

Monthly Economic Update (MEU)

May 2024

**Economic Intelligence Unit
The Ceylon Chamber of Commerce**

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Highlights

Sri Lankan Economy

CBSL Maintains their Policy Rates at Current Level

On 27 May 2024, the Monetary Policy Board of the Central Bank of Sri Lanka decided to maintain the Standing Deposit Facility Rate at 8.50% and the Standing Lending Facility Rate at 9.50%. This decision aims to keep inflation at the target of 5% while supporting economic growth. The Monetary Board noted the need for a further reduction in market lending rates to ease domestic monetary conditions and support economic recovery.

Headline Inflation Remained Subdued

CCPI headline inflation recorded a slight increase in April compared to March 2024. However, the April inflation rate was significantly lower at 1.5% compared to 35.2% in April of the previous year. In April 2024, inflation in the food group declined slightly, while inflation in the non-food group picked up marginally.

A Further Decline in Market Interest Rates is Warranted: CBSL

The Central Bank of Sri Lanka (CBSL) has created a further space for overall lending interest rates to decrease in the coming period, due to the moderation of benchmark interest rates and a decline in average deposit interest rates in the banking sector. A further reduction in retail lending interest rates could facilitate the pickup in private sector credit, thereby supporting the ongoing recovery of economic activity. However, elevated interest rates on certain loan products have yet to be adjusted downward in line with the overall interest rate structure, according to the CBSL.

Sri Lanka Exceeds Revenue Targets by Q1 2024

Key takeaway: Sri Lanka's revenue collection surpassed expectations in Q1 2024, marking a positive turnaround from 2023's challenges. Exceeding the target by 6%, this success indicates improved economic conditions and more effective revenue collection strategies, setting a strong start towards meeting the ambitious 2024 revenue goals and fostering economic stability and growth.

Increased net inflows to the services sector and workers' remittances have helped cushion the widened trade deficit.

In Q1 2024, merchandise exports saw a moderate increase, driven by industrial and agricultural sectors, while imports surged primarily due to higher fuel imports and increased investment in machinery. Consequently, the trade deficit widened. However, the services sector experienced significant growth, notably in tourism earnings, which more than doubled compared to the previous year, alongside a notable rise in tourist arrivals. Workers' remittances also increased, supporting domestic consumption and foreign exchange reserves.

Global Economy

Global Recovery is Steady, but Slow: IMF

The IMF projects global growth to remain steady at 3.2% in 2024 and 2025, with a decline in global inflation from 6.8% in 2023 to 5.9% in 2024 and 4.5% in 2025. Risks are balanced, with geopolitical tensions and persistent inflation posing downside risks, while looser fiscal policy could boost short-term activity. Structural reforms and AI advancements could enhance productivity positively.

Global Trade Growth Expected to More Than Double in 2024

Global trade is set for a strong rebound in 2024, potentially doubling compared to 2023, driven by declining inflation, lower interest rates, and robust economic activity, especially in the US. Projections from major economic organizations like the IMF, OECD, and WTO indicate a significant uptick in trade flows, signaling recovery from 2023's sluggish growth. However, risks such as geopolitical tensions and environmental challenges could hinder sustained growth, emphasizing the need for resilient strategies amidst an optimistic outlook.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

4.5% in Q4-2023
-2.3% in 2023 (Full Year)

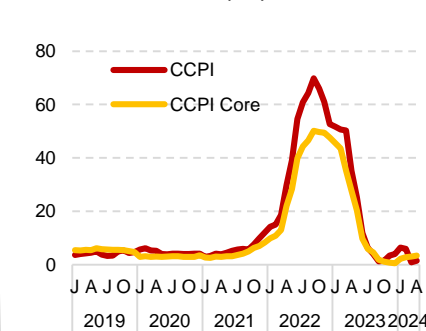
Movement of Purchasing Managers' Index-Apr 2024

Manufacturing PMI **42.0**
 Services PMI **56.7**

Manufacturing activities recorded a contraction following the seasonal pattern, however Services activities indicated a slower expansion.

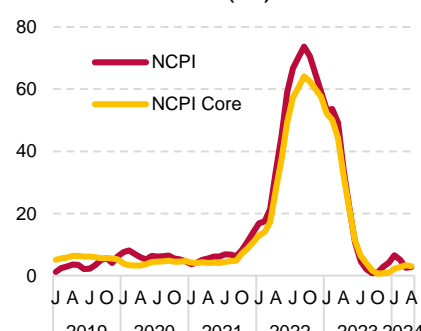
Inflation

CCPI Inflation (%) - Base 2021



Apr. 2024
 Headline **1.5%**
 Core **3.4%**

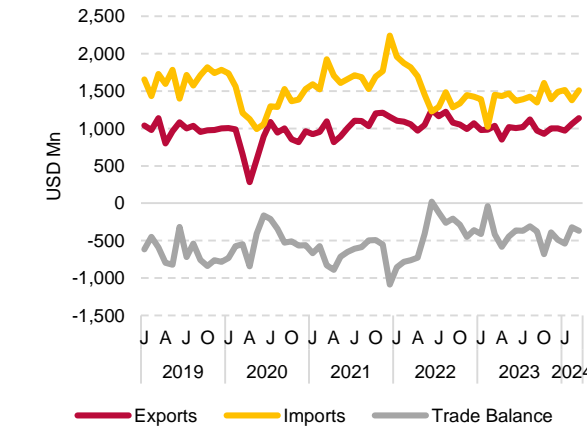
NCPI Inflation (%) - Base 2021



Apr. 2024
 Headline **2.7%**
 Core **3.0%**

External Sector

Merchandise Trade



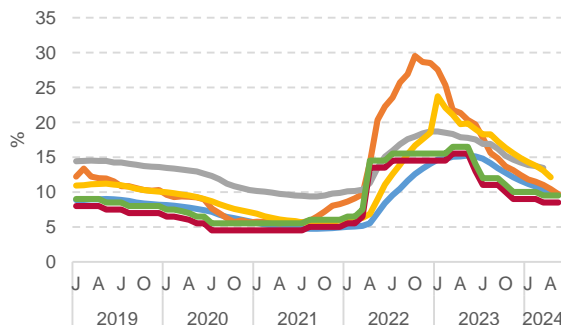
Tourism

Mar. 2024
 Exports **9.8%** ↑
 Imports **4%** ↑

Apr. 2024
 Arrivals **41%** ↑
 Earnings **36%** ↑

Workers' Remittances
 Apr. 2024 **20%** ↑

Interest Rates

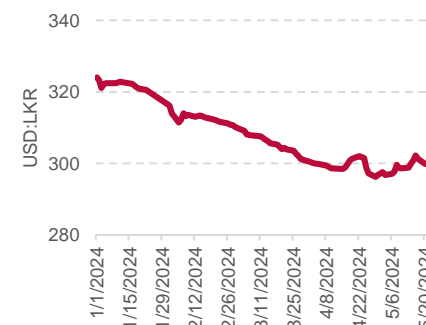


SDFR: 8.50%
SLFR: 9.50%

Growth in Credit to Private Sector

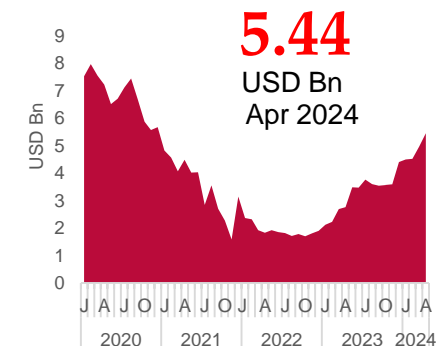
Mar 2024
3.6%

Exchange Rate



Appreciation of LKR thus far 2024
8%

Official Reserves



5.44
 USD Bn
 Apr 2024

KEY INSIGHTS

Sri Lankan Economy

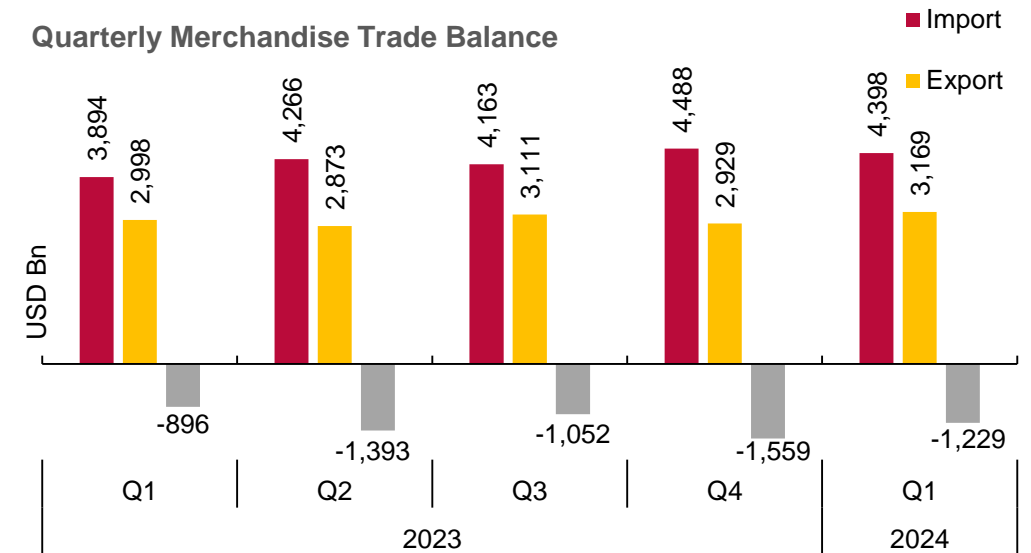
Q1 2024 Sri Lanka External Sector Performance

Earnings from merchandise exports grew by 5.7%, reaching USD 3,169 million in Q1 2024, up from USD 2,998 million in Q1 2023. This increase was driven primarily by industrial exports, particularly textiles and garments, and petroleum products. Agricultural exports also saw improvements, notably in tea and coconut products, despite a decline in spices. Merchandise imports increased by 8.2% to USD 4,398 million in Q1 2024 from USD 3,894 million in Q1 2023. The rise in imports was primarily due to higher fuel imports and a broad-based increase in investment goods, particularly machinery and equipment. As the rise in imports exceeded the rise in exports, the merchandise trade deficit widened to USD 1,229 million in Q1 2024 from USD 896 million in Q1 2023.

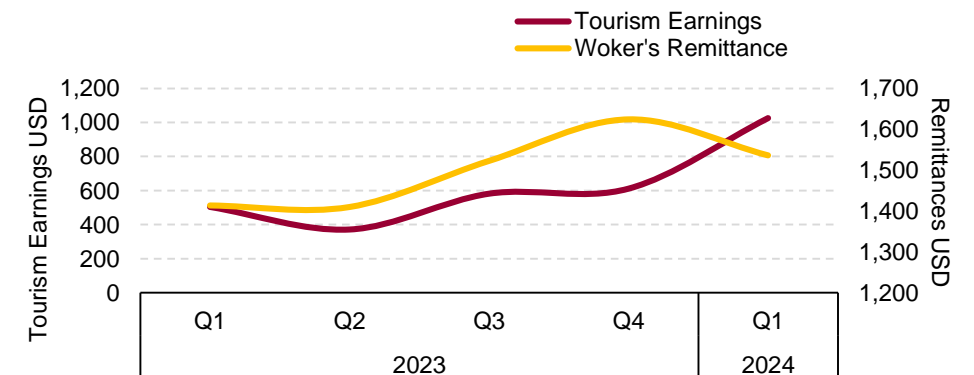
The services sector experienced a significant net inflow, with tourism earnings playing a major role. Earnings from tourism surged by 103.6% year-on-year, reaching USD 1,026 million in Q1 2024 from USD 504 million in Q1 2023. Number of tourist inflows also surged by 89% in the first quarter reaching 635,784 compared to the 335,679 in the same period last year. Other services, such as sea transport, also contributed positively to the inflows, despite a slight decline in IT services. Workers' remittances totalled USD 1,536 million in Q1 2024, marking an 8.7% increase from USD 1,413 million in Q1 2023. This steady inflow supports domestic consumption and foreign exchange reserves.

Net foreign investment in the Colombo Stock Exchange (CSE) and government securities market saw outflows, reflecting cautious investor sentiment. However, the Sri Lankan rupee appreciated against the US dollar, indicating improved market confidence and stability. Gross official reserves increased to USD 5.0 billion by the end of Q1 2024, compared to USD 4.4 billion at the end of Q1 2023, supported by robust remittances and foreign currency inflows from the tourism sector.

Quarterly Merchandise Trade Balance



Quarterly Tourism Earnings & Worker Remittances



KEY INSIGHTS

Sri Lankan Economy

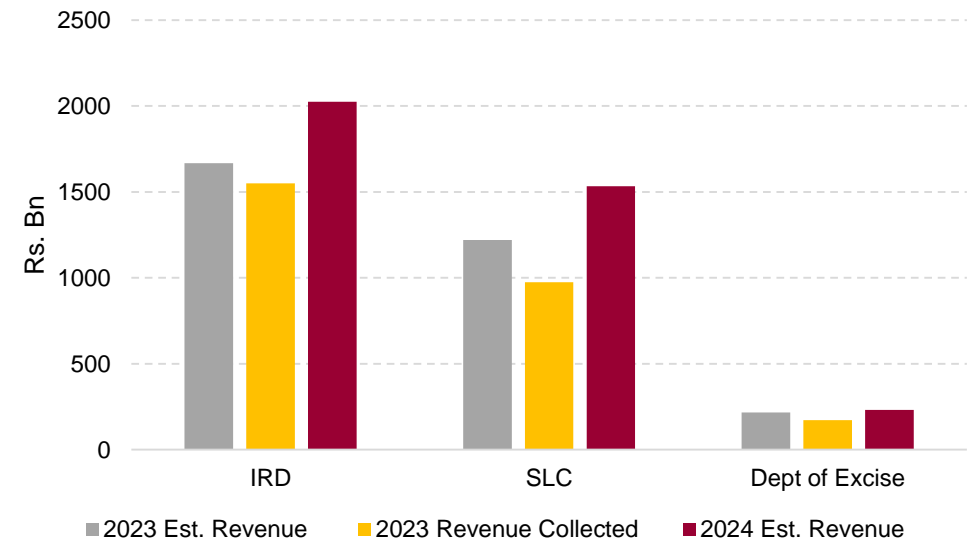
Sri Lanka Exceeds Tax Revenue Target in the Q1

In the first quarter of 2024, Sri Lanka's revenue collection significantly surpassed expectations, marking a positive turnaround for the economy. State Revenue Minister Ranjith Siyambalapitiya announced that the revenue collecting bodies exceeded the tax revenue target by 6%. The government's revenue target for 2024 is set at 4,106 billion rupees, and this achievement in the first quarter indicates a strong start towards meeting this goal. The combined efforts of Sri Lankan Customs, the Excise Department, and the Inland Revenue Department resulted in a collection of 834 billion rupees. This figure is notably higher than the anticipated 787 billion rupees. Specifically, the Inland Revenue Department excelled by collecting 430 billion rupees, 13% above its target of 381 billion rupees.

This uptick in revenue collection comes after a challenging 2023, where the three revenue collecting institutions failed to achieve their annual targets. The estimated total tax revenue for 2023 was 3,130 billion rupees, but only approximately 2,720.6 billion rupees was collected by year-end. The shortfall was attributed to the shrinking economy, declining purchasing power, and import restrictions, especially on vehicles. The reasons for the revenue shortfall in 2023 highlight the economic difficulties Sri Lanka faced. The economy contracted, reducing the tax base, while inflation eroded purchasing power, further diminishing tax revenues. Import restrictions, particularly on high-revenue items like vehicles, compounded the issue by limiting taxable imports.

The first quarter's success in 2024 suggests a promising trend for the rest of the year. The notable increase in revenue collection reflects not only improved economic conditions but also more effective revenue collection strategies. If this pattern continues, Sri Lanka is on track to achieve its ambitious revenue targets for 2024, which would significantly contribute to economic stability and growth.

Institution	Estimated Revenue for 2023 (Rs. Bn)	Revenue collection for 2023 (Rs. Bn)	Estimated Revenue for 2024 (Rs. Bin)
Inland Revenue Department (IRD)	1,667	1,550	2,024
Sri Lanka Customs (SLC)	1,220	974	1,533
Excise Department of Sri Lanka	217	171	232



KEY INSIGHTS

Global Economy

Global Recovery is Steady but Slow: The IMF

According to the World Economic Outlook-April 2024 Update by the International Monetary Fund, the global growth which was estimated at 3.2% in 2023 is projected to continue at the same pace in 2024 and 2025.

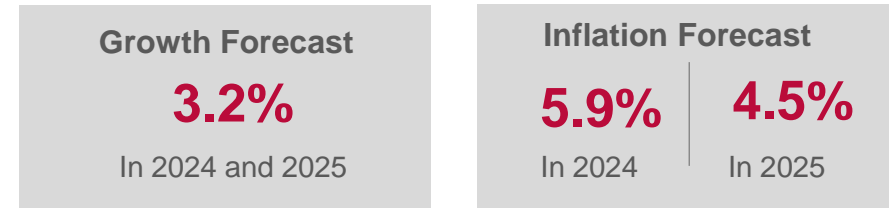
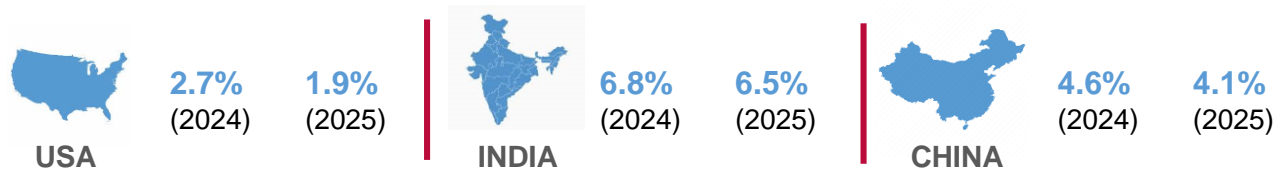
Global headline inflation is expected to fall from an annual average of 6.8% in 2023 to 5.9% in 2024 and 4.5% in 2025, with advanced economies returning to their inflation targets sooner than emerging market and developing economies.

Risks to the global outlook are broadly balanced, as per the IMF report. On the downside, new price spikes stemming from geopolitical tensions, including those from the war in Ukraine and the conflict in Gaza and Israel could, along with the persistent core inflation where labour markets are still tight, raise interest rate expectations and reduce asset prices. A divergence in disinflation speeds among major economies could also cause currency movements that put financial sectors under pressure.

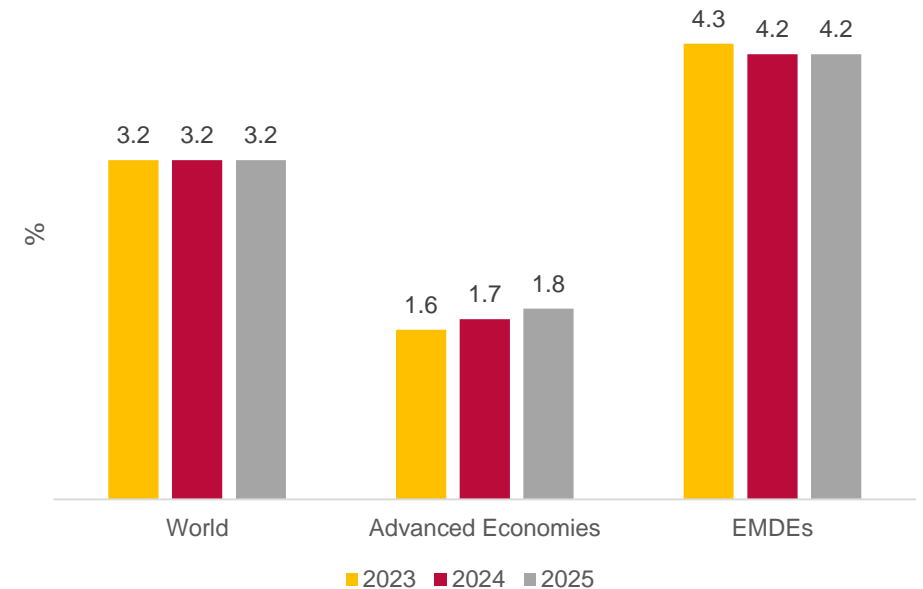
Amidst high government debt in many economies, a disruptive turn to tax hikes and spending cuts could weaken activity, erode confidence and sap support for reform and spending to reduce risks from climate change.

On the upside, looser fiscal policy than necessary and assumed projections could raise economic activity in the short term, although risking more costly policy adjustment later on. Inflation could fall faster than expected amidst further gains in labour force participation, allowing central banks to bring easing plans forward. Artificial Intelligence and stronger structural reforms than anticipated, could spur productivity.

Growth Projections for Economic Giants



Growth Projections by the IMF



KEY INSIGHTS

Global Economy

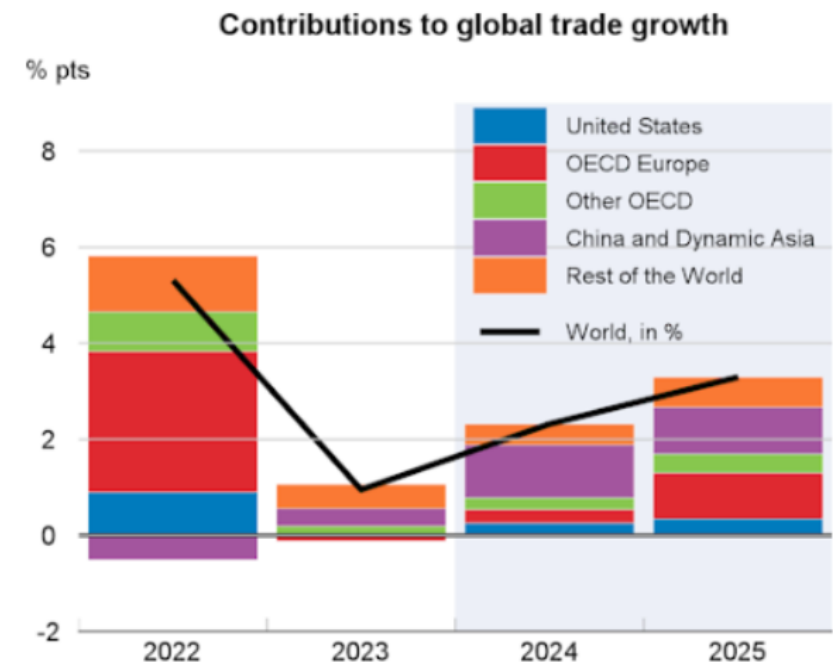
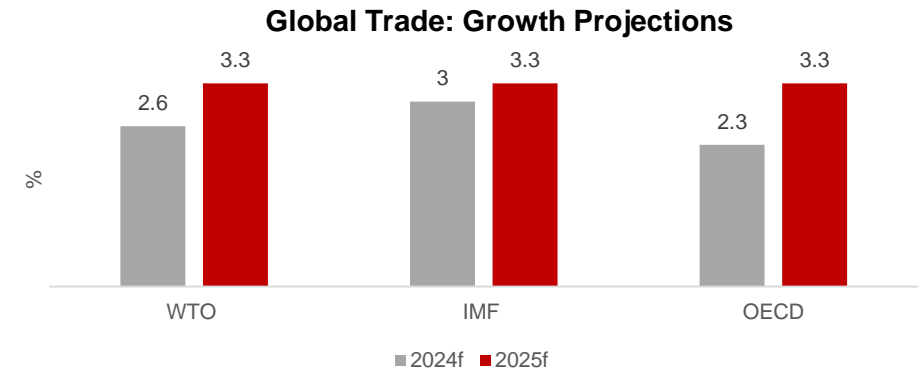
Global Trade Growth Expected to More Than Double in 2024

Global trade growth is poised for a significant rebound in 2024, potentially more than doubling compared to the previous year. This optimistic outlook is driven by declining inflation, reduced interest rates, and robust economic activity, particularly in the United States. Major international economic organizations, including the IMF, OECD, and WTO, forecast a notable increase in global trade flows, marking a recovery from the sluggish growth of 2023 caused by high inflation and interest rates.

The OECD projects that global trade in goods and services will grow by 2.3% in 2024 and 3.3% in 2025, while the IMF and WTO have similarly positive forecasts. This resurgence is attributed to broad economic growth, with the IMF predicting a global economic expansion of 3.2% over the next two years. Key drivers include the US economy's robust performance and the anticipated growth in China and East Asia. Africa is also expected to see the fastest export growth among regions, albeit from a low base.

However, the path to sustained growth is fraught with risks. Geopolitical tensions, such as the Red Sea crisis and Middle Eastern conflicts, could disrupt trade. Additionally, trade fragmentation and environmental issues, like low water levels in the Panama Canal, pose significant challenges. While developed economies are poised for recovery, many low-income countries face persistent high inflation and low growth, necessitating structural reforms to attract investment and manage debt.

Overall, while the outlook for global trade is optimistic, it remains contingent on navigating these complex risks and fostering resilient and equitable growth strategies.



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.

Insights from the Sri Lanka Climate Summit-2024

The Ceylon Chamber of Commerce organized Sri Lanka's first Climate Summit in May 2024 under the theme "Code Red: Climate Risks and Opportunities for Sri Lankan Businesses." Here are a few key insights from the summit.

Climate change, driven by greenhouse gas emissions and the depletion of carbon sinks, leads to rising temperatures and altered weather patterns. These shifts threaten water and food security, city resilience, energy production, and ecosystem services. Developing areas, particularly farmers, pastoralists, and indigenous communities, face heightened vulnerability due to inadequate infrastructure. The broader economic impacts are profound, with significant GDP risks projected for regions like South Asia, where temperatures are expected to escalate. For example, South Asia could see a 10.5% reduction in GDP by 2050 if climate shocks are not mitigated, necessitating adaptive strategies and technological advancements. Sri Lanka is grappling with a climate crisis that manifests in altered rainfall patterns, temperature shifts, and extreme weather events. These changes have substantial effects on key economic sectors such as rice, coconut, and hydro-electricity production. Additionally, the health sector is impacted through increased heat stress, the spread of infectious diseases, and deteriorating air quality. The business environment in Sri Lanka is also evolving due to climate change, with physical, transition, liability, and reputation risks altering the landscape.

Decarbonisation Strategies for Sri Lanka

To address its climate crisis, Sri Lanka has set ambitious goals to decarbonize its energy sector and mitigate climate impacts. These include achieving 70% of electricity from renewable sources by 2030 and aiming for carbon neutrality by 2050. The country plans to add 5000 MW to its installed capacity to meet rising demand.

Energy and Transportation Transformation: The transformation of the energy and transportation sectors is critical. The global trend towards electric vehicles (EVs) and renewable energy sources is both cost-effective and sustainable. By transitioning from internal combustion engines (ICE) to EVs and from fossil fuels to renewables, Sri Lanka can significantly reduce its carbon footprint. This shift is not only economically advantageous but also crucial for long-term sustainability.

Building Energy Efficiency: Buildings account for a significant portion of energy consumption, and making them more efficient is essential. Improved insulation and efficient design can drastically reduce energy use. For instance, using double brick walls with insulation and air gaps minimizes heat transfer, leading to substantial cost savings on heating and cooling. Sri Lanka should enforce stringent building codes across all structures, not just large buildings, to ensure energy efficiency. Energy Building Conservation Code Building Code (ECBC) plus is the standard to be followed. Promoting efficient building designs and publicizing best practices can help decision-makers and architects create energy-efficient buildings that are profitable and sustainable in the long run. The inclusion of light shelves in building designs can significantly reduce daylighting and glare, thereby lowering electricity costs. This makes it unnecessary to use artificial lighting in rooms from 8 am to 4 pm.

Renewable Energy and Grid Integration: Rooftop solar energy represents a significant untapped potential in Sri Lanka. Despite the availability of six million rooftops, only 40,000 are currently utilized for solar energy. Expanding this initiative can harness considerable renewable energy resources scattered across the country. Moreover, interconnecting Sri Lanka's grid with India's can enhance energy security and enable energy exports. This interconnection, although initially costly, offers long-term economic benefits by providing access to cheaper energy and facilitating large-scale sustainable energy projects.

Green Hydrogen and Education: Green hydrogen offers a future pathway for energy trading and increasing efficiency in energy use. Integrating the concept of energy transition into Sri Lanka's education system can empower citizens to contribute to lowering energy costs and fostering grassroots change. Leveraging the country's renewable energy production capacity can also enhance trade, particularly with the Free Trade Agreement with India.

Datasheet

Latest Available data

External Trade (USD Mn)	Mar-2024	Month Ago	Year Ago
Exports	1,139	1,059	1,032
Agricultural Exports	222	222	216
Industrial Exports	912	834	816
Imports	1,508	1,378	1,450
Consumer Goods	271	250	266
Intermediate Goods	1,010	840	972
Investment Goods	226	286	210
Trade Balance	-369	-319	-412
Tourist Arrivals (No.)	148,867 (Apr 2024)	209,181	105,498
Tourism Earnings	226 (Apr 2024)	338	148
Workers' Remittances	544 (Apr 2024)	572	454
Inflation (%)	Apr 2024	Month Ago	
CCPI (2021 base)			
Headline	1.5	0.9	
Core	3.4	3.1	
NCPI (2021 base)			
Headline	2.7	2.5	
Core	3.0	3.4	
Interest Rates (%)		Month Ago	Year Ago
AWPR	9.68 (May)	10.41	21.28
AWLR	13.43 (Mar)	13.74	18.29
AWDR	9.66(Apr)	10.30	15.12
AWFDR	12.12 (Apr)	13.10	19.72
SDFR	8.50	8.50	15.50
SLFR	9.50	9.50	16.50
Growth in Credit to Private Sector	3.6 (Mar)	0.9	-5.2
Fiscal Sector (LKR Bn)		Jan-2024	Year Ago
Revenue and Grants		283	176
Expenditure and Net Lending		450	290

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