QER - Second Quarter 2006

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Whilst on the one hand the Presidentâ€™s hold on political power was strengthened due to the resounding victory at the local government polls, on the other hand such political power at the centre was undermined by intensified violence in the conflict region as well as in Colombo and the suburbs. Lightening strikes staged by certain trade unions in the railways, power, petroleum, and port sectors compounded the foregoing politico military developments. Rising oil price continued to pose a major challenge to the economy, particularly to the cost of living.

The economy posted impressive growth during the first quarter 2006. The GDP grew by 8% in real terms, with services (9.5%) and agriculture (7.3%) sectors posting the highest sectoral growth rates. The second quarter growth rates are still not available. The record growth in the first quarter was due to low GDP base of the first quarter 2005 in the aftermath of the tsunami. The second quarter 2006 growth rate is expected to be between 6 to 7%.

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In the agricultural sector, while tea and coconut production increased considerably, rubber production declined marginally during the second quarter compared to the previous quarter. Besides, while tea and rubber production in the quarter under review was lower than that in the corresponding quarter last year, coconut production was higher. Colombo tea auction price was on downward path during the second quarter.

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Generally, both the private and public sector industrial production were lower compared to the first quarter. Though both the private and public sector industrial production indices declined in April and May it partially recovered in June. Nonetheless, these indices were considerably higher than those during the same quarter last year. Industrial exports value during the quarter under review was considerably higher than the preceding quarter, and significantly higher than the corresponding quarter last year.Â Â

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The interest rates under consideration in this report, i.e. prime-lending rate, treasury bill rate, repo rate, and reverse repo rate, remained more or less static in the first two months of the quarter but increased considerably in June. Interest rates rose in order to arrest the demand-pull inflation (rise in cost of living).

Inflation during the second quarter, in terms of both the Sri Lanka Consumer Price Index (SLCPI) and the Colombo Consumer Price Index (CCPI), was on upward trend (in comparison to the previous quarter) though the annual average rate of inflation in terms of SLCPI was on downward trend. However, inflation, both in terms of the SLCPI and CCPI, during the quarter under review was lower than in the corresponding quarter last year.

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Public debt incurred during the second quarter was considerably higher than in the previous quarter and significantly higher than in the same quarter last year. Foreign aid received increased during the quarter under review compared to the preceding quarter. The gap between the total government revenue and expenditure widened during the second quarter.

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In the external sector of the economy, exports, imports, and trade deficit in terms of value soared during the quarter under review. These were all record quarterly figures. Imports increased by greater value than exports, and therefore trade deficit widened significantly. Export, import, and trade deficit values were significantly higher than the preceding quarter as well as the same quarter last year.

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Despite the record trade deficit, lower net private remittances received, and lower tourism earnings during the quarter under review gross official reserves increased marginally due to higher foreign aid received in comparison to the first quarter. The gross official foreign exchange reserve at the end of April was highest ever recorded (almost USD 3 billion). Net private remittances received during the first half of the year exceeded USD 1 billion, whereas earning from tourism was only USD 217 million during the same period.Â Â Â

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Capital market indicators (ASPI, MPI, and turnover) were pointing down compared to the first quarter. However, these indicators were higher than the corresponding quarter last year. Capital market is very sensitive to the conflict in Sri Lanka. Hence, decline in capital market indicators during the second quarter of this year is directly related to the deteriorating security situation in the country, particularly in Colombo and the suburbs.

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The economy in the conflict region continued to deteriorate with mass displacements, loss of livelihoods, business gloom, and security restrictions increasing transaction costs. In the ethnic rioting in Trincomalee town in mid-April around 50 businesses were directly affected. The direct costs to affected businesses amounted to LKR 150 million according to the Chamber of Commerce and Industries of Trincomalee District (CCITD). In addition there are several hundred millions of indirect costs. Forecast for the economy in the conflict region is gloomy at least until the end of the year.

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