CENTRAL BANK OF SRI LANKA

RECENT ECONOMIC DEVELOPMENTS

Highlights of 2017 and Prospects for 2018

November 2017

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CENTRAL BANK OF SRI LANKA
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KEY ECONOMIC INDICATORS

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Indicator	2013	2014	2015	2016 (a)	First Half (a)	
					2016	2017
DEMOGRAPHY						
Mid-year population ('000 persons) (b) (c)	20,585 (d)	20,771 (a)	20,966 (a)	21,203	-	-
Growth of mid-year population (per cent) (b)	0.8 (d)	0.9 (a)	0.9 (a)	1.1	-	-
Population density (persons per sq.km.) (b)	328 (d)	331 (a)	334 (a)	338	-	-
Labour force ('000 persons) (e) (f)	8,034	8,049	8,214	8,311	8,256	8,551
Labour force participation rate (per cent) (e) (f)	53.7	53.2	53.8	53.8	53.7	54.3
Unemployment rate (per cent of labour force) (e) (f)	4.4	4.3	4.7	4.4	4.4	4.3
OUTPUT (g)						
GDP at current market price (Rs. billion)	9,592	10,361 (d)	10,952 (a)(d)	11,839	5,761 (d)	6,342
GNI at current market price (Rs. billion)	9,366	10,125 (d)	10,677 (a)(d)(h)	11,522 (h)	5,622 (d)(i)	6,185 (i)
GDP at current market price (US$ billion)	74.3	79.4 (d)	80.6 (a)(d)	81.3	39.9 (d)	41.9
GNI at current market price (US$ billion)	72.5	77.6 (d)	78.5 (a)(d)(h)	79.1 (h)	38.9 (d)(i)	40.8 (i)
Per capita GDP at current market price (Rs.) (j)	465,976	498,828 (d)	522,355 (a)(d)	558,363	-	-
Per capita GNI at current market price (Rs.) (j)	454,993	487,462 (d)	509,251 (a)(d)(h)	543,410 (h)	-	-
Per capita GDP at current market price (US$) (j)	3,609	3,821 (d)	3,843 (a)(d)	3,835	-	-
Per capita GNI at current market price (US$) (j)	3,524	3,734 (d)	3,746 (a)(d)(h)	3,732 (h)	-	-
REAL OUTPUT (percentage change) (g)						
GDP	3.4	5.0 (d)	4.8 (a)(d)	4.4	3.7 (d)	3.9
Sectoral classification of GDP						
Agriculture	3.2	4.6 (d)	4.8 (a)(d)	-4.2	-3.0 (d)	-3.1
Industry	4.1	4.7 (d)	2.1 (a)(d)	6.7	5.8 (d)	5.8
Services	3.8	4.8 (d)	5.7 (a)(d)	4.2	3.6 (d)	4.0
GNI	2.8	5.1 (d)	4.5 (a)(d)	4.1	3.4 (d)	4.0
AGGREGATE DEMAND AND SAVINGS (per cent of GDP) (g)						
Consumption	75.4	75.8 (d)	79.1 (a)(d)	76.2	75.0 (d)	75.3
Private	67.6	67.4 (d)	70.1 (a)(d)	67.6	66.5 (d)	67.1
Government	7.8	8.4 (d)	9.0 (a)(d)	8.6	8.5 (d)	8.1
Investment	33.2	32.3 (d)	28.4 (a)(d)	31.5	32.2 (d)	32.8
Net exports of goods & services	-8.6	-8.1 (d)	-7.5 (a)(d)	-7.6	-7.2 (d)	-8.0
Exports of goods & services	20.3	21.1 (d)	21.0 (a)(d)	21.4	21.6 (d)	21.5
Imports of goods & services	28.9	29.2 (d)	28.5 (a)(d)	29.1	28.8 (d)	29.6
Domestic savings	24.6	24.2 (d)	20.9 (a)(d)	23.8	-	-
Net primary and secondary income from rest of the world	5.2	5.6 (d)	5.2 (a)(d)(h)	5.3 (h)	-	-
National savings	29.9	29.8 (d)	26.1 (a)(d)(h)	29.1 (h)	-	-
PRICES AND WAGES (percentage change)						
National Consumer Price Index (2013 = 100) - annual average	-	-	3.8	4.0	3.1	6.1
National Consumer Price Index (2013 = 100) - year-on-year (end period)	-	-	4.2	4.2	6.4	6.3
Colombo Consumer Price Index (2013 = 100) - annual average	-	-	2.2	4.0	3.0	5.5
Colombo Consumer Price Index (2013 = 100) - year-on-year (end period)	-	-	4.6	4.5	5.5	6.1
Colombo Consumer Price Index (2006/07 = 100) - annual average	6.9	3.3	0.9	3.7	2.2	-
Colombo Consumer Price Index (2006/07 = 100) - year-on-year (end period)	4.7	2.1	2.8	4.1	6.0	-
Producer's Price Index (2013 Q4 = 100) - annual average	-	-	3.6	1.7	1.7	10.6
GDP deflator (g)	6.2	2.9 (d)	0.8 (a)(d)	3.6	3.8 (d)	5.9
GNI deflator (g)	6.2	2.9 (d)	0.8 (a)(d)	3.6	3.8 (d)	5.9
Nominal wage rate index for workers in wages boards trades(1978 Dec = 100) - annual average	5.7	3.7	2.9	0.0	0.0	0.0
Nominal wage rate index for public sector employees (2012 = 100) - annual average	6.3	10.5	31.7	3.9	7.8	0.0
Nominal wage rate index for informal private sector employees (2012 = 100) - annual average	9.8	7.6	7.3	7.9	6.6	9.3
EXTERNAL TRADE						
Trade balance (US$ million)	-7,609	-8,287	-8,388 (d)	-9,090 (d)	-4,191 (d)	-4,753
Exports	10,394	11,130	10,546 (d)	10,310 (d)	5,130 (d)	5,398
Imports	18,003	19,417	18,935	19,400	9,321	10,151
Terms of trade (percentage change)	4.6	4.3	2.7 (d)	3.7 (d)	2.8	-0.5
Export unit value index (2010 = 100) (percentage change)	-0.3	2.7	-9.4 (d)	-1.5 (d)	-4.7	0.1
Import unit value index (2010 = 100) (percentage change)	-4.7	-1.5	-11.8	-5.1	-7.3	0.5
Export volume index (2010 = 100) (percentage change)	6.7	4.3	4.6	-0.7	-1.1 (d)	5.1
Import volume index (2010 = 100) (percentage change)	-1.5	9.5	10.6	7.9	5.4	8.3
EXTERNAL FINANCE (US$ million)						
Services and primary income account (net)	-572	72	312	695	343	369
Current private transfers (net)	5,619	6,199	6,167	6,434	3,199	2,897
Current official transfers (net)	21	28	27	19	6	7
Current account balance	-2,541	-1,988	-1,883	-1,942	-644	-1,480
Overall balance	985	1,369	-1,489	-500	-1,186	1,563

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

KEY ECONOMIC INDICATORS (Contd.)

Indicator	2013	2014	2015	2016 (a)	First Half (a) 2016	First Half (a) 2017
Current account balance (per cent of GDP) (g) (k)	-3.4	-2.5	-2.3	-2.4	-	-
Total foreign assets (months of the same year imports) (l)	5.7	6.1	5.9	5.2	4.7	5.4
Gross official reserves (months of the same year imports)	5.0	5.1	4.6	3.7	3.4	4.1
Overall debt service ratio (m)						
As a percentage of export of goods and services	26.8	20.8	27.3	25.0	26.4	31.7
As a percentage of current receipts	18.7	14.5	19.2	17.6	18.5	23.0
Total external debt (per cent of GDP) (g) (k)	53.7	54.1	55.7	57.3	-	-
EXCHANGE RATES						
Annual average						
Rs/US$	129.11	130.56	135.94	145.60	144.47	151.54
Rs/SDR (n)	196.19	198.35	190.16	202.39	202.24	206.67
NEER (2010 = 100) (24 - currency basket) (o)	91.39	91.99	96.61	92.46	92.67	89.91
REER (2010 = 100) (24 - currency basket) (o) (p) (q)	101.13	103.77	109.50	106.94	106.57	107.65
Year end						
Rs/US$	130.75	131.05	144.06	149.80	145.25	153.51
Rs/SDR (n)	201.36	189.86	199.63	201.38	203.18	213.59
GOVERNMENT FINANCE (per cent of GDP) (g) (r)						
Revenue and grants	12.0	11.6	13.3	14.3	6.0	6.8
Revenue	11.9	11.5	13.3	14.2	6.0	6.7
o/w Tax revenue	10.5	10.1	12.4	12.4	5.6	6.3
Grants	0.2	0.1	0.1	0.1	...	...
Expenditure and net lending	17.4	17.3	20.9	19.7	8.7	9.3
Recurrent expenditure	12.6	12.8	15.5	14.8	6.8	7.1
Capital expenditure and net lending	4.8	4.6	5.4	4.9	1.9	2.2
Current account surplus (+) / deficit (-)	-0.7	-1.2	-2.3	-0.6	-0.8	-0.3
Primary account surplus (+) / deficit (-)	-0.8	-1.5	-2.9	-0.2	-0.3	0.1
Overall fiscal surplus (+) / deficit (-)	-5.4	-5.7	-7.6	-5.4	-2.7	-2.6
Deficit financing	5.4	5.7	7.6	5.4	2.7	2.6
Foreign	1.3	2.1	2.2	3.3	-0.3	0.5
Domestic	4.1	3.7	5.4	2.1	3.0	2.1
Central Government debt	70.8	71.3	77.6	79.3	-	-
Foreign	30.9	30.0	32.4	34.2	-	-
Domestic	40.0	41.3	45.3	45.1	-	-
MONETARY AGGREGATES (year-on-year percentage change)						
Reserve money	0.9	18.3	16.5	27.1	24.5	17.8
Narrow money (M_1)	7.7	26.3	16.8	8.6	12.1	6.8
Broad money (M_{2b}) (s)	16.7	13.4	17.8	18.4	17.0	21.2
Net foreign assets of the banking system	-195.5	119.8	-2,071.2	22.4	-139.4	50.0
Net domestic assets of the banking system	18.3	10.5	26.0	15.9	22.8	14.7
Domestic credit from the banking system to						
Government (net)	24.5	10.3	22.5	12.1	19.8	11.4
Public corporations	24.8	22.2	17.2	-5.3	0.5	13.7
Private sector	7.5	8.8	25.1	21.9	28.2	18.6
Money multiplier for M_{2b} (end year)	7.00	6.71	6.78	6.31	6.40	6.59
Velocity of M_{2b} (average for the year) (g)	2.99	2.85 (d)	2.62 (d)	2.40 (d)	-	-
INTEREST RATES (per cent per annum at year end)						
Standing Deposit Facility Rate (SDFR) (t)	6.50	6.50	6.00	7.00	6.50	7.25
Standing Lending Facility Rate (SLFR) (t)	8.50	8.00	7.50	8.50	8.00	8.75
Money market rates						
Average weighted call money rate (AWCMR)	7.66	6.21	6.40	8.42	8.20	8.75
Treasury bill yields						
91 days	7.54	5.74	6.45	8.72	8.88	9.60
364 days	8.29	6.01	7.30	10.17	10.55	10.47
Deposit rates						
Commercial banks' average weighted deposit rate (AWDR)	9.37	6.20	6.20	8.17	6.87	9.13
Commercial banks' average weighted fixed deposit rate (AWFDR)	11.78	7.33	7.57	10.46	8.64	11.66
NSB savings rate	5.00	5.00	5.00	4.25	4.50	4.00
NSB 12 month fixed deposit rate	9.50	6.50	7.25	11.00	10.00	11.00
Lending rates						
Commercial banks' average weighted prime lending rate (AWPR)	10.13	6.26	7.53	11.52	10.70	11.70
Commercial banks' average weighted lending rate (AWLR)	15.18	11.91	11.00	13.20	12.09	13.73
CAPITAL MARKET						
All share price index (ASPI) (1985 = 100)	5,912.8	7,299.0	6,894.5	6,228.3	6,283.3	6,747.1
S&P SL20 index (2004 Dec = 1,000)	3,263.9	4,089.1	3,625.7	3,496.4	3,300.2	3,933.5
Value of shares traded (Rs. million)	200,468	340,917	253,251	176,935	87,378	110,531
Net purchases by non nationals (Rs. million)	22,783	21,217	-5,372	338	-6,374	21,640
Market capitalisation (Rs. billion)	2,459.9	3,104.9	2,938.0	2,745.4	2,677.6	3,041.2

(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 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). 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) With the rebasing of CCPI (2013=100) REER indices have been recalculated.

(r) Based on revised GDP estimates for 2014 and 2015 made avaliable in 2017 by the Department of Census and Statistics.

(s) Figures for 2015 and 2016 include assets/liabilities of DFCC Bank PLC, which merged with DFCC Vardhana Bank, with effect from 1 October 2015.

(t) 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.

CONTENTS

1

OVERVIEW

In response to macroeconomic stabilisation measures taken by fiscal and monetary authorities, the Sri Lankan economy exhibited signs of improvement in the first nine months of the year, despite economy-wide effects arising from adverse weather conditions. The economy grew at a rate of 3.9 per cent in real terms in the first half of the year in comparison to the growth of 3.7 per cent in the first half of 2016. The drought- and flood-related disturbances mainly affected Agriculture activities, which contributed to overall growth negatively and spilled over to the other sectors of the economy as well. However, Industry and Services related activities positively contributed to the expansion of the economy. Activities in the Industry sector were led by the continued growth in construction and mining and quarrying activities. The growth in Services related activities was mainly supported by financial services, wholesale and retail trade activities and transportation. The negative spillover effects of adverse weather conditions were felt by the other sectors of the economy through increased expenditure on imports amidst rising international commodity prices, higher prices of domestic food supplies and costs incurred on relief measures. Both investment and consumption expenditure contributed to the expansion in economic activities, while net exports continued to weigh down the growth momentum. Meanwhile, unemployment declined in the first half of the year, on a year-on-year basis. Domestic supply disruptions, tax revisions, and increased prices of imported commodities caused consumer price inflation to remain at elevated levels during the year, but further tightening of the monetary policy stance helped curtail demand driven inflationary pressures and inflation expectations. The growth of credit extended to the private sector decelerated gradually during the year, although broad money growth remained high as a result of the buildup of both foreign assets and domestic assets of the banking system. In spite of increased earnings from exports, the expected improvement in the external current account did not materialise largely due to increased expenditure on weather related imports and the decline in workers' remittances. However, inflows to the financial account amidst positive investor sentiments resulted in an improvement in the Balance of Payments (BOP). Increased foreign exchange inflows helped the Central Bank to replenish international reserves within a more market based exchange rate policy during the year. Meanwhile, in the fiscal sector, revenue collection as well as the government's primary balance improved during the period under review. Nevertheless, some deviation from the envisaged budget deficit target is likely in 2017 mainly as a result of adverse weather related fiscal costs. Meanwhile, the financial sector remained sound. Furthermore, the performance under the Extended Fund Facility programme of the International Monetary Fund (IMF-EFF) progressed, helping to boost investor confidence. Going forward, it is expected that the forward looking approach to monetary policy, the market-based exchange rate policy, and the process of fiscal consolidation will continue. Priority is also being attached to institutionalising these processes to make them more durable. However, these processes should be complemented by the implementation of the envisaged structural adjustments aimed at promoting external trade, attracting foreign direct investments and improving the productivity and efficiency of the economy for the country to build on the improvements observed thus far during the year, enabling the economy to reach its potential.

1

Sectoral Developments

Real Sector and Inflation

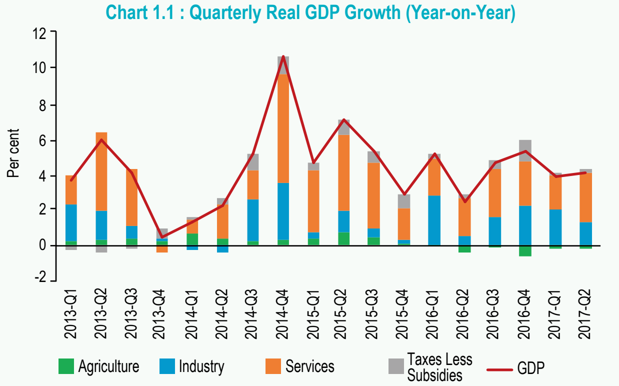
- **The Sri Lankan economy grew by 3.9 per cent in real terms during the first half of 2017 compared to the 3.7 per cent growth in the first half of 2016.** As in the previous year, adverse weather conditions hampered economic expansion during the first half of this year. Accordingly, value added growth in Agriculture related activities contracted while exerting spillover effects on other sectors of the economy. The contraction in Agriculture related activities was particularly witnessed in relation to paddy, oleaginous fruits (coconut, king coconut, oil palm), vegetables and cereals (except rice). However, both Industry and Services activities recorded an expansion during the first half of the year. The expansion in Industry related activities was mainly supported by the continued growth in construction and mining and quarrying activities. The growth in Services related activities was mainly sustained by financial services, wholesale and retail trade activities, and transportation. Meanwhile, in terms of expenditure approach estimates, the expansion in GDP was due to the increase in both investment and consumption expenditure during the first half of 2017. Net external demand continued to dampen economic growth during the first quarter of 2017, although some improvement was observed in the second quarter of the year.

- **The unemployment rate declined marginally to 4.3 per cent during the first half of 2017 from 4.4 per cent in the corresponding period of 2016.** This marginal improvement was due to the decline in the male unemployment rate amidst a marginal increase in the female unemployment rate. Moreover, unemployment among youth and educationally qualified remained high during the period under review. Although the unemployment rate declined, the total number of unemployed persons increased marginally during the first half of the year. Meanwhile, the overall Labour Force Participation Rate (LFPR) increased to 54.3 per cent in the first half of 2017 compared to 53.7 per cent in the corresponding period of 2016. The increase in the LFPR was due to the increase in the female LFPR while there was a marginal decline in the male LFPR during the first half of 2017. However, the female LFPR continued to be significantly lower than the male LFPR, emphasising the potential of the LFPR to be improved through the increase in female employment.

- **Consumer price inflation remained higher than the desired levels thus far in 2017 due to the combined effect of tax revisions, domestic weather related disturbances and rising international commodity prices**. Headline inflation, measured using the National Consumer Price Index (NCPI, 2013=100) as well as the Colombo Consumer Price Index (CCPI, 2013=100) remained high during the first quarter of 2017, impacted by supply side disruptions resulting from adverse weather conditions as well as the effect of upward tax revisions. However, a moderation in inflation was observed during the second quarter of 2017, underpinned by improvements in supply conditions and the government's initiatives to import essential food items. However, this trend reversed since August 2017 mainly due to a sharp acceleration in volatile food inflation given continued adverse weather conditions. Accordingly, NCPI based headline inflation increased to 8.6 per cent, year-on-year, in September 2017, mainly reflecting the high food inflation while CCPI based headline inflation also increased to 7.1 per cent, year-on-year. Meanwhile, the movements in core inflation were also impacted by tax revisions to some extent. However, core inflation remained low on average, indicating that demand driven inflationary pressures were broadly contained as a result of monetary policy measures adopted by the Central Bank. Accordingly, NCPI based core inflation declined to 4.6 per cent, year-on-year, by September 2017 from 6.7 per cent at end 2016. In contrast, CCPI based core inflation edged up marginally to 6.0 per cent, year-on-year, in September 2017 from 5.8 per cent at end 2016.

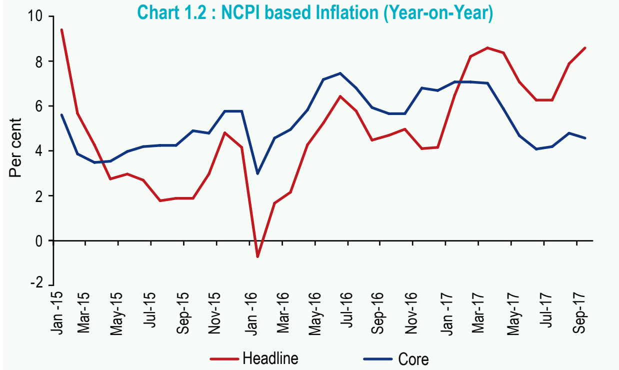
The Sri Lankan economy grew amidst weather related disturbances…

Chart 1.1 : Quarterly Real GDP Growth (Year-on-Year)



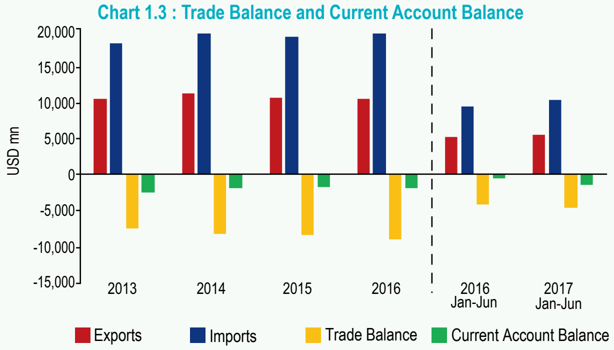
…while rising food prices pushed up headline inflation.

Chart 1.2 : NCPI based Inflation (Year-on-Year)



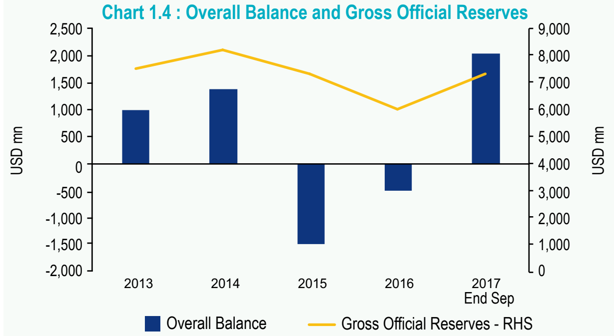
In spite of the pick up in exports, adverse weather also forestalled the anticipated improvement in the current account…

Chart 1.3 : Trade Balance and Current Account Balance



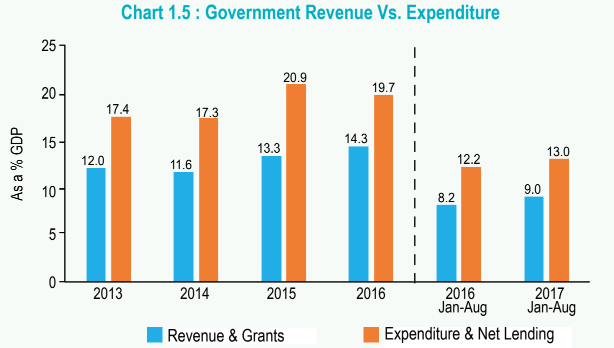
…but continued foreign financial inflows helped improve the country's BOP and foreign exchange reserves.

Chart 1.4 : Overall Balance and Gross Official Reserves



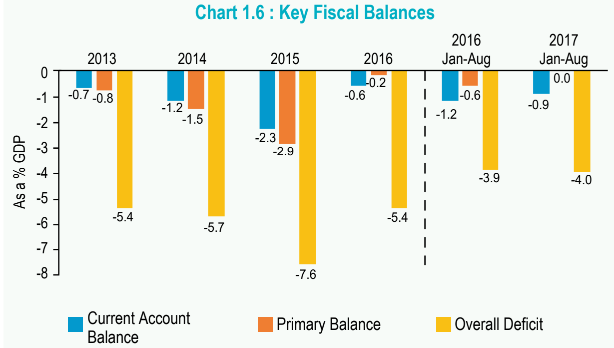
Government revenue collection increased, but expenditure also expanded, particularly with relief measures…

Chart 1.5 : Government Revenue Vs. Expenditure



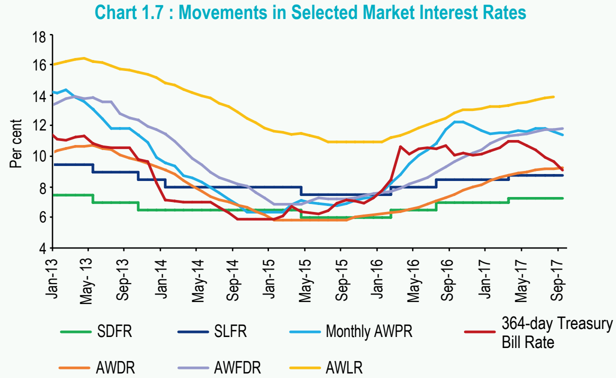
…and amidst challenges, fiscal consolidation continued.

Chart 1.6 : Key Fiscal Balances



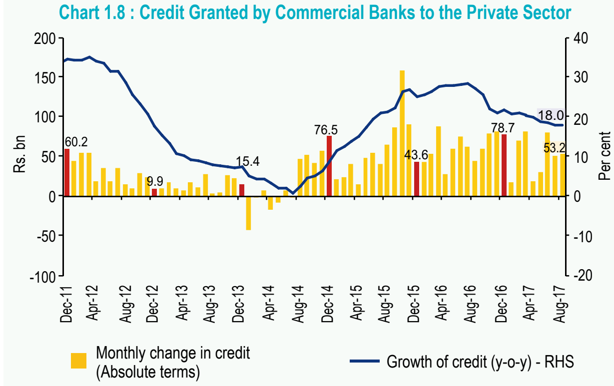
With the tight monetary policy stance, market interest rates remained high...

Chart 1.7 : Movements in Selected Market Interest Rates



...and the expansion of credit to the private sector decelerated gradually.

Chart 1.8 : Credit Granted by Commercial Banks to the Private Sector



Overall, many sectors of the economy responded well to the stabilisation measures taken, creating a conducive environment to focus more on economic growth in the period ahead.

1

External Sector

- **In the external sector, the gradual pick up in export earnings contained the expansion in the trade deficit in the first eight months of 2017**. Reversing the lacklustre performance experienced during the past two years, exports recovered from March 2017, registering a 7.6 per cent growth in cumulative earnings, on a year-on-year basis, to US dollars 7,413 million in the first eight months of 2017. The gradual recovery in key export markets, increased commodity prices in international markets, the restoration of the GSP+ concessions from the European Union, conducive external trade policies together with institutional support and a more competitive exchange rate contributed towards the increase in export earnings. Accordingly, higher export earnings were received from tea, petroleum products, transport equipment, spices, seafood, and machinery and mechanical appliances. However, export earnings from textiles and garments declined moderately during the first eight months of 2017, due to the weak performance recorded in the first half of the year. Nevertheless, a notable increase in textiles and garments exports was seen during the months of July and August 2017 following the restoration of GSP+. Meanwhile, expenditure on imports also grew substantially, recording a year-on-year growth of 9.6 per cent to US dollars 13,599 million during this period. The increase in import expenditure was mainly driven by the significant increase in fuel imports, together with gold and rice imports. Increased import expenditure on fuel was mainly due to the higher demand from the domestic power generation sector in view of low hydropower generation as a result of the drought. Increased fuel prices in the international market also impacted the fuel bill. Further, rice imports continued to increase since January 2017 as a result of the measures taken by the government to encourage imports to meet the shortage in the weather affected domestic supply. The removal of the Ports and Airport Development Levy (PAL) in the previous year may have contributed to the increased volume of gold imports during the year. However, import expenditure on machinery and equipment, personal vehicles, fertiliser and mineral products declined during the period. With these developments, the trade deficit widened to US dollars 6,186 million during the first eight months of 2017 from US dollars 5,515 million in the corresponding period of the previous year.

- **In addition to developments in the trade account, the widening of the deficit in the primary income account together with the moderation of inflows to the services and secondary income accounts resulted in a widening of the external current account deficit in the first half of 2017**. The deficit in the primary income account widened during the first half of 2017, mainly driven by increased interest payments on International Sovereign Bonds (ISBs). The surplus in the services account recorded a marginal increase during the first half of 2017, primarily due to the moderate growth of earnings from tourism. The partial closure of the Bandaranaike International Airport (BIA) owing to the re-surfacing of the runway and the breakout of dengue epidemic also affected tourist arrivals. Meanwhile, the transportation services sector remained positive with a healthy growth in transhipments. The sluggish performance of the Middle Eastern economies due to persistently low oil prices and geo-political uncertainties and changes in government policies resulted in a decline in workers' remittances, leading to a reduction in the surplus of the secondary income account during the first half of the year vis-à-vis the corresponding period of 2016. The widening of the deficits in the trade and primary income accounts, together with the lacklustre performance in earnings from tourism and workers' remittances, resulted in a notable current account deficit of US dollars 1,480 million in the first half of 2017, compared to a deficit of US dollars 644 million in the corresponding period of 2016.

- **The financial account, which recorded significant outflows in the first quarter, experienced substantial inflows in the second quarter of 2017**. Outflows from the financial account in the first quarter were primarily driven by significant withdrawals of foreign investments from the government securities market. However, a reversal in financial flows was witnessed in the second quarter of the year with increased investor confidence brought by the successful conclusion of the Second Review of the IMF-EFF programme as well as the gradual stabilisation of the yields of US government securities. Inflows to the government securities market gradually improved from the second quarter of the year, offsetting the outflow recorded in the first quarter. The financial account also benefitted from higher inflows to the Colombo Stock Exchange (CSE), increased foreign direct investments (FDI) and proceeds from the eleventh ISB and the foreign currency term financing facility obtained by the government. Reflecting these developments in the external sector accounts, the BOP, which registered an overall surplus of US dollars 1,563 million by end June 2017, further improved by end September to record an estimated surplus of US dollars 2,027 million. By end 2016, the corresponding figure was a deficit of US dollars 500 million.

- **Meanwhile, gross official reserves of the country increased to US dollars 7.3 billion at end September 2017 from US dollars 6.0 billion at end 2016.** The level of gross official reserves increased at end September 2017, primarily due to net purchases of foreign currency by the Central Bank amounting to US dollars 1,161 million from the domestic foreign exchange market, together with other foreign currency inflows such as the proceeds from the ISB, foreign currency term financing facility, net borrowings through Sri Lanka Development Bonds (SLDBs) and the receipt of the third tranche under the IMF-EFF programme. The major outflows during this period included the settlement of the RBI foreign currency swap arrangement, foreign currency debt service payments, including IMF Stand-By Arrangement (SBA) principal payments, and net Asian Clearing Union (ACU) outflows. Accordingly, the country's gross official reserve level at end September 2017 is estimated to be equivalent to 4.2 months of imports. Reflecting the qualitative improvement brought about by the build-up of reserves through direct market purchases and the decline in short term liabilities, reserve adequacy in terms of short-term debt and liabilities improved to 62 per cent at end September 2017 from 52 per cent at end 2016.

- **The improved external environment facilitated the Central Bank to implement a more market based exchange rate policy in 2017, under which the Central Bank intervened in the domestic foreign exchange market to build up international reserves with minimal impact on the exchange rate**. Continued outflows in terms of import expenditure, debt service payments and unwinding of foreign investments in rupee denominated government securities exerted pressure on the rupee during the first quarter of 2017. However, market conditions improved thereafter, with inflows from foreign investments to the CSE and the government securities market, and the subsequent conversion of export proceeds. This turnaround enabled the Central Bank to absorb foreign exchange from the domestic market on a net basis during this period. Meanwhile, the depreciation pressure on the rupee further eased gradually from May 2017, with improved investor confidence following the issuance of the ISB, the obtaining of the term loan and the receipt of the third tranche under the IMF-EFF programme. Overall, the Sri Lankan rupee depreciated by 2.2 per cent against the US dollar during the year up to end September 2017. Reflecting the nominal movement of the Sri Lankan rupee against some of the major currencies, both the 5-currency and 24-currency nominal effective exchange rate (NEER) indices depreciated during the year up to end September 2017. The real effective exchange rate (REER) indices, which also take into account the inflation differential amongst countries in the currency basket, depreciated considerably during the period under review, but remained above the 100 threshold, suggesting the need for further depreciation to reach the level of competitiveness that prevailed in 2010.

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Fiscal Sector

- **Several policy measures were introduced by the government during the year 2017 to further strengthen the fiscal consolidation process and public debt management**. Accordingly, a new Inland Revenue Bill was enacted by the Parliament in September 2017 with a view to simplify and rationalise the existing income tax structure, broaden the direct tax collection by removing exemptions and strengthening tax administration. In this respect, the Revenue Administration Management Information System (RAMIS) has been set-up at the Inland Revenue Department to enable tax payers to make online payments in respect of several taxes. In addition, initial steps were also taken to establish a National Single Window System (NSWS) at the Sri Lanka Customs to facilitate external trade, while the Integrated Treasury Management Information System (ITMIS) at the Ministry of Finance and Mass Media (MOF) is expected to commence from the last quarter of 2017 as a pilot project for selected ministries. In relation to rationalising recurrent expenditure, quarterly expenditure and income outcome reports for the first and second quarters of 2017 were presented to the Parliament as announced in the Budget 2017 for strengthening Parliamentary control on public finances. Further, the National Agency for Public Private Partnership (NAPPP) was established at the MOF with a view to promoting public private partnerships (PPPs). The government also introduced several initiatives to implement structural reforms in State Owned Business Enterprises (SOBEs) in order to improve their financial strength, thereby ensuring long term financial viability. Accordingly, Statements of Corporate Intent (SCIs) were signed with five selected key SOBEs in order to improve the oversight and fiscal discipline of these SOBEs, while SCIs are expected to be signed with another ten SOBEs. During the year, several measures were taken to improve the public debt management strategy and transparency in the government securities market. A new Fiscal Liability Management Bill is also being drafted to create the space for proactive debt management.

- **The performance of the fiscal sector showed some improvement in 2017, although weather related relief expenditure is likely to cause a deviation from the envisaged fiscal targets for the year**. The government revenue to GDP ratio recorded a notable improvement increasing to 9.0 per cent during the first eight months of 2017 from 8.2 per cent in the corresponding period of 2016. This increase in government revenue was mainly due to the increase in the proceeds from goods and services related taxes, especially the Value Added Tax (VAT), excise duty on petroleum and motor vehicles, Nation Building Tax (NBT), Special Commodity Levy (SCL) and PAL. The revenue collection from income taxes also improved due to higher revenue from the Economic Service Charge (ESC). However, revenue from excise duty on liquor, cigarettes and tobacco declined during this period mainly due to the drop in sales of liquor and cigarettes. The increase in duties to an extremely high level is likely to be a significant causal factor. Total expenditure and net lending as a percentage of estimated GDP also increased to 13.0 per cent during the first eight months of 2017, in comparison to 12.2 per cent recorded in the same period of 2016, due to increases in both recurrent expenditure and public investment. As the increase in government expenditure was higher than the increase in government revenue, the overall budget deficit increased to 4.0 per cent of the estimated GDP during the first eight months of 2017 from 3.9 per cent in the corresponding period of 2016. However, both the current account and the primary account improved during this period vis-a-vis the corresponding period of the previous year and the IMF-EFF target as at 30 June 2017 was met.

- **Both domestic and foreign sources were utilised to finance the overall budget deficit of Rs. 520.2 billion during the first eight months of 2017**. However, net domestic financing at Rs. 273.5 billion during this period remained below the sum of Rs. 309.5 billion recorded during the first eight months of the previous year. Meanwhile, net foreign financing increased significantly to Rs. 246.7 billion during the period under consideration from Rs. 175.6 billion in the same period of 2016.

Monetary Sector

- **The Central Bank continued to maintain a tight monetary policy stance in the first nine months of 2017 in view of the developments in inflation as well as monetary and credit aggregates**. With a view to containing the build-up of adverse inflation expectations and reining in the excessive expansion of money supply, the Central Bank further tightened its monetary policy by raising policy interest rates by 25 basis points in March 2017. The Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank stood at 7.25 per cent and 8.75 per cent, respectively, since then.

- **In response to the monetary policy stance maintained by the Central Bank and the high financing requirement of the government budget, most market interest rates moved upwards during the first nine months of 2017, although short term rates adjusted downwards with liquidity improvements in the domestic money market since mid July 2017**. The Average Weighted Call Money Rate (AWCMR) hovered around the upper bound of the policy rate corridor during the first seven months of 2017, reflecting tight monetary conditions. However, with improved liquidity conditions since mid July 2017, the AWCMR adjusted downwards towards the middle of the policy rate corridor by end September 2017. Meanwhile, Sri Lanka Inter Bank Offered Rates (SLIBOR) adjusted in line with movements in the AWCMR. The deposit interest rates of commercial banks increased particularly during the first seven months of 2017, reflecting the increased funding costs of commercial banks. Lending rates of commercial banks also increased further and stabilised at high levels by end September 2017. Yields on Treasury bills in the primary market, which increased during the first four months of 2017 reflecting the increased demand for funds by the government, declined thereafter due to increased foreign inflows to the government, improved confidence with the receipt of the third tranche of the IMF-EFF and increased government revenue collection. Similarly, yields on Treasury bonds in the primary market also declined since April 2017, reversing the upward movement witnessed during the first quarter of 2017. Secondary market yields followed suit, resulting in a downward shift in the yield curve for government securities, particularly in the long end, during the first nine months of 2017. Meanwhile, interest rates applicable on corporate debt instruments moved upwards during the first eight months of 2017. In line with the movements in global interest rates, interest rates applicable on foreign currency deposits maintained with commercial banks increased marginally during the first nine months of 2017.

Table 1.1

Recent Monetary Policy Measures

Date	Measure
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) 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.
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.
24-Mar-2017	The SDFR and SLFR increased by 25 basis points to 7.25% and 8.75%, respectively.

Source: Central Bank of Sri Lanka

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- **Broad money supply (M_{2b}) continued to expand during the first eight months of 2017**. By end August 2017, M_{2b} recorded a year-on-year growth of 21.3 per cent in comparison to a growth of 18.4 per cent at end 2016. Net domestic assets (NDA) contributed 78 per cent to the year-on-year expansion of broad money driven by credit flows to the private sector, the government and public corporations, despite the deceleration in private sector credit growth observed since July 2016. Net foreign assets (NFA) of the banking sector also expanded during the first eight months of 2017, led mainly by the NFA of the Central Bank.

- **The growth of credit extended to the private sector decelerated during the first eight months of 2017 responding to the monetary policy stance and the resultant high market interest rates**. The year-on-year growth of credit to the private sector decelerated to 18.0 per cent by end August 2017 from 21.9 per cent at end 2016 and its peak of 28.5 per cent in July 2016. In absolute terms, credit to the private sector increased by Rs. 404.6 billion during the first eight months of 2017 in comparison to an increase of Rs. 456.3 billion in the corresponding period of 2016. Credit to all major sectors of the economy continued to expand, albeit at a slower pace, during the first half of 2017 as reflected by the Quarterly Survey of Commercial Banks' Loans and Advances to the Private Sector. The growth of credit to the private sector is expected to moderate further and reach the envisaged level of 15-16 per cent by end 2017.

- **Borrowing by the public sector from the banking system remained high in the first eight months of 2017**. Net credit to the government (NCG) by the banking sector continued to increase during the first eight months of 2017, entirely on account of the expansion in NCG from commercial banks. While NCG from commercial banks increased significantly by Rs. 384.9 billion during the first eight months of 2017, NCG from the Central Bank contracted significantly by Rs. 119.5 billion during this period. Accordingly, the increase in NCG by the banking system at Rs. 265.4 billion in the first eight months of 2017 was noticeably higher than the Rs. 178.4 billion recorded in the corresponding period of 2016. Meanwhile, the increasing trend in credit granted to public corporations observed during the first five months of 2017 moderated thereafter. Credit obtained by public corporations rose by Rs. 7.8 billion by end August 2017 as against a contraction of Rs. 81.5 billion recorded in the corresponding period of 2016.

Financial Sector

- **The financial sector continued to expand during the first eight months of 2017 with all major sectors remaining sound**. The banking system continued to expand while maintaining capital and liquidity well above the regulatory minimum requirements, thereby ensuring the resilience of the sector. While the asset base of the banking sector continued to grow, a marginal deterioration was observed in asset quality, as reflected in the increase in the non-performing loans (NPL) ratio. The profitability of the sector improved during this period mainly due to higher net interest income and significant revaluation gains. The banking sector also continued to contribute to enhanced financial inclusion through the active expansion of the branch and ATM networks during this period. Moreover, implementation of the Basel III framework would further enhance the resilience of the banking sector. Although the asset base of non-bank financial institutions (NBFIs) expanded, it expanded at a slower pace compared to the performance in 2016. Lending activities of the sector were weighed down by macroprudential policy measures, while asset quality showed signs of stress although remaining at manageable levels. Other sub sectors of the financial sector such as the insurance and the superannuation fund sectors recorded a positive performance, while the unit trust sector contracted. Amidst further strengthening of capital regulations, the stock broker sector showed a mixed performance during the first eight months of 2017. While activities of financial institutions engaged in microfinance expanded, rural poverty and indebtedness remained key concerns though the latest Household Income and Expenditure Survey (HIES:2016) showed positive trends in terms of incomes, poverty and the Gini Coefficient. Meanwhile, the domestic money market and foreign exchange market remained sufficiently liquid during the year. The corporate debt securities market performed moderately during the first half of 2017. Some improvement was observed in the share price indices, market capitalisation and foreign inflows to the CSE thus far during the year, although domestic investor activity remained weak. The efficiency and safety of the national payment system continued to be enhanced during this period to effectively cater to the payment needs of institutions, corporates and individuals.

International Economic Environment

- **The upswing in global economic activity witnessed during the end of 2016 is expected to be further strengthened in 2017 and 2018, according to the IMF World Economic Outlook (WEO) – October 2017**. Synchronised growth is being experienced in Europe, Japan and the US for the first time since the Global Financial Crisis in 2007, while economic growth is expected to expand in emerging market and developing countries. The pick up in growth is supported by notable improvements in investment, trade and industrial production, coupled with strengthening business and consumer confidence. Accordingly, the IMF forecasts global growth at 3.6 per cent in 2017 and 3.7 per cent in 2018. Stronger than previously projected rebound in the Euro area, Japan and Canada is expected to drive the growth momentum of advanced economies in 2017 and 2018, while growth projections for the US and the UK have been revised downward. Meanwhile, growth in emerging market and developing economies is projected to rise in 2017 and 2018 owing to strong growth expectations for China and a host of other emerging market economies. Weak productivity and adverse demographic factors, mainly in advanced economies, remain downside risks to medium term growth.

- **Advanced economies are expected to continue to grow at a moderate pace in 2017 and 2018, buoyed by the cyclical recovery in manufacturing and trade and the upturn in financial markets**. These economies are projected to grow by 2.2 per cent and 2.0 per cent during 2017 and 2018, respectively. The IMF revised the projected growth rates upwards for 2017 based on stronger than expected growth in the Euro area and Japan, which are supported by the pick up in global trade and manufacturing. Nevertheless, the IMF revised downward the projections for the US and the UK. In spite of the downward revision, the US economy, Sri Lanka’s largest export destination, is expected to grow at a healthy rate of 2.2 per cent in 2017, followed by a growth of 2.3 per cent in 2018. The growth in the UK, which is Sri Lanka’s second largest export destination, is projected at 1.7 per cent and 1.5 per cent, respectively, in 2017 and 2018. Growth prospects for the UK continue to be marred by the uncertainty surrounding post-Brexit arrangements.

- **The growth momentum in emerging market and developing economies is expected to pick up markedly in 2017 and 2018, recovering from slackened activity in 2016**. This growth is expected to be mainly supported by growth enhancing structural reforms and spillover effects of growth in advanced economies and China. The IMF growth projection for emerging market and developing economies is 4.6 per cent for 2017 and 4.9 per cent for 2018, rising from the growth rate of 4.3 per cent estimated for 2016. The annual economic growth of China is expected to remain above 6.0 per cent over the medium term, supported by supply side reforms, including efforts to reduce excess capacity in the industrial sector. India’s growth is projected to decelerate to 6.7 per cent in 2017, reflecting the lingering effects of the currency demonetisation in 2016 and the imposition of the Goods and Services tax in July 2017. These effects are expected to be of a short term nature and growth is expected to accelerate from 2018. The ASEAN-5 economies are expected to sustain growth at 5.2 per cent in 2017 and 2018 propped by external demand from China and Europe.

- **Global growth projections may be affected by numerous downside risks to the strength and durability of the global economic recovery, but could also be subject to upward revisions, with stronger cyclical recovery and stronger consumer and business confidence**. Uncertainties relating to macroeconomic policies in the US could hinder the global growth, affecting asset prices and global financial market stability. Monetary policy normalisation in the US could tighten global financial conditions as well. Such an effect may result in capital outflows from emerging economies. Persistently low inflation in advanced economies could weigh on achieving full employment and potential output, and produce negative spillover effects on emerging economies, amplified by restrictions on trade. The IMF is also concerned that the strong credit growth in China, unless addressed proactively by Chinese authorities without allowing for sudden market adjustments, could adversely affect the global economy through trade and commodity price channels. Meanwhile, non-economic factors such as geopolitical tensions and terrorism, as well as extreme weather events could hamper global growth prospects as well.

- **Inflation in advanced economies, which has picked up since 2016, is expected to increase further in 2017 and 2018, while inflation in emerging market and developing economies is projected to remain broadly stable**. Consumer price inflation that stood at 0.8 per cent, on average, in advanced economies during 2016 is expected to increase to 1.7 per cent in 2017 and 2018, albeit at a slower pace than anticipated at the beginning of the year, partly reflecting weaker than expected oil prices. Notably, the headline inflation rates in all advanced economies, particularly in Japan, which experienced deflation in 2016, are expected to record positive levels in 2017. Meanwhile, consumer price inflation in emerging market and developing economies is expected to stabilise over the medium term, with forecasts reaching 4.2 per cent in 2017 and 4.4 per cent in 2018. However, several emerging economies are expected to witness a decline in inflation. Further, oil prices have become firmer due to the reduction in oil inventories and the supply limitations imposed by the Organization of the Petroleum Exporting Countries (OPEC) and Russia. The IMF projects average global oil prices at US dollars 50.28 per barrel in 2017 and US dollars 50.17 per barrel in 2018.

- **Monetary policy in advanced economies continued to move in diverse directions given uneven economic recovery**. Reflecting these divergences, the US Federal Reserve continued its policy normalisation programme, while the Bank of England (BoE) and European Central Bank (ECB) maintained accommodative monetary policies. Further to raising the target range for the Federal funds rate on two occasions so far during 2017, the US Federal Reserve has indicated its intention to reduce the size of its balance sheet substantially in the period

Table 1.2

Changes in the Policy Interest Rates of Selected Central Banks

Per cent

Country	Key Policy Rate	End 2014	End 2015	End 2016	Sep-17
Sri Lanka	Standing Deposit Facility Rate	6.50	6.00	7.00	7.25
	Standing Lending Facility Rate	8.00	7.50	8.50	8.75
Emerging Market Economies					
India	Repurchase rate	8.00	6.75	6.25	6.00
Malaysia	Overnight policy rate	3.25	3.25	3.00	3.00
Thailand	1-day bilateral repo rate	2.00	1.50	1.50	1.50
China	1-year yuan lending rate	5.60	4.35	4.35	4.35
Advanced Economies					
USA	Federal funds rate	0-0.25	0.25-0.50	0.50-0.75	1.00-1.25
UK	Bank rate	0.50	0.50	0.25	0.25
ECB	Refinance rate	0.05	0.05	0.00	0.00
Japan	Overnight call rate	0.00	0.00	-0.10	-0.10
Canada	Overnight rate	1.00	0.50	0.50	1.00
Australia	Cash rate	2.50	2.00	1.50	1.50
Sweden	Repo rate	0.00	-0.35	-0.50	-0.50

Source: Websites of respective central banks ahead. The UK is currently experiencing the lowest level of unemployment in four decades while inflation remains above the BoE's target, but the uncertainties arising from Brexit have prevented monetary policy tightening in the UK so far. Nevertheless, some withdrawal of monetary stimulus by the BoE is expected in order to maintain inflation at targeted levels in the period ahead. The ECB is expected to rationalise its asset purchase programme, given the expected economic recovery in the Eurozone. Meanwhile, the Bank of Japan (BoJ) continued with Quantitative and Qualitative Monetary Easing (QQE), aiming to achieve the inflation target of 2 per cent. Further, the Reserve Bank of Australia (RBA) also held its monetary policy stance unchanged with a view to supporting the achievement of the inflation target and sustain growth in the economy.

- **The monetary policy stances of the emerging market economies also varied in the midst of a complex global economic environment**. Some emerging economies eased monetary policy with a view to boost economic growth. The Reserve Bank of India (RBI) reduced its repo rate under the liquidity adjustment facility (LAF) by 25 basis points to 6.0 per cent in August 2017, in consonance with the objective of achieving the medium term target for inflation of 4 per cent within a band of +/- 2 per cent, while supporting economic growth. The Central Bank of Chile also reduced its benchmark rate by 100 basis points to 2.50 per cent on three occasions during the first half of 2017. Meanwhile, a number of emerging market economies gradually tightened their monetary policies to address issues such as currency depreciation, capital outflows and inflationary pressures. The Central Bank of Mexico raised its benchmark rate on multiple occasions, totaling 125 basis points to 7.0 per cent during 2017, with a view to curtailing demand pressures of inflation. The Central Bank of the Republic of Turkey also raised its overnight lending rate by 75 basis points to 9.25 per cent in January 2017, and raised the late liquidity window's lending rate by 75 basis points and 50 basis points in March and April 2017, respectively, to 12.25 per cent. Meanwhile, considering the improved growth outlook and to maintain the current growth momentum, Bank of Thailand decided to keep its policy rates unchanged at 1.50 per cent in 2017. Bank Negara Malaysia also decided to maintain its overnight policy rate unchanged at 3.0 per cent, citing improved performance of the economy during the first half of 2017, supported by stronger domestic demand and an additional impetus from exports.

Expected Developments

- **Sri Lanka's growth trajectory is expected to improve gradually in the medium term with the support of ongoing structural adjustments, improving macroeconomic stability and consistent policies**. Nevertheless, economic growth during the second half of 2017 is expected to be low, due to the effects of adverse weather conditions, although it is expected to perform better than the first half of the year. Accordingly, real economic growth during 2017 is projected to be between 4.0 - 4.5 per cent, on a year-on-year basis, in comparison to the 4.4 per cent expansion recorded in 2016. Growth is envisaged to improve thereafter with the support of conducive macroeconomic policies and the realisation of growth promoting strategies of the government, and the resultant increase in domestic and foreign investments. The macroeconomic environment is expected to improve with revenue based fiscal consolidation measures, the market based flexible exchange rate system, and mid-single digit inflation. Furthermore, initiatives aimed at harnessing higher economic growth through the development of the country as an export driven economic hub are expected to provide a major impetus towards growth. This would entail improving the production capacity of the country through mechanisation of economic activities, enhancing the skill level of the labour force and digitalisation of the economy as well as improving global linkages through entering into trade agreements and global production networks. The envisaged growth needs to be driven by the active participation of the private sector, including higher FDI inflows, which would facilitate the transfer of technological knowledge as well as improved access to global markets. The growth outlook of the country would also benefit from complementary policies that would exploit its geographical location in terms of port and airport related activities. Major development initiatives such as the Colombo International Financial City, the Western Region Megapolis Development project and the establishment of Special Economic Zones are some of the activities that would help realise the expected economic expansion in the future. With these expected developments, economic growth is projected to gradually improve to 7.0 per cent by 2020.

- **Sri Lanka's external sector is expected to improve gradually in the medium term, despite the likely widening of the current account deficit in 2017**. Slower than expected adjustment in the trade account, mainly due to the increased fuel and food import requirements caused by adverse weather conditions, and the slowdown in workers' remittances are anticipated to weigh down on previously projected improvement in the external current account in 2017. However, the current account is projected to improve thereafter with the support of the anticipated improvement in trade in goods and services. With improved global trade including growth in Sri Lanka's major export markets; the US and EU, the reinstatement of the EU GSP+ facility, enhanced trade relations expected through bilateral trade agreements, strong institutional support and consistent policies that will result in increased domestic and foreign investments in export oriented industries, exports are projected to record an expansion in the medium term. In line with the expected economic growth, imports of investment and intermediate goods are also projected to increase over the period ahead, thereby leading to increased expenditure on imports. However, the growth in expenditure on imports are expected be lower than the growth in export earnings, thus contributing to a gradual rebalance in the trade account. The services account is expected to continue its momentum, with a positive growth in tourism, transportation, and information technology – business process outsourcing (IT-BPO) sectors. However, workers' remittances are expected to remain broadly at the current levels in the medium term, due to domestic and external factors. The financial account is expected to strengthen with higher direct investment inflows as well as debt inflows to the government and the private sector. The continuation of the IMF-EFF programme is also expected to play a vital role in supporting the government's reform agenda and improving investor confidence, leading to increased foreign investment in the country. Within an environment of rising global interest rates, and in consideration of the government's debt servicing obligations falling due in the period ahead, a cautious approach towards external financing is necessary. In this regard, the pre-emptive measures to be taken by the government, particularly in terms of liability management, are an essential step towards mitigating risks faced by the external sector in the medium term, along with attracting non-debt creating foreign inflows.

- **Several decisive measures have been introduced by the government to enhance revenue while rationalising expenditure in the process of fiscal consolidation, which is aimed at improving the fiscal sector over the medium term**. Accordingly, the new Inland Revenue Act, along with ongoing digitalisation efforts, are expected to simplify and rationalise the existing income tax structure, broaden the direct tax collection by removing exemptions, strengthen administration and introduce international best practices to the Sri Lankan tax system. Further, submission of Quarterly Expenditure and Income Outcome Reports to the Parliament would strengthen Parliamentary control over public finances. In addition, the government has taken several initiatives to implement structural reforms, with a view to improving the financial strength of SOBEs, thereby ensuring their long term viability. With these developments, tax revenue is expected to increase to around 16 per cent of GDP by 2020, while maintaining public investment at 5-6 per cent of GDP in the medium term. Consequently, the budget deficit is expected to be reduced to 3.5 per cent of GDP with a surplus in the primary balance and the current account balance. Government debt is also expected to decline to a sustainable level in the medium term.

- **The Central Bank will conduct monetary policy within the current enhanced monetary policy framework, with a view to transiting towards Flexible Inflation Targeting (FIT) in the medium term**. The key stages of this transition include introducing necessary legal reforms, building institutional and technical capacity, strengthening Central Bank credibility and autonomy, enhancing monetary-fiscal policy coordination, including through strengthening of the Fiscal Management (Responsibility) Act, allowing greater flexibility in the exchange rate, improving monetary policy operations and enriching public and stakeholder awareness. Having met several prerequisites to adopt FIT, the Central Bank intends to announce a Road Map for the smooth transition towards the FIT framework in the medium term, with the support of the government. Despite the recent increase in inflation due to supply disruptions and tax adjustments, inflation is expected to remain at mid-single digit levels in the medium-term, provided that fiscal consolidation continues as envisaged. However, considering the large share of food items and imported components in the consumption basket, domestic supply disruptions and volatile international commodity prices pose a threat to maintaining inflation at desired levels, unless addressed by the government through appropriate proactive measures. With regard to monetary aggregates, it is expected that monetary expansion will normalise from the current high levels from 2018 onwards, with sufficient credit flows to facilitate private sector led economic growth.

- **Developments in monetary, external and fiscal sectors of the Sri Lankan economy during the first three quarters of the year suggest that macroeconomic stability is being gradually restored, and increased attention is required to boost economic growth to reach its potential over the medium term**. In addition to the conduct of monetary policy to maintain inflation around the targeted path of 4-6 per cent with due regard to real sector stability, the Central Bank will also maintain a competitive exchange rate driven by market fundamentals with minimal intervention. With the exchange rate acting as an automatic stabiliser, and with the realisation of expected non-debt creating foreign inflows, the external sector is expected to strengthen further with improved resilience. The structural reforms to be implemented towards improving the government's revenue mobilisation, tax administration and compliance, expenditure rationalisation, and the active management of fiscal liabilities in a forward looking framework as well as ensuring the viability of SOBEs are essential for improved fiscal discipline. In the meantime, the implementation of growth enhancing reforms identified in various country diagnostic studies must be expedited to harness the benefits of improving global economic conditions and increasing access to global markets. In this regard, the implementation of the policies aimed at improving the country's efficiency and competitiveness with a medium to long term view, is essential for Sri Lanka to move forward to become an enriched nation.

2

NATIONAL OUTPUT AND EXPENDITURE

The Sri Lankan economy grew by 3.9 per cent during the first half of 2017 compared to the growth of 3.7 per cent recorded during the same period of 2016. Industry related activities benefitted from the growth momentum in the construction activities, while Services activities grew at a moderate pace supported by financial services and wholesale and retail trade activities. However, severe drought conditions that prevailed during the first half of the year adversely impacted the economic performance, downsizing value added growth in Agriculture activities with some spillover impact particularly on manufacturing activities. On the external front, growth remained tepid in some major export destinations, dampening the external demand. Going forward, an improvement in economic activities is expected during the rest of the year, as reflected by early indicators and business sentiment surveys conducted by the Central Bank, driven by industry activities, especially construction activities. Services activities would also push up overall growth, supported by trade related and financial services activities. Meanwhile, the realisation of expected benefits from GSP+ and other trade pacts would boost the performance of manufacturing as well as external trade activities. The downside risks to this positive outlook include the continuation of adverse weather conditions and possible delays in the implementation of envisaged structural reforms.

Developments in 2017

Output

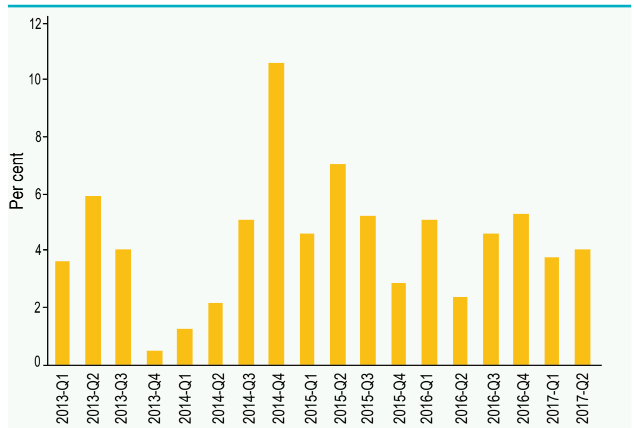
2

- **The Gross Domestic Product (GDP) grew by 3.9 per cent in the first half of 2017 compared to 3.7 per cent growth recorded in the corresponding period of 2016.** This growth was mainly driven by Industry activities, supported by the expansion in Services activities amidst the contraction recorded in the Agriculture activities. Accordingly, Industry activities grew by 5.8 per cent in value added terms during the first half of 2017 mainly backed by the significant increase in construction activities together with the expansion in mining and quarrying activities. Value added of Services related activities grew by 4.0 per cent in the first half of the year. This growth was largely attributable to the expansion in financial services, wholesale and retail trade activities, transportation, health and other personal services activities. However, the value added of Agriculture activities contracted by 3.1 per cent during the first half of 2017 primarily due to the contraction recorded in growing of rice, oleaginous fruits (coconut, king coconut, oil palm), vegetables and other cereals. In the meantime, taxes less subsidies on products increased by 3.0 per cent in the first half of 2017.

- **The economy is projected to grow around 4.5 per cent in 2017 compared to the growth of 4.4 per cent recorded in 2016.** This annual growth is expected to be fuelled by the expansion in Industry and Services activities while the contribution from Agriculture activities would be subdued largely due to the continuing adverse weather conditions. The significant growth momentum in construction activities is expected to continue during the latter part of the year contributing to Industry activities. Expansion in financial services activities and wholesale and retail trade activities are expected to be the key drivers of growth in Services activities. Meanwhile, agriculture activities are anticipated to contract mainly on account of the decline in major agricultural activities including growing of rice, vegetables, coconut and other cereals owing to adverse weather conditions in areas where the majority of the Yala harvest is concentrated.

- **There are downside risks to the expected growth prospects for 2017 arising from both internal and external developments**. The continuation of the prolonged drought, resulting in low water availability in irrigation tanks, has restricted the extent of cultivation of major crops during the Yala season in 2017. Further, there would be some negative impact on Maha 2017/18 if the expected monsoons do not materialize. The adverse weather impact on agricultural activities would spillover to other activities, particularly to food processing related manufacturing activities. Further, any increase in commodity prices, including oil prices, would impact activities such as electricity generation, transportation as well as manufacturing, which particularly depend on imported intermediate goods. Meanwhile, the government's commitments on fiscal consolidation measures would moderate both government consumption and investment expenditure during the year, which in turn would impact aggregate demand. Moreover, any downturn in global demand would cause further delay in accruing benefits of opened up market access from the external front. The uncertainty of the US trade and fiscal policies and expected monetary policy normalisation, ongoing rebalancing in China and continued geopolitical tensions in the Middle East would weigh on external demand.

Chart 2.1
Quarterly GDP Growth Rates (a)



(a) The data is based on the base year 2010 GDP estimates of the Department of Census and Statistics.

Growth in Economic Activities

Agriculture, Forestry and Fishing

- **As per the GDP estimates, the value added of Agriculture, Forestry and Fishing activities contracted by 3.1 per cent during the first half of 2017 compared to the contraction of 3.0 per cent recorded in the corresponding period of 2016.** The contraction recorded in growing of rice, oleaginous fruits (coconut, king coconut, oil palm), vegetables, other cereals, rubber and sugar cane, tobacco and other non-perennial crops dampened the growth in the Agriculture activities. However, fishing activities, animal production, forestry and logging, growing of fruits, spices, tea, other perennial crops, and plant propagation and support activities to agriculture contributed positively to the Agriculture growth.

Production Trends and Institutional Support: Agriculture

Agriculture Production Index

- **The output of the Agriculture and Fisheries sector, as measured by the Agriculture Production Index (API), recorded a sharp decline of 11.5 per cent during the first half of 2017 in comparison to the decline of 3.4 per cent during the corresponding period of 2016.** All sub-indices with the exception of tea, fish and livestock contracted during the first half of 2017. The decrease in the paddy sub-index by 51.1 per cent was mainly due to the persistent adverse weather conditions coupled with the decline in the extent harvested. Meanwhile, the tea sub-index increased marginally by 0.8 per cent in line with the expansion in production. Rubber, coconut and other crops, however, posted a negative performance in comparison to the previous year, while the livestock subsector recorded a growth of 11.3 per cent, reflecting a positive performance in all its sub categories. Similarly fisheries activities expanded with a considerable increase in marine fish production.

Table 2.1

Agriculture Production Index (2007-2010=100)

Item	2016 First Half (a)	2017 First Half (b)	Growth Rate (%) 2015/16 (a)	Growth Rate (%) 2016/17 (b)
Agriculture and Fishing	**133.6**	**118.1**	**-3.4**	**-11.5**
1 Agriculture	**131.5**	**111.0**	**-2.6**	**-15.5**
1.1 Agriculture Crops	128.6	103.3	-2.6	-19.7
Paddy	155.2	75.9	0.9	-51.1
Tea	99.0	99.8	-10.6	0.8
Rubber	71.4	67.2	- 4.9	-5.9
Coconut	104.8	91.0	-1.1	-13.2
Other Crops	154.0	143.4	-1.2	-6.9
Vegetables	157.9	154.2	- 4.1	-2.3
Fruits	145.8	149.2	- 4.6	2.3
Other Field Crops	167.8	146.6	-3.5	-12.6
1.2 Livestock	153.2	170.5	-3.3	11.3
2 Fisheries	**143.4**	**151.6**	**-6.6**	**5.7**

(a) Revised
(b) Provisional

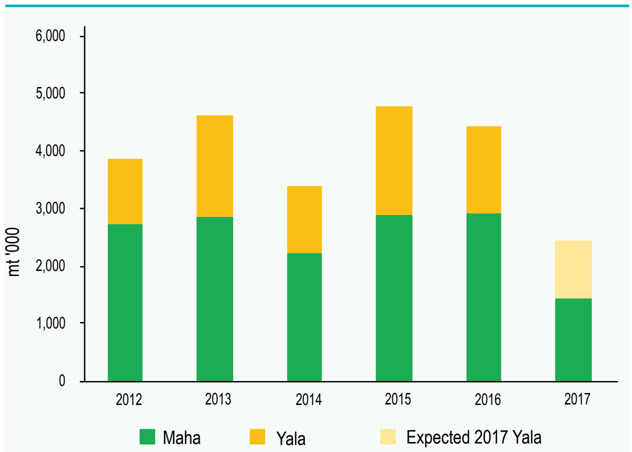
Source: Central Bank of Sri Lanka

Paddy

- **According to available information, paddy production is estimated to drop significantly by around 46 per cent in 2017 compared to the previous year**. Adverse weather conditions that prevailed during the 2016/17 Maha season and the 2017 Yala season are expected to cause a low production of 2.4 million metric tons during the year, which would be the lowest level of annual paddy production over the last decade. Paddy production during the 2016/17 Maha season was significantly impacted by dry weather conditions experienced in major paddy producing areas. This is expected to have resulted in a decline in the 2016/17 Maha paddy production by 51.1 per cent to 1.42 million metric tons according to the Department of Census and Statistics (DCS). Meanwhile, the estimated gross extent sown was 531,440 hectares, which is a 29.7 per cent reduction when compared with the previous Maha season. The drought conditions also had an impact on the island-wide extent of paddy harvested during the 2016/17 Maha season, resulting in a considerable decline of 44.4 per cent to 371,339 hectares, compared with the 2015/16 Maha season. Meanwhile, according to the DCS, paddy production during the 2017 Yala season, which is mainly irrigated by stored water is estimated to have declined by 32.2 per cent in comparison to the previous Yala season, resulting in a production of 1.02 million metric tons. Lower output during the Yala season is mainly due to the effect of the widespread drought and the periodic floods in the wet zone. The estimated gross extent sown for the 2017 Yala season at 269,596 hectares, is a decline of 30.0 per cent from the previous Yala season. Meanwhile, the harvested extent is also estimated to have declined by 33.1 per cent to 229,929 hectares in comparison to the previous Yala season.

- **Out of the stock of available paddy, about 1.5 million metric tons of rice is expected to be milled, resulting in a shortage of around 800,000 metric tons of rice for 2017.** Low harvests and diminishing reserves drove up local prices, necessitating the government to take proactive measures to encourage rice imports. Accordingly, 337,769 metric tons have been imported at a total cost of US dollars 131.8 million during the first six months of this year, compared to 15,231 metric tons of rice imports during the first half of 2016. Meanwhile, the approval of the Cabinet of Ministers was granted to release stocks of paddy available with the Paddy Marketing Board (PMB) in a timely manner in order to dampen price pressures in the market. Accordingly, the Lanka Sathosa network sold rice milled from paddy purchased from the PMB.

Chart 2.2
Paddy Production



Source : Department of Census and Statistics

- **Although open market paddy prices were on a declining path in the first quarter with 2016/17 Maha season stocks entering the market, prices increased thereafter due to diminishing supplies**. The average price of Samba paddy was Rs. 48.10 per kilogramme in the first half of 2017, which is an increase of 26.6 per cent in comparison with the first half of 2016. Meanwhile, the average price of Nadu paddy also increased by 51.1 per cent to Rs. 48.33 per kilogramme during the first six months of 2017 compared to the first half of 2016. The shortage in the paddy supply caused an increase in retail rice prices, which prompted the government to take various measures to stabilise rice prices. These measures included the introduction of a maximum retail price for rice, which was subsequently removed on 16 August 2017, while augmenting the supply with imported rice and the reduction of taxes imposed on imported rice varieties. The average retail price of Samba was Rs. 95.21 per kilogramme during the first half of 2017, recording a marginal increase of 1.8 per cent compared to the same period of 2016. The average retail price of Nadu was Rs. 87.03 per kilogramme, which was an increase of 11.9 per cent compared to the same period of the previous year.

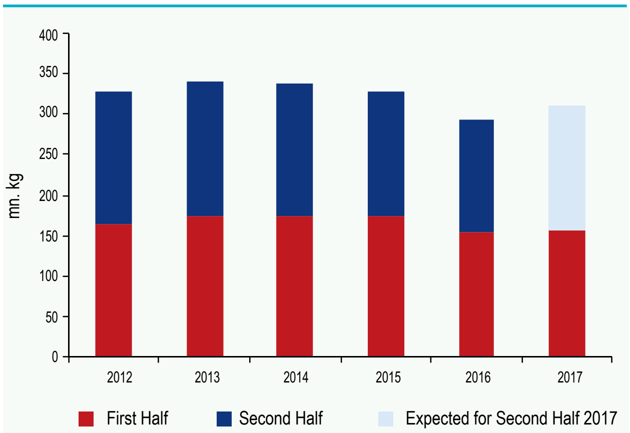
Tea

- **Tea production increased marginally during the first half of the year, mainly supported by the increased production from low elevations**. Tea production during the first six months of 2017 at 155.5 million kilogrammes recorded a marginal increase of 0.8 per cent over the corresponding period in 2016. Low grown tea, which accounts for 62.0 per cent of the total tea production, increased by 2.6 per cent to 95.9 million kilogrammes during the first six months of 2017, while high grown and medium grown tea production dropped by 2.4 per cent and 1.1 per cent to 35.5 million kilogrammes and 24.1 million kilogrammes, respectively. The tea smallholder sector increased its contribution to the total tea production to 74.4 per cent during the first half of 2017 from 60.0 per cent during the first half of 2016. However, a reduction in the production volume was observed in tea smallholdings towards the end of the first half of 2017 due to unfavourable weather conditions, particularly with the damages caused by severe floods in May 2017 and lower average yields.

- **A considerable increase in international prices was observed during the first half of 2017 in the backdrop of a substantial drop in global tea production in 2016 which continued into the first half of 2017 as well**. Tea prices at the Colombo Tea Auction (CTA) witnessed an upward trend since September 2016. The average price at the CTA for the first half of 2017 increased by 46.7 per cent to Rs. 618.33 per kilogramme from Rs. 421.41 per kilogramme in the corresponding period of the previous year. The highest increase was recorded for medium grown tea (50.1 per cent) followed by low grown tea (47.7 per cent) and high grown tea (47.2 per cent). The export price of tea (FOB) increased significantly by 30.6 per cent to Rs. 796.34 per kilogramme during the first half of 2017, from Rs. 609.88 per kilogramme recorded during the corresponding period of 2016. Meanwhile, the average price received by tea smallholders for green leaf increased to Rs. 89.98 per kilogramme during the first half of 2017 from Rs. 62.20 per kilogramme during the first half of 2016.

Chart 2.3

Tea Production



Source : Sri Lanka Tea Board

Rubber

- **Unfavourable weather conditions had an adverse impact on rubber production during the first half of the year**. Rubber production in the first half of 2017 witnessed a decline of 5.9 per cent to 45.1 million kilogrammes, in comparison to the first half of 2016. Sheet rubber production, the largest component of total rubber production, declined by 5.9 per cent to 22.5 million kilogrammes, while crepe rubber production decreased by 11.9 per cent to 6.8 million kilogrammes. Meanwhile, the production of centrifuged latex and other category of rubber also recorded a decline of 2.9 per cent to 15.7 million kilogrammes during the first half of 2017, vis-a-vis the corresponding period of the previous year. The decline in production was partly attributable to severe floods in traditional rubber growing areas in May 2017, which caused heavy damage to the plantation sector. A considerable number of estates in the Southern and Western Provinces were at a complete standstill due to the floods, whilst some factories were inaccessible due to landslides. However, rubber production for the year 2017 may increase above 2016 levels, particularly in response to relatively high prices in the market.

- **With the increase in global rubber prices amidst stronger demand for natural rubber, the domestic market also witnessed an increasing trend in prices during the first half of 2017**. The favourable global demand with stronger demand for natural rubber from the major markets improved the prices of Ribbed Smoked Sheet 1 (RSS1) and latex crepe. The average price of RSS1 registered a significant increase of 44.5 per cent, to Rs. 331.65 per kilogramme whilst the average price of latex crepe witnessed an increase of 11.2 per cent to Rs. 312.10 per kilogramme at the Colombo Rubber Auction during the first half of 2017. China, the largest rubber consuming country in the world, increased its import volumes as their buffer stocks were gradually depleting. This indicates that the demand for domestic rubber is likely to increase in the medium term, which is an encouraging development for the local rubber industry.

2

Coconut

- **The decline in coconut production witnessed in the previous year was observed in the first half of 2017 as well**. The output fell to 1,289.0 million nuts in the first half of 2017 from 1,483.8 million nuts in the corresponding period of 2016. The drop in production was mainly due to the lagged effect of the drought that prevailed during 2016. Meanwhile, dry conditions experienced in certain parts of the coconut triangle were conducive to the proliferation of mite infestation, which also had a negative impact on the output. The production and export of all three major kernel products declined considerably in the first half of 2017, mainly due to the depressed nut output during the period. Desiccated coconut (DC) production, declined by 32.5 per cent to 16,444 metric tons, from 24,361 metric tons in the first half of 2016. Coconut oil production, which reported a considerable decline in 2016, suffered a further setback during the first half of 2017 due to the low crop, which resulted in high fresh nut prices. Accordingly, coconut oil output declined by 61.2 per cent to 9,689 metric tons. Meanwhile, copra exports and fresh nut exports also declined by 52.9 per cent and 20.9 per cent, respectively, during the period. However, in contrast, coconut cream, milk powder and milk production, which together consume around 2 per cent of the total nut production, recorded a 1.2 per cent improvement compared to the previous year, reflecting a notable change in the traditional export structure of coconut products as well as in domestic lifestyles.

- **With the decline in production, the average price of coconut and major coconut based commodities in the local market remained at elevated levels during the first half of 2017**. In line with the shortfall in nut production, the average wholesale price of a nut increased by 71.7 per cent to Rs. 55.80 and the corresponding retail price increased by 32.8 per cent to Rs. 61.71 per nut. Compared to the first half of 2016, the local market price of a kilogramme of DC and a bottle of 750 millilitres of coconut oil rose by 55.7 per cent and 44.4 per cent, respectively. Meanwhile, the average export price (FOB) of DC increased by 31.6 per cent to Rs. 318.18 per kilogramme. However, Sri Lanka could not benefit from high international prices due to inadequate stocks of nuts. Furthermore, the average FOB price of coconut oil and copra also reported significant increases of 8.2 per cent and 34.8 per cent, respectively, in rupee terms. In the wake of increasing coconut oil prices in the domestic market, the government reduced the Special Commodity Levy on the import of edible oils by Rs. 20.00 per kilogramme with effect from 23 February 2017. This led to a large volume of palm oil imports, which increased by 23.7 per cent to 91,497 metric tons during the first half of 2017. In the meantime, the government allowed a consignment of coconut imports for experimental purposes. Attractive farm gate prices received during the period coupled with the assistance extended to revive the coconut sector, are expected to encourage growers to increase fertiliser application and improve management practices to achieve higher yields, which is expected to impact future coconut production favourably.

Other Field Crops

- **Almost all the other field crops (OFCs) showed a decline in production during the 2016/17 Maha season due to the impact of unfavourable weather conditions that prevailed at the commencement of the agricultural seasons**. Accordingly, production of OFCs at 317,647 metric tons registered a decline of 20.9 per cent during the 2016/17 Maha season compared to the previous Maha season, while the extent cultivated declined by 25.0 per cent to 87,004 hectares. However, production of sorghum, soya bean and meneri recorded an increase during the 2016/17 Maha season vis-a-vis the previous Maha season. Meanwhile, weather related disturbances delayed OFC cultivation during the 2017 Yala season as well and the cultivated extent was also considerably lower than the 2016 Yala season.

Vegetables

- **According to estimates of the DCS, vegetable production during the first half of 2017 increased by about 3 per cent to 950,467 metric tons, compared with the first half of 2016.** However, up-country vegetable production was affected by adverse weather conditions and, as a result, recorded a decline in the 2016/17 Maha season. In contrast, the production of low-country vegetables such as luffa, ladies' fingers, bitter gourd, red pumpkin, long bean, winged bean and vatana increased considerably. With the delay in the onset of the North-Eastern monsoons, the commencement of the Maha season cultivation, particularly in the up-country areas, was also delayed. Meanwhile, both up-country and low-country vegetable prices remained high during the reference period, except during January where supplies increased with the peak Maha harvesting season reaching the market. Further, heavy rainfall resulted in floods and landslides and hampered the supply of vegetables, contributing to a sharp increase in prices during June. Prices continued to remain high thereafter with the approach of the off-season. In addition to the general consumption demand for vegetables, there was an increased demand from the export markets as well. Vegetable exports in the first half of 2017 increased by 2.4 per cent to 10,887 metric tons from the corresponding period of the previous year.

Sugar

- **Sugar production declined to 14,654 metric tons during the first half of 2017, which was a decline of 36.8 per cent over the corresponding period of 2016.** The lower production is a combined outcome of the decrease in the volume of sugarcane crushed at all factories and the decline in the Sugar Recovery Rate.[1] Sugar production at Sevanagala factory decreased by 39.7 per cent, while the output at Pelwatte and Gal Oya factories decreased by 39.1 per cent and 29.0 per cent, respectively. Low rainfall that occurred intermittently with erratic weather patterns created unexpected dry conditions in Sevanagala, Pelwatte, Siyabalanduwa and Hingurana during the first half of 2017. Adverse weather conditions increased the severity of moisture stress while retarding crop growth, which lowered the sugar recovery rate. The total cane input crushed at the three factories decreased by 29.6 per cent to 217,264 metric tons. The overall sugar recovery rate declined from 7.7 per cent in the first half of 2016 to 6.7 per cent in the first half of 2017, mainly due to the lower recovery rate at Pelwatte and Sevanagala factories. Sugar imports also decreased by 8.9 per cent to 265,384 metric tons during the first half of 2017 compared to the corresponding period in 2016. It is expected that the total sugar production would increase by 13.5 per cent to 61,000 metric tons in 2017, which would be adequate to meet around 9 per cent of the national requirement. Meanwhile, the Board of Investment of Sri Lanka entered into an investment agreement with a new investor to revive and restructure the Kantale sugar factory. The restructured Kantale sugar factory is expected to process 4,000 metric tons of sugarcane per day, resulting in producing 72,000 metric tons of sugar per year, while also generating electricity by burning sugarcane fibre and produce dairy products.

Fisheries

- **During the first half of 2017, total fish production increased by 5.7 per cent to 252,940 metric tons.** Production in the marine sector, which accounts for 90 per cent (227,890 metric tons) of total fish production, increased by 4.8 per cent. The growth recorded in the marine sector is partly due to the lifting of the European Union (EU) ban for Sri Lankan fish exports in June 2016. Furthermore, policy measures which were implemented towards the removal of the fish ban will ensure the sector's sustainability in the long run by limiting overexploitation of marine resources. However, the growth in the marine sector was affected by the loss of fishing days due to adverse weather conditions experienced in the Western and Southern coastal areas during

[1] Sugar Recovery Rate = $\frac{\text{Sugar Produced}}{\text{Quantity of Cane Crushed}} \times 100$

May 2017. Meanwhile, inland and aquaculture fish production increased by 15.0 per cent to 25,050 metric tons in the first half of 2017. The increase in inland and aquaculture fish production could be mainly attributed to the improved management of the water bodies with community participation, establishing community based mini-hatcheries and free issue of fingerlings.

Livestock

- **The livestock sector recorded a favourable performance during the first half of 2017**. According to estimates of the Department of Animal Production and Health (DAPH), milk production increased by 13.5 per cent, to 222.3 million litres during the first half of 2017, from the corresponding period in 2016. Cattle milk production, which accounted for around 83 per cent of total milk production, increased by 13.6 per cent to 185.5 million litres, whilst buffalo milk production increased by 13.1 per cent to 36.8 million litres. Meanwhile, according to DAPH projections, overall milk production would increase by 8.0 per cent to 490 million litres in 2017, which would be sufficient to meet around 63 per cent of the total domestic demand. Meanwhile, egg production registered an increase of 9.4 per cent to 1,233.5 million in the first half of 2017, prompted by increased imports of layer parents in 2016, resulting in a higher pullet and egg production in the country. However, layer parent imports reduced from 66,597 in the first half of 2016 to 53,146 during the corresponding period of 2017. In the meantime, poultry meat production at 93,000 metric tons recorded an increase of 15.1 per cent during the first half of 2017. Production of pork increased by 11.3 per cent, while beef production witnessed a decline of 4.4 per cent during the first half of 2017. The average cost of poultry meat production experienced a decline during this period, mainly due to the reduction in prices of day-old chicks. The broiler parent imports were affected by the spread of highly pathogenic avian influenza in bird exporting countries, resulting in a 42.7 per cent decline in imports. However, the local production of broiler parents increased by 7.0 per cent in the first half of 2017 compared to the same period of 2016.

Industries

- **As per GDP estimates, Industry activities expanded by 5.8 per cent in value added terms during the first half of 2017, at the same pace of growth recorded in the corresponding period of 2016.** This growth was largely attributable to the continued expansion in construction activities supported by thriving mining and quarrying activities during this period. Meanwhile, manufacturing activities also contributed positively, yet at a slower pace compared to the first half of 2016. In the meantime, sewerage, waste treatment and disposal activities, and water collection, treatment and supply activities grew substantially during the first half of the year. However, electricity, gas, steam and air conditioning supply activities grew marginally during the first half of 2017.

- **The expansion in Industry activities was supported by the considerable increase in construction activities, which grew by 12.8 per cent in value added terms during the first half of 2017 in comparison to 13.5 per cent growth recorded in the corresponding period of 2016.** This upsurge in construction activities also provided stimulus for the substantial growth in mining and quarrying activities, which grew by 18.1 per cent in value added terms during the first half of 2017 in comparison to a growth of 4.9 per cent recorded in the same period of 2016. Meanwhile, the value added of manufacturing activities, which is the largest segment of industrial activities, recorded a modest growth of 0.9 per cent during this period compared to a 2.2 per cent growth in the first half of 2016. The slower growth in manufacturing activities was mainly attributed to the setback recorded in the manufacture of food, beverages and tobacco products, and manufacture of coke and refined petroleum products, which contracted by 1.1 per cent and 15.2 per cent, respectively, during the first half of 2017 compared to the corresponding period of 2016. However, positive contributions particularly from the manufacture of other non-metallic mineral products, textiles, wearing apparel and leather related products, furniture, machinery and equipment, and rubber and plastic products were large enough to offset negativity in key activities to record a positive growth in manufacturing activities. Accordingly, the manufacture of furniture expanded while other non-metallic mineral products and manufacture of textile, wearing apparel and leather related products recovered during the first half of 2017 compared to the same period in 2016. Considering other Industrial activities, sewerage, waste treatment and disposal activities grew by 10.7 per cent in value added terms during the first half of 2017 compared to the growth of 21.0 per cent in the corresponding period of 2016. Meanwhile, the value added of water collection, treatment and supply activities expanded significantly by 13.3 per cent during the period compared to the growth of 3.8 per cent recorded in the first half of 2016. Further, the value added of electricity, gas, steam and air conditioning supply activities recorded relatively slow growth of 1.2 per cent in the first half of 2017 in comparison to the growth of 8.9 per cent recorded during the same period of 2016.

Production Trends and Institutional Support: Manufacturing Activities

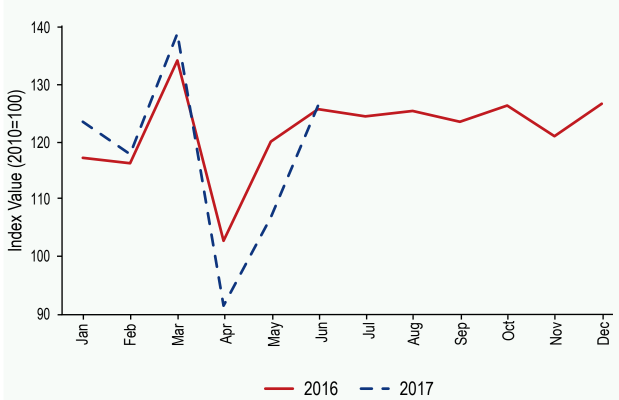
Factory Industry Production Index[2]

- **The Factory Industry Production Index (FIPI) registered a decline of 1.8 per cent during the first half of 2017 compared to decline of 2.3 per cent in the same period of 2016.** Production disturbances that occurred due to adverse weather conditions coupled with stagnant levels of productivity and competitiveness, lack of product and market diversification, labour shortages and the competition from cheap imports in some industries contributed to this decline. Meanwhile, the increased cost of credit and the overvalued exchange rate may also have discouraged new investments to some extent. Consequently, the sub-indices of the FIPI relating to apparel, beverages, tobacco products, leather and related products, refined petroleum products and basic metals declined during the first half of 2017 compared to the corresponding period in 2016. However, production of food, chemicals and chemical products, rubber and plastic products, other non-metallic mineral products, fabricated metal products, wood products except furniture and electrical equipment recorded a modest increase in output.

- **The food products subsector, which is the largest subsector in the FIPI, recorded a modest increase of 2.6 per cent during the first half of 2017 compared to the first half of 2016.** This subsector was severely affected by floods that occurred during May 2017 as well as the resultant reduction in supplies, disruption to production, supply and distribution networks and low employee attendance. Nevertheless, prepared meals, margarine, cocoa, chocolate and confectionery, starch products, bakery products, dairy products and animal feed recorded an increase during the first half of 2017 compared to the first half of 2016. Factory processing of tea recorded a marginal decline as a result of adverse weather.

- **The wearing apparel subsector, which is the second largest subsector in the FIPI, experienced a setback during the first half of 2017, reporting a reduction of 5.4 per cent in the sub-index compared to the first half of 2016.** Lower demand for selected categories of apparel exports from traditional export destinations such as the USA and the EU was

Chart 2.4
Factory Industry Production Index (FIPI)

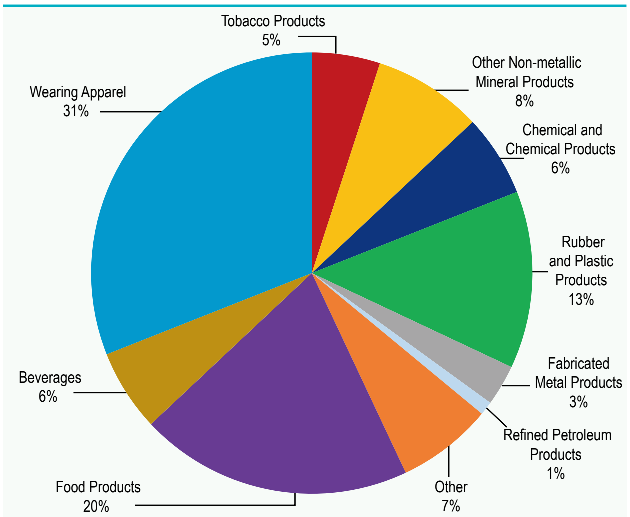


Source : Central Bank of Sri Lanka

2 The weights in this index have been assigned using 2010 as the base year. Industries have been categorised according to the International Standard Industrial Classification (ISIC) Revision 4. The Department of Census and Statistics compiles the Index of Industrial Production (IIP) with 2015 as the base year and has commenced using the IIP for National Accounts compilation as well. Accordingly, the IIP will be used as the basis for analysis from the next issue of the Recent Economic Developments publication.

2

Chart 2.5
Composition of Factory Industry Production Index (FIPI)
First Half 2017



Source : Central Bank of Sri Lanka

the key reason for the poor performance of this subsector. However, the apparel subsector is expected to rebound during the second half of the year, supported by an increase in export volumes with the reinstatement of the GSP+ and the competitive strategies pursued by the industry to compete in high-end apparel segments.

- **The rubber and plastic products subsector grew by 4.9 per cent during the first half of 2017, compared to the first half of 2016.** Increased production of air tyres and solid tyres to cater to international markets in the USA, Germany and Brazil as well as the local market contributed to this growth. Export demand for industrial and surgical gloves too expanded considerably.

- **The output of the tobacco products subsector declined by 29.3 per cent during the first half of 2017 compared to the first half of 2016.** This was primarily due to lower consumer demand arising from higher cigarette prices caused by the increase in excise duties during the latter part of 2015 and further price increases during 2016.

- **The beverages subsector contracted by 14.7 per cent during the first half of 2017 compared to the first half of 2016.** A reduction in production volumes of alcohol, malted drinks and soft drinks contributed to the decline in the output of this subsector. Alcohol production was adversely affected by the increase in import duties for alcohol imports for blending purposes and the imposition of the VAT. However, the mineral and bottled water subsector recorded a substantial growth owing to increased distribution of bottled water to areas affected by adverse weather conditions.

- **The non-metallic mineral products subsector grew by 4.7 per cent during the first half of 2017.** Increased manufacturing of cement was the key contributory factor towards this improved performance. The production of roofing tiles and ready-mix concrete declined significantly due to new regulations on sand excavation as well as lower mining and excavation activities in the flood-affected areas. Manufacturing of porcelain and ceramic products declined during the reference period. High costs of production in Sri Lanka compared to its Asian competitors adversely affected the competitiveness of Sri Lankan products in the local and foreign porcelain and ceramic market. Manufacturing of glass products picked up due to the increase in production capacity.

- **The chemicals and chemical products subsector grew by a significant 24.2 per cent during the first half of 2017 largely due to the increased output in paints, varnishes, printing ink, and soap and detergent products.** In the meantime, the production of fertiliser for some plant categories gained momentum under the new fertiliser subsidy scheme. However, the slowdown in agricultural activities as a result of drought conditions suppressed the demand for some fertiliser products. Meanwhile, the fabricated metal products, except machinery and equipment subsector, which consists mainly of ship building and repair activities, experienced an increase in production with a growth of 33.4 per cent during the first half of 2017.

- **The electrical equipment subsector expanded by about 12.4 per cent during the first half of 2017 compared to the corresponding period of 2016.** The manufacturing of wires, cables and optical isolators recorded an increase while the production of transformers declined marginally. Manufacturing of batteries increased during this period, highlighting the need to setup a mechanism for recycling used batteries in Sri Lanka urgently as these contain toxins and hard metals which severely pollute soil and water.

- **The output in the refined petroleum products subsector, which solely consists of the production in the refinery of Ceylon Petroleum Corporation (CPC), declined by 16.4 per cent during the first half of 2017 as against the positive performance witnessed during the same period of 2016.** The reduced importation of crude oil by the CPC and the increased imports of refined petroleum products, as well as a temporary shutdown of some facilities for repairs contributed to this outcome.

- **Production in the textiles subsector increased during the first half of 2017 recording a growth of 3.3 per cent.** This increase was mainly driven by the increase in the production of knitted fabric used in the production of wearing apparel for the export market.

- **Leather and related products, which showed signs of recovery during 2016, declined by 3.2 per cent during the first half of 2017.** The growth in the manufacturing of finished leather as well as the manufacturing of footwear considerably declined. Although global competition is necessary, it is important to address dumping of such products in order to support the sector to provide high-quality products to the local as well as the export market.

- **Public sector institutions that support the manufacturing sector continued to implement measures aimed at increasing output and productivity of the sector**. The Ministry of Industry and Commerce implemented measures to further develop infrastructure facilities in the existing 32 industrial estates as well as establish an Accredited Food Laboratory to promote the food manufacturing industry. Meanwhile, initial steps were taken for the establishment of the National Business Registry and the Office of the Trade Prosecutor. The National Enterprise Development Authority established an Incubation Technology Transfer Centre at Makandura with the Wayamba University to facilitate micro and small industries in the area and start-up businesses of graduates until these firms attain self-sustainability. The Ministry of Finance and Mass Media took initial steps towards implementing a National Credit Guarantee Scheme and a Venture Capital Fund to improve equity funding for small and medium enterprises (SMEs). The Industrial Technology Institute and the National Science Foundation implemented various measures to improve technological research and knowledge transfer towards manufacturing institutions and undertook many new product development activities and support activities for industries which utilise local raw materials. The Ministry of Skills Development and Vocational Training took measures to improve technical and vocational training activities and to address the acute labour shortage issue in manufacturing and construction industries. The Sri Lanka Chamber of Small and Medium Enterprises, Ceylon Chamber of Commerce, the National Chamber of Commerce of Sri Lanka and the Federation of Chambers of Commerce and Industry of Sri Lanka facilitated the manufacturing sector by organising seminars on areas such as economic matters, trade, exports, innovation and skills development. In order to promote the export of manufactured products, the Export Development Board (EDB) held a symposium to assist in the development of the National Export Strategy and provided technical support to all concerned stakeholders. The other initiatives of the EDB during the first half of 2017 included the “2000 exporters development programme”, the Ornamental Fish Trade Conference, product development programme for footwear manufacturers, technical training and exposure programme for rubber product manufacturers and the facilitation of inbound and outbound international trade delegations. In order to support apparel manufacturing, the Joint Apparel Association Forum (JAAF) and the Sri Lanka Institute of Apparel and Textiles provided training facilities on 3D printing and multi-task machinery handling for small scale apparel manufacturers.

Services

- **The value added of Services related economic activities expanded by 4.0 per cent during the first half of 2017 in comparison to the growth of 3.6 per cent recorded in the corresponding period of 2016.** This growth was mainly attributable to the continuous expansion in financial services, and wholesale and retail trade activities. Further, transportation, human health, other personal services, real estate activities, education, accommodation related services, insurance related activities and telecommunication services contributed positively to growth. However, public administration, professional services, and programming and broadcasting activities contracted during the first half of the year, dampening the Services growth.

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

- **The wholesale and retail trade, transportation and storage, accommodation and food service activities grew by 3.4 per cent in value added terms during the first half of 2017 compared to the growth of 2.4 per cent recorded in the corresponding period of 2016.** All sub activities within this segment contributed positively to this growth. The continuous expansion in wholesale and retail trade activities, which grew by 4.2 per cent in value added terms during the first half of 2017, compared to 1.9 per cent growth recorded in the same period of 2016, largely supported this growth. Further, transportation of goods and passengers including warehousing activities expanded by 2.3 per cent in value added terms during the period, compared to the growth of 2.7 per cent recorded in the corresponding period of 2016. Furthermore, accommodation, food and beverage service activities, and postal and courier activities grew by 3.5 per cent and 6.0 per cent, respectively, in value added terms during the first half of 2017 compared to the expansion of 3.7 per cent and 7.3 per cent, respectively, recorded in the same period of 2016.

Information and Communication Activities

- **The value added of information and communication activities grew by 6.3 per cent during the first half of 2017 compared to 10.8 per cent growth recorded in the corresponding period of 2016.** This growth was largely attributable to the development in telecommunication services, which grew by 7.9 per cent in value added terms in the first half of 2017 compared to the growth of 12.1 per cent recorded in the corresponding period of 2016. Further, value added of IT programming consultancy and related activities continued to increase by 3.3 per cent during the period under consideration, on top of the 6.9 per cent growth recorded in the same period of 2016, contributing positively to the growth within the segment. However, programming and broadcasting activities and audio video production activities contracted marginally by 0.7 per cent in value added terms during the first half of the year as opposed to the growth of 12.4 per cent recorded in the corresponding period of 2016.

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

- **The financial, insurance and real estate activities including ownership of dwellings expanded by 9.4 per cent in value added terms during the first half of the year, in comparison to a growth of 8.4 per cent recorded in the corresponding period of 2016.** This expansion was mainly fuelled by the continuous development in financial service activities and auxiliary financial services, which grew by 15.8 per cent in value added terms during the period, compared to the growth of 14.5 per cent in the corresponding period of 2016. Further, real estate activities, including ownership of dwellings, grew by 2.7 per cent in value added terms during the first half of the year, compared to the growth of 2.5 per cent in the same period of 2016. Moreover, value added of insurance, reinsurance and pension funding activities grew by 6.5 per cent in the first half of 2017 compared to a growth of 8.7 per cent in the corresponding period of 2016.

Professional Services and Other Personal Service Activities

- **Professional services and other personal service activities grew by 1.6 per cent in value added terms during the first half of 2017 in comparison to a growth of 0.9 per cent in the corresponding period of 2016.** This growth was mainly driven by the improvement in other personal services activities, which grew by 2.0 per cent in value added terms during the period, compared to the growth of 1.8 per cent recorded in the corresponding period of 2016. However, professional services activities contracted by 0.8 per cent during the first half of 2017 compared to the contraction of 3.9 per cent posted in the same period of 2016, thus continuing its declining trend and dampening the overall growth within this segment.

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

- **The public administration, defence, education, human health and social work activities grew marginally by 0.8 per cent in value added terms during the first half of 2017 in comparison to the growth of 3.4 per cent recorded in the corresponding period of 2016.** This slowdown was largely attributable to the contraction of 4.8 per cent recorded in value added of public administration and defence, compulsory social security activities during the period as opposed to the growth of 5.2 per cent recorded in the corresponding period of 2016. However, the value added of human health, residential care and social work activities significantly grew by 12.4 per cent during the period, recovering from the contraction of 3.1 per cent recorded in the corresponding period of 2016. Further, education services grew by 4.3 per cent in value added terms during the first half of 2017 compared to the growth of 5.1 per cent recorded in the same period of 2016.

Expenditure

- **Gross Domestic Expenditure (GDE), which consists of consumption and investment expenditure that represent the domestic demand in the economy, grew by 10.9 per cent in nominal terms during the first half of 2017, compared to the growth of 7.3 per cent recorded in the corresponding period of 2016.** The substantial growth in both investment and consumption expenditure contributed to this expansion. The investment expenditure grew by 12.0 per cent in nominal terms during the first half of 2017 compared to the growth of 12.5 per cent in the corresponding period of 2016, while consumption expenditure grew by 10.5 per cent in nominal terms during the period vis-à-vis a growth of 5.2 per cent in the first six months of 2016. However, net external demand worsened during the first half of 2017, contracting significantly by 22.7 per cent in nominal terms in comparison to a contraction of 2.8 per cent recorded in the corresponding period of 2016. This decline was attributable to the higher growth in imports relative to exports during the period. Consequently, GDP, which comprises of the aggregate of domestic demand and external demand, grew by 10.1 per cent in nominal terms during the first half of 2017 compared to the growth of 7.6 per cent recorded in the corresponding period of 2016.

- **GDE in 2017 is projected to grow by 8.7 per cent in nominal terms to Rs. 13,850 billion in comparison to a growth of 8.2 per cent recorded in 2016.** The increase in investment activities in tandem with the expansion in consumption expenditure is expected to contribute to the growth in GDE. However, net external demand is projected to contract by 8.3 per cent in 2017 although at a slower pace than 9.6 per cent contraction recorded in the previous year. Consequently, GDP is projected to grow by 8.7 per cent in nominal terms during 2017 registering Rs. 12,871 billion, in comparison to a 8.1 per cent growth recorded in 2016.

2

Consumption

- **Consumption expenditure, which accounts for the highest share in aggregate demand, is projected to grow by 7.9 per cent in nominal terms in 2017 compared to a 4.1 per cent growth in 2016.** Private consumption expenditure, which witnessed some slowdown in 2016 is anticipated to increase during the year, continuing the trend observed in the first half of 2017. Accordingly, the private consumption expenditure is projected to grow by 8.3 per cent in nominal terms in 2017 compared to 4.3 per cent growth recorded in 2016. Based on the approved budget estimates and progress during the first half of 2017, public consumption expenditure is expected to increase at a moderate pace during the year, in line with the fiscal consolidation path of the government.

Investment

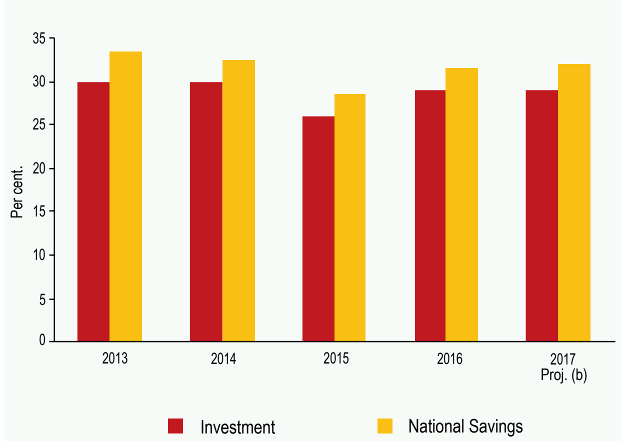
- **Investment expenditure in nominal terms is expected to grow by 10.6 per cent during 2017 compared to the 19.6 per cent 2016.** Investment expenditure is expected to be mainly driven by private investment activities while public investment activities would increase at a moderate pace. Construction activities have expanded substantially as reflected by the significant increase in cement availability and building material imports during the first six months of 2017. Further, the Cost of Construction Index also recorded a positive growth during the first half of 2017, indicating the expansion in construction activities in nominal terms. Moreover, credit granted by commercial banks to the private sector for personal housing, including purchase/construction/repair activities, also grew at a higher rate by end June 2017 compared to the corresponding period of 2016. Meanwhile, the importation of investment goods including machinery and equipment and other investment goods, increased both in volume and value terms as reflected by trade indices during the first half of 2017. It is envisaged that these developments would continue during the rest of the year stimulating investment growth. Accordingly, investment expenditure as a percentage of GDP is expected to increase to 32.0 per cent in 2017, from 31.5 per cent in 2016.

- **Inflows of Foreign Direct Investments (FDI) to projects approved by the Board of Investment (BOI), including loans to such projects, amounted to US dollars 601.3 million in the first half of 2017 compared to US dollars 332.2 million in the first half of 2016, reflecting a year-on-year growth of 81.0 per cent.** FDI inflows relating to infrastructure projects, services and manufacturing increased respectively by 138.2 per cent, 15.1 per cent and 93.8 per cent. Majority of FDI during the period was on account of infrastructure related projects representing around 46 per cent of total FDI (US dollars 276.6 million). FDI in the manufacturing sector amounted to around 31 per cent of total FDI inflows (US dollars 185.6 million), whereas FDI in the services sector amounted to US dollars 138.5 million representing about 23 per cent of total FDI during the first half of 2017.

Savings

- **Domestic savings as a percentage of GDP, are projected to increase while national savings would remain marginally below the level recorded in the previous year**. Domestic savings are expected to increase to 24.4 per cent of GDP in 2017 from 23.8 per cent of

Chart 2.6
Investment and Savings as a Percentage of GDP (a)



(a) The data is based on the base year 2010 GDP estimates of the Department of Census and Statistics
(b) CBSL estimates based on the medium term macroeconomic framework

GDP in 2016. It is envisaged that the government dis-savings would decline, contributing to the expected improvement in domestic savings in 2017. In the meantime, in rupee terms, net primary income from the rest of the world is anticipated to contract at a slower pace in 2017 compared to the previous year, while net current transfers from the rest of the world are projected to grow at a slower rate during 2017 mainly on account of the slow growth in workers' remittances. Accordingly, national savings as a percentage of GDP are projected at 29.0 per cent in 2017 compared to 29.1 per cent recorded in 2016.

Expected Developments

- **The Sri Lankan economy is expected to grow by around 6.0 per cent in real terms in 2018 as per the medium term macroeconomic framework.** The growth is expected to be broad based buoyed by all major economic activities. Further, improvements in the investment climate are expected to boost domestic and foreign private investments in the country.

- **The agriculture activities are expected to recover partially in 2018 from the impact of adverse weather conditions experienced in 2017, amidst favourable domestic and global conditions**. The tea industry is expected to gather momentum in 2018 with perceived higher international prices, encouraging domestic tea producers to increase production. However, the cost of tea production is expected to increase, adversely affecting profit margins while yield per hectare is expected to remain at low levels. Meanwhile, the export demand for rubber, amidst depleting global stocks, is expected to provide an impetus for the local rubber industry in 2018. However, it is imperative that rubber cultivation is extended to non-traditional areas to ensure the long-term viability of the industry as per the Rubber Sector Master Plan that would address disruptions to tapping operations caused by the persistent heavy rainfall in traditional rubber growing areas. Although the lagged effect of the drought that prevailed since the second half of 2016 resulted in a substantial decline in coconut production in 2017, intermittent rainfall received during this year would stimulate nut setting leading to an increase in coconut production in 2018 compared to 2017. Subsequent to the lifting of the EU ban on fish exports from Sri Lanka, the fisheries sector performance is expected to further improve during 2018. Growth in inland and aquaculture fish production is envisaged to increase due to better management practices adopted for inland water bodies during 2017. Measures taken through the effective implementation of the Livestock Sector Master Plan would enable the dairy and poultry sectors to move in to a higher level of production in 2018. It is expected that the domestic dairy production, which has seen an increasing trend during recent years, would be sufficient to meet around 60 per cent of the local requirement in 2018.

- **The industry related economic activities are expected to continue the positive momentum in 2018**. Manufacturing activities are expected to provide a high contribution to industry activities supported by the improvement in macroeconomic conditions, continuous efforts of the government to attract FDI and the favourable impact of the GSP+ concession. Regaining of GSP+ is expected to increase apparel exports. In addition, the envisaged development of industrial corridors and logistic facilities are likely to help attract FDI and provide an environment for industrial development in the country. These are expected to be supplemented through conducive and consistent policies on taxation, land administration, labour regulations, along with increased digitalisation and other incentives offered by the government. Meanwhile, SMEs are envisaged to benefit from the new credit guarantee and SME funding schemes introduced by the government. Although trade agreements are a vital linkage in obtaining access to global value chains, the government will have to take necessary steps to enforce the planned anti-dumping policies expeditiously to ensure the growth prospects of the Micro, Small and Medium Enterprises (MSMEs). Another policy priority is the need to upgrade the manufacturing sector as a technologically intensive high value adding sector. Meanwhile, it is expected that the private sector would drive construction activities absorbing the demand for residential and commercial buildings, while government construction activities on essential areas related to infrastructure development are expected to continue, particularly on a PPP basis. Nevertheless, capacity constraints such as skilled labour shortages, skill mismatches, and the increase in the cost of labour and utilities have been identified as issues that need to be addressed in order to unleash the full potential of the industry activities.

- **Services activities are expected to maintain the high growth momentum in 2018, supported by all major economic activities within this segment**. This broad-based growth is expected to be supported by traditional economic activities such as wholesale and retail trade and transport activities as well as more dynamic activities such as financial services, professional services, IT programming, telecommunication and personal services, which have gathered momentum in line with global developments. Initiatives in enhancing supportive services such as transportation, financial services, communication, etc., which provide significant synergy effects in boosting value added of other economic activities, are essential in moving towards this broad-based growth. Implementation of policies to develop the existing road network and to supply better public transportation modes would enhance transport activities. Further, professional services have an enormous potential to contribute towards the growth in this segment through services exports. Appropriate strategies to attract foreign and local ventures and to provide institutional support, together with an enabling environment are essential in promoting such services exports. This would be further facilitated by introducing modern technology to improve education standards, and providing government support to boost innovation, R&D and other technological enhancements related investments. Tourism related activities are also expected to provide positive impetus to the growth within services activities. Thus, policies should focus on developing marketing strategies to promote specific tourism segments with low price elasticity of demand such as medical tourism in addition to traditional tourism segments. Services and Industry oriented activities, which have the potential of contributing to a significant growth in the foreseeable future, currently face a labour shortage, both skilled and unskilled, which is expected to aggravate by 2020. Therefore, attracting foreign investments and developing public–private partnerships to establish demand driven training centres that cater to market needs are crucial at this juncture to address the skills gap and to create a knowledge hub that meets both domestic and international skill requirements.

- **Investment activities, mainly driven by private investment expenditure are expected to maintain its positive growth momentum in 2018, accounting for about 32.5 per cent of GDP.** Private investment expenditure is expected to increase with the prudent government policy measures that would eventually boost investor confidence. Private investment activities specifically related to the construction of condominium and commercial building schemes are expected to contribute towards this growth. Government investment expenditure is also expected to grow at a moderate pace, with prioritised investments on infrastructure development projects to facilitate economic growth.

- **The level of savings in the economy needs to be sustained at a favourable level in stepping to a higher growth trajectory**. In this regard, both private and government savings need to be improved. The government's continuous commitment towards fiscal consolidation and positive real interest rates are expected to improve domestic savings. Meanwhile, adopting appropriate macroeconomic policies to facilitate domestic investments and promote FDIs would help reduce the savings-investment gap of the economy.

3

ECONOMIC AND SOCIAL INFRASTRUCTURE

While recognising the importance of engaging the private sector for the provision of economic and social infrastructure, the government utilised its limited fiscal space to make qualitative and quantitative improvements to these much-needed facilities during the first half of 2017. Continuous progress was witnessed in telecommunication, road development, transportation and ports sectors, as well as in social infrastructure, such as education and health service provision. Amidst severe drought conditions, the country met the growing electricity demand during this period through increased thermal power generation. A Long-Term Electricity Generation Expansion Plan that covers the next 20-year period is expected to be implemented with the aim of ensuring energy security through a sustainable energy policy. With the aim of improving the quality of physical connectivity across regions, development work on the road network of the country, such as expressways and highways, and the i-Road programme, continued during the first half of 2017. Activities under the Western Region Megapolis Master Plan, including those for addressing issues that arise due to rapid urbanisation such as poor housing conditions and waste accumulation, were carried out during this period. On the social infrastructure front, efforts to modernise the education system and enhance equitable access to education for all students across the country continued. In the health sector, several projects were in progress during this period to enhance physical infrastructure. Going forward, ensuring a higher quality standard in social infrastructure delivery by both public and private sectors is vital to enhance the wellbeing of the general public and for overall economic development. Therefore, the government needs to expeditiously implement quality assurance mechanisms, particularly in the education and health sectors, while planning for future challenges. Further encouraging the participation of the private sector in developing economic and social infrastructure would be essential in the coming years due to government budget constraints in the context of rising health care costs associated with an ageing population and increasing costs linked to improving education outcomes, especially in Science, Technology, Engineering and Mathematics, as well as the need to expand training and skills related tertiary education. In this regard, measures should also be expedited to create an enabling environment for public-private partnerships (PPPs) for such service provision.

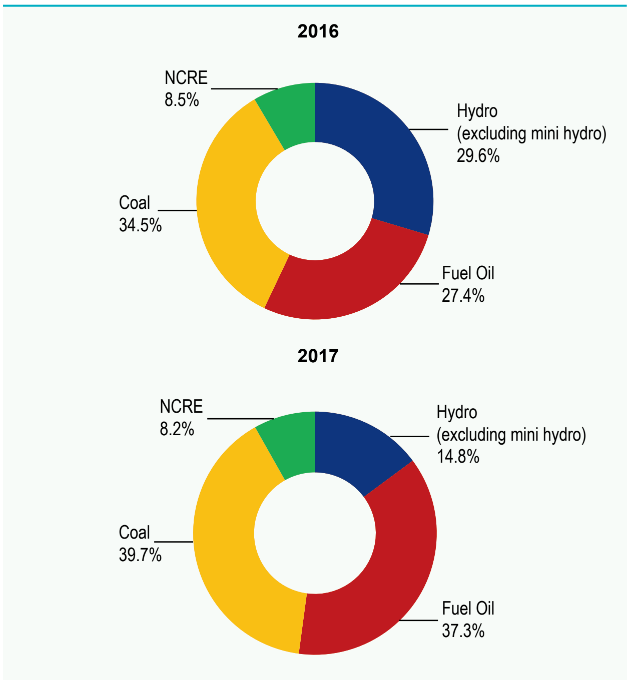
3

Developments in Economic Infrastructure

Electricity

- **During the first seven months of 2017, the total electricity generation increased by 2.9 per cent to 8,374 GWh compared to 8,141 GWh recorded in the corresponding period of 2016.** The drought that prevailed during the first half of the year had an adverse impact on hydropower generation, which declined substantially by 48.5 per cent to 1,243 GWh (excluding mini hydro) in the first seven months of 2017 in comparison to the same period in 2016. Consequently, thermal power generation increased notably to compensate for the reduction in hydropower generation. Accordingly, fuel oil-based power generation and coal power generation increased by 40.0 per cent and 18.5 per cent, to 3,122 GWh and 3,325 GWh, respectively, during the first seven months of 2017, compared to the corresponding period of the previous year. Meanwhile, power generation through Non-Conventional Renewable Energy (NCRE) sources declined by 1.2 per cent to 684 GWh in the first seven months of 2017 in comparison to the same period of 2016. This was mainly due to the reduction in power generation by mini hydropower plants owing to drought conditions. During the period under review, the Ceylon Electricity Board (CEB) contributed 72.9 per cent of the total electricity generation in the country while the remainder was generated by Independent Power Producers (IPPs). The transmission and distribution losses declined in the first seven months of 2017 to 7.4 per cent of the total generation in comparison to 9.7 per cent loss in the first seven months of 2016.

Chart 3. 1
Electricity Generation Mix (Jan-Jul)



Source: Ceylon Electricity Board

- **The total electricity sales in the first seven months of 2017 increased by 5.5 per cent to 7,756 GWh from 7,349 GWh in the corresponding period in 2016.** The growth in demand for electricity was mainly driven by the demand from 'Industry' and 'General Purpose' categories, which absorbed 29.8 per cent and 20.8 per cent of the total electricity sales, respectively. Meanwhile, the electricity consumption by the 'Domestic' category, which accounted for 32.6 per cent of the total electricity sales, also grew in the first seven months of 2017 in comparison to the corresponding period in the preceding year. Further, the electrification level of the country reached 99.43 per cent by end June 2017.

- **The Ministry of Power and Renewable Energy continued its efforts to promote renewable energy generation in the country.** The 'Soorya Bala Sangramaya' programme aims at installing 200MW solar roof-top projects by 2020 and ultimately convert 1 million households to solar energy roof-top plants. In addition, solar power projects of 1MW each, which are expected to generate 60MW in total, will be connected to the national grid under this programme. Competitive bidding and the evaluation process are in progress to select private sector participants for these small-scale power projects. Since the inception of the 'Soorya Bala Sangramaya' programme in September 2016, 2,038 consumers have commenced solar roof-top energy generation through the Net Metering, Net Accounting and Net Plus plans,

Table 3.1
Electricity Sales

Item	2015	2016 (a)	2016 Jan-Jul	2017 Jan-Jul (a)	Change %
Total Sales by CEB (GWh)	11,786	12,785	7,349	7,756	5.5
Domestic	3,876	4,198	2,431	2,542	4.6
Religious	67	74	42	45	6.5
Industrial	3,608	3,864	2,190	2,311	5.5
General Purpose	2,324	2,579	1,489	1,617	8.5
Government	152	160	94	99	5.5
Hotel	205	247	140	153	8.9
Bulk Sales to LECO	1,446	1,553	899	927	3.1
Street Lighting	108	109	63	63	-0.7

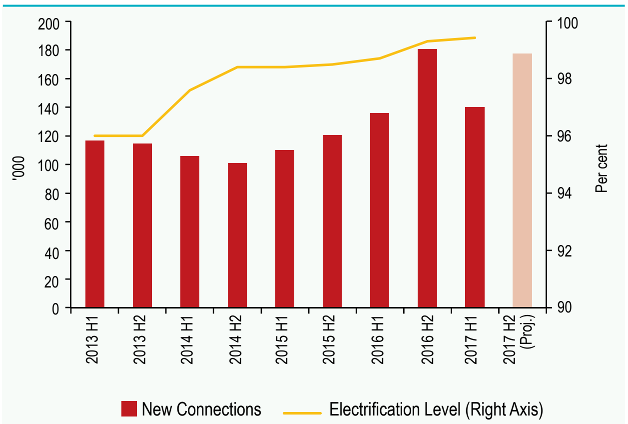
Source: Ceylon Electricity Board

(a) Provisional

3

adding 16.3MW to the national grid by end June 2017. Further, two 10MW solar energy parks in Valaichchenai in the Batticaloa district and Welikanda in the Polonnaruwa district are expected to be commissioned in 2019. Meanwhile, a 100MW solar energy park is being constructed at Siyambalanduwa in the Monaragala district, which is expected to commence energy generation by 2020, while another 100MW solar energy park will be commissioned in Pooneryn in the Kilinochchi district by 2020. Moreover, a 300MW wind energy park is expected to be constructed in Mannar island. Initially, a 100MW wind power plant is planned to be constructed at the site. Meanwhile, the Public Utilities Commission of Sri Lanka (PUCSL) approved the Least Cost Long-Term Generation Expansion Plan of the CEB for the 2018-2037 period with the view of ensuring energy security and continuous supply of electricity in the country. The approved generation plan recommends adding 242MW of major hydro, 215MW of mini hydro, 1,389MW of solar, 1,205MW of wind, 85MW of biomass, 4,800MW of natural gas, 320 MW of furnace oil based, and 105MW of gas turbine capacity to the electricity generation system of the CEB during the next 20-year period. The approved plan is in line with the government's policy target of generating 70 per cent of the country's energy requirement through renewable sources by 2030.

Chart 3.2
New Electricity Connections and Electrification Level



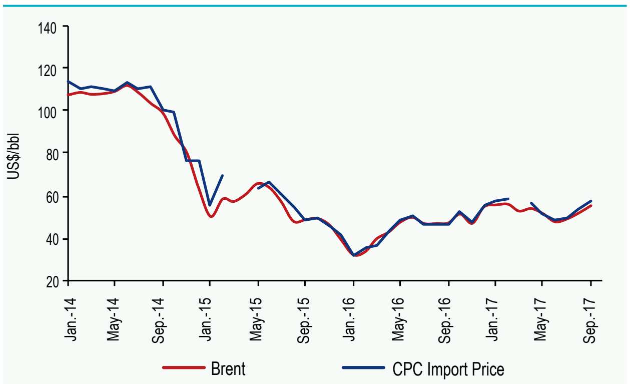
Source: Ceylon Electricity Board

Petroleum

- **The declining trend in global crude oil (Brent) prices observed during the first five months of the year reversed since mid-June, resulting in the average price to remain at an elevated level in the first three quarters of 2017 in comparison to the corresponding period of 2016.** In December 2016, the Organisation of Petroleum Exporting Countries (OPEC) agreed to cut crude oil production for a period of six months from January 2017. Meanwhile, non-OPEC members, including Russia, also announced to reduce their output. In May 2017, OPEC members and several non-OPEC countries such as Russia and Venezuela decided to extend their production cut until March 2018 to curb the oil supply glut in the global market. However, during the first half of 2017, the average daily oil production of the US was more than 4 per cent higher than that of in mid-2016, creating a downward pressure on crude oil prices despite the production cut by OPEC. Consequently, the monthly average Brent price declined from

US dollars 55.67 per barrel in January 2017 to US dollars 47.71 per barrel in June 2017. However, an upward trend in prices was observed since mid-June 2017, supported by a slowdown in the US drilling activities and perceptions of stronger global demand. Nevertheless, an unexpected temporary decline in crude oil prices was observed in end August due to Hurricane Harvey, which hit and damaged major US refineries in the US Gulf coast, and worries over Hurricane Irma, one of the most powerful storms of the century. With the gradual restart of refineries, crude oil prices began to increase, and was also supported by the higher demand forecasts for 2018 by OPEC. According to major oil producing countries, the global market was on its way to rebalancing the crude oil prices. Reflecting this, the crude oil (Brent) prices recorded its highest value since July 2015, of US dollars 59.14 per barrel at end September 2017. Accordingly, the average price of crude oil (Brent) increased by 22.1 per cent to US dollars 52.60 per barrel in the first nine months of 2017 compared to the average price of US dollars 43.08 per barrel in the corresponding period of 2016. With these developments, the Ceylon Petroleum Corporation's (CPC's) average import price of crude oil increased by 25.4 per cent to US dollars 54.81 per barrel in the first nine months of 2017 from US dollars 43.72 per barrel in the corresponding period of the preceding year.

Chart 3.3
Average Price of Crude Oil (Brent) in the International Market and the Crude Oil Import Price of the CPC



Sources: Bloomberg
Ceylon Petroleum Corporation

- **Domestic petroleum sales increased in the first eight months of 2017 mainly driven by the demand from the power generation sector.** The drought conditions prevailing in the country since mid-2016 and continuous disruptions to the operations of the Norochcholai coal power plant resulted in an increased dependence on fuel oil-based thermal power generation Accordingly, petroleum sales to the energy generation sector grew by 40.4 per cent during the first eight months of 2017 relative to the corresponding period in the previous year. Further, domestic petroleum sales to the transportation sector, which accounts for a share of 61.4 per cent of the total petroleum consumption in the country, grew by 6.6 per cent in the first eight months of 2017 in comparison to the same period in 2016, owing to the increased demand for petrol and diesel from the transportation sector. Moreover, the sale of furnace oil, a product that is mainly used in the energy generation sector, grew by 42.6 per cent during the reference period. In the meantime, domestic sales of kerosene grew by 9.7 per cent during the first eight months of 2017 relative to the corresponding period in 2016.

Road Development

- **The Road Development Authority (RDA) continued with the upgrading and maintenance activities related to the national road network during the first half of 2017.** Accordingly, the RDA incurred a total expenditure of Rs. 48.8 billion during the period on maintenance, rehabilitation and development of roads and bridges. This was an increase of 27.1 per cent compared to the expenditure of Rs. 38.4 billion incurred by the RDA during the corresponding period of 2016. The RDA maintained a total length of 12,380 km of national highways including expressways as well as around 4,662 bridges during the first half of 2017.

- **Projects that commenced in the previous years with the aim of improving the road network, continued during the first half of 2017.** These included the Integrated Road

Investment Programme (i-Road), which was identified as one of the key projects in developing the road network that supports and facilitates the enhancement of the economic and social status of the people living in rural areas in lagging provinces. Meanwhile, preliminary work in relation to the construction of a new bridge over the Kelani River with a view to minimising the traffic congestion and thereby improving the transport network in the Colombo city continued during the period with the assistance of Japan International Cooperation Agency (JICA). The Colombo National Highways Project commenced two new rehabilitation and improvement projects, namely, Kottawa–Thalagala Road and Kotte–Bope Road in February 2017. Meanwhile, the construction work of the Polgahawela, Ganemulla and Rajagiriya flyovers registered a progress of 93.5 per cent by end June 2017. The extension of the Southern Expressway Project (ESEP) from Matara to Hambantota with a link to the Mattala International Airport continued in 2017. Meanwhile, construction work of the Central Expressway that extends from Kadawatha to Dambulla with its Pothuhera-Galagedara link continued during the first half of 2017. Also, construction work 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 continued in 2017. It is expected that the completion of the OCH would reduce the traffic congestion within the Colombo metropolitan region. At the same time, rehabilitation and improvement of some roads and bridges continued during the first half of 2017.

- **Several other measures were undertaken to reduce traffic congestion and improve road safety in major cities.** Currently, a technical assistance project under a Korea International Cooperation Agency (KOICA) grant for the establishment of an Advanced Traffic Management System (ATMS) in Colombo metropolitan region is in progress. Under this project, a Centralised Traffic Control System with advanced traffic management features is expected to be developed aiming to support economic activity of Colombo metropolitan region by relieving traffic congestion, strengthening road safety and improving public transport. Further, 79 locations have been identified for the installation of pelican crossings covering 211.4 km of road length and the basic design has been completed.

Road Passenger Transportation

- **Public passenger transportation showed a negative performance during the first half of 2017.** The total operated kilometres of the Sri Lanka Transport Board (SLTB) decreased by 1.6 per cent to 219.4 million km and total passenger kilometrage was 7,737 million km, registering a marginal decline of 0.4 per cent during the first half of 2017 in comparison to the corresponding period of 2016. The total number of buses owned by the SLTB stood at 7,608 by end June 2017 while the average number of buses operated per day decreased by 87 to 5,219 during the period. Meanwhile, the number of buses owned by private operators declined by 2.0 per cent to 19,917 while their average bus fleet operated declined by 3.4 per cent to 17,728 during the first half of 2017 compared to the corresponding period of 2016. The operated kilometres of private buses declined by 3.6 per cent to 523.1 million km, while the passenger kilometres showed a decline of 3.5 per cent to 26,345.5 million km, during the period under review. The reduction of bus operations by both public and private operators was mainly due to the impact of floods in many parts of the island during the latter part of the second quarter. Meanwhile, bus fares were revised as per the annual national bus fares policy with effect from 1 July 2017. Accordingly, the minimum bus fare was increased to Rs. 10.00 from Rs. 9.00 and fares for other categories were revised upwards by 6.28 per cent, on average.

- **During the first half of 2017, the National Transport Commission (NTC) continued several road passenger transportation projects.** The NTC implemented three major services, namely, Sisu Sariya, Gami Sariya and Nisi Sariya, under a budget of Rs. 690 million for 2017. Under the ‘Sisu Sariya’ project, which is aimed to facilitate school children's attendance to school on time and return home safely, 45 new

Table 3.2
New Registration of Motor Vehicles

Item	2015	2016 (a)	2016 Jan-Sep	2017 Jan-Sep (a)	Change %
New Registration of Motor Vehicles	668,907	493,328	355,155	342,215	-3.6
Buses	4,140	2,685	2,011	2,356	17.2
Motor Cars	105,628	45,172	33,198	29,684	-10.6
Cars Less than 1,000cc	60,641	24,593	17,256	14,806	-14.2
Three Wheelers	129,547	56,945	40,314	17,519	-56.5
Dual Purpose Vehicles	39,456	26,887	19,336	12,613	-34.8
Motor Cycles	370,889	340,129	245,350	262,012	6.8
Goods Transport Vehicles	7,142	7,563	5,326	8,503	59.7
Land Vehicles	12,105	13,947	9,620	9,528	-1.0

Source: Department of Motor Traffic

(a) Provisional

bus services were launched during the first half of 2017. The 'Gami Sariya' service continued to provide transport facilities in relatively uneconomical routes in rural areas. The NTC has initiated 11 new services under the 'Gami Sariya' project during the first half of 2017. Under the 'Nisi Sariya' project, the NTC plans to launch 35 new bus services during the year 2017. The subsidy granted by the Treasury to the SLTB for the operations in uneconomical routes and subsidised season tickets amounted to Rs. 2.9 billion and Rs. 2.5 billion, respectively, during the first half of 2017.

- **New registration of motor vehicles witnessed a reduction during the first nine months of 2017 compared to the corresponding period of the previous year.** The decline in vehicle registration was mainly observed in motor vehicles under the categories of motor cars, three wheelers, and dual-purpose vehicles. The deceleration of vehicle registration during the first nine months of 2017 was mainly due to the increase in import duty, depreciation of the Sri Lankan rupee against the US dollar, the increase in market interest rates with tight monetary policy, and tightened macroprudential policies to discourage borrowings to purchase certain categories of motor vehicles.

Rail Transportation

- **Transportation services provided by Sri Lanka Railways (SLR) recorded an expansion in terms of both passenger and freight transportation during the first half of 2017.** During the first half of 2017, rail passenger kilometrage witnessed an increase of 1.5 per cent to reach 3.6 billion km, incomparison to the corresponding period of 2016. Further, goods kilometrage registered an increase of 4.9 per cent recording 70.6 million MT km during the first half of 2017, and this was largely supported by increased coal, oil and cement transportation services. Meanwhile, the SLR continued the project on improving the Kalani Valley Railway line. In addition, steps were taken to commence the rehabilitation of 200 passenger carriages. Another major project of the SLR during the first half of 2017 was the initiation of the procurement process for a rolling stock with the assistance of an Indian line of credit. The feasibility study of the Colombo Suburban Railway project continued in 2017 as well, under the financial assistance of the Asian Development Bank (ADB). Meanwhile, the feasibility study with regard to the railway electrification project from Veyangoda to Panadura continued during the period under review.

Civil Aviation

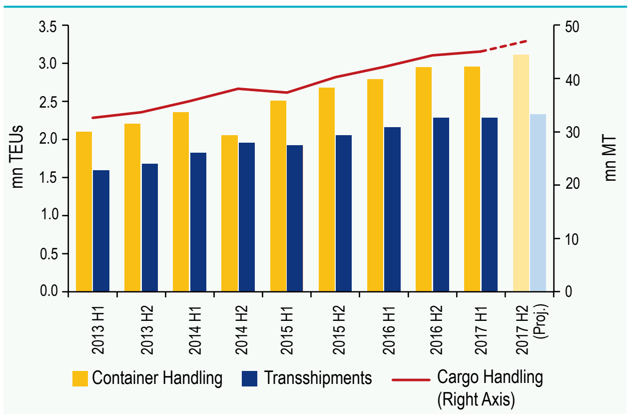
- **The civil aviation sector showed a marginal growth during the first half of 2017 amidst the renovation activities that took place at the Bandaranaike International Airport (BIA).** Although the BIA was closed during the day time from January to early April this year for runway resurfacing activities, air passenger movements through the BIA increased to 4.5 million during first half of 2017, recording a marginal growth of 0.5 per cent in comparison to the corresponding period of the preceding year. However, transit passenger movements at the BIA witnessed a decline of 0.6 per cent to 0.6 million during the first half of 2017 compared to the same period of the previous year. Meanwhile, total volume of cargo handled by the BIA decreased by 10.0 per cent to 121,816 MT, which consisted of 74,182 MT of export cargo and 47,633 MT of import cargo. In response to the closure of the BIA, the total number of aircraft departures at the BIA during the first half of 2017 declined by 9.8 per cent to 15,037 from 16,670 in the first half of 2016. However, with the temporary closure of the BIA, the Mattala Rajapaksa International Airport (MRIA) handled 980 aircraft departures during this period compared to 670 recorded during the first half of 2016. At the same time, passenger movements at the MRIA significantly increased to 52,905 during the period under review, compared to the 1,652 recorded in the corresponding period of the previous year. Total cargo handled at the MRIA was 60 MT during the first half of 2017. Meanwhile, the passenger kilometres pertaining to domestic services witnessed an increase of 19.6 per cent to 2.32 million km during the first half of 2017 from 1.94 million km in the comparable period of 2016.

- **The construction work of the project to expand passenger handling capacity at the BIA continued in 2017.** The existing terminal has a handling capacity of 6 million passengers per annum, and in 2016 it handled almost 9.3 million passengers, which is an excess of 56 per cent. The current oversaturation at the BIA is an impediment to improve the tourism sector of the country. During the first half of 2017, the expansion project was carried out under two packages. Financial bids for the first package, which focuses on passenger terminal building and associated work, are currently under review. In addition, a technical proposal was completed with the support of JICA to construct a multi-level terminal where arrivals and departures are separated vertically. The second package, which focuses on the remote apron and taxiways outside the second terminal and the related construction activities, commenced in April 2017. Moreover, the government is in the process of finding a suitable investor to form a PPP to restructure SriLankan Airlines (SLA) and to minimise losses incurred by the airline.

Port Services

- **Port sector performance improved during the first nine months of 2017, mainly reflecting increased commercial operations of the Colombo International Container Terminal (CICT).** The total container handling at the CICT and South Asia Gateway Terminal (SAGT) registered growth rates of 19.2 per cent and 12.1 per cent, recording 1,742,889 Twenty-foot Equivalent Container Units (TEUs) and 1,330,863 TEUs, respectively, during the first nine months of 2017. Meanwhile, container handling at both the Jaye Container Terminal (JCT) and Unity Container Terminal (UCT), which are fully owned by the Sri Lanka Ports Authority (SLPA), continued its negative growth, registering a decline of 8.4 per cent to 1,471,679 TEUs during the first nine months of 2017 compared to the corresponding period of the previous year. By end September 2017, the shares of the SLPA, CICT and SAGT in the overall container handling were 32.4 per cent, 38.3 per cent and 29.3 per cent, respectively. The poor performance of terminals owned by the SLPA is mainly due to CICT's ability

Chart 3.4
Container Handling, Transshipments and Cargo Handling



Sources: Sri Lanka Ports Authority
Central Bank of Sri Lanka

Table 3.3
Performance of Port Services

Item	2016 Jan-Sep	2017 Jan-Sep (a)	Change %
Total Cargo Handling (MT '000)	64,502	69,337	7.5
Total Container Handling (TEUs '000)	4,255	4,545	6.8
Transshipments (TEUs '000)	3,304	3,523	6.6

Source: Sri Lanka Ports Authority

(a) Provisional

3

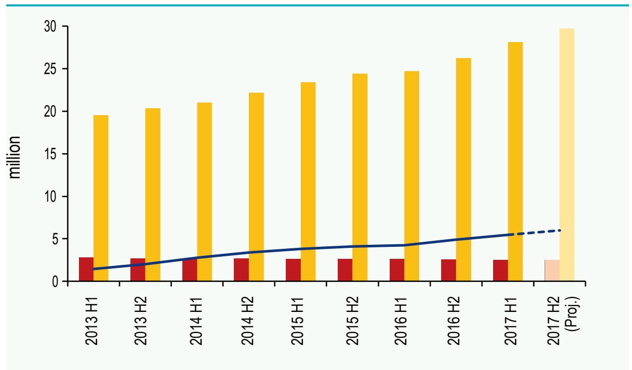
to accommodate ultra large container ships. Meanwhile, total cargo handling at the CICT and the SAGT witnessed growth rates of 20.7 per cent and 12.5 per cent, respectively, while cargo handling at terminals owned by the SLPA recorded a negative growth of 3.3 per cent in the first nine months of 2017. Meanwhile, total vehicle handling at the Hambantota port registered a decline of 39.3 per cent during the first nine months of 2017 compared to the corresponding period of the previous year. Furthermore, at the Hambantota port, transshipment vehicle handling registered a decline of 54.5 per cent, while handling of vehicles imported for domestic usage witnessed an increase of 38.0 per cent in the first nine months of 2017 in comparison to the corresponding period in 2016. During the same period, handling of vehicles for domestic usage at the port of Colombo declined by 52.0 per cent, reflecting an overall reduction in vehicle imports to the country.

- **Measures were taken to continue the Colombo port development projects during the first half of 2017.** The internal road widening work at the port of Colombo has been carried out in several phases during the first half of 2017 with the aim of enhancing operational activities of the terminals. The total financial progress of the project including widening of two bridges amounted to Rs. 795 million as at June 2017. Meanwhile, a concession agreement for a PPP relating to the Hambantota port was signed between the SLPA, Government of Sri Lanka (GoSL), China Merchant Port Holdings Company Ltd (CMPort), Hambantota International Port Group (Pvt) Ltd (HIPG), and Hambantota International Port Services (Pvt) Ltd (HIPS) in July 2017 with the aim of restructuring the port development project.

Telecommunication Services

- **The telecommunication sector performed well during the first half of 2017 with improved telephone density and rapid growth in internet services.** The number of mobile telephone connections increased while fixed wireline telephone connections also registered a growth of 2.7 per cent during the first half of 2017 compared to the corresponding period of the previous year. The fixed wireless connections continued to decline with increased mobile telephone connections and registered a contraction of 7.9 per cent during the first half of 2017 compared to the corresponding period in 2016. By end June 2017, fixed telephone penetration (connections per 100 persons) and the mobile telephone penetration stood at 11.7 and 131.3, respectively. Internet penetration (connections per 100 persons) increased to 25.6 by end June 2017 from 20.0 at end June 2016. The growth in internet connections was mainly supported by the high growth of fixed internet connections, which witnessed a growth of 37.5 per cent by end June 2017 compared to end June of the preceding year. Mobile internet connections registered a year-on-year growth of 27.7 per cent by end June 2017 in comparison to a year-on-year growth of 8.5 per cent recorded at the end June 2016.

Chart 3.5
Telephone Connections (Fixed Access and Cellular) and Internet Connections



Sources: Telecommunications Regulatory Commission of Sri Lanka
Central Bank of Sri Lanka

Table 3.4
Telecommunication Services

No. of Subscribers	End June 2016	End June 2017 (a)	Change (%)
Fixed Access Telephones ('000)	2,597	2,514	-3.2
Cellular Telephones ('000)	24,696	28,113	13.8
Internet Connections ('000) (b)	4,232	5,479	29.5
Total Telephone Penetration	128.72	143.02	11.1
Mobile Telephone Penetration	116.47	131.28	12.7

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

(a) Provisional
(b) Including mobile internet connections

- **The Telecommunications Regulatory Commission of Sri Lanka (TRCSL) is in the process of devising a National Broadband Policy in consultation with all stakeholders.** This initiative is aimed at developing a high level framework to promote and facilitate the expansion and utilisation of broadband services by the public sector, private sector and civil society. Further, in tandem with the National Policy of 'Digitalisation of the Economy', the Information and Communication Technology Agency of Sri Lanka (ICTA) also initiated several new projects to provide efficient services while improving and developing the digital infrastructure of the country. The Lanka Government Network version 1.0 (LGN 1.0), which was implemented during 2007 to 2013, connected 514 government organisations through a cost effective and secure network. Moving forward, the first phase of the Lanka Government Network version 2.0 (LGN 2.0) project was commenced during the first half of 2017 with the aim of connecting 860 government institutions and providing centralised internet, email and video conferencing services to these organisations. Under this project, it is also expected to expand the number of e-services provided by the government while establishing a trusted and secure connection to exchange government data. Moreover, the government removed the 10 per cent telecommunication levy on internet services with effect from September 2017 aiming to encourage entrepreneurship while creating new jobs. The construction of the Lotus Tower Project, which commenced in 2012 with the aim of supporting the hosting of television and radio broadcasting as well as providing a hub station for telecommunication networks, continued and is expected to be completed by end March 2018.

Urban Development

- **The Western Region Megapolis Project, which was launched by the government in 2016 with the aim of transforming Sri Lanka's main commercial city into a vibrant and liveable cosmopolitan region, was in progress during the first half of 2017.** The Ministry of Megapolis and Western Development has taken initial steps to set up the country's first elevated Light Rail Transit System (LRT) with financial assistance from JICA. The total estimated cost of the project is Rs. 187.5 billion and the project is expected to be completed by 2021. By end June 2017, JICA has completed topographic and geological surveys while the Environmental Impact Assessment (EIA) survey was in progress. Further, the Ministry of Megapolis and Western Development implemented the Bus Priority Lanes project in 2017 jointly with stakeholders such as the RDA, SLTB, Sri Lanka Police, University of Moratuwa, Western Province Road Passenger Transport Authority, and Colombo Municipal Council in selected road sections, with the aim of reducing traffic congestion in Colombo and uplifting the standard of public transportation.

- **The Urban Development Authority (UDA) initiated 108 new projects including Sukitha Purawara (stage II), and township development and urban solid waste management projects, during the first half of 2017, targeting to improve the living standards of people in urban areas.** In addition, steps were taken to commence the Anuradhapura Integrated Urban Development Project (AIUDP) in 2017 and the project is expected to be completed by 2021. The objectives of the project are to improve high intensity rain water management to reduce flood risk, promote access and develop alternative mobility modes through upgraded public transport infrastructure, efficient transport systems and quality public spaces, and strengthen urban and heritage management practices to preserve and enhance the attractiveness of the Anuradhapura district. Under the Strategic Cities Development Project, the Ministry has planned to commence the Trincomalee Integrated Urban Development Project (TIUDP), which consists of urban regeneration, heritage conservation and environment preservation in the Trincomalee district, during the second half of 2017 with financial assistance from the ADB. Meanwhile, Strategic City Development Projects in Kandy, Galle and Jaffna were in progress during the first half of 2017. The UDA has already identified around 200 projects to be implemented during the period 2018-2020 covering the entire country.

- **The Colombo Financial City (Port City) Development project was in progress during the first half of 2017.** As at end July 2017, the physical progress of reclamation work through sea sand dredging was around 32 per cent while the progress of rock delivery, compaction work, and construction of offshore breakwaters, which are financed through Foreign Direct Investments (FDIs), were recorded at 22 per cent, 15 per cent and 15 per cent, respectively. Around 21 million cubic metres of sea sand has been extracted since the commencement of dredging in September 2016. Construction and development work of the project is expected to be completed within 20 years from the completion of sea bed reclamation work.

Developments in Social Infrastructure

Education

- **The government implemented numerous measures to improve the general education sector during the first half of 2017.** The student net enrolment ratio (NER) for the 5-14 age group (Grade 1-9) of the country stood at 97.35 per cent by end June 2017. The NER for male and female students were 98.38 per cent and 96.31 per cent, respectively. During the first half of 2017, approximately 9,600 teachers have been evaluated through the Ministry of Education, Provincial Departments of Education, Zonal Education offices and Divisional Education offices. In addition, the government allocated approximately Rs. 25.8 billion in 2017 for physical infrastructure development under the 'Nearest school is the best school' programme. Under this programme, 13,087 infrastructure development activities in 7,887 provincial schools and 280 national schools have commenced, and 5,030 activities have been completed by end June 2017. In addition, infrastructure in 451 schools, 19 National Colleges of Education, 7 Teacher Training Colleges and 75 Teacher Training Centres and Pirivenas are being developed under the annual budget allocation of the Ministry of Education. A pilot project for implementing the 'guaranteed 13 years of education' policy through the introduction of new Advanced Level subject streams was commenced in September 2017. The pilot project is initially carried out in 42 national schools and the new reforms will be introduced to all schools from 2019. In addition, the government plans to establish 300 digital classrooms with smart devices in 150 schools. To this end, the process of procurement of equipment was commenced during the first half of 2017 to establish 50 digital classrooms by the end of the year. Supervision of government approved private schools continued during the first half of 2017 through the provincial and zonal education authorities.

- **The government has taken various measures to improve university education in the country during the first half of 2017.** In 2017, online application was made compulsory for university admission to reduce application processing time and to release cut-off marks early. Accordingly, in spite of initial glitches, the University Grants Commission (UGC) was able to release the university admission cut-off marks for the Academic Year 2016/2017 in June 2017, three months earlier than the previous academic year. The computer-based application process has reduced the time taken to fill vacancies and consequently, all universities could commence their academic sessions for the Academic Year 2016/2017 simultaneously from October 2017. Meanwhile, 29,696 students have been selected for university admission under the normal intake for this academic year. During the first half of 2017, four new undergraduate degree programmes and 12 new postgraduate degree programmes have been approved by the UGC. Further, two faculties, 20 departments and one postgraduate institute have been approved by the UGC during this period. In addition, the UGC Centre for Gender Equity and Equality was established to give policy direction to universities, undertake capacity building among women for leadership in management, facilitate gender sensitive university cultures, and reduce gender-based violence, oppression and discrimination in the university environment. Moreover, an ICT-based Ragging Complaints Mechanism was established and operationalised to prevent ragging, sexual and gender-based violence in universities.

- **The private sector continued to engage in the provision of tertiary education alongside the government.** As of end June 2017, there were 15 Non-State Higher Education Institutes (NSHEIs) recognised as degree awarding institutes that offer 95 locally accredited degree programmes. During the first half of 2017, two bachelors' degree programmes and one postgraduate diploma offered by two NSHEIs were accredited. The Ministry of Higher Education and Highways took initiatives to establish an independent body to regulate the quality assurance and accreditation of the courses offered by the state universities as well as NSHEIs, and the relevant legislation is in the process of being drafted.

- **There were 740 registered institutions in the Technical and Vocational Education and Training (TVET) sector, which include 142 public institutions and 598 private and non-governmental institutions as at end June 2017.** These institutions offered 1,950 accredited TVET courses, while 17,491 National Vocational Qualification (NVQ) certificates were issued by these institutions in the first half of 2017. During the same period, an assessment monitoring programme was introduced by the Tertiary and Vocational Education Commission to ensure the trainees' competencies are in line with the National Competency Standards.

- **The issue pertaining to the medical education provided by the South Asian Institute of Technology and Medicine (SAITM) caused serious disruptions to the university education system and the health sector.** Medical students in all state universities have abstained from attending lectures, tutorials and clinical training as a result of student union action against SAITM since January 2017. A Presidential Commission was appointed to resolve the issues related to SAITM and the Commission submitted an interim report to the government, recommending the establishment of the proposed Independent Quality Assurance and Accreditation Authority (IQAAA) expeditiously. The IQAAA, in consultation and collaboration with the Sri Lanka Medical Council, is expected to evaluate the medical degree programmes for accreditation purposes. Nevertheless, the issue remains unresolved, significantly delaying the graduation of medical students and new student enrolments in the state medical faculties. Therefore, a workable solution to this issue is urgently required to enable private sector provision of higher education, including medical education, within a quality assurance mechanism acceptable to the public.

Health

- **The government continued its efforts to strengthen the physical and human resources of the health sector during the first half of 2017.** There were 20,575 qualified doctors and 33,363 nurses in government hospitals, representing one doctor for every 1,041 persons and one nurse for 642 persons, by end June 2017. Further, there were 76,829 beds in government hospitals, which convert to 3.6 beds for every 1,000 persons. Meanwhile, there were 100 government Ayurvedic hospitals with 5,114 beds and 23,180 registered Ayurvedic physicians as at end June 2017. Numerous projects were in progress during the first half of 2017 to improve the physical infrastructure in the health sector. The extension of the Premature Baby Unit of the De Soyza Maternity hospital and Accident Ward Complex of the Ragama Teaching Hospital are expected to be completed during 2017. Further, development projects at the District General Hospitals in Hambantota and Nuwara Eliya, and the Maternity Hospital in Karapitiya were in progress during the first half of the year. The construction and upgrading of 17 peripheral blood banks that are under the purview of National Blood Transfusion Services of the Ministry of Health, Nutrition and Indigenous Medicine (MoH) have been completed during the first half of 2017. Development of the Ambulatory Care Centre at the National Hospital commenced in April 2017. In addition, three Cancer Hospitals are proposed to be constructed in Thellipalei, Kandy and Matara. Moreover, plans are also being made to establish Renal Units in Batticaloa, Hambantota, Trincomalee and Jaffna and to develop infrastructure related to dialysis services in 38 hospitals in the Chronic Kidney Disease (CKD) prevalent areas. The Cabinet has decided in October 2017 to establish the 'Suvaseriya' Foundation and to extend the 1990 ambulance service to all provinces of the country.

- **The dengue epidemy continued to be a serious public health issue with the country's worst-ever dengue outbreak reported in 2017**. The number of dengue cases reported during January to end August 2017 was 149,126, which corresponds to a rate of 696 per 100,000 population. Dengue prevalence was 186 per 100,000 population in the corresponding period of 2016. Over 40 per cent of the dengue cases were reported from the Western Province while most affected areas are Colombo, Gampaha, Kandy, Ratnapura, Kurunegala, Kalutara, Kegalle, Matara, Galle, Puttalam, Trincomalee and Batticaloa. Heavy monsoon rains during the month of May, failure to clear rain-soaked garbage, and standing water and other potential breeding grounds for mosquito larvae led to the spread of the epidemy in urban and suburban areas. The number of dengue related deaths during the first eight months was 389, indicating a fatality rate of 0.26 per cent, in comparison to 0.17 per cent in the corresponding period of 2016. The MoH has implemented numerous activities to minimise and control the burden of dengue epidemy by vector control, early diagnosis and proactive case management. A series of mass scale premises inspection programmes was continued, targeting government institutions, private institutions, religious places, schools and higher education institutions, residential houses, construction sites, fisheries harbours and fishing boats, etc., by mobilising personnel from the armed forces and the Police as well as from Health Services. Further, High-Dependency Unit (HDU facilities were established and other facilities were upgraded to strengthen dengue case management in many hospitals throughout the country. Rs. 68 million was allocated to establish HDUs in 10 selected hospitals covering four provinces of the country. In addition, 500 mosquito prevention field assistants were recruited during the first half of 2017, while a further 1,000 will be recruited in a phased-out manner.

- **The private sector continued to play a key role in the healthcare sector.** There were 198 registered private hospitals with the capacity of 6,196 beds in the country including 20 Ayurvedic hospitals with 430 beds, by the end of the first half of 2017. Moreover, there were 110 registered medical and channelling centres, 292 registered medical laboratories, 190 full time and part time medical clinics operating around the country by end July 2017.

Safety Nets and Poverty Alleviation

- **The overall poverty level has declined considerably reflecting improved household income and living standards in the country, but poverty pockets and income disparity still remain as key social issues.** According to the Household Income and Expenditure Survey (HIES)–2016 conducted by the Department of Census and Statistics, the poverty level, as measured by the Poverty Head Count Ratio (PHCR) reduced to 4.1 per cent from 6.7 per cent in 2012/13. Although disparities in poverty levels among the urban, rural and estate sectors continued, an improvement was recorded in 2016 compared to 2012/13. Accordingly, PHCRs of urban, rural and estate sectors improved to 1.9 per cent, 4.3 per cent and 8.8 per cent, respectively, from 2.1 per cent, 7.6 per cent and 10.9 per cent, respectively, in 2012/13. Moreover, at the district level, Colombo continued to record the lowest level of poverty while Killinochchi recorded the highest PHRC in 2016. In terms of the number of the poor, the Kandy (9.1 per cent), Ratnapura (8.6 per cent), Kegalle (7.2 per cent), Batticaloa (7.2 per cent), and Badulla (6.7 per cent) districts recorded the highest contribution to the total poor population in the country. Meanwhile, the income disparity as measured by the Gini coefficient based on household income declined to 0.45 in 2016 from 0.48 in 2012/13. The Gini coefficients of urban, rural and estate sectors stood at 0.48, 0.44 and 0.36, respectively, in 2016, suggesting higher income disparity in the urban and rural areas. As per the HIES-2016, the poorest 20 per cent and the richest 20 per cent of the population received 4.8 per cent and 50.8 per cent of the total income of the population, respectively, reflecting the severity of income disparity in the country.

- **The government continued the existing social protection programmes in 2017 with the aim of supporting the livelihood of the low-income and economically vulnerable households.** During the first half 2017, Rs.19.9 billion has been disbursed under the Samurdhi subsidy programme, while Rs. 382 million has been granted to 76,011 beneficiaries under the Samurdhi Social Security Benefit Scheme. Moreover, 239,226 loans, amounting to Rs. 23.6 billion, have been disbursed through the Samurdhi community-based banks during the first half of 2017. In addition, the Ministry of Women and Child Affairs continued to provide nutritional food packages for expectant mothers incurring a total value of Rs. 1.4 billion during this period. The aim of this programme is to reduce the incidence of low weight births and improve the nutritional status of the pregnant and lactating mothers. Furthermore, the government took numerous measures with the assistance of civil society, private sector and multilateral agencies to ease the burden of the people affected by natural disasters.

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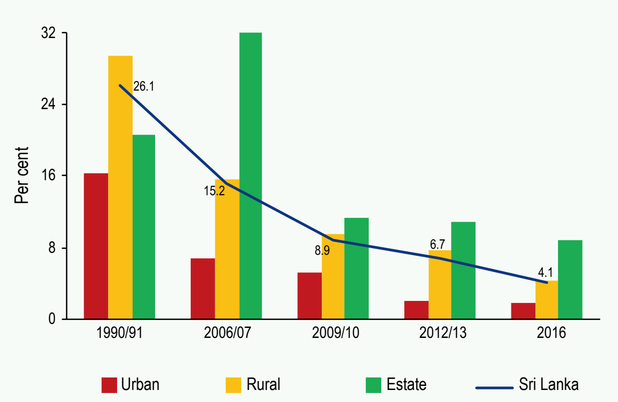
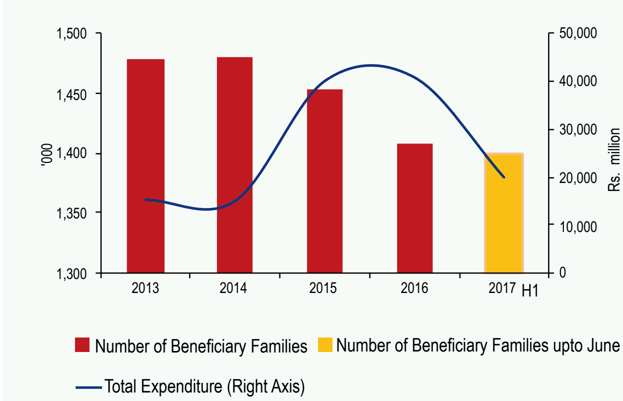
Chart 3.6
Poverty Headcount Ratio



Source: Department of Census and Statistics

Chart 3.7
Performance of the Samurdhi/Divineguma Subsidy Programme



Sources: Department of Samurdhi Development
Ministry of Finance and Mass Media

- **In line with the sustainable development goals of alleviating poverty, ensuring zero hunger and gender equality, the Year 2017 was declared as the 'Year of Poverty Alleviation' in Sri Lanka.** The Department of Samurdhi Development (DSD) prepared an empowerment plan to be implemented from 2017 onwards with the view of alleviating poverty in Sri Lanka by 2030. Accordingly, the DSD has targeted to empower 10 per cent of the families that have been identified as those having a higher potential to be empowered, which amounted to 125,385 families. This initiative is to be carried out through livelihood development, marketing promotion and model village programmes and providing micro-finance facilities for poor families. The strategy of empowerment is through education, entrepreneurship and employment. In order to achieve the above target, Samurdhi Officers are in the process of selecting nine families from each Grama Niladhari (GN) division.

Expected Developments

- **The growth momentum in electricity demand is expected to continue over the medium term, necessitating lasting solutions for the energy sector.** The lower hydropower generation and higher fuel oil-based power generation during the first half of 2017 have adversely affected the financial performance of the CEB substantially. Therefore, the effects of frequent adverse weather conditions on electricity generation highlight the need for diversifying the country's energy mix while expanding the generation capacity to meet the future demand for electricity.

- **It is expected that the government will introduce cost reflective pricing policies for public utilities in the near future.** In particular, a cost reflective pricing formula is expected for domestic petroleum prices, which will induce domestic users to internalise fluctuations in global market prices directly, rather than through fiscal costs associated with losses made by the CPC.

- **In line with the fiscal consolidation process and with a view to enhancing the financial viability of the state-owned business enterprises (SOBEs), the government is in the process of establishing PPPs for selected state-owned ventures such as the Hambantota port, SLA and MRIA.** These PPPs are expected to reduce the burden on the government budget, reduce contingent liabilities of the government, increase the operational efficiency while attracting much-needed non-debt creating FDIs to the country. In addition to the five key SOBEs that signed Statements of Corporate Intent (SCIs) during the first half of 2017, the government is planning to introduce SCIs for 10 more SOBEs, selected based on their size and strategic importance. These SCIs are intended to improve transparency, accountability, operational efficiency and financial viability of the SOBEs in the long-run.

- **The government is in the process of reforming the upper secondary education with the aim of making 13 years of school education available to all students.** Accordingly, a diversified subject stream that offers a new set of general and applied subjects will be introduced for the Advanced Level stage. The new subject stream will allow the students who do not pass the GCE Ordinary Level to proceed to Advanced Level and pursue vocational studies to succeed in the future. While providing opportunities for all the students to complete 13 years of school education, the new education reform is expected to address the mismatch between school education, job market requirements and student expectations.

4

PRICES, WAGES, EMPLOYMENT AND PRODUCTIVITY

The general price level, in terms of both the National Consumer Price Index (NCPI, 2013=100) and the Colombo Consumer Price Index (CCPI, 2013=100) compiled by the Department of Census and Statistics (DCS), followed an overall increasing trend, with mixed movements during the first nine months of the year. The movement of both NCPI and CCPI was largely in line with the price movements of the Food category which was subjected to severe supply side disruptions. Meanwhile, inflation, as measured by the year-on-year change in NCPI and CCPI also reflected mixed movements during the observed period. These movements in the general price level and inflation were mainly due to the base effect caused by the significant fluctuations in indices as a result of the changes in taxes in 2016. Meanwhile, underlying inflation as reflected by the movements in NCPI Core and CCPI Core indices generally followed a decreasing trend during the period, on a year-on-year basis highlighting the comparatively low volatility in prices of Non-food category during the observed period. Furthermore, year-on-year producer price inflation was driven by the overall increasing trend of the Agriculture sub-index resulting in high rates of producer price inflation during the first eight months of the year. Meanwhile, nominal wages in the economy increased at a slower pace compared to inflation, leading to a decline in overall real wages during the first half of 2017. This signals possible pressures for wages to increase and also possible deterioration in labour productivity in the near future. On the employment front, the unemployment rate declined amidst an increase in the Labour Force Participation Rate (LFPR) during the first half of 2017, compared to the same period of 2016, indicating that the capacity to absorb labour in the economy has increased. The increase in LFPR was solely due to the increase in female LFPR. Departures for foreign employment declined as a result of continued policy efforts of the government to reduce the departures in unskilled categories and also due to the ongoing geo-political tensions in major Sri Lankan migrant employment destinations. Meanwhile, labour relations improved as reflected by lower number of strikes reported to the Labour Department by private industries, although an increasing trend in disturbances was observed with regard to public services in the recent past. During the first quarter of 2017, labour productivity declined in all three major sectors: Agriculture, Industry and Services, leading to an overall decline in labour productivity in the economy.

Developments in 2017

Prices

National Consumer Price Index (NCPI)

- **The general price level, as measured by the movement in NCPI (2013=100), which covers the entire island, followed an overall increasing trend, with mixed movements during the period from January to September 2017**. NCPI was 119.3 index points in January 2017, peaked at 123.4 index points in June 2017 and recorded 123.3 index points in September 2017. NCPI largely followed the movements of prices of the Food category during the observed period while the Non-food category which moved on an increasing trend also contributed towards the increase in NCPI.

- **Inflation as measured by the year-on-year change in NCPI also followed an overall increasing trend with mixed movements during the first nine months of 2017**. Year-on-year NCPI inflation increased during the first three months of the year, moderated by mid-year and thereafter increased until September 2017, settling above mid-single digit levels. The increase in year-on-year inflation during the first two months was mainly driven by both the monthly increases in NCPI and the low base in the corresponding months of the previous year. However, its movements during the period from March 2017 to June 2017, was solely driven by the base effect. The monthly decline recorded in July 2017 helped maintain the year-on-year inflation at the same level recorded in June 2017. Meanwhile, the low base in August 2016 caused the year-on-year NCPI inflation to increase significantly in August 2017 albeit a monthly decline was recorded in the same month. The year-on-year NCPI inflation increased further in September 2017 with a monthly increase in NCPI. Meanwhile, the annual average NCPI inflation gradually increased from 4.6 per cent in January 2017 to 6.8 per cent in September 2017.

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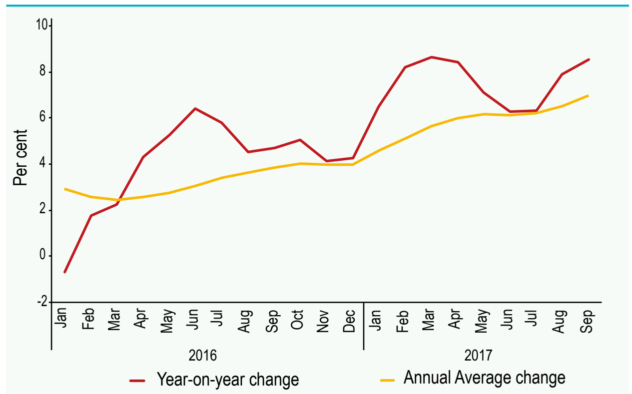
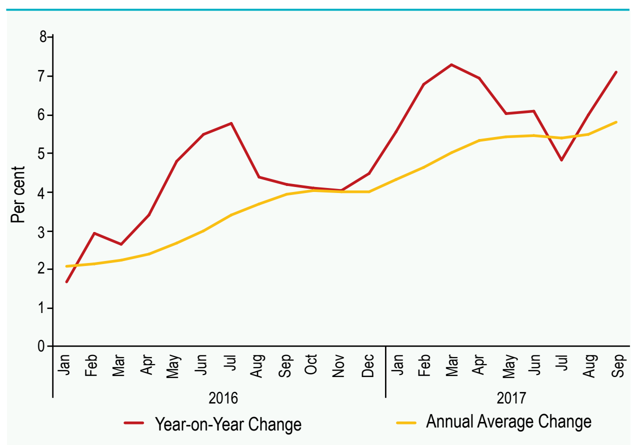
Chart 4.1
Movements of Headline Inflation (2016-2017) NCPI (2013=100)



Colombo Consumer Price Index (CCPI)

- **CCPI (2013=100), which measures the price developments of urban areas of the Colombo district also moved on an increasing trend with mixed movements during the first nine months of 2017**. CCPI which was 116.1 index points in January 2017, peaked at 120.1 index points in June 2017 and recorded 119.7 index points in September 2017. The movement of CCPI was mainly led by the movements in the Food category during the observed period. Although the Non-food category has a higher weight in the index, contribution from the Non-food category towards the movement in CCPI was minimal. Year-on-year CCPI inflation also followed a similar movement to NCPI inflation, following an increasing trend with mixed movements. As such, year-on-year CCPI inflation, which was 5.5 per cent in January 2017, peaked at 7.3 per cent in March 2017 and declined gradually

Chart 4.2
Movements of Headline Inflation (2016-2017) CCPI (2013=100)



until June 2017. Reflecting the moderation in prices in the Food category during July 2017 and the high base that prevailed in July 2016, the year-on-year CCPI inflation declined significantly to 4.8 per cent in July 2017. However, despite a monthly decline in the index in August 2017, the low base that prevailed in August 2016 resulted in an increase in CCPI inflation to 6.0 per cent. Contributed by both the lower base and increased food prices, year-on-year CCPI inflation increased further to 7.1 per cent in September 2017. Meanwhile, annual average CCPI inflation increased from 4.3 per cent in January 2017 to 5.8 per cent in September 2017.

Price Movements in the Food Category

- **On average, prices in the Food category increased, with mixed movements in line with the supply conditions of Volatile Food[1] items during the first nine months of the year**. Prices of rice on average increased at a higher rate during the first nine months of the year compared to the same period of the previous year, primarily due to drought driven supply disruptions. Furthermore, prices of fresh fish also increased at a higher rate during the observed period compared to the same period of the previous year. This was mainly due to the sharp price increase recorded in June 2017 driven by adverse weather conditions. The prolonged drought conditions that prevailed in the past caused a continuous low coconut production, which led to the rapid increase of coconut prices since September 2016. Accordingly, coconut prices remained high during the first nine months of 2017 compared to the same period of 2016. Even though, the prices of vegetables showed an increasing trend, the average price that prevailed during the first nine months of 2017 was lower than that prevailed during the corresponding period of the previous year. Nevertheless, prices of potatoes, red onions and big onions increased at a higher rate during the first nine months of 2017 compared to the same period of the previous year. The increasing trend of the prices of items in the volatile food category caused significant upward pressure on the general price level during the period under review.

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

- **The domestic prices of key imported food items increased at a slower rate during the first nine months of 2017 compared to the same period of the previous year**. The price of sugar increased marginally while the prices of wheat flour and dhal declined during the observed period of 2017 compared to the same period of 2016. The Special Commodity Levy (SCL) on rice imports was reduced on several occasions, to contain rice prices and complement lower domestic supply conditions. In addition, maximum retail prices were also imposed on prices of some food items, including rice, dhal, dried sprats, sugar and potatoes to contain price pressures in the market. However, the maximum retail price imposed on rice prices was removed in August 2017.

- **Year-on-year food inflation in terms of both NCPI and CCPI moved on an increasing trend with mixed movements**. The year-on-year NCPI food inflation increased significantly from January 2017 to February 2017 mainly due to the base effect, and also due to the monthly increases in prices of the items in the Food category. Despite the decline in food prices in March 2017, NCPI food inflation increased in March 2017 due to the low base in the previous year. NCPI food inflation increased further in April 2017, driven by the increase in food prices during the month. Even though the food prices continued to increase during May and June 2017, the year on-year NCPI food inflation declined due to the base effect. Meanwhile, Food prices declined during July 2017 as a result of favourable supply conditions, leading a further decline in the year-on-year food inflation in July 2017. However, it recorded a significant increase amid a monthly decline during August 2017, driven by the low base that prevailed in August 2016. It increased further in September 2017 owing to the base effect and the monthly increase in food prices. The year-on-year CCPI food inflation also showed an increasing trend with mixed movements during the observed period. Meanwhile, the annual average food inflation moved on an increasing trend during this period.

Price Movements in Non-food Category

- **Prices in Non-food category exhibited an overall upward trend during the observed period**. All sub-categories contributed towards this increase during the observed period. In terms of administered Non-food prices, the bus fares were increased by 6.28 per cent with effect from 1st July 2017 and the price of a 12.5 kg cylinder of LP Gas was increased by Rs.110 with effect from 26th September 2017. These developments resulted in an overall increasing trend in the Non-food prices during the period. Nevertheless, the year-on-year Non-food inflation in terms of both NCPI and CCPI recorded a decreasing trend with mixed movements, due to the base effect caused by tax adjustments in 2016. The annual average NCPI Non-food inflation showed an increasing trend with mixed movements while the annual average CCPI Non-food inflation moved on a steadily increasing trend.

Core Inflation

- **Year-on-year core inflation in terms of both the NCPI Core (2013=100) and CCPI Core (2013=100) moved on an overall decreasing trend during the period**. The decline in core inflation during the period reflects the lagged effect of the tight monetary policy stance of the Central Bank since early 2016. Furthermore, the base effect resulted by the changes introduced to taxes during 2016 also contributed to the decline in core inflation during the period, amid the increasing trend recorded during the observed period by both NCPI Core and CCPI Core. Accordingly, year-on-year NCPI core inflation decreased from 7.1 per cent in January 2017 to 4.6 per cent in September 2017 with mixed movements in between months. Annual average NCPI core inflation declined from 6.2 per cent in January 2017 to 5.7 per cent in September 2017, exhibiting mixed movements. Meanwhile, year-on-year CCPI core inflation exhibited a declining trend from 7.0 per cent in January 2017 to 6.0 per cent in September 2017, with mixed movements. Nevertheless, annual average CCPI core inflation increased from 4.7 per cent in January 2017 to 5.8 per cent in September 2017.

Chart 4.3
Movements of Core Inflation (2016-2017) NCPI (2013=100)

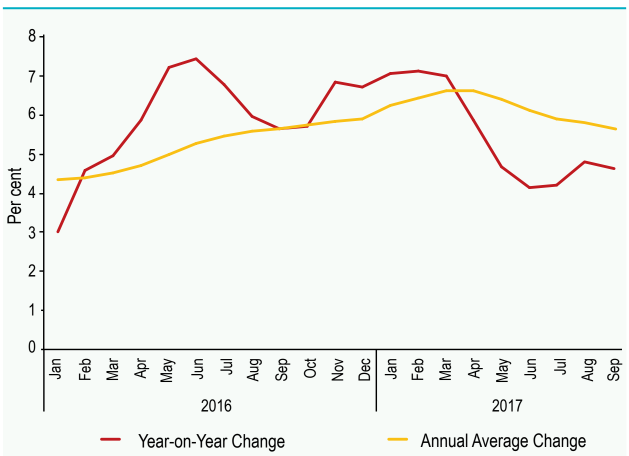
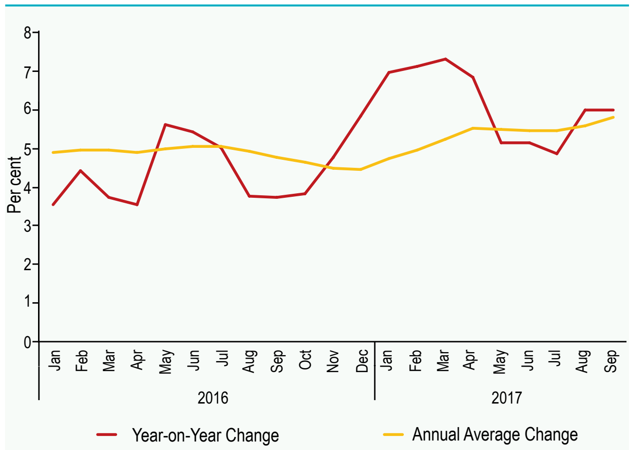


Chart 4.4
Movements of Core Inflation (2016-2017) CCPI (2013=100)



Producer Price Inflation

- **Producer price inflation exhibited an increasing trend in general during the first eight months of 2017**. 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 DCS. The year-on-year changes in the Agriculture, Electricity and Water (Utilities) sub-indices exhibited overall increasing trends with mixed movements. Year-on-year producer price inflation largely followed the trend of the inflation in the Agriculture sub-index during the period, a trend which was also observed in consumer price inflation. Meanwhile, the year-on-year change in the Manufacturing sub-index moved on a decreasing trend during the first eight months of the year.

Impact of Fiscal Policy Measures on Prices

- **There were several fiscal policy measures that had a direct impact on consumer prices during the period under review**. The changes in the Value Added Tax (VAT) rate, which were effected since May 2016 led to both upward and downward movements in the consumer price indices in 2016. The impact of changes in the VAT also contributed to the consumer price inflation in 2017 through the base effect. Furthermore, to balance the effect of supply side deteriorations in the Food category, maximum retail prices were imposed on prices of several essential food items including rice. However, the effect of the maximum retail price on observed market prices was marginal. Nevertheless, the maximum retail price imposed on rice prices was removed in August 2017. Moreover, the SCL of several imported food commodities was revised on several occasions to balance supply side developments.

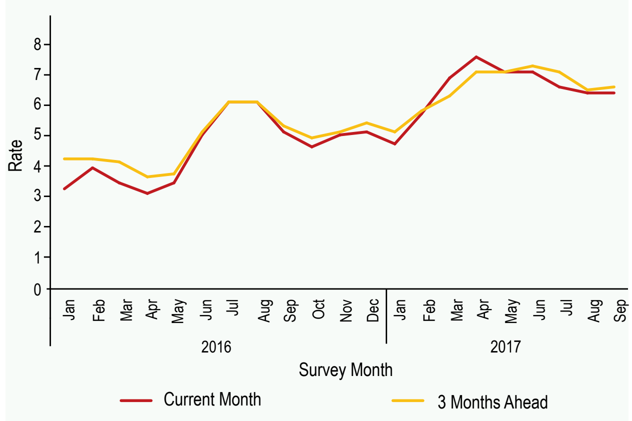
Inflation Expectations

- **Inflation expectations respond to changes in Monetary and Fiscal measures, at times with a time lag**. Corporate sector inflation expectations reflected an increasing trend since the beginning of 2017 to April 2017. However, a stabilisation of expectations was observed with the exception of the month of June 2017, which had an impact on expectations due to the policy rate change introduced in March 2017. Expectations marginally edged higher in September 2017 as a result of the increase in food items being largely felt by the respondents. Meanwhile, the gap between the near term and long-term expectations of the corporate sector narrowed during the observed period.

Wages

- **Wage indices indicate signs of wage pressures in the economy with real wages being on a downward trend due to a slower increase in nominal wages than the increase in inflation**. This scenario indicates that nominal wage increases have not been sufficient to match the increase in the rate of inflation, particularly in the Public and Formal Private sectors in the period January to July 2017. It signals an increase in the wage pressure in the near future leading to possible deteriorations in the labour productivity.

Chart 4.5
Inflation Expectations of the Corporate Sector



- **Nominal wages of public sector employees, as measured by the public sector wage rate index (2012=100), remained unchanged in the first seven months of 2017**. However, public sector employees experienced a real wage erosion of 6.9 per cent during the same period. This development is observed subsequent to the growth in nominal and real wages in the public sector by 6.7 per cent and 2.9 per cent, respectively, during the same period of 2016.

- **Nominal wages of the employees in the formal private sector, as measured by the minimum wage rate index (1978 December=100) of employees whose wages are governed by the wages boards trades, increased marginally in the first seven months of 2017**. Real wages

Chart 4.6
Movements in Real Wage Rate Indices

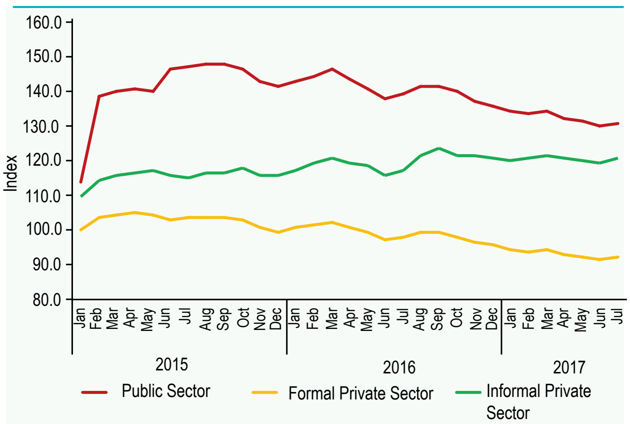


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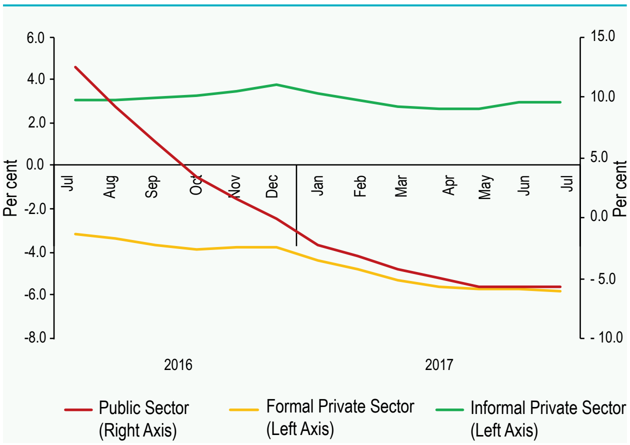
Chart 4.7
Annual Average Change in Real Wage Rate Indices



of employees in the formal private sector also declined by 5.6 per cent during the same period, as the percentage increase in the nominal wage rate index remained insignificant during the period.

- **Nominal wages of informal private sector employees, as measured by the informal private sector wage rate index (2012=100), increased by 9.3 per cent during the first seven months of 2017 compared to the 6.8 per cent increase recorded during the same period of 2016.** Nominal wages of the three main economic activities, namely, Agriculture, Industry and Services, increased by 9.3 per cent, 10.5 per cent and 8.1 per cent, respectively, during the first seven months of 2017. Meanwhile, real wages in the informal private sector increased by 1.8 per cent during the first seven months of 2017. Real wages of employees in Agriculture, Industry and Services activities increased by 1.8 per cent, 2.9 per cent and 0.7 per cent, respectively, during the first seven months of 2017. Increases in terms of wages in masonry and carpentry trades were observed during the first seven months of 2017 owing to the increased demand for labour in these sectors with the rapid expansion of the construction sector. In the informal private sector, wages are determined based on market conditions, which contributes towards securing growth in both nominal and real wages.

Labour Force and Employment

- **The overall condition in the labour market reflected mixed signals with improvement in several key labour market indicators, albeit with persistent structural issues**. The Unemployment rate declined during the first half of 2017, amidst an increase in labour force participation. Female labour force participation, which remains at low levels also increased notably. Amid these positive developments, unemployment among youth, educationally qualified and females continued to remain at high levels. On the labour demand side, as revealed by the business sentiment surveys carried out by the Central Bank of Sri Lanka, employers continued to stress on the fact that both skilled and unskilled labour availability in the market remained below the desired level, indicating a labour shortage in the economy. The labour shortage needs to be

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

Item	2016		2017 (c)	
	H1	Annual	H1	Projections
Household Population, '000 (Age 15 years and above)	15,383	15,449	15,749	15,616
Labour Force, '000	8,256	8,311	8,551	8,511
Employed, '000	7,892	7,948	8,184	8,145
Unemployed, '000	364	363	367	366
Labour Force Participation Rate (% of Household Population)	53.7	53.8	54.3	54.5
Unemployment Rate (% of Labour Force)	4.4	4.4	4.3	4.3

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

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

supplemented by an infusion of economically inactive working aged to the economically active category with an improved skill profile, and the creation of a conducive environment to engage in work.

Labour Force

- **The working age (15 years and above) household population, which is the key indicator of the potential labour supply in the country increased by around 0.4 million persons (2.4 per cent) during the first half of 2017, compared to the same period of 2016.** This increase could be due to the increase in the inward migration of persons and also the internal movement of persons from institutional living to household living[2]. Meanwhile, females accounted for a share of 54 per cent of the total working age household population, reflecting the importance of increasing the participation of females in the labour force.

- **Along with the increase in the working age household population, the labour force, which is the key indicator of the current supply of labour in the economy, increased significantly by 3.6 per cent to 8.551 million persons in the first half of 2017, from 8.256 million in the corresponding period of 2016**. The labour force comprises the economically active population aged 15 years and above. In other words, labour force is defined as persons who were employed or unemployed during the reference period of the Labour Force Survey (LFS). Increases in both female and male entrants to the labour force were observed during the period. Labour force in the estate sector and urban sector has increased notably, while that in the rural sector increased only marginally in the first half of 2017 compared to the same period in 2016. Subsequent to the Census of Population and Housing conducted by the DCS in 2012 covering the entire island, the LFS estimates were re-weighted, and published in July 2016 for the first time in Sri Lanka by the DCS, using the rebased Mid-Year Population Estimate (MYPE) published by the Registrar General Department (RGD)[3]. The intention behind re-weighting was to keep LFS estimates in line with latest population data as practiced by many other countries. Thus, the re-weighted labour market estimates could differ from estimates reported prior to 2016.

- **The Labour Force Participation Rate (LFPR), which is the ratio of the labour force to the working age population, increased to 54.3 per cent in the first half of 2017 compared to the 53.7 per cent in the corresponding period of 2016, as a result of a higher increase in the labour force compared to the increase in the working age population.** The increase in female LFPR to 36.7 per cent in the first half of 2017 from 35.7 per cent in the first half of 2016 mainly contributed to this development. The male LFPR declined to 74.8 per cent from 75.2 per cent as a result of the higher growth in the male household population than the growth observed in the male labour force during the same period. Overall LFPR and female LFPR have recorded the highest quarterly rate in the first quarter of 2017 compared to past five years, after which a moderation was observed in the second quarter of 2017. There is further potential for the LFPR to be increased particularly through the increase in female LFPR, supporting the desired growth momentum in the economy.

Employment

- **The number employed, which reflects the fulfilled labour demand in the economy, increased by 3.7 per cent to 8.184 million in the first half of 2017 compared to 7.892 million in the corresponding period of 2016.** This increase was mainly led by the 10.0 per cent increase in the number employed in the Industry sector while numbers employed in the Agriculture and Services sectors increased by 2.3 per cent

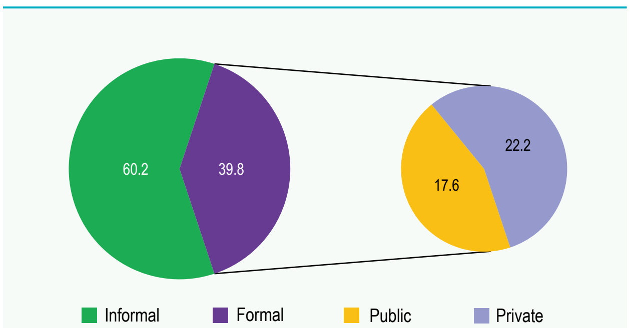
2. The Labour Force Survey (LFS) conducted by the Department of Census and Statistics (DCS) is a household survey which captures the labour force trends in the population that live in households (non-institutional population). Institutional population includes persons living in institutions such as welfare camps, hostels, etc.

3. The Mid-Year Population Estimates (MYPE) published by the Registrar General Department subsequent to the Census of Population and Housing 2012 indicated a decline in mid-year population from 2011 to 2012. Accordingly, Labour Force Estimates were re-weighted to reflect the changes introduced to the mid-year population and a new series of labour force estimates for the period from 2011 to 2016 was published by the DCS in July 2016, which is in line with international practices.

0.9 per cent, respectively, in the first half of 2017. The increase observed in the number employed in the Industry and Service sectors underpin the recent trends in increasing economic activities of those sectors. However, despite the deceleration in economic activities of the Agriculture sector, an increase in the number employed in the Agricultural activities was observed, particularly in the second quarter of 2017. Meanwhile, the Services sector continued to be the foremost employment generator accounting for a 45 per cent share of total employment. The Agriculture and Industry sectors contributed to 26 per cent and 28 per cent shares of total employment, respectively, during the first half of 2017. A possible temporary shift in employment from Agriculture to other sectors can be observed, since farming in certain rural areas of the country no longer remains a viable option, particularly to the youth who are in areas affected by a series of extreme weather conditions in the recent past.

- **In terms of employment status, the number employed in all categories increased during the first half of 2017**. The increase in employment was prominent in the Employer category, which is encouraging as it would lead to multiple employment generation, as reflected by the 6.2 per cent increase in private sector employment. However, in absolute terms, the private sector employee category mostly contributed to the increase in the number employed in the first half of 2017 compared to the corresponding period of 2016. Employment in the contributing family worker category also increased by 5.1 per cent, which signals an increase in vulnerable employment[4], as these employees are not covered under any labour laws. Meanwhile, the number employed in the self-employed category increased by 0.9 percent. On the other hand, informal employment accounted for 60.2 per cent of total employment in 2016.

Chart 4.8
Structure of Employment



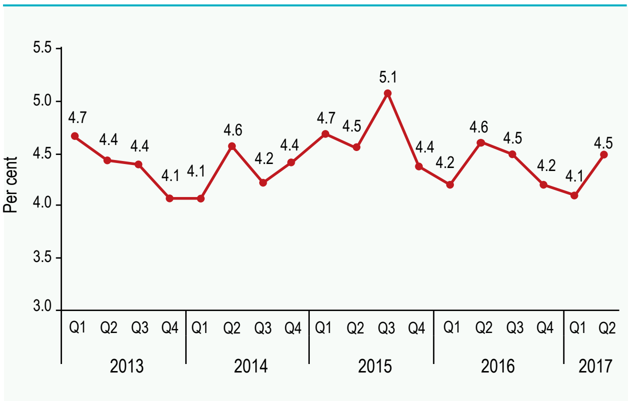
- **As per the Semi-annual Public Sector Employment Survey conducted by the Central Bank of Sri Lanka, public sector employment stood at 1.398 million at the end of the first half of 2017.** The semi-government sector accounted for 17.4 per cent of the total public sector employment, while other types of government institutions accounted for the remaining 82.6 per cent. Ministries, departments and provincial councils accounted for 10.4 per cent, 39.7 per cent, and 29.3 per cent of the total public sector employment, respectively. District secretariats and divisional secretariats accounted for 3.3 per cent of the total public sector employment.

Unemployment

- **The unemployment rate reached 4.3 per cent in the first half of 2017 compared to 4.4 per cent in the corresponding period of the previous year.** The total number of unemployed persons during the period under review was estimated at 366,734 compared to 363,843 recorded in the same period of the last year, which is an increase of 0.8 per cent. However, the percentage increase in the number unemployed was lower than the percentage increase in the labour force during the period under review, which resulted in a decline in the unemployment rate. Amid these developments, the increase in the number employed indicates that employment opportunities in the economy have increased during this period. The increase in employment opportunities were largely secured by males, as the increase in the number of employed males is greater than that of females. The male unemployment rate declined to 2.9 per cent from 3.1 per cent, reflecting that the increase in male labour force was surpassed

4. Vulnerable employment is defined as the sum of own-account workers and contributing family workers – International Labour Organisation

Chart 4.9
Unemployment Rate (2013-2017)



by the increase in employment opportunities secured by males. Meanwhile, the female unemployment rate increased to 6.8 per cent from 6.7 per cent. This reflects that the increase in employment opportunities secured by females was lesser than the increase in female labour force. These developments continued to highlight that the employability of females remains low and/or that there is a gap in terms of expectations of female job seekers.

- **Disparities among age wise unemployment rates continued to remain notable during the first half of 2017**. Youth[5] unemployment continued to remain at a significantly high level of 19.3 per cent during the first half of 2017. On the other hand, age groups between 30-39 years, and 40 years and above recorded relatively low unemployment rates of 2.7 per cent and 1.0 per cent, respectively, mainly due to higher human skills and working experience in those groups.

- **In terms of the education level, the highest unemployment rate of 8.0 per cent was reported among persons with GCE (A/L) and higher level of educational attainment.** High unemployment among the educationally qualified persons can be largely attributed to skills mismatch and lack of experience, variations in expected and actual remuneration packages, gender stereotypes in certain professions and career breaks in the employment history. It could also be due to the preference to be employed in the public sector with conventional social security arrangements and other benefits rather than seeking opportunities in the more vibrant private sector. Meanwhile, the unemployment rate among the persons with 6-10 years of schooling decreased to 3.2 per cent from 3.4 per cent, while it increased to 5.9 per cent from 5.8 per cent among those who have passed GCE (O/L) during the first half of 2017, compared to the same period of the previous year.

Foreign Employment

- **Departures for foreign employment declined in the first half of 2017 by 14.6 per cent, compared to the corresponding period of 2016, leading to a decline in workers remittances by 7.2 per cent for the same period.** The continuation of severed ties between Qatar and Saudi Arabia, United Arab Emirates, Bahrain and several other Middle Eastern and African countries, slowdown of the growth of major oil exporting countries and the measures taken to streamline departures under the housemaid category by local authorities mainly contributed to the decline in departures for foreign employment. Male departures and female departures in the first half of 2017 accounted for 66 per cent and 34 per cent of total departures, respectively, while the number of departures in both genders declined by approximately 15 per cent compared to that of the first half of 2016.

- **With regard to skill categories, worker departures under all categories declined in the first half of 2017 compared to the corresponding period of 2016**. Skill categories, which mainly contributed to the decline were Semi-Skilled, Clerical & Related and Housemaid categories. Implementation of policies to encourage departures under higher skill categories need to be further strengthened to ensure a sustainable growth in remittance inflows in the future. With the objective of improving the skill profile of Sri Lankan migrant workers, three Memorandums of Understanding (MoUs) were signed during the first half of 2017. The first MoU

5. Age between 15-24 years

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was signed with Singapore to streamline the recruitment and provide protection for overseas workers. The second MoU was signed to provide training to health workers of Sri Lanka and facilitate health sector employment for the trained workers in hospitals of the Kingdom of Saudi Arabia. A third MoU was signed with the Federal Ministry of Economic Affairs and Energy of Germany to facilitate training and employment opportunities in the elderly care sector in Germany.

- **A notable decline in the number of licensed employment agencies was observed due to stringent action taken by the Sri Lanka Bureau of Foreign Employment (SLBFE) against foreign employment agencies which have failed to comply with stipulated standards**. Continuing the trend observed in the recent past, departures for foreign employment through licensed agents accounted for 36 per cent while departure through private sources accounted for 64 per cent of total departures in the first half of 2017. The SLBFE issued only 3 new licenses in the first half of 2017 compared to 50 new licensed issued in the same period of 2016. The number of licenses renewed fell by 16 to reach 449 in the first half of 2017. The SLBFE conducted 69 raids on illegal recruitment activities during the first six months of 2017 and filed 127 court cases against illegal and licensed agencies which are alleged to have violated the law, in order to ensure trustworthy foreign employment for Sri Lankan migrants. A total of 2,194 new complaints received from migrant workers and 3,079 complaints were settled during the first half of 2017.

- **Minimum wages to be paid for migrant workers were increased for all countries with effect from 01st February 2017**. Accordingly, the minimum wage to be paid to skilled and unskilled migrants has been raised to USD 450 and USD 350 per month, respectively. The objectives of this measure were to increase the remittance flow from migrant workers, discourage foreign employment in lower salary scales and to encourage skill development of migrant workers. However, a minimum wage regulation will raise the cost of Sri Lankan migrant labour, thereby affecting the competitiveness of Sri Lankan migrant employees in the international labour market.

Labour Relations

- **As per the data reported to the Labour Department pertaining to private industries, labour relations improved in the first half of 2017 in terms of the number of strikes, workers involved and man days lost due to strikes**. The number of man days lost declined by 63 per cent to 20,454 in the first half of 2017, compared to 55,219 in the corresponding period of 2016, mainly as a result of the decline in the man days lost in the Plantation sector. Workers involved in strikes declined to 4,559 during the period under review, compared to 13,628 workers involved in the same period, in the previous year. Apart from the strikes in the private industries, publicly available data revealed a number of strikes (14 strikes since the beginning of 2017) in sectors such as health, education, petroleum, postal and transportation, which could have had a significant negative impact on the daily lives of the general public and the social and economic activities of the country.

- **The Ministry of Labour and Trade Union Relations implemented a number of programmes to enhance industrial harmony**. This includes the introduction of new Acts, amendments to Acts and legal provisions, and the adoption of several precautionary measures to address issues relating to labour, employment and existing regulatory framework. As agreed in the National Labour Advisory Council (NLAC), decisions have been made to amend necessary legislation to address the issues such as low female labour participation, restriction of night work for women, comparatively lower maternity benefits, employment injury, unemployment and the ineffectiveness of the Industrial Dispute Settlement Mechanism. With the purpose of managing the industrial disputes, a decision was made to establish a special Median Unit at the Department of Labour to ensure productivity and sustainability of businesses.

Labour Productivity

- **Labour productivity measured in terms of Gross Value Added (in 2010 prices) per hour worked decreased by 1.4 per cent to reach Rs. 446.57 per hour worked in the first quarter of 2017 compared to Rs.452.82 in the corresponding period of 2016.** All three sectors reported a negative growth in labour productivity when compared to the same period in 2016. In terms of the level of productivity, the Services sector exhibited the most efficient use of the labour resource, recording the highest productivity level of Rs. 524.96 per hour worked, and was closely followed by the Industry sector with a productivity level of Rs 522.26 per hour worked. The decline in productivity in these two sectors during the first quarter of 2017, compared to the corresponding period of the previous year, was mainly due to the addition of new labour to those sectors, as observed by the increase in the number of persons employed in the two sectors. Continuing the trend observed in recent past, the Agriculture sector registered the lowest productivity levels. Accordingly, the Agriculture sector recorded a productivity level of Rs. 159.61 per hour worked during the first quarter of 2017, which is a decline compared to the level recorded in the corresponding period of the previous year. This is largely due to the decline in the Gross Value Added in the Agriculture sector, caused by adverse weather conditions despite the decline in the number employed.

Expected Developments

Prices

- **Inflation is expected to remain above the mid-single digit levels during the remainder of 2017**. Disturbed weather patterns in the recent past led to significant persistent supply disruptions of fresh food. Particularly, prices of vegetables, rice and coconuts, which already caused the general price level to reach an elevated level are expected to exhibit downward rigidities in the short run. If revisions to administered prices are introduced, inflation in the Non-food category would also increase. Furthermore, international commodity prices, which remained at benign levels in the recent past also show signs of increase. Along with the weakening of the domestic currency, the impact of the price developments in imported commodities will be more prominent on the domestic price level. Nevertheless, well anchored inflation expectations and forward-looking demand management policies are expected to contain inflation at single digits in the short run.

Wages and Productivity

- **The real wage erosion in both the formal private and public sectors signals a buildup of wage pressures and also possible productivity deteriorations in the near future**. The composite wage rate index, which measures the weighted average real wage growth across the public, formal private and informal private sectors has experienced a real wage erosion from the beginning of 2017. In such an environment, pressures remain high for wages to increase and productivity to decline. With respect to attracting Foreign Direct Investments (FDIs), Sri Lanka should focus more on cost competitiveness and productivity. In order to benefit from the available opportunities through regained market access to a greater global consumer base through GSP+ and upcoming trade agreements, the production capacities as well as productivity must be improved. As such, a range of measures has to be taken to improve productivity in the economy including skill upgrading, adoption of new technology, alignment of attitudes of the workforce and adjustments to wages associated with productivity linked incentives.

- **Low productivity levels in the Agriculture sector amid the real wage erosion would lead to further declines in productivity in the sector, contributing to other social and economic disturbances**. Considering the significant percentage of people employed in the Agriculture sector, the living standards of a large number of persons who are depending on the sector would also deteriorate. Apart from lack of new technologies, the decline in productivity in the Agriculture sector is also caused by frequent extreme weather conditions. Ultimately, the volatilities in the Agriculture sector affect the prices of fresh food, leading to high inflation, affecting the economy and the people.

- **Real wage erosion in the economy can be remedied through correcting the skewness of the current tax structure from indirect to direct taxes**. The current tax structure's skewness towards indirect taxes cause real wage erosion through the increase in inflation. Irrespective of the income level, the average consumer is compelled to pay a certain amount of taxes at the point of purchasing/consuming goods and services. These indirect taxes raise the cost of goods and services and in turn, inflation, leading to a real wage erosion. Thus, apart from remedying the real wage erosion through arrangements such as increasing the nominal wage levels, the erosion should be looked at from different aspects in which remedies can be offered, such as expedited reforms to the tax structure and productivity linked compensation packages.

Labour Force and Employment

- **The skills gaps and other deficiencies in the labour market need to be addressed through public private partnerships, and should reach the rural youth**. The persistent skill gaps and high level of unemployment among youth and females need to be continuously remedied through critical involvement by the private sector through need analysis based employment opportunities. The current initiatives by both the Government and Private sector institutions to address this issue is encouraging. Large scale campaigns on breaking the stigmas and gender stereotypes around certain professions are occurring at a leveraged scale through the participation of both government and private institutions. However, these campaigns should continue to reach the rural and poverty ridden youth with an intention of providing well targeted sustainable solutions. Such arrangements would lead to reducing the youth NEET (Not in Employment, Education or Training) ratio, and would address issues such as long term unemployment and underemployment. Further, it is important that the upskilling initiatives are carried out with proper coordination of all agencies involved. The training institutions and programme curricula need to be dynamic and should focus on the employability of participants in labour shortage and emerging sectors while phasing out obsolete courses in the consultation and participation of private sector institutions. If the training is not linked to labour market needs, it may create unrealistic expectations and will not provide income generating opportunities. Furthermore, if the domestic skilled labour supply does not cater to the emerging industries, it is necessary to facilitate the import of labour through appropriate legal provisions to support such industries.

- **The existence of a large informal sector would need to be addressed gradually to reduce vulnerability of employment and also to ensure that labour standards of the country are maintained at desirable levels**. The current employment structure of the country reflects 60.2 per cent of employees in the informal sector, of which a part of this segment might not have the benefit of proper superannuation schemes. Facilitating the availability of self-contributory superannuation schemes and increasing the awareness on the importance of such measures have to be mobilised for the workers to retire gracefully and also be able to meet the future challenges of an ageing population. Policy reforms need to be introduced to support innovative entrepreneurs in the informal economy through improved access to finance. An arrangement to standardize all professions through a process of progressive licensing based on their competencies will remove informality of employment, provide recognition and acceptance towards certain professions and also improve labour standards in the economy. This will also help to stipulate minimum wages for workers based on selected brand categories of professional skills supporting to improve the quality of labour available in the country.

- **Labour law reforms need to be initiated with a borderless international focus to facilitate new initiatives including the Hub Concept and the Colombo International Financial Center (CIFC)**. Labour laws are required to promote the creation of sustainable, productive and permanent employment while discouraging unprotected part-time and casual employment. As such, reforms should be initiated facilitating flexible and night time work (with adequate incentives and facilities ensuring safety and suitable working conditions for workers), spread over of working hours, market determination of wages and productivity linked incentives that would create novel working conditions which are beneficial for both employers and employees. Such initiatives would stimulate productivity progression, improve the potential to attract FDIs and ultimately improve the living standards through facilitating the economic growth.

- **As per the Gender Statistics published by the DCS, there is high potential for the female population to contribute towards enhancing economic activities**. Although females make up more than half of the success events at most education levels from Grade 5 scholarship examination through university entry, their contribution to economic activity is far below the potential, as reflected by persistently low female LFPRs. National level action has to be taken to attract females in to the labour force through increasing the availability of affordable and reliable child care facilities, safe transportation and accommodation facilities, enabling working from home, part time and flexible work options and also encouraging the private sector in expanding economic activities to the regional level, as well as strengthening the labour contracts including regulations to address gender discrimination.

- **Current demographics of the country indicate very high potential for child care and elderly care industries**. Since females make up the majority in the working age population amid a very low LFPR due to engaging in household responsibilities, it is required to attract more females into the labour force to meet the labour demand in the economy. Relieving household responsibilities from females will contribute in encouraging females to be economically active. Facilitating the creation of child care facilities for young children and day hostels for children of higher ages will generate employment opportunities for interested service providers and will provide time and space for service receivers also to be economically active. Furthermore, it is predicted that elderly persons will consist of 20 per cent of the population in Sri Lanka by 2030, which reflects the potential for elderly care facilities in the future. Furthermore, differently abled persons consist of around 7.9 per cent (1.6 million persons) of the population[6]. Inclusion of differently abled persons in income generating activities depending on their abilities will empower them by creating self-reliance, financial strength and dignity, while providing them an opportunity to contribute in the development process of the country.

- **The subjects introduced in the Professional Stream under the pilot project to certify 13 year education by the Government adds value to the free education system by trying to ensure readiness to labour market requirements**. Under this scheme, the students will be able to pursue a stream of education of their interest after sitting for the G.C.E. Ordinary Level Examination while the subjects introduced target on developing the soft skills of students. If implemented with proper resources, the young generation will be ready to take up opportunities in the domestic labour market after the successful completion of a 13 year education.

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6. Census of Housing and Population (2012) conducted by the DCS

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EXTERNAL SECTOR DEVELOPMENTS

Sri Lanka's external sector showed signs of improvement in 2017 as the pressure on the Balance of Payments (BOP) continued to ease with higher inflows to the financial account, despite the increased current account deficit. The current account deficit increased to US dollars 1,466 million during the first half of 2017, from US dollars 644 million in the corresponding period of 2016. This expansion in the current account deficit was particularly due to the widened trade deficit owing to higher imports recorded during the first half of the year, amidst the gradual pickup in exports since March, moderate earnings from tourism with the partial closure of the Bandaranaike International Airport (BIA) for resurfacing of the runway as well as health advisories related to an increase in dengue cases and the decline in workers' remittances amidst the slowdown in the Middle Eastern economies. Conversely, the financial account, which was under pressure due to higher foreign exchange outflows during the first quarter of 2017, improved substantially during the second quarter. Increased investor confidence brought about by the successful completion of the Second Review of the IMF Extended Fund Facility (IMF - EFF) and the gradual stabilisation of US bond yields positively contributed to this improvement in the financial account. Accordingly, foreign investment in the government securities market increased substantially in the second quarter of 2017, offsetting the impact of higher withdrawals during the first quarter. The financial account was also augmented by inflows to the Colombo Stock Exchange (CSE), foreign direct investment (FDI), and proceeds of the eleventh International Sovereign Bond (ISB) and the foreign currency term financing facility obtained by the government. Reflecting these developments, the BOP recorded an overall surplus of US dollars 2,037 million by end September 2017. Improved external sector performance facilitated the Central Bank's policy of implementing a more market-based exchange rate. Accordingly, the Central Bank limited its intervention in the foreign exchange market only to build up international reserves with a minimal impact on the exchange rate. With the Central Bank purchases of US dollars 1,161 million from the market, on a net basis during the first nine months of the year, the level of gross official reserves improved to US dollars 7.3 billion, equivalent to 4.2 months of imports, by end September 2017, from US dollars 6.0 billion at end 2016. During the year up to end September, the external value of the Sri Lankan rupee remained relatively stable, depreciating only by 2.2 per cent against the US dollar. However, an adjustment in the current account through an improved trade balance and higher foreign investment inflows, particularly in the form of export-oriented FDI, is needed for the recent positive developments in the external sector to be sustained in the medium term.

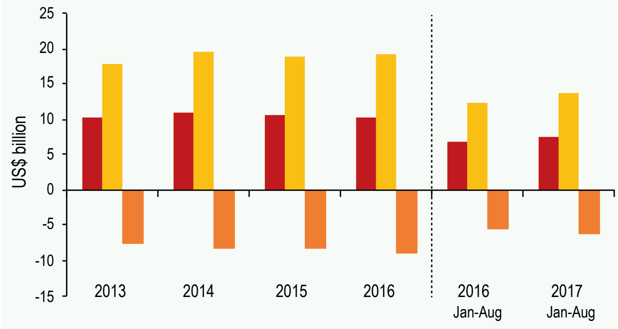
Trade in Goods and Trade Balance

- **External trade, which indicated a sluggish performance during the past two years, rebounded during the first eight months of 2017.** Both earnings from exports and expenditure on imports increased during this period. However, the overall trade deficit expanded during the first eight months of 2017, owing to a significant increase in import expenditure compared to export earnings. Accordingly, the deficit in the trade account widened to US dollars 6,186 million during the first eight months of 2017 from US dollars 5,515 million in the corresponding period of 2016.

- **Benefitting from several positive developments, earnings from exports revived during the first eight months of 2017.** Earnings from exports increased by 7.6 per cent to US dollars 7,413 million during the first eight months of 2017, from US dollars 6,888 million in the corresponding period of 2016. This was owing to the recovery in key export markets, increased commodity prices in the international market, conducive external trade policies together with institutional support, the gradual depreciation of the exchange rate, the removal of the ban on exports of Sri Lankan fisheries products to the European Union (EU) and the reinstatement of the EU GSP+ facility.[1] Exports of all major categories increased during this period and the highest contribution to the growth in exports was from agricultural exports (56.1 per cent), followed by industrial exports (42.8 per cent).

- **Earnings from agricultural exports, which account for about a quarter of total exports, showed a strong performance during the first eight months of 2017, registering a 19.4 per cent year-on-year growth to reach US dollars 1,815 million.** Higher export earnings from tea, spices and seafood largely contributed to this growth. Earnings from tea exports, which declined by 7.3 per cent (year-on-year) during the first eight months of 2016, increased significantly by 20.1 per cent to US dollars 1,003 million during the first eight months of 2017. This was mainly due to high average export prices of tea despite the decline in export volumes by 3.6 per cent. Reflecting the higher tea prices in the international market, the average export price of tea increased by 24.6 per cent to US dollars 5.27 per kg during the first eight months of 2017 compared to US dollars 4.23 per kg recorded in the same period of 2016. Export earnings from spices increased by 28.1 per cent (year-on-year) to US dollars 249 million during the first eight months of 2017 mainly due to the increase in export volumes of cloves and cinnamon. Export earnings from cloves increased more than four-fold during the first eight months of 2017, while earnings from cinnamon increased by 18.7 per cent (year-on-year). Further, earnings from seafood exports rose by 40.4 per cent (year-on-year) to US dollars 155 million during the first eight months of 2017 following the removal of the ban on exports of fisheries products to the EU market in June 2016 together with the regaining of the GSP+ facility. Accordingly, earnings from seafood exports to the EU market increased significantly by 118.3 per cent (year-on-year), benefiting from the high demand from France, the UK, Italy, Germany and Netherlands. In addition, earnings from minor agricultural products, such as betel leaves and fruits as well as rubber and unmanufactured tobacco contributed to the growth in earnings from agricultural exports during this period. Earnings from coconut exports also increased marginally by 0.7 per cent

Chart 5.1
External Trade Performance



Sources : Sri Lanka Customs
Central Bank of Sri Lanka

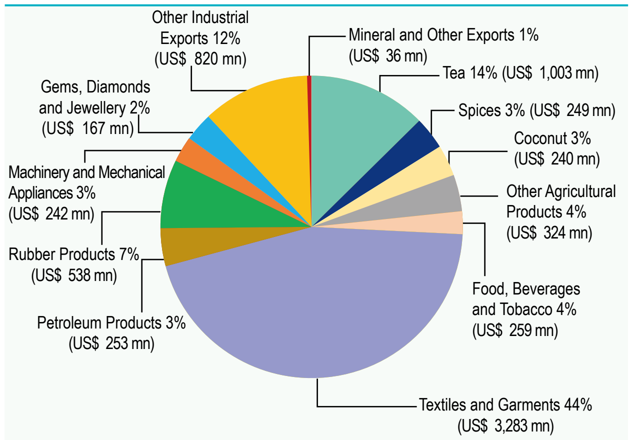
1 EU GSP+ was granted to Sri Lanka from July 2005. However, the lack of progress in 27 specified international conventions in the fields of core human and labour rights, the environment and good governance led to Sri Lanka losing the GSP+ facility in August 2010. This facility was regained in May 2017 allowing the country to export 66 per cent of its products tax-free to the European market.

(year-on-year) to US dollars 240 million, owing to an increase in earnings from non-kernel coconut products exports by 7.0 per cent, despite the poor performance registered in coconut kernel products, particularly in desiccated coconut exports.

- **Earnings from industrial exports, which account for around 75 per cent of total exports, increased by 4.2 per cent (year-on-year) to US dollars 5,562 million during the first eight months of 2017.** This was mainly due to higher export earnings from petroleum products, transport equipment, and machinery and mechanical appliances. Earnings from exports of petroleum products increased by 36.3 per cent (year-on-year) during the first eight months of 2017, owing to the increased export volumes and high prices for bunkering fuel in the international market. Earnings from transport equipment increased by 70.7 per cent (year-on-year) to US dollars 138 million during the first eight months of 2017, due to the export of three ships to Singapore. Further, earnings from machinery and mechanical appliances registered a 20.9 per cent growth (year-on-year) during this period due to increases recorded in all sub categories except for electronic equipment. In addition, export earnings from food, beverages and tobacco, rubber products, base metals and articles, and wood and paper products also increased during this period. However, earnings from textiles and garments, which account for more than 44 per cent of total exports, declined by 1.5 per cent (year-on-year) to US dollars 3,283 million during the first eight months of 2017, reflecting the decline in the exports of garments to the EU and USA, the main traditional markets for Sri Lankan garment exports, particularly in the first half of the year. In contrast, garment exports to non-traditional markets such as Canada, Australia, Hong Kong, Mexico and the UAE increased during this period. Although, export earnings from textiles and garments reported a decline in the first eight months of the year, on a cumulative basis, a notable increase was recorded during the months of July and August 2017, signalling the positive impact of the restoration of the GSP+ facility in May 2017. Meanwhile, earnings from gems, diamonds and jewellery, and leather, travel goods and footwear declined by 11.0 per cent and 7.5 per cent to US dollars 167 million and US dollars 107 million, respectively, during the period under review.

Chart 5.2

Composition of Exports (Jan-Aug 2017)



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

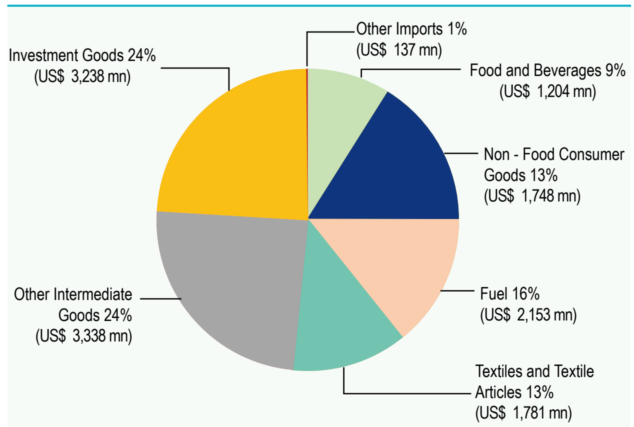
- **Earnings from the export of mineral products increased by 24.6 per cent (year-on-year) to US dollars 25 million during the first eight months of 2017.** All sub categories, particularly exports of earths and stones, contributed to the growth in earnings from mineral exports during this period.

- **Expenditure on imports increased by 9.6 per cent (year-on-year) to US dollars 13,599 million during the first eight months of 2017.** High commodity prices in the international market, increased reliance on thermal power generation due to drought conditions and measures taken to import rice to meet the shortage in the domestic supply led to an increase in expenditure on imports during the first eight months of 2017. Meanwhile, expenditure on non-fuel imports grew by 5.0 per cent to US dollars 11,446 million during this period.

- **Imports of intermediate goods largely contributed to the expansion in expenditure on imports.** Expenditure on intermediate goods, which accounts for more than half of total imports, increased by 15.3 per cent (year-on-year) to US dollars 7,272 million during the first eight months of 2017, mainly driven by high fuel imports. Expenditure on fuel imports increased by 43.4 per cent (year-on-year) to US dollars 2,153 million during this period, mainly due to the increase in import expenditure on refined petroleum products by 54.0 per cent (year-on-year) to US dollars 1,588 million, reflecting the impact of price increases in the international market as well as the increase in import volumes. Import expenditure on crude oil and coal also increased during the period, owing to increased prices in the international market and increased demand from the domestic power generation sector. The average import price of crude oil increased by 25.2 per cent to US dollars 54.38 per barrel during the first eight months of 2017, in comparison to US dollars 43.44 per barrel recorded during the corresponding period of 2016. Meanwhile, import expenditure on diamonds, precious stones and metals grew by 58.6 per cent (year-on-year) to US dollars 475 million during the first eight months of 2017, mainly due to the increase in gold imports by 90.6 per cent to US dollars 403 million, owing to the high volumes imported following the removal of the Port and Airport Development Levy (PAL) on gold imports with effect from January 2016. Increases in expenditure on imports of base metals (41.5 per cent), wheat and maize (36.9 per cent) and food preparation (29.7 per cent) also contributed towards the increase in intermediate goods imports during the first eight months of 2017. Expenditure on textiles and textile articles imports increased marginally by 0.9 per cent (year-on-year) during the first eight months of 2017. In line with the improved performance observed in export earnings from textiles and garments, following the restoration of the GSP+ facility, the import of raw material for textiles and garment industry is expected to increase in the future. However, import expenditure on fertiliser, mineral products and chemical products decreased by 35.4 per cent, 22.4 per cent and 3.2 per cent, respectively, during the period concerned.

- **With respect to the consumer goods category, import expenditure on food and beverages increased during the first eight months of 2017, while expenditure on non-food consumer goods declined**. The overall import expenditure on consumer goods, which accounts for around 22 per cent of total imports, increased by 4.5 per cent to US dollars 2,952 million during the first eight months of 2017 from US dollars 2,825 million in the corresponding period of 2016. Import expenditure on food and beverages increased by 15.9 per cent to US dollars 1,204 million, mainly due to the high expenditure on rice and dairy products. A continuous increase in rice imports was recorded since January 2017, as a result of the measures taken by the government to encourage rice imports to meet the shortage in the domestic supply. Accordingly, the import volume of rice increased to 446 million kg during the first eight months of 2017 from 18 million kg recorded during the corresponding period of 2016. The import expenditure on dairy products also increased by 29.2 per cent (year-on-year) during the first eight months of 2017, reflecting to a larger extent higher average import prices for milk powder that prevailed in the international market amidst global supply disturbances. In addition, expenditure on fruits, and oils and fats contributed towards the higher import outlays on food and beverages during the period. However, import expenditure on spices and vegetables declined during the first eight months of 2017. Meanwhile,

Chart 5.3
Composition of Imports (Jan-Aug 2017)



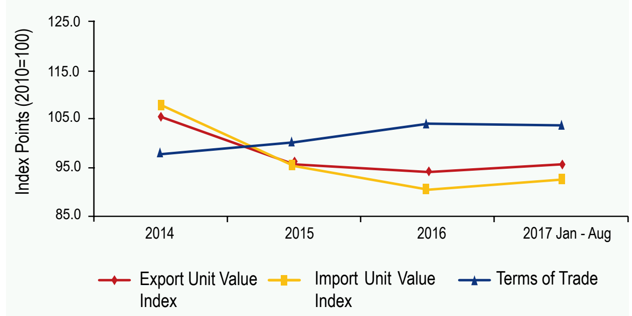
Sources : Ceylon Petroleum Corporation
Lanka IOC PLC
Sri Lanka Customs
Central Bank of Sri Lanka

expenditure on non-food consumer goods imports declined by 2.1 per cent (year-on-year) to US dollars 1,748 million, mainly due to the decline in vehicles for personal use, and medical and pharmaceutical items. However, import expenditure on telecommunication devices, and clothing and accessories increased during the period under review.

- **Expenditure on investment goods imports declined marginally during the first eight months of 2017**. Expenditure on imports of investment goods decreased by 0.7 per cent to US dollars 3,238 million during the first eight months of 2017 due to reduced imports of machinery and equipment, which declined by 4.2 per cent (year-on-year). This was driven by a reduction in the imports of machinery for the textile industry and agricultural activities, electric motors and generating sets, turbines and telecommunication devices, despite the increase in imports of engineering equipment as well as machines for office work. However, import expenditure on building materials increased by 2.8 per cent to US dollars 1,055 million during the first eight months of 2017, due to higher import expenditure on iron and steel, aluminium articles, wood products, and insulated wires and cables. Import expenditure on transport equipment also increased by 5.9 per cent, due to higher imports of tankers, bowsers and vans.

Chart 5.4

Terms of Trade and Trade Indices



Source : Central Bank of Sri Lanka

Terms of Trade

- **The terms of trade, on average, increased during the first eight months of 2017 in comparison to the corresponding period in 2016, reflecting a higher increase in the export price index relative to the increase in the import price index**. The overall export price index rose moderately by 1.5 per cent (year-on-year) to 95.8 index points during the first eight months of 2017 due to increases in prices of agricultural exports. The export price index for agricultural products increased by 13.1 per cent (year-on-year) during the first eight months of 2017, mainly on account of a 23.3 per cent increase in tea prices, in line with the high prices prevailing in the international market. However, the export price index for industrial products decreased by 1.8 per cent (year-on-year) due to the decline in the average price of many sub categories, particularly transport equipment, machinery and mechanical appliances, base metals and articles, wood and wood products, and plastics and articles. Reflecting higher fuel prices in the international market, the price index of petroleum product exports increased substantially by 27.4 per cent during the first eight months of 2017. Meanwhile, the overall import price index increased marginally by 0.4 per cent during the first eight months of 2017, due to higher prices of intermediate goods despite the decline in prices of investment and consumer goods. The intermediate goods import price index increased by 2.9 per cent, reflecting a 21.6 per cent increase in the fuel price index, despite the reduction in prices of most of the other intermediate goods imports, particularly fertiliser, mineral products, plastic and articles thereof, and diamonds, precious stones and metals. Meanwhile, the price index for investment goods imports declined during the first eight months of 2017, indicative of lower prices in machinery and equipment, and building materials. The price index for consumer goods declined during the period as a result of lower prices, on average, for food and beverages, and non-food consumer goods. Accordingly, the terms of trade improved by 1.0 per cent to 103.7 index points during the first eight months of 2017 over the corresponding period in 2016. Further, excluding oil-related products, the terms of trade recorded an increase of 2.8 per cent.

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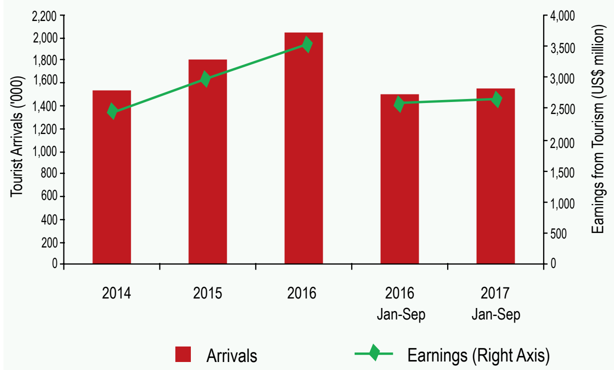
Trade in Services

- **The surplus in the services account increased during the first half of 2017, as earnings from services exports outgrew expenditure on services imports**. Accordingly, the services account of the BOP, which mainly consists of travel, transport and telecommunication, computer and information services, recorded a surplus of US dollars 1,407 million during the first half of 2017 compared to a surplus of US dollars 1,314 million during the corresponding period of 2016.

- **Gross inflows on account of transport services, which consist of passenger fares, freight charges, and port and airport related activities, grew moderately during the first half of the year 2017**. Accordingly, gross earnings from transport services registered a growth of 3.9 per cent to reach US dollars 1,182 million during this period. Meanwhile, outflows on account of transportation services increased at a higher rate of 5.3 per cent to US dollars 872 million, largely due to the increased port and airport related service payments, particularly the higher spending incurred on freight and air travel services. Inflows relating to passenger fares increased by 2.9 per cent to US dollars 568 million during the first half of 2017. The slowdown of earnings from passenger fares particularly in the first quarter of the year could be mainly attributed to the drop in the number of passengers travelling to Sri Lanka as a result of the partial closure of the Bandaranaike International Airport (BIA) during January to April 2017 for the re-laying of the runway. Meanwhile, with the expansion in port related activities, inflows on account of freight charges, with respect to both port and airport related activities, increased during the first half of 2017. Gross inflows from freight charges increased by 4.9 per cent to US dollars 614 million, mainly due to the increased cargo, container and transhipment volumes handled at the port of Colombo.

Chart 5.5
Tourist Arrivals and Earnings from Tourism



Sources : Sri Lanka Tourism Development Authority
Central Bank of Sri Lanka

- **The tourism industry indicated some moderation during the first nine months of 2017 while remaining a major foreign exchange earner to the country**. Although tourist arrivals crossed the 2 million milestone for the first time in 2016, the performance of the industry during the first nine months of 2017 was moderate, as tourist arrivals recorded a subdued growth of 2.9 per cent (1,551,931 arrivals) over the corresponding period of 2016. Flight cancellations and delays at the BIA until April 2017, caused by partial operations of the airport owing to the repair and upgrade of the runway, and the breakout of dengue epidemic partly contributed to the sluggish performance in the tourism industry. Tourists from Western Europe dominated arrivals, followed by South Asia and East Asia. However, tourist arrivals from the South Asian region recorded a marginal decline compared to the first nine months of 2016, mainly due to the decline in arrivals from Maldives by 17.3 per cent. In terms of country origin, arrivals from India, the major tourist origin for Sri Lanka, increased by 6.1 per cent to 267,601, while a moderate decline was recorded in arrivals from China.

- **Following the trend in tourist arrivals, earnings from tourism[2] recorded a moderate growth during the first half of 2017**. On a cumulative basis, earnings from tourism increased by 4.8 per cent to US dollars 1,733.6 million during the first

2 This provisional estimate may be revised once the Sri Lanka Tourism Development Authority releases its survey results on average stay period and average spending per day estimates for 2017.

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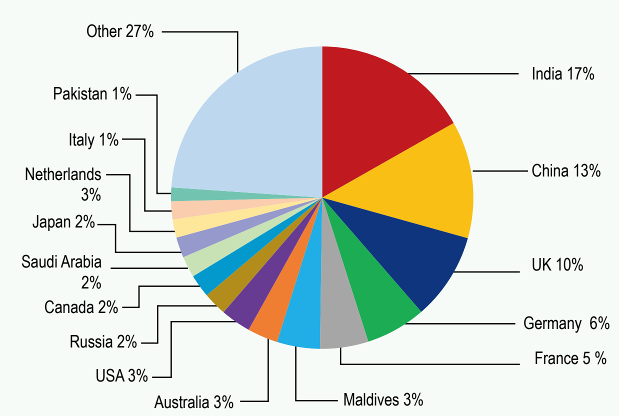
Chart 5.6
Tourist Arrivals by Country (Jan-Sep 2017)



Source : Sri Lanka Tourism Development Authority

half of 2017. Earnings from tourism during the period from January to September 2017 grew by 2.9 per cent to US dollars 2,662.6 million from US dollars 2,587.9 million in the corresponding period of 2016.

- **The tourism industry has attracted a substantial amount of investments during the first eight months of 2017**. Since the initiation of the One Stop Unit (OSU) at the Sri Lanka Tourism Development Authority (SLTDA) in 2010, a centralised promotion and facilitation centre established to assist potential investors interested in investing in the tourism industry, 597 project proposals have been received. Out of these, 497 hotel projects with 28,783 rooms were approved, totalling an investment of US dollars 5,137 million. Among those, proposals for 53 new hotel projects worth US dollars 261 million, with room capacity of 1,966 were received during the first eight months of 2017, while approvals were granted for 26 projects worth US dollars 314 million with a capacity of 1,550 rooms. In addition, 17 hotel projects commenced operations, adding 1,190 rooms during this period. These developments will help cater to the expected 4 million tourist arrivals by 2020.

- **Earnings from telecommunication, computer and information services, the main contributor to growth in the services account, continued to grow steadily during the first half of 2017**. Earnings from the export of telecommunications, computer and information services amounted to US dollars 457 million in the first half of 2017, compared to US dollars 442 million during the corresponding period of 2016. The growth in this sub sector was mainly driven by increased inflows from the export of software and Information Technology Enabled Services (ITES), including Business Process Outsourcing (BPO) and Knowledge Process Outsourcing (KPO).

Primary Income

- **The deficit in the primary income account continued to expand in the first half of 2017, albeit marginally, mainly due to interest payments on International Sovereign Bonds (ISBs).** The deficit in the primary income account was US dollars 1,038 million during the first half of the year in comparison to US dollars 971 million in the corresponding period of 2016. However, withdrawal of dividends by direct investors and reinvestment of earnings with respect to direct investments remained at similar levels during the period under review vis-a-vis the first half of 2016. There is a gradual increase in interest payments on government borrowings with new issuances of ISBs as well as borrowings from the foreign currency term financing facility, as the increase in global interest rates affected the cost of borrowing of both the government and private sector.

Secondary Income

- **The secondary income account, which consists of private and government transfers, recorded a notable decline in its surplus during the first half of 2017 with reduced workers' remittances**. Net inflows to the secondary income account declined by 9.4 per cent, year-on-year, to US dollars 2,904 million in the first half of 2017, from US dollars 3,204 million in the corresponding period of 2016. As observed in the last year, the sluggish performance of the Middle Eastern economies, as a result of relatively low oil prices and geopolitical uncertainties, adversely affected the growth in workers' remittances during 2017 as well. Moreover, according to data provided by the Sri Lanka Bureau of Foreign Employment, labour migration for foreign employment under each skill category declined, reducing the overall labour migration rate significantly by 14.6 per cent during the first half of 2017, in comparison to the corresponding period of the previous year. This may have also contributed towards the decline of workers' remittances. Meanwhile, workers' remittances have declined by 7.4 per cent to US dollars 4,985 million during the first nine months of 2017 compared to US dollars 5,382 million recorded during the corresponding period in 2016.

Current Account Balance

- **Sri Lanka's current account deficit further widened in the first half of 2017, deviating from the expected improvement for the year, mainly due to increased drought related imports, slower pick up in exports, moderation in tourist earnings and decline in workers' remittances**. The trade balance deteriorated significantly despite the pickup in export earnings since March 2017, as exports proceeds were insufficient to offset the substantial increase in import expenditure. The increase in import expenditure during the first half of the year was mainly due to higher expenditure on drought related imports of fuel and rice. The higher importation of gold also contributed to the increase in import expenditure during the period under review. Moreover, the deficit in the primary income account widened during the year up to end June, driven mostly by increased interest payments. The surplus in the services account also moderated during the period primarily due to the subdued performance of the travel and transport subsectors, while inflows to the secondary income account, which mainly consists of workers' remittances, declined considerably, exerting more pressure on the current account of the BOP. As a result, the current account deficit widened to US dollars 1,480 million in the first half of 2017, from a deficit of US dollars 644 million in the corresponding period of 2016.

Capital Account Balance

- **Net inflows to the capital account remained modest in the first half of 2017**. Net inflows to the capital account amounted to US dollars 8 million in the first half of the year from US dollars 1 million in the first half of 2016. The significance of the capital account in the overall context of the balance of payments has diminished over the past few years as capital grants to the government have reduced with Sri Lanka's elevation to a lower middle-income country status in 2010.

Financial Account

- **The financial account recorded a mixed performance in the first half of 2017**. The financial account witnessed significant outflows in the first quarter of 2017, primarily due to considerable foreign investment outflows from the government securities market. Low foreign investments in the CSE as well as low levels of direct investments during the first quarter of the year also affected the performance of the financial account. However, a reversal in financial flows was witnessed in the second quarter of the year, with increased investor confidence brought by the continuation of the IMF-EFF program as well as the gradual stabilisation of US government bond yields. Consequently, there were steady inflows to the government securities market in the second quarter of the year, while net foreign inflows to the CSE were also witnessed during this period. The eleventh international sovereign bond (ISB) and the foreign currency term financing facility obtained by the government were the major sources of foreign inflows to the financial account of the BOP.

- **Foreign Direct Investment (FDI) inflows improved substantially in the first half of 2017 compared to the first half of 2016**. Total FDI inflows, inclusive of foreign loans to BOI companies, amounted to US dollars 711 million during the first half of 2017, in comparison to US dollars 293 million in the corresponding period of 2016. Meanwhile, FDI excluding foreign loans to BOI companies, increased to US dollars 509 million during the first half of 2017, from US dollars 173 million during the comparable period of 2016. Tourism, telecommunication and infrastructure sectors attracted a major share of the FDI inflows during the first half of 2017. Attracting FDI to Sri Lanka is crucial since they are non-debt creating and long term in nature. Hence, Sri Lanka needs to attract FDI by accelerating reforms to enhance competitiveness, while assuring consistency in policies and political stability. There were several proposals in the Budget 2017 to reach a higher level of FDI, including initiatives such as an allocation to brand Sri Lanka and establish the Agency for Development to facilitate foreign investments, with the objective of providing clearance for BOI projects within 50 days. The government introduced 'Roadmap for Improving Investment Climate' in July 2017 with technical assistance of the World Bank Group, to improve the ease of doing business in Sri Lanka. This road map proposes a single window for new business registration, which will drastically reduce the difficulties in starting-up new businesses.

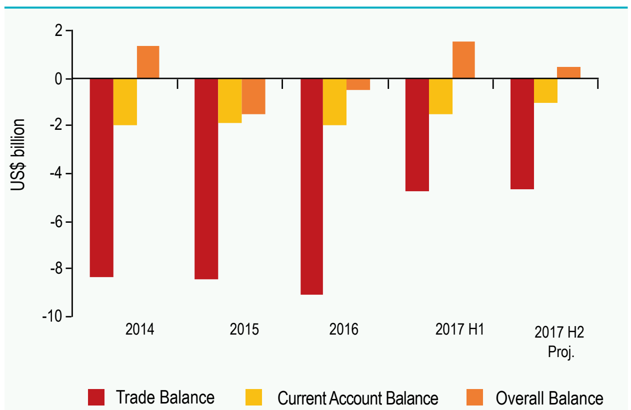
- **Sri Lanka also settled the foreign currency SWAP arrangement with the Reserve Bank of India (RBI) as well as the remaining balance of the IMF-SBA facility obtained in 2009 during the year**.The outstanding amount of the RBI swap facility of US dollars 400 million, which was the only remaining international swap arrangement as at end 2016, was fully settled in March 2017. Further, the Central Bank fully settled the IMF-SBA facility in July 2017.

- **The overall developments in the financial account resulted in a net inflow to the financial account in the first half of 2017**. As a result, the net incurrence of liabilities amounted to US dollars 2,353 million, while the net acquisition of assets amounted to US dollars 1,057 million in the first half of 2017. Consequently, the net inflow to the financial account amounted to US dollars 1,295 million during the period under review.

- **Reflecting movements in financial account inflows, gross official reserves, which declined to US dollars 5.1 billion at the end of the first quarter of 2017 from US dollars 6.0 billion as at end 2016, increased to US dollars 7.0 billion by June 2017.** Continuous outflow of foreign investments from government securities in the first two months of the year prompted the Central Bank to intervene in the domestic foreign exchange market significantly during this period, which led to a drain in reserves. However, with the reversal in the trend of foreign investment inflows during the second quarter, the Central Bank was able to purchase foreign exchange from the market gradually from March 2017 onwards, thereby improving the level of reserves during the second quarter of 2017. Gross official reserves increased further with the proceeds of the ISB issuance, foreign currency term financing facility and the receipt of the third tranche of the IMF- EFF by the end of the third quarter of 2017.

- **In the backdrop of the unfavourable global economic environment that prevailed in 2016 and continued pressure on external sector stability, Sri Lanka obtained a three year EFF from the IMF in June 2016**. The facility was obtained with the aim of improving Sri Lanka's BOP position and supporting the government's

Chart 5.7
Balance of Payments



Source : Central Bank of Sri Lanka

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economic reform agenda. The total value of the facility at SDR 1.1 billion (approximately US dollars 1.5 billion), is equivalent to 185 per cent of the country's current quota with the IMF. The first tranche under the EFF amounting to SDR 119.9 million (approximately USD 169 million) was made available to Sri Lanka in June 2016. Two more tranches have been disbursed thereafter, with the latest being the third tranche received in July 2017. Consequently, Sri Lanka has received SDR 360 million (approximately US dollars 500 million) from the IMF-EFF program as at end September 2017 and the fourth tranche is to be disbursed in December 2017. The remaining portion of the facility is expected to be disbursed in three more tranches over the next two years, with the final tranche expected in April 2019.

International Investment Position (IIP)

- **In terms of the International Investment Position (IIP), Sri Lanka's external asset position and the liability position increased at end June 2017 from the position at end 2016.** The stock position of assets increased primarily as a result of the increase in gross official reserves. The reserve asset position, which stood at US dollars 6,019 million at end December 2016, increased to US dollars 6,959 million by end June 2017, as a result of continuous foreign exchange purchases from the market by the Central Bank in addition to proceeds from the ISB and the foreign currency term financing facility. 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 declined at end June 2017 in comparison to end 2016. The asset position of direct investments also increased marginally during the period.

- **Sri Lanka's total external liability position at end June 2017 registered an increase from the previous year**. The increase in external liabilities was primarily an outcome of the issuance of the ISB of US dollars 1.5 billion as well as the increase in the outstanding government foreign loans position with the proceeds of the foreign currency term financing facility. Consequently, the total external liability position increased from US dollars 55,036 million at end December 2016 to US dollars 58,094 million at end June 2017. The stock position of direct investments increased due to the increase in the outstanding position of direct investment equity and investment fund shares as at end June 2017. The increase in the stock position of equity and investment fund shares can be attributed to higher direct investment transactions during the period and the valuation gains, particularly of companies listed in the CSE. The total outstanding position of portfolio investments increased with the issuance of the ISB and moderate inflows to the CSE during the first half of 2017. Continuous foreign investment inflows to the primary and secondary markets of the CSE resulted in increasing the equity stock position during the first half of 2017, despite valuation losses in market prices in publicly listed companies. The portfolio investment stock position of debt securities increased with the issuance of the ISB as well as the marginal increase in outstanding rupee denominated debt securities in the form of treasury bills and treasury bonds.

- **The total outstanding position of foreign loans increased with the foreign currency term financing facility obtained by the government in June 2017 and other project loans to the government as well as the increase in long term loans by deposit taking corporations during the first half of 2017**. The outstanding position of government foreign loans, which represent the largest component of the outstanding liability position of the IIP, increased with higher government project loans, including the foreign currency term financing facility obtained during the first half of the year. The outstanding position of foreign loans obtained by deposit taking corporations has also increased, particularly due to the increase in long term loan facilities obtained by the banking sector. Meanwhile, the Central Bank completed paying off the IMF-SBA facility obtained in 2009 by July 2017.

- **The outstanding position of currency and deposit liabilities and other payables declined while payables on trade credit and advances increased during the first half of 2017**. The outstanding currency and deposit liability position of deposit taking corporations declined significantly with deposit taking corporations opting for higher foreign loan liabilities during the period. Outstanding trade credit and advances increased during the period particularly due to an increase in trade credit obtained by the Ceylon Petroleum Corporation (CPC).

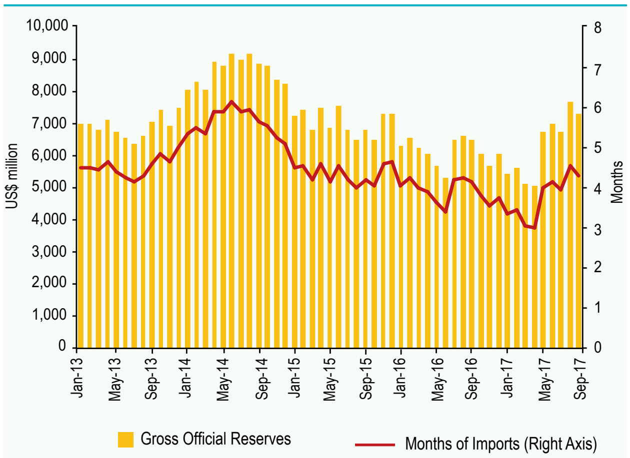
External Debt Position

- **Sri Lanka's external debt increased during the first half of 2017.** Consequently, the total external debt stock increased from US dollars 46.6 billion as at end 2016 to US dollars 49.1 billion at end June 2017. The external debt position of the government, which is the major component of external debt of the country, increased to US dollars 29,697 million as at end June 2017 from US dollars 27,197 million at end 2016, primarily due to the proceeds of the eleventh ISB issuance of US dollars 1.5 billion and proceeds from the first tranche of the foreign currency term financing facility of US dollars 450 million. Project loan inflows to the government also increased, contributing to the higher government external debt position. However, the outstanding external debt position of the Central Bank reduced with the settlement of the currency swap agreement with the RBI amounting to US dollars 400 million, net repayment of the Asian Clearing Union (ACU) liabilities amounting to US dollars 50 million and IMF-SBA payments amounting to US dollars 187 million during the first half of 2017. Meanwhile, the external debt stock of deposit taking corporations increased primarily due to higher inflows of long term loans. Further, the external debt position of the private sector also increased mainly due to the increase in trade credit and advances.

Reserve Asset Position

- **Gross official reserves of the country increased to US dollars 7.3 billion at end September 2017 from US dollars 6.0 billion at the end of 2016.** This significant increase was observed at end of first nine months of 2017, amidst the settlement of US dollars 400 million under the RBI currency swap agreement in March 2017, foreign currency debt service payments of around US dollars 1.3 billion, IMF-SBA principal payment of around US dollars 187 million and net ACU outflows of around US dollars 319 million. Apart from the receipt of the ISB, proceeds of the foreign currency term financing facility and net borrowings through Sri Lanka Development Bonds, the Central Bank's net absorption of US dollars 1,161 million from the domestic foreign exchange market contributed to the significant increase in gross official reserves during the first nine months of the year. Consequently, the level of gross official reserves increased to US dollars 7.3 billion by end September 2017, equivalent to 4.2 months of imports. This, in turn, enabled the Central Bank to build up reserves to meet the Net International Reserve (NIR) targets under the

Chart 5.8
Gross Official Reserves and Months of Imports



Source : Central Bank of Sri Lanka

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IMF-EFF. The build-up of reserves through direct market purchases and the reduction in short-term liabilities led to a qualitative improvement in international reserves during the year. As such, the reserve adequacy as a percentage of short-term debt and liabilities improved to 62 per cent by end September 2017 from 52 per cent at end 2016.

- **Total international reserves, which comprise gross official reserves and foreign assets of commercial banks, increased to US dollars 9.8 billion at end August 2017 from US dollars 8.4 billion at end 2016.** The increase was a combined effect of the increase in gross official reserves by US dollars 1,675 million and the decrease in holdings of commercial bank foreign assets by US dollars 276 million. By end August 2017, the coverage of total international reserves was equivalent to 5.7 months.

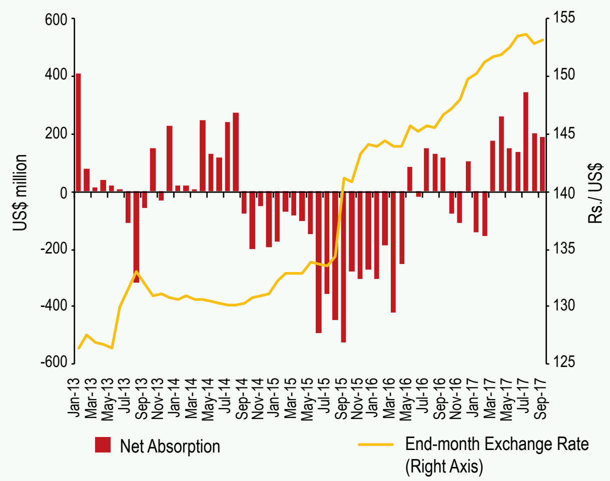
Balance of Payments (BOP)

- **The BOP recorded an overall surplus of US dollars 1,563 million during the first half of 2017 against an overall deficit of US dollars 1,186 million recorded during the corresponding period of 2016**. The BOP surplus is estimated to have further improved to US dollars 2,027 million at end September 2017. Reflecting the pressure on the external sector, the BOP was in deficit during the past two years and in the first quarter of 2017, but turned in to a surplus during the second quarter of the year. The receipt of the proceeds of the ISB amounting to US dollars 1.5 billion, foreign currency term financing facility of US dollars 1.0 billion, net borrowing of around US dollars 410 million through Sri Lanka Development Bonds, the net absorption of US dollars 1,161 million from the domestic foreign exchange market and the receipt of the third tranche of the IMF-EFF at US dollars 167 million in mid-July helped strengthen the external position throughout the year up to end September 2017.

Exchange Rate Movements

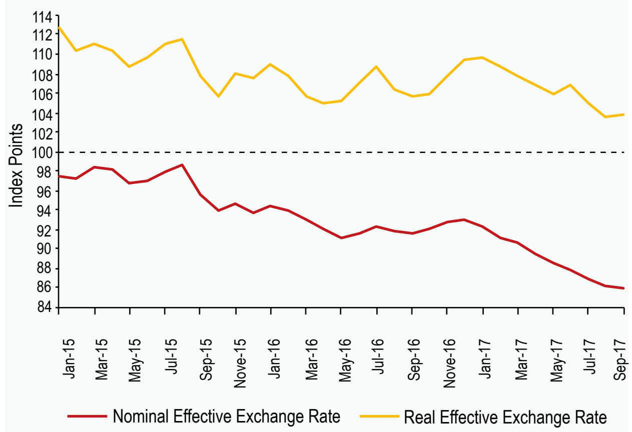
- **As stated in the Road Map 2017, the Central Bank implemented a more market based exchange rate policy during the year, which limited the Central Bank intervention in the foreign exchange market only to build-up international reserves with a minimal impact on the exchange rate**. Accordingly, the external value of the Sri Lankan rupee remained relatively stable during the year up to end September 2017 amidst substantial absorption of foreign exchange liquidity by the Central Bank. The significant depreciation pressure on the rupee that existed particularly during the first quarter of 2017, was mainly due to continued outflows in terms of import expenditure, debt service payments and unwinding of foreign investments in the government securities market. The depreciation pressure that prevailed during the first two months of the year necessitated the Central Bank to supply foreign currency liquidity to the domestic foreign exchange market to defend the external value of the Sri Lankan rupee. However, this situation turned around since March 2017, particularly with increased foreign investments in the CSE and the government securities market and the conversion of export proceeds, and provided an opportunity for the Central Bank to absorb foreign exchange liquidity from the market. This contributed towards the relative stability of the rupee against the US dollar during the period March to September 2017. The depreciation pressure on the rupee further eased gradually from May onwards with the issuance of the ISB, the receipt of the foreign currency term financing facility and the disbursement of the third tranche of the IMF-EFF programme, which helped improve investor confidence. Overall, the Sri Lankan rupee depreciated by 2.2 per cent against the US dollar during 2017 up to end September. The Sri Lankan rupee also depreciated by 10.4 per cent against the pound sterling, 5.3 per cent against the Japanese yen, 12.5 per cent against the euro and 5.7 per cent against the Indian rupee, based on cross currency movements.

Chart 5.9
Central Bank Intervention in the Domestic Foreign Exchange Market and the Exchange Rate



Source : Central Bank of Sri Lanka

Chart 5.10
Effective Exchange Rate Indices : 24 - Currency (2010 = 100) (a)



(a) With the rebasing of CCPI (2013=100) REER indices have been recalculated.

Source : Central Bank of Sri Lanka

- **The Central Bank intervened in the domestic foreign exchange market to ease the pressure on the exchange rate by supplying foreign exchange to the market on a net basis during the first two months of 2017, while absorbing on a net basis thereafter**. Accordingly, the Central Bank supplied US dollars 292 million, on a net basis, during the months of January and February 2017, while absorbing US dollars 1,453 million during the period from March to September 2017. Consequently, the Central Bank absorbed US dollars 1,161 million, on a net basis, during the first nine months of 2017, in comparison to US dollars 693 million supplied during the corresponding period of 2016, which contributed towards replenishing the level of official international reserves. The implementation of a more market-based exchange rate policy along with foreign currency inflows has helped the external value of the rupee to be relatively stable during the first nine months of the year. As such, the rupee which depreciated by 1.0 per cent against the US dollar during the first two months, depreciated only by another 1.2 per cent during the period from March to end September, even with the absorption of a significant amount of foreign exchange liquidity from the market. Notably, the rupee appreciated albeit marginally, against the US dollar in August and September.

- **Both the 5-currency and 24-currency Nominal and Real Effective Exchange Rate indices depreciated during the first nine months of 2017**. Nominal Effective Exchange Rate (NEER) indices depreciated, reflecting the nominal depreciation of the Sri Lankan rupee against some of the major currencies together with the movements in cross currency exchange rates. Accordingly, 5-currency and 24-currency NEER indices depreciated by 7.6 per cent and 6.7 per cent, respectively, during the year up to end September 2017. Meanwhile, Real Effective Exchange Rate (REER) indices, an indicator of Sri Lanka's external competitiveness that takes into account the inflation differentials among countries in addition to the variation in nominal exchange rates, also depreciated based on 5-currency and 24-currency REER indices, by 4.2 per cent and 4.7 per cent, respectively. However, REER indices remained above the threshold of 100 index points, indicating the need for further depreciation of the external value of the rupee, to arrive at the level of external competitiveness that prevailed in 2010, given the relatively high inflation experienced by the country at present.

- **During the first three quarters of 2017, the domestic foreign exchange market recorded an expansion in terms of spot and forward transactions**. By end September 2017, the total volume of spot transactions was US dollars 6,193 million in comparison to US dollars 4,779 million during the corresponding period of 2016. Meanwhile, the total volume of forward transactions also increased to US dollars 6,557 million during the first nine months of 2017 from US dollars 6,462 million during the corresponding period of 2016. The average forward premia for one-month transactions remained above the level of average interest rate differential, while the average NOP of commercial banks stood at a positive level by end September 2017.

Expected Developments

- **With the envisaged adjustments in the current account of the BOP and the continuation of inflows to the financial account, the external sector is expected to improve further during the latter part of 2017 and in 2018**. The overall BOP, which recorded a surplus by end September 2017, is expected to be maintained at similar levels by end 2017 and improve further in 2018. Accordingly, the overall BOP is projected to record a surplus of around US dollars 1.5 billion and international reserves are expected to remain at around US dollars 7.3 billion by end 2017. However, sluggish global growth, possible increase in commodity prices including crude oil, lower than expected FDI inflows, declining trend in workers' remittances and geopolitical tensions in Sri Lanka's trading partners are downside risks to the envisaged path in the external sector accounts.

- **Reversing the lacklustre performance experienced during the past two years, exports are projected to continue their increasing trend in the remainder of 2017 and 2018**. The trade deficit is expected to remain at 11.2 per cent of GDP in 2017 with the envisaged increase in both exports and imports. As per the forecast of World Trade Organization (WTO) in April 2017, the volume of world merchandise trade is expected to increase in a range of 1.8 - 3.6 per cent in 2017 and 2.1 - 4.0 per cent in 2018. Improved global trade, the reinstatement of the EU GSP+ facility from May 2017, enhanced trade relations expected through multilateral trade agreements, strong institutional support and consistent policies that will result in increased domestic and foreign investments in export oriented industries, are expected to drive the momentum in exports. The revival of fish exports, following the removal of the ban on fisheries products by the EU for Sri Lankan fish exports with effect from mid-2016, is expected to yield a strong growth in fish exports. With the gradual recovery of global commodity prices, earnings from tea and spices are also expected to increase in 2018. Meanwhile, import expenditure is projected to grow moderately in 2018. Higher commodity prices in the international market, particularly petroleum prices, would affect the expenditure on imports as well. In addition, import volumes are also expected to increase in 2018 in line with the expected growth of exports and domestic economic activities. Reflecting these developments, the trade deficit is estimated to improve to around 10.8 per cent of GDP in 2018.

- **The services account of the BOP is expected to expand further during the second half of 2017 and beyond**. The tourism sector is expected to rebound with the expansion in the number of arrivals complemented by the resumption of full-scale operations of the BIA. The growth in earnings from tourism would be supported by efforts to uplift Sri Lanka's brand value through targeted promotional campaigns and continued investments in enhancing the tourism infrastructure of the country. Foreign investments are expected to contribute towards the expansion in services exports, particularly transportation and IT/BPO, by capitalising on Sri Lanka's strategic location and availability of skilled work force. Moreover, earnings from computer and information services are also projected to improve further, with a move towards mobile and cloud based applications beyond traditional software development and leveraging the trend. Gaining momentum from these positive developments, the services account is expected to expand further in 2018.

- **The growth in workers' remittances is expected to moderate in the period ahead**. The declining trend observed in workers' remittances is expected to revive during 2018, albeit at a lower rate, with improvements in economic activity in source countries. Even though an upward trend in labour migration under skilled and professional categories was witnessed during the past few years, there exists a large mismatch between the international demand for jobs and Sri Lanka's supply capabilities, especially with regard to specific skills demanded by the foreign employers. Therefore, investments in competency development through vocational training, providing high quality training on par with international standards, is beneficial in securing employment opportunities with higher earnings. In addition, attention should also be drawn to improving the language proficiency of migrant employees. It is equally important to explore new labour markets and enter into bilateral agreements with other advanced economies, including Singapore, Japan and European countries, rather than relying on the Middle Eastern countries, in the backdrop of rising economic and geopolitical uncertainties in the region.

- **The current account deficit as a percentage of GDP is projected to widen in 2017 to 3.0 per cent of GDP, but is expected to improve to 2.5 per cent of GDP in 2018.** The trade deficit is expected to widen only moderately in the second half of the year with an expected increase in exports and a moderate growth in imports, compared to the corresponding period in 2016. The rebalancing of the trade account is expected to continue and improve further in 2018. Inflows to the services account are expected to grow at a faster rate in 2018, although it grew at a lower rate in 2017 due to lower growth in tourist earnings. Growth in workers' remittances, which are projected to be lower in 2017 as a result of adverse economic and geopolitical conditions in the Middle Eastern region, are expected to exhibit some improvement in 2018. Limited diversification of exports, greater reliance on tourist earnings and workers' remittances to finance the trade and primary income account deficit will remain challenges in curtailing the current account deficit.

- **The financial account is expected to remain strong during 2017 and beyond**. Thus far during the second half of 2017, the financial account was strengthened with proceeds from the foreign currency term financing facility and inflows to the government securities market. The current positive momentum in inflows to the government securities market is expected to continue in 2018, while the CSE is expected to attract more foreign investments. The financial account is expected to be further strengthened in 2018 with higher non-debt creating inflows by way of FDI, supplemented by policy consistency, political stability and stable macro-economic conditions. However, expected developments around the world, including probable interest rate hikes and tax policy reforms in the United States, may pose challenges in attracting financial flows.

6

FISCAL POLICY AND GOVERNMENT FINANCE

Reflecting the government's commitment towards revenue based fiscal consolidation, the fiscal sector showed some improvement during the first eight months of 2017. Government revenue as a percentage of estimated GDP increased to 9.0 per cent during this period from 8.2 per cent in the corresponding period of 2016 mainly due to higher tax revenue generated, particularly from the Value Added Tax (VAT). Total expenditure and net lending as a percentage of estimated GDP also increased to 13.0 per cent during the first eight months of 2017 in comparison to 12.2 per cent in the same period of 2016, due to increases in both recurrent expenditure and public investment. The overall budget deficit increased to 4.0 per cent of the estimated GDP during the first eight months of 2017 from 3.9 per cent in the corresponding period of 2016 as the increase in the government expenditure was higher than the increase in government revenue. However, the current account deficit, which indicates the government dis-savings, declined to 0.9 per cent of the estimated GDP during the first eight months of 2017 from 1.2 per cent recorded in the same period of 2016. A salutary feature of budgetary operations during 2017 was the surplus in the primary account witnessed during the first six months of the year. The primary account, which reflects the difference between revenue and non-interest expenditure, was in surplus to the tune of Rs. 16.1 billion by June 2017 indicating a marked improvement in budgetary operations this year, while meeting the quantitative performance criteria (QPC) of the IMF Extended Fund Facility (EFF) programme for the fiscal sector. However, expenses related to flood and drought reduced the surplus in the primary balance to a deficit of Rs. 1.6 billion by August 2017. In financing the budget deficit, the government relied on both domestic and foreign sources. In domestic financing, borrowings from the banking sector on a net basis increased to Rs. 236.5 billion during the first eight months of 2017 from Rs. 138.1 billion during the same period of 2016, while financing from the non banking sector declined significantly to Rs. 37.0 billion during the first eight months of 2017 from Rs. 171.4 billion during the same period of 2016. In spite of improvements, achieving fiscal targets stipulated in the Budget 2017 would be challenging. Delays in the implementation of the new Inland Revenue Bill, lower revenue collection from import duties and excise taxes on liquor and cigarettes, increased expenditure on interest payment and fiscal expenses on drought and flood relief schemes would hinder the performance of the fiscal sector in 2017.

Fiscal Policy Measures

- **Government continued its revenue based fiscal consolidation process in 2017 with the aim of gradually reducing the budget deficit and the government debt to GDP ratio in the medium term**. The medium term framework envisages to reduce the budget deficit to 3.5 per cent of GDP and debt to GDP ratio to a sustainable level by 2020. In order to achieve these targets, several policy measures were introduced to enhance government revenue and rationalise recurrent expenditure while maintaining public investment at a sustainable level. Accordingly, a new Inland Revenue Bill was enacted by the Parliament in September 2017 aimed at simplifying the existing tax system and broadening the tax base while introducing reforms to tax administration. In addition, under the Revenue Administration Management Information System (RAMIS) tax payers were enabled to make payments online for several taxes. In addition, quarterly expenditure and income outcome reports for the first and second quarters of 2017 were presented to the Parliament as announced in the Budget 2017 for strengthening Parliamentary control on public finances. Further, the National Agency for Public Private Partnership (NAPPP) was established at the Ministry of Finance and Mass Media (MOF) with a view to promoting public private partnerships (PPPs). Statements of Corporate Intent (SCIs) were signed with selected five main State Owned Business Enterprises (SOBEs) in order to improve the oversight and fiscal discipline of these SOBEs, while it is expected to sign SCIs with another ten SOBEs. During the year, several measures were taken to improve the transparency in the government securities market while a new Fiscal Liability Management Act is also being drafted for better liability management. In moving towards the medium term targets, the government in its 2017 Budget announced a reduction in the deficit to 4.6 per cent of GDP in 2017 from 5.4 per cent in 2016. Moreover, the current account balance of the Budget is expected to be in surplus at 0.5 per cent of GDP. Similarly the primary balance is also envisaged at positive levels in 2017 with a surplus of 0.4 per cent of GDP.

- **A new Inland Revenue Bill was enacted by the Parliament on 7 September 2017 with the objective of increasing the ratio of direct taxes**.The new Act is expected to simplify and rationalise the existing income tax structure, broaden the income tax base by removing exemptions, strengthen tax administration, while enhancing the direct tax collection. On the individual income tax front, tax free threshold is proposed to be maintained at the prevailing level of Rs. 500,000. However, for employment income, the tax free threshold will be increased to Rs. 1.2 million from the current Rs. 750,000. The corporate income tax structure is to be streamlined with the introduction of three tier tax structure, i.e., 40 per cent for liquor, tobacco, lottery, and betting and gaming, 28 per cent for banking, finance, insurance industry and trading activities and 14 per cent for all other sectors. In addition, a Capital Gains Tax is proposed to be introduced at a rate of 10 per cent upon the gains of the realisation of capital assets. Further, the withholding tax rate on interest earnings of resident individuals will be increased to 5 per cent from the current 2.5 per cent, while the withholding tax will be introduced for specified fees and contract payments at a rate of 5 per cent and 14 per cent with a view of broadening the tax base. Meanwhile, amendments were made to the Economic Service Charge (ESC) with effect from 01 April 2017. Accordingly, threshold of ESC was reduced to Rs. 12.5 million per quarter from Rs. 50 million per quarter. Further, ESC was charged in advance on the Cost, Insurance and Freight (CIF) value certified by the Director General of Customs, of an importer, in respect of every consignment of imports of motor vehicles.

- **The VAT (Amendment) Act was approved by the Parliament in October 2016**. Accordingly, the VAT rate was raised to 15 per cent from 11 per cent with effect from 01 November 2016[1]. In addition to the revision of rates, the threshold for registration of VAT was reduced to Rs. 3 million per quarter from Rs. 3.75 million per quarter. Further, VAT was imposed on several items, namely

1 As per the VAT (Amendment) Act No 20 of 2016, VAT changes were valid for the period 02 May 2016 to 11 July 2016 and from 01 November 2016.

liquor, cigarettes, coal, perfumes, electrical and electronic goods, and telecommunication equipment with a view to broadening the VAT base. The full impact of VAT amendments on revenue generation is expected in 2017. In addition to the changes introduced by the VAT (Amendment) Act on 01 November 2016, several other measures were also proposed with regard to VAT in the Budget 2017. Plant, machinery and accessories for generation of renewable energy, supply of geriatric care services and child care services and certain electrical goods were proposed to be exempted from VAT, and the amendments to the VAT Act in relation to these proposals have been submitted to the Legal Draftsman (LD).

- **Several amendments were also made to the Nation Building Tax (NBT) Act with effect from 01 November 2016 to enhance the revenue collection from NBT**. Accordingly, the liable threshold for NBT registration was reduced to Rs. 3 million per quarter from Rs. 3.75 million per quarter while removing the NBT exemptions on telecommunication, supply of electricity and lubricants. Meanwhile, as proposed in the Budget 2017, the NBT exemption on goods required for services of international transportation, supply of residential apartments and the supply of goods and services by any Co-operative Society or Lak Sathosa Limited was removed with effect from 01 August 2017.

- **Harmonized System (HS) codes[2] and some tariff lines were adjusted as per international guidelines**. Accordingly, HS Code National Sub Divisions have been created as directed by the World Customs Organization (WCO) and duty rates of 96 tariff lines have been adjusted based on Sri Lanka's rate commitments to the World Trade Organization (WTO) in November 2016. In addition, the Ports and Airports Development Levy (PAL) on printed books, magazines, journals, and periodicals was removed while PAL on certain pharmaceutical products was reduced to 2.5 per cent with effect from 11 November 2016.

2 The Harmonized Commodity Description and Coding System generally referred to as "Harmonized System" or simply HS is a multipurpose international product nomenclature developed by the World Customs Organization.

- **The Special Commodity Levy (SCL) on the importation of several food items was revised a number of times during 2017 to provide necessary protection for domestic agricultural producers during harvesting seasons and reduce volatility in domestic market prices**. Accordingly, SCL was introduced on imported raw rice (kekulu), nadu rice and samba rice at Rs. 15 per kg with effect from 07 January 2017. However, it was reduced to Rs. 5 per kg with effect from 28 January 2017 and further reduced to 25 cents per kg with effect from 27 July 2017 due to supply shortages that prevailed in the domestic market resulting from drought conditions experienced in several districts of the country. In addition, SCL on the importation of vegetable oils was reduced by Rs. 20 per kg with effect from January 2017. It was further reduced by Rs. 20 per kg with effect from 24 February 2017 for a period of six months. Further, SCL applicable on 12 items, including dried fish, yoghurt, butter, garlic, oranges, apples, salt, kurakkan flour, etc. was extended for a period of six months with effect from 02 April 2017. Meanwhile, SCL on fish, green gram, mangosteen, dried oranges, kiwifruit, pear, cherries, plums and soles was also extended for a period of six months with effect from 08 May 2017.

- **Several measures were introduced to improve tax administration in the Budget 2017 with a view to strengthening revenue collecting agencies**. Registered taxpayers were able to make online payments for personal and partnership taxes with effect from March 2017 through banks to the RAMIS System, which is being set up at the Inland Revenue Department (IRD). Meanwhile, VAT payments on financial services through RAMIS commenced in September 2017. In addition, web based instructions and other e-services to facilitate taxpayers were made available for VAT, SVAT, NBT, Pay-As-You-Earn (PAYE), and Corporate Income Tax (CIT). Meanwhile, Sri Lanka Customs took initial steps to establish a National Single Window System (NSWS) to provide a better service to facilitate importers and exporters. The Integrated Treasury

Management Information System (ITMIS), which was set up at the MOF, envisages to modernise the Public Financial Management (PFM) through the automation of key Treasury operations such as budget preparation, budget execution, accounting for public expenditure and revenues, treasury management and cash management while supporting the government in the preparation of financial statements. The rolling-out of ITMIS is expected to start in the last quarter of 2017 as a pilot project for a few selected ministries. However, rolling-out to cover all ministries, departments and other spending agencies of the government is expected to be implemented gradually in 2018. ITMIS will help strengthen the link between the planning and the budgeting process, implement commitment accounting, centralise payments in the Treasury Operations Department, move to accrual accounting and implement a Unified Chart of Accounts.

- **On the expenditure front, several measures were introduced in order to minimise fiscal slippages**. Accordingly, quarterly expenditure and income outcome reports for the first and second quarters of 2017 were presented to the Parliament as announced in the Budget for 2017 for strengthening the Parliamentary control on public finances. In line with the fiscal consolidation path, any revenue shortfall in a particular quarter will warrant the government to realign its expenditure with the approval of the Parliament. According to these reports, both revenue and expenditure outcomes in the first and second quarters of 2017 remained below the targeted levels. Under the National Budget Circular No. 01/2017, a decision has been taken to continue the monitoring process on the utilisation of budgetary provisions allocated to spending agencies with the objective of achieving efficiency in resource allocation. The Budget Review and Implementation Committee (BRIC) established under the MOF monitored the performance of major capital projects of fourteen selected ministries. Based on their performance, monthly cash releases were made in order to rationalise government expenditure.

- **While the government continued with its pension scheme for retired public officials, necessary steps were taken to grant the "Ranaviru Surakum Allowance" for disabled officers of Tri Forces while granting a pension to defence personnel who have not completed 10/12 years of service**. Accordingly, under the Pension Circular No. 01/2017, the officers in Tri Forces are entitled to the "Ranaviru Surakum Allowance" with effect from 01 January 2017. This allowance is granted as a fixed allowance with the pension to officers in Tri Forces (i) who became disabled during the active service due to terrorist activities (ii) their spouses after their demise, and (iii) the widows of war heroes who died during active service due to terrorist activities. Further, a pension was granted to defence personnel who had been sent on retirement after becoming disabled due to terrorist activities without completing 10/12 years in the service. Accordingly, officers who have not completed 10 years service in the Sri Lanka Police and Tri Forces and 12 years service in the other ranks of armed forces were granted pension. In addition, under the Public Administration Circular No. 06/2017, the compulsory retirement age for officers in the Sri Lanka Engineering Service was extended up to 61 years with effect from 01 January 2017.

- **The government maintained its public investment programme during the first eight months of 2017 with the continuation of several major infrastructure projects**. Accordingly, the construction of Phase III of the Kadawatha to Kerawalapitiya section of the Outer Circular highway and the Matara to Hambantota section of the Southern Expressway Extension Project continued during the first eight months of 2017. Further, investments were also made for the acquisition of lands for the construction of the Central Expressway from Kadawatha to Dambulla and the linked Expressway from Pothuhera to Galagedara during the same period. Construction work related to Phase II of the Central

Expressway from Meerigama to Kurunagala commenced in early 2017. Meanwhile, public investments in the health sector were focused mainly on the construction and the improvement of hospitals while investments for education infrastructure within the first eight months of 2017 were channeled towards the development of both human resources and physical infrastructure under the "Nearest School is the Best School (NSBS)" Programme.

- **With a view to promoting PPPs as a national strategy to address the infrastructure requirement in the country amidst the limited fiscal space available for public investments, the NAPPP was established in 2017**. The main objective of the NAPPP is to create a central agency with adequate legal, administrative and financial authority to identify suitable projects, which can be executed as PPP's, prepare required guidelines and invite bids and select investors, in consultation with relevant line ministries. This central agency is located within the MOF.

- **Several initiatives were taken during the first eight months of 2017 to strengthen the financial position and operations of major SOBEs.** Accordingly, SCIs were signed with selected five main SOBEs, namely Ceylon Electricity Board, Ceylon Petroleum Corporation, National Water Supply and Drainage Board (NWS&DB), Airport and Aviation Services (Sri Lanka) Ltd., and Sri Lanka Ports Authority (SLPA), in March 2017 in order to improve the oversight and financial discipline of these SOBEs. Further, it is expected to sign SCIs with another ten SOBEs, namely, Urban Development Authority (UDA), State Pharmaceuticals Corporation (SPC), Sri Lanka State Plantation Corporation (SLSPC), State Timber Corporation, Sri Lanka Transport Board (SLTB), MILCO Ltd., National Livestock Development Board (NLDB), Central Engineering Consultancy Bureau (CECB), Lanka Sathosa Ltd., and Lankaputhra Development Bank (LDB) in order to improve their efficiency.

- **The government successfully issued the 11th International Sovereign Bond (ISB), reflecting investors' continued confidence and positive outlook for the economy**. Under this, the government was able to raise US dollars 1.5 billion in May 2017 with a 10-year maturity at a yield of 6.20 per cent per annum. In addition, a Foreign Currency Term Financing Facility (FCTFF) of US dollars 1.0 billion was obtained during the year and funds were received in two tranches; US dollars 450 million in May 2017 and US dollars 550 million in August 2017.

- **Complementing the improved fiscal performance of the country, the Central Bank also implemented several measures during the year to improve the transparency in the government securities market**. Accordingly, the Central Bank mandated the Primary Dealers (PDs) and licensed banks to use the Bloomberg electronic bond trading platform on secondary market transactions in government securities on 26 April 2017. The PDs are also required to quote and engage in repurchase transactions (repos) within PDs through the trading platform and report repos of Rs. 100 million or above carried out over-the-counter with investors through the trading platform, within 30 minutes of the completion of each repo transaction. The Central Bank releases the daily summary trade information of repo volumes and yield rates based on standardised tenures such as overnight, one week and two weeks shortly for the information of the market participants. These measures are expected to help improve transparency while facilitating price discovery, increasing market liquidity and outreach, thereby reducing the cost of borrowing in the medium term. A new primary issuance system for Treasury bonds was introduced with effect from 27 July 2017. The new system replaced the fully auction based issuance system for Treasury bonds that had been in practice since February 2015. The more structured newly introduced system includes regular monthly Treasury bond auctions. Each monthly auction offers two

Treasury bond series of different maturities and tenures of the series are expected to match the resource availability in the market. Issuance under each series takes effect in three or less sequential phases depending on the outcome of each preceding phase. The Phase I explores issuance of the entire announced volume in a competitive multiple price auction system through reasonable market bids. However, in the event of any under allocation at the Phase I, the Phase II opens for voluntary, volume based bidding. Issuance under the Phase II is made at the Weighted Average Yield Rate (WAYR) determined at the Phase I and is limited to the under allocated quantum in the Phase I. All PDs and other authorised participants at primary issuances are eligible for submission of bids under the Phase II. Any under allocation during Phases I and II, is issued on a mandatory basis at WAYR only among PDs in the Phase III. A new performance review mechanism will also be introduced to assess the effective participation of PDs. Meanwhile, in order to improve the investment planning of PDs and investors at large, a quarterly Treasury bond auction calendar will be published in advance. As such, the newly introduced system will further enhance the efficiency and transparency of domestic borrowings of the government.

- **Sovereign credit ratings for Sri Lanka were revised by international sovereign rating agencies in 2017**. On 09 February 2017, Fitch affirmed Sri Lanka's long-term foreign and local currency issuer Default Ratings (IDR) at "B+", and revised the outlook to "stable" from "negative" highlighting improving fiscal finances, improved policy coherence and credibility, and stable growth. Standard and Poor's (S&P) affirmed its "B+" long-term rating and "B" short-term sovereign credit rating on 07 March 2017, highlighting improvements in the fiscal performance. However, its outlook remained "negative", citing the weak external sector performance and the rising exchange rate pressure on public debt. Moody's Investor Services also affirmed Sri Lanka's sovereign rating at "B1" with a "negative" outlook on 13 July 2017.

Government Budgetary Operations

Government Revenue and Grants

Revenue

- **According to the estimates for 2017, total government revenue in 2017 is expected to increase by 19.2 per cent to Rs. 2,010.3 billion.** As a percentage of GDP, total revenue is estimated at 14.9 per cent in 2017 comprising 13.5 per cent of tax revenue and 1.4 per cent of non tax revenue.

- **During the first eight months of 2017, government revenue as a percentage of estimated GDP increased to 9.0 per cent from 8.2 per cent in the corresponding period in 2016 due to increased tax revenue.** Accordingly, total government revenue in nominal terms increased by 15.7 per cent to Rs. 1,172.4 billion during the first eight months of 2017 from Rs. 1,013.4 billion recorded in the corresponding period of the previous year. This was mainly due to the increase in revenue from goods and services related taxes, especially VAT, excise duty on petroleum and motor vehicles, NBT, SCL, and PAL. Meanwhile, the revenue collection from income taxes also improved due to increased revenue from the ESC. However, revenue from excise duty on liquor and cigarettes and tobacco declined during this period mainly due lower sales of liquor and cigarettes. Non tax revenue declined by 4.9 per cent to Rs. 77.4 billion during the first eight months of 2017 as a result of the decline in profit and dividend transfers from SOBEs. However, non tax revenue realised from rent and interest, fees and charges and social security contributions increased during the period concerned vis-a-vis to the previous year. Overall, the total revenue collection during the first eight months was 58.3 per cent of the annual estimate of Rs. 2,010.3 billion in comparison to 55.6 per cent generated in the corresponding period of 2016. However, the average monthly revenue during this period was only around Rs. 146.5 billion in comparison to the estimated average monthly revenue of Rs. 167.5 billion in the Budget 2017.

- **In nominal terms, revenue from income taxes increased by 9.1 per cent during the first eight months of 2017 mainly due to higher revenue from ESC.** As a percentage of the estimated GDP however, revenue from income taxes remained unchanged at 1.3 per cent from the corresponding period of 2016. Corporate and non corporate income taxes declined by 1.3 per cent in nominal terms to Rs. 81.2 billion during the first eight months of 2017 from Rs. 82.3 billion recorded in the same period of 2016. However, revenue from PAYE tax increased considerably to Rs. 22.4 billion during the first eight months of 2017 from Rs. 18.9 billion in the first eight months of the previous year, mainly due to strengthening of the monitoring process related to the submission of PAYE returns and payments with the initiation of the RAMIS system. During this period, revenue from withholding taxes at Rs. 36.2 billion declined by 18.6 per cent in comparison to the corresponding period of previous year due to the reduced issuance of government securities. Revenue from ESC increased significantly to Rs. 31.2 billion during the period under review from Rs. 11.1 billion in the first eight months of 2016 mainly due to the increase in ESC from 0.25 per cent to 0.5 per cent, the removal of the maximum liability of Rs. 120 million and the extension of the coverage of the ESC to profit making businesses of which the turnover exceeds Rs. 50 million per quater.

- **Revenue from VAT as a percentage of the estimated GDP increased to 2.2 per cent in the first eight months of 2017 from 1.4 per cent in the first eight months of 2016.** In nominal terms also, revenue from VAT increased by 65.0 per cent to Rs. 290.0 billion during this period from Rs. 175.8 billion in the corresponding period of 2016. Accordingly, revenue from VAT on both domestic economic activity and import related activity increased significantly during the first eight months of 2017. The increase in revenue from VAT was an outcome of the hike in the VAT rate to 15 per cent from 11 per cent and the expansion of the VAT base with the removal of several exemptions in the latter part of 2016 and the enhanced compliance with the initiation of RAMIS. Accordingly, revenue from VAT on domestic economic activity increased by 67.5 per cent to Rs. 181.4 billion from Rs. 108.3 billion in the first eight months of the previous year. Similarly, revenue from VAT on import related activities also increased by 61.0 per cent to Rs. 108.6 billion during the period in comparison to a sum of Rs. 67.5 billion mobilised during the first eight months of 2016. Further, VAT revenue as a percentage of total tax revenue increased to 26.5 per cent during the first eight months of 2017 from 18.9 per cent in the corresponding period of 2016. Meanwhile, the contribution of VAT revenue to total revenue rose to 24.7 per cent in the first eight months of 2017 from 17.3 per cent in the same period of 2016.

Table 6.1

Economic Classification of Government Revenue

Rs. billion

Item	2015	2016 (a)	2017 Approved Estimates	2016 Jan - Aug (a)	2017 Jan - Aug (a)
Tax Revenue	**1,355.8**	**1,463.7**	**1,827.0**	**932.0**	**1,094.9**
Income Taxes	262.6	258.9	334.6	156.7	171.0
VAT	219.7	283.5	380.0	175.8	290.0
Excise Taxes	497.7	455.0	579.0	297.2	312.5
Import Duties	132.2	156.5	165.5	100.8	92.5
PAL	58.6	88.8	106.0	56.7	65.6
NBT	45.0	57.4	66.0	35.4	45.0
SCL	52.3	55.8	65.0	39.9	49.2
Cess	46.3	61.7	60.0	38.9	39.5
Other Taxes	41.4	46.1	70.9	30.6	29.5
Non Tax Revenue	**99.1**	**222.4**	**183.3**	**81.4**	**77.4**
Total Revenue	**1,454.9**	**1,686.1**	**2,010.3**	**1,013.4**	**1,172.4**

Source: Ministry of Finance and Mass Media

(a) Provisional

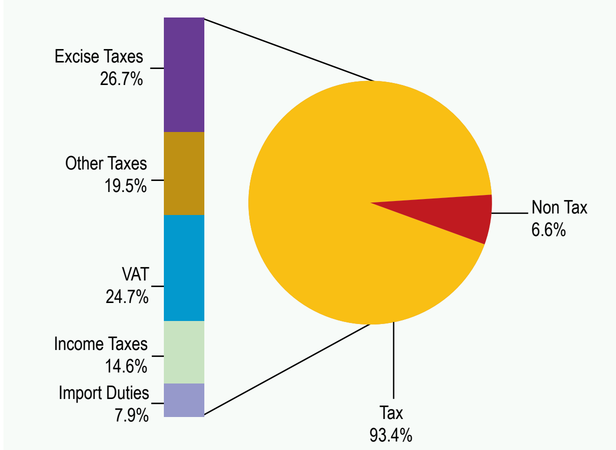
- **Revenue from excise duties as a percentage of the estimated GDP remained unchanged at 2.4 per cent during the first eight months of 2017 in comparison to the corresponding period of 2016.** However, in nominal terms, revenue from excise tax increased by 5.2 per cent to Rs. 312.5 billion from Rs. 297.2 billion recorded during the same period of 2016. Revenue from excise duty at Rs. 50.1 billion on petroleum rose by 35.2 per cent during this period due to the increased importation of petroleum products during the first eight months of 2017. Meanwhile, despite the decline in imports of motor vehicles during the first eight months of 2017, revenue from excise duty on motor vehicles also increased by 8.0 per cent in comparison to the previous year to Rs. 129.5 billion due to the revision of excise duty rates in

2016. Reflecting the decline in sales of hard and malt liquor, the collection of excise tax revenue from liquor reduced to Rs. 73.7 billion registering a decline of 5.9 per cent from Rs. 78.3 billion recorded in the corresponding period of 2016. Meanwhile, revenue from tobacco and cigarettes at Rs. 54.6 billion in the first eight months of 2017, also declined by 8.1 per cent due to lower sales of cigarettes during this period.

- **Revenue from import duties during the first eight months of 2017 declined marginally to 0.7 per cent of the estimated GDP from 0.8 per cent recorded during the same period of 2016.** In nominal terms, revenue from import duties declined by 8.3 per cent to Rs. 92.5 billion in comparison to Rs. 100.8 billion recorded in the first eight months of 2016 mainly due to the decline in imports which are subject to import duties. However, revenue from SCL in nominal terms increased by 23.4 per cent to Rs. 49.2 billion from Rs. 39.9 billion in the corresponding period of the previous year with the increase in SCL on several commodities with a view to safeguarding the interests of the farming community.

- **In nominal terms, revenue from NBT and Cess increased during the first eight months of 2017**. Accordingly, revenue from NBT in nominal terms increased by 27.1 per cent to Rs. 45.0 billion. As a percentage of estimated GDP, revenue from NBT in the first eight months of the year, remained unchanged at 0.3 per cent in comparison to the corresponding period of 2016. Revenue from NBT on both domestic economic activity and import related activity increased during the first eight months of 2017. Accordingly, revenue from NBT on domestic economic activities increased by 37.6 per cent to Rs. 32.6 billion in comparison to Rs. 23.7 billion in the first eight months of 2016 as a result of the reduction of the NBT threshold to Rs. 12 million per annum from Rs. 15 million per annum and the removal of several exemptions mainly during the latter part of 2016[3]. The collection of NBT on import related activities also increased by 6.0 per cent to Rs. 12.4 billion from Rs. 11.7 billion in the first eight months of 2016. Revenue from PAL increased by 15.8 per cent to Rs. 65.6 billion from Rs. 56.7 billion recorded during the same period of 2016. Revenue from Cess also increased by 1.7 per cent during the first eight months of 2017 to Rs. 39.5 billion from Rs. 38.9 billion recorded during the same period of 2016.

Chart 6.1
Composition of Government Revenue
(Jan-Aug 2017)



Source: Ministry of Finance and Mass Media

- **During the first eight months of 2017, non tax revenue as a percentage of the estimated GDP, declined to 0.6 per cent from 0.7 per cent recorded in the same period of 2016.** Further, non tax revenue in nominal terms was also lower declining by 4.9 per cent to Rs. 77.4 billion from Rs. 81.4 billion in the corresponding period of 2016. The decline in profit and dividend transfers of SOBEs, despite the increase in the other non tax revenue sources, namely fees and charges, rent, interest, and social security contributions, was the main reason for this reduction. Profit and dividend transfers from SOBEs at Rs. 12.5 billion during this period was lower by 58.4 per cent to Rs. 29.9 billion mobilised during the same period of 2016. This was largely due to the deteriorated financial performance of major SOBEs during the first eight months of 2017. Revenue through fees and charges increased by 25.0 per cent to Rs. 41.6 billion in the first eight months of 2017 due to the increase in the embarkation levy and the imposition of licensing fees on firearms and

3 As per the NBT (Amendment) Act No. 22 of 2016, NBT changes were valid from 02 May 2016 to 11 July 2016 and from 01 November 2016.

6

beedi leaves. Revenue generated from rent and interest also increased by 25.9 per cent and 35.2 per cent, respectively, to Rs. 2.6 billion and Rs. 4.2 billion, as a result of increased revenue collections from rentals on regional plantation companies and interest payments received from on-lending to SOBEs.

Grants

- **Disbursement of foreign grants during the first eight months of 2017 was significantly below the annual estimate for 2017**. Accordingly, the realised amount of foreign grants in the first eight months of 2017 was Rs. 2.3 billion in comparison to the annual estimate of Rs. 10.0 billion for 2017, although foreign grant disbursements showed some improvement over the sum of Rs. 0.7 billion witnessed in the same period of 2016.

Expenditure and Net Lending

- **As per the budget estimates for 2017, total expenditure and net lending is estimated to decline to 19.6 per cent from GDP to 19.7 per cent of GDP in 2016.** Recurrent expenditure is estimated to decline to 14.4 per cent of GDP from 14.8 per cent in 2016 whereas capital expenditure and net lending is estimated to increase to 5.2 per cent of GDP in 2017 from 4.9 per cent in 2016. In nominal terms, total expenditure and net lending in 2017 is estimated to increase by 13.3 per cent to Rs. 2,645.3 billion from Rs. 2,333.9 billion in 2016. Recurrent expenditure is expected to increase by 10.7 per cent to Rs. 1,946.0 billion in 2017, while capital expenditure and net lending is also expected to increase by 21.4 per cent to Rs. 699.3 billion.

- **Total expenditure and net lending during the first eight months of 2017 increased to 13.0 per cent of the estimated GDP from 12.2 per cent during the same period in 2016, due to increases in both recurrent expenditure and capital expenditure and net lending.** In nominal terms, government expenditure and net lending increased by 13.1 per cent to Rs. 1,694.9 billion during the first eight months of 2017 from Rs. 1,499.1 billion recorded during the corresponding period of 2016. Total expenditure and net lending in the first eight months of 2017 accounted for 64.1 per cent of the annual estimate for 2017, higher than the share recorded in the first eight months of 2016.

- **During the first eight months of 2017, recurrent expenditure increased to 10.0 per cent of the estimated GDP from 9.4 per cent in the same period in 2016 mainly due to the increase in interest payments.** In nominal terms, recurrent expenditure increased by 11.6 per cent to Rs. 1,294.4 billion during the first eight months of 2017 in comparison to Rs. 1,159.5 billion in the same period of 2016. Expenditure on interest payments increased by 25.1 per cent to Rs. 518.6 billion during the first eight months of 2017 from Rs. 414.6 billion during the corresponding period in 2016, mainly due to the relatively high interest rates prevailing in the domestic market and the gradual increase in interest rates in international markets which affected interest payments of loans obtained at variable interest rates. Expenditure on salaries and wages increased by 3.6 per cent to Rs. 392.5 billion while pension payments also increased by 5.9 per cent to Rs. 120.3 billion. Meanwhile, expenditure on the fertiliser subsidy declined by 18.2 per cent to Rs. 16.8 billion during the first eight months of 2017 reflecting the effectiveness of the rationalisation of the fertiliser subsidy.

Table 6.2
Economic Classification of Expenditure

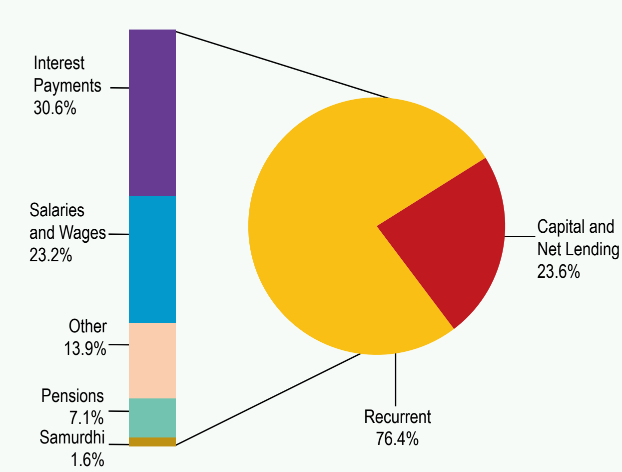
Rs. billion

Item	2015	2016 (a)	2017 Approved Estimates	2016 Jan - Aug (a)	2017 Jan - Aug (a)
Recurrent Expenditure	**1,701.7**	**1,757.8**	**1,946.0**	**1,159.5**	**1,294.4**
o/w Salaries and Wages	561.7	576.5	615.0	378.9	392.5
Interest Payments	509.7	610.9	680.1	414.6	518.6
Foreign	115.4	126.7	123.3	71.9	97.6
Domestic	394.3	484.2	556.8	342.7	421.0
Samurdhi	40.0	40.7	44.0	27.3	26.6
Pensions	155.3	171.9	180.8	113.5	120.3
Fertiliser Subsidy	49.6	27.8	36.5	20.6	16.8
Capital and Net Lending	**588.7**	**576.1**	**699.3**	**339.7**	**400.5**
Total Expenditure and Net Lending	**2,290.4**	**2,333.9**	**2,645.3**	**1,499.1**	**1,694.9**

Source: Ministry of Finance and Mass Media

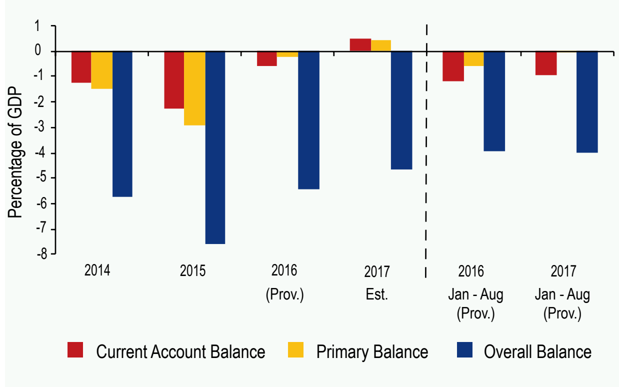
(a) Provisional

Chart 6.2
Composition of Government Expenditure
(Jan-Aug 2017)



Source: Ministry of Finance and Mass Media

Chart 6.3
Major Fiscal Indicators



Source: Ministry of Finance and Mass Media

- **Capital expenditure and net lending increased to 3.1 per cent of estimated GDP during the first eight months of 2017 from 2.8 per cent of GDP in the corresponding period of 2016.** In nominal terms, capital expenditure and net lending increased by 17.9 per cent to Rs. 400.5 billion. This was mainly due to the efforts by the government to implement the planned infrastructure development projects. The realised capital expenditure and net lending in the first eight months of 2017 accounted for 57.3 per cent of the annual estimate for the year in comparison to the share of 39.5 per cent recorded during the corresponding period of 2016.

Key Fiscal Balances

- **Although budget deficit increased marginally during the first eight months of 2017 both current account balance and primary balance improved**. Accodingly, the overall budget deficit increased to 4.0 per cent of the estimated GDP during the first eight months of 2017 from 3.9 per cent of the GDP in the corresponding period of the previous year. In nominal terms, the overall budget deficit increased to Rs. 520.2 billion in the first eight months of 2017 from Rs. 485.1 billion during the same period of 2016. The current account deficit, which reflects government dissavings, declined to 0.9 per cent of the estimated GDP during the first eight months of 2017 from 1.2 per cent in the same period of 2016. The primary account (overall deficit net of interest payments) was recorded at 0.0 per cent of GDP (deficit of Rs. 1.6 billion) during the period under review, in comparison to a deficit of 0.6 per cent of GDP (deficit of Rs. 70.5 billion) recorded during the same period of 2016.

Financing the Budget Deficit

- **The government relied on both domestic sources and foreign sources to finance the budget deficit during the first eight months of 2017**. Net domestic financing during this period, which amounted to Rs. 273.5 billion, remained below the level of Rs. 309.5 billion observed in the first eight months of 2016. Meanwhile, net foreign financing increased significantly, amounting to Rs. 246.7 billion during the period under review in comparison to Rs. 175.6 billion recorded in the same period of 2016.

- **Domestic borrowings to finance the budget deficit were mainly sourced from the banking sector, while the reliance placed on the non banking sector declined significantly during the first eight months of 2017 compared to the same period in 2016**. Bank financing amounted

Table 6.3
Sources of Financing

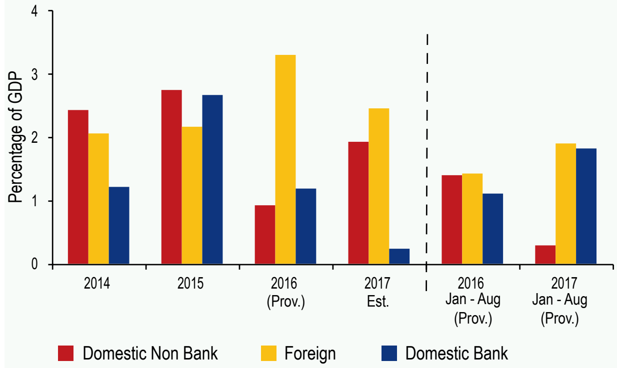
Rs. billion

Item	2015	2016 (a)	2016 Jan - Aug (a)	2017 Jan - Aug (a)
Domestic Financing (b)	**592.7**	**248.4**	**309.5**	**273.5**
Bank	291.8	140.0	138.1	236.5
Non Bank	300.9	108.5	171.4	37.0
Foreign Financing	**236.8**	**391.9**	**175.6**	**246.7**
Loans	131.3	109.3	37.6	15.1
Commercial Loans	232.8	319.7	136.8	224.6
Non Resident Investments in Treasury Bonds	-79.9	-44.3	-2.9	7.1
Non Resident Investments in Treasury Bills	-47.3	7.2	4.0	....
Total Financing	**829.5**	**640.3**	**485.1**	**520.2**

Sources: Ministry of Finance and Mass Media
Ministry of National Policies and Economic Affairs
Central Bank of Sri Lanka

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

Chart 6.4
Deficit Financing



Sources: Ministry of Finance and Mass Media
Ministry of National Policies and Economic Affairs
Central Bank of Sri Lanka

to Rs. 236.5 billion, accounting for 86.5 per cent of total domestic financing in comparison to Rs. 138.1 billion during the first eight months of 2016. The substantial increase in commercial bank financing at Rs. 355.9 billion in the first eight months of 2017 as against a repayment of Rs. 28.5 billion made during the same period of 2016 largely contributed to the higher financing from the banking sector. However, Central Bank financing reduced significantly to a net repayment of Rs. 119.5 billion in the first eight months of 2017 from a borrowing of Rs. 166.6 billion in the same period of 2016. Meanwhile, net financing from the domestic non banking sector declined significantly to Rs. 37.0 billion in the first eight months of 2017 from Rs. 171.4 billion in the same period of 2016.

- **While advances from the Central Bank contributed largely to net domestic borrowings, the contribution from financing through debt instruments such as Treasury bills and Treasury bonds was lower in the first eight months of 2017 compared to the first eight months of 2016.** Net borrowings from Treasury bills amounted to Rs. 7.4 billion in the first eight months of 2017 compared to Rs. 57.3 billion in the same period of the previous year. Meanwhile, net borrowings from Treasury bonds also declined significantly to Rs. 48.7 billion in the first eight months of 2017 from Rs. 314.3 billion in the same period of 2016. There was a net repayment of Rs. 239.8 billion in respect of Central Bank holdings of Treasury bills during the first eight months of 2017 in comparison to a net borrowing of Rs. 133.0 billion witnessed during the same period of 2016. However, government borrowings through Central Bank provisional advances increased significantly by Rs. 120.3 billion during the period under review from Rs. 33.5 billion in the same period of 2016. Meanwhile, net borrowings by way of Sri Lanka Development Bonds (SLDBs) amounted to Rs. 53.3 billion during the period under consideration in comparison to a repayment of Rs. 56.0 billion in the first eight months of 2016.

- **Foreign financing increased considerably during the first eight months of 2017.** With the issuance of the ISBs during the first eight months of 2017, foreign borrowings to finance the budget deficit increased to Rs. 246.7 billion during the first eight months of 2017 as against a borrowing of Rs. 175.6 billion recorded in the corresponding period of 2016. Net foreign financing comprised Rs. 15.1 billion of net borrowings related to foreign project loans, Rs. 224.6 billion of ISBs, Rs. 7.1 billion of foreign investments in Treasury bonds and net repayments of Treasury bills of Rs. 39.0 million.

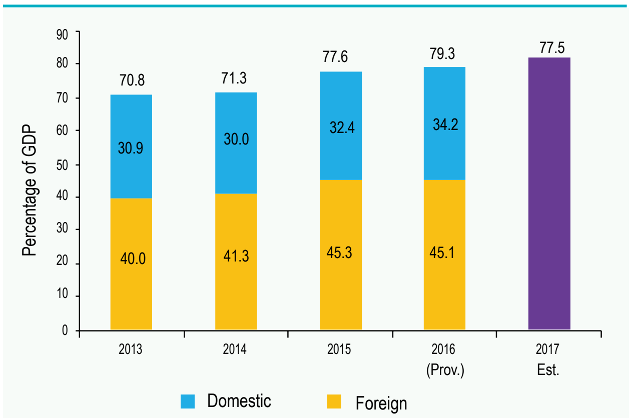
Government Debt and Debt Service Payments

Government Debt

- **Total outstanding central government debt stock increased by Rs. 898.6 billion to Rs. 10,285.9 billion as at end August 2017 from Rs. 9,387.3 billion at end 2016.** Domestic debt increased by Rs. 317.9 billion to Rs. 5,659.4 billion, while foreign debt increased by Rs. 580.7 billion to Rs. 4,626.5 billion. The budget deficit and the depreciation of the Sri Lankan rupee against major foreign currencies contributed significantly to the increase in the debt stock.

- **The share of short term debt in total domestic debt increased mainly due to higher borrowings through Central Bank provisional advances**. Accordingly, the share of short term debt in total domestic debt increased to 20.1 per cent by end August 2017 from 18.1 per cent at the end of 2016. Conversely, the share of medium and long term debt in the total domestic debt declined to 79.9 per cent at the end of August 2017 compared to 81.9 per cent as at end 2016. The share of Treasury bills in total domestic debt as at end August 2017 declined marginally to 14.0 per cent from 14.6 per cent at end 2016. Treasury bonds, which account for the highest share of the outstanding domestic debt portfolio, also declined to 66.5 per cent as at end August 2017 compared to 69.5 per cent as at end 2016. However, the share of SLDBs in the total domestic debt as at end August 2017 increased to 11.3 per cent from 10.7 per cent at end 2016 due to the increased reliance on SLDBs to finance the budget deficit. Meanwhile, the Central Bank provisional advances increased to Rs. 203.7 billion during 2017 as at end August 2017 from Rs. 83.3 billion at the end of 2016.

Chart 6.5
Outstanding Central Government Debt



Sources: Ministry of Finance and Mass Media
Ministry of National Policies and Economic Affairs
Central Bank of Sri Lanka

6

Table 6.4
Outstanding Central Government Debt

Rs. billion

Item	2015	2016 (a)	2016 End Aug (a)	2017 End Aug (a)
Domestic Debt (b)	**4,959.2**	**5,341.5**	**5,345.3**	**5,659.4**
By Maturity Period				
Short Term	913.3	968.4	987.9	1,135.0
Medium and Long Term	4,045.9	4,373.1	4,357.4	4,524.4
By Institution				
Banks	1,924.0	2,114.9	2,071.6	2,401.5
Non Bank Sector	3,035.2	3,226.6	3,273.7	3,257.9
Foreign Debt (c)	**3,544.0**	**4,045.8**	**3,970.7**	**4,626.5**
Concessional	1,729.9	1,897.7	1,863.7	2,061.0
Non Concessional	1,814.1	2,148.1	2,107.0	2,565.5
Total Government Debt	**8,503.2**	**9,387.3**	**9,316.0**	**10,285.9**

Sources: Ministry of Finance and Mass Media
Ministry of National Policies and Economic Affairs
Central Bank of Sri Lanka

(a) Provisional
(b) Excludes Treasury bonds of 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.

- **The outstanding foreign currency denominated domestic debt increased to Rs. 702.0 billion (US dollars 4,593.2 million) at the end of August 2017 from Rs. 602.2 billion (US dollars 4,019.8 million) at the end of 2016.** Accordingly, the outstanding debt on account of SLDBs amounted to Rs. 637.8 billion (US dollars 4,173.2 million) while the outstanding debt to Offshore Banking Units (OBUs) of licensed commercial banks amounted to Rs. 64.2 billion (US dollars 420.0 million) as at end August 2017. The share of foreign currency denominated domestic debt to total domestic debt increased to 12.4 per cent at end August 2017 from 11.3 per cent at end 2016.

- **Non concessional debt as a share of the total foreign debt stock increased to 55.5 per cent by end August 2017 from 53.1 per cent at end 2016.** Consequently, the share of concessional debt in total foreign debt declined to 44.5 per cent by end August 2017 from 46.9 per cent at end 2016. Non concessional debt increased by 19.4 per cent to Rs. 2,565.5 billion mainly due to higher commercial borrowings, largely on account of ISBs.

Debt Service Payments

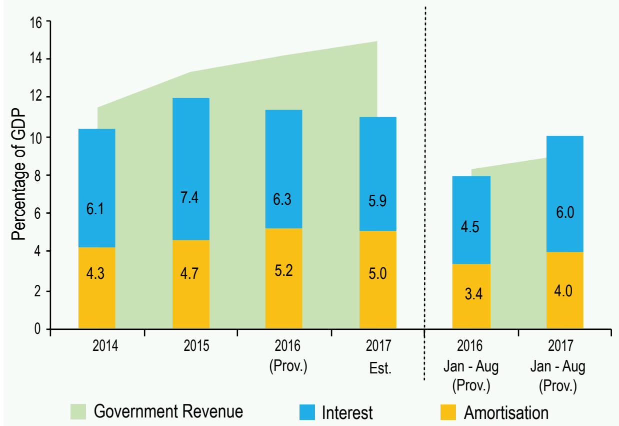
- **During the first eight months of 2017, domestic and foreign debt service payments amounted to Rs. 1,304.4 billion.** This consists of amortisation payments of Rs. 785.8 billion (60.2 per cent) and interest payments of Rs. 518.6 billion (39.8 per cent). Further, debt service payments to domestic and foreign sources amounted to Rs. 1,065.4 billion and Rs. 239.0 billion, respectively. By end August 2017, total debt service payments amounted to 88.1 per cent of the original budget estimate.

Expected Developments

- **Although some deviation from the envisaged budget deficit target of 4.6 per cent of GDP is likely in 2017, mainly as a result of flood and drought related fiscal expenses, medium term fiscal targets will be met through the revenue based fiscal consolidation.** Implementation of new Inland Revenue Act from April 2018 will be a major step in this direction. Accordingly, tax revenue is expected to increase to around 16 per cent of GDP by 2020 and public investment will be maintained at 5-6 per cent of GDP during 2017-2020 while unproductive expenditure will be eliminated. Further, the budget deficit is expected to reduce to 3.5 per cent of GDP by 2020 while the debt to GDP ratio is expected to reduce to a more sustainable level. However, meeting these medium term targets will be challenging without focused efforts by the government and other stakeholders. In this regard, the government is expected to strengthen the Fiscal Management Responsibility Act as stated in the Vision 2025 policy document.

Chart 6.6

Government Debt Service Payments vs Revenue



Sources: Ministry of Finance and Mass Media
Ministry of National Policies and Economic Affairs
Central Bank of Sri Lanka

6

7

MONETARY POLICY, INTEREST RATES, MONEY AND CREDIT

The Central Bank maintained a tight monetary policy stance during the first nine months of 2017 to preempt the buildup of excessive demand pressures and adverse inflation expectations in the economy. The policy interest rates of the Central Bank were increased by 25 basis points (bps) in March 2017, in addition to the 100 bps increase in policy interest rates and the 1.50 percentage point increase in the Statutory Reserve Ratio (SRR) in 2016. The year-on-year headline inflation, measured using the Colombo Consumer Price Index (CCPI) and the National Consumer Price Index (NCPI), remained in single digits, but above the desired levels during most months, mainly reflecting the impact of tax adjustments made in 2016 as well as high food inflation driven by adverse weather conditions. Meanwhile, broad money supply continued to expand at an elevated pace, caused by the gradual buildup of net foreign assets of the banking system as well as the continued, but slower, expansion in domestic credit disbursed by the banking system to both the private and public sectors. Credit obtained by the government from the Central Bank declined, although net credit to the government from commercial banks remained high. Credit extended to public corporations by the banking system expanded in 2017, although some moderation has been observed since June 2017. Credit extended to the private sector by commercial banks decelerated gradually during the year responding to tighter monetary conditions in the economy as reflected by high nominal and real interest rates. The monetary policy stance, along with the decline in market liquidity conditions, caused further upward adjustments in market interest rates, during the first half of the year. However, surplus rupee liquidity, which was observed in the market since July 2017, resulted in a moderation of interest rates in the interbank call money market and prompted other bank interest rates to stabilise at high levels. Increased foreign financial inflows to the government, improved revenue collection, and improvements to the auction system for government securities, caused a notable reduction in the yields of government securities since April 2017. Going forward, monetary expansion is expected to decelerate with the gradual moderation of the growth of private sector credit and envisaged fiscal consolidation. Although inflation is expected to remain elevated in the near term due to food price volatility, inflation outlook remains favourable in the medium term.

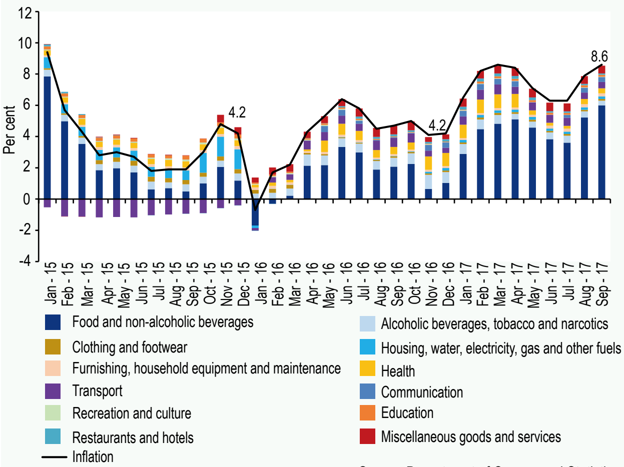
Monetary Policy Stance of the Central Bank

- **The Central Bank of Sri Lanka conducted its monetary policy within an enhanced monetary policy framework with the intention of transiting to Flexible Inflation Targeting (FIT) in the medium term to stabilise inflation in mid-single digits of 4 - 6 per cent, thereby facilitating a sustainable growth trajectory**. Under the current enhanced monetary policy framework, the conduct of monetary policy is grounded on market based monetary policy instruments, particularly policy interest rates and open market operations, to guide the average weighted call money rate (AWCMR), which is the operating target of the framework. Broad money (M_{2b}) remains a key indicative intermediate variable of this framework to guide the conduct of monetary policy. To facilitate the transition towards FIT, the monetary policy formulation process is being enriched with more forward looking monetary policy analysis complemented by several institutional changes within the Central Bank. Further, the Central Bank adopted a more flexible exchange rate policy during the first nine months of 2017, as announced, to complement the current monetary policy measures and support the transition to FIT. At the same time, as the successful implementation of FIT hinges on reliable medium term forecasts of key macroeconomic variables and macroeconomic simulation and policy analysis, a Forecasting and Policy Analysis System (FPAS) has been developed by the Central Bank with the assistance of the International Monetary Fund (IMF), which is currently being integrated into the monetary policy formulation process of the Central Bank. Further, as announced in the "Road Map: Monetary and Financial Sector Policies for 2017 and beyond" (Road Map 2017), the number of Monetary Policy Committee (MPC) meetings was reduced to eight meetings per year in order to provide staff sufficient time for deeper macroeconomic analysis and forecasting. Moreover, the Monetary Policy Consultative Committee (MPCC) comprising academics, professionals and private sector representatives was re-established in 2017, enabling the Central Bank to obtain views of the private sector to be used in the monetary policy formulation process.

- **Consumer price inflation remained at higher than desired levels thus far in 2017 due to the combined effect of tax revisions, domestic weather related disturbances and rising commodity prices in the global market**. Headline inflation, as measured by the year-on-year change in the National Consumer Price Index (NCPI, 2013=100), remained high during the first quarter of 2017, mainly reflecting the impact of supply side disruptions on account of adverse weather conditions as well as the impact of tax revisions. However, improvements in supply conditions with the dissipation of weather related disturbances and the government's initiatives to facilitate imports of essential food items eased price pressures in the domestic market, helping inflation to gradually moderate during the second quarter of the year. However, NCPI based headline inflation increased again and reached 8.6 per cent in September 2017, mainly reflecting high food inflation. On an annual average basis, NCPI based headline inflation was 6.8 per cent in September 2017, compared to 4.0 per cent recorded at end 2016. Meanwhile, Colombo Consumer Price Index (CCPI 2013=100) based headline inflation also recorded a similar movement and peaked at 7.3 per cent, year-on-year, in March 2017 before gradually declining to 4.8 per cent in July 2017 due to the decline in food inflation with the moderation of the impact of supply disruptions. Thereafter, CCPI based headline inflation increased again to 7.1 per cent in September 2017, mainly due to the sharp increase in food inflation. On an annual average basis, CCPI based headline inflation stood at 5.8 per cent in September 2017 compared to 4.0 per cent at end 2016.

7

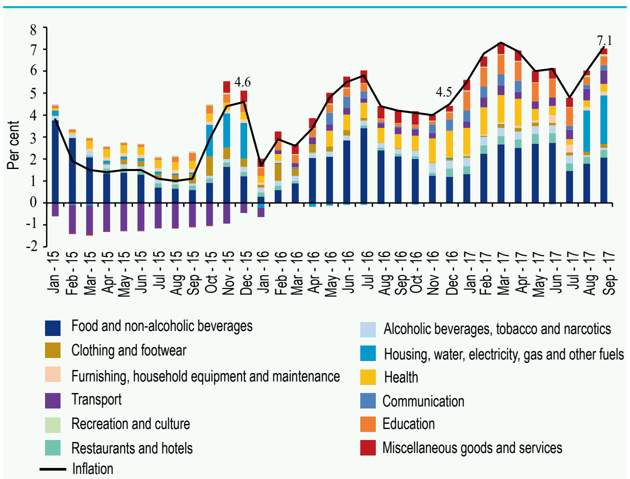
Chart 7.1
Contribution to Year-on-Year Headline Inflation (NCPI)



Source: Department of Census and Statistics

- **Core inflation, which is generally considered as the demand driven component of inflation, indicated an upward trend during the first quarter of 2017 before moderating thereafter.** The increase in core inflation during the first quarter of 2017 was largely driven by the prices of the non-food category, and the effect of tax revisions was also observed in the movement of core inflation. Partly reflecting the response to demand management policies of the Central Bank, core inflation remained below headline inflation during most months. Accordingly, NCPI based core inflation declined to 4.6 per cent, year-on-year, in September 2017, compared to 6.7 per cent recorded at end 2016. On an annual average basis, NCPI based core inflation was 5.7 per cent in September 2017 in comparison to 5.9 per cent at end 2016. CCPI based core inflation was recorded at 6.0 per cent, year-on-year, in September 2017 in comparison to 5.8 per cent at end 2016, while on an annual average basis, it was at 5.8 per cent in September 2017, in comparison to 4.4 per cent at end 2016.

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



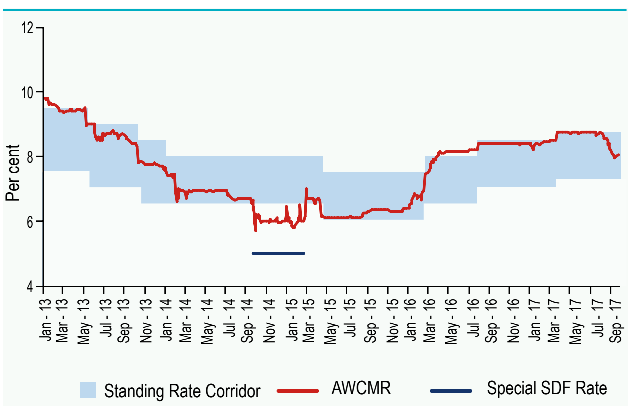
Source: Department of Census and Statistics

- **Thus far in 2017, inflation expectations of economic agents remained broadly contained in view of the forward looking monetary policy conduct of the Central Bank.** Inflation expectations of the corporate sector as per the Inflation Expectations Survey of the Central Bank showed an upward movement during the early part of 2017, but improved thereafter indicating the views of the corporate sector on the possible easing of price pressures. Nevertheless, inflation expectations of the household sector indicated an upward bias till June 2017 before moderating thereafter. Domestic supply side disruptions due to unfavourable weather conditions and the impact of tax revisions were the main contributory factors for the upward movement in inflation expectations. In addition, the increase in prices in the domestic and international markets was also highlighted by respondents as a factor affecting their sentiments on future inflation.

- **In view of the developments mainly on the inflation front and monetary aggregates, the Central Bank pursued a tight monetary stance thus far in 2017.** In January 2016, the Central Bank commenced monetary tightening by raising the Statutory Reserve Ratio (SRR) applicable on all rupee deposit liabilities of licensed commercial banks by 1.50 percentage points to 7.50 per cent. The Central Bank also raised policy interest rates by a total of 100 basis points in two steps during 2016 to preempt the buildup of demand driven inflationary pressures and excessive monetary and credit expansion. Meanwhile, monetary tightening measures coupled with declining levels of market liquidity caused an upward adjustment in market interest rates. However, amidst upward adjustment in lending rates, credit disbursements to the private sector by commercial banks continued to expand beyond the desired levels. Driven by the excessive domestic credit flows to the private sector as well as to the public sector, monetary expansion continued to be high during the latter part of 2016 and early 2017. Considering these developments, and to contain second round effects of price increases, which were driven by supply side factors and tax adjustments, the Central Bank further tightened the monetary policy stance by raising its policy interest rates by 25 basis points in March 2017. The Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank remained at 7.25 per cent and 8.75 per cent, respectively, thereafter. Reflecting the transmission of the tight monetary policy stance of the Central Bank, market interest rates increased, and a gradual deceleration in the growth of credit to the private sector was observed thus far in 2017.

- **In order to steer overnight interest rates consistent with monetary policy objectives, the Central Bank conducted open market operations (OMO) effectively**. Rupee liquidity in the domestic money market showed a mixed movement in view of the domestic and foreign currency operations of the Central Bank and the government treasury operations, but remained mostly negative during the first seven months of 2017. At the beginning of the year, the Central Bank conducted repurchase auctions and outright sales of Treasury bills to absorb the excess liquidity that prevailed in the market. As market liquidity remained mostly at deficit levels during February to mid July 2017, the Central Bank injected liquidity into the market through reverse repurchase auctions and standing facilities. The deficit liquidity levels prompted the AWCMR to remain around the upper bound of the policy rate corridor. As a result of tight monetary policy measures amidst deficit liquidity conditions, deposit and lending rates of commercial banks also increased gradually. However, in line with the improvements in market liquidity conditions from mid July 2017, short term interest rates, particularly AWCMR and Sri Lanka Inter Bank Offered Rates (SLIBOR) indicated a moderation.

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



Source: Central Bank of Sri Lanka

- **The communication strategy of the Central Bank continued to aim at enhancing the transparency of communicating monetary policy decisions to the general public, while guiding expectations of economic agents appropriately**. Through its Road Map, the Central Bank published an advance release calendar for monetary policy announcements at the beginning of the year. Moreover, the press release on the review of the monetary policy stance, which explained the rationale for the monetary policy decision, continued to be the key mode of announcing monetary policy decisions to the market. In addition, each monetary policy review announcement was followed by a media conference chaired by the Governor and attended by senior officials of the Central Bank. This move is critical in helping to build and maintain policy credibility of the Central Bank, which is crucial to ensure the effectiveness of monetary policy. At the same time, issuing regular and occasional communiqués, conducting of seminars and lectures as well as delivering speeches by the

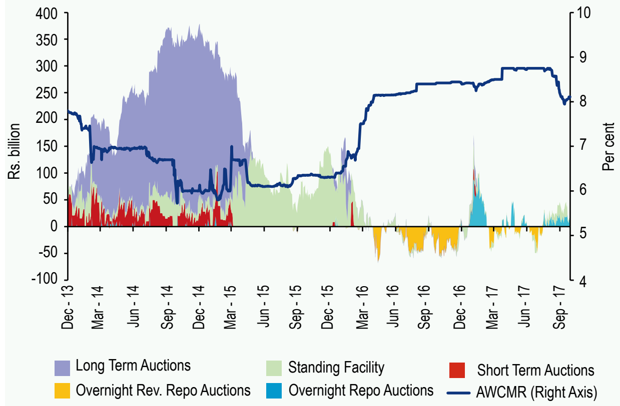
Governor and the senior officials of the Central Bank enabled managing inflation expectations of the public. Meanwhile, the Central Bank continued to release its regular publications and useful economic information on a daily, weekly, monthly, quarterly and annual basis in all three languages, through online and print media.

Movements in Interest Rates

Market Liquidity, Market Operations and Short Term Interest Rates

- **Rupee liquidity in the domestic money market remained mostly tight until mid July 2017 and turned to positive levels thereafter**. The money market, which operated with deficit liquidity conditions mostly in the latter part of 2016, recorded surplus overnight liquidity for a short period during December 2016-January 2017 mainly due to the return of currency to the banking system after the festive season, the release of provisional advances to the government as well as the maturing term repurchase agreements with the Central Bank. Since the early part of February 2017, however, excess liquidity declined significantly and remained in the negative territory as a result of the maturing of Treasury bill holdings of the Central Bank as well as the net foreign exchange sales by the Central Bank in the first quarter of 2017 in view of capital outflows. Even though liquidity turned to surplus levels occasionally due to the returning of currency into the banking system after the New Year season, foreign exchange purchases by the Central Bank on a net basis and conversion of a part of the International Sovereign Bond (ISB) proceeds, liquidity remained mostly in deficit levels averaged around Rs. 7.9 billion during the early February to mid July 2017 period due to the substantial retirements of Treasury bill holdings of the Central Bank. Continued foreign exchange purchases by the Central Bank and further conversions of ISB proceeds and foreign loans received by the government led to a turnaround in domestic money market liquidity into a surplus level since mid July 2017. Accordingly, the liquidity surplus in the domestic money market during mid July to September 2017 averaged around Rs. 25.0 billion. In line with these developments, the Central Bank engaged in conducting OMO through auctions and providing standing facilities as required, to ensure the stability in overnight interest rates.

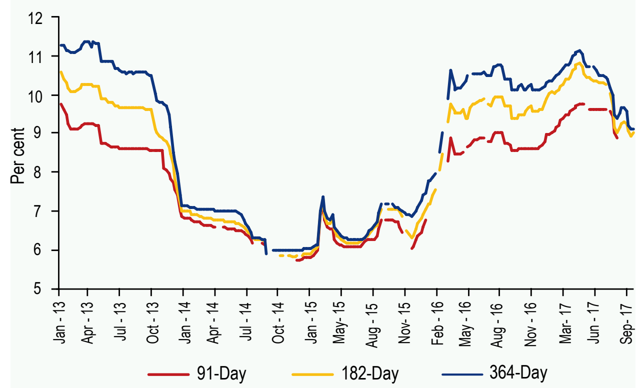
Chart 7.4
Rupee Liquidity in the Domestic Money Market and Liquidity Management



Source: Central Bank of Sri Lanka

- **Overnight money market rates hovered around the upper bound of the policy rate corridor during the first seven months of 2017 reflecting tight monetary conditions, and a downward movement towards the middle of the policy rate corridor was observed since mid July 2017 in response to improved liquidity conditions**. AWCMR, which adjusted downwards in January 2017 with the transitory improvements in market liquidity levels, moved upwards and remained around the upper bound of the policy rate corridor thereafter, as market liquidity levels declined and policy interest rates were increased in March 2017. Nevertheless, with the improvements in money market liquidity levels, AWCMR, which was at 8.75 per cent, started adjusting downwards since mid July 2017 and reached 8.11 per cent by end September 2017. Following a similar trend, weighted average yields at the daily OMO auctions adjusted upwards gradually until mid July 2017 responding to the movements in policy interest rates and liquidity shortage, before moving downwards since mid July 2017 with improved liquidity conditions in the money market. Meanwhile, the SLIBOR adjusted in line with the movements in the AWCMR and liquidity conditions, and overnight and 12-months SLIBOR were at 8.11 per cent and 11.99 per cent, respectively, by end September 2017, compared to 8.44 per cent and 12.00 per cent recorded at end 2016.

Chart 7.5
Primary Market Treasury Bill Yields (a)



Source: Central Bank of Sri Lanka

(a) Yield rates for some weeks are not available.

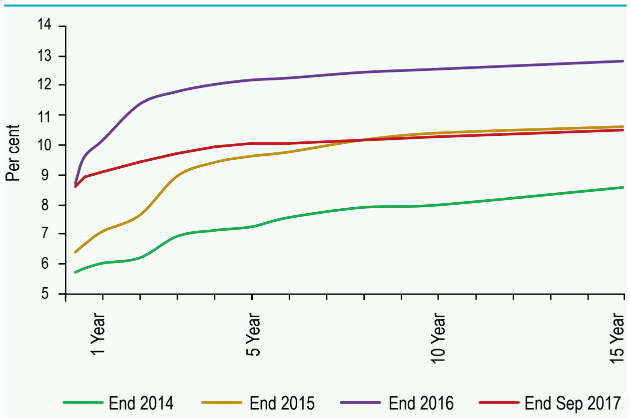
Yields on Government Securities

- **Although an increase was observed during the first four months of 2017, yields on government securities declined considerably thereafter, in response to favourable market sentiments arising from improved fiscal performance, availability of foreign financing and the improvements made to the auction system**. Yields on Treasury bills in the primary market showed an upward movement during the first four months of 2017, reflecting the impact of increased demand for funds by the government within a purely auction based system for issuing government securities as well as the transmission of tight monetary conditions. Accordingly, by end April 2017, yields on 91- day, 182-day and 364-day Treasury bills increased by 101 basis points, 107 basis points and 85 basis points, respectively, compared to the yields that prevailed at end 2016. However, due to increased foreign inflows to the government securities market since March 2017 as well as the receipt of the proceeds of the ISB amounting to US dollars 1.5 billion and the syndicate loan proceeds totaling US dollars 1.0 billion, the pressure in the government securities market reduced substantially. Further, increased government revenue collection and the receipt of the third tranche of the IMF-EFF Programme also helped enhance market expectations. In response to these developments, yields of 91-day, 182-day and 364-day Treasury bills decreased by 102, 169 and 192 basis points to 8.71 per cent, 9.01 per cent, and 9.10 per cent, respectively, by end September 2017 compared to the yields recorded at end April 2017.

- **Following short term yields, rates on Treasury bonds in the primary market also declined since April 2017**. In view of the high borrowing requirements of the government, yields on Treasury bonds displayed an increasing trend during the first quarter of 2017, before declining thereafter. Considering the high interest rates, the government relied more on short and medium term Treasury bonds during the first nine months of 2017. Yields on 5-year Treasury bonds, which increased from 12.16 per cent in early January 2017 to 12.60 per cent by early April 2017, moderated to 10.09 per cent by end September 2017. Yields on 10-year Treasury bonds also declined from 12.11 per cent by end 2016 to 10.31 per cent by end September 2017. Similar movements were observed in the yields pertaining to Treasury bonds of other maturities as well. Meanwhile, the government issued short and medium term US dollar denominated Sri Lanka Development Bonds (SLDBs) at various fixed and floating rates. Further, a 10-year ISB was issued in May 2017 at a relatively low rate of 6.20 per cent. The issuance of these foreign currency denominated debt securities helped to ease the pressure on yields of domestic debt instruments to a great extent. Meanwhile, in order to enhance the efficiency and transparency of domestic borrowings of the government, the Central Bank introduced a new primary issuance system for Treasury bonds in July 2017.

- **The secondary market yields that increased during the first four months of 2017, declined thereafter, leading to a sharp downward shift in the yield curve for government securities, particularly from the long end**. The yields on short term maturities declined marginally, while the long term yields declined substantially. Accordingly, the yields on 91-day, 182-day and 364-day Treasury bills declined by 8 basis points, 68 basis points and 106 basis points, respectively, by end September 2017, in comparison to the yields observed at end 2016. Secondary market yields on Treasury bonds declined within a range of 196 to 242 basis points by end September 2017, in comparison to the yields observed at end 2016. This downward shift in the yield curve could be attributed to favourable market expectations in view of continued fiscal consolidation and improved debt management strategies as well as favourable inflation expectations over the medium term, as a result of forward looking monetary policy decisions.

Chart 7.6
Secondary Market Yield Curve for Government Securities



Source: Central Bank of Sri Lanka

Table 7.1
Movements in Interest Rates

Per cent per annum

Interest Rate	End 2016	End September 2017
Policy Interest Rates		
Standing Deposit Facility Rate	7.00	7.25
Standing Lending Facility Rate	8.50	8.75
Average Weighted Call Money Rate (AWCMR)	8.42	8.11
Yield Rates on Government Securities		
Primary Market (a)		
Treasury bills		
91-day	8.72	8.71
182-day	9.63	9.01
364-day	10.17	9.10
Treasury bonds		
2-year	11.04	9.83
3-year	11.62	-
4-year	11.94	11.14
5-year	11.76	10.09
10-year	12.11	10.31
Secondary Market		
Treasury bills		
91-day	8.69	8.61
182-day	9.60	8.92
364-day	10.17	9.11
Treasury bonds		
2-year	11.38	9.42
3-year	11.80	9.71
4-year	12.04	9.94
5-year	12.18	10.04
10-year	12.55	10.28
Licensed Commercial Banks (b)		
Interest Rates on Deposits		
Savings Deposits	0.50-9.00	0.50-9.50
1 Year Fixed Deposits (c)	4.50-15.00	4.89-15.00
Average Weighted Deposit Rate (AWDR)	8.17	9.25
Average Weighted Fixed Deposit Rate (AWFDR)	10.46	11.81
Average Weighted New Deposit Rate (AWNDR)	11.17	11.04 (d)
Interest Rates on Lending		
Average Weighted Prime Lending Rate (AWPR)	11.73	11.42
Average Weighted Lending Rate (AWLR)	13.20	13.90 (d)
Average Weighted New Lending Rate (AWNLR)	14.37	15.12 (d)
Other Financial Institutions (e)		
Interest Rates on Deposits		
National Savings Bank		
Savings Deposits	4.25	4.00
1 - year Fixed Deposits	11.00	11.00
Licensed Finance Companies (f)		
Savings Deposits	5.38-7.74	5.44-7.84 (d)
1 - year Fixed Deposits	12.13-14.06	12.53-14.08 (d)
Interest Rates on Lending		
National Savings Bank	9.75-15.00	13.00-16.00
State Mortgage and Investment Bank (g)	10.50-20.00	10.50-20.00
Licensed Finance Companies (f)		
Finance Leasing	17.48-25.97	17.52-29.29 (d)
Hire Purchase	17.51-22.65	16.83-20.77 (d)
Loans against Real Estate	19.12-20.80	18.03-20.23 (d)
Corporate Debt Market		
Debentures	9.60-13.75	12.75-15.00 (d)
Commercial Paper	8.70-14.80	14.25-16.50 (d)

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

(a) Weighted average yield rates at the latest available auction.
(b) Based on the rates quoted by commercial banks.
(c) Maximum rate is a special rate offered by certain Commercial banks.
(d) As at end August 2017.
(e) Based on the rates quoted by other selected Financial Institutions.
(f) Interest rate ranges are based on the average maximum and average minimum rates quoted by LFCs. Data for 2017 are provisional.
(g) Lending for housing purposes only.

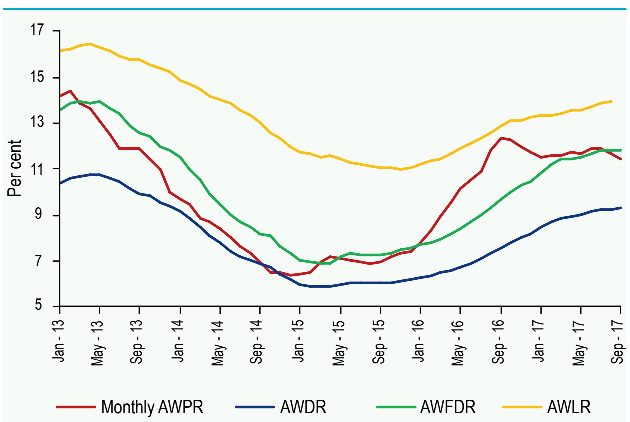
7

Deposit and Lending Interest Rates

- **Deposit interest rates of commercial banks continued to increase particularly during the first seven months of 2017**. Reflecting the increased competition among banks to mobilise deposits from the general public amidst tight monetary conditions in the market, deposit interest rates increased during the period under review. Accordingly, the average weighted deposit rate (AWDR), which reflects the movements in interest rates pertaining to all outstanding interest bearing deposits held with commercial banks, increased by 108 basis points to 9.25 per cent by end September 2017 from 8.17 per cent at end 2016. Meanwhile, the average weighted fixed deposit rate (AWFDR), which is based on interest rates pertaining to all outstanding time deposits held with commercial banks, also increased by 135 basis points to 11.81 per cent by end September 2017 from 10.46 per cent at end 2016. Moreover, the average weighted new deposit rate (AWNDR), which captures the interest rates pertaining to all new interest bearing deposits, increased by 55 basis points to 11.72 per cent by end July 2017 from 11.17 per cent at end December 2016. However, following the declining trend in other short term interest rates, AWNDR declined to 11.04 per cent by end August 2017.

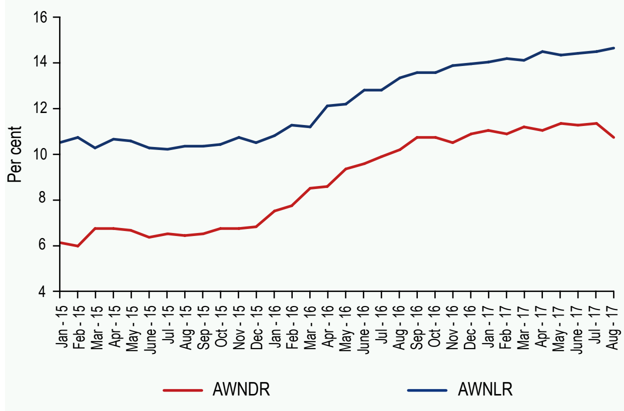
- **With the gradual transmission of the impact of tight monetary conditions, lending rates of commercial banks increased further and stabilised at high levels by end September 2017**. Reflecting the movement in short term interest rates, the weekly average weighted prime lending rate (AWPR), which is based on interest rates applicable on short term loans and advances granted by commercial banks to their prime customers during a week, increased by 74 basis points to a peak of 12.26 per cent by end July 2017 from 11.52 per cent at end 2016. Nevertheless, along with the movements in other short term interest rates amidst the gradual increase in market liquidity, weekly AWPR declined to 11.55 per cent by end September 2017. Moreover, the average weighted lending rate (AWLR), which is based on interest rates of all outstanding loans and advances extended by commercial banks to the private sector, increased by 70 basis points to 13.90 per cent by end August 2017 from 13.20 per cent that was observed at end 2016. Meanwhile, bank-wise average weighted lending rates increased to a range of 10.80-16.31 per cent by end August 2017 compared to the range of 10.12-15.66 per cent prevailed at end 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 by 75 basis points to 15.12 per cent by end August 2017 from 14.37 per cent at end December 2016.

Chart 7.7
Selected Market Interest Rates



Source: Central Bank of Sri Lanka

Chart 7.8
New Deposit and New Lending Rates



Source: Central Bank of Sri Lanka

Interest Rates on Debt Instruments

- **In line with other market interest rates, interest rates applicable on corporate debt securities increased during the first eight months of 2017**. Interest rates on commercial paper, which is a short term debt instrument, increased substantially to a range of 14.25-16.50 per cent during the first eight months of 2017 compared to the range of 8.70 - 14.80 per cent observed in 2016. Meanwhile, there were seven listings of debentures by two corporates during the first eight months of 2017 with maturities of 5-8 years at various fixed and floating rates. Fixed interest rates applicable on debentures were in the range of 12.75-15.00 per cent by end August 2017 compared to a range of 9.60-13.75 per cent recorded at end 2016.

Interest Rates on Foreign Currency Deposits

- **Interest rates applicable on foreign currency deposits maintained with commercial banks increased marginally during the first nine months of 2017**. Following the increase in the Federal funds target rate in March and June 2017, interest rates on US dollar denominated savings deposits were recorded in a range of 0.02-4.23 per cent by end September 2017 compared to the range of 0.02-3.62 per cent observed at end 2016. Moreover, interest rates pertaining to US dollar denominated time deposits were in the range of 0.15-6.15 per cent by end September 2017 compared to the range of 0.15-5.00 per cent at end 2016. Meanwhile, interest rates on savings deposits denominated in pound sterling remained broadly unchanged in a range of 0.10-2.00 per cent by end September 2017 compared to the range of 0.05-2.01 per cent at end 2016. Interest rates applicable on pound sterling denominated time deposits were in the range of 0.20-4.52 per cent by end September 2017 in comparison to the range of 0.25-4.02 per cent at end 2016.

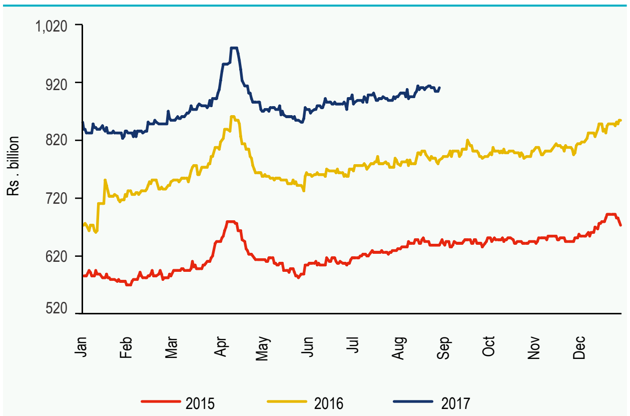
Movements in Monetary and Credit Aggregates

Reserve Money

- **Reserve money, which increased at a high rate in 2016, moderated during the first eight months of 2017 mainly on account of the high base observed in the corresponding period of 2016 due to upward adjustment in SRR in January 2016**. The year-on-year growth of reserve money decelerated to 16.0 per cent by end August 2017 compared to 27.1 per cent recorded at end 2016. In absolute terms, reserve money increased by Rs. 55.2 billion to Rs. 911.4 billion during the first eight months of 2017 compared to the increase of Rs. 112.3 billion recorded in the corresponding period of 2016, reflecting a significant moderation in the increase of commercial bank deposits with the Central Bank. From the liability side of reserve money, commercial banks' deposits with the Central Bank increased by Rs. 26.4 billion to Rs. 329.7 billion by end August 2017 compared to the increase of Rs. 82.3 billion during the corresponding period of 2016. Currency in circulation also increased by Rs. 28.9 billion to Rs. 581.7 billion by end August 2017. Although the movements in currency in circulation followed historical patterns with a sharp pickup during festive seasons, the year-on-year growth of currency in circulation was at 11.5 per cent by end August 2017 compared to 12.4 per cent during the corresponding period of 2016. With these developments, reserve money, which is considered as an indicative target under the current IMF-EFF Programme, remained below the target for the third quarter of 2017.

- **Viewed from the assets side, the increase in reserve money during the first eight months of 2017 was entirely due to the expansion in net foreign assets (NFA) of the Central Bank, while net domestic assets (NDA) of the Central Bank contracted during the period under review**. NFA of the Central Bank increased by

Chart 7.9
Daily Reserve Money (a)



Source: Central Bank of Sri Lanka

(a) Sudden changes in the movement of reserve money are due to SRR adjustments and seasonal factors.

Rs. 187.2 billion during the first eight months of 2017 compared to the decline of Rs. 77.2 billion in the corresponding period of 2016. The expansion in NFA of the Central Bank was attributable to the increase in Central Bank's foreign currency financial assets, particularly with the foreign exchange purchases of the Central Bank from the domestic foreign exchange market as well as the conversions of proceeds of the ISB and the syndicated loans obtained by the government. In contrast to the buildup of NFA, NDA of the Central Bank contracted by Rs. 131.9 billion to reach Rs. 165.6 billion during the first eight months of 2017 in comparison to the significant increase of Rs. 200.3 billion recorded during 2016. The decline in NDA was mainly due to the contraction in net credit to the government (NCG) by the Central Bank. With the Central Bank retiring its Treasury bill holdings, NCG by the Central Bank declined by Rs. 119.5 billion to Rs. 293.5 billion during the first eight months of 2017 compared to an increase of Rs. 166.6 billion during the corresponding period of 2016. Significantly contributing to the contraction in NCG, Central Bank Treasury bill holdings (net of repurchase transactions) declined by Rs. 239.8 billion to Rs. 90.2 billion by end August 2017, compared to the historically highest level of Rs. 330.0 billion recorded at end 2016. In addition to allowing the Treasury bill holdings to mature, the Central Bank conducted auctions to sell its Treasury bills on an outright basis to absorb excess liquidity in the market permanently since mid July 2017. Nevertheless, provisional advances to the government by the Central Bank increased by Rs. 120.3 billion to Rs. 203.7 billion by end August 2017.

Narrow Money (M_1)

- **The year-on-year growth of narrow money (M_1) continued to moderate during the first eight months of 2017 reflecting the increased opportunity cost of holding money in an environment of high market interest rates.** M_1, which consists of the most liquid financial assets such as currency and demand deposits, recorded a moderate growth of 6.3 per cent, year-on-year, by end August 2017 compared to 8.6 per cent by end 2016. With regard to the components of M_1, currency held by the public grew by 9.7 per cent, year-on-year, during the first eight months of 2017 compared to a growth of 10.7 per cent in 2016, and accounted for around 87 per cent of the expansion in M_1. Demand deposits held by the public with commercial banks grew only by 1.9 per cent, year-on-year, during the first eight months of 2017 compared to 6.2 per cent recorded in 2016. In absolute terms, demand deposits held by the public with commercial banks increased by Rs. 6.0 billion during the 12 months ending August 2017 compared to the increase of Rs. 23.5 billion recorded in the preceding 12 months.

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

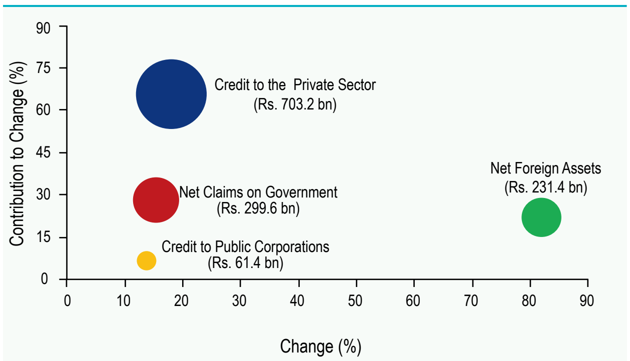
- **Broad money supply (M_{2b}) continued to expand at a high rate during the first eight months of 2017.** The year-on-year growth of M_{2b} was 21.3 per cent by end August 2017 compared to a growth of 18.4 per cent by end 2016, while the average growth stood at 20.1 per cent during the first eight months of 2017 compared to 18.1 per cent in 2016. The expansion in M_{2b} is attributable to both NDA and NFA of the banking system. During the period under review, NDA contributed 78 per cent to the year-on-year expansion in broad money aggregates, while NFA accounted for the remainder.

- **On the liability side, the increase in time and saving deposits held by the public with commercial banks largely contributed to the expansion in M_{2b}.** High market interest rates driven by the tight monetary policy stance continued to attract considerable amounts of interest bearing deposits to commercial banks. As a result, time and saving deposits of the commercial banking sector increased by Rs. 1,017.1 billion during the 12 months ending August 2017 compared to an increase of Rs. 671.9 billion recorded during the previous 12 months. Contributing around 96 per cent of the expansion in M_{2b}, time and saving deposits grew by 23.8 per cent, year-on-year, by end August 2017 compared to 20.2 per cent at end 2016. Meanwhile, demand deposits held by the public with commercial banks recorded only a moderate growth during the 12 months ending August 2017.

- **On the assets side, NFA of the banking sector increased during the first eight months of 2017, led largely by the NFA of the Central Bank**. In absolute terms, NFA of the banking sector increased significantly by Rs. 181.1 billion during the first eight months of 2017 (Rs. 231.4

Chart 7.10

Key Contributory Factors to Year-on-Year Growth of Broad Money (M_{2b}) (a)

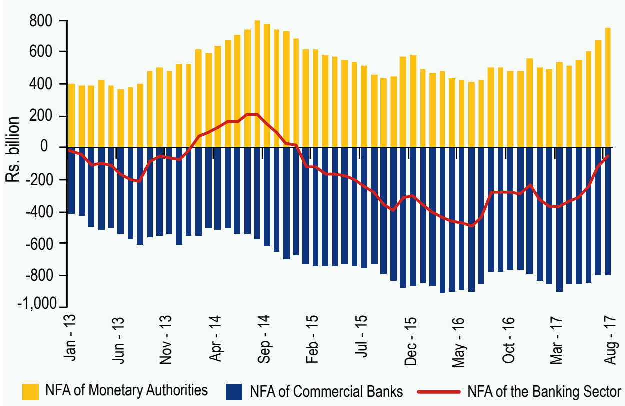


Source: Central Bank of Sri Lanka

(a) The size of the bubble represents the change in sources of broad money (M_{2b}) in absolute terms (Rs. bn) from August 2016 to August 2017.

Chart 7.11

Net Foreign Assets (NFA) of the Banking Sector



Source: Central Bank of Sri Lanka

billion in the 12 months ending August 2017) compared to the increase of Rs. 66.9 billion in 2016 entirely on account of the increase in NFA of the Central Bank by Rs. 187.2 billion resulting from the increase in international reserves of the Central Bank. Although NFA of commercial banks have gradually improved since June 2017 underpinned by the contraction in foreign liabilities of commercial banks, on a cumulative basis, NFA of commercial banks declined by Rs. 6.0 billion during the first eight months of 2017 compared to an increase of Rs. 93.8 billion in the corresponding period of 2016. This is attributable to the net impact of the decrease in NFA of OBUs by Rs. 18.7 billion and the increase in NFA of DBUs by Rs. 12.7 billion during the first eight months of 2017. The contraction in NFA of OBUs was due to a combination of several factors such as increased deposits from non-residents and the decline in credit to non-residents, amidst the contraction in borrowings from banks abroad. NFA of DBUs of commercial banks increased during the first eight months of 2017 largely on account of the decline in borrowings from banks abroad, although foreign currency placements with banks abroad also recorded a contraction during the period under review.

- **NDA of the banking sector continued to expand during the first eight months of 2017 due to increased credit disbursements to both private and public sectors**. In absolute terms, NDA of the banking system increased by Rs. 463.8 billion during the first eight months of 2017 (Rs. 830.6 billion in the 12 months ending August 2017) contributing towards 78 per cent of the monetary expansion compared to an increase of Rs. 406.0 billion observed during the corresponding period of 2016. The expansion in NDA of the banking sector thus far in 2017 was driven by credit flows to the private sector, the government as well as to public corporations, despite the deceleration in private sector credit growth observed since July 2016 and the moderate increase in credit to public corporations during the first eight months of 2017.

- **NCG by the banking sector continued to increase during the first eight months of 2017 contributing around 57 per cent of the expansion in NDA**. NCG from the banking system increased by Rs. 265.4 billion during the first eight months of 2017 compared to the increase of Rs. 178.4 billion in the corresponding period of 2016. The increase in NCG is entirely attributable to the expansion in NCG from commercial banks, while NCG from the Central Bank contracted considerably during the period under review. Accordingly, NCG from commercial banks increased significantly by Rs. 384.9 billion in the first eight months of 2017 in comparison to the increase of Rs. 11.8 billion in the corresponding period of 2016. The increase in NCG of commercial banks was driven by the credit disbursed by both DBUs and OBUs of commercial banks. NCG by DBUs increased by Rs. 323.6 billion in the first eight months of 2017 following the increase of Rs. 96.6 billion in 2016 mainly driven by investments in Treasury bills and SLDBs amounting to Rs. 255.4 billion and Rs. 39.5 billion, respectively. Meanwhile, government overdraft balances with commercial banks also increased by Rs. 50.6 billion during the period under review. Nevertheless, investments in Treasury bonds by commercial banks contracted by Rs. 14.7 billion during the first eight months of 2017. Moreover, NCG by OBUs increased by Rs. 61.3 billion during the first eight months of 2017, following a contraction of Rs. 67.1 billion by end 2016. This was mainly due to an increase in investments in SLDBs by Rs. 22.1 billion and the increase in foreign currency loans to the government amounting to Rs. 39.2 billion. Meanwhile, reversing the trend observed during 2016, NCG of the Central Bank declined significantly by Rs. 119.5 billion during the first eight months of 2017. This decline was entirely due to the notable reduction in Treasury bill holdings (net of repurchase transactions) of the Central Bank by Rs. 239.8 billion during the first eight months of 2017 to reach Rs. 90.2 billion. The Central Bank allowed a considerable amount of Treasury bills to mature during the period under review, while outright sales of Treasury bills by the Central Bank during the months of July and August 2017 to absorb excess liquidity in the market on permanent basis also contributed to the recorded contraction in Treasury bill holdings of the Central Bank. Meanwhile, provisional advances to the government by the Central

Table 7.2
Domestic Credit Expansion and Contributory Factors

Period	Absolute Change (Rs. billion)				Share of Domestic Credit (%)		
	Domestic Credit (a)	Credit to Private Sector	Net Credit to the Government	Credit to Public Corporations	Credit to Private Sector	Net Credit to the Government	Credit to Public Corporations
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
2016	939.6	754.9	212.6	-27.9	80.3	22.6	-3.0
Jan - Aug 2016	553.3	456.3	178.4	-81.5	82.5	32.3	-14.7
Jan - Aug 2017	**677.8**	**404.6**	**265.4**	**7.8**	**59.7**	**39.2**	**1.2**

(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

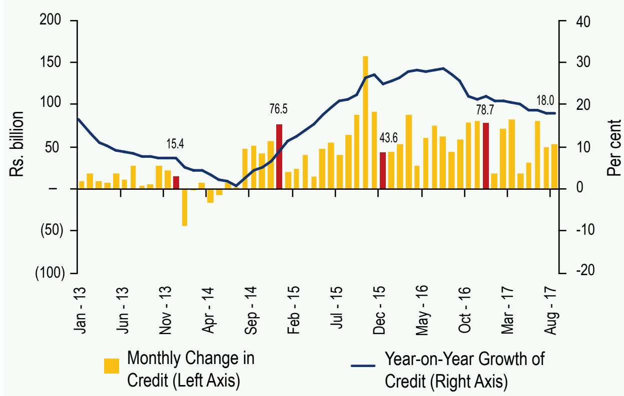
Bank, which recorded a sharp increase of around Rs. 120 billion to Rs. 203.7 billion in January 2017 with the full utilisation of the entitlement for the year, remained almost unchanged by end August 2017.

- **The increasing trend in credit to public corporations since September 2016 continued during the first five months of 2017, but moderated thereafter**. The total cumulative increase in credit obtained by public corporations in 2017, which amounted to Rs. 66.6 billion by end May, subsequently reduced to Rs. 7.8 billion by end August 2017, compared to a contraction of Rs. 81.5 billion recorded in the corresponding period of 2016. The increase in credit to public corporations during the first eight months of 2017 was largely driven by borrowings by National Water Supply and Drainage Board (NWS&DB) amounting to Rs. 16.2 billion, Road Development Authority (RDA) amounting to Rs. 7.8 billion and SriLankan Airlines amounting to Rs. 7.6 billion. Although, Ceylon Petroleum Corporation (CPC) repaid around Rs. 52.8 billion of its loan liabilities during the period from May to August 2017, containing the overall expansion in credit to public corporations, net repayment by CPC was limited to Rs. 10.8 billion during the first eight months of 2017 as a result of their borrowings during the first four months of 2017. Further during the first eight months of 2017, Urban Development Authority, Ceylon Fertilizer Corporation, Ceylon Electricity Board (CEB), Paddy Marketing Board, Colombo Commercial Fertilizer Corporation and Sri Lanka Ports Authority also partially settled their loan liabilities to commercial banks by Rs. 6.5 billion, Rs. 2.7 billion, Rs. 2.6 billion, Rs. 1.8 billion, Rs. 1.3 billion and Rs. 1.1 billion, respectively.

- **In an environment of high nominal and real interest rates, the growth of credit to the private sector by commercial banks showed signs of deceleration during the first eight months of 2017**. In addition to the upward adjustment in policy interest rates in view of high

Chart 7.12

Credit Granted by Commercial Banks to the Private Sector

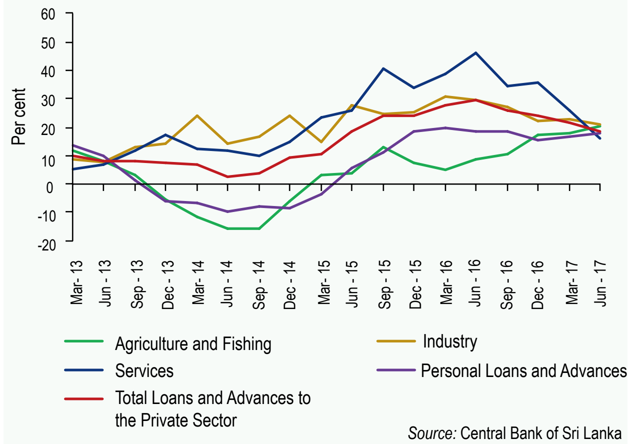


Source: Central Bank of Sri Lanka

credit expansion, macroprudential measures and tariff adjustments to discourage selected imports also contributed to the deceleration of private sector credit growth. Accordingly, the year-on-year growth of credit to the private sector was at 18.0 per cent by end August 2017 compared to 21.9 per cent at end 2016 and the peak level of 28.5 per cent recorded in July 2016. In absolute terms also, the growth of credit to the private sector in the first eight months of 2017 remained below the expansion observed in the corresponding period of 2016. Accordingly, credit to the private sector increased by Rs. 404.6 billion during the first eight months of 2017 compared to the increase of Rs. 456.3 billion in the corresponding period of 2016. Meanwhile, the removal of interest rate caps on credit cards, other loans and advances and penal interest rates charged on overdue loans and advances by licensed banks with effect from 01 July 2017 could also dampen the demand for credit by the private sector to some extent in the period ahead.

- **Credit granted to all major sectors continued to expand during the first half of 2017, although at a slower rate than in 2016**. As per the Quarterly Survey of Commercial Banks' Loans and Advances to the private sector, credit to the Industry sector and the Agriculture sector grew by 21.1 per cent and 20.5 per cent, on a year-on-year basis, respectively, by end June 2017. In the Agriculture sector, credit to all sub sectors recorded positive growth rates, and credit to Coconut, Paddy, Livestock and Dairy Farming and Fisheries grew by more than 35 per cent, year-on-year, by end June 2017. This increase in growth of credit to the Agriculture sector could be, in part, a reflection of increased borrowings to support the recovery from weather related disruptions in certain regions. Meanwhile, credit flows towards all sub sectors of the Industry sector recorded positive growth rates, with the Construction sector, which accounts for around 48 per cent of the total credit flows to the Industry sector and around 20 per cent of total private sector credit, recording a growth of 21.8 per cent, year-on-year, by end June 2017. Growth in credit to the Services sector moderated to 15.8 per cent by end June 2017 compared to the growth of 46.1 per cent recorded during the corresponding period of 2016 largely on account of the moderation in credit flows to the Financial and Business Services sub-sector. Further,

Chart 7.13
Year-on-Year Growth of Credit Granted by Commercial Banks to Key Sectors



Source: Central Bank of Sri Lanka

credit flows to sub sectors of Tourism, Transport, Printing and Publishing, and Education recorded relatively high growth rates, while credit to the sub-sector of Shipping, Aviation and Freight Forwarding contracted by 12.9 per cent by end June 2017. Credit under the Personal Loans and

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

Rs. billion

Sector	End June 2016 (c)	End June 2017 (d)	Year-on-Year Change	
			Amount	%
Agriculture and Fishing	**317.0**	**382.0**	**65.0**	**20.5**
of which, Tea	78.1	84.6	6.6	8.4
Rubber	20.4	25.3	4.9	23.8
Coconut	12.5	19.6	7.0	56.0
Paddy	23.5	32.3	8.9	37.8
Vegetables, Fruit and Minor Food Crops	22.0	27.2	5.2	23.6
Fisheries	12.3	16.8	4.5	36.8
Industry	**1,539.6**	**1,864.0**	**324.4**	**21.1**
of which, Construction	741.0	902.8	161.8	21.8
Food and Beverages	86.5	103.6	17.2	19.8
Textiles and Apparel	144.7	156.8	12.0	8.3
Fabricated Metal Products, Machinery and Transport Equipment	126.5	158.5	32.0	25.3
Services	**1,149.7**	**1,331.0**	**181.3**	**15.8**
of which, Wholesale and Retail Trade	353.6	400.0	46.3	13.1
Tourism	118.8	160.4	41.7	35.1
Financial and Business Services	282.2	306.6	24.4	8.7
Shipping, Aviation and Freight Forwarding	26.1	22.7	-3.4	-12.9
Personal Loans and Advances (e)	**824.2**	**972.1**	**147.9**	**17.9**
of which, Consumer Durables	172.0	207.0	35.1	20.4
Pawning	122.3	137.5	15.2	12.4
Total	**3,830.5**	**4,549.1**	**718.6**	**18.8**

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

Source: Central Bank of Sri Lanka

7

Advances category grew by 17.9 per cent, year-on-year, during the first half of 2017, a marginal moderation compared to the growth of 18.7 per cent recorded in the corresponding period of 2016. Within this sub-sector, credit disbursed under credit cards grew by 22.6 per cent during the first half of 2017. Pawning Advances, which continued to decline since September 2013, reversed this trend during the first half of 2017, recording a year-on-year growth of 12.4 per cent by end June 2017. This was mainly attributable to the rise in international gold prices as well as gold imports. Nevertheless, growth in credit disbursed to purchase consumer durables decelerated to 20.4 per cent by end June 2017 compared to the significant growth of 58.9 per cent recorded in the corresponding period of the previous year. With regard to the maturity-wise analysis of credit, the year-on-year growth of short term loans accelerated to 18.4 per cent by end June 2017 compared to 15.7 per cent recorded in the corresponding period of 2016. Meanwhile, growth in medium and long term loans moderated significantly to 14.2 per cent and 23.3 per cent, respectively, by end June 2017, compared to 25.6 per cent and 55.8 per cent, respectively, at end June 2016.

Broad Money (M_4)

- **Growth of broad money supply (M_4)[1], as measured by the financial survey, moved in line with the growth of M_{2b}.** By end August 2017, M_4 grew at a higher rate of 20.7 per cent compared to a growth of 15.9 per cent recorded at end 2016. Viewed from the liability side of M_4, total time and savings deposits held by the public with licensed commercial banks (LCBs), licensed specialised banks (LSBs) and licensed finance companies (LFCs) grew by 22.7 per cent,

1 Financial Survey provides a broader measure of liquidity, covering LSBs and LFCs, in addition to LCBs and the Central Bank.

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

Rs. billion

Sector	End Aug-16	End 2016	End Aug-17 (a)	Year-on-Year Change			
				End 2016		Aug-17	
				Amount	%	Amount	%
Financial Survey (M_4)	**6,178.8**	**6,630.3**	**7,457.0**	**910.0**	**15.9**	**1,278.2**	**20.7**
Underlying Factors							
Net Foreign Assets	**-429.1**	**-383.2**	**-205.2**	**61.0**	**13.7**	**223.9**	**52.2**
Monetary Authorities	499.0	558.6	745.8	-17.6	-3.1	246.8	49.4
LCBs	-780.5	-789.8	-795.9	84.5	9.7	-15.3	-2.0
LSBs & LFCs	-147.6	-152.0	-155.1	-6.0	-4.1	-7.6	-5.1
Net Domestic Assets	**6,607.9**	**7,013.5**	**7,662.3**	**849.1**	**13.8**	**1,054.4**	**16.0**
Domestic Credit	**8,293.2**	**8,763.3**	**9,595.6**	**1,159.6**	**15.3**	**1,302.4**	**15.7**
Net Credit to the Government	**2,529.4**	**2,555.9**	**2,843.2**	**211.6**	**9.0**	**313.7**	**12.4**
Monetary Authorities	396.5	413.0	293.5	183.1	79.6	-103.0	-26.0
LCBs	1,541.4	1,559.1	1,944.0	29.6	1.9	402.6	26.1
LSBs	527.0	515.7	541.4	-13.6	-2.6	14.5	2.7
LFCs	64.5	68.1	64.2	12.5	22.5	-0.3	-0.5
Credit to Public Corporations (LCBs)	**441.5**	**495.1**	**502.9**	**-27.9**	**-5.3**	**61.4**	**13.9**
Credit to the Private Sector	**5,322.3**	**5,712.3**	**6,249.5**	**975.9**	**20.6**	**927.2**	**17.4**
LCBs	3,905.9	4,204.4	4,609.1	754.9	21.9	703.2	18.0
LSBs	528.2	562.2	631.9	80.5	16.7	103.7	19.6
LFCs	888.2	945.7	1,008.6	140.5	17.4	120.3	13.5
Other Items (net) (b)	**-1,685.3**	**-1,749.8**	**-1,933.3**	**-310.6**	**-21.6**	**-248.0**	**-14.7**

(a) Provisional
(b) Computed as the difference between other assets and other liabilities.

Source: Central Bank of Sri Lanka

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year-on-year, by end August 2017, compared to 17.1 per cent growth recorded at end 2016. Time and savings deposits held at LSBs and LFCs grew by 15.5 per cent and 25.6 per cent, respectively, by end August 2017, supported by high and competitive interest rates offered for deposits during the period under review. From the assets side, largely contributing to the expansion in M_4, NDA of licensed banks and LFCs increased by Rs. 648.8 billion, while NFA also increased by Rs. 178.0 billion during the period under review.

- **The growth in credit to the private sector in the financial survey also displayed a moderation during the first eight months of 2017**. According to M_4, growth in credit to the private sector moderated to 17.4 per cent, year-on-year, by end August 2017 compared to 20.6 per cent at the end of 2016. Following the same trend, credit growth of LFCs moderated to 13.5 per cent, year-on-year, by end August 2017 compared to 17.4 per cent at end 2016. In contrast, credit growth of LSBs increased to 19.6 per cent, year-on-year, by end August 2017 compared to 16.7 per cent recorded at end 2016. In absolute terms, the growth of credit amounted to Rs. 537.2 billion during the first eight months of 2017 compared to the increase of Rs. 585.9 billion in the corresponding period of 2016. Further, NCG by all institutions covered in the financial survey recorded an increase during the period under review. Accordingly, overall NCG increased by Rs. 287.3 billion during the first eight months of 2017 compared to an increase of Rs. 185.1 billion during the same period of the previous year.

Expected Developments

- **The monetary policy framework of the Central Bank is being further strengthened with the aim of adopting a FIT framework over the medium term**. The key aspects of this transition include introducing necessary legal reforms, building institutional and technical capacity, strengthening central bank credibility and autonomy, enhancing government-central bank coordination, continuing the market based flexible exchange rate regime, improving monetary policy operations and enhancing public and stakeholder awareness. In the near future, the Central Bank intends to announce a Road Map, with the support of the government, to facilitate a smooth transition towards completing the remaining building blocks necessary for adopting this new monetary policy framework. In the recently published policy document "Vision 2025: A Country Enriched", the government has also indicated its willingness to further strengthen the legal framework of the Central Bank to conduct its monetary policy more efficiently under the FIT framework and to allow greater flexibility in exchange rate determination.

- **The unhindered progression of the ongoing fiscal consolidation process is essential for the smooth transition and successful implementation of FIT**. There is a strong need for enhanced monetary-fiscal coordination at this juncture with the government's commitment to the ongoing revenue-based fiscal consolidation process to ensure the success of the FIT framework in maintaining low and stable inflation over the medium term. The improved fiscal space will provide the Central Bank with enhanced flexibility to conduct its monetary policy more effectively and independently, that will pave way for a more growth-conducive environment supported by low levels of market interest rates on a more predictable and consistent basis.

- **With prudent monetary policy measures and short term cost adjustments by the government, the disturbances to price levels observed at present are expected to dissipate in the near term**. The increase in inflation observed during the most part of 2017 was mainly associated with tax revisions and supply disruptions caused by inclement weather conditions along with upward movements in international commodity prices. However, underlying inflation as indicated by core inflation has remained at tolerable levels in view of proactive monetary policy measures adopted by the Central Bank. While the Central Bank is committed to contain demand driven inflation through monetary policy measures and anchor inflation expectations towards targeted level of inflation, short and medium term actions are necessary to curb food inflation, which remains a serious concern. As a large proportion of the consumption basket comprises food items and imported components, supply disruptions in the domestic economy and the surge in international commodity prices, including oil, threaten price stability. Strengthening domestic supply networks and strengthening safety nets to dampen the impact of supply disturbances on the vulnerable segments of the population are necessary to increase the resilience of the economy to such disturbances.

8

FINANCIAL SECTOR PERFORMANCE AND SYSTEM STABILITY

The financial sector continued to expand and remained stable during the first half of 2017. The expansion of the asset base of the banking sector, which comprised credit and investment portfolios, was largely funded through deposits. Liquidity and capital ratios of the banking sector were maintained at levels that were well above the statutory requirements. The bank branch network expanded, contributing to improved financial inclusion in the country. The expansion of the licensed finance companies (LFCs) and specialised leasing companies (SLCs) sectors which slowed down with macroprudential policy measures implemented to curtail unhealthy developments in the market, showed signs of gradual rebounding with secured lending activities. Although the asset quality of LFC and SLC sectors deteriorated, it was at manageable levels in comparison to the expansion of the loan portfolio. Performance of primary dealers showed signs of some moderation. The insurance sector and superannuation funds recorded positive performance while the unit trust sector recorded a contraction. Amidst strengthened capital regulations, the stock broker sector recorded a mixed performance during the period under consideration. In the domestic money market, rupee liquidity remained mostly at deficit levels during the year, before turning to an excess from mid-July 2017. Accordingly, the interbank call money market rate, which remained close to the upper bound of the standing rate corridor, receded gradually since early August 2017. The yield rates of government securities across all maturities in the secondary market, which increased somewhat during the first four months of the year, declined substantially thereafter, particularly in view of improved domestic market conditions underpinned by foreign currency inflows to the government. The domestic foreign exchange market remained under pressure during the first seven months of the year on account of the tightening of global financial conditions and outflows resulting from import bills. However, with the receipt of the third tranche of the Extended Fund Facility (EFF) from the International Monetary Fund (IMF) along with notable conversions by exporters eased the pressure on the exchange rate. Reflecting these developments, the Sri Lankan rupee depreciated at a moderate level against the US dollar by 2.15 per cent during the first nine months of the year. Activities in the corporate debt securities market moderated, while the equity market performance remained subdued, reflecting volatile market behaviour and lower level of investor confidence. Nevertheless, share price indices and market capitalisation have recorded improvements, where foreigners remained net buyers in the equity market thus far during the year. Meanwhile, the national payment systems of the country operated smoothly without major disruptions or systemic risk concerns. Several initiatives were undertaken during the period to improve payment and settlement infrastructure to facilitate growing and changing payment needs of the financial sector.

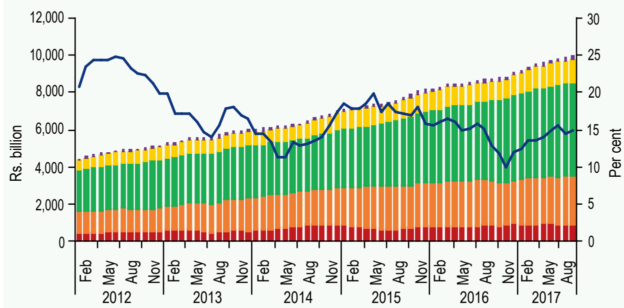
Developments in Financial Institutions

Banking Sector

- **The asset base of the banking sector expanded further during the first eight months of 2017 reflecting a growth in credit and investment portfolios of banks.** The increase in the asset base was funded mainly through deposits. Profitability of the banking sector improved due to higher net interest income, significant revaluation gains and lower operating expenses. Liquidity was maintained at comfortable levels and the banks maintained sufficient levels of capital to absorb adverse shocks. The banking sector continued to establish its presence by expanding its branch and Automated Teller Machine (ATM) networks.

- **Total assets of the banking sector stood at Rs. 9.9 trillion by end August 2017 recording an increase of 9.4 per cent during the first 8 months of 2017 compared to a growth of 6.8 per cent during the reference period of 2016.** The asset base increased by Rs. 854.9 billion resulting from an increase in net loans and advances by Rs. 599.4 billion and investments by Rs. 296.2 billion. This expansion was largely financed through the increase in deposits. The investments in government securities and Sri Lanka Development Bonds (SLDBs) contributed to around 97 per cent of the investment portfolio.

Chart 8.1
Assets of the Banking Sector



Source: Central Bank of Sri Lanka

- **Total loans and advances increased by 10.8 per cent during the first eight months of 2017 and stood at Rs. 6.1 trillion by end August 2017.** Despite higher market interest rates, lending to all economic sectors increased during the first half of 2017 with large disbursements towards transport, trading, tourism and manufacturing sectors. Credit was mainly concentrated in the construction (17.7 per cent), trading (14.3 per cent), manufacturing (10.8 per cent) and other (16.5 per cent) sectors as at end June 2017. During the first eight months of 2017, overdrafts (18.4 per cent), term loans (10.3 per cent) and pawning (8.7 per cent) reported significant increases. However, the leasing portfolio recorded only a marginal increase of 3.1 per cent due to the introduction of the loan to value ratio, as a macroprudential measure, in January 2017.

Table 8.1
Banking Sector - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (a)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets (Rs.billion)	7,491	8,624	9,047	9,901	15.1	14.8
Loans & Advances (Rs.billion)	4,338	5,092	5,541	6,140	17.4	20.6
Investments (Rs.billion)	2,345	2,428	2,291	2,588	3.6	6.6
Deposits (Rs.billion)	5,067	5,855	6,296	7,063	15.6	20.6
Borrowings (Rs.billion)	1,520	1,758	1,696	1,604	15.7	-8.8
Capital Funds (Rs.billion)	613	683	707	823	11.4	20.5
Tier 1 Capital Adequacy Ratio (%) (b)	13.5	12.2	12.5	12.2		
Total Capital Adequacy Ratio (%) (b)	16.0	14.7	15.6	15.0		
Gross Non-performing Loans Ratio (%)	4.2	3.0	2.6	2.8		
Net Non-performing Loans Ratio (%)	2.2	1.1	0.7	0.9		
Return on Assets (Before Tax) (%)	1.8	1.9	1.9	2.0		
Return on Equity (After Tax) (%)	15.5	16.9	17.3	17.6		
Statutory Liquid Assets Ratio (DBU) (%)	35.4	31.4	30.0	31.2		
Liquid Assets to Total Assets (%)	30.6	29.2	27.3	29.0		

(a) Provisional
(b) As at end June

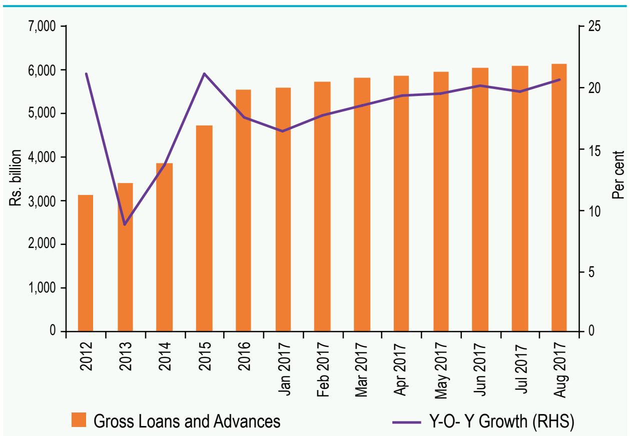
Source: Central Bank of Sri Lanka

Foreign currency loans and advances increased by 13.4 per cent during the first eight months of 2017 while its share in total loans and advances increased to 19 per cent by end August 2017 from 18 per cent at end December 2016.

- **There was a shift in the composition of investment portfolio during the first eight months of 2017**. As at end August 2017, the held to maturity investment portfolio was 73.8 per cent of the total investment portfolio compared to 79.5 per cent as at end 2016. Share of trading portfolio increased to 25.9 per cent from 20.5 per cent as at end 2016. Year-to-date growth in the trading investment portfolio was 43.3 per cent.

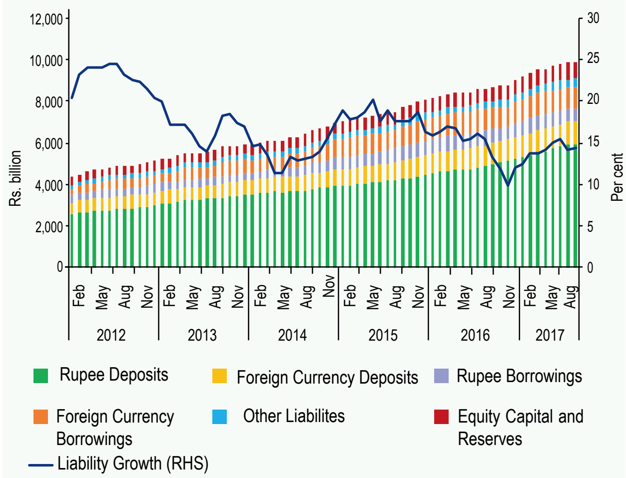
- **Deposits, which were the main source of funding, represented 71.3 per cent of the total assets of the banking sector, surpassing Rs. 7 trillion by end August 2017.** The deposit base of the banking sector grew by Rs. 767.9 billion (12.2 per cent), of which 84 per cent consisted of rupee deposits. The increase in deposits was mainly from term deposits, which recorded an increase of 19.1 per cent. However, demand deposits decreased by 8.9 per cent, while savings deposits increased by 3.9 per cent during this period. The current and savings deposits to total deposits (CASA) ratio declined to 33.5 per cent at end August 2017 from 37.1 per cent at end 2016.

Chart 8.2
Loans and Advances of the Banking Sector



Source: Central Bank of Sri Lanka

Chart 8.3
Sources of Funding of the Banking Sector

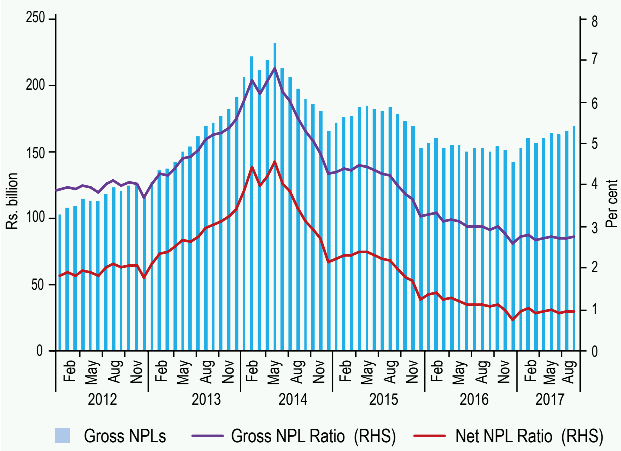


Source: Central Bank of Sri Lanka

- **Borrowings of the banking sector decreased by Rs. 92.2 billion (5.4 per cent) during the first eight months of 2017 due to a decline in rupee borrowings by Rs. 100.3 billion (15.1 per cent).** In contrast, foreign currency borrowings increased by Rs. 8.1 billion (US dollars 52.9 million), increasing its share to 65 per cent by end August 2017 from 61 per cent at end 2016. Foreign currency borrowings from domestic sources increased by Rs. 14.5 billion or US dollars 95.2 million (18.4 per cent) while borrowings from foreign sources decreased by Rs. 6.5 billion or US dollars 42.2 million (0.7 per cent).

- **Asset quality of the banking sector deteriorated marginally during the year by end August 2017**. Total Non-Performing Loans (NPLs) increased by Rs. 26.8 billion to Rs. 169 billion. However, the NPL ratio increased marginally from 2.6 per cent at end 2016 to 2.8 per cent in August 2017 due to recovery measures adopted by banks and higher growth in the credit portfolio. Higher NPL ratios were reported in tourism (4.7 per cent), agriculture and fishing (4.1 per cent), manufacturing (3.8 per cent), traders (3.6 per cent), information and communication technology (3.2 percent) and construction (3.0 per cent) sectors as at end June 2017. Although specific provisions were 72.5 per cent of total provisions as at end August 2017, specific provision coverage ratio decreased to 48.0 per cent by end August 2017 from 52.1 per cent as at end December 2016.

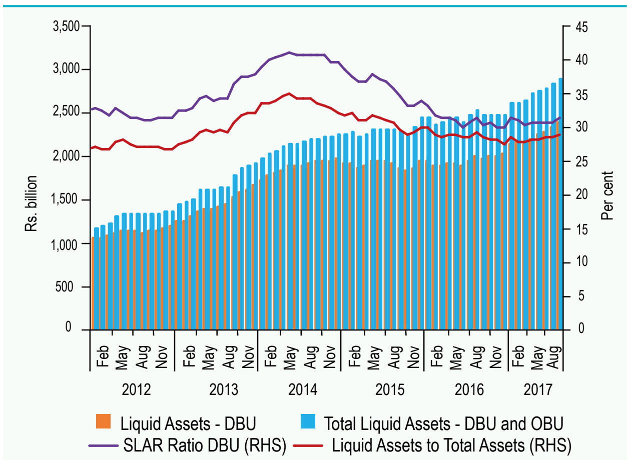
Chart 8.4
Non-performing Loans of the Banking Sector



Source: Central Bank of Sri Lanka

- **The banking sector maintained liquidity at a comfortable level during the first eight months of 2017**. The Statutory Liquid Assets Ratios (SLAR) of Domestic Banking Units (DBUs) and Offshore Banking Units (OBUs) were well above the minimum statutory requirement of 20.0 per cent, recording 31.2 per cent and 35.4 per cent, respectively. The ratio of liquid assets to total assets stood at 29.0 per cent. Loans to deposits ratio decreased from 88.0 per cent as at end 2016 to 86.9 per cent at end August 2017 due to relatively higher increase in deposit mobilisation. Rupee and all currency liquidity coverage ratios, which were introduced under Basel III liquidity standards, stood at 205.3 per cent and 176.2 per cent, respectively, remaining well above the regulatory minimum of 80 per cent.

Chart 8.5
Liquidity Position of the Banking Sector



Source: Central Bank of Sri Lanka

- **The foreign currency exposure of DBUs in the banking sector increased during the first six months of 2017 due to increase in the rupee value of foreign currency borrowings**. Net foreign currency exposure of DBUs as a percentage of banks' regulatory capital and on-balance sheet foreign currency assets stood at 1.9 per cent and 1.5 per cent, respectively. The banking sector reported a long foreign currency position of Rs. 15.6 billion at end June 2017 compared to a long position of Rs. 16.4 billion at end 2016.

- **Capital gains on treasury bonds for the first eight months of 2017 increased to Rs. 3.4 billion compared to Rs. 2.3 billion reported during the corresponding period of 2016 due to the downward trend that prevailed in yield rates of government securities.** Equity risk of the banking sector was minimal as exposure to the equity market of Rs. 42.1 billion was only 0.4 per cent and 3.1 per cent, respectively, of total assets and investments held for trading of the banking sector.

- **The banking sector reported a profit (after tax) of Rs. 86.6 billion during the first eight months of 2017, which is an increase of 18.2 per cent when compared with the corresponding period of 2016.** The increased profitability was due to higher net interest income, which increased by Rs. 24.9 billion. Non-interest income also increased by Rs. 18.3 billion during this period as a result of significant capital gains and an increase in other sources of income. Operating expenses increased by Rs. 5.1 billion while losses on trading and investment securities declined during this period. Staff costs increased by Rs. 3.3 billion reporting an increase of 5.7 per cent over the corresponding period of last year.

- **Profitability ratios as measured by the Return on Assets (ROA) before tax and Return on Equity (ROE) improved to 2.0 per cent and 17.6 per cent, respectively, during the first eight months of 2017 compared to 1.9 per cent and 16.9 per cent, respectively, in the corresponding period of 2016.** The efficiency

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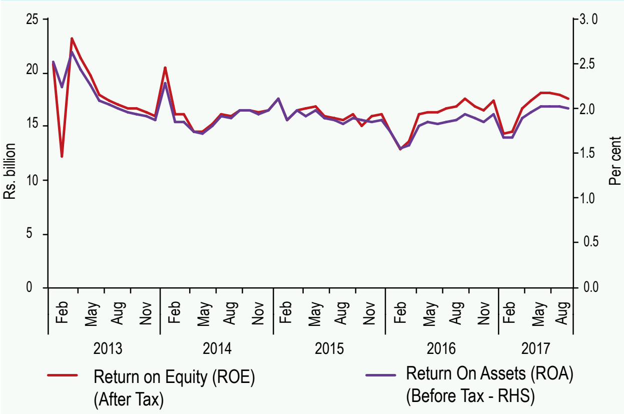
Chart 8.6
ROA and ROE of the Banking Sector



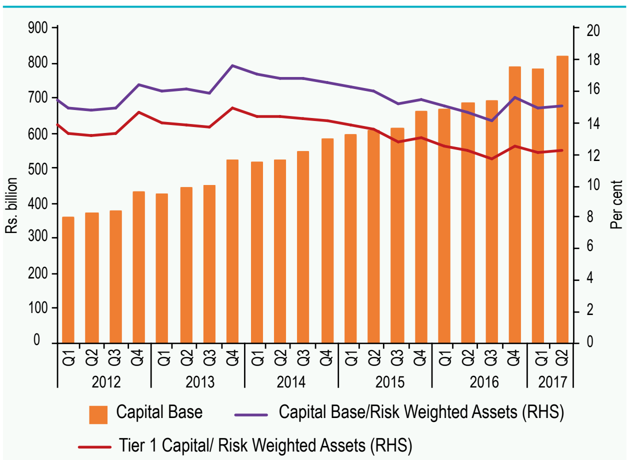
Source: Central Bank of Sri Lanka

ratio, which stood at 46.2 per cent has improved by 300 basis points when compared with end 2016. Net interest margin has remained unchanged year-on-year and stood at 3.5 per cent by end August 2017.

- **The banking sector maintained sufficient capital levels in order to absorb any adverse shocks**. The Core Capital Adequacy Ratio (CAR) and total CAR as at end June 2017 were 12.2 per cent and 15 per cent, respectively, and were maintained at healthy levels, well above the regulatory minimum of 5 per cent and 10 per cent, respectively.

- **The branch network expanded further during the first half of 2017 improving financial accessibility**. Accordingly, there were 3,543 bank branches, 3,045 student savings units and 4,148 ATMs installed by end June 2017. During this period, 19 new branches were opened and one branch was closed. Meanwhile, 335 ATMs were opened during this period.

Chart 8.7
Capital Adequacy of the Banking Sector



Source: Central Bank of Sri Lanka

- **With a view to enhancing the presence of foreign banks in Sri Lanka, a Letter of Provisional Approval was issued to the Bank of China in July 2017 to establish a branch in Sri Lanka.**

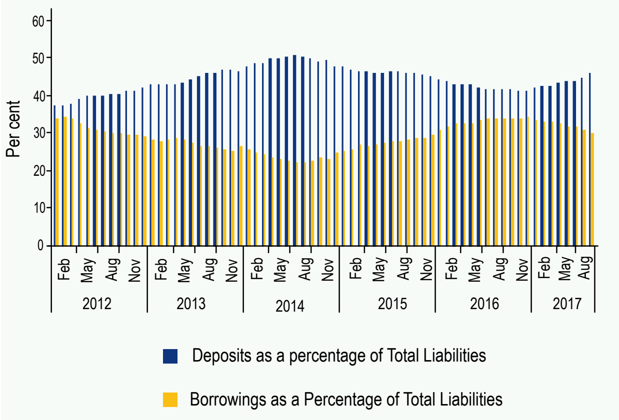
Non-Bank Financial Institutions (NBFIs) Sector

- **The performance of Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs) showed signs of slowing down during the first eight months of 2017**. The fiscal and macroprudential policy measures taken to curtail the imports and lending for motor vehicle purchases and the increasing trend of lending rates that prevailed in the second quarter negatively affected the demand for core lending products of the sector. However, it is observed that LFCs and SLCs are gradually moving from core business of vehicle financing to other secured lending activities. LFC and SLC sectors represent 7.8 per cent of assets of the financial system of Sri Lanka and consist of 45 LFCs and 6 SLCs with a network of 1,344 branches.

- **Expansion of NBFI Sector has slowed down noticeably**. Total assets of the sector expanded by 7.8 per cent (Rs. 94.9 billion) to Rs. 1,306.8 billion in the first eight months of 2017 compared to a growth of 14.4 per cent (Rs. 143.5 billion) in the corresponding period of 2016. The slow growth in credit hindered the expansion of the asset base of the LFCs and SLCs sector.

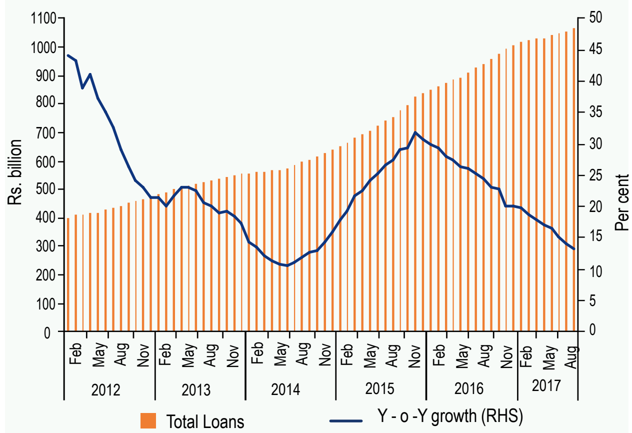
- **The sector expansion was largely funded through deposits**. During the past two years, the sector growth was propelled by the funds raised through borrowings. Nevertheless, sector borrowings declined by 5.8 per cent

Chart 8.8
Total Deposits and Borrowings of NBFIs



Source: Central Bank of Sri Lanka

Chart 8.9
Total Loans and Advances of NBFIs



Source: Central Bank of Sri Lanka

(Rs. 25.5 billion) to Rs. 413.2 billion in the first eight months of 2017 compared to the growth of 29.9 per cent in the corresponding period of 2016. In contrast, the deposits grew by 19.8 per cent (Rs. 104.9 billion) to Rs. 635.6 billion in the first eight months of 2017 compared to the growth of 5.3 per cent (Rs. 25.6 billion) in the corresponding period of 2016.

- **Credit growth responded to the macroprudential policy measures introduced by the CBSL**. Lending activities of the sector showed signs of slowing down in response to macroprudential policies implemented on vehicle loans as well as the increasing trend observed in lending rates, which affected the demand side. Credit extended by LFCs and SLCs grew by 6 per cent (Rs. 57.5 billion) to Rs. 1,020.2 billion in the first eight months of 2017 compared to the growth of 13.0 per cent in the corresponding period of 2016.

- **Asset quality showed signs of stress, but remained manageable**. Non-Performing Accommodations (NPAs) increased by 11.5 per cent to Rs. 59.0 billion during 2017. However, the NPA ratio remained at 5.5 per cent by end August 2017, which is a marginal increase from 5.3 per cent recorded at end 2016. When the loan loss provision is considered, the net NPA ratio increased marginally to 1.3 per cent by end August 2017 from 1.2 per cent at end 2016.

- **The overall liquidity position of NBFIs recorded a surplus**. The sector reported total liquid assets of Rs.115.6 billion with a surplus

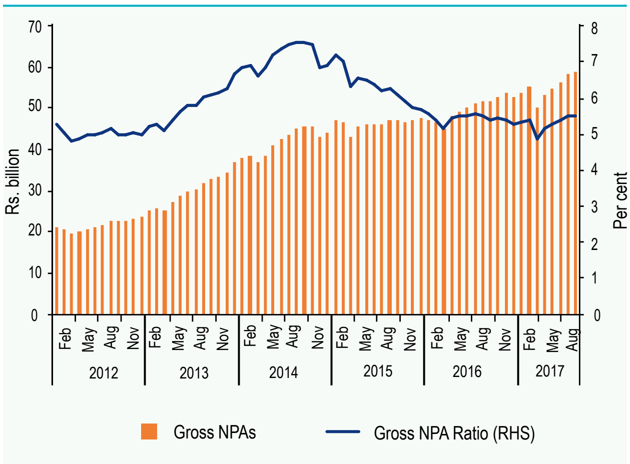
Table 8.2
NBFIs (a) - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (b)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets - Net (Rs.billion)	924.8	1,139.7	1,211.9	1,306.8	23.2	14.7
Loans & Advances - Net (Rs.billion)	715.2	899.5	962.7	1,020.2	25.8	13.4
Deposits (Rs.billion)	454.5	506.2	530.7	635.6	11.4	25.6
Borrowings (Rs.billion)	272.8	408.3	438.7	413.2	49.7	1.2
Capital Funds (Rs.billion)	127.0	142.4	144.1	167.4	12.2	17.6
Tier 1 Capital Adequacy Ratio (%)	13.0	12.0	11.3	12.5		
Total Capital Adequacy Ratio (%)	13.6	12.6	11.7	13.3		
Gross Non-performing Accommodations Ratio (%)	6.3	5.5	5.3	5.5		
Net Non-performing Accommodations Ratio (%)	1.8	1.3	1.2	1.3		
Return on Assets (Before Tax) (%) - Annualised	4.2	3.7	3.6	3.0		
Return on Equity (After Tax) (%) - Annualised	20.8	20.0	19.8	14.9		
Liquid Assets to Total Assets (%)	8.2	7.0	7.1	8.5		

(a) NBFIs sector represents licensed finance companies and specialised leasing companies
(b) Provisional

Source: Central Bank of Sri Lanka

Chart 8.10
Non-performing Accommodations of NBFIs

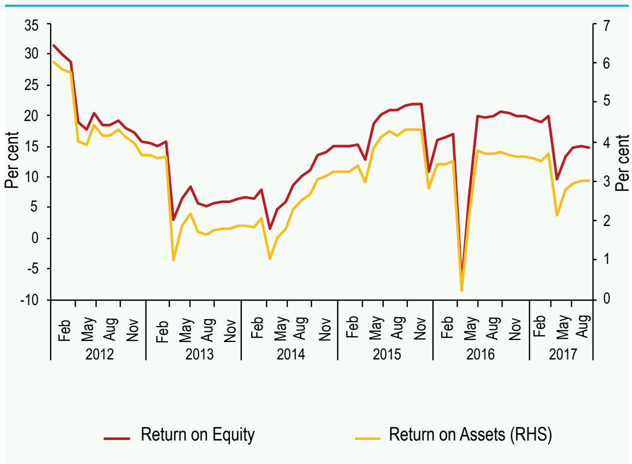


Source: Central Bank of Sri Lanka

liquidity of Rs. 30.5 billion against the stipulated minimum requirement of Rs. 85.2 billion. This surplus was mainly due to companies preferring to maintain liquid assets while funding the regular business operations with borrowings. The liquidity ratio (liquid assets to deposits and borrowings) improved to 11.0 per cent by end August 2017 compared to 9.3 per cent recorded at end 2016 due to reduced borrowings.

- **Sustained profitability**. Profit of the LFC and SLC sector was Rs.17.6 billion during the first eight months of 2017 compared to Rs. 22.1 billion in the corresponding period of 2016. Relatively high margins enabled the sector to sustain profits

Chart 8.12
ROA and ROE of NBFIs

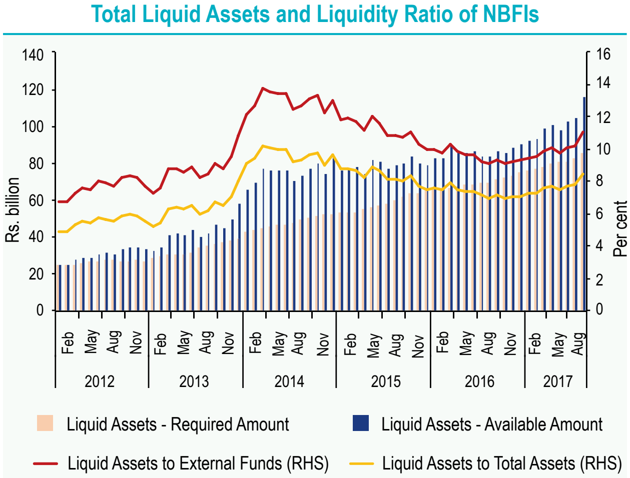


Source: Central Bank of Sri Lanka

as net interest income grew by 11.4 per cent to Rs. 67.2 billion. The annualised ROA and ROE ratios were at 3.0 per cent and 14.9 per cent, respectively, by end August 2017 compared to 3.7 per cent and 20.0 per cent, respectively, in the corresponding period of the previous year.

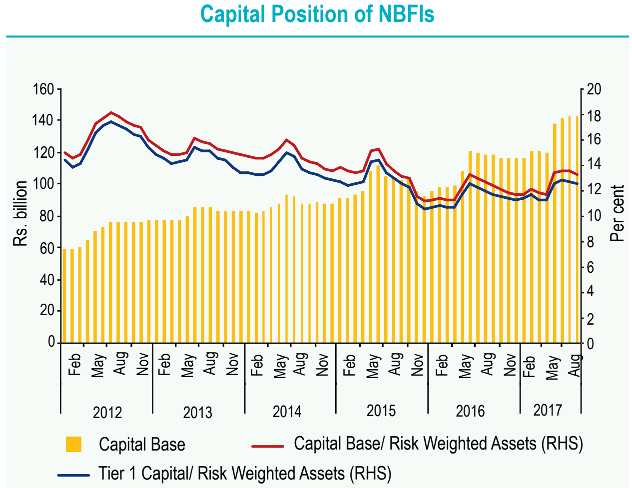
- **Improved capital position.** Capital elements increased by 10.8 per cent in the first eight months of 2017 to Rs.161.9 billion mainly due to retained profits**.** The regulatory Capital Adequacy Ratio (CAR) of the LFC/SLC sector has been maintained above the minimum requirement with CAR increasing to 13.3 per cent in August 2017 from 11.7 per cent at end 2016.

Chart 8.11
Total Liquid Assets and Liquidity Ratio of NBFIs



Source: Central Bank of Sri Lanka

Chart 8.13
Capital Position of NBFIs



Source: Central Bank of Sri Lanka

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Microfinance Institutions

- **During 2017, the Department of Supervision of Microfinance Institutions (DSMI) of the Central Bank continued exercising its duties as stipulated by the Microfinance Act No.6 of 2016.** DSMI issued two directions approved by the Monetary Board, namely, Opening, Closure and Relocation of Business Places and the Structural Changes, regulating Licensed Microfinance Companies (LMFCs). Further, DSMI issued Principles, Standards and Guidelines, approved by the Monetary Board under Section 28(1) of the Microfinance Act, to the Registrar of Voluntary Social Service Organisations, for rules to be made to give effect to the same. DSMI received several applications for licence under the Microfinance Act and is in the process of evaluating those applications.

Insurance Sector

- **The insurance sector continued to grow in terms of total assets and premium income.** Total assets of the sector improved by 11.4 per cent, on a year-on-year basis, by end June 2017, compared to a growth of 9.9 per cent reported at end June 2016. Gross Written Premiums (GWP) grew by 13.9 per cent in the first half of 2017 compared to a growth of 17.2 per cent in the corresponding period of 2016. The general insurance premium grew by 16.2 per cent, largely underpinned the growth in GWP during the first half of 2017. Meanwhile, growth in premium income of long-term insurance decelerated to 11.1 per cent by end June 2017 compared to the growth of 21.3 per cent at end June 2016. Motor insurance, the largest contributor to the general insurance business, representing a share of 63.3 per cent, recorded a growth in premium income of 15.8 per cent in the first half of 2017, compared to the increase of 14.5 per cent in the corresponding period of 2016. Further, premium income from fire insurance (share of 9.4 per cent) and marine insurance (share of 2.6 per cent) also recorded growth rates of 11.0 per cent and 7.3 per cent, respectively, compared to the negative growth of 18.3 per cent and 0.1 per cent, respectively, in the first half of 2016.

Table 8.3

Insurance Sector - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%)	
					Jun 2016	Jun 2017 (a)
Total Assets (Rs.billion)	**435.4**	**478.4**	**503.1**	**533.1**	**9.9**	**11.4**
Total Income (Rs.billion) (b)	**71.2**	**82.2**	**181.0**	**96.6**	**15.5**	**17.6**
Gross Premium Income (Rs.billion) (b)	57.1	66.9	140.3	76.2	17.2	13.9
Investment Income (Rs.billion) (b)	14.1	15.3	40.7	20.5	8.7	33.9
Profit Before Tax (Rs.billion) (b)	**3.9**	**5.2**	**21.6**	**4.7**	**32.7**	**-10.0**
Solvency Margin Ratio (Times)						
Long-term Insurance	9.3	n.a.	n.a.	n.a.		
General Insurance	2.2	n.a.	n.a.	n.a.		
Capital Adequacy Ratio (CAR) (%) (c)						
Long-term Insurance	n.a.	296	317	358		
General Insurance	n.a.	166	192	117		
Retention Ratio (%)						
Long-term Insurance	96.1	96.2	96.6	95.9		
General Insurance	161.2	159.1	80.1	78.5		
Claims Ratio (%)						
Long-term Insurance	40.3	37.1	37.5	36.9		
General Insurance	63.0	55.7	65.9	63.9		
Combined Operating Ratio (%)						
Long-term Insurance	87.0	85.1	84.2	86.2		
General Insurance	107.6	97.2	105.2	102.9		
Return on Assets (ROA) (%)						
Long-term Insurance	2.0	2.2	2.9	1.8		
General Insurance	1.8	2.4	7.3	8.9		
Return on Equity (ROE) (%) - General Insurance	**2.9**	**4.5**	**14.5**	**18.8**		
Underwriting Ratio (%) - General Insurance	**14.6**	**15.7**	**17.8**	**17.1**		

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

Source: Insurance Board of Sri Lanka

- **Insurance sector recorded a decline in overall profits**. The aggregate profit before tax dropped by 11.4 per cent in the first half of 2017 compared to a growth of 34.9 per cent in the corresponding period of 2016, largely due to weak performance in long-term insurance business, whose profits declined by 78.5 per cent in first half of 2017 compared to a growth of 34.1 per cent during the reference period of 2016. The claims of general insurance and long-term insurance sectors increased by 11.9 per cent and 8.3 per cent, respectively, during the period under consideration. Investment income of insurance companies increased by 33.9 per cent in the first half of 2017 compared to the 8.7 per cent growth in 2016. The investments in government securities by the long-term and general insurance sectors accounted for 51.3 per cent and 30.3 per cent, respectively, of their total investment portfolio.

Primary Dealers

- **The Primary Dealer (PD) sector expanded during the first eight months of 2017**. Total assets increased by 34.2 per cent to Rs. 418.3 billion and the total portfolio of government securities increased by 53.8 per cent to Rs. 393.8 billion, largely underpinned by the increase in investment portfolio. Meanwhile, borrowings under repo agreements decreased by 12.3 per cent to Rs. 149.9 billion.

- **Profitability decreased**. The sector recorded a profit of Rs. 10.3 billion over the period ending August 2017 compared to a profit of Rs. 11.1 billion in the corresponding period of 2016. Total capital gains (realised and unrealised) marked Rs. 3.0 billion compared to Rs. 6.9 billion in 2016. Profitability measured in terms of return on assets and return on equity of standalone PDs stood at 4.6 per cent and 14.1 per cent, respectively, as at end August 2017.

Table 8.4

Primary Dealers - Selected Indicators

Item	End Aug 2015	End Aug 2016	End Dec 2016	End Aug 2017 (a)	Y-O-Y Change (%)	
					Aug 2016	Aug 2017 (a)
Total Assets (Rs.billion)	**235.8**	**311.8**	**260.0**	**418.3**	**32.2**	**34.2**
Standalone PDs	54.0	87.5	77.1	67.6	62.0	-22.7
Bank PDs	181.9	224.4	183.0	350.7	23.4	56.3
Total Portfolio (Rs.billion)	**217.1**	**256.0**	**222.7**	**393.8**	**17.9**	**53.8**
Standalone PDs	42.8	41.3	46.9	50.6	-3.5	22.4
Bank PDs	174.3	214.6	175.9	343.2	23.2	59.9
Total Capital (Rs.billion) (b)	9.3	19.5	21.5	23.2	108.6	19.3
Profit before Tax (Rs.billion) (c)	3.8	11.1	15.2	10.3	193.7	-7.3
Standalone PDs	1.5	7.4	8.7	2.4	392.9	-68.3
Bank PDs	2.3	3.7	6.5	8.0	62.3	114.8
Tier 1 Capital Adequacy Ratio (%) (b)	18.0	33.7	59.9	57.4	15.7	23.7
Total Capital Adequacy Ratio (%) (b)	19.1	35.0	61.5	58.8	15.9	23.8
Return on Assets (%)	2.8	5.8	5.8	4.6	3.0	-1.2
Standalone PDs	4.1	15.0	12.6	4.9	10.9	-10.1
Bank PDs	2.3	2.6	3.3	4.5	0.3	1.9
Return on Equity (%) (b)	25.1	70.8	52.1	14.1	45.6	-56.7
Leverage Times (b)	5.0	3.5	2.6	1.9	-29.0	-46.0
Operating Expenses to Total Income (%) (c)	6.2	3.1	3.5	3.0	-3.1	-0.1
Standalone PDs	14.0	5.6	7.1	12.1	-8.4	6.5
Bank PDs	1.8	0.8	0.8	0.5	-1.0	-0.3
Total Cost to Total Income (%) (c)	66.3	52.7	57.9	66.2	-13.6	13.4
Standalone PDs	63.2	34.0	43.9	64.0	-29.2	30.0
Bank PDs	68.1	69.8	68.4	66.7	1.7	-3.1
Duration of Assets and Liabilities (years)	1.2	1.3	1.2	1.0	7.9	-25.9
Standalone PDs	2.6	3.0	2.1	2.4	16.6	-21.7
Bank PDs	0.6	0.6	0.6	0.4	-6.1	-33.2

(a) Provisional
(b) Standalone PDs only
(c) During the period
Note: Above data excludes financials of Entrust Securities PLC.

Source: Central Bank of Sri Lanka

- **Capital was maintained at healthy levels**. All standalone PDs except one maintained their core capital above the minimum requirement of Rs. 1 billion by end August 2017. The risk weighted capital adequacy ratio of the sector was above the minimum of 10 per cent and the ratio increased to 58.8 per cent by end August 2017 from 35.0 per cent at end August 2016.

- **Risk profile improved**. The share of trading portfolio in total investment portfolio decreased from 52.1 per cent at end August 2016 to 34.5 per cent at end August 2017. As a result, the exposure of the sector to market risk decreased. In view of the large holding of risk-free government securities and its ability to be used 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 recorded a contraction in terms of number of units in issue and net asset value**. Despite the dismal performance of the sector, the total number of unit holders marginally increased by 2.3 per cent on year-on-year basis while total number of UTs managed by 14 unit trust management companies remained constant. The Net Asset Value (NAV) of the UT sector marked a decrease of 18.5 per cent, on a year-on-year basis, to Rs.103.3 billion by end June 2017. Meanwhile, the share of equities in investment portfolios of UTs increased to 13.9 per cent as at end June 2017 from 9.9 per cent as at end June 2016.

Stock Broking Companies Sector

- **Stock broking companies sector showed a positive performance with further strengthening of capital regulations**. The income of stock brokers showed a moderate decline during the first half of 2017 recording Rs. 406 million compared to Rs. 447 million in the first half of 2016. However, net profit before taxes improved during this period to Rs. 35 million from the recorded loss of Rs. 121 million at end June 2016. In addition, net capital of the stock broking companies sector increased by 22.6 per cent to Rs. 5.6 billion during the period under consideration from Rs. 4.5 billion in the previous year, while total assets increased marginally.

- **Capital requirements of the stock brokers were upgraded to risk based capital adequacy ratio and minimum liquid capital in March 2017 from the previous requirement of minimum net capital**. All stock broking companies have met the net capital requirement in the first two months of 2017. Two companies failed to comply with the new requirement of risk, based capital adequacy ratio and minimum liquid capital introduced in March 2017. However, only one company failed

Table 8.5
Unit Trust Sector - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%) Jun 2016	Y-O-Y Change (%) Jun 2017 (a)
Total Assets (Rs.billion)	133.8	127.7	103.1	104.4	-4.6	-18.3
Net Asset Value - NAV (Rs.billion)	133.1	126.8	103.1	103.3	-4.7	-18.5
Investments (Rs.billion)	133.6	122.8	102.9	102.3	-8.1	-16.7
Equity	13.5	12.6	13.9	14.4	-6.6	13.9
Government Securities	55.4	55.9	49.6	42.8	0.8	-23.4
Other (E.g.,Commercial Papers, Debentures, Trust Certificates & Bank Deposits)	64.7	54.4	39.3	45.2	-16.0	-16.8
Investments in Equity as a % of NAV	10.1	9.9	13.5	13.9		
Investments in Government Securities as a % of NAV	41.6	43.7	48.1	41.0		
Other Investments as a % of NAV	48.6	42.9	38.1	43.8		
Total No. of Unit Holders	35,660	39,707	41,249	40,651		
No. of Units in Issue (billion)	9.6	8.9	7.2	6.7		
No. of Unit Trusts	70	76	77	76		

(a) Provisional

Source: Unit Trust Association of Sri Lanka

Table 8.6
Stock Broking Companies - Selected Indicators

Item	End Jun 2015	End Jun 2016	End Dec 2016	End Jun 2017 (a)	Y-O-Y Change (%)	
					Jun 2016	Jun 2017 (a)
Total Assets (Rs. billion)	10.9	9.5	10.1	12.8	-12.2	34.4
Total Liabilities (Rs. billion)	4.8	3.9	4.5	7.3	-18.7	87.5
Net Capital (Rs. billion)	4.7	4.5	4.6	5.6	-2.8	22.6
Income (Rs. billion) (b)	0.6	0.4	0.3	0.4	-26.7	10.1
Net profit/(Loss) before tax (Rs. million) (b)	19.2	-121.0	-460.0	35.0	-729.4	128.9

(a) Provisional
(b) During the period

Source: Securities and Exchange Commission of Sri Lanka

to comply with the new regulatory requirement as at 30 June 2017.

Superannuation Funds

- **The Employees' Provident Fund (EPF) is the largest superannuation fund in Sri Lanka with an asset base of over Rs. 1.9 trillion as at end June 2017.** The total number of member accounts of the EPF reached 17.5 million mark in December 2016, recording an increase of 3.6 per cent when compared with the previous year. Total member contributions during the first six months of 2017 increased by 16.0 per cent to Rs. 65.3 billion while refund payments increased by 14.9 per cent to Rs. 63.1 billion when compared with the corresponding period of the previous year. During the period under review, the net contribution (contributions minus refunds) stood at Rs. 2.2 billion, which is an increase of 57.1 per cent compared to the corresponding period of 2016. During the 12 month period ending 30 June 2017, total assets of the EPF increased by 11.9 per cent to Rs. 1,948 billion whereas the total investment of EPF also grew by 11.9 per cent to Rs. 1,873 billion. The investments of EPF consist of government securities (91.6 per cent), equity (4.5 per cent), corporate debt, trust certificates and reverse repo (2.1 per cent) and fixed deposits (1.8 per cent). The Fund reported a gross investment income of Rs. 107.0 billion during the first half of 2017, which is an increase of 11.5 per cent compared to the corresponding period of 2016.

- **The Employees' Trust Fund (ETF) has about 12.5 million accounts, of which about 2.6 million are active accounts.** Total contributions received and benefits paid to members during the first six months of 2017 increased to Rs. 11.1 billion (13.7 per cent) and Rs. 9.4 billion (27.9 per cent), respectively, from Rs. 9.8 billion and Rs. 7.3 billion, respectively, during the corresponding period of 2016. With the high growth in the disbursement of benefits, net contributions of the ETF decreased by 35.3 per cent in the first half of 2017. Meanwhile, total assets of the ETF increased by 12.1 per cent to Rs. 263.2 billion by end June 2017. The investment portfolio of

Table 8.7
Superannuation Funds - Selected Indicators

Item	Employees' Provident Fund (EPF)			Employees' Trust Fund (ETF)		
	End Jun 2016	End Jun 2017 (a)	Change (%) (a)	End Jun 2016	End Jun 2017 (a)	Change (%) (a)
Total Contributions (Rs. billion) (b)	56.3	65.3	16.0	9.8	11.1	13.7
Total Refunds (Rs. billion) (b)	54.9	63.1	14.9	7.3	9.4	27.9
Total Assets (Rs. billion)	1,741	1,948	11.9	234.7	263.2	12.1
Total Investment Portfolio (Rs. billion)	1,674	1,873	11.9	221.0	247.6	12.1
o/w, Government Securities (%)	93.2	91.6	-1.7	91.7	84.1	-8.3
Gross Income (Rs. billion) (b)	96.0	107.2	11.7	11.5	13.6	18.8

(a) Provisional
(b) During the period

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

the ETF remained concentrated in government securities. However, the share of government securities declined to 84.1 per cent as at end June 2017 from 91.7 per cent as at end June 2016. Investments in equity stood at 4.9 per cent by end June 2017.

- **The Public Service Provident Fund (PSPF) had 229,951 members as at end June 2017**. Total assets of the PSPF amounted to Rs. 49.9 billion as at end June 2017 compared to Rs. 47.7 billion as at end June 2016. Total contributions and refunds of the PSPF during the first six months of 2017 amounted to Rs. 897.0 million and Rs. 256.8 million, respectively.

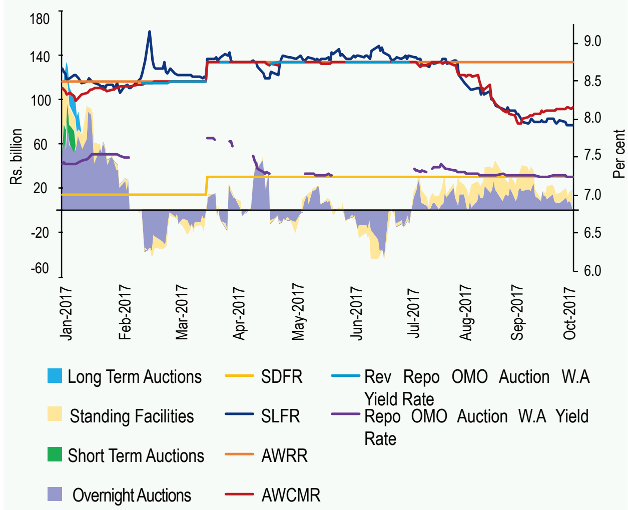
- **There were 151 privately managed approved provident funds (APFs) with around 169,281 members as at end June 2017**. The total assets of APFs stood at Rs. 434.3 billion while total investments stood at Rs. 264.5 billion at the end June 2017.

Developments in Financial Markets

Inter-Bank Call Money Market

- **The Average Weighted Call Money Rate (AWCMR), which moved closer to the upper bound of the Standing Rate Corridor (SRC), formed by the Standing Lending Facility Rate (SLFR) and the Standing Deposit Facility Rate (SDFR) till early August, moved downwards thereafter and has hovered at levels around the middle of the SRC since early September**. The AWCMR, which was at 8.42 per cent by end 2016, increased towards the upper bound of the SRC with the decline in excess money market liquidity, which reached deficit levels by around mid-February. Central Bank tightened its monetary policy stance in March 2017 by increasing the SDFR and the SLFR by 25 basis points each to 7.25 per cent and 8.75 per cent, respectively. Consequently, the AWCMR increased further and continued to hover at rates close to the upper bound of the SRC up until early August 2017. While the money market has

Chart 8.14
Standing Rate Corridor, OMO Auction Yield Rates, AWCMR and Absorption of the Market Liquidity

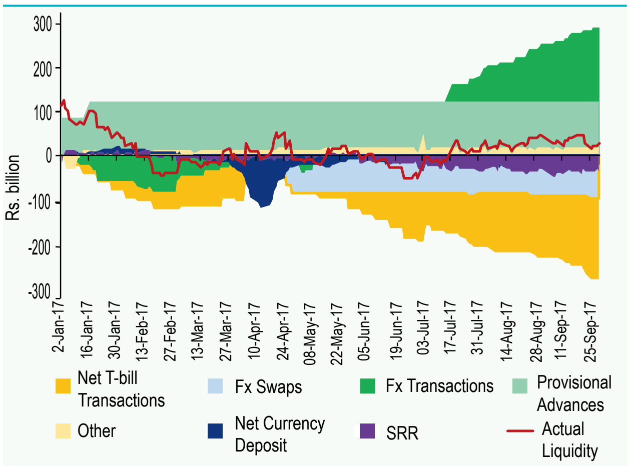


Source: Central Bank of Sri Lanka

continued to have surplus levels of liquidity since around mid-July 2017, the weighted average yield rate at the daily overnight repo auctions conducted by the Central Bank has declined since around mid-August, recording 7.25 per cent by end September 2017. Following this trend, the AWCMR also declined to around 8.00 per cent by mid-September 2017 and increased marginally to 8.11 per cent by end September 2017. With market repo rates following the movements of call money rates, the Average Weighted Repo Rate (AWRR) recorded at end September 2017 was 8.01 per cent, having declined in recently along with the decline in call money market rates.

- **Excess rupee liquidity in the domestic money market increased sharply at the beginning of 2017**. Whilst declining to deficit levels by early February, market liquidity fluctuated thereafter till mid-July, moving between deficit and surplus levels. Since mid-July, the domestic money market has continued to have excess rupee liquidity. The sharp increase in money market liquidity from a surplus of Rs. 39.2 billion at end 2016 to over Rs. 100 billion at the beginning of the year 2017 was mainly due to the provisional advances extended to the Government by the Central Bank. However, money market liquidity declined thereafter with the market experiencing deficits in liquidity from time to time from around mid-February until

Chart 8.15
Changes in the Central Bank's Balance Sheet driving Money Market Liquidity



Source: Central Bank of Sri Lanka

mid-July, primarily as a result of the Central Bank allowing its Treasury bill holdings to mature as well as outright sales of Treasury bills by way of conducting OMO. Seasonal withdrawals of currency was an additional factor that drove down money market liquidity during the month of April. Foreign exchange related transactions of the Central Bank including foreign exchange purchases and foreign exchange swaps have had a positive impact, on money market liquidity on a net basis during the first nine months of 2017. Conversion of a part of the proceeds from the International Sovereign Bond (ISB) to rupees by the government to settle its dues was another factor that led to an increase in market liquidity to surplus levels since around mid-July 2017. However, measures adopted by the Central Bank to reduce its holdings of Treasury bills by way of allowing its Treasury bill holdings to mature and outright sales of Treasury bills through OMO, have resulted in a decline in excess money market liquidity from the beginning of September. By end September 2017, excess money market liquidity amounted to Rs. 20.96 billion.

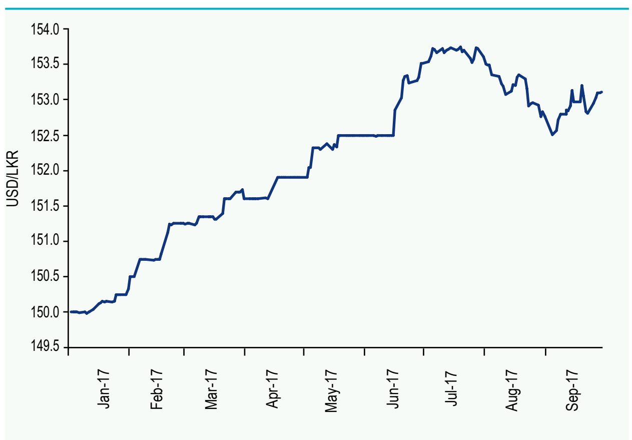
Domestic Foreign Exchange Market

- **The Sri Lankan rupee depreciated against US dollar by 2.15 per cent during the first nine months of 2017.** The pressure on the Sri Lankan rupee to depreciate surged in the first two quarters of 2017 due to the increased outflows of investments from government securities market with the interest rate hike by the Federal Reserve USA in March 2017 as well as due to the heightened import demand. This depreciating trend continued further until end July 2017 along with the second announcement by the Federal Reserve USA to raise interest rates in June 2017. However, with the positive sentiments created through the receipt of the third tranche of the EFF from the IMF, and the conversions of export proceeds, the pressure on the exchange rate eased towards end September 2017. During the period up to end September 2017, the Sri Lankan rupee depreciated against other major currencies such as the Japanese yen, the Indian rupee, the pound sterling and the euro.

- **Central Bank was a net buyer in the domestic foreign exchange market during the first nine months of 2017 with the intention of curbing excess volatility while engaging in foreign reserves accumulation**. Accordingly, during the period up to end September 2017, Central Bank absorbed US dollars 1,710.6 million from the market and supplied US dollars 549.8 million to the market resulting in a net purchase of US dollars 1,160.9 million.

- **During the period up to end September 2017, trading volumes in the domestic foreign exchange market increased by 13.54 per cent**

Chart 8.16
Movement of Rupee per US dollar



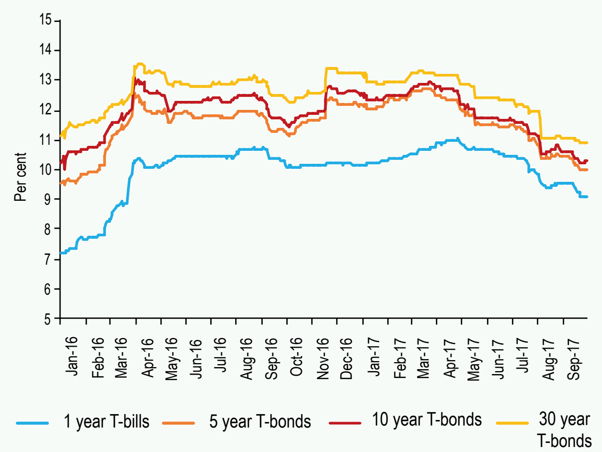
Source: Central Bank of Sri Lanka

8

compared to the corresponding period in 2016. The total volume of inter-bank foreign exchange transactions was US dollars 12.75 billion up to end September 2017 as against US dollars 11.23 billion in the corresponding period of 2016. The daily average volumes in the inter-bank foreign exchange market also increased by 11.43 per cent to US dollars 70.44 million during the reference period, from US dollars 62.39 million in the corresponding period of 2016. The total volume of forward transactions for the period up to end September 2017 also increased to US dollars 6.56 billion compared to US dollar 6.45 billion recorded during the first nine months of 2016.

Chart 8.17

Secondary Market Yield Curve of Government Securities



Source: Central Bank of Sri Lanka

Government Securities Market

- **In the first half of 2017, majority of borrowings were sourced from the domestic market**. With high interest rates and the liquidity shortage then prevailed in the market, the strategies adopted for debt issuance in the first half of 2017 included the issuance of Treasury bonds with shorter maturities and the issuance of Sri Lanka Development Bonds (SLDBs) amounting to US dollars 2,231.4 million. This was intended to offset any possibilities to crowd out the available domestic investible funds. However, with the relatively high volume of issuance of short and medium-term Treasury bonds in the first half of the year, the average time to maturity of government securities decreased.

- **The secondary market yield curve of government securities moderated during the first half of 2017, compared to first half of 2016**. The secondary market yield rates pertaining to 91-day and 182-day Treasury bills moved upward by 73 basis points and 51 basis points, respectively, while yield rates pertaining to 364-day Treasury bills decreased by around 3 basis points. Market yield rates of actively traded Treasury bonds with maturities of 2 to 10 years decreased by about 33 basis points, at the end of the first half of 2017 compared to the yield rates at end of the corresponding period. of 2016. The improved market conditions along with foreign inflows from International Sovereign Bonds, syndicated loans and increased foreign investments in Treasury bills and Treasury bonds combined with government strategy to settle only the principal amount of maturing Treasury bonds through domestic sources, contributed positively towards reducing the dependency in domestic funding. This has caused the secondary market yield rates to ease during the first seven months of 2017. The non-resident holdings of Treasury bills and Treasury bonds increased by 7.49 per cent to Rs. 254.44 billion by end July 2017 from Rs. 236.71 billion at end January 2017.

Corporate Debt Securities Market

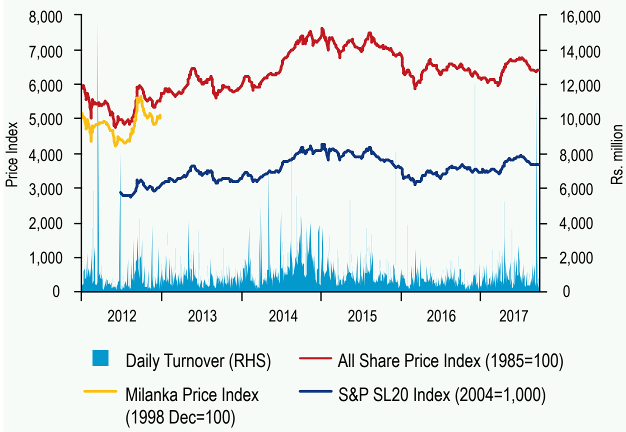
- **Activities of the commercial paper market moderated during the first six months of 2017**. The value of Commercial Papers (CPs) issued during the period under review amounted to Rs. 3.6 billion in comparison to Rs. 4.8 billion during the same period of 2016. Continuing the upward trend observed in the previous year, interest rates appliable on CPs continued to increase to a range of 14.5-16.5 per cent in the first half of 2017 from the range of 8.7 - 13.0 per cent in the same period of 2016. The CPs issued during the period, had shorter maturities compared to the previous periods, reflecting somewhat unfavourable investor sentiments. The CPs with maturities up to 3 months accounted for 92.5 per cent of the market, while the share of CPs between 3 months to 6 months maturity amounted to 7.5 per cent. There were no commercial papers issued for higher maturities than 6 months during the year. The total outstanding value of CPs amounted to Rs. 2.3 billion as at end June 2017 compared to Rs. 4.5 billion as at end June 2016.

- **The volumes in the corporate bond market contracted during the first half of 2017 compared to the corresponding period of the previous year**. During the first six months of 2017, there were seven listings of corporate debentures by two institutions, compared with 17 issues by nine institutions during the first six months of 2016. Consequently, the total value of the corporate bonds listed in the first six months of 2017, reduced to Rs. 10.0 billion compared to Rs. 34.4 billion in the corresponding period of the previous year. During the first six months of 2017, the two issuers were from the banking and finance sector, and the interest rates applicable to these bonds varied between 11.95 per cent and 15.00 per cent.

Equity Market

- **The Colombo Stock Exchange (CSE) could not sustain the positive performance it gained during the second quarter of the year, as reflected by the volatile movements in price indices during the last few months**. The sluggish behaviour of the equity market that prevailed at the end of 2016 continued in the first three months of 2017. This was largely due to expected policy rate hikes in advanced economies, uncertainty in the local policy direction and sustained pressure on the exchange rate. An upward trend was observed in early April as a result of the substantial net foreign investments. In addition, local institutional investors started to accumulate sound stocks at the prevailing lower prices while retail investors bounced back with regained confidence on the recovery of the CSE. However, starting from July 2017 onwards, performance of the equity market deteriorated diminishing the positive momentum prevailed in the preceding months. Although the momentum in the equity market diminished after the first half of 2017, an improvement in market activity was recorded during the first nine months of the year when compared to the performance in the corresponding period of the previous year. The All Share Price Index (ASPI) and S&P SL20 Index increased by 3.4 per cent and 5.5 per cent respectively, by September compared to end 2016.

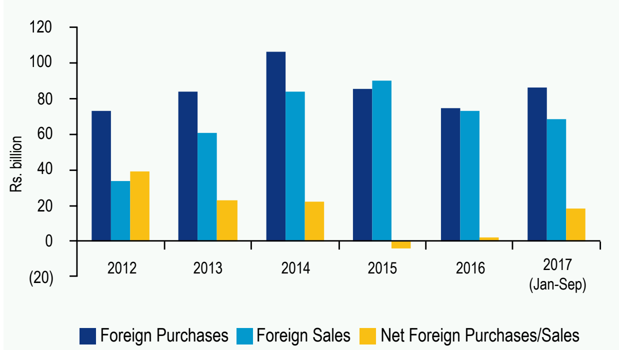
Chart 8.18
Movements of Share Price Indices



Source: Colombo Stock Exchange

- **Business involvement in the stock market as reflected by market capitalisation and turnover improved during the first nine month of 2017**. Market capitalisation increased to Rs. 2,919.7 billion at the end of September 2017, compared to Rs. 2,745 billion at end 2016. Further, total turnover for the first nine months of 2017 improved to Rs. 165.6 billion compared to Rs. 135.4 billion of the corresponding period of the

Chart 8.19
Foreign Participation at the CSE



Source: Colombo Stock Exchange

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Table 8.8
Equity Market - Selected Indicators

Item	End Sep 2015	End Sep 2016	End 2016	End Sep 2017 (a)
All Share Price Index (1985 = 100)	7,050.9	6,534.8	6,228.3	6,438.2
Year-to-date change (%)	-3.4	-5.2	-9.7	3.4
S&P SL20 Index (2004 = 1,000)	3,826.2	3,617.3	3,496.4	3,688.0
Year-to-date change (%)	-0.1	-0.2	-3.6	5.5
Market Capitalisation (Rs.billion)	2,990.8	2,785.7	2,745.4	2,919.7
As a percentage of GDP* (%)	25.3	23.5	23.2	24.7
Market Price Earnings Ratio	18.4	13.4	12.4	10.7
Average Daily Turnover (Rs. million)	1,115.4	753.2	737.2	914.8
Net Cumulative Foreign Purchases in Secondary Market (USD million)	-23.4	-19.4	13.7	118.6
Number of Companies Listed	296	295	295	295
Number of Rights Issues (b)	12	6	6	14
Amount raised through Rights issues (Rs. billion) (b)	12.0	2.5	2.5	42.0
Initial Public Offering (b)	2	3	3	2
Amount raised through IPOs (Rs. billion) (b)	0.3	1.9	1.9	8.5

*Based on GDP for 2016 (Rs.11,839 billion)
(a) Provisional
(b) During the period

Source: Colombo Stock Exchange

previous year. The average daily turnover and the number of shares traded in the equity market also improved during the first nine months of the year. The net cumulative foreign purchases increased significantly by 711.3 per cent to US dollars 118.9 million in September 2017. However, the total number of trades declined to 727,064 compared to 882,201 in the corresponding period while market Price Earnings Ratio (PER) deteriorated to 10.7 times as at end September 2017 compared to 13.4 times prevailed at the end of 2016. During the period, there were 2 Initial Public offerings (IPO) at CSE which raised Rs. 8.5 billion while 14 right issues raised Rs. 42.0 billion.

Development Finance and Access to Finance

- **Central Bank continued to implement a number of development credit schemes with concessionary interest rates, terms and conditions through Participating Financial Institutions (PFIs) during the first eight months of 2017**. These schemes provided refinance facilities, interest subsidies and/or credit guarantees and credit supplementary services, targeting development of agriculture and livestock and Micro, Small and Medium Scale Enterprise (MSME) sectors. The primary objective of implementing these schemes was to assist farmers and entrepreneurs who are having limited or no access to the formal financial institutions and cannot afford high cost of financing to carry out their income generating activities. Broadly, these schemes are expected to promote access to finance and thereby improve the financial inclusion and balanced regional growth in the country. Overall, loans totalling to Rs. 11,562.3 million were disbursed among 78,740 beneficiaries through eleven credit Schemes by the Central Bank up to August 2017. The amount of funds released to the Agriculture and Livestock sector accounted for 50.2 per cent of the loans disbursed followed by 36.4 per cent and 13.4 per cent to the MSME sector and microfinance sector, respectively.

- **Central Bank provided concessionary credit to the MSME sector focusing on sustainable economic growth, employment generation, poverty eradication, etc. through five credit schemes.** These schemes, namely, the “Saubagya” Loan Scheme (SLS), “Swashakthi – Towards One Million Jobs” Loan Scheme, Dry Zone

Table 8.9
Sector-wise Loan Disbursements

Loan Scheme	Share (%)			
	2016 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
MSME	10	41	12	36
Microfinance	24	13	29	13
Agriculture and Livestock	66	46	60	50

Source: Central Bank of Sri Lanka

8

Livelihood Support and Partnership Programme (DZLiSPP-RF), Second Phase of Self Employment Initiative Promotion Loan Scheme (SEPI Ph II) and Working Capital Loan Scheme for Tea Factories (WCLSTF), together, disbursed loans totalling Rs. 4,206.5 million among 9,393 beneficiaries. Of these schemes, SLS alone, which operates island-wide as the flagship loan scheme distributed Rs. 2,616.3 million which accounted for 62.2 per cent of total disbursements to the sector. New loan registrations under the WCLSTF declined during the first eight months of 2017, compared to the same period of 2016 as the scheme is nearing its completion as expected targets have been attained. The "Swashakthi - towards one million jobs" loan scheme that was introduced in March 2017 targeting the MSME sector development, and employment generation, disbursed loans totalling Rs. 930.4 million among 4,045 beneficiaries during the first eight months of the year.

- **Overall, the number and amount of loans disbursed to the MSME sector declined mainly due to limited availability of funds in the "Saubagya" loan scheme during the first eight months of 2017 compared to the corresponding period of the previous year since these schemes were nearing their completion**.

- **With a view to broadening the financial outreach among the masses and promoting poverty alleviation in the country, Central Bank provided financial support to the Microfinance sector through four microfinance loan schemes**. These Schemes, which included, 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) targeted the micro level entrepreneurs engaged in income generating activities in the agriculture and livestock, trade and other services, and fisheries sectors. Under these schemes, loans amounting to Rs. 1,555.9 million were disbursed among 22,421 beneficiaries, during the first eight months of the year. The amount of funds released to this sector accounted for 13.4 per cent of the total disbursements made by the Central Bank. Overall, the amount of loans disbursed under the microfinance loan schemes decreased by 22.2 per cent during the first eight months of 2017 compared to the corresponding period of the previous year, since PAMP II-RF and SFLCP-RF to be concluded shortly.

- **The agriculture and livestock sector continued its dominance in receiving concessionary credit facilities provided through the Central Bank operated loan schemes**. Funds amounting to Rs. 5,799.9 million released to this sector, accounted for 50.2 per cent of the total disbursements made through the credit schemes implemented by the Central Bank during the first eight months of 2017. Of the total disbursements, Rs. 4,959.5 million of loans or 85.5 per cent of loans granted to the sector, were delivered through the New Comprehensive Rural Credit

Table 8.10

Loan Disbursements to the MSME Sector

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
Saubagya	9,776	3,574	5,141	2,616	-47.4	-26.8
Swashakthi*	-	-	4,045	930	-	-
SEPI Ph II*	-	-	190	82	-	-
SPEnDP**	198	25	-	-	-	-
DZLiSPP-RF	12	1	3	0	-75.0	-66.7
WCLSTF	108	3,450	14	577	-87.0	-83.3
Total	**10,094**	**7,050**	**9,393**	**4,207**	**-6.9**	**-40.3**

Source: Central Bank of Sri Lanka

* Loan Scheme has been commenced in 2017
** Loan scheme was concluded in December 2016

Table 8.11

Loan Disbursements under the Microfinance Loan Schemes

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.	No. of Loans	Amount Rs. mn.
PAMP RF	3,747	183	6,174	307	64.8	67.7
PAMP II RF	15,283	1,247	10,468	889	-31.5	-28.7
SFLCP RF	1,219	67	328	22	-73.1	-67.2
NADeP	4,299	502	5,451	338	26.8	-32.7
Total	**24,548**	**1,999**	**22,421**	**1,556**	**-8.7**	**-22.2**

Source: Central Bank of Sri Lanka

8

Scheme (NCRCS) which is the principal scheme that provides both interest subsidy and credit guarantee for loans granted for working capital requirements of small-scale farmers covering 33 short-term crop varieties. The amount of loans granted under NCRCS increased by 3.6 per cent in spite of the prevailed drought condition throughout the country. Among all the districts, the Monaragala District received the highest (14 per cent) amount of loan disbursements made under this scheme, followed by Anuradhapura (13 per cent), and Ampara (12 per cent) districts respectively. Paddy, being the major crop item, received the highest share of 59 per cent of total loan disbursements to the sector.

- **Commercial Scale Dairy Development Loan Scheme (CSDDLS) operated successfully during the first eight months of 2017, made disbursements to dairy farmers and entrepreneurs in the dairy related activities**. Compared to the first eight months of 2016, disbursements under CSDDLS decreased by 9 per cent during the corresponding period of 2017 due to limited availability of funds for the interest subsidy payments under this scheme. However, overall amount of loans granted under these two schemes to the agriculture and livestock sector increased by 1.6 per cent during the period under review.

- **The Central Bank continued to promote financial literacy and inclusiveness and helped entrepreneurship development through a number of programmes and workshops conducted during the reference period covering financial literacy, financial management, entrepreneurship development and Training of Trainers (TOT) and project appraisal workshops for entrepreneurs**. Formation of Self Help Groups and awareness of financial management were also given priority.

Table 8.12

Loan Disbursements to the Agriculture and Livestock Sector

Loan Scheme	Loan Disbursements				Growth (%)	
	2016 Jan - Aug		2017 Jan - Aug		2017 Jan - Aug	
	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.	No. of Loans	Amount Rs. Mn.
NCRCS	53,437	4,788	45,917	4,960	-14.1	3.6
CSDDLS	1,281	923	1,009	840	-21.2	-9.0
TDP RF	2	0	-	-	-	-
Total	**54,720**	**5,711**	**46,926**	**5,800**	**-14.2**	**1.6**

Source: Central Bank of Sri Lanka

- **Accordingly, Central Bank conducted 110 Skills Development programmes, 13 Capacity Building programmes and 56 programmes for beneficiaries of the PAMP II - RF project**. The number of programmes conducted under the category of awareness building in the reference period exceeded the targets given under the strategic goals. 30 societies of low income families under the Microfinance Credit Schemes too were formed during the reference period.

Developments in the Payment and Settlement Systems

- **Central Bank supervises and regulates payment and settlement systems in order to maintain a secure, reliable and efficient payment and settlement system in the country, which is a key requirement for achieving financial system stability**. In 2017, Central Bank continued to facilitate the national payment infrastructure to facilitate the economic activities of the country.

- **Central Bank continued to facilitate the establishment of Common Card and Payment Switch (CCAPS) operated by LankaClear (Pvt.) Ltd. (LCPL) under the brand name of 'LankaPay', which is a network of five interoperable switches. i.e. Common ATM Switch (CAS), Common Electronic Fund Transfer Switch (CEFTS), Shared ATM Switch (SAS), Common Point of Sale Switch (CPS) and Common Mobile Switch (CMobS).**

- **CAS, which is the first phase of CCAPS, started live operations in July 2013**. During first nine months of 2017, membership of CAS increased to 27. Within this period CAS settled 32.4 million transactions amounting to Rs. 189.2 billion. In order to enhance the security of card transactions carried through CAS network, CAS members were instructed by Central Bank to enable Europay, MasterCard and Visa (EMV) technology in ATM machines installed by all CAS members.

- **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 2017, eight financial institutions integrated with CEFTS increasing the members of CEFTS, thereby to 30. CEFTS settled 2.1 million transactions amounting to Rs. 181.1 billion during the first nine months of 2017.

- **LankaPay Online Payment Platform (LPOPP) was launched on 20 July 2017 to facilitate real time payments to Sri Lanka Customs through CEFTS member financial institutions**. By end September 2017, six LCBs had connected to LPOPP. LPOPP can be extended to facilitate payments to other government institutions as well. Payment and Settlement Systems Circular No. 08 of 2017 on Maximum Limits on Transaction Value and Fees of CEFTS was issued replacing the Payment and Settlement Systems Circular No. 01 of 2015, in order to increase the maximum per transaction value limit for transactions carried out through a specific transaction code to facilitate real time payments to Sri Lanka Customs.

- **The Central Bank approved the request made by LCPL to implement a National Card Scheme in partnership with an international card scheme**. Accordingly, the National Card Scheme, which will be implemented in 2018, will facilitate the introduction of low cost products for national initiatives such as social benefit schemes and public transport. The CPS will commence live operations after implementation of the national card scheme.

- **The National Payment Council (NPC), which is the industry consultative and monitoring committee on payment systems commenced the consultative process for preparation of a Roadmap for medium-term development of payment systems covering application of new technology, new payment products and system stability and consumer protection focused regulation**. The draft Roadmap was finalised after incorporating the suggestions made by council members. In order to facilitate implementation of the action points of the Roadmap, the NPC appointed two committees to study the potential impact of FinTech and Blockchain and to make recommendations.

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 an increase in the NPLs and banks will need to be cautious of further 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 strengthen further, with the build-up of capital as a result of the enhanced capital requirements**. With the enhanced minimum capital levels and the implementation of Basel III Minimum Capital Requirements, banks are required to increase their high quality capital. Banks which are unable to comply, will be encouraged to consolidate on a voluntary basis. Further, with the adoption of Sri Lanka Financial Reporting Standard – 9, Financial Instruments (SLFRS 9) in January 2018, banks will be required to recognise loan losses under expected credit loss approach instead of the existing incurred loan loss approach. Accordingly, banks will be required to augment their capital levels further to be in line with the new accounting standard. This will improve the ability of the banking sector to absorb shocks arising from financial and economic stress, reducing the risks of spill over from the financial sector to the real economy in the coming years.

- **The liquidity positions of banks will continue to be maintained at healthy levels**. Banking Act Directions on Liquidity Coverage Ratio (LCR) under Basel III Liquidity Standards were issued in 2015 to be complied with on a staggered basis and the banks are required to maintain an LCR of 100 per cent by 2019. Also with the implementation of the Net Stable Funding Ratio (NSFR) in 2018, the liquidity risk profile of banks will be further strengthened.

- **With a view to strengthening the banking sector, the Central Bank issued a consultation paper on Basel III Leverage Ratio Framework for Licensed Banks**. Commencing 31 March 2017 banks were required to report Leverage Ratio for monitoring purposes within 30 days from the end of each quarter. Banking Act Directions on the Leverage ratio will be issued upon the issuance of final guidelines by the Basel Committee on Banking Supervision and with this, banks may need to reassess the balance sheet size and business expansion, as the leverage ratio restricts the assets expansion regardless of the relative risk of different assets classes.

- **Changes in macroeconomic variables will be closely monitored to identify and address any spillover risks arising from the real economy to the banking sector and appropriate macroprudential measures will be introduced to preempt any future 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. Examination methodology of banks will be enhanced focusing on the efficiency, effectiveness and sustainability of individual banks and the banking sector.

- **Changes are to be introduced to the regulatory and supervisory framework with respect to Cyber-Security and FINTECH, pertaining to banks in line with international standards and best practices**. This will prompt banks to upgrade and strengthen their management information systems and related technological platforms enabling the banks to cater to emerging information requirements. Digital initiatives such as mobile/phone banking and internet banking will be used to increase access for banking services, utilising Information Technology as a service delivery channel. This will require banks to take preventive measures to strengthen information security management of all systems related aspects.

- **The banking sector is expected to increase access to banking 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 utilize funds collected from a particular region to finance economic activities of the same region.

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

- **Direction on risk weighted capital adequacy ratio**. A new capital adequacy framework for LFCs and SLCs is proposed to be implemented during 2017 in view of fostering a strong emphasis on risk management and to encourage ongoing improvements in LFC and SLC's risk assessment capabilities. Therefore, the proposed capital adequacy framework provides for maintenance of capital adequacy ratios on a more risk sensitive focus covering credit risk and operational risks under the basic approach available in the Basel accord. Further, the above proposed new regulatory framework is expected to enforce a strict regulatory environment and a natural consolidation drive by pushing smaller, inefficient, weak LFCs/SLCs to consolidate with bigger players or to seek strategic investors with capital infusions.

- **The stability of the sector is expected to be reinforced further in the medium-term horizon with changes to the existing regulatory framework**. The changes are proposed to the existing risk management, liquidity and provisioning regulations, which will enable to establish an Integrated Risk Management Framework for LFCs and SLCs. New governance practices are also expected to be incorporated to the Corporate Governance Framework with a view to improving governance.

- **A positive outcome will be expected through the initiatives proposed on the resolution of some distressed finance companies**. Initiatives will be taken to resolve distressed finance companies, largely through mergers and recapitalisation through strategic investors. Further, options are being evaluated to settle the existing depositors of these institutions through the Sri Lanka Deposit Insurance and Liquidity Support Scheme and thereafter to liquidate those companies.

- **During 2018, DSMI expects to receive applications for licence under the Microfinance Act, which would be evaluated and suitable applicants will be licensed.** Action will be taken to include LMFCs under the Credit Information Bureau of Sri Lanka.

- **DSMI is in the process of reviewing the Microfinance Act to suggest amendments for more effective regulation of the microfinance sector**. DSMI has identified the need for provisions on regulation of non-deposit taking micro-credit institutions through an appropriate regulatory framework, and a unified customer protection framework for protection of microfinance customers. DSMI expects to issue a customer protection charter during 2018, With a view to protecting microfinance customers.

- **Regulation of the microfinance sector in a holistic manner has been difficult due to the fact that Microfinance Institutions (MFIs) are regulated by a number of other regulators apart from the Central Bank, such as Samurdhi Development Department and Co-operative Development Department, which are exempted from the purview of the Microfinance Act**. Therefore, DSMI expects to take mesures during 2018 to convene an inter-regulatory council comprising of all regulators of MFIs, which would meet at regular intervals. It is anticipated that Central Bank would entering into MOUs with other regulators of MFIs for sharing of information and regulatory knowledge during 2018.

- **It is expected that new and advanced electronic retail payment instruments such as payment cards, mobile and internet payments will become more popular as a means of settling transactions**. The increased use of these new electronic retail payment systems, has necessitated measures to minimise risks, and to increase efficiency levels and reduce costs. Accordingly, the Central Bank introduced policy measures to provide a safe and sound environment for easy adoption of electronic payment systems and to maintain public confidence in the electronic retail payment and settlement systems.

- **Central Bank is engaged in the preparation of guidelines for mobile applications used by institutions providing payment services for payment related mobile applications which is expected to be issued during the year**. These guidelines will lay down the minimum standards in relation to protection of customer information and transaction security and is expected to ensure availability of secure mobile applications to effect payments.

- **Central Bank is in the process of revising the Credit Card Operational Guidelines issued in 2010, in line with the new developments in the credit card industry**. It is expected to issue revised guidelines during the year after considering the suggestions made by relevant stakeholders.

- **Strengthening of the supervisory and regulatory framework governing the capital markets and the insurance sector continued during the year**. The Insurance Board of Sri Lanka (IBSL) has taken measures to streamline the provision of ancillary services by insurance brokering companies. In addition, IBSL intends to work with the World Bank for developing a Micro-Insurance Framework for Sri Lanka. This framework intends to promote micro-insurance as an effective poverty reduction tool. The development of the micro-insurance sector would improve the ability of risk mitigation and reduce the vulnerability of low-income households by facilitating them with access to affordable insurance products.

- **The Securities and Exchange Commission (SEC) introduced new risk based criteria on minimum capital requirements and minimum liquid capital of stock brokers while promotional activities of unit trust were streamlined**. Approval of a Small and Medium Enterprises Board and minimum public float enforcement rules by SEC in 2017 are considered to be a major step towards further expansion of capital market operations. Further, the SEC intends to facilitate the demutualisation of the CSE with technical assistance from Asian Development Bank. Demutualisation of the CSE is expected to yield a number of advantages including raising additional capital for expansion and innovation purposes, increasing the ability to operate in a more customer-focused and responding to changes in the dynamic business environment in speedily manner.

- **Central Bank has formulated new strategies expecting to promote access to finance, improve financial inclusion and balanced regional growth in the country**. Accordingly, the Central Bank facilitates all sectors by enhancing the flow of credit and credit plus services and provision of non-financial support to achieve sustainable development of the country and create a conducive financial environment to bring-in excluded segment to the formal financial sector by developing a National Financial Inclusion Strategy for the country.

APPENDIX 1

Major Economic Policy Changes and Measures: January - October 2017[1]

Monetary Policy

24 March 2017 - The Standing Deposit Facility Rate (SDFR) and Standing Lending Facility Rate (SLFR) of the Central Bank were increased by 25 basis points each to 7.25 per cent and 8.75 per cent, respectively.

Financial Sector

Licensed Banks

10 January 2017 - A consultation paper was issued on 'Basel III Leverage Ratio Framework for Licensed Banks'.

13 January 2017 - Banking Act Directions No. 01 of 2017 were issued to licensed banks informing the Loan to Value ratio (LTV) for credit facilities granted by the licensed banks for the purpose of purchase or utilisation of vehicles commencing 16 January 2017.

01 February 2017 - A Circular was issued to licensed banks informing the national policy approved in the Budget 2017 in respect of the following;

- credit to identified sectors such as small and medium enterprises, exports, tourism activities, agriculture, youth and women
- enhancing banking services

15 February 2017 - A Direction on LTV for credit facilities in respect of motor vehicles was issued amending and replacing some interpretations in the Direction 5 of the Banking Act Directions No. 01 of 2017.

22 March 2017 - A determination was issued to licensed banks amending the pawning conditions issued on 07 September 1998.

26 May 2017 - A Circular was issued permitting licensed banks to charge interest rates on credit products and penal interest as per their policies, provided banks make adequate disclosures.

29 May 2017 - A Circular was issued to licensed banks informing that they may grant the concessions on a case by case basis to the borrowers affected by the recent floods, adverse weather conditions and connected circumstances in terms of the national policy adopted to facilitate rehabilitation of business and normal operations of such borrowers.

31 May 2017 - A Direction on LTV for credit facilities in respect of motor vehicles was issued amending and replacing Directions 5.1 and 5.4 of the Banking Act Directions No. 02 of 2017.

1. This includes major economic policy changes and measures implemented during January to October 2017. Policy changes and measures that have been announced and are yet to be implemented during the remaining period of 2017 are also included.

26 October 2017	-	A Direction on enhancing the Minimum Capital Requirement of licensed banks was issued.
Forthcoming	-	Introducing the Leverage Ratio to licensed banks
	-	Introducing the Net Stable Funding Ratio (NSFR) to licensed banks
	-	Enhancing bank examination methodology

Licensed Finance Companies (LFCs) and Specialised Leasing Companies (SLCs)

13 January 2017	-	The Directions issued to LFCs and SLCs on LTV for credit facilities in respect of motor vehicles were revised in line with the National Budget 2017.
17 February 2017	-	Amendments were issued to the LTV Direction issued on 13 January 2017 as the vehicle categories were mapped to vehicle classes given by the Department of Motor Traffic.
23 February 2017	-	A Direction was issued to increase the minimum core capital for LFCs on a staggered basis.
30 May 2017	-	LFCs and SLCs were allowed to grant the following concessions to borrowers which have been affected by floods, adverse weather conditions and connected circumstances in terms of the national policy adopted to facilitate rehabilitation of businesses and normal operations of such borrower; - grant a moratorium of not exceeding 3 months in respect of all performing credit facilities - waive off the penal interest on overdue loans of the borrowers under the above moratorium and non-performing borrowers as affected above who are willing to settle their loans on rescheduled terms to recommence/restructure their business activities
02 June 2017	-	Amendments were made to the LTV Direction issued on 17 February 2017 as the vehicle categories were mapped to vehicle classes given by the Department of Motor Traffic.
Forthcoming	-	Implementing a new capital adequacy framework for LFCs and SLCs

Insurance

01 January 2017	-	Insurance Board of Sri Lanka (IBSL) issued guidelines on conducting investigations on insurance claims with the objective of promoting professionalism and enhancing the image of the industry while safeguarding the interests of the policy holder.
09 May 2017	-	IBSL issued a Direction requiring prior approval of IBSL for the provision of ancillary services other than insurance brokering business by Insurance Brokering Companies.
Forthcoming	-	Formalising the insurance dispute resolution process by establishing an independent dispute resolution panel, as an alternative dispute resolution mechanism, to resolve disputes arising out of insurance contracts

	-	Developing a comprehensive strategy for deepening financial literacy on insurance products
	-	Providing new guidelines to streamline investment activities and unclaimed benefits of insurance companies

Capital Market

09 May 2017	-	Securities and Exchange Commission of Sri Lanka (SEC) approved Multi-Currency Board (MCB) to be implemented by Colombo Stock Exchange (CSE) in order to list foreign entities, subject to clearance from the Attorney General's Department.
06 June 2017	-	SEC issued guidelines on the content of advertisements and promotional material to be followed by the companies of unit trust when marketing unit trusts to the public.
13 June 2017	-	SEC approved Small and Medium Enterprises (SME) Board to facilitate SME listing in CSE.
28 June 2017	-	SEC approved the minimum public float enforcement rules for noncompliance, which is to be implemented by CSE.
01 August 2017	-	SEC approved a procedure to be enforced on stock brokering companies to strengthen the framework for risk based capital adequacy requirement of stock brokering firms.

Small and Medium Enterprise (SME) Development

20 January 2017	-	Operating Instructions were issued to Participating Financial Institutions (PFIs) to extend operations of the Self-Employment Promotion Initiative (SEPI) Loan Scheme – Phase II up to 31 December 2019.
06 February 2017	-	Maximum period for loan repayments under the Commercial Scale Dairy Development Loan Scheme (CSDDLS) was increased to 6 years from 5 years inclusive of a maximum grace period of one year, depending on the nature of the project.
08 February 2017	-	A new loan scheme named "Swashakthi – Towards One Million Jobs" was launched by the Central Bank of Sri Lanka (CBSL) for the development of Micro, Small and Medium scale Enterprise (MSME) sector and employment generation, on behalf of the Government.
03 April 2017	-	The period of operations of National Agribusiness Development Programme (NADeP) was extended up to 31 December 2017 and the Operating Instructions were issued to PFIs.
26 April 2017	-	Operating Instructions were issued to PFIs to establish the Partial Credit Guarantee Scheme (PCG) under the Agriculture Sector Modernisation Project funded by the World Bank.
08 May 2017	-	Loan size and repayment period of "Tharuna Diriya" loan scheme were increased up to Rs. 1 million and 48 months, respectively.

28 June 2017	-	Operating Instructions were issued to PFIs to implement the Post-disaster Economic Activity Recovery Loan Scheme (PEARL) under NADeP.
18 August 2017	-	"Athwela" loan scheme was launched by CBSL to provide credit facilities at concessionary terms and conditions to resume economic activities affected by disasters.

Payments and Settlements

20 July 2017	-	Payment and Settlement Systems Circular No. 08 of 2017 on maximum limits on transaction value and fees of Common Electronic Fund Transfer Switch (CEFTS) was issued replacing the Payment and Settlement Systems Circular No. 01 of 2015 in order to increase the maximum per transaction value limit for transactions carried out through a specific transaction code to facilitate real time payments to Sri Lanka Customs.
Forthcoming	-	Issuing guidelines to set standards for payment related mobile applications

Suspicious Transactions Formats

30 March 2017	-	Extraordinary Gazette No. 2015/56 dated 30 March 2017 was issued on the Suspicious Transactions (Format) Regulations of 2017.

Foreign Exchange Management

07 March 2017	-	Permission was granted to Sri Lankans, resident outside Sri Lanka on Permanent Residency visa (PR) in another country and individuals who have obtained dual citizenship in Sri Lanka and any other country, to obtain loans in foreign currency and in Sri Lanka rupees, from the Domestic Banking Units (DBUs) of authorised dealers.
	-	Permission was granted to repay such foreign currency or Sri Lanka rupee loans by utilising funds available in Non-Resident Foreign Currency (NRFCs) accounts, Resident Foreign Currency (RFCs) accounts and Securities Investment Accounts (SIAs) of the same account holder and transfer funds from Foreign Currency Loan Accounts (FCLAs) to Foreign Exchange Earners' Accounts (FEEAs) for the purpose of acquisition/ construction/ development and renovation of a residential property.
25 May 2017	-	New Directions on NRFCs, RFCs, FEEAs and Resident Non-National Foreign Currency (RNNFCs) accounts were issued to the National Savings Bank (NSB) incorporating relaxations made so far with respect to such accounts opened and maintained with authorised dealers.
23 June 2017	-	Permission was granted to authorised dealers on considering funds received from exchange companies/ houses, as inward remittances received from abroad through the banking system for the purpose of permitted credits to RFCs, NRFCs, SIAs and Special Foreign Investment Deposit Accounts (SFIDAs).

05 July 2017 - The permission granted to authorised dealers to open new Foreign Currency Accounts for International Services Providers and their Employees (FCAISPE) was withdrawn, as the income tax exemption granted for the professional service providers has been withdrawn by the Inland Revenue (Amendment) Act No.09 of 2015. However, authorised dealers were permitted to maintain existing FCAISPE.

10 July 2017 - Permission was granted to authorised dealers and NSB to open and maintain RFCs jointly, provided that each joint holder is an eligible person to open a RFC account.

28 July 2017 - Foreign Exchange Act, No. 12 of 2017 was enacted;

- to promote and regulate foreign exchange
- to vest the responsibility for promoting and regulating foreign exchange in the Central Bank as the agent of the government
- to provide for the repeal of the Exchange Control Act (Chapter 423)

Price Revisions

09 January 2017 - The retail price of kerosene was reduced by Rs. 5 to Rs. 44 per litre.

27 January 2017 - The Maximum Retail Prices (MRP) on certain items were reduced as follows:

- Masoor Dhal (red lentils) from Rs. 169 to Rs. 159 per kg
- Dried sprats (imported - Thailand) from Rs. 495 to Rs. 490 per kg
- Dried sprats (imported - Dubai) from Rs. 410 to Rs. 405 per kg
- Green gram (Moong) from Rs. 220 to Rs. 205 per kg
- White sugar from Rs. 95 to Rs. 93 per kg
- Potatoes (imported) from Rs. 120 to Rs. 115 per kg

08 February 2017 - The MRP on rice was set as follows:

- Samba rice at Rs. 80 per kg
- Naadu rice at Rs. 72 per kg
- Raw rice (Kekulu) at Rs. 70 per kg

17 February 2017 - The MRP on rice was revised as follows:

Variety of Rice	MRP on Locally Produced Rice (Rs. per kg.)	MRP on Imported Rice (Rs. per kg.)
Samba Rice (excluding Keeri and Suduru Samba)	90	80
Naadu Rice	80	72
Raw Rice (Kekulu)	78	70

- Medical Devices Pricing Regulations, No. 01 of 2017 was issued to set MRP on medical devices.

14 March 2017 - The MRP on following items was removed:

- White sugar
- Frozen or chilled Broiler chicken meat (whole chicken) with skin and without skin

01 July 2017 - Passenger bus fares were increased by 6.28 per cent. The minimum bus fare was increased to Rs. 10 from Rs. 9.

16 August 2017 - MRP imposed on rice was removed.

30 August 2017 - MRP imposed on dried sprats (imported - Thailand and Dubai) was removed.

26 September 2017 - Price of a 12.5 kg cylinder of LP gas was increased by Rs. 110 to Rs. 1,431.

Tax Revisions

Personal Income Tax

Forthcoming - Increasing tax free threshold on employment from Rs. 750,000 to Rs. 1.2 million per annum.

- Tax free allowance will be remained as Rs. 500,000 and the progressive tax rate structure will be introduced as follows;

Taxable Income	Tax Rate
First Rs. 600,000	4%
Rs. 600,000- Rs. 1,200,000	8%
Rs. 1,200,000- Rs. 1,800,000	12%
Rs. 1,800,000- Rs. 2,400,000	16%
Rs. 2,400,000- Rs. 3,000,000	20%
Exceeding Rs. 3,000,000	24%

- Introducing Capital Gains Tax (CGT) at a rate of 10 per cent

Corporate Income Tax

Forthcoming - Revising income tax rates as follows:

- The corporate income tax to a 3 tier structure with a lower rate of 14 per cent, a standard rate of 28 per cent and a higher rate of 40 per cent as follows:
  - (a) Lower rate of 14 per cent will be applicable to profits and income of SMEs, export of goods or services, agriculture enterprises and educational services
  - (b) Higher rate of 40 per cent will be applicable to profits and income of betting and gaming, liquor and tobacco
  - (c) The standard rate of 28 per cent will be applicable on profits and income of all other sectors including banking and finance, insurance, leasing and related activities, etc

Withholding Tax (WHT)

Forthcoming	-	Increasing WHT on interest income to 5 per cent from current 2.5 per cent
	-	Introducing WHT for specified fees exceeding Rs. 50,000 per month

Economic Service Charge (ESC)

01 April 2017	-	Threshold of ESC was reduced from Rs. 50 million per quarter to Rs. 12.5 million per quarter.
	-	ESC was charged on motor vehicles in advance on the CIF value certified by the Director General of Customs, of an importer (disregarding the threshold for ESC liability) in respect of every consignment of imports of motor vehicles.
	-	The CBSL was redefined as a person for the purpose of ESC and made liable for ESC.

Value Added Tax (VAT)

Forthcoming	-	Granting VAT exemptions on plant, machinery and accessories imported for renewable energy
	-	Granting VAT exemptions on plant and machinery imported by Ceylon Electricity Board (CEB) for generation, transmission and distribution of energy
	-	Removing VAT exemptions on locally manufactured dairy products other than milk powder

Nation Building Tax (NBT)

01 April 2017	-	Following goods and services were made exempt: - Supply of international telecommunication services to local operators by External Gateway Operators - Supply of printed books, magazines, journals, or periodicals other than newspapers - Supply of electricity other than supply of electricity by CEB
01 August 2017	-	Following exemptions were removed and made liable for NBT: - Supply of any goods required for the purpose of providing of services of international transportation, being goods consigned to Sri Lankan Airlines Ltd, Mihin Lanka (Pvt) Ltd. or Air Lanka Catering services Ltd. - Supply of any goods or services provided by any Cooperative Society or Lak Sathosa - Construction services by a contractor other than by a sub contractor - Services of a travel agent in respect of inbound tours (other than services where the payment is received in foreign currency through a bank) - The supply of residential apartments

Excise Duty

01 January 2017	-	The duty on bottled toddy was increased to Rs. 50 per litre from Rs. 30 per litre.
	-	Annual distillery license (except Palmyrah arrack) fee was reduced to Rs. 1 million from Rs. 100 million.
	-	A license fee of Rs. 100,000 was imposed on arrack licenses that are issued together with foreign liquor license.
	-	A license fee of Rs. 50,000 was imposed on the sale of bottled toddy.
13 March 2017	-	A Gazette was issued to simplify the process of issuing licenses on the importation of foreign liquor.

Excise (Special Provisions)

18 August 2017	-	Excise duty on motor vehicles for the transport of goods under HS Headings 87.04 was revised downwards to Rs. 700,000 per unit from Rs. 1,000,000 per unit.
	-	Excise duty on motorcycles including mopeds under HS Headings 87.11 was revised.

Customs Duty

01 February 2017	-	Customs duty waiver of Rs. 3 per litre was imposed on the importation of diesel. Hence, the applicable rate is Rs. 12 per litre.
	-	Customs duty waiver of Rs. 10 per litre was imposed on the importation of petrol. Hence, the applicable rate is Rs. 25 per litre.
17 February 2017	-	Importation of ingredients for animal feed production, alloy steel bars for manufacturing of leaf spring and steel for manufacturing of prefabricated buildings was exempted from Customs duty.
	-	Customs duty on the importation of polymers in primary forms, soya beans, tyres, steel, ball bearings, sparking plugs and batteries was revised.
08 July 2017	-	Customs duty waiver on milk powder was increased to Rs. 223 per kg from Rs. 180 per kg. Hence, the applicable rate is Rs. 2 per kg.
02 August 2017	-	Customs duty waiver on wheat grain was increased to Rs. 6 per kg from Rs. 3 per kg. Hence, the applicable rate is Rs. 6 per kg.

Customs Valuation

15 March 2017	-	A method was prescribed for determination of Customs value for disposal of machinery and equipment imported under exemption of customs import duty on conditional basis by enterprises in the business of manufacturing and exporting apparel.

Cess

02 August 2017 - Cess on wheat flour was reduced to Rs. 15 per kg from Rs. 25 per kg

Special Commodity Levy (SCL)

07 January 2017 - SCL of Rs. 15 per kg was imposed on the importation of semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) for a period of three months.

19 January 2017 - SCL on the importation of Maldive fish, dried sprats, 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 vegetable oils was reduced by Rs. 20 per kg for a period of six months.

28 January 2017 - SCL duty waiver of Rs. 10 per kg was imposed on the semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) for a period of 30 days. Hence the applicable rate is Rs. 5 per kg.

17 February 2017 - SCL on the importation of potatoes and b' onions was extended for a period of six months.

- SCL on the importation of red and yellow lentils was increased for a period of six months as follows:
  - Whole from Rs. 5 per kg to Rs. 10 per kg
  - Split from Rs. 10 per kg to Rs. 15 per kg

24 February 2017 - SCL on the importation of vegetable oils was reduced by Rs. 20 per kg for a period of six months.

27 February 2017 - SCL duty waiver of Rs. 10 per kg imposed on semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) was extended for a period of 30 days. Hence, the applicable rate is Rs. 5 per kg.

08 March 2017 - SCL on the importation of mackerel, peas, chickpeas, cowpeas, kurakkan and sugar other than white crystalline sugar was extended for a period of six months.

28 March 2017 - SCL duty waiver of Rs. 10 per kg imposed on semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) was extended up to 31 March 2017. Hence, the applicable rate is Rs. 5 per kg.

01 April 2017 - SCL on the importation of semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) was reduced to Rs. 5 per kg from Rs. 15 per kg for a period of 60 days.

02 April 2017 - SCL on the importation of dried fish, yoghurt, butter, dairy spreads, garlic, fresh oranges, grapes, apples, mathe seeds, kurakkan flour, ground nuts, mustard seeds and salt was extended for a period of six months.

08 May 2017	-	SCL on the importation of fish, fresh or chilled and frozen, excluding fish fillets and other fish meat, green gram (Moong), Mangoesteens (fresh and dried), Oranges (dried), Pears, Cherries, Plums and soles, Kiwifruit and other fresh fruits under HS Code No. 0810.90.90 was extended for a period of six months.
21 May 2017	-	SCL on the importation of red onion, dates, grapes (dried), seeds of cumin and seeds of fennel was extended for a period of six months.
	-	SCL of Rs. 5 per kg was imposed on husked (brown) rice for a period of six months.
31 May 2017	-	SCL on the importation of semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) was extended up to 31 August 2017.
06 June 2017	-	SCL on the importation of margarine was extended for a period of six months.
	-	SCL on the importation of sugar was increased by Rs. 10 per kg for a period of six months.
07 June 2017	-	SCL duty waiver of Rs. 25 per kg was imposed on fish for a period of 30 days. Hence, the applicable rate is 10 per cent or Rs. 50 per kg.
01 July 2017	-	SCL of Rs. 5 per kg was imposed on broken rice for a period of three months.
19 July 2017	-	SCL on the importation of Maldive fish, dried sprats, black gram, chillies, seeds of coriander, turmeric, black gram flour and canned fish was extended for a period of six months.
27 July 2017	-	SCL on the importation of husked brown rice, semi-milled or wholly milled raw rice (Kekulu), Naadu rice (red or white) and Samba rice (red or white) was reduced to 25 cents per kg from Rs. 5 per kg until 31 December 2017.
01 August 2017	-	SCL on the importation of frozen fish meat of Sail fish and Marlin fish was reduced to Rs. 25 per kg from 10 per cent or Rs. 75 per kg, the amount of levy whichever is higher, for a period of three months.
	-	SCL of Rs. 10 per kg was imposed on the importation of maize for a period of six months.
02 August 2017	-	SCL on the importation of broken rice was reduced to 25 cents per kg from Rs. 5 per kg until 31 December 2017.
16 August 2017	-	SCL on the importation of sugar was increased by Rs. 8 per kg for a period of six months.
17 August 2017	-	SCL on the importation potatoes, b' onion and lentils was extended for a period of six months.
08 September 2017	-	SCL on the importation of mackerel, peas, chickpeas, cowpeas and kurakkan was extended for a period of six months.

Stamp Duty

21 February 2017 - Motor vehicle categories, which are liable for paying stamp duty on policy insurance, finance lease agreement and hire purchase agreement were specified.

Embarkation Levy

01 January 2017 - Embarkation Levy was increased to US dollars 50 from US dollars 30.

Fees and Charges

Forthcoming - Increasing fines on traffic offences

Other

01 September 2017 - Telecommunication Levy on internet services was removed.

Forthcoming - Introducing a Financial Transaction Levy at 0.05 per cent on the basis of the total transaction value by banks or financial institutions

- Increasing teledrama levy applicable on the foreign teledramas flowing in to the country and dubbed in Sinhala, Tamil or any other language

- Imposing a SIM Activation Levy of Rs. 200

- Imposing a Carbon Tax on vehicles other than electric cars and tractors

- Charging a fee for license to import lubricants, bitumen and gold

Government Expenditure

09 February 2017 - A Pension Instruction Letter No. 02/2017 was issued to grant a pension entitlement to the officers who had been sent on retirement after becoming disabled due to terrorist activities without completing 10 years of service in the Armed Forces and Police and 12 years service in the other ranks of Armed Forces.

08 March 2017 - Public Administration Circular No. 06/2017 was issued to extend the age limit of compulsory retirement of the officers in Sri Lanka Engineering Service up to 61 years with effect from 01 January 2017.

09 June 2017 - Pension Circular No.01/2017 was issued to grant a “Ranaviru Surakum Allowance” for disabled officers of Tri Forces who became disabled during the active service due to terrorist activities and their widows with effect from 01 January 2017.

Debt Management

10 January 2017 - Issuance of Sri Lanka Development Bonds (SLDBs) up to a limit of US dollars 1,500 million for 2017 was authorised.

24 April 2017 - A Circular was issued requiring all licensed commercial banks, licensed specialised banks and primary dealers to use the Bloomberg trading platform (Fixed Income Quote - FIQ) designed for Sri Lanka to;

- quote repurchase rates, tenures and volumes
- report yield rates, tenures and volumes of all repurchase transactions carried out over the counter within 30 minutes of each such trade of Rs. 100 million or above

08 May 2017	-	Issuance of SLDBs up to a limit of US dollars 3,000 million for 2017 was re-authorised.
27 July 2017	-	A new primary issuance system for Treasury bonds was introduced. Regular monthly Treasury bond auctions are carried out through this system. There are three standard phases for each issuance of Treasury bonds;

Phase I	-	explores issuance of the entire announced volume in a competitive multiple price auction system through reasonable market bids
Phase II	-	opens for voluntary, volume based bidding
Phase III	-	any under allocation during Phases I and II, is issued on a mandatory basis to primary dealers

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	2014 (b)	2015 (b) (c)	2016 (c)	2017 First Half (c)	% Change 15/14 (b) (c)	16/15 (c)	17/16 First Half (c)
Agriculture, Forestry and Fishing	**829,577**	**894,780**	**890,659**	**479,067**	**7.9**	**-0.5**	**10.6**
1. Growing of cereals (except rice)	18,454	20,383	19,863	9,168	10.4	-2.6	-15.6
2. Growing of rice	100,931	117,136	73,484	25,362	16.1	-37.3	-19.3
3. Growing of vegetables	73,091	90,525	89,251	44,282	23.9	-1.4	-8.2
4. Growing of sugar cane, tobacco and other non-perennial crops	3,431	2,774	3,171	1,499	-19.1	14.3	-8.1
5. Growing of fruits	45,697	55,252	63,557	42,819	20.9	15.0	32.6
6. Growing of oleaginous fruits (coconut, king coconut, oil palm)	79,820	95,573	70,860	48,770	19.7	-25.9	27.4
7. Growing of tea (green leaves)	91,533	75,746	82,321	57,646	-17.2	8.7	47.5
8. Growing of other beverage crops (coffee, cocoa etc.)	1,622	1,366	2,096	1,190	-15.8	53.4	44.9
9. Growing of spices, aromatic, drug and pharmaceutical crops	75,735	80,476	89,381	46,113	6.3	11.1	11.3
10. Growing of rubber	17,437	14,218	10,643	6,941	-18.5	-25.1	1.5
11. Growing of other perennial crops	22,636	24,507	25,411	12,230	8.3	3.7	2.2
12. Animal production	57,284	65,458	88,836	46,522	14.3	35.7	18.9
13. Plant propagation and support activities to agriculture	12,110	13,808	14,414	7,324	14.0	4.4	3.5
14. Forestry and logging	71,767	75,546	84,003	40,151	5.3	11.2	-0.7
15. Marine fishing and marine aquaculture	141,987	146,709	159,064	83,680	3.3	8.4	5.8
16. Fresh water fishing and fresh water aquaculture	16,043	15,303	14,305	5,368	-4.6	-6.5	14.8
Industries	**2,931,998**	**2,991,106**	**3,208,476**	**1,800,797**	**2.0**	**7.3**	**13.7**
17. Mining and quarrying	254,392	249,056	315,067	166,607	-2.1	26.5	17.8
18. Manufacture of food, beverages & tobacco products	759,354	851,869	858,954	515,747	12.2	0.8	17.7
19. Manufacture of textiles, wearing apparel and leather related products	415,363	396,724	383,411	223,188	-4.5	-3.4	7.3
20. Manufacture of wood and of products of wood and cork, except furniture	22,269	27,947	26,879	10,532	25.5	-3.8	-5.0
21. Manufacture of paper products, printing and reproduction of media products	36,585	37,897	41,361	21,639	3.6	9.1	3.7
22. Manufacture of coke and refined petroleum products	66,690	20,399	2,406	1,520	-69.4	-88.2	19.4
23. Manufacture of chemical products and basic pharmaceutical products	74,134	70,385	84,870	41,507	-5.1	20.6	-5.1
24. Manufacture of rubber and plastic products	77,754	80,133	96,811	41,371	3.1	20.8	3.7
25. Manufacture of other non- metallic mineral products	110,571	93,903	97,578	55,381	-15.1	3.9	11.7
26. Manufacture of basic metals and fabricated metal products	33,635	38,600	48,848	22,919	14.8	26.6	7.3
27. Manufacture of machinery and equipment	33,421	41,758	46,804	21,820	24.9	12.1	10.7
28. Manufacture of furniture	78,967	82,639	84,434	47,872	4.7	2.2	15.4
29. Other manufacturing, and repair and installation of machinery and equipment	49,971	56,669	64,823	34,166	13.4	14.4	13.0
30. Electricity, gas, steam and air conditioning supply	77,639	82,793	86,660	45,871	6.6	4.7	9.6
31. Water collection, treatment and supply	14,425	15,075	17,792	9,026	4.5	18.0	1.7
32. Sewerage, waste, treatment and disposal activities	13,140	16,873	19,517	11,326	28.4	15.7	19.5
33. Construction	813,689	828,388	932,260	530,306	1.8	12.5	16.2
Services	**5,895,618**	**6,270,028**	**6,743,346**	**3,450,595**	**6.4**	**7.5**	**7.8**
34. Wholesale and retail trade	1,117,234	1,188,521	1,264,170	734,019	6.4	6.4	11.1
35. Transportation of goods and passengers including warehousing	1,288,124	1,300,167	1,426,726	628,554	0.9	9.7	2.0
36. Postal and courier activities	4,821	5,001	4,890	2,647	3.7	-2.2	16.5
37. Accommodation, food and beverage service activities	166,608	171,314	184,992	98,424	2.8	8.0	10.2
38. Programming and broadcasting activities and audio video productions	3,680	4,425	4,749	2,444	20.2	7.3	11.3
39. Telecommunication	44,733	57,222	68,316	35,765	27.9	19.4	6.1
40. IT programming consultancy and related activities	13,405	15,528	17,265	9,298	15.8	11.2	10.0
41. Financial service activities and auxiliary financial services	340,727	346,447	405,572	212,650	1.7	17.1	20.5
42. Insurance, reinsurance and pension funding	92,938	102,251	120,973	47,344	10.0	18.3	6.0
43. Real estate activities, including ownership of dwelling	562,687	625,521	676,760	360,222	11.2	8.2	9.4
44. Professional services	210,966	197,212	198,198	102,843	-6.5	0.5	5.6
45. Public administration and defence; compulsory social security	563,280	637,464	678,665	334,422	13.2	6.5	6.1
46. Education	212,148	250,024	256,726	130,945	17.9	2.7	1.8
47. Human health activities, residential care and social work activities	210,304	257,008	265,962	134,163	22.2	3.5	3.4
48. Other personal service activities	1,063,962	1,111,922	1,169,381	616,855	4.5	5.2	8.8
Equals Gross Value Added (GVA) at Basic Price	**9,657,194**	**10,155,914**	**10,842,481**	**5,730,458**	**5.2**	**6.8**	**9.8**
Taxes less subsidies on products	703,957	795,782	996,495	611,682	13.0	25.2	12.6
Equals Gross Domestic Product (GDP) at Market Price	**10,361,151**	**10,951,695**	**11,838,975**	**6,342,141**	**5.7**	**8.1**	**10.1**

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

Source : Department of Census and Statistics

TABLE 2

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

Rs. million

ECONOMIC ACTIVITY	2014 (b)	2015 (b) (c)	2016 (c)	2017 First Half (c)	% Change		
					15/14 (b) (c)	16/15 (c)	17/16 First Half (c)
Agriculture, Forestry and Fishing	**639,696**	**670,106**	**641,943**	**310,400**	**4.8**	**-4.2**	**-3.1**
1. Growing of cereals (except rice)	13,969	14,982	13,410	6,238	7.3	-10.5	-15.2
2. Growing of rice	61,019	76,256	52,649	13,497	25.0	-31.0	-42.1
3. Growing of vegetables	55,244	56,714	55,522	27,231	2.7	-2.1	-4.6
4. Growing of sugar cane, tobacco and other non-perennial crops	2,287	1,944	2,205	1,061	-15.0	13.4	-10.2
5. Growing of fruits	40,888	48,033	46,258	26,348	17.5	-3.7	1.7
6. Growing of oleaginous fruits (coconut, king coconut, oil palm)	64,158	67,504	67,074	30,367	5.2	-0.6	-14.9
7. Growing of tea (green leaves)	73,936	71,978	63,893	34,105	-2.6	-11.2	1.2
8. Growing of other beverage crops (coffee, cocoa etc.)	1,538	1,259	1,353	682	-18.1	7.5	0.7
9. Growing of spices, aromatic, drug and pharmaceutical crops	57,505	61,483	65,417	33,728	6.9	6.4	1.3
10. Growing of rubber	28,688	25,777	23,023	13,119	-10.1	-10.7	-5.9
11. Growing of other perennial crops	15,402	16,839	16,473	8,604	9.3	-2.2	3.9
12. Animal production	47,950	51,811	55,060	27,763	8.1	6.3	8.9
13. Plant propagation and support activities to agriculture	9,767	10,421	9,936	5,124	6.7	-4.7	3.5
14. Forestry and logging	47,450	48,360	51,020	25,306	1.9	5.5	7.2
15. Marine fishing and marine aquaculture	105,822	104,245	104,915	52,578	-1.5	0.6	4.5
16. Fresh water fishing and fresh water aquaculture	14,072	12,501	13,734	4,651	-11.2	9.9	15.1
Industries	**2,218,711**	**2,264,673**	**2,416,276**	**1,255,249**	**2.1**	**6.7**	**5.8**
17. Mining and quarrying	201,613	191,112	218,545	116,914	-5.2	14.4	18.1
18. Manufacture of food, beverages & tobacco products	513,960	532,936	519,815	260,512	3.7	-2.5	-1.1
19. Manufacture of textiles, wearing apparel and leather related products	276,800	282,070	281,481	152,768	1.9	-0.2	1.3
20. Manufacture of wood and of products of wood and cork, except furniture	23,139	26,239	30,311	12,136	13.4	15.5	-3.2
21. Manufacture of paper products, printing and reproduction of media products	24,968	27,092	29,730	16,213	8.5	9.7	6.8
22. Manufacture of coke and refined petroleum products	28,723	29,075	31,245	15,907	1.2	7.5	-15.2
23. Manufacture of chemical products and basic pharmaceutical products	82,243	82,303	85,623	41,881	0.1	4.0	-5.1
24. Manufacture of rubber and plastic products	71,909	76,446	90,119	39,197	6.3	17.9	5.7
25. Manufacture of other non- metallic mineral products	78,671	74,269	64,520	37,708	-5.6	-13.1	16.8
26. Manufacture of basic metals and fabricated metal products	24,882	28,516	36,711	17,010	14.6	28.7	4.8
27. Manufacture of machinery and equipment	32,064	38,838	44,300	20,680	21.1	14.1	13.0
28. Manufacture of furniture	82,748	93,529	96,684	51,174	13.0	3.4	7.1
29. Other manufacturing, and repair and installation of machinery and equipment	55,993	68,380	72,922	33,020	22.1	6.6	-7.2
30. Electricity, gas, steam and air conditioning supply	80,298	85,067	92,175	45,712	5.9	8.4	1.2
31. Water collection, treatment and supply	11,504	12,005	12,950	6,913	4.4	7.9	13.3
32. Sewerage, waste, treatment and disposal activities	17,355	21,681	25,539	13,856	24.9	17.8	10.7
33. Construction	611,842	595,115	683,604	373,650	-2.7	14.9	12.8
Services	**4,618,501**	**4,883,444**	**5,087,452**	**2,536,917**	**5.7**	**4.2**	**4.0**
34. Wholesale and retail trade	884,094	929,208	952,652	521,757	5.1	2.5	4.2
35. Transportation of goods and passengers including warehousing	885,506	929,854	968,421	426,310	5.0	4.1	2.3
36. Postal and courier activities	4,056	4,052	4,259	2,088	-0.1	5.1	6.0
37. Accommodation, food and beverage service activities	131,481	133,984	139,406	70,536	1.9	4.0	3.5
38. Programming and broadcasting activities and audio video productions	2,513	2,623	2,824	1,317	4.4	7.7	-0.7
39. Telecommunication	30,986	34,125	36,967	20,062	10.1	8.3	7.9
40. IT programming consultancy and related activities	10,579	12,144	13,011	6,659	14.8	7.1	3.3
41. Financial service activities and auxiliary financial services	420,223	492,642	553,826	317,008	17.2	12.4	15.8
42. Insurance, reinsurance and pension funding	74,978	81,960	88,962	34,215	9.3	8.5	6.5
43. Real estate activities, including ownership of dwelling	444,049	489,217	509,993	258,110	10.2	4.2	2.7
44. Professional services	166,486	154,239	149,382	73,710	-7.4	-3.1	-0.8
45. Public administration and defence; compulsory social security	402,205	430,098	452,579	198,213	6.9	5.2	-4.8
46. Education	173,751	159,758	171,707	85,375	-8.1	7.5	4.3
47. Human health activities, residential care and social work activities	147,962	159,901	162,243	82,632	8.1	1.5	12.4
48. Other personal service activities	839,633	869,640	881,221	438,923	3.6	1.3	2.0
Equals Gross Value Added (GVA) at Basic Price	**7,476,908**	**7,818,224**	**8,145,671**	**4,102,566**	**4.6**	**4.2**	**4.0**
Taxes less subsidies on products	758,521	815,667	866,355	270,781	7.5	6.2	3.0
Equals Gross Domestic Product (GDP) at Market Price	**8,235,429**	**8,633,890**	**9,012,026**	**4,373,347**	**4.8**	**4.4**	**3.9**

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

Source : Department of Census and Statistics

(b) Revised

(c) Provisional

TABLE 3

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

Rs. million

ITEM	2015 (b)(c)	2016 (c)	2017 First Half (c)	2017 (d)
1. Private Consumption Expenditure	7,677,131	8,003,789	4,257,982	8,667,529
2. General Government Consumption Expenditure	984,755	1,015,107	516,614	1,063,575
3. Gross Domestic Capital Formation	3,114,674	3,723,875	2,078,023	4,118,572
4. Export of Goods and Services	2,301,065	2,538,695	1,366,566	2,923,450
5. Less: Import of Goods and Services	3,125,931	3,442,490	1,877,044	3,902,589
Gross Domestic Product	**10,951,695**	**11,838,975**	**6,342,141**	**12,870,538**

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

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

TABLE 4
Trends in Principal Agricultural Crops

CATEGORY	Unit	2013	2014	2015	2016 (a)	2017	
						First Half (b)	Annual (c)
1. Tea							
1.1 Production (d)	kg mn	340.0	338.0	328.8	292.6	156.5	311.0
1.2 Extent	hectares '000	222	203	203	203	201	201
1.3 Cost of Production (e)	Rs./kg	422.70	475.11	458.84	469.24	-	n.a.
1.4 Average Price							
Colombo Auction	Rs./kg	445.83	459.01	401.46	473.15	618.33	644.62
Export (F.O.B.)	Rs./kg	623.91	649.44	593.08	639.88	796.34	821.09
2. Rubber							
2.1 Production	kg mn	130.4	98.6	88.6	79.1	45.1	85.0
2.2 Extent	hectares '000	134	134	137	136	136	136
2.3 Average Yield	kg/hectare	1,247	889	819	851	n.a.	864
2.4 Cost of Production							
Estate Sector	Rs./kg	259.43	282.04	266.41	277.60	-	n.a.
Small Holding Sector	Rs./kg	150.00	160.00	170.00	180.00	-	195.00
2.5 Average Price							
Colombo Auction (RSS 1)	Rs./kg	376.90	286.05	248.17	239.28	331.65	336.10
Export (F.O.B.)	Rs./kg	389.81	362.83	342.03	294.33	330.09	334.07
3. Coconut							
3.1 Production	nuts mn	2,513	2,870	3,056	3,011	1,289	2,650
3.2 Extent	hectares '000	392	441	455	447	449	452
3.3 Cost of Production	Rs./nut	13.58	13.67	16.39	16.70	-	n.a.
3.4 Average Export Price (F.O.B.) (f)	Rs./nut	29.36	39.08	54.54	41.16	53.15	50.55
4. Paddy (g)							
4.1 Production	mt '000	4,621	3,381	4,819	4,420	1,419	2,448
Maha	mt '000	2,846	2,236	2,877	2,903	1,419	1,419
Yala	mt '000	1,774	1,145	1,942	1,517	-	1,029
4.2 Area							
Sown	hectares '000	1,227	964	1,254	1,114	531	801
Harvested	hectares '000	1,067	793	1,088	1,011	371	601
4.3 Fertiliser Issued (h)	mt '000	363	275	341	202	-	-
4.4 Average Yield	kg/hectare	4,329	4,264	4,429	4,372	4,277	4,071

(F.O.B. = Freight on Board)
(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, including 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 existing fertiliser subsidy scheme. Accordingly, Rs. 6,468.6 million was disbursed for the 2016 Yala Season and figure for 2016 is only for 2015/16 Maha Season.

Sources : Sri Lanka Tea Board
Tea Small Holdings 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	2012	2013	2014	2015	2016 (b)	First Half	
						2016	2017 (b)
Manufacturing							
Food, Beverages and Tobacco Products	75.9	49.7	44.7	42.7	49.5	19.9	37.6
Textile, Wearing Apparel and Leather Products	86.7	102.6	83.1	45.4	21.3	6.5	27.3
Wood and Wooden Products	2.4	1.7	2.5	2.8	3.1	1.5	1.1
Paper, Paper Products, Printing and Publishing	4.0	2.1	36.3	2.2	3.1	0.2	4.0
Chemicals, Petroleum, Coal, Rubber and Plastic Products	59.2	114.4	91.9	75.4	99.5	51.9	74.3
Non-metallic Mineral Products	17.7	45.2	29.7	13.7	31.2	4.2	6.1
Fabricated Metal, Machinery and Transport Equipment	38.8	17.0	7.0	46.1	11.9	3.7	3.1
Manufactured Products not elsewhere specified	22.9	27.1	38.7	28.7	28.2	7.8	31.9
Agriculture	7.2	8.5	5.7	3.9	1.9	...	0.6
Services							
Hotels and Restaurants	117.3	67.9	68.4	181.9	141.3	95.9	97.1
IT and BPO (c)	25.9	19.3	24.7	13.6	23.0	8.5	20.8
Other Services	224.6	149.1	413.3	59.9	47.6	15.9	20.5
Infrastructure							
Housing, Property Development and Shop Office	55.7	217.6	339.2	212.1	79.5	16.0	199.0
Telephone and Telecommunication Network	242.1	359.8	152.5	138.8	243.6	97.0	76.2
Power Generation, Fuel, Gas, Petroleum and Other	96.5	44.9	12.5	51.3	14.8	1.7	0.7
Port Container Terminals	202.2	164.5	178.2	51.2	1.6	1.4	0.7
Total	**1,279.2**	**1,391.4**	**1,528.4**	**969.7**	**801.0**	**332.2**	**601.3**

(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

Source : Board of Investment of Sri Lanka

TABLE 6
Developments in Economic Infrastructure

SECTOR	2013	2014	2015	2016 (a)	2016 (a) For the Period	2017 (a) For the Period
1. Electricity					**Jan.-Jul.**	**Jan.-Jul.**
Installed Capacity (MW - End Period)	3,362	3,932	3,847	4,018	3,975	4,134
Total Power Generation (GWh)	11,898	12,357	13,090	14,149	8,141	8,374
Share of Hydropower in Total Generation (%) (b)	50	29	37	25	30	15
2. Transport					**Jan.-Jun.**	**Jan.-Jun.**
2.1 Sri Lanka Transport Board						
Operated Kilometrage (million)	344	371	440	452	223	219
Passenger Kilometrage (million)	12,201	12,717	15,210	16,101	7,770	7,737
Average No. of Operated Buses	4,373	4,226	5,284	5,315	5,306	5,219
Total Revenue (Rs. million)	30,189	33,665	35,825	40,928	20,334	20,514
Operating Expenditure (Rs. million)	33,684	35,527	40,555	42,004	20,998	19,971
Operating Profit/(Loss) (Rs. million)	(3,496)	(1,862)	(4,730)	(1,076)	(664)	542
2.2 Sri Lanka Railways						
Operated Kilometrage ('000)	10,924	11,075	11,797	11,921	5,896	5,941 (c)
Passenger Kilometrage (million)	6,257	6,842	7,407	7,413	3,577	3,639
Freight Ton Kilometrage (million)	133	130	130	140	67	71
Total Revenue (Rs. million)	5,423	5,909	6,335	6,623	3,173	3,193
Operating Expenditure (Rs. million)	10,586	16,943	14,049	13,396	6,529	7,011
Operating Profit/(Loss) (Rs. million)	(5,163)	(11,034)	(7,714)	(6,773)	(3,356)	(3,818)
2.3 New Registration of Motor Vehicles					**Jan.-Sep.**	**Jan.-Sep.**
Buses	1,805	3,851	4,140	2,685	2,011	2,356
Motor Cars	28,380	38,780	105,628	45,172	33,198	29,684
Three Wheelers	83,673	79,038	129,547	56,945	40,314	17,519
Dual Purpose Vehicles	24,603	20,799	39,456	26,887	19,336	12,613
Motor Cycles	169,280	272,885	370,889	340,129	245,350	262,012
Goods Transport Vehicles	5,872	5,121	7,142	7,563	5,326	8,503
Land Vehicles	13,038	9,082	12,105	13,947	9,620	9,528
Total Vehicles Registered	326,651	429,556	668,907	493,328	355,155	342,215
3. Port Services					**Jan.-Sep.**	**Jan.-Sep.**
Ships Arrived at Ports of Sri Lanka	3,976	4,264	4,728	4,998	3,769	3,647
Total Cargo Handling (MT '000)	66,243	74,410	77,579	86,519	64,502	69,337
Total Container Handling (TEUs '000)	4,306	4,908	5,185	5,735	4,255	4,545
Transshipments (TEUs '000)	3,274	3,781	3,967	4,435	3,304	3,523
4. Telecommunication Services					**End June**	**End June**
Fixed Access Telephones (No.)	2,706,787	2,709,848	2,601,196	2,550,432	2,597,297	2,514,154
Cellular Telephones (No.)	20,315,150	22,123,000	24,384,544	26,227,631	24,695,535	28,113,153
Internet Connections (No.)	2,009,456	3,396,295	4,090,920	4,920,554	4,232,291	5,479,328
Total Telephone Penetration						
(Telephones per 100 Persons)	112	120	129	136	129	143
Mobile Telephone Penetration						
(Telephones per 100 Persons)	99	107	116	124	116	131

(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 - 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
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
	October	114.7	118.2	5.0	5.7	4.0	5.7
	November	116.6	120.4	4.1	6.8	4.0	5.8
	December	118.0	120.5	4.2	6.7	4.0	5.9
2017	January	119.3	121.4	6.5	7.1	4.6	6.2
	February	119.9	122.0	8.2	7.1	5.1	6.4
	March	119.5	122.3	8.6	7.0	5.6	6.6
	April	121.0	122.5	8.4	5.9	6.0	6.6
	May	121.8	123.0	7.1	4.7	6.1	6.4
	June	123.4	123.1	6.3	4.1	6.1	6.1
	July	122.4	122.9	6.3	4.2	6.2	5.9
	August	122.3	123.0	7.9	4.8	6.5	5.8
	September	123.3	123.1	8.6	4.6	6.8	5.7

NCPI - National Consumer Price Index

Core NCPI - Core National Consumer Price Index

Source : Department of Census and Statistics

TABLE 8

Consumer Price Indices - Colombo Consumer Price Index

2013 = 100

PERIOD		Index		Year-on-Year Change (%)		Annual Average Change (%)	
		CCPI	Core CCPI	CCPI	Core CCPI	CCPI	Core CCPI
2015	December	109.8	113.2	4.6	6.7	2.2	4.9
2016	January	110.0	113.4	1.7	3.6	2.1	4.9
	February	109.3	113.5	2.9	4.4	2.1	5.0
	March	108.6	113.5	2.6	3.7	2.2	5.0
	April	109.5	114.1	3.4	3.5	2.4	4.9
	May	111.5	116.5	4.8	5.6	2.7	5.0
	June	113.2	116.8	5.5	5.4	3.0	5.1
	July	113.9	116.8	5.8	5.0	3.4	5.1
	August	112.1	116.0	4.4	3.8	3.7	4.9
	September	111.8	116.3	4.2	3.7	3.9	4.8
	October	112.1	116.6	4.1	3.8	4.0	4.6
	November	113.6	118.5	4.0	4.8	4.0	4.5
	December	114.7	119.8	4.5	5.8	4.0	4.4
2017	January	116.1	121.3	5.5	7.0	4.3	4.7
	February	116.7	121.6	6.8	7.1	4.6	5.0
	March	116.5	121.8	7.3	7.3	5.0	5.3
	April	117.1	121.9	6.9	6.8	5.3	5.5
	May	118.2	122.5	6.0	5.2	5.4	5.5
	June	120.1	122.8	6.1	5.1	5.5	5.5
	July	119.4	122.5	4.8	4.9	5.4	5.4
	August	118.8	123.0	6.0	6.0	5.5	5.6
	September	119.7	123.3	7.1	6.0	5.8	5.8

CCPI - Colombo Consumer Price Index

Core CCPI - Core Colombo Consumer Price Index

Source : Department of Census and Statistics

TABLE 9
Wage Rate Indices

PERIOD		Index			Year-on-Year Change (%)			Annual Average Change (%)		
		Workers in Wages Boards(a)	Public Sector Employees(b)	Informal Private Sector Employees	Workers in Wages Boards	Public Sector Employees	Informal Private Sector Employees	Workers in Wages Boards	Public Sector Employees	Informal Private Sector Employees
2014	December	4,127.0	128.8	124.1	4.8	17.3	9.3	3.7	10.5	7.6
2015	December	4,127.9	160.4	131.2	0.0	24.5	5.8	2.9	31.7	7.3
2016	December	4,128.1	160.8	143.1	0.0	0.2	9.1	0.0	3.9	7.9
2017 (c)	January	4,128.3	160.8	143.5	0.0	0.2	8.9	0.0	2.2	8.1
	February	4,128.4	160.8	145.2	0.0	0.2	9.5	0.0	1.7	8.4
	March	4,128.4	160.8	145.7	0.0	-0.4	9.2	0.0	1.1	8.5
	April	4,128.4	160.8	146.5	0.0	0.0	9.5	0.0	0.6	8.8
	May	4,128.5	160.8	147.0	0.0	0.0	8.9	0.0	0.1	9.0
	June	4,128.6	160.8	148.0	0.0	0.0	9.7	0.0	0.1	9.2
	July	4,128.7	160.8	148.2	0.0	0.0	9.3	0.0	0.1	9.3

(a) The Index numbers are calculated by the Labour Department on fixed weights based on the numbers employed as at 31 December, 1978. The wage rates used in the calculation of index numbers are nominal wages for different trades fixed by the Wages Boards.

(b) This 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 .

(c) Provisional

Sources : Department of Labour
Central Bank of Sri Lanka

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

ITEM	2013	2014	2015	2016	2017 (c)	
					First Half	Projections
Household Population, '000 (Age 15 years and above)	14,959	15,134	15,282	15,449	15,749	15,616
Labour Force, '000	8,034	8,049	8,214	8,311	8,551	8,511
Employed, '000	7,681	7,700	7,831	7,948	8,184	8,145
Unemployed, '000	353	348	383	363	367	366
Labour Force Participation Rate (% of Household Population)	53.7	53.2	53.8	53.8	54.3	54.5
Unemployment Rate (% of Labour Force)	4.4	4.3	4.7	4.4	4.3	4.3

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

(b) Data covers entire island

(c) Provisional

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

TABLE 11

Developments in External Trade

US dollars million

CATEGORY	2013	2014	2015	2016	2016 Jan.-Aug.	2017 Jan.-Aug. (a)	Growth % Jan.-Aug.
EXPORTS							
Agricultural Exports	**2,581.1**	**2,793.9**	**2,481.5**	**2,326.1**	**1,520.6**	**1,815.0**	**19.4**
Tea	1,542.2	1,628.3	1,340.5	1,269.0	835.0	1,002.7	20.1
Rubber	71.3	45.3	26.1	32.7	20.9	28.7	37.4
Coconut	204.6	356.4	351.7	366.0	238.3	240.1	0.7
Kernel Products	85.8	214.3	221.7	216.1	137.0	131.8	-3.9
Other	118.9	142.1	130.0	149.9	101.3	108.3	7.0
Spices	355.4	264.6	377.4	317.1	194.1	248.7	28.1
Vegetables	24.9	40.1	30.5	26.5	18.3	19.5	6.6
Unmanufactured Tobacco	47.6	41.3	31.8	31.2	19.9	23.5	18.0
Minor Agricultural Products	101.3	165.2	160.4	114.1	83.4	96.6	15.7
Seafood	233.7	252.7	163.1	169.6	110.7	155.4	40.4
Industrial Exports	**7,749.4**	**8,262.0**	**8,017.1 (b)**	**7,940.1 (b)**	**5,337.6 (b)**	**5,562.3**	**4.2**
Textiles and Garments	4,508.3	4,929.9	4,820.2	4,884.1	3,333.7	3,283.4	-1.5
Rubber Products	887.8	889.8	761.2	767.9	508.4	538.1	5.8
Petroleum Products	427.7	338.0	373.9	286.9	185.4	252.7	36.3
Gems, Diamonds and Jewellery	445.5	393.6	331.7	273.9	187.3	166.7	-11.0
Food, Beverages and Tobacco	235.2	289.3	306.8 (b)	323.7 (b)	222.4 (b)	259.1	16.5
Machinery and Mechanical Appliances	312.3	342.9	293.8	317.6	200.2	242.1	20.9
Printing Industry Products	36.3	52.4	45.7	42.4	17.7	28.0	58.3
Transport Equipment	146.3	151.8	243.7	131.5	80.9	138.1	70.7
Leather, Travel Goods and Footwear	76.8	138.9	135.7	165.6	115.7	107.0	-7.5
Ceramic Products	40.4	41.3	35.2	34.4	22.8	22.1	-3.0
Other Industrial Exports	632.7	694.1	669.4	712.2	463.1	525.0	13.4
Mineral Exports	**51.6**	**59.5**	**28.4**	**29.0**	**19.7**	**24.5**	**24.6**
Unclassified Exports	**12.2**	**14.7**	**19.5**	**14.5**	**10.2**	**11.3**	**10.1**
Total Exports	**10,394.3**	**11,130.1**	**10,546.5 (b)**	**10,309.7 (b)**	**6,888.1 (b)**	**7,413.1**	**7.6**
IMPORTS							
Consumer Goods	**3,182.5**	**3,852.5**	**4,713.5**	**4,319.0**	**2,824.9**	**2,952.1**	**4.5**
Food and Beverages	1,368.1	1,633.7	1,627.8	1,627.4	1,039.1	1,204.5	15.9
Rice	17.9	281.7	135.1	12.8	7.2	176.4	2,346.4
Sugar	288.9	255.5	252.5	342.5	194.5	187.5	-3.6
Dairy Products	291.0	339.4	250.9	249.3	157.1	202.9	29.2
Lentils	104.1	121.2	148.0	139.4	86.8	81.8	-5.7
Other	666.1	636.0	841.3	883.4	593.6	555.8	-6.4
Other Consumer Goods	1,814.4	2,218.8	3,085.7	2,691.5	1,785.8	1,747.6	-2.1
Vehicles	582.2	896.7	1,359.6	794.8	547.1	505.0	-7.7
Medical and Pharmaceuticals	378.3	380.5	459.8	525.8	354.2	334.9	-5.4
Home Appliances	192.2	156.4	221.0	270.7	175.6	168.2	-4.2
Clothing and Accessories	201.7	282.7	390.1	365.8	243.2	262.3	7.9
Other	460.0	502.5	655.0	734.4	465.7	477.2	2.5
Intermediate Goods	**10,553.7**	**11,397.7**	**9,638.2**	**9,870.0**	**6,309.0**	**7,271.7**	**15.3**
Fuel	4,308.2	4,597.3	2,699.6	2,481.0	1,500.8	2,152.8	43.4
Textiles and Textile Articles	2,045.8	2,327.6	2,296.2	2,704.9	1,764.7	1,781.3	0.9
Diamonds, Precious Stones and Metals	482.9	175.4	161.5	514.4	299.3	474.6	58.6
Chemical Products	734.3	808.2	870.3	856.3	568.1	549.9	-3.2
Wheat and Maize	323.2	404.7	357.2	249.2	164.5	225.2	36.9
Fertiliser	238.7	272.4	289.6	136.9	99.2	64.0	-35.4
Other Intermediate Goods	2,420.8	2,812.0	2,963.7	2,927.3	1,912.4	2,023.9	5.8
Investment Goods	**4,252.7**	**4,152.2**	**4,567.0**	**5,198.0**	**3,259.6**	**3,237.7**	**-0.7**
Machinery and Equipment	2,221.9	2,131.0	2,278.1	2,740.7	1,815.4	1,738.3	-4.2
Building Materials	1,357.2	1,308.9	1,352.0	1,568.7	1,025.7	1,054.8	2.8
Transport Equipment	667.8	707.3	930.9	880.2	414.3	438.6	5.9
Other Investment Goods	5.8	4.9	5.9	8.5	4.1	6.0	45.8
Unclassified Imports	**13.9**	**14.4**	**15.9**	**13.1**	**9.4**	**137.5**	**1,358.3**
Total Imports	**18,002.8**	**19,416.8**	**18,934.6**	**19,400.1**	**12,402.9**	**13,599.1**	**9.6**

(a) Provisional
(b) Revised

Sources : Sri Lanka Customs
Ceylon Petroleum Corporation and 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	2015	2016 (b)	First Half	
			2016 (c)	2017 (b)
Current Account Balance	**-1,883**	**-1,942**	**-644**	**-1,480**
Trade Balance	**-8,388**	**-9,090**	**-4,191**	**-4,753**
Exports	10,546	10,310	5,130	5,398
Imports	18,935	19,400	9,321	10,151
Services (net)	**2,325**	**2,879**	**1,314**	**1,407**
Receipts	6,397	7,138	3,493	3,646
Payments	4,072	4,259	2,179	2,239
Primary Income (net)	**-2,013**	**-2,184**	**-971**	**-1,038**
Receipts	127	120	59	73
Payments	2,140	2,304	1,030	1,111
Secondary Income (net)	**6,193**	**6,453**	**3,204**	**2,904**
Secondary Income: credit	7,007	7,260	3,619	3,362
Secondary Income: debit	814	807	414	458
Capital Account (net)	**46**	**26**	**1**	**8**
Capital Account: credit	71	46	21	23
Capital Account: debit	24	21	21	15
Current and Capital Account (net)	**-1,836**	**-1,917**	**-643**	**-1,473**
Financial Account (net) (d)	**-2,312**	**-2,117**	**-1,234**	**-1,295**
Direct Investment: Assets	**53**	**237**	**118**	**37**
Direct Investment: Liabilities	**680**	**898**	**173**	**509**
Portfolio Investment: Assets	**0.02**	**-0.01**	**-0.01**	**-**
Debt Securities	0.02	-0.01	-0.01	-
Portfolio Investment: Liabilities	**686**	**993**	**-623**	**1,036**
Equity and Investment Fund Shares	-60	24	-45	201
Debt Securities	747	969	-578	835
Financial Derivatives	-	-	-	-
Other Investment: Assets	**503**	**317**	**-62**	**-250**
Currency and Deposits	143	5	-134	-87
Trade Credit and Advances	116	-67	-56	38
Other Accounts Receivable	244	379	128	-201
Other Investment: Liabilities	**1,857**	**308**	**-259**	**808**
Currency and Deposits	1,457	-609	-981	-607
Loans	759	753	740	1,314
Trade Credits and Advances	-401	109	15	151
Other Accounts Payable	41	55	-34	-50
Special Drawing Rights	-	-	-	-
Reserve Assets	**354**	**-472**	**-2,000**	**1,270**
Net Errors and Omissions	**-476**	**-201**	**-591**	**177**
Overall Balance	**-1,489**	**-500**	**-1,186**	**1,563**

(a) This presentation is a summery of the BPM6 format and conforms to the latest (sixth) edition of the 'Balance of Payments and International Investment Position' Manual (BPM6) of the Inetrnational 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	2016 (a)		June 2017 (a)	
	Assets	Liabilities	Assets	Liabilities
Direct Investment (b)	**1,136**	**9,745**	**1,173**	**10,249**
Equity and Investment Fund Shares	1,131	6,943	1,166	7,221
Debt Instruments	5	2,802	7	3,027
Portfolio Investment	**0.1**	**13,772**	**0.1**	**15,019**
Equity and Investment Fund Shares		1,507		1,726
Debt Securities (c)	0.1	12,265	0.1	13,293
Deposit-taking Corporations	0.1	2,190	0.1	1,691
General Government		9,903		11,424
Other Sectors		172		178
Other Investment	**2,931**	**31,519**	**2,681**	**32,827**
Currency and Deposits	**706**	**2,442**	**619**	**1,835**
Central Bank	-	403	-	2
Deposit-taking Corporations	706	2,039	619	1,832
Loans	-	**26,530**	-	**28,324**
Central Bank	-	554	-	382
Deposit-taking Corporations	-	4,562	-	5,464
General Government	-	17,295	-	18,274
Other Sectors (d)	-	4,119	-	4,205
Trade Credit and Advances	**610**	**1,483**	**648**	**1,634**
Deposit-taking Corporations	93	-	101	-
Other Sectors (e)	517	1,483	547	1,634
Other Accounts Receivable/Payable	**1,615**	**533**	**1,414**	**483**
Central Bank (f)	-	533	-	483
Deposit-taking Corporations	1,615	-	1,414	-
Special Drawing Rights		**532**		**550**
Reserve Assets	**6,019**		**6,959**	
Monetary Gold	830		890	
Special Drawing Rights	2		0.3	
Reserve Position in the IMF	64		67	
Other Reserve Assets	5,122		6,002	
Currency and Deposits	2,644		3,847	
Debt Securities	2,478		2,155	
Total Assets / Liabilities	**10,086**	**55,036**	**10,813**	**58,094**
Net International Investment Position		**-44,949**		**-47,281**
IIP- Maturity-wise Breakdown				
Short Term	6,299	8,853	7,180	9,264
Long Term	3,788	46,182	3,633	48,831

(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

Source : Central Bank of Sri Lanka

TABLE 14

Outstanding External Debt Position

US dollars million
(End Period Position)

ITEM	2015	2016 (a)	June 2017 (a)
General Government	**24,681**	**27,197**	**29,697**
Short Term	**33**	**80**	**71**
Debt Securities (Treasury Bills) (b)	33	80	71
Long Term	**24,647**	**27,118**	**29,626**
Debt Securities	8,501	9,823	11,352
Treasury Bonds (b)	1,811	1,440	1,087
SLDBs (c)	265	58	31
International Sovereign Bonds (d)	6,425	8,325	10,235
Loans	16,147	17,295	18,274
Central Bank	**2,823**	**2,022**	**1,417**
Short Term	**483**	**536**	**485**
Currency and Deposits	5	3	2
Other Accounts Payable (ACU Liabilities)	478	533	483
Long Term	**2,340**	**1,486**	**932**
Special Drawing Rights allocation	548	532	550
Currency and Deposits	1,100	400	-
Loans (IMF-SBA and EFF Facility)	692	554	382
Deposit-taking Corporations	**9,156**	**8,790**	**8,987**
Short Term	**5,762**	**5,247**	**5,347**
Currency and Deposits (e)	1,946	2,039	1,832
Loans	3,816	3,209	3,514
Long Term	**3,393**	**3,543**	**3,640**
Debt Securities (d)	2,140	2,190	1,691
Loans	1,253	1,354	1,950
Other Sectors (f)	**5,567**	**5,774**	**6,018**
Short Term	**1,375**	**1,483**	**1,634**
Trade Credit and Advances (g)	1,375	1,483	1,634
Long Term	**4,192**	**4,291**	**4,383**
Debt Securities (d)	164	172	178
Loans	4,028	4,119	4,205
Private Sector Corporations	1,604	1,876	2,052
State Owned Business Enterprises and Public Corporations	2,423	2,242	2,153
Direct Investment: Intercompany Lending (h)	**2,613**	**2,802**	**3,027**
Gross External Debt Position	**44,839**	**46,586**	**49,147**
As a Percentage of GDP			
Gross External Debt	55.7	57.3	60.2
Short Term Debt	9.5	9.0	9.2
Long Term Debt	46.2	48.3	51.0

(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)
	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
	2016	149.8000	184.0443	157.8742	1.2867	2.2056	201.3810
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
	October	147.1136	179.1991	161.2733	1.4027	2.2026	202.1120
	November	147.9500	184.6342	157.5520	1.3176	2.1559	200.2890
	December	149.8000	184.0443	157.8742	1.2867	2.2056	201.3810
2017	January	150.2429	187.9614	160.7299	1.3231	2.2158	204.1550
	February	151.2500	188.0264	160.0906	1.3435	2.2676	204.7760
	March	151.7354	189.5327	162.0306	1.3538	2.3394	205.8820
	April	151.9000	196.0953	165.1305	1.3665	2.3692	208.2590
	May	152.5000	195.5508	170.4264	1.3729	2.3598	211.1090
	June	153.5100	199.9314	175.6154	1.3728	2.3741	213.5920
	July	153.7278	201.9061	180.4764	1.3918	2.3977	216.4100
	August	152.8350	197.3788	181.5145	1.3833	2.3884	216.0150
	September	153.0983	205.3890	180.3651	1.3594	2.3384	216.3730

(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	2013	2014	2015	2016 (a)	2016 Jan.-Aug. (a)	2017 Jan.-Aug. (a)	2017 Estimates
				Rs. million			
Total Revenue and Grants	**1,153,306**	**1,204,621**	**1,460,892**	**1,693,558**	**1,014,088**	**1,174,639**	**2,020,300**
Total Revenue	1,137,447	1,195,206	1,454,878	1,686,062	1,013,395	1,172,374	2,010,300
Tax Revenue	1,005,895	1,050,362	1,355,779	1,463,689	931,980	1,094,948	1,827,000
Non Tax Revenue	131,552	144,844	99,099	222,374	81,415	77,426	183,300
Grants	15,859	9,415	6,014	7,496	693	2,265	10,000
Expenditure and Net Lending	**1,669,396**	**1,795,865**	**2,290,394**	**2,333,883**	**1,499,138**	**1,694,859**	**2,645,300**
Recurrent	1,205,180	1,322,898	1,701,658	1,757,782	1,159,488	1,294,354	1,946,000
Capital and Net Lending	464,216	472,967	588,737	576,101	339,650	400,505	699,300
o/w Public Investment	481,203	486,610	602,767	594,013	348,795	404,859	708,300
Current Account Surplus (+)/Deficit (-)	**-67,733**	**-127,692**	**-246,779**	**-71,719**	**-146,093**	**-121,980**	**64,300**
Primary Account Surplus (+)/Deficit (-)	**-72,083**	**-154,849**	**-319,827**	**-29,430**	**-70,465**	**-1,590**	**55,087**
Overall Fiscal Surplus (+)/Deficit (-)	**-516,090**	**-591,244**	**-829,502**	**-640,325**	**-485,050**	**-520,220**	**-625,000**
Total Financing	**516,090**	**591,244**	**829,502**	**640,325**	**485,050**	**520,220**	**625,000**
Foreign Financing	123,700	212,523	236,803	391,914	175,560	246,731	332,000
Loans	67,905	14,562	131,253	109,293	37,633	15,112	52,000
Commercial Loans	-	197,171	232,751	319,689	136,828	224,604	220,000
Non Resident Investments in Treasury Bills/ Bonds	55,795	790	-127,201	-37,069	1,099	7,015	60,000
Domestic Financing	392,390	378,721	592,699	248,411	309,490	273,489	293,000
Market Borrowings	379,390	392,084	592,699	248,411	309,490	273,489	293,000
Non Bank	82,414	265,155	300,858	108,456	171,384	37,034	261,000
Bank	296,977	126,929	291,841	139,955	138,106	236,456	32,000
Other Borrowings	13,000	-13,363	-	-	-	-	-
				As a per cent of GDP			
Total Revenue and Grants	**12.0**	**11.6**	**13.3**	**14.3**	**8.2**	**9.0**	**15.0**
Total Revenue	11.9	11.5	13.3	14.2	8.2	9.0	14.9
Tax Revenue	10.5	10.1	12.4	12.4	7.6	8.4	13.5
Non Tax Revenue	1.4	1.4	0.9	1.9	0.7	0.6	1.4
Grants	0.2	0.1	0.1	0.1	...	...	0.1
Expenditure and Net Lending	**17.4**	**17.3**	**20.9**	**19.7**	**12.2**	**13.0**	**19.6**
Recurrent	12.6	12.8	15.5	14.8	9.4	10.0	14.4
Capital and Net Lending	4.8	4.6	5.4	4.9	2.8	3.1	5.2
o/w Public Investment	5.0	4.7	5.5	5.0	2.8	3.1	5.2
Current Account Surplus (+)/Deficit (-)	**-0.7**	**-1.2**	**-2.3**	**-0.6**	**-1.2**	**-0.9**	**0.5**
Primary Account Surplus (+)/Deficit (-)	**-0.8**	**-1.5**	**-2.9**	**-0.2**	**-0.6**	**...**	**0.4**
Overall Fiscal Surplus (+)/Deficit (-)	**-5.4**	**-5.7**	**-7.6**	**-5.4**	**-3.9**	**-4.0**	**-4.6**
Total Financing	**5.4**	**5.7**	**7.6**	**5.4**	**3.9**	**4.0**	**4.6**
Foreign Financing	1.3	2.1	2.2	3.3	1.4	1.9	2.5
Loans	0.7	0.1	1.2	0.9	0.3	0.1	0.4
Commercial Loans	-	1.9	2.1	2.7	1.1	1.7	1.6
Non Resident Investments in Treasury Bills/ Bonds	0.6	...	-1.2	-0.3	...	0.1	0.4
Domestic Financing	4.1	3.7	5.4	2.1	2.5	2.1	2.2
Market Borrowings	4.0	3.8	5.4	2.1	2.5	2.1	2.2
Non Bank	0.9	2.6	2.7	0.9	1.4	0.3	1.9
Bank	3.1	1.2	2.7	1.2	1.1	1.8	0.2
Other Borrowings	0.1	-0.1	-	-	-	-	-

(a) Provisional

Source : Ministry of Finance and Mass Media

TABLE 17

Developments in Monetary Aggregates and Underlying Factors

Rs. million (End Period)

ITEM	2013	2014	2015	2016	August 2017 (a)
1. Reserve Money	**488,586**	**577,912**	**673,432**	**856,147**	**911,389**
(year-on-year change in per cent)	0.9	18.3	16.5	27.1	16.0
Net Foreign Assets of the Central Bank	529,128	688,007	576,187	558,589	745,768
Net Domestic Assets of the Central Bank	-40,543	-110,095	97,245	297,557	165,621
2. Narrow Money (M_1)	**484,578**	**612,155**	**714,988**	**776,624**	**759,137**
(year-on-year change in per cent)	7.7	26.3	16.8	8.6	6.3
3. Broad Money (M_{2b})	**3,417,853**	**3,875,853**	**4,565,917**	**5,405,596**	**6,050,583**
(year-on-year change in per cent)	16.7	13.4	17.8	18.4	21.3
3.1 Net Foreign Assets	-76,325	15,126	-298,163	-231,238	-50,097
Monetary Authorities	529,128	688,007	576,187	558,589	745,768
Commercial Banks	-605,453	-672,881	-874,350	-789,827	-795,865
3.2 Net Domestic Assets	3,494,178	3,860,727	4,864,081	5,636,834	6,100,680
Domestic Credit	4,200,783	4,640,146	5,732,034	6,671,677	7,349,510
Net Credit to the Government	1,301,342	1,435,900	1,759,492	1,972,133	2,237,515
Central Bank	114,007	149,672	229,926	413,016	293,545
Commercial Banks	1,187,335	1,286,228	1,529,566	1,559,116	1,943,970
Credit to Public Corporations	365,098	446,047	522,966	495,114	502,943
(year-on-year change in per cent)	24.8	22.2	17.2	-5.3	13.9
Credit to the Private Sector	2,534,343	2,758,199	3,449,577	4,204,430	4,609,052
(year-on-year change in per cent)	7.5	8.8	25.1	21.9	18.0
Other Items (net)	-706,605	-779,418	-867,954	-1,034,843	-1,248,830
Memorandum Items:					
Money Multiplier (M_{2b})	7.00	6.71	6.78	6.31	6.64
Velocity (M_{2b} average) (b)	2.99	2.85(c)	2.62(c)	2.40(c)	n.a.

(a) Provisional
(b) Based on GDP estimates by the Department of Census and Statistics
(c) Revised

Source : Central Bank of Sri Lanka

TABLE 18

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

CATEGORY	End June 2016 (d)		End June 2017 (e)		% Change
	Amount (Rs. mn)	As a % of Total	Amount (Rs. mn)	As a % of Total	
1. Agriculture and Fishing	**316,993**	**8.3**	**382,033**	**8.4**	**20.5**
of which...					
Tea	78,051	2.0	84,610	1.9	8.4
Rubber	20,411	0.5	25,265	0.6	23.8
Coconut	12,541	0.3	19,567	0.4	56.0
Paddy	23,456	0.6	32,323	0.7	37.8
Vegetable and Fruit Cultivation and Minor Food Crops	22,000	0.6	27,200	0.6	23.6
Livestock and Dairy Farming	13,061	0.3	17,644	0.4	35.1
Fisheries	12,254	0.3	16,767	0.4	36.8
2. Industry	**1,539,581**	**40.2**	**1,863,992**	**41.0**	**21.1**
of which...					
Construction	740,963	19.3	902,762	19.8	21.8
of which...					
Personal Housing including Purchasing/Construction/Repairs	354,255	9.2	435,454	9.6	22.9
Staff Housing	66,261	1.7	70,991	1.6	7.1
Food and Beverages	86,472	2.3	103,627	2.3	19.8
Textiles and Apparel	144,718	3.8	156,759	3.4	8.3
Wood and Wood Products including Furniture	14,692	0.4	15,651	0.3	6.5
Paper and Paper Products	11,758	0.3	14,493	0.3	23.3
Chemical, Petroleum, Pharmaceutical and Healthcare, and Rubber and Plastic Products	77,939	2.0	82,758	1.8	6.2
Non-metallic Mineral Products	14,961	0.4	17,944	0.4	19.9
Basic Metal Products	20,702	0.5	28,182	0.6	36.1
Fabricated Metal Products, Machinery and Transport Equipment	126,529	3.3	158,490	3.5	25.3
Other Manufactured Products	16,179	0.4	20,477	0.5	26.6
3. Services	**1,149,743**	**30.0**	**1,331,024**	**29.3**	**15.8**
of which...					
Wholesale and Retail Trade	353,623	9.2	399,951	8.8	13.1
Tourism	118,778	3.1	160,429	3.5	35.1
Financial and Business Services	282,150	7.4	306,580	6.7	8.7
Transport	56,731	1.5	72,458	1.6	27.7
Communication and Information Technology	56,808	1.5	61,177	1.3	7.7
Printing and Publishing	16,841	0.4	21,677	0.5	28.7
Education	8,881	0.2	10,321	0.2	16.2
Health	29,034	0.8	31,916	0.7	9.9
Shipping, Aviation and Freight Forwarding	26,065	0.7	22,708	0.5	-12.9
4. Personal Loans and Advances (f)	**824,209**	**21.5**	**972,084**	**21.4**	**17.9**
of which...					
Consumer Durables	171,955	4.5	207,018	4.6	20.4
Pawning	122,309	3.2	137,517	3.0	12.4
Credit Cards	66,912	1.7	82,003	1.8	22.6
Personal Education	2,078	0.1	2,415	0.1	16.3
Personal Healthcare	2,728	0.1	3,848	0.1	41.1
Other	416,501	10.9	502,607	11.0	20.7
5. Total	**3,830,526**	**100.0**	**4,549,133**	**100.0**	**18.8**

Source : Central Bank of Sri Lanka

(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) Total values in this Table differ from credit to the private sector values in Table 17 due to differences in the compilation methodologies.

(d) Revised

(e) Provisional

(f) Excludes personal housing loans, which have been included under 'Construction' classified under 'Industry' and includes Safety Net Scheme related loans.

TABLE 19
Selected Interest Rates

Per cent per annum

END PERIOD RATE	2013	2014	2015	2016	2017 September
1. Standing Deposit Facility Rate (SDFR) (a)	6.50	6.50	6.00	7.00	7.25
2. Standing Lending Facility Rate (SLFR) (a)	8.50	8.00	7.50	8.50	8.75
3. Bank Rate (b)	15.00	15.00	15.00	15.00	15.00
4. Average Weighted Prime Lending Rate (AWPR) - Weekly	10.13	6.26	7.53	11.52	11.55
5. Average Weighted Deposit Rate (AWDR)	9.37	6.20	6.20	8.17	9.25
6. Average Weighted Call Money Rate (AWCMR)	7.66	6.21	6.40	8.42	8.11
7. Treasury Bill Yields (c)					
91-day	7.54	5.74	6.45	8.72	8.71
364-day	8.29	6.01	7.30	10.17	9.10
8. Treasury Bond Yields (c)					
2-year	-	-	6.70	11.04	9.83
3-year	10.87	-	8.18	11.62	-
4-year	-	-	8.91	11.94	11.14
5-year	10.64	8.93	9.79	11.76	10.09
6-year	10.97	-	9.90	12.03	11.21
9. Rates on Foreign Currency Deposits					
Savings Deposits - US Dollar	0.02-2.68	0.01-3.25	0.02-3.00	0.02 - 3.62	0.02-4.23
Fixed Deposits - US Dollar (1 year)	0.15-5.00	0.06-4.25	0.14-4.25	0.15 - 5.00	0.15-6.15
10. National Savings Bank					
Savings Deposits	5.00	5.00	5.00	4.25	4.00
Fixed Deposits (1 year)	9.50	6.50	7.25	11.00	11.00

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

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

TABLE 20
Expansion of Banking Activities (a)

CATEGORY	2013	2014	2015	2016 (b)	2017 (b) Jan.-Jun.
1. Number of Banks	33	34	32	32	32
2. Number of Bank Branches Excluding Students Savings Units (c)	3,306	3,377	3,452	3,524	3,543
3. Number of Automated Teller Machines (ATMs)	3,122	3,344	3,569	3,871	4,035
4. Number of Credit Cards Issued (d)	166,181	176,750	198,843	264,058	130,953
5. Number of Credit Cards in Use	951,625	1,032,833	1,145,055	1,315,915	1,392,931
6. Number of Debit Cards Issued (d)	2,324,579	2,872,673	2,798,873	3,025,664	1,734,352
7. Number of Debit Cards in Use	12,441,743	13,591,317	15,243,811	17,732,516	18,167,593
8. Number of Phone Banking Transactions (d)	300,094	731,773	1,992,826	3,444,065	1,871,613
9. Number of Internet Based Transactions (d)	8,942,384	10,817,849	13,725,195	18,163,636	10,734,964
10. Banking Density (e)	16.1	16.3	16.5	16.6	n.a.

(a) End Period
(b) Provisional
(c) Revised
(d) During the period
(e) Number of branches per 100,000 people

Source : Central Bank of Sri Lanka

TABLE 21
Money and Capital Market Developments

Rs. million

CATEGORY	2013	2014	2015	2016	2017 (a) Jan.-Sep.
Money Market					
Call Money Market					
Total Turnover	2,079,206	2,198,356	2,827,930	3,493,392	2,709,772
Treasury Bill Market					
Total Amount Issued (b)	1,235,304	1,121,705	1,589,527	1,635,349	1,286,604
Total Outstanding (b) (c)	774,052	750,267	663,285	792,396	782,039
Capital Market					
Treasury Bond Market					
Total Amount Issued (b)	1,017,134	860,695	869,923	663,616	476,315
Total Outstanding (b) (c)	2,951,809	3,341,727	3,699,945	4,053,575	4,114,967
Listed Corporate Bond Market					
Total Amount Issued	68,262	51,235	83,414	77,995	10,000
Total Issues (Number)	28	20	25	17	2
Total Turnover	2,229	7,140	4,714	2,932	2,937
Market Value of Listed Corporate Debt	100,838	160,924	232,458	289,324	283,006
Share Market					
ASPI (1985 = 100) (c)	5,913	7,299	6,895	6,228	6,438
S&P SL 20 (2004=1,000) (c)	3,264	4,089	3,626	3,496	3,688
Total Turnover	200,468	340,917	253,251	176,935	165,574
Net Foreign Purchase	22,783	21,217	-5,372	338	17,185
Market Capitalisation (c)	2,459,897	3,104,860	2,938,000	2,745,410	2,919,698

(a) Provisional
(b) Face Value
(c) End Period

Sources : Central Bank of Sri Lanka
Colombo Stock Exchange

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