations increased during the year. In line with the low inflows to the private sector in the form of direct investments and portfolio investments, loan inflows to the private sector also remained stagnant during the period. Consequent to the reduced asset and liability positions, the net international investment position deteriorated from a net liability position of US dollars 42,699 million at end 2015 to US dollars 44,300 million as at end June 2016.

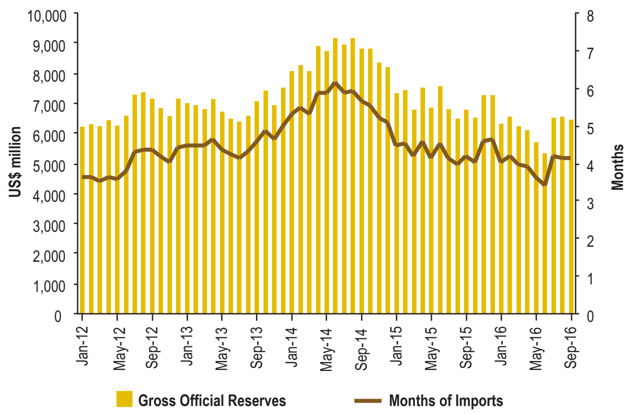
Outstanding External Debt Position

- **Sri Lanka's total outstanding external debt stock increased marginally during the first half of 2016.** However, the growth in outstanding external debt remained in line with the growth of GDP, resulting in the total outstanding debt as a percentage of GDP remaining at similar levels as at end June 2016 compared to the end 2015 position. The government has increasingly relied on the issuance of ISBs for its foreign financing needs in the past few years compared to project loans, which was the major government borrowing source previously. The outstanding position of currency swap liabilities reduced with the settlement of the RBI swap facility of US dollars 700 million in June 2016. However, the outstanding external debt of the Central Bank with the IMF is expected to increase gradually with the receipt of the tranches of the EFF. Further, the outstanding debt of deposit taking corporations also increased with the expansion in long term loans, while private sector debt outstanding remained at similar levels with limited loan inflows to direct investment enterprises and the corporate sector.

Reserve Asset Position

- **Gross official reserves amounted to US dollars 6.5 billion by end September 2016, is estimated to be equivalent to 4.1 months of imports.** The receipt of the first tranche (amounting to SDR 119 million or approximately US dollars 169 million) of the three year EFF obtained from the IMF, proceeds from two syndicated loans of US dollars 700 million and proceeds from the 10th ISB of US dollars 1.5 billion, as well as the rolling over of US dollars 400 million under the SAARCFINANCE currency swap arrangement contributed to re-build the level of gross official reserves of the country. Meanwhile, the settlement of the RBI swap facility, foreign currency debt service payments, supply of liquidity to the domestic foreign exchange market and principal payments of the IMF-SBA weighed on the level of gross official reserves during the first nine months of the year. Meanwhile, total international reserves, which

Chart 5.8 Gross Official Reserves and Months of Imports



comprise gross official reserves and foreign assets of deposit taking corporations, stood at US dollars 9.2 billion as at end August 2016. This marginal decline in total international reserves mainly came from the decline in gross official reserves, but a large decline was abated by the increase in holdings of commercial bank assets. By end August 2016, the import coverage of total international reserves was equivalent to 5.9 months.

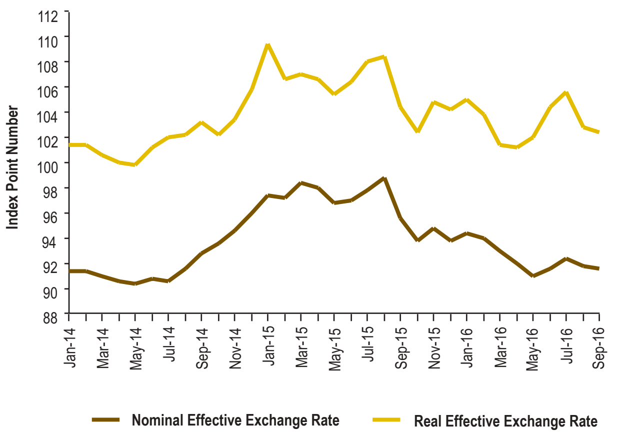
Exchange Rate Movements

- **The external value of the Sri Lankan rupee remained relatively stable during the year up to end September 2016.** However, there existed a considerable depreciation pressure on the rupee, particularly during the first four months of 2016. This was mainly due to continued outflows in terms of import expenditure, debt service payments and the unwinding of investments in the government securities market in the aftermath of the rate hike by the US Federal Reserve amidst modest inflows, mainly to the financial account of the BOP. These developments in the external accounts necessitated the Central Bank to intervene in the domestic foreign exchange market by supplying foreign currency liquidity, predominantly during the first four months of the year, which contributed towards the relative stability of the rupee against the US dollar during the period under review. The depreciation pressure on the rupee eased gradually from May onwards with the receipt of the first tranche under the IMF-EFF programme, the gradual reversal in outflows from the government securities market and proceeds from the ISB and syndicated loans. Overall, the Sri Lankan rupee recorded a depreciation of 1.8 per cent against the US dollar during the year up to end September. Reflecting cross currency exchange rate movements, the Sri Lankan rupee depreciated against the Japanese yen (17.72 per cent), the euro (4.37 per cent) and the Indian rupee (1.24 per cent) while appreciating against the pound sterling (12.31 per cent) on the backdrop of its depreciation against the US dollar after the 'Brexit' vote in June 2016.

- **The Central Bank intervened in the domestic foreign exchange market to ease the pressure on the exchange rate, particularly during the first four months of 2016.** The Central Bank, which supplied foreign exchange on a net basis during the first four months of the year, gradually reversed this trend thereafter by absorbing foreign exchange on a net basis from the domestic market. This contributed to a gradual build-up of international reserves while meeting the end June net international reserve target under the IMF-EFF programme. During the year up to end September, the Central Bank has supplied US dollars 693 million, on a net basis, in comparison to a net supply of US dollars 2,394 million during the corresponding period of 2015.

- **During the first nine months of 2016, both the 5-currency and 24-currency effective exchange rate indices depreciated.** Depreciation in the Nominal Effective Exchange Rate (NEER) indices was mainly attributed to the depreciation of the Sri Lankan rupee against the US dollar and some other major currencies in line with the movements in cross currency exchange rates. Accordingly, the 5-currency and 24-currency NEER indices depreciated by 1.67 per cent and 2.64 per cent, respectively, during the year up to end September 2016. Meanwhile, the 5-currency and 24-currency Real Effective Exchange Rate (REER) indices, which take in to account the inflation differentials among countries in the currency baskets, in addition to the variation

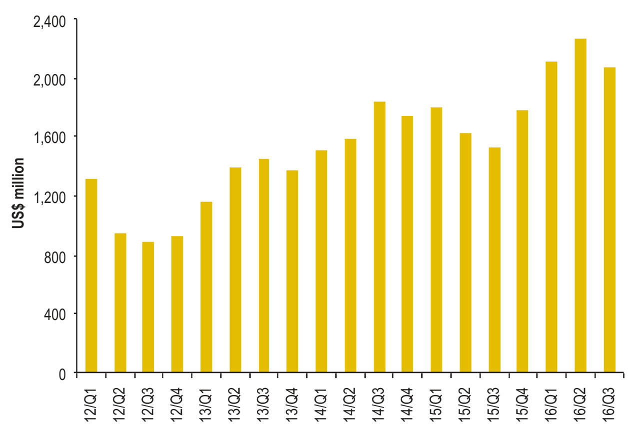
Chart 5.9 Effective Exchange Rate Indices: 24 - Currency (2010 = 100)



in nominal exchange rates, depreciated by 0.06 per cent and 2.06 per cent, respectively, during the period under review, indicating some improvement in the country's competitiveness in the international market.

- **During the first three quarters of 2016, the domestic foreign exchange market recorded an expansion in terms of spot and forward transactions.** By end September 2016, the total volume of spot transactions was US dollars 4,779 million in comparison to US dollars 4,502 million recorded during the corresponding period of 2015. Meanwhile, the total volume of forward transactions increased to US dollars 6,462 million during the first nine months of 2016 from US dollars 4,945 million during the corresponding period of 2015. The average forward premia for one-month and three-month transactions remained above the level of average interest rate differentials, while the average Net Open Position (NOP) of commercial banks stood at a positive level by end September 2016.

Chart 5.10 Quarterly Inter-Bank Forward Transaction Volumes



Expected Developments

- **The external sector performance is expected to improve gradually in 2017.** The balance of payments condition of the country is expected to improve in the second half of 2016 and in 2017 with the expected positive effects of the IMF-EFF programme, which aims at supporting the BOP position and the economic reform agenda of the government. Accordingly, the overall BOP is projected to record a surplus of around US dollars 690 million, and international reserves are expected to rise to US dollars 7.6 billion in 2017. However, sluggish global growth and continuation of weak global demand, possible increase in oil prices, expected rate hike in the US and lower than expected growth in FDI and workers' remittances remain as downside risks to the envisaged path of external sector developments.

- **Export earnings are projected to increase by 9.6 per cent in 2017 with the expected improved economic conditions in the global economy and improvements in trade relations with main trading partners.** As per the World Trade Organization (WTO) forecast in April 2016, the volume of world merchandise trade is expected to increase by 2.8 per cent in 2016 and 3.6 per cent in 2017. Further, Sri Lanka is in the process of obtaining concessional market access opportunities to the USA, China and Singapore through preferential trade agreements. In addition, it is expected to get concessional access for selected products to the EU market under the GSP+ facility in the near future. The removal of the fish ban by the EU for Sri Lankan fish exports with effect from mid-2016 would also increase earnings from fish exports. With the gradual recovery in the Middle East and Russia, the demand for Sri Lankan tea is expected to increase in 2017. These factors, together with a favourable domestic economic outlook, are expected to help enhance export performance. Meanwhile, import expenditure is projected to grow at 7.1 per cent in 2017 mainly due to expected higher commodity prices in the international market, particularly petroleum prices. Further, import volumes are also expected to increase in 2017 to support the higher level of domestic economic activity. Accordingly, the trade deficit, which is expected to expand by 4.2 per cent, year–on-year, is estimated to be around 9.9 per cent of GDP in 2017.

- **The services account of the BOP is projected to expand during 2017.** The tourism sector would provide the main contribution to the services account through the continued expansion in tourist receipts with higher tourist arrivals, particularly in the form of more high-end tourists. The growth in tourist earnings would be supplemented through continued investment activities in developing the tourism infrastructure of the country and tourism promotional activities. Receipts from passenger fares would also increase with higher tourist arrivals, contributing towards the projected increase in receipts from transportation services. However, the partial closure of the Bandaranaike international airport for three months from January 2017 for the renovation of the runway would have some impact on the services account during the first half of the year. Envisaged higher foreign investment in information technology and infrastructure related projects are expected to contribute to the projected increase in earnings from services. Meanwhile, earnings from telecommunications, computer and information services would rise with continuing developments in the industry with Sri Lanka diversifying into KPO services in high revenue generating sectors. The planned establishment of the Colombo International Financial City would also provide continued impetus towards the expansion of the services sector beyond 2017.

- **Workers' remittances are expected to record a moderate growth in 2017.** The growth in remittances would be supported by the compositional shift in foreign employment with higher contribution from professional employment categories. Meanwhile, the fall in migration under the unskilled category amidst the backdrop of policies aimed at discouraging female migration under these categories and economic stagnation in the Middle Eastern countries would adversely impact workers' remittances. This highlights the importance of encouraging skilled migration, which would provide higher benefits to migrant workers. Additionally, in the backdrop of the limited labour force availability in the country, as reflected through the relatively low level of unemployment, Sri Lanka should endeavour to reap the best possible returns through the creation of high value added employment opportunities locally as well as encouraging worker migration under semi-skilled and skilled categories.

- **With the expected developments in merchandise trade, services and secondary income accounts, the current account deficit, which is projected to be around 2.5 per cent of GDP in 2016, is expected to reduce**

to 2.0 per cent of GDP in 2017. The trade deficit, which is expected to widen in 2016, is forecasted to improve gradually in 2017 due to the expected growth in exports despite the growth in imports with the forecasted increase in oil prices during 2017. The negative impact of the trade account would be dampened to some extent by the higher inflows forecasted from the export of services and workers' remittances. However, these developments highlight some persistent issues in the current account of the country with the continuing trade gap, limited diversification in exports and higher dependence on workers' remittances.

- **Receipts to the financial account are projected to increase at a moderate level in 2017.** Inflows to the private sector are envisaged to improve with the support of FDIs. However, the lower than expected growth in FDI inflows has already been identified as a key issue that has to be addressed immediately. Attracting FDI is particularly important amidst the backdrop of diminishing access to concessional loans, with Sri Lanka progressing towards a higher middle-income country, expected moderation in remittances and the potential increase in the cost of new borrowing due to monetary policy normalisation in advanced economies. Meanwhile, inflows to the government will continue in the form of foreign project loans and through the issuance of international sovereign bonds. Sri Lanka will also continue to receive the rest of the tranches under the IMF-EFF upon the successful meeting of performance targets. The improvement of external sector buffers through the expected higher foreign currency inflows with non-debt creating flows, such as export earnings and FDI, would increase the resilience of the economy.

6

FISCAL POLICY AND GOVERNMENT FINANCE

The fiscal sector performance showed an improvement during the first seven months of 2016. Government revenue as a percentage of estimated GDP increased marginally to 7.0 per cent during this period compared to 6.4 per cent in the corresponding period in 2015 mainly due to the increase in tax revenue. Total expenditure and net lending as a percentage of GDP declined marginally to 10.5 per cent during the first seven months of 2016, compared to 10.8 per cent recorded in the same period in 2015, mainly due to a decline in recurrent expenditure during this period. As a result, during the first seven months of 2016, the overall budget deficit declined to 3.5 per cent of the estimated GDP from 4.4 per cent recorded in the corresponding period of 2015. In financing this overall budget deficit, the government relied mainly on domestic sources amidst comparatively low disbursement of foreign project loans and the net outflow of foreign holdings of government securities. In domestic financing, net borrowings from the banking sector increased to Rs. 234.3 billion compared to the annual estimate of Rs. 182.0 billion in the Budget for 2016. Although fiscal performance in the first seven months of 2016 showed some improvement, the remaining period of the year would be challenging and as such, new revenue enhancing measures are needed to achieve the annual revenue target, with the delaying of implementing some revenue enhancing measures, especially the revisions proposed to the Value Added Tax (VAT). In addition, interest payments are estimated to increase over the originally estimated amount for 2016, exerting upward pressure on fiscal balances. In this context, meeting the budget deficit target of 5.4 per cent of GDP in 2016 would be a challenging task.

Fiscal Policy Measures

- **Fiscal policy in 2016 has been directed towards strengthening the fiscal consolidation process to reduce the budget deficit and government debt to GDP ratio.** In order to achieve these targets, several policy measures were introduced by the government to enhance government revenue and rationalise recurrent expenditure.

- **The medium term objective of the government is to reduce the budget deficit to 3.5 per cent of GDP by 2020.** In line with this, regressive taxes are also expected to be minimised in the medium term while increasing the ratio of direct and indirect tax to 40 : 60 from the ratio of 19 : 81 that prevailed in 2015. The Budget for 2016, presented in November 2015, proposed a number of measures mainly related to the tax system as well as reforms in the pension system, fertiliser subsidy and State Owned Enterprises (SOEs) with a number of policies related to other sectors in the economy. According to the original Budget for 2016, the overall deficit was expected to be reduced to 5.9 per cent of GDP in 2016. In a subsequent development, in March 2016, the government announced revisions to certain taxes in the backdrop of the changing global economic climate while highlighting the commitment of the government to reduce the budget deficit further to 5.4 per cent of GDP in 2016, instead of the originally targeted level of 5.9 per cent of GDP, envisaged in the Budget for 2016. Hence, hereinafter the revised estimates for 2016 are considered as the baseline in this analysis, in general.

- **In line with the budgetary targets, several revenue measures were introduced in the Budget for 2016 with the view of increasing the government revenue to GDP ratio.** Accordingly, measures were proposed to broaden the income tax base while simplifying the existing tax system. A single tax rate of 17.5 per cent was introduced for all sectors other than banking and financial services, insurance industry, trading activities, liquor, tobacco, lottery, betting and gaming. A higher rate of 40 per cent was introduced for liquor, tobacco, lottery, betting and gaming while banking and financial services, insurance industry and trading activities were liable to pay taxes at a rate of 28 per cent. Further, the maximum tax rate applicable to individuals on the profits from any activity other than financial, trading, liquor, tobacco, lottery, betting and gaming activity was set at 17.5 per cent. In addition, Economic Service Charge (ESC) was increased to 0.5 per cent from 0.25 per cent while removing the exclusion given to profit making businesses and the maximum liability of Rs. 120 million per annum.

- **Several measures were proposed to VAT and Nation Building Tax (NBT) with the view of enhancing government revenue.** Budget for 2016 proposed to revise the two band structure of VAT rate of zero and 11 per cent into a three band rate structure as zero rate, standard rate of 8 per cent and higher rate of 12.5 per cent for the services sector. In addition, chargeability of VAT on wholesale and retail trade was proposed to be removed with effect from 01 January 2016. Further, the VAT threshold of Rs. 3.75 million per quarter was also proposed to be revised as Rs. 3.0 million per quarter. However, on 04 March 2016, approval was granted by the Cabinet of Ministers to impose a higher VAT rate of 15 per cent with effect from 02 May 2016 while removing the exemption granted to wholesale and retail trade. On 11 July 2016, Sri Lanka's Supreme Court suspended the changes to the VAT and granted leave to proceed in response to a petition made to the Supreme Court. On 09 August 2016, Hon. Speaker informed the Parliament of the Supreme Court ruling that the amendments to the changes in VAT have failed to follow the due Constitutional process.

Subsequently, a fresh VAT (Amendment) bill was approved by the Cabinet of Ministers on 13 September 2016, which is to be submitted to the Parliament on 26 October 2016. In the Budget for 2016, the existing NBT rate of 2 per cent was proposed to be increased to 4 per cent while removing the exemptions given under NBT on electricity, lubricants and telecommunication services and reducing the threshold of liable turnover of NBT to Rs. 3.0 million per quarter from Rs. 3.75 million per quarter. A fresh NBT (Amendment) bill is also to be submitted to the Parliament on 26 October 2016.

- **Customs duty structure was rationalised by introducing a three band tariff structure while increasing Customs duty rates on selected items.** The four band tariff structure of 25 per cent, 15 per cent, 7.5 per cent and exempt was revised by introducing a three band structure of 30 per cent, 15 per cent and exempt with effect from 20 November 2015. In addition, Ports and Airports Development Levy (PAL) was increased to 7.5 per cent from the prevailing 5.0 per cent. However, a low rate of 2.5 per cent was introduced for certain electronic and electrical items while PAL on certain plant and machinery used for construction, dairy and agricultural industries was removed as proposed in the Budget for 2016.

- **Special Commodity Levy (SCL) on importation of several food items was changed a number of times to provide necessary protection for domestic agricultural producers while using it to reduce the volatility in domestic market prices.** Accordingly, SCL on the importation of b'onions and potatoes increased to Rs. 25 per kg and Rs. 35 per kg, respectively in March 2016 and increased SCL on both food items again to Rs. 40 per kg in August 2016, considering the domestic supply conditions. Further, SCL on the importation of red onions was increased to Rs. 25 per kg from Rs. 5 per kg while SCL on the importation of white sugar and brown sugar was increased to Rs. 2 per kg and Rs. 15 per kg, respectively, with effect from 16 September 2016. In addition, SCL on the importation of vegetable oil and seeds of fennel was also increased during this year. Further, maximum retail prices were introduced for seventeen food items with effect from 14 July 2016 with the view of reducing the cost of living that would rise due to the planned increase of VAT from 02 May 2016. These food items include red lentils, dried sprats, green gram (Moong), sugar, wheat flour, milk powder, broiler chicken meat, potatoes, b'onions, dried chilies, dried fish, Sustagen and Maldive fish.

- **Emphasis was placed on expediting the process of automating revenue agencies to improve tax administration and to enhance revenue collection.** The Revenue Administration Management Information System (RAMIS), which is located at the Inland Revenue Department (IRD), and enables taxpayers to register online for the payment of taxes and return submission of VAT, Simplified VAT (SVAT), NBT, Withholding tax and Pay-As-You-Earn (PAYE), commenced its operations during the year 2016. Meanwhile, Sri Lanka Customs has also established a single window system to provide all the necessary permissions, certificates, clearances and approvals to facilitate the import and export traders. The Integrated Treasury Management Information System (ITMIS), which is being set up at the Ministry of Finance (MOF), is mainly aimed at automating the key Departments of MOF. Under this system, a new web portal for MOF was developed and launched in April 2016. Development and customisation of Budget Planning module was completed and it will be used in parallel with the current Budget Formulation System (BFS) of the National Budget Department (NBD) for 2017 budget preparation work. Further, the first round of User Acceptance Testing

(UAT), which includes Treasury Management, Revenue Management, Budget Appropriation, Purchasing Management, Expenditure Management, General Ledger and System Administration, is expected to be launched in November 2016 in MOF and Ministry of Health as a pilot implementation. Meanwhile, a Budget Implementation and Monitoring Unit was established under the Department of National Budget of the MOF in order to strengthen the review process of the recurrent and capital expenditure allocated for spending agencies. Accordingly, the monitoring process is carried out periodically giving attention to the financial and physical progress of development activities implemented by the line ministries and agencies. In addition, measures have also been taken by the NBD of MOF to strengthen the monthly cash releases for government agencies and institutions submitting recommendations to the Department of Treasury Operations (TOD), based on the progress of the projects.

- **On the expenditure front, several measures were introduced in order to ensure the proper management of public expenditure in 2016.** Under the National Budget Circular No. 01/2016, all spending agencies were instructed to follow the operational leasing method, proposed in the Budget for 2016 to purchase vehicles for government agencies, which is considered to be more cost effective than the previous method.

- **A new salary structure was introduced for public service employees in five phases commencing from 01 January 2016 as per the Public Administration Circular No. 03/2016.** This includes a special non pensionable allowance paid to retired public officers who have been re-employed (in terms of the Public Administration Circulars No 31/2011 and 18/2012) and the interim monthly allowance of Rs.10,000 (in terms of the Public Administration Circulars No. 24/2014, 24/2014 (I) and 05/2015). Meanwhile, the conversion of the salary of the public service employees from the existing salary to the new salary scales is scheduled to take place on step by step basis under five phases until 2020.

- **In order to improve the registration and expedite the process of pension payments, Department of Pensions has introduced a fully automated online application processes.** Accordingly, a fully automated online application process for registration of government employees to Widowers' and Orphans' Pension (W&OP) was introduced. This process was earlier managed manually. Further, pensioners were allowed to submit pension applications online with effect from 10 October 2016 through the Pension Management System (PMS). Pension disbursements are managed through the online payment process of the Department of Posts. In addition, an online railway warrant system was also introduced for pensioners in collaboration with Sri Lanka Railways and Mobitel (Pvt.) Ltd.

- **A deceleration was seen in the implementation of projects under the public investment programme during the year mainly due to lower disbursement under foreign funded project loans.** Ongoing irrigation schemes, such as Moragahakanda and Kaluganga projects, were continued during the year. Meanwhile, development of expressways, and widening and improvement of national roads were continued. Accordingly, construction of Phase III of the Outer Circular Highway - Kadawatha to Kerawalapitiya section, and Southern expressway Extension Project – Matara to Hambantota section, were also continued during the year. Further, investments were also made for the acquisition of lands for the construction of the Central Expressway during the same period. Construction work of the Phase II of the Central Expressway – Meerigama to Kurunegala, was commenced in October 2016. In addition, conducting a feasibility study for the Ruwanpura Expressway is in the final stages, and construction is expected to commence in 2017.

- **The government continued to channel resources for welfare programmes, such as food nutritional programmes, Samurdhi relief, elders' allowance, special grant for kidney patients, and fertiliser subsidy.** Accordingly, nutritional programmes, such as Poshanamalla, Thriposha programme, fresh milk and school nutrition programme, were continued during the year with the view of improving child and maternal nutrition. Meanwhile, the government converted the fertiliser subsidy to an allowance of Rs. 25,000 per hectare up to a maximum of two hectares per paddy farmer per annum in place of providing a 50 kg bag of fertiliser at Rs. 350 as a part of rationalising household transfers. Further, the government extended the fertiliser subsidy to tea, coconut and rubber farmers as well in 2016 under which a cash grant of Rs. 15,000, Rs. 9,000 and Rs. 5,000, respectively was provided per hectare per annum.

- **Several initiatives were taken to strengthen the financial position and operations of major SOEs during the year 2016.** Accordingly, having considered the financial constraints of the National Water Supply and Drainage Board (NWS&DB), 50 per cent of the debt service payments of the Urban Water Supply Projects and 75 per cent of the Rural Water Supply Projects are to be borne by the General Treasury. In addition, two Letters of Comfort, issued to SriLankan Airlines (SLA) in 2015, were extended up to 31 December 2016 considering the deterioration of the financial position of SLA. Further, two Letters of Comfort were issued to both SLA and Mihin Lanka Ltd. (MLL) in order to meet their urgent capital requirements. However, having considered the continuous loss making position of SLA, the government appointed the National Savings Bank (NSB) as the Lead Manager in order to restructure SLA by selecting a suitable business partner to run its business in a commercially viable manner.

- **The public debt management strategy was further developed in 2016 by introducing several measures in the debt management front, while ensuring the availability of adequate funding for the government's financing needs at the lowest possible cost with the minimum risks.** Accordingly, on 04 August 2016, the Central Bank commenced releasing summary trading statistics on actual trading of government securities in the secondary market for the first time with the objectives of promoting fair market practices and to yield benefits of the government securities market to all participants. In order to improve transparency in government securities, all Primary Dealers and commercial banks joined the Bloomberg electronic bond-trading platform for government securities secondary market transactions as per the instructions issued by the Central Bank. As a result, all Primary Dealers and banks are required to undertake trade among them in the platform and report all outright sales of government securities with investors of Rs. 50 million and above within 30 minutes. This will enable the Central Bank to monitor the relevant transactions on an ongoing basis. Further, releasing this information would be beneficial for investors to study the current status of the government securities market conditions, while promoting transparency, price discovery and outreach of the government securities market in parallel with the other financial markets. In addition, the Central Bank has commenced a procurement process for setting up a dedicated electronic trading platform along with the Central Counterparty System. This is expected to provide market information on real time basis in line with other developed financial markets, while developing the government securities market to international standards.

- **Several measures were taken to strengthen the regulation and supervision of the Primary Dealer market in line with international standards.** Accordingly, the regulation and supervision of the government securities market was assigned to the Department of Supervision of Non-bank Financial Institutions of the Central Bank. In addition, the Central Bank has decided to hold pre-bid meetings with all the Primary Dealers to share information on market developments and to have a clear defined auction calendar, while following the international best practices with respect to volumes advertised and accepted at public auctions. Measures were also taken relating to the Employees' Provident Fund (EPF) actively participating at the Primary Auctions of government securities. The planned introduction of a hybrid system for the issuance of government securities, with features of both competitive and non-competitive bids, based on global best practices and domestic conditions, will also be an important step towards instilling greater confidence in the government bond market. Meanwhile, several measures are in the pipeline to take outright secondary market sales of government securities by Non-Primary Dealer banks to their customers.

- **The government successfully issued its 10th International Sovereign Bond, reflecting improved investor confidence in Sri Lanka.** Accordingly, the government was able to raise US dollars 1.5 billion in July 2016 through its first dual tranche offering of 5.5 years (US dollars 500 million) and 10 years (US dollars 1.0 billion) at yield rates of 5.750 per cent and 6.825 per cent, respectively, amidst high volatility in the global markets following the impact of Brexit. In addition, the government issued US dollars 300 million worth of Foreign Currency Term Financing Facility (FCTFF) (Syndicated loan) with a maturity period of 3 years in June 2016. Further, government issued another FCTFF amounting to US dollars 400 million with a maturity period of 3 years in September 2016.

- **International sovereign rating agencies made some revisions to Sri Lanka's sovereign credit ratings in 2016.** On 29 February 2016, Fitch revised Sri Lanka's foreign currency rating of "BB-" to "B+", and revised Sri Lanka's sovereign rating outlook to "negative" from "stable", citing Sri Lanka's heightened vulnerabilities, due to increasing refinancing risks, significant debt maturities, weak public finances, decline in foreign exchange reserves and high foreign currency debt portion. Standard and Poor's (S&P) affirmed its "B+" long-term rating and "B" short-term sovereign credit rating on 26 March 2016, although its outlook on Sri Lanka's long-term foreign currency sovereign credit rating was changed to "negative" from "stable", citing the rising pressures on Sri Lanka's external liquidity and weakened public finances. The Moody's Investor Services also changed the outlook on Sri Lanka's B1 sovereign rating to "negative" from "stable" on 20 June 2016, highlighting the weakening of some of Sri Lanka's fiscal metrics in an environment of subdued GDP growth which could lead to renewed balance of payments pressure and lower than expected effectiveness of the fiscal reforms envisaged by the government, which could further weaken fiscal and economic performance.

- **Meanwhile, the government entered in to an Extended Fund Facility (EFF) programme with the IMF on 03 June 2016 to support the government's economic reform agenda, particularly to strengthen fiscal sustainability and the balance of payments (BOP) position of the country.** Under this programme, the primary balance has been agreed as the key fiscal target and IMF Quantitative Performance Criteria (PC) for primary balance for the period of January-June 2016 was a deficit of Rs. 46.0 billion. According to the latest available information, PC for primary balance for the period of January - June 2016 has been met.

Government Budgetary Operations

Government Revenue and Grants

Revenue

- **According to the revised estimates for 2016, total government revenue in 2016 is expected to increase by 6.3 per cent to Rs. 1,546.0 billion.** As a percentage of estimated GDP, total revenue is estimated at 12.6 per cent in 2016 comprising 11.5 per cent of tax revenue and 1.1 per cent of non tax revenue.

- **During the first seven months of 2016, government revenue as a percentage of estimated GDP increased to 7.0 per cent in comparison to 6.4 per cent in the corresponding period in 2015 mainly due to the increase in tax revenue.** Total government revenue in nominal terms increased by 19.7 per cent to Rs. 863.7 billion during this period from Rs. 721.5 billion recorded in the corresponding period of the previous year. This was mainly due to the increase in the revenue from goods and services related taxes, especially from VAT, PAL, import duties, Cess, SCL and NBT. Meanwhile, revenue collection from income taxes also improved due to increased revenue from corporate and non corporate income taxes, ESC and withholding taxes. However, the revenue from excise duty on motor vehicles declined during this period mainly due to the decline in vehicle importation mainly consequent to the introduction of a new method of computing the Customs value of motor vehicles for the purpose of calculating excise duty during the latter part of the year 2015, and the increasing the unit rate of excise duty in May 2016. On the non tax revenue front, revenue generated from rent and interest, fees and charges, and social security contributions showed a considerable increase compared to the previous year. Meanwhile, the total revenue collection during this period showed an improvement recording 55.9 per cent of the annual estimate of Rs. 1,546.0 billion in comparison to 47.9 per cent generated in the corresponding period of 2015. However, the average monthly revenue during this period was only around Rs. 123.4 billion compared to the estimate of Rs. 128.8 billion in the revised estimates for 2016.

- **Revenue from income taxes in nominal terms increased by 29.4 per cent during the first seven months of 2016 mainly due to the increased revenue from corporate and non corporate income tax, ESC and withholding taxes.** Accordingly, as a percentage of estimated GDP, revenue from income taxes also increased to 1.0 per cent from 0.9 per cent in the corresponding period of 2015. The revenue from corporate and non corporate income tax increased by 39.9 per cent in nominal terms to Rs. 60.1 billion from Rs. 43.0 billion mainly due to strengthening the monitoring and supervision process by the IRD and the automation of revenue collection. During this period, revenue from withholding taxes increased by 12.7 per cent to Rs. 39.1 billion from Rs. 34.7 billion in the previous year due to the increase in issuance of government securities and market interest rates in comparison to the previous year. Revenue from ESC also increased to Rs. 11.0 billion during the period under consideration from Rs. 4.1 billion in the first seven months of 2015 mainly due to the removal of the exclusion given to profit making businesses and increase of the rate to 0.5 per cent from 0.25 per cent with effect from April 2016. Revenue from PAYE tax increased marginally to Rs. 16.6 billion during the first seven months of 2016 in comparison to Rs. 16.2 billion in the first seven months of the previous year.

- **Revenue from VAT as a percentage of estimated GDP increased to 1.3 per cent from 1.1 per cent in the first seven months of 2015.** In

Table 6.1 Economic Classification of Government Revenue

Rs. billion

Item	2014	2015 (a)	2016 Revised Estimates	2015 Jan - Jul (a)	2016 Jan - Jul (a)
Tax Revenue	**1,050.4**	**1,355.8**	**1,412.0**	**663.3**	**798.7**
Income Taxes	198.1	262.6	226.0	98.0	126.8
VAT	275.4	219.7	315.0	123.2	155.3
Excise Taxes	256.7	497.7	444.0	256.3	255.0
Import Duties	81.1	132.2	125.0	53.7	85.7
PAL	68.6	58.6	92.0	30.0	49.1
NBT	44.6	45.0	54.0	24.0	31.3
SCL	48.0	52.3	60.0	31.0	35.7
Cess	38.7	46.3	55.0	23.7	32.9
Other Taxes	39.2	41.4	41.0	23.3	26.8
Non Tax Revenue	**144.8**	**99.1**	**134.0**	**58.2**	**64.9**
Total Revenue	**1,195.2**	**1,454.9**	**1,546.0**	**721.5**	**863.7**

Source: Ministry of Finance

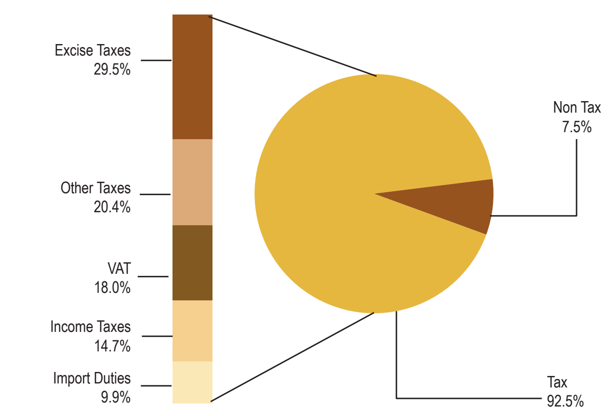
(a) Provisional

nominal terms also, revenue from VAT on both domestic economic activities and import related activities increased by 26.1 per cent to Rs. 155.3 billion from Rs. 123.2 billion recorded in the corresponding period of 2015. The revenue from the VAT on domestic economic activities increased by 26.2 per cent to Rs. 96.5 billion from Rs. 76.4 billion in the first seven months of the previous year mainly due to automating revenue collection of IRD and thereby resolving technical errors, increased compliance, and improvement in domestic economic activities. Similarly, the revenue from VAT on imports also increased by 25.8 per cent to Rs. 58.9 billion in comparison to Rs. 46.8 billion recorded in the first seven months of 2015 due to the increase in imports which are liable for VAT. Further, during the first seven months of 2016, VAT revenue as a percentage of total tax revenue increased to 19.4 per cent from 18.6 per cent in the corresponding period of 2015.

- **Revenue from excise duties as a percentage of estimated GDP declined marginally to 2.1 per cent during the first seven months of 2016 in comparison to 2.3 per cent recorded in the corresponding period of 2015 mainly due to the declined revenue from excise duty on motor vehicles.** In nominal terms also, revenue from excise duty declined marginally by 0.5 per cent to Rs. 255.0 billion compared to the same period in 2015. Although the revenue from excise duty on petroleum, tobacco and cigarettes, and liquor recorded a considerable growth during this period, revenue from excise duty on motor vehicles declined considerably. Revenue from excise duty on motor vehicles declined significantly by 28.9 per cent to Rs.101.7 billion compared to Rs. 143.1 billion recorded in the corresponding period of 2015, with the declining trend in the importation of motor vehicles during the first seven months of 2016 mainly due to the increase in taxes on selected motor vehicles, introduction of a new valuation method for motor vehicles for the purpose of calculation of excise duty from the latter part of 2015 and rising market interest rates due to monetary tightening measures taken by the Central Bank. However, revenue from excise duty on liquor increased by 21.0 per cent to Rs. 69.3 billion during the first seven months of 2016 due to the increase in tax rates although the production of malt liquor declined significantly during the latter part of this period compared to the same period in 2015. Meanwhile, revenue from excise duty on tobacco and cigarettes also increased by 7.9 per cent to Rs. 50.6 billion in the first seven months of 2016 mainly resulting from the increase in tax rates.

- **During the first seven months of 2016, revenue from NBT in nominal terms increased by 30.6 per cent to Rs. 31.3 billion from Rs. 24.0 billion, while it increased to 0.3 per cent from 0.2 per cent as a percentage of estimated GDP.** Revenue from NBT on both domestic economic activities and import related activities increased during the first seven months of 2016. Accordingly, revenue from NBT on domestic economic activities increased by 37.2 per cent to Rs. 21.0 billion in comparison to Rs. 15.3 billion in the same period of the previous year due to the improvement of domestic economic activities. NBT on import related activities also

Chart 6.1 Composition of Governement Revenue (Jan-Jul 2016)



increased by 18.8 per cent to Rs. 10.2 billion compared to Rs. 8.6 billion in the first seven months of 2015 due to increased NBT applicable on imports.

- **Revenue from all import related taxes and levies, such as import duties, PAL, Cess and SCL, increased during the first seven months of 2016.** Revenue from import duties increased by 59.7 per cent to Rs. 85.7 billion compared to Rs. 53.7 billion recorded in the same period of 2015 mainly due to the increased imports for which import duties are applicable and the strengthening of the monitoring process. Revenue from PAL also increased significantly by 63.7 per cent to Rs. 49.1 billion from Rs. 30.0 billion recorded during the same period in 2015 mainly reflecting the impact of increasing the PAL rate to 7.5 per cent from 5.0 per cent. Revenue from Cess levy increased by 38.9 per cent to Rs. 32.9 billion mainly on account of imposing Cess on new items and increasing Cess rates on selected items during the latter part of 2015. Revenue from SCL also increased by 15.2 per cent to Rs. 35.7 billion from Rs. 31.0 billion recorded in the corresponding period of the previous year mainly due to the increase in SCL on several commodities considering the enhanced availability in the domestic market during the harvesting period.

- **During the first seven months of 2016, non tax revenue as a percentage of estimated GDP remained unchanged at 0.5 per cent as in the same period of 2015.** However, in nominal terms, non tax revenue increased by 11.5 per cent to Rs. 64.9 billion compared to Rs. 58.2 billion in the corresponding period of 2015. This nominal increase was due to the increase in non tax revenue sources, namely fees and charges, rent, interest income and social security contributions. Revenue from fees and charges increased by 24.8 per cent to Rs. 29.9 billion from Rs. 24.0 billion recorded in the first seven months of 2015. Rent and interest income also showed a 29.0 per cent increase to Rs. 4.5 billion in the first seven months of 2016 from Rs. 3.5 billion recorded during the first seven months of 2015 due to the relatively high interest rates that prevailed in the domestic market. However, profit and dividend transfers from SOEs declined by 9.1 per cent to Rs. 19.3 billion during this period from Rs. 21.3 billion recorded in the corresponding period of 2015.

Grants

- **Disbursements of foreign grants during the first seven months of 2016 were significantly below the annual estimate for 2016.** Accordingly, the realised amount of foreign grants during this period was Rs. 0.5 billion in comparison to the annual estimate of Rs. 10.0 billion for 2016, although it showed an improvement compared to 0.2 billion recorded in the same period of 2015.

Expenditure and Net Lending

- **As per the revised estimates for 2016, total expenditure and net lending is estimated to decline to 18.0 per cent of GDP compared to 20.5 per cent of GDP in 2015.** Recurrent expenditure is estimated to decline to 14.0 per cent of GDP from 15.2 per cent in 2015 while capital expenditure and net lending is also estimated to decline to 4.0 per cent of GDP in 2016 from 5.3 per cent recorded in 2015. In nominal terms, total expenditure and net lending in 2016 is estimated to decline by 3.3 per cent to Rs. 2,215.0 billion in comparison to Rs. 2,290.4 billion recorded in 2015. Recurrent expenditure is expected to increase by 1.3 per cent to Rs. 1,724.0 billion in 2016, while capital expenditure and net lending is expected to decline by 16.6 per cent to Rs. 491.0 billion.

- **Total expenditure and net lending during the first seven months of 2016 declined to 10.5 per cent of estimated GDP from 10.8 per cent during the same period in 2015, mainly due to the decline in recurrent expenditure.** However, in nominal terms, government expenditure and net lending increased by 5.9 per cent to Rs. 1,296.9 billion during the first seven months of 2016 compared to Rs. 1,225.1 billion recorded during the corresponding period in 2015. Total expenditure and net lending in the first seven months of 2016 accounted only for 58.5 per cent of the revised annual estimate for 2016 compared to 60.2 per cent recorded during the corresponding period in 2015.

- **During the first seven months of 2016, recurrent expenditure declined to 8.2 per cent of estimated GDP from the 8.4 per cent recorded during the same period in 2015.** However, in nominal terms, recurrent expenditure increased by 5.5 per cent to Rs. 1,006.8 billion during the first seven months of 2016 compared to Rs. 954.2 billion recoded in the same period in 2015. Expenditure on salaries and wages increased by 3.7 per cent to Rs. 331.5 billion from Rs. 319.6 billion recorded in the same period of 2015. In addition, expenditure on interest payments also increased by 13.0 per cent to Rs. 370.4 billion during the first seven months of 2016 compared to Rs. 327.7 billion during the corresponding period in 2015 mainly due to the relatively higher interest rates that prevailed in the domestic market and the gradual increase in the foreign interest rates affecting loans that have been obtained at variable interest rates. Pension payments were also increased by 14.2 per cent to Rs. 99.4 billion due to the increase in the number of pensioners and the conversion of the salary of the government employees to new salary scales as per the Public Administration Circular No. 03/2016. Meanwhile, expenditure on the Samurdhi programme increased by 3.5 per cent to Rs. 23.9 billion during the first seven months of 2016 compared to Rs. 23.1 billion during the corresponding period in 2015. The expenditure on the fertiliser subsidy declined by 28.3 per cent to Rs. 13.1 billion from Rs. 18.3 billion recorded during the first seven months of 2015.

Table 6.2 Economic Classification of Expenditure

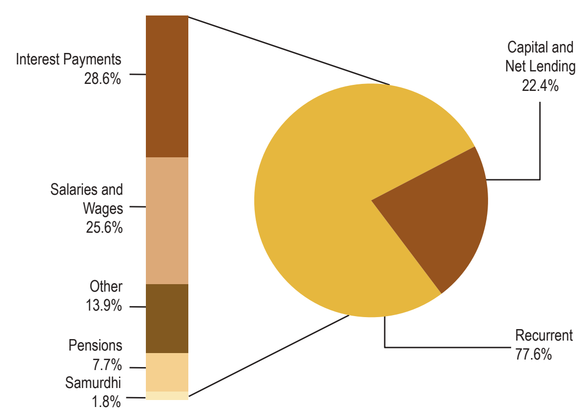
Rs. billion

Item	2014	2015 (a)	2016 Revised Estimates	2015 Jan - Jul (a)	2016 Jan - Jul (a)
Recurrent Expenditure	**1,322.9**	**1,701.7**	**1,724.0**	**954.2**	**1,006.8**
o/w Salaries and Wages	441.0	561.7	590.0	319.6	331.5
Interest Payments	436.4	509.7	562.0	327.7	370.4
Foreign	108.5	115.4	82.0	79.7	69.9
Domestic	327.9	394.3	480.0	248.0	300.6
Samurdhi	15.0	40.0	44.0	23.1	23.9
Pensions	126.1	155.3	169.0	87.0	99.4
Fertiliser Subsidy	31.8	49.6	35.0	18.3	13.1
Capital and Net Lending	**473.0**	**588.7**	**491.0**	**270.8**	**290.1**
Total Expenditure and Net Lending	**1,795.9**	**2,290.4**	**2,215.0**	**1,225.1**	**1,296.9**

(a) Provisional

Source: Ministry of Finance

Chart 6.2 Composition of Government Expenditure (Jan-Jul 2016)



- **Capital expenditure and net lending as a percentage of estimated GDP remained unchanged at 2.4 per cent during the first seven months of 2016 as in the corresponding period in 2015.** However, in nominal terms, it increased by 7.1 per cent to Rs. 290.1 billion during this period from Rs. 270.8 billion recorded in the same period in 2015. The realised capital expenditure and net lending in the first seven months of 2016 accounted for 59.1 per cent of the revised annual estimate for the year.

Key Fiscal Balances

- **The key fiscal balances witnessed an improvement during the first seven months of 2016, with the overall budget deficit as a percentage of estimated GDP declining to 3.5 per cent during this period from 4.4 per cent in the corresponding period in 2015.** In nominal terms, the overall budget deficit improved to Rs. 432.7 billion from Rs. 503.3 billion recorded in the corresponding period of the previous year, particularly reflecting the efforts made by the government to enhance revenue and rationalise recurrent expenditure. Meanwhile, the primary deficit (overall deficit net of interest payments) declined to 0.5 per cent of GDP from 1.7 per cent recorded in the same period in 2015. The current account deficit (government dis-savings) also declined to 1.2 per cent of GDP during the first seven months of 2016 from 2.1 per cent recorded in the corresponding period of 2015.

Financing the Budget Deficit

- **The overall budget deficit of Rs. 432.7 billion was mainly financed through domestic sources during the first seven months of 2016.** Accordingly, net domestic financing during this period amounted to Rs. 409.8 billion compared with Rs. 545.2 billion in the corresponding period of 2015, whereas net foreign financing during the period under consideration amounted to Rs. 22.9 billion in comparison to the repayment of Rs. 41.8 billion recorded in the corresponding period of 2015.

- **Reliance on borrowings from domestic sources declined significantly during the first seven months of 2016 compared to the corresponding period in 2015 mainly due to the decline in the budget deficit during this period.** Bank financing amounted to Rs. 234.2 billion, accounting for 57.2 per cent of total domestic financing. This was significantly lower than Rs. 319.4 billion recorded during the first seven months of 2015 although it was higher than the original annual estimate of Rs. 182.0 billion for 2016. Financing from the Central Bank increased substantially to Rs. 226.2 billion

Chart 6.3 Major Fiscal Indicators

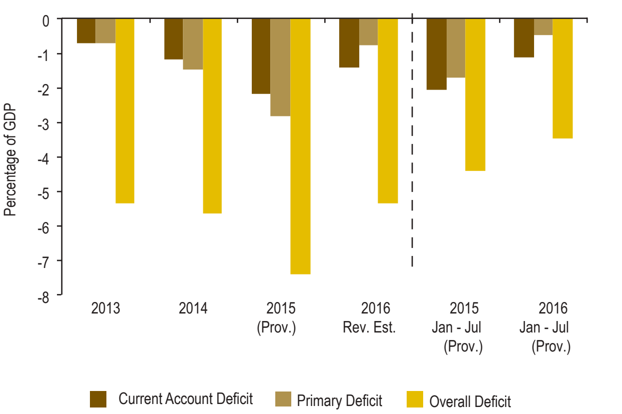


Table 6.3 Sources of Financing

Rs. billion

Item	2014	2015 (a)	2015 Jan-Jul (a)	2016 Jan- Jul (a)
Domestic Financing (b)	**378.7**	**592.7**	**545.2**	**409.8**
Bank	126.9	291.8	319.4	234.2
Non Bank	251.8	300.9	225.8	175.6
Foreign Financing	**212.5**	**236.8**	**-41.8**	**22.9**
Loans	211.7	364.0	2.4	35.0
Non Resident Investments in Treasury Bonds	15.0	-79.9	-11.4	-15.8
Non Resident Investments in Treasury Bills	-14.2	-47.3	-32.9	3.7
Total Financing	**591.2**	**829.5**	**503.3**	**432.7**

Sources: Ministry of Finance
Central Bank of Sri Lanka

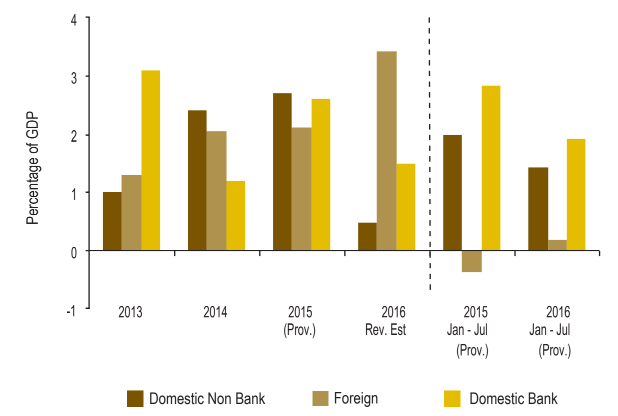
(a) Provisional
(b) Excludes funds raised through Treasury bonds issued for restructuring of SOBEs in 2014 and 2015.

from Rs. 68.9 billion during this period. However, there was a significant decline in financing from the commercial banking sector to Rs. 8.1 billion in the first seven months of 2016 from Rs. 250.5 billion in the corresponding period of 2015, which contributed largely to the decline in the total financing from the banking sector during the period under review. Net financing from the domestic non banking sector also declined to Rs. 175.6 billion in the first seven months of 2016 compared to Rs. 225.8 billion in the corresponding period in 2015.

- **During the first seven months of 2016, domestic borrowings were made mainly through debt instruments, particularly from Treasury bonds and Treasury bills.** Net borrowings from Treasury bonds and Treasury bills were Rs. 339.4 billion and Rs. 57.6 billion, respectively in the first seven months of 2016 compared to Rs. 284.6 billion and Rs. 99.4 billion, respectively recorded in the corresponding period of the previous year. From the total net borrowings by way of Treasury bills, the contribution of the Central Bank increased significantly to Rs. 192.3 billion from Rs. 60.1 billion, reflecting significant repayments of Treasury bills to commercial banks and the non banking sector. However, net borrowings through Sri Lanka Development Bonds (SLDBs) declined significantly to Rs. 13.4 billion during the period under consideration from Rs. 170.2 billion in the corresponding period of the previous year, reflecting larger repayments.

- **Net foreign financing during the first seven months of 2016 amounted to Rs. 22.9 billion compared to the net repayment of Rs. 41.8 billion recorded in the corresponding period of 2015.** Despite the comparatively low disbursement of foreign project loans and the continued net outflow of rupee denominated foreign holdings of Treasury bonds, the utilisation of a part of the proceeds from ISBs during the period and increased foreign holdings of Treasury bills mainly contributed to the increase in foreign borrowings during this period. Net foreign financing comprised Rs. 37.4 billion of utilisation of proceeds of ISBs, Rs. 3.7 billion of net foreign investments in Treasury bills, Rs. 15.8 billion, net repayments of foreign investments in Treasury bonds and Rs. 2.4 billion of net repayments of foreign project loans.

Chart 6.4 **Deficit Financing**



Government Debt and Debt Service Payments

Government Debt

- **Total outstanding central government debt increased by Rs. 878.7 billion to Rs. 9,382.0 billion as at end July 2016 compared to Rs. 8,503.2 billion at end 2015.** The increase in outstanding debt was mainly due to high domestic borrowings, issuance of a FCTFF in June 2016, issuance of an ISB in July 2016 and the depreciation of the Sri Lankan rupee against major foreign currencies over the period under consideration. During the first seven months of 2016, total debt increased by Rs. 141.7 billion due to exchange rate variations on account of the depreciation of the rupee against major foreign currencies. Accordingly, the outstanding foreign

Chart 6.5 Outstanding Government Debt

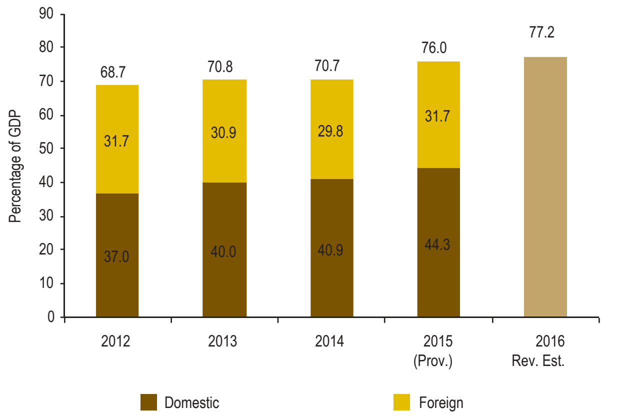


Table 6.4 Outstanding Government Debt

Rs. billion

Item	2014	2015 (a)	2015 End Jul (a)	2016 End Jul (a)
Domestic Debt (b)	**4,277.8**	**4,959.2**	**4,862.2**	**5,460.4**
By Maturity Period				
Short Term	941.2	913.3	1,104.8	994.3
Medium and Long Term	3,336.6	4,045.9	3,757.4	4,466.1
By Institution				
Banks	1,669.9	1,924.0	1,875.5	2,155.3
Non Bank Sector	2,607.9	3,035.2	2,986.7	3,305.2
Foreign Debt (c)	**3,113.1**	**3,544.0**	**3,139.9**	**3,921.5**
Concessional	1,491.0	1,729.9	1,540.6	1,833.2
Non Concessional	1,622.1	1,814.1	1,599.3	2,088.3
Total Government Debt	**7,390.9**	**8,503.2**	**8,002.1**	**9,382.0**

Sources: Ministry of Finance
Central Bank of Sri Lanka

(a) Provisional
(b) Excludes Treasury bonds of Rs. 4,397 million issued to CWE in November 2003, Rs. 78,447 million issued to settle dues to CPC in January 2012 and Rs. 13,125 million issued to capitalise SriLankan Airlines in March 2013.
(c) Includes outstanding amounts of foreign investments in rupee denominated Treasury bills and Treasury bonds.

debt increased by Rs. 133.0 billion, while foreign currency denominated domestic debt increased by Rs. 8.7 billion due to the exchange rate variation. Moreover, the discount factor (which is the net difference in the book value and the face value of issues and maturities of Treasury bills and Treasury bonds) contributed to the increase in debt by Rs. 70.1 billion due to the issuance of government securities at a discount during the period under review. Domestic debt increased by Rs. 501.2 billion to Rs. 5,460.4 billion, while foreign debt increased by Rs. 377.5 billion to Rs. 3,921.5 billion.

- **Of the total domestic debt, short term debt as at end July 2016 increased by 8.9 per cent, while medium and long term debt also increased by 10.4 per cent from end 2015.** The share of short term debt in the total domestic debt declined marginally to 18.2 per cent at the end of July 2016 from 18.4 per cent at the end of 2015. In contrast, the share of medium and long term debt in the total domestic debt increased slightly to 81.8 per cent at the end of July 2016 compared to 81.6 per cent as at end 2015. The share of Treasury bills in the total domestic debt remains unchanged at 13.3 per cent compared to the level recorded at end 2015. The share of Treasury bonds, which dominates the outstanding domestic debt portfolio, increased to 67.7 per cent as at end July 2016 compared to 66.6 per cent as at end 2015. However, the share of SLDBs in the total domestic debt as at end July 2016 declined to 12.6 per cent from 13.5 per cent at end 2015 due to the relatively lower reliance on SLDBs to finance the budget deficit during this period.

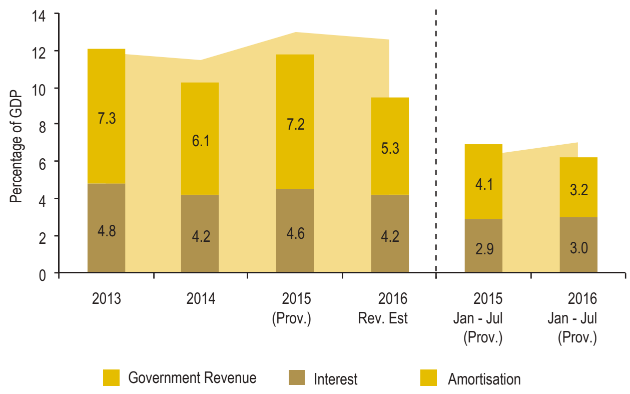
- **The outstanding foreign currency denominated domestic debt as at end July 2016 increased by Rs. 22.1 billion to Rs. 712.2 billion (US dollars 4,886.3 million) from Rs. 690.1 billion (US dollars 4,790.1 million) as at end 2015.** Accordingly, outstanding borrowings from SLDBs amounted to Rs. 690.3 billion (US dollars 4,736.3 million) and the outstanding borrowings from Offshore Banking Units (OBUs) amounted to Rs. 21.9 billion (US dollars 150.0 million) as at end July 2016. The share of foreign currency denominated domestic debt to total domestic debt declined to 13.0 per cent as at end July 2016 in comparison to 13.9 per cent at end 2015.

- **The share of non concessional debt in the total foreign debt increased to 53.3 per cent by end July 2016 from 51.2 per cent at end 2015.** In contrast, the share of concessional debt in the total foreign debt declined to 46.7 per cent by end July 2016 from 48.8 per cent at end 2015. The significant 15.1 per cent increase in non concessional debt to Rs. 2,088.3 billion was mainly due to the increase in commercial borrowings.

Debt Service Payments

- **As per the original estimates, total debt service payments in 2016 were expected to be Rs. 1,169.3 billion, which is significantly lower than Rs. 1,317.8 billion recorded in 2015.** This decline was mainly attributable to the fact that there were no ISB maturities in 2016, as against the ISB maturity of US dollars 500 million in January 2015. Estimated total debt service payments consist of amortisation payments of Rs. 648.9 billion and interest payments of Rs. 520.5 billion. Amortisation payments on domestic debt was estimated to be Rs. 505.4 billion, while amortisation payments on foreign debt was estimated to be Rs. 143.4 billion in 2016. Interest payments on domestic and foreign debt were estimated to be Rs. 441.2 billion and Rs. 79.2 billion, respectively in 2016. However, with the developments in the market interest rates, the estimated interest payment was revised to Rs. 562.0 billion during the year.

Chart 6.6 Government Debt Service Payments vs Revenue



- **During the first seven months of 2016, total domestic and foreign debt service payments amounted to Rs. 766.4 billion.** This consisted of amortisation payments of Rs. 396.0 billion (51.7 per cent) and interest payments of Rs. 370.4 billion (48.3 per cent). Further, debt service payments to domestic and foreign sources amounted to Rs. 583.1 billion and Rs. 183.3 billion, respectively. Up to July 2016, total debt service payments amounted to 63.3 per cent of the revised annual estimate, comprising amortisation payments accounting for 61.0 per cent of the revised annual estimate and interest payments accounting for 65.9 per cent of the revised annual estimate.

7

MONETARY POLICY, INTEREST RATES, MONEY AND CREDIT

The Central Bank tightened its monetary policy stance in several steps during the first nine months of 2016 to curtail the high expansion in money and credit aggregates with a view to pre-empting the emergence of demand driven inflationary pressures in the economy. The Central Bank ended the relaxation cycle of monetary policy by raising the Statutory Reserve Ratio (SRR) applicable to all rupee deposit liabilities of commercial banks by 1.50 percentage points effective January 2016. Thereafter, the Central Bank increased its key policy interest rates, namely the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 50 basis points each, in February 2016. Nevertheless, monetary aggregates expanded at a rate higher than projected, reflecting the significant expansion in credit disbursements to the private sector as well as credit extended to the government from the banking sector. However, credit obtained by public corporations recorded a decline reflecting the improved financial position of certain key public corporations. While headline inflation indicated some upward movement towards mid-2016, particularly due to supply side disturbances and changes to the government tax structure, core inflation indicated a continuous upward trend reflecting the emergence of demand pressures in the economy. Considering the sustained increase in credit and monetary aggregates and the increasing trend inflation, the Central Bank further tightened its monetary policy stance, in a forward looking manner, in July 2016 by increasing its key policy interest rates by 50 basis points. Responding to monetary tightening measures, short term interest rates increased substantially, while the Central Bank engaged in open market operations (OMO) appropriately with a view to maintaining overnight interest rates at levels consistent with the monetary policy stance and to prevent undue volatility in interest rates. The increase in short term interest rates gradually transmitted to other market interest rates including lending and deposit rates of financial institutions. The transmission of monetary policy adjustments so far during the year is expected to pre-empt the emergence of inflationary pressures in the economy by maintaining credit and monetary expansion at desired levels, while containing adverse inflation expectations. Going forward, the conduct of monetary policy will be focused on maintaining inflation at mid-single digits, while facilitating the economy to realise its potential in the medium term.

Monetary Policy Stance of the Central Bank of Sri Lanka

- **The Central Bank continued to conduct monetary policy within an enhanced monetary policy framework aligning towards flexible inflation targeting (FIT) with the objective of maintaining economic and price stability on a sustainable basis.** Under this enhanced monetary policy framework, the Central Bank focuses on stabilising inflation at mid-single digits over the medium term, while facilitating the growth momentum of the economy. In operationalising the monetary policy conduct, the Central Bank employs market based instruments, particularly policy interest rates and open market operations (OMO) to guide the average weighted call money rate (AWCMR), which serves as the operating target of the present enhanced monetary policy framework, along the desired path. Meanwhile, broad money (M_{2b}) continued to remain the key indicative intermediate variable, which reflects the broad liquidity conditions in the economy, to guide the conduct of monetary policy of the Central Bank. The monetary policy decision making process continued to be based on a comprehensive analysis of the economy, including developments in the monetary sector as well as other key sectors of the economy, supplemented by forecasts and surveys of the expectations of economic agents. Risks to future inflation were regularly assessed and any foreseeable deviations from the desired levels were informed to the Monetary Board through the Monetary Policy Committee (MPC) of the Central Bank in order to decide on required policy measures in a forward looking manner.

- **Consumer price inflation indicated an upward trend during the first half of 2016 and stabilised around mid-single digits thereafter.** Headline inflation, as measured by the year-on-year change in the National Consumer Price Index (NCPI, 2013=100), which reflects price movements across the country, was below mid-single digits during the first quarter of 2016, but registered an increase in the second quarter of the year. The increase in inflation was a reflection of the combined impact of domestic supply side disruptions, particularly due to adverse weather conditions, and the increase in the Value Added Tax (VAT) rate as well as the removal of certain exemptions applicable to VAT and the Nation Building Tax (NBT). While the unfavourable supply conditions resulted in a momentary increase in food inflation, the initial impact of revisions made to the tax structure was more profound on non-food inflation, particularly in the categories of Communication and Health. Nonetheless, inflation declined in the third quarter of 2016 reflecting the impact of normalisation in supply conditions as well as the suspension of the implementation of changes to the government tax structure. Accordingly, on a year-on-year basis, NCPI based headline inflation, which increased to a peak of 6.4 per cent in June 2016, moderated to 4.7 per cent by September 2016. On an annual average basis, NCPI based headline inflation was 3.8 per cent in September 2016. Following a similar trend, the Colombo Consumers' Price Index (CCPI, 2006/2007=100) based headline inflation also reached a peak of 6.0 per cent by June 2016 and declined gradually to 3.9 per cent in September 2016, while on an annual average basis, it stood at 3.4 per cent in September 2016.

- **Core inflation, which measures the underlying price pressures in the economy, indicated some stabilisation following an increasing trend, while inflation expectations, which reflect economic agents' sentiments about future inflation, remained broadly anchored.** Core inflation continued its upward trend in the first half of 2016 reflecting the firming up of demand conditions in the economy, while it steepened towards the latter part of this period following the revisions made to the tax structure by the

Chart 7.1 **Contribution to Year-on-Year Headline Inflation (NCPI)**

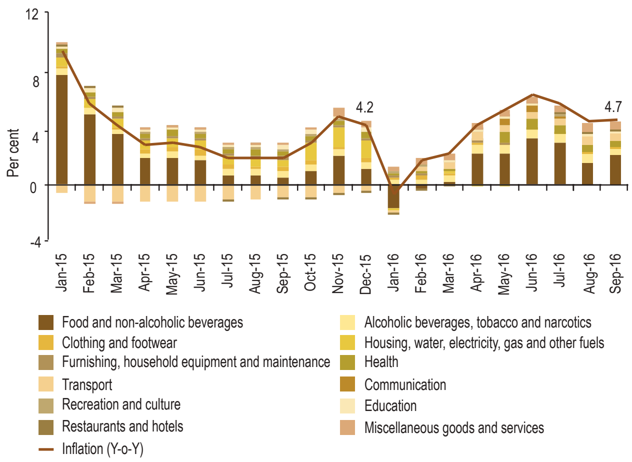
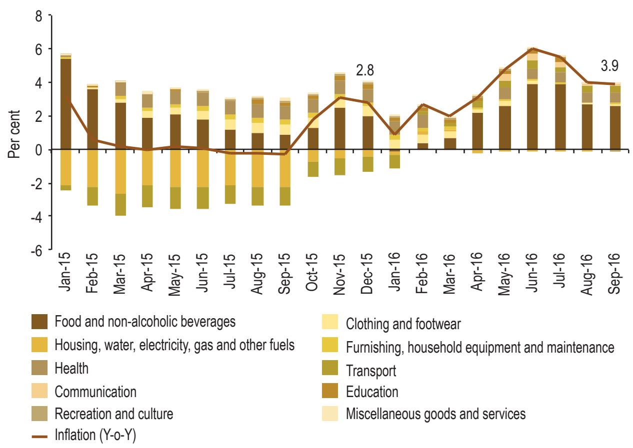


Chart 7.2 **Contribution to Year-on-Year Headline Inflation (CCPI)**



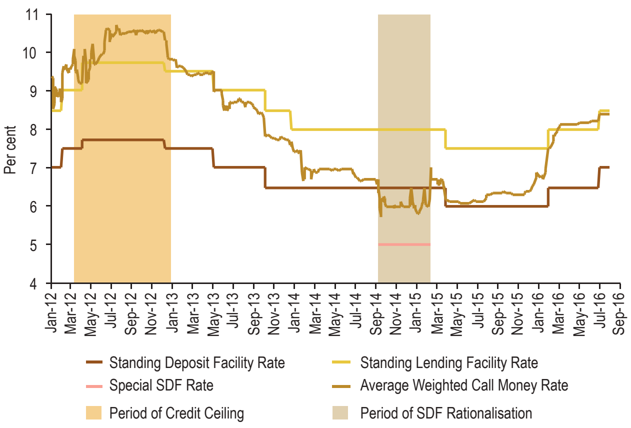
government. However, core inflation stabilised around mid-single digits thereafter, part of which could be attributed to the reversal of the changes made to the tax structure. Accordingly, core inflation based on NCPI, which excludes volatile food items, energy and transport from the NCPI basket, was 5.7 per cent in September 2016, year-on-year, compared to the peak level of 7.5 per cent recorded in June 2016 and 5.8 per cent recorded at end 2015. CCPI based core inflation was 4.2 per cent, year-on-year, in September 2016 in comparison to 4.5 per cent at end 2015. Meanwhile, although inflation expectations of both the corporate and the household sectors, as measured by the Inflation Expectations Survey of the Central Bank, indicated a temporary upward shift following the announcement of changes to the tax structure, inflation expectations remained broadly anchored during the first nine months of the year.

- **Broad money supply continued to remain an important indicative-intermediate variable of the monetary policy framework to guide the conduct of monetary policy.** Although the original monetary programme for 2016 envisaged an annual growth of around 10.0 per cent in broad money (M_{2b}) by end 2016, consistent with the projected real GDP growth and the expected implicit GDP deflator, M_{2b} growth remained high at 17.3 per cent by end August 2016 on account of the larger than expected expansion in credit extended to the private sector as well as to the government.

- **The Central Bank tightened its monetary policy stance in several stages during the first nine months of 2016 with a view to curtail the excessive monetary expansion resulting from high credit growth and contain the possible emergence of demand-driven inflationary pressures in the economy.** Monetary aggregates grew at a rate higher than projected during 2015 driven by enhanced credit flows to both private and the public sectors, amidst the accommodative monetary policy stance of the Central Bank. Given the higher than expected domestic credit growth, which could fuel demand pressures in the economy, and considering the concerns relating to financial system stability, several prudential policy measures were introduced by the Central Bank towards end 2015 to curb the excessive credit flows to selected sectors, while allowing the exchange rate to be determined predominantly by market forces. Accordingly, a minimum cash margin requirement was imposed on Letters of Credit (LCs) opened for the importation of motor vehicles, which was subsequently replaced by a maximum

Loan-to-Value (LTV) ratio on loans and advances granted for the purpose of purchase or utilisation of motor vehicles. At the same time, the Central Bank commenced tightening its monetary policy stance gradually from end 2015 with a view to forestall excessive demand pressures on inflation arising from high monetary expansion and the continued high excess rupee liquidity in the domestic money market. As such, in December 2015, the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of commercial banks was raised by 1.50 percentage points to 7.50 per cent, to be effective from the reserve period commencing 16 January 2016. The increase in SRR absorbed around Rs. 52 billion of excess liquidity on a permanent basis from the domestic money market, while short term money market rates responded to tightened market liquidity conditions. In spite of the upward adjustments observed in market interest rates following the increase in SRR, certain risks to macroeconomic stability continued, warranting further monetary policy measures. In particular, certain imbalances were visible during this period due to excessive growth of broad money fuelled by domestic credit expansion as well as the continued upward trend in underlying inflation. Accordingly, considering possible threats to economic and price stability, the Central Bank tightened its monetary policy stance again by increasing its Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) by 50 basis points each, to 6.50 per cent and 8.00 per cent, respectively, effective from the close of business on 19 February 2016, as a pre-emptive policy measure to contain further build-up of demand driven inflationary pressures in the economy. Monetary tightening measures coupled with declining levels of excess market liquidity resulted in an upward trend in short term money market rates, while other market interest rates also experienced a gradual upward adjustment. However, amidst increasing lending

Chart 7.3 Standing Rate Corridor and Average Weighted Call Money Rate (AWCMR)



rates, credit disbursements to the private sector by commercial banks continued to grow unabated beyond the desired levels. Therefore, the Central Bank tightened its monetary policy stance further by increasing the SDFR and SLFR by 50 basis points each, to 7.00 per cent and 8.50 per cent, respectively, to be effective from the close of business on 28 July 2016.

- **The Central Bank conducted OMO appropriately to maintain overnight interest rates at desired levels.** Accordingly, amidst an environment of declining rupee liquidity in the domestic money market, the Central Bank conducted regular reverse repurchase auctions, particularly from the second quarter of 2016, to provide liquidity to OMO participants who experienced a shortage of funds, while allowing access to standing facilities of the Central Bank to meet their daily liquidity requirements. These operations helped maintain the AWCMR at appropriate levels, thereby guiding the interest rate structure of the economy to desired levels. The increase in short term interest rates, which was driven by policy rate hikes and declining liquidity levels, gradually transmitted to other market rates, including lending and deposit rates of financial institutions, particularly commercial banks. The resultant increase in cost of funds in the economy is expected to dampen the high demand for credit from the private sector, thereby containing overall monetary expansion at desired levels.

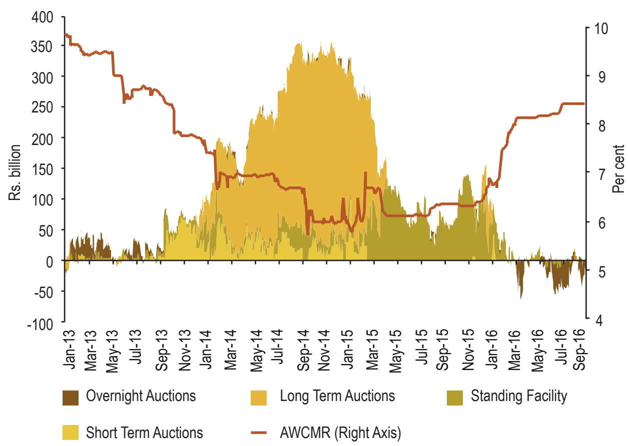
- **The communication strategy of the Central Bank continued to focus on providing greater clarity about the monetary policy decisions to market participants and the general public.** The policies and decisions of the Central Bank were communicated to market participants and the general public on a regular basis with the rationale for such measures thus helping the Central Bank to maintain its credibility, which is key to ensure policy effectiveness. At the same time, issuing regular and occasional communiqués, conducting of press conferences, seminars and lectures as well as delivering speeches by the Governor and the senior officials of the Central Bank enabled managing expectations of the public, particularly on inflation. Meanwhile, the Central Bank continued publishing useful economic information on a daily, weekly and monthly basis in the form of economic indicators, bulletins and in graphical forms, in all three languages, on the Central Bank website.

Movements in Interest Rates

Market Liquidity, Market Operations and Short Term Interest Rates

- **Rupee liquidity in the domestic money market declined gradually during 2016 requiring the Central Bank to engage in liquidity management operations as appropriate to provide greater stability to short term interest rates.** In the last quarter of 2015, high levels of excess liquidity, averaging around Rs. 94 billion, was observed due to the purchase of the proceeds of the Sri Lanka Development Bonds (SLDBs) and a part of the proceeds of the International Sovereign Bonds (ISBs) as well as subscriptions to Treasury bills at primary auctions by the Central Bank. With the view of bringing down the continuously high liquidity in the domestic money market, the Central Bank raised the SRR applicable on all rupee deposits of commercial banks by 1.50 percentage points with effect from 16 January 2016, and this resulted in a permanent absorption of liquidity of around Rs. 52 billion from the domestic money market. As a result, short term interest rates experienced an upward adjustment. Nevertheless, rupee liquidity remained noticeably high during January 2016 as well due to the maturing of term repurchase agreements and the purchasing of Treasury bills by the Central Bank along with the granting of provisional advances to the government. However, foreign loan repayments, new term repurchase agreements as well as the supply of foreign exchange to the domestic foreign exchange market by the Central Bank caused a gradual decline in excess liquidity. Accordingly, the average excess liquidity in the market, which stood at Rs. 71 billion in January, declined to around Rs. 9 billion in March 2016. Despite occasional improvements in the liquidity levels, market liquidity in general continued to remain in deficit levels thereafter reflecting the combined impact of the maturing of Treasury bills held by the Central Bank as well

Chart 7.4 Movements in Market Liquidity Conditions and AWCMR



as foreign loan repayments. Accordingly, the liquidity deficit in the domestic market during April to September 2016 averaged around Rs. 19.1 billion. Reflecting the upward pressure on short term interest rates due to deficit liquidity levels in the domestic money market amidst monetary tightening measures, AWCMR increased and the Central Bank commenced conducting overnight reverse repurchase auctions, particularly since April 2016, on a regular basis with the view of injecting liquidity into the domestic money market, thereby preventing excessive volatility in short term market interest rates.

- **Short term interest rates, particularly AWCMR, which is the operating target of the current enhanced monetary policy framework, displayed a sharp increase during the first quarter of 2016 and stabilised thereafter**. Following the upward adjustment in the SRR as well as the increase in policy interest rates of the Central Bank, by mid-February 2016, AWCMR increased to around 7.51 per cent compared to 6.40 per cent at end 2015. Responding to the sharp decline in market liquidity levels by end March 2016, AWCMR increased further to reach 8.15 per cent by the first week of April 2016. The OMO conducted by the Central Bank helped mitigate further increases in money market rates and thus AWCMR continued to hover within the range of 8.15-8.24 per cent until the Central Bank tightened its monetary policy stance further in July 2016. Following the policy rate hike in July, the AWCMR increased to 8.40 per cent and remained at 8.42 per cent by end September 2016. Meanwhile, the Sri Lanka Inter Bank Offered Rates (SLIBOR) increased gradually in line with the movements in AWCMR. Accordingly, by end September 2016, overnight and 12-months SLIBOR remained at 8.44 per cent and 11.98 per cent, respectively, compared to 6.40 per cent and 7.66 per cent, respectively, prevailed at end 2015.

Yields on Government Securities

- **Yields on government securities continued to increase during the first quarter of 2016 but moderated thereafter following improvements in government finances**. Yields pertaining to Treasury bills in the primary market increased sharply during the first three months of the year due to relatively high domestic borrowings of the government amidst the delay in foreign financial flows to the government and overall adjustment of the interest rate structure due to monetary tightening measures. Accordingly, the 91-day Treasury bill rate, which stood at 6.45 per cent by end December 2015, increased considerably by 245 basis points within a period of three months to reach 8.90 per cent by end March 2016. Meanwhile, the 182-day and 364-day Treasury bill yields also increased to 9.76 per cent and 10.64 per cent, respectively, by end March 2016 compared to 6.83 per cent and 7.30 per cent, respectively, reported at end 2015. Market expectations of high government borrowings and the anticipation of further monetary tightening may have led to a significant increase in yields in the primary market. Nevertheless, as the government securities market experienced a net foreign inflow since the latter part of April 2016, the pressure on yields was eased to some extent. Meanwhile, enhancements of government revenue collection and the announcement of the Extended Fund Facility (EFF) Programme of the International Monetary Fund (IMF) yielded favourable market expectations in the government securities market. Although some upward movements of the yields of Treasury bills were witnessed during April-July, yields in the primary market remained broadly stable during this period. Meanwhile, the receipt of long term financial flows due to the successful issuance of Sri Lanka's tenth ISB amounting to US dollars 1.5 billion in July 2016 as well as the

Chart 7.5 Primary Market Treasury Bill Yields

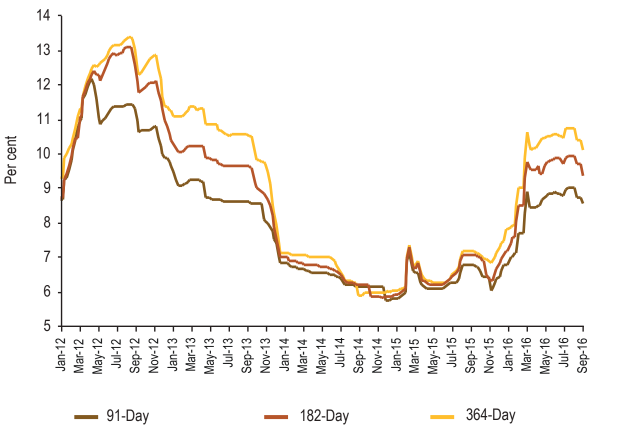
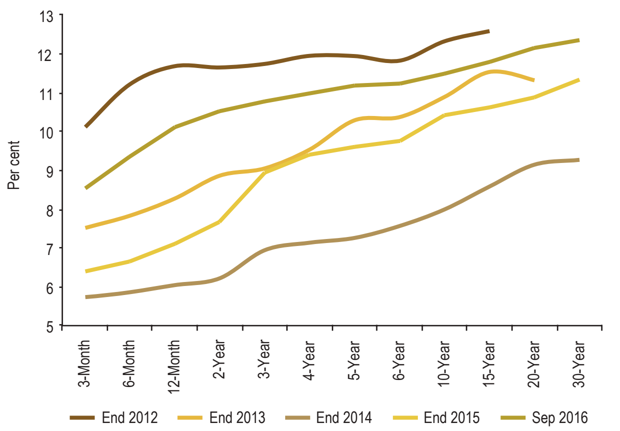


Chart 7.6 Secondary Market Yield Curve for Government Securities



receipt of the syndicated loan proceeds of US dollars 700 million during this period helped ease the pressure on yields of government securities. Although there was an upward adjustment in the yields immediately after the policy rate hike in July 2016, reflecting the low supply of government securities amidst some improvements in government finances and the availability of foreign inflows, the yields of Treasury bill rates started to decline from end August 2016. Accordingly, 91-day, 182-day and 364-day Treasury bill rates declined to 8.55 per cent, 9.39 per cent and 10.11 per cent, respectively, by end September 2016.

- **Yields on Treasury bonds displayed an upward trend during the first nine months of 2016 despite some moderation observed towards the end of the period under consideration.** Following a similar trend observed for the yields of Treasury bills, the yields on Treasury bonds increased sharply during the first three months of the year in the midst of a high borrowing requirement of the government, increasing money market interest rates and unfavourable market expectations, but moderated thereafter. The government continued to resort to short and medium term Treasury bonds during this period and issued short and medium term SLDBs at various floating rates. Yields on 5-year Treasury bonds increased from 9.79 per cent by end December 2015 to its peak at 13.0 per cent level by early April 2016 and moderated thereafter to 11.76 per cent recording a 197 basis point increase during the year up to end September 2016. Treasury bond yields for 10-year maturity also increased from 10.94 per cent by end December 2015 to 13.93 per cent by end March 2016 and declined to 11.06 per cent as at end September 2016.

- **Reflecting the overall increase in the interest rate structure, the upward trend in the secondary market Treasury bill and bond yields continued during the first nine months of the year.** An upward shift in the yield curve for government securities was witnessed during this period, particularly for the short end. Accordingly, yields on Treasury bills of all maturities in the secondary market increased by 214 to 298 basis points by end September 2016 in comparison to the yield rates observed at end 2015. Yields on Treasury bonds with short to medium term maturities increased by 154 to 288 basis points, while those on long term maturities increased by 100 to 146 basis points by end September 2016 in comparison to the yields observed at end 2015.

Table 7.1 **Movements in Interest Rates**

Per cent per annum

Interest Rate	End 2015	End Sep 2016
Policy Interest Rates (a)		
Standing Deposit Facility Rate	6.00	7.00
Standing Lending Facility Rate	7.50	8.50
Average Weighted Call Money Rate (AWCMR)	6.40	8.42
Yield Rates on Government Securities		
Primary Market (b)		
Treasury bills		
91-day	6.45	8.55
182-day	6.83	9.39
364-day	7.30	10.11
Treasury bonds		
2-year	6.70	11.04
3-year	8.18	11.62
4-year	8.91	10.61
5-year	9.79	11.76
10-year	10.94	11.06
Secondary Market		
Treasury bills		
91-day	6.39	8.54
182-day	6.66	9.37
364-day	7.11	10.09
Treasury bonds		
2-year	7.65	10.54
3-year	8.96	10.80
4-year	9.42	10.96
5-year	9.63	11.19
10-year	10.41	11.51
Licensed Commercial Banks (c)		
Interest Rates on Deposits		
Savings Deposits	0.50-8.00	0.50-12.25
One Year Fixed Deposits (d)	3.95-15.00	4.50-15.00
Average Weighted Deposit Rate (AWDR)	6.20	7.56
Average Weighted Fixed Deposit Rate (AWFDR)	7.57	9.67
Average Weighted New Deposit Rate (AWNDR)	6.96	11.01
Interest Rates on Lending		
Average Weighted Prime Lending Rate (AWPR)	7.40	12.29
Average Weighted Lending Rate (AWLR)	11.00	12.88
Average Weighted New Lending Rate (AWNLR)	10.79	13.97
Other Financial Institutions		
Interest Rates on Deposits		
National Savings Bank		
Savings Deposits	5.00	4.25
One Year Fixed Deposits	7.25	11.00
Licensed Finance Companies (e)		
Savings Deposits	4.98-6.77	5.34-7.47
One Year Fixed Deposits	9.34-10.68	11.44-13.07
Interest Rates on Lending		
National Savings Bank (f)	8.00-13.00	12.00-16.00
State Mortgage and Investment Bank (f)	7.07-13.50	9.96-20.00
Licensed Finance Companies (e)		
Finance Leasing	15.38-24.05	16.30-25.87
Hire Purchase	18.20-20.38	17.77-19.28
Loans against Real Estate	20.00-22.00	16.60-19.33
Corporate Debt Market		
Debentures	8.00-12.00	9.60-13.75
Commercial Paper	7.00-12.00	8.70-14.60

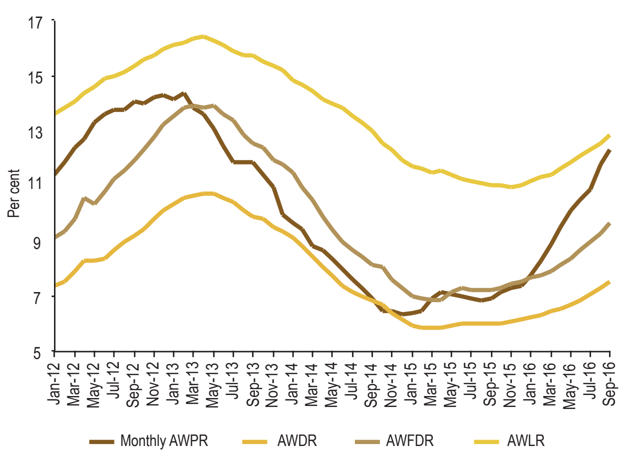
(a) The Repurchase rate and the Reverse Repurchase rate of the Central Bank were renamed as the Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR), respectively, w.e.f. 2 January 2014.
(b) Weighted average yield rates at the latest available auction.
(c) Based on the rates quoted by commercial banks and other selected financial institutions.
(d) Maximum rate is a special rate offered by certain commercial banks.
(e) Average rates, based on the maximum and minimum rates quoted by Licensed Finance Companies and therefore data for 2015 and 2016 is provisional.
(f) Lending for housing purposes only.

Sources: Colombo Stock Exchange
Respective financial institutions
Central Bank of Sri Lanka

Deposit and Lending Interest Rates

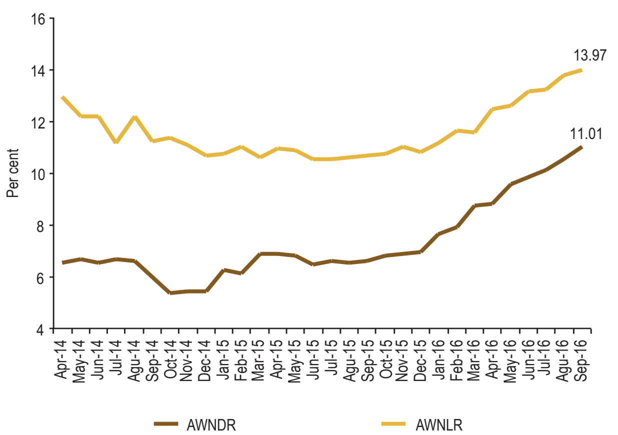
- **Both deposit and lending rates continued their upward trend reflecting the gradual transmission of the increase in short term interest rates to retail interest rates.** The average weighted deposit rate (AWDR), which reflects the movements in interest rates relating to all outstanding interest bearing deposits held with commercial banks, increased by 136 basis points to 7.56 per cent during the first nine months of the year. Meanwhile, the Average Weighted Fixed Deposit Rate (AWFDR), which is computed in respect of outstanding term deposits maintained with commercial banks, increased by 210 basis points to 9.67 per cent by end September 2016. A substantial increase in interest rates pertaining to short term time deposits, particularly for 3-month and 1-year, was observed during this period. Moreover, average weighted new deposit rate (AWNDR), which captures interest rates pertaining to all new interest bearing deposits, increased by 405 basis points to 11.01 per cent by end September 2016 from 6.96 per cent reported at end 2015. As such, the depositors continued to benefit from positive real rates of return on their deposits despite there being some increase in inflation during this period.

Chart 7.7 **Movements in Selected Market Interest Rates**



- **Following monetary tightening measures, lending rates of commercial banks increased at a higher rate causing a widening of interest spreads.** The Average Weighted Lending Rate (AWLR), which reflects the interest rates pertaining to the stock of all outstanding loans and advances extended by commercial banks to the private sector, increased by 188 basis points from 11.00 per cent at end 2015 to 12.88 per cent by end September 2016. Accordingly, the spread between the AWDR and AWLR also increased from 4.80 per cent recorded at end 2015 to 5.32 per cent by September 2016. Bank-wise average weighted lending rates remained in the range of 10.28-15.48 per cent by end September 2016. The Average Weighted New Lending Rate (AWNLR), which captures interest rates of all new loans and advances extended by commercial banks to the private sector during a particular month, also increased from 10.79 per cent by end December 2015 to 13.97 per cent at end September 2016. Meanwhile, reflecting the significant upward pressure on short term interest rates, the weekly Average Weighted Prime Lending Rate (AWPR), which is the rate applicable for borrowings by prime customers of commercial banks, increased substantially by 459 basis points to 12.12 per cent by end September 2016 compared to 7.53 per cent at end 2015. The monthly average of the weekly AWPR also increased by 489 basis points to 12.29 per cent by end September 2016 compared to 7.40 per cent at end 2015.

Chart 7.8 Movements in New Deposit and New Lending Rates*



* The Central Bank commenced the compilation of average weighted interest rates on new deposits and new loans in April 2014.

Other Interest Rates

Interest Rates on Debt Instruments

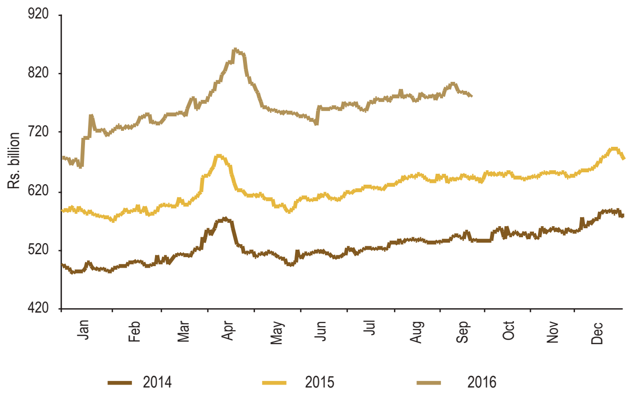
- **Interest rates applicable on debt instruments issued by the corporate sector have also shown some upward movement during the first nine months of 2016.** Accordingly, interest rates pertaining to commercial papers increased to a range of 8.70-14.60 per cent during the first nine months of 2016 compared to the range of 7.00-12.00 per cent that prevailed during 2015. Meanwhile, during the first nine months of the year, there were 22 listings of debentures by 11 corporates with maturities ranging from 2 to 10 years. Interest rates offered on these issues, payable annually, were in the range of 9.60-13.75 per cent by end September 2016, compared to 7.60-12.00 per cent reported during 2015.

Interest Rates on Foreign Currency Deposits

- **Indicating the impact of the movements in key global interest rates, particularly interest rates in the United States (US), interest rates on foreign currency deposits maintained at commercial banks increased marginally in 2016 compared to the rates that prevailed at end 2015.** Further, relaxation of controls on withdrawals from foreign currency deposits and allowing retail investors to invest in SLDBs may also have induced commercial banks to increase interest rates applicable on foreign currency deposits to some extent. Accordingly, interest rates on US dollar denominated savings deposits increased marginally to a range of 0.02-3.53

per cent by end September 2016 compared to a range of 0.02-3.00 per cent reported at end 2015. Moreover, interest rates pertaining to US dollar denominated time deposits were in the range of 0.10-5.00 per cent by end September 2016 compared to a range of 0.14-4.25 per cent recorded at end 2015. Meanwhile, interest rates on savings deposits denominated in pound sterling were in the range of 0.10-2.03 per cent by end September 2016 in comparison to the range of 0.05-2.25 per cent at end 2015. Interest rates applicable on pound sterling denominated time deposits were in the range of 0.25-4.00 per cent by end September 2016 compared to the range of 0.09-4.00 per cent by end 2015.

Chart 7.9 Movements in Daily Reserve Money*



* Sudden changes in the movement of reserve money in particular months are due to revisions to SRR and seasonal factors.

Movements in Money and Credit Aggregates

Reserve Money

- **Reserve money, which represents the monetary base of the economy, continued to expand at a high rate during the first eight months of 2016, reflecting the significant expansion in commercial banks' deposits maintained at the Central Bank along with the increase in SRR applicable to all rupee deposit liabilities of commercial banks.** Accordingly, reserve money recorded a year-on-year growth of 23.3 per cent by end August 2016 compared to 16.5 per cent recorded at end 2015. In absolute terms, reserve money increased substantially by Rs. 112.3 billion to Rs. 785.7 billion during the first eight months of the year. The increase in both currency in circulation and commercial banks' deposits with the Central Bank contributed to the expansion in reserve money from the perspective of the liability side. Currency in circulation increased by Rs. 29.9 billion to Rs. 521.6 billion by end August 2016, whereas commercial banks' deposits with the Central Bank increased by Rs. 82.3 billion to Rs. 264.0 billion. During the festive seasons, currency in circulation exhibited a similar historical pattern indicating some sharp increases. However, the year-on-year growth of currency in circulation moderated to 12.4 per cent by end August 2016 compared to 17.9 per cent observed at end 2015 reflecting the increased opportunity cost of holding currency amidst rising interest rates in the economy.

- **On the assets side, the expansion in reserve money during the first eight months of 2016 was entirely due to the increase in net domestic assets (NDA) of the Central Bank, while net foreign assets (NFA) of the Central Bank recorded a contraction from end 2015.** The expansion in NDA of the Central Bank was Rs. 189.4 billion during the first eight months of 2016 compared to the increase of Rs. 207.3 billion in 2015, albeit the significant increase of Rs. 260.4 billion recorded during the period from January to July 2016. Within NDA, net credit to the government (NCG) provided by the Central Bank increased by Rs. 166.6 billion to Rs. 396.5 billion during the first eight months of 2016. Significantly contributing to the expansion in NCG, Central Bank holdings of government securities (net of repurchase transactions) increased by Rs. 133.0 billion to Rs. 212.2 billion by end August 2016 compared to Rs. 79.2 billion recorded at end 2015, although Central Bank holdings of government securities reported a contraction of Rs. 59.3 billion in August 2016 due to maturities of Treasury bills held by the Central Bank. Meanwhile, provisional advances to the government by the Central Bank, which is the other main component of NCG, also increased by Rs. 33.5 billion during this period. Among the other contributory factors towards the increase in NDA, other liabilities of the Central Bank contracted by Rs. 26.3 billion by end August 2016 contributing to enhance the NDA. This contraction was mainly attributable to the decline in funds placed under the Standing Deposit Facility by around Rs. 51.2 billion reflecting the prevailing deficit liquidity conditions in the domestic money market. Meanwhile, NFA of the Central Bank declined by Rs. 77.2 billion during the first eight months of the year reflecting a decline in foreign currency reserves of the Central Bank.

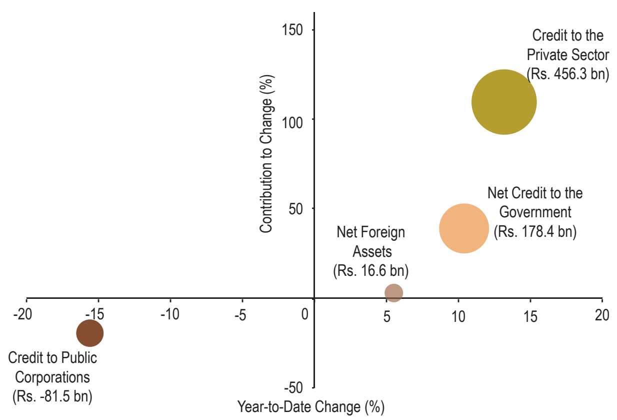
Narrow Money (M_1)

- **Continuing the slowdown observed since the latter part of 2015, the year-on-year growth of narrow money supply (M_1) moderated further during the first eight months of 2016.** The year-on-year growth of narrow money decelerated to 9.9 per cent by end August 2016 compared to 16.8 per cent recorded at end 2015. With regard to the components, currency held by the public, which accounts for about 56 per cent of the expansion of narrow money, increased by 11.3 per cent on a year-on-year basis to Rs. 402.6 billion by end August 2016 compared to 17.8 per cent recorded at end 2015. The slowdown in demand for currency is partly attributable to the increase in the opportunity cost of holding currency in an environment of rising interest rates. Meanwhile, the year-on-year growth of demand deposits held by the public at commercial banks was 8.1 per cent in August 2016 compared to 15.6 per cent recorded at end 2015. In absolute terms, demand deposits held by the public with commercial banks contracted by Rs. 15.3 billion during the first eight months of the year compared to the increase of Rs. 44.2 billion that was observed during 2015.

Broad Money (M_{2b}) and Domestic Credit

- **The expansion in broad money supply (M_{2b}) continued at a higher rate than projected during the first eight months of 2016, although some moderation was observed in August 2016.** M_{2b} recorded a year-on-year growth of 17.3 per cent by end August 2016 compared to 17.8 per cent recorded at end 2015. On average, broad money growth was 18.1 per cent during the first eight months of the year indicating a significant expansion of monetary aggregates in the economy. The expansion in NDA of the banking sector, driven by domestic credit flows, contributed mainly to broad money growth during the first eight months of 2016, while NFA of the banking system also recorded an increase during this period reversing the contractionary trend observed in NFA during the first half of the year.

Chart 7.10 Key Contributory Factors to Year-to-Date Growth of Broad Money (M_{2b})

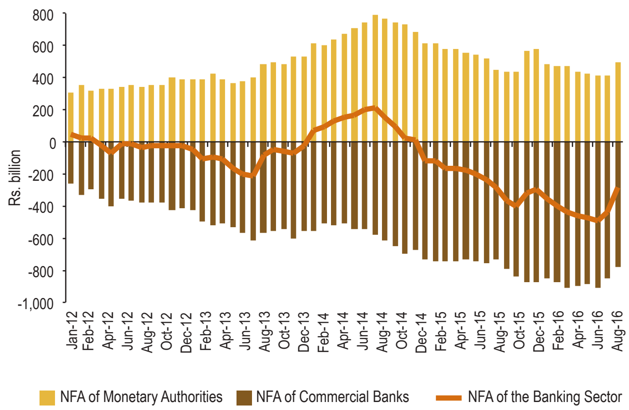


Note: The size of the bubble represents the change in credit in absolute terms (Rs. bn) from January to August 2016.

- **With regard to the liability side of monetary aggregates, during the first eight months of 2016, the increase in time and savings deposits held by the public with commercial banks contributed mainly to the expansion in broad money supply as measured by M_{2b}.** Reflecting the impact of the upward adjustment in retail interest rates applicable on time and savings deposits due to monetary tightening measures amidst aggressive marketing campaigns by commercial banks to raise deposits, time and savings deposits increased by Rs. 423.5 billion during the first eight months of 2016 compared to the increase of Rs. 338.8 billion recorded in the corresponding period of the previous year. On a year-on-year basis, time and savings deposits recorded a growth of 18.6 per cent by end August 2016 contributing over 90 per cent of the total increase in broad money liabilities. Time and savings deposits held in domestic banking units (DBUs) of commercial banks increased by Rs. 418.9 billion, while such deposits placed with offshore banking units (OBUs) also increased by Rs. 4.6 billion during this period. Meanwhile, demand deposits held by the public increased at a lower rate of 8.1 per cent on a year-on-year basis, although it contracted by Rs. 15.3 billion on a cumulative basis during the first eight months of 2016.

- **On the source side of M_{2b}, NFA of the banking system increased marginally during the first eight months of 2016 on account of the increase in NFA of commercial banks, while NFA of the Central Bank contributed negatively to the monetary expansion.** NFA of the Central Bank decreased by Rs. 77.2 billion by end August 2016 compared to the cumulative decline of Rs. 237.1 billion in the corresponding period of 2015. Meanwhile, NFA of commercial banks, which continued to decline during the first half of 2016, increased since July thereby recording a total increase of Rs. 93.8 billion by

Chart 7.11 Movements in Net Foreign Assets (NFA) of the Banking Sector



end August 2016 due to the expansion in NFA of both DBUs and OBUs by Rs. 27.0 billion and Rs. 66.9 billion, respectively. As reported by the commercial banks, the increase in NFA of DBUs during the period under review was mainly due to the combined impact of the increase in foreign currency placements with banks abroad as well as the decline in commercial bank borrowings from abroad, while both non-resident foreign currency account (NRFC) and resident non-national foreign currency account (RNNFC) balances of commercial banks increased by around Rs. 6.7 billion during this period. The expansion recorded in NFA of OBUs was mainly attributable to the increased placements with non-residents, including banks and non-banks, while borrowings from banks abroad also declined marginally during this period. Consequent to these developments, NFA of the banking system expanded by Rs. 16.6 billion during the first eight months of 2016 compared to the significant contraction of Rs. 294.0 billion during the same period in 2015.

- **NDA of the banking system increased significantly contributing to over 96 per cent of the expansion in broad money supply during the first eight months of 2016.** NDA of the banking system increased by 16.3 per cent on a year-on-year basis by end August 2016 and in

Table 7.2 Domestic Credit Expansion and Contributory Factors

Period	Absolute Change (Rs. billion)				Share of Domestic Credit (%)		
	Domestic Credit (a)	Credit to the Private Sector	Net Credit to the Government	Credit to Public Corporations	Credit to the Private Sector	Net Credit to the Government	Credit to Public Corporations
2011	775.1	514.8	206.4	53.9	66.4	26.6	7.0
2012	658.2	352.6	211.6	94.0	53.6	32.2	14.3
2013	504.7	175.9	256.1	72.6	34.9	50.7	14.4
2014	439.4	223.9	134.6	80.9	51.0	30.6	18.4
2015	1,091.9	691.4	323.6	76.9	63.3	29.6	7.0
Jan - Aug 2016	**553.3**	**456.3**	**178.4**	**-81.5**	**82.5**	**32.3**	**-14.7**

(a) Domestic Credit includes Credit to the Private Sector, Net Credit to the Government and Credit to Public Corporations.

Source: Central Bank of Sri Lanka

absolute terms, NDA expanded by Rs. 406.0 billion during the first eight months of 2016 compared to the increase of Rs. 670.6 billion in the corresponding period of the previous year. The expansion in NDA was largely driven by the credit flows to both public and private sectors, despite a notable decline in credit extended to public corporations during this period. During the first eight months of the year, domestic credit by the banking system expanded significantly by Rs. 553.3 billion although a noticeable decline of Rs. 79.7 billion was observed in August mainly due to the contraction in domestic credit granted to the public sector due to maturing of Treasury bills using proceeds of the ISB.

- **Within NDA of the banking system, NCG from both the Central Bank and commercial banks increased significantly during the first eight months of 2016**. During the period under review, NCG from the banking system increased by Rs. 178.4 billion compared to the increase of Rs. 299.7 billion in the corresponding period of the previous year although some contraction was observed in August 2016 due to maturing of Treasury bills held by the Central Bank. The expansion in NCG during the reference period was mainly due to the increase in credit extended by the Central Bank amounting to Rs. 166.6 billion in comparison to the increase of Rs. 80.3 billion recorded at end 2015. Contributing to the expansion in NCG by the Central Bank, Treasury bill holdings of the Central Bank (net of repurchase transactions) and provisional advances to the government by the Central Bank reported an increase during the reference period. Reflecting lower reliance on the commercial banking system, NCG by commercial banks increased only by Rs. 11.8 billion during the first eight months of 2016 compared to the substantial increase of Rs. 243.3 billion recorded during 2015 and Rs. 204.9 billion recorded for the first eight months of the previous year. Contributing to this expansion, during the first eight months of the year, NCG by DBUs of commercial banks increased by Rs. 50.5 billion compared to the increase of Rs. 105.5 billion in the same period of 2015 due to the increase in investments in Treasury bonds (amounting to Rs. 110.9 billion) and SLDBs (amounting to Rs. 6.4 billion), while there was a decline of Rs. 31.2 billion in investments in Treasury bills. Meanwhile, outstanding overdraft balances of the government with the banking sector also declined by Rs. 68.1 billion to Rs. 56.9 billion by end August 2016 compared to Rs. 125.1 billion recorded at end 2015. Compared to the significant increase of Rs. 163.6 billion during 2015, NCG by OBUs of commercial banks contracted by Rs. 38.7 billion, year-to-date, by end August 2016 largely due to a decline in investments in SLDBs by about Rs. 31.9 billion during this period.

- **The declining trend in credit obtained by public corporations that was observed since November 2015 continued during the first eight months of 2016 as well.** Credit extended to public corporations by the banking system contracted by Rs. 81.5 billion during the first eight months of the year compared to the increase of Rs. 36.5 billion in the corresponding period of the previous year and the overall increase of Rs. 76.9 billion recorded in 2015. The decline in credit to public corporations was mainly due to the repayments made by key public corporations including the Ceylon Petroleum Corporation (CPC) and the Ceylon Electricity Board (CEB). Reflecting the improved financial position, CPC settled around Rs. 97.5 billion of its outstanding debt with commercial banks. Meanwhile, CEB and Sri Lanka Ports Authority also settled around Rs. 8.4 billion and Rs. 1.7 billion, respectively, of their outstanding liabilities to commercial banks by end August 2016. However, borrowings by SriLankan Airlines and the Ceylon Fertilizer Corporation increased by Rs. 5.6 billion and Rs. 4.0 billion, respectively, while the increase in credit extended to Colombo Commercial Fertilizer, Road Development Authority and Ceylon Shipping Corporation amounted to Rs. 9.0 billion during the first eight months of 2016.

- **Mainly reflecting aggressive borrowings by the private sector in anticipation of future increases in interest rates due to monetary tightening as well as the positive impact of the increase in real incomes, credit to the private sector continued to flow at a higher rate in 2016.** In addition to the low interest rates that prevailed particularly during the previous year, the significant expansion in credit to the private sector is also attributable to competitive marketing campaigns by commercial banks as well as market expectations of upward adjustments in the government tax structure. The year-on-year growth of credit to the private sector continued to accelerate during the first seven months of 2016, recording a growth of 28.5 per cent by end July 2016 compared to 25.1 per cent that was observed at end 2015. However, the growth in credit to the private sector indicated some moderation to record 27.3 per cent in August 2016. On average, credit to the private sector grew by 27.5 per cent during the first eight months of 2016 compared to 16.6 per cent recorded in the corresponding period of the previous year. In absolute terms, the expansion in credit to the private sector was Rs. 456.3 billion during the first eight months of 2016 compared to the increase of Rs. 310.5 billion in the corresponding period of

Chart 7.12 Credit Granted by Commercial Banks to the Private Sector

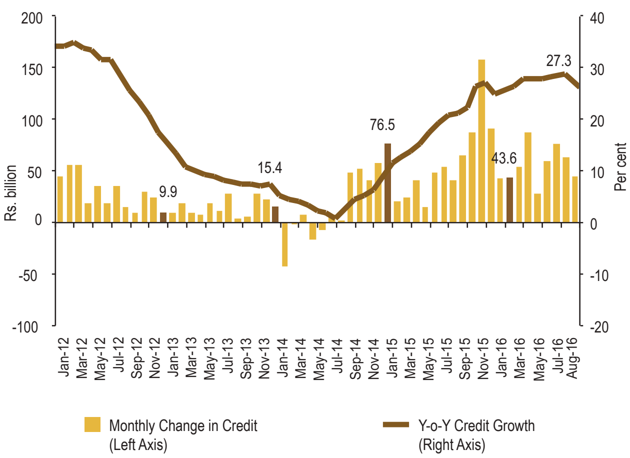
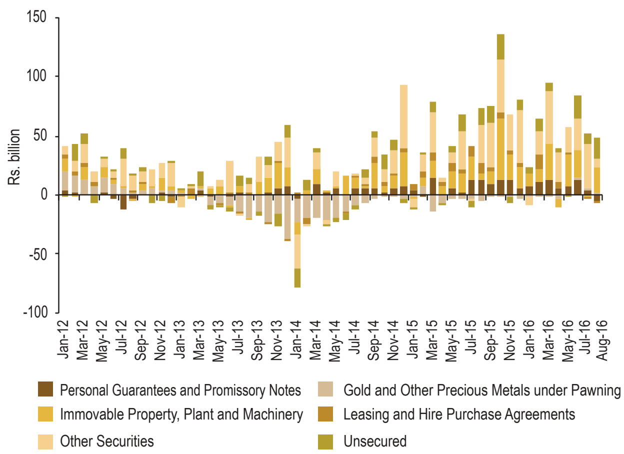


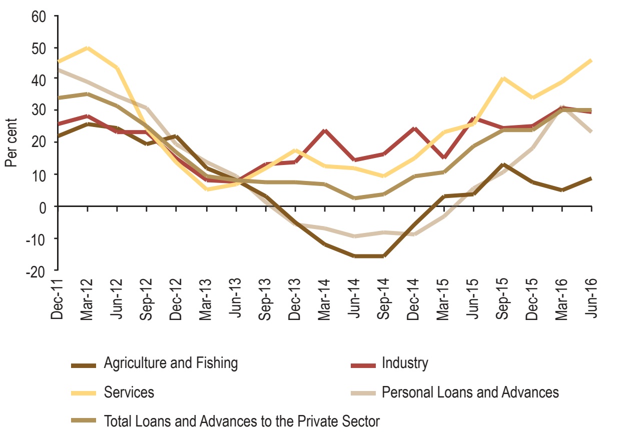
Chart 7.13 Monthly Change in Security-wise Advances of DBUs of Licensed Commercial Banks



the previous year, yielding an average of around Rs. 57 billion per month. As per the security-wise presentation of advances, by end August 2016, credit against Immovable Property, Plant and Machinery; Other Securities; Fixed, Savings and Other Deposits as well as Personal Guarantees and Promissory Notes, increased by Rs. 112.9 billion, Rs. 95.3 billion, Rs. 68.4 billion and Rs. 54.9 billion, respectively. Meanwhile, the increase in credit on account of Leasing and Hire Purchase Agreements has been limited to Rs. 18.0 billion thus far in 2016 compared to the substantial increase of Rs. 65.6 billion recorded at end 2015. This reflects the subdued import demand for motor vehicles in view of certain measures adopted by the Central Bank, including the imposition of minimum cash margin requirements and a maximum LTV ratio as well as the revisions to the tax structure made by the government.

- **A considerable expansion in credit disbursed to all major sectors of the economy was observed thus far in 2016.** As per the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, which is available up to end June 2016, credit to the Services and Industry sectors expanded significantly by 46.1 per cent and 29.6 per cent, respectively, on a year-on-year basis. In the Services sector, credit flows to Shipping, Aviation and Supply, and Freight Forwarding; Financial and Business Services; Transport; Health; Education and Wholesale and Retail Trade recorded considerable growth rates. Credit to major subsectors in the Industry sector also increased during the first half of 2016. Amongst these, by end June 2016, the Construction subsector, which accounts for around 60 per cent of total credit to the Industry sector, grew significantly by 40.2 per cent, on a year-on-year basis. Meanwhile, credit flows to the Agriculture

Chart 7.14 Year-on-Year Growth of Credit Granted by Commercial Banks to Key Sectors



sector grew at a moderate pace of 8.9 per cent, year-on-year, compared to 3.9 per cent recorded in the corresponding period of the previous year. Despite the slow growth in credit flows to certain subsectors such as Rubber, and Livestock and Dairy Farming, all other subsectors of the Agriculture sector received adequate credit flows during the period. Credit to the Paddy sector grew by 41.6 per cent by end June 2016, on a year-on-year basis, mainly due to increased disbursements of loans for cultivation during the Yala season. Meanwhile, credit under the Personal Loans and Advances category increased by 23.3 per cent, year-on-year, by end June 2016 compared to 3.1 per cent recorded in the corresponding period of 2015. Within this category, credit disbursed towards purchase of consumer durables grew at a higher rate of 58.9 per cent on a year-on-year basis. However, continuing the declining trend that was observed since September 2013, pawning advances continued to contract by 20.2 per cent, year-on-year. Meanwhile, indicating the borrowers' desire towards long term borrowings, long term credit grew by 59.7 per cent, year-on-year, by end June 2016 compared to 28.5 per cent recorded in the same period of 2015.

Table 7.3 Classification of Outstanding Credit to the Private Sector Granted by Commercial Banks (a)(b)

Rs. billion

Sector	End June 2015	End June 2016 (c)	Year-on-Year Change	
			Amount	%
Agriculture and Fishing	**291.2**	**317.0**	**25.8**	**8.9**
of which, Tea	69.0	78.1	9.1	13.2
Rubber	20.3	20.4	0.1	0.5
Coconut	9.8	12.5	2.7	27.7
Paddy	16.6	23.5	6.9	41.6
Vegetables, Fruit and Minor Food Crops	16.2	22.0	5.8	35.5
Fisheries	10.3	12.3	2.0	19.5
Industry	**1,188.0**	**1,539.6**	**351.6**	**29.6**
of which, Construction	528.5	741.0	212.4	40.2
Food and Beverages	73.5	86.5	12.9	17.6
Textiles and Apparel	131.8	144.7	13.0	9.8
Fabricated Metal Products, Machinery and Transport Equipment	105.2	126.5	21.3	20.3
Services	**787.0**	**1,149.7**	**362.8**	**46.1**
of which, Wholesale and Retail Trade	232.0	353.6	121.6	52.4
Tourism	88.8	118.8	30.0	33.7
Financial and Business Services	165.3	282.2	116.9	70.7
Shipping, Aviation and Supply, and Freight Forwarding	12.7	26.1	13.4	105.5
Personal Loans and Advances (d)	**694.2**	**855.7**	**161.5**	**23.3**
of which, Consumer Durables	108.2	172.0	63.8	58.9
Pawning	153.3	122.3	-30.9	-20.2
Total	**2,960.5**	**3,862.0**	**901.6**	**30.5**

(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector
(b) Includes loans, overdrafts and bills discounted and excludes cash items in the process of collection
(c) Provisional
(d) Excludes personal housing loans, which have been included under 'Construction' classified under 'Industry' and includes outstanding balances of credit card advances, which is a part of 'credit to the private sector' in the monetary survey

Source: Central Bank of Sri Lanka

Broad Money (M_4)

- **Following the same trend observed in broad money (M_{2b}) based on the monetary survey, broad money supply as per the financial survey (M_4), which considers monetary liabilities of the central bank, all licensed commercial banks (LCBs), licensed specialised banks (LSBs) and licensed finance companies (LFCs), increased by 14.6 per cent, year-on-year, in August 2016 compared to 16.8 per cent reported at end 2015.** From the liabilities side, time and savings deposits of all licensed banks and LFCs grew by 15.4 per cent, year-on-year, in August 2016 compared to 16.8 per cent at end 2015. The growth in time and savings deposits held with LSBs and LFCs declined on a year-on-year basis to 7.2 per cent and 10.6 per cent, respectively, in August 2016 compared to 7.7 per cent and 16.0 per cent, respectively, recorded at end 2015. However, time and savings deposits of both LCBs and LSBs increased during the first eight months of the year, while the growth in time and savings deposits of LFCs indicated a decline. This could be largely due to attractive interest rates offered on new rupee deposit accounts by licensed banks resulting in a shift of deposits. On the assets side, NDA of LCBs, LSBs and LFCs increased by around Rs. 444 billion, in absolute terms, during the first eight months of the year, contributing almost entirely to the expansion of broad money as per the financial survey, while NFA of these institutions increased marginally by around Rs. 15 billion during this period. The expansion of NFA as per the financial survey was largely due to improvements in NFA of LCBs, while a marginal decline of around Rs. 2 billion was observed in NFA of LSBs during the first eight months of the year. Despite the contraction in credit granted to public corporations, credit to the government as well as the private sector contributed to the expansion in NDA of licensed banks and LFCs by end August 2016.

- **In spite of elevated market interest rates in response to tight monetary policy measures, credit to the private sector, as per the financial survey, has continued to be buoyant.** The year-on-year growth of credit to the private sector was 22.9 per cent in August 2016 compared to 23.5 per cent at end 2015. In absolute terms, credit flows to the private sector as per the financial survey increased by around Rs. 586 billion during the first eight months of the year compared to around Rs. 495 billion in the corresponding period of the previous year. In addition to the substantial increase in credit disbursed by LCBs during the first eight months of 2016, LFCs also granted around Rs. 83 billion as loans and advances to the private sector, while LSBs granted around Rs. 47 billion during this period. During the first eight months of the year, NCG as per the financial survey increased by around Rs. 185 billion, in absolute terms, with NCG by LFCs increasing by about Rs. 9 billion, while that of LSBs declining by around Rs. 2 billion by end August 2016.

Monetary Policy in Other Countries

- **Most advanced economies continue to pursue accommodative monetary policies to spur economic growth and to achieve desirable levels of inflation amidst concerns about uncertainty arising from unexpected global developments.** Reflecting the divergence between monetary policy stance between key advanced countries, the US Federal Reserve embarked on changing its monetary policy

Table 7.4 Sources of Broad Money (M_4) (Computed as per the Financial Survey)

Rs. billion

Item	End August 2015	End 2015	End August 2016 (a)	Year-on-Year Change: End 2015 Amount	End 2015 %	Aug - 2016 Amount	Aug - 2016 %
Financial Survey (M_4)	**5,390.7**	**5,720.3**	**6,178.8**	**822.6**	**16.8**	**788.1**	**14.6**
Underlying Factors							
Net Foreign Assets	**-435.7**	**-444.1**	**-429.1**	**-307.4**	**-224.8**	**6.6**	**1.5**
Monetary Authorities	450.9	576.2	499.0	-111.8	-16.3	48.1	10.7
LCBs	-729.7	-874.3	-780.5	-201.5	-29.9	-50.8	-7.0
LSBs & LFCs	-156.9	-146.0	-147.6	5.9	3.9	9.3	5.9
Net Domestic Assets	**5,826.5**	**6,164.4**	**6,607.9**	**1,130.0**	**22.4**	**781.4**	**13.4**
Domestic Credit	**7,161.8**	**7,603.7**	**8,293.2**	**1,311.8**	**20.8**	**1,131.5**	**15.8**
Net Credit to the Government	**2,349.3**	**2,344.3**	**2,529.4**	**333.9**	**16.6**	**180.2**	**7.7**
Central Bank	244.5	229.9	396.5	80.3	53.6	152.0	62.2
LCBs	1,491.1	1,529.6	1,541.4	243.3	18.9	50.3	3.4
LSBs	552.1	529.2	527.0	14.4	2.8	-25.1	-4.6
LFCs	61.5	55.6	64.5	-4.1	-6.8	3.0	4.9
Credit to Public Corporations (LCBs)	**482.5**	**523.0**	**441.5**	**76.9**	**17.2**	**-41.0**	**-8.5**
Credit to the Private Sector	**4,330.0**	**4,736.4**	**5,322.3**	**900.9**	**23.5**	**992.3**	**22.9**
LCBs	3,068.7	3,449.6	3,905.9	691.4	25.1	837.1	27.3
LSBs	534.2	481.7	528.2	7.2	1.5	-6.0	-1.1
LFCs	727.0	805.2	888.2	202.3	33.6	161.2	22.2
Other Items (net)	**-1,335.3**	**-1,439.3**	**-1,685.3**	**-181.8**	**-14.5**	**-350.0**	**-26.2**

(a) Provisional

Source: Central Bank of Sri Lanka

direction, while the European Central Bank (ECB) and Bank of Japan (BOJ) continued to adopt an accommodative monetary policy stance. Nevertheless, despite the monetary policy normalisation measures adopted by way of raising its policy interest rates in December 2015, the US Federal Reserve continued to pursue an accommodative monetary policy stance to support further improvements in the labour market conditions and return to its inflation target of 2 per cent. Meanwhile, in the aftermath of the United Kingdom (UK) referendum decision to leave the European Union (Brexit), many advanced European economies have opted to confront adverse consequences via several monetary policy initiatives. Consequently, the Bank of England (BOE) launched a four-pronged approach to provide additional support to growth and to achieve its 2 per cent inflation target. In this context, measures including a 25 basis point reduction in the Bank Rate to 0.25 per cent, a new Term Funding Scheme to reinforce the pass-through of the cut in Bank Rate, the purchase of up to pound sterling 10 billion worth of corporate bonds as well as an expansion of the asset purchase scheme for government bonds of pound sterling 60 billion were implemented in August 2016. Meanwhile, continuing to pursue an accommodative stance, the ECB relaxed its monetary policy stance further in March 2016. Accordingly, interest rates on main refinancing operations (MRO) of the Eurosystem and marginal lending facility (MLF) were reduced by 5 basis points each to 0.00 per cent and 0.25 per cent, respectively, while the interest rate on the deposit facility was also reduced by 10 basis points to -0.40 per cent. Furthermore, the monthly asset purchase programme of the ECB is to continue until end of March 2017, or until inflation in the euro area increases up to its 2 per cent target level. Meanwhile, in view of achieving the inflation target of 2 per cent, in September 2016, BOJ strengthened its existing

Table 7.5 **Changes in Policy Interest Rates of Selected Central Banks**

Per cent

Country	Key Policy Rate	End 2013	End 2014	End 2015	Sep 2016
Emerging Economies					
India*	Repurchase rate	7.75	8.00	6.75	6.50
Malaysia	Overnight policy rate	3.00	3.25	3.25	3.00
Thailand	1-day bilateral repo rate	2.25	2.00	1.50	1.50
China	1-year yuan lending rate	6.00	5.60	4.35	4.35
Advanced Economies					
USA	Federal funds rate	0-0.25	0-0.25	0.25-0.50	0.25-0.50
UK	Bank rate	0.50	0.50	0.50	0.25
ECB	Main refinancing rate	0.25	0.05	0.05	0.00
Japan	Overnight call rate	0-0.10	0-0.10	0-0.10	-0.10-0.10
Canada	Overnight rate	1.00	1.00	0.50	0.50
Australia	Cash rate	2.50	2.50	2.00	1.50
Sweden	Repo rate	0.75	0.00	-0.35	-0.50
South Korea	Base rate	2.50	2.00	1.50	1.25

* On 4 October 2016, Repurchase rate was reduced by 25 bps to 6.25% from 6.50%.

Source: Websites of respective Central Banks

Quantitative and Qualitative Monetary Easing (QQE) and QQE with a negative interest rate frameworks by introducing a new policy framework consisting of two major components. The first component is yield curve control where the BOJ will control short term and long term interest rates and the second component is an inflation overshooting commitment where the BOJ commits itself to expand the monetary base until year-on-year inflation exceeds the inflation target of 2 per cent and remains above the target in a stable manner. Meanwhile, the Reserve Bank of Australia (RBA) lowered its cash rate by 25 basis points to 1.50 per cent in August 2016 indicating that easing of monetary policy will favour the prospects for a sustainable growth in the economy with inflation returning to 2-3 per cent target range over time. At the same time, the Reserve Bank of New Zealand (RBNZ) also continued its accommodative monetary policy stance. Accordingly, the RBNZ reduced its official cash rate by 25 basis points to 2 per cent. Among other advanced countries, Sweden, Norway and South Korea also continued to follow monetary relaxation measures mainly through reductions in policy interest rates with the view of supporting the recovery of the respective economies.

- **Central banks of emerging market economies appear to be focusing on accommodative monetary policy measures in view of continued risks and uncertainties, although the growth prospects of those countries for 2016 and beyond have improved.** As per the latest available information, business and consumer sentiment has improved regarding emerging market economies reflecting reduced concerns about economic prospects in China following policy support for growth as well as some recovery in commodity prices and expectations of lower interest rates in advanced economies. As the indicators of real activity in China were somewhat strengthened reflecting the effects of policy stimulus, the People's Bank of China (PBOC) has kept its policy rate unchanged at 4.35 per cent so far in 2016 since lowering its policy interest rate by 100 basis points in 2015. At the same time, amidst the improved prospects for the near term, many emerging countries continued to pursue an accommodative monetary policy. Taking advantage of the well contained inflation, the Reserve Bank of India (RBI) reduced its key policy rate, the repurchase rate, by 25 basis points to 6.25 per cent from 6.50 per cent on 4 October 2016. However, RBI is closely monitoring possible cost push pressures to inflation due to recent increase of salaries and housing allowances of government servants. Moreover, implementation of the Goods and Services Tax (GST) is forecast to have a moderate impact on consumer price inflation if the standard GST rate is set at 18 per cent. Meanwhile, Bank Negara Malaysia reduced its overnight policy rate by 25 basis points to 3.00 per cent and the ceiling and floor rates of the corridor for the overnight policy rate by 25 basis points each to 3.25 per cent and 2.75 per cent, respectively, in order to ensure a steady growth of the economy in a stable inflation environment.

Expected Developments

- **The Central Bank currently relies on an enhanced monetary policy framework with the view of moving towards a FIT framework in order to maintain low and stable inflation on a sustainable basis, while stabilising the real economy.** In 2015, the Central Bank officially announced that the monetary targeting framework that was in operation since early 1980s would be replaced gradually by aligning its monetary policy conduct towards a FIT framework. Under this framework, the Central Bank manoeuvres its policy tools to directly impact the general price levels in the economy, while considering broad monetary aggregates as the indicative-intermediate variable to guide monetary policy conduct. At the same time, the Central Bank continues to fulfill certain prerequisites to ensure the effectiveness of the monetary policy framework in terms of increased reliance on market based monetary policy instruments and enhanced institutional setup of the monetary policy conduct. In this endeavour, it is also expected that the government would extend its support by way of adhering to fiscal targets and ensuring fiscal consolidation on a sustainable basis, which is a key prerequisite for moving towards a full-fledged inflation targeting framework in the future. At the same time, in order to improve the efficacy of the monetary policy conduct as well as to reduce market uncertainties, the Central Bank would continue to further enhance its communication policy and transparency through various initiatives, including the announcement of the medium term policy framework, particularly the desired inflation path. Moreover, the Central Bank would continue to strengthen its technical capability, particularly with regard to macroeconomic modelling and forecasting, while upgrading the compilation methodologies of macroeconomic statistics in line with international standards in order to devise sound economic analyses and forecasts for the purpose of formulating effective policies.

- **A slowdown in domestic credit expansion is expected in the period ahead in response to monetary tightening measures adopted by the Central Bank.** Reflecting the impact of monetary policy measures, market interest rates, particularly medium to long term lending rates, indicate a significant upward adjustment leading to a rise in the cost of funds in the economy. As a result, credit aggregates, particularly credit to the private sector, are expected to flow at a level sufficient to facilitate the growth momentum of the economy, while a gradual decline in credit to the public sector is also expected with the anticipated strengthening of the fiscal position of the government as well as the improved financial position of key state owned enterprises. Nevertheless, it is essential that credit flows are channelled to productive economic activity rather than directed predominantly for consumption needs. At the same time, past episodes suggest that the domestic economy generally experiences undue credit cycles with substantial variations. In particular, it is observed that credit flows to the private sector could pick up sharply subsequent to a period of credit contraction or experience a sharp drop in response to tight monetary conditions thus disturbing the smooth flow of credit. As such, the Central Bank would continue to closely monitor the developments in credit to the private sector and adopt timely and effective monetary policy measures, supported by other macro-prudential measures, in order to ensure stable credit flows to the economy without creating bubbles that could threaten both monetary and financial stability.

- **The low inflation trajectory that prevailed during the past several years is expected to be sustained in the medium term mainly due to proactive policy measures taken by the Central Bank.** Although some upward trend in both headline and core inflation was observed in 2016, demand pressures in the economy are expected to moderate in response to early monetary tightening measures adopted by the Central Bank. Accordingly, it is expected that inflation would be sustained in a range of 4-6 per cent in the medium term, which is also consistent with the inflation target bands stipulated under the EFF Programme of the IMF. Nevertheless, supply shortages stemming from weather-related developments as well as shocks that could arise due to possible reversal of global commodity prices could cause temporary variations in price levels. In addition, the changes to the government tax structure could also elevate price levels. As such variations in inflation seem temporary or could only lead to a one-off adjustment in prices, it is expected that inflation expectations would broadly remain anchored. However, in response to such temporary disturbances to prices, it is expected that the government would adopt relevant short and long term measures to counter the adverse supply side effects on domestic prices as well as to curb imported inflation emanating from external shocks thus helping to mitigate the adverse inflation expectations of the general public. The Central Bank would also continue to discharge its function of conducting monetary policy by way of adopting pre-emptive policy measures in order to curb the sustained rise in general price levels in the economy emanating due to excessive demand, and hence to ensure a stable macroeconomic environment essential for sustainable economic growth.

8

FINANCIAL SECTOR PERFORMANCE AND SYSTEM STABILITY

The financial sector recorded a continuation of its growth momentum during the first eight months of 2016 within the prudential parameters. The banking sector sustained its asset growth while maintaining capital and liquidity levels well above the statutory minimum requirements. Increasing demand for domestic credit helped the sector to maintain higher loan growth while profitability and asset quality improved. The conducive market environment that prevailed during the period enabled licensed banks to manage foreign currency exposures within the prudential limits. The bank branch network was expanded further with new branches being added to the system thereby increasing financial inclusion in the country. The non-bank financial sector showed a positive momentum in terms of asset growth while preserving asset quality, overall liquidity, capital position and profitability. Other sub sectors of the financial sector, which include the insurance sector, the primary dealers in government securities, the unit trust sector and the superannuation fund sector, showed positive business expansion during the period under consideration, without major stability concerns.

Domestic financial markets continued to be active. The domestic interbank money market reflected a liquidity shortfall towards the latter part of the first nine months of 2016, and as a result, the volatility in interbank call money rates increased. The yield rates of government securities in the secondary market continued to be volatile and increased during the first nine months of 2016, compared to the same period of 2015. Increased government borrowing requirements coupled with the upward adjustment of the statutory reserve requirement at the beginning of the year and the tightening of policy rates in February and July 2016 have contributed primarily to the above increase. The domestic foreign exchange market reflected mixed performances during the period amidst the depreciation of USD/LKR exchange rate by 1.8 per cent, mainly due to the withdrawals by foreigners from their holdings of government securities during the first quarter of 2016. However, this trend was reversed during the second quarter with increased foreign investments in government securities and the provision of Extended Fund Facility by the International Monetary Fund to Sri Lanka. The corporate debt securities market reflected a modest improvement in its activities. The equity market recorded a sluggish performance in terms of average daily turnover, net foreign investment inflows and market capitalisation while price indices declined.

Meanwhile, the national payment systems of the country operated smoothly without any major disruption or stability concerns while facilitating the growing and changing payment needs of the financial sector with improved efficiency and safety.

Developments in Financial Institutions

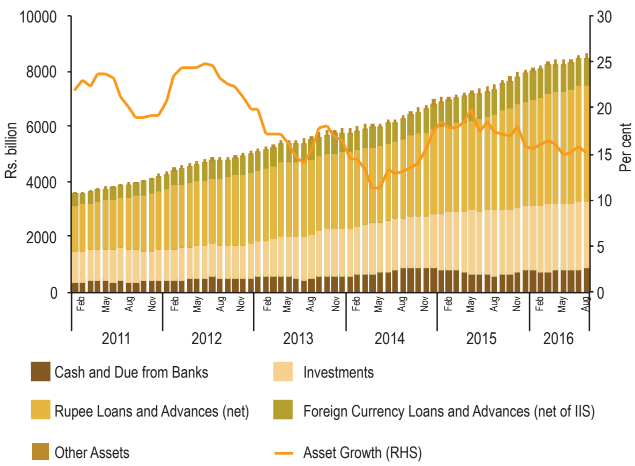
Banking Sector

- **The banking sector continued to expand its asset base during the first eight months of 2016 maintaining its capital and liquidity at adequate levels.**

- **During the first eight months of 2016, the total net assets of the banking sector reached Rs. 8.6 trillion recording an increase of 6.8 per cent.** Accordingly, the total net assets increased from Rs. 8.1 trillion as at end 2015. This was mainly due to the increase in loans and advances. Meanwhile, investments in government securities contributed to the remainder of asset growth. The asset growth was largely funded by deposits (Rs. 5,855 billion) and borrowings (Rs. 1,758 billion).

- **Total loans and advances reported an increase of 8.0 per cent during the first eight months of 2016 and stood at Rs. 5,092 billion at the end of August 2016.** The year-on-year loan growth as at end August 2016 was 17.3 per cent. Growth in loans and advances was driven by increased lending by banks to the private sector, while there was decreased lending to the central Government and state owned enterprises. The pawning portfolio contracted further during the first eight months of 2016 continuing the trend prevalent in the previous years. Meanwhile, a notable increase in loans and advances was observed in major sectors such as construction, financial and business services, consumption and manufacturing while a decline was reported in the infrastructure sector.

Chart 8.1 Assets of the Banking Sector



- **Deposits were the main source of funding utilised for lending during the first eight months of 2016 and contributed to 82.8 per**

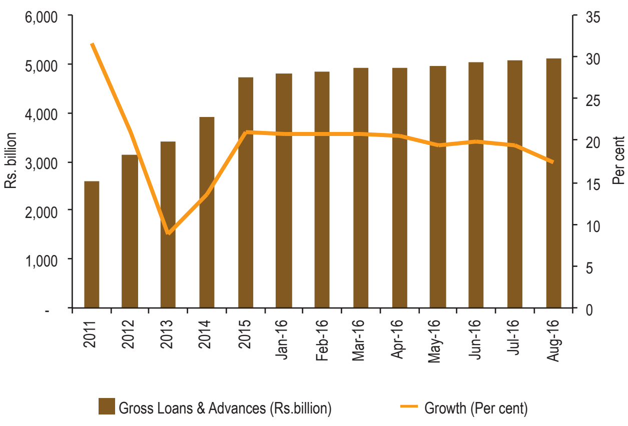
Table 8.1 Selected Indicators of the Banking Sector

Item	End Aug 2014	End Aug 2015	End Dec 2015	End Aug 2016 (a)	Y-O-Y Change (%) Aug 2015	Y-O-Y Change (%) Aug 2016 (a)
Total Assets (Rs. billion)	6,388.2	7,490.9	8,077.5	8,623.7	17.3	15.1
Loans & Advances (Rs. billion)	3,505.8	4,337.5	4,715.3	5,091.5	23.7	17.4
Investments (Rs. billion)	1,837.1	2,344.7	2,367.8	2,428.4	27.6	3.6
Deposits (Rs. billion)	4,432.2	5,067.2	5,403.1	5,855.2	14.3	15.6
Borrowings (Rs. billion)	1,164.4	1,520.2	1,758.4	1,758.5	30.6	15.7
Capital Funds (Rs. billion)	534.6	613.2	636.7	683.4	14.7	11.4
Tier 1 Capital Adequacy Ratio (%) (b)	14.4	13.5	13.0	12.2		
Total Capital Adequacy Ratio (%) (b)	16.9	16.0	15.4	14.7		
Gross Non-performing Loans Ratio (%)	5.6	4.2	3.2	3.0		
Net Non-performing Loans Ratio (%)	3.5	2.2	1.2	1.1		
Return on Assets (Before Tax) (%)	1.9	1.8	1.9	1.9		
Return on Equity (After Tax) (%)	16.0	15.5	16.2	16.9		
Statutory Liquid Assets Ratio (DBU) (%)	40.6	35.4	33.9	31.4		
Liquid Assets to Total Assets (%)	34.2	30.6	30.0	29.2		

(a) Provisional
(b) As at end June

Source: Central Bank of Sri Lanka

Chart 8.2 Loans and Advances of the Banking Sector



cent of the total assets of the banking sector. The deposit base of the banking sector grew by Rs. 452 billion with 8.4 per cent growth and primarily consisted of rupee deposits. Meanwhile, a notable decrease in demand deposits was observed during this period with a shift in deposits from demand to term deposits and short term savings, mainly in 3 month maturity term deposits. During the first eight months of 2016, the total borrowings had not changed due to the decrease in foreign currency borrowings nullifying the increase in rupee borrowings.

- **Asset quality of the banking sector improved during the first eight months of 2016.** The total non-performing loans (NPLs) decreased by Rs. 31.2 billion from Rs. 183 billion as at end August 2015 to Rs. 152 billion by end August 2016. The decrease during the first eight months was Rs. 0.7 billion resulting in the NPL ratio decreasing from 3.2 per cent in end December 2015 to 3.0 per cent by end August 2016. This is a historically low NPL ratio and was mainly due to the combined effect of the recovery of NPLs and increased loan growth during the period. Provision coverage ratio improved by 860 basis points from 38.0 per cent as at end August 2015 to 46.6 per cent at end August 2016 mainly due to increase in loan loss provisions and decrease in NPLs. However, provision coverage had slightly decreased by 30 basis points during the first eight months of 2016. There was no notable concentration risk in the credit portfolio to economic sectors, with credit being primarily distributed among the construction (17.6 per cent), traders (14.5 per cent), manufacturing (10.4 per cent) and agriculture (8.9 per cent) sectors which together accounted for more than 51.4 per cent of the credit portfolio. The government sector, new economy and other consumption sectors together accounted for 17.9 per cent of the total credit portfolio.

Chart 8.3 Sources of Funding of the Banking Sector

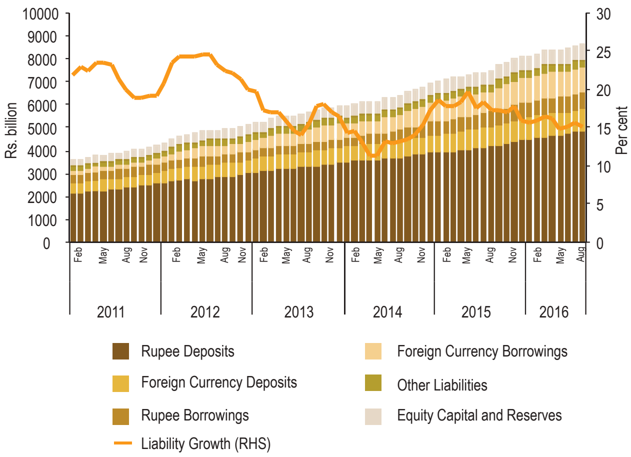


Chart 8.4 Non-performing Loans of the Banking Sector

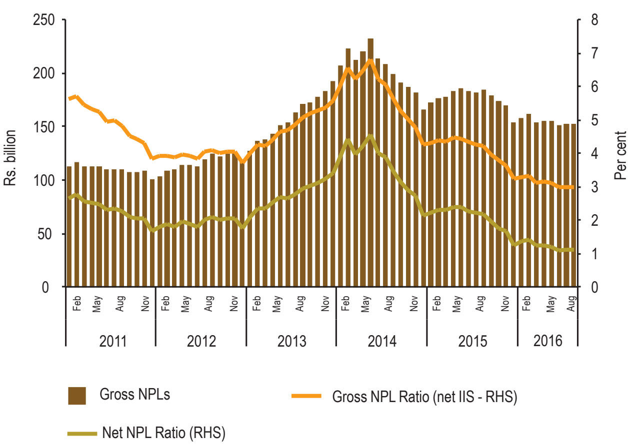
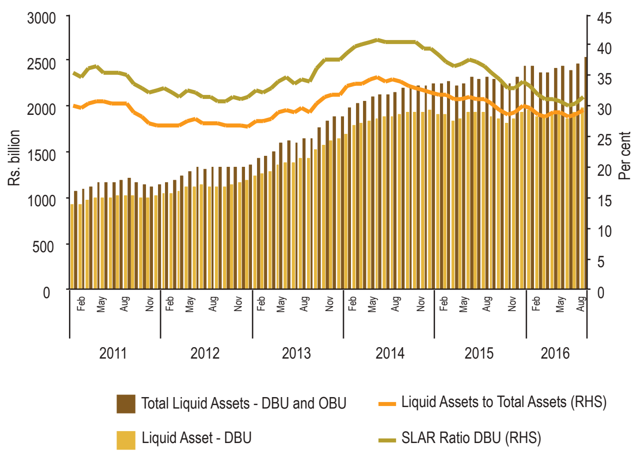


Chart 8.5 Liquidity Position of the Banking Sector



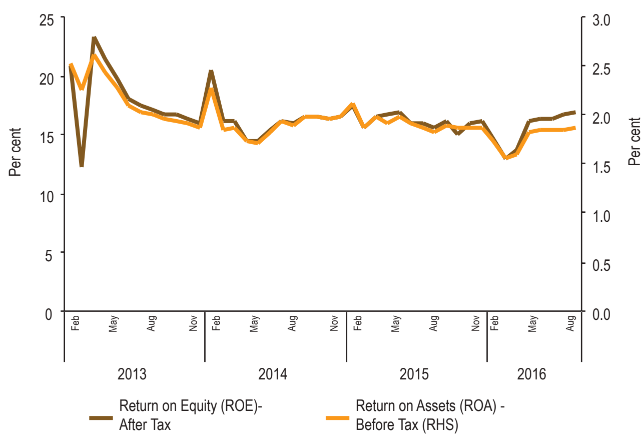
- **The liquidity position of the banking sector continued to be maintained at healthy levels.** The statutory liquid assets ratios (SLAR) were well above the minimum statutory requirement of 20 per cent, while the ratio of liquid assets to total assets stood at 29.2 per cent at end August 2016, although lower than the ratio of 30.0 per cent at end 2015. The credit to deposits ratio slightly decreased from 87.3 per cent at end 2015 to 87.0 per cent at end August 2016. The rupee liquidity coverage ratio (LCR) and all currency LCR under Basel III stood well above the minimum requirement of 70 per cent at 193 per cent and 154 per cent, respectively. The ratio in the less than 6 months and less than 1 year periods widened to negative 20.7 per cent and negative 23.2 per cent, respectively, by end June 2016.

- **The net foreign currency exposure of the banking sector increased during the first six months of 2016.** The foreign borrowing exposure was largely mitigated by entering into foreign currency swap agreements. The net foreign currency exposure as a percentage of banks' regulatory capital and on-balance sheet foreign currency assets stood at 1.7 per cent and 1.3 per cent, respectively, at end June 2016. The banking sector reported a long foreign currency position of Rs. 11.6 billion at end June 2016. There was a net gain of Rs. 5.5 billion on foreign currency revaluation during this period.

- **The gradual upward movement in market interest rates during the first eight months of 2016 resulted in a decrease in capital gains in Treasury bonds to Rs 1.9 billion reported during the first eight months of 2016 from Rs 2.6 billion reported during the corresponding period in 2015.** Equity risk of the banking sector was minimal as exposure of Rs. 16.4 billion to the equity market was only 0.2 per cent and 2.9 per cent of total assets and investments held for trading, respectively, of the banking sector.

- **Profits of the banking sector increased by 21.1 per cent during the first eight months of 2016 when compared with the corresponding period of 2015.** Profits after tax of the banking sector was Rs. 97.0 billion for the year 2015 and Rs. 73.0 billion for the first eight months of 2016. The higher profits were due to higher net interest income, which reported an increase of Rs. 22.6 billion. Overall business expansion, increased lending and investment activity resulted in an increase in net interest income. Non-interest income increased by Rs. 3.9 billion during the first eight months of 2016. This was due to significant increased in foreign exchange income and other sources of income. Operating expenses during the first eight months of 2016 were Rs. 128.9 billion and increased by 10.4 per cent when compared with the corresponding period of 2015. The profitability ratio as measured by the return on assets (ROA) and return on equity (ROE) improved to 1.9 per cent and 16.9 per cent, from 1.8 per cent and 15.5 per cent, respectively, compared to the corresponding period of last year. However, the efficiency ratio has deteriorated by 170 basis points while cost to income ratio increased by 180 basis points to 76.2 per cent at end August 2016 from 74.4 per

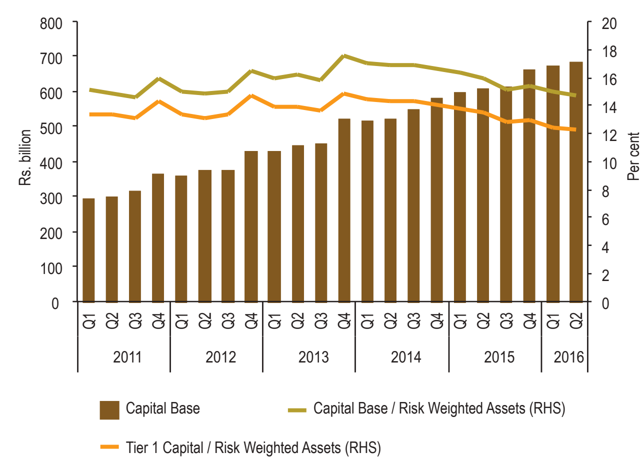
Chart 8.6 ROA and ROE of the Banking Sector



cent at end August 2015. Net interest margin had declined by 10 basis points on a year-on-year basis. Hence, banks will need to focus on maintaining the net interest margins by allocating resources to high yielding asset classes, while mitigating any risks, and enhance fee based income in order to increase the current level of earnings.

- **The banking sector continued to maintain sufficient capital in order to absorb any adverse shocks.** The core capital adequacy ratio (CAR) and total CAR at end June 2016 were 12.2 per cent and 14.7 per cent, respectively, and were maintained at a healthy

Chart 8.7 Capital Adequacy of the Banking Sector



level well above the regulatory minimum of 5 and 10 per cent, respectively. However, a declining trend is observed due to increased lending and the resultant increase in risk weighted assets.

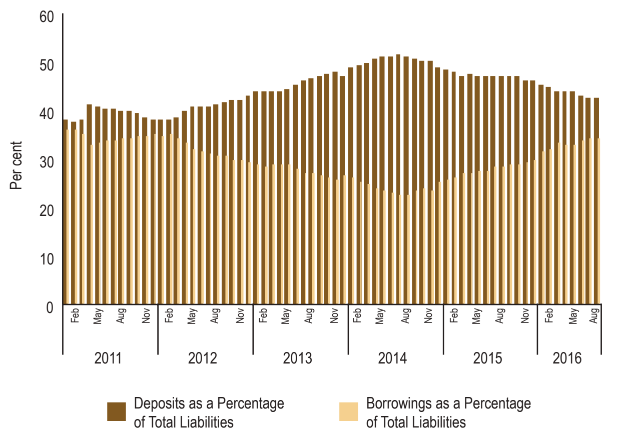
- **The branch network expanded moderately during the first eight months of 2016 improving financial accessibility.** Accordingly, 40 new branches and 89 automated teller machines (ATMs) were opened during this period.

- **The Central Bank continued to introduce prudential policy measures and regulations with a view to enhancing the safety and soundness of the banking sector.** With a view to expanding surveillance on looming cyber security threats to banks, all licensed banks were instructed to submit information on the occurrence of cyber security events to the Director of Bank Supervision within one working day from the date of detection and within 15 days from the end of each quarter. As a measure of enhancing consumer awareness, licensed banks were required to display the fees charged from customers for fund transfers effected through the LankaSettle System, Sri Lanka Interbank Payment System (SLIPS) and the Common Electronic Fund Transfer Switch (CEFTS) in all branches and display them on the banks' websites. With a view to enhancing transparency in dealings and price discovery in the secondary market for government securities, licensed banks were instructed to use the Bloomberg Trading Platform available to Sri Lanka to conduct all outright trades of government securities and report yield rates and volumes of all such outright trades in excess of Rs. 50 million, commencing 15 September 2016. Further, the Central Bank continuously monitored the preparedness of the banking sector to adopt the Basel III Minimum Capital Requirements and Leverage Ratio and the final Directions on the same will be issued for implementation, in line with the international timeline. Existing limits on share ownership of banks and assessment criteria of fitness and propriety of Board of Directors are being reviewed to further strengthen the resilience of the banking sector. Benefiting from the enhanced regulatory and supervisory framework and conducive macroeconomic factors, the banking sector is expected to enhance its performance and resilience during the remainder of 2016.

Non-Bank Financial Institutions Sector

- **The performance of the non-bank financial institutions (NBFIs) sector remained upbeat during the first eight months of 2016.** NBFIs sector comprising licensed finance companies (LFCs) and specialised leasing companies (SLCs) represents 7.3 per cent of assets of the Sri Lanka's financial system and consists of 46 LFCs and 7 SLCs with a network of 1,239 branches. NBFIs sector growth showed positive momentum with the diversification of the loan portfolio in response to the implementation of some stringent fiscal and macro prudential policy measures with respect to importation and lending for motor vehicles. Total assets of the sector expanded by 14.4 per cent (Rs. 143.5 billion) to Rs. 1,139.7 billion in the first eight months of 2016 compared to the growth of 13.5 per cent (Rs. 110.3 billion) in the corresponding period of 2015. The increased appetite for credit at the grass-roots level of the economy enabled NBFIs sector to grow their business volumes and increase profitability.

Chart 8.8 Total Deposits and Borrowings of NBFIs



- **Increase in assets was largely funded through borrowings.** 67 per cent of the assets increase during the period was funded through borrowings. The sector borrowings increased notably by 29.9 per cent (Rs. 94.0 billion) to Rs. 408.3 billion in the first eight months of 2016 compared with a growth of 25.6 per cent in the corresponding period of 2015 as NBFIs opted

Table 8.2 Selected Indicators of NBFIs

Item	End Aug 2014	End Aug 2015	End Dec 2015	End Aug 2016 (a)	Y-O-Y Change (%)	
					Aug 2015	Aug 2016 (a)
Total Assets - Net (Rs. billion)	743.6	924.8	996.1	1,139.7	24.4	23.2
Loans & Advances - Net (Rs. billion)	557.8	715.2	795.8	899.5	28.2	25.8
Deposits (Rs. billion)	397.4	454.5	480.6	506.2	14.4	11.4
Borrowings (Rs. billion)	177.6	272.8	314.3	408.3	53.6	49.7
Capital Funds (Rs. billion)	108.6	127.0	121.5	142.0	16.9	11.9
Tier 1 Capital Adequacy Ratio (%)	13.7	13.0	10.5	12.2		
Total Capital Adequacy Ratio (%)	14.5	13.6	11.2	12.9		
Gross Non-performing Accommodations Ratio (%)	7.6	6.3	5.7	5.5		
Net Non-performing Accommodations Ratio (%)	3.0	1.8	1.6	1.3		
Return on Assets (Before Tax) (%) - Annualised	2.5	4.2	2.8	3.7		
Return on Equity (After Tax) (%) - Annualised	10.1	20.8	10.9	20.0		
Liquid Assets to Total Assets (%)	9.4	8.2	7.6	7.0		

(a) Provisional

Source: Central Bank of Sri Lanka

Chart 8.9 Total Loans and Advances of NBFIs

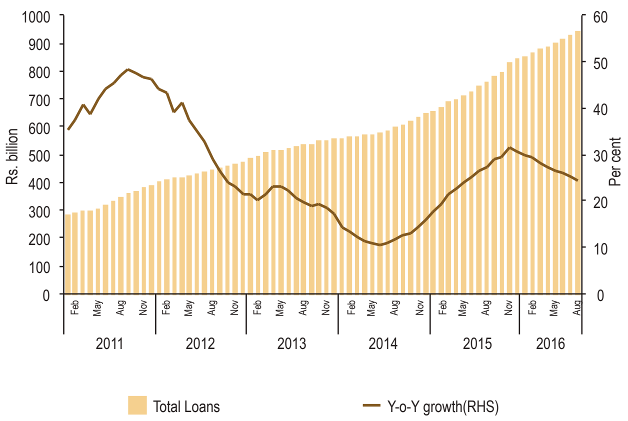
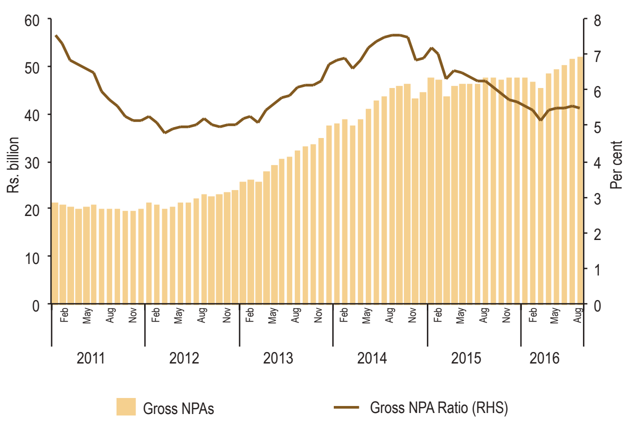


Chart 8.10 Non-performing Accommodations of NBFIs



for lower cost bank borrowings. In contrast, the deposits grew by 5.3 per cent (Rs. 25.6 billion) to Rs. 506.2 billion in the first eight months of 2016 compared with the growth of 9.8 per cent (Rs. 40.4 billion) in the corresponding period of 2015.

- **Credit growth remained positive.** Credit provided by NBFIs sector grew by 13.0 per cent (Rs. 103.6 billion) to Rs. 899.5 billion in the first eight months of 2016 compared to the growth of 18.5 per cent in the corresponding period of 2015. The core businesses of NBFIs sector, namely, finance lease & hire purchase portfolio grew by a marginal 2.8 per cent during the first eight months of 2016, compared with a growth of 15.5 per cent growth in the corresponding period of 2015. Further, the secured loan category which mainly comprise of term loans, factoring and micro finance loans recorded a growth of 29.6 per cent in the first eight months of 2016 compared with a growth of 25.0 per cent in the corresponding period of 2015.

- **Asset quality remained manageable despite the growth of the loan portfolio.** There was no major adverse change of non-performing accommodations (NPAs) when compared to the expansion of the loan portfolio during 2016. NPAs increased by Rs. 4.3 billion during the first eight months of 2016 and amounted to Rs. 51.7 billion. However, gross & net NPAs ratios decreased marginally to 5.5 per cent and 1.3 per cent, respectively, at end August 2016 from 5.7 per cent and 1.6 per cent, respectively, at end August 2015.

- **The overall liquidity position of NBFIs recorded a surplus.** The surplus liquidity position has been increasing since 2014 and stood at Rs. 14.1 billion against the stipulated minimum requirement of Rs. 69.5 billion. However, sector liquidity ratio (liquid assets to deposits and borrowings) declined to 9.1 per cent at end August 2016 compared to 10.0 per

Chart 8.11 Total Liquid Assets and Liquidity Ratio of NBFIs

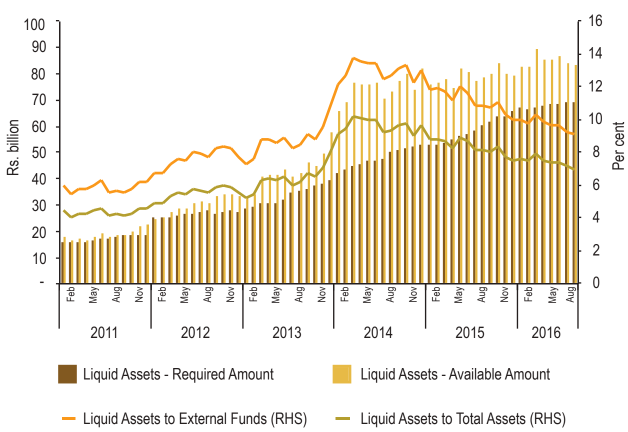
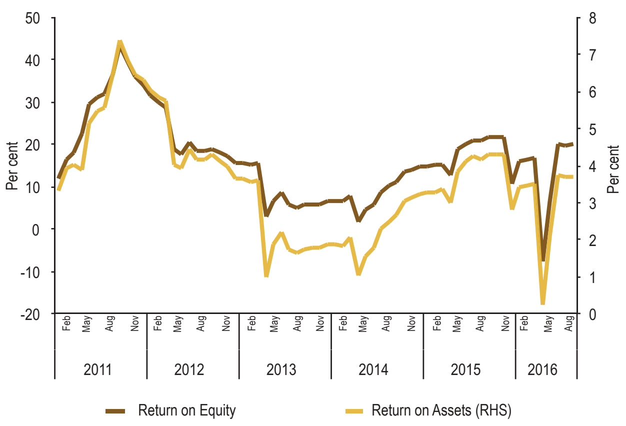


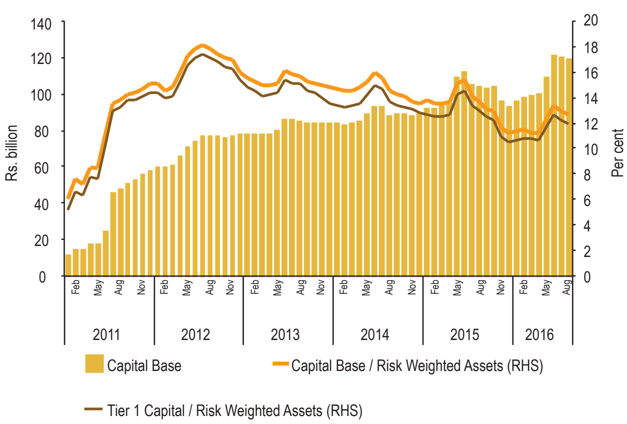
Chart 8.12 ROA and ROE of NBFIs



cent at end December 2015 due to the growth in borrowings (of the borrowings, liquidity is only required for unsecured borrowings).

- **Profitability improved significantly.** Profits of NBFIs sector were Rs. 22.0 billion during the first eight months of 2016 compared to a profit of Rs. 15.4 billion in the corresponding period of 2015. High yielding non-core business products of the sector enabled the increase in profits which was reflected in an increase of 14.1 per cent (Rs. 60.3 billion) of net interest margin. The annualised ROA and ROE ratios were at 3.7 per cent and 20.0 per cent, respectively, for the eight-month period ending August 2016, compared with 4.2 per cent and 20.8 per cent in the corresponding period of the previous year.

Chart 8.13 Capital Position of NBFIs



- **Improved capital position.** Capital funds increased by 16.9 per cent during the first eight months of 2016 to Rs.142.0 billion and whilst the regulatory CAR of NBFIs sector have been maintained. CAR increased to 12.9 per cent in August 2016 from 11.2 per cent in December 2015.

Insurance Companies Sector

- **The premium income of insurance companies increased significantly, with total assets showing a significant growth.** Total assets of the insurance sector recorded a growth of 9.9 per cent on a year-on-year basis, by end June 2016, in comparison to the growth of 11.4 per cent recorded at end June 2015. The gross written premiums (GWP) of the insurance sector grew by 21.5 per cent in the first half of 2016, when compared with the increase of 11.8 per cent in the corresponding period of 2015. Relatively high growth in the premium income of the general insurance sector, particularly motor insurance, has largely contributed towards the high growth of overall GWP. The gross premium income from motor insurance, which constitutes about 63.6 per cent of the general insurance premium, increased by 14.5 per cent in the first half of 2016 compared with 16.0 per cent increase in the corresponding period of 2015. Further, the gross premium income from miscellaneous insurance (23.7 per cent) increased by 36.8 per cent on a year-on-year basis and gross premium income from fire (9.8 per cent) and marine (2.8 per cent) decreased by 18.3 per cent and 12.6 per cent, respectively, in the first half of 2016.

- **Overall profits of the insurance sector increased notably during the period under review.** The aggregate profits before tax increased by 33.3 per cent in the first half of 2016 when compared to a decrease of 33.9 per cent in the corresponding

Table 8.3 Selected Indicators of the Insurance Sector

Item	End Jun 2014	End Jun 2015	End Dec 2015	End Jun 2016 (a)	Y-O-Y Change (%)	
					Jun 2015	Jun 2016 (a)
Total Assets (Rs. billion)	390.9	435.4	453.6	478.4	11.4	9.9
Total Income (Rs. billion) (b)	65.8	69.1	152.1	82.1	4.9	18.9
Gross Premium Income (Rs. billion) (b)	49.2	57.1	120.9	66.8	11.8	21.5
Investment Income (Rs. billion) (b)	16.6	14.1	31.2	15.3	-15.3	8.8
Profit Before Tax (Rs. billion) (b)	5.9	3.9	12.9	5.2	-33.9	33.3
Solvency Margin Ratio (Times)						
Long-term Insurance	8.7	9.3	7.6	9.3		
General Insurance	2.2	2.2	2.3	2.2		
Capital Adequacy Ration (CAR) (%) (c)						
Long-term Insurance						296.0
General Insurance						166.0
Retention Ratio (%)						
Long-term Insurance	78.5	161.2	80.0	96.2		
General Insurance	96.3	96.0	96.2	159.1		
Claims Ratio (%)						
Long-term Insurance	42.4	40.1	40.7	37.1		
General Insurance	59.2	63.0	65.7	55.7		
Combined Operating Ratio (%)						
Long-term Insurance	89.7	87.0	86.5	85.1		
General Insurance	105.1	107.6	105.9	97.2		
Return on Assets (%)						
Long-term Insurance	2.9	2.0	2.7	2.2		
General Insurance	3.5	1.8	3.5	2.4		
Return on Equity (%) - General Insurance	6.0	2.9	5.7	4.5		
Underwriting Ratio (%) - General Insurance	18.1	14.6	16.4	15.7		

(a) Provisional
(b) During the period
(c) Introduced in lieu of solvency margin ratio since 2016

Source: Central Bank of Sri Lanka

period of 2015. The increase in investment income and lower claims positively affected profits of the insurance sector. The investment income increased by 8.7 per cent during the first half of 2016, when compared to the decrease of 15.4 per cent in the corresponding period of 2015.

- **Insurance sector maintained its soundness.** The capital adequacy ratio for long-term and general insurance sectors were 296 per cent and 166 per cent, respectively, at end June 2016. Investments in government securities by the long-term and general insurance sectors increased by 31.3 per cent and 9.1 per cent, respectively.

Primary Dealers in Government Securities

- **Total assets, total investment portfolio and repo borrowings of the Primary Dealers (PDs) industry increased during the first eight months of 2016.** Total assets of PDs industry increased by 29.0 per cent to Rs. 328.1 billion and the total investment portfolio of government securities held by PDs increased by 28.6 per cent to Rs. 322.4 billion during the first eight months of the year. This increase was mainly attributed to the significant increase in the held-to-maturity portfolio. The reverse repo portfolio also increased to Rs. 64.9 billion at end August 2016. Borrowings under repo agreements increased by 36.7 per cent to Rs.184.0 billion at end August 2016 compared to the corresponding period of the previous year.

- **Profitability increased**. Profitability of PDs industry measured in terms of ROA and ROE of standalone PDs stood at 5.5 per cent and 61.4 per cent, respectively, during the first eight months of 2016. Overall, PDs industry recorded a profit of Rs. 7.4 billion during the first eight months of 2016, compared to Rs.3.8 billion in corresponding period of 2015. The increase in overall profit was mainly attributed to the increase in capital gains.

PDs industry recorded a capital gain of Rs.7.2 billion for the first eight months of 2016, compared to Rs. 2.2 billion in the corresponding period of 2015.

- **Capital was maintained at healthy levels.** Except Entrust Securities PLC, all standalone PDs maintained their core capital above the minimum requirement of Rs. 1.0 billion as at 01 October 2016. The risk weighted capital adequacy ratio (RWCAR) of the industry was above the minimum of 10 per cent and the ratio increased to 35.0 per cent at end August 2016 from 19.7 per cent at end August 2015.

- **Risk level improved.** As the proportion of trading portfolio to total investment portfolio decreased from 60.6 per cent at end August 2015 to 52.4 per cent at end August 2016, the exposure of the industry to the market risk has decreased.

In view of the large proportion of risk free government securities holdings of PDs and also the ability of PDs to use such government securities as collateral for obtaining funds to bridge unforeseen liquidity gaps, the liquidity risk profile of PDs remained low. Further, most PDs had stand-by contingency funding arrangements to bridge liquidity gaps, if emerged.

Unit Trust Sector

- **The unit trust (UT) sector continued to expand with the formation of new funds.** The total number of unit trusts managed by 14 unit trust management companies, increased to 76 funds by the end of June 2016, reflecting a further expansion of the sector. Meanwhile, the total number of unit holders and the number of units in issue also significantly increased to

Table 8.4 Selected Indicators of Primary Dealers

Item	End Aug 2014	End Aug 2015	End Dec 2015	End Aug 2016 (a) (b)	Y-O-Y Change (%) Aug 2015	Y-O-Y Change (%) Aug 2016 (a)
Total Assets (Rs. billion)	**194.4**	**254.4**	**282.6**	**328.1**	**30.9**	**29.0**
Standalone PDs	78.1	72.6	77.2	103.8	(7.1)	43.0
Bank PDs	116.3	181.9	205.5	224.4	56.3	23.4
Total Portfolio (Rs. billion)	**189.5**	**250.7**	**278.1**	**322.4**	**32.3**	**28.6**
Standalone PDs	76.9	71.8	76.2	102.7	(6.7)	43.0
Bank PDs	112.5	178.9	201.9	219.7	59.0	22.8
Total Capital (Rs. billion) (c)	**9.5**	**10.6**	**13.5**	**20.1**	**11.4**	**90.6**
Profit before Tax (Rs. billion) (d)	**6.3**	**3.8**	**8.8**	**7.4**	**(40.3)**	**96.6**
Standalone PDs	3.2	1.5	5.0	7.4	(54.0)	401.0
Bank PDs	3.1	2.3	3.9	3.7	(26.2)	62.3
Tier 1 Capital Adequacy Ratio (%) (c)	**13.9**	**18.7**	**24.2**	**33.7**	**4.8**	**15.0**
Total Capital Adequacy Ratio (%) (c)	**13.9**	**19.7**	**25.5**	**35.0**	**5.8**	**15.3**
Return on Assets (%)	4.5	2.5	3.7	5.5	(2.0)	3.0
Standalone PDs	7.3	2.9	6.5	14.7	(4.4)	11.8
Bank PDs	3.2	2.3	2.3	2.7	(1.0)	0.4
Return on Equity (%) (c)	**56.9**	**21.1**	**46.1**	**61.4**	**(35.8)**	**40.3**
Leverage Times (c)	**7.1**	**6.1**	**4.8**	**8.9**	**(14.2)**	**46.4**
Operating Expenses to Total Income (%) (e)	**5.8**	**6.5**	**6.0**	**3.2**	**0.7**	**(3.3)**
Standalone PDs	12.0	13.5	11.1	5.7	1.5	(7.8)
Bank PDs	1.4	1.8	1.6	0.8	0.4	(1.0)
Total Cost to Total Income (%) (d)	**61.1**	**68.7**	**60.5**	**53.8**	**7.5**	**(14.9)**
Standalone PDs	52.9	69.5	52.3	36.9	16.6	(32.6)
Bank PDs	67.1	68.1	67.8	69.8	1.0	1.7
Duration of Assets and Liabilities (years)	**1.7**	**1.3**	**1.1**	**1.4**	**(20.1)**	**6.8**
Standalone PDs	3.1	2.7	2.6	3.2	(13.2)	18.5
Bank PDs	1.7	1.3	1.1	1.4	(20.1)	6.8

(a) Provisional
(b) Includes financial data of Entrust Securities PLC upto May 2016 only
(c) Standalone PDs only
(d) During the period
(e) Revised

Source: Central Bank of Sri Lanka

Table 8.5 Selected Indicators of the Unit Trust Sector

Item	End Jun 2014	End Jun 2015	End Dec 2015	End Jun 2016 (a)	Y-O-Y Change (%)	
					Jun 2015	Jun 2016 (a)
Total Assets (Rs. million)	75.9	133.8	130.3	127.7	76.3	-4.6
Net Asset Value - NAV (Rs. million)	75.4	133.1	129.4	126.8	76.6	-4.7
Investments (Rs. million)	75.9	133.6	130.1	122.8	76.0	-8.1
Equity	11.7	13.5	14.4	12.6	15.3	-6.6
Government Securities	23.4	55.4	29.4	55.9	136.5	0.8
Other (E.g., Commercial Papers, Debentures, Trust Certificates & Bank Deposits)	40.8	64.7	86.3	54.4	58.6	-16.0
Investments in Equity as a % of NAV	15.5	10.1	11.1	9.9		
Investments in Government Securities as a % of NAV	31.1	41.6	22.7	44.1		
Other Investments as a % of NAV	54.1	48.6	66.7	42.9		
Total No. of Unit Holders	29,797	35,660	38,008	39,707		
No. of Units in Issue (million)	5.5	9.6	8.8	8.9		
No. of Unit Trusts	53	70	74	76		

(a) Provisional

Source: Unit Trust Association of Sri Lanka

39,707 and 8.9 billion, respectively, at end June 2016. At the same time, the net asset value (NAV) of UT sector declined by 4.7 per cent, on a year-on-year basis, at end June 2016, following a significant growth of 76.6 per cent at end June 2015. At end June 2016, the share of equities in investment portfolios of unit trusts further declined to 9.9 per cent, from 10.1 per cent at end June 2015, while the share of government securities in investment portfolios increased to 44.1 per cent, from 41.6 per cent, despite the low interest rates in the market.

Stock Brokering Companies Sector

- **The stock brokering companies sector showed a mixed performance with the subdued activities that prevailed in the Colombo Stock Exchange (CSE).** The income of stock brokering companies sector declined in the first half of 2016. Consequently, the extent of losses before tax of stock brokering companies increased significantly during the period under consideration. The total assets declined at end June 2016, and the net capital of stock brokering companies also declined when compared to the first half of 2015. The slow performances experienced in CSE have negatively affected the activities of the stock brokering companies sector. Currently, there are 28 stock brokering companies operating in CSE and of them 27 stock brokering companies have complied with the minimum net capital requirement and liquidity requirement during the second quarter of 2016 while one stock brokering company could not comply with the regulatory requirements. Accordingly, the license of the same was not renewed.

Table 8.6 Selected Indicators of Stock Brokering Companies

Item	End Jun 2014	End Jun 2015	End Dec 2015	End Jun 2016 (a)	Y-O-Y Change (%)	
					Jun 2015	Jun 2016 (a)
Total Assets (Rs. billion)	11.0	10.9	9.8	9.5	-1.5	-12.2
Total Liabilities excl. equity (Rs. billion)	5.1	4.8	3.6	3.9	-5.8	-18.7
Net Capital (Rs. billion)	4.6	4.7	5.0	4.5	2.4	-2.8
Income (Rs. billion) (b)	1.2	0.6	2.4	0.4	-55.0	-26.7
Net Profit/(Loss) before tax (Rs. million) (b)	-0.06	0.02	-0.01	-0.12	-132.6	-728.3

(a) Provisional
(b) During the period

Source: Securities and Exchange Commission of Sri Lanka

Superannuation Funds

- **The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka with an asset base of over 1.8 trillion rupees as of August 2016.** The total number of EPF member accounts reached the 16.8 million mark in December 2015, recording an increase of 6.3 per cent when compared with the previous year.

- **Total contributions during the first eight months of the year increased by 15.9 per cent to Rs. 77.3 billion while refund payments increased by 51.8 per cent to 75.6 billion when compared with the corresponding period in the previous year.** However, during the first eight months of 2016, the net contributions (contributions minus refunds) stood at Rs. 1.7 billion, which is a marked decline of 89.9 per cent compared with the corresponding period of 2015. This significant decline is due to the drastic increase in the refund payments with the introduction of the pre-retirement benefit to release 30 per cent of the EPF balance for housing and medical treatment.

- **Total assets of the EPF increased by 10.3 per cent on a year-on-year basis to Rs. 1,759 billion at end August 2016.** The total investment portfolio of the EPF also grew by 9.9 per cent to Rs. 1,716 billion at end August 2016 and consists of 93.2 per cent of government securities, 4.8 per cent in equity market, 2.0 per cent in corporate debt and reverse repos. The Fund reported an investment income of Rs. 127.2 billion during the first eight months of 2016 which is an increase of 13.4 per cent compared with the corresponding period of 2015.

- **The Employees' Trust Fund (ETF) has about 12.5 million accounts, of which about 2.4 million are active accounts.** Total contributions and benefits paid to members during the first six months of 2016 increased to Rs. 9.8 billion, an increase of 11.4 per cent, and Rs. 7.2 billion, an increase of 18.0 per cent, respectively, from Rs. 8.8 billion and Rs. 6.1 billion during the corresponding period of 2015. The total assets of the ETF increased by 11.4 per cent to Rs. 234.7 billion at end June 2016. As in the case of the EPF, the investment portfolio of the ETF is highly concentrated in government securities, which account for 91.7 per cent of the total portfolio. Investments in equities and corporate debt securities accounted for 5.4 per cent and 0.7 per cent, respectively.

- **The Public Service Provident Fund (PSPF) had 231,273 members at end June 2016.** The total assets of the PSPF amounted to Rs. 47.7 billion at end June 2016. Total contributions

Table 8.7 Selected Indicators of Superannuation Funds

Item	Employees' Provident Fund (EPF)			Employees' Trust Fund (ETF)		
	End Aug 2015	End Aug 2016 (a)	Change (%) (a)	End Jun 2015	End Jun 2016 (a)	Change (%) (a)
Total Contributions (Rs. billion)	66.7	77.3	15.9	8.8	9.8	11.4
Total Refunds (Rs. billion)	49.8	75.6	51.8	6.1	7.2	18.0
Total Assets (Rs. billion)	1,595.0	1,759.0	10.3	210.6	234.7	11.4
Total Investment Portfolio (Rs. billion)	1,562.0	1,716.0	9.9	196.0	221.0	12.8
o/w, Government Securities (%)	92.1	93.2	1.2	92.6	91.7	-1.0
Gross Income (Rs. billion) (b)	112.3	127.3	13.4	9.4	10.5	11.7

(a) Provisional
(b) During the period

Sources: Central Bank of Sri Lanka
Employees' Trust Fund Board

and refunds of the PSPF during the first six months of 2016 amounted to Rs. 619.8 million and Rs. 253.0 million, respectively.

- **There were 155 privately managed approved provident funds with about 190,984 members as at end March 2016.** The total assets increased by 32.5 per cent and investments decreased by 0.9 per cent on a year-on-year basis to Rs. 195.8 billion and Rs. 115.3 billion, respectively, at end March 2016.

Developments in Financial Markets

Inter-bank Call Money Market

- **Excess liquidity in the domestic inter-bank money market which remained high during 2015 turned to a deficit since the latter part of March 2016.** The excess liquidity remained high in the early part of the year 2016, mainly due to Treasury bill purchases. Excess liquidity was absorbed on a temporary basis by short term and long term repo auctions and on a permanent basis by way of outright sales of Treasury bills during the said period. In addition, the Central Bank increased the statutory reserve ratio (SRR) applicable to all rupee deposit liabilities of commercial banks by 150 basis points to 7.50 per cent with effect from 16 January 2016.

Chart 8.14 Inter-bank Call Money Market

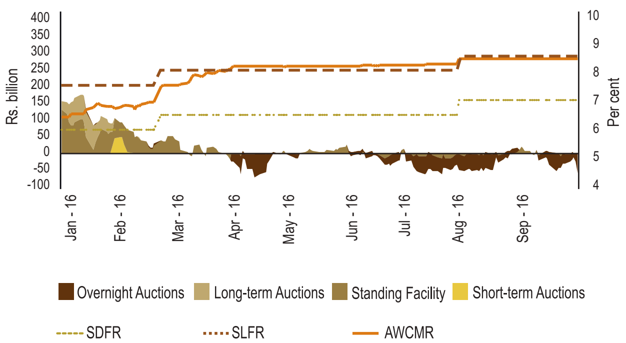


Table 8.8 Factors contributing to change in market liquidity

Rs. billion

Total Excess Liquidity as at end 2015		**81.7**
Add: Injections		**98.9**
Net Impact of T-bill Transactions*	29.0	
Increase in Provisional Advance	33.7	
Net Repo Maturity	23.7	
Other Injections	12.5	
Less: Absorptions		**(234.7)**
Net FX Transactions**	114.4	
Net Currency Withdrawals	32.5	
Net SRR Impact	87.8	
Net Impact		**(135.8)**
Total Liquidity as at end September 2016		**(54.1)**

* Includes purchases, outright sales, maturities and retirements of T-bills.
** Includes net FX sales, net foreign loan repayment, net FX SWAP transactions and Sovereign Bond and SLDB proceeds.

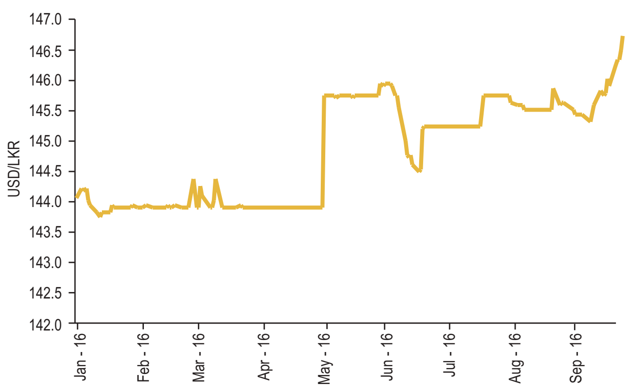
Accordingly, excess rupee liquidity in the domestic money market declined by Rs. 31.9 billion on the following day. Subsequently, the liquidity in the domestic money market declined further with the withdrawals of currency before it turned to negative territory by end March 2016. During the first nine months of the year, overnight liquidity ranged between an excess of Rs. 124.9 billion and a deficit of Rs. 67.7 billion. The main contributory factors for this drain of the liquidity were the foreign exchange related transactions. Total market liquidity stood at a deficit of Rs. 54.2 billion by end September 2016, compared to the excess liquidity position of Rs. 81.7 billion at end 2015. Due to the liquidity shortage prevailing since the latter part of March 2016, the Central Bank conducted reverse repo auctions on most of the days.

- **The average weighted call money rate (AWCMR) which showed an upward trend during the first quarter of the year 2016 was mostly stable until the policy rate change in latter part of July 2016 and increased thereafter.** AWCMR which increased during the first quarter of the year 2016, mainly due to the decline in market liquidity was mostly stable during the period from April to the latter part of July ranging from 8.1 per cent to 8.2 per cent. Accordingly, the call rate breached the upper bound of the policy rate corridor of 8.0 per cent, due to the fact that the standing lending facility rate (SLFR) is the net of tax rate where the call money rate is before the tax rate. However, it remained below the net of tax SLFR of 8.9 per cent. In view of the escalation of inflationary pressures and to support the balance of payments, the Central Bank increased policy interest rates by 50 basis points with effect from 29 July 2016. Accordingly, the standing deposit facility rate (SDFR) and SLFR were increased to 7.0 per cent and 8.5 per cent, respectively. As a result, AWCMR increased to 8.4 per cent by 16 basis points with effect from 29 July 2016, and remained closer to the upper bound of the policy rate corridor. The average weighted repo rate (AWRR) which moved up slowly and reached 8.2 per cent in mid-April decreased to 8.1 per cent by latter part of July. However, with the policy rate change since 29 July 2016 AWRR also increased and stood at 8.8 per cent by end September 2016.

Domestic Foreign Exchange Market

- **The USD/LKR exchange rate depreciated by 1.8 per cent over the first nine months of 2016, reaching Rs. 146.7229 by 30 September 2016.** During the period under review a mixed trend was observed in the USD/LKR exchange rate. There was an increased pressure on the exchange rate mainly through outflows of government securities during the first quarter of 2016. However, this trend reversed from the second quarter of 2016 with the increased foreign currency inflows through government securities. The pressure on the exchange rate was further eased after the International Monetary Fund approved a 36 month Extended Fund Facility for Sri Lanka. During this period, the rupee depreciated against the Japanese yen after the Bank of Japan (BoJ) surprised markets by adopting a target for long-term interest rates in an overhaul of its massive monetary stimulus programme. As per BoJ, they will ease further when necessary, cut short-term rates, lower the long-term rate target, buy more assets or if conditions warrant, accelerate the pace of expansion in monetary base which led the yen to appreciate. The Sri Lankan rupee depreciated even against the euro after the US Federal Reserve kept monetary policy steady. Further, the Sri Lankan rupee depreciated against the Indian rupee during the period under review. However, the rupee appreciated against the sterling pound after the referendum, which voted for the United Kingdom (UK) leaving the European Union (Brexit). The UK intends to withdraw from the European Union in the first quarter of 2017. As per the Bank of England, they would need to pump more stimulus into UK's economy at some point as it needs to adjust to the shock of the vote to leave the European Union.

Chart 8.15 **Movement of Rupee per US dollar**



- **Central Bank intervened, buying as well as selling US dollars in the domestic foreign exchange market during the period under review with the intention of curbing excess volatility.** Accordingly, the Central Bank purchased US dollars 855.1 million and sold US dollars 1,548.0 million resulting in a net sale of US dollars 692.8 million.

- **Trading volumes in the domestic foreign exchange market increased by 18.9 per cent during the first nine months of 2016 compared**

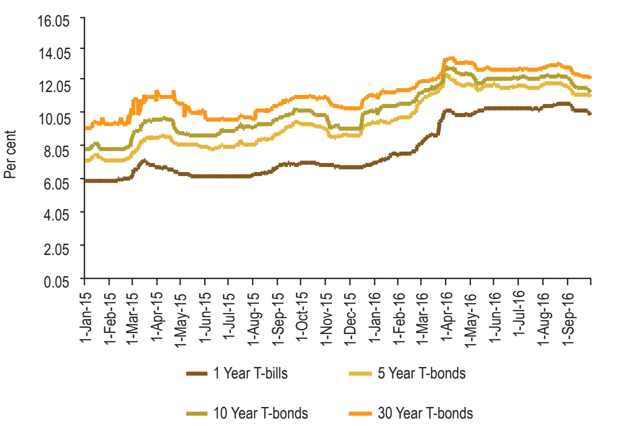
with the corresponding period of the previous year. The total volume of interbank foreign exchange transactions during the period under consideration in 2016 stood at US dollars 11.2 billion as against US dollars 9.4 billion in the corresponding period of 2015. Accordingly, the daily average turnover in the interbank foreign exchange market increased to US dollars 62.4 million as against US dollars 52.7 million in the corresponding period of 2015. However, the total volume of forward transactions up to 30 September 2016 increased to US dollars 6.5 billion reporting a 30.6 per cent growth compared to US dollar 4.9 billion recorded in the corresponding period of 2015.

Government Securities Market

- **During the first half of 2016, the majority of borrowing was sourced from domestic sources.** In view of the prevalence of high interest rates and liquidity shortage in the market, the financing strategies practiced for debt issuance in the first half of 2016 included the issuance of government securities with shorter maturities and issuances of Sri Lanka Development Bonds (SLDBs) amounting to US dollars 1.4 billion to offset any possibilities to crowd out the available domestic investible funds. However, with the issuance of long term Treasury bonds at the beginning of the year, average time to maturity of the government securities increased. During the remainder of 2016, based on market conditions the funding requirements will be sourced through both domestic and foreign sources, also taking into account the issuance of International Sovereign Bonds of US dollars 1.5 billion in July 2016.

- **The yield rates of government securities in the secondary market increased during the first half of 2016, compared to the first half of 2015.** The yield rates pertaining to 91-day, 182-day and 364-day Treasury bills moved upward by

Chart 8.16 Secondary Market Yield Curve of Government Securities



271 basis points, 356 basis points, and 417 basis points, respectively, while those pertaining to Treasury bonds in the secondary market increased by around 327 basis points to 453 basis points across an actively traded yield curve from 2 to 10 years, at the end of the first half of 2016 compared to the rates at the end of the first half of 2015. The high borrowing requirements of the government coupled with the upward adjustment of the statutory reserve requirement by 150 basis points at the beginning of the year and the subsequent adjustment of the policy interest rate by 50 basis points, had resulted in an increase of the yield rates. Further, the increasing trend in the yield rates was partly propelled by the sale of Treasury bills and Treasury bonds by foreign investors. The non-resident holdings of Treasury bills and Treasury bonds declined by 16.6 per cent to Rs. 253.34 billion by end June 2016, from Rs. 303.78 billion at end 2015.

- **As envisaged in the medium-term macro fiscal framework, the medium-term debt management strategy (MTDS) of the Government is designed to further strengthen the fiscal consolidation process by improving the government debt profile and its dynamics.** Despite the attempt to implement long term fiscal sustainability policies to reduce the debt to gross domestic product (GDP) ratio to 60 per cent by end 2020, at end 2015 the outstanding central government debt as a percentage of GDP increased to 76.0 per cent reflecting weak fiscal performance and relatively low economic growth. However, debt to GDP and budget deficit to GDP ratios are expected to move along a declining path over the medium-term, in an environment with an appropriate and stable interest rate regime and enhanced government revenue as well as continuous efforts to rationalise expenditure.

Corporate Debt Securities Market

- **Commercial paper market maintained its momentum during the first half of 2016.** The value of commercial papers (CPs) issued with the support of banks amounted to Rs. 4.8 billion in the first six months of 2016 in comparison to Rs. 4.9 billion recorded during the same period of 2015. The interest rates on CPs increased to a range of 8.7 per cent to 13.0 per cent in 2016 from a range of 7.0 per cent to 11.0 per cent in 2015. CPs with a maturity of up to 3 months accounted for 32.8 per cent of the market, while the shares of CPs with 6 month and 9 month maturities were 27.8 per cent and 39.4 per cent, respectively. The total outstanding value of CPs amounted to Rs. 4.5 billion at end June 2016 compared to Rs. 6.0 billion by June 2015.

- **The volumes in the corporate bond market continued to improve with diversified investor base.** During the first six months of 2016, there were ten issues of corporate debentures by nine institutions, amounting to Rs. 34.5 billion, compared with twenty six issues by fourteen institutions, totalling to Rs. 29.5 billion in the corresponding period of 2015. Funds raised through the corporate bond market increased by 16.9 per cent during the first six months of 2016 and the major issuers were finance and leasing companies at rates varying from 9.6 per cent to 12.8 per cent.

Equity Market

- **The equity market exhibited a slow performance with volatile movement in price indices during the first nine months of 2016.** The price indices, market capitalisation and turnover levels declined. Increased investor uncertainty over future policy directions and political changes, pressure on the exchange rate and global developments that resulted in significant foreign outflows from the market, seem to have created a negative impact on the equity market despite a low interest rate environment in the market. Consequently, the All Share Price Index (ASPI) and S&P SL 20 Index dropped by 5.2 per cent and 0.2 per cent, respectively, during the period under review. In line with the movement of ASPI, market capitalisation also dropped to Rs. 2,785.7 billion at end September 2016 from Rs. 2,938 billion at end December 2015. The price indices of the majority of sub-sectors recorded losses, while others registered gains during the period under consideration. The overall price earnings ratio (PER) of the market declined to 13.4 times as at end September 2016.

Chart 8.17 Movements of Share Price Indices

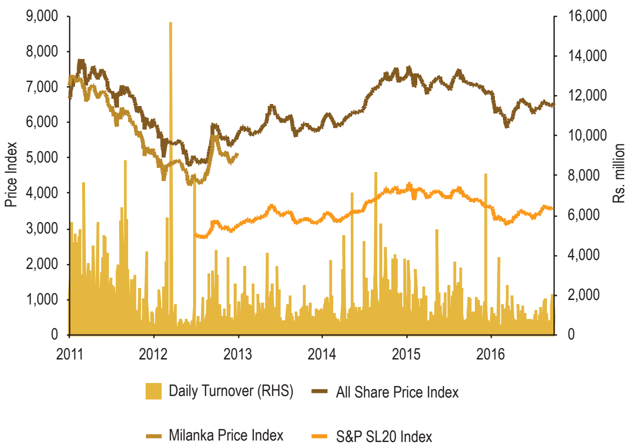
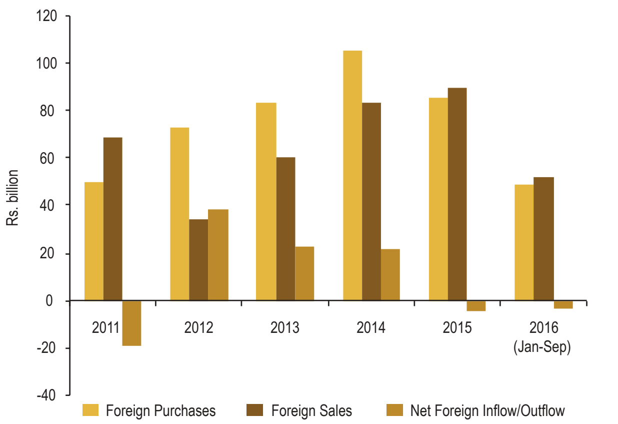


Chart 8.18 Foreign Participation at CSE



- **Equity market operations were moderated in terms of value and volumes.** The average daily turnover declined by 27.3 per cent to Rs 0.8 billion during the first nine months of 2016, from Rs. 1.1 billion in the corresponding period of 2015.

- **Trend in foreign participation, which showed a net outflow by end 2015, continued with the slowing down of investments by foreigners during the first nine months of 2016.** This was mainly due to the interest rate hike in advanced economies (especially in the US) and increased investor uncertainty over the recent political changes in the country. Consequently, foreign investors in the equity market were net sellers, resulting in a cumulative net foreign outflow of Rs. 3.2 billion during the first nine months of 2016.

- **There were 3 initial public offerings (IPO) at CSE during the first nine months of 2016, which raised Rs. 14.3 billion** and a further Rs. 8.9 billion was raised through 4 right issues.

Development Finance and Access to Finance

- **The Central Bank of Sri Lanka, as an agent of the Government of Sri Lanka, continued to implement many concessionary development credit schemes through participating financial institutions (PFIs).** These schemes provided refinance facilities, credit guarantees and/or interest subsidies and credit supplementary services, targeting the development of the agriculture, livestock and micro, small and medium scale enterprise (MSME) sectors. The primary objective of implementing these schemes is to assist the MSME farmers and entrepreneurs who experience constraints when accessing formal sector finance. Broadly, it is expected to promote access to finance, thereby improving the financial inclusion and balanced

Table 8.9 Selected Indicators of the Equity Market

Item	End Sep 2014	End Sep 2015	End 2015	End Sep 2016
All Share Price Index	7,252.1	7,050.9	6,894.5	6,534.8
Year to date change (%)	22.7	-3.4	-5.5	-5.2
S&P SL 20 Index (From 26 June 2012)	4,038.3	3,826.2	3,625.7	3,617.3
June to date change (%)	23.7	-6.4	-11.3	-0.2
Market Capitalisation (Rs.Bn)	3,066.3	2,990.8	2,938.0	2,785.7
As a Percentage of GDP* (%)	29.5	26.7	26.3	24.9
Market Price Earning Ratio	19.7	18.4	18.0	13.4
Average Daily Turnover (Rs. million)	1.3	1.1	1.1	0.8
Net Cumulative Foreign Purchases (USD million)	53.5	-23.4	-32.3	-3.0
Number of Companies Listed	293.0	296.0	294.0	295.0
Number of Right Issues	13.0	9.0	14.0	4.0
Amount raised through Right issues (Rs. billion)	11.3	9.9	100.2	8.9
Initial Public Offers	5.0	2.0	2.0	3.0
Amount raised through IPOs (Rs. billion)	3.3	0.3	3.3	14.3

*Based on actual GDP for 2015 (Rs. 11,183 billion)

Source: Colombo Stock Exchange

regional growth in the country. Under the loan schemes operated by the Central Bank, loans totalling to Rs. 15.6 billion were disbursed to 93,244 beneficiaries through PFIs from January to September 2016.

- **The MSME sector, received nearly a half of the loan amount granted through the Central Bank operated loan schemes during the first nine months of 2016.** These schemes, namely, the Saubagya Loan Scheme (SLS), Smallholder Plantation Entrepreneurship Development Programme (SPEnDP), Dry Zone Livelihood Support and Partnership Programme – Revolving Fund (DZLiSPP-RF), and Working Capital Loan Scheme for Tea Factories (WCLSTF) together disbursed loans totalling Rs. 7.7 billion among 11,787 beneficiaries by September 2016. Funds released to MSME sector accounted for about 49.2 per cent of the total disbursements during this period. Total disbursements of these schemes, excluding that of WCLSTF, increased by 83.9 per cent over the first nine months in 2015. Of these schemes, SLS, which operates island-wide as the flagship loan scheme to provide loans to MSME sector, disbursed Rs. 4.2 billion during the first nine months of 2016, indicating a growth of 89.8 per cent over the first nine months in 2015. WCLSTF, which was introduced in August 2015, disbursed Rs. 3.5 billion among the 108 registered tea factory owners, who were eligible under the Scheme for short term working capital loans. It accounted for a sizeable portion of 44.9 per cent of loans given to MSME sector.

- **With a view to broadening financial outreach among the masses and promoting poverty alleviation in the country, the Central Bank operated four microfinance loan schemes.** These were namely, Poverty Alleviation Micro-Finance Project II- Revolving Fund (PAMP II–RF), Poverty Alleviation Micro-Finance Project – Revolving Fund (PAMP-RF), Small Farmers and Landless Credit Project–Revolving Fund (SFLCP-RF) and National Agribusiness Development Programme (NADeP). Under these schemes, loans amounting to Rs. 2.2 billion were disbursed among 26,739 beneficiaries during the first three quarters of 2016. These schemes mainly targeted the micro level entrepreneurs who engaged in income generating activities related to industries, agriculture, livestock, fisheries and trade and other services in the country.

- **The agriculture and livestock sector received 36.5 per cent of loans disbursed through the credit schemes implemented by the Central Bank.** Funds released to this sector during the period ending September 2016, amounted to Rs. 4.8 billion. Of the total disbursements, 83.8 per cent of loans were delivered through the New Comprehensive Rural Credit Scheme

Table 8.10 Loan Disbursements to the MSME Sector

Loan Scheme	Loan Disbursements				Share (%)		Growth (%)	
	2015 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep	
	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.
Saubagya	9,615	2,215	11,452	4,203	97.2	54.7	19.1	89.8
SPEnDP	501	74	215	27	1.8	0.4	-57.1	-63.5
DZLiSPP-RF	111	12	12	1	0.1	0.0	-89.2	-89.8
WCLSTF1*	-	-	108	3,450	0.9	44.9	-	-
Total	**10,227**	**2,300**	**11,787**	**7,681**	**100.0**	**100.0**	**14.2****	**83.9****

* Project commenced in August 2015.
** Overall growth, excluding disbursements made under WCLSTF.

Source: Central Bank of Sri Lanka

Table 8.11 **Loan Disbursements under the Microfinance Loan Schemes**

Loan Scheme	Loan Disbursements				Share (%)		Growth (%)	
	2015 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep	
	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.
PAMP RF	8,964	442	4,197	205	15.7	9.2	-53.2	-53.5
PA I RF	15,316	1,033	15,941	1,300	59.6	58.2	4.1	25.9
SFLCP RF	3,431	187	1,219	67	4.6	3.0	-64.5	-64.0
NADeP*	-	-	5,382	662	20.1	29.6	-	-
Total	**27,711**	**1,662**	**26,739**	**2,235**	**100.0**	**100.0**	**-22.9****	**-5.4****

* Project was re-commenced in January 2016.
** Overall growth, excluding disbursements made under NADeP.

Source: Central Bank of Sri Lanka

(NCRCS), which is the principal scheme that provides both interest subsidy and credit guarantee for loans granted by PFIs to meet working capital requirements of small scale farmers for 32 short-term crop varieties. During the first three quarters of 2016, amount of loans granted through NCRCS increased by 12.9 per cent mainly due to the favourable weather condition that prevailed in the major cultivation areas. Under the Scheme, as in the past, the Anuradhapura District received the highest (19.0 per cent) amount of loan disbursements, among all districts. It was followed by Pollonnaruwa (11.0 per cent), and Ampara (9.0 per cent) districts. Paddy, being the major crop, received the highest share of 60.0 per cent of the total amount of loan disbursements. The performance of the Commercial Scale Dairy Development Loan Scheme (CSDDLS) moderated during the period under review. Overall, loans granted under these two schemes to the agriculture and livestock sector increased by 10.7 per cent during the period ending September, 2016.

- **Central Bank has taken a number of new policy measures to strengthen effective credit delivery.** These policies include the following:

  – Component of NADeP in January 2016 mainly to assist the small farmers and the landless: After meeting the disbursement target of Rs. 90 million well before the deadline, the programme was further extended for operation by the International Fund for Agricultural Development (IFAD), since April 2016. Accordingly, under NADeP, Rs. 662.3 million was disbursed to 5,382 borrowers by end September 2016.

Table 8.12 **Loan Disbursements to the Agriculture and Livestock Sector**

Loan Scheme	Loan Disbursements				Share (%)		Growth (%)	
	2015 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep		2016 Jan - Sep	
	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.
NCRCS	55,545	4,241	53,437	4,788	97.7	83.8	-3.8	12.9
CSDDLS	1,374	919	1,281	923	2.3	16.2	-6.8	0.5
Total	**56,919**	**5,159**	**54,718**	**5,711**	**100.0**	**100.0**	**-3.9**	**10.7**

Source: Central Bank of Sri Lanka

- The grace period of CSDDLS was increased from 6 months to 12 months, depending on the requirements of the project: Through this measure, it is expected to allow the investors to have sufficient time to generate a positive cash flow due to the fact that the gestation period of most dairy related activities are relatively longer than six months.

- Established the Phase II of the Self-Employment Promotion Initiative Loan Scheme (SEPI-II), on behalf of the Government: Through this Scheme, it is expected to continue providing refinance for loans granted by PFIs to the students who have completed vocational training courses conducted by the relevant training institutes to initiate self-employment projects. Operating instructions were issued and the agreements were signed with the selected PFIs to implement the loan scheme.

- Conducted an island-wide field survey to collect demand side information on the financial inclusiveness of the country: The information gathered under this survey will provide baseline information to measure the level of financial inclusion of the country and to develop a National Strategy for Financial Inclusiveness which enables all stakeholders to operate in one direction to achieve its objectives.

- Introduced a new loan scheme named, "Tharuna Diriya" Youth Empowerment & Employment Project under NADeP: The purpose of this Scheme is to assist the rural youth to improve their livelihood by providing credit facilities and required training to establish small scale enterprises. Operating instructions were issued to PFIs on 28 July 2016.

- Initiated actions to implement the 'Value Chain Development Capital Agriculture Loan Scheme' and 'Value Chain Development Seasonal Agriculture Loan Scheme' under The 'Out–Grower Farmers Loan Scheme' of NADeP.

- **Preliminary actions were taken to introduce a loan Scheme for MSMEs sector development and employment generation jointly with the Ministry of National Policies and Economic Affairs to provide financial support for new entrants and existing MSMEs at village level.**

- **Drafted operational manual to establish the Partial Credit Guarantee Scheme (PCG) proposed under the Agriculture Sector Modernisation Project of the World Bank.**

- **Central Bank continued to promote financial literacy and financial inclusiveness through a number of awareness programmes and workshops conducted during the period under review.** These programmes mainly covered the areas of financial literacy, financial management, entrepreneurship development and Training of Trainers and project appraisal workshops for entrepreneurs. In addition, the formation of Self Help Groups was also given priority.

- **Accordingly, under the category of awareness building, the Central Bank conducted 81 skills development programmes and 20 capacity building programmes with the assistance of PFIs.** In addition, 62 financial literacy programmes were also conducted for beneficiaries of PAMP II and PAMP II RF projects. Under these projects, nearly 110 societies of low income families were formed to empower them to cross pass poverty. Further, a poster campaign was also launched to disseminate information on banking and finance to the public.

Development in the Payment and Settlement System

LankaSettle System

- **Central Bank, as the operator of the LankaSettle System, continued to ensure a reliable and safe mechanism for efficient settlement of transactions through the Real Time Gross Settlement (RTGS) system.** The RTGS system which facilitates the electronic payments accounted for 88 per cent of the total value of non-cash payments during the first half of 2016 and continued to be the main interbank fund transfer system in the country. The volume and the value of transactions carried out through RTGS System during this period were 176,531 and Rs 43,354 billion, respectively.

Cheque Imaging and Truncation (CIT) System

- **CIT system continued to ensure a safe and efficient retail payment system.** CIT system, which was introduced in 2006 and is operated by LankaClear (Pvt.) Ltd. (LCPL), had substantially improved the cheque clearing process reducing the island-wide cheque realisation time to one day (T+1). At end September 2016, CIT system cleared 38,715,878 cheques to the value of Rs 7.0 trillion.

Sri Lanka Interbank Payment System

- **SLIPS, which is the electronic interbank payment system operated by LCPL was enhanced from an off-line mechanism to an on-line mechanism to facilitate pre-authorised low value payments on T+0 basis.** The volume and the value of transactions effected through SLIPS during the first nine months of 2016 were 19,407,820 and Rs. 1.0 trillion, respectively.

Common Card and Payment Switch (CCAPS)

- **Central Bank continued to facilitate the establishment of the Common Card and Payment Switch (CCAPS), which is a network of five interoperable switches, i.e., Common ATM Switch (CAS), CEFTS, Shared ATM Switch, Common POS Switch and Common Mobile Switch, by LCPL.**

- **CAS which is the first phase of CCAPS, started live operations in July 2013.** During the first nine months of 2016, 11 financial institutions integrated with CAS increasing the membership to 23. During the period of January to September 2016, CAS settled 22 million transactions amounting to Rs. 120 billion.

- **CEFTS, which is the second phase of CCAPS, was implemented on 21 August 2015.** CEFTS provides a common infrastructure to clear payments effected through multiple payment channels such as ATM, Internet Banking, Mobile Banking, Kiosks and over-the-counter. During the first nine months of 2016, 12 financial institutions integrated with CEFTS increasing the membership to 20. CEFTS settled 534,254 transactions amounting to Rs. 42 billion during the period January to September 2016.

Payment Cards and Mobile Payment Systems

- **Central Bank, continued to regulate the service providers of payment cards and mobile payment systems in terms of the provisions of the Payment Cards and Mobile Payment Systems Regulations No.1 of 2013.**

- **In 2016, the Central Bank conducted onsite supervision of licensed operators of mobile phone based e-money systems and made recommendations to ensure that e-money**

systems are operating within the framework approved by the Central Bank. Implementation of the recommendations were monitored to mitigate risks associated with such e-money systems.

- **In addition, the Central Bank continued to carry out offsite supervision of licensed service providers of payment cards and mobile payment systems based on the reports collected by the Central Bank on the operations of such licensed service providers.**

Business Continuity Planning

- **In 2016, the Central Bank continued supervising business continuity arrangements of LankaSettle Participants and LCPL in order to improve the operational robustness of the LankaSettle System.** The Central Bank evaluated the business continuity planning (BCP) documents and BCP drill reports and supervised BCP drills conducted by participants of the LankaSettle System and LCPL.

National Payments Council

- **The National Payment Council (NPC) which is the industry consultative and monitoring committee on payment systems commenced a consultative process for the preparation of a Road Map for medium-term development of payment systems.** Policy proposals were submitted by NPC members with regard to the application of new technology, new payment products, system stability, consumer protection and awareness on payment systems and instruments were taken into consideration. The draft Road Map prepared considering the policy proposals was circulated among NPC members for observations and will be finalised after incorporating the suggestions made by NPC members.

Expected Developments

- **The credit growth is expected to gradually moderate to a sustainable rate in the medium term in line with the current monetary policy direction.** There has been a gradual improvement in the relative level of performing loans with the decline in low quality assets. However, banks should be cautious of the possible increase in NPLs associated with the increase in credit and ensure that proper risk management mechanisms are in place to mitigate such risks.

- **Capital levels of banks are expected to be strengthened with enhanced capital requirements with the implementation of Basel III Minimum Capital Requirements, commencing 01 January 2017.** The requirements will be introduced on a staggered basis, in line with international timelines. Under these new requirements, banks will be expected to augment high quality capital to be in line with these enhanced capital requirements. This will improve the ability of the banking sector to absorb shocks arising from financial and economic stress, reducing the risk of spill-over from the financial sector to the real economy in the coming years. Under the potential implementation of the leverage ratio, banks may need to reassess the balance sheet size and business expansion, as the minimum ratio considers assets expansion regardless of the relative risk of different assets classes.

- **The liquidity position of banks will continue to be maintained at a healthy level which is over and above the minimum statutory requirement of 20 per cent.** Banking Act Directions on Liquidity Coverage Ratio (LCR) under Basel III Liquidity Standards were issued to banks during the first quarter of 2015, on a staggered basis. Being a forward looking indicator, the impact of its successful implementation is expected to strengthen the short-term resilience of the liquidity risk profile of banks.

- **Changes in macro-economic variables will be closely monitored to identify and address any spill-over risks arising from the real economy to the banking sector and appropriate macro-prudential measures will be introduced to pre-empt any looming risks to the stability of the financial system.** The regulatory and supervisory framework will be further strengthened in line with the Basel Core Principles on Effective Banking Supervision and other international and regional best practices.

- **Changes introduced to the regulatory and supervisory framework pertaining to banks in line with international standards and best practices will prompt banks to upgrade and strengthen their management information systems and related technological platforms to be able to cater to the resulting information requirements.** Further, banks are expected to upgrade and strengthen their management information systems and related technological platforms to enhance banking access through digital initiatives such as mobile / phone banking and internet banking. Increasing reliance on technology as a service delivery channel will require banks to take preventive measures to strengthen the information security management of all systems related aspects.

- **The banking sector is expected to enhance access to banking to all citizens with a view to enhancing financial inclusion and supporting economic activities throughout the country.** With a view to achieving a balanced growth island-wide, banks will be expected to closely monitor and take steps to improve region-wise credit to deposit ratios to be able to direct funds collected from a particular region to finance economic activities of the same region.

- **Large commercial banks will look into avenues of regional expansion, which will lead to an increase in the geographical reach of the banking sector.** Hence, close interactions will be maintained with other local and regional regulators with a view to enhancing information sharing among regulators and cross-border supervision.

- **NBFI sector growth to continue through diversification of the loan portfolio.** The sector is envisaged to grow further with the diversification of the traditional loan portfolio which mainly comprised finance leasing to non-core business products such as term loans, factoring and micro finance loans. Macro-prudential and fiscal measures imposed on the importation and lending for motor vehicles will prompt the sector to diversify their portfolios further. In addition, the growing demand for credit at the grass-root level of the economy will enable the sector for greater diversification of the loan portfolio to non-core products. Such non-core products will increase the risk profile of the sector loan portfolio as most of these loans tend to be non-collateralised or low quality collateral. However, these types of loans are expected to generate notable profits as a result of high yields following the risks and return paradigm. Further, NBFIs are expected to access funds through the banking system instead of retail deposits due to cost effectiveness. Considering the projected economic growth mainly in the rural areas of the country and increasing per capita income levels, the demand for the leasing business is expected to remain steady in the future. The large NBFIs are expected to operate as mini-banks in this sector with their economies of scale and outreach.

- **The stability of the sector is expected to be reinforced further in the short to medium-term horizon with the proposed changes to the existing regulatory framework.** The capital levels of NBFIs are expected to be strengthened further, in terms of quantity as well as quality with the enhanced minimum capital requirements where the existing LFCs and SLCs will be required to maintain a higher minimum core capital than the prevailing requirement of Rs. 400 million and Rs. 300 million, respectively, and the implementation of appropriate measures in line with Basel II and III Capital Adequacy Framework. Therefore, the proposed framework on capital adequacy will be more risk sensitive focusing credit risk based on borrowers risk profiles, operational and market risks in the trading book while the enhanced minimum core capital levels will ensure entry barriers for undercapitalized/weak institutions and create a level playing field in the sector.

- **The proposed changes to the existing risk management regulations will enable to establish an Integrated Risk Management Framework for NBFIs.** New governance practices are expected to be incorporated to the Corporate Governance Framework with a view to improving governance.

- **The above proposed new regulatory framework is expected to enforce a strict regulatory environment and natural consolidation drive by pushing smaller, inefficient, weak NBFIs to consolidate with bigger players or to seek strategic investors with capital infusions.**

- **Most of the companies are operating with high cost to income ratios leading to high lending rates.** Therefore, the proposed changes are expected to tighten the high margins existing in the sector when compared with the banking sector.

- **A positive outcome is expected through the government intervention in the resolution of some distressed finance companies.** As proposed in 2016 budget, the preliminary steps have been taken by the Ministry of Finance in establishing Financial Assets Management Agency (FAMA). Further, the Central Bank continuously works with potential local and foreign strategic investors to strengthen the capital of these companies.

- **Revised guidelines on financial derivatives is to be issued with the objective of addressing the issues,** (i.e. the variety of new instruments, eligibility criteria, permitted activities in the trading derivatives; the inclusion of SLBs to the guideline; the need to sign the master agreement of International Swaps and Derivatives Association (ISDA) when entering into a derivate contract; pooling of derivative contracts into one contract and the regulations with regard to entering into derivative contracts with foreign counterparties) raised by the banking sector.

- **Considering the economic benefits of effecting payments electronically, the Central Bank is promoting electronic payments to establish a less cash society to reduce the cost in printing and delivering currency for economic activities.** Accordingly, the following measures will be adopted by the Central Bank;

    - Implementation of an electronic payment solution to facilitate payments to government institutions – With the introduction of electronic payments to the government sector, it is expected to streamline the collection process of the government. Provision of online payment solutions will ensure timely fund flows to the government while reducing the cost of revenue collection. As the first phase, the Central Bank is facilitating the implementation of an online payment system for Sri Lanka Customs which will be extended to other government departments as well.

    - Introduction of a National Card Scheme - The Central Bank will facilitate the introduction of a National Card Scheme as a measure to reduce the transaction and other costs paid for payment cards issued by local banks under International Card Schemes and to reduce foreign currency payments to such card schemes.

APPENDIX 1

Major Economic Policy Changes and Measures: January - October 2016[1]

Real Sector[2]

01 February 2016 - The common floor rates for local voice calls and SMS/ MMS were determined as follows:

Item	Floor Rate per Minute (Rs.)
Local voice call (per minute basis billing)	1.50
Local voice call (per second basis billing)	1.80
SMS/ MMS	0.20 (per message)

14 July 2016 - The Maximum Retail Price (MRP) of certain items was set as follows:

- Masoor Dhal (red lentils) at Rs. 169 per kg
- Dried sprats (imported - Thailand) at Rs. 495 per kg
- Dried sprats (imported - Dubai) at Rs. 410 per kg
- Gram at Rs. 260 per kg
- Green gram (Moong) at Rs. 220 per kg
- Canned fish (imported) at Rs. 140 per net weight of 425 g or drained weight of 280 g and Rs. 70 per net weight of 155 g or drained weight of 105 g
- White sugar at Rs. 95 per kg
- Wheat flour at Rs. 87 per kg
- Full cream milk powder (imported) at Rs. 325 per 400 g and Rs. 810 per 1 kg
- Full cream milk powder (local) at Rs. 295 per 400 g and Rs. 735 per 1 kg
- Frozen or chilled Broiler chicken meat (whole chicken) with skin at Rs. 410 and without skin at Rs. 495
- Potatoes (imported) at Rs. 120 per kg
- B' onions (imported) at Rs. 78 per kg
- Dried chillies (neither crushed nor ground) at Rs. 385 per kg

1. This includes major economic policy changes and measures implemented during January to October 2016. Policy changes and measures that have been announced and are yet to be implemented during the remaining period of 2016 are also included.

2. Details of fiscal incentives granted for the development of the real sector are included in policy measures under the fiscal sector.

		- Dried fish - Katta at Rs. 1,100 per kg
		- Dried fish - Salaya at Rs. 425 per kg
		- Sustagen at Rs. 1,500 per 400g
		- Maldive fish at Rs. 1,500 per kg
01 August 2016	-	Passenger bus fares were increased by 6 per cent. The minimum bus fare was increased to Rs. 9 from Rs. 8.
21 October 2016	-	National Medicines Regulatory Authority (Ceiling on Prices) Regulation No. 2 of 2016 on MRP of 48 selected medicinal products was issued.

External Sector

Trade and Tariff

21 January 2016	-	Special Commodity Levy (SCL) on the importation of Maldive fish, dried sprats, green gram (Moong), black gram, chillies, seeds of coriander, turmeric, black gram flour and canned fish was extended for a period of six months.
29 January 2016	-	SCL of 10 per cent on the importation of maize and grain sorghum was extended until 29 February 2016.
	-	SCL of Rs. 175 per kg on the importation of vegetable fats and oils and their fractions was extended up to 28 April 2016.
01 February 2016	-	Customs duty on the importation of rice was increased to Rs. 50 per kg from Rs. 35 per kg.
09 February 2016	-	Full Customs duty waiver of 15 per cent or Rs. 10 per kg granted on the importation of wheat grain was reduced to Rs. 4 per kg. Hence, the applicable rate is Rs. 6 per kg.
01 March 2016	-	SCL on the importation of potatoes was increased to Rs. 35 per kg from Rs. 15 per kg for a period of four months.
	-	SCL on the importation of b' onions was increased to Rs. 25 per kg from Rs. 5 per kg for a period of four months.
08 March 2016	-	SCL on the importation of mackerel, peas, chickpeas, cowpeas, kurakkan, margarine, sugar and vegetable oils was extended for a period of six months.
02 April 2016	-	SCL on the importation of dried fish, yoghurt, butter, dairy spreads, red onions, garlic, fresh oranges, grapes, apples, seeds of cumin, seeds of fennel, mathe seeds, kurakkan flour, ground nut, mustard seeds and salt was extended for a period of six months.
13 May 2016	-	SCL on the importation of vegetable oils was increased by Rs. 20 per kg for a period of six months.

	-	SCL on the importation of margarine with fat content of 80 per cent or more was increased to Rs. 195 per kg from Rs. 175 per kg for a period of six months.
	-	SCL on the importation of margarine (other) was increased to Rs. 295 per kg from Rs. 275 per kg for a period of six months.
21 May 2016	-	SCL on the importation of fresh, chilled or frozen fish, Masoor dhal (red lentils), yellow lentils, dates and seeds of cumin was extended for a period of six months.
	-	SCL on the importation of red onions was increased to Rs. 25 per kg from Rs. 5 per kg for a period of six months.
	-	SCL on the importation of seeds of fennel was increased to Rs. 162 per kg from Rs. 52 per kg for a period of six months.
17 June 2016	-	SCL on the importation of vegetable oils was increased by Rs. 20 per kg for a period of six months.
	-	SCL of Rs. 155 per kg was imposed on palm olein for a period of six months.
23 June 2016	-	Customs duty waiver of Rs. 6 per litre granted on the importation of diesel was removed. Hence, the applicable rate is Rs. 15 per litre.
01 July 2016	-	SCL on the importation of potatoes and b' onions was extended for a period of three months.
	-	SCL of 10 per cent was imposed on the importation of maize and grain sorghum for a period of three months.
15 July 2016	-	Customs duty waiver of Rs. 90 per kg was granted on the importation of milk powder. Hence, the applicable rate is Rs. 135 per kg.
19 July 2016	-	SCL on the importation of Maldive fish, dried sprats, green gram (Moong), black gram, chillies, seeds of coriander, turmeric, black gram flour and canned fish was extended for a period of six months.
	-	SCL on the importation of sugar was decreased to Rs. 0.25 per kg from Rs. 30 per kg for a period of six months.
20 August 2016	-	SCL on the importation of b' onions was increased to Rs. 40 per kg from Rs. 25 per kg for a period of six months.
25 August 2016	-	SCL on the importation of potatoes was increased to Rs. 40 per kg from Rs. 35 per kg for a period of six months.
08 September 2016	-	SCL on the importation of mackerel, peas, chickpeas, cowpeas and kurakkan was extended for a period of six months.
15 September 2016	-	Customs duty waiver of Rs. 4 per kg on wheat grain was removed and Customs duty of 15 per cent or Rs. 10 per kg applicable on the importation of wheat grain was increased to 15 per cent or Rs. 12 per kg.

16 September 2016 - SCL on the importation of sugar was increased for a period six months as follows:

- White crystalline sugar from Rs. 0.25 per kg to Rs. 2 per kg
- Other sugar from Rs. 0.25 per kg to Rs. 15 per kg

30 September 2016 - SCL on the importation of red and yellow lentils was increased for a period of six months as follows:

- Whole from Rs. 0.25 per kg to Rs. 5 per kg
- Split from Rs. 0.25 per kg to Rs. 10 per kg

02 October 2016 - SCL on the importation of dried fish, yoghurt, butter, dairy spreads, garlic, fresh oranges, grapes, apples, mathe seeds, kurakkan flour, ground nut, mustard seeds and salt was extended for a period of six months.

Foreign Exchange Management

20 January 2016 - New Directions were issued to authorised dealers on Non Resident Foreign Currency Accounts (NRFC), Resident Foreign Currency Accounts (RFC), Resident Non National Foreign Currency Accounts (RNNFC) and Foreign Exchange Earners' Accounts (FEEA) allowing account holders to freely remit the funds of such accounts outside Sri Lanka for any purpose.

- A new Gazette notification was issued permitting individuals to retain in his/ her possession foreign currency up to US dollars 10,000 or its equivalent in any other foreign currencies.

23 March 2016 - Directions were issued to authorised dealers and primary dealers appointed as designated agents for Sri Lanka Development Bonds (SLDBs) permitting them to open special foreign currency accounts titled 'Sri Lanka Development Bonds Investment Account' and 'Dollar Account for Bond Investment' for the purpose of acquiring, holding and transferring SLDBs and to purchase US dollars from an authorised dealer.

01 April 2016 - The exemption which has been granted in the Gazette No. 759/15 dated 26 March 1993 was repealed and exporters were required to repatriate export proceeds retained abroad within 90 days of the date of exportation. Further, the exporters were required to repatriate any such proceeds retained abroad not later than 01 May 2016.

19 April 2016 - Directions on Diplomatic Foreign Currency Accounts and Diplomatic Rupee Accounts were issued to authorised dealers permitting them to remit visa collection fees of the Diplomatic Missions and proceeds realised from the sale of vehicles owned by Diplomatic personnel without referring to the Controller of Exchange and to make investments in Sri Lanka through Securities Investment Account (SIA).

16 May 2016 - The emigrants who migrated before 12 June 2013 on Permanent Resident Visas were permitted to remit superannuation benefits including provident fund and gratuity benefits and current income including interest, dividends, pension, rent, lease rentals and profits derived in Sri Lanka after 12 June 2013 through their respective Non Resident Blocked Accounts, without being deducted from the eligible migration allowance.

- Migrants were permitted to transfer the eligible migration allowance to a SIA for investment in Sri Lanka.

07 June 2016 - A new External Commercial Borrowing Scheme (ECBS) was implemented for companies incorporated in Sri Lanka other than Licensed Commercial Banks (LCBs), LSBs, LFCs, specialised leasing companies, companies limited by guarantee and overseas companies, to borrow from foreign sources and a direction was issued to authorised dealers permitting them to open and operate 'External Commercial Borrowing Accounts' in the name of eligible borrowers.

10 June 2016 - The restriction prevailed on foreign investments in the areas of money lending and providing security services including security management, assessment and consulting to individuals or private organisations was removed.

29 September 2016 - The Gazette No. 1960/66 dated 01 April 2016 was repealed and exporters were required to repatriate export proceeds within 120 days from the date of exportation. A grace period of 30 days may be granted by the Central Bank of Sri Lanka (CBSL), prior to instituting action against any violation.

Fiscal Sector

Government Revenue

01 January 2016 - An import license fee of Rs. 1.5 million per annum was imposed on all importers engaged in the business of importing and selling motor vehicles.

- The duty on bottled toddy was increased to Rs. 30 per litre from Rs. 10 per litre.
- Stamp duty of 1.5 per cent levied on credit card usage was removed with regard to local usage of credit cards.
- Stamp duty on usage of credit cards for foreign purchases was increased to 2.5 per cent.
- Stamp duty on any share certificate issued consequent to the issue, transfer or assignment of any number of shares of any company was removed.
- Embarkation Levy was increased as follows:
    - To a person leaving Sri Lanka by aircraft from US dollars 25 to US dollars 30
    - To a person leaving Sri Lanka by ship from US dollars 5 to US dollars 30

- Fees for passport and dual citizenship were increased as follows;

		Previous (Rs.)	Current (Rs.)
Passport fee One day service	Adult	7,500	10,000
	Child	3,500	5,000
Passport fee Normal service	Adult	2,500	3,000
	Child	1,500	2,000
Dual citizenship fee		250,000	300,000

- SAARC visa fee was increased to US dollars 20 from US dollars 10.
- The rate of Ports and Airports Development Levy (PAL) was increased to 7.5 per cent from 5 per cent.
- Vehicle Entitlement Levy was introduced.
- Tax imposed on the leasing of land to foreigners was removed.
- Construction Industry Guarantee Fund Levy was removed.
- The rates on International Telecommunication Operators' Levy (ITOL) were increased from US dollars 9 cents to US dollars 12 cents.
- Concessionary PAL rate of 2.5 per cent was imposed on electronic and electric items.
- Machinery used for construction, dairy and agricultural industries was exempted from PAL.
- Retail sales and transportation of maximum quantity of foreign liquor were restricted to 7.5 litres.

01 March 2016 - Instead of using Customs value determined by the Director General of Customs based on the price furnished by the manufacturer of such vehicle higher of the two alternative values of (a) and (b) below was applied by the Gazette No. 1956/17 (item i) issued on 01 March 2016 to calculate Customs value of motor vehicles:

(a) Value of the vehicle, determined by the Director General of Customs based on the price furnished by the manufacturer of such vehicle.

(b) Invoiced Free on Board (FOB) Value of the vehicle.

01 April 2016 - Revisions made on Economic Service Charge (ESC) were as follows:

- Exclusion on profit making businesses was removed.
- Maximum liability of Rs.120 million per year was removed.
- The rate was increased to 0.5 per cent from 0.25 per cent.

- The period for carrying forward of ESC to be set off against income tax payable for any period commencing from 01 April 2016, was reduced from 5 years to 3 years.
- Retail trade of petrol, diesel and kerosene was made liable for ESC if the aggregate turnover for a quarter is Rs. 50 million. Tax is calculated on 1/10th of the liable turnover of such trade.

- Revisions made on corporate income tax were as follows:
  - 28 per cent on banking and financial services, insurance industry and trading activities (including any primary preparation for the adapting for sale of any article).
  - 40 per cent on liquor, tobacco, lottery and betting and gaming.
  - 17.5 per cent on other activities (excluding interest income, royalty, dividends, etc. depending on the source of income).
- Revisions made on personal income tax were as follows:
  - Employment income taxed at the maximum rate of 16 per cent and the current Pay-As-You-Earn (PAYE) tables were applied for the year of assessment commencing from 01 April 2016.
  - The PAYE tax liability of an employee shall be deducted from the employee's remuneration and the provisions preventing employer settling employee's PAYE liability was introduced.
- Maximum income tax rate applicable for individuals on the;
  - Profits from any activity other than any financial, trading, liquor, tobacco, lottery, and betting and gaming were limited to 17.5 per cent.
  - Profits from any financial or trading activity (including any primary preparation for the adapting for sale of any article) were limited to 24 per cent.
  - Profits from any liquor, tobacco, lottery, betting and gaming activity were limited to 40 per cent.
  - Income from rent, net annual value and similar sources taxed up to the maximum rate of 24 per cent.
- Excise duty on the importation and local supply of ethyl alcohol was increased.

26 May 2016 - Gazette No. 1956/17 issued on 01 March 2016 was repealed by the Gazette No. 1968/11 issued on 25 May 2016 and revised the method on calculation of Customs value of motor vehicles (item (i)) as follows:

(a) Transacted value of brand new motor vehicle should be proved with invoice issued by the manufacturer or certified by the manufacturer of such vehicles.

		(b) Transacted value of other motor vehicles should not be below 82.5 per cent of the transacted value of a similar or identical brand new vehicle at the country of export of such vehicle.
27 May 2016	-	Unit rate of excise duty on the importation of motor vehicles was revised.
14 June 2016	-	The Gazette no 1968/11 issued on 25 May 2016 was repealed by the Gazette No. 1971/10 issued on 14 June 2016 and revised the method of calculation of Customs value of motor vehicles (item (i) (B)) as follows: Transacted value should not be below 85 per cent of the transacted value of a similar or identical brand new vehicle at the country of export of such vehicle. Further, brokerage and selling commission incurred by the buyer until the vehicle reaches the port of Sri Lanka (item (5)) was included to calculate the Customs value of motor vehicles.
27 August 2016	-	Excise duty on diesel was increased to Rs. 13 per litre from Rs. 3 per litre.
Forthcoming	-	Submitting the Value Added Tax (VAT) (Amendment) bill and the Nation Building Tax (NBT) (Amendment) bill to the Parliament.

Government Expenditure

25 February 2016	-	Public Administration Circular No. 03/2016 was issued to implement salary scales for public service in five phases with effect from 01 January 2016.
09 March 2016	-	Circular No. 2016NFS/FCG(1) was issued to grant a maximum cash grant of Rs. 25,000 per hectare for maximum two hectares per year in place of the fertiliser subsidy for paddy farmers.
01 May 2016	-	Pension Circular No. 04/2016 was issued to establish the new insurance scheme "Agrahara Rekawarana" for officers who retired after 01 January 2016.
03 May 2016	-	A Circular was issued to grant a cash grant of Rs. 15,000, Rs. 9,000 and Rs. 5,000 per hectare per year for tea, coconut and rubber, respectively, in lieu of fertiliser subsidy.

Debt Management

07 January 2016	-	Issuance of SLDBs up to a limit of US dollars 2,500 million for 2016 was authorised.
16 February 2016	-	A Circular was issued on 'Recording of Ownership of Government Securities in the LankaSecure Central Depository System' to all participants of LankaSettle System to ensure compliance with LankaSettle System Rules (version 2.1) issued on 01 August 2013 in the conduct of their business operations.
13 March 2016	-	The minimum investment amount in SLDBs was decreased from US dollars 100,000 to US dollars 10,000.

07 April 2016	-	The regulatory and supervisory functions of the CBSL carried out hitherto by the Superintendent/Registrar of Public Debt in relation to primary dealers and other participants in terms of Local Treasury Bills Ordinance, Registered Stock and Securities Ordinance and other relevant regulations and statues were assigned to the Director, Department of Supervision of Non Bank Financial Institutions of the CBSL.
01 August 2016	-	Issuance of a Circular requiring all primary dealers to use the Bloomberg trading platform Fixed Income Quote (FIQ) designed for Sri Lanka to; - conduct all inter primary dealer outright trades. - report yield rates and volumes of all outright trades carried out over the counter in excess of Rs. 50 million with non primary dealer investors within 30 minutes of each trade.
15 September 2016	-	The Circular issued on 01 August 2016 was extended to all LCBs and LSBs requiring; - conduct all outright trades with other banks and primary dealers and - report yield rates and volumes of all outright trades carried out over the counter in excess of Rs. 50 million, within 30 minutes of each such trade.

Monetary Sector

16 January 2016	-	The Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of LCBs was increased by 1.50 percentage points to 7.50 per cent from 6.00 per cent.
19 February 2016	-	The Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) were increased by 50 basis points to 6.50 per cent and 8.00 per cent, respectively.
28 July 2016	-	The SDFR and SLFR were increased by 50 basis points to 7.00 per cent and 8.50 per cent, respectively.

Financial Sector

Licensed Banks

25 January 2016	-	All licensed banks were instructed to submit information on the occurrence of cyber security events to the Director of Bank Supervision, CBSL within one working day from the date of detection and within 15 days from the end of each quarter, for purposes of monitoring.
01 February 2016	-	All licensed banks were required to display of fees charged from customers for fund transfers effected through systemically important payment systems in all branches and display them in banks' web site.
Forthcoming	-	Implementation of minimum capital requirement and leverage ratio for licensed banks under Basel III.

Other Financial Institutions

18 January 2016	-	Directions were issued to strengthen and streamline the existing policies and practices in respect of the opening of new branches and automated teller machines, closure and relocation of branches and other outlets of LFCs and Specialised Leasing Companies (SLCs).
Forthcoming	-	Revising following directions on LFCs and SLCs; - Minimum core capital requirement - Risk weighted capital adequacy ratio - Classification and impairment/provisioning for loans and advances - Preparation, presentation and publication of annual and interim financial statements - Methodology used in calculating the maximum interest rate limit on deposits and debt instruments

Other

01 January 2016	-	Share Transaction Levy (STL) was removed.
	-	The Insurance Board of Sri Lanka (IBSL) issued Solvency Margin (Risk Based Capital) Rules to all insurance companies to be complied with effect from 01 January 2016.
04 January 2016	-	IBSL issued a direction under section 96A of the Regulation of Insurance Industry (RII) Act to all insurers and brokers, to obtain approval from IBSL on changes in ownership and control over 50 per cent of shareholding.
06 January 2016	-	A national policy on Anti-Money Laundering (AML) and Countering the Financing of Terrorism (CFT) approved by the Cabinet of Ministers was adopted.
07 January 2016	-	Operating Instructions were issued to Participating Financial Institutions (PFIs) to recommence the Microfinance Component of the National Agribusiness Development Programme (NADeP) to disburse Rs. 90 million island wide.
14 January 2016	-	The grace period of the Commercial Scale Dairy Development Loan Scheme (CSDDLS) was increased to 12 months from 06 months, depending on the requirements of the project.
27 January 2016	-	Extraordinary Gazette No. 1951/13 on the Financial Institutions (Customer Due Diligence) Rules No. 1 of 2016 was issued to financial institutions.
15 March 2016	-	IBSL increased the policy acknowledgement period by the policy holders from 7 days to 14 days.

01 April 2016	-	IBSL introduced a 21 day minimum period, known as cooling off period/free look period, for prospective life insurance policy holders to examine the terms and conditions of proposed insurance contract.
	-	STL was re-imposed at a rate of 0.3 per cent.
28 April 2016	-	Operating Instructions to implement the Self-Employment Promotion Initiative Loan Scheme-Phase II (SEPI-II) were issued.
20 May 2016	-	Microfinance Act No. 6 of 2016 was enacted for; - the licensing, regulation and supervision of companies carrying on microfinance business, - the registration of non-governmental organisations accepting limited savings deposits as microfinance non-governmental organisations and - the setting up of standards for the regulation and supervision of micro finance non-governmental organisations and micro credit non-governmental organisations.
28 July 2016	-	Operating Instructions to implement the "Tharuna Diriya" Youth Empowerment and Employment Programme operated under the NADeP were issued to PFIs.

APPENDIX 2

STATISTICAL APPENDIX

Definitions and Explanatory Notes

The following general notes supplement the footnotes given below the individual tables:

1. In an attempt to bring the material up-to-date, provisional figures are included in some tables.
2. Figures in some tables have been rounded off to the nearest final digit. Hence, there may be a slight discrepancy between the total as shown and the sum of its components.
3. Differences as compared with previously published figures are due to subsequent revisions.
4. The following symbols have been used throughout:-

...	=	negligible
-	=	nil
n.a.	=	not available

TABLE 1
Gross Domestic Product by Industrial Origin at Current Market Prices (a)

Rs. million

ECONOMIC ACTIVITY	2013	2014 (b) (c)	2015 (b)	2016 First Half (b)	% Change 14/13 (b) (c)	% Change 15/14 (b)	% Change 16/15 First Half (b)
Agriculture, Forestry and Fishing	**735,382**	**833,889**	**901,579**	**449,190**	**13.4**	**8.1**	**4.5**
1. Growing of cereals (except rice)	17,592	18,436	20,436	12,417	4.8	10.8	23.4
2. Growing of rice	66,851	104,723	119,254	32,255	56.7	13.9	-24.5
3. Growing of vegetables	69,065	72,651	90,938	49,907	5.2	25.2	3.8
4. Growing of sugar cane, tobacco and other non-perennial crops	3,263	3,431	2,859	1,650	5.1	-16.7	14.8
5. Growing of fruits	44,839	45,697	59,723	34,034	1.9	30.7	31.3
6. Growing of oleaginous fruits (coconut, king coconut, oil palm)	74,654	79,821	91,863	44,319	6.9	15.1	-8.6
7. Growing of tea (green leaves)	90,921	91,544	75,042	36,736	0.7	-18.0	-8.1
8. Growing of other beverage crops (coffee, cocoa etc.)	1,263	1,622	1,366	757	28.5	-15.8	15.5
9. Growing of spices, aromatic, drug and pharmaceutical crops	49,507	75,740	82,876	44,974	53.0	9.4	21.6
10. Growing of rubber	31,493	17,438	14,045	7,089	-44.6	-19.5	-4.3
11. Growing of other perennial crops	19,251	22,623	26,773	13,966	17.5	18.3	6.0
12. Animal production	40,334	57,289	66,863	40,121	42.0	16.7	33.6
13. Plant propagation and support activities to agriculture	11,166	12,110	11,979	6,487	8.5	-1.1	9.3
14. Forestry and logging	64,072	71,767	75,545	42,423	12.0	5.3	15.8
15. Marine fishing and marine aquaculture	137,651	142,953	146,714	77,410	3.9	2.6	2.0
16. Fresh water fishing and fresh water aquaculture	13,460	16,043	15,303	4,646	19.2	-4.6	-27.8
Industries	**2,797,328**	**2,986,199**	**3,190,006**	**1,725,614**	**6.8**	**6.8**	**10.0**
17. Mining and quarrying	245,382	254,640	262,231	141,470	3.8	3.0	12.6
18. Manufacture of food, beverages & tobacco products	801,748	969,402	1,099,149	583,641	20.9	13.4	5.9
19. Manufacture of textiles, wearing apparel and leather related products	365,685	379,633	384,746	216,529	3.8	1.3	4.2
20. Manufacture of wood and of products of wood and cork, except furniture	27,365	30,313	32,544	14,424	10.8	7.4	17.5
21. Manufacture of paper products, printing and reproduction of media products	28,261	21,294	22,530	12,024	-24.7	5.8	8.3
22. Manufacture of coke and refined petroleum products	66,064	11,869	33,909	18,655	-82.0	185.7	6.9
23. Manufacture of chemical products and basic pharmaceutical products	62,740	83,855	87,789	44,138	33.7	4.7	-2.2
24. Manufacture of rubber and plastic products	74,995	69,071	73,639	31,858	-7.9	6.6	-1.7
25. Manufacture of other non- metallic mineral products	124,831	116,002	123,040	69,683	-7.1	6.1	14.4
26. Manufacture of basic metals and fabricated metal products	34,300	35,014	39,162	20,646	2.1	11.8	23.2
27. Manufacture of machinery and equipment	34,584	21,694	22,973	10,373	-37.3	5.9	15.6
28. Manufacture of furniture	57,966	59,805	60,172	35,822	3.2	0.6	19.4
29. Other manufacturing, and repair and installation of machinery and equipment	44,553	43,278	47,592	24,539	-2.9	10.0	4.9
30. Electricity, gas, steam and air conditioning supply	90,539	76,370	45,620	36,847	-15.6	-40.3	41.9
31. Water collection, treatment and supply	11,189	14,427	14,939	8,666	28.9	3.5	16.0
32. Sewerage, waste treatment and disposal activities	11,671	13,140	16,453	10,479	12.6	25.2	38.4
33. Construction	715,455	786,393	823,519	445,818	9.9	4.7	16.0
Services	**5,406,544**	**5,924,433**	**6,295,853**	**3,207,956**	**9.6**	**6.3**	**5.9**
34. Wholesale and retail trade	1,047,793	1,135,949	1,203,367	673,523	8.4	5.9	7.4
35. Transportation of goods and passengers including warehousing	1,162,834	1,288,346	1,301,177	597,505	10.8	1.0	0.4
36. Postal and courier activities	4,695	4,822	5,001	2,271	2.7	3.7	-9.4
37. Accommodation, food and beverage service activities	155,197	166,613	165,878	88,773	7.4	-0.4	7.1
38. Programming and broadcasting activities and audio/video productions	4,198	3,680	4,461	1,805	-12.3	21.2	-18.5
39. Telecommunication	41,986	44,738	56,531	31,937	6.6	26.4	6.1
40. IT programming consultancy and related activities	11,902	13,431	16,409	8,659	12.8	22.2	7.1
41. Financial service activities and auxiliary financial services	308,810	348,748	374,133	193,082	12.9	7.3	15.7
42. Insurance, reinsurance and pension funding	81,712	92,945	102,225	48,516	13.7	10.0	23.2
43. Real estate activities, including ownership of dwelling	512,063	562,804	622,286	322,357	9.9	10.6	5.1
44. Professional services	198,873	210,970	197,800	98,882	6.1	-6.2	-0.3
45. Public administration and defence; compulsory social security	501,755	563,281	637,465	315,865	12.3	13.2	3.6
46. Education	189,298	212,162	251,473	132,019	12.1	18.5	10.1
47. Human health activities, residential care and social work activities	198,796	210,321	250,765	123,805	5.8	19.2	6.5
48. Other personal service activities	986,633	1,065,625	1,106,882	568,958	8.0	3.9	7.5
Equals Gross Value Added (GVA) at Basic Price	**8,939,254**	**9,744,522**	**10,387,438**	**5,382,761**	**9.0**	**6.6**	**7.0**
Taxes less subsidies on products	652,871	703,957	795,782	543,276	7.8	13.0	34.5
Equals Gross Domestic Product (GDP) at Market Price	**9,592,125**	**10,448,479**	**11,183,220**	**5,926,037**	**8.9**	**7.0**	**9.1**

(a) The data is based on the base year 2010 GDP estimates of Department of Census and Statistics
(b) Provisional
(c) Revised

Source : Department of Census and Statistics

TABLE 2
Gross Domestic Product by Industrial Origin at Constant (2010) Prices (a)

Rs. million

ECONOMIC ACTIVITY	2013	2014 (b) (c)	2015 (b)	2016 First Half (b)	% Change 14/13 (b) (c)	% Change 15/14 (b)	% Change 16/15 First Half (b)
Agriculture, Forestry and Fishing	**611,676**	**641,493**	**676,899**	**325,408**	**4.9**	**5.5**	**-2.5**
1. Growing of cereals (except rice)	14,307	14,927	15,077	8,704	4.3	1.0	18.1
2. Growing of rice	65,607	61,022	75,219	23,934	-7.0	23.3	-10.5
3. Growing of vegetables	54,153	55,307	69,060	36,369	2.1	24.9	5.0
4. Growing of sugar cane, tobacco and other non-perennial crops	2,441	2,286	1,954	1,076	-6.3	-14.5	9.3
5. Growing of fruits	37,385	40,889	47,629	25,768	9.4	16.5	-0.4
6. Growing of oleaginous fruits (coconut, king coconut, oil palm)	53,424	64,159	67,439	36,915	20.1	5.1	5.3
7. Growing of tea (green leaves)	74,734	73,946	72,027	33,457	-1.1	-2.6	-11.9
8. Growing of other beverage crops (coffee, cocoa etc.)	1,321	1,538	1,259	603	16.4	-18.1	-4.2
9. Growing of spices, aromatic, drug and pharmaceutical crops	50,833	57,509	58,278	26,954	13.1	1.3	-4.3
10. Growing of rubber	37,987	28,689	25,777	13,939	-24.5	-10.1	-5.0
11. Growing of other perennial crops	14,344	15,392	15,829	7,935	7.3	2.8	0.8
12. Animal production	36,599	47,954	51,782	25,711	31.0	8.0	3.4
13. Plant propagation and support activities to agriculture	9,183	9,767	9,781	4,844	6.4	0.1	-1.5
14. Forestry and logging	43,044	47,451	48,333	24,552	10.2	1.9	-4.0
15. Marine fishing and marine aquaculture	103,879	106,585	104,952	50,607	2.6	-1.5	-5.1
16. Fresh water fishing and fresh water aquaculture	12,435	14,072	12,501	4,039	13.2	-11.2	-21.4
Industries	**2,119,080**	**2,194,167**	**2,259,223**	**1,165,358**	**3.5**	**3.0**	**5.2**
17. Mining and quarrying	198,447	202,905	201,036	99,002	2.2	-0.9	1.5
18. Manufacture of food, beverages & tobacco products	507,127	513,895	542,573	272,948	1.3	5.6	0.8
19. Manufacture of textiles, wearing apparel and leather related products	264,527	276,653	276,710	151,419	4.6	0.0	1.6
20. Manufacture of wood and of products of wood and cork, except furniture	25,258	23,141	24,780	11,190	-8.4	7.1	21.6
21. Manufacture of paper products, printing and reproduction of media products	24,925	24,970	27,326	17,168	0.2	9.4	29.8
22. Manufacture of coke and refined petroleum products	27,514	28,723	29,075	20,264	4.4	1.2	37.0
23. Manufacture of chemical products and basic pharmaceutical products	81,982	82,244	85,101	42,330	0.3	3.5	-3.4
24. Manufacture of rubber and plastic products	82,187	71,914	75,296	32,603	-12.5	4.7	-1.6
25. Manufacture of other non- metallic mineral products	81,037	78,678	76,503	37,919	-2.9	-2.8	-4.0
26. Manufacture of basic metals and fabricated metal products	26,589	24,883	29,112	15,761	-6.4	17.0	28.6
27. Manufacture of machinery and equipment	30,845	32,064	37,574	17,251	4.0	17.2	17.0
28. Manufacture of furniture	67,488	82,752	88,269	50,833	22.6	6.7	17.1
29. Other manufacturing, and repair and installation of machinery and equipment	44,443	53,077	61,763	30,774	19.4	16.4	2.8
30. Electricity, gas, steam and air conditioning supply	76,789	79,296	85,446	45,191	3.3	7.8	8.5
31. Water collection, treatment and supply	10,975	11,505	12,000	5,966	4.8	4.3	1.0
32. Sewerage, waste treatment and disposal activities	15,511	17,355	21,659	12,520	11.9	24.8	21.0
33. Construction	553,438	590,111	584,999	302,218	6.6	-0.9	8.5
Services	**4,405,644**	**4,634,805**	**4,881,273**	**2,471,301**	**5.2**	**5.3**	**4.9**
34. Wholesale and retail trade	859,977	898,864	940,814	514,008	4.5	4.7	4.5
35. Transportation of goods and passengers including warehousing	849,539	879,833	928,279	424,367	3.6	5.5	2.1
36. Postal and courier activities	4,364	4,056	3,830	1,882	-7.1	-5.6	0.9
37. Accommodation, food and beverage service activities	126,392	131,484	129,732	67,792	4.0	-1.3	3.7
38. Programming and broadcasting activities and audio/video productions	2,422	2,513	2,651	1,285	3.8	5.5	-2.4
39. Telecommunication	27,395	30,989	34,128	20,126	13.1	10.1	21.0
40. IT programming consultancy and related activities	9,693	10,599	12,834	6,607	9.3	21.1	3.7
41. Financial service activities and auxiliary financial services	386,009	425,965	493,124	275,866	10.4	15.8	15.1
42. Insurance, reinsurance and pension funding	70,854	74,983	81,948	33,559	5.8	9.3	13.4
43. Real estate activities, including ownership of dwelling	417,024	444,142	486,686	246,104	6.5	9.6	1.8
44. Professional services	161,963	166,489	154,698	74,004	2.8	-7.1	-5.4
45. Public administration and defence; compulsory social security	382,470	402,206	430,098	208,370	5.2	6.9	5.2
46. Education	157,477	173,762	160,702	84,055	10.3	-7.5	8.1
47. Human health activities, residential care and social work activities	146,551	147,975	156,052	78,866	1.0	5.5	5.2
48. Other personal service activities	803,514	840,946	865,698	434,407	4.7	2.9	4.4
Equals Gross Value Added (GVA) at Basic Price	**7,136,401**	**7,470,465**	**7,817,394**	**3,962,067**	**4.7**	**4.6**	**4.3**
Taxes less subsidies on products	709,801	758,521	805,431	249,334	6.9	6.2	-3.1
Equals Gross Domestic Product (GDP) at Market Price	**7,846,202**	**8,228,986**	**8,622,825**	**4,211,402**	**4.9**	**4.8**	**3.9**

(a) The data is based on the base year 2010 GDP estimates of Department of Census and Statistics
(b) Provisional
(c) Revised

Source : Department of Census and Statistics

TABLE 3
Expenditure on Gross Domestic Product at Current Market Prices (a)

Rs. million

ITEM	2014 (b)	2015 (b)	2016 First Half (b)	2016 (c)
1. Private Consumption Expenditure	7,074,658	7,666,365	3,898,166	8,512,810
2. General Government Consumption Expenditure	869,138	985,815	504,453	947,488
3. Gross Domestic Capital Formation	3,341,174	3,361,546	1,955,149	3,719,282
4. Export of Goods and Services	2,185,039	2,295,423	1,231,112	2,474,303
5. Less: Import of Goods and Services	3,021,530	3,125,930	1,662,843	3,379,025
Gross Domestic Product	**10,448,479**	**11,183,220**	**5,926,037**	**12,274,858**

(a) The data is based on the base year 2010 GDP estimates of Department of Census and Statistics
(b) Provisional
(c) CBSL Projections

Sources: Department of Census and Statistics
Central Bank of Sri Lanka

TABLE 4
Trends in Principal Agricultural Crops

CATEGORY	Unit	2012	2013	2014	2015 (a)	2016 First Half (b)	2016 Annual (c)
Tea							
1.1 Production (d)	kg. mn	328.4	340.0	338.0	328.8	153.8	290.0
1.2 Extent	hectares '000	222	222	203	203	203	203
1.3 Cost of Production (e)	Rs/kg	390.89	422.70	475.11	478.23	n.a.	n.a.
1.4 Average Price							
Colombo Auction	Rs/kg	392.40	445.83	459.01	403.10	425.38	460.11
Export (f.o.b.)	Rs/kg	563.94	623.91	649.44	593.11	609.88	591.34
Rubber							
2.1 Production	kg. mn	152.0	130.4	98.6	88.6	47.9	82.0
2.2 Extent	hectares '000	131	134	134	134	134	134
2.3 Average Yield	kg/hectare	1,459	1,247	889	777	n.a.	811
2.4 Cost of Production							
Estate Sector	Rs/kg	223.69	259.43	282.04	266.41	n.a.	n.a.
Small Holding Sector	Rs/kg	136.00	150.00	160.00	170.00	n.a.	180.00
2.5 Average Price							
Colombo Auction (RSS 1)	Rs/kg	416.47	376.90	286.05	248.17	229.59	232.66
Export (f.o.b)	Rs/kg	420.74	389.81	362.83	342.03	322.18	323.96
Coconut							
3.1 Production	nuts mn	2,940	2,513	2,870	3,056	1,527	2,915
3.2 Extent	hectare '000	395	392	441	455	443	447
3.3 Cost of Production	Rs/nut	11.63	13.58	13.67	15.25	n.a.	n.a.
3.4 Average Export Price (f.o.b.) (f)	Rs/nut	28.80	29.36	39.08	54.54	41.23	41.06
Paddy (g)							
4.1 Production	mt '000	3,846	4,621	3,381	4,819	2,903	4,499
Maha	mt '000	2,717	2,846	2,236	2,877	2,903	2,903
Yala	mt '000	1,129	1,774	1,145	1,942	-	1,597
4.2 Area							
Sown	hectares '000	1,067	1,227	964	1,254	756	1,186
Harvested	hectares '000	883	1,067	793	1,088	743	1,113
4.3 Fertiliser issued (h)	mt '000	412	363	275	341	202	202
4.4 Average Yield	kg/hectare	4,353	4,329	4,264	4,429	4,349	4,045

(a) Revised
(b) Provisional
(c) Projections are based on information available upto end August
(d) Including green tea
(e) Weighted average cost of production of public sector estates and private plantation companies. Includes green leaf suppliers profit margin
(f) Three major coconut kernel products only.
(g) On a cultivation year basis (Maha harvesting falls in the first half of the year).
(h) From 2016 Yala season, a direct cash grant was provided, replacing exsisting fertiliser subsidy scheme. Accordingly, around Rs. 6,266 million was disbursed for the 2016 Yala season and figure for 2016 Annual is only for 2015/16 Maha season.

Sources : Sri Lanka Tea Board
Tea Small Holding Development Authority
Ministry of Plantation Industries
Department of Census and Statistics
Rubber Development Department
Coconut Cultivation Board
Coconut Development Authority
Plantation Companies
National Fertiliser Secretariat
Sri Lanka Customs
Central Bank of Sri Lanka

TABLE 5
Foreign Direct Investment of BOI Enterprises by Sector (a)

US dollars million

SECTOR	2011	2012	2013	2014	2015 (b)	First Half	
						2015	2016 (b)
Manufacturing							
Food, Beverages and Tobacco Products	41.8	75.9	49.7	44.7	42.7	34.8	19.9
Textile, Wearing Apparel and Leather Products	95.0	86.7	102.6	83.1	45.4	12.3	6.5
Wood and Wooden Products	2.1	2.4	1.7	2.5	2.8	0.8	1.5
Paper, Paper Products, Printing and Publishing	3.9	4.0	2.1	36.3	2.2	0.7	0.2
Chemicals, Petroleum, Coal, Rubber and Plastic Products	66.1	59.2	114.4	91.9	75.4	31.8	51.9
Non-metallic Mineral Products	17.2	17.7	45.2	29.7	13.7	7.7	4.2
Fabricated Metal, Machinery and Transport Equipment	68.3	38.8	17.0	7.0	46.1	40.3	3.7
Manufactured Products not elsewhere specified	28.0	22.9	27.1	38.7	28.7	19.6	7.8
Agriculture	18.0	7.2	8.5	5.7	3.9	2.8	0.0
Services							
Hotels & Restaurants	215.6	117.3	67.9	68.4	181.9	140.2	95.9
IT & BPO (c)	14.1	25.9	19.3	24.7	13.6	8.3	8.5
Other Services	40.9	224.6	149.1	413.3	59.9	11.0	15.9
Infrastructure							
Housing, Property Development and Shop Office	91.5	55.7	217.6	339.2	212.1	102.9	16.0
Telephone and Telecommunication Network	196.8	242.1	359.8	152.5	138.8	45.9	97.0
Power Generation, Fuel, Gas, Petroleum and Other	166.7	96.5	44.9	12.5	51.3	4.9	1.7
Port Container Terminals	n.a.	202.2	164.5	178.2	51.2	51.1	1.4
Total	**1,066.1**	**1,279.2**	**1,391.4**	**1,528.4**	**969.7**	**515.1**	**332.2**

(a) Includes loans, excludes inflows to non-BOI companies and direct investment in listed companies in the CSE not registered with the BOI.
(b) Provisional
(c) Information Technology and Business Process Outsourcing
n.a. - not available

Source : Board of Investment of Sri Lanka

TABLE 6
Developments in Economic Infrastructure

SECTOR	2012	2013	2014	2015 (a)	2015 (a) For the Period	2016 (a) For the Period
1. Electricity					**Jan.-Aug.**	**Jan.-Aug.**
Installed Capacity (MW - End Period)	3,312	3,362	3,932	3,852	3,789	3,971
Total Power Generation (GWh)	11,801	11,898	12,357	13,090	8,678	9,375
Share of Hydropower in Total Generation (%) (b)	23	50	29	37	34	28
2. Transport					**Jan.-Jun.**	**Jan.-Jun.**
2.1 Sri Lanka Transport Board						
Operated Kilometerage (million)	338	344	371	440	211	223
Passenger Kilometerage (million)	11,909	12,201	12,717	15,210	7,236	7,780
Average no. of Operated Buses	4,314	4,373	4,226	5,270	5,141	5,306
Total Revenue (Rs. million)	26,313	30,189	33,665	35,825	17,767	19,913
Operating Expenditure (Rs. million)	30,122	33,684	35,527	40,555	19,488	20,998
Operating Loss (Rs. million)	3,809	3,496	1,862	4,730	1,721	1,084
2.2 Sri Lanka Railways						
Operated Kilometerage ('000)	10,367	10,924	11,075	11,797	5,843	6,085 (c)
Passenger Kilometerage (million)	5,039	6,257	6,842	7,407	3,505	3,577
Freight Ton Kilometerage (million)	142	133	130	130	65	67
Total Revenue (Rs. million)	4,852	5,423	5,909	6,335	3,114	3,173
Operating Expenditure (Rs. million)	8,648	10,586	16,943	14,049	5,746	6,529
Operating Loss (Rs. million)	3,796	5,163	11,034	7,714	2,632	3,356
2.3 New Registration of Motor Vehicles					**Jan.-Sep.**	**Jan.-Sep.**
Buses	3,095	1,805	3,851	4,140	3,264	2,011
Motor Cars	31,546	28,380	38,780	105,628	74,966	33,198
Three Wheelers	98,815	83,673	79,038	129,547	96,987	40,314
Dual Purpose Vehicles	37,397	24,603	20,799	39,456	29,442	19,336
Motor Cycles	192,284	169,280	272,885	370,889	273,691	245,350
Goods Transport Vehicles	12,266	5,872	5,121	7,142	5,459	5,326
Land Vehicles	21,892	13,038	9,082	12,105	7,823	9,620
Total Vehicles Registered	397,295	326,651	429,556	668,907	491,632	355,155
3. Port Services					**Jan.-Sep.**	**Jan.-Sep.**
Ships Arrived at Ports of Sri Lanka	4,134	3,976	4,264	4,728	3,528	3,769
Total Cargo Handling (MT '000)	64,970	66,243	74,410	77,579	57,860	64,502
Total Container Handling (TEUs '000)	4,187	4,306	4,908	5,185	3,888	4,255
Transshipments (TEUs '000)	3,167	3,274	3,781	3,967	2,985	3,304
4. Telecommunication Services					**End June**	**End June**
Fixed Access Telephones (No.)	3,449,391	2,706,787	2,709,848	2,601,196	2,676,695	2,597,297
Cellular Telephones (No.)	20,324,070	20,315,150	22,123,000	24,384,544	23,380,756	24,695,535
Internet Connections (No.)	1,365,655	2,009,456	3,396,295	4,090,920	3,799,205	4,232,291
Telephone Penetration						
(Telephones per 100 Persons)	116	112	120	129	124	129
Mobile Telephone Penetration						
(Telephones per 100 Persons)	100	99	107	116	112	117

(TEUs=Twenty-foot Equivalent Container Units)
(a) Provisional
(b) Excluding mini hydropower
(c) Estimates

Sources: Ceylon Electricity Board
Sri Lanka Transport Board
Sri Lanka Railways
Department of Motor Traffic
Sri Lanka Ports Authority
Telecommunications Regulatory Commission of Sri Lanka

TABLE 7
Consumer Price Indices - Colombo Consumers' Price Index

2006/07 = 100

PERIOD		Index		Year-on-Year Change (%)		Annual Average Change (%)	
		CCPI	Core CCPI	CCPI	Core CCPI	CCPI	Core CCPI
2014	December	180.2	173.0	2.1	3.2	3.3	3.5
2015	December	185.2	180.7	2.8	4.5	0.9	3.1
2015	January	183.2	173.6	3.2	2.1	3.2	3.4
	February	178.9	172.0	0.6	0.8	2.9	3.2
	March	178.1	173.9	0.1	1.4	2.5	3.0
	April	178.5	176.1	0.1	2.4	2.1	2.9
	May	179.8	176.5	0.2	2.6	1.9	2.9
	June	181.6	177.5	0.1	2.8	1.7	2.8
	July	182.8	178.9	-0.2	3.5	1.3	2.8
	August	181.9	180.0	-0.2	3.9	1.0	2.8
	September	181.4	180.2	-0.3	4.2	0.7	2.8
	October	182.1	180.6	1.7	4.5	0.7	2.9
	November	184.7	180.7	3.1	4.3	0.9	3.0
	December	185.2	180.7	2.8	4.5	0.9	3.1
2016	January	184.9	181.5	0.9	4.6	0.7	3.3
	February	183.8	181.8	2.7	5.7	0.9	3.7
	March	181.7	181.7	2.0	4.5	1.1	3.9
	April	184.1	184.0	3.1	4.5	1.3	4.1
	May	188.5	188.1	4.8	6.6	1.7	4.5
	June	192.5	188.8	6.0	6.4	2.2	4.8
	July	192.9	189.2	5.5	5.8	2.7	4.9
	August	189.1	187.4	4.0	4.1	3.0	5.0
	September	188.5	187.7	3.9	4.2	3.4	5.0

CCPI - Colombo Consumers' Price Index
Core CCPI - Core Colombo Consumers' Price Index

Source : Department of Census and Statistics

TABLE 8
Consumer Price Indices - National Consumer Price Index

2013 = 100

PERIOD		Index		Year-on-Year Change (%)		Annual Average Change (%)	
		NCPI	Core NCPI	NCPI	Core NCPI	NCPI	Core NCPI
2015	December	113.2	112.9	4.2	5.8	3.8	4.6
2015	January	112.8	110.1	9.4	5.6	-	-
	February	108.9	108.9	5.7	3.9	-	-
	March	107.6	108.9	4.3	3.5	-	-
	April	107.0	109.3	2.8	3.6	-	-
	May	108.0	109.6	3.0	4.0	-	-
	June	109.1	110.0	2.7	4.2	-	-
	July	108.9	110.4	1.8	4.3	-	-
	August	108.4	110.8	1.9	4.3	-	-
	September	108.4	111.4	1.9	4.9	-	-
	October	109.2	111.8	3.0	4.8	-	-
	November	112.0	112.7	4.8	5.8	-	-
	December	113.2	112.9	4.2	5.8	3.8	4.6
2016	January	112.0	113.4	-0.7	3.0	2.9	4.3
	February	110.8	113.9	1.7	4.6	2.6	4.4
	March	110.0	114.3	2.2	5.0	2.4	4.5
	April	111.6	115.7	4.3	5.9	2.6	4.7
	May	113.7	117.5	5.3	7.2	2.7	5.0
	June	116.1	118.2	6.4	7.5	3.1	5.3
	July	115.2	117.9	5.8	6.8	3.4	5.5
	August	113.3	117.4	4.5	6.0	3.6	5.6
	September	113.5	117.7	4.7	5.7	3.8	5.7

NCPI - National Consumer Price Index
Core NCPI - Core National Consumer Price Index

Source : Department of Census and Statistics

TABLE 9
Wage Rate Indices

PERIOD		Index				Year-on-Year Change (%)				Annual Average Change (%)			
		Public Sector Employees (a)		Informal Private Sector Employees (b)		Public Sector Employees		Informal Private Sector Employees		Public Sector Employees		Informal Private Sector Employees	
		NWRI	RWRI(c)	NWRI	RWRI(c)	NWRI	RWRI(c)	NWRI	RWRI(c)	NWRI	RWRI(c)	NWRI	RWRI(c)
2013	December	109.9	105.6	113.5	109.1	9.9	5.6	8.0	3.8	6.3	-2.7	9.8	0.6
2014	December	128.8	118.3	124.1	113.9	17.3	12.0	9.3	4.4	10.5	6.7	7.6	3.8
2015	December	160.4	141.3	131.2	115.6	24.5	19.5	5.8	1.5	31.7	27.0	7.3	3.5
2016 (d)	January	160.4	142.8	131.7	117.3	24.5	25.4	6.2	7.0	32.7	28.9	7.1	4.1
	February	160.4	144.4	132.6	119.3	6.0	4.1	6.4	4.6	30.0	26.8	6.9	4.2
	March	161.5	146.4	133.4	120.9	6.7	4.3	7.1	4.8	27.5	24.6	6.8	4.3
	April	160.8	143.6	133.7	119.5	6.2	1.8	6.8	2.4	25.1	22.1	6.6	4.0
	May	160.8	141.0	134.9	118.3	6.2	0.9	6.4	1.1	22.9	19.6	6.4	3.5
	June	160.8	138.1	134.9	115.8	0.2	-5.8	6.6	0.2	19.4	16.0	6.3	3.1
	July	160.8	139.2	135.7	117.4	0.2	-5.3	8.1	2.2	16.2	12.5	6.5	3.0
	August	160.8	141.5	137.7	121.2	0.2	-4.1	8.6	3.9	13.2	9.3	6.8	3.0

(a) Recognizing the need to have a more representative Public Sector Wage Rate Index, a new Index was compiled. Old index (1978=100) covers non executive government employees and school teachers only. The new index covers all levels of public sector employees, under the disaggregation of Senior, Tertiary, Secondary and Primary levels. The base period employment structure was based on a special Annual Public Sector Employment Survey (APSES) conducted in 2012. Initial salary scales of specific occupations and due allowances as specified in the Public Administration Circular No. 06/2006 issued by the Ministry of Public Administration and Home Affairs on 25th April 2006 were used to construct the Index.

(b) In the informal private sector, wages are determined by the market forces and nominal wages get adjusted according to the change in demand and supply factors in the labour market. The Central Bank compiled a new wage rate index to analyse the movements of wages in the informal private sector.

(c) Based on National Consumer Price Index (2013=100)

(d) Provisional

Note : NWRI = Nominal Wage Rate Index RWRI = Real Wage Rate Index

Source : Central Bank of Sri Lanka

TABLE 10
Labour Force, Employment and Unemployment (a) (b)

ITEM	2012 (c)	2013 (c)	2014 (c)	2015 (c)	2016	
					First Half	Projections
Household Population, ' 000 (Age 15 years and above)	14,858	14,959	15,134	15,282	15,383	15,420
Labour Force, ' 000	7,798	8,034	8,049	8,214	8,256	8,172
Employed, ' 000	7,489	7,681	7,700	7,831	7,892	7,805
Unemployed, ' 000	310	353	348	383	364	368
Labour Force Participation Rate (% of Household Population)	52.5	53.7	53.2	53.8	53.7	53.0
Unemployment Rate (% of Labour Force)	4.0	4.4	4.3	4.7	4.4	4.5

(a) In July 2016, the Department of Census and Statistics published a re-weighted and revised labour force data series for 2011 onwards.

(b) Provisional

(c) Revised

Source: Department of Census and Statistics
Central Bank of Sri Lanka

TABLE 11
Developments in External Trade

US dollars million

CATEGORY	2012	2013	2014	2015 (a)	2015 (a) Jan - Aug	2016 (a) Jan - Aug	Growth % Jan - Aug
EXPORTS							
Agricultural Exports	**2,331.5**	**2,581.1**	**2,793.9**	**2,481.5**	**1,667.8**	**1,520.6**	**-8.8**
Tea	1,411.9	1,542.2	1,628.3	1,340.5	901.2	835.0	-7.3
Rubber	125.1	71.3	45.3	26.1	17.8	20.9	17.2
Coconut	208.9	204.6	356.4	351.7	238.0	238.3	0.1
Kernel Products	79.7	85.8	214.3	221.7	147.3	137.0	-6.9
Other	129.2	118.9	142.1	130.0	90.7	101.3	11.6
Spices	256.1	355.4	264.6	377.4	249.3	194.1	-22.1
Vegetables	13.3	24.9	40.1	30.5	19.9	18.3	-8.3
Unmanufactured Tobacco	42.2	47.6	41.3	31.8	22.5	19.9	-11.6
Minor Agricultural Products	76.0	101.3	165.2	160.4	106.7	83.4	-21.8
Seafood	198.0	233.7	252.7	163.1	112.5	110.7	-1.6
Industrial Exports	**7,371.2**	**7,749.4**	**8,262.0**	**7,975.6**	**5,455.0**	**5,314.7**	**-2.6**
Textiles and Garments	3,991.1	4,508.3	4,929.9	4,820.2	3,218.7	3,333.7	3.6
Rubber Products	859.4	887.8	889.8	761.2	524.9	508.4	-3.1
Petroleum Products	463.0	427.7	338.0	373.9	289.4	185.4	-35.9
Gems, Diamonds and Jewellery	558.9	445.5	393.6	331.7	227.8	187.3	-17.8
Food, Beverages and Tobacco	284.3	235.2	289.3	265.2	174.3	199.5	14.5
Machinery and Mechanical Appliances	297.5	312.3	342.9	293.8	197.3	200.2	1.5
Printing Industry Products	41.8	36.3	52.4	45.7	32.6	17.7	-45.7
Transport Equipment	164.9	146.3	151.8	243.7	219.7	80.9	-63.2
Leather, Travel Goods and Footwear	55.4	76.8	138.9	135.7	95.0	115.7	21.7
Ceramic Products	35.8	40.4	41.3	35.2	24.0	22.8	-5.2
Other Industrial Exports	619.2	632.7	694.1	669.4	451.5	463.1	2.6
Mineral Exports	**61.3**	**51.6**	**59.5**	**28.4**	**22.4**	**19.7**	**-12.1**
Unclassified Exports	**9.6**	**12.2**	**14.7**	**19.5**	**10.2**	**10.2**	**0.4**
Total Exports	**9,773.5**	**10,394.3**	**11,130.1**	**10,504.9**	**7,155.4**	**6,865.2**	**-4.1**
IMPORTS							
Consumer Goods	**2,995.2**	**3,182.5**	**3,852.5**	**4,713.5**	**3,142.4**	**2,824.9**	**-10.1**
Food and Beverages	1,304.4	1,368.1	1,633.7	1,627.8	1,124.4	1,039.1	-7.6
Rice	24.4	17.9	281.7	135.1	128.4	7.2	-94.4
Sugar	344.9	288.9	255.5	252.5	185.7	194.5	4.7
Dairy Products	307.3	291.0	339.4	250.9	169.6	157.1	-7.4
Lentils	69.0	104.1	121.2	148.0	99.6	86.8	-12.8
Other	558.8	666.1	636.0	841.3	541.2	593.6	9.7
Other Consumer Goods	1,690.8	1,814.4	2,218.8	3,085.7	2,018.0	1,785.8	-11.5
Vehicles	495.1	582.2	896.7	1,359.6	904.6	547.1	-39.5
Medical and Pharmaceuticals Items	372.2	378.3	380.5	459.8	304.7	354.2	16.2
Home Appliances	218.5	192.2	156.4	221.0	135.9	175.6	29.2
Clothing and Accessories	174.5	201.7	282.7	390.1	255.7	243.2	-4.9
Other	430.5	460.0	502.5	655.0	417.1	465.7	11.7
Intermediate Goods	**11,577.6**	**10,553.7**	**11,397.7**	**9,638.2**	**6,442.7**	**6,309.0**	**-2.1**
Fuel	5,044.6	4,308.2	4,597.3	2,699.6	1,834.7	1,500.8	-18.2
Textiles and Textile Articles	2,266.4	2,045.8	2,327.6	2,296.2	1,547.4	1,764.7	14.0
Diamonds and Precious Stones and Metals	587.7	482.9	175.4	161.5	131.3	299.3	128.0
Chemical Products	669.7	734.3	808.2	870.3	585.8	568.1	-3.0
Wheat and Maize	363.8	323.2	404.7	357.2	214.0	164.5	-23.2
Fertiliser	311.0	238.7	272.4	289.6	162.0	99.2	-38.8
Other Intermediate Goods	2,334.4	2,420.8	2,812.0	2,963.7	1,967.5	1,912.5	-2.8
Investment Goods	**4,589.8**	**4,252.7**	**4,152.2**	**4,567.0**	**3,007.4**	**3,259.6**	**8.4**
Machinery and Equipment	2,356.0	2,221.9	2,131.0	2,278.1	1,482.9	1,815.4	22.4
Building Materials	1,237.4	1,357.2	1,308.9	1,352.0	845.1	1,025.7	21.4
Transport Equipment	991.9	667.8	707.3	930.9	676.3	414.3	-38.7
Other Investment Goods	4.5	5.8	4.9	5.9	3.0	4.1	36.8
Unclassified Imports	**27.7**	**13.9**	**14.4**	**15.9**	**11.5**	**9.4**	**-18.2**
Total Imports	**19,190.2**	**18,002.8**	**19,416.8**	**18,934.6**	**12,604.0**	**12,402.9**	**-1.6**

(a) Provisional

Sources : Sri Lanka Customs
Ceylon Petroleum Corporation & Other Exporters of Petroleum
Lanka IOC PLC
National Gem and Jewellery Authority
Central Bank of Sri Lanka

TABLE 12
Balance of Payments (a)

US dollars million

ITEM	2014	2015 (b)	First Half	
			2015 (c)	2016 (b)
Current Account Balance	**-1,988**	**-2,009**	**-953**	**-795**
Trade Balance	**-8,287**	**-8,430**	**-4,122**	**-4,213**
Exports	11,130	10,505	5,424	5,108
Imports	19,417	18,935	9,547	9,321
Services (net)	**1,880**	**2,325**	**1,059**	**1,228**
Receipts	5,605	6,397	3,095	3,417
Payments	3,725	4,072	2,036	2,190
Primary Income (net)	**-1,808**	**-2,097**	**-925**	**-955**
Receipts	155	127	70	61
Payments	1,963	2,224	995	1,016
Secondary Income (net)	**6,227**	**6,193**	**3,035**	**3,146**
Secondary Income: credit	7,046	7,007	3,450	3,617
Secondary Income: debit	819	814	415	471
Capital Account (net)	**58**	**46**	**29**	**-2**
Capital Account: credit	73	71	43	19
Capital Account: debit	15	24	14	21
Current and Capital Account (net)	**-1,929**	**-1,962**	**-924**	**-797**
Financial Account (net) (d)	**-1,536**	**-2,271**	**-667**	**-967**
Direct Investment: Assets	**67**	**53**	**27**	**30**
Direct Investment: Liabilities	**894**	**681**	**268**	**216**
Portfolio Investment: Assets	**-0.2**	**0.02**	**0.01**	**-0.01**
Debt Securities	-0.2	0.02	0.01	-0.01
Portfolio Investment: Liabilities	**2,065**	**689**	**130**	**-622**
Equity and Investment Fund Shares	178	-58	-7	-45
Debt Securities	1,887	747	137	-578
Financial Derivatives	-	-	-	-
Other Investment: Assets	**973**	**553**	**171**	**90**
Currency and Deposits	276	143	-65	-134
Trade Credit and Advances	383	166	131	95
Other Accounts Receivable	314	244	104	128
Other Investment: Liabilities	**1,165**	**1,857**	**688**	**-509**
Currency and Deposits	-292	1,457	400	-981
Loans	1,713	734	434	551
Trade Credit and Advances	-407	-376	-133	-45
Other Accounts Payable	151	41	-13	-34
Special Drawing Rights	-	-	-	-
Reserve Assets	**1,548**	**350**	**222**	**-2,002**
Net Errors and Omissions	**393**	**-308**	**257**	**-170**
Overall Balance	**1,369**	**-1,489**	**-792**	**-1,186**

(a) This presentation is a summary of the BPM6 format and conforms to the latest (sixth) edition of the Balance of Payments and International Investment Position Manual (BPM6) of the International Monetary Fund.
(b) Provisional
(c) Revised
(d) Assets - Liabilities

Source: Central Bank of Sri Lanka

TABLE 13
International Investment Position

US dollars million
(End Period Position)

ITEM	2015 (a)		June 2016 (a)	
	Assets	Liabilities	Assets	Liabilities
Direct Investment (b)	**660**	**9,972**	**677**	**9,899**
Equity and Investment Fund Shares	657	7,253	674	7,105
Debt Instruments	3	2,719	3	2,794
Portfolio Investment	**0.1**	**12,375**	**0.1**	**11,839**
Equity and Investment Fund Shares		1,536		1,134
Debt Securities (c)	0.1	10,839	0.1	10,706
Deposit-taking Corporations	0.1	2,140	0.1	2,203
General Government		8,534		8,330
Other Sectors		164		172
Other Investment	**2,923**	**31,240**	**3,013**	**31,544**
Currency and Deposits	**701**	**3,051**	**567**	**2,070**
Central Bank	-	1,105	-	404
Deposit-taking Corporations	701	1,946	567	1,666
Loans	-	**25,864**	-	**27,223**
Central Bank	-	692	-	601
Deposit-taking Corporations	-	5,070	-	5,494
General Government	-	16,147	-	17,122
Other Sectors (d)	-	3,956	-	4,005
Trade Credit and Advances	**986**	**1,299**	**1,081**	**1,254**
Deposit-taking Corporations	96	-	71	-
Other Sectors (e)	890	1,299	1,010	1,254
Other Accounts Receivable/Payable	**1,236**	**478**	**1,365**	**445**
Central Bank (f)	-	478	-	445
Deposit-taking Corporations	1,236	-	1,365	-
Special Drawing Rights		**548**		**553**
Reserve Assets	**7,304**		**5,292**	
Monetary Gold	760		943	
Special Drawing Rights	7		4	
Reserve Position in the IMF	66		67	
Other Reserve Assets	6,470		4,279	
Currency and Deposits	3,911		2,343	
Debt Securities	2,559		1,935	
Total Assets / Liabilities	**10,887**	**53,586**	**8,982**	**53,283**
Net International Investment Position		**-42,699**		**-44,300**
IIP- Maturity-wise Breakdown				
Short Term	7,499	9,113	6,292	8,515
Long Term	3,388	44,473	2,690	44,767

Source: Central Bank of Sri Lanka

(a) Provisional
(b) Include direct investment stock position of BOI, CSE and other private companies
(c) Foreign currency debt issuances are based on market values while domestic currency issuances are based on book values
(d) Include loans outstanding position of project loans obtained by State Owned Business Enterprises and private sector companies
(e) Include outstanding trade credit position of Ceylon Petroleum Corporation and other private sector companies
(f) Outstanding position of ACU liabilities managed by the Central Bank

TABLE 14
Outstanding External Debt Position

US dollars million
(End Period Position)

ITEM	2014	2015 (a)	June 2016 (a)
General Government	**24,132**	**24,681**	**25,452**
Short Term	**399**	**33**	**36**
Debt Securities (Treasury Bills) (b)	399	33	36
Long Term	**23,733**	**24,647**	**25,416**
Debt Securities	7,959	8,501	8,293
Treasury Bonds (b)	2,597	1,811	1,486
SLDBs (c)	75	265	59
International Sovereign Bonds (d)	5,287	6,425	6,748
Loans	15,774	16,147	17,122
Central Bank	**2,264**	**2,823**	**2,003**
Short Term	**443**	**483**	**448**
Currency and Deposits	6	5	4
Other Accounts Payable (ACU Liabilities)	437	478	445
Long Term	**1,821**	**2,340**	**1,555**
Special Drawing Rights allocation	573	548	553
Currency and Deposits	-	1,100	400
Loans (IMF-SBA and EFF Facility)	1,248	692	601
Deposit-taking Corporations	**8,133**	**9,156**	**9,364**
Short Term	**4,747**	**5,762**	**5,643**
Currency and Deposits (e)	1,587	1,946	1,666
Loans	3,159	3,816	3,977
Long Term	**3,386**	**3,393**	**3,720**
Debt Securities (d)	2,263	2,140	2,203
Loans	1,123	1,253	1,517
Other Sectors (f)	**5,841**	**5,419**	**5,431**
Short Term	**1,674**	**1,299**	**1,254**
Trade Credit and Advances (g)	1,674	1,299	1,254
Long Term	**4,167**	**4,120**	**4,178**
Debt Securities (d)	174	164	172
Loans	3,993	3,956	4,005
Private Sector Corporations	1,363	1,533	1,637
State Owned Business Enterprises and Public Corporations	2,630	2,423	2,369
Direct Investment: Intercompany Lending (h)	**2,544**	**2,719**	**2,794**
Gross External Debt Position	**42,914**	**44,797**	**45,044**
As a Percentage of GDP			
Gross External Debt	53.6	54.4	55.9
Short Term Debt	9.1	9.2	9.2
Long Term Debt	44.5	45.2	46.8

(a) Provisional
(b) Based on book value
(c) Based on face value
(d) Based on market prices
(e) Include deposits of non-resident foreign currency holders
(f) Include private sector and State Owned Business Enterprises
(g) Include trade credits outstanding of Ceylon Petroleum Corporation and private sector companies
(h) Include inter-company borrowings and shareholder advances on BOI registered companies

Source: Central Bank of Sri Lanka

TABLE 15
Exchange Rate Movements (Rupees per Unit of Foreign Currency)

PERIOD		End Period Rates					
		US Dollar	Pound Sterling	Euro	Japanese Yen	Indian Rupee	SDR (a)
	2011	113.9013	175.4479	147.4225	1.4669	2.1529	174.8690
	2012	127.1608	205.4728	168.1257	1.4799	2.3262	195.3110
	2013	130.7530	215.5790	180.4522	1.2459	2.1116	201.3550
	2014	131.0486	204.0427	159.4206	1.0979	2.0675	189.8640
	2015	144.0623	213.5724	157.3737	1.1960	2.1677	199.6310
2015	January	132.2000	199.3510	149.8090	1.1204	2.1406	186.3760
	February	132.9000	204.9983	148.9078	1.1143	2.1478	187.0430
	March	132.9000	196.5990	143.8709	1.1066	2.1242	183.3350
	April	132.9000	205.0448	147.7383	1.1185	2.0932	186.9130
	May	133.9000	205.3022	146.7410	1.0828	2.0979	186.1880
	June	133.7000	210.2967	149.6237	1.0927	2.0971	188.0350
	July	133.6000	208.4828	146.5993	1.0761	2.0905	186.2870
	August	134.3000	207.2383	150.8861	1.1082	2.0277	188.5310
	September	141.2335	214.0041	158.9159	1.1786	2.1433	198.2550
	October	140.8543	215.7747	154.6299	1.1651	2.1563	196.7560
	November	143.2074	215.1405	151.4848	1.1665	2.1401	196.5040
	December	144.0623	213.5724	157.3737	1.1960	2.1677	199.6310
2016	January	143.9208	206.5911	157.3630	1.2135	2.1132	198.6820
	February	144.3450	200.0313	157.8655	1.2735	2.0986	199.3980
	March	143.9000	206.5685	162.9452	1.2810	2.1680	202.7290
	April	143.9000	210.6984	163.8014	1.3407	2.1653	203.9540
	May	145.7500	214.0922	162.4675	1.3121	2.1694	204.4700
	June	145.2500	194.8747	161.4381	1.4142	2.1518	203.1820
	July	145.7466	192.2398	161.5310	1.4009	2.1731	203.0800
	August	145.6200	190.7768	162.3954	1.4143	2.1702	203.0440
	September	146.7229	190.1676	164.5644	1.4536	2.1950	204.7980

(a) Special Drawing Rights (SDRs), the unit of account of the International Monetary Fund

Source: Central Bank of Sri Lanka

TABLE 16
Government Fiscal Operations

ITEM	2012	2013	2014	2015 (a)	2015 Jan. -Jul. (a)	2016 Jan. -Jul. (a)	2016 Revised Estimates
Rs. million							
Total Revenue and Grants	**1,067,532**	**1,153,306**	**1,204,621**	**1,460,892**	**721,715**	**864,134**	**1,556,000**
Total Revenue	1,051,460	1,137,447	1,195,206	1,454,878	721,477	863,674	1,546,000
Tax Revenue	908,913	1,005,895	1,050,362	1,355,779	663,262	798,742	1,412,000
Non Tax Revenue	142,547	131,552	144,844	99,099	58,215	64,932	134,000
Grants	16,071	15,859	9,415	6,014	238	460	10,000
Expenditure and Net Lending	**1,556,499**	**1,669,396**	**1,795,865**	**2,290,394**	**1,225,054**	**1,296,865**	**2,215,000**
Recurrent	1,131,023	1,205,180	1,322,898	1,701,658	954,212	1,006,758	1,724,000
Capital and Net Lending	425,476	464,216	472,967	588,737	270,842	290,107	491,000
o/w Public Investment	443,973	481,203	486,610	602,767	255,164	296,309	505,000
Current Account Surplus (+)/Deficit (-)	**-79,563**	**-67,733**	**-127,692**	**-246,779**	**-232,735**	**-143,084**	**-178,000**
Primary Account Surplus (+)/Deficit (-)	**-80,469**	**-72,083**	**-154,849**	**-319,827**	**-196,481**	**-62,298**	**-97,000**
Overall Surplus (+)/Deficit (-)	**-488,967**	**-516,090**	**-591,244**	**-829,502**	**-503,339**	**-432,731**	**-659,000**
Total Financing	**488,967**	**516,090**	**591,244**	**829,502**	**503,339**	**432,731**	**659,000**
Foreign Financing	286,455	123,700	212,523	236,803	-41,830	22,896	420,000
Loans	180,759	67,905	211,733	364,004	2,447	34,974	300,000
Non Resident Investments in Treasury Bills/ Bonds	105,696	55,795	790	-127,201	-44,277	-12,077	120,000
Domestic Financing	202,511	392,390	378,721	592,699	545,169	409,835	239,000
Market Borrowings	202,511	379,390	392,084	592,699	545,169	409,835	n.a.
Non Bank	70,984	82,414	265,155	300,858	225,769	175,585	n.a.
Bank	131,527	296,977	126,929	291,841	319,400	234,250	n.a.
Other Borrowings	–	13,000	-13,363	–	–	–	–
As a per cent of GDP							
Total Revenue and Grants	**12.2**	**12.0**	**11.5**	**13.1**	**6.4**	**7.0**	**12.7**
Total Revenue	12.0	11.9	11.4	13.0	6.4	7.0	12.6
Tax Revenue	10.4	10.5	10.1	12.1	5.9	6.5	11.5
Non Tax Revenue	1.6	1.4	1.4	0.9	0.5	0.5	1.1
Grants	0.2	0.2	0.1	0.1	...	...	0.1
Expenditure and Net Lending	**17.8**	**17.4**	**17.2**	**20.5**	**10.8**	**10.5**	**18.0**
Recurrent	13.0	12.6	12.7	15.2	8.4	8.2	14.0
Capital and Net Lending	4.9	4.8	4.5	5.3	2.4	2.4	4.0
o/w Public Investment	5.1	5.0	4.7	5.4	2.3	2.4	4.1
Current Account Surplus (+)/Deficit (-)	**-0.9**	**-0.7**	**-1.2**	**-2.2**	**-2.1**	**-1.2**	**-1.4**
Primary Account Surplus (+)/Deficit (-)	**-0.9**	**-0.8**	**-1.5**	**-2.9**	**-1.7**	**-0.5**	**-0.8**
Overall Surplus (+)/Deficit (-)	**-5.6**	**-5.4**	**-5.7**	**-7.4**	**-4.4**	**-3.5**	**-5.4**
Total Financing	**5.6**	**5.4**	**5.7**	**7.4**	**4.4**	**3.5**	**5.4**
Foreign Financing	3.3	1.3	2.0	2.1	-0.4	0.2	3.4
Loans	2.1	0.7	2.0	3.5	...	0.3	2.4
Non Resident Investments in Treasury Bills/ Bonds	1.2	0.6	...	-1.1	-0.4	-0.1	1.0
Domestic Financing	2.3	4.1	3.6	5.3	4.8	3.3	1.9
Market Borrowings	2.3	4.0	3.8	5.3	4.8	3.3	n.a.
Non Bank	0.8	0.9	2.5	2.7	2.0	1.4	n.a.
Bank	1.5	3.1	1.2	2.6	2.8	1.9	n.a.
Other Borrowings	–	0.1	-0.1	–	–	–	–

(a) Provisional

Source: Ministry of Finance

TABLE 17

Developments in Monetary Aggregates and Underlying Factors

Rs. million

ITEM	End 2012	End 2013	End 2014	End 2015 (a)	End August 2016 (b)
1. **Reserve Money**	**484,362**	**488,586**	**577,912**	**673,432**	**785,691**
(year-on-year change in per cent)	10.2	0.9	18.3	16.5	23.3
Net Foreign Assets of the Central Bank	396,468	529,128	688,007	576,187	499,014
Net Domestic Assets of the Central Bank	87,894	-40,543	-110,095	97,245	286,677
2. **Narrow Money (M_1)**	**450,049**	**484,578**	**612,155**	**714,988**	**714,183**
(year-on-year change in per cent)	2.6	7.7	26.3	16.8	9.9
3. **Broad Money (M_{2b})**	**2,929,070**	**3,417,853**	**3,875,853**	**4,565,917**	**4,988,563**
(year-on-year change in per cent)	17.6	16.7	13.4	17.8	17.3
3.1 Net Foreign Assets	-25,831	-76,325	15,126	-298,163	-281,520
Monetary Authorities	396,468	529,128	688,007	576,187	499,014
Commercial Banks	-422,299	-605,453	-672,881	-874,350	-780,535
3.2 Net Domestic Assets	2,954,901	3,494,178	3,860,727	4,864,081	5,270,083
Domestic Credit	3,696,131	4,200,783	4,640,146	5,732,034	6,285,302
Net Credit to the Government	1,045,232	1,301,342	1,435,900	1,759,492	1,937,922
Central Bank	278,843	114,007	149,672	229,926	396,548
Commercial Banks	766,389	1,187,335	1,286,228	1,529,566	1,541,374
Credit to Public Corporations	292,477	365,098	446,047	522,966	441,498
(year-on-year change in per cent)	47.3	24.8	22.2	17.2	-8.5
Credit to the Private Sector	2,358,421	2,534,343	2,758,199	3,449,577	3,905,882
(year-on-year change in per cent)	17.6	7.5	8.8	25.1	27.3
Other Items (Net)	-741,230	-706,605	-779,418	-867,954	-1,015,219
Memorandum Items:					
Money Multiplier (M_{2b})	6.05	7.00	6.71	6.78	6.35
Velocity (M_{2b} Average) (c)	3.17(a)	2.99(a)	2.88(a)	2.67	n.a.

(a) Revised

(b) Provisional

(c) Based on rebased GDP estimates (2010 Prices) by the Department of Census and Statistics

Source: Central Bank of Sri Lanka

TABLE 18
Commercial Banks' Loans and Advances to the Private Sector (a)(b)

CATEGORY	End June 2015 (c)		End June 2016 (d)		% Change
	Amount (Rs. mn)	as a % of Total	Amount (Rs. mn)	as a % of Total	
1. Agriculture and Fishing	**291,215**	**9.8**	**316,993**	**8.2**	**8.9**
of which					
Tea	68,979	2.3	78,051	2.0	13.2
Rubber	20,312	0.7	20,411	0.5	0.5
Coconut	9,820	0.3	12,541	0.3	27.7
Paddy	16,562	0.6	23,456	0.6	41.6
Vegetable and Fruit Cultivation and Minor Food Crops	16,239	0.5	22,000	0.6	35.5
Livestock and Dairy Farming	12,401	0.4	13,061	0.3	5.3
Fisheries	10,259	0.3	12,254	0.3	19.5
2. Industry	**1,188,002**	**40.1**	**1,539,581**	**39.9**	**29.6**
of which					
Construction	528,541	17.9	740,963	19.2	40.2
of which					
Personal Housing including Purchasing/Construction/Repairs	249,940	8.4	354,255	9.2	41.7
Staff Housing	60,786	2.1	66,261	1.7	9.0
Food and Beverages	73,524	2.5	86,472	2.2	17.6
Textiles and Apparel	131,767	4.5	144,718	3.7	9.8
Wood and Wood Products including Furniture	9,952	0.3	14,692	0.4	47.6
Paper and Paper Products	8,293	0.3	11,758	0.3	41.8
Chemical, Petroleum, Pharmaceutical and Healthcare, and Rubber and Plastic Products	60,910	2.1	77,939	2.0	28.0
Non-metallic Mineral Products	10,510	0.4	14,961	0.4	42.3
Basic Metal Products	15,105	0.5	20,702	0.5	37.1
Fabricated Metal Products, Machinery and Transport Equipment	105,203	3.6	126,529	3.3	20.3
Other Manufactured Products	11,664	0.4	16,179	0.4	38.7
3. Services	**786,989**	**26.6**	**1,149,743**	**29.8**	**46.1**
of which					
Wholesale and Retail Trade	232,007	7.8	353,623	9.2	52.4
Tourism	88,809	3.0	118,778	3.1	33.7
Financial and Business Services	165,266	5.6	282,150	7.3	70.7
Transport	34,723	1.2	56,731	1.5	63.4
Communication and Information Technology	43,489	1.5	56,808	1.5	30.6
Printing and Publishing	14,320	0.5	16,841	0.4	17.6
Education	5,562	0.2	8,881	0.2	59.7
Health	17,818	0.6	29,034	0.8	62.9
Shipping, Aviation and Supply, and Freight Forwarding	12,685	0.4	26,065	0.7	105.5
4. Personal Loans and Advances (e)	**694,245**	**23.5**	**855,707**	**22.2**	**23.3**
of which					
Consumer Durables	108,197	3.7	171,955	4.5	58.9
Pawning	153,259	5.2	122,309	3.2	-20.2
Credit Cards	58,880	2.0	66,912	1.7	13.6
Personal Education	2,013	0.1	2,078	0.1	3.2
Personal Healthcare	2,458	0.1	2,728	0.1	11.0
Other	328,881	11.1	447,999	11.6	36.2
5. Total	**2,960,451**	**100.0**	**3,862,025**	**100.0**	**30.5**

(a) Based on the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector, which includes loans and advances of both DBUs and OBUs of commercial banks.
(b) Includes loans, overdrafts, bills discounted and purchased and excludes cash items in the process of collection
(c) Revised
(d) Provisional
(e) Excludes personal housing loans, classified under ' Construction' and includes Safety Net Scheme related loans.

Source: Central Bank of Sri Lanka

TABLE 19
Selected Interest Rates

Per cent per annum

END PERIOD RATE	2012	2013	2014	2015	2016 September
1. Standing Deposit Facility Rate (SDFR) (a)	7.50	6.50	6.50	6.00	7.00
2. Standing Lending Facility Rate (SLFR) (b)	9.50	8.50	8.00	7.50	8.50
3. Bank Rate (c)	15.00	15.00	15.00	15.00	15.00
4. Average Weighted Prime Lending Rate (AWPR) - Weekly	14.40	10.13	6.26	7.53	12.12
5. Average Weighted Deposit Rate (AWDR)	10.10	9.37	6.20	6.20	7.56
6. Average Weighted Call Money Rate (AWCMR)	9.83	7.66	6.21	6.40	8.42
7. Treasury Bill Yields (d)					
91-day	10.00	7.54	5.74	6.45	8.55
364-day	11.69	8.29	6.01	7.30	10.11
8. Treasury Bond Yields (d)					
2-year	13.62	-	-	6.70	11.04
3-year	13.50	10.87	-	8.18	11.62
4-year	14.10	-	-	8.91	10.61
5-year	14.15	10.64	8.93	9.79	11.76
6-year	14.25	10.97	-	9.90	12.03
9. Rates on Foreign Currency Deposits					
Savings Deposits - US Dollar	0.02-2.70	0.02-2.68	0.01-3.25	0.02-3.00	0.02-3.53
Fixed Deposits - US Dollar (1 year)	0.15-6.00	0.15-5.00	0.06-4.25	0.14-4.25	0.10-5.00
10. National Savings Bank					
Savings Deposits	5.00	5.00	5.00	5.00	4.25
Fixed Deposits (1 year)	12.50	9.50	6.50	7.25	11.00

(a) Repurchase rate was renamed as Standing Deposit Facility Rate (SDFR) with effect from 02 January 2014.
(b) Reverse repurchase rate was renamed as Standing Lending Facility Rate (SLFR) with effect from 02 January 2014.
(c) Bank Rate: Central Bank rate on advances to commercial banks.
(d) Weighted average yield rates at the latest available auction

Sources: Central Bank of Sri Lanka
Licensed Commercial Banks
National Savings Bank

TABLE 20
Expansion of Banking Activities (a)

CATEGORY	2012	2013	2014	2015	Jan. - June 2016 (b)
1. Number of Banks	33	33	34	32	32
2. Number of Bank Branches (c)	3,389	3,484	3,546	3,549	3,587
3. Number of Automated Teller Machines (ATMs)	2,845 (d)	3,122 (d)	3,344 (d)	3,569	3,649
4. Number of Credit Cards Issued (e)	167,424	166,181	176,750	198,843	101,238
5. Number of Credit Cards in Use	891,170	951,625	1,032,833	1,145,055	1,206,677
6. Number of Debit Cards Issued (e)	1,902,241 (d)	2,324,579 (d)	2,872,673 (d)	2,798,873	1,457,174
7. Number of Debit Cards in Use	10,374,819 (d)	12,441,743 (d)	13,591,317 (d)	15,243,811	16,399,025
8. Number of Phone Banking Transactions (e)	210,295 (d)	300,094	731,773	1,992,826	1,688,407
9. Number of Internet Based Transactions (e)	6,972,538	8,942,384	10,817,849	13,725,195	8,331,873
10. Banking Density (f)	16.6	16.9	17.1	16.9	n.a.

(a) End Period
(b) Provisional
(c) All banking outlets except Student Savings Units
(d) Revised
(e) During the period
(f) Number of branches per 100,000 people

Source: Central Bank of Sri Lanka

TABLE 21
Money and Capital Market Developments

Rs. million

CATEGORY	2012	2013	2014	2015	Jan. - Sep. 2016 (a)
Money Market					
Call Money Market					
Total Turnover	3,179,061	2,079,206	2,198,356	2,827,930	2,655,356
Treasury Bill Market					
Total Amount Issued	1,649,984	1,235,304	1,121,705	1,589,527	1,221,473
Total Outstanding (b)	709,254	774,052	750,267	663,285	712,925
Capital Market					
Treasury Bond Market					
Total Amount Issued	968,221	1,017,134	860,695	869,923	633,511
Total Outstanding (b)	2,495,495	2,951,809	3,341,727	3,603,982	3,966,437
Listed Corporate Bond Market					
Total Amount Issued	12,500	68,262	54,234	83,414	41,995
Total Issues (Number)	3	28	20	25	11
Total Turnover	76	2,229	7,140	4,714	2,181
Market Value of Listed Corporate Debt (c)	34,141	100,838	160,924	232,458	261,090
Share Market (b)					
ASPI (1985=100)	5,643	5,913	7,299	6,895	6,535
S&P SL20 (2004=1,000) (d)	3,085	3,264	4,089	3,626	3,617
Total Turnover	213,827	200,468	340,917	253,251	135,385
Net Foreign Purchases	38,661	22,783	21,217	-5,372	-3,247
Market Capitalisation	2,167,581	2,459,897	3,104,860	2,937,998	2,785,681

(a) Provisional
(b) End Period
(c) With effect from 2012, Market Capitalisation is replaced by Market Value of Listed Corporate Debt
(d) With effect from 01 January 2013, the Milanka Price Index (MPI) was replaced by a newly introduced index, namely S&P SL20 Index. This index was introduced on 27 June 2012 and its base period is December 2004=1,000

Sources: Central Bank of Sri Lanka
Colombo Stock Exchange