

Monthly Economic Update (MEU)

June 2024

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

Compiled by,
Saumya Amarasiriwardane (Economist)
Trent Hemachandra (Research Associate)



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EIU

Highlights

Sri Lankan Economy

Economy Gradually Stabilizing: Recorded 5.3% Growth in Q1 2024

Marking the third consecutive quarter of positive growth, the first quarter of 2024 recorded a 5.3% increase in the Sri Lankan economy, with the 'Agriculture', 'Industry', and 'Services' sectors contributing 7.7%, 26.2%, and 58.9% respectively to the GDP. Decreased inflation and interest rates, increased foreign currency liquidity, lifted import restrictions, and a rise in tourist arrivals all positively impacted economic activities, especially benefiting the construction industry and manufacturing sectors.

IMF Completed the Second Review of the EFF Programme

The Executive Board of the International Monetary Fund (IMF) completed the second review under the 48-month Extended Fund Facility (EFF) Arrangement, allowing the authorities to draw SDR 254 Mn (about USD 336 Mn). This brings the total IMF financial support disbursed so far to SDR 762 Mn (about USD 1 Bn). Performance under the program has been strong. All quantitative targets for end December 2023 were met, except the indicative target on social spending. Most structural benchmarks due by end-April 2024 were either met or implemented with delay.

Sri Lanka Reaches Debt Deal with Creditor Nations, Including China

Sri Lanka has reached a final restructuring agreement for USD 10.58 billion of debt with its bilateral lenders' Official Creditor Committee in Paris, France and China Exim Bank. This agreement grants significant debt relief, allowing Sri Lanka to allocate funds to essential public services and secure concessional financing for its development needs.

Trade Deficit Narrows in April 2024 as Exports Surge

Exports increased more than imports year-over-year, reducing the trade deficit in April 2024. However, the cumulative trade deficit for January to April 2024 widened. The momentum in tourism continues, although tourist arrivals slowed in April and May 2024 in line with seasonal patterns. Workers' remittances continued to contribute significantly to the external current account and forex market liquidity.

Three Key Legislative Reforms taken place thus far 2024

1. Public Financial Management (PFM) Bill which establishes a robust legislative framework for fiscal reforms, defining the budget cycle's processes, roles, responsibilities, and accountability requirements.
2. Public Debt Management (PDM) Bill, which creates a comprehensive framework for public debt management, authorizing the government to borrow, issue, and service debt, including provisions for guarantees, on-lending, and financial agreements.
3. Economic Transformation Bill, which establishes the National Policy on Economic Transformation to improve living standards, foster rapid development, and prevent economic crises by restructuring debt and transforming Sri Lanka into a competitive, export-oriented, and digital economy.

Global Economy

Global Economy Steadies, But Developing Nations Struggle to Regain Momentum Post-Pandemic

Global growth is stabilizing with inflation at a three-year low and improved financial conditions, suggesting a "soft landing" for the world economy. However, developing economies are still struggling post-COVID-19, with growth expected to average 2.7% annually through 2026, below the pre-pandemic 3.1%.

Dashboard

Y-o-Y changes, otherwise specified

Economic Growth

5.3% in Q1-2024

-10.7% (Q1-2023)

Movement of Purchasing Managers' Index-May 2024

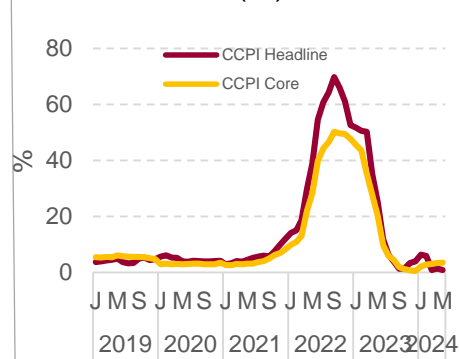
Manufacturing PMI **58.2**

Services PMI **55.0**

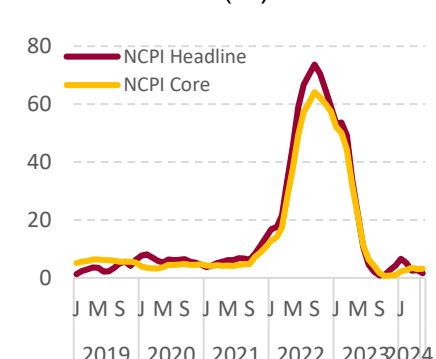
Both Manufacturing and Services activities recorded an improvement in May 2024.

Inflation

CCPI Inflation (%) - Base 2021

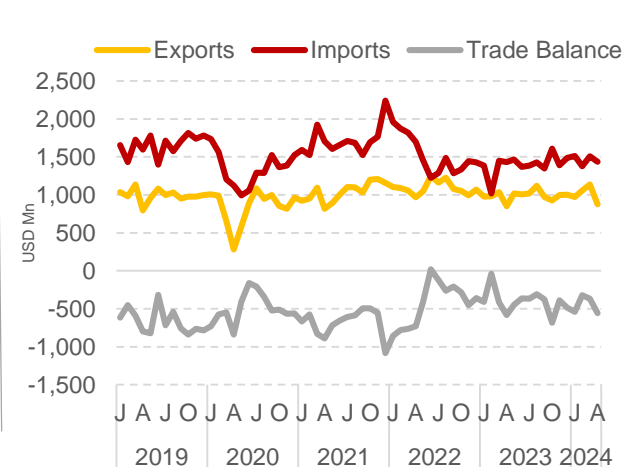


NCPI Inflation (%) - Base 2021



External Sector

Merchandise Trade



Tourism

Apr. 2024

Exports **3.4%** ↑

Imports **0.3%** ↑

Workers' Remittances

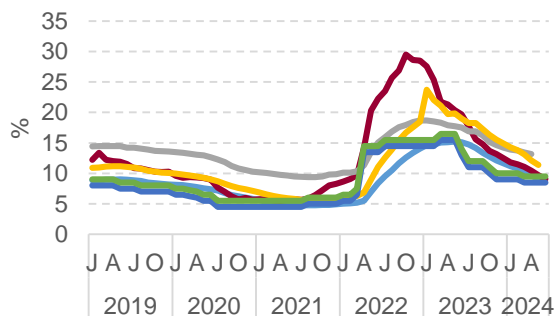
May 2024 **13%** ↑

May 2024

Arrivals **35%** ↑

Earnings **17%** ↑

Interest Rates



- AWDR
- AWPR
- AWLR
- AWFDR
- SDFR (Repo)
- SLFR (Rev.Repo)

SDFR: 8.50%
SLFR: 9.50%

Growth in Credit to Private Sector

Apr 2024

4.1%

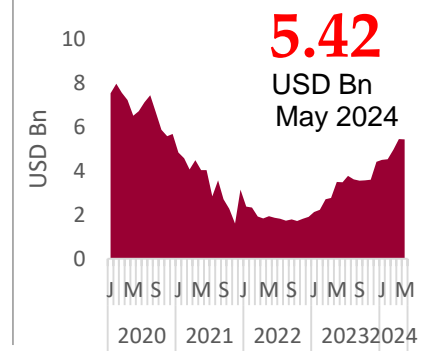
Exchange Rate



Appreciation of LKR thus far 2024

6.1%

Official Reserves



KEY INSIGHTS

Sri Lankan Economy

Economy Gradually Stabilizing: Q1 2024 Records 5.3% Growth

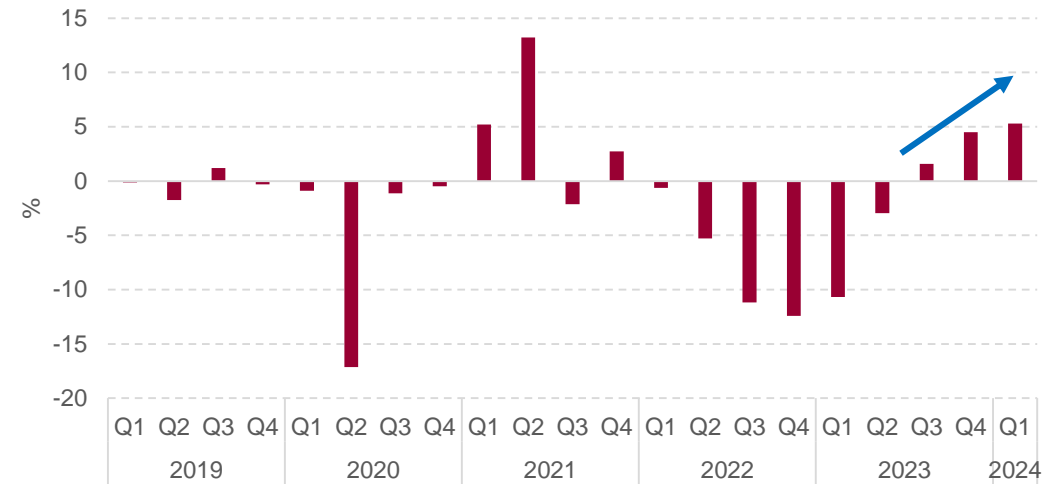
Marking the third consecutive quarter of positive growth, the first quarter of 2024 recorded a 5.3% growth in the Sri Lankan economy. The three major economic sectors—'Agriculture', 'Industry', and 'Services'—contributed 7.7%, 26.2%, and 58.9% respectively to the GDP at current prices.

High inflation, which prevailed in the first quarter of 2023, gradually decreased to a lower level by the first quarter of 2024. This reduction in inflation incentivized the economy by providing inputs at much lower prices. The construction industry, severely affected by high input prices in the first quarter of 2023, notably benefited from this change. Alongside decreasing inflation, interest rates also showed a downward trend towards the end of the first quarter of 2024. Furthermore, increased liquidity in the foreign currency market and the lifting of import restrictions had a favourable impact on almost all manufacturing activities in the first quarter of 2024. Additionally, a rise in tourist arrivals led to expansions in many tourism-related activities during this quarter.

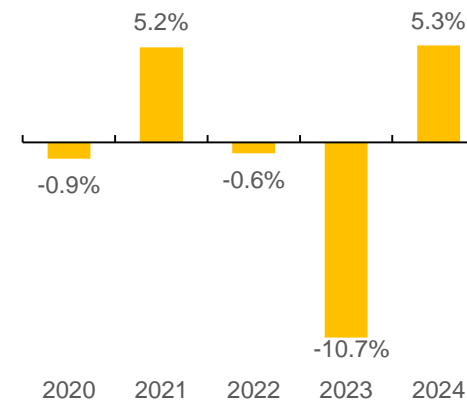
In the first quarter of 2024, agricultural activities expanded by 1.1%, driven by significant growth in 'Growing of cereals' (22.4%) and 'Freshwater fishing and freshwater aquaculture' (18.1%). Industrial activities overall grew by 11.8%. Within 'Industrial activities', the 'Construction industry' grew by 14.2% due to declining input prices, and the 'Mining and quarrying' industry expanded by 18.3%. Service activities increased by 2.6%, supported by growth in 'Accommodation, food, and beverage serving activities' (40.4%) and 'Insurance, reinsurance, and pension funding' (17.8%).

The World Bank's Global Economic Prospects June 2024 report forecasts that Sri Lanka's economy is projected to grow at 2.2% in 2024 and 2.5% in 2025. This represents an improvement of 0.5 percentage points for 2024 and 0.2 percentage points for 2025 from their January 2024 forecasts.

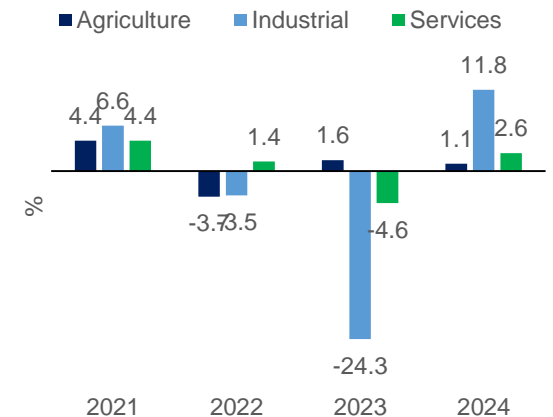
Economy is Gradually Stabilizing



Year-on-Year Q1 Growth Rates



Q1 Year on Year Sectorial Growth



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The performance of quantitative conditionality at the end of December 2023 was strong, with all targets met except one.

- The primary balance posted a Rs. 173.3 Bn surplus, surpassing the Rs. 209 Bn deficit target, while tax revenues of Rs. 2,721 Bn exceeded the Rs. 2,550 Bn target.
- However, the social spending target was narrowly missed.
- Inflation was 3%, within the outer band but outside the inner band of the Monetary Policy Consultative clause (MPCC).
- Net Credit to Government declined to Rs. 2,742 Bn, Rs. 58 Bn below the target.
- Net International Reserve reached USD 2.18 Bn, exceeding the target.

Fiscal SBs achieved include setting fuel and electricity prices at cost recovery levels, parliamentary approval of the 2024 Appropriation Act, and cabinet approval of strategies for VAT refunds and reducing government guarantees. The tax administration KPIs report and the Bulk Supply Transaction account (BSTA) operationalization were delayed. Financial SBs met include recapitalization plans for Phase 2 banks and Banking Act amendments. Governance and anti-corruption SBs saw the publication of rules for Anti-corruption commissioners and procurement contracts. The Asset Recovery Bill enactment was delayed for public consultation, resetting the SB to end-November 2024.

The IMF stressed the importance of governance and structural reforms to unlock growth potential, including trade liberalization, investment climate improvement, SOE efficiency, gender gap reduction, and climate vulnerability mitigation.

Macroeconomic Targets by the IMF

	2021	2022	2023	2024	2025	2026	2027	2028	2029
			Prelim	Projections					
Real GDP Growth	4.2	-7.3	-2.3	2	2.7	3	3.1	3.1	3.1
Average Inflation	6	45.2	17.4	7	5.8	5.4	5.2	5.1	5
Fiscal Revenue and Grants (% of GDP)	8.3	8.4	11.1	13.6	15.1	15.3	15.4	15.4	15.4
Primary Balance (% of GDP)	-5.7	-3.7	0.6	1	2.3	2.3	2.3	2.3	2.3
Central Government Balance (% of GDP)	-11.7	-10.2	-8.3	-7.3	-5.2	-4.6	-4.1	-3.8	-3.8
Government's Gross Financing Needs (% of GDP)	31	34.1	27.8	24.9	23.7	20.5	16.6	13.1	11.9
Government Debt (% of GDP)	102.7	115.9	109.8	108.8	108.4	108.3	106.6	103.2	100.1
External Trade- Current Account Balance (% of GDP)	-3.7	-1	3.1	0.5	-1.1	-1.2	-0.9	-0.9	-0.8
Growth in Credit to Private Sector	13.1	6.4	-0.8	7.2	9.2	9.3	9.5	9.4	9.3
Gross Official Reserves (End Period- US\$ Bn)	3.1	1.9	4.4	5.6	7.2	9.3	13.5	15.1	15.2

KEY INSIGHTS

Sri Lankan Economy

Sri Lanka Reaches Debt Deal with Creditor Nations, Including China

Sri Lanka has finalized a restructuring agreement for USD 5.8 billion of debt with its bilateral lenders' Official Creditor Committee (OCC) in Paris. The agreement, reached on June 26th, provides significant debt relief, allowing Sri Lanka to allocate funds to essential public services and secure concessional financing for development needs. This move finalizes an initial agreement struck late last year with a group of official creditors led by France, India, and Japan. Concurrently, a final agreement has been reached on debt treatment between Sri Lanka and the Export-Import Bank of China (EXIM), which covers about USD 4.6 billion of outstanding external debt.

With these agreements, Sri Lanka can defer all bilateral loan payments until 2028 and repay on concessional terms until 2043, providing significant economic relief. In 2022, Sri Lanka spent 9.2% of GDP on foreign debt payments. The new agreements will reduce this to under 4.5% of GDP between 2027 and 2032. Additionally, the government's annual gross fiscal requirement, which was 34.6% of GDP in 2022, will decrease by over 13% during 2027-2032. This also facilitates Sri Lanka to achieve a 2.3% primary budget surplus by 2025, the key fiscal target set by the IMF. The restructuring deal will enable creditor nations to resume lending to Sri Lanka, a critical step to maintain funding from the IMF's Extended Fund Facility (EFF) program. The agreement's successful implementation will allow Sri Lanka to reduce its overall debt burden by USD 16.9 billion, providing a much-needed boost to the nation's economic stability and growth prospects.

The finalized agreements with the OCC and EXIM Bank of China demonstrate Sri Lanka's commitment to achieving fiscal sustainability and restoring investor confidence. These agreements are expected to pave the way for further international support and investment, which are vital for the country's long-term economic recovery. The next objective is to reach an agreement with commercial creditors, including International Sovereign Bond holders.

Instrument Category	End March 2024 (USD Mn)
Domestic Debt	57,283
LKR Denominated	57,043
FX Denominated	240
External Debt	37,041
Bilateral	10,589
Multilateral	11,716
Commercial	14,736
Guaranteed Debt	5,860
LKR Denominated	1,924
FX Denominated	3,936
International Sovereign Bond Issuances	12,550
Term Financing Facilities - China Development Bank	2,185.9
Public Debt	100,184

KEY INSIGHTS

Global Economy

Global Economy Steadies, But Developing Nations Struggle to Regain Momentum Post-Pandemic

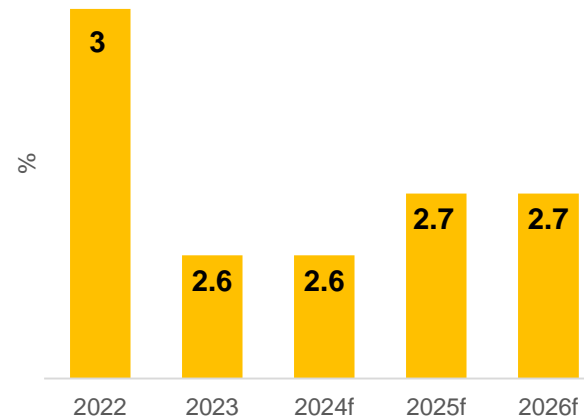
Global growth is stabilizing after slowing for three years, with inflation at a three-year low and improved financial conditions, suggesting a "soft landing" for the world economy.

However, over four years after COVID-19, developing economies still struggle to find a path to prosperity. Growth is expected to average 2.7% annually through 2026, below the pre-pandemic 3.1%. By year-end, a quarter of developing economies will be poorer than before the pandemic, and by 2026, most countries will grow slower than pre-COVID-19 levels. By the end of 2026, global inflation is expected to settle at an average rate of 2.8 percent, broadly consistent with central bank targets.

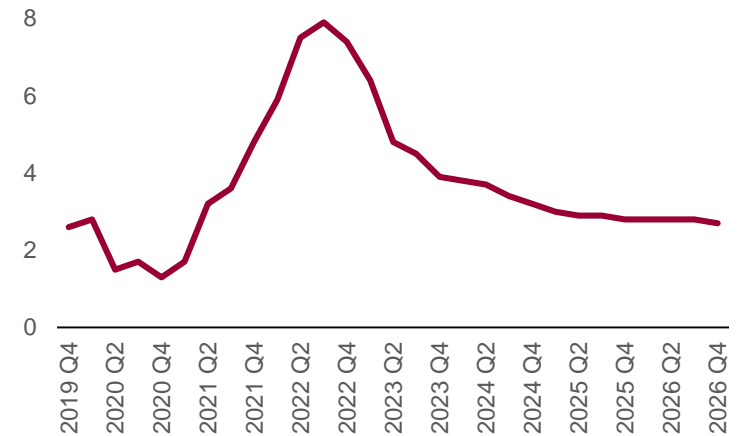
Without better policies, global interest rates averaging 4% through 2026 will hinder improvement. Prosperity requires policies fostering productivity, entrepreneurship, innovation, and international cooperation, akin to the post-Berlin Wall era, which saw significant global economic progress and reduction in extreme poverty, as stated in the latest Global Economic Prospects Update of the World Bank.

Growth in South Asia is expected to slow from 6.6% in 2023 to 6.2% in 2024, mainly due to India's moderating growth. The region's growth is forecasted to remain at 6.2% through 2025-26. Bangladesh will see robust, but slower growth, while growth in Sri Lanka and Pakistan is expected to strengthen. However, risks such as commodity market disruptions, fiscal consolidations, financial instability, extreme weather events, and slower growth in China and Europe pose threats. Upside risks include stronger U.S. activity and faster global disinflation.

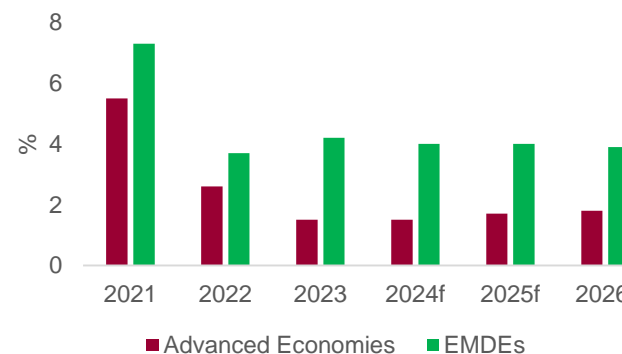
Global Growth is Holding Steady



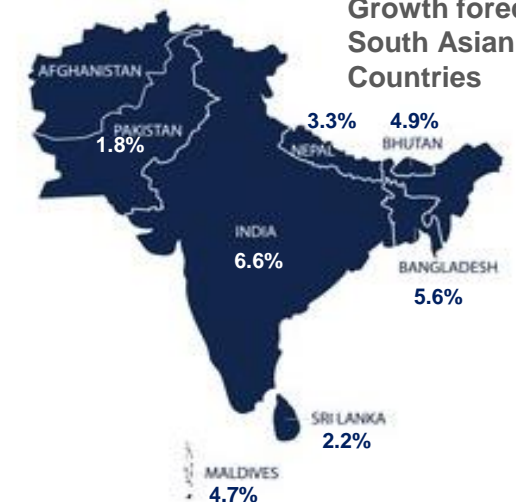
Global Inflation Expected to Settle at 2.8% by the end of 2026



Growth for Advanced Economies and EMDEs



Growth forecasts for South Asian Countries



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.

Legislative Reforms in Sri Lanka 2024

Public Financial Management Bill

The Public Financial Management (PFM) Bill, presented to Parliament on May 22, 2024, introduces a comprehensive array of fiscal reforms within a robust legislative framework. This Bill establishes a clear legal structure for the budget cycle, detailing relevant processes, roles, responsibilities, and accountability requirements.

It repeals the Fiscal Management (Responsibility) Act, No. 03 of 2003, and implements a stricter fiscal rules framework, including a primary balance target and primary expenditure ceiling tied to a legally established Medium Term Macro-Fiscal Framework (MTFF). The MTFF must be published annually in June as part of a Fiscal Strategy Statement, providing a medium-term fiscal outlook that guides budget preparation. The Bill enhances fiscal discipline by prioritizing and selecting capital expenditure projects more effectively and addressing fiscal risks from State-Owned Enterprises and Public-Private Partnerships through a Fiscal Risk Statement. It also enforces stricter guidelines on issuing Treasury guarantees.

These improvements aim to ensure fiscal consolidation and achieve fiscal targets under a medium-term approach aligned with the overall debt reduction strategy. The PFM Bill is poised to be landmark legislation, cementing key fiscal reforms from the past two years and helping prevent a recurrence of the economic crisis Sri Lanka faced in 2022.

Public Debt Management Bill

The Public Debt Management (PDM) Bill, presented to Parliament on April 26, 2024, establishes a comprehensive framework for public debt management. This Bill authorizes the government to borrow, issue, and service public debt, and includes provisions for issuing guarantees, on-lending, and entering into supplier credit and financial lease agreements.

A key aspect of the Bill is the creation of the Public Debt Management Office (PDMO) within the Ministry of Finance. The PDMO will be responsible for preparing and publishing the medium-term debt management strategy, the annual borrowing plan, and auction calendars for issuing government securities. Additionally, the PDMO will handle the negotiation of financial terms and conditions for domestic and external borrowings, credit arrangements, and other debt management activities. This legislative framework aims to enhance the efficiency and transparency of Sri Lanka's public debt management, ensuring better fiscal discipline and strategic planning in managing the nation's debt obligations. The Parliament of Sri Lanka has passed the PDM Bill on June 7th.

Public Debt Management Bill

The Economic Transformation Bill, presented to Parliament on May 22, 2024, outlines the foundation for establishing the National Policy on Economic Transformation, aimed at providing citizens with an adequate standard of living, fostering rapid national development, and preventing future economic crises. This policy includes restructuring government debt and transforming Sri Lanka into a highly competitive, export-oriented, and digital economy.

The Bill proposes the creation of an Economic Commission to foster a robust investment climate, promote sustainable foreign direct investment, and evaluate the need for Investment Zones in Sri Lanka. Under this Commission, "Invest Sri Lanka" will be established to identify investment opportunities, guide potential investors, and facilitate investment establishment, retention, and expansion. Additionally, the Bill establishes "Investment Zones of Sri Lanka (Zones SL)" to conduct studies on the necessity of creating or expanding Investment Zones, make recommendations to the Economic Commission, and manage these zones on behalf of the government. Upon enactment, the Bill will repeal the Board of Investment of Sri Lanka Law, No. 4 of 1978.

The Bill also entails the creation of an Office for International Trade to promote, develop, and facilitate Sri Lanka's international trade. An ambassador for international trade will be appointed as the chief negotiator for international trade agreements. Furthermore, the Bill calls for the establishment of a National Productivity Commission as an independent body accountable to Parliament. This Commission will make evidence-based recommendations to enhance productivity and economic performance. The Bill also proposes the creation of the Sri Lanka Institute of Economics and International Trade as a platform for research and policymaking related to economics, international finance, and trade.

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

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