

COUNTRY REPORT



This section of the Report aims to lend our readers, particularly the international audience an insight into Sri Lanka.

This section of the Report provides an overview of Sri Lanka's physical features, demography and key economic indicators. It also presents the global economy during the period under review, which helps to bring the Sri Lankan economy into perspective.

Ceylon which is officially known as Democratic Socialist Republic of Sri Lanka is located approximately 31 Km off the Southern coast of India. Sri Lanka is a strategic naval link between West Asia and South East Asia as a result of its location in the part of major sea routes and has been a centre of Buddhism and culture from ancient times.

Sri Lanka is placed high on the list of world's top tourist destinations as a result of the natural beauty of the Island's tropical forest, beaches and landscape, as well as its rich cultural heritage. The country is renowned for the production and export of tea, coffee, coconut and rubber. Sri Lanka also boasts of a progressive and modern industrial economy with the third highest per capita income in South Asia.

Physical Features

Total area	65,610 Sq. km.
Land area	62,705 Sq. km.
Capital	Sri Jayewardenapura
Commercial Capital	Colombo

Demographics

	2010	2009	2008	2007	2006
Mid-year population (mn persons)	20.65	20.5	20.2	20.0	19.8
Labour force (mn persons)	8.11	8.1	7.5	7.4	7.5
Labour force participation rate (%)	48.1	48.7	50.2	49.8	51.2
Unemployment rate (% of labour force)	4.9	5.8	5.2	6.0	6.5

Source - Central Bank of Sri Lanka Annual Report 2010

Sri Lankan Economic Performance

Highlights

Achieving 8% GDP growth rate in 2010, highest in the last thirty year history

Sri Lanka achieved an outstanding growth rate of 8.0% in 2010, the highest annual rate of growth in the last three decades. This growth was supported by the restoration of peace which created a conducive environment for expansion in economic activity, a strong macroeconomic environment, increased domestic demand, development of infrastructure facilities, improved external demand consequent to the gradual recovery in the global economy and favourable domestic weather conditions.

Sectorial Composition and Increase in Gross Domestic Product (GDP)

	As a Share of GDP (%)				Rate of Change (%)		
	2010	2009	2008	2007	2010	2009	2008
Agriculture Sector	11.9	12.0	12.1	11.9	7.0	3.2	7.5
Industrial Sector	27.8	28.6	28.4	28.5	8.4	4.2	5.9
Services Sector	59.3	59.3	59.5	59.6	8.0	3.3	5.6
Gross Domestic Product (GDP)	100.0	100.0	100.0	100.0	8.0	3.5	6.0

Key Economic Indicators

	2010	2009	2008	2007	2006
GDP at Market Prices (Rs. bn)	5,602	4,769	4,312	3,540	2,898
GDP per capita (US \$)	2,399	2,057	2,014	1,617	1,421
GDP growth (%)	8.0	3.5	6.0	6.8	7.7
Colombo Consumers' Price Index (2002=100) Annual average	5.9	3.4	22.6	15.8	10
Colombo Consumers' Price Index (2002=100) Point-to-point-end period	6.9	4.8	14.4	18.8	13.5
Fiscal deficit (% of GDP)	-7.9	-9.8	-7	-7.7	-8
Current account balance (% of GDP)	-2.9	-0.5	-9.3	-4.2	-5.3

Source - Central Bank of Sri Lanka Annual Report 2010

Stable Inflation Rate at 5.9% at end of year 2010

Inflation was contained at a low and at a mid-single digit during 2010. The annual average inflation as measured by the Colombo Consumers' Price Index (CCPI) (2002=100), which has been in the declining trend since November 2008, reached a low of 3.1% in February 2010 and increased gradually to 5.9% in December 2010. The stable level of inflation during the year was consequent to the improved domestic supply conditions, supportive fiscal policies aided by the adjustment in import duties, and downward revisions in administered prices as well as the prudent monetary policy stance. The relatively stable exchange rate and improved productivity also helped to lower the inflation rate.

Sri Lanka was graduated to middle-income status

International Monetary Fund (IMF) graduated Sri Lanka to middle-income status from the list of Poverty Reduction and Growth Trust (PRGT) eligible countries, in January 2010. The strong economic performance in recent years lifted Sri Lanka's per capita income while the relatively stable exchange rate and improved productivity lowered the price pressures during the year. A country is graduated from the PRGT eligibility category when the nation's per capita income is well above the International Development Association (IDA) threshold for a sustainable period, has the capacity for durable and substantial access to international financial markets and does not face serious short-term vulnerabilities, such as a sharp drop in per capita income and loss of market access.

Interest Rates

	2010	2009	2008	2007	2006
(Percentage per annum at end-year)					
Treasury Bill rate -					
91 days	7.24	7.73	17.33	21.3	12.76
364 days	7.55	9.33	19.12	19.96	12.96
Commercial Banks -					
Weighted average - prime lending rate (AWPR)	9.27	11.12	18.5	17.95	15.19
Weighted average - deposit rate (AWDR)	6.23	8.01	11.63	10.31	7.6

Source - Central Bank of Sri Lanka Annual Report 2010

Treasury Bill (365 days) Rate stood at 7.55%

In response to the easing of the Central Bank's monetary policy stance, market interest rates adjusted downwards in 2010. The Central Bank relaxed its monetary policy stance further, in July and August 2010, with a view to providing further impetus to revive economic activity, following the significant downward adjustment of its policy rates in 2009. The Repurchase rate and the Reverse Repurchase rate were reduced by 25 basis points each in July 2010 while the Reverse Repurchase rate was reduced by a further 50 basis points in August 2010. Sequentially, benchmark yield rates on Treasury Bills adjusted downwards, leading other market interest rates on a downward sloping path.

AWPR declined to 9.27%

In 2010, the declining trend in the interest rates charged by long-term lending institutions continued. The monthly average weighted prime lending rate (AWPLR) which reflects the rates applicable to loans and advances granted by commercial banks to their prime customers, declined from 11.12% in December 2009 to 9.27% by December 2010.

SL Rupee continued to appreciate against US\$

Maintaining stability in the domestic foreign exchange market was the focus of the exchange rate policy in 2010. In the face of significant inflows during the first nine months of the year, the Rupee continued to appreciate gradually against the US Dollar. To avoid excessive Rupee appreciation and building up of reserves, the Central Bank purchased foreign exchange from the domestic foreign exchange market. However, in the last quarter of 2010, to ensure adequate foreign exchange liquidity in the face of large outflows arising from the settlement of petroleum bills, the Central Bank supplied foreign exchange to the domestic foreign exchange market. The recent announcement by the Central Bank to implement major relaxations of foreign exchange controls would promote financial openness, attract more financing and investments for the private sector and enhance the overall competitiveness of the economy.

Exchange Rates

	2010	2009	2008	2007	2006	2005
Annual average Rs./US\$	113.06	114.94	108.33	110.62	103.96	100.5
End-year Rs./US\$	110.95	114.38	113.14	108.72	107.71	102.12

Source: Central Bank of Sri Lanka Annual Report 2010

External Reserves reached a record high level of US\$ 7,173 mn equivalent to 6.7 months of imports

Gross official reserves excluding ACU receipts, increased substantially to US\$ 6,610 mn end 2010 (equivalent to 5.9 months of imports), compared to US\$ 5,097 mn end-2009. Disbursements under the foreign funded projects, the proceeds of the third international sovereign bond, the receipt of three tranches under the IMF-SBA facility, and inflows to the private sector mainly contributed to the building up of foreign reserves in 2010.

Fitch Ratings Long-term Foreign Currency rating was raised to B+

International rating agencies raised their ratings of the country in 2010. The Fitch Ratings Agency affirmed the long-term foreign and local currency Issuer Default Rate at 'B+' and revised the outlook to 'Positive' from 'Stable.' The Standard and Poor's (S&P) raised the long-term foreign currency rating from 'B' to 'B+' and the local currency rating from 'B+' to 'BB-.' Further, Moody's Investor Services, covering Sri Lanka for the first time, assigned a 'B1' sovereign rating with a 'Stable' outlook.

Colombo Stock Market recorded highest performance in year 2010

The Colombo Stock Exchange (CSE) emerged as one of the best performing stock exchanges in the world as the activity at the CSE rose to historically high levels in 2010. The All Share Price Index (ASPI) rose by 96% while the Milanka Price Index (MPI) increased by 83% in 2010. The number of shares traded quadrupled while the average daily turnover tripled. The market price earnings ratio reached 25.2 in 2010 compared to 16.6 in 2009. The market capitalisation of the CSE, which more than doubled in 2009, doubled again in 2010 to reach Rs. 2.2 tn by end-2010.

Capital Markets

	2010	2009	2008	2007	2006
All Share Price Index	6,635.9	3,385.60	1,503	2,541	2,722.40
Sensitive Price Index	7,061.5	3,849.40	1,631.30	3,291.90	3,711.80
Value of shares traded (Rs. mn)	570.3	142.5	101.4	105.0	105.1
Market capitalisation (Rs. bn)	2,210.5	1,092.10	488.8	820.7	834.8
Market capitalisation (% of GDP)	39.4	23	11	23	28

Source: Central Bank of Sri Lanka Annual Report 2010

Indicators of Sri Lankan Social Infrastructure Development

Population and Vital Statistics

	2010
Age distribution (%) (2010) -	
0-14 years	26.30%
15-64 years	67.40%
65 years and over	6.30%
Population density (2009)	329 persons per sq. km.
Infant mortality rate (2007)	8.5 per 1,000 live births
Dependency ratio (2010)	48.40%
Human Development Index (2010)	0.658
Ranking Among 169 Countries	91

Expectation of life at Birth (2007)

	2010
Male	70.3 years
Female	77.9 years

Literacy Rate (2009)

Overall	91.40%
Male	92.80%
Female	90.00%

Poverty

Population below US\$ 1 a day (1990 - 2005)	5.60%
Population below US\$ 2 a day (1990 - 2005)	41.60%

Recent Significant Changes to Tax Law

- Personal income tax liability was reduced from 35% to a maximum limit of 24%.
- Individual Tax Free Allowance was increased up to Rs. 500,000/-.
- Company maximum tax rate was set at 28%.
- The tax rate for partnerships was set at 8%.
- Companies which were previously eligible to a concessionary tax rate of 15% were made liable to a reduced tax rate of 12%.
- For the purpose of deemed dividend tax, the minimum dividend distribution requirement of a company out of its distributable profit was reduced to 10% from 25%. However, the deemed dividend tax liability was maintained at 15%.
- NBT rate was reduced to 2% from 3% with effect from 1st January 2011.
- Debits tax was removed with effect from 1st April 2011.
- VAT on luxury vehicles was reduced to 12% from 20% with effect from 23rd November 2011.
- Social Responsibility Levy (SRL) was removed with effect from 1st April 2011.
- Motor vehicle allowance/benefit to the employees up to Rs. 50,000/- per month, was exempted from PAYE Tax.
- WHT on interest income on individuals up to Rs. 500,000/- level of income is exempt from WHT deduction; interest income between Rs. 500,000/- and Rs. 1.5 mn will be subject to 2.5% WHT deduction and any excess amount was made subject to 8% WHT deduction. This amendment had been implemented with effect from 1st April 2011.

Recent changes to Custom Tariff applicable to automotive industry

- Total duty on hybrid cars with engine capacities below 2,000cc was increased from 38% to almost 50% while total duty on hybrids between 2,000cc to 3,000cc reached nearly 75% and vehicles above 3,000cc to 100%.
- The excise duty on small hybrids was raised by 8% but total duty increased by a larger amount when added.
- Taxes on petrol cars with engine capacities below 1,000cc increased from 95% to 120% while taxes on vehicles with 1,000cc to 1,600cc increased from 119% to 128%.
- Tax on petrol three-wheelers increased from 38% to 50% while tax on diesel three-wheelers increased to 60%.

The Central Bank of Sri Lanka has forecast the following outlook for 2011

- The medium-term outlook for Sri Lanka's economy is encouraging, supported by post-conflict optimism and strengthening global demand. The economy is expected to grow by 8% - 9% per annum in the medium term, following the 8.0% real growth in the economy in 2010. Expansion in the agriculture sector with a larger contribution coming from the Northern and Eastern provinces, greater capacity utilisation with the development of infrastructure facilities, improved productivity, product and market diversification, expansion of industries, trade and services sectors including tourism, ports, transportation, banking and insurance, are expected to provide the required impetus for realising the higher growth prospects.
- Inflation is expected to be maintained at a mid single digit level in the medium term. Credit flows to the private sector and the claims of the banking system on the Government and public corporations will be closely monitored to contain the build-up of excessive demand pressures. Along with prudent demand management policies supply-side improvements are expected to continue.
- Higher levels of foreign inflows to the Government and private sector are expected with the relaxation of exchange controls focused fiscal incentives and improved macroeconomic environment. The Government had a cumulative financial commitment of approximately US\$ 7.1 bn by end-2010 from Sri Lanka's development partners, compared to US\$ 6.6 bn at end-2009. These commitments which has a project implementation duration of 2-5 years are mainly for infrastructure projects which would facilitate the development process and earning sources of people.
- The movements in international commodity prices during the latter part of 2010, particularly the price of crude oil would pose challenges to macroeconomic stability.
- Tourism sector is expected to be a key driver of economic activity. In this context, tourism-related infrastructure and facilities around the country would need to be expanded to cater to the influx of 2.5 mn tourists envisaged in 2016. Activities in the periphery of the main tourism attractions would ensure tourists spending more time and money in these areas, thus expanding the income-generating potential of the industry.