



EMPOWERING INVESTORS AND MARKETS FOR 150 YEARS

# Sri Lanka Economic Outlook 2011

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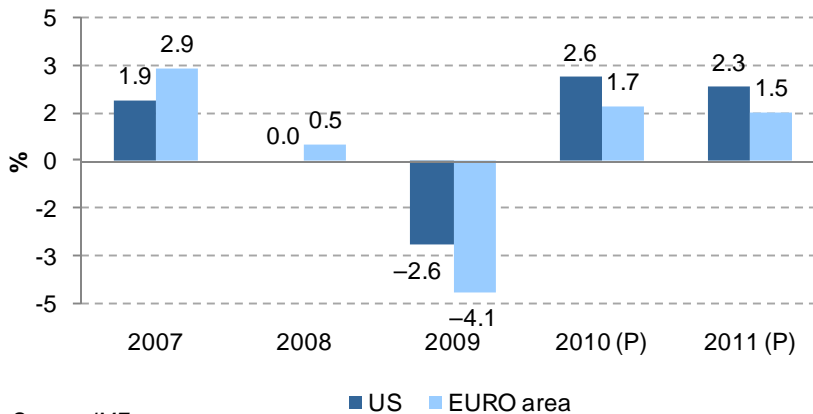
# Key Messages

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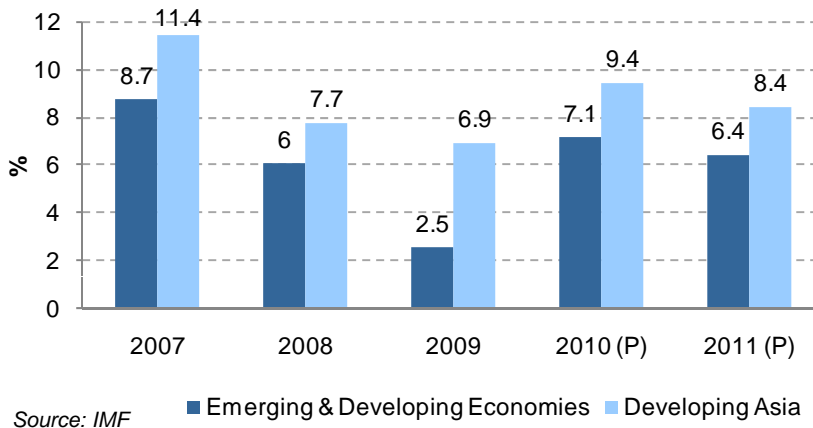
- **Economic uncertainty prevails in the advanced economies; developing economies have better prospects**
- **South Asia has strong growth prospects, but inflation is a concern**
- **S&P expects Sri Lanka will grow 6.5% in 2010, and 6.8% in 2011**
  - Expected economic reforms under the IMF program are a key factor
  - The return of peace has improved investor confidence
- **Fiscal risks remain due to Sri Lanka's high debt and interest burdens**

# The Global Economy

GDP growth in US & EU



GDP growth in Emerging & Developing Economies



- **The economic recovery in the US is a 'half-speed' recovery**

- Consumption spending is weak. Growth projection for 2010 lowered to 2.6% from 3.3%

- **The recoveries in the EU and the UK were affected by the situation in Greece**

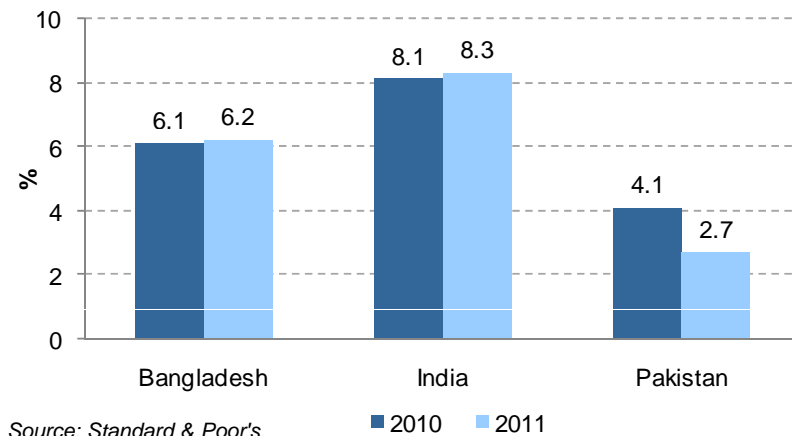
- Fears of a widespread financial collapse have eased due to concerted action
- But fiscal tightening and elevated unemployment will weigh on domestic demand

- **Developing economies, especially in Asia, have strong growth prospects**

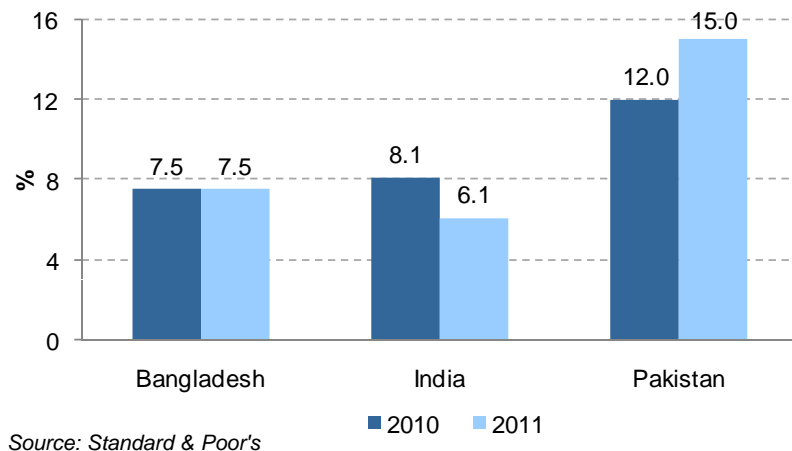
- Asian banks' capitalization remains adequate and can drive credit growth
- Surging capital inflows lead to sharp currency appreciation; this may trigger 'currency wars'

# South Asian Economies

## Projections of Real GDP Growth

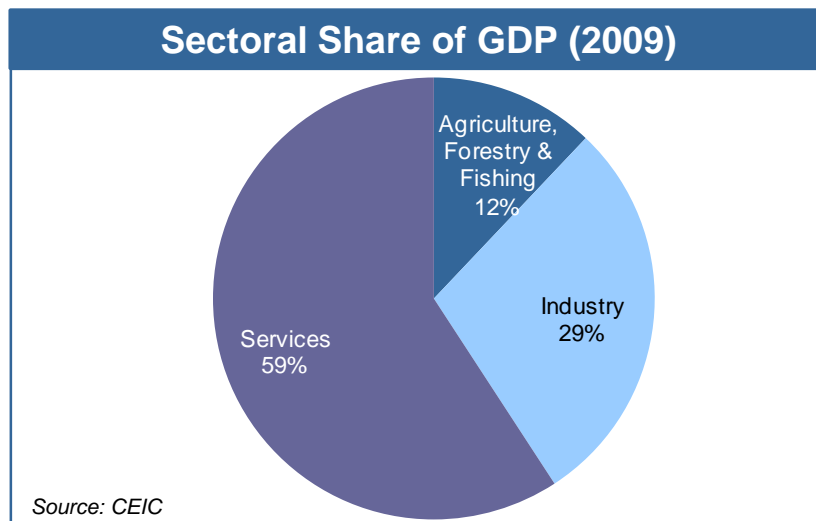
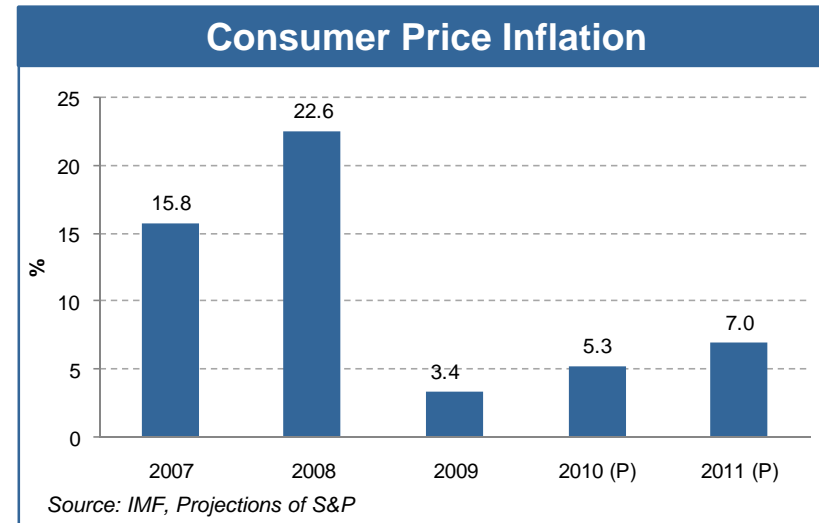
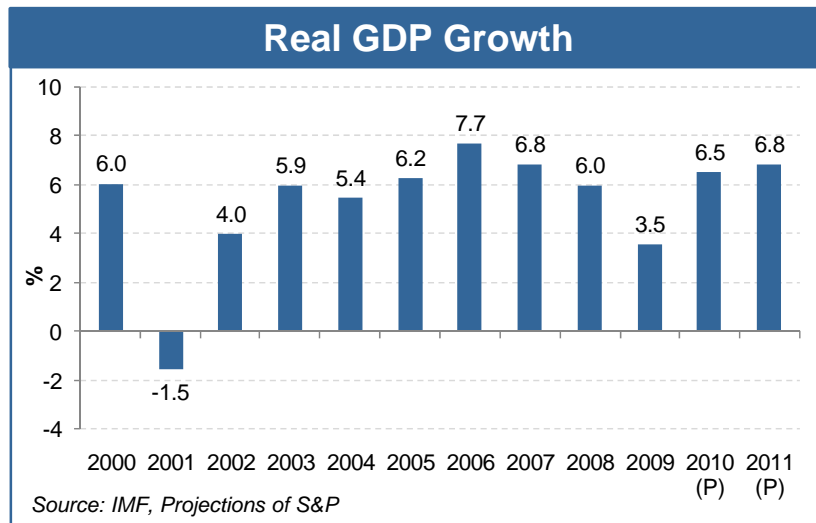


## Projections of Consumer Price Inflation



- **South Asia has strong growth prospects, but inflation is a concern**
  - S&P expects the Indian economy will grow by 8.3% in 2011. This is based on a steep gain in industrial output, and resurgent private consumption, investment, and exports
  - Pakistan's GDP growth is set to moderate significantly to around 2.7% in 2011. Inflation is a major concern for Pakistan
  - Bangladesh's economy expanded 6.1% during fiscal year 2009-10. The growth momentum will be maintained in 2010 and 2011

# Sri Lanka's GDP Growth to Accelerate in 2010 and 2011



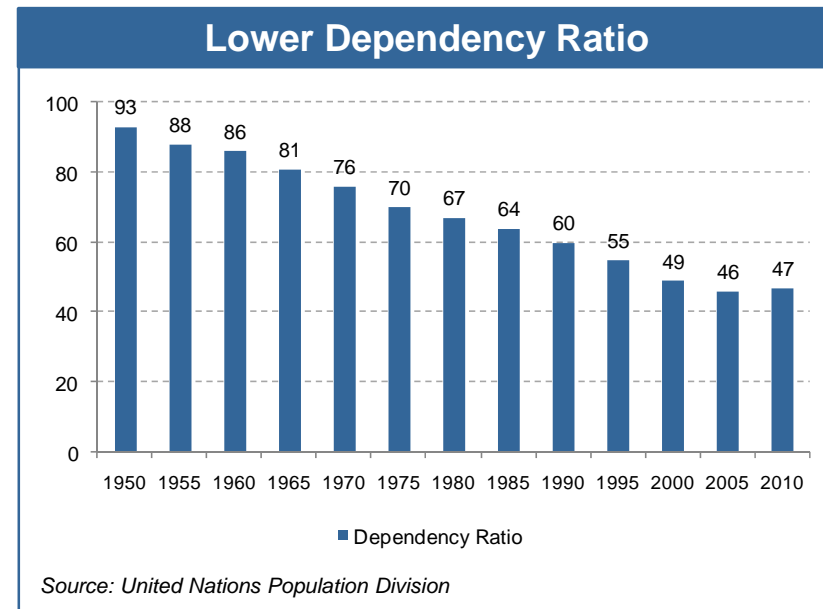
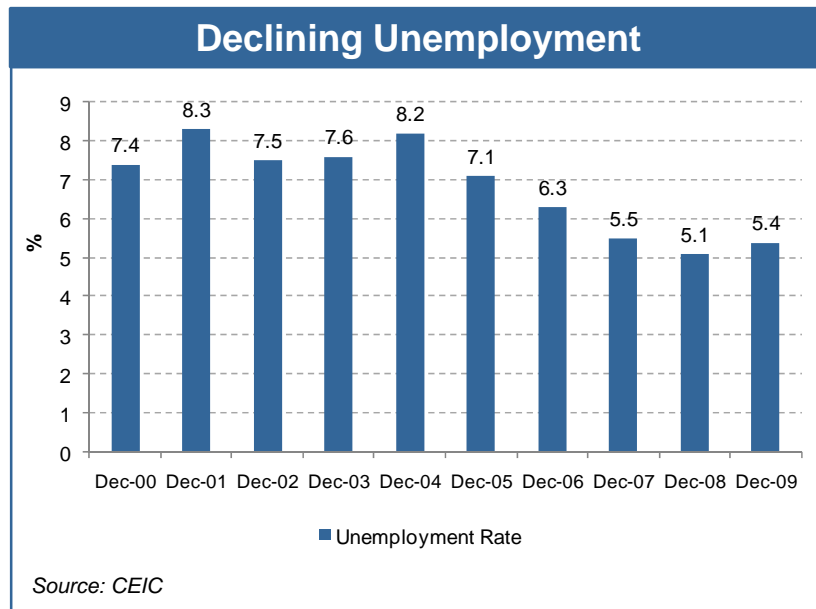
- Sri Lanka has weathered the 2008-2009 financial crisis better than many other countries
- Sri Lanka has strong growth prospects: S&P expects Sri Lanka will grow 6.5% in 2010, and 6.8% in 2011
- Inflation has moderated in 2009. S&P expects inflation will rise to 5.3% in 2010, and 7% in 2011

# Drivers of Sri Lanka's Growth

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- **Sri Lanka recorded a GDP growth rate of 8.5% in the second quarter of 2010**
  - This is Sri Lanka's highest-ever recorded quarterly GDP growth since 2002. Agriculture, Industry and Services registered significant growth rates of 5.1%, 9.2% and 8.8%, respectively
  - This comes on top of growth of 7.1% in Q1, 2010 and 6.2% in Q4, 2009
- **Growth momentum propelled by broad-based growth across Industry sub-sectors**
- **Growth in Services, both government and private services, remains strong**
- **Strong growth in tourist arrivals and sustained activity in tourism-related segments**
- **Private remittance flows also remain strong**

# Sri Lanka's Changing Demographics – A Key Factor



- **Demographic trends have supported Sri Lanka's growth**
- **The declining unemployment rate is a key lagging indicator of the long-term growth trend of Sri Lanka**
- **Declining dependency ratio augurs well for growth prospects of the economy**
  - The lower ratio means the overall economy faces a smaller burden in supporting its non-productive population

# Growth in Emerging Industry Sectors

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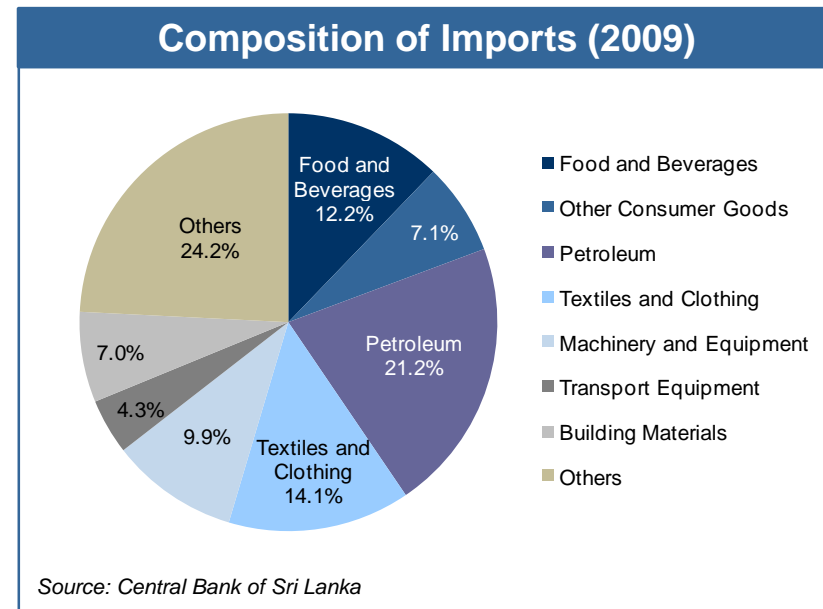
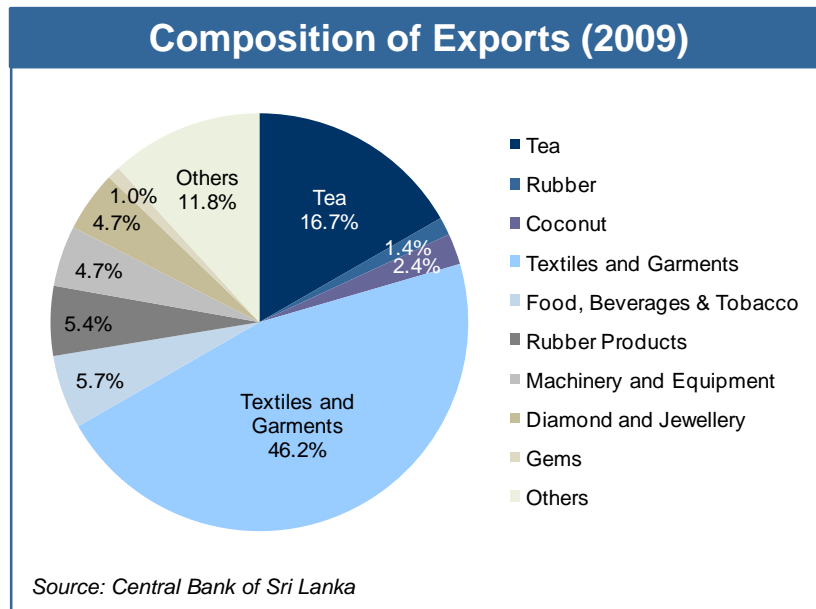
## Travel and Tourism

- The end of the internal conflict has opened up new vistas for the travel and tourism sector in Sri Lanka
- Tourism holds vast income and employment generation potential for Sri Lanka. The sector employs around 125,153 people in 2009
- The largest number of tourist arrivals was recorded from India (83,634), followed by the UK (81,594) in 2009

## IT-ITES

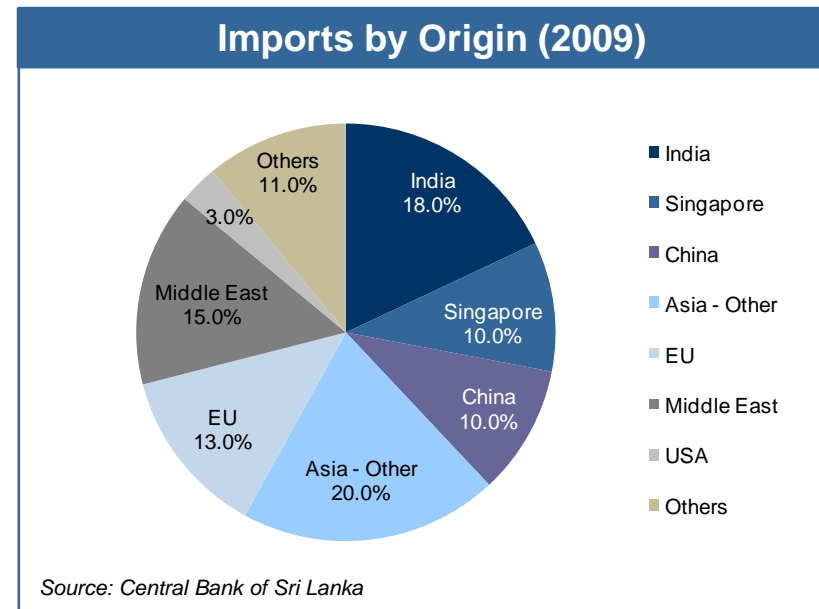
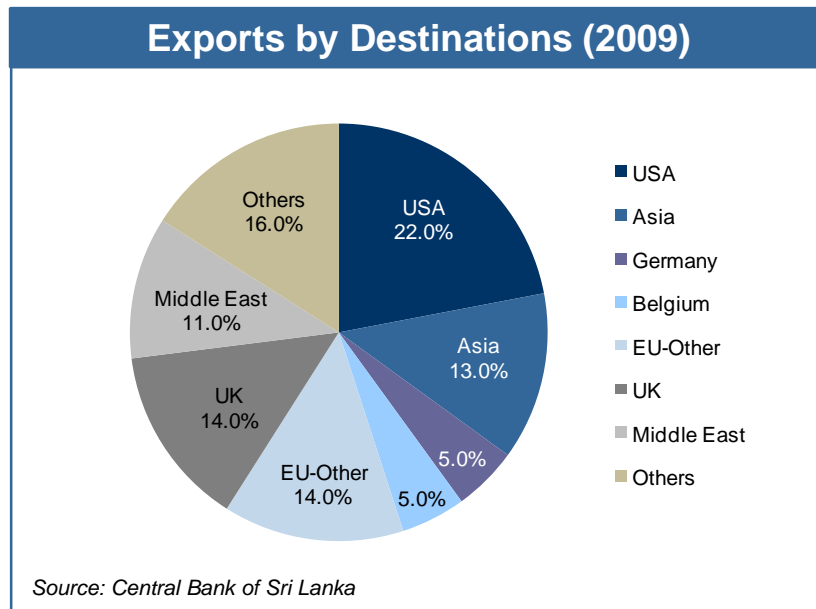
- Despite the economic slowdown, this sector has grown around 6.5% in 2009. The sector contributed a net inflow of USD245 million in 2009
- Positive factors driving the sector are the availability of qualified IT engineers, high literacy rates, strong English language skills, sound legal framework for IT development, and liberalization of the international telecommunications gateway

# Composition of Sri Lanka's Trade



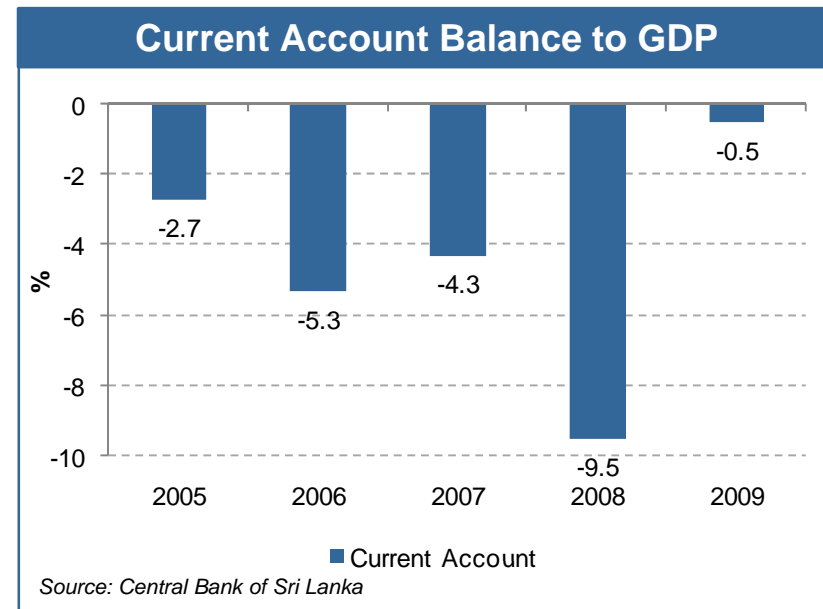
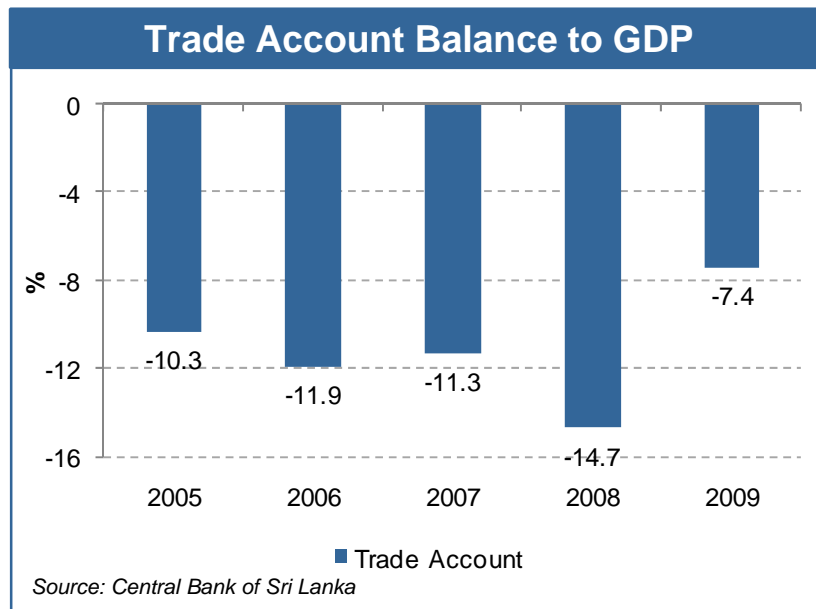
- **Industrial Exports constitute 74.9% of exports; Agriculture constitutes 23.9%**
  - Textiles and Garments, the largest export category, contributes 46.2%
- **Intermediate Goods constitute 55.5% of imports; Investment Goods constitute 24%**
  - Petroleum, the largest import category, contributes 21.2%

# Sri Lanka's Trade Partners



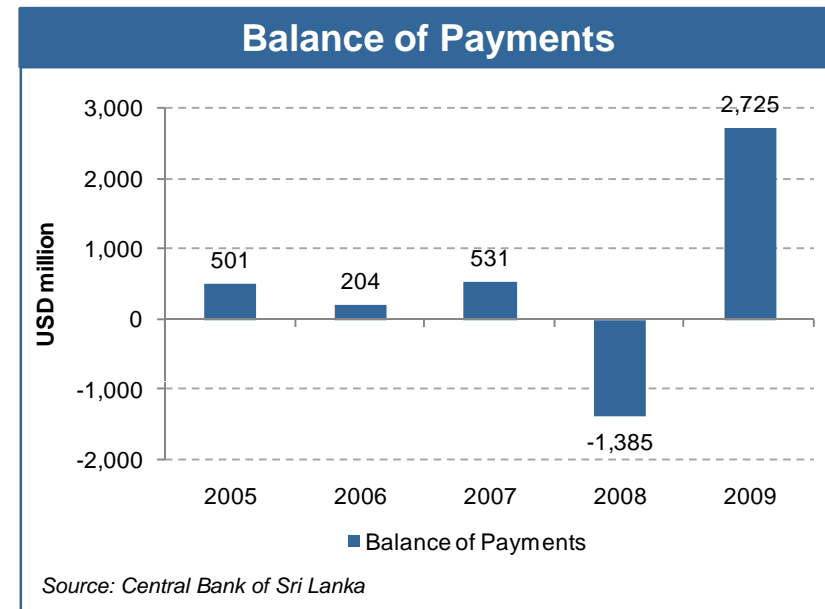
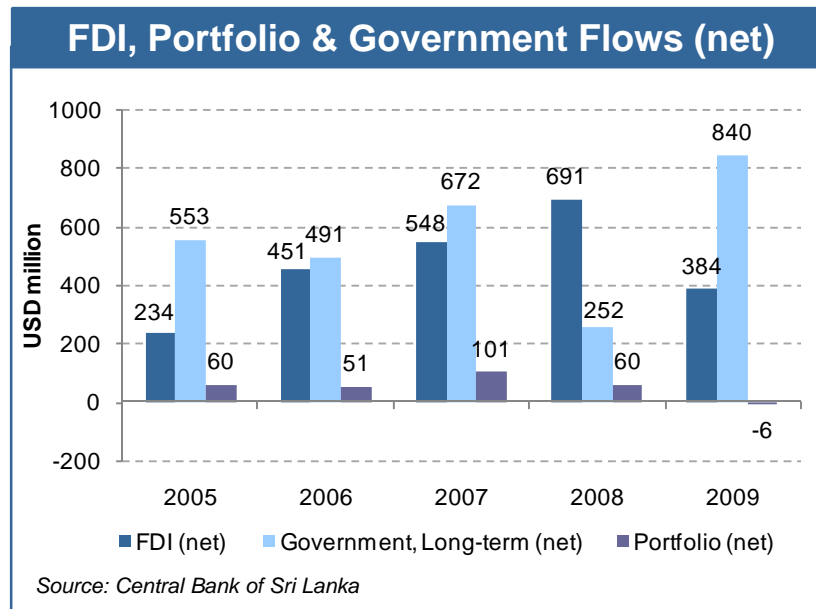
- **The US and the EU are important destinations for Sri Lanka's exports**
  - Linkages to these regions are a significant factor for evaluating the prospects for Sri Lanka's economy
- **India continued to be the largest source of imports in 2009**

# Sri Lanka's Trade and Current Account Balance



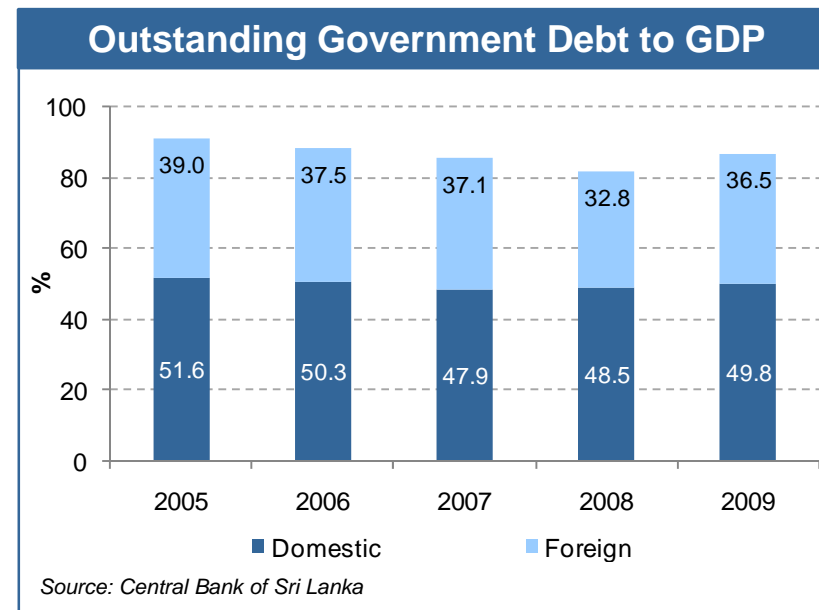
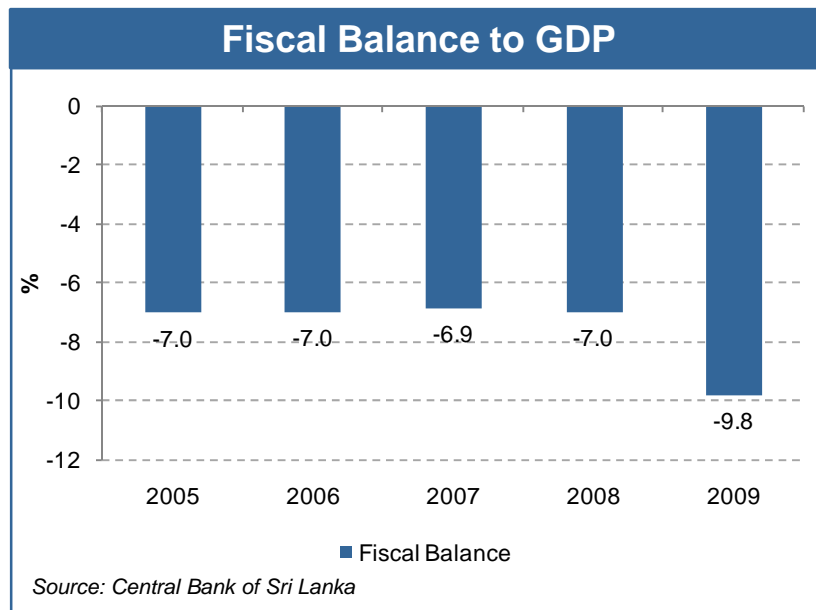
- **Current Account Deficit has narrowed significantly in 2009 over the previous year**
  - The main reason is a fall in the value of imports, which has narrowed the Trade Account Deficit
  - Growth in net private transfers is another reason

# Sri Lanka's Capital Flows and Overall Balance of Payments



- In 2009, the highest FDI inflow was recorded from China (USD145 million), followed by the UK (USD80 million) and India (USD78 million)
- Strong recovery in foreign financial inflows to the government in the second half of 2009, helped improve the Capital and Financial Account and overall Balance of Payments
- Except in 2008, the Balance-of-Payments position of Sri Lanka has steadily improved over the years

# Government Finances of Sri Lanka



- **Though the government had buoyant tax revenues (CAGR of 17%) in the past 5 years, the current expenditure increased fast too. Hence, the fiscal deficit has widened**
- **In 2009, foreign debt (LKR1760 billion) formed 42% of total outstanding government debt of LKR4161 billion**

# Impact of Sri Lanka's Economic Reforms

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- **Sri Lanka has undertaken a significant reform program**
  - Fiscal and structural reforms under the IMF program are expected to have a positive impact on the economy
  - Fiscal performance in the early part of 2010 is encouraging. In the first quarter, revenue increased by 26%, while expenditure increased by only 2%
- **Under the Fiscal Management Responsibility Act (FMRA), the fiscal deficit target for 2011 is 6.8%**
  - The target can be achieved mainly through a reduction in security-related spending. Sri Lanka's defence expenditure was LKR188.6 billion, about 3.9% of the GDP, in 2009
  - Post-conflict reconstruction spending is also expected to decline in 2011

# Outlook for the Medium Term

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- **Sri Lanka has favorable growth prospects for the medium term**
- **Investor confidence has improved with the return of peace**
  - This supports the country's Balance-of-Payments position
  - From US\$1.3 billion in March 2009, Sri Lanka's gross international reserves have increased to US\$5.7 billion in September 2010
- **Investor confidence is also supported by the IMF's extension of its Standby Loan Program by one year**
  - The planned fiscal and microeconomic adjustments are expected to make the economy more competitive
- **Growth is expected to be supported by enhanced public and private investments**
- **Fiscal risks remain due to the high debt and interest burdens**



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