

ROAD MAP

Monetary and Financial Sector Policies
for 2012 and Beyond



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இலங்கை மத்திய வங்கி
CENTRAL BANK OF SRI LANKA



Presented by
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Governor
Central Bank of Sri Lanka

3rd January 2012



2012 IS THE SIXTH CONSECUTIVE YEAR THAT WE COMMUNICATE OUR PLANS FOR THE FORTHCOMING PERIOD

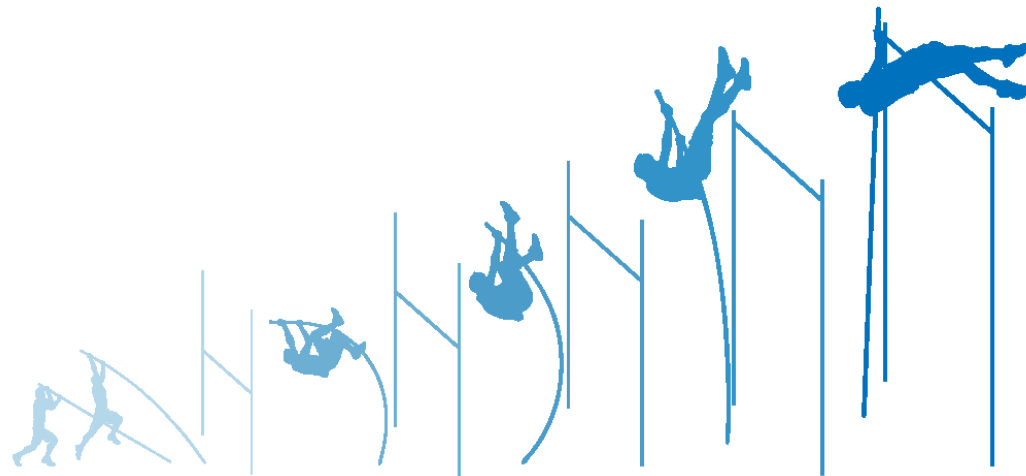


TODAY'S STATEMENT WILL BE IN 7 PARTS...

1. Background and Introduction to the Road Map
2. **Key Macroeconomic Developments in 2011**
3. Developments in the Financial System in 2011
4. **Macroeconomic Outlook and Proposed Monetary Policy Strategy for 2012 and Beyond**
5. Proposed Strategies for Financial System Stability for 2012 and Beyond
6. **Policies to Strengthen the Economy in 2012 and Beyond**
7. Concluding Remarks

1. BACKGROUND AND INTRODUCTION TO THE ROAD MAP

*A quiet peek into
history is always useful...*



SRI LANKA INTRODUCED OPEN ECONOMIC POLICIES FROM 1978...

- Adoption of more market oriented policies promoting greater private sector participation in economic activity
- **De-regulation of interest rates**
- Relaxation of exchange controls
- **Removal of price controls**
- Elimination of quantitative restrictions on imports
- **Foreign banks permitted to open branches in the country**
- Establishment of new domestic private banks
- **Adoption of export market oriented industrial policy**
- Promotion of private sector and foreign investments

FURTHER RELAXATION OF POLICY MEASURES TOOK PLACE FROM 1990 TO 2005...

- Extensive privatisation programme
- **Medium term budget deficit reduction programme**
- Liberalisation of current account transactions in 1994
- **Gradual liberalisation of capital account, commencing 1997**
- Independently floating exchange rate policy, commencing 2001
- **Export oriented industrialisation policy further strengthened**
- Tax reforms and incentives to encourage private sector investments

FROM 2006 ONWARDS, POLICY MEASURES WERE BASED ON THE *MAHINDA CHINTANA*...

- Transforming the country into an economic hub in the region
- **“Inclusive growth” policy and many incentives to promote the SME sector and Local entrepreneurship**
- Balanced Regional Development promotion
- **Emphasis on the development of the Northern and Eastern Provinces**
- Strong focus on Food Security
- **Address infrastructure bottlenecks by implementing a mega infrastructure development drive**
- Relaxation of exchange control regulations to address the Savings and Investment gap
- **Tax reforms and incentives to encourage private sector investments**
- Fiscal consolidation and prudent debt management
- **Foreign investment policy directed towards attracting large scale strategic investments**
- Emphasis on export of high value added manufactured products
- **Export oriented industrialisation policy further strengthened**
- Monetary Policy and Exchange Rate Policy implemented to facilitate stability
- **Expansion of domestic banking activities to regional areas including the North and East**
- Strengthen the banking sector and capital market

MAHINDA CHINTANA: VISION FOR THE FUTURE ENVISAGES THE TRANSFORMATION OF SRI LANKA INTO AN ECONOMIC HUB IN SOUTH ASIA AND DOUBLING OF PER CAPITA INCOME TO US\$ 4,000 BY 2016...

Maritime Hub

- Colombo Port – Container mega hub
- Hambantota Port – Free port-service, industrial and multi-purpose
- Galle Port – Cruise shipping centre
- Trincomalee – Port-related industries
- Oluvil Port – Commercial and fisheries
- Kankasanthurei & Point Pedro – Regional ports



Aviation Hub

- Second international airport at Mattala
- Modernisation of the Bandaranaike International Airport (BIA) and building of second runway at the BIA
- Development and upgrading of domestic airports
- Position Colombo as a regional logistics and services hub and as a hub for budget airlines



Commercial Hub

- Establish Sri Lanka as the foremost centre in the region in the provision of commercial services, International banking and international investments
- With growth of ports and tourism, Sri Lanka's commercial sector will develop naturally



South Asian Economic Hub



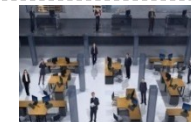
Energy Hub

- Develop renewable energy sources
- New oil refinery at Hambantota
- Oil exploration and production – 3 sea basins (offshore) have been identified (Mannar, Cauvery, Southern Waters)
- Develop oil trade-related ancillary services including gas



Knowledge Hub

- Target IT literacy and internet access for all
- Creation of knowledge-based jobs
- Commence degree programmes directly targeting foreign students
- Accredited foreign universities to set up university colleges in Sri Lanka



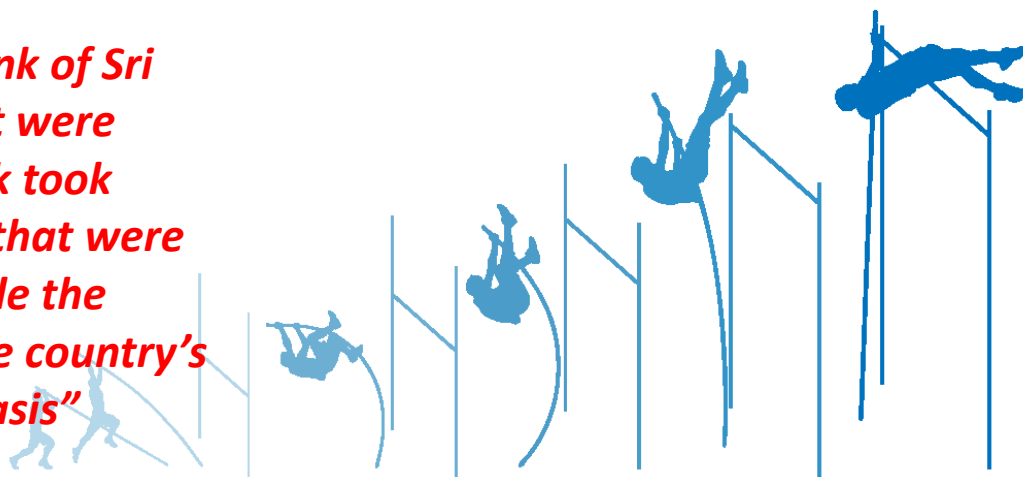
2. KEY MACROECONOMIC DEVELOPMENTS IN 2011

Since the start of the global crisis in 2007, each year seems to be more challenging than the previous one...

“The world has moved from a troubled multi-speed recovery ... to a new and more dangerous phase.”

Robert Zoellick - President, World Bank

“During the past year, the Central Bank of Sri Lanka took courageous decisions that were based on its core objectives. The Bank took advantage of the structural changes that were emerging in the economy. It also made the necessary interventions to fashion the country’s economic journey on a “fast track” basis”



THE PROTRACTED EUROZONE DEBT CRISIS AND LOSS OF CONFIDENCE HAS SLOWED THE GLOBAL RECOVERY...

- **Estimates of World Economic growth**

- **World economy:**

2010: 5.1%

2011: 4.0%

2012: 4.0%

- **Advanced economies:**

2010: 3.1%

2011: 1.6%

2012: 1.9%

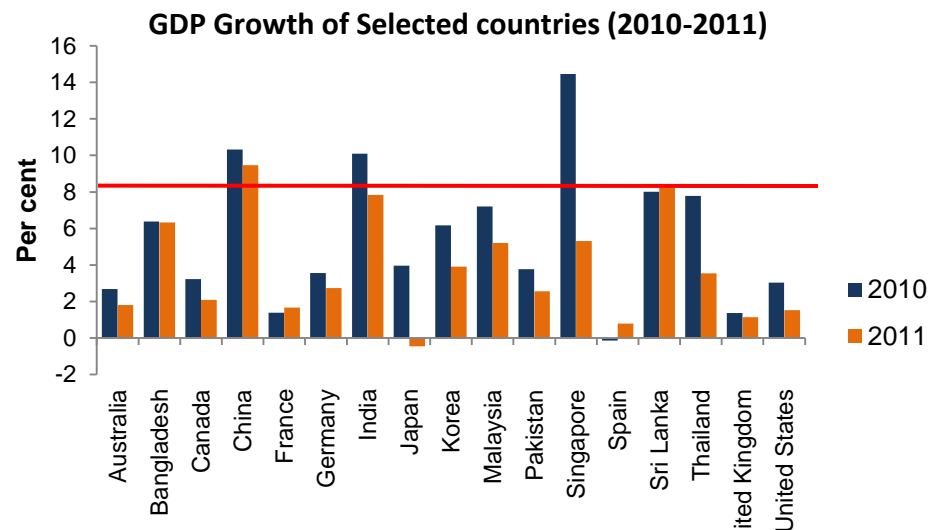
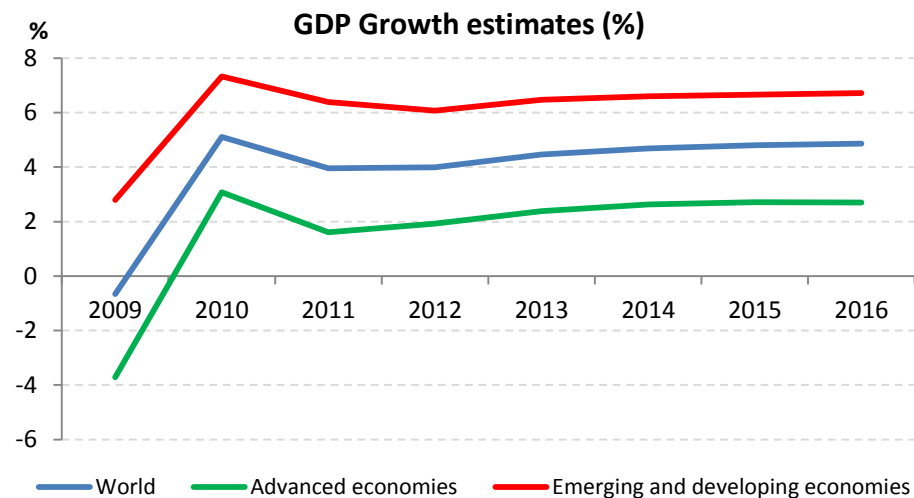
- **Emerging & developing economies:**

2010: 7.3%

2011: 6.4%

2012: 6.1%

Source : IMF, WEO Database, Sep 2011

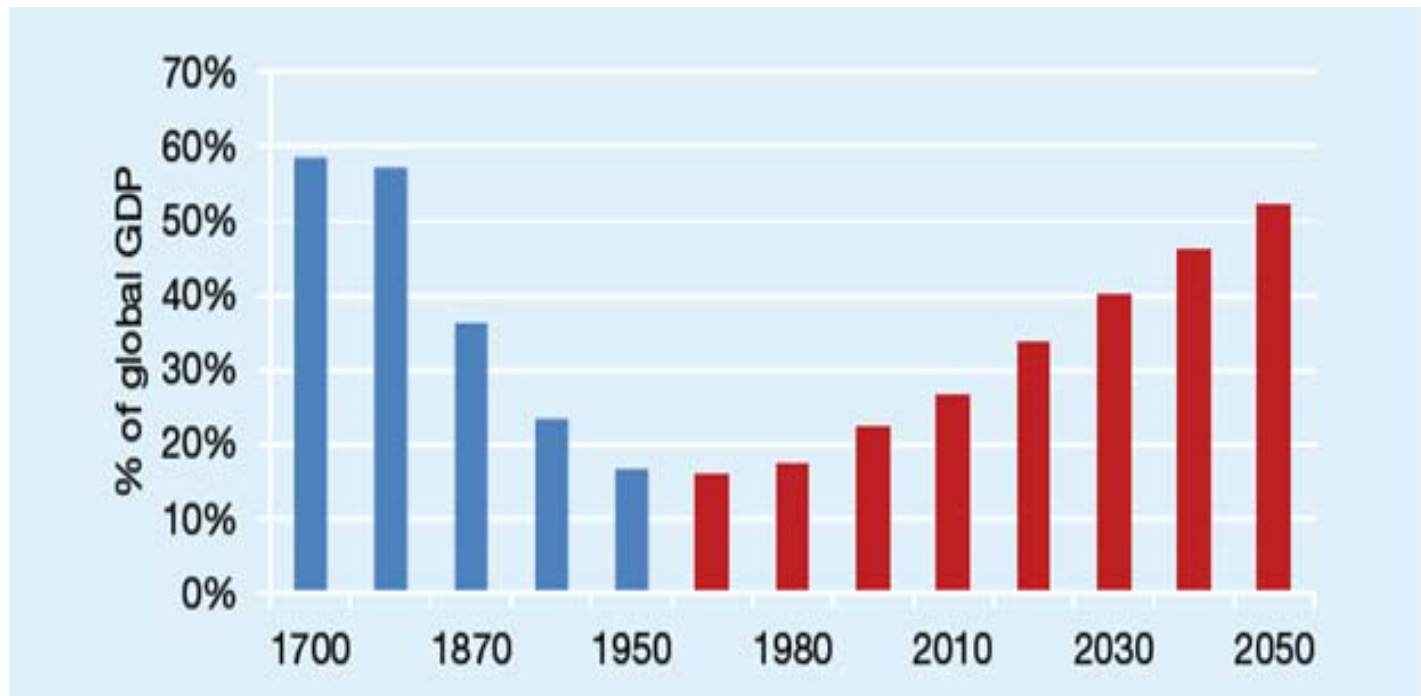


THE BELIEF THAT THE WORLD ECONOMIC GROWTH WOULD CONTINUE TO BE SLUGGISH IN 2012 IS GAINING GROUND...

- The Central Bank's own projections and policy propositions have been based on assumptions and judgments, which would need to be modified in line with emerging developments in the global as well as Sri Lankan economy.
- **Naturally therefore, any deviations in trends in the economy would be watched even more closely, and policies and strategies altered, going forward...**

NEVERTHELESS, ASIA'S IMPORTANCE IN THE GLOBAL ECONOMY HAS BEEN STEADILY RISING...

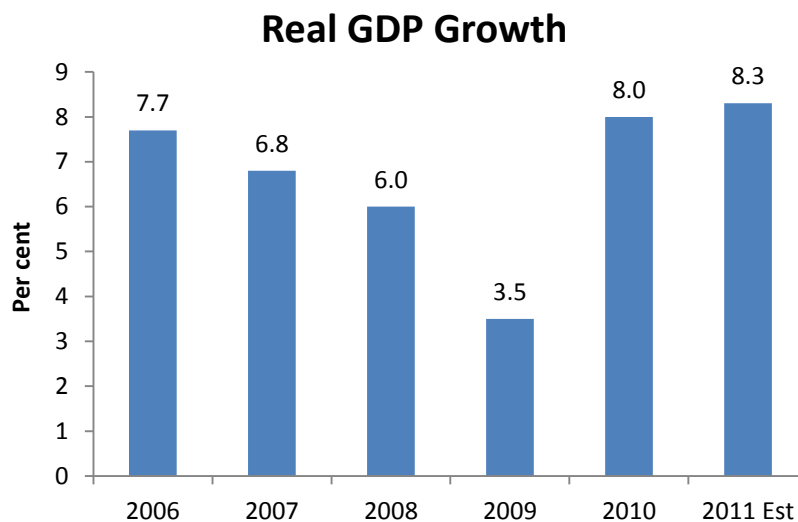
Asia's Share of Global GDP, 1700-2050



Source: Asia 2050 – Realising the Asia Century, ADB 2011

IN THIS SCENARIO, THE SRI LANKAN ECONOMY HAS ACHIEVED A HIGH GROWTH PATH...

- The growth in 2011 is estimated at 8.3%
- **First time in history to record over 8% growth in two consecutive years**
- GDP ESTIMATED TO EXCEED US\$ 59 BILLION & GDP PER CAPITA TO REACH US\$ 2,830
- **Inflation steadied at mid-single digit level**
- Comparatively low interest rate environment
- **Savings and investments on a steady growth path**
- External trade on a buoyant path
- **Foreign reserves preserved at a comfortable level**
- Stable exchange rate
- **Some pressure on BOP was observed**
- Sovereign Credit Ratings, Doing Business Index, FDI, etc. on the rise
- **Continuation of fiscal consolidation process**
- Lowest unemployment rate of 4.3%
- **Significant reduction in poverty**



THE SERVICES SECTOR CONTRIBUTION TO THE GROWTH WAS SIGNIFICANT...

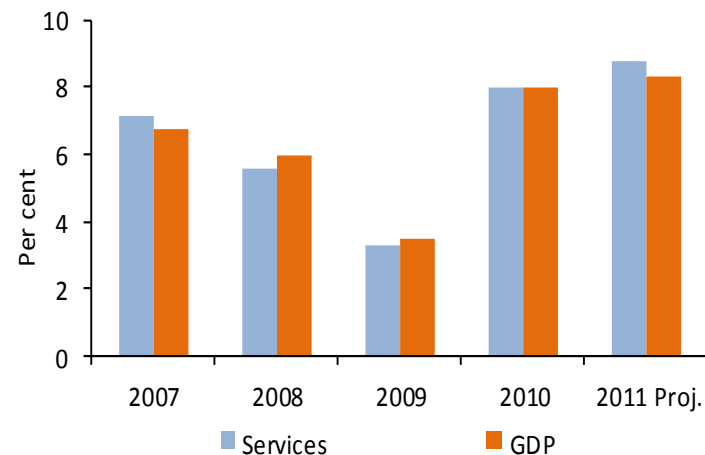
Services sector estimated to grow by 8.6% in 2011

- Services sector growth was 8.7% for the first three quarters of 2011
- **Healthy growth in consumer demand for services with increasing real income level in the country**
- Wholesale and retail trade, port operations, cargo and container handling, post and telecommunication, banking, insurance and real estate continued to expand
- **Transport and communication grew with gradual integration of Northern and Eastern Provinces with the rest of the economy**

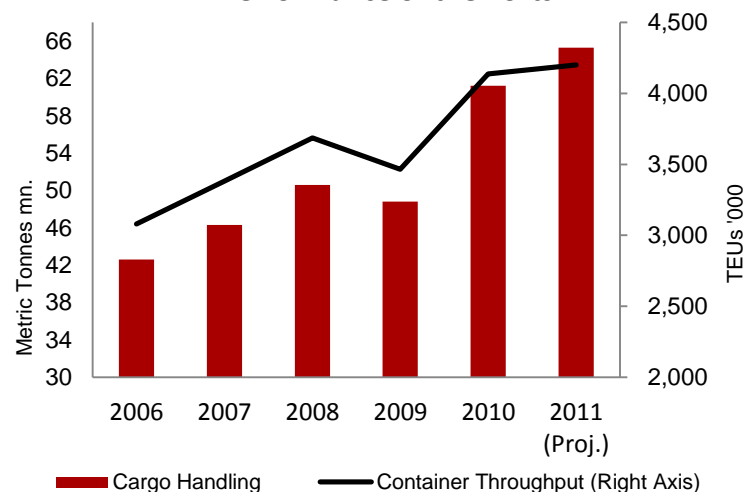
- **Services estimated to contribute about US\$ 34 billion to the GDP (58%)**



Services Sector and GDP Growth



Performance of the Ports



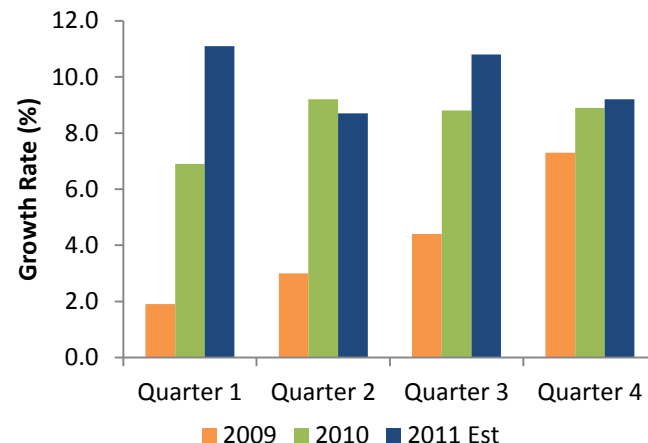
THE INDUSTRY SECTOR RECORDED THE HIGHEST SECTORAL GROWTH...

Industry sector estimated to grow by 10.1% in 2011

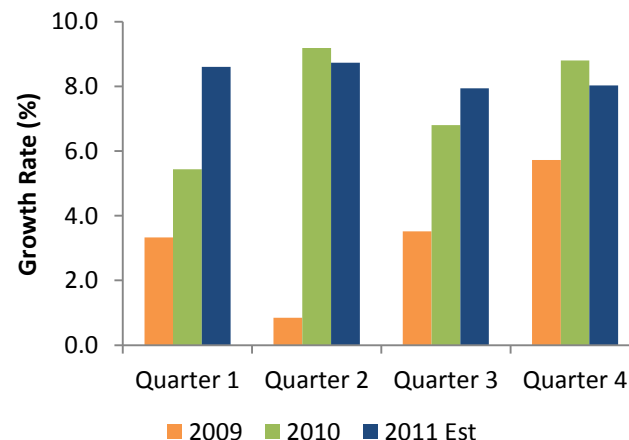
- Industry sector growth was 10.5 % during the first three quarters of 2011
- **Increased demand from both domestic and external sectors**
- Manufacturing, mining and quarrying, electricity, gas and water and construction sub-sectors recorded higher growth rates
- **Factory industry grew by 8.4 % during the first three quarters of 2011 mainly due to export market oriented industries, despite global economic slowdown**
- Food, beverages and Tobacco industries performed exceptionally well

Industries estimated to contribute about US\$ 18 billion to the GDP (30%)

Industry Sector Quarterly Growth Rates (2009-2011)



Factory Industry Quarterly Growth Rates (2009-2011)

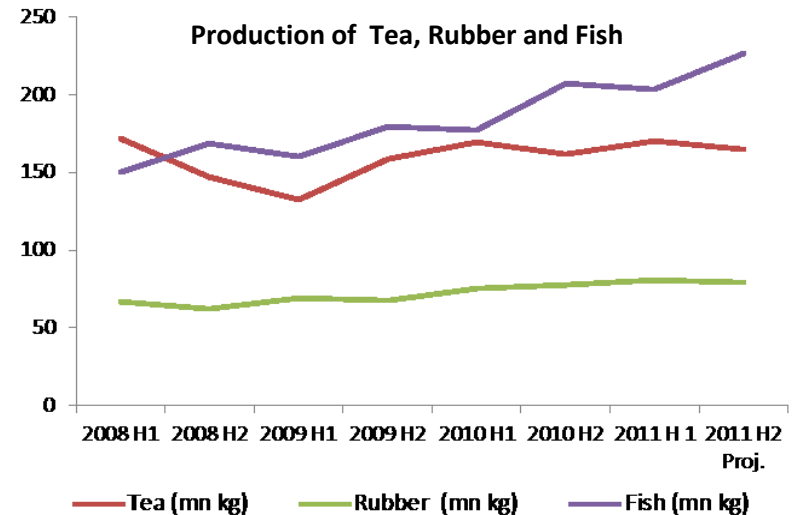
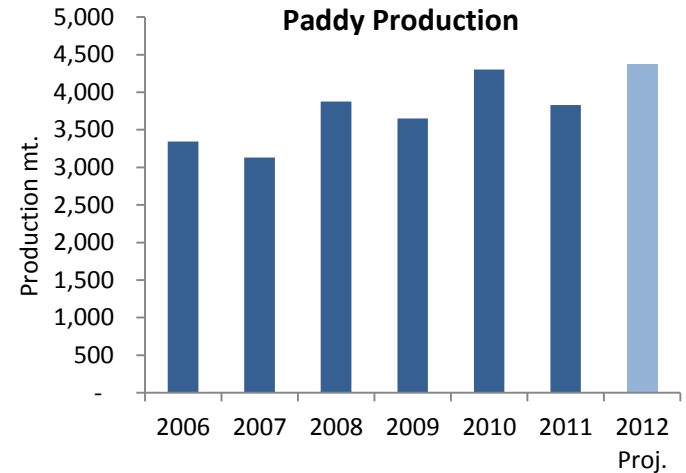


THE AGRICULTURE SECTOR GROWTH WAS AFFECTED, BUT RECOVERED...

Agriculture sector is estimated to grow by 2.0% in 2011

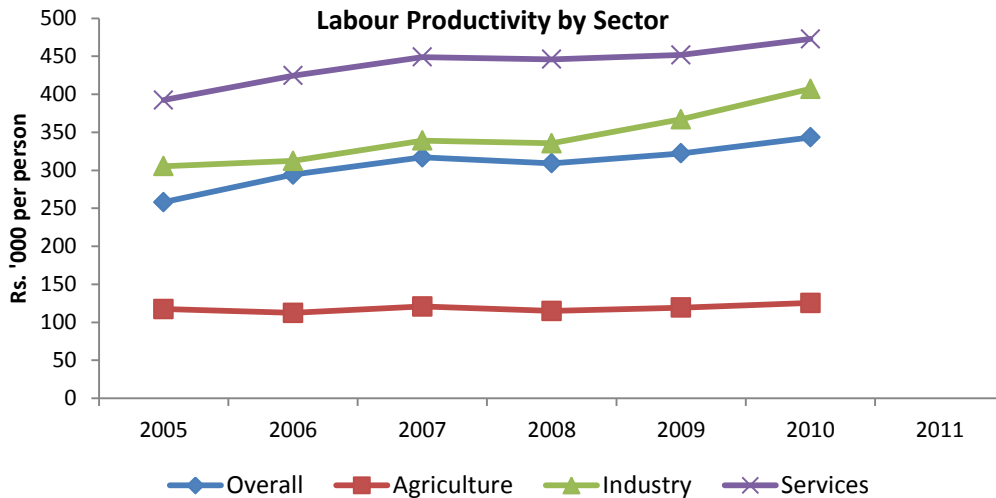
- Sector contracted by 1.8% in the first half of 2011 due to adverse weather
- **Fertilizer support programme and high prices in first half of 2011 helped production of export agriculture**
- Rubber production and prices remained strong
- **Coconut production recovered**
- Fish production for Jan-Oct 2011 recorded an increase of 15.5%

• **Agriculture estimated to contribute about US\$ 7 billion to the GDP (12%)**

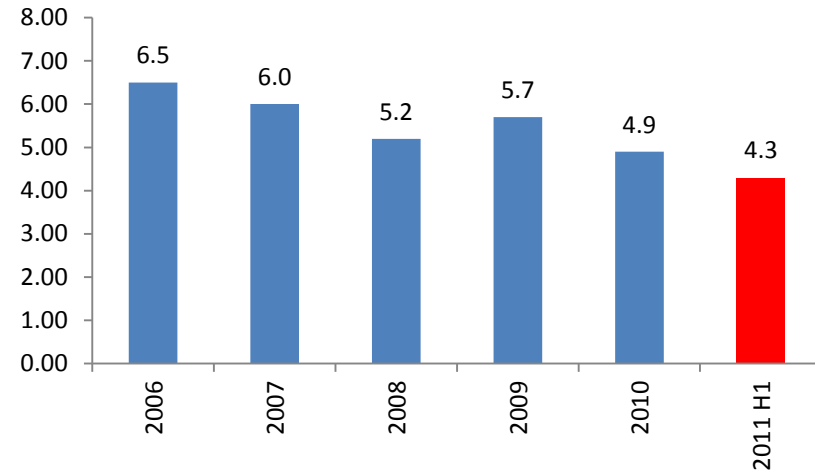


UNEMPLOYMENT DECLINED WHILE LABOUR PRODUCTIVITY INCREASED....

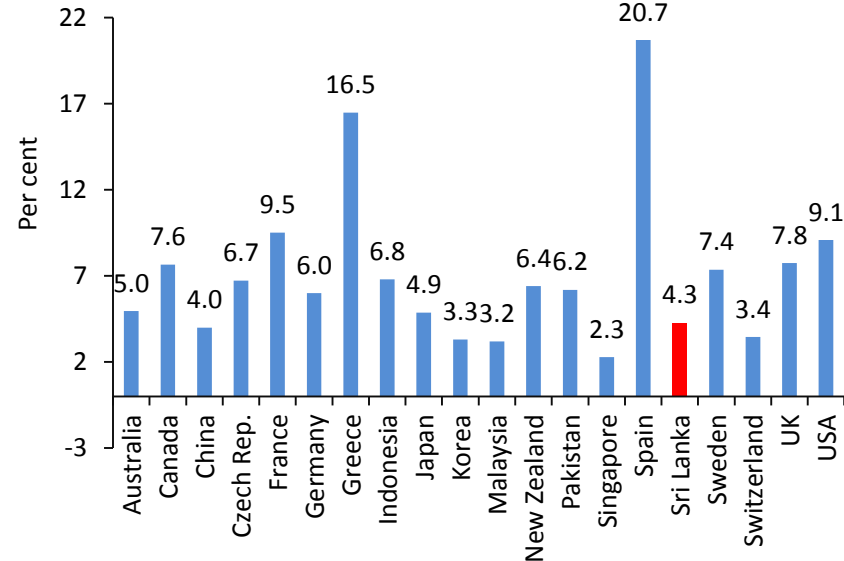
- Unemployment rate declined to 4.3% in first half of 2011**
 - Continued employment generation was due to reconstruction, infrastructure development and expansion of economic activities
 - Increase in share of employment in micro entrepreneurship category
 - Sharp drop in unemployment among the age group of 15-24 years
- Overall labour productivity, measured by GDP per worker, is continuing to improve**
 - Industry and Service sectors recorded growth in productivity



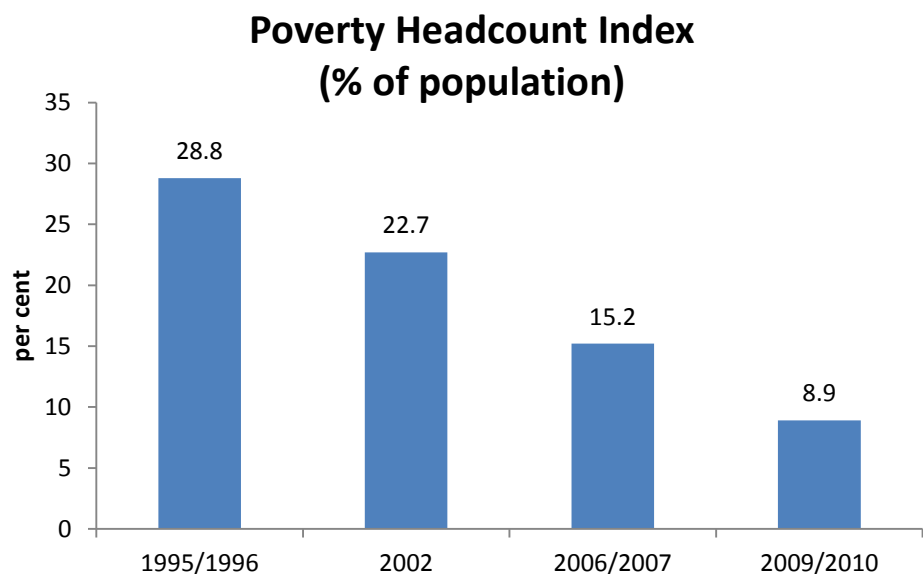
Unemployment Rate (%)



Unemployment Rates of Advanced and Some Emerging Economies - 2011 Est.



AT THE SAME TIME, POVERTY ALLEVIATION HAS BEEN GIVEN SERIOUS ATTENTION...



Source : Department of Census and Statistics

Sector	Poverty HCI	
	2006/07	2009/2010
Sri Lanka	15.2	8.9
Urban	6.7	5.3
Rural	15.7	9.4
Estate	32.0	11.4

Source : Department of Census and Statistics

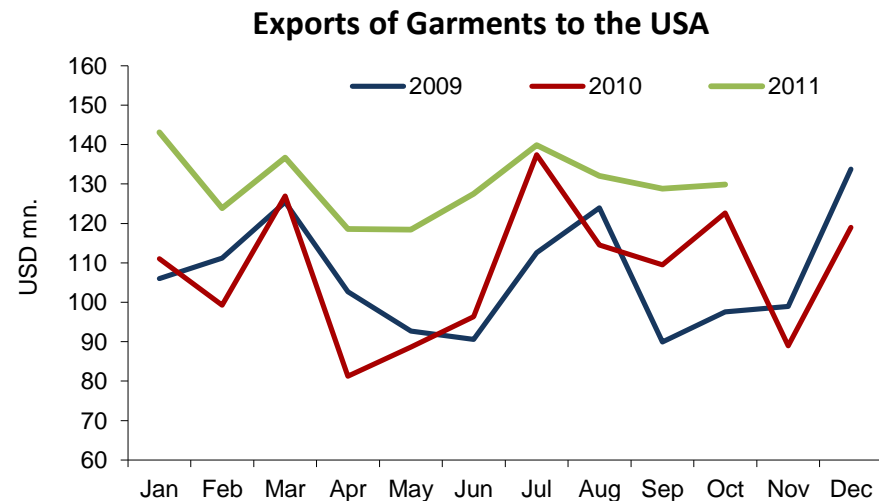
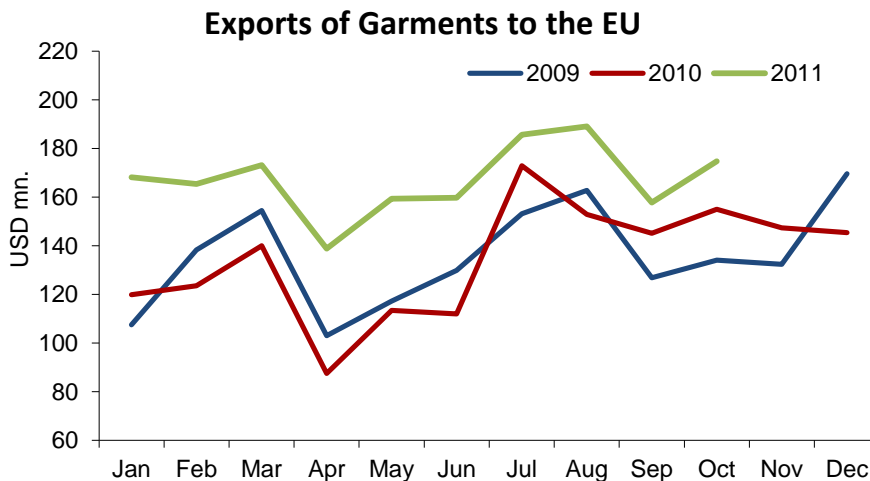
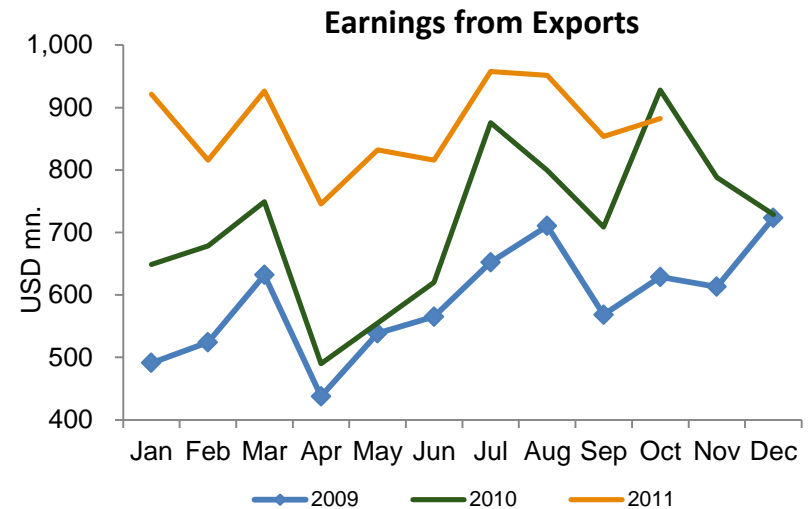
THE EXTERNAL SECTOR DISPLAYED STRONG PERFORMANCE AMIDST THE SLOW PACE RECOVERY IN THE WORLD ECONOMY...

- **External trade in 2011 remained strong where both exports and imports expanded recording 51.6% of GDP, up from 44.4% in 2010**
- **Tourism on an accelerator (1.4% of GDP)**
- **International investor confidence at high levels**
- **Expatriate workers' remittances continued to be the foremost foreign exchange earner, recording 8.8% of GDP, up from 8.3% in 2010**
- **Consolidation of 'Middle-Income Emerging Market Country' status**



A SIGNIFICANT INCREASE IN EXPORT EARNINGS WAS RECORDED DESPITE SLOWER GROWTH IN TRADITIONAL MARKETS...

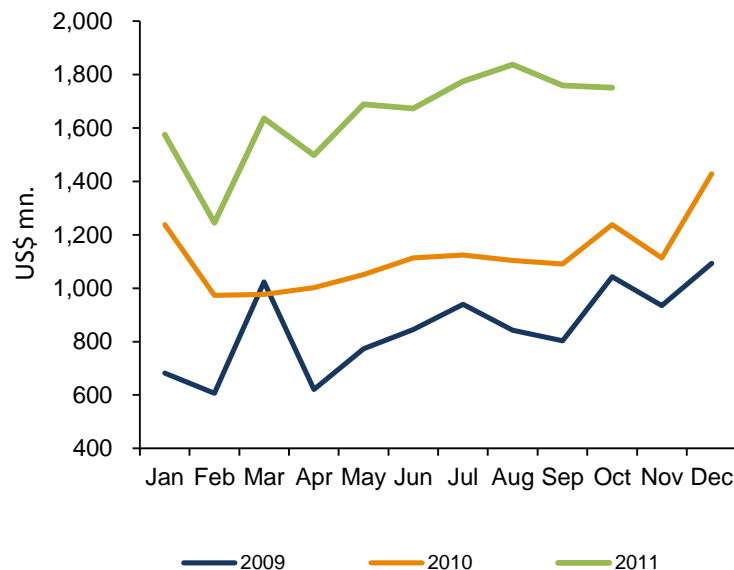
- Export earnings increased by over 23% with continuous growth in exports to the EU and the USA
- **Export diversification in terms of markets and products**
- Value addition was more price competitive
- **Exports as a percentage of GDP: 17.7%**



AT THE SAME TIME, IMPORTS EXPANDED AT AN EVEN FASTER PACE...

- **For the first 10 months of 2011, imports expanded by over 50%, y-o-y**
 - **Investment goods imports increased by over 60%**
 - **Intermediate goods imports increased by over 51%**
 - **Consumer good imports increased by over 47 %**
- **The sharp rise in investment goods imports was due to expanding infrastructure development projects**
- **The bulk of the expenditure on intermediate good imports was on account of petroleum imports with increases in both volume and price**
- **Consumer goods were driven by motor vehicle imports and non-essential goods: Higher demand due to increased real incomes**
- **Imports as a percentage of GDP: 33.9%**

Expenditure on Imports

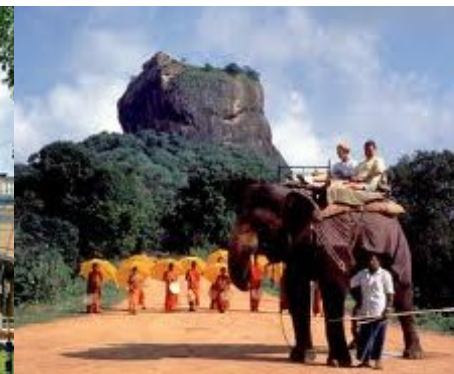
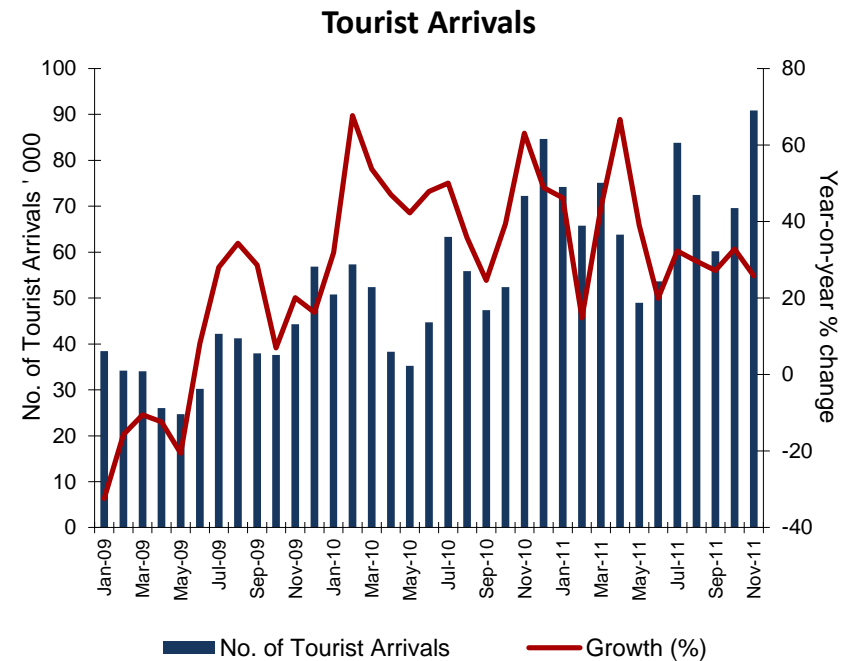


IN PARTICULAR, PETROLEUM, MOTOR VEHICLES AND GOLD IMPORTS SURGED IN 2011...

Imports (US\$ mn)				
Category	2010	2011 Est.	Growth Rate (%)	Share of imports (%)
1. Consumer goods	2,870	4,137	44	20.7
Food and drink	1,642	2,108	28	10.5
Other consumer goods	1,228	2,029	65	10.1
Motor Cars, Cycles, Electrical Appl.	632	1,121	77	5.6
Other	596	908	52	4.5
2. Intermediate goods	7,496	11,234	50	56.1
Petroleum	3,019	4,505	49	22.5
Textiles and clothing	1,732	2,223	28	11.1
Other intermediate goods	2,745	4,056	64	22.5
Gold	82	600	632	3.0
3. Investment goods	2,909	4,550	56	22.7
Machinery and equipment	1,206	1,975	64	9.9
Transport equipment	582	990	70	4.9
Building materials	810	1,124	39	5.6
Other investment goods	312	461	48	2.3
Total Imports	13,451	20,021	49	100.0

TOURISM ENTERED A HIGH GROWTH ERA...

- Tourist arrivals poised to record 850,000 for 2011. Tourist arrivals 758,458 for Jan-Nov 2011, an increase of 33% y-o-y
- **Earnings from tourism increased by 47% to US\$ 736 million & average spending per tourist per night increased to US\$ 97 from US\$ 88 in 2010**
- **Western Europe (37%), India (20%), East Asia (11%) and Middle East (7%)**
- **As of November 2011, 197 hotel projects for 12,579 rooms are in the pipeline**
- **Tourism as a percentage of GDP: 1.4%**



SEVERAL ADDITIONS TO TOURISM INDUSTRY ARE EXPECTED TO TAKE THE INDUSTRY TO THE NEXT LEVEL....

- **More International Hotel Chains**
 - Shangri-La, Sheraton, Hyatt, Sun City

- **11 new airlines have registered since 2010**

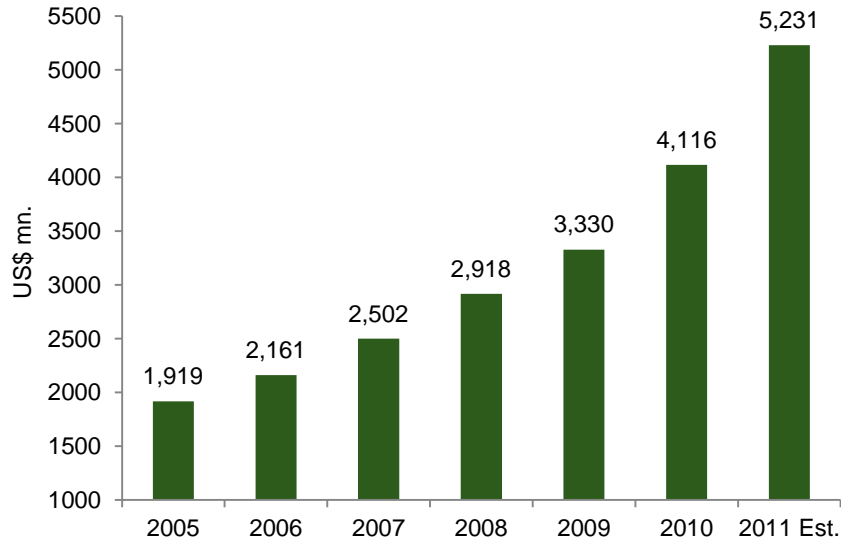
New air lines start after conflict ended in Sri Lanka		
1. Gulf Air	5. China Eastern	9. Aerosvit Airlines
2. Oman Air	6. Finnair	10. Hainan Airlines
3. Flydubai	7. Nova Airways	11. PIA – Pakistan International Airlines
4. SpiceJet	8. Aeroflot	

- **SriLankan Air Taxis now operate to 14 popular domestic tourist destinations**
- **“Mirissa” has now established itself as the world’s top spot for watching Blue Whales...**
- **The East coast and the Southern coastline are becoming major attractions for surfers and windsurfers**
- **New Shipping lines**
 - Top 20 shipping lines, which contribute to 80% of international trade, use the Colombo Port



WORKERS' REMITTANCES EMERGED AS THE FOREMOST FOREIGN EXCHANGE EARNER INDICATING A MAJOR SHIFT IN SRI LANKA'S EXTERNAL SECTOR...

Workers' Remittances



- Workers' remittances estimated to be around US\$ 5.2 billion in 2011, up by 27% from previous year

- As a percentage of GDP: 8.8%
- As a percentage of total external receipts: 18%

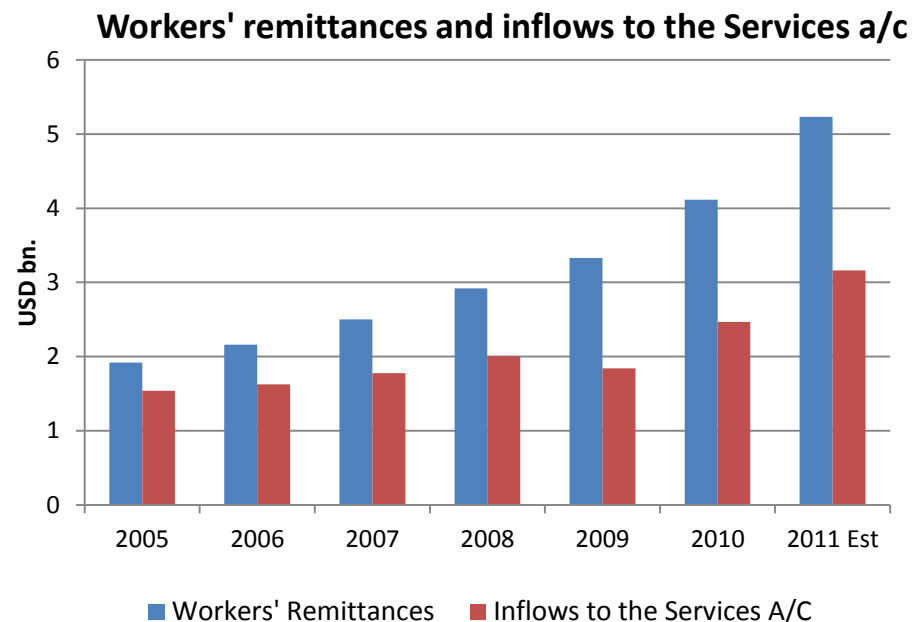
Results mainly due to...

- Attention to skilled labour migration
- Negotiations to increase average wages and working conditions
- Improved arrangements to channel remittances through banking sources
- Positive sentiment on domestic environment
- Diversification in terms of employment destinations



WORKERS' REMITTANCES AND INFLOWS TO THE SERVICES ACCOUNT SERVED TO CONTAIN THE WIDENED TRADE DEFICIT...

- Deficit in trade account is now offset by:
 - Higher inflows of workers' remittances
 - Surplus in the services account
- Inflows on account of emerging services – transportation, computer and information, BPOs, insurance, and business services, also increasing



THIS NEW TREND SUGGESTS THAT NEW OPPORTUNITIES ARE AVAILABLE IN THIS REGARD IN THE FUTURE...

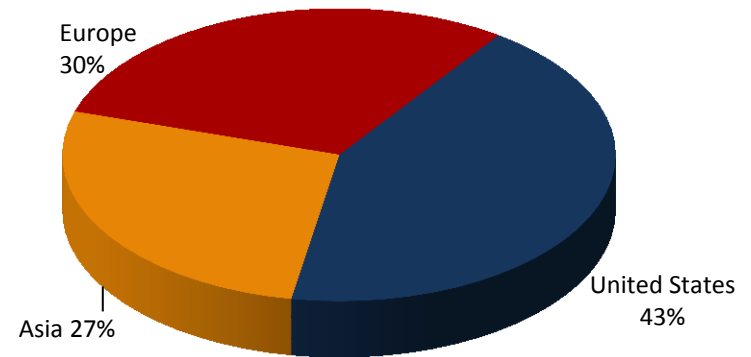
FOREIGN CAPITAL INFLOWS CONTINUED TO BE SIGNIFICANT & PICKED UP MOMENTUM...

- Fourth international sovereign bond in July 2011 was oversubscribed by 7.5 times
- **FDI exceeded US\$ 1,000 million for the first time in history**
- Limit on foreign investment in Sri Lanka rupee denominated government securities relaxed from 10% to 12.5%
- **Further impetus provided to external financing by relaxation of private sector external financing**
- Gross official reserves being equivalent to cover about 4 months of imports
- **Exchange rate remained competitive and stable in a highly volatile external environment**

THE FOURTH SOVEREIGN BOND ISSUE CLEARLY RESONATED WITH INVESTORS...

- The 10 year bond of US\$ 1 bn was oversubscribed by over 7.5 times
- **Issue attracted highly diverse investor interest**
- ‘Best Sri Lanka Deal’ awarded for the US\$1 billion 10-year sovereign bond by Finance Asia, for the second consecutive year
- **Highly competitive yield**

Investor Mix of 2011 Sovereign Bond Issue



Harmonised long-term interest rates (% p.a)

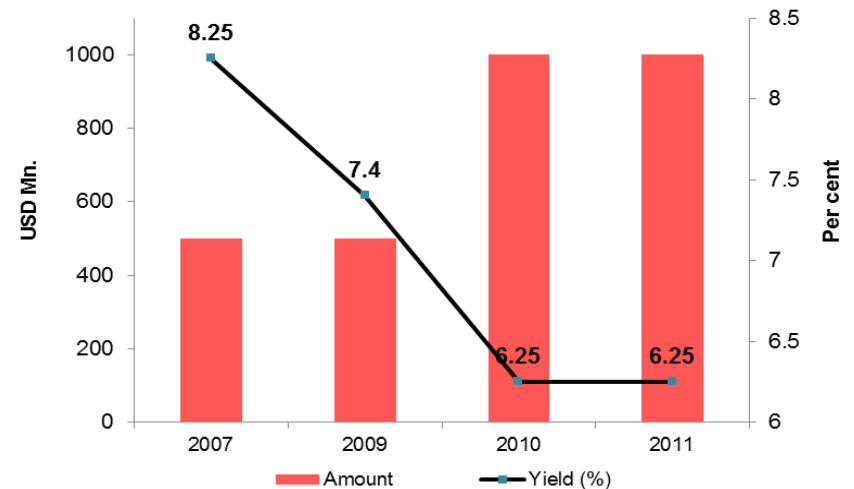
(Period averages; secondary market yields of government bonds with maturities of close to ten years)

Euro area		
	Jul-11	Nov-11
Greece	16.2	17.9
Ireland	12.4	8.5
Portugal	12.2	11.9
Spain	5.8	6.2
Italy	5.5	7.1
Belgium	4.2	4.8
France	3.4	3.4
Austria	3.4	3.4
Netherlands	3.2	2.4
Finland	3.2	2.5
Germany	2.7	1.9

Sources: ECB and European Commission

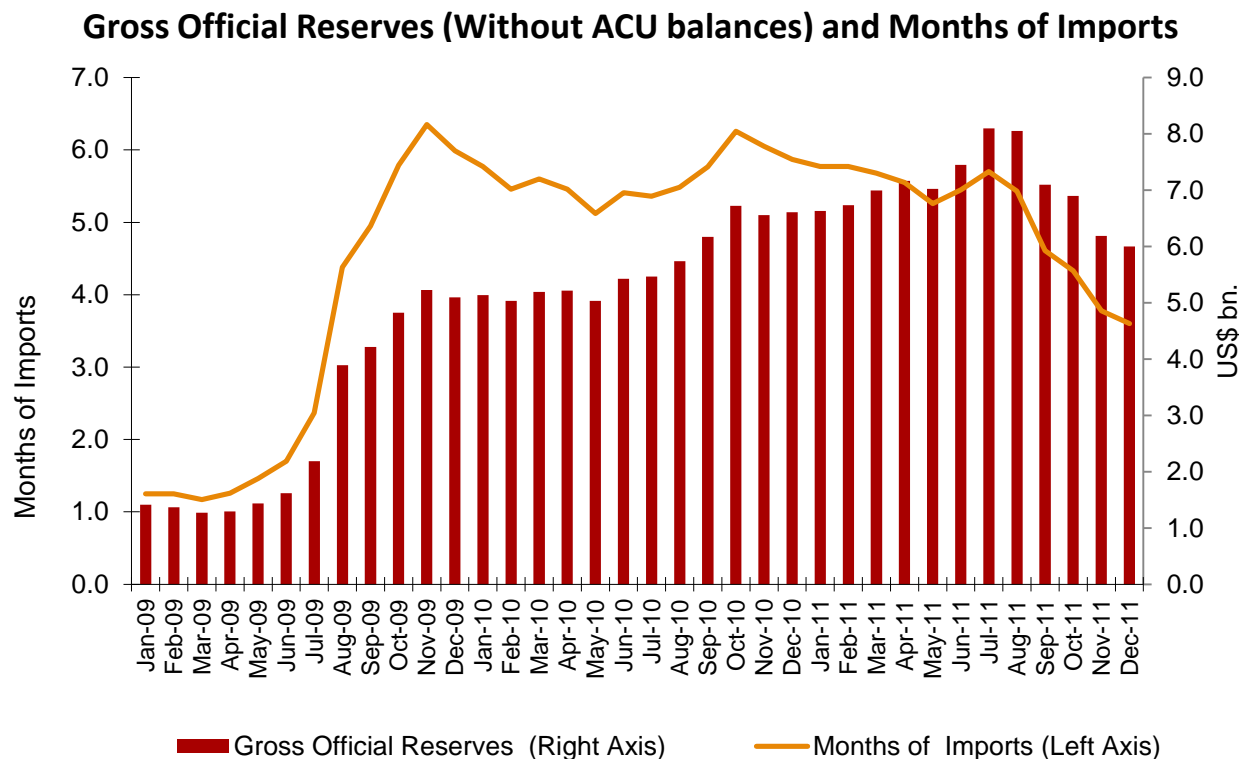
	Jul-11	Nov-11
Sri Lanka	5.7	6.2

Sovereign Bond Issues - Amount & Coupon Rate (%)



AS A RESULT, GROSS OFFICIAL RESERVES REMAINED AT COMFORTABLE LEVELS, ALTHOUGH LOWER THAN AT THE BEGINNING OF THE YEAR...

- Gross Official Reserves amounted to US\$ 6.0 billion by end 2011 compared to US\$ 6.6 bn by end 2010.



DURING 2011, INTERNATIONAL RESERVES WERE ACCUMULATED TO HISTORICALLY HIGH LEVELS, AND ALLOWED TO DECLINE TOWARDS THE END OF THE YEAR...

- **Foreign reserves, stood at US\$ 6.6 billion on 30 December 2010 and increased to a record high level of US\$ 8.2 billion by mid August 2011, due to large-scale absorption of foreign exchange by the Central Bank**
- **Thereafter, there was a draw down of reserves, mainly due to significant supply of foreign exchange to the market by the Central Bank**
- **Yet, The current level of reserves is well above the level needed to:**
 - **Maintain confidence in the policies for monetary and exchange rate management including the capacity to intervene**
 - **Limit external vulnerability by maintaining foreign currency liquidity to absorb shocks during times of crisis or when private access to borrowing is slow**
 - **Assist the government in meeting its foreign exchange needs and external debt obligations**
- **The current reserve level is also higher than the reserves level contemplated of 3.5 months imports equivalent, which was envisaged at the time of entering into the Stand-by Arrangement with the IMF**

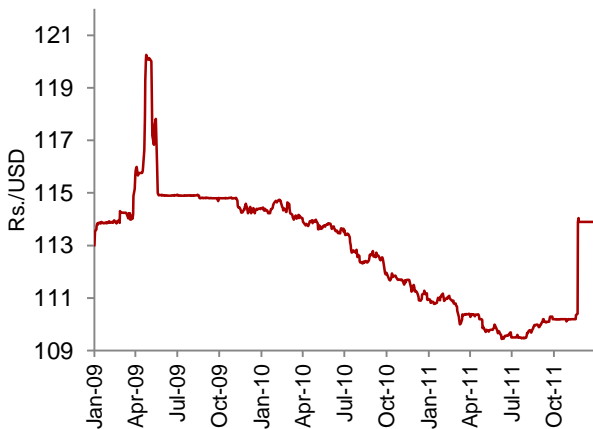
THE CENTRAL BANK HAS BEEN CONFIDENT OF ITS STANCE IN THE SECOND HALF OF 2011, SINCE SUBSTANTIAL FOREIGN EXCHANGE INFLOWS ARE EXPECTED IN 2012...

- Expected inflows in 2012 are well over US\$ 25 billion:
 - Exports: US\$ 12.5 bn
 - **Tourism: US\$ 1.2 bn (1.8% of GDP)**
 - Expat Workers' remittances: US\$ 6.5 bn (9.8% of GDP)
 - **Foreign Direct Investments: US\$ 2.0 bn (2.9% of GDP)**
 - Commercial Banks' Tier II capital: US\$ 1 bn
 - **Major Corporates' capital from abroad: US\$ 500 mn**
 - Special long term financing expected for Petroleum: US\$ 1.0 bn
 - **Long-term currency swaps: US\$ 500 mn**
 - Net Stock Market inflows: US\$ 500 mn
 - **Net Treasury Bill & Bond inflows: US\$ 500 mn**

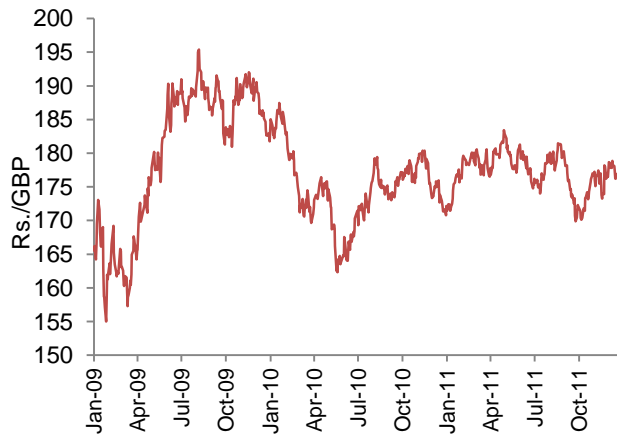
AS A RESULT OF THE CENTRAL BANK POLICIES, THE EXCHANGE RATE IN 2011 DID NOT SUFFER UNNECESSARY VOLATILITY...

- The Central Bank absorbed and supplied foreign currency to avoid excessive volatility in the domestic foreign exchange market and to maintain stability.
- The Central Bank also accommodated the high growth driven demand for the increased import of intermediate and investment goods.
- **Overall, the Rupee depreciated against the US dollar by 2.6% in 2011**

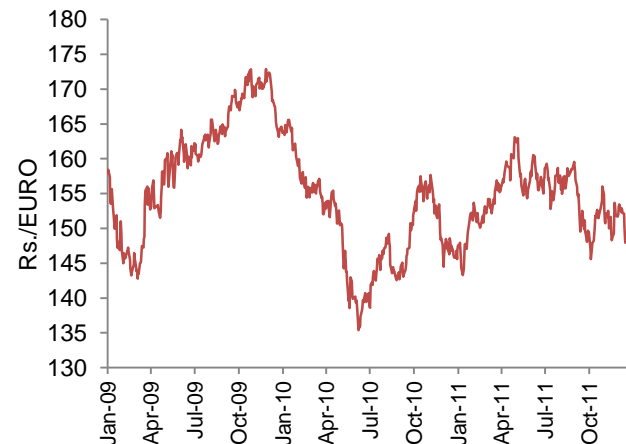
Daily Sri Lanka Rupee/US Dollar Exchange Rate Movements



Daily Sri Lanka Rupee/Sterling Pound Exchange Rate Movements

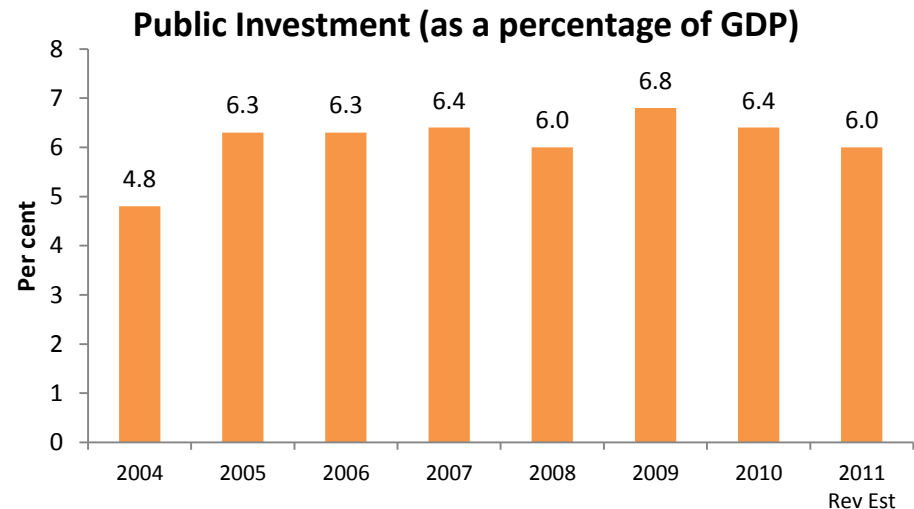
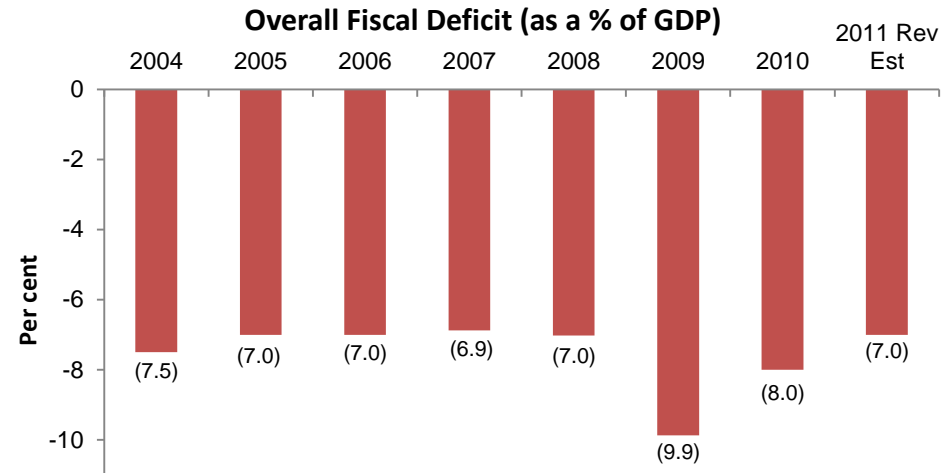


Daily Sri Lanka Rupee/EURO Exchange Rate Movements

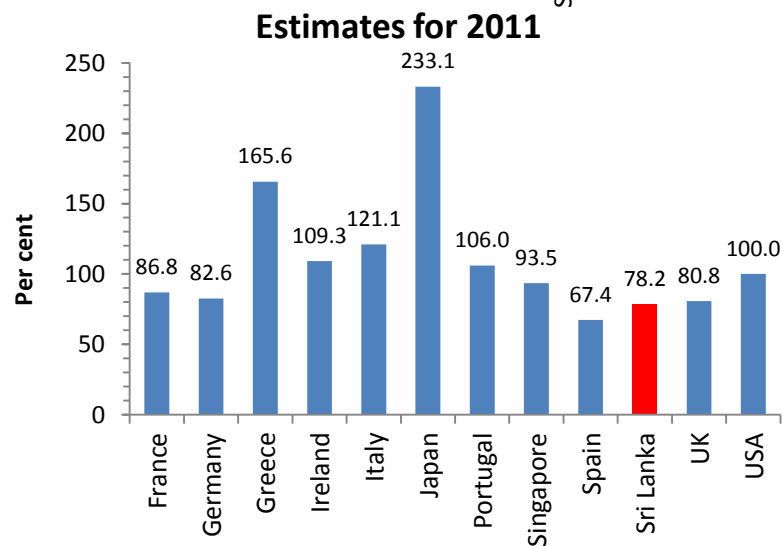
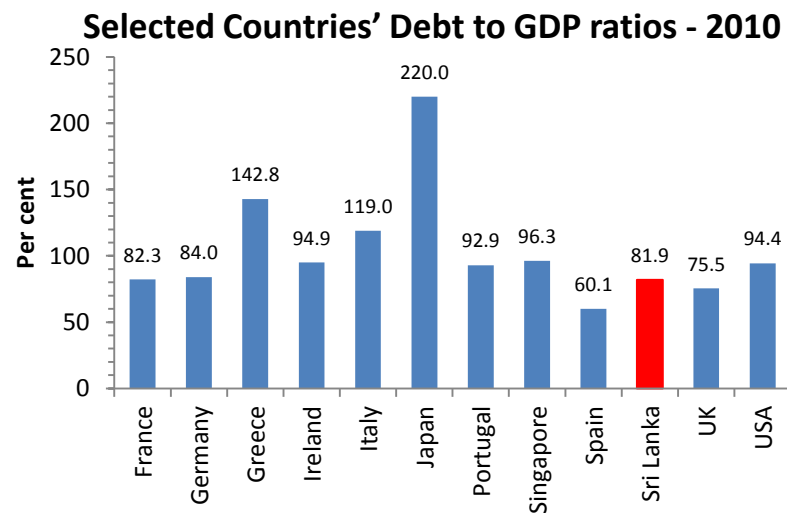
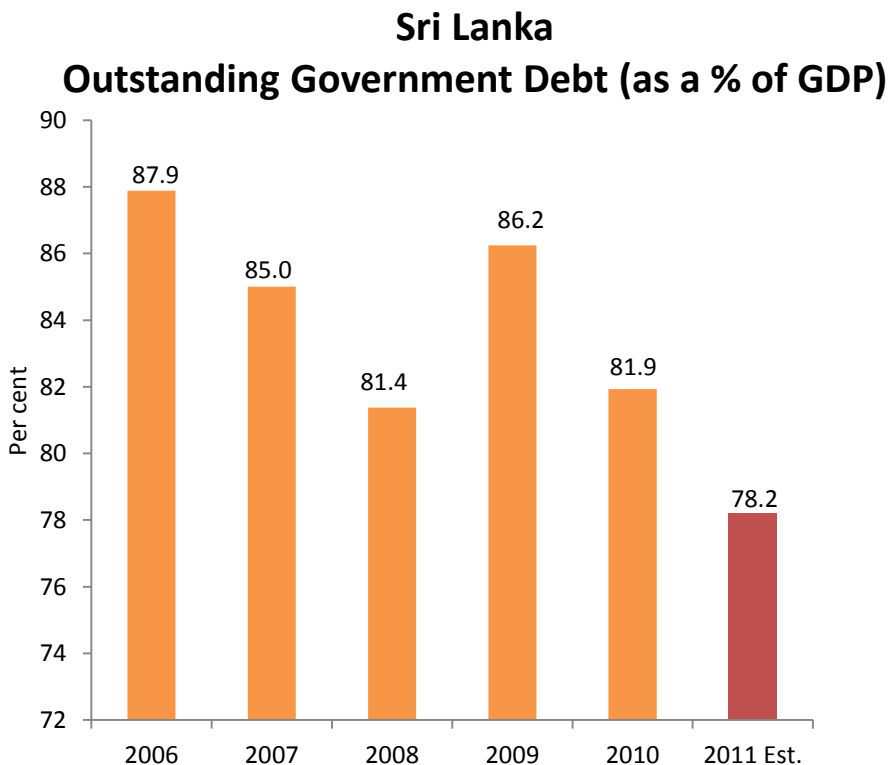


AT THE SAME TIME, THE FISCAL CONSOLIDATION EFFORT CONTINUED, WHILE MAINTAINING PUBLIC INVESTMENT AT HIGH LEVELS...

- The overall fiscal deficit is estimated to be below 7% of GDP in 2011, down from 8% in 2010, mainly due to expenditure containment policies
- Such consolidation is expected to be achieved, even while maintaining public investment at 6% of GDP in 2011



LEADING TO THE DEBT TO GDP RATIO ESTIMATED TO FALL TO 78% IN 2011, WHILE IN MANY COUNTRIES THIS RATIO HAS SOARED...



Source: IMF WEO September 2011 & MOFP

THE RISK INDICATORS OF SRI LANKAN PUBLIC DEBT IMPROVED, IN A TIME WHERE GLOBAL RISK HAS BEEN RISING...

Indicator	Less Indebted	Moderately Indebted	Highly Indebted	Sri Lanka 2011
Disbursed External Debt Outstanding/Gross National Income	<30%	>30% and <50%	>50%	36.0%
Disbursed External Debt Outstanding/Exports of Goods and Non Factor Services	<165%	>165% and <275%	>275%	155.6%
Total External Debt Service Payments/Exports of Goods and Non-Factor Services	<18%	>18% and <30%	>30%	9.1%
External Interest Payments/Exports of Goods and Non-Factor Services	<12%	>12% and <20%	>20%	2.9%
Net Present Value/Gross National Income	<48%	>48% and <80%	>80%	36.9% *
Net Present Value/Exports of Goods and Non-Factor Services	<132%	>132% and <220%	>220%	119.7% *

* Data for 2010

Source: Manual on Effective Debt Management, UN-ESCAP, 2006.

THE CONTINUOUS UPGRADE IN INFRASTRUCTURE GREATLY ENHANCED THE COUNTRY'S PRODUCTIVE CAPACITY...

– Road development projects

- The Southern Highway Project, *(Stage 1 : completed and Phase 2 in progress)*
- The Colombo - Katunayake Expressway *(Completion by 2013)*
- The Colombo Outer Circular Road Project *(Completion by 2013)*

– Power projects

- Upper Kothmale Hydro Power Plant will be commissioned shortly
- Norochcholai Coal Power Plant *(Phase 1 : Completed, Phase 2 in progress)*
- Uma Oya Hydro Power Project *(Completion by 2014)*
- Moragahakanda and Kaluganga Reservoir Projects *(In progress)*
- Sampur Coal Power Project *will be commissioned by 2017*

– Port development projects

- The South Colombo Harbour Project, *(Phase 1 Completion by 2013)*
- The Hambantota Port Development Project *(Phase 1 : Completed)*
- The Oluvil Port Development Project *(Completion by 2012)*
- The Galle Port *(In progress)*
- The Kankasanthurei Port *(In progress)*

– Several mega hotel projects, condominiums, shopping malls, development of North and East, and water supply projects

– On-going rural infrastructure development projects

- Gama Neguma, Maga Neguma, Small Irrigation Projects, Kirigammana projects, etc.

– Lighting Sri Lanka (Targeted 100% electricity coverage by 2013)

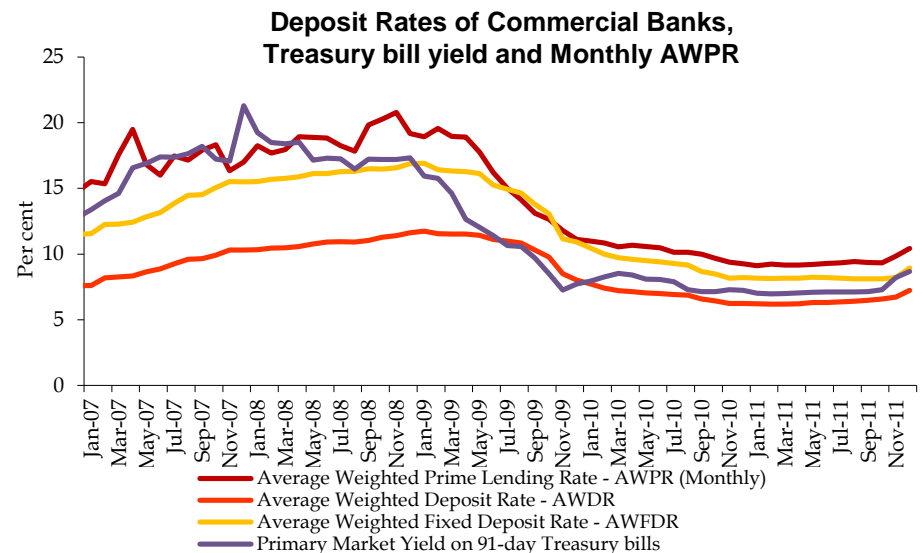
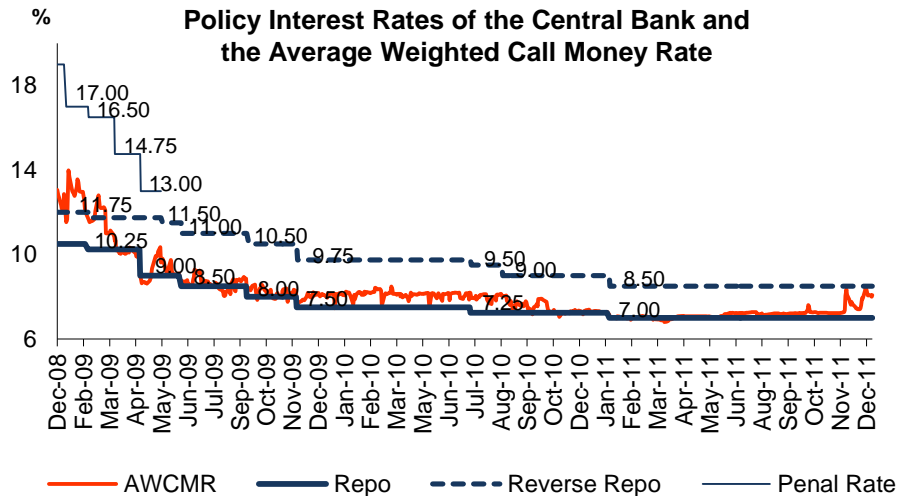


ON THE BACK OF SUCH INFRASTRUCTURE UPGRADE, PRIVATE SECTOR INVESTMENTS HAVE BEEN ON THE RISE...

- New terminal at Colombo South Port: US\$ 500 mn project - just commenced
- **Petroleum exploration in the Mannar basin in progress**
- New industries at Hambantota Port
 - 4 new industries have received Cabinet approval
 - Sugar Refinery plant
 - Cement binding and bagging plant
 - Fertilizer complex
 - Petrochemical plant
 - Many more industries in the pipeline: Warehousing, Vehicle Assembly, etc.
- 197 Hotel projects and other Tourism related projects
 - Shangri-La, Sheraton, Hyatt and Sun City
- **Universities/Hospitals**
 - **Expansion of local universities and private education opportunities**
- ICT, BPO projects, Hambantota Sports City
- **Fisheries: deep sea fishing, cold stores**

THE CENTRAL BANK'S MONETARY POLICY STANCE IN 2011, WAS CAUTIOUS AND CONSISTENT, & DELIVERED STABILITY...

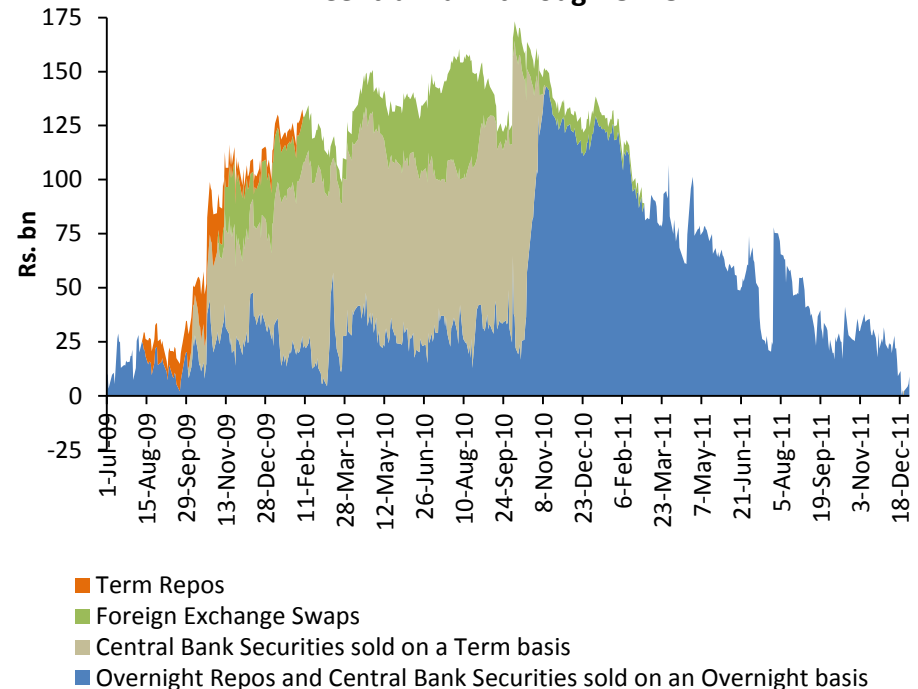
- Policy interest rates in 2011 remained unchanged after one downward adjustment in January 2011
- Weighted average call money rate continued to remain largely stable within the policy rate corridor
- Market interest rates remained broadly stable.
- Slight increase in rates witnessed towards end of 2011



MARKET LIQUIDITY HAS NOW REDUCED TO MANAGEABLE LEVELS...

- Excess liquidity in the money market gradually declined in 2011 to under Rs.10 bn, from Rs.124 bn at end 2010.
- **The Statutory Reserve Ratio (SRR) was increased by 1 percentage point to 8% in April 2011, which absorbed about Rs. 18 billion of excess liquidity on a permanent basis.**
- The Central Bank commenced overnight reverse repurchase auctions towards year-end to contain pressure on market interest rates.

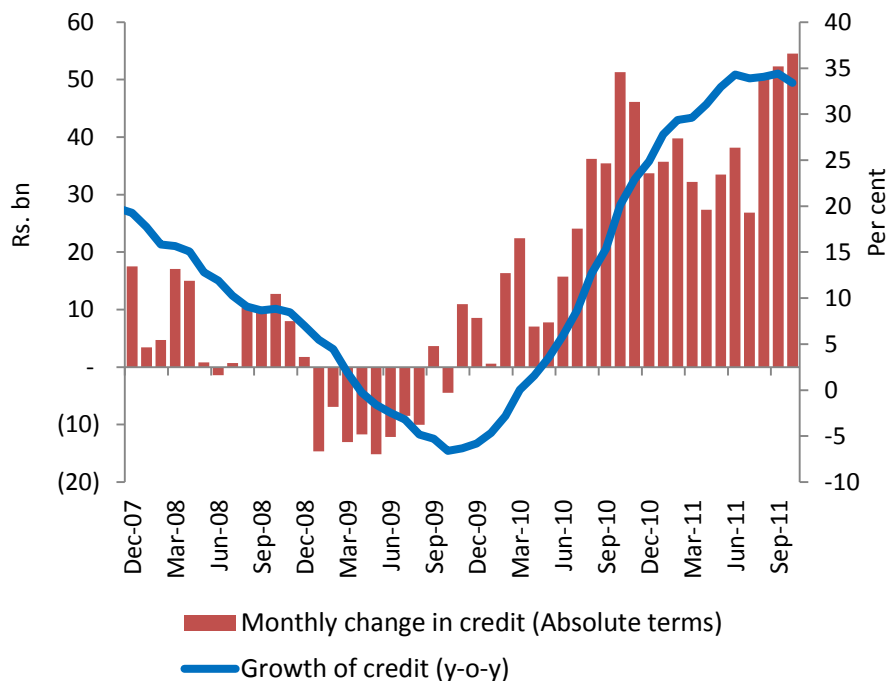
Excess Money Market Liquidity absorbed by the Central Bank through OMO



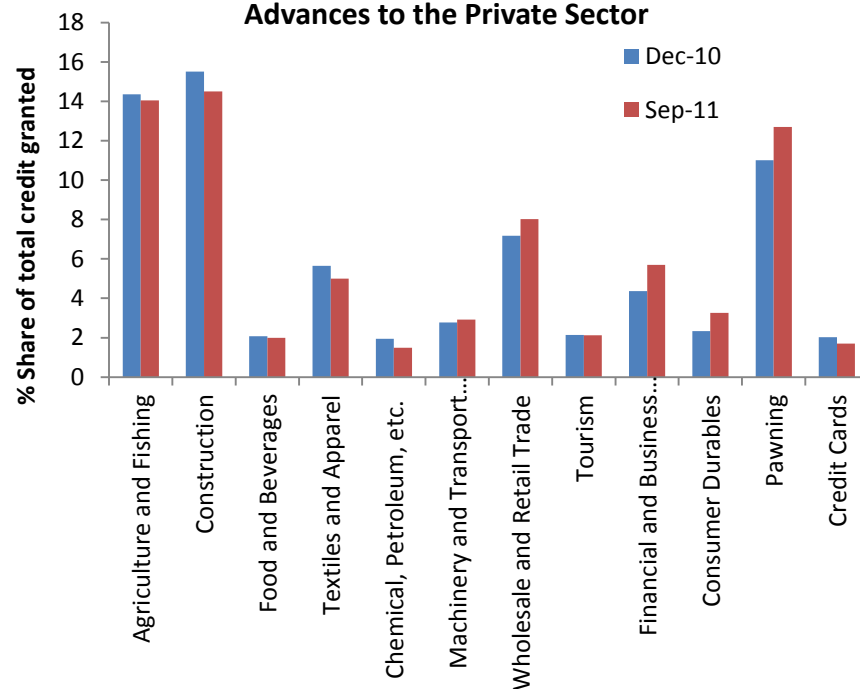
PRIVATE SECTOR CREDIT EXPANDED RAPIDLY, RECOVERING FROM THE LOW BASE IN PREVIOUS YEARS...

- Growth in credit extended to the private sector by commercial banks was broad based and sharp increases were observed in credit for consumer durables and on pawning

Credit to the Private Sector

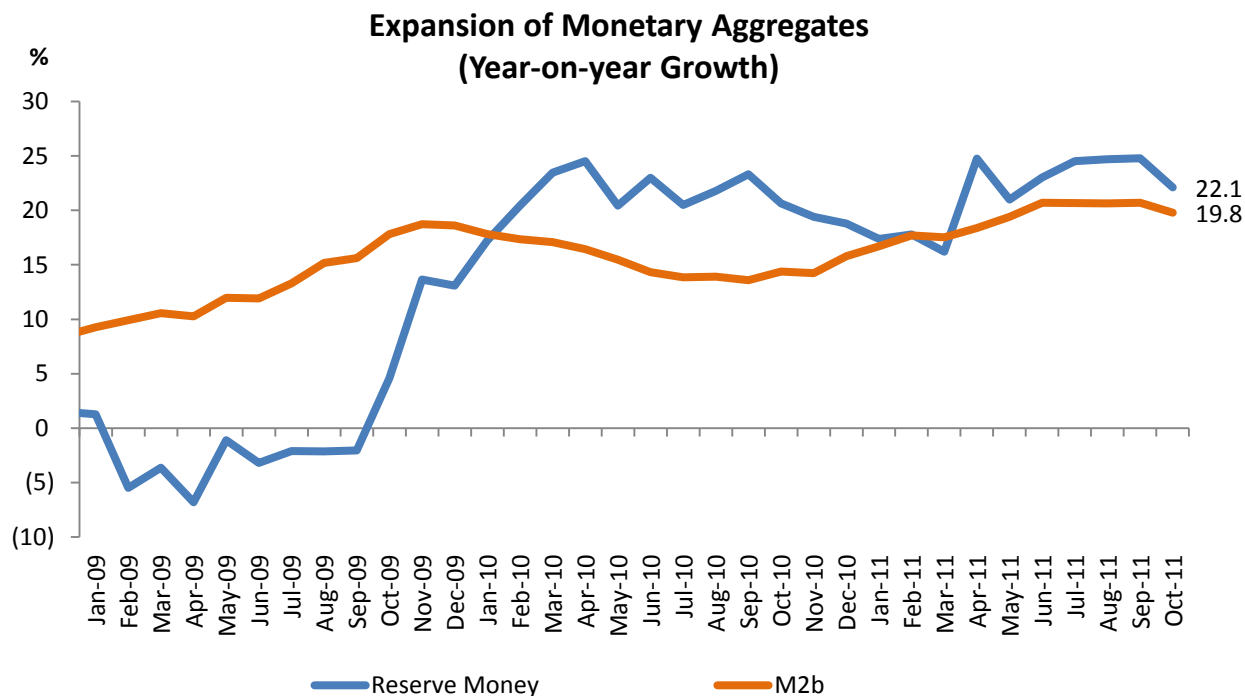


Classification of Commercial Banks' Loans and Advances to the Private Sector



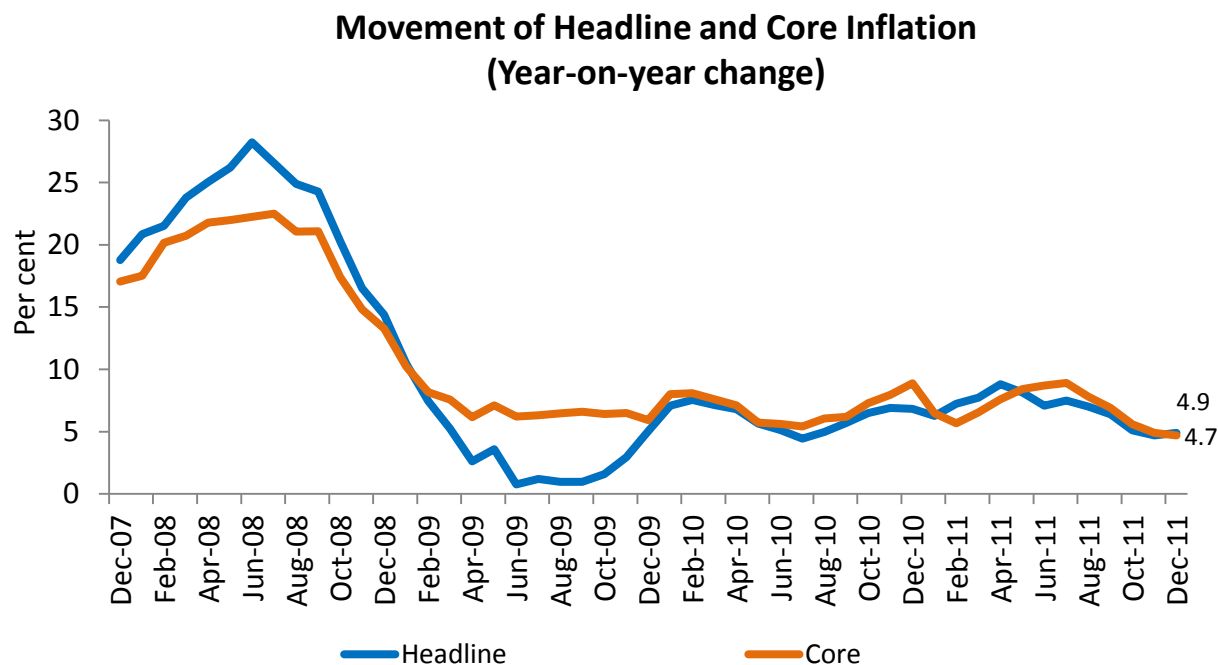
BUT OVERALL, THE MONETARY EXPANSION WAS HIGHER THAN EXPECTED...

- Broad money recorded a year-on-year growth of 19.8% in October 2011, up from 15.8% in 2010, and considerably higher than the projected 14.5%



NEVERTHELESS, INFLATION WAS CONTAINED AT MID-SINGLE DIGIT LEVELS...

- Year-on-year inflation declined to 4.9% in December 2011 from 6.8% at end December 2010
- **Annual average inflation in December was 6.7%**
- Year-on-year core inflation was less volatile recording 4.7% in December 2011



IN THE MEANTIME, SRI LANKA'S SOVEREIGN RATING

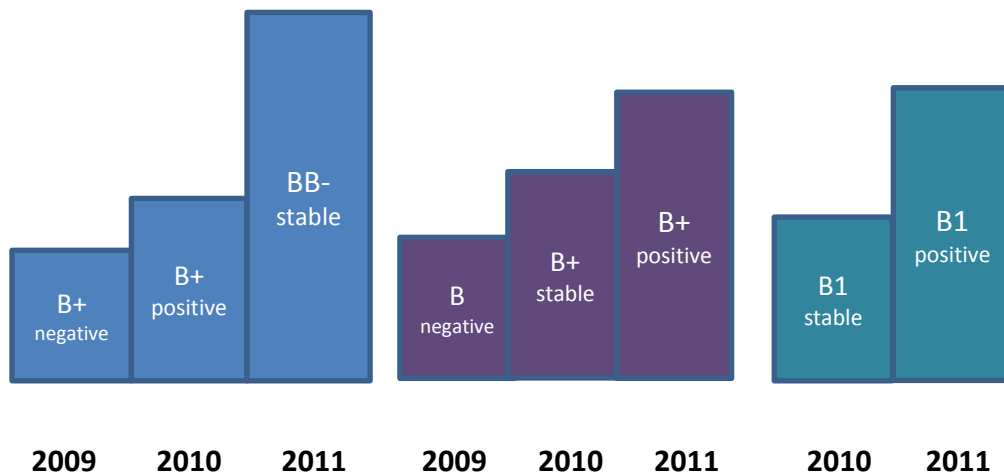
IMPROVED...

- The Central Bank selected and invited representatives from the Government and Private Sector who provided positive contributions towards enhancing the country's sovereign rating
- **3 international sovereign rating advisors, Bank of America Merrill Lynch, HSBC and Royal Bank of Scotland, assisted the effort**

Fitch Ratings

Standard & Poor's

Moody's



The Sovereign Rating Committee comprised of Central Bank officials and other eminent persons:

- Mr. U.R. Seneviratne
Former Deputy Secretary to the Treasury
- Mr. Ashroff Omar
Chief Executive Officer, Brandix Lanka Ltd
- Mr. David Saudan
Former Managing Director, Nestle Lanka PLC
- Dr. Anura Ekanayake
Former Chairman, Ceylon Chamber of Commerce
- Mr. Upali de Silva
Secretary General, Sri Lanka Banks' Assn
- Mr. Dilith Jayaweera
Managing Director, Triad Advertising
- Mr. K.R. Suresh Kumar
Managing Director, Lanka IOC Ltd

... AND THE IMF STAND-BY ARRANGEMENT PROVIDED STRONG SUPPORT...

- In early 2009, Sri Lanka requested an IMF-SBA facility of US\$ 1.9 bn equivalent to 300% of quota. On July 24, 2009, IMF approved a US\$ 2.6 bn facility, equivalent to 400% of quota
- **So far, Sri Lanka has received tranches to the value of US\$ 1.7 bn. In addition, Sri Lanka also received US\$ 0.5 bn from the IMF under the general and special SDR allocation, making a total of US\$ 2.2 bn**
- The objective of the IMF SBA programme was to build Sri Lanka's foreign reserves to an equivalent of 3.5 months of imports by the end of the programme

THE GLOBAL RANKING OF SRI LANKA IN MANY AREAS IMPROVED IN 2011...

- Global Competitiveness Index
 - up to 52nd from 62nd
- Doing Business Index
 - up to 89th from 98th
- Civic Engagement Index
 - placed 7th

Rankings on the Ease of Doing Business



Economy	2012 Rank	2011 Rank	
Maldives	79	78	▼
Sri Lanka	89	98	▲
Pakistan	105	96	▼
Nepal	107	110	▲
Bangladesh	122	118	▼
India	132	139	▲
Bhutan	142	146	▲
Afghanistan	160	154	▼

Source: International Finance Corporation

SRI LANKA'S INDEX VALUE IN THE HUMAN DEVELOPMENT INDEX IMPROVED AND REACHED THE BEST LEVEL IN THE REGION, ALTHOUGH THE RANKING FELL IN 2011

Country	Adult Literacy Rate % (Most recent)	Life Expectancy - 2011	HDI Rank - 2011
Bangladesh	56	69	146
Philippines	95	69	112
Malaysia	92	74	61
India	63	65	134
China	94	73	101
Pakistan	56	65	145
Sri Lanka	91	75	97

Sources: Human Development Report – 2011

CONFIDENCE IN THE ECONOMY WAS REFLECTED IN OTHER INDICATORS TOO...



Business confidence high...
(November 2011)

Last 12 months

158
LATEST

159
AVERAGE

173
HIGH

134
LOW

All-time summary

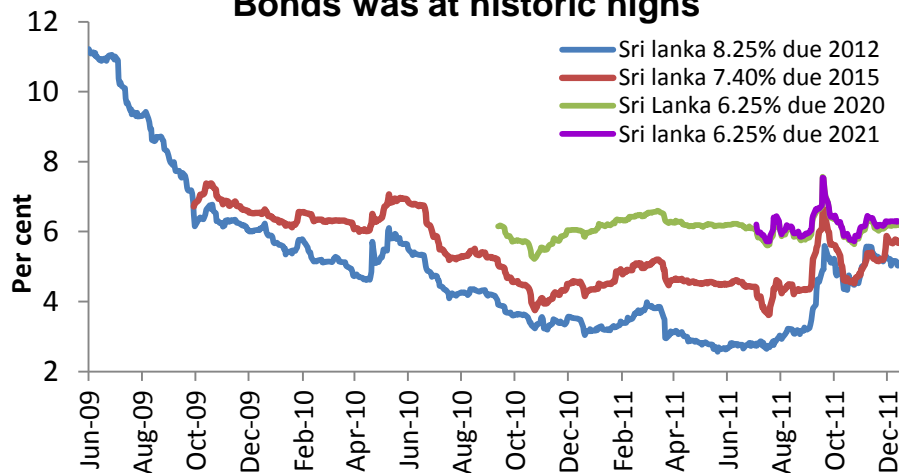
159
YEAR AGO

127
AVERAGE

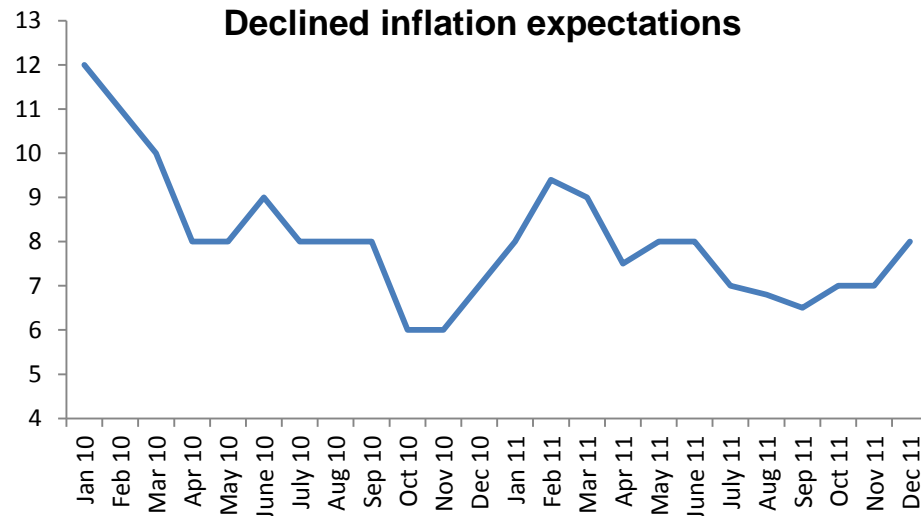
178
HIGH

31
LOW

Confidence of international investors in Sri Lanka Bonds was at historic highs



Declined inflation expectations



OVERALL, MASSIVE OPPORTUNITIES AROSE WITHIN THE COUNTRY TO INCREASE PRODUCTIVITY...

- Secure environment and political stability
- **High and sustained growth & New growth areas / opportunities**
- Better Infrastructure – Electricity, Roads, Health, Education, etc.
- **Lower Inflation**
- Lower Interest rates
- **Stable exchange rates**
- Industrial harmony
- **Better utilisation of production factors: Eg. People, machines, energy, land, etc.**
- Greater consumer demand due to higher local incomes

3. DEVELOPMENTS IN THE FINANCIAL SYSTEM IN 2011

“In an international environment where political and economic chaos has been the order of the day, Sri Lanka has been able to stay calm, safe and confident...”

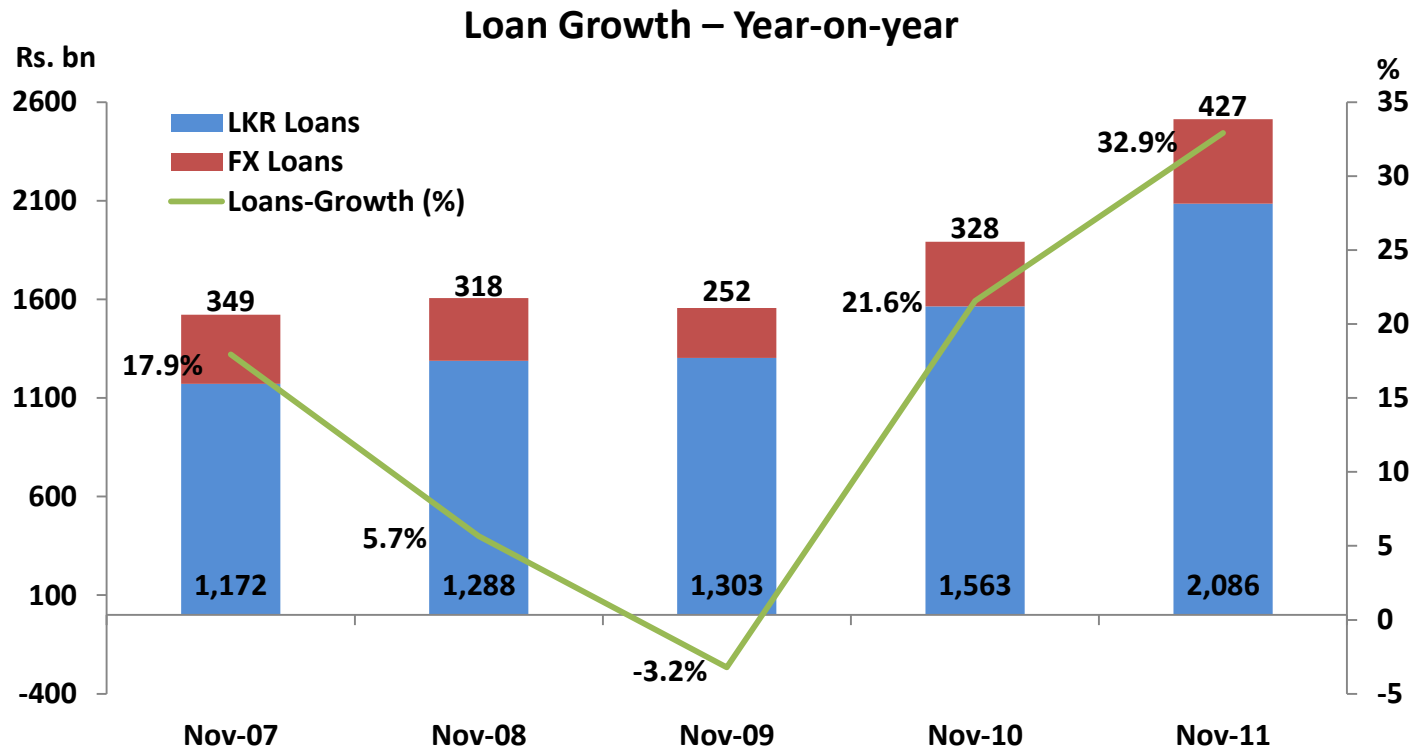


THE SRI LANKAN FINANCIAL SYSTEM WAS FURTHER STRENGTHENED DURING THE YEAR, AND AS A RESULT...

- Banking sector recorded substantial growth
- **Soundness of financial institutions (banks/non-banks) improved**
- Confidence in the financial system was enhanced
- **Financial markets were maintained in a stable state**
- Efficiency in Payment and settlement systems improved
- **Regulations were strengthened**

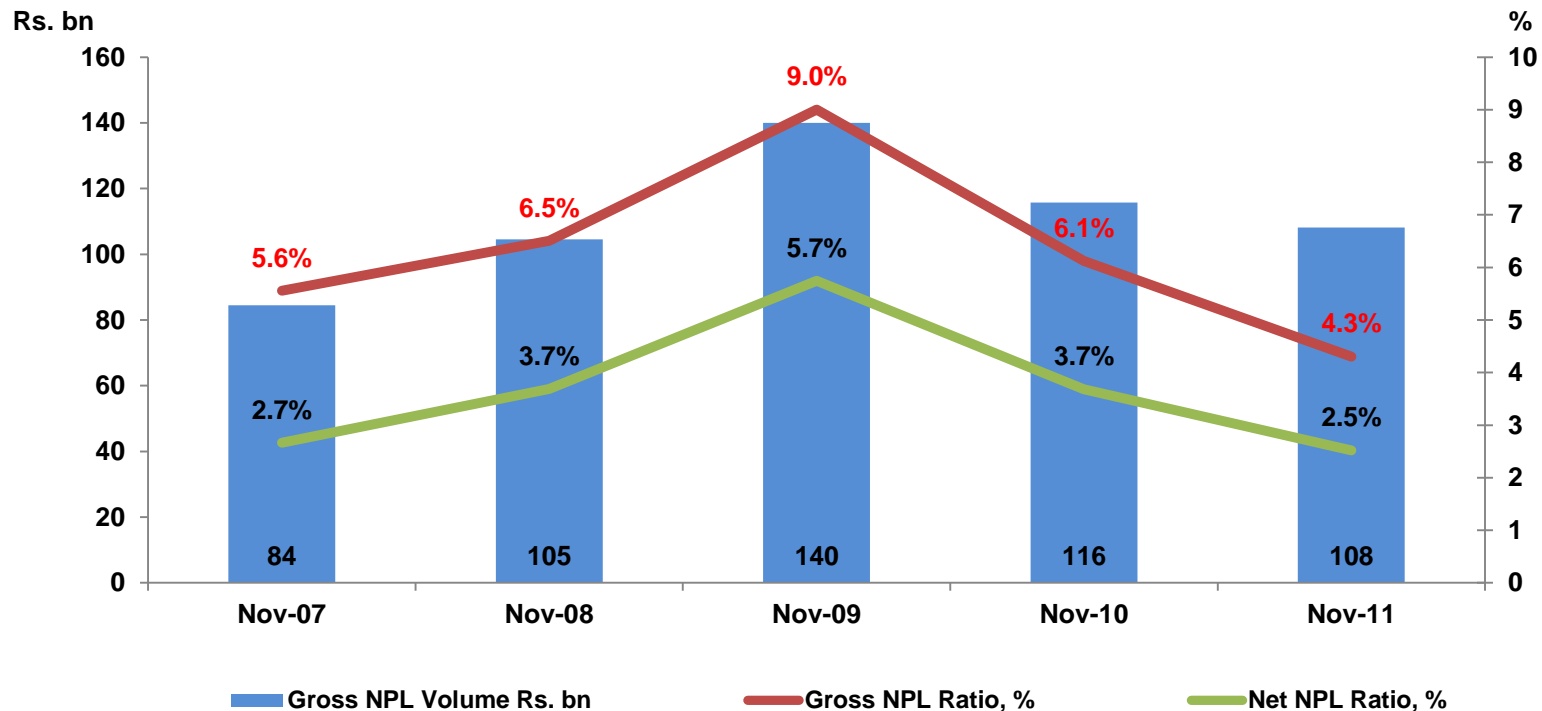
THE BANKING SECTOR BENEFITTED FROM HIGHER CREDIT GROWTH, DRIVEN BY INCREASED CONFIDENCE AND EXPANDING ECONOMIC ACTIVITIES...

- Credit expansion continued with LKR loans increasing by 33.4% and foreign exchange loans by 30.4%



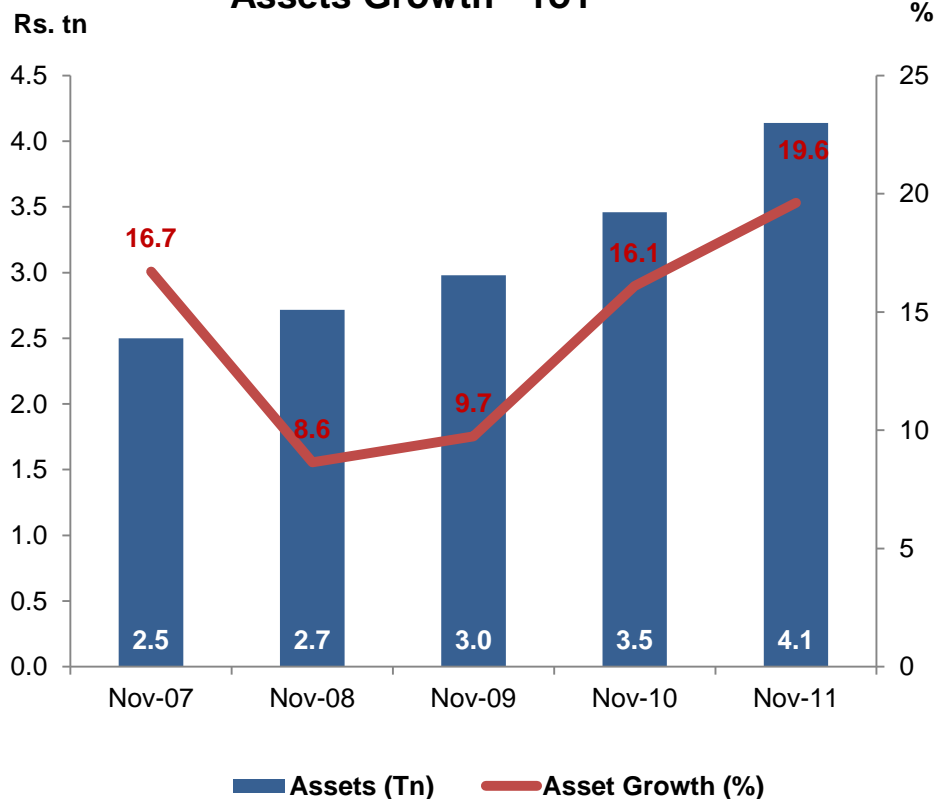
THE NON-PERFORMING LOANS RATIOS CONTINUED TO DECLINE...

Trends in NPLs

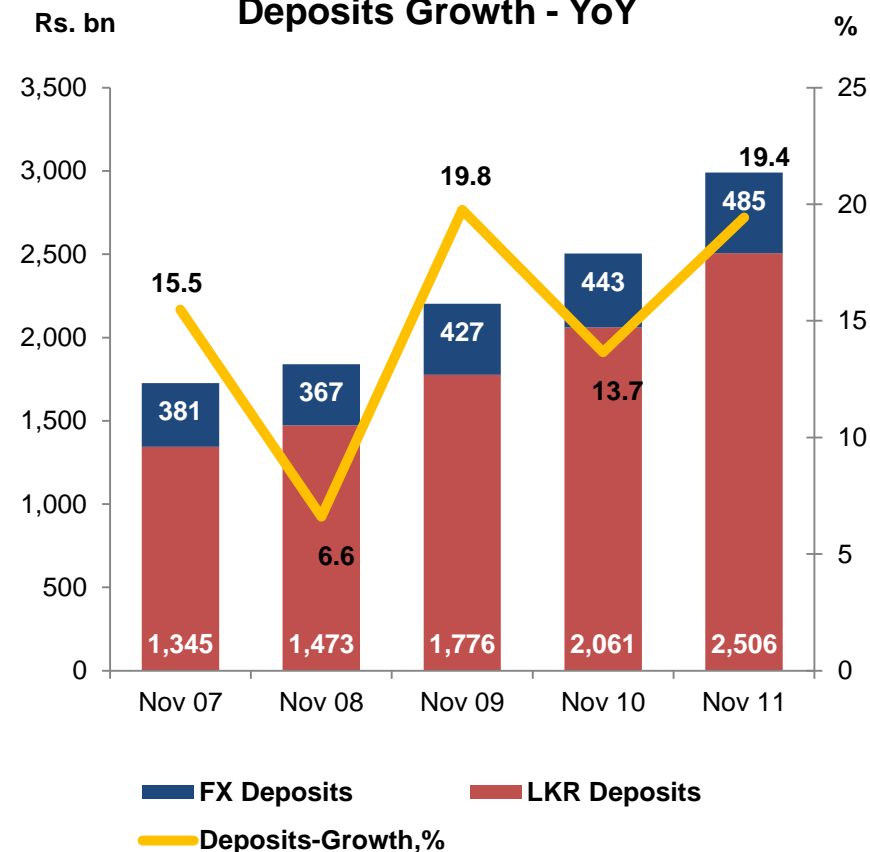


WHILE TOTAL ASSETS INCREASED...

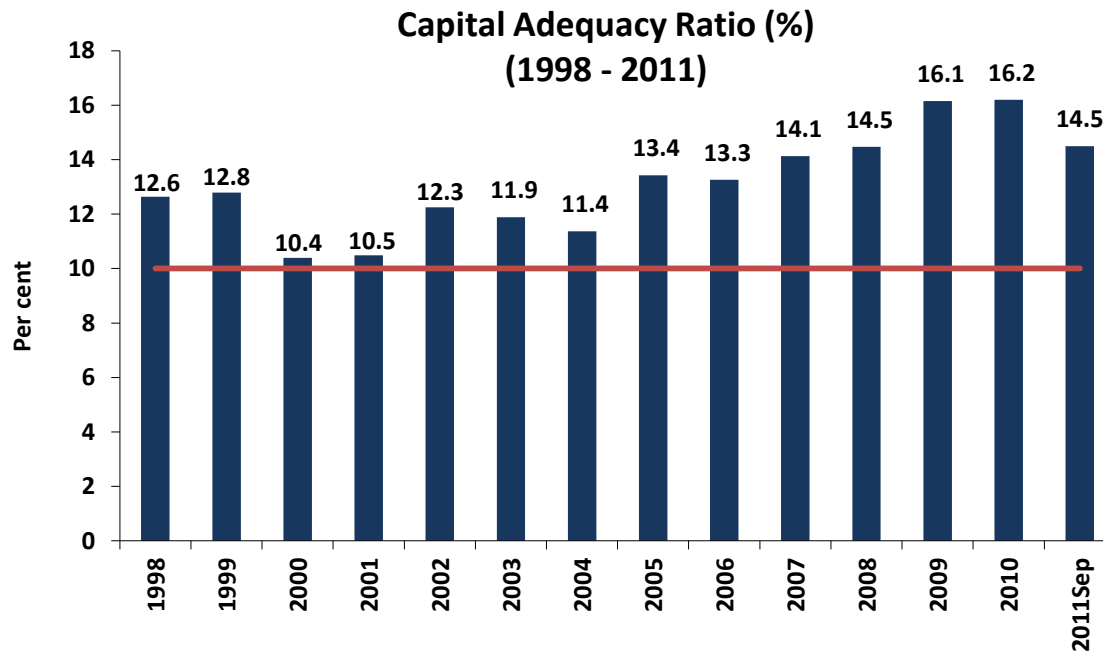
Assets Growth - YoY



Deposits Growth - YoY



SATISFACTORY LEVELS WERE ALSO OBSERVED IN THE CAPITAL ADEQUACY OF BANKS...



- Capital Adequacy Ratio (CAR) of banks maintained at well over the minimum level of 10%

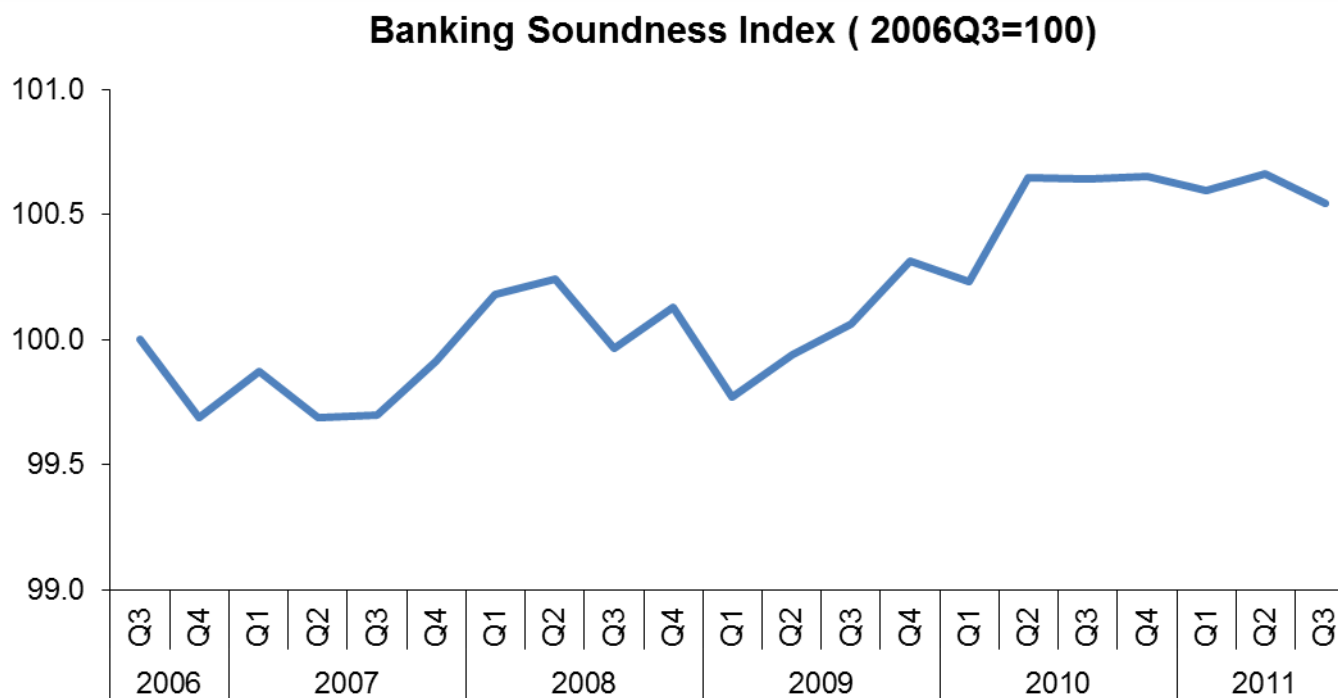
BANKING SECTOR INTERMEDIATION COSTS SHOWED SOME TIGHTENING...

Interest Margin in Sri Lanka (2006-2011)

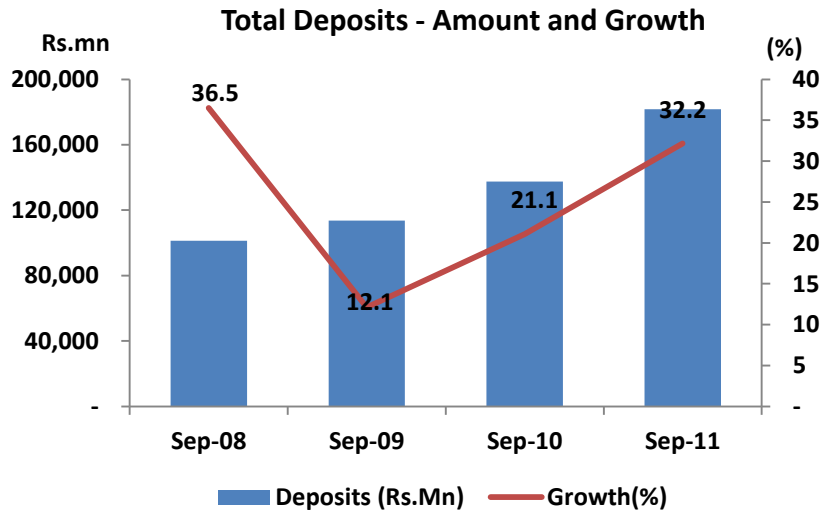
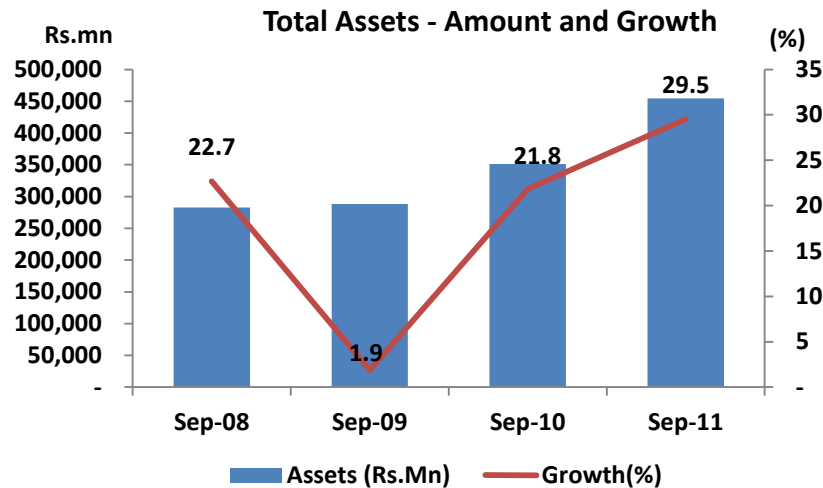
Item (% of Avg. Assets)	2007	2008	2009	2010	Sep-11
Interest Income	12.0	13.2	12.8	10.1	9.1
Interest Expenses	7.6	8.8	8.2	5.5	4.9
Net Interest Income (Interest Margin)	4.4	4.4	4.6	4.6	4.2
Non Interest Income	1.7	2.1	2.1	2.1	1.6
Non Interest Expenses	3.2	3.4	3.4	3.2	3.0

THE BANKING SYSTEM HAS BEEN SOUND AND STABLE OVER THE MEDIUM TERM...

- Soundness of the banking sector has improved since mid 2009.

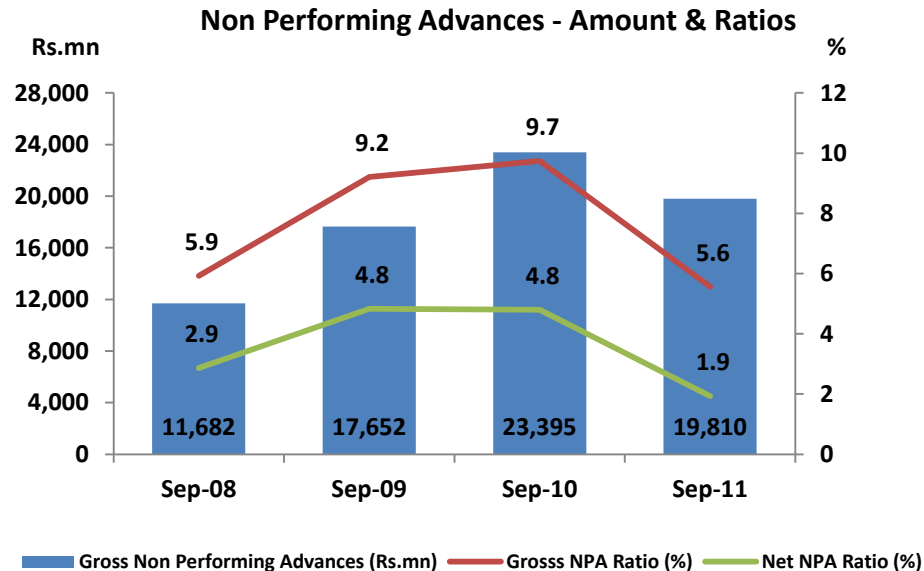
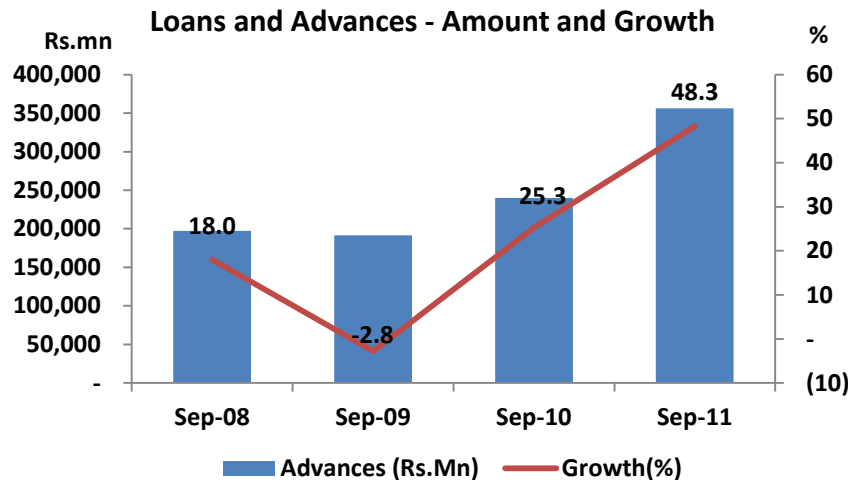


THE NON-BANKING SECTOR ASSETS & DEPOSITS IMPROVED...



- Total assets of NBFIs increased to Rs. 455 billion
- Deposits were the major source of funding, representing 40% of the total liabilities
- Total deposits increased by 32% to Rs. 182 billion due to improving public confidence
- Capital Funds increased by 30% to Rs.57 billion

THE NON-BANKING SECTOR LOANS ALSO RECORDED HEALTHY GROWTH WHILE NON PERFORMING ADVANCES DECLINED...



- Loan portfolios grew by 48% to Rs. 356 billion
- Loans and advances accounted for 78% of assets, of which, finance leasing and hire purchases accounted for around 41%
- Asset quality of the sector improved, with NPA ratio reducing from 9.7% in 2010 to 5.6% in 2011

THE NEW CAPITAL LIMITS SET OUT BY THE CENTRAL BANK FOR FINANCIAL INSTITUTIONS ARE EXPECTED TO PROMOTE NEW & DIVERSE SOURCES FOR FUNDING IN THE FUTURE...

LCBs

Effective date	Amount (Rs. mn)
01.01.2012	3,000
01.01.2014	4,000
01.01.2016	5,000

LSBs

Effective date	Amount (Rs. mn)
01.01.2012	2,000
01.01.2014	2,500
01.01.2016	3,000

RFCs

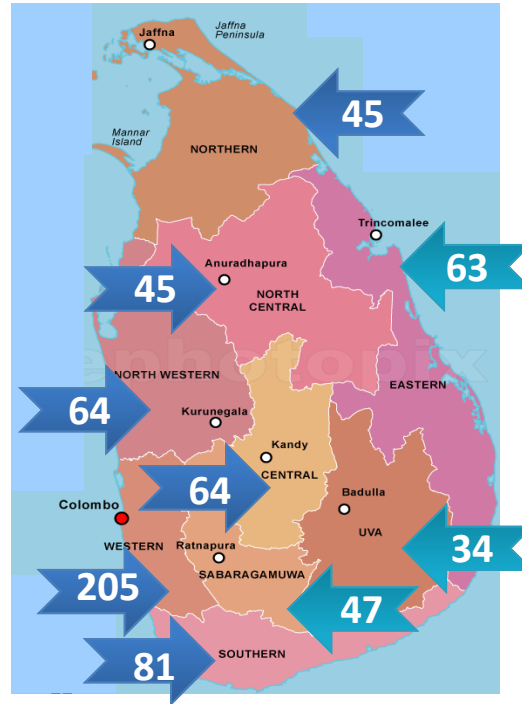
Effective date	Amount (Rs. mn)
01.01.2013	300
01.01.2015	400

SLCs

Effective date	Amount (Rs. mn)
01.01.2012	100
01.01.2013	150
01.01.2014	200
01.01.2015	250
01.01.2016	300

- **Listed RFCs have more opportunities to tap into equity and debt funding, and are expected to improve their transparency and accountability levels**

THE NON BANKING SECTOR WAS PARTICULARLY RESILIENT & VIBRANT AND RECORDED SIGNIFICANT GROWTH...



- **Presently a network of 648 branches operate in the country**
- **Industry expected to enjoy high growth momentum**
- **Almost all “distressed” companies have now found strategic investors**

2011 ALSO WITNESSED SEVERAL BANKING AND FINANCIAL INNOVATIONS...

- **A Banking license was granted to Amana Bank, which mainly deals in Islamic banking products**
- **Licensed banks were encouraged to operate Islamic Banking units**
- **A banking licence was granted to Axis Bank Ltd., India to open its branch in Sri Lanka**
- **A private sector group was granted a provisional banking licence**
- **Chinese Renminbi (RMB), was specified as a designated currency for foreign exchange transactions**



IN THE MEANTIME, OUTLETS OF FINANCIAL INSTITUTIONS INCREASED RAPIDLY, PARTICULARLY IN THE NORTHERN & EASTERN PROVINCES...

Item	As at end 2010	New Outlets	
		In 2011	In North & East (2011)
Banking Sector			
No. of Branches	1,955	110	35
No. of Extension Offices	970	68	26
No. of Other Banking Outlets	2,976	-	-
No. of ATMs	2,020	161	43
Non-Banking Sector			
No. of Branches of NBFIs	600	48	22

WHILE DURING THE YEAR, THE REGULATORY AND PRUDENTIAL FRAMEWORK WAS ALSO STRENGTHENED.

- Finance Business Act enacted by Parliament
- **Amendments to the Regulation of Insurance Act enacted**
- Regulation for mobile payments introduced
- **Early Warning System for timely rectification of supervisory concerns introduced**
- Customer Charter to safeguard the interests of consumers of Licensed Banks introduced
- **Credit exposure limits of banks to the stock market introduced when market was moving rapidly, and subsequently removed when such a measure was no longer needed**
- Guidelines on Integrated Risk Management issued
- **Guidelines on Investment Fund Account issued**

OVERALL, THE FINANCIAL SYSTEM EXPANDED, SUPPORTING THE EMERGING ECONOMIC NEEDS OF THE COUNTRY...

- Funds mobilisation through IPOs & Rights Issues increased
- **Secured transaction registry for movables established**
- Financial market remained largely liquid, to withstand the impact of the global financial crisis
- **Implementation of Basel II Capital Adequacy Standards confirmed with necessary steps taken to implement:**
 - **Internal Capital Assessment Process (ICAAP)**
 - **Supervisory Review Process (SREP) under Pillar 2 of Basel II framework**



TOWARDS ENSURING FURTHER STABILITY, THE PAYMENT & SETTLEMENT SYSTEMS WERE IMPROVED, BOTH QUANTITATIVELY & QUALITATIVELY...

- High value transactions increased by 8.2% while retail payment transactions increased by 7.4% in 2011
- **Payment & Settlement System operated with a high degree of availability (99.9%)**
- **Membership in the LankaSettle system increased from 31 to 34 in 2011**
- Credit card operations were streamlined by ensuring compliance by credit card issuers to the operational guidelines
- **Retail payment systems were equipped with on-line connectivity to the national clearing house in order to expedite the clearing processes**
- Guidelines were issued to promote and secure mobile phone based payment mechanisms for both bank-led model and custodian bank model
- **Groundwork for the establishment of the National Payment Switch i.e., Common Card and Payment Switch (CCAPS) implemented**
- Regional co-operation on PSS development was strengthened by conducting the 10th meeting of the SAARC Payment Council in Sri Lanka

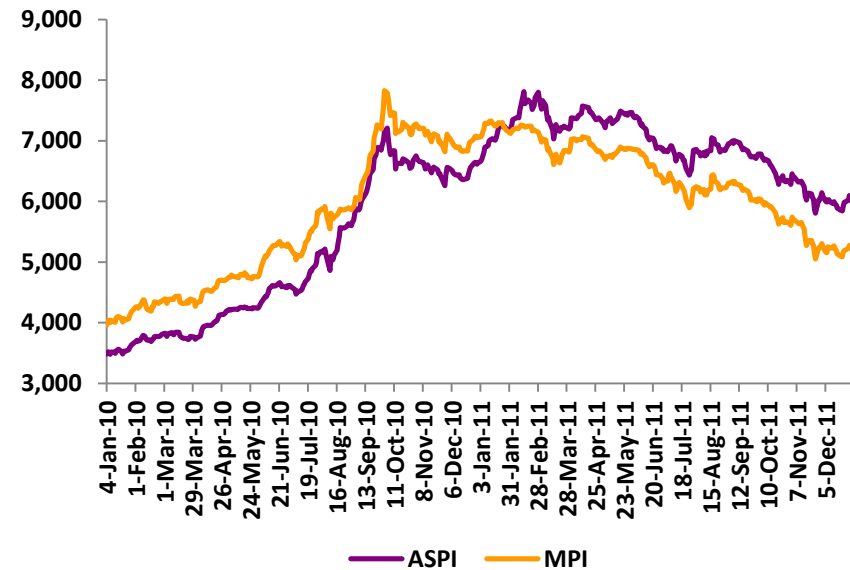


COLOMBO STOCK EXCHANGE EXPERIENCED MIXED RESULTS

IN 2011...

- CSE improved in the early months of 2011, while recording a decline in the past half year
- **Funds raised through Initial Public Offerings (IPOs) and rights issues increased in 2011**
 - 13 IPOs, Rs.19 billion
 - 22 rights issues, Rs.26 billion
- The number of companies listed on the CSE increased by 26 to 267
- **The net foreign outflow was Rs.19 billion in 2011, which was 0.9% of the market capitalisation of Rs.2,214 billion**
- Net foreign outflows through the stock market were offset by foreign inflows to Government securities during 2011, which increased by Rs.25 billion
- **Total value of foreign holdings as at end 2011 was Rs. 437 billion (about 20% of the total market capitalisation)**

Share Price Indices at the CSE – 2010/11



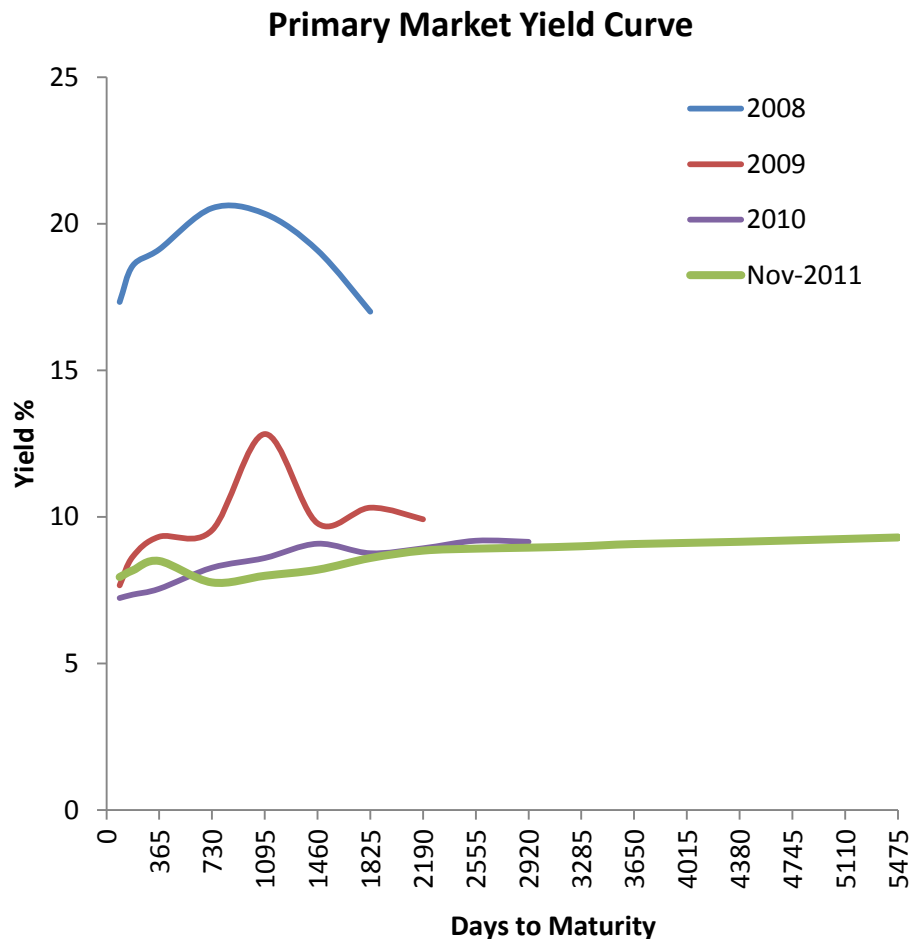
Foreign Inflows through Securities Investment Accounts (SIA) During 2011

	Rs. bn
Net foreign Inflows to SIA (Prov.)	14.6
<i>(Of which)</i>	
Net Inflows to the Stock Market	-19.0
Net Inflows to the Govt. Securities Market	25.3

THE PUBLIC DEBT MANAGEMENT RECORDED MANY IMPROVEMENTS...

- Serviced Government debt on time thereby maintaining the unblemished record
- Broadened and diversified investor base further
 - CDS account holders increased by 4% from 73,396 in 2010 to 76,249 in 2011
 - Secondary market transactions increased from 382,753 in 2010 to 619,641 in 2011
- Diversification of primary dealer activities was regulated
- Timely information on public debt was disseminated
 - Daily Report on market information to PDs and number of other institutions regularly
 - Monthly Information Report, Flash Report, Expenditure Report to General Treasury, Auditor General and several internal departments
- Sovereign rating missions were facilitated, focusing on medium term sovereign rating strategy

THE COST OF DEBT WAS BROUGHT DOWN...



- In 2011, the overall average interest rate of Treasury bills and Treasury bonds declined by about 101 and 81 basis points, respectively
- **Government expenditure reduced by an estimated Rs. 15.5 billion due to the decline in interest rates**
- However, from mid October 2011, the short term yields moved upwards
- **Volatility was minimised and a stable yield curve was established**
- Lower inflation expectation, higher investor appetite both from domestic and foreign investors contributed to build a stable interest rate structure in the market

THE FINANCIAL INTELLIGENCE ENVIRONMENT WAS SAFEGUARDED FURTHER...

- **Legislative amendments to:**
 - **Prevention of Money Laundering Act No. 5 of 2006**
 - *Expands the applicability of the law to cover any person who has committed a Money Laundering offence while in Sri Lanka*
 - *Includes foreign predicate offences as unlawful activities*
 - **Convention on the Suppression of Terrorist Financing Act No. 25 of 2005**
 - *Extends the applicability to include citizens and non-citizens*
 - *Widens the “funds” definition*
 - *Widens the scope of terrorist financing offences*
 - *Provides authority for Police to freeze/suspend terrorist funds and properties relating to the terrorist financing or activities before indictment*
- **Consequently, Sri Lanka is now fully compliant with all requirements imposed by Financial Action Task Force and International Cooperation Review Group.**
- **MOUs entered into with FIUs of South Africa, Canada, Slovenia and Fiji Islands bringing total MOUs signed up to 13 by end 2011**
- **Increased awareness on Anti Money Laundering and Countering the Financing of Terrorism (AML/CFT) of various stakeholders**

THE LIBERALISATION OF EXCHANGE CONTROL REGULATIONS

CONTINUED...

- Permission granted for Sri Lankans to invest in shares of foreign companies and sovereign bonds of foreign governments
- **Permission granted for Sri Lankan companies to make payments to non-residents for setting up and maintenance of places of business outside the country**
- Relaxed restrictions on foreign investments in local unit trusts
- **Permission granted for Sri Lankan students to obtain loans from abroad during their studies**
- Permission granted for selected supermarkets to engage in money changing
- **Permission granted for Sri Lankans to make payments to non-residents who are selling real-estate properties in Sri Lanka**
- Permission granted to expatriate employees to convert salaries to foreign currency
- **Permission granted to exporters of services to borrow foreign exchange from domestic banks**
- New facilities granted to Resident Non National Foreign Currency Account Holders
- **Approvals for companies to borrow from foreign sources expedited**
- Permission granted to foreign exchange earners to open and operate foreign currency accounts
- **Foreign exchange transactions through NRFC and RFC accounts streamlined**

BUT, SEVERAL “LEAKAGES” OF FOREIGN CURRENCY SEEMS TO BE PREVALENT...

- “Hawala” & “Hundi” informal and illegal schemes seem to be still operating, leading to a possible leakage of over US\$ 1.5 billion!
- **“Money Changing” operations do not seem to be providing the desired results, and Currency smuggling seems to be on the increase**
- “Gold” transactions reconciliation is underway

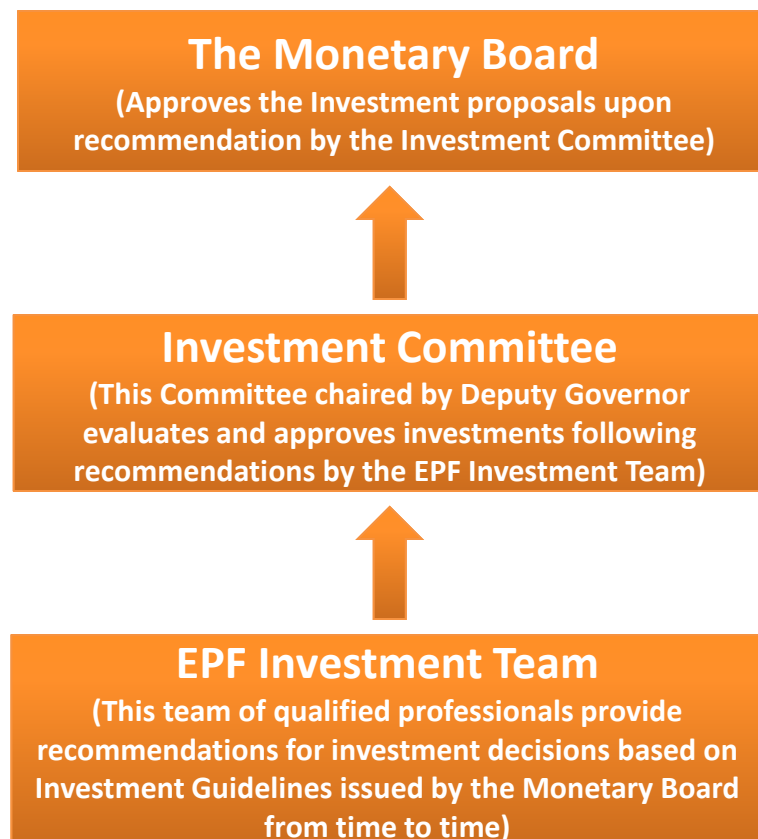
	Forex Changed by Money Changers (US\$ mn)
2009	297
2010	132
2011 (up to Nov)	82

DURING THE YEAR, THE EMPLOYEES' PROVIDENT FUND REACHED THE RS. 1 TRILLION MILESTONE...

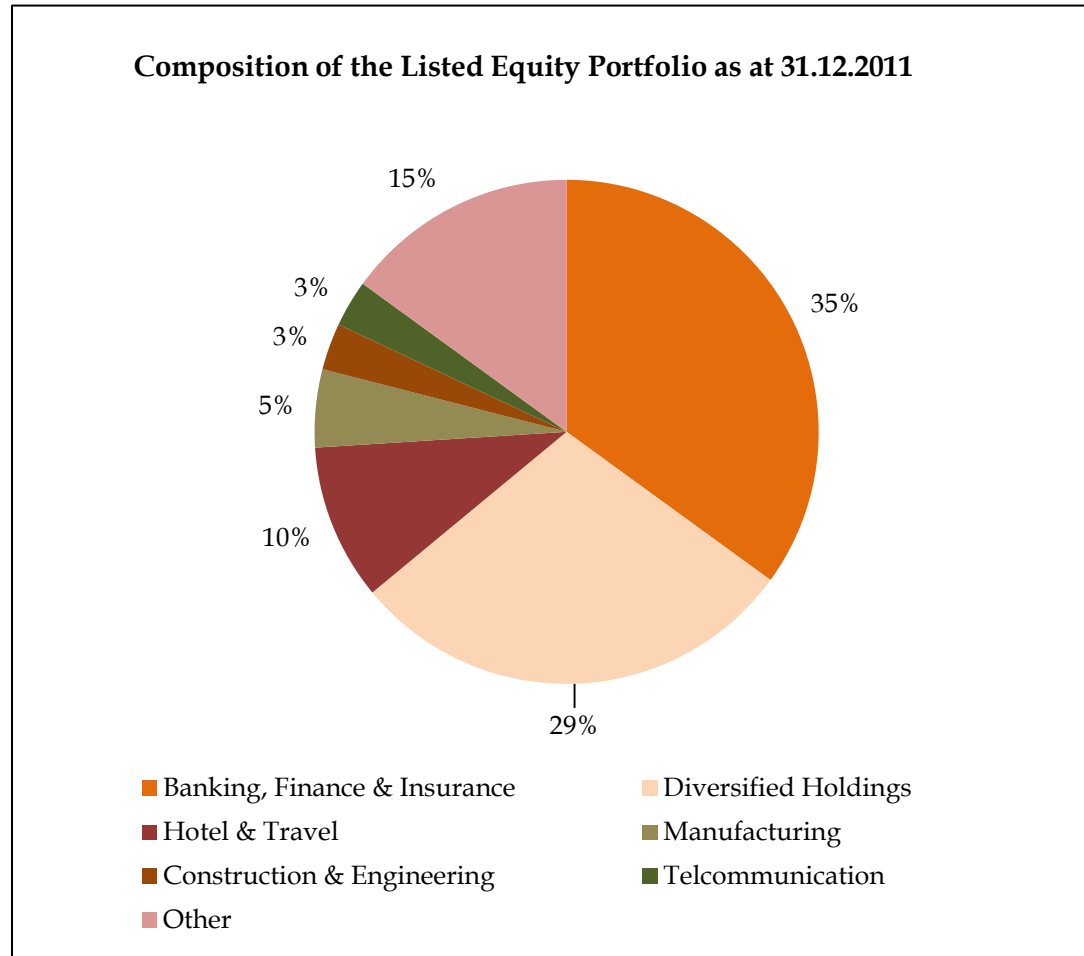
- Investment portfolio has been diversified further to reap the benefits of the fast growing sectors of the economy, in an environment where interest rates are falling
- **EPF invests in shares of fundamentally sound companies approved by the Monetary Board, with a long-term view**

Type	2010		2011	
	Value (Rs.bn)	Share %	Value (Rs.bn)	Share %
Govt. Securities	816	90.7	890	88.4
Equities	44	4.9	78	7.7
Debentures	6	0.7	10	1.0
Reverse Repo	1	0.1	3	0.3
Fixed Assets & Net Current Assets	33	3.7	26	2.6
Total	900	100	1,007	100

Investment Approval Structure



EPF HAS INVESTED IN DIVERSIFIED SECTORS OF THE ECONOMY INCLUDING BANKING AND FINANCIAL INSTITUTIONS...



THE CENTRAL BANK ISSUED THE 11TH SERIES OF CURRENCY NOTES ON 4TH FEBRUARY 2011...

- The 11th currency notes series on the theme of Development, Prosperity and Sri Lankan Dancers was issued in February 2011.
- **The Central Bank won the 2011 Best New Banknote Series Finalist Award at the International Association of Currency Affairs Conference**
- Public educated on the issuance of new currency and their enhanced security features.
- **The Bank improved its currency management systems with enhanced productivity to facilitate smooth functioning of the payment system**



IN ALL ITS ACTIVITIES, THE CENTRAL BANK KEPT IN CLOSE TOUCH WITH ITS NUMEROUS STAKEHOLDERS...

Awareness Programmes

- Educational Seminars – 39

Social Media Interaction

- Facebook – 327 Posts
- Twitter – 327 Tweets
- Youtube – 482 views & 15 Videos

Speaking Engagements of the Governor during the year - 675

Top Management Meetings with Investors in Sri Lanka and Overseas – 165

Data Releases

- Weekly Economic Indicators – 51
- Monthly Economic Indicators – 12

Web Communications

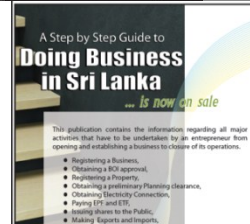
- Average visitors to the CBSL web per day – 195,479

Media Releases

- Newspaper Advertisements (All three languages) - 326
- Press Releases issued - 1704
- Media Conferences - 60
- Media Interviews - 35
- Gazette notifications - 14

Periodic Reports

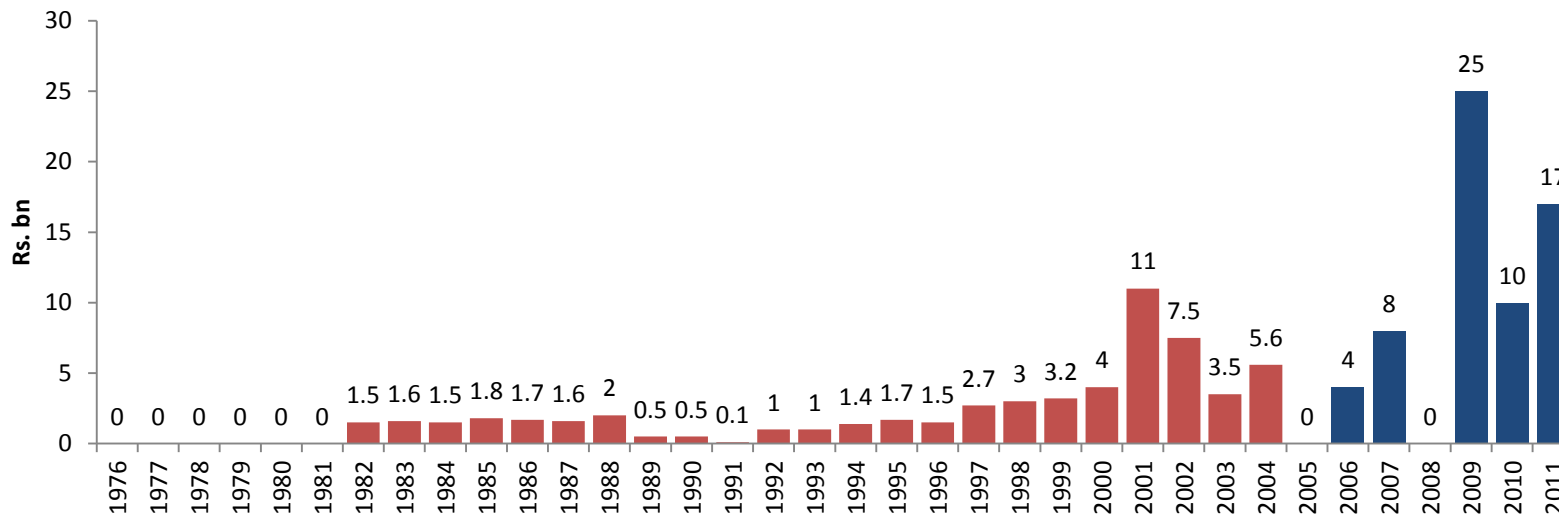
- Annual Report
- Economic and Social Statistics
- Recent Economic Developments
- Reports to the Parliament and Cabinet



THE CENTRAL BANK PROFIT TRANSFERS HAVE GREATLY ASSISTED THE GOVERNMENT...

- During the period 2006-2011 the Central Bank has been able to appropriate a sum of Rs.64 billion to the Government from the surpluses the Bank generated, mainly from its international operations
- In real terms (based on 2006 prices), this amounts to over Rs. 46 billion

Profit Transfers by the Central Bank to the Government



- During 1976-2005 period of 30 years, the Central Bank transferred a sum of Rs. 60 billion. From 1950 to 1975 period, the transfers amounted to about Rs. 1 billion.

4. MACROECONOMIC OUTLOOK AND THE MONETARY POLICY STRATEGY FOR 2012 AND BEYOND

“Debt crisis is causing a dangerous dependence on Central banks”

Mervyn King

Governor, Bank of England

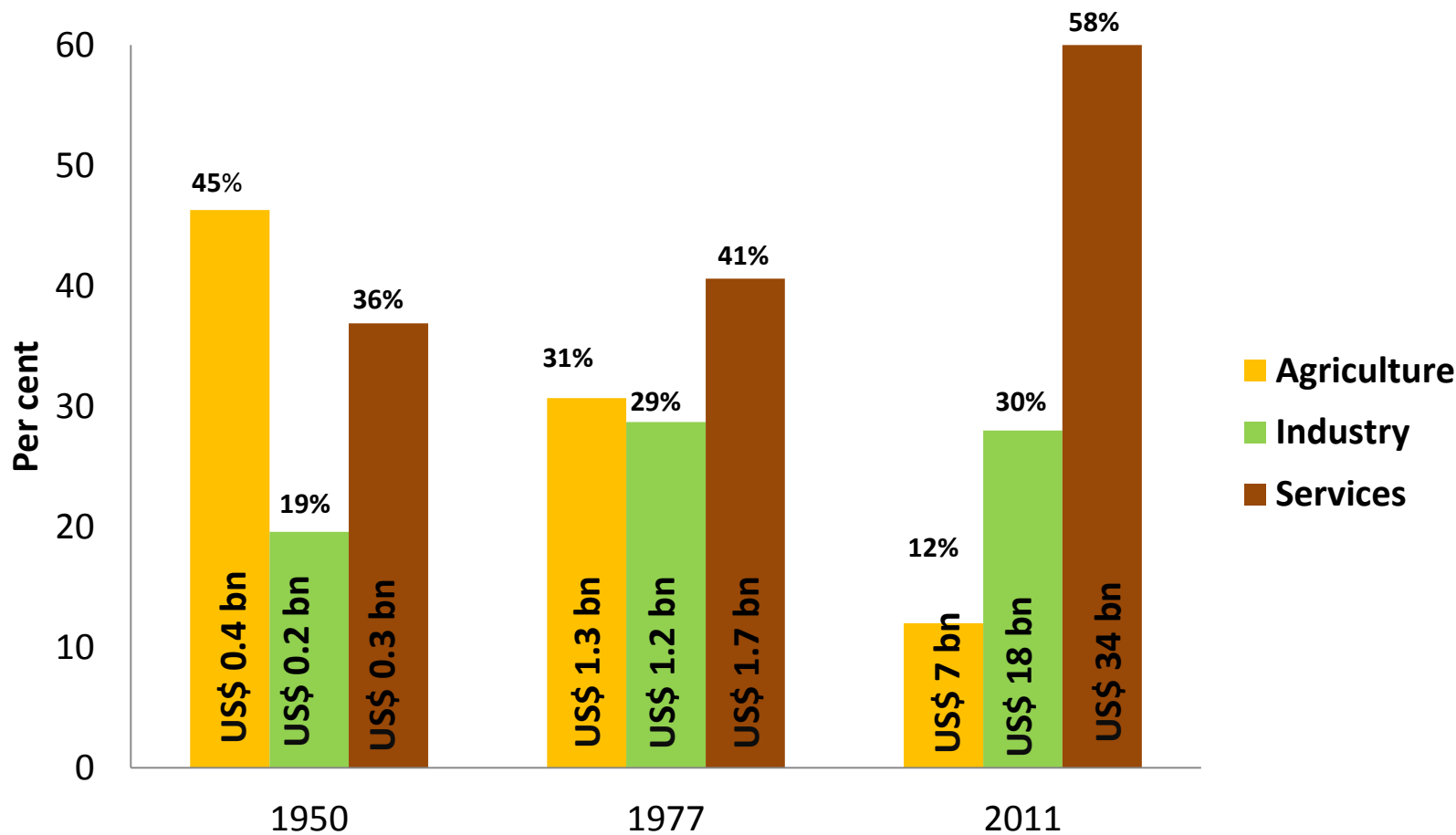
“Today, Sri Lanka is on the threshold of a new era, where its economy is undergoing fundamental structural changes that are expected to provide a new platform that will pave the way for a robust future direction in the economy”



MAJOR STRUCTURAL CHANGES HAVE TAKEN PLACE IN THE SRI LANKAN ECONOMY OVER THE YEARS ON SEVERAL FRONTS, AND MORE PARTICULARLY, IN RECENT TIMES...

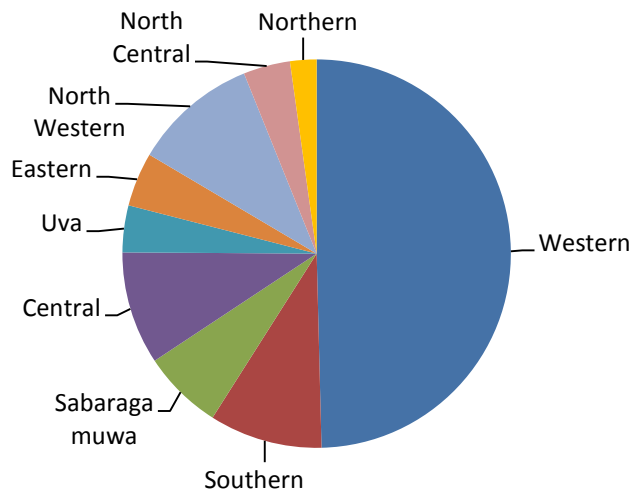


THE SECTORAL SHARE OF GDP HAS UNDERGONE A REMARKABLE CHANGE...

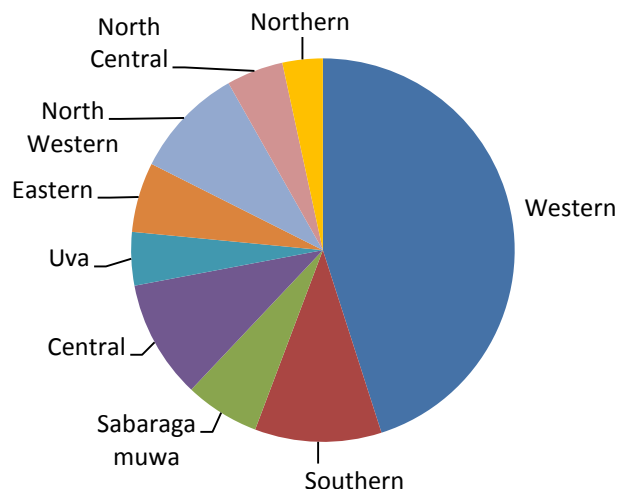


THE DOMINANCE OF THE WESTERN PROVINCE IS DIMINISHING AND THE CONTRIBUTION BY OTHER PROVINCES TO GDP IS ON THE RISE ...

Provincial Share of GDP-2000



Provincial Share of GDP-2010



	2000	2010
Western	49.6	45.1
Southern	9.4	10.7
Sabaragamuwa	6.7	6.3
Central	9.4	10
Uva	3.9	4.5
Eastern	4.5	5.9
North Western	10.4	9.4
North Central	3.9	4.8
Northern	2.2	3.4

- With the end of the conflict, the Northern and Eastern provinces are experiencing greater economic activity
- Other rural areas also show greater contribution due to the peaceful environment and increased inter-province mobility

THE COUNTRY'S ECONOMIC AND SOCIAL STRUCTURES HAVE ALSO UNDERGONE A MASSIVE TRANSFORMATION...

	1980	1990	2000	2010	2011 (latest)
Telephone Density (Telephones per 100 persons, incl. cellular phones)	0.4	0.7	6.3	100.8	105.3
Percentage of households electrified	15.8	26.5	68.2	90.0	92.0
Labour Force Participation Rate (Female)	17.1	34.7	33.9	31.2	33.1
No. of Persons per Doctor	7,176	6,973	2,779	1,462	1,443
Life expectancy at birth (Male)	67.7	69.5	71.7	70.3	
Life expectancy at birth (Female)	72.1	74.2	76.4	77.9	
Govt. University Admissions for the basic degree	4,688	6,143	11,805	21,547	
No. of Banking Outlets	879	918	1,411	5,874	6,094
Sources: Department of Census and Statistics, Central Bank of Sri Lanka					

THE SRI LANKAN MACROECONOMIC FUNDAMENTALS IN 2011 SEEM TO BE VERY DIFFERENT TO THAT IN 2005!

	2005	2011 (Est/Prov)
Real GDP Growth (%)	6.2	8.3
GDP (US\$ bn)	24.4	59.1
GDP per capita (US\$)	1,241	2,830
Consumer Price Inflation	11.0	6.7
Trade: Exports (US\$ bn)	6.3	10.5
Imports (US\$ bn)	8.9	20.0
Workers' Remittances (US\$ bn)	1.9	5.2
Tourist Arrivals ('000)	549	850
Earnings from Tourism (US\$ bn)	0.3	0.8
FDI (US\$ bn)	0.3	1.0
Government Inflows (US\$ bn)	0.7	2.7
Debt/GDP (%)	91	78
Public Investment/GDP (%)	6.3	6.0

IN 2012, IT WILL BE EVEN MORE DIFFERENT!!

	2005	2011 (Est/Prov)	2012 (Expectation)
Real GDP Growth (%)	6.2	8.3	8.0
GDP (US\$ bn)	24.4	59.1	66.0
GDP per capita (US\$)	1,241	2,830	3,129
Consumer Price Inflation (%) (Average)	11.0	6.7	5.5
Trade: Exports (US\$ bn)	6.3	10.5	12.5
Imports (US\$ bn)	8.9	20.0	23.4
Workers' Remittances (US\$ bn)	1.9	5.2	6.5
Tourist Arrivals ('000)	549	850	Over 1,000
Earnings from Tourism (US\$ bn)	0.3	0.8	1.2
FDI (US\$ bn)	0.3	1.0	2.0
Government Inflows (US\$ bn)	0.7	2.7	2.5
Debt/GDP (%)	91	78	75
Public Investment/GDP (%)	6.3	6.0	6.6
Foreign Funds into Banks – Tier II Capital (US\$ bn)	-	0.1	1.0

THE COUNTRY'S EXTERNAL SECTOR WILL FURTHER UNDERGO AN EVEN MORE FUNDAMENTAL CHANGE...

In 2005...

Inflows:

- Exports: US\$ 6.3bn
- Tourism: US\$ 0.3bn
- Workers' remittances: US\$ 1.9 bn
- FDI: US\$ 0.3bn
- Net Stock Market inflows: US\$ 0.06 bn

Outflows:

- Imports: US\$ 8.9 bn
- Govt. Loan Repayments: US\$ 0.2 bn
- Sri Lankan Investments outside: US\$ 0.04 bn

In 2012...

Inflows:

- Exports: US\$ 12.5 bn
- Tourism: US\$ 1.2 bn
- Workers' remittances: US\$ 6.5 bn
- FDI: US\$ 2.0 bn
- Net Stock Market inflows: US\$ 0.5 bn
- Commercial Banks' Tier II Capital: US\$ 1 bn
- Major Corporates' capital from abroad: US\$ 0.5 bn
- Special long term financing expected for Petroleum: US\$ 1.0 bn
- Long-term currency swaps: US\$ 0.5 bn
- Net Treasury Bills & Bond inflows: US\$ 0.5 bn

Outflows:

- Imports: US\$ 23.4 bn
- Govt. Loan Repayments: US\$ 1.4 bn
- Sri Lankan Investments outside: US\$ 0.5 bn

THE COMMITTED MAJOR FDI PROJECTS IN THE PIPELINE ARE EXPECTED TO PLAY A KEY ROLE...

- **Colombo Port Expansion Project – South Terminal (Sri Lanka Ports Authority, China Merchants Holding (International) Company Ltd, Aitken Spence PLC and Colombo International Container Terminals Ltd) – US\$ 500 million**
- **Shangri-La – Colombo and Hambantota Hotel Projects – US\$ 400 million**
- **Cairn Lanka Pvt Ltd (For oil exploration) – US\$ 125 million**
- **Sampur Coal Power Plant – US\$ 400 million**
- **Sheraton Group- (Starwood) – US\$ 300 million**
- **Hambantota Port Related Projects**
 - **Identified 15 investment projects worth US\$ 1 billion**
 - **Sugar Refinery Plant**
 - **Petrol Chemical Plant**
 - **Fertilizer Storage, Processing and Bagging Plant**

IN THE MEANTIME, THE CENTRAL BANK HAS CAREFULLY PREPARED TO MOVE TO A MORE ADVANCED MONETARY POLICY FRAMEWORK FROM THE TRADITIONAL FRAMEWORK FOLLOWED SINCE EARLY 1980s...

- Since early 2000s, the Central Bank has publicly acknowledged that with financial market developments and innovations, as well as the structural changes taking place in the economy, a new framework may be needed for more effective monetary management
- **It had cautioned that without such changes, the efficacy of the monetary targeting framework could diminish**
- Towards that end, the Central Bank identified the measures needed to move to a better monetary policy framework in the medium term

IN FACT, ALMOST 10 YEARS AGO, THE CENTRAL BANK ARTICULATED PRE-CONDITIONS* FOR MOVING TO A FRAMEWORK SUCH AS THE TARGETING OF INFLATION...

- Reduce budget deficit to a reasonable and predictable level to reduce inflationary impact of budgetary financing
- **Use a more representative price index to better reflect consumer behaviour**
- Have a measure of core inflation to identify demand driven inflationary pressures
- **Improve inflation forecasting and identify inflation expectations**
- Strengthen monetary policy transmission
- **Improve transparency of monetary policy and policy communication**
- Ensure the accountability of the Monetary Authority to deliver low and stable inflation

* Jayamaha, R. *et al*, Feasibility of Inflation Targeting in Sri Lanka, Central Bank Staff Studies, 2001/02, Vols. 31-32.

MANY OF THESE PRE-CONDITIONS HAVE NOW BEEN ACHIEVED...

- **The Government has shown its strong commitment to reduce the budget deficit.**
 - In 2011 to 7% of GDP, 2012 to 6.2%, and within the next few years to below 5%
- **The base year of CCPI was revised to 2002 and then to 2006/07 based on Consumer Income and Expenditure Survey, to better reflect consumer behaviour**
 - Revisions to continue every 5 years
- **New core inflation measure introduced to identify demand driven inflationary pressures**
- **Inflation forecasting techniques improved**
- **Monetary policy transmission improved with the improvements in the financial sector**
- **Volatility in supply driven inflation reduced through structural interventions in the economy**
 - Improved roads, transportation, electricity, village based agricultural projects, telecommunication, banking facilities, financial inclusion, etc.
- **Communication and transparency of monetary policy improved**
 - Road Map, Strategic Planning, Advance Release Calendar, Detailed policy statements, daily updated website, etc.
- **Inflation expectations surveys conducted to capture expectations of various stakeholders on future inflation**
- **Price stability delivered through inflation at single digit levels for the past 3 years**

THE CENTRAL BANK NOW HAS GREATER CONFIDENCE IN ITS ABILITY TO FACE NEW CHALLENGES AND ADOPT NEW FRAMEWORKS OF MONETARY POLICY SINCE IT CAN USE THESE NEW STRENGTHS...



IN THAT BACKGROUND...

THE CENTRAL BANK CAN, WITH GREATER CONFIDENCE, “TARGET” INFLATION IN A MORE BROADER SENSE. HENCE, FROM 2012 ONWARDS IT WOULD START DOING SO, PARALLEL TO ITS EXISTING FRAMEWORK...

THE BANK WOULD ALSO GIVE RECOGNITION TO THE MAJOR STRUCTURAL CHANGES THAT HAVE TAKEN PLACE IN THE ECONOMY AND DISPLAY A POLICY SHIFT THAT SHOWS GREATER CONSIDERATION OF SUCH FACTORS...

**ON THAT BASIS, A COHESIVE AND INTEGRATED
MONETARY POLICY FRAMEWORK WILL BE
FASHIONED...**

**SUCH A POLICY FRAMEWORK WILL ALSO TAKE
INTO ACCOUNT THE NEW EMERGING POLICY
ENVIRONMENT, WHICH WILL INCLUDE...**

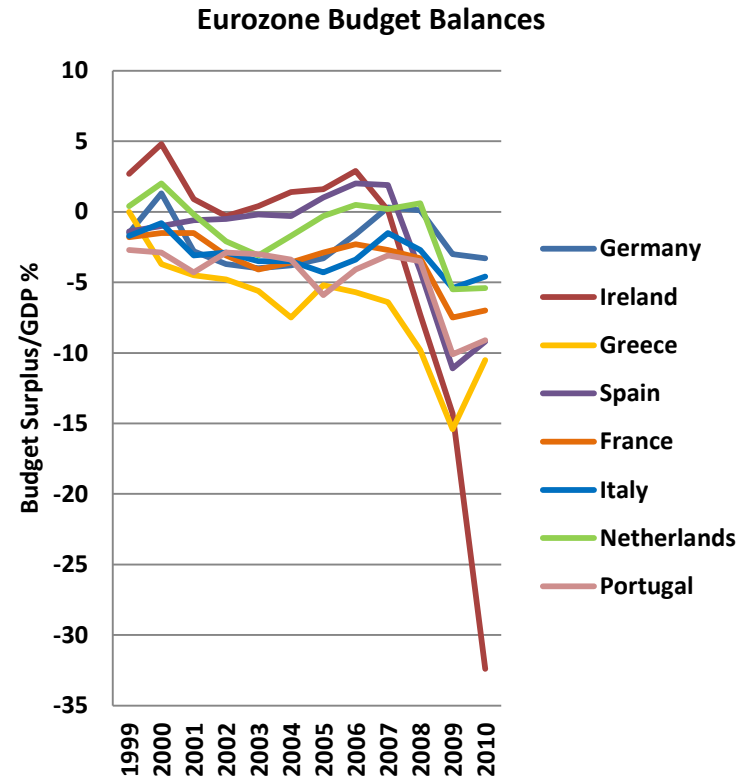
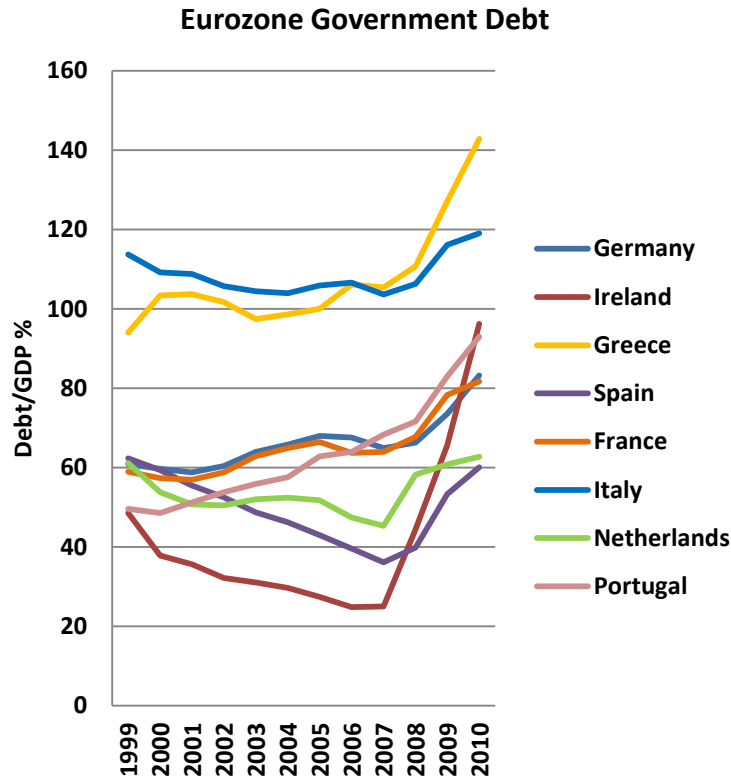
THE TIGHTENING OF THE GLOBAL SUPPLY CONDITIONS AMIDST RISING DEMAND, WHICH IS PRESSURISING PRICES...

- In spite of low growth in advanced economies, demand for energy as well as primary non-food commodities continues to increase with manufacturing production in emerging markets continuing at high levels
 - Note: Vehicle ownership in emerging markets including Sri Lanka has increased tremendously increasing demand for liquid fuels
- **Demand for food commodities is also at unprecedented levels as large populations grow out of poverty in high growth emerging economies**
 - Note: Another factor for high demand for food commodities is that some food commodities are being used to produce alternative energy (eg: Ethanol)
- Volatility of commodity prices driven by global economic uncertainty is causing further disturbances to macroeconomic management

CLIMATE CHANGE, NATURAL CALAMITIES, AND WIDESPREAD POLITICAL UNREST, WHICH ARE CONTINUING TO CAUSE TURMOIL TO GLOBAL DEMAND-SUPPLY CONDITIONS, WHILE ADDING FURTHER UNCERTAINTY...

- **Climate change affecting demand conditions**
 - Europe – Coldest weather on record in January 2011
 - Drought followed by flooding in Africa and Asia
- **Natural calamities across the world have added pressure on global supply chains**
 - Japanese Tsunami – disruptions to global vehicle production
 - Fukushima - questions on nuclear power production
 - Thai and Philippine floods – supply disruptions to rice, computer accessories production
 - Brisbane flooding, New Zealand earthquakes, Japanese earthquake and Tsunami, increased US tornados, Earthquake in Turkey, all added to reconstruction demand for raw material
- **“Arab spring” continues to disrupt petroleum production leaving oil prices high**
- **Global political interventions by several advanced nations are causing further tensions in targeted countries while causing social unrest in their own**
- **Some traditionally “stable societies” are now affected by large-scale “Occupy” protests, while the sudden British riots exposed new vulnerabilities**

THE EURO DEBT CRISIS, WHICH CONTINUES WITH NO END IN SIGHT, SHRINKING CONFIDENCE IN GOVERNMENTS AS WELL AS FINANCIAL MARKETS...

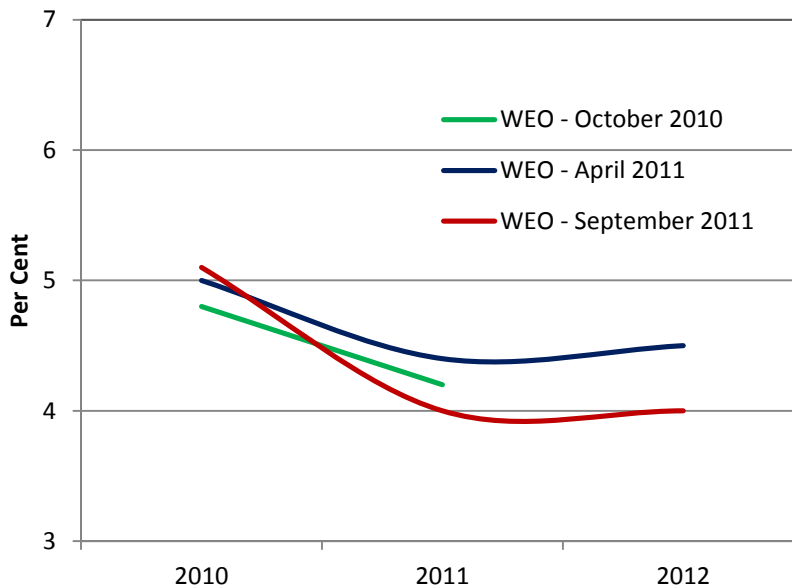


Source: Eurostat

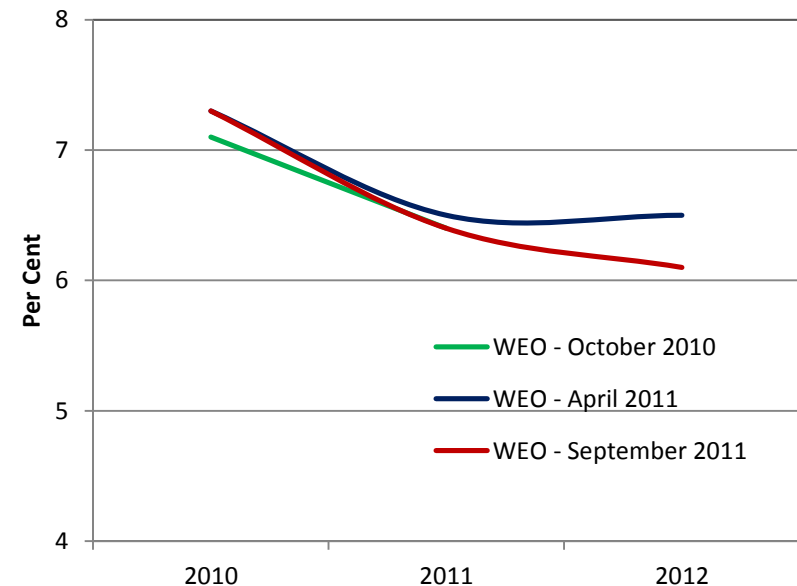
THE LOW GROWTH IN THE GLOBAL ECONOMY...

- The IMF raised its global growth projections for 2011 and 2022 in WEO-April 2011, but lowered the projections in WEO-September 2011, citing renewed global economic uncertainties

Revisions to IMF Projections for Global Economic Growth



Revisions to IMF Projections for Economic Growth in Emerging and Developing Economies



IN THIS UNCERTAIN GLOBAL SCENARIO, CAN SRI LANKA MAINTAIN ITS GROWTH MOMENTUM?



IN 2012, MAJOR CONTRIBUTIONS TOWARDS GROWTH ARE EXPECTED FROM...

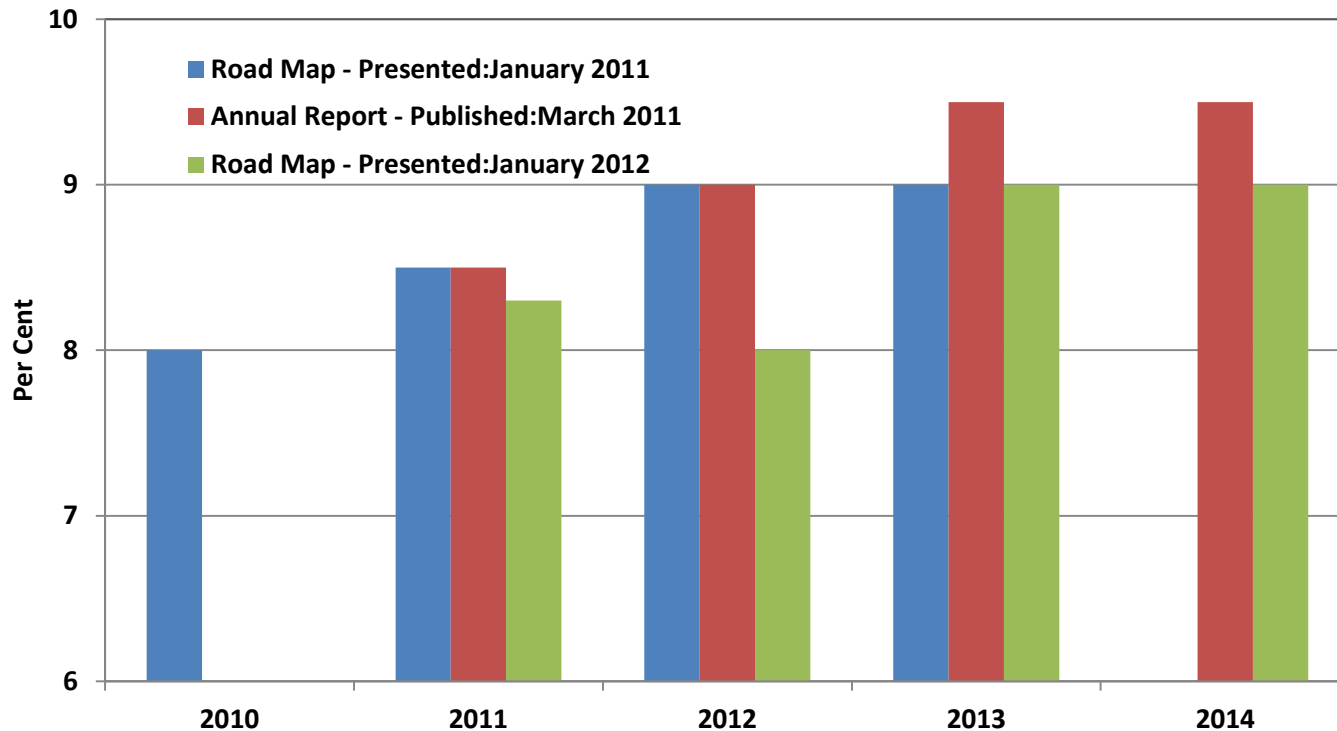
- **Agriculture sector: expected to expand at 7.3%, compared to 2.0% in 2011**
 - **14.2% growth in Paddy due to favourable weather conditions and expected expansion in new cultivation in North and East**
 - **9.8% growth in Fishing due to favourable weather conditions and improvement in marketing and infrastructure facilities**
 - **1.4% growth in Tea mainly due to Productivity improvements among tea small holders (74%) and favourable Impact of fertilizer Subsidy**
 - **5.5% growth in Coconut production owing to the government effort on the sector**
- **Industry sector: expected to expand at 9.0%, compared to 10.1% in 2011**
 - **12.2% growth in construction due to expansion in infrastructure development work by the government sector and expansion of tourism industry**
 - **11.8% growth in Mining and Quarrying due to Growth momentum in construction activities**
 - **8.0% growth in cottage industry due to completion of resettlements in the Northern and Eastern provinces**
 - **7.9% growth in Electricity owing to Increase in low cost thermal power generation using coal power**
- **Services sector: expected to expand at 7.7%, compared to 8.6% in 2011**
 - **22.1% growth in Hotels and Restaurant sector due to the improvement in tourist arrivals**
 - **8.2% growth in Domestic trade due to growth in agriculture and domestic industries**
 - **10.2% growth in Post and telecommunications due to increase in data transferring and increase in broadband connections with the availability of low cost 3G mobile phones**
 - **8.2% growth in Financial services owing to expansion in economic activity**

IT IS ALSO EXPECTED THAT SRI LANKA'S MACROECONOMIC CONDITIONS AND POLICIES WOULD BE FASHIONED TO SUPPORT THE HIGH GROWTH IN 2012...

- Prudent macroeconomic management to maintain benign fundamentals
- **Strengthened investor confidence**
- Promotion of agricultural and industrial products for both traditional and non traditional export markets
- **Continuation of government support schemes to increase the agricultural production (financial and other facilities)**
- Improvements in infrastructure facilities and deep sea fishing, contributing to increase in fish harvest
- **Promotion of FDIs for infrastructure and construction of tourist hotels**

ON THAT BASIS, A HIGH GROWTH RATE OF 8% WILL BE ACHIEVABLE, GIVEN SRI LANKA'S CURRENT STRUCTURAL TRANSFORMATION...

Revisions to GDP Growth Projections



ON ITS PART, THE CENTRAL BANK WILL BE KEEN TO ACCOMMODATE THE HIGHER GROWTH OF ECONOMIC ACTIVITY, ALTHOUGH ITS PRIORITY WOULD BE TO CHECK INFLATIONARY PRESSURES IN THE ECONOMY...

- **The Bank's Monetary Policy will be formulated so as to achieve mid-single digit rates of inflation, going forward into the medium term**
 - Given that Sri Lanka is a developing country, it is unlikely that a target of a very low single-digit inflation would be optimum, as structural bottlenecks still persist
- **Broad money growth would be designed to accommodate the growth while ensuring the achievement of the mid-single digit inflation**

THE CENTRAL BANK EXPECTS TO DELIVER AVERAGE INFLATION IN 2012 AT MID SINGLE DIGIT LEVELS...

- Assuming favourable domestic supply conditions, international commodity prices remaining reasonably stable, and international crude oil prices remaining at around the current levels, **Consumer price inflation based on CCPI is expected to be maintained at between 5 and 6% in 2012**
- Inflation as measured by the GDP deflator is expected to be around 7.7% in 2011 compared to 7.3% in 2010. **But, a moderation in price pressures is expected over 2012 thereby bringing down inflation as measured by the GDP deflator to around 6.5% in 2012**

THE CENTRAL BANK ALSO EXPECTS THE FISCAL DEFICIT TO DECLINE TO 6.2% OF GDP FROM LESS THAN 7.0% OF GDP IN 2011...

- Domestic financing is expected to amount to Rs. 271.6 billion in 2012, an increase of Rs. 16.5 billion compared to 2011
- **Within domestic financing, non-bank borrowings are expected to increase in 2012, with non-bank sources showing a greater appetite for government securities. Accordingly, bank borrowings are expected to be Rs. 64 billion in 2012**
- The reduction in net credit granted by the banking system to the government is expected to impact favourably on both the availability of funds to the private sector as well as domestic interest rates

IN ADDITION, THE EXTERNAL SECTOR PERFORMANCE IS EXPECTED TO UNDERGO A MAJOR STRUCTURAL CHANGE IN 2012...

- The BOP is expected to record a surplus of around US\$ 825 million
- **Although the deficit in the trade balance is likely to expand further, that will be cushioned by:**
 - **Earnings from Tourism projected at US\$ 1.2 billion**
 - **Worker remittances, projected at US\$ 6.5 billion**
 - **FDI, projected at US\$ 2.0 billion**
- High net inflows are expected to both the government and private sector on account of long-term debt obtained mainly for projects
- **Reflecting these inflows, the net foreign assets of the banking system are expected to increase in 2012, which will make a positive contribution to the financial system stability**
- These inflows are also expected to support the continued expansion of domestic economic activity
- **The higher inflows will help create a favourable investment climate in the country, which will, in turn, augment the country's growth potential**

IN THIS BACKGROUND, THE IMPLEMENTATION OF MONETARY POLICY, WILL BE MULTI-DIMENSIONAL AND BROAD...

- **THE POLICY INTEREST RATES** will continue to serve as a key monetary policy instrument of the Central Bank and the policy interest rate corridor approach will be continued
- **OPEN MARKET OPERATIONS (OMO), THE STATUTORY RESERVE RATIO (SRR) & MORAL SUASION** will be important monetary policy instruments with which the bank would manoeuvre its monetary policy stance
- **THE EXCHANGE RATE** will be viewed as a key stabilisation factor of the economy
- **The Bank will continue to engage in POLICY DISCUSSIONS** with different stakeholders of the economy including the Monetary Policy Consultative Committee (MPCC) comprising of representatives from the private sector, to strengthen its monetary policy decision making process.
- Steps to improve **PRODUCTIVITY AND CAPACITY UTILISATION** will also be considered as crucial factors

FOR 2012, ACCORDING TO THE MONETARY ANALYSIS...

- **THE MONEY MULTIPLIER** is projected to remain unchanged at around 5.6 in 2012
 - Remained relatively high at 6.1 and 5.8 respectively, in 2009 and 2010
 - It has reduced since raising the SRR by one percentage point to 8% in April 2011

The money multiplier averaged 5.6 in the ten months to October 2011
- **GROWTH OF BROAD MONEY** is targeted to be around 15%, on average, in 2012
 - This growth of the money supply is believed to adequately facilitate the expansion of economic activity in the year ahead
- **RESERVE MONEY** would be targeted to grow by around 15% on a daily average basis, in 2012
- **PRIVATE SECTOR CREDIT** is expected to moderate and reach around 16%
- **FOREIGN INFLOWS** will be actively encouraged to address the Savings-Investment gap and will show a marked increase
- **THE REAL VALUE OF SAVINGS** is expected to be preserved over the longer-term

ON THAT BASIS, PROJECTED EXPANSION OF BROAD MONEY AND OTHER KEY VARIABLES IN THE MEDIUM TERM WOULD BE...

Annual Average Broad Money (M_{2b}) Growth: 2011 - 2014*
(Percentage change over previous year)

	2011	2012	2013	2014
GDP Growth	8.3	8.0	9.0	9.0
GDP Deflator	7.7	6.5	5.5	5.0
Broad Money- M_{2b} (Annual Average)	19.0	15.0	15.0	14.5

*2011: provisional estimates
2012 to 2014: projections

MEANWHILE, COLLABORATION WITH GLOBAL FINANCIAL INSTITUTIONS WILL CONTINUE...

- The last test date for the IMF-SBA programme was 31st December 2011 and the review mission is expected in the 3rd week of January 2012.
- **Close co-operation with the IMF will continue with a follow up or surveillance programme, which is to be negotiated**
- A Financial Sector Assessment Program (FSAP) is expected to be conducted in 2012 in collaboration with the IMF and World Bank to further strengthen the financial system stability

THE CENTRAL BANK REITERATES THAT THESE PROJECTIONS AND TARGETS WOULD HOLD IF THE ECONOMY IS NOT SUBJECT TO MAJOR UNFORESEEN SUPPLY SIDE SHOCKS.

ANY SIGNIFICANT DEVIATIONS IN ECONOMIC FUNDAMENTALS FROM THOSE PROJECTED WOULD NECESSARILY REQUIRE A REVIEW OF STRATEGIES AND REVISIONS OF TARGETS FOR 2012.

THE CENTRAL BANK'S CLOSE COMMUNICATION WITH ALL STAKEHOLDERS AND THE PUBLIC WOULD CONTINUE...

- To facilitate informed decision making by economic agents in relation to their investments and savings.
- **Policy announcements will continue to be made available online and through other media**

www.cbsl.gov.lk

Monetary Policy Announcement Dates for 2012

Month	Date of Announcement
January	12 th Thursday
February	9 th Thursday
March	6 th Tuesday
April	18 th Wednesday
May	15 th Tuesday
June	12 th Tuesday
July	10 th Tuesday
August	7 th Tuesday
September	18 th Tuesday
October	16 th Tuesday
November	8 th Thursday
December	6 th Thursday

IN IMPLEMENTING MONETARY POLICY, THE CENTRAL BANK WILL CONTINUE TO SEEK VIEWS OF ALL STAKEHOLDERS...

- Discussions with the Consultative Committee on Monetary Policy will continue, to strengthen the policy decision making process
- Special thanks to Mr. Mahen Dayananda, who agreed to continue to serve as the Chairman
- Other eminent members of the Monetary Policy Consultative Committee (MPCC) for 2012 will be:
 - Mr. Sohli Captain – Chairman, CEI Plastics Ltd.
 - Mr. Cubby Wijetunge – Director & Chairman Emeritus, Nestle Lanka Pvt Ltd.
 - Mr. Raja Senanayake – Chairman, SKM Lanka Holdings Ltd.
 - Mr. Preethi Jayawardane – Jt. Managing Director, Chemanex Ltd.
 - Mr. Amal Cabraal – Chairman, Unilever – Sri Lanka
 - Mrs. Nirmali Samaratunga – Co-Chairperson & Jt. Managing Director, Mackwoods (Pvt) Ltd.
 - Mr. Sujeewa Rajapakse – President, Institute of Chartered Accountants of Sri Lanka
 - Mr. Mohan Pandithage – Chairman and Chief Executive Officer, Hayleys Group
- Discussions with Chambers, Financial Institutions, Industrialists, etc. will continue

5. PROPOSED POLICIES FOR FINANCIAL SYSTEM STABILITY IN 2012 AND BEYOND

“One of the most important legacies of the crisis will be the restoration of financial stability policy to co-equal status with monetary policy”

*Ben S. Bernanke
Chairman, US Federal Reserve Bank*

“Desired outcomes are not realised by chance. Required results are not won by mere good fortune. Indeed, successes are achieved through meticulous planning, timely implementation, and steadfast belief in our own abilities and strengths”



THE LOGICAL STARTING POINT FOR THE PROPOSED POLICIES WOULD BE AS TO WHERE THE BANKING SECTOR IS PROJECTED TO BE IN 2016, IN A US\$ 100 BILLION ECONOMY

- Assets of the banking sector projected to increase to Rs. 8,000 bn from current level of around Rs. 4,100 bn
- **Lending projected to reach Rs. 5,000 bn from current level of around Rs 2,500 bn**
- Lending projected to reach a broader spectrum of corporates and households
- **Access to finance in the country projected to improve significantly**
- Net interest margin projected to decline to around 3.3% from current level of 4.2%
- **Market capitalisation of the CSE projected to reach 70% of GDP by 2016**
- Corporate bond market outstanding to increase from below Rs. 100 bn to Rs. 1,000 bn by 2016

TOWARDS THAT SCENARIO, BANKS WILL NEED TO REALIGN THEIR BUSINESS MODELS AND PROCESSES TO BE IN SYNC WITH THE EVOLVING NEEDS IN THE ECONOMY...

- Diversify the sources of funding and business operations while strengthening integration with regional and international financial markets
- **Upgrade the systems and processes to facilitate increasing business activities**
- Expand the range of products, services and delivery channels to cater to the emerging needs of the economy
- **Concentrate on cost efficiency and resource utilisation to improve profitability**
- Address human capital issues including increased staff requirements and improved management to cater to the evolving financial environment

IN PARTICULAR, INNOVATIVE AND SOPHISTICATED FINANCING SOLUTIONS WILL NEED TO BE IMPLEMENTED...

- Banks will be expected to use and leverage their balance sheets better
 - Banks will need to meet the resource gap in financing the “doubling of assets” scenario, mainly through foreign sources by adopting an internationalised approach
 - *Although some have initiated such efforts, many are yet to test themselves out in the international markets and secure such funding*
- **There is a potential for banks to raise approximately US\$ 1 billion as Tier II debt capital in 2012, and thereafter raise around US\$ 1.5 billion each year as Tier I and Tier II capital, from foreign sources**
 - **Banks to look for stable wholesale funding sources without relying only on small scale customer deposits**
- Fee based banking and investment banking products also to be explored, rather than relying only on fund based conventional banking products

CENTRAL BANK WILL CONTINUE TO STRENGTHEN THE REGULATORY REGIME...

- **Banks & NBFIs will be required to further strengthen:**
 - the quantity and quality of capital to enhance their loss absorbency
 - the systems and processes to migrate to advanced approaches on the Basel II capital framework
 - the management of banking risks in an integrated manner, and
 - the governance, fitness and propriety of directors and senior management to establish operational accountability
- **The Central Bank will carry out more frequent examinations of banks and NBFIs to implement a corrective action based bank rating system**
- **The industry will be re-positioned to provide greater customer protection and care**
- **Exposure to related parties and other sensitive sectors will be capped while also limiting the involvement of banks and financial institutions in shadow banking activities**
- **Strengthen the RFC Sector while providing more effective mechanism to combat unauthorised deposit taking, through the Finance Business Act No. 42 of 2011**

TO FACE THE CHALLENGE OF SUPERVISION IN 2016, THE CENTRAL BANK TOO WILL TAKE THE REQUIRED STEPS INTERNALLY...

- Strengthen the regulatory capacity by equipping the supervisory teams with the necessary skills
- **Build capacity through strengthening the knowledge base of the existing supervisors**
- Train and require the external auditors and compliance officers of banks to act as the first defense of the Regulator
- **Enhance the supervisory framework through a robust early warning system to ensure prompt corrective action**
- Strengthen the legal framework to facilitate weak bank & FI resolution
- **Continue to enhance the knowledge of the banking community and the general public on the prudential regulatory regime**

THE CENTRAL BANK WILL ALSO SUPPORT A DEEPER, MORE LIQUID AND VIBRANT BOND MARKET...

- **Corporate Debt Market projected to takeoff**
 - Encourage issuance of debt by Quality Corporates
 - Improve infrastructure of the corporate debt exchange
 - Encourage banks to issue bonds to raise Tier II capital
 - Raise awareness of foreign investors on investment opportunities in Sri Lanka
 - Continue the Rating facilitation process
 - Encourage the creation of a layer of intermediaries to facilitate the issuance of corporate debt
- **Government Securities Market projected to grow further**
 - Secondary market operations to take place through an electronic trading platform
 - Conduct Buy-back/switching operations to minimise rollover risk
 - Further reduction in the fragmentation of the bond market to improve market liquidity
 - Continuation of the issuance of benchmark bond series
 - Development of the benchmark yield curve

A DEEPER, MORE LIQUID AND VIBRANT EQUITY MARKET WILL ALSO BE ENCOURAGED...

Stock Market projected to grow to a value of 70% of GDP when GDP reaches US\$ 100 bn. In this context, it would be necessary to:

- **Raise awareness of foreign investors on investment opportunities in Sri Lanka through continuous investor updates and road shows**
- **Encourage listing of Sri Lankan Corporates**
- **Consider the demutualisation of the CSE to segregate ownership from trading rights**
- **Introduce new products including exchange traded futures and options**
- **Encourage listing of foreign companies on the CSE**

THE PAYMENTS AND SETTLEMENTS SYSTEMS WILL ALSO BE STRENGTHENED FURTHER TO ACCOMMODATE THE INCREASE OF FINANCIAL TRANSACTIONS BY OVER 45% BY 2015...

- **The expected growth is projected in following three aspects:**
 - Larger volumes of transactions
 - Increased usage of electronic payment mechanisms
 - Introduction of innovative payment instruments
- Upgrade LankaSettle system to provide more security in information, avenues for monitoring the system and flexibility in operations
- **Establish National payment switch for ATMs and debit cards to provide the platform for settlement of electronic retail payments, improving efficiency in on-line retail payment system, reducing transactions cost and facilitating the integration of future financial services**
- Introduce Line-encryption technology to ensure a secured environment for payment card operations
- **Assess Payment systems against new core principles of BIS in order to be compliant with international standards and best practices**
- Publish Oversight Practices of Payment and Settlement Systems (PSS) in Sri Lanka to enhance public confidence on PSS

THE FINANCIAL INTELLIGENCE ENVIRONMENT WILL BE MADE MORE ROBUST...

- Complete legal review process to amend the Financial Transactions Reporting Act No 6 of 2006.
- Establish a mechanism to implement United Nations Security Council Resolution (UNSCR) 1373 and 1267
- Publication of Annual Report on the activities of FIU
- Carry out country risk assessment on AML/CFT vulnerabilities. The yardstick for measuring the country's AML/CFT compliance is the extent to which we have implemented the 40 + 9 recommendations of the FATF
 - The amendments made to the CSTFA and PMLA have improved compliance to a great extent

THE FOREIGN EXCHANGE ENVIRONMENT WILL BE FURTHER RELAXED...

- Grant permission for local listed companies to be listed in foreign stock exchanges
- **Grant permission for issuance of redeemable preferences shares to non residents with a specific minimum redemption basis**
- Broad base money-changing operations in the formal sector, including the issue of general money changing licenses to hotels and restaurants registered with the Tourist Board
- **Grant permission to Licensed Specialised Banks and Registered Finance Companies to open and maintain NRFC and RFC accounts**

MEASURES WILL ALSO BE INTRODUCED TO POPULARISE FOREIGN EXCHANGE INFLOWS AND OUTFLOWS, THROUGH CONVENIENT FORMAL MECHANISMS...

- **Non-Bank Financial Institutions to be authorised to carry out money changing activities**
- **Facilitate transmission of foreign exchange collected by authorised dealers outside the Colombo District**
- **Automate foreign currency encashment operations at certain popular commercial outlets**
- **Promote training and awareness programmes relating to foreign exchange transactions**
- **Introduce and implement strict regulatory and punitive action against unauthorised and/or illegal money changing activities**

THE CENTRAL BANK WILL CONTINUE TO SEEK VIEWS OF A WIDE CROSS-SECTION OF STAKEHOLDERS IN FORMULATING POLICIES FOR THE FINANCIAL SECTOR...

- **The Financial System Stability Consultative Committee (FSSCC) will continue to contribute towards strengthening the financial system**
- **Special thanks to Mr. R.N. Asirwatham, who agreed to continue to serve as the Chairman**
- **Other eminent members of the FSSCC for 2012 will be:**
 - Mr. M.U. De Silva – Secretary General, Sri Lanka Banks Association
 - Mr. A. Devasurendra – Deputy Chairman, Browns Group
 - Mr. S. Kulatunga - Director, Amba Research Ltd
 - Mr. S. Jeyavarman – CEO, National Asset Management
 - Mr. S. Mudalige – Partner, PriceWaterHouse Coopers
 - Mr. A.N. Fonseka – CEO, DFCC Bank
 - Mr. N. Goonewardena - Partner, Nithya Partners
 - Mr. M. Fernando – CEO, Softlogic Finance Ltd
 - Mr. R. Jasinghe – CEO, Asian Alliance Ltd
- **Discussions with Financial Institutions, Chambers, Industrialists, etc. will continue**

6. POLICIES TO STRENGTHEN THE ECONOMY IN 2012 & BEYOND

“We will have to continue to anticipate challenges, and prepare ourselves even better. Such new focus suggests that we improve on our previous performance.”

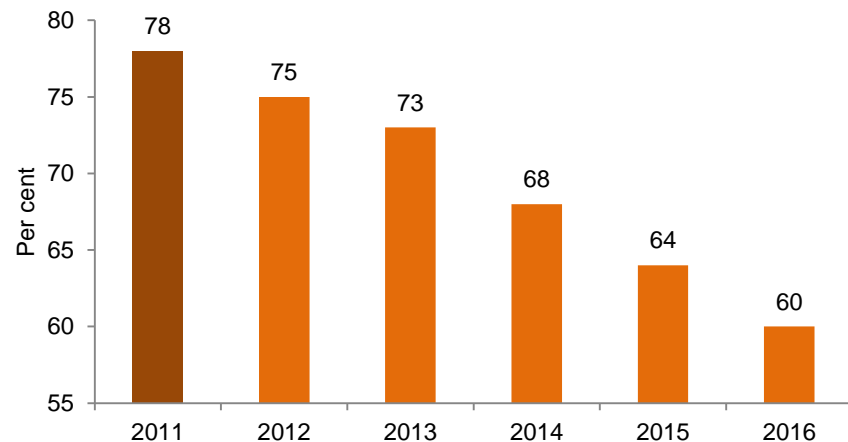


**FURTHER IMPROVEMENTS WILL TAKE PLACE
IN VARIOUS AGENCY FUNCTIONS CARRIED
OUT BY THE CENTRAL BANK ON BEHALF OF
THE GOVERNMENT...**

PUBLIC DEBT MANAGEMENT WILL BE IMPROVED FURTHER IN ORDER TO DELIVER A 60% DEBT/GDP RATIO BY 2016...

- Meet borrowing targets at lowest cost with a prudent degree of risk
- **Further enhancement of sovereign credit rating**
- Broaden investor base
- **Maintain a sound regulatory framework**
- Enhance secondary market trading of Government Securities
- **Study the impact of appreciation in different currencies on the debt servicing obligations**

Projections of Outstanding Public Debt (as a % of GDP)



Indicator	Current level 2011	Annual Target*				
		2012	2013	2014	2015	2016
Debt/GDP ratio (%)	78	75	73	68	64	60
Average Time to Maturity of Domestic Debt (ATM)(years)	2.03	2.5	2.7	3.0	3.2	3.5
Ratio of Short-term Domestic Debt (SDD) to Total Domestic Debt (TDD) (%)	27	24	22	19	17	15
Average Time to Refixing – Domestic Debt (ATR) (years)	2.21	2.6	2.8	3.0	3.2	3.5
Share of Foreign Currency Debt (FCD) to Total Debt (TD) (%)	43	40	37	35	33	30

IN THAT ENDEAVOUR, MEASURES TO MITIGATE THE IMPACT OF RUPEE DEPRECIATION ON PUBLIC DEBT OF SRI LANKA WILL ALSO NEED TO BE GIVEN CAREFUL CONSIDERATION...

- **Outstanding Foreign Currency Debt Stock as at end November 2011 - Rs. 2,253.7 bn**
- **Total effect of Rupee Depreciation on the Foreign Currency Debt Stock (1977 - 2011 Nov.) - Rs. 677.3 bn**
- **Impact of Rupee Depreciation as a percentage of outstanding Foreign Currency Debt Stock (1977 - 2011 Nov.) - 30%**

Currency	Outstanding Foreign Currency Debt Stock (Rs. billion)		Impact of Rupee Depreciation (Rs. billion)	% Increase Due to the Exchange Rate Depreciation
	As per the Exchange Rate at the time of disbursement	As Per the Current Exchange Rate		
USD	739.7	871.2	131.6	15.1%
SDR	381.5	606.4	225.0	37.1%
JPY	260.6	550.1	289.4	52.6%
EUR	140.7	152.6	12.0	7.8%
Other	53.9	73.2	19.4	
Total	1,576.3	2,253.7	677.3	

PROVINCIAL DEVELOPMENT WILL BE GIVEN A MAJOR BOOST WHILE PARTICULARLY TARGETING THE SME SECTOR...

- Provision of credit facilities with special attention to lagging regions amounting to approximately Rs.16 billion
 - Expected to increase the loan disbursements by 23% in 2012
- **Promote Information & Communication Technology based SMEs, with special attention to entrepreneurial innovations related to;**
 - Hospitality industry
 - Energy sector
 - Transport sector
 - Services required by education and health sectors
- Conduct training to increase knowledge and skills base of potential and existing entrepreneurs



THE CENTRAL BANK WILL ASSIST THE GOVERNMENT AND PRIVATE SECTOR WITH THE INTERVENTIONS NECESSARY TO MOVE TOWARDS HIGHER GROWTH TARGETS...



TOURISM, AGRICULTURE AND CONSTRUCTION WILL BE KEY...

• Tourism

- ✓ Earnings - US\$ 825mn in 2011 to US\$ 2,500mn by 2016
- ✓ Arrivals: 850,000 in 2011 to 2,500,000 by 2016
- ✓ Tourist spending to increase from US\$ 97 to US\$ 150 per day
- ✓ Investment in the sector will increase substantially in the next 5 years



• Agriculture and Fisheries Sector

- ✓ Tea: Target US\$ 2.5bn export earnings by 2015
- ✓ Rubber & Rubber products: Target US\$ 2bn by 2015
- ✓ Fruits and Vegetables: to US\$ 1bn by 2015
- ✓ Fisheries: to US\$ 1bn by 2015
- ✓ Milk: Self sufficiency by 2016



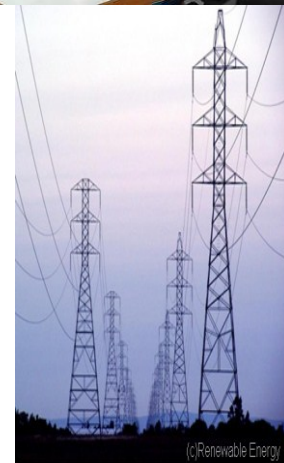
• Construction Sector

- ✓ Hotels/ Apartments developments
- ✓ Ports & Airports
- ✓ Roads & other infrastructure development



ICT, APPARELS, INDUSTRY AND REMITTANCES WILL ALSO BE SUPPORTED AS VITAL SECTORS...

- **Information and Communication Technology**
 - ✓ First IT park in Hambantota
 - ✓ Business Process Outsourcing emerging as one of the top export earners - Target to reach US\$ 1 billion by 2015
 - ✓ Colombo Lotus Tower Project - multifunctional TV and Telecommunication Tower to be built with capacity for 50 telecasting services, 10 telecommunication services and 50 radio broadcasting services
 - ✓ Increased quality and penetration of telecommunication services
- **Transformation into the Apparel hub of the region**
 - ✓ Textile and apparel - Target to have net exports of US\$ 3 bn by 2015
 - ✓ Establish a free port and entrepot trading
 - ✓ Lead buyers to establish their headquarters in Sri Lanka
- **Industry Sector**
 - ✓ Electric, Electronic and Assembling Industries
 - ✓ Rubber and Rubber based industries
 - ✓ Dockyard services
 - ✓ Gems and Jewellery
- **Remittances**
 - ✓ The importance of remittances from expatriate workers is expected to increase in the coming years and reach 10% of GDP



PORTS AND AVIATION ARE POISED TO PLAY A MAJOR ROLE...

Port

- ✓ Mahinda Rajapakse Port to be the largest port in South Asia functioning as a service and industrial port with transshipment and bunkering facilities Business ventures also to be established
- ✓ Capacity limitations in Colombo port to be addressed with Colombo South Port expansion project. Capacity to be increased by 160% upon completion
- ✓ Galle Port Development and Trincomalee Port Development to cater to the emerging tourist demand as Leisure ports
- ✓ The Oluvil Port to be developed as a Fisheries harbour



Aviation

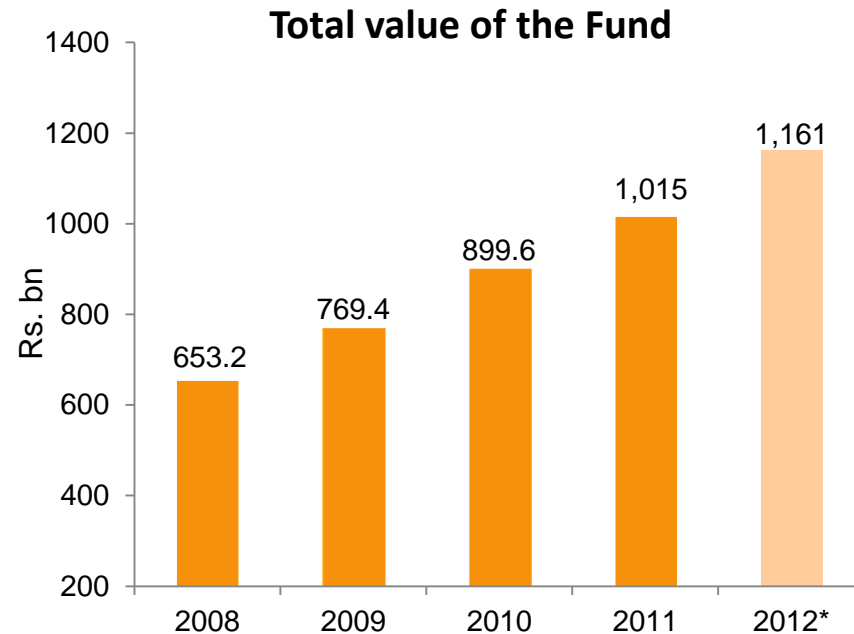
- ✓ BIA Expansion project will help to increase annual passenger capacity to 6 million
- ✓ Construction work of Mattala International Airport to be completed by 2013
- ✓ Domestic travel to be catered through the development of new airports in Ratmalana, Ampara, Koggala, Kandy, China-Bay and Jaffna

IN LINE WITH ITS OBJECTIVES, THE EPF WILL ACTIVELY IMPLEMENT STRATEGIES TO MAXIMISE RETURNS IN A LOW INTEREST RATE REGIME...

- **Focus of the EPF will be to:**
 - Ensure a significant positive real rate of return to the members in a medium to long term time horizon (Benchmark to be at least 1.5% over inflation in any 5 year period)
 - Ensure safety of the Fund
 - Provide an efficient and caring service to the members through enhancing the efficiency of operational processes
- **Specific strategies in a low interest rate regime will also include:**
 - The diversification of the investment portfolio into:
 - Listed Equities
 - Unlisted Equities
 - Corporate Debt and Securitisation products
 - Investment in long-term government bonds
 - Exploring possibilities for mega project financing (eg. Power projects, Housing projects, etc.)

THE EPF WILL ALSO ENSURE THE STEADY GROWTH OF THE FUND...

- Growth of 14% estimated in 2012
- **Rate of Return on Investments in 2011 expected to be 12.3% (prov) while in 2012, the projected return is 11.1%**
- **Rate of Return to Members is 10.5% (prov) in 2011, and 10% (proj) in 2012**
- **Online member contributions expected to increase from 25% of contributing members (0.6 million) in 2011, to 75% of contributing members (1.65 million) by end 2012**
- **125,000 contributing employers projected from current level of 62,000**
- **A Web-based Information Dissemination System expected to be implemented by end 2012**



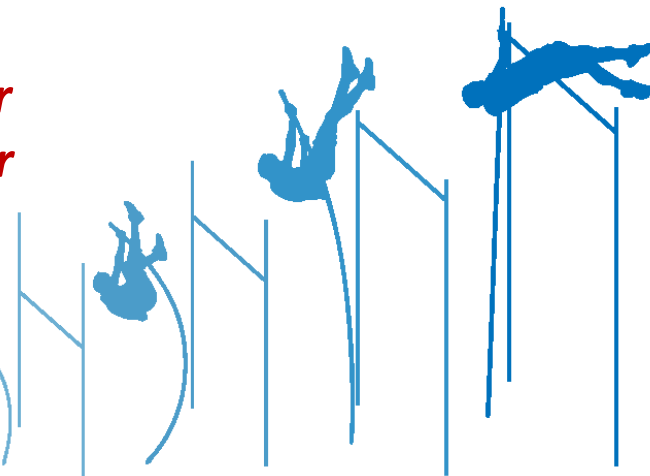
CURRENCY MANAGEMENT WILL BE STRENGTHENED FURTHER AND THE CLEAN NOTE POLICY WILL BE PURSUED WITH VIGOUR...

- **Remove and replace unfit notes of low denominations from circulation. For this purpose...**
 - Encourage an incentive mechanism so that commercial banks will forward soiled low denomination notes
 - Implement a system through school children to collect soiled and unfit notes through bank branches in schools
 - Establish a system to collect unfit notes through bank branches at Economic Centres
- Enhance security features of currency notes to minimise counterfeit threat
- **Issue a new coin series to portray the Administrative Districts of Sri Lanka**
- Rationalise the metal composition of coins to minimise cost of minting

7. CONCLUDING REMARKS

“The wide range of goals as we have set for ourselves are not easy to achieve. And if we are to succeed, we will need total focus and diligent implementation of our policies and plans. We will also need to motivate and energise our fellow countrymen to realise the ambitious goals that have been endorsed by our people through their mandate for the “Mahinda Chintana – Vision for the Future”

Ajith Nivard Cabraal
Governor
1st January 2012



THE RECENT ACHIEVEMENTS HAVE BEEN POSSIBLE AS A RESULT OF A MASSIVE COLLECTIVE EFFORT, AND GRATITUDE IS THEREFORE DUE TO MANY...

- His Excellency the President, Mahinda Rajapaksa as the Minister of Finance for the excellent leadership and guidance given to us
- The Deputy Minister of Finance, Hon. Geethanjana Gunawardena
- The members of the Monetary Board, Dr. P.B. Jayasundera, Secretary to the Treasury, Mrs. Mano Ramanathan, Mr. Nimal Welgama and Mr Neil Umagiliya for all their assistance, guidance and wise counsel
- Deputy Governors, Mr. K.G.D.D. Dheerasinghe and Mr. P.D.J. Fernando who retired from the Bank in 2011 and to Deputy Governor, Dr. P.N. Weerasinghe, on release to the IMF, Mr. B.D.W.A. Silva and Mrs. C. Premaratne
- Assistant Governors, Heads of Departments, particularly the former Chief Economist & Director of Economic Research, Mr. K.D. Ranasinghe and the staff of Economic Research for today's effort, and all staff of the Central Bank who have worked with dedication, commitment and professionalism to fulfill the mandate of the Central Bank
- The Consultative Committees on Monetary Policy, the Financial System Stability and all other committees for the policy discussions and advise

IT MUST BE RECALLED THAT 2011 WAS A CHALLENGING YEAR, BUT AMIDST TENSE GLOBAL DEVELOPMENTS, SRI LANKA'S ECONOMY WAS ABLE TO DELIVER THE PROMISED RESULTS...

	Target	Achievement
Growth	8.5%	8.3% (Est)
Inflation (Y-on-Y)	4 to 6%	4.9%
Broad Money Growth	14.5%	19.8% (Oct)
International Reserves	5 to 6 months	4.6 months (Oct)
Debt to GDP Ratio	79%	78% (Est)
Remittances	US\$ 5.1 bn	US\$ 5.2 bn (Est)
Unemployment	4.5%	4.3% H1

THAT IS BECAUSE

THE CENTRAL BANK IS DEEPLY COMMITTED TO ITS

MISSION TO MAINTAIN ECONOMIC AND PRICE

STABILITY AND FINANCIAL SYSTEM STABILITY,

IN ORDER TO SUPPORT SUSTAINABLE GROWTH...

OVER THE PAST SEVERAL YEARS, THE CENTRAL

BANK'S JOURNEY HAS BEEN FOCUSED, INNOVATIVE

AND PRACTICAL, AND...

IN 2012, IT WILL FURTHER

RAISE THE BAR

central bank of sri lanka
REPOSITIONING
for . the . new . era

FAST TRACK
Prosperity 



**CHALLENGE THE
COMFORT ZONE**

Towards Prosperity
The Way Forward



**TO DELIVER PROSPERITY
TO**

sri lanka
W O N D E R O F A S I A

