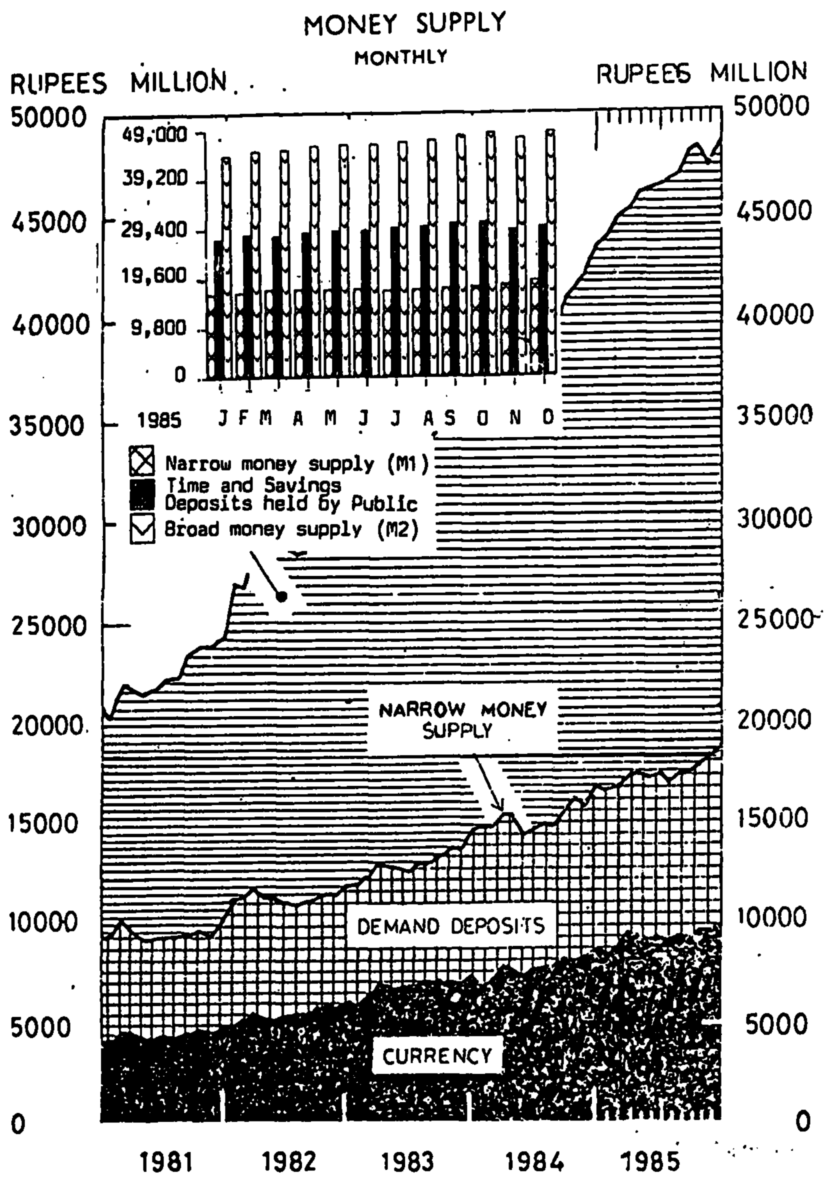
ECONOMIC INDICATORS



The budget deficit in 1985 was nearly twice that of 1984 as a result of the decline in the tea ad-valorem tax and export duties,and the steep rise in government spending on defence related activities.In order to finance this deficit the government was compelled to resort to expansionary sources of financing; particularly a heavy recourse to bank credit.This sharp growth in net credit to government had a major influence on monetary developments from early 1985.In order to cope with the excess liquidity position in 1985 the Central Bank continued with its restrictive monetary package.

But since the commercial banks were unable to lend to non-priority sectors with the credit restrictions in force,and the low demand for credit from the private sector the excess liquidity situation was further aggravated. These restrictions on commercial bank credit for non - essential imports were further strengthened by extending restrictions over finance companies activities.The transactions in the inter-bank call money market were a reflection of this excess liquidity position experienced by the commercial banks.With the slackened demand for short term credit,transactions in the inter-bank market continued to register a drop.

The depreciation of the Sri Lanka rupee against all major currencies continued through 1985 into 1986.The cummulative changes since 1977 showed that by the end of February 1986 the Rupee had depeciated by 42 percent against the U.S. Dollar,28.3 percent against the Pound Sterling,57.4 percent against the Japanese Yen,42.8 percent against the Deutsche Mark and 40.7 percent against the SDR.