Economic Update

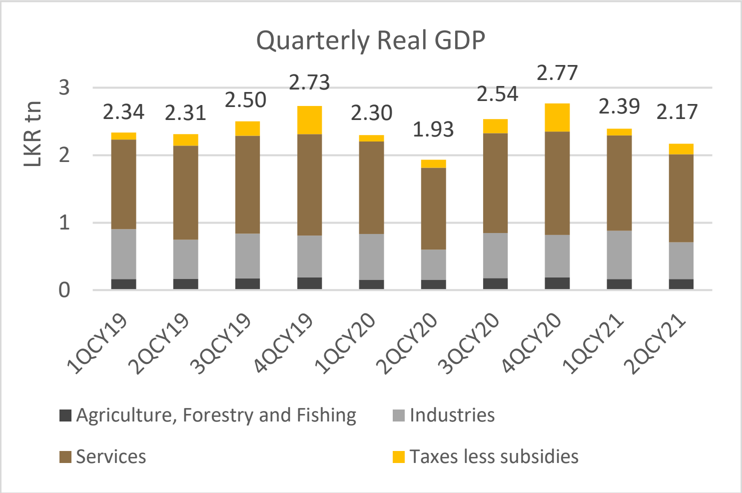
November 2021

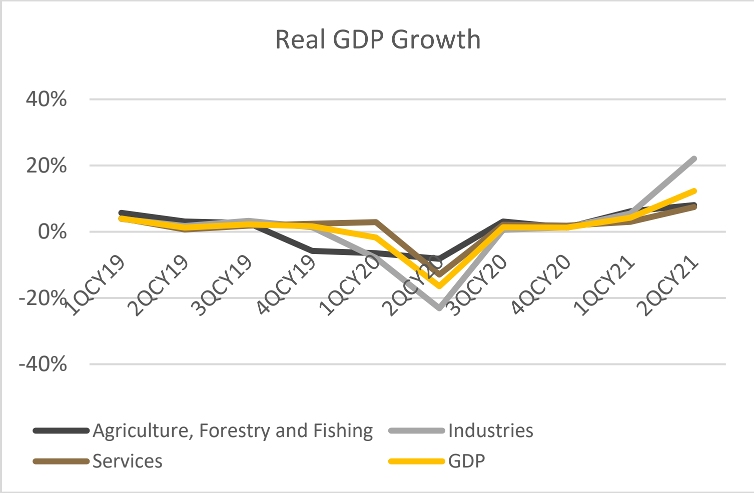
Saniya Tauseef | Team Lead Research | saniya.tauseef@pacra.com
Aqeela Albar | Research Analyst | aqeela@lra.com.lk
Rabiya Ahamad | Analyst | rabiya@lra.com.lk
Shenuka Waniganayake | Analyst | shenuka@lra.com.lk

Summary

- **LRA expects the overall GDP growth rate to increase to 3.6% from 3.3% previously estimated.**
- **Inflation would increase but remain within single digit level.**
- **LRA expects the new budget to be more investment oriented.**
- **LRA does not expect any major tax concessions with the budget.**
- **Reviving of the domestic economy would take a centre stage in the new budget.**

Real sector





Sri Lanka recorded a GDP growth of 12% in the 2QCY21 (LKR 2.2tn) from a low GDP base of LKR 1.9tn recorded in 2QCY20. The services sector had the largest contribution, with an output of LKR 1.3tn, an 8% YoY growth compared to the -13% YoY decline in the 2QCY20. Accommodation and food and beverages services grew by 43%, however the growth in the absolute value was only LKR 5.3bn. Financial and auxiliary services grew by 14% (LKR 32bn).

The agriculture, forestry and fishing sector recorded an output of LKR 0.16tn which was an 8% growth YoY, compared to the -8% decline in the previous year. Marine fishing and marine aquaculture grew by 25%.

The industrial sector recorded a GDP growth of 22% YoY (LKR 0.55tn), a rebound from the -23% decline in the previous year. Manufacture of textiles recorded a growth of 61% (LKR 21.5bn) and manufacture of rubber products grew by 67% (LKR 9.6bn).

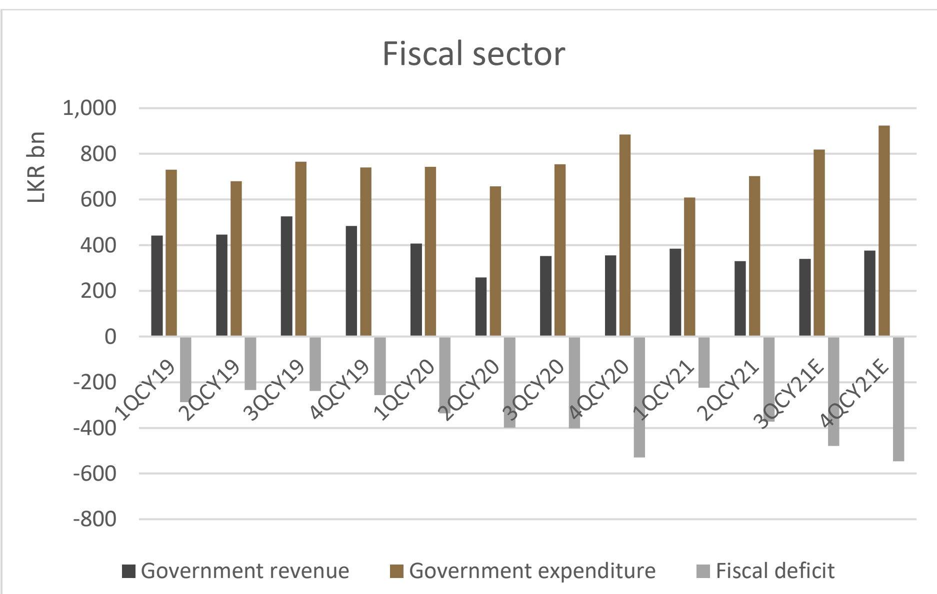
However, it should be noted that the GDP suffered a QoQ decline of 9% when compared with the 1QCY21 GDP of LKR 2.4tn. This was because the country was hit by the 3rd wave of the Covid-19, and an outbreak of the highly transmittable delta variant, resulting in another series of lockdowns and travel restrictions. For the most part however, industries and construction sites were allowed to operate, while adhering to strict guidelines.

The Q3 too was affected by lockdowns and travel restrictions, but with these restrictions being lifted in the Q4, the festive season and the uplifted spirits of the people are expected to get the economy rolling. Tourism too has resumed, and the number of tourist arrivals are expected to show a marked increase by December. LRA expects a QoQ growth of ~10% in the 4QCY21 compared to the 3QCY21, and has revised its annual GDP growth rate to 3.6%.

Fiscal Sector

Considering the period Jan-July 2021, the total government revenue (revenue and grants) was LKR 799.8bn, of which LKR 716.7bn (90%) was tax revenue, LKR 82.2bn (10%) was non-tax revenue and LKR 0.9b was grants. During the same period, government expenditure (recurring and capital) was LKR 1,814.5bn, resulting in a fiscal deficit of LKR 1,014.5bn. The deficit is expected to increase further in 3Q and 4Q, resulting in an estimated annual fiscal deficit of LKR 1,622bn (10% of GDP).

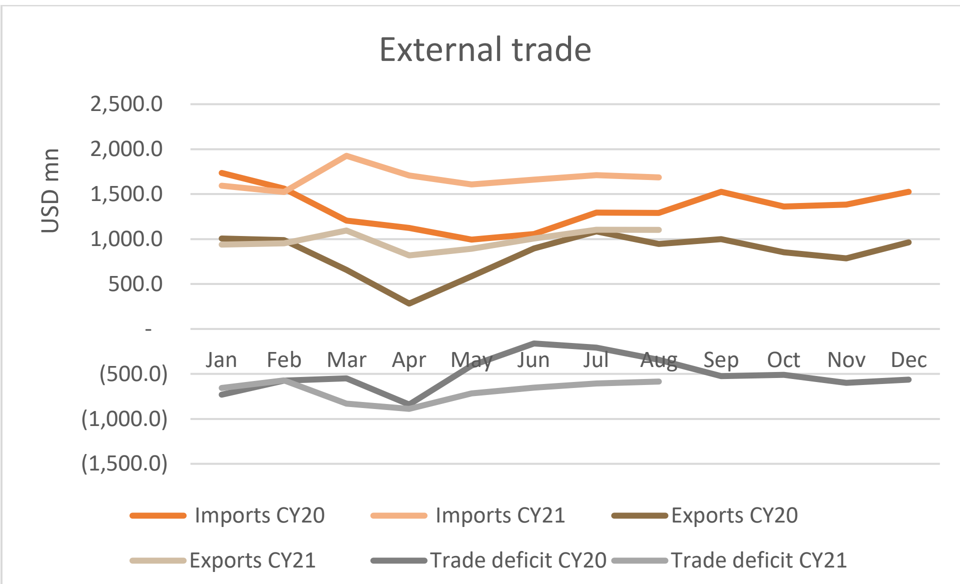
Government debt at the end 2QCY21 was 104% of GDP (LKR 16.6tn), of which LKR 9.9tn (60%) was domestic debt and LKR 6.6tn (40%) was foreign debt. Government debt is expected to increase to ~108% of GDP by end CY21.



Inflation

Headline inflation increased to 7.6% in October (from 5.7% in September) while core inflation increased to 6.3% from 5.0%. During the month of October, the price controls of several essential item were removed, resulting in the prices of many food items including rice, milk powder, wheat flour, and bread and non-food items like L.P gas increasing. With the approaching festive season, global logistics and supply chain issues and the surge in global commodity prices, this trend in inflation could be expected to continue for the rest of the year.

External Sector



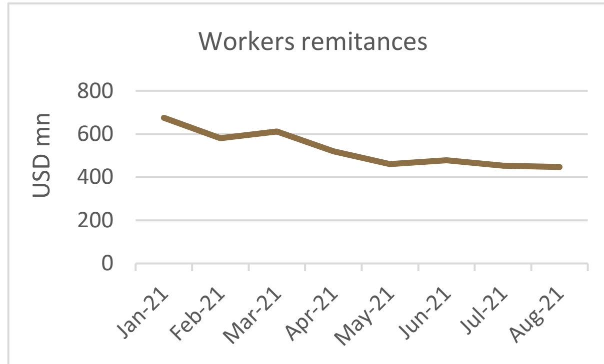
Total imports for the year so far (Jan-Aug) have been USD 13.4bn. This is 31% higher than the import value of the corresponding period in CY20 (which was USD 10.3bn). This increase is despite there being import restrictions, and has been mainly due to increase in commodity prices. The import expenditure per barrel of crude oil rose by 57% over the last year (from USD 47.7 in Aug 2020 to 74.9 in Aug 2021). This resulted in an increase in import expenditure on crude oil by 42%. The import cost of machinery and equipment too rose by 39% and intermediate textiles and textile articles rose by 35% during the period.

Total exports for the period Jan-Aug 2021 (USD 7.9bn) is a 24% increase compared to the total export value in Jan-Aug 2020 (USD 6.4bn). The largest contributors to this increase are the export of garments which increased by USD 544mn (25%) and rubber products which increased by USD 175mn (42%). Export of tea too increased by USD 77mn (10%).

The trade deficit for the period Jan-Aug 2021 is USD 5.5bn, up 45% from the USD 3.8bn trade deficit recorded during the same period last year. Rising commodity prices and weak terms of trade place a year-end trade deficit of USD 8bn on the cards.

Terms of trade, deteriorated by 19% in August 2021, compared to August 2020, as the increase in import prices surpassed the increase in export prices.

The 1HCY21 current account deficit (USD 1,536mn) increased by 46% compared to the 1HCY20 value of USD 1,054mn. Workers' remittances were USD 344mn (12%) higher in 1HCY21 compared to 1HCY20. (1HCY21 – USD 3,324mn, 1HCY20 – USD 2,980mn). The boom in workers remittances was caused by the usage of official channels to remit money back to Sri Lanka during the pandemic. However, over the past five months, remittances have been on a steady decline due to the depreciating LKR and the higher value given by informal channels for the USD.



The opening up of borders and gradual containment of the Covid-19 pandemic has started to attract a trickle of tourists which is encouraging. Tourist arrivals in September was 13,547 up 169% from the 5,040 recorded in August. If the pandemic could be kept under control, this sunny isle could expect a reasonable growth in the number of tourist arrivals in the last two months of the year, which would help both the economy and the forex situation.

The forex reserve balance at the end of August 2021 was USD 3.5bn (~2 months of imports). The government has taken many measures to facilitate the inflow of non-debt forex to address the ongoing forex crisis. These includes monetizing selected under-utilized assets and attracting new FDIs to the Colombo Port City and other industrial zones. Measures to increase repatriation and conversion of export earnings, and mechanisms to facilitate motor vehicle taxes to be paid in forex are also expected to increase forex inflow to the country.