Monthly Economic Update (MEU)

July 2024

Economic Intelligence Unit
The Ceylon Chamber of Commerce

Highlights

Sri Lankan Economy

CBSL Reduced Policy Rates by 25 Basis Points

The Monetary Policy Board of the Central Bank of Sri Lanka, decided to reduce the Standing Deposit Facility Rate (SDFR) and the Standing Lending Facility Rate (SLFR) of the Central Bank by 25 basis points (bps) to 8.25 per cent and 9.25 per cent, respectively in July 2024.

Sri Lanka's Economic Outlook Brightens with Positive PMI figures

In June 2024, Sri Lanka's Manufacturing PMI reached 56.6, showing a positive expansion, particularly in the food and beverages sector, despite continued caution in employment. The Services PMI also grew, driven by the wholesale and retail trade, and financial services. However, tourist-related services remained flat. The Construction PMI in May 2024 improved to 54.5, with resumed projects and stable material costs, although employment in the sector remained cautious. Overall, the economic outlook for the next three months is optimistic across these sectors.

External Sector is Strengthening

In May 2024, Sri Lanka's external sector showed improvement with a narrowed trade deficit and increased inflows in the services account and workers' remittances. Although the trade deficit narrowed year-on-year for May, it widened over the January-May period. Services inflows, excluding tourism, saw a significant increase, as did workers' remittances. Tourist earnings also experienced a notable rise during this period. Foreign investment outflows from the government securities market continued and gross official reserves saw a substantial increase by the end of May compared to the end of 2023.

Weather Watch- The Latest Addition to the Monthly Economic Update

With the aim of keeping our members updated, a new "Weather Watch" section is added to the MEU in collaboration with the World Bank. "Weather Watch" will provide localised weather forecasts and insights for Sri Lanka, enabling businesses to proactively plan, manage disruptions, and make informed decisions. Please refer page 7 and 8 for details.

Global Economy

The Global Economy is in a Sticky Spot, Says the IMF

The IMF expects global economic growth of 3.2% in 2024 and 3.3% in 2025, in line with their April forecasts. While the overall risks to the economic outlook are balanced, some near-term risks have increased. Key concerns include persistent inflation in the services sector due to wage pressures and potential geopolitical tensions impacting trade. Higher wage growth without corresponding productivity gains could lead to sticky inflation, while trade tensions might raise import costs. These inflation risks could result in prolonged high interest rates, increasing external, fiscal, and financial risks, disrupting capital flows, and hindering monetary policy easing, which could negatively impact growth and financial stability.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

5.3% in Q1-2024

-10.7% (Q1-2023)

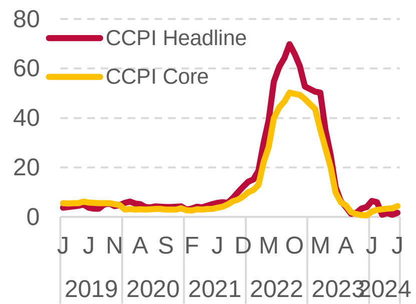
Movement of Purchasing Managers' Index-June 2024

Manufacturing PMI	56.6
Services PMI	63.5

Both Manufacturing and Services activities indicated an expansion in June 2024.

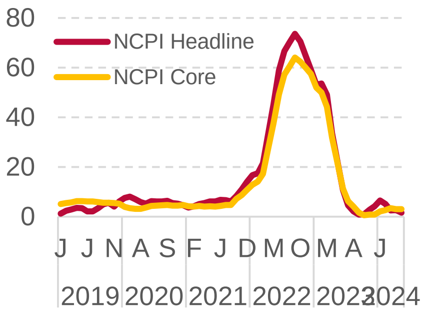
Inflation

CCPI Inflation (%)-*Base 2021*



June 2024	Headline	Core
	1.7%	4.4%

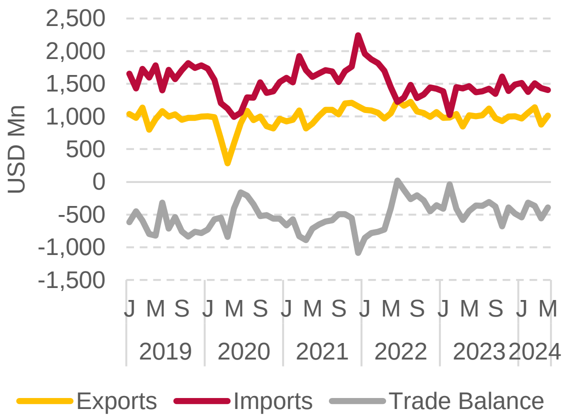
NCPI Inflation (%)-*Base 2021*



May. 2024	Headline	Core
	1.6%	3.1%

External Sector

Merchandise Trade



May 2024

Exports
0.8%

Imports
4.2%

Tourism

June 2024

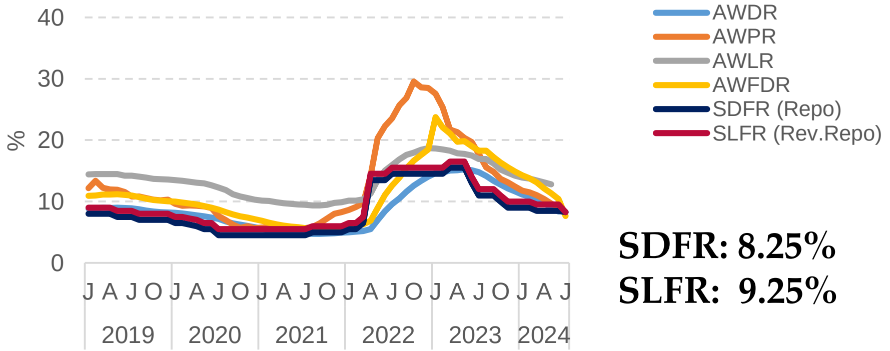
Arrivals
13%

Earnings
5%

Workers' Remittances

June 2024
9%

Interest Rates



SDFR: 8.25%
SLFR: 9.25%

Growth in Credit to Private Sector

May 2024

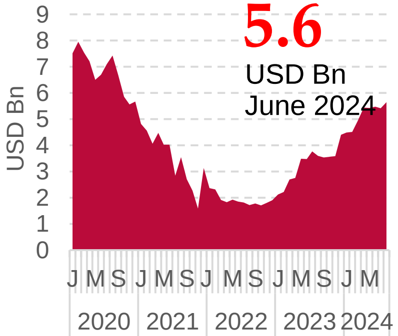
6.3%

Exchange Rate

Appreciation of LKR thus far 2024

6.7%

Official Reserves



5.6
USD Bn
June 2024

KEY INSIGHTS
Sri Lankan Economy

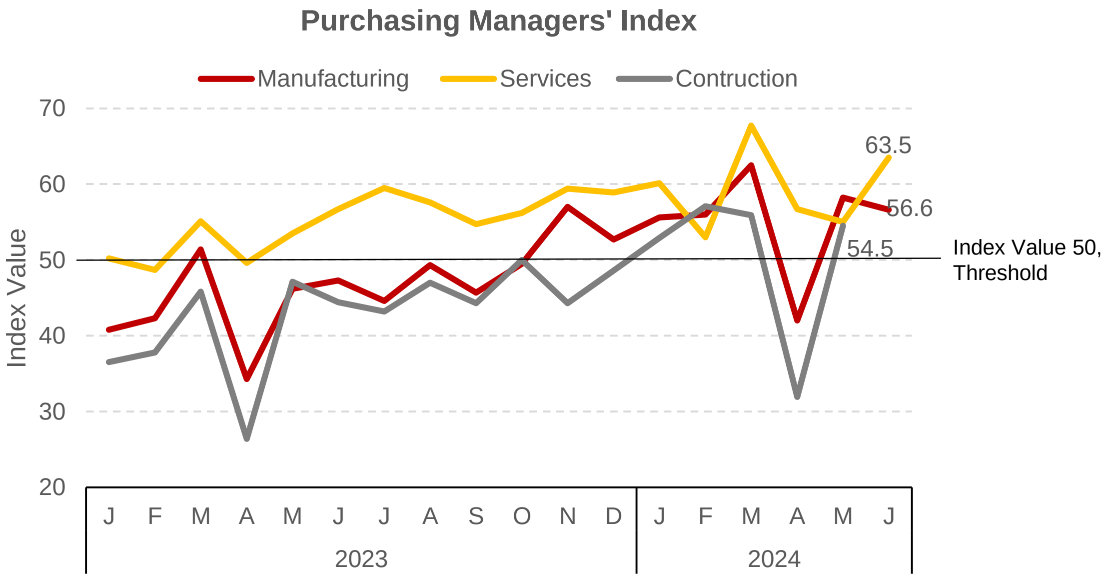
Sri Lanka’s Economic Outlook Brightens with Positive PMI figures

Sri Lanka's **Manufacturing PMI** reached 56.6 in June 2024, signifying an expansion in manufacturing activities. Most sub-indices, except employment, were above the neutral (50) threshold. The growth in ‘New Orders’ and ‘Production’ was driven by the food and beverages sector, with ‘Stock of Purchases’ also rising in line with increased orders and production. Employment, however, remained contracted as firms were cautious about filling vacancies. ‘Suppliers' Delivery Time’ lengthened due to congestion at major shipping ports. The industry expects economic conditions to gradually recover over the next three months.

The **Services PMI** showed further expansion in June 2024, with the Business Activity Index at 63.5. Growth was seen across most sectors, particularly in wholesale and retail trade due to the Haj festive season, as well as in transportation, financial, and personal services. However, activities in accommodation, food, and beverages services remained flat, reflecting sluggish tourist arrivals during the off-season. ‘New Businesses’ increased, especially in financial and personal services. Employment rose due to new recruitments, while ‘Backlogs of Work’ declined. Business activity expectations for the next three months are optimistic, supported by favorable macroeconomic conditions.

The **Construction PMI** recorded 54.5 in May 2024, indicating an improvement in construction activities. Many projects resumed after the extended holidays of the previous month, though adverse weather conditions tempered expected gains. ‘New Orders’ saw a slight increase. Road construction projects were prominent, but there was a call for more large-scale infrastructure projects to stimulate the industry. Employment continued to contract at a slower pace as firms remained cautious in hiring. The ‘Quantity of Purchases’ stayed stable, with a noted decline in the price of construction materials, beneficial for the industry. ‘Suppliers' Delivery Time’ remained extended. The construction outlook for the next three months is positive, with an expected rise in project availability.

Sub-Index	Manufacturing (June)	Services (June)	Construction (May)
New Orders	57.1 ↑		51.5 ↑
Prodution	58.2 ↑		
Employment	48.5 ↓	56.6 ↑	39.4 ↓
Stock of Purchases	56.1 ↑		
Supplier’s Delivery Time	63.9 ↑		51.5 ↑
New Businesses		60.5 ↑	
Backlogs of Work		48.4 ↓	
Expectations for Activity		73.2 ↑	
Quantity of Purchases			50



Data Source: CBSL

KEY INSIGHTS
Sri Lankan Economy

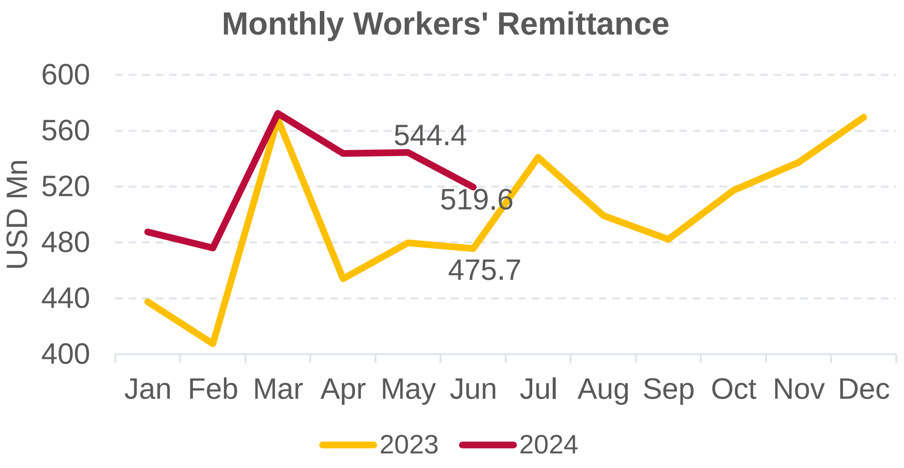
Seasonal Dip in Tourism and Remittances, Yet Stronger than 2023

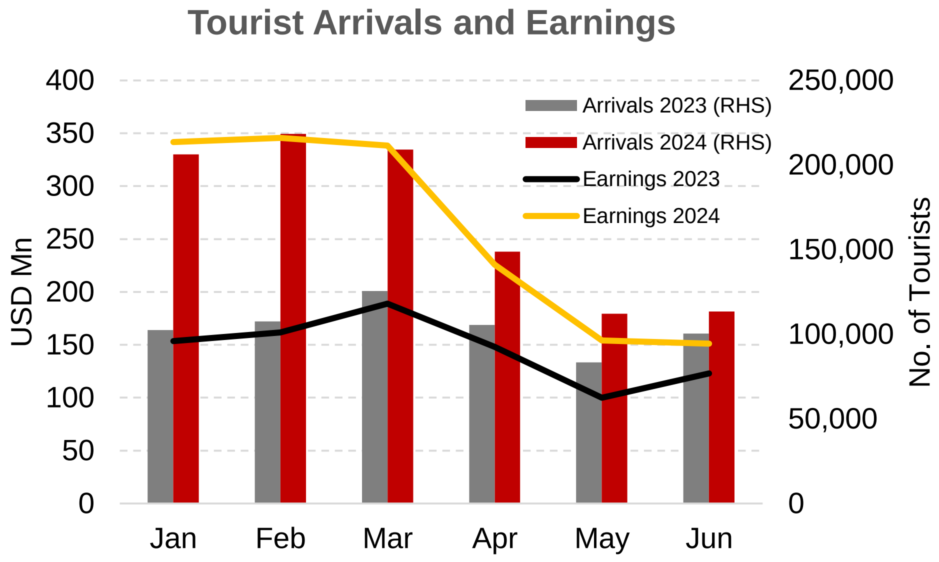
By mid-2024, Sri Lanka experienced significant growth in two key foreign exchange earners: workers' remittances and tourism revenue. Workers' remittances surpassed USD 3 billion, while tourism revenue crossed USD 1.5 billion.

Remittances through official channels increased by 11.4%, reaching USD 3.14 billion in the first half of 2024 compared to the same period last year. This growth was driven by more expatriates using official banking channels, which offer a secure and reliable means of transferring money. In June alone, remittances were USD 519.6 million, up 9.2% from the same month last year, according to official data.

Tourist arrivals in June remained slow due to the off-season. The Sri Lanka Tourism Development Authority (SLTDA) reported that 113,470 international visitors arrived in June, bringing the total number of arrivals in the first six months to just over 1 million. Currently, Sri Lanka has achieved only 40% of the annual tourist arrival target. To meet the annual target of 2.5 million tourists for 2024, arrivals are expected to increase in the latter half of the year. This uptick is anticipated as the peak tourist season approaches. Notably, the Maldives emerged as a significant source market for Sri Lankan tourism, entering the top 10 list since May. The introduction of the new e-visa system may have led to this cause.

Tourism earnings fell to USD 151 million in June due to the seasonal drop in arrivals. However, total tourism earnings for the first six months of 2024 reached USD 1.557 billion, a 77% increase compared to the same period last year. The continued focus on enhancing tourist experiences and diversifying the source markets is expected to sustain this growth momentum in the coming months.





Data Sources:CBSL, SLTDA

KEY INSIGHTS
Sri Lankan Economy

Leveraging GTEX/MENATEX for SME Apparel Sector Resilience in Sri Lanka

Sri Lanka is engaged in various trade negotiations and agreements, benefiting from schemes that target the Western market. Despite these efforts, small and medium enterprises (SMEs) in the apparel sector still face significant challenges in competing internationally. However, the GTEX/MENATEX program (Phase II 2024) brings a promising solution. This initiative, a collaborative effort involving Switzerland's State Secretariat for Economic Affairs (SECO), the Swedish International Development Cooperation Agency (SIDCA), and the International Trade Center (ITC), is designed to strengthen these SMEs and enhance their competitiveness on the international stage. GTEX2 will support 20-25 local businesses, a few designers, as well as organizations, academia, and training centers. The program focuses on spreading the benefits of improved environmental regulations, digital growth, and trade facilitation, fostering stronger government-business partnerships.

Small businesses often struggle with global market entry due to limited support compared to larger companies. They require government assistance to access trade benefits and easier market entry. GTEX/MENATEX addresses this need by helping businesses reach new customers in different countries, essential for competing with regional neighbors who have better market access.

The program also emphasises market diversification. While traditional markets such as the United States, United Kingdom, EU, and India remain crucial, exploring untapped markets in Eastern Europe, the Middle East, and East Asia is vital. GTEX2 promotes this by encouraging participation in international trade exhibitions and fostering new commercial partnerships, increasing the visibility of Sri Lankan SMEs.

Another cornerstone of GTEX2 is improving the technological and business environment. By investing in technology and R&D, the program aims to boost productivity and competitiveness, positioning Sri Lankan SMEs as leaders in sustainable manufacturing. Simplifying regulatory processes and improving the ease of doing business are important for attracting investments and creating a conducive environment for SME growth. However, government trade facilitation is key to achieving the program's outcomes.

Summary of GTEX Phase I Results

Metric	Value
Jobs Created	4,624
Increase in Exports (USD)	$101,059,935
Companies Implementing Cleaner Production	58
Annual Cost Savings from Cleaner Production (USD)	$1,044,228
Investment Volume (USD)	$1,248,452
Energy Savings (MWh/year)	6,276
CO2 Reduction (tons/year)	11,010
Water Savings (m^3/year)	78,203
Curricula Developed/Updated	38
Students Placed in Internships	2,799

Data Sources: Reuters, Bloomberg, The Quarterly Debt Bulletin

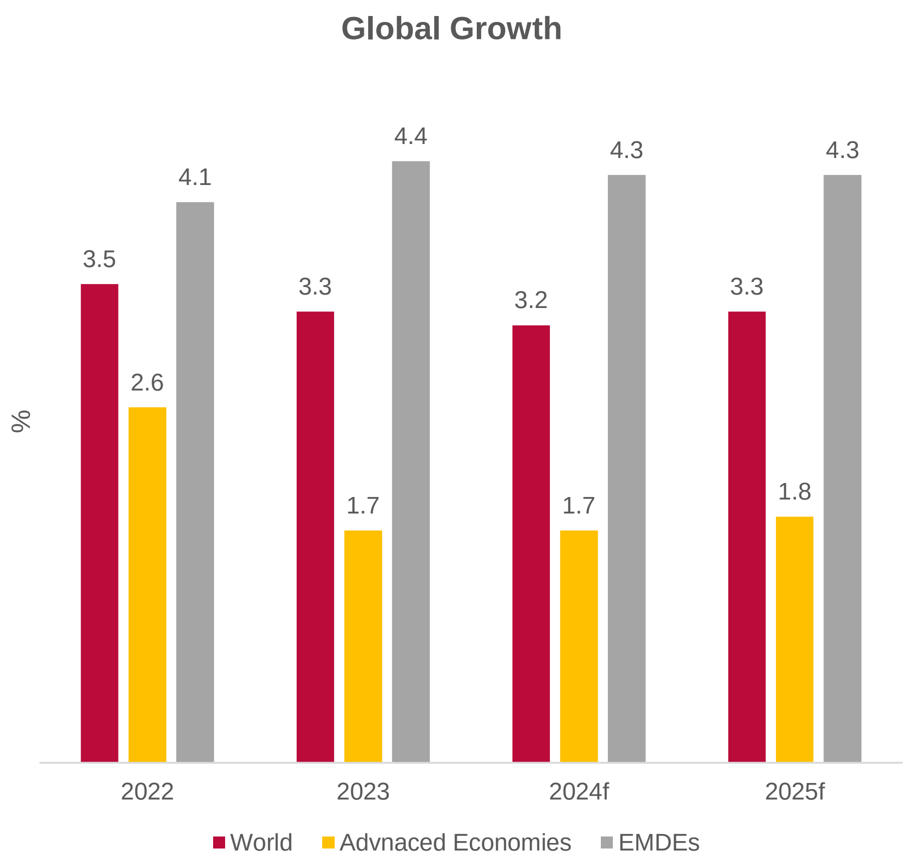
KEY INSIGHTS
Global Economy

Global Economy is in a Sticky Spot: The IMF

Current Growth Performance: Global economic activity and world trade improved at the beginning of the year, driven by strong exports from Asia, particularly in the technology sector. First quarter growth exceeded expectations in many countries compared to the April 2024 update of the World Economic Outlook report of the IMF, despite notable slowdowns in Japan and the United States. In the U.S., growth slowed due to reduced consumption and negative net trade contributions. Japan's growth was hindered by supply disruptions from a major automobile plant shutdown. Europe saw economic recovery led by improved services activity, while China's resurgence in domestic consumption and a temporary export surge boosted its first quarter performance. These developments have reduced output divergences across economies as cyclical factors diminish and activity aligns more closely with potential.

Inflation: Global disinflation is slowing due to persistent high inflation in services, despite stronger disinflation in commodities. As per the IMF, their projections are based on upward revisions to commodity prices, including a rise in nonfuel prices by 5% in 2024. Energy commodity prices are expected to fall by about 4.6% in 2024, less than projected in April by the IMF, reflecting the elevated oil prices from deep cuts by OPEC+, and reduced, but still present. Price pressure from the Middle East Conflict. Monetary policy rates of major central Banks are still expected to decline in the 2H of 2024, with divergence in the pace of normalization reflecting varied inflation circumstances.

Outlook: The IMF is expecting a 3.2% global economic growth in 2024 and 3.3% in 2025, which is broadly unchanged from their April forecasts. Overall, risks to the economic outlook remain balanced, but some near-term risks have increased. Key concerns include persistent inflation in the services sector due to wage pressures and potential geopolitical tensions affecting trade. Higher nominal wage growth without corresponding productivity gains could make it hard for firms to moderate prices, leading to sticky inflation. Trade tensions might raise inflation by increasing import costs. Elevated inflation risks could lead to prolonged high interest rates, increasing external, fiscal, and financial risks, disrupting capital flows, and hindering monetary policy easing, potentially affecting growth and financial stability.



EMDEs: Emerging Markets and Developing Economies

Data Source: IMF

Weather Watch
(In Collaboration with the World Bank)

With the aim of keeping our members updated, a new "Weather Watch" section is added to the MEU in collaboration with the World Bank. "Weather Watch" will provide localised weather forecasts and insights for Sri Lanka, enabling businesses to proactively plan, manage disruptions, and make informed decisions.

Sri Lanka should Prepare for Possible Extreme Rainfall Events in August.

There is an increased risk of extreme rainfall events, floods, and consequent landslides, especially across Southwestern parts of the country, during August 2024. These are likely to be preceded by a drier but very hot period for the last week of July.

The risk of a 01 June 2024 extreme event occurring in August is rated high enough to take precautionary action (20% chance). Sri Lanka: Floods and Landslides - May 2024 | ReliefWeb,

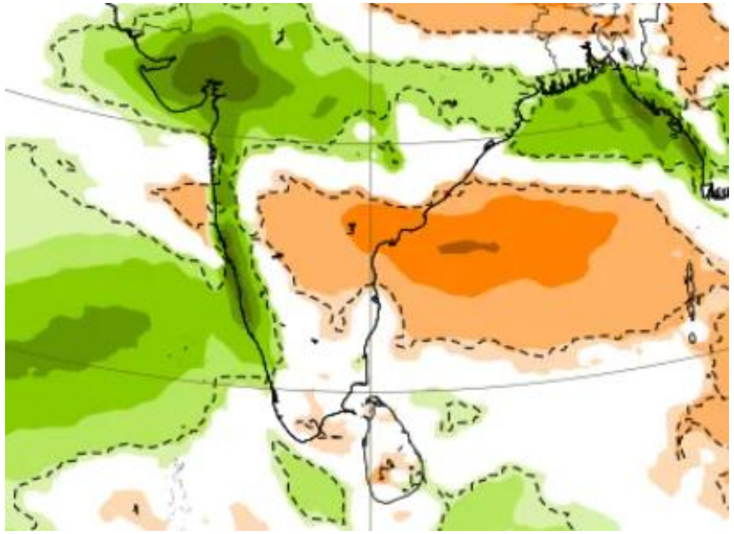
We advise members to review business continuity plans and to check the resilience of key infrastructure facilities to severe weather, especially floods. Members might consider discussing contingency plans with staff, and alerting customers to the risk of service disruption should an extreme event occur.

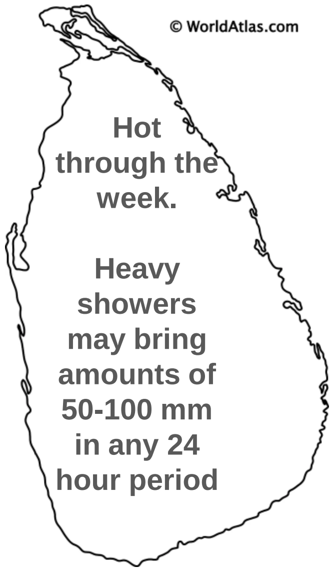
Members should also check daily for the latest warnings, advice and guidance from Department of Meteorology (DoM) , National Building Research Organization (NBRO), and Disaster Management Center (DMC).

Data Source: The World Bank

Weather Watch cont’d

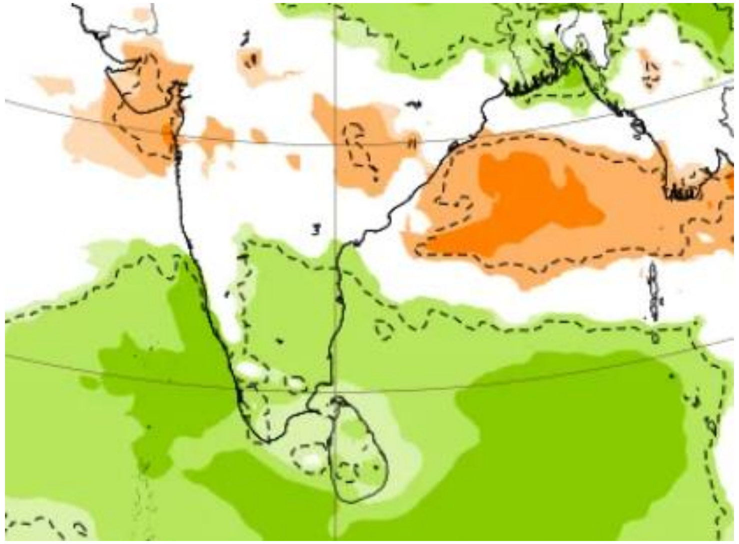
22 July to 29 July 2024

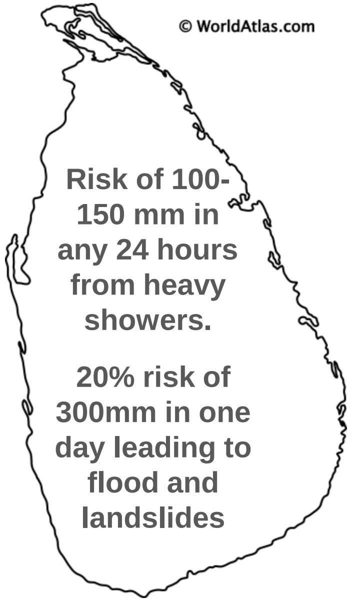




ECMWF 7-day mean anomalies of precipitation for period 22 to 29 July 2024.
Green = wet
Orange = dry.
This shows a relatively dry and hot conditions across Sri Lanka during the last week of July.

29 July to 05 August 2024





ECMWF 7-day mean anomalies of precipitation for period 29 July to 05 August 2024.
Green = wet
Orange = dry
This shows heavy rainfall anomalies developing across Sri Lanka indicative of an increased risk of a rainfall extreme events during August 2024.

Data Source: The World Bank

Evolving Landscape

With the aim of keeping our members updated on latest global trends, especially those influencing Sri Lanka, 'Evolving Landscape' section was added to the MEU. This section guide our members in strategic planning, innovation and competitiveness and helping them identify sector-specific opportunities and challenges.

Sri Lanka Reaches a Deal with its Commercial Creditors

The International Sovereign Bond (ISB) restructuring proposal from the Ad-Hoc Group (AHG) introduced the concept of Macro-Linked Bonds (MLB), a financial instrument aimed at linking debt repayments to Sri Lanka's economic performance. This approach aims to balance the interests of creditors and the debtor by tying the debt service obligations to macroeconomic indicators. The key features of this proposal and the associated negotiations reflect a complex interplay of interests and economic realities.

One of the primary points of negotiation was the choice of the baseline parameter. Sri Lanka insisted on using the IMF macro baseline as the reference point, emphasizing a more conservative and realistic assessment of its economic situation. On the other hand, the AHG preferred its more optimistic "alternative baseline," which projected better economic outcomes. This difference in perspectives necessitated extensive discussions to find common ground. Ultimately, the Joint Working Framework, agreed upon in June 2024, incorporated the IMF baseline, ensuring that the projections were grounded in widely accepted economic analyses.

Another critical feature of the restructuring proposal was the inclusion of downside risk scenarios. Sri Lanka proposed multiple downside scenarios to appropriately balance risks and provide adequate debt relief in adverse economic conditions. Initially, the AHG included only one downside scenario, which was seen as insufficient by Sri Lanka. **The Joint Working Framework** addressed this concern by including additional downside scenarios, thereby providing a more robust mechanism for debt relief if the country faced unfavourable macroeconomic outcomes. This adjustment was crucial in making the restructuring proposal more equitable and responsive to potential economic challenges.

DEBT SERVICE UNDER JOINT WORKING FRAMEWORK

	GDP (USD Bn)	Principal Haircut	Total Debt Service (2024 – 2038) USD Mn
Threshold 1	100.0	15%	19,640
Threshold 2	96.0	15%	18,947
Threshold 3	92.0	20%	17,527
IMF Baseline	88.6	28%	15,963
Threshold -1	86.7	35%	14,827
Threshold -2	84.7	40%	13,794

The choice of trigger for the MLB was also a contentious issue. The AHG preferred a single trigger based on nominal GDP in USD terms, which could be influenced by currency appreciation rather than real economic growth. Sri Lanka raised concerns about this approach, arguing that it might not accurately reflect the country's economic performance. To address this, the Joint Working Framework included a "control variable" that captured **real GDP growth**, ensuring that higher payouts would only be triggered by actual economic improvements. Additionally, the period for the trigger was extended from 2 to 3 years, providing a more extended timeframe to assess economic performance.

The share of upside in economic performance was another significant point of negotiation. Initially, the AHG's proposal allocated most of the upside to bondholders, which was seen as unfair by Sri Lanka. The country advocated for a more balanced distribution, ensuring that both creditors and the debtor shared the benefits of any economic improvement. The Joint Working Framework adjusted the upside thresholds and payouts to ensure a fairer share between the parties. This adjustment was essential in making the restructuring proposal more acceptable to Sri Lanka and its stakeholders.

Following the finalization of a memorandum of understanding (MOU) with the Official Creditor Committee and restructuring agreements with Exim Bank of China, restricted negotiations resumed on June 27-28, 2024, in Paris. During these negotiations, the AHG submitted a new proposal addressing Sri Lanka's concerns, which led to the formulation of the Joint Working Framework. This framework represents a significant milestone in the restructuring process, reflecting a more balanced approach to risk-sharing and economic recovery.

The restructuring proposal includes specific scenarios to illustrate potential outcomes. For instance, if Sri Lanka's GDP were to grow by 4% annually from 2024-2027, the average USD GDP during 2025-2027 would be USD 95 billion. This could trigger threshold 3, resulting in a reduction of the nominal principal haircut from 28% to 20%, with an NPV effort of 35% at an 11% discount rate. Such scenarios highlight the potential benefits of the MLB structure in aligning debt service obligations with economic performance.

The Ceylon Chamber of Commerce

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Reach us at +94 11 558 8809 | eiu@chamber.lk

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