

Trends in the Economy in 1988

Sri Lanka's economic performance in 1988 fell considerably below expectations with the Gross National Product (GNP) recording a growth of only 2.5 percent. It is described by the Central Bank as a "modest recovery" when compared with the poorer performance of a 1.6 percent GNP growth rate in 1987. The comparative figures for Gross Domestic Product (GDP) growth rate were 2.7 percent in 1988 as against 1.5 percent in 1987.

Agriculture

The "modest" growth rate in 1988 is attributed mainly to an improvement in agricultural production. As the Central Bank records it "The agricultural sector recovered considerably in 1988, from the drought affected low production levels experienced in the preceding year. Most tree crops and field crops recorded improved performances in 1988, compared with 1987. Tea production increased by 6 percent to a record 227 million kgs. in 1988, while rubber production also rose marginally to reach 125.5 million kgs. However, coconut production declined substantially by 16 percent to 1,933 million nuts — the lowest level since 1978. Paddy production which suffered during the previous two years due to unfavourable weather and unsettled conditions in the Northern and Eastern regions, recovered sharply to register a 16 percent growth and an output level of 2.5 million metric tons. The performance of both minor food crops and minor export crops was also favourable."

Industry

The industrial sector also showed an expansion in 1988, despite the adverse conditions facing manufacturers in the latter part of the year. In real terms, industrial output is estimated to have increased by 6 percent in 1988, a slightly lower rate of growth than in the previous year. The output of private sector industries is estimated to have increased by 11 percent, while production in public sector industries declined by 1 percent.

Energy

The energy situation in the country also showed improvement in 1988. There were increased opportunities for hydro-electrical generation; while the decline in oil prices in the international

market also contributed to a better performance for the energy sector.

There were several minus factors in Sri Lanka's economic performance in 1988. The adverse circumstances that confronted the economy, resulting particularly from the escalation of civil disturbances and also unsettled conditions connected with two major general elections facing the country, led to a serious deterioration in the budgetary situation, an excessive growth in the money supply, an escalation of consumer price levels, and unfavourable trends in the balance of payments with external reserves continuing to fall heavily.

Money Supply

A significant adverse development in 1988 was the considerable acceleration in domestic credit. All components in the money supply rose during last year, the most notable being the currency component which increased by as much as 37 percent over that of 1987. This increase was to an extent caused by the high preference for liquid cash by businessmen and the public owing to the escalation in the civil disturbances during the latter part of the year. Together both currency and demand deposits increased by 29 percent by December 1988 as against an 18 percent increase by December 1987 and 13 percent by December 1986.

Credit granted to the private sector, including Public Corporations recorded the sharpest growth in 1988. Several private sector enterprises and major Public Corporations such as Petroleum, State Plantations, JEDB and C.W.E. were threatened by liquidity problems due to the difficulties in obtaining funds and they were compelled to take precautionary measures of raising additional funds for their working capital requirements. Commercial Bank credit to Public Corporations increased mainly due to these heavy borrowings.

Balance of Payments

The sharp growth in money supply resulted in an expansionary impact on the economy. Fortunately this expansionary effect was moderated due to the decline in the country's net external banking assets. Sri Lanka's balance of payments position weakened to a large extent in 1988. The causes were mainly a slow growth in export earnings, increased import payments, decline in the earn-

ings from tourism, higher interest payments on foreign loans, a slower flow in private transfers, reduction in private foreign investment and larger amortization payments of foreign debts.

The effect of all these adverse trends was an overall deficit of Rs.5,000 million (SDR Rs. 101 million) in the overall balance of payments as compared with a deficit of Rs.1,801 million in 1987. The massive payments deficit in 1988 had to be financed by running down external reserves. The level of gross external assets at the end of December 1988 stood at SDR 298 million as compared with assets worth SDR 415 million in 1987. This level of gross external assets at the end of 1988 was sufficient to meet only 2½ months of imports projected for 1989, which compares with a position of 3.7 months of imports in 1987 and 4.4 months of imports in 1986.

Government Finance

The budgetary performance in 1988 also reflected negative trends, particularly a deterioration in the fiscal position. Government revenue showed only a marginal increase, with lower collection of revenues due to the unsettled conditions. There were also increased commitments on account of several items of current expenditure such as salaries and wages, drought relief and the Food Stamp scheme. In addition, a large number of supplementary capital expenditure programmes were permitted for ongoing development activities. The result was an overall increase, in the budget deficit, of 11 percent of GDP in 1987 compared to 15 percent of GDP in 1988. The widening of the budget deficit was a combined outcome of slow growth in government revenue and a larger increase in expenditure. The resulting resources gap of nearly Rs 11 billion had to be financed from banking sources. This resulted in an expansionary financing of the budget deficit.

Prices

Consumer prices showed an increase of 14 percent during 1988 over the average level of 1987. This was almost twice the increase recorded in the previous year. Much of the increase in prices was due to higher food prices. Meanwhile, the Wholesale Price Index, maintained by the Central Bank, also showed a sharp upward movement during the year (17.8 percent), indicating considerable price pressure at the primary market level as well.

Our January/February 1989 and March 1989 issues will carry more details of how the economy performed in 1988.