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## QER-First Quarter 2006

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The security situation in the country deteriorated sharply since the assumption of office by the new President in late-November. Despite lull in attacks on the security forces and counter attacks during February the overall security situation did not improve much during the first quarter 2006. The macro economy of Sri Lanka was performing well amidst deteriorating security situation in the conflict region. Although the quarterly GDP growth rate is still not available other economic indicators suggest that the economy would have grown by over 6% (in real terms) during the quarter under review.

In the agriculture sector, while paddy, tea, and rubber production increased compared to the previous quarter and the corresponding quarter last year, coconut production increased significantly compared to the corresponding quarter last year but declined marginally compared to the preceding quarter. The average tea auction price during the quarter declined compared to the previous quarter and the same quarter last year. Tea price is likely to increase during this year due to anticipated shortfall in output in Kenya as a result of drought. In the industrial sector, both the private and public sector industrial production indices increased in comparison to the preceding quarter as well as the corresponding quarter last year. However, industrial exports (in value terms) dropped considerably in the first quarter compared to the previous quarter, but was marginally higher than the corresponding quarter last year.Â

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Interest rates started to decline or stagnate during the first quarter because of declining inflation. That is, while the weighted average prime-lending rate dropped marginally in the last two months of the quarter, the Treasury bill rate, and repo & reverse repo rates remained the same throughout the quarter compared to the previous quarter. However, interest rates were considerably higher than the rates prevalent during the corresponding quarter last year. The cost of living, in terms of the Sri Lanka Consumer Price Index (SLCPI), declined in the first two months of the quarter but increased in March. However, cost of living during the first three months of this year was lower than the corresponding months last year. Cost of living in terms of the Colombo Consumer Price Index (CCPI) was higher than in terms of the SLCPI. Total public debt incurred during the quarter under review was significantly higher than the previous quarter and the same quarter last year. Public debt contributes to inflation and crowds out private investment.

In the external sector of the economy both exports and imports dropped in value during the quarter under review compared to the preceding quarter. However, drop in exports was higher than the drop in imports thereby increasing the trade deficit. Besides, while quarterly export value was marginally lower, quarterly import value was considerably higher than the corresponding quarter last year. Therefore, trade deficit during the first quarter this year was almost double that in the first quarter last year.

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Despite the rise in trade deficit foreign exchange reserve of the government improved due to rise in net foreign remittances received, increase in tourism earnings, and modest rise in foreign aid. Gross official reserve increased marginally at the end of the quarter under review compared to end of the previous quarter, but was significantly higher than end of the same quarter last year. Gross official reserve has continued to rise since the tsunami. Net private remittances received increased during the first quarter in comparison to the previous quarter and the corresponding quarter last year. Remittances are the second largest source of foreign exchange earnings to the country. Total remittance received in the first quarter was one of the highest quarterly receipts.

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Despite deteriorating security situation in the conflict region of the country tourist arrivals and earnings increased considerably during the first quarter. Quarterly tourist arrival in the first quarter was the highest since the last quarter of 2004. Further, this was the highest number of arrivals recorded during the first quarter of any year. Tourism earnings also increased significantly compared to the preceding quarter and the same quarter last year (which was low because of the tsunami), and was the highest since fourth quarter 2004.

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Capital market performed better than the previous quarter. Both All Share Price Index (ASPI) and Milanka Price Index (MPI) increased considerably reversing the declining trend in November and December last year. Besides they were also higher than the corresponding period last year. Monetary turnover in the Colombo Stock Exchange was higher than the preceding quarter but lower than the corresponding quarter last year.

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The economy of the conflict affected North&East region seems to be sliding back to the pre-2002 status quo. Population displacements, restrictions on fishing, shortage of certain goods (particularly fuel), restrictions on taking certain goods (such as building materials) to LTTE-controlled areas in the N&E, loss of livelihoods, and curtailment of donor funded projects are negatively impacting on the economy of the conflict region. While cost of living is soaring employment opportunities are shrinking, thereby leading the population to economic vulnerability and political insecurity.

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