

THE ECONOMY WEAKENING OF SRI LANKA'S BALANCE OF PAYMENTS

Sri Lanka's balance of payments situation in 1988 was one of the most disappointing in recent years. Last year the deficit on the Merchandise Account widened by 9 percent, while the Current Account deficit expanded by 22 percent. The ratio of the Current Account deficit to GDP, which is a basic indicator of the degree of weakness of a country's balance of payments situation, increased from 5.9 percent in 1987 to 6.7 percent in 1988. Gross external assets also recorded a drop in 1988 compared to that of the previous year. There were several factors responsible. The slow growth in export earnings, increased import payments, the decline in earnings from tourism, a reduced flow of private foreign investment and larger amortization payments on foreign debts were all contributory factors. The effect of these adverse developments was an overall deficit of SDR 101 million (Rs. 5,000 million) which had to be financed by running down the country's external reserves.

The Central Bank has drawn attention to the adverse impact on the balance of

payments in 1988 caused by the continued civil unrest in the country. The escalation of civil disturbances after October had not only disrupted export supplies but also hindered recovery of the tourist sector and slowed down most business and economic activity. The attempts to improve balance of payments performance, such as implementation of recommended macro economic policies, under the IMF supported adjustment programme were also interrupted by the continuous instability in the country, according to the Central Bank.

The merchandise trade situation was among the most seriously affected from the unstable conditions in the latter part of 1988. For instance, export earnings which showed a 10 percent growth rate upto October 1988, declined sharply during the last two months of the year. The result was that the rate of growth of exports in 1988 was restricted to 2 percent. Meanwhile import payments increased by 4 percent in 1988 in SDR terms, as against the 5 percent decrease in the previous year. Rice imports in-

creased by as much as 86 percent. The Central Bank however, has noted that the growth of consumer goods exports has moderated since 1985 owing to the slow growth of incomes and rising in rupee costs of imports mainly due to the depreciation of the Sri Lankan rupee against the major currencies, especially the Japanese Yen.

The overall price movements in the international markets also turned out to be adverse for Sri Lanka during 1988, with the export price index rising by only 1 percent in SDR terms, while import prices increased by nearly 9 percent. The result was a deterioration of Sri Lanka's terms of trade by 7 percent in 1988 as against an improvement in the previous year.

Payments outwards on account of services also increased by over Rs. 5 billion (SDR 5 million) in 1988, mainly because of the increased payments on interest on loans that fell due in 1988 and a further decline in earnings from tourism. Interest payments on the external debts rose from SDR 150 million in 1987 to SDR 165 million in 1988. Meanwhile, gross earnings from tourism

Balance of Payments Analytic Presentation 1984 - 1988

Item	SDR Million					Rupees Million				
	1984	1985	1986	1987 (a)	1988 (b)	1984	1985	1986	1987 (a)	1988 (b)
1. Trade Balance	453	711	649	525	574	-11,850	-19,801	-21,390	-20,005	-24,512
Exports	1,427	1,296	1,029	1,077	1,093	37,198	35,728	33,893	41,097	46,764
Imports	1,880	2,007	1,678	1,602	1,667	49,048	55,529	55,283	61,102	71,276
2. Services, net	66	133	109	121	126	-1,735	-3,647	-3,616	-4,625	-5,403
Receipts	329	323	323	307	293	8,567	8,926	10,601	11,721	12,524
Payments	395	456	432	428	419	10,302	12,573	14,217	16,346	17,927
3. Goods and Services, net	519	844	758	646	700	-13,585	-23,448	-25,006	-24,630	-29,915
4. Transfers, net	468	434	395	381	376	12,185	12,040	13,097	14,537	16,074
Private	270	262	242	242	234	7,031	7,212	7,983	9,226	9,998
Official	198	172	153	139	142	5,154	4,828	5,114	5,311	6,076
5. Current Account Balance (3+4)	51	410	363	265	324	-1,400	-11,408	-11,909	-10,093	-13,841
6. Non-Monetary Capital, net	335	328	279	218	193	8,755	9,062	9,094	8,408	8,232
Direct Investment	32	24	24	45	41	829	679	784	1,727	1,732
Private Long-term, net	5	31	15	10	22	119	847	514	437	947
Private Short-term, net	25	3	11	30	10	648	120	377	1,217	438
Government, Long-term, net	333	270	251	153	164	8,693	7,416	8,173	5,901	7,009
Inflows	398	342	350	265	286	10,387	9,422	11,425	10,162	12,243
Outflows	65	72	99	112	122	1,694	2,006	3,252	4,261	5,234
7. Valuation Adjustments	-	-	-	-	-	39	1,491	1,371	1,841	7
8. SDR Allocations	-	-	-	-	-	-	-	-	-	-
9. Errors and Omissions	13	29	10	25	30	-254	-205	-680	-1,957	603
10. Overall Balance	297	111	74	72	101	7,062	-1,060	-2,124	-1,801	-5,000
11. Monetary Movements	297	111	74	72	101	7,062	1,060	2,124	1,801	5,000
Exchange Rate Rs./SDR						26.08	27.63	32.90	38.10	42.76
Ratios to GDP in Percentages										
Trade Account						-7.68	-12.10	-11.90	-10.17	-11.01
Current Account						-0.87	-6.97	-6.67	-5.12	-6.21
Current Account without grants						-4.23	-9.90	-9.47	-7.81	-8.94

(a) Revised
(b) Provisional

Note: All transactions in the Monetary Sector are converted at end of the year exchange rates.

Source: Central Bank of Sri Lanka.

declined from SDR 55 million in 1987 to SDR 46 million in 1988.

Among the positive developments in the balance of payments situation was the increased earnings from the port, transportation and insurance services which increased from SDR 2 million in 1987 to SDR 6 million in 1988. Also, investment income outflows from the repatriation of profits and dividends by non-resident enterprises in Sri Lanka declined from SDR 27 million in 1987 to SDR 15 million in 1988.

Foreign exchange inflows in the form of private remittances, the major part of which is the inward remittance by Sri Lankans working abroad, fell by 3 percent in 1988 and showed a continuation of this decline for the fourth consecutive year. The decline in 1988 of transfer receipts from both private and official sources contributed to the worsening of the balance of payments situation. Usually, a significant part of the payments deficit on goods and services is met out of the net transfer receipts, but because a large current account deficit amounting to SDR 324 million (Rs. 13.8 billion) emerged, the deficit had to be financed out of the net non-monetary capital flows and use of external assets.

Altogether, the net capital flows different sources were sufficient to finance only 60 percent of the widened current account deficit in 1988, leaving an overall deficit of SDR 101 million (Rs. 5,000 million) for financing by drawing on external reserves.

Gross external assets at the end of December, 1988, stood at SDR 393 million (Rs. 17,482 million), compared with SDR 415 million (Rs. 18,134 million) at the end of 1987. The level of gross external assets at the end of 1988 was sufficient to finance approximately two and a half months of imports projected for 1989.

Total debt service payments increased from SDR 383 million (Rs. 14,538 million) in 1987 to SDR 399 million (Rs. 17,018 million) in 1988. Interest payments accounted for 37 percent of the total debt service payments in 1988 as compared with 34 percent in 1987, reflecting a deepening of the burden of foreign debt. The debt service ratio, that is, the total debt service payments as a ratio of exports of goods and services, rose marginally from 28 percent in 1987 to 29 percent in 1988.