THE ECONOMY

Inflation in 1979

The price situation has been a matter of serious concern in 1979 with fears that it could be aggravated by further increases in oil prices and unstable conditions in certain areas on the international scene. Furthermore, the relatively poor Yala harvest this year, and the wage increase granted in September were expected to add to inflationary pressures. Commencement of the Government's larger development projects such as the Accelerated Mahaweli Project, which has a long gestation period will also contribute to further pressure on the price level in the short-run.

All indications are that the rise in consumer prices in Sri Lanka towards the end of 1979 was of the order of a rate of 20 to 30 per cent which was of an unprecedented magnitude. By comparison, the consumer price rise recorded during 1978 was less than 13 per cent. Available information suggests that the bulk of the consumer price increases took place in food items and in the fuel and light category. Moreover, the price increases were sharper in the second half of the year compared to the first half.

Containing Pressures

The Government had been able to contain inflationary pressures in the economy in the earlier part of 1979, when compared to the situation in several other countries, despite adverse world conditions. The Colombo Consumers Price Index showed a very moderate increase of 2.1 percent in the first half of this year as compared with the recorded increase of 10.9 percent during the first half of 1978. The Central Bank Wholesale Price Index on the other hand declined by 5.3 percent compared to an increase of 2.4 percent in the first half of 1978. This was due primarlly to a sharp decline in tea prices, which have a high weightage in the index, and a drop in the price of rice.

The inflationary trend in the latter half of the year was a result of a combination of factors originating in the supply on the cost side as well as in the demand side. It appears, however, that the supply or cost factors played a more important role in putting pressures on the price level. In the context of liberalised imports, the demand pressures led to a higher import volume and this was a factor offsetting the inflationary impact. On the supply or cost side the following were the important factors which led to a sharp upward movement in consumer prices:

* the secondary effects of the increase in the prices of petroleum products effected in June 1979.
* the withdrawal of price subsidies on kerosene, milk powder and rice in September along with the introduction of the food stamp scheme.
* the upward revision of the prices of wheat, flour and bread in October.
* sharp rise in the price of coconuts (reflecting the drop in the coconut crop during the second half of the year) and the higher price of rice (reflecting the poor Yala harvest).
* the sharp rise in the prices of several other food items such as onions, chillies and vegetables, particularly during the November-December period due to seasonal factors.

In summary the important supply factors (causing inflationary pressures) relate to the rise in fuel costs (reflecting higher import costs) withdrawal or reduction of price subsidies, and supply shortages of some domestically produced food items due to production shortfalls or seasonal factors.

On the demand side, the important factors which put pressure on the price level can be identified as follows:

* The money supply which rose by nearly 11 percent in 1978 rose by a very much higher percentage during 1979. By October 1979 the increase in the money supply (over December 1978) was as much as 21 percent. During the twelve-month period ending October, the increase was 23 percent. During January-October 1979, a sum of over Rs. 1,200 million had been added to the money supply.
* The large scale remittances from migrants, particularly from the Middle-Eastern countries (roughly estimated to be Rs. 40 to 50 million per month.) A substantial portion of these remittances would have gone into consumption that is for the purchase of both durable and non-durable consumption goods.
* About 350,000 unemployed persons received payment (Rs. 50 per month) under the Income Support Scheme, and the money pumped into the economy through this scheme amounted to about Rs. 300 million during 1979. There is no doubt that the bulk of this money went directly into consumption.
* New incomes generated through the higher level of activity particularly in the construction and service (mainly commerce sectors) was a further important sector in creating demand pressures in the economy.

It is importa t to note, in the context of liberalised imports, these demand pressures led to a higher flow of imports which helped to offset (at least partially) the inflationary impact on the domestic price level.

Wage Increases

The effects of the rise in consumer prices on the living standards was cushioned to some extent by an increase in wages. A salary increase of 10 percent was granted to public sector employees in January 1979 and a further increase of Rs. 55 per month was granted in September to compensate for the withdrawal of price subsidies. Similar wage adjustments took place in the private sector, at least in the organised businesses of the private sector.

The sharp rise in consumer prices during 1979 and the possibility of further price increases in the coming months, and the reduction of the number of leave days for public sector

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employees from January 1980, are factors which are expected to lead to a further round of wage increases in the early half of 1980. The recent fuel price increases announced by some OPEC countries should lead to a further upward adjustment in the local fuel prices and this should lead to widespread secondary effects on prices and costs in practically all sectors of the economy. In this context, it may become necessary to adjust rail and bus fares in order to avoid a sharp rise in the losses (which are already very high) suffered by the public transport system. Another important item, presently subsidised, which is likely to experience further upward price adjustment is wheat flour and bread, where the government policy appears to be to eliminate the subsidy in gradual stages. The immediate prospects thus appear to be a further round of wage increases and upward movements in consumer prices. Price stability remains a problem the authorities would have to battle with.

There is hardly any developing capitalist country that is not seriously affected with inflation at home and has been compelled in recent months to face up to the situation of world recessionary tendencies. The London *Financial Times* of January 21 reported that in Turkey inflation is unchecked with prices rising at an annual rate of 70 percent. The *Economist* of January 18 reported that in Brazil the 1979 inflation rate was 77.2 percent. Again, the *Economist* of January 26 reported that the increase in the rate of inflation in Argentina was as high as 170 percent in 1979 and has been at this level over the last few years. Reports from many Asian capitals indicate that the inflation rates in 1979 ranged between 20 & 30 percent in Asian countries such as the Philippines. South Korea and India.

International bankers were expecting 1979 to surpass the record lending in Asia and the Pacific during 1978; while in 1980 it is expected to go even higher. With the struggle against inflation and anticipated world recession most Asian nations were trying to control their appetite for large international loans. An *Asian Wall Street Journal* report states that this was causing bankers who make syndicated loans "to cringe as they watch profit margins narrow in a strong borrowers market"

In South Korea. for example. to slow development's pace and inflation the government has repeatedly delayed several large industrial and petrochemical projects. "Asian nations are adopting tight money and credit policies at home. Most have raised interest rates. while central banks have enacted restrictions to reduce money supply growth. In several countries. this has hobbled local capital investment and kept stock markets sluggish."