

Continued from yesterday

The Central Bank reveals the plans of meeting the challenges ahead. The bank points out that social and economic indicators have continued to improve throughout the years. This will be further strengthened and the Central Bank would continuously fulfill its core objectives of maintaining economic and price stability and financial system stability to support sustainable growth.



appreciated from the level of Rs. 113.48 per US\$ to around Rs. 108.72 by end December 2007 and continued to appreciate there onwards.

Consequently, the debt service payment cost will be lowered by Rs. 5,693m on servicing foreign currency debt in 2007 and a further Rs. 7,335m in 2008.

Allegations on excessive

Perception / Claim
Deficit financing through money printing has increased

Perception / Claim
Fiscal deficit will constrain the economy

Reality
Fiscal consolidation is underway

KEY HIGHLIGHTS
Since 2001, the non-tsunami deficit has declined by nearly 32 per cent.

More marked fiscal improvements masked by the one-off tsunami-related spending.

Stronger fiscal performance driven by comprehensive strategies to enhance revenue growth and manage expenditures.

Positive trend expected to persist, going forward

Perception / Claim
Public debt on a rapidly declining path

Reality
Public debt ratios improving, composition stronger, and serviceability at comfortable levels

Perception / Claim
When loans from bilateral agencies at an interest rate of about two per cent is available, borrowing in the international markets at a higher rate of interest, is highly detrimental

Reality
The bond issue has yielded a multitude of benefits

yield thereby paving the way for Sri Lanka's private sector to access international markets. Exchange rate

Perception / Claim
Government is borrowing heavily from the banks and it is out of control

Reality
Net Credit to the Government from the banking system has declined significantly in 2007

Reality
Reserve money growth on target and credit growth moderated

money printing are false.

Reserve money targets for 2007 were set based on the assumption of a 7.5% GDP growth and a GDP deflator at 8.5%. Such targets have been comfortably met, each quarter in 2007.

Central Bank has only issued Rs. 24.6 billion as against the target of Rs. 27.7 billion as new money (reserve money) in 2007.

So far in 2008, reserve money hovers well below the targets.

Perception / Claim
Excessive money printing (net credit to Government) has fuelled high and persistent inflation

Reality
Relationship between NCG and inflation is spurious

Relationship between inflation and monetary aggregates is not so simple.

Net credit to the Government (NCG) is only a part of reserve (new) money.

Also, the relationship between inflation and monetary aggregates is not so simple. If the relationship is valid, inflation can be brought down easily by maintaining NCG at a certain level for a few months.

Inflation is driven both by supply and demand side factors.

Long-term trend in inflation is due to demand pressures and short-run fluctuations are due to supply side factors.

Perception / Claim
Government is borrowing heavily from the banks and it is out of control

Reality
Net Credit to the Government from the banking system has declined significantly in 2007

The Sri Lankan ECONOMY

PART THREE

“ Many perceptions/claims that are being circulated are not consistent with reality. Sri Lanka could however do even better. We have a long way to go. At the same time, we have great challenges ahead of us. But, Sri Lanka and its economy is certainly not down and out as some may claim, or may want us to believe. ”

Perceptions / Claims vs. Reality



Lanka geared to meet development goals

Perception / Claim
People do not feel the economic growth

Reality
Social and economic indicators continue to improve notwithstanding such claim

lowest level of 5.6% by 3rd quarter 2007.

The higher expansion of the economy in recent years, together with a sharp rise in public sector recruitments led to a significant reduction in the unemployment rate to 6.0 per cent at end 2007 from a rate of 7.7 per cent in 2005. The recruitment to the public sector on an adhoc basis and the availability of non-performance based benefits in the public sector not only discourage unemployed youth from joining the private sector, but also encourage those already engaged in the private sector to join the public sector.

Perception / Claim
Inflation is out of control

Reality
Inflation containment policy is biting and would show results in 2008

Bringing down inflation to a single digit from the current high levels would be a challenging task in view of rising commodity prices in international markets.

Earlier inflation estimates were not achieved because of unprecedented international prices of some imported items including oil. However, demand driven inflation has been curbed through money supply containment.

Increase in prices due to supply shocks are expected to be one-off increases and expected to decelerate in coming months.

Key policy rate rose 4 times in 2006 and once in 2007 accompanied by aggressive open market operations.

Monetary policy has focused on containing inflationary pressures while not damaging the growth momentum. Inflation expected to moderate by end 2008.

The Central Bank in its "Road Map for Monetary and Financial Sector Policies for 2008 and Beyond", has announced strategies to bring down the inflation rate to around 10-11 per cent by end 2008.

However, the achievement of this target will be significantly affected by various developments in the global economy, especially movements in the international prices of oil and other essential commodities.

Currently, serious inflationary pressures are building up world-wide, largely due to a sharp rise in commodity prices, including higher food prices resulting from increased use of certain food crops for bio-fuel production, and adverse weather conditions.

In this context, monetary policy will be directed towards containing inflationary pressures arising from higher domestic demand, without affecting the continuous higher growth prospects.

Key highlights
Rising Cost of Living (COL) and unemployment will hamper growth and stability

Perception / Claim
Higher employment and rising GDP per capita reflect strong growth momentum notwithstanding COL

Reality
Higher employment and rising GDP per capita reflect strong growth momentum notwithstanding COL

GDP per capita (US\$) has grown by over 60% in the past four years and now projected to be around US\$ 1,600 by end 2007.

Strong job creation backed by solid economic growth.

World oil and commodity prices have been rising at an unprecedented rate.

Focus on agriculture, fisheries and animal husbandry is fully justified.

Unemployment rate has fallen to historically

Perception / Claim
The Government is involved in unwinnable war

Reality
The Government has made significant progress on the military side, and has put forward its first political solution to the conflict

much stronger military position.

The Government has recaptured the Eastern province.

It has also made significant progress in reclaiming territory in the North.

APRC proposal proves a good first move towards a political solution.

The proposal holds the following main tenets:

Implement the 13th amendment of the Constitution while maintaining the unitary framework of governance.

This would set the foundation to develop a new Constitution for Sri Lanka in the long-term.

Provide adequate funding of the Provincial Councils by the Government.

Hold provincial elections in the Eastern Province.

Establishment of Interim Council as a temporary measure for the Northern Province.

Concluded

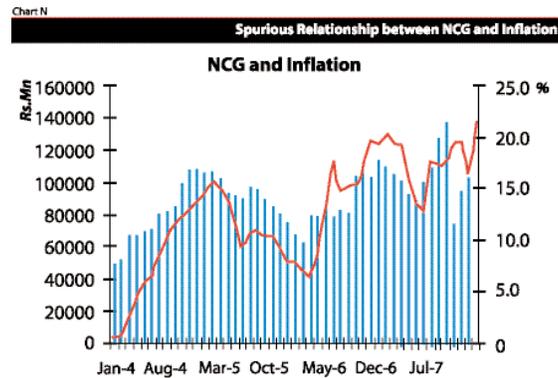
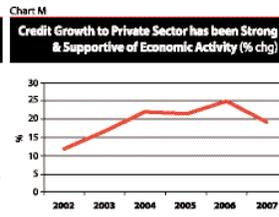


Chart O
Public debt on a rapidly declining path, albeit from a high base. Public debt % of GAP

