

Public finances are improving but remain a source of concern

General Information



GDP	USD59.42bn (World ranking 69, World Bank 2012)
Population	20.33 million (World ranking 57, World Bank 2012)
Form of state	Republic
Head of government	Mahinda Percy RAJAPAKSA
Next elections	2015, presidential



Strengths

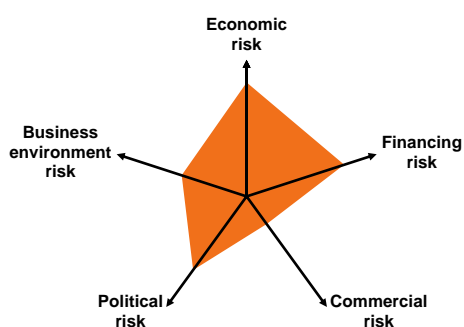
- Strong economic growth, despite the currency crisis of 2000/2001 and global downturn in 2009
- Increased tourism revenues and workers' remittances
- Economic policies are broadly supportive of business and economic growth
- Growing tourism sector

Weaknesses

- Ethnic tensions remain a threat to stability and growth prospects
- Fractured nature of the political system, with generally weak coalition governments
- Vulnerability of export base (45% textiles and clothing)
- Large fiscal deficits and high public debt

Country Rating

C3



Source: Euler Hermes

Trade Structure

By destination/origin (% of total)

Exports	Rank	Imports
United States	23% 1	20% India
United Kingdom	11% 2	14% China
India	6% 3	7% United Arab Emirates
Italy	6% 4	7% Singapore
Belgium	5% 5	4% Iran (Islamic Republic of)

By product (% of total)

Exports	Rank	Imports
Apparel and clothing accessories	43% 1	20% Petroleum and related materials
Coffee, tea, cocoa, spices, and manufactures thereof	18% 2	12% Textile yarn and related products
Rubber manufactures, n.e.s.	7% 3	7% Road vehicles
Non metallic mineral manufactures, n.e.s.	5% 4	5% Non metallic mineral manufactures, n.e.s.
Textile yarn and related products	2% 5	4% Iron and steel

Source: UNCTAD (2012)

Economic Overview

A rapid economic growth

Since the end of civil war, economic growth has been sustained, averaging +7.4% per year. GDP per capita tripled from USD869 in 2000 to USD3256 in 2013, and economic transformation is ongoing. In particular, the economy appears to shift towards a higher value added production and the services sector is developing. After reaching +7.3% in 2013, growth should remain strong at +7% in 2014 and +6.5% in 2015, close to its ten-year average (+6.4%).

January 2015 elections will challenge the recent political stability

The ceasefire signed in 2009 ended 25 years of civil war, restoring political stability and improving international relations. However, the country has a history of fractious political parties, reflecting family and regional rivalries. The Tamil minority represents approximately 12% of the population and the government has done little to address the root causes of conflict with communal tensions increasing again.

President Mahinda Rajapaksa (United People's Freedom Alliance (UPFA)) won a resounding mandate in April 2010 parliamentary election. However, growing negative public perception about the government's economic performance in 2014 led the government to call for anticipated elections, which will take place on January 8 2015 (instead of January 2016). This could trigger higher political instability.

Sri Lanka ranks 99 out of 189 economies in the Doing Business 2015 survey, better than most economies in the region (India ranks 142). After the civil war, the government invested in infrastructures, mostly in the Eastern part of the country but further investment in this field would help sustain growth.

Lowering inflationary pressures

After a long period of sustained high inflation rates (averaging +12% from 2000 to 2008), inflation fell considerably. In October 2014, it eased to +1.6% y/y, its lowest level since 2009. Low food and oil prices are the key reason behind this deceleration. It should thus average +3.8% in 2014 before a modest pick up to +5.4% on average in 2015 reflecting drought conditions.

The Central Bank of Sri Lanka (CBSL) maintained its cautious accommodative stance with policy rate at 6.5% since October 2013. However, this did not translate into credit acceleration. Private credit growth fell to +7.5% in 2013, compared to +17.6% in 2012 and +34.5% in 2011. According to the IMF, banks are reluctant to lend, given the recent rise in nonperforming assets.

Weak public finances remain a cause of concern

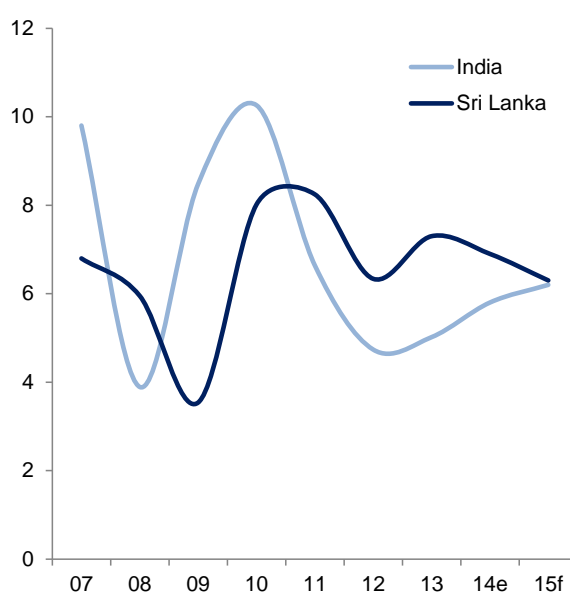
Public finances remain weak in Sri Lanka. Revenues represent only 12.4% of GDP in 2013. Subsidies and transfers are progressively being cut but still account for approximately 3% of GDP in 2014. As a result, public expenditures are relatively constrained (about 18.2% of GDP in 2013) and the fiscal deficit is large, representing -5.9% of GDP in 2013. It improved in 2014 (-5.2% of GDP) but should slightly deepen again given the upcoming elections: the 2015 budget proposes salary rises and increased spending, and the government also proposed

Key economic forecasts

	2012	2013	2014	2015f
GDP growth (% change)	6.3	7.3	7.0	6.5
Inflation (% year average)	7.6	6.9	3.8	5.4
General gov. net lending (% of GDP)	-6.5	-5.9	-5.2	-5.4
Public debt (% of GDP)	79.2	78.3	76.6	74.6
Current account (% of GDP)	-6.7	-3.9	-3.3	-3.3
External debt (% of GDP)	42.8	40.0	37.3	34.9

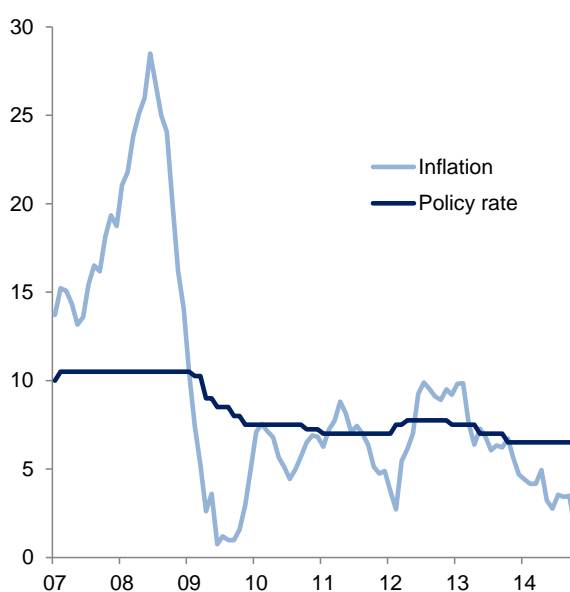
Sources: National sources, IHS, Euler Hermes

GDP growth (%)



Sources: National sources, IHS, Euler Hermes

Inflation (y/y) and policy rate



Sources: National sources, IHS, Euler Hermes

to raise government's borrowing limits.

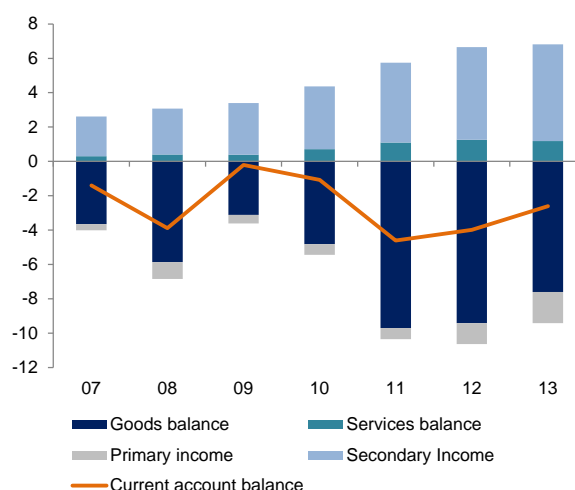
Public debt is high (above 70% of GDP) but on a decreasing trend since 2004 when it peaked at 102% of GDP. From 78.3% of GDP in 2013, it should reach 76.6% in 2014 and 74.6% of GDP in 2015. Over 40% of governmental debt is externally financed. Interest payments (5% of GDP) weight on government finances.

Improving external conditions but more efforts will be needed

Sri Lanka's external position recently improved. From -6.7% of GDP in 2012, the current account deficit improved to -3.9% in 2013 and should stabilize at -3.3% of GDP in 2014. More restrictive policies on gold imports (duties raised to 10%) limited import growth. The economic recovery in the US and the UK (approximately 60% of Sri Lanka's exports) helped boost goods exports in the second half of 2013 and into 2014. Services balance improved also thanks to tourism receipts Worker's remittances (secondary income) account for over 8% of GDP and cushion the large trade deficit. Moreover, FDI are set to improve progressively (from 1.3% GDP in 2013 to 1.7% in 2014)

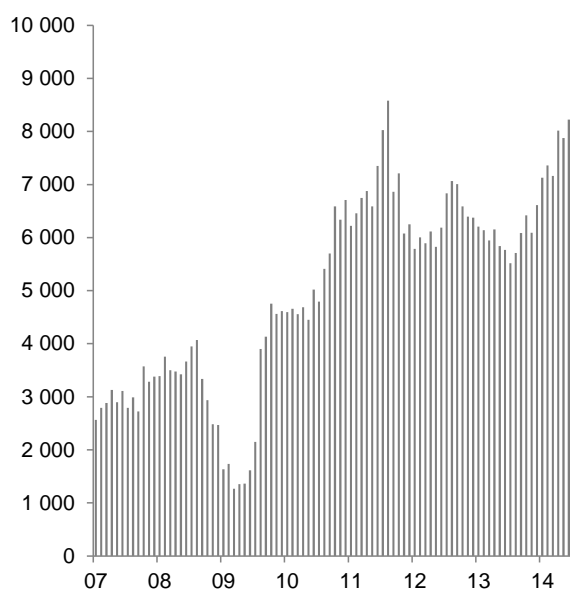
However more efforts will be needed to build strong external resilience. First, external debt is high, standing at 40% of GDP in 2013. It should slowly slow down, averaging 37.3% of GDP in 2014 and 34.9% in 2015. Second, currency risk remains a concern. From December 2012 to December 2013, the exchange rate depreciated by 14.4%. It has stabilized at approximately 130 Sri Lankan rupee per USD. Reserves ratios continue to show weaknesses. In July 2014, foreign reserves averaged USD8 bn, covering approximately 4 months of imports. However, reserves are quite fragile and have partly increased thanks to new borrowings. The government issued four different bonds in 2007, 2009 and 2014 (two international sovereign bonds totaling USD1.5 bn).

Current account balance (USD billion)



Sources: National sources, IHS, Euler Hermes

Foreign exchange reserves (USD million)



Sources: National sources, IHS, Euler Hermes

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