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## QER-Fourth Quarter 2005

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The fourth quarter 2005 was dominated by the Presidential election in November, presentation of two budgets – one by the outgoing President (in November) and the other by the incoming President (in December) – which is unprecedented and reflection of a government within government, and the resumption of collective violence (group killings) in the conflict affected region for the first time since the ceasefire agreement signed in February 2002.

The Gross Domestic Product (GDP) growth figure for the final quarter of 2005 is not available yet. The growth of GDP, in real terms, during the first nine months of the year was about 5.5%. The annual real GDP growth for 2005 is expected to be more or less equal to the 2004 growth rate, i.e. around 5.5%. The achievement of this reasonable growth rate despite the impact of the tsunami is remarkable. The growth momentum was primarily due to more than anticipated performance of the external sector of the economy (exports/imports, foreign exchange reserves, and remittances) while the domestic sector, particularly the agricultural sector, was reeling under the twin impacts of drought (on crops) and tsunami (on fisheries).

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Paddy, tea, rubber, and coconut are the major agricultural crops in Sri Lanka. While paddy and tea production increased, rubber production declined marginally and coconut output declined considerably during the quarter under review. Paddy production increased by 23.5% in 2005 compared to 2004 thanks to favourable weather in the latter half of the year. Tea production was 3% higher than in the 3rd quarter while 8% less than in the 4th quarter 2004. On the other hand, rubber production was 1% less than the previous quarter but 32% higher than in the corresponding quarter in 2004. Similarly, coconut production dropped by 8.5% in the 4th quarter (compared to 3rd quarter) but was 13% higher than that of the 4th quarter 2004. Fish catches in 2005 were 44% less than in 2004 due to the tsunami. Tea auction price on average during the quarter was higher than in the preceding quarter and the corresponding quarter in 2004.

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Both the private and public sector industrial production indices were higher at the end of 4th quarter compared to end of 3rd quarter. However, on monthly basis, while the private sector industrial production indices were higher the public sector industrial production indices were lower during each month of the quarter under review compared to the corresponding months in 2004. Industrial exports (in value) increased by 4% in comparison to the previous quarter and by 8% in comparison to the same quarter in 2004. Total industrial exports in 2005 posted a record, reaching USD 5 billion for the first time.

While interest rates were on the rise inflation was on the fall during the final quarter of 2004 in comparison to the 3rd quarter. This has made the negative real interest rate lower in the 4th quarter than it was in the previous quarter. However, both the interest rates and the inflation rate were higher in the 4th quarter compared to the corresponding quarter in 2004. Annual average rate of inflation, in terms of Sri Lanka Consumer Price Index (SLCPI), at the end of 2005 was almost 11% (after peaking to 14.5% in mid-year) as against just 8% at end 2004. Similarly, the annual average rate of inflation, in terms of Colombo Consumer Price Index (CCPI), was almost 12% at the end of 2005 as opposed to almost 8% at end 2004. Å Å

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While total public expenditure during the eleven months up to November 2005 increased by 20% (compared to the same period in 2004) total government revenue also increased by 19% in the same period. Besides, public expenditure and revenue anticipated in the Budget 2005 is more or less the same, and therefore there is no overshooting of the budget despite two external shocks to the economy during 2005, viz. unanticipated tsunami reconstruction expenditure and world oil price rise.

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External trade was buoyant as both the exports and imports were rising (in terms of value) in the last quarter of 2005. The rise in exports was much higher than rise in imports. Therefore, trade deficit declined in the 4th quarter in comparison to the 3rd quarter. Further, both the exports and imports during the quarter under review were records. Trade deficit in the 4th quarter 2005 was lower compared to the same quarter in 2004. Exports were boosted by rising demand while imports were high primarily due to rise in world oil price. Crude oil price averaged USD 58 per barrel in the final quarter of 2005 as opposed to USD 42 per barrel in the final quarter of 2004 (38% rise). Å Å

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The balance of payments position of the country continued to improve during the quarter under review. The gross official reserves of the country reached a record USD 2,735 million at the end of 2005; a staggering 25% rise in comparison to the level at end 2004 and 13% higher compared to the end of preceding quarter. Despite the rise in trade deficit (from USD 2,216 million in 2004 to USD 2,519 million in 2005) and decline in tourism earnings the gross official reserve shot up by 25% at end of 2005 (compared to end 2004) because of the debt moratorium and significant rise in net private remittances received.

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Net private remittances received during the 4th quarter 2005 was 17% greater than that received in the 3rd quarter 2005 and 26% greater than that received in the corresponding quarter in 2004. Furthermore, the annual net private remittance

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received in 2005 (almost USD 1,750 million) was a record, and the total net private remittances of USD 500 million received in the last quarter of 2005 is also a quarterly record. Tourist arrivals dropped but tourism earnings increased in the last quarter of 2005 in comparison to the previous quarter. However, both the tourist arrivals and tourism earnings dropped drastically (by 25% and 59% respectively) in the 4th quarter 2005 in comparison to the same quarter in 2004. On annual basis, tourist arrivals dropped by only 3% but tourism earnings dropped by 18% in 2005 compared to 2004. Needless to say this was due to the tsunami. The upbeat performance of the stock market throughout 2005 came to an end in the quarter under review due to political uncertainty and setback in the peace process. The impending Presidential election created political uncertainty in November, which was followed by eruption of collective violence in the conflict-affected region in December. Both these politico-military developments dampened capital market performance. The All Share Price Index (ASPI), Milanka Price Index (MPI), and average daily turnover dipped in November and December 2005 compared to previous months. Nevertheless, all these indicators were higher than in the corresponding months in 2004.

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In December the security situation in the North&East dramatically changed for the worse with over 50 casualties among the security forces and about 20 civilian casualties. This upsurge in violence resulted in displacement of civilians, loss of livelihoods, and sudden rise in cost of living. Restrictions on fishing along the coast of Jaffna, Mannar, and Trincomalee and suspension of reconstruction activities in the Jaffna peninsula resulted in significant losses of livelihood. Furthermore, prices of essential commodities shot up as a result of closure of markets, lack of transport to markets, curtailment of movement of goods from rest of the country, and shortage of goods due to supply constraints and hoarding.

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