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# QER - Third Quarter 2005

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The assassination of the internationally respected Foreign Minister Mr. Lakshman Kadirgamar, legal challenge to the P-TOMS agreement between the GoSL and the LTTE, and the arguments and counter arguments over the date of holding the Presidential election preoccupied the politico economic milieu in the quarter under review (third quarter 2005). Eventually, the P-TOMS became a non-starter because there was no real commitment from the GoSL or the LTTE as it was essentially a donor-driven piece of paper.

The Gross Domestic Product (GDP) grew by 6.4% in the third quarter following on the 6% growth in the second quarter. Furthermore, the third quarter GDP growth was the highest ever quarterly growth in the past five years. Services and industrial sectors spearheaded the growth momentum during the second and third quarters. Agricultural sector, for the first time in the last one year, recorded a positive growth of 2% in the third quarter thereby contributing to the higher GDP growth than the second quarter. However, the industrial and services sector growth rates in the third quarter (6.9% & 7.5% respectively) were lower than in the second quarter (7.8% & 7.7% respectively). In the agricultural sector tea output dropped considerably (by 21%) while rubber output declined marginally (by 4%) during the third quarter compared to the previous quarter. In contrast coconut output increased considerably by 13%. Further, tea, rubber, and coconut outputs in the third quarter of this year were higher (by 4%, 21% & 4% respectively) than in the corresponding quarter last year (2004). The

Colombo tea auction price rose by 13% between the end of second quarter and the end of third quarter. However,

Colombo tea auction price remained more or less the same during the third quarter this year in comparison to the same quarter last year.

Although the industrial sector grew by almost 7% in the third quarter the manufacturing sub-sector experienced decline in production. Thus, both the private and public sector industrial production indices declined in the third quarter by 11% and 2% respectively compared to the preceding quarter. However, the private sector industrial production index was higher, but the public sector industrial production index was lower than the same period last year. On the other hand, industrial exports improved a lot by 21% in value terms compared to second quarter 2005, and by 9% in comparison to the same quarter last year. In fact, industrial export in the third quarter 2005 was the largest quarterly figure in the past five years.

Interest rates continued its rising streak during the quarter under review compared to the previous quarter as well as the corresponding quarter last year. The weighted-average prime lending rate, Treasury bill rate, repo, and reverse repo rates were all upwardly mobile as in the recent past. Nevertheless, since the rate of inflation was higher than the interest rate the real rate of interest was negative.

Inflation, for the first time in the past one year, began to decline during the third quarter (in terms of the Sri Lanka Consumer Price Index). While the point-to-point rate of change in inflation continued its downward trend the annual average rate of change in inflation started to decline for the first time in recent past. The annual average rate of inflation decreased by almost one percentage from 14.4% in June to 13.5% in September, while the point-to-point change halved from almost 12% in June to almost 6% in September. However, inflation during the third quarter 2005 was higher than during the corresponding quarter in 2004.

Public debt increased significantly during the quarter under review particularly because of the net receipt of foreign aid. However, total public debt incurred during the third quarter was less than that incurred in the same quarter last year. Tsunami reconstruction expenditures and rising world oil price were the two most important factors pushing up the public debt.

External trade demonstrated buoyancy because exports (in value) increased by 24% while imports increased by only 8% during the quarter under review in comparison to the preceding quarter. However, it was the reverse compared to the corresponding quarter last year when exports increased by 11% whilst imports increased by 20%. Hence, the trade deficit dropped by 18% in the third quarter (2005) compared to the previous quarter. Yet the trade deficit during the third quarter 2005 was 50% higher than the trade deficit in the same quarter last year (2004). Trade deficit in the quarter under review was the second highest quarterly figure in the last four years.

Gross official foreign currency reserves touched almost USD 2.5 billion at the end of third quarter, which is a record in the recent economic history of , thanks to the debt moratorium, tsunami aid flows, and increased remittances. The gross official reserve at the end of the third quarter was 2% and 25% greater than at the end of second quarter 2005 and at the end of third quarter 2004 respectively. Mind you, this is in spite of the record trade deficit in the last two quarters.Â

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Net private remittances also bolstered the balance-of-payments of the country. Net private remittances increased by 10% in the third quarter compared to the second quarter, and by 26% compared to the corresponding quarter last year. Net private remittances would exceed USD 1.5 billion by the end of the year; the second largest source of foreign exchange earnings to and double the annual flow of foreign aid to the country.

Curiously, despite the rise in tourist arrivals, tourism earnings dropped significantly during the third quarter. That is, while tourist arrivals increased by 18%, income from tourism dropped by 40% in the quarter under review. At the same time tourist arrivals increased by less than 1% and tourism income declined by 50% compared to the third quarter 2004. This sharp decline in tourism income is due to adjustment/correction of figures in July 2005. Capital market was upbeat as has been the case throughout this year. Both the All Share Price Index (ASPI) and the Milanka Price Index (MPI) increased by around 500 points between the end of June (second quarter) and the end of September (third quarter). The average daily turnover also doubled (almost) between the end of second quarter and the end of third quarter

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