



ROAD MAP 2013

Monetary and Financial Sector Policies for 2013 and Beyond

Presented by
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2013 is the seventh consecutive year that the Central Bank is presenting its policy direction & work plan for the upcoming period



ROAD MAP 2013

Monetary and Financial Sector Policies for 2013 and Beyond

Last year's satisfactory results were due to the contributions of many, to whom sincere thanks are due...

- His Excellency the President, Mahinda Rajapaksa as the Minister of Finance for the excellent leadership and guidance given
- **The Deputy Minister of Finance and Planning, Hon. Dr. Sarath Amunugama and the Former Deputy Minister of Finance and Planning, Hon. Geethanjana Gunawardene for their constant guidance and support**
- 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, Dr. Nandalal Weerasinghe, Mr. Ananda Silva and Mrs. Chandra Premaratne, Assistant Governors, Heads of Departments 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 advice

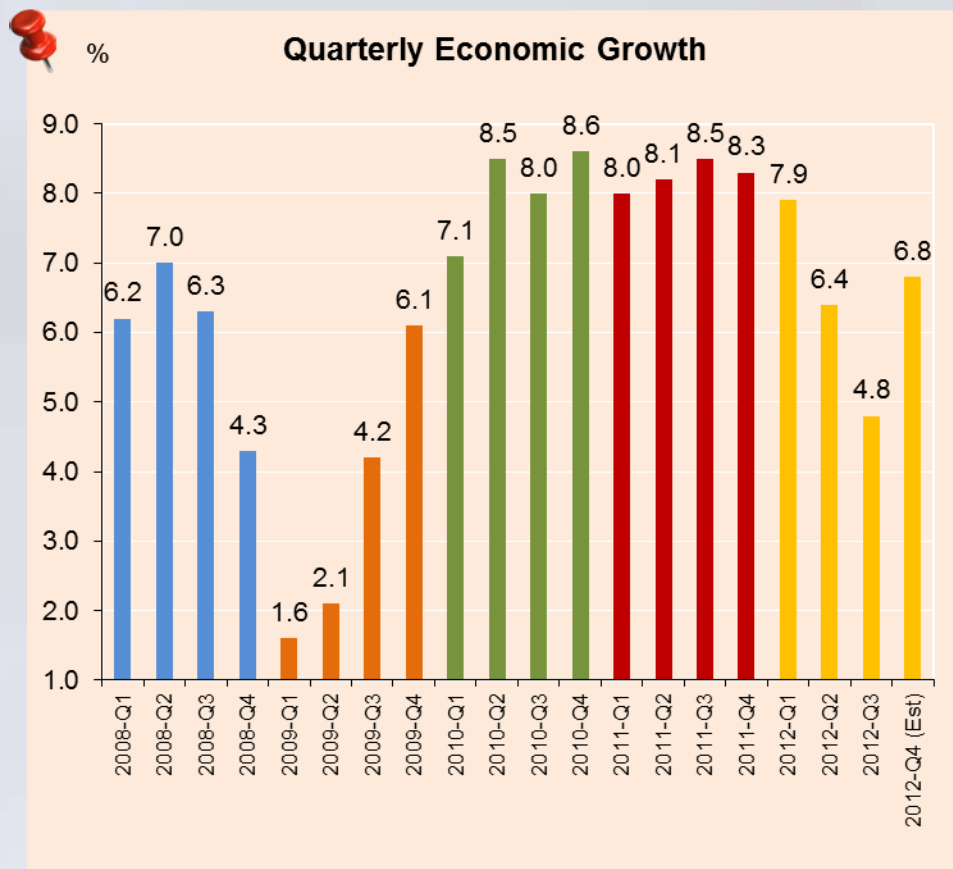


**Prior to presenting
the policy direction and strategies
for 2013 and beyond,
a review of the post-conflict period of
2010, 2011 and 2012*
would be useful...**

** Figures for 2012 are provisional*



A major growth momentum has been witnessed in the first two years, 2010 & 2011, while a gentle deceleration in growth took place in 2012...



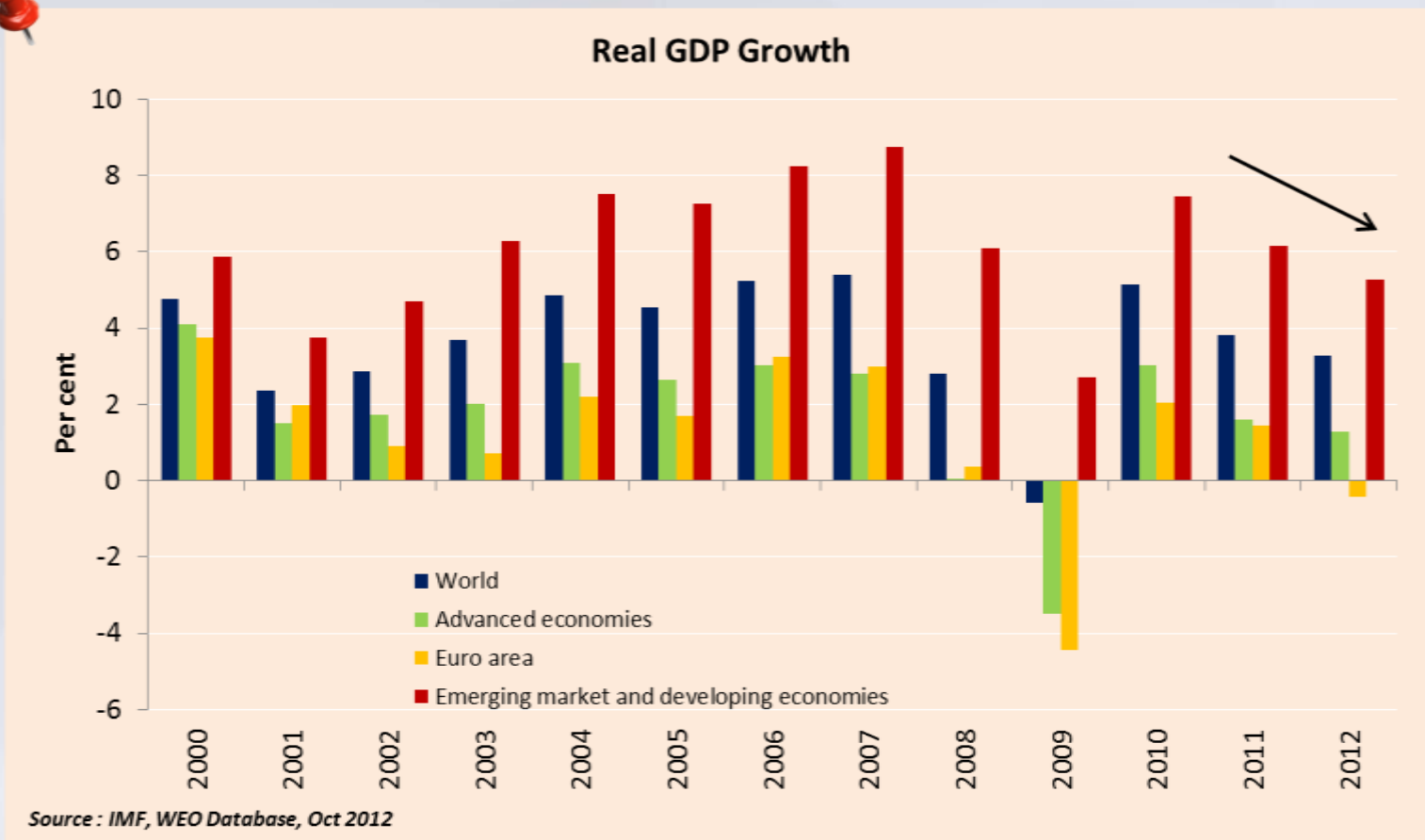
- “Peace” dividend has been clearly visible
- **Remarkable performances have been witnessed in all key sectors of the economy**
- **Business confidence has been enhanced during the 3-year period**
- **Benign macro-economic fundamentals have been established across all vital sectors**



By end 2011, the Sri Lankan economy had recorded remarkable progress amidst global challenges...

High Economic Growth	8.3% on top of 8.0% in 2010 (First time ever)
Increased level of Investment	29.9% of GDP
Low Inflation	Declined to 6.7% (Annual Average) in December 2011 (Longest ever continuous period at single digits)
Decline in Unemployment	Historic low at 4.2%
Buoyant External Trade	Exports grew by 22.4% and Imports by 50.7% Exports & Imports as a % of GDP: 17.8% & 34.3%, respectively
Tourism on an accelerator	Arrivals increased by 30.8% to 855,975 Earnings increased by over 44% to US\$ 830 mn
Remittances continued to increase	Grew by 25% to US\$ 5.1 bn
Highest FDI recorded	US\$ 1,066 mn
Balance of payments	A deficit of US\$ 1,061 mn, mainly due to unprecedented import demand
Foreign Reserves at comfortable levels	US\$ 6 bn at end year (3.5 months of imports)
Decline in Budget Deficit	6.9% of GDP
Decline in Govt. debt /GDP ratio	78.5% compared to 81.9% in 2010 (Lowest in 30 years)
Stable interest rates	Along with improved business confidence, leading to high credit growth of 34.5%

By that time however, the global economy which failed to take off in 2011, had slowed down further in 2012...



The Sri Lankan economy too, faced heightened global and domestic challenges in 2012...

- **Globally...**

- The European Sovereign debt crisis, Fiscal cliff in the US, etc.
- Global geo-political uncertainties, Iran sanctions, etc.
- Persistently high petroleum prices

- **Locally...**

- Excessive credit demand and high imports
- Drought conditions that severely affected Agriculture and hydro power generation
- Heavy rains in the last quarter that disrupted food supplies



To deal with these challenges, several tough policy decisions were implemented at the beginning of 2012...

- **Monetary policy**

- Increased policy interest rates
- Placed ceiling of 18% on bank credit expansion; Additional 5% for foreign funds

- **Exchange rate policy**

- Allowed greater flexibility
- Curbed speculative behaviour in the Forex market

- **Fiscal policy**

- Imposed higher tariffs and excise duties on selected imports

- **Administered pricing policy**

- Allowed greater pass-through of Energy and Transport prices

February 2012

The Repurchase rate and the Reverse Repurchase rate of the Central Bank raised by 50 bps each

March 2012

A ceiling on rupee credit growth imposed on Licensed Banks. This was expected to directly impact the intermediate target of the Monetary Policy Framework

April 2012

The Repurchase rate raised by 25 bps and the Reverse Repurchase rate raised by 75 bps



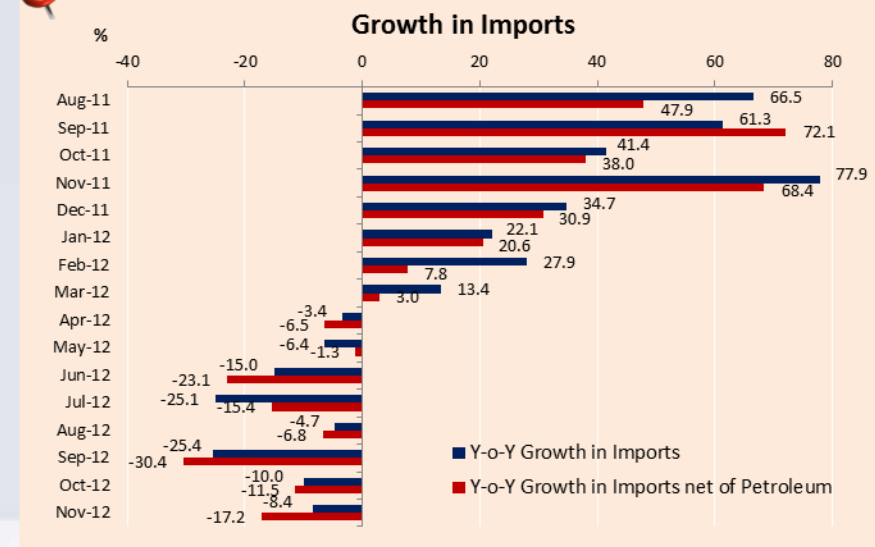
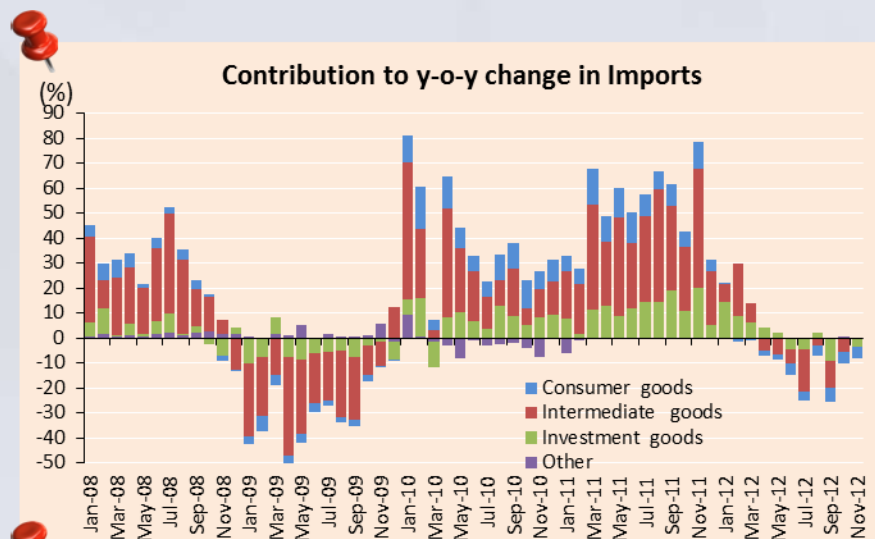
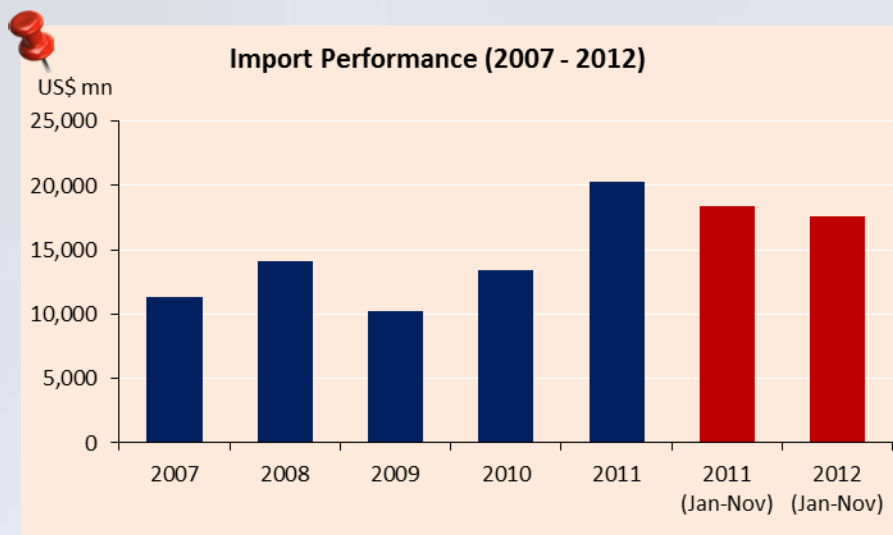
The Sri Lankan economy showed resilience and adjusted reasonably well to those measures...



And, as expected, import expenditure declined...

- Cumulative expenditure on imports declined by 4.5% during the first 11 months, reflecting declines in:
 - Consumer goods imports by 17.2%
 - Intermediate goods imports by 3.7%
- **Non-oil imports declined by 8.4%**
- Nevertheless, Investment goods imports increased by 4.8%

Imports as a % of GDP: 31.5%



At the same time however, export earnings too, declined as a result of weak global demand...

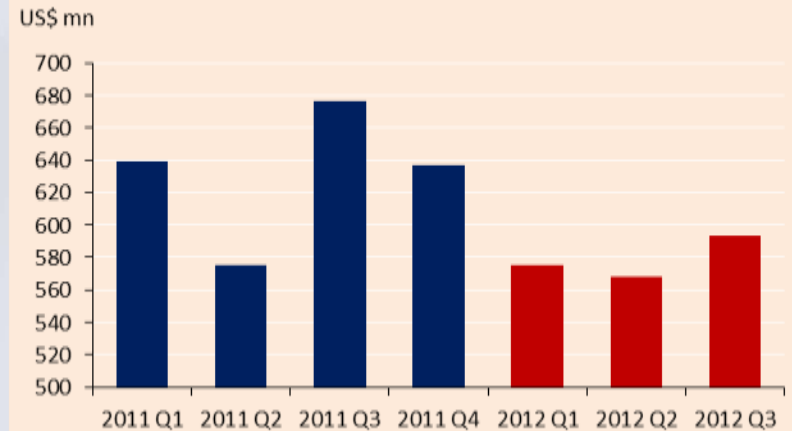
- Earnings from exports declined due to;
 - Lower prices of key export items stemming from lower international commodity prices
 - Subdued global demand in major exports markets
- Earnings from exports declined by 6.6% in the first 11 months in 2012
 - Industrial exports by 7.5%
 - Agricultural exports by 8.7%
- However, exports of mineral products increased by 68.1%

Exports as a % of GDP: 16.5%

Export Performance (2007 - 2012)



Agricultural Exports (2011 - 2012 Q3)

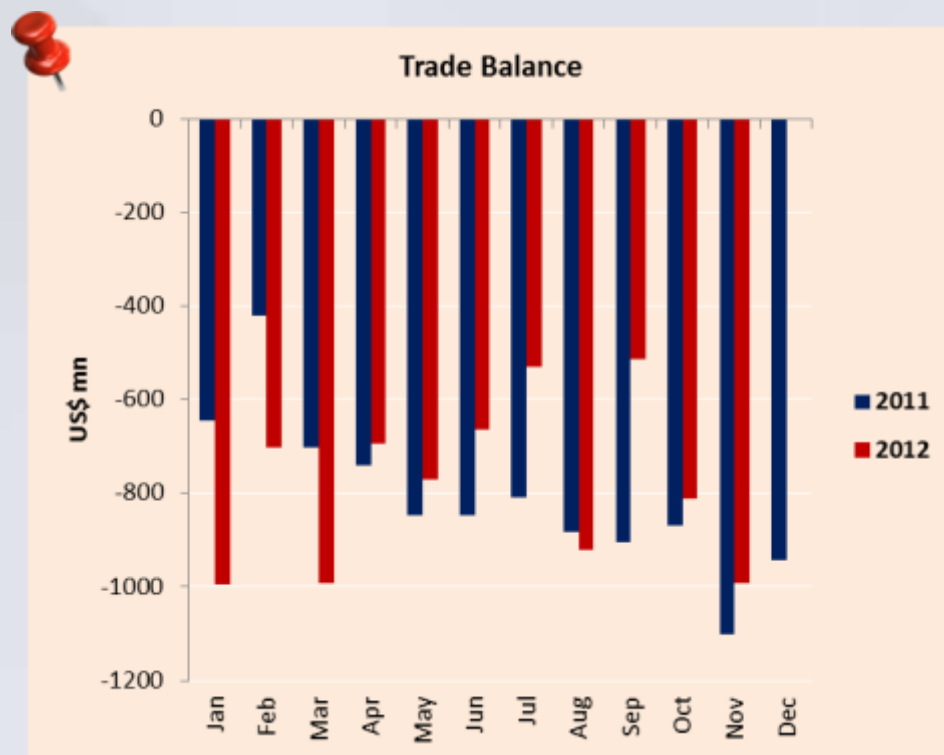


Industrial Exports (2011 - 2012 Q3)



More importantly, the trade balance contracted...

- The cumulative deficit in the trade account declined by 2.1% to US\$ 8,583 mn during the first eleven months of 2012 from the corresponding period of 2011.
- **Deceleration in the growth in the trade balance was driven by declining expenditure on consumer and non-oil intermediate goods imports.**



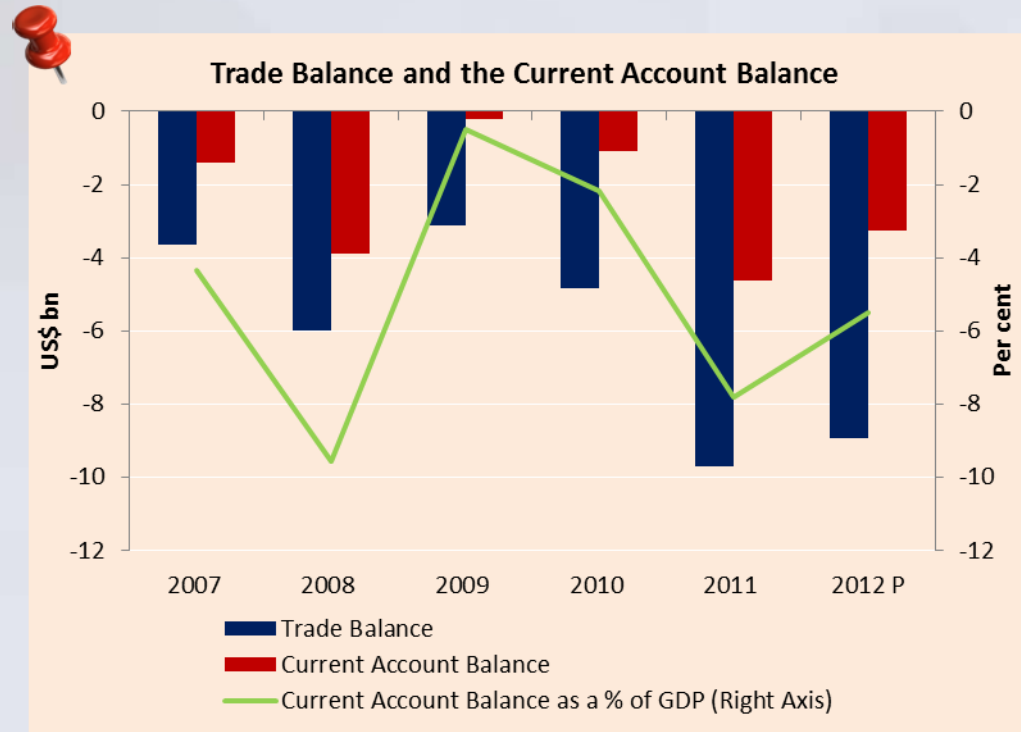
Trade deficit is expected to contract to 15.1% of GDP in 2012, from 16.4% in 2011



As a result of the contraction of the trade deficit and the increase in other earnings, the current account deficit reduced substantially in 2012...

Other inflows to the Current Account

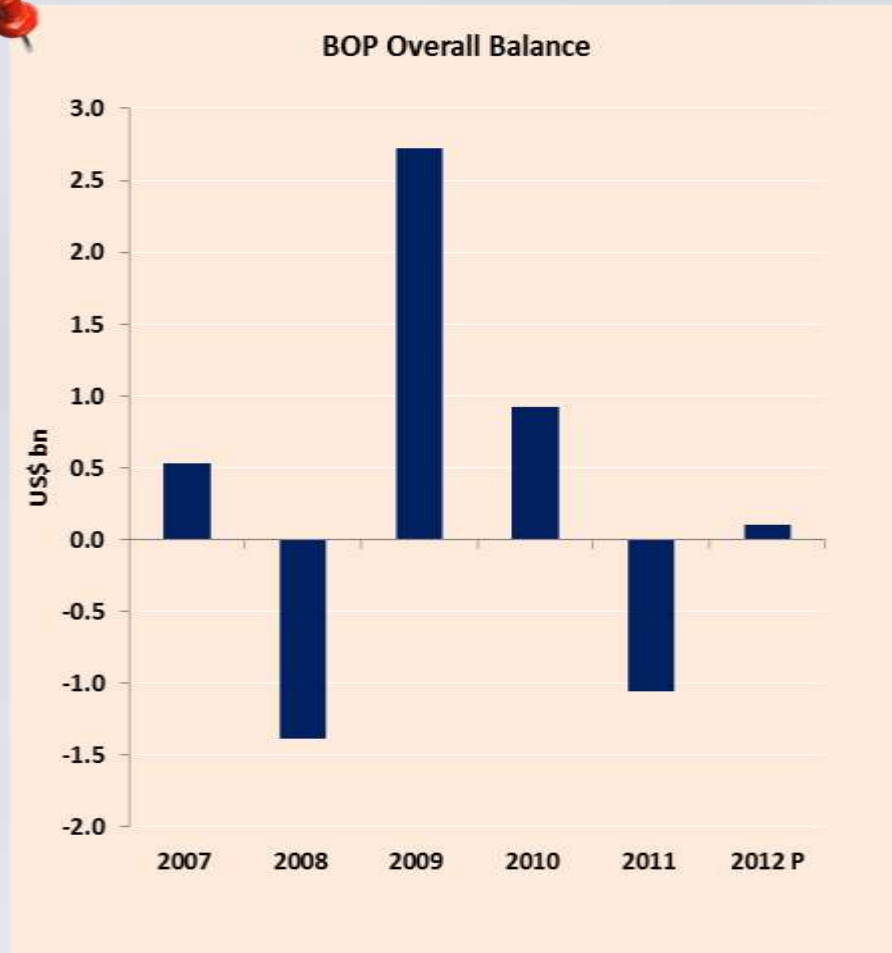
- **Tourism on an accelerator**
- **Workers' remittances continued to bring in substantial foreign exchange**
- **Trade in services improved with BPO and KPO sectors gathering momentum**



Accordingly, the current account deficit is expected to reduce to US\$ 3.3 bn or 5.5% of GDP in 2012, down from 7.8% in 2011.



...Leading to the Balance of Payments recording a surplus in 2012...

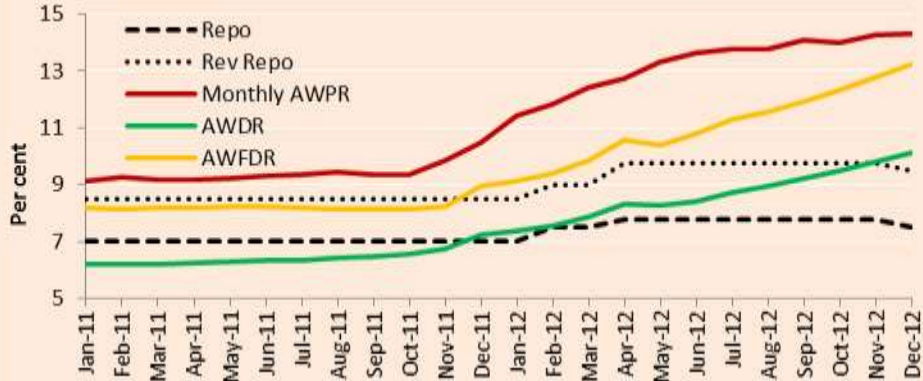


- The BOP improved from a deficit of US\$ 1,061 mn in 2011, to a surplus of over US\$ 100 mn in 2012
- The BOP is expected to strengthen further in 2013 and beyond, with the gradual recovery of trading, services and investment partners across the globe



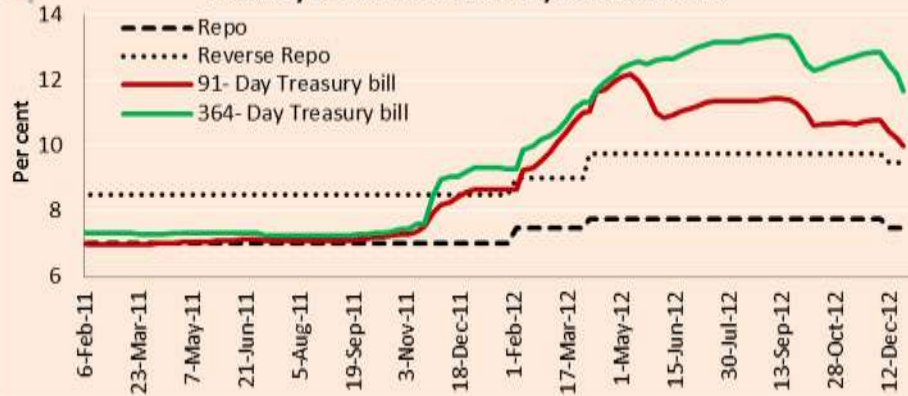
During the year, higher policy rates, credit ceiling & lower levels of liquidity led to higher market interest rates, curtailed rapid increase in credit & checked import demand...

Movement of Selected Market Interest Rates

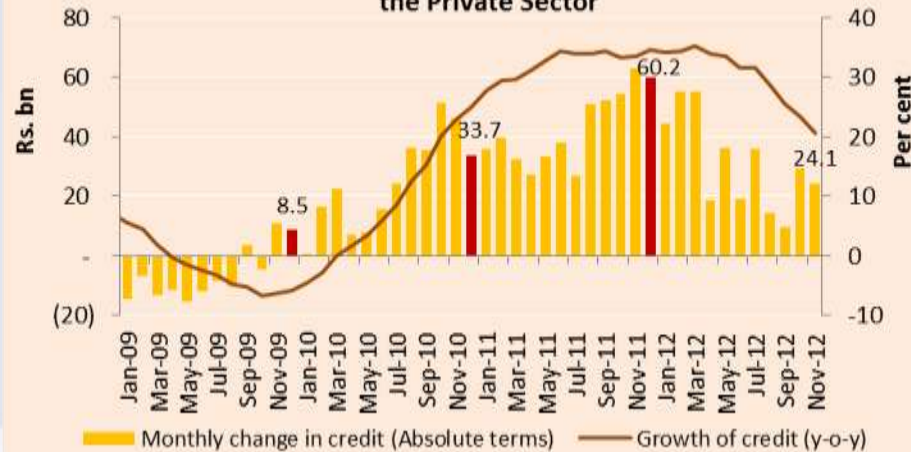


- **Growth in private sector credit, which increased rapidly since the latter part of 2010 and continued until Q1 2012, declined thereafter**

Treasury Bill Rates and Policy Interest Rates

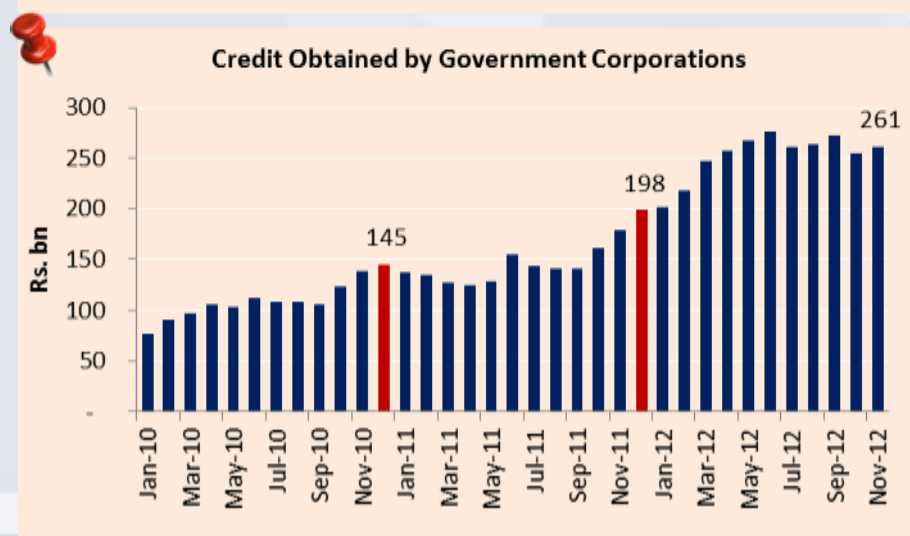
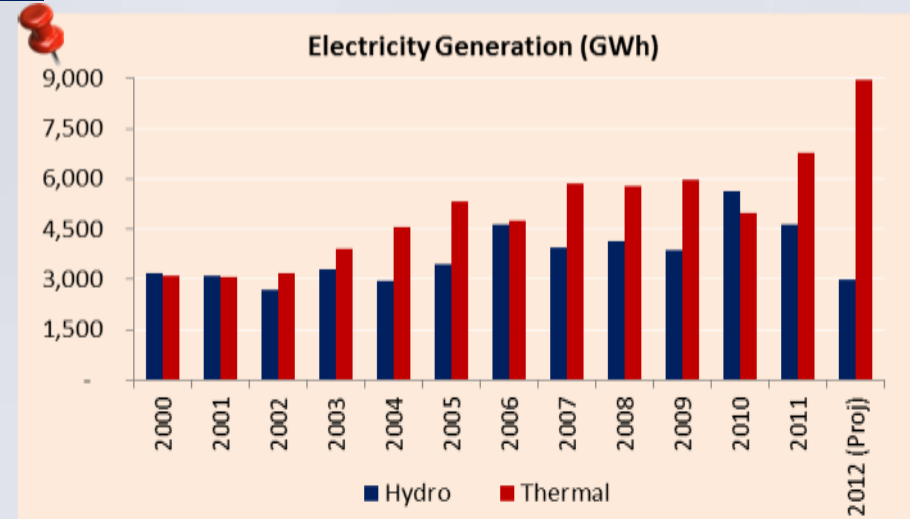


Credit granted by Commercial Banks to the Private Sector



However, in spite of significant price revisions, credit to public corporations increased in 2012...

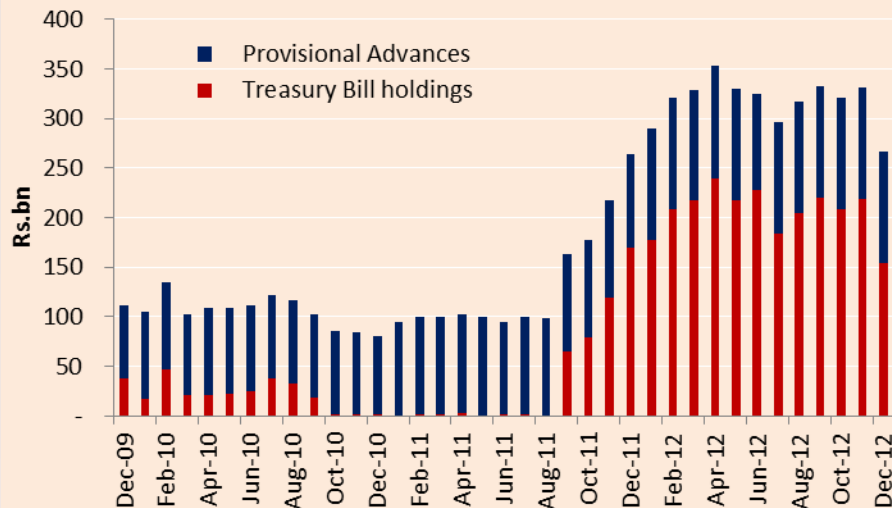
- Credit to public corporations increased by around Rs.63 bn.
- **Bulk of the increase was due to credit extended to CEB and CPC, as a result of:**
 - CEB's reliance on thermal power generation due to erratic weather patterns and continued drought.
 - **CEB's increased cost of generation and the re-imposition of the FAC did not offer sufficient relief to cover costs.**
 - CPC selling fuel at a loss to the transportation sector, and supplying fuel to CEB for electricity generation at well below cost.



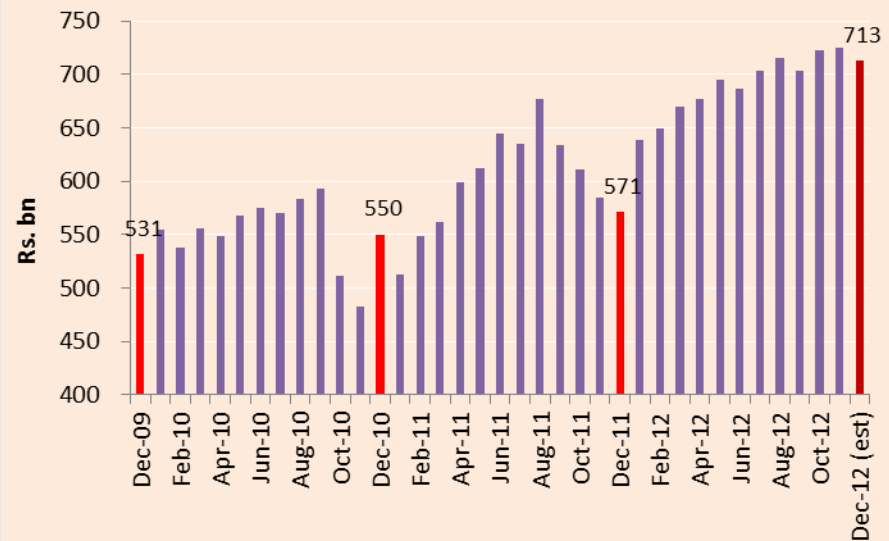
Net Credit to Government (NCG) also increased during 2012...

- The increase in NCG by Monetary Authorities was around Rs. 3 bn during 2012.
- The increase in NCG by LCBs is estimated to have been around Rs.142 bn during 2012.

CBSL Treasury bill holdings and Provisional advances to the Government



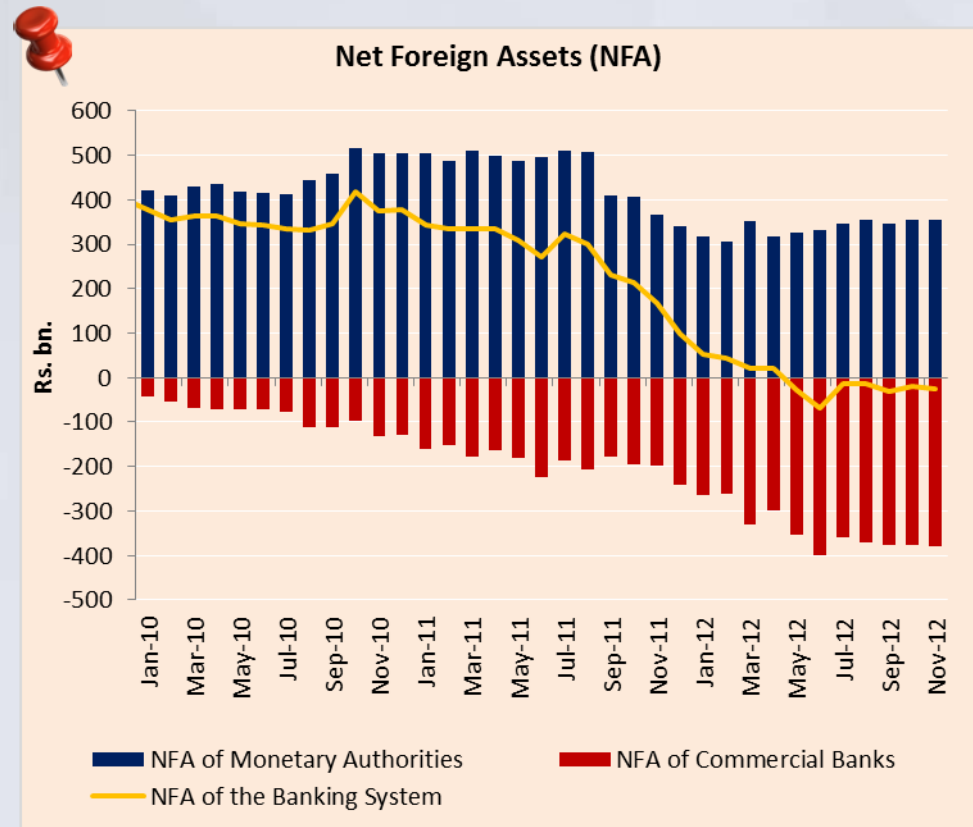
NCG by Licensed Commercial Banks (LCBs)



The banking sector utilised funds raised from abroad to facilitate domestic economic activity, resulting in a decline in Net Foreign Assets (NFA)...

- NFA of the banking system declined significantly by around Rs.122 bn during the first eleven months of 2012, following the decline in NFA of commercial banks.

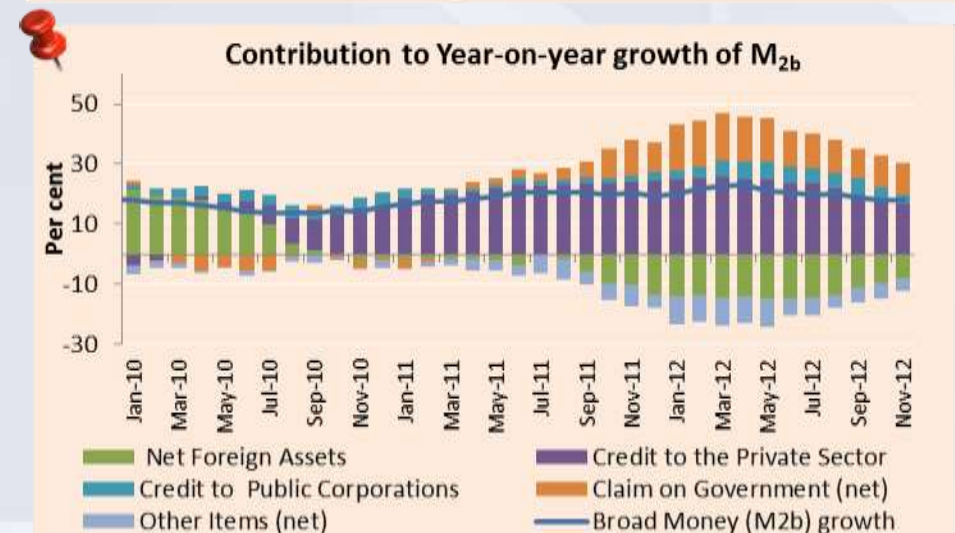
This decline was a reflection of the shift in commercial banks' foreign assets to domestic assets.



Monetary expansion was subdued and reached the targeted levels by end 2012...

- Broad money growth, year-on-year (y-o-y), was expected to decline to 16.2% by end December 2012, from a peak of 22.9% in April.
- Reserve money growth was in line with the projected path for 2012

Y-o-Y Growth of M _{2b} (%)		
Month	2011	2012
January	16.7	20.1
February	17.7	21.9
March	17.5	22.8
April	18.4	22.9
May	19.4	20.9
June	20.7	20.5
July	20.7	19.8
August	20.6	20.2
September	20.7	18.9
October	19.8	18.2
November	20.6	18.1
December	19.1	16.2 (proj)



As a result, it was possible to maintain inflation at single digit levels during the year (and cumulatively for 47 months), although supply side pressures were severe...

Inflation moved upwards during the year mainly due to:

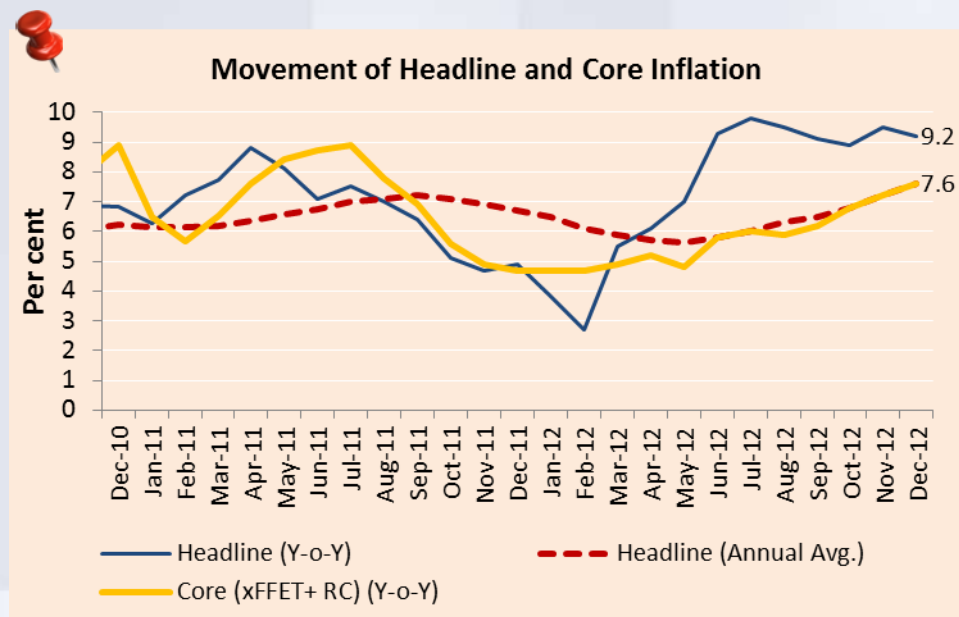
- Supply disruptions on account of drought conditions
- **Upward adjustments of several administratively determined prices**
- Upward duty revisions of several imported items
- **Pass-through of the depreciation of the rupee**
- High credit expansion in the past
- **Low base that prevailed in 2011**

Headline Inflation

- Annual average: 7.6% in Dec. 2012
- Year-on-year: 9.2% in Dec. 2012

Core Inflation

- Annual average: 5.8% in Dec. 2012
- Year-on-year: 7.6% in Dec. 2012



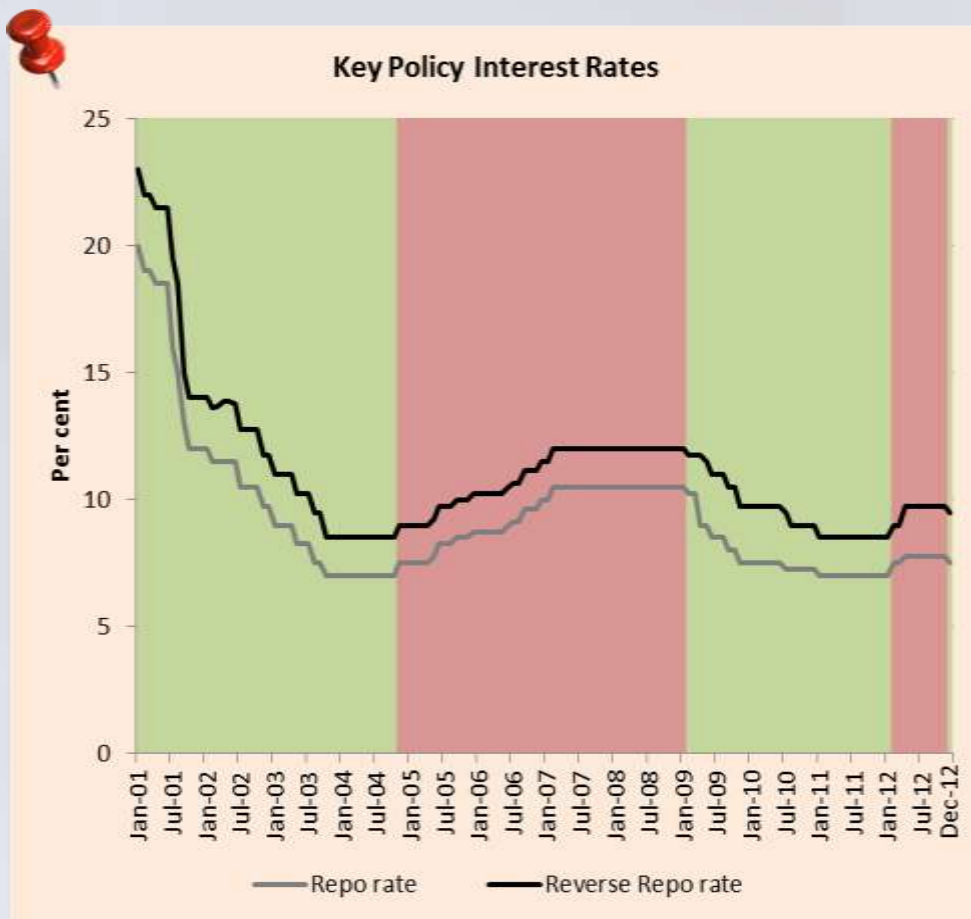
Towards the end of the year, with the tight monetary policy attaining the expected stabilisation objectives, some relaxation measures were possible and were effected...

- **Repurchase rate and the Reverse Repurchase rate were reduced by 25 basis points in December 2012**
- **Announcement was made that the credit ceiling will be allowed to expire at the end of 2012**

These measures are expected to stimulate the economy to return to a higher growth path this year while maintaining inflation around the targeted levels.



The multi-pronged policy package in early 2012, helped the economy get back on track swiftly, and to record the shortest tightening cycle since 2001...

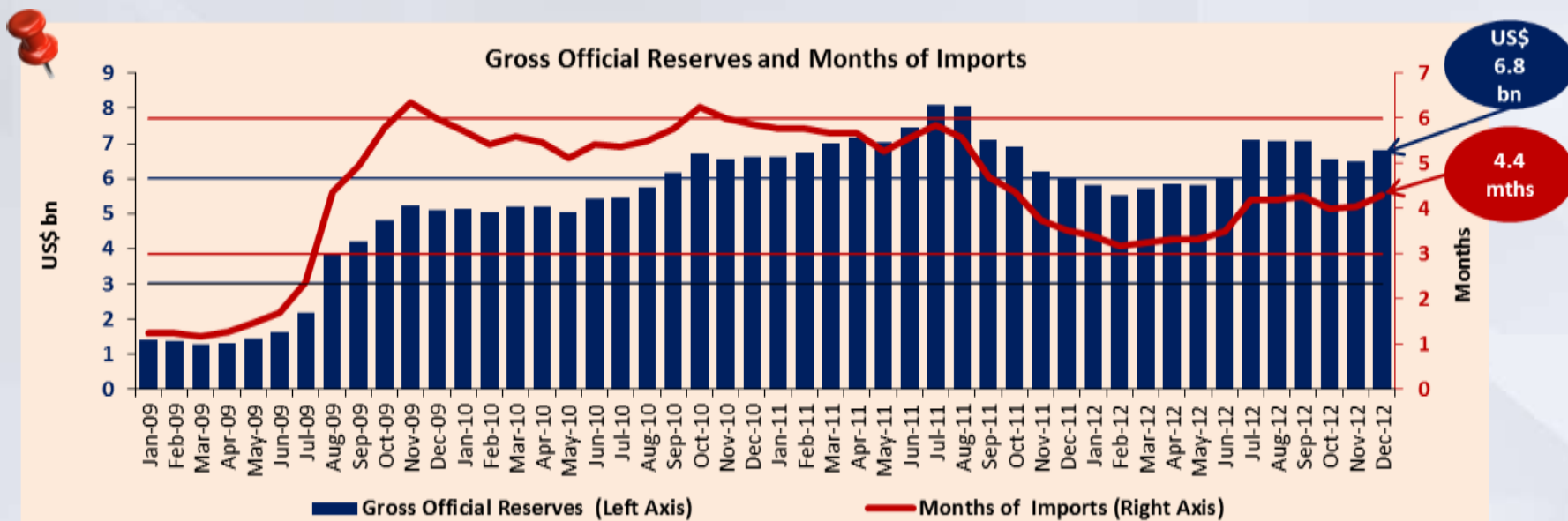


- Since 2001, Sri Lanka has completed two **tightening** and two **relaxing** cycles in terms of policy interest rates
- **The proactive measure of placing a ceiling on rupee credit expansion, considerably shortened the transmission lag.**



During the year, foreign reserve accumulation has been prudent... not too excessive nor too low...

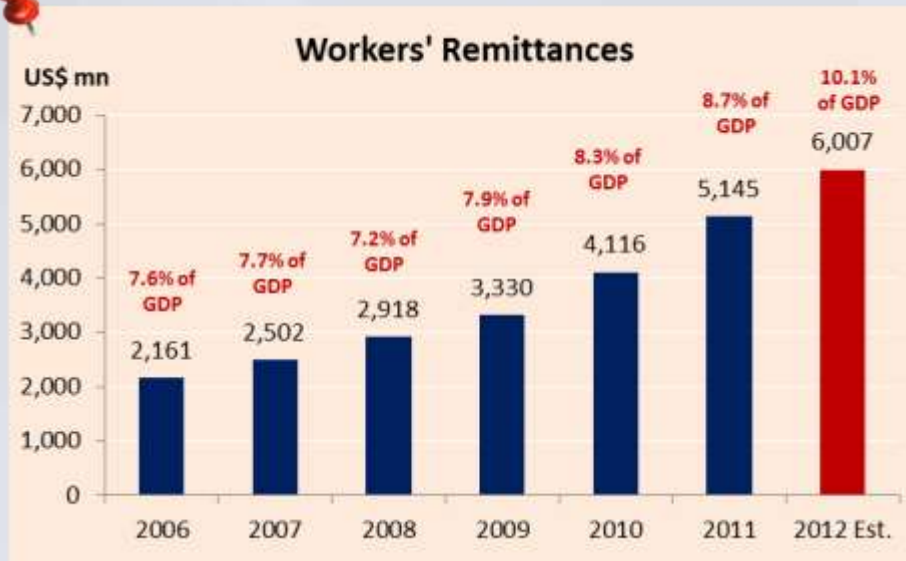
- Reserves, which were used for intervention during the first half to face external challenges and to effect an orderly adjustment, were shored up by the end of the year...
- Reserves improved to US\$ 6.8 bn by end 2012 from US\$ 6.0 bn by end 2011. This is equivalent to 4.4 months of imports.



The healthy reserve position was supported by the inflow of funds from foreign sources, which have been continuously encouraged in order to bridge the savings-investment gap...

In particular, workers' remittances increased significantly...

- Workers' remittances are estimated to be around US\$ 6 bn in 2012, up by 16.8% from US\$ 5.1 bn in 2011
 - As a percentage of GDP: 10%
 - As a percentage of external current receipts: 30%



Main reasons for the increase:

- Incentives to encourage Sri Lankan migrants to open NRFC accounts
- Expansion in global branches of Sri Lankan commercial banks and ATM network mainly in the Middle East, Australia, France, Canada and Singapore
- Setting up of new exchange centers in Canada, Malaysia, Japan, Cyprus and Singapore
- Introduction of new web based products supported by the latest technology such as "People's eRemittance"
- Departures for foreign employment during the first half of 2012 stood at 139,092, which is an increase of 9.9%
- Increase of migrant workers of the professional category by 33%

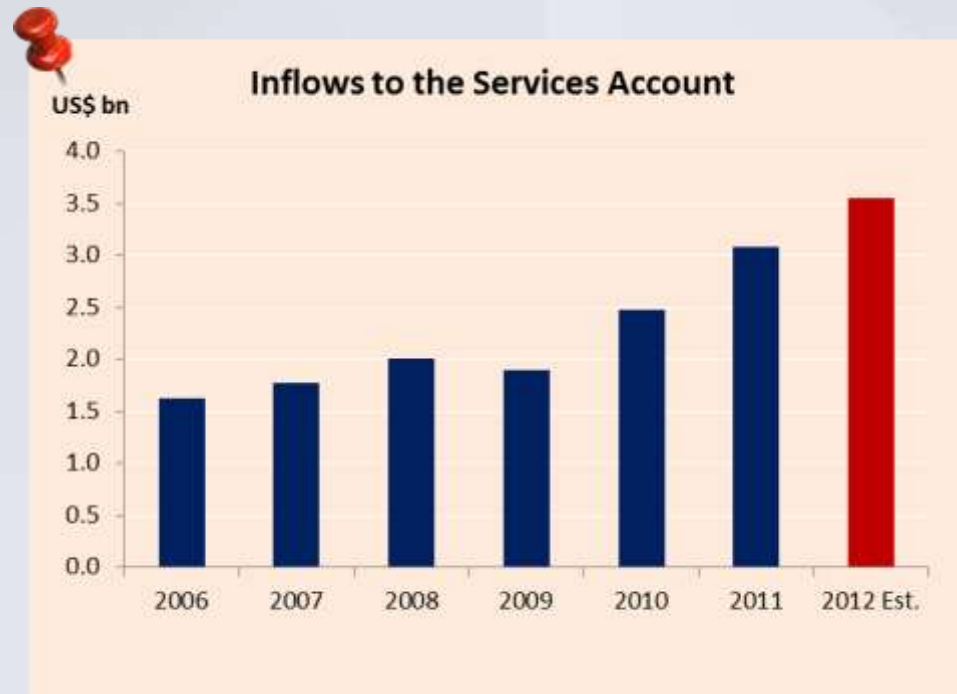


The high level of inflows on account of emerging services, also buttressed the current account...

Foreign exchange inflows on account of emerging services such as export of software and Information Technology Enabled Services (ITES), helped to support the current account substantially...

- **Presently, there are over 400 IT and IT enabled entities with international recognition operating in Sri Lanka**
- **The Sri Lankan ICT/ BPO industry is among the top 5 export revenue earners for Sri Lanka, employing a workforce of 35,000, with exports amounting to over US\$ 600 mn**

Sri Lanka's ICT/BPO industry is set to achieve the target of reaching US\$ 1 bn in exports by 2015 with an estimated workforce of over 80,000



In addition, other inflows to the capital and financial account were timely and significant...

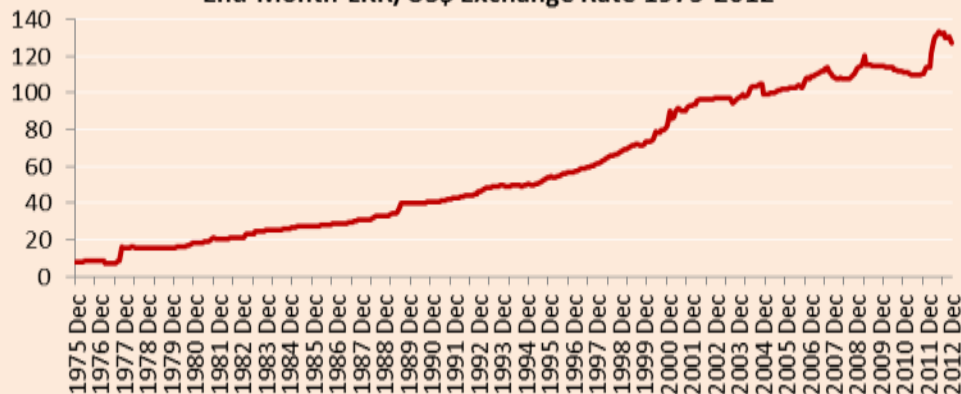
- Net portfolio investments inflow (2012): US\$ 305 mn.
(In 2011, an outflow of US\$ 171.5 mn was recorded)
- **Project loans to the Government (excluding sovereign bond proceeds): US\$ 1.6 bn (Jan–Oct)**
- Net inflows from sale of Government securities: Treasury Bills + Treasury Bonds (2012): US\$ 843 mn
- **Receipt of Government Grants: US\$ 124 mn (Jan–Oct)**
- Foreign Borrowings by the Commercial Banks: US\$ 973 mn (Jan–Nov)
- **Sovereign Bond receipts: US\$ 1 bn**
- Corporate Sector inflows: US\$ 307 mn (Jan–Sep)



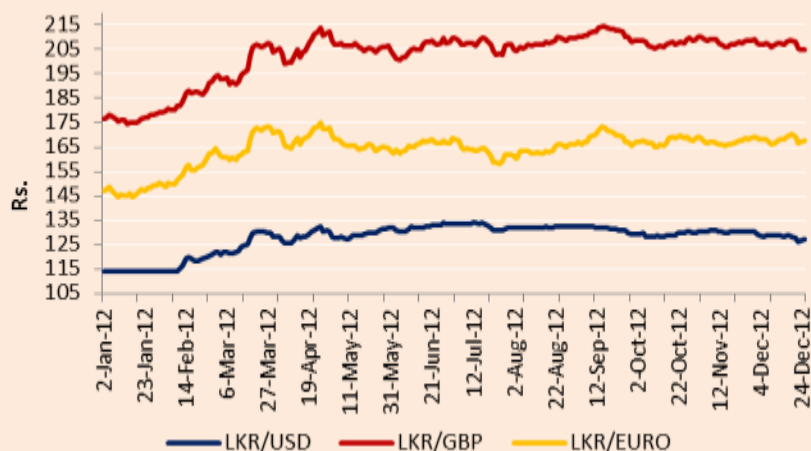
A robust and flexible exchange rate policy had been implemented, which has given consideration to all key aspects of the economy..

- Overall, the rupee depreciated against the US dollar by 10.4% in 2012, reflecting the increased demand for forex in the market, due mainly to oil imports
- However, since June 2012, the rupee appreciated by 5.3%, and is expected to stabilise over the medium-term

End-Month LKR/US\$ Exchange Rate 1975-2012



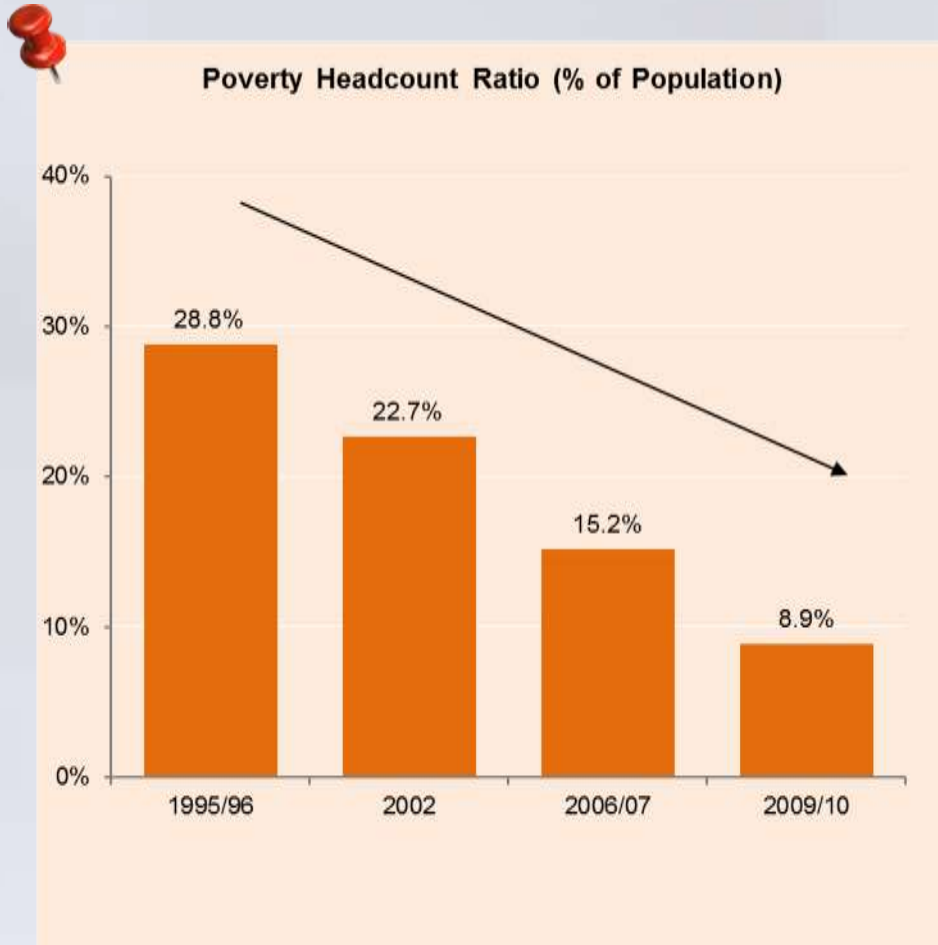
LKR Movements against US\$, GBP, and Euro



Rupee depreciation against the US\$ 1975-2012



Poverty alleviation and inclusive growth have been given high priority while socio-economic factors have been improving constantly and consistently...



The dominance of the Western Province is diminishing and the contribution by other provinces to GDP is on the rise...

Provincial Share of GDP

Province	2000	2005	2011
Western	49.6	50.8	44.4
Central	9.4	8.5	9.8
Southern	9.4	8.9	11.1
Northern	2.2	3.0	3.7
Eastern	4.5	4.7	5.7
North Western	10.4	8.9	10.0
North Central	3.9	4.3	4.6
Uva	3.9	4.5	4.5
Sabaragamuwa	6.7	6.4	6.2



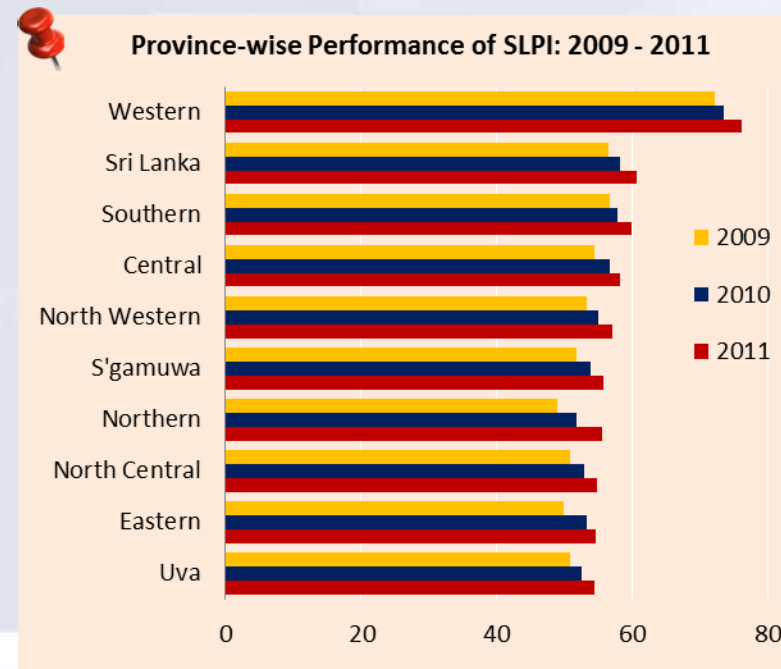
Prosperity as tracked by the Sri Lanka Prosperity Index (SLPI) has increased over the years...

Indicator	2009	2010	2011	Growth 2010/11
Sri Lanka Prosperity Index	56.5	58.2	60.6	4.1
Economy & Business Climate	66.0	67.4	70.1	4.0
Well Being of the People	52.5	54.4	56.4	3.6
Socio-Economic Infrastructure	50.9	52.8	55.4	4.9

- Improvements have taken place in all sub-indices. But the highest improvement has been in the Socio-Economic Infrastructure sub-index
- Prosperity has improved in every province during this period

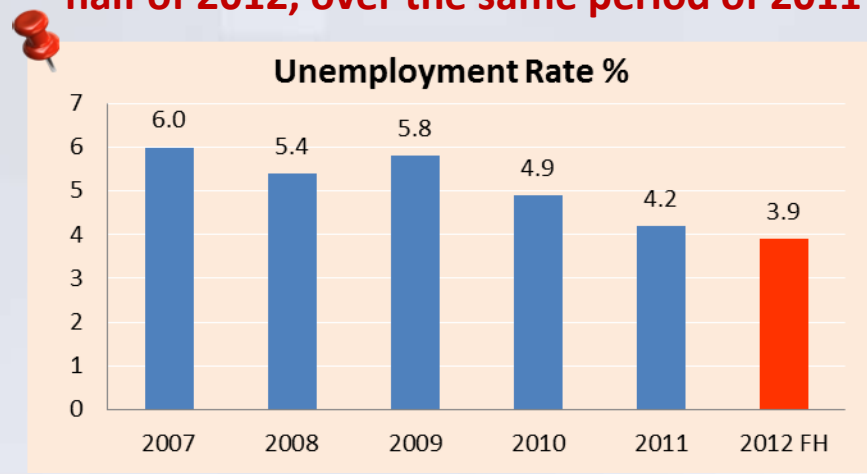
Variables of the Sri Lanka Prosperity Index

1. Per capita GDP
2. Employment Rate
3. Informal Sector Wages
4. Percentage of Poor Households
5. All Island/Provincial CPI
6. Number of Industrial Enterprises per 1,000 Population (Density)
7. Number of Bank Branches per 100,000 Population (Density)
8. Government Hospital Beds per 1,000 Population
9. Government Medical Officers per 100,000 Population
10. Low Weight Births per 1,000 Live Births
11. Schools per sq km
12. Pupil Teacher Ratio
13. Dropouts from Secondary Education (Secondary School Attainment)
14. G.C.E O/L Pass Rate and Number of University Admissions per 100,000 Population
15. Percentage of Schools with English Medium Classes
16. Number of Vehicles per 1,000 Population
17. Number of Supermarkets per 1 Million Population
18. Average number of Film-goers per Month as a Percentage of Population
19. Number of Persons Treated for Respiratory Diseases per 1,000 Population
20. Per Capita Mosquito Coil Usage
21. Per Capita Electricity Usage
22. Number of Telephone Connections per 1,000 Population
23. Road Density
24. Number of Reported crimes per 1,000 Population
25. Percentage of Schools with Safe Drinking Water Facilities
26. Percentage of Schools with Computer Facilities

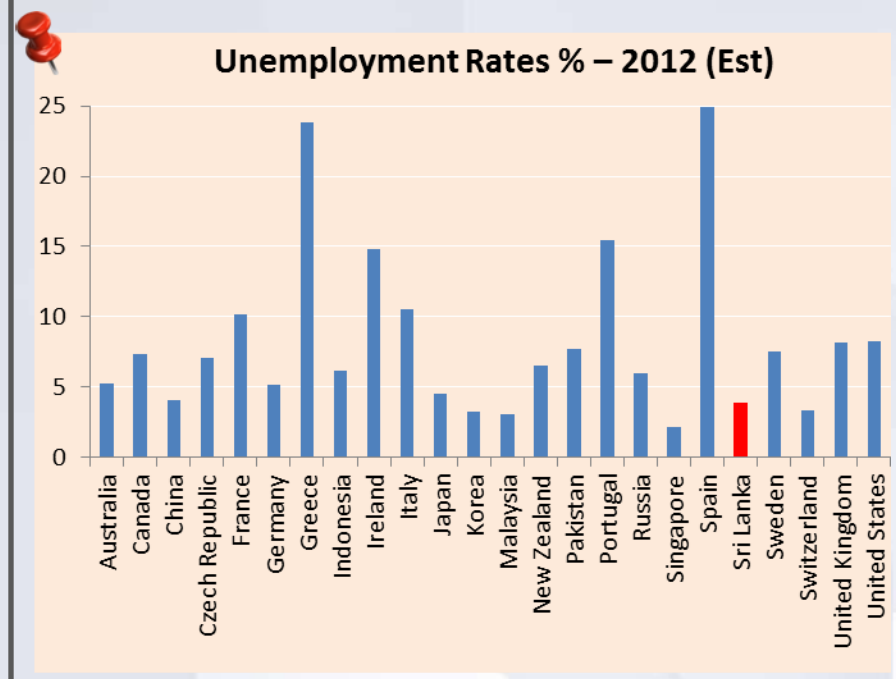


At the same time, unemployment reached its historically lowest rate...

- **Unemployment rate declined to 3.9% in first half of 2012 due to:**
 - Continued employment generation due to expansion of economic activities
 - **Increased employment in the Industry sector, particularly construction**
 - Unemployment declining among more educated categories (GCE A/L and above)
 - **Total number of departures for foreign employment increased by 7.7% in the first half of 2012, over the same period of 2011**



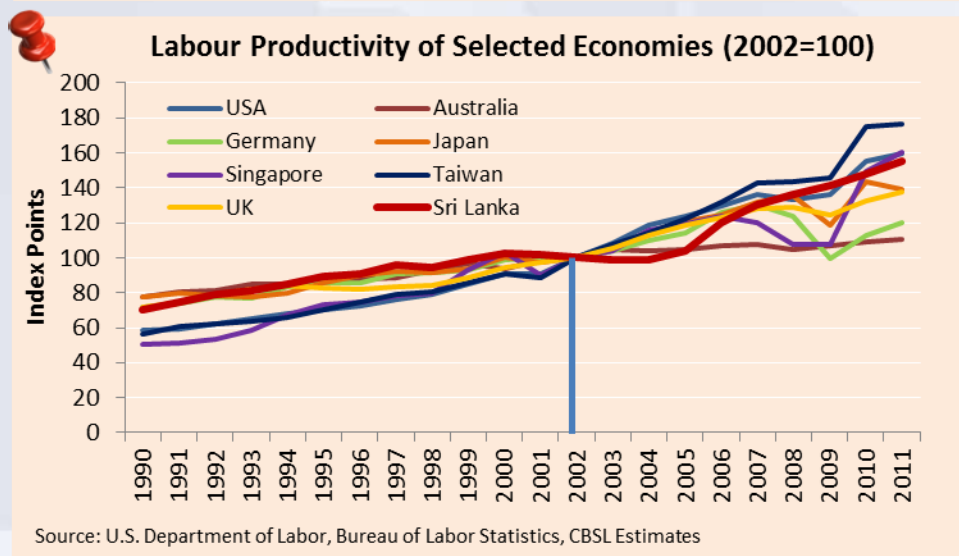
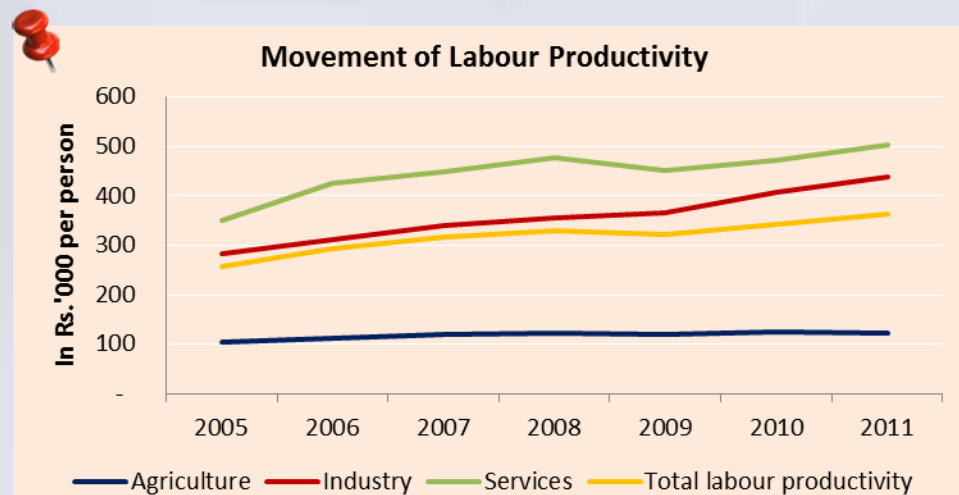
These developments were in contrast to the experiences of other economies



Labour productivity also improved, but continued improvements are necessary...

- Overall labour productivity, measured by GDP per worker, has been improving
 - Industry and Service sectors recorded growth in productivity
 - However, labour productivity in the Agriculture sector remains low

With declining unemployment and rising relative wages, improving labour productivity to spur economic growth has become increasingly important.

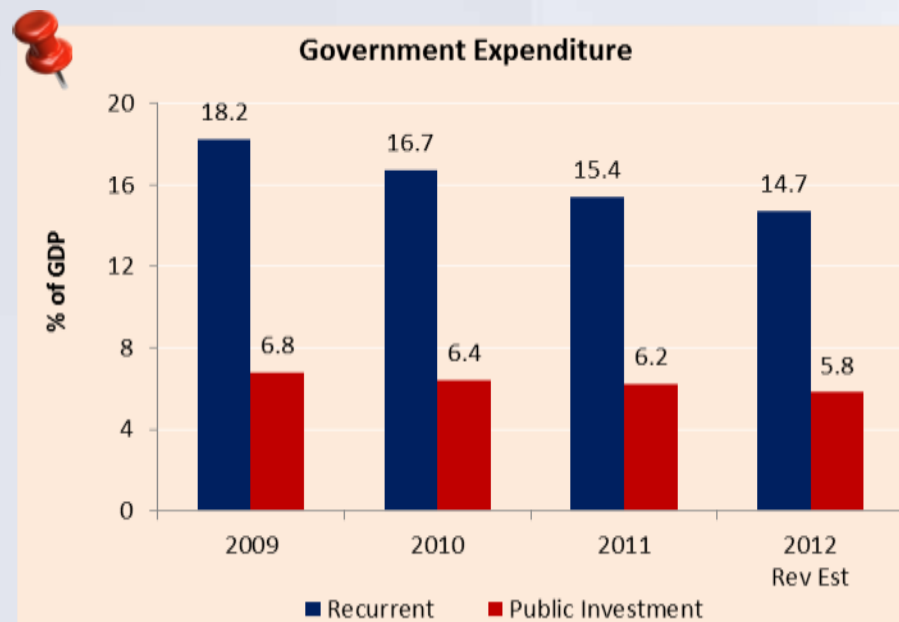
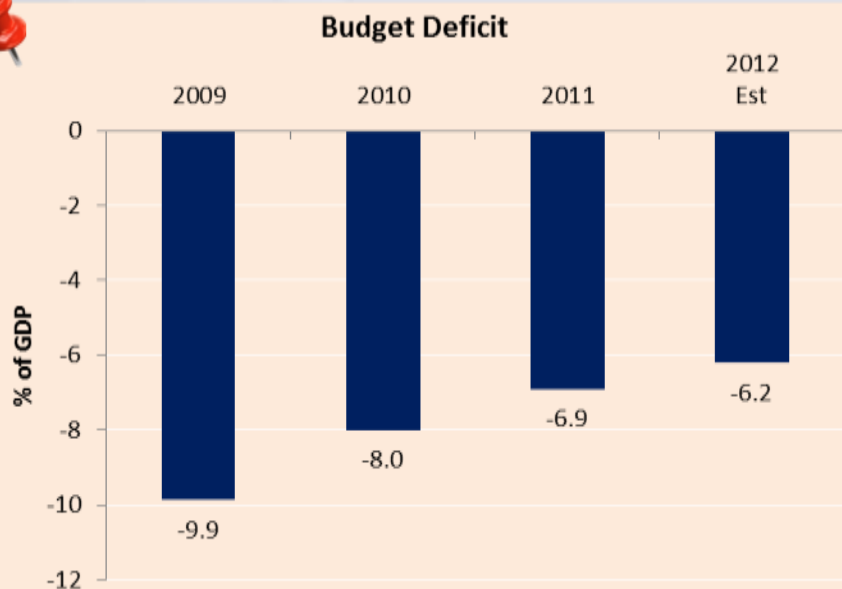


Source: U.S. Department of Labor, Bureau of Labor Statistics, CBSL Estimates



A serious commitment has been made by the Government towards sustainable fiscal consolidation...

- The overall fiscal deficit is estimated to be 6.2% of GDP in 2012, down from 6.9% of GDP in 2011, mainly due to expenditure rationalisation policies
- Recurrent expenditure declined, while public investment was maintained at a level to sustain the targeted growth momentum



As a direct result of the public investment, massive infrastructure projects have transformed the country...



– Road development projects

- The Southern Expressway Project - 126 km *(Phase 1- Completed, Phase 2 – completion 2013)*
- The Colombo - Katunayake Expressway - 26 km *(Completion 2013)*
- The Colombo Outer Circular Highway Project – 29 km *(Phase 1- Completion 2013)*
- Colombo – North/East Highway Project *(Feasibility study in progress)*
- Kandy – Badulla Alternate Highway Project – 34 km *(Feasibility study done)*



– Power projects

- 900 MW Norochcholai Coal Power Plant *(Phase 1 (300 MW) – Commissioned, Phase 2 - completion 2014)*
- 120 MW Uma Oya Hydro Power Project *(Completion 2015)*
- 500 MW Sampur Coal Power Project *(Completion 2017)*
- 20 MW Moragahakanda and Kaluganga Reservoir Project *(In Progress)*



– Port development projects

- The South Colombo Harbour Project *(Phase 1 Completion 2013)*
- The Hambantota Port Development Project *(Phase 1 - Completed, Phase 2 – completion 2015)*
- The Oluwil Port Development Project *(Completion 2013)*
- The Kankasanthurei Port development Projects *(In progress)*



– Airport development projects

- Second International Airport at Mattala *(Completion 2013)*
- BIA Expansion Project *(In progress)*
- Domestic Airport Development – Ampara, Koggala, China-Bay, Jaffna and Ratmalana

– Ongoing rural infrastructure development projects

- Gama Neguma, Maga Neguma, Small Irrigation projects and Kirigamma projects

– Lighting Sri Lanka (Target - 100% electrification by 2013)

– Several mega hotel projects, condominiums, shopping malls, development of Northern and Eastern provinces, and water supply projects

The **5-hub** concept introduced in *Mahinda Chintana*, has been gaining ground while tourism has emerged as a key thrust industry...



Tourist arrivals and earnings have been on target for 2012 & beyond...

- Tourist arrivals increased by over 17% to 1,003,000
- **During 2012, earnings from tourism is expected to have increased by 24% to US\$ 1,029 mn.**
- Targets for Tourism Sector by 2016, now seem more realistic:
 - Tourist arrivals: 2.5 mn
 - Foreign Direct Investment in Tourist related projects: US\$ 3 bn
 - Tourism related employment: 500,000 persons
 - Foreign exchange earnings: US\$ 3.5 bn

- Many accolades have been received from reputed media:

“Best place to visit in 2013” – *Lonely Planet*

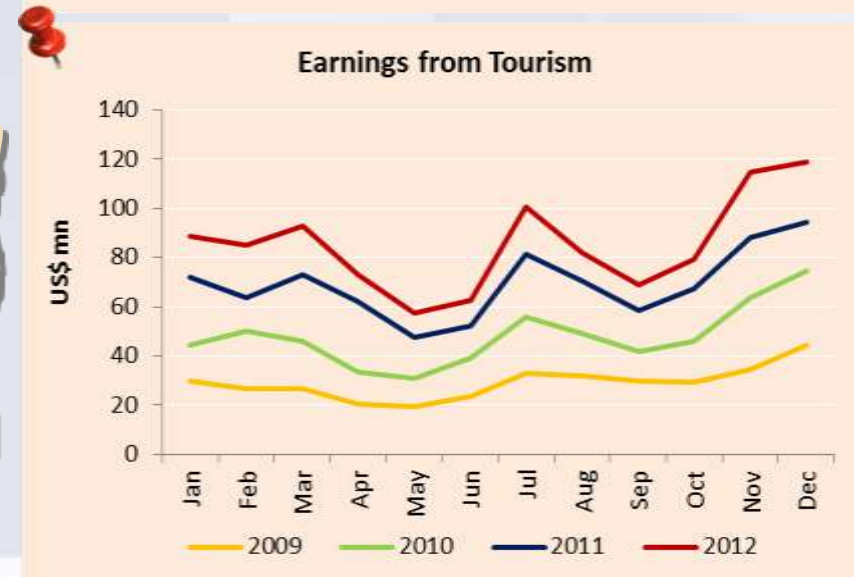
Among six best of the world 2012 destinations

– *National Geographic Traveler Magazine*

Ranked 3rd hottest new holiday destination to travel in

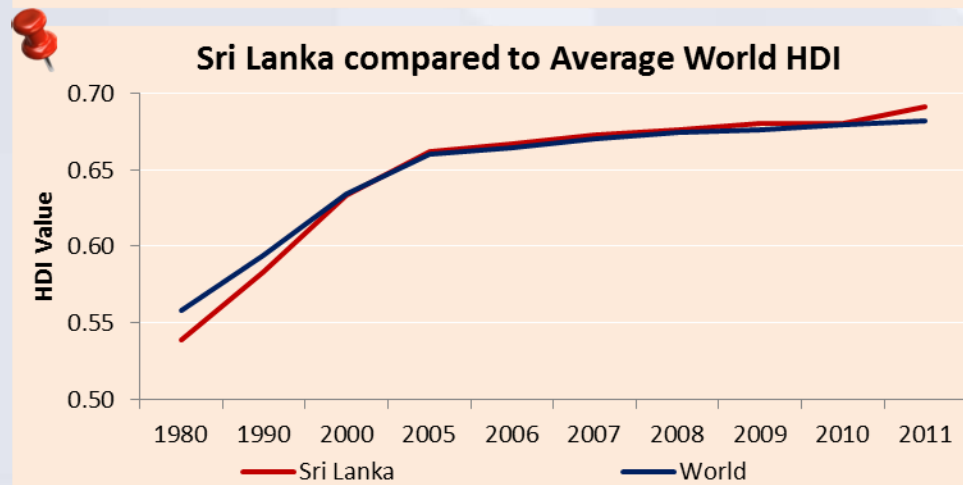
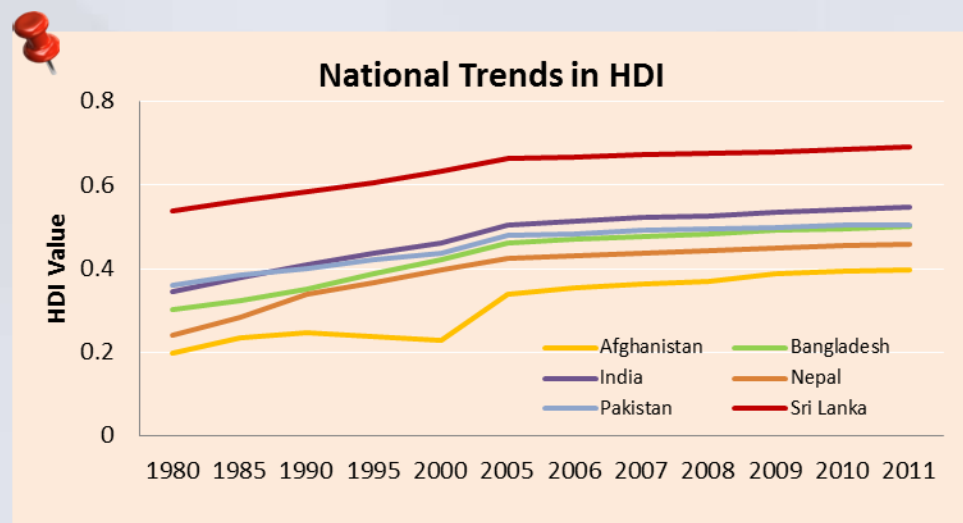
2012 – *Condé Nast Traveller Magazine*

Best destination to visit in 2013 – *British Airways*



At the same time, Sri Lanka's HDI Ranking has now reached the best level in South Asia, and is above the world average...

- Sri Lanka is the highest ranked in South Asia
- Sri Lanka is ranked 97 out of 187 countries
- Sri Lanka's ranking in the Global Prosperity Index also increased with the ranking moving up to the 58th from the 63rd position



“Doing Business” indicators and other international ratings have also recorded noteworthy improvements...

- **Doing Business Index rose to 81st (for 2013) from 89th (for 2012)**
- **Sri Lanka is the highest ranking country in South Asia and is the only country in the region to improve its ranking for 2013**
- **For the first time in 7 years, a South Asian country – Sri Lanka, ranks among those improving the most**

The 10 economies improving the most across 3 or more areas measured by Doing Business in 2011/12

	Economy	Ease of doing business rank
1	Poland	55
2	Sri Lanka	81
2	Ukraine	137
4	Uzbekistan	154
5	Burundi	159
6	Costa Rica	110
6	Mongolia	76
8	Greece	78
9	Serbia	86
10	Kazakhstan	49

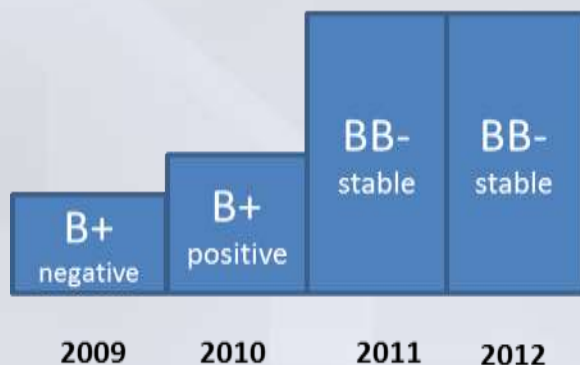
Sri Lanka’s position in World Indicators

	2009	2010	2011	2012
Index of Economic Freedom (Rank)	111	120	107	97
Corruption Perception Index (Rank)	97	91	86	79
Global Competitiveness Index (Rank)	79	62	52	68

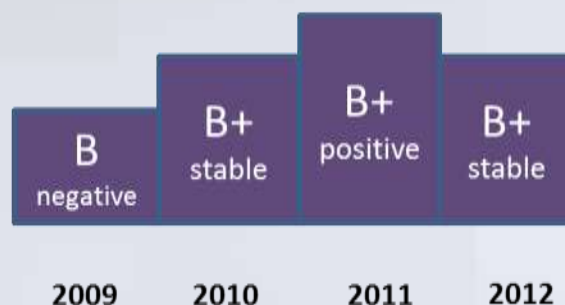


Sovereign credit rating was maintained in a year where many countries' ratings were downgraded...

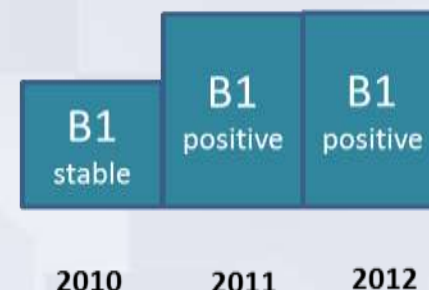
Fitch Ratings



Standard & Poor's



Moody's



Sovereign Downgrades during 2012

Fitch Ratings

South Africa BBB+ stable to BBB+ Negative
Spain A to BBB
Cyprus BBB to BB-
Slovenia AA- to A Negative
Belgium AA+ to AA
Egypt BB- to B+
Greece CCC to C
Japan AAA to AA+

Standard & Poor's

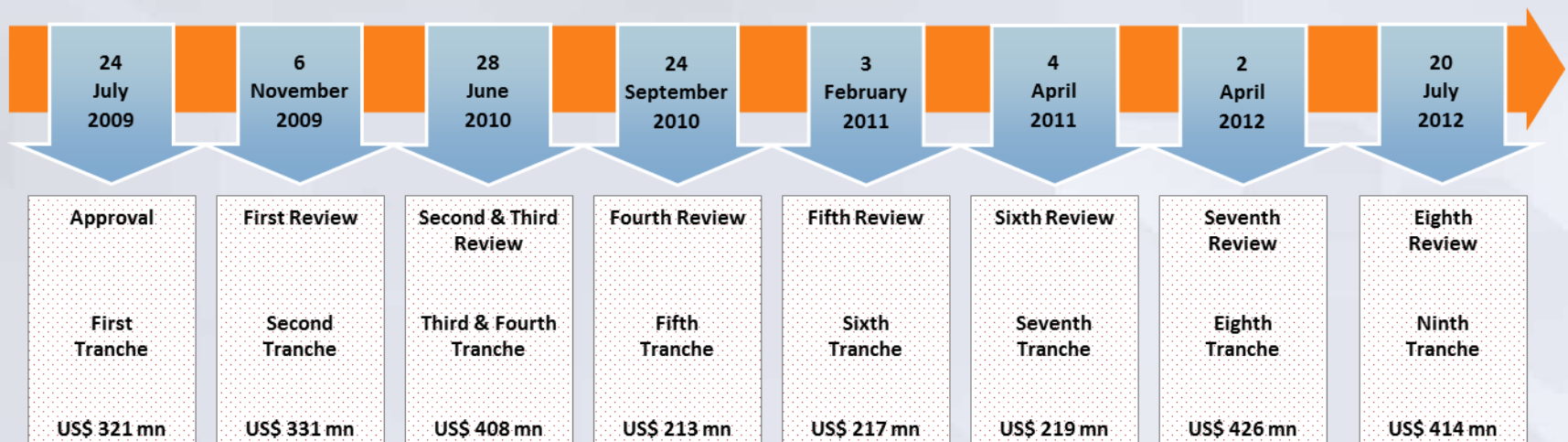
South Africa A to A-
Italy A to BBB+
France AAA to AA+ Negative
Spain AA- to BB-
Cyprus BBB to B
Portugal BBB- to BB Negative
Slovenia AA- to A
Egypt B+ to B
Argentina B to B-

Moody's

South Africa A3 to Baa1
France Aaa to Aa1
Spain A3 to Baa3
Cyprus Ba1 to B3
Greece Ca to C
Pakistan B3 to Caa1

The successful completion of the IMF - SBA was a significant milestone in the country's economic history...

- By July 2012, the IMF completed eight reviews and released the entirety of the facility totalling US\$ 2.55 bn, under the SBA

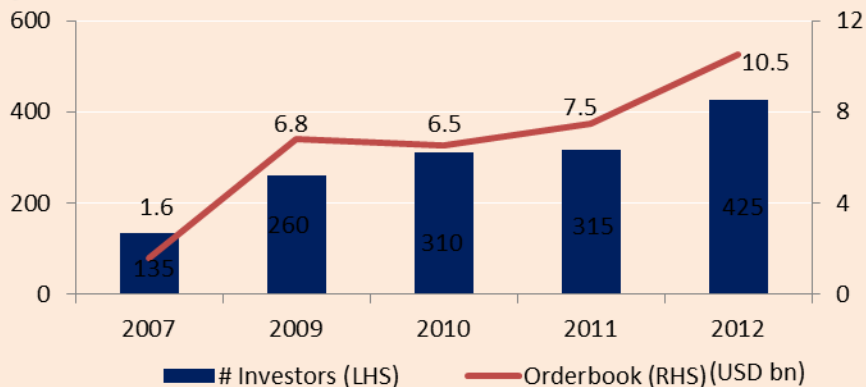


- Discussions will take place this year regarding the way forward in the country's future engagements with the IMF

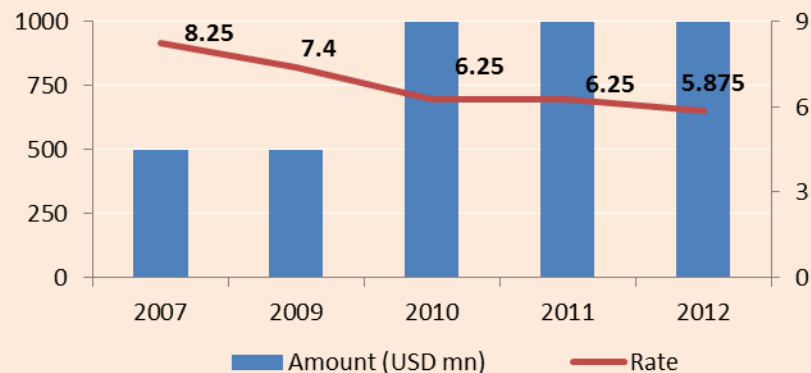


The growing confidence of overseas investors was evident from the performance of the fifth sovereign bond, which set a new benchmark...

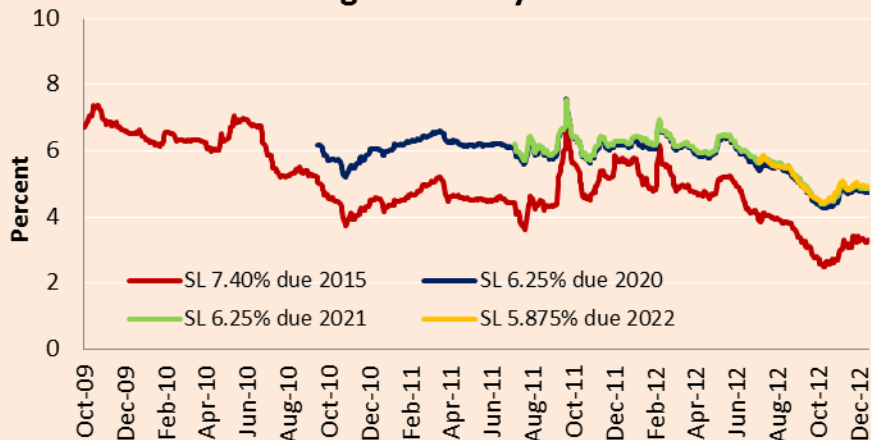
Increased Investor Base



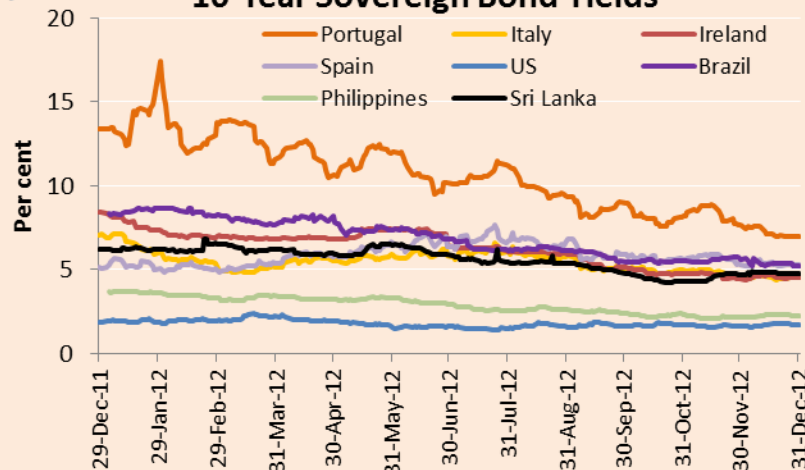
Progressive Reduction in Cost



Strong Secondary Market



10-Year Sovereign Bond Yields



Although somewhat slow, gradual adjustments took place in the two key SOEs, CPC and CEB...

Ceylon Petroleum Corporation (CPC)

- Domestic Petroleum prices were revised substantially in February 2012 and again in December 2012. These measures have served to reduce the losses of CPC, but still, significant losses are incurred.
- **Discussions are being held to extend suppliers' credit beyond 30 days, thereby avoiding/delaying the necessity to obtain foreign exchange loans from banks at market rates**
- Arrangements are being made to acquire crude oil and bulk petroleum through bilateral arrangements with oil producing countries. As a result, spot tenders and price hikes would be avoided.
- **Plans are being made to expand the existing refinery.**
- Measures are being taken to improve the product mix yield in the refinery, i.e., conversion of crude oil to yield greater output of high-end products such as diesel and petrol.

Ceylon Electricity Board (CEB)

- The Fuel Adjustment Charge (FAC) was introduced to recover fuel usage cost due to drought conditions. However, electricity is still being provided at subsidised prices and significant losses are incurred.
- **Action is continuously being taken to change the power generation mix in favour of less costly sources, such as hydro, wind and coal. Work on such power plants is already in progress.**

Urgent steps need to be taken to ensure that these two institutions reach at least break-even level by end 2013, in order to ensure their viability and to eliminate any imbalances being created in the banking sector



Improvements in other SOEs have been aimed at minimising losses and transforming loss making ventures into profit making institutions...

National Water Supply and Drainage Board

- Water tariffs were revised upwards to better reflect costs

Sri Lanka Railways

- Reduced recurrent expenditure using better management techniques.
- Deployed 30 new power sets
- Northern railway line was completed up to Omanthai
- Improvements to the southern railway line to enable high speed train services
- Southern railway line extension up to Beliatta is in progress

Sri Lanka Transport Board

- Procured 291 new buses and repaired 1,024 buses
- 13 luxury and 11 semi-luxury buses were deployed during 2012

Lanka Phosphate Limited

- Increased dividend payments to the Treasury in 2011/12.
- New machinery worth Rs.56mn installed
- Manufacturing capacity to be doubled

SriLankan Airlines

- Added more destinations and increased frequencies to existing destinations
- Increased the airline's fleet to benefit from tourism boom

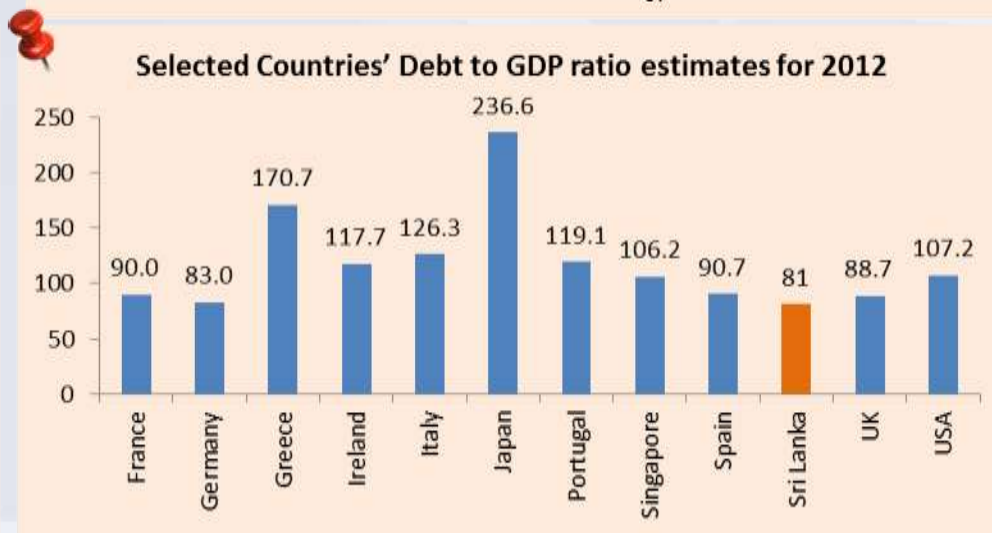
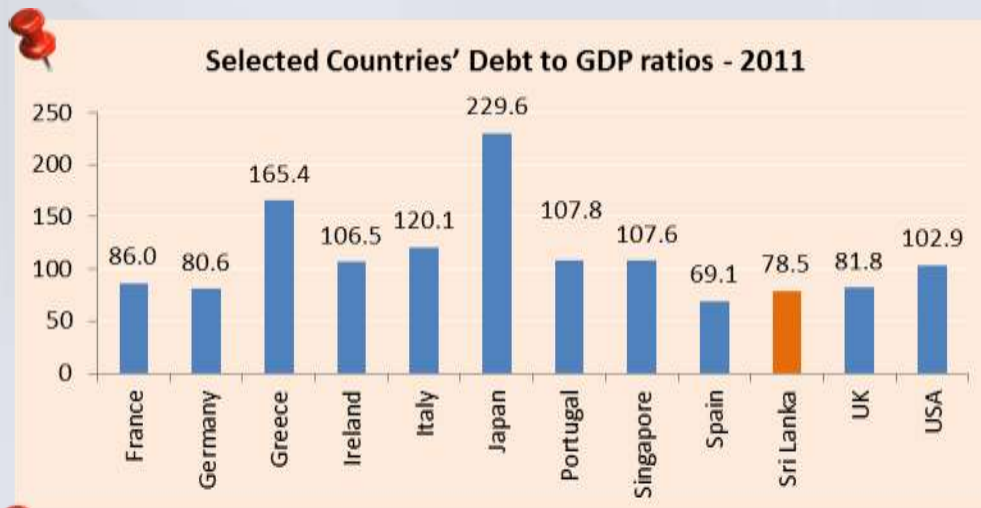
It is vital that these improvements are effected at a faster pace, in order to reduce/eliminate their dependence on Treasury funds, at least by the end of 2014



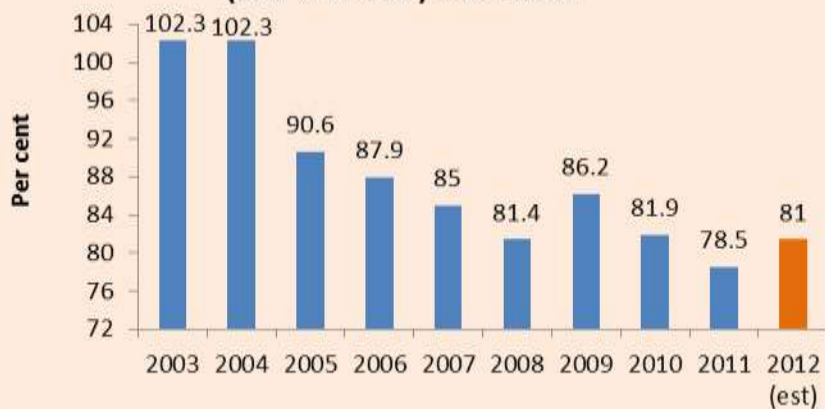
The Public Debt has been managed prudently, and the Debt to GDP ratio has been improving gradually...

- The debt to GDP ratio is estimated to be 81% in 2012, marginally higher than 78.5% of GDP in 2011.

This is mainly due to the one-off increase of about Rs.278 bn in the public debt on account of the depreciation of the rupee



Outstanding Government Debt (as a % of GDP) – Sri Lanka



The risk indicators of Sri Lankan public debt have also improved, at a time where global risk has been rising...

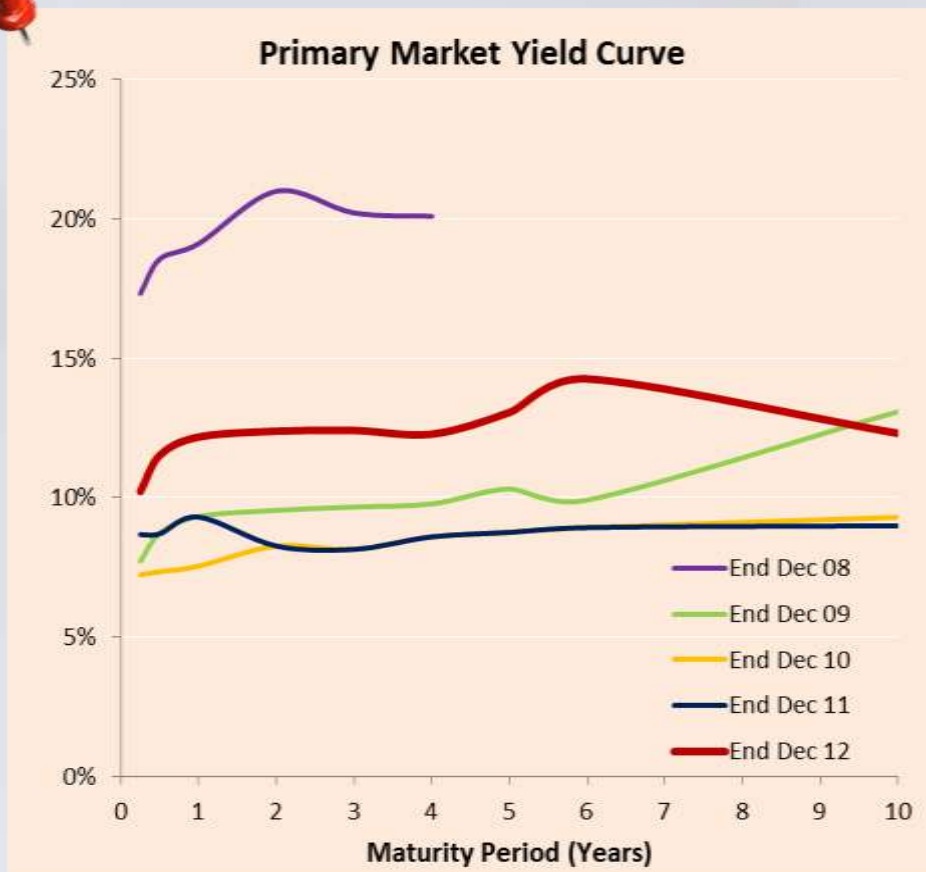
Indicator	UN-ESCAP Definition Levels			Sri Lanka 2012
	Less Indebted	Moderately Indebted	Highly Indebted	
Disbursed External Debt Outstanding/Gross National Income	<30%	>30% and <50%	>50%	37.0%
Disbursed External Debt Outstanding/Exports of Goods and Non Factor Services	<165%	>165% and <275%	>275%	112.6%
Total External Debt Service Payments/Exports of Goods and Non-Factor Services	<18%	>18% and <30%	>30%	10.7%
External Interest Payments/Exports of Goods and Non-Factor Services	<12%	>12% and <20%	>20%	3.7%
Net Present Value of External Debt/Gross National Income	<48%	>48% and <80%	>80%	40.0% *
Net Present Value of External Debt/Exports of Goods and Non- Factor Services	<132%	>132% and <220%	>220%	130.0% *

* Data for 2011

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



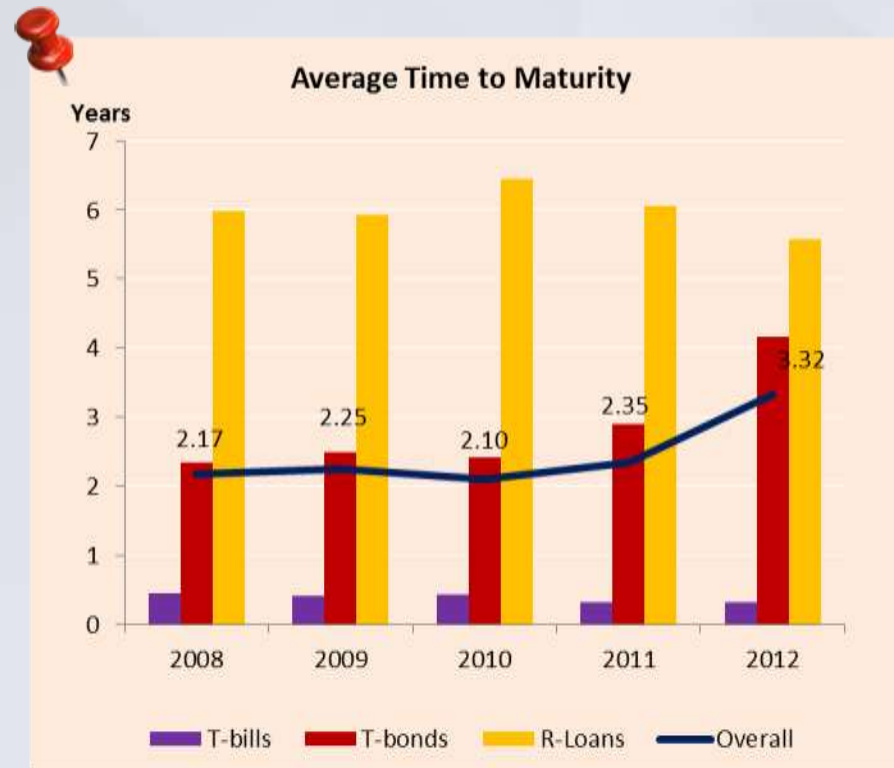
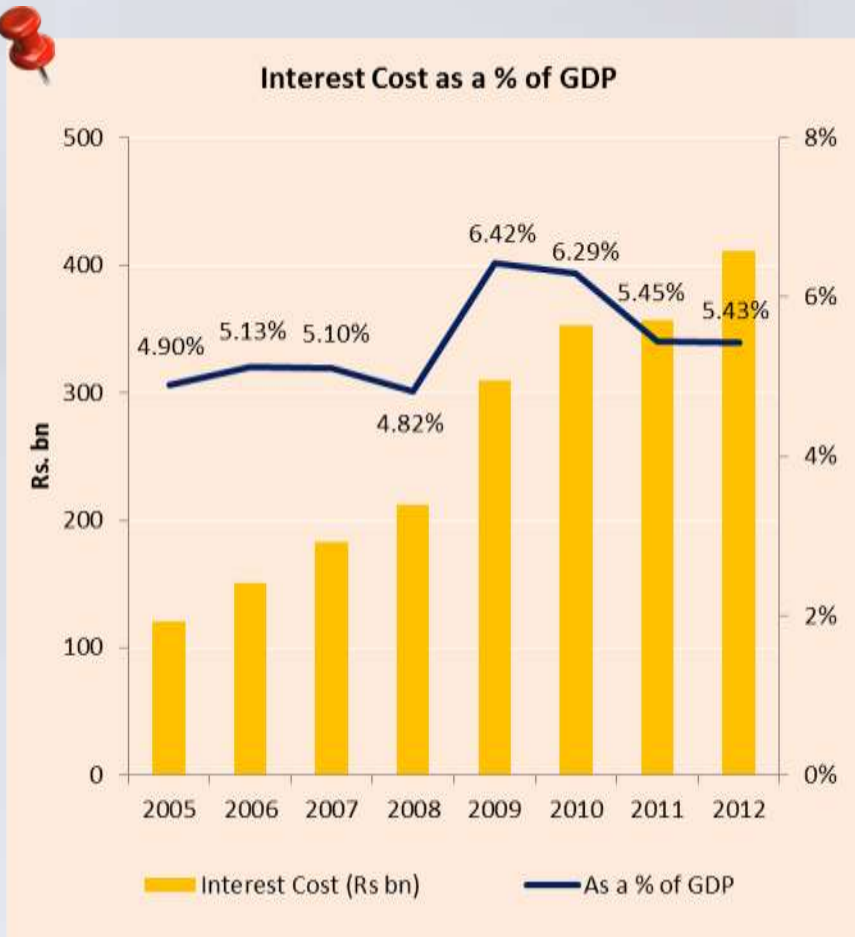
However, the cost of domestic debt portfolio increased for most part of the year, but started moderating towards the latter part of the year...



- Due to the tight monetary policy conducted by the Central Bank and increased investor preference for short term securities, the overall average interest rate of Treasury bills and Treasury bonds increased during the first four months of 2012.
- **However this trend reversed during the latter part of the year**



During the year, the interest cost as a percentage of GDP decreased marginally, while the average time to maturity of domestic currency debt improved...



Total interest cost as a percentage of GDP reduced marginally to 5.43% despite the depreciation of the Exchange Rate and the Interest Rate fluctuations throughout the year.



Despite challenges and shocks to the economy, Sri Lanka's financial system maintained stability, even while expanding...

- Stability and strength of the banking sector was maintained
- **Performance of financial institutions improved**
- Regulations were strengthened and streamlined
- **Efficiency of the Payment and Settlements system increased**
- Safety net mechanisms and consumer protection were further strengthen and developed

Expansion of Banking Outlets

Item	2008	2011	2012 (Provisional)
Bank Branches	1,782	2,130	2,193
Other Banking Outlets	3,646	4,054	4,103
ATMs	1,676	2,237	2,331

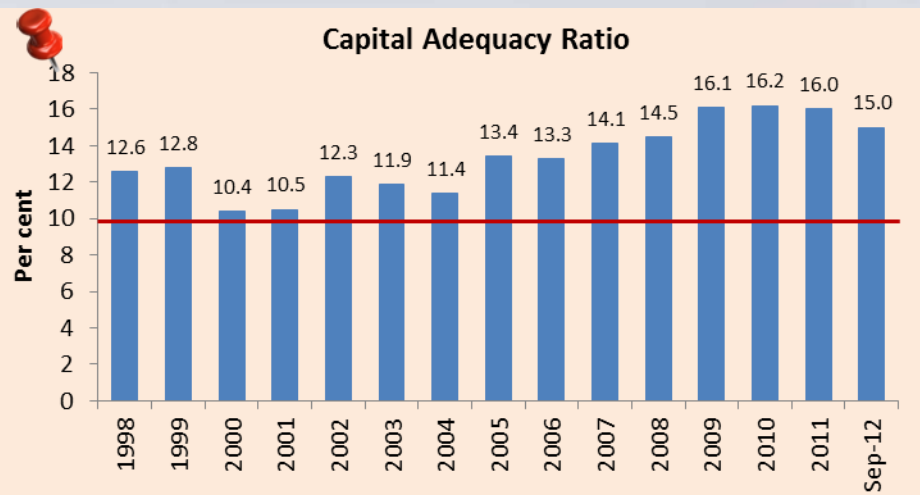


The Banking sector was responsive to the needs of the economy, and thereby helped achieve a more rapid and sustainable economic growth...

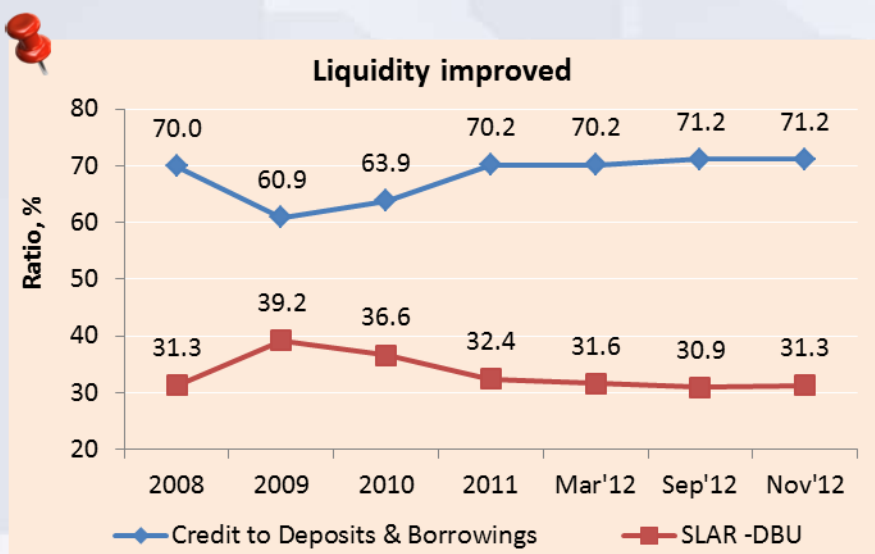
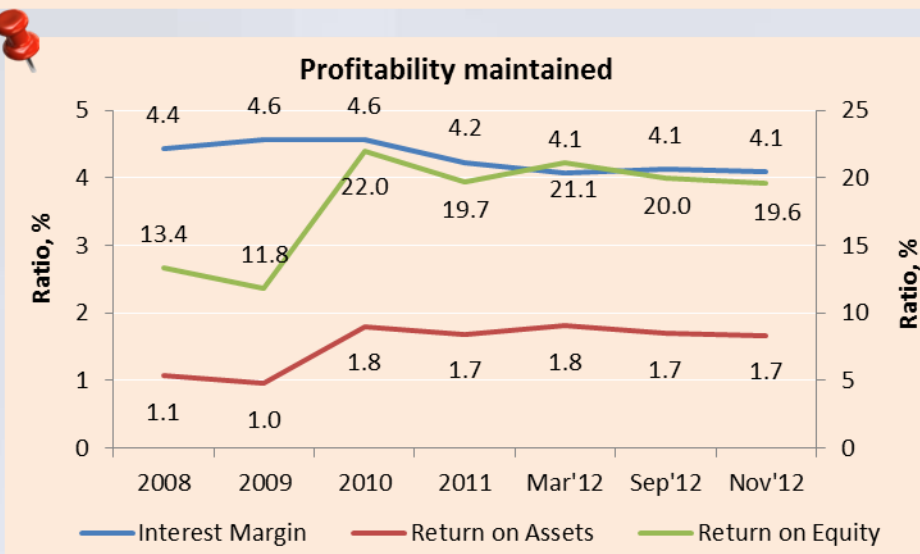
- The Banking sector has become increasingly competitive and strong during the recent years



Banking sector stability indicators improved, further consolidating the progress...

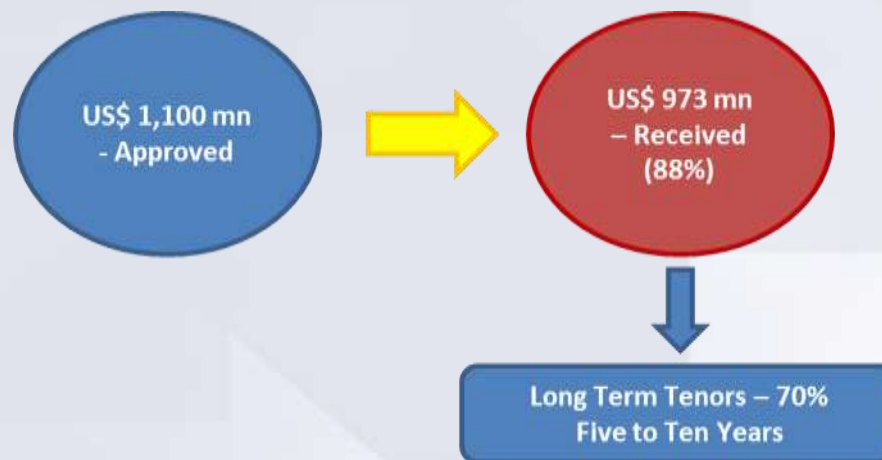


- Capital Adequacy Ratio (CAR) of banks was maintained at well over the minimum level of 10%
- **The Basel II Capital Adequacy Standards continued to be implemented and monitored.**
- Consultation paper on implementation of ICAAP and SRP under Pillar 2 of Basel II issued.



During the year, several banks successfully accessed international debt capital following the advice of the Central Bank to tap the international markets...

- Banks adopted an internationalised approach and used/leveraged their balance sheets more efficiently to meet the resource gap
- **Several banks secured a total US\$ 973 mn, of which 70% were long term borrowings**



Continuous supervision and quick guidance helped to ensure a stable, streamlined financial system...

- Speedy approval granted to open bank outlets islandwide
- **Reviewed current classification of banking outlets to streamline and rationalise approval procedure**



Safety net mechanism and consumer protection was strengthened...

- The Mandatory Deposit Insurance Scheme continued to grow and reached around Rs.8.9 bn by end 2012
- **Obligations of customers and banks were published in the form of a Customer Charter**
- Continuous monitoring took place to ensure adherence to Customer Charter



The massive campaign against Prohibited schemes continued during the year...

- Newspaper advertisements regularly listed institutions licensed to accept deposits
- **Extensive TV and Radio ad campaigns targeted Northern and Eastern provinces especially, in combating prohibited schemes**
- A framework was put in place to take action against prohibited schemes, in a systematic manner



ROAD MAP 2013

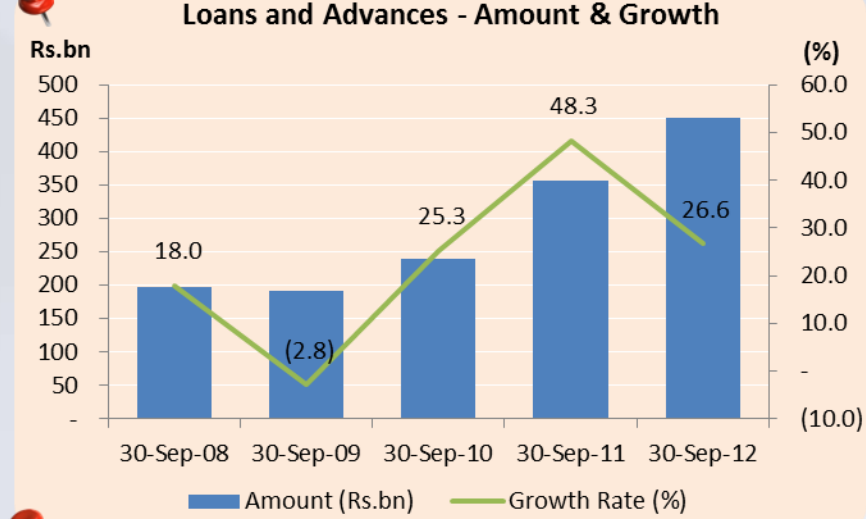
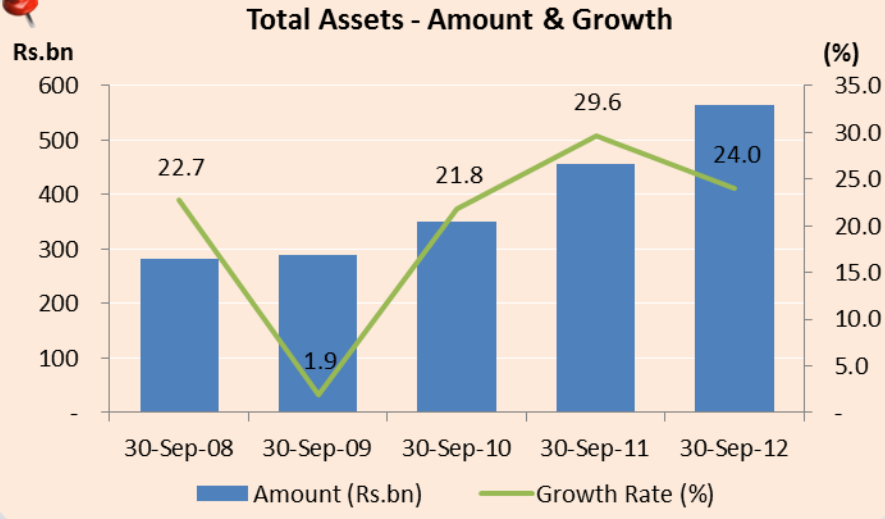
Monetary and Financial Sector Policies for 2013 and Beyond

A number of financial risk assessment techniques were developed to assist in the system stability analyses...

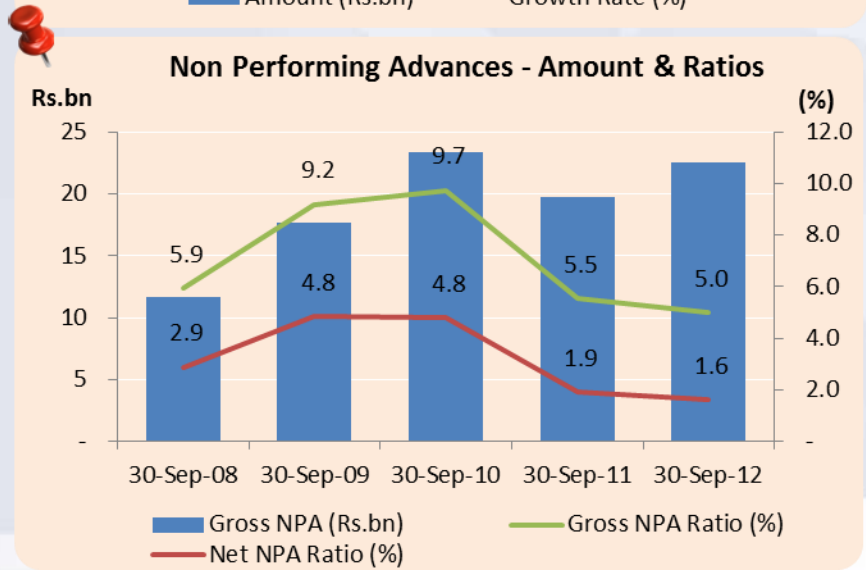
Test/Indicator	What it does...	Test is based on...
Sensitivity Stress Testing	Gauges resilience to shocks relating to credit risk, market risk, liquidity risk and exchange risk (Quarterly)	Information of individual banks and banking industry, relevant to each risk category
Macro Stress Testing	Assesses resilience of the financial system to extreme but plausible macroeconomic shocks (Quarterly)	Selected macro-economic variables and its impact on the asset quality of the banking sector
Banking Soundness Index (BSI)	Assesses the soundness (financial stability) of the banking sector (Quarterly)	Selected financial soundness indicators (capital, asset quality, profitability, liquidity, sensitivity to market risk)
Financial Market Stability Indicator (FMSI)	Assesses the stability of the financial markets over a period of time for any buildup of risks (Monthly)	Analysis of 10 variables associated with money and bond market, forex market and equity market
Macro-economic Stability Indicator (MESI)	Assesses macro-economic stability (Quarterly)	Analysis of key indicators of the real, external, fiscal and monetary sectors of the domestic economy and global developments
Financial System Stability Indicator (FSSI)	Quantifies overall financial system stability in Sri Lanka through a composite indicator (Quarterly)	Analysis of 3 major indices, BSI, FMSI and MESI



Non-banking sector assets & deposits improved...



- Deposits were the major source of funding, representing 41% of the total liabilities
- Capital Funds increased by 24% to **Rs. 84 bn**
- Loans and advances accounted for 80% of assets, of which, finance leasing and hire purchases accounted for around 72%
- Asset quality of the sector improved, with NPA ratio reducing from 5.5% in 2011 to **5.0%** in 2012
- Branch network increased by 129 to **833** during the first nine months of 2012



...while proactive and timely supervisory policy measures produced the desired outcomes...

New Directions Issued to Finance Institutions

- Upper limit interest rates for LFCs revised
- Minimum requirements for information systems security
- Panel of External Auditors selected and guidelines
- Gradual increase of minimum core capital to be maintained by SLCs from Rs.100 mn by Dec. 2012 to Rs.300 mn by Jan. 2016
- Core capital as yardstick for gearing ratio
- Fitness and Propriety of Directors
- Changes to borrowing definitions

Supervisory Action Taken

- Internal Rating system developed
- Early Warning Systems developed

Combating Unauthorised Finance Institutions

- Regularised unauthorised institutions and initiated action against others
- 27 Public awareness programs, 14 Audio programmes, 33,000 Brochures and 1,550 Posters
- Established procedure manual for investigation of unauthorised firms

Initiating Regulatory Mechanism for Microfinance Sector

- Finalising legislation to consolidate the microfinance sector

Revival of Distressed Companies

- 7 Distressed finance companies affected by liquidity crisis were being restructured



The Payments & Settlements System benefitted by several innovations in 2012...

- Issued licences to 3 new service providers to engage in debit card business
- **Issued a licence to a mobile telecommunication network operator to operate an e-money scheme**
- Facilitated the establishment of the Common Card and Payment Switch (CCAPS) by LankaClear (Pvt) Ltd., to provide a national level platform for clearing and settlement of electronic payments
- **Commenced self assessment of the LankaSettle System against the new core principles of the Committee on Payment and Settlement Systems (CPSS)**
- Conducted public awareness programmes to increase awareness on payment and settlement systems

Performance of the Payments System – 2012

System availability	99.8%
Average No. of RTGS Transactions per day (High value payments)	1,140
Average No. of Retail Payments per day	387,050



The Employees' Provident Fund grew by 13% to Rs.1.15 trillion in 2012...

- Rs.301 bn was invested in government securities during 2012 to benefit from high interest rates in the government securities market.
- **The share portfolio yielded Rs.2,774 mn as realised income (dividends and capital gains) during the year**
- Long term share portfolio was maintained in order to benefit from the expected future upturn in the equity markets
- **Interest paid on member balances for 2011: 11.5% pa.**

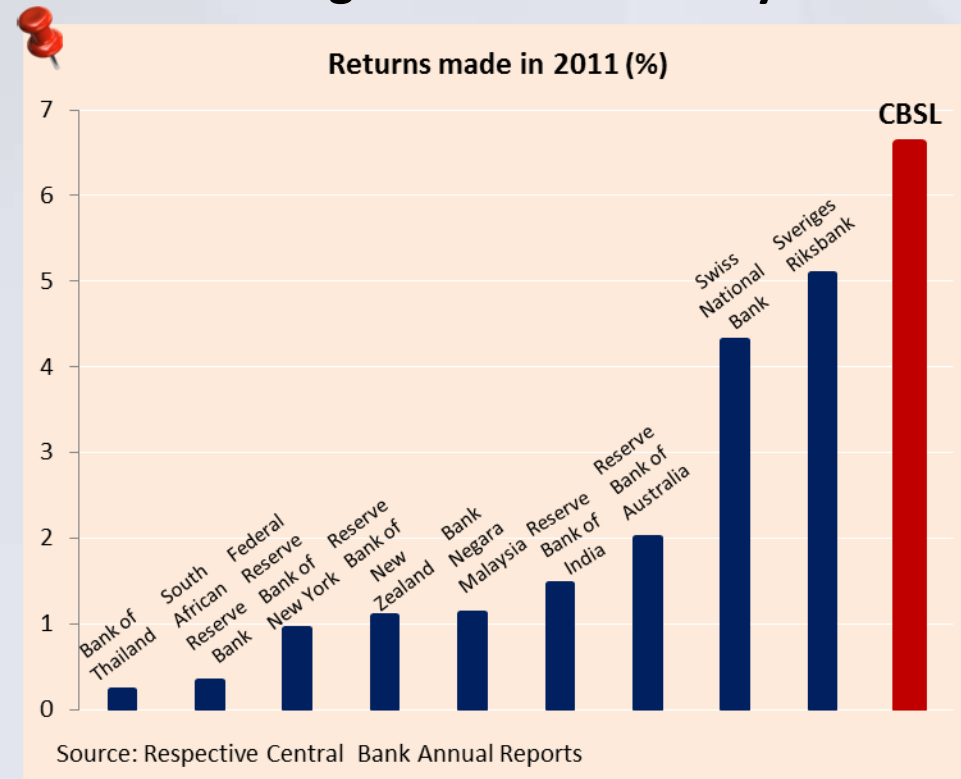
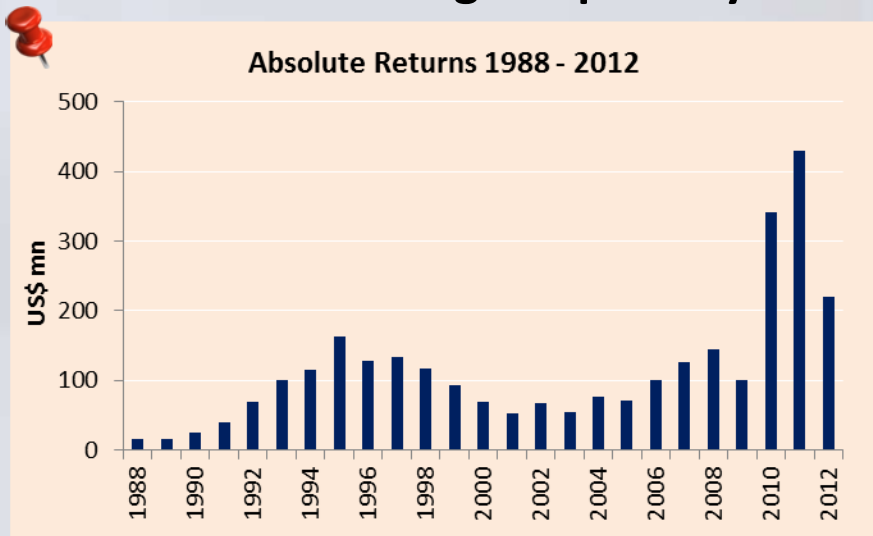
- **To enhance the efficiency of member service:**
 - EPF Act No 15 of 1958 was amended to compel employers to send member contributions and payment details electronically.
 - Commercial banks were appointed as collecting agents of member contributions
 - EPF Website was connected with Lanka Gate E-governance service to provide wider access for members
 - New members were registered under a unique identification number to enable linking with their previous account numbers.

Type	2011		2012	
	Value (Rs.bn)	Share %	Value (Rs.bn)	Share %
Govt. Securities	898	88.0	1,036	89.9
Equities	78	7.7	68	5.9
Corporate Debentures & Other	9	0.9	9	0.8
Reverse Repo	3	0.3	2	0.2
Fixed Assets & Net Current Assets	32	3.1	37	3.2
Total	1,020	100	1,152	100



Foreign Reserves management returns showed remarkable results in 2010, 2011 and 2012 amidst challenges...

- Returns earned between 2010 - 2012 amounted to almost US\$ 1.0 bn.
- Returns during the past 3 years have been the highest ever in history



Year	Absolute Return (US\$ mn)	CBSL Return %	Benchmark return % (2 Yr Govt Treasuries Average Rate)
2010	341	6.2%	0.7%
2011	430	6.6%	0.4%
2012	220	4.0%	0.3%

- CBSL out-performed most of the leading central banks in reserve management during 2011



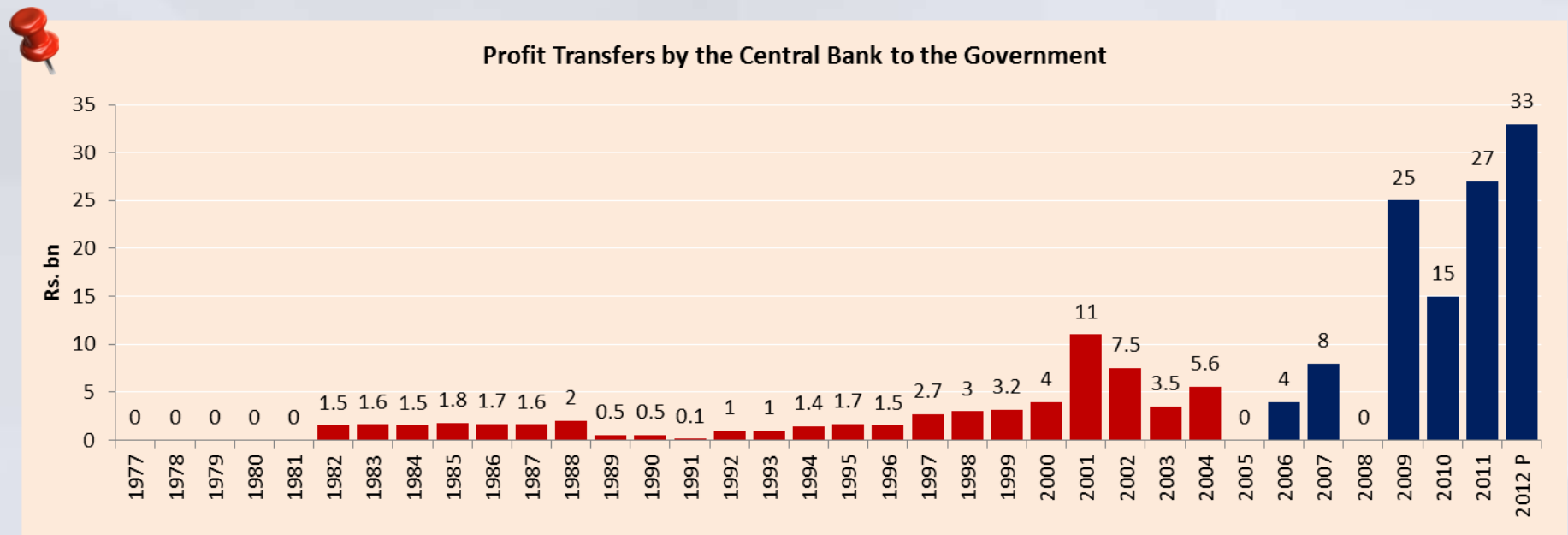
Currency management improved further in 2012...

- Measures taken to inculcate good habits of handling currency notes and coins through public awareness programmes
- **Implemented the Clean Note Policy, in association with licensed banks and general public**
- Developed close relationship with law enforcement authorities to educate the general public on security features of currency notes
- **Issued instructions to licensed banks and finance companies to have counterfeit detectable counting/sorting machines**
- Effected continuous improvements in human capital, with regular and special training programmes, seminars, workshops and discussions conducted, locally and internationally
- **Issued two commemorative coins to mark 100 years of Scouting in Sri Lanka and the 60th anniversary of Sri Lanka-Japan diplomatic relations**



Profit transfers increased several fold in the past few years, greatly assisting the revenue streams of the Government...

- During the period 2006-2012, the Central Bank has been able to appropriate a sum of Rs.112 billion to the Government from the surpluses the Bank generated, mainly from its international operations



- From 1976-2005 period of 30 years, the profit transfers amounted to about Rs.60 billion.
- From 1950-1975 period, the total profit transfers amounted to about Rs.30 million.



The Central Bank has been in constant touch with its stakeholders in 2012...

Awareness Programmes - 45

Newspaper Advertisements - 450

Press Releases - 1,792

Media Conferences - 36

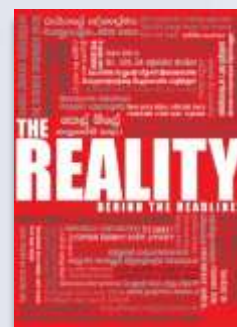
Gazette Notifications - 19

Weekly Economic indicators - 52

Monthly Economics Indicators - 12

Official Speaking Engagements of the Governor - 184

Social Media....



Web Communication

Average visitors in 2012

– 212,929 per day

SMS Alerts: Our new initiative, since October 15th... 382 SUBSCRIBERS



ROAD MAP 2013

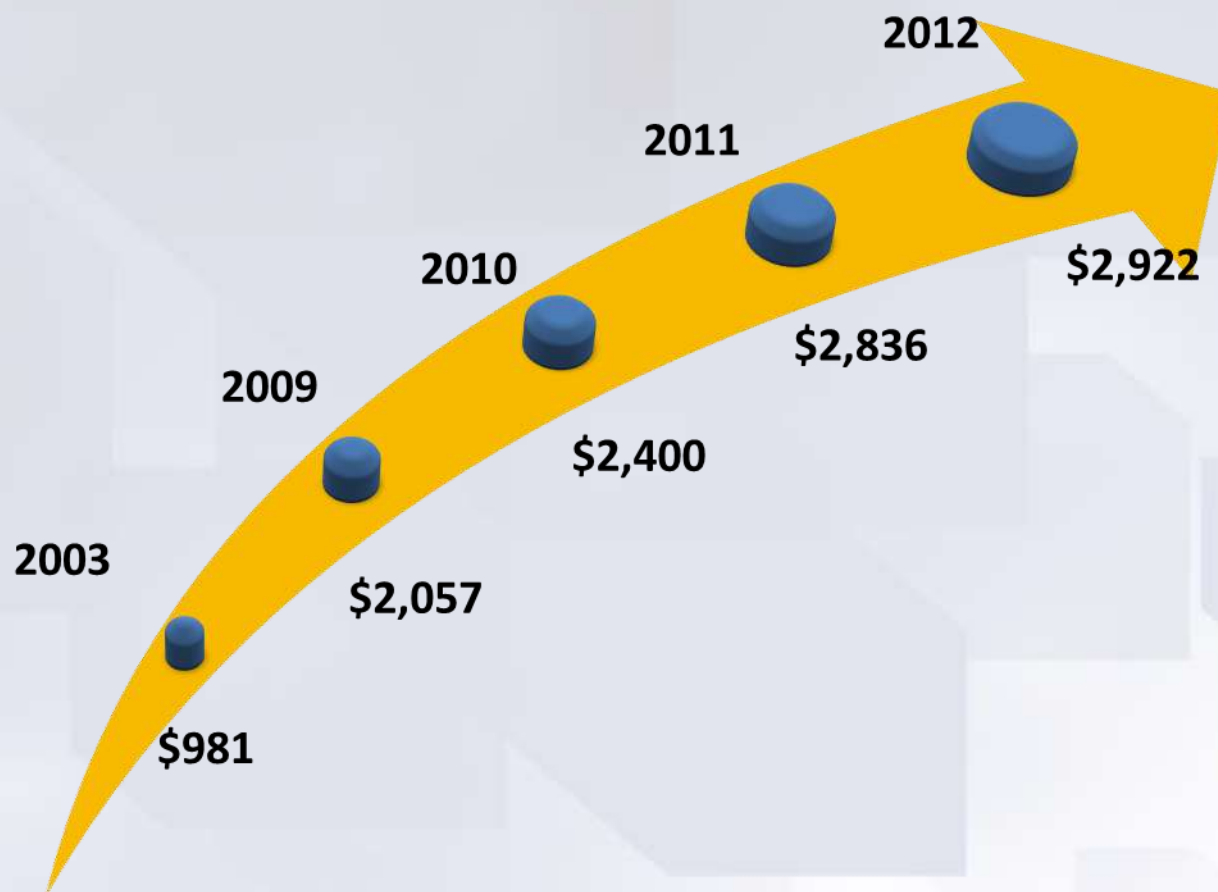
Monetary and Financial Sector Policies for 2013 and Beyond

CBSL SMS Alerts

When taken on an overall basis, current macro fundamentals have reached reasonably benign levels, and have been moving in the right direction...

	Unit	2000	2006	2011	2012 (Est/Proj)
Real GDP Growth	%	6.0	7.7	8.3	6.5
GDP at 2002 Prices	Rs. bn	1,598	2,091	2,864	3,049
GDP	US\$ mn	16,596	28,267	59,175	59,253
Per Capita GDP in US\$	US\$	899	1,421	2,836	2,922
Unemployment	%	7.6	6.5	4.2	4.0
Inflation (Average)	%	6.2	10.0	6.7	7.6
Trade Balance	% of GDP	-10.8	-11.9	-16.4	-15.1
Tourist Arrivals	'000	400	560	856	1,003
Remittances	US\$ mn	1,160	2,161	5,145	6,007
FDI Inflows	US\$ mn	175	604	1,066	1,000
International Reserves	US\$ mn	2,131	4,005	7,989	7,800
International Reserves	Months of Imports	3.5	4.7	4.7	5.0
Exchange Rate	Rs./US\$	80.06	107.71	113.90	127.16
Budget Deficit	% of GDP	9.5	7.0	6.9	6.2
Public Debt	% of GDP	96.9	87.9	78.5	81
Broad Money Growth (M _{2b})	%	12.9	17.8	19.1	16.2
Private Sector Credit Growth	%	11.8	24.0	34.5	18.6
Stock Market Capitalisation	Rs. bn	88.8	834.8	2,213.9	2,167.6

In that scenario, per capita incomes have been improving consistently, as envisaged...



**The stage is now set for
sustained progress
towards a**

US\$ 100 billion economy

and a

US\$ 4,000+ per capita income...



Towards such an outcome, the Medium Term Macroeconomic Framework will need to be carefully fashioned, while providing for the expected acceleration of economic activity...

Indicator	Unit	2012 (Est)	Projections		
			2013	2014	2015
Real Sector					
Real GDP Growth	%	6.5	7.5	8.0	8.3
GDP Deflator	%	8.5	7.0	6.0	5.0
Total Investment	% of GDP	30.3	31.0	32.0	32.5
External Sector					
Trade Balance	% of GDP	-15.1	-14.4	-13.3	-12.7
Current Account Balance	% of GDP	-5.5	-4.7	-3.3	-2.0
Overall Balance	US\$ mn	100	510	795	1,925
Fiscal Sector					
Current Account Balance	% of GDP	-0.8	-0.1	0.8	1.4
Overall Budget Deficit	% of GDP	-6.2	-5.8	-5.2	-4.7
Government Debt	% of GDP	81	78	75	71
Monetary Sector					
Broad Money Growth (M _{2b})	%	16.2	15.0	15.0	14.0

The projections for 2013 are based on the following assumptions...

- Global economy expected to grow by around 3.3%
- Commodity prices expected to remain reasonably stable
- Advanced economies expected to maintain accommodative policies
- Domestic weather conditions expected to be favourable



Ensuring that inflation stays on course to be at mid-single digits over the next 5 years will be a priority...

- The Central Bank will continue to focus on keeping demand driven inflationary pressures in check, and maintain inflation, particularly core inflation, at the desired mid single digit levels...

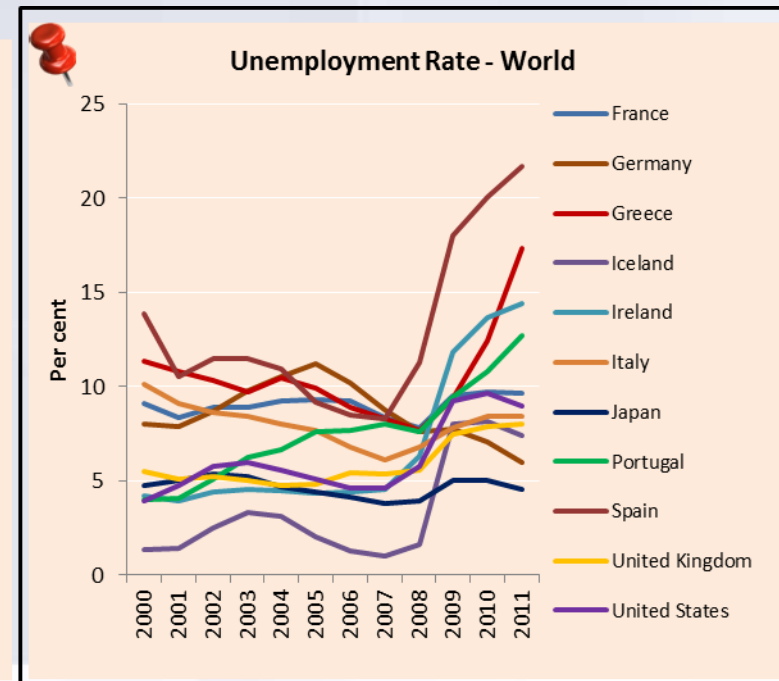
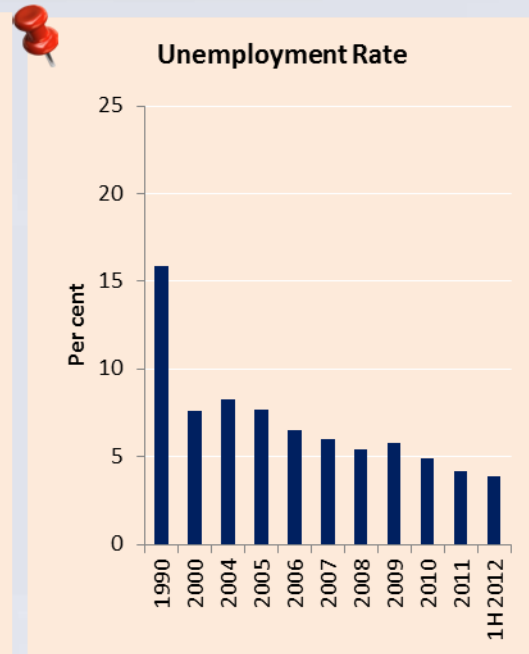
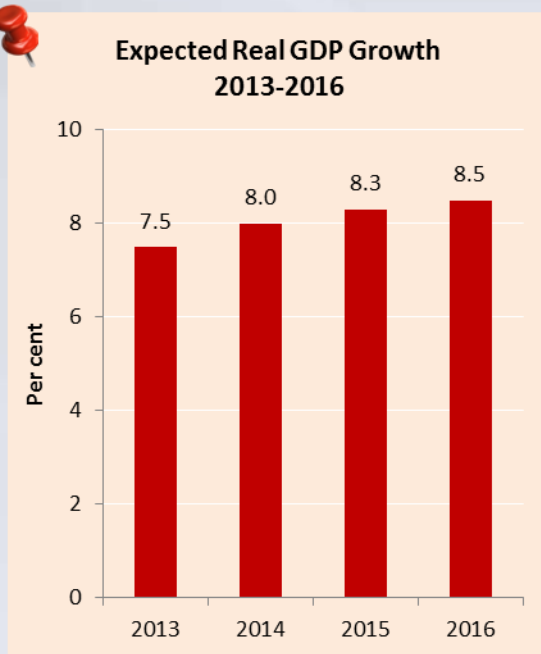


The achievement of maintaining single digit inflation for 47 months in spite of severe supply side shocks would help contain adverse inflation expectations and inflation-related wage spirals.



The Central Bank will also focus on two key factors in order to maintain macro-economic stability...

- With inflation stabilising, sustainable economic growth will be a key outcome, especially under the current global economic conditions
- **Employment, which is at a historic high, will be considered a continuous priority, while due attention will be paid, to deal with any incidence of wage driven inflation**



In the determination of the Exchange Rate (ER), market based flexibility will be maintained...

- **The ER will be allowed to reflect market conditions.**
- **The Central Bank intervention in directly supplying and absorbing foreign exchange, will be limited to reducing excessive fluctuations and maintaining external reserves at desired levels.**
- **NOP limits of LCBs will be increased with effect from 2nd January 2013 to give LCBs more flexibility in managing their foreign exchange transactions.**
- **Limits on forward market transactions will be relaxed with effect from 2nd January 2013.**
- **Selected Derivative products will be allowed to be developed within broad guidelines that will be issued during 2013.**



The Central Bank's monetary policy will be conducted within the current framework of monetary targeting...

- This framework has provided greater transparency and flexibility in the conduct of monetary policy, particularly in difficult times.

The imposition of monetary targets, such as the credit ceiling acted as a tool to supplement the traditional transmission mechanism, and served to control the intermediate target of broad money directly.

In the global economy too, with key policy rates reaching almost zero, central banks are increasingly using monetary and liquidity aggregates to communicate monetary policy signals. Recent comments by Governor-elect, Bank of England regarding nominal income targeting, confirms the usefulness of unconventional strategies.



The policy rate corridor will continue to guide short term interest rates...

- Considering short term interest rates as a target variable could support the economy to move towards explicit inflation targeting in future
- **Stability of the benchmark yield curve will be promoted, which would help the effectiveness of monetary policy transmission**
- Greater focus will be on real interest rates in order to promote domestic savings while encouraging productive activity

Operationally, the following changes will be considered during the year...

- Lengthening the current one week reserve maintenance period to two weeks, thereby allowing greater flexibility for banks in managing their day-to-day liquidity
- Conducting regular term auctions to address structural liquidity
- Enhancing operational capabilities in order to be able to fine-tune operations to manage day-to-day liquidity in a more effective manner



The Central Bank's Communication policy will act as a key instrument in monetary policy...

Market expectations have become an important component of monetary policy transmission

- An advance release calendar for Monetary Policy announcements will be issued
- **Press conferences and interviews will be held regularly**
- Training courses for journalists will continue
- **Awareness programmes will continue**
- Web presence will be enhanced through the official website, social media and mobile networking

The Central Bank's future communications will also reflect the economy's structural shift towards a wider range of foreign exchange earning activities



At the same time, the Central Bank will facilitate other key activities that have a direct impact on the ER, since a flexible, but stable ER will be considered a key stabilisation factor...

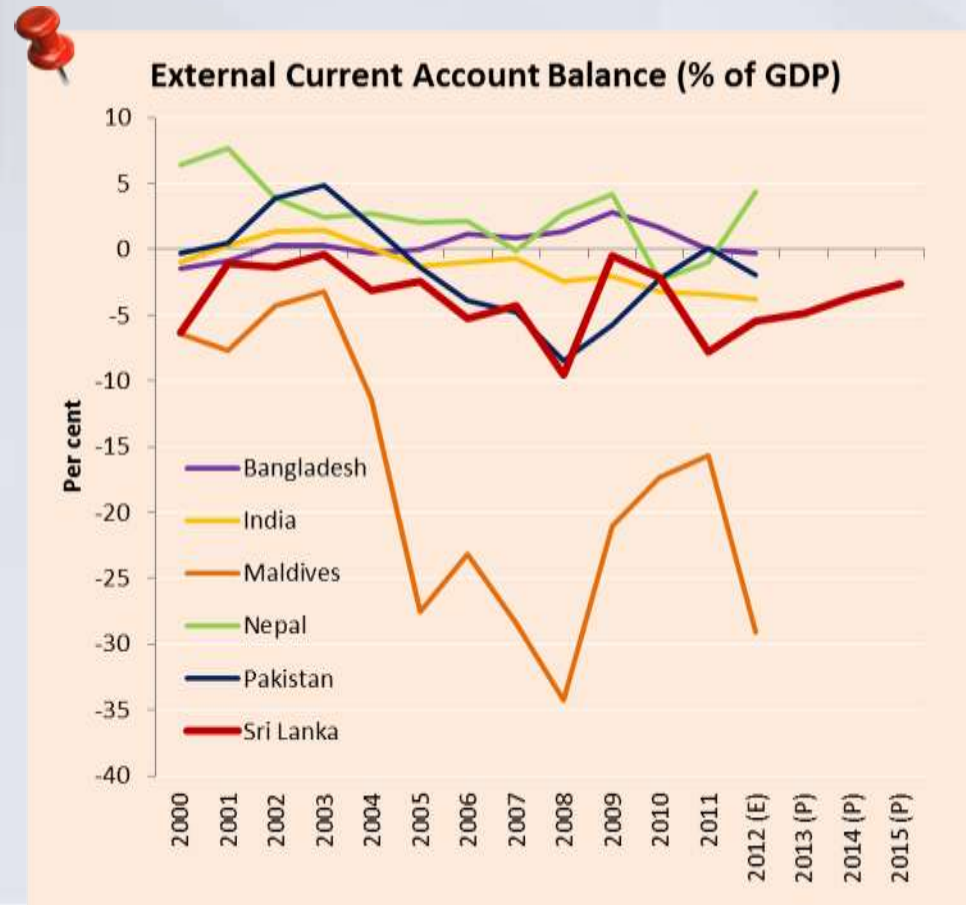
- FDI, portfolio investments and bond market investments will be supported
- **Raising debt capital by banks from foreign sources will be encouraged**
- Foreign borrowings by the private sector will be made more convenient
- **Private and Workers' remittances will be continuously encouraged**
- Import substitution measures, particularly in food, will be supported
- **Fuel and electricity generation that involve large amounts of imported inputs, will be supported to become more efficient and less reliant on such inputs**
- Large scale foreign exchange earning activities will be encouraged:
e.g. tourism, knowledge based activities, global commercial activities, education, health, port and aviation related activities, etc.
- **Prudent sovereign debt management will be pursued, to provide a continuously improving international benchmark that will assist private sector funding activities as well**
- Productivity level enhancements will be actively promoted



The trade & services gap will also be managed proactively, so as to not lead to excessive pressure on the BOP and the Exchange Rate...

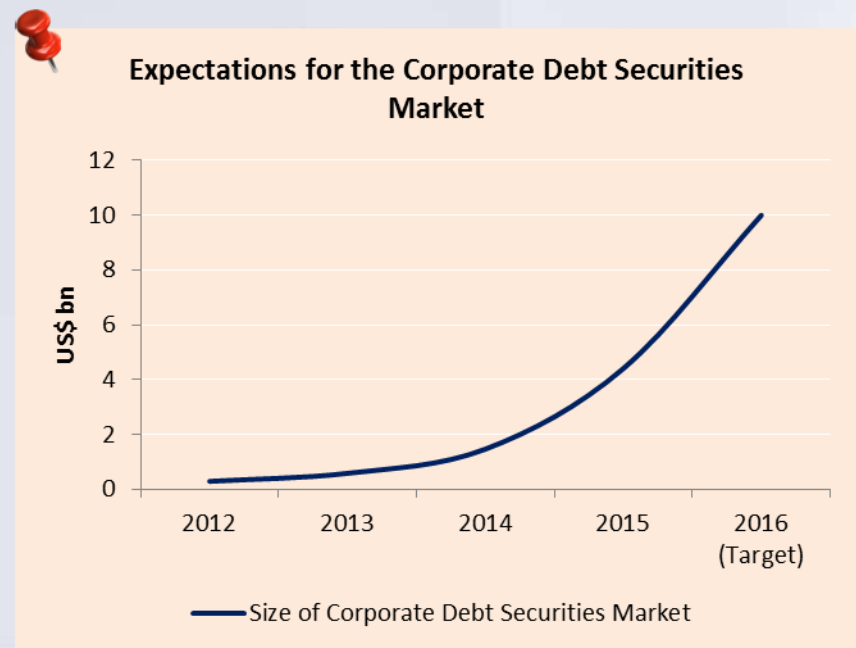
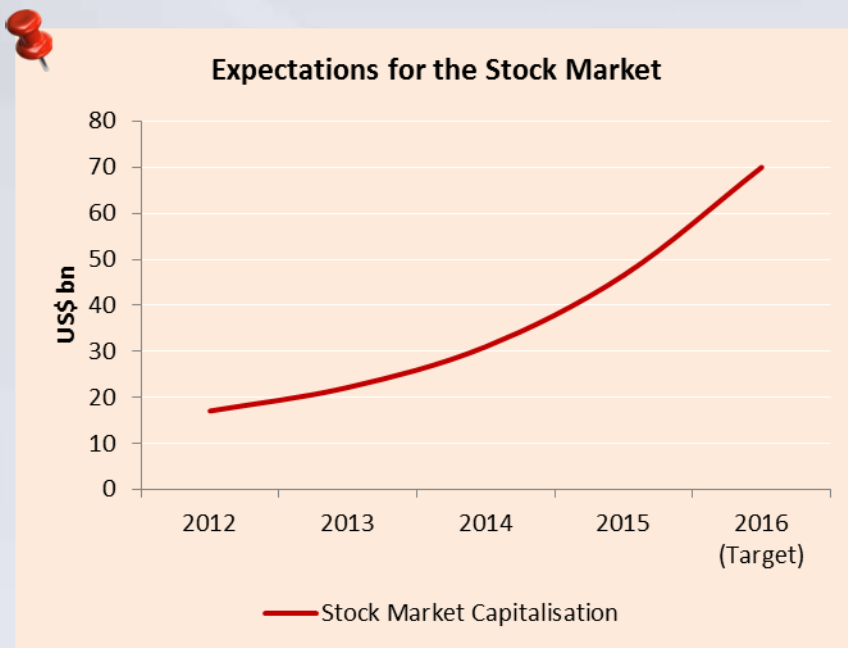
- Increased inflows from tourism, service exports and workers' remittances will be keenly supported to mitigate the impact of the trade deficit

Realisation of expected capital flows will result in a favourable outcome in the BOP.



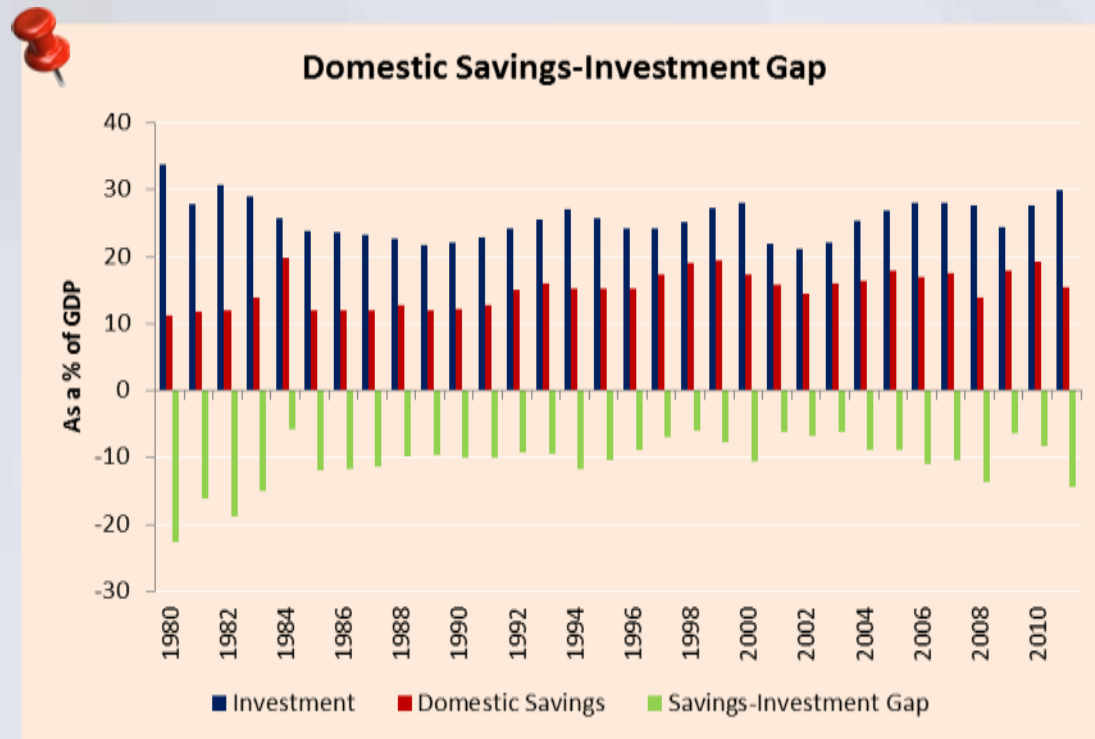
In addition, greater emphasis will be placed on developing alternative non-inflationary sources of financing...

- The corporate bond market and the equity market will be encouraged to play a greater role in supporting the financing needs of the economy, thereby reducing reliance on short-term bank credit.
- **Direct financing from external sources will be encouraged**



Steps will be taken to bridge the high savings-investment gap through medium to long-term measures, for the economy to realise its true potential...

- Long-term domestic savings will be encouraged through positive real interest rates and promotion of pension funds and life insurance
- **Capital market development will be promoted to support investments, local and foreign**
- Foreign investment will be encouraged by maintaining a conducive policy environment and creating an enabling environment



Further strengthening financial institutions and deepening financial markets will be key strategies for 2013 and beyond...

- Approval from the Controller of Exchange has been dispensed with, for
 - Corporate entities to borrow up to US\$ 10 mn per annum over the next 3 years
 - **LCBs to borrow from overseas up to US\$ 50 mn each year over the next 3 years**
 - All residents who provide services to non-residents to be able to maintain Foreign Exchange Earners' Accounts in currencies of their choice in LCBs
 - **Resident Sri Lankans as well as expatriates to be able to transfer foreign savings up to US\$ 5 mn into Sri Lanka**
- Banks will be encouraged to access stable wholesale funding sources without relying only on short-term small scale customer deposits.
- **National Development Bank and DFCC Bank will be allowed to raise US\$ 250 mn each, with up to 10-year tenor to fund SMEs, plantations, construction and manufacturing industries.**
- Banks will be expected to consider raising a significant part of their Tier I and Tier II capital, from foreign sources, by building strong Balance Sheets.



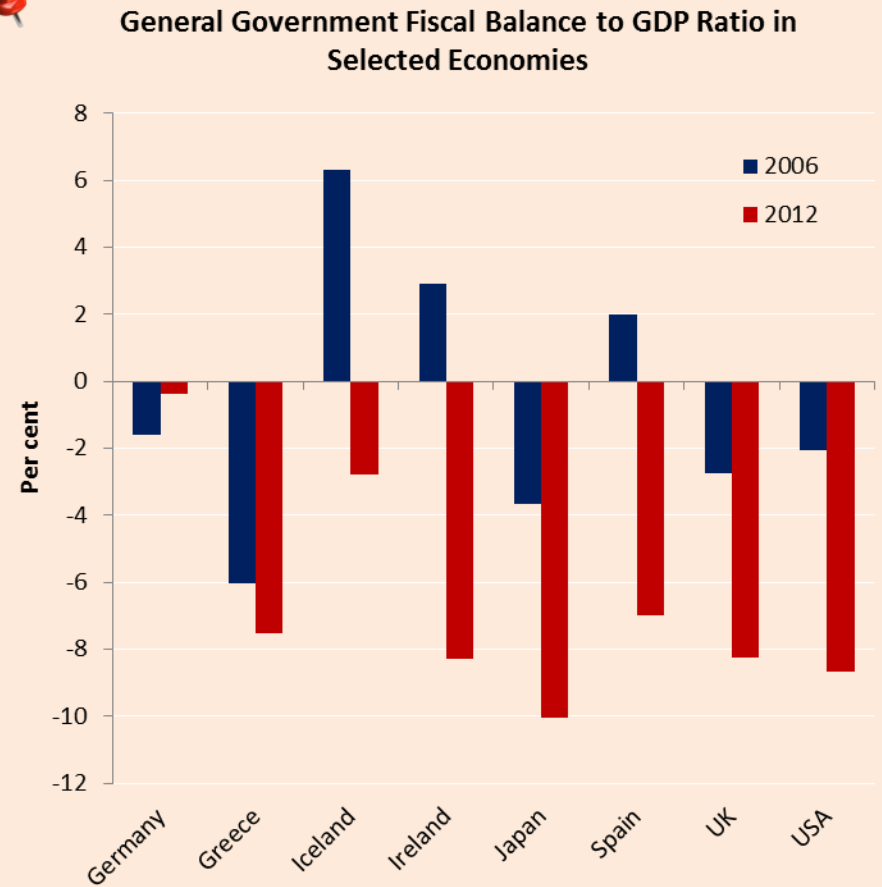
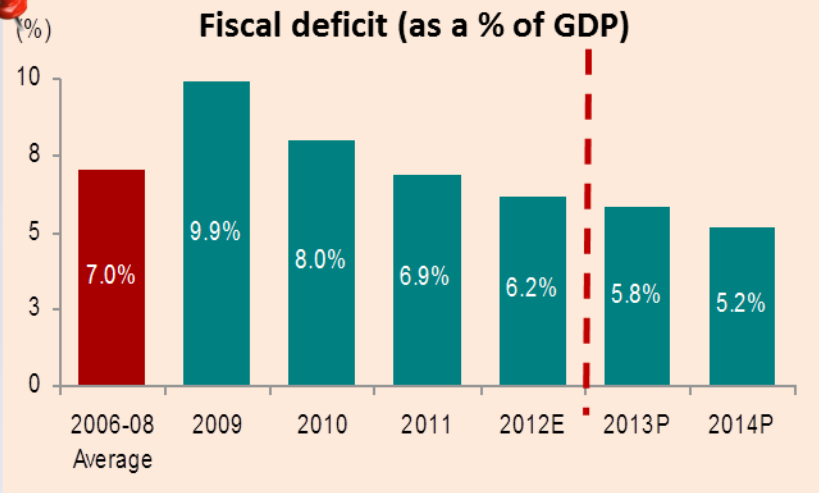
Several existing Exchange Control policies will be relaxed in 2013 and beyond...

- Time restrictions on forward foreign exchange transactions will be removed with effect from 2nd January 2013
- A new investment account for non-residents amalgamating several types of investment accounts currently maintained at LCBs will be introduced with effect from 2nd January 2013
- A new Inward Remittances Distribution Account, which can be used as a clearing account to disburse earnings of Sri Lankans providing services abroad, will be introduced with effect from 2nd January 2013
- Foreign borrowings by companies for investment and business purposes to be allowed under the “External Commercial Borrowing Scheme”
- **The current limit on overseas investments by residents will be increased**
- Criteria for permitting selected non-banking entities to engage in foreign currency deposit business will be introduced
- **Inward remittances through mobile phones will be facilitated**
- A mechanism to change foreign currency through ATMs of LCBs will be introduced
- **Fund transfers involving shipping companies, port operations and harbour services will be facilitated**



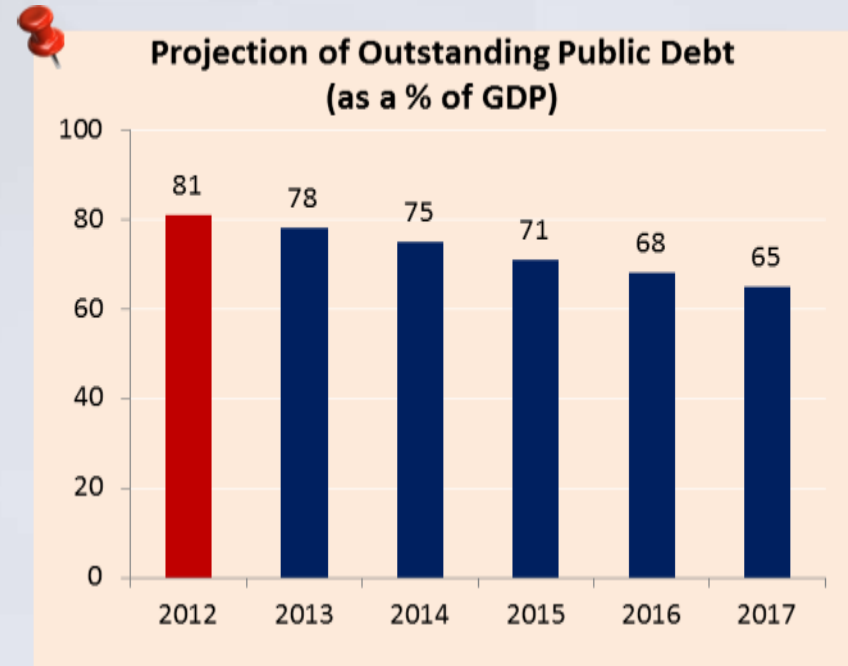
The Government's announced commitment to continued fiscal consolidation would greatly facilitate the effective conduct of monetary policy...

This commitment is particularly welcome when many other countries are grappling with fiscal deterioration.



Since debt dynamics play a vital role in the maintenance of both price and financial system stability, developments in public debt will be monitored carefully...

- Transparency in public debt management will be enhanced
- **Advanced risk management systems for public debt management will be introduced**
- The continuous enhancement of sovereign credit rating will be pursued



Indicator	2011	2012 (Est)	Revised Annual Target		
			2013	2014	2015
Debt/GDP ratio (%)	78.5	81	78	75	71
Average Time to Maturity of Domestic Debt (years)	2.4	3.2	3.5	3.7	4.0
Ratio of Short-term Domestic Debt to Total Domestic Debt (%)	25	24	23	22	21
Share of Foreign Currency Debt to Total Debt (%)	44	47	42	40	38

Many improvements to the G-SEC market are planned/contemplated for 2013 and beyond...

Efficiency of the primary auction system will be further improved

- Half-yearly Treasury bond Calendar will be issued to the market
- **Competition at primary auctions will be increased through greater participation of institutional investors**
- Complete underwriting of issuances will be ensured by putting in place, an appropriate mechanism, including liquidity support for primary dealers

Secondary market will be broadened and deepened while improving transparency

- **An e-trading platform will be established and reporting of all G-SEC transactions will be made mandatory**
- A guaranteed central clearing arrangement on net-settlement basis (rupee leg and security leg) will be established to eliminate counterparty credit risk while enhancing the efficiency of intraday liquidity of participants
- **The trading platform to require mandatory two-way quotes**
- Covered short selling will be introduced
- **Information asymmetry will be eliminated, thereby narrowing spreads**
- Appropriate products for a derivative market which will help participants to enhance their return while hedging their risk exposures in the cash market, will be introduced once the cash market is developed

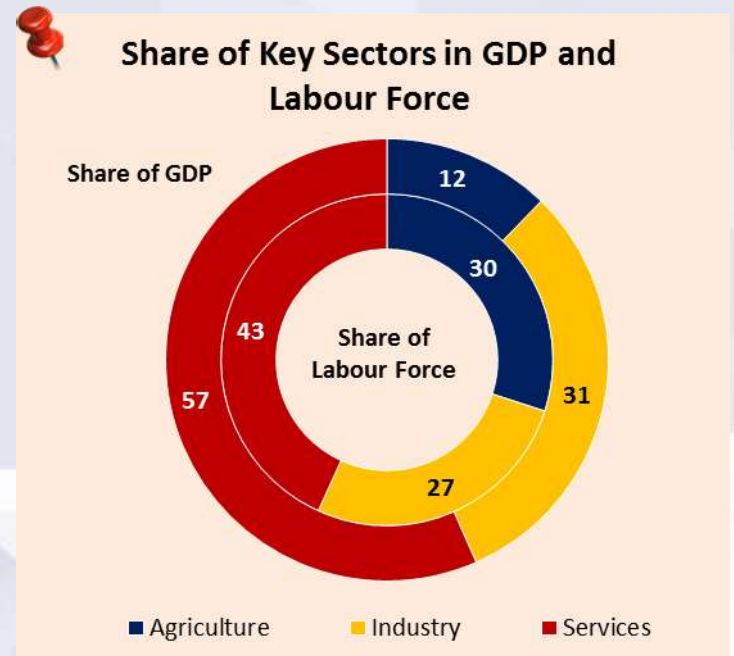


In the long-run, productivity growth will be a vital instrument of improving competitiveness and living standards...

- The continued decline in unemployment in Sri Lanka in recent years, compels re-thinking of the future employment strategies. In this context, labour force concentration will need to be given careful attention
 - **Although the share of Agriculture in the GDP has declined over time, the share of employees in the sector has not reduced proportionately**
 - Despite inherent limitations for expansion, special attention will need to be paid to developing productivity in the Agriculture sector, as it is a vital sector of the economy

Concerted efforts by relevant authorities will need to be continued in order to improve agricultural output and reduce price volatility:

- Effective information dissemination,
- Introduction of a crop calendar,
- Facilitation and enhancement of storage facilities,
- Strengthening of domestic forward and futures markets for agricultural produce



Closer integration of the key sectors will also improve productivity...

- One of the key issues with Sri Lanka's external trade has been the export of primary products where domestic value addition is low
- Given Sri Lanka's widespread agricultural base, forward linking into Agro based Industries would be a natural next step for workers in Agriculture

A stronger domestic production base would lead to a more sustainable economic growth

Improvements in productivity in the Long-Term will also provide an important positive “supply side shock”

- Very often, **negative shocks** to the economy from various sources are discussed
- **However, improved productivity in all three sectors of the economy would help bring down inflation and sustain price stability in the long run**
- Sri Lanka would then be able to remain a competitive supplier in the global economy



Productivity improvements will need to be supported by evolving physical and socio-economic infrastructure...

- Continue improving:
 - Road and rail networks for connectivity
 - **Ports and Airports to facilitate transportation**
 - Energy, telecommunication, etc. to facilitate economic activity
 - **Education and health services to suit the country's requirements**
 - Use of technology
- **Introduce socio-economic practices that are vital in a society that is gradually improving:**
 - Have child-care facilities at work places, especially to increase female labour force participation
 - **Introduce flexible work hours/ strategies**
 - Absorb differently-abled citizens into the workforce

The Central Bank is proud to welcome nine new differently-abled graduates to its workforce from 1st January 2013



Since oil imports account for over 25% of current imports, moving towards sustainable and renewable energy is an important factor in the future progress of the economy...

There is renewed focus on increasing the Renewable Energy share of Sri Lanka's energy mix

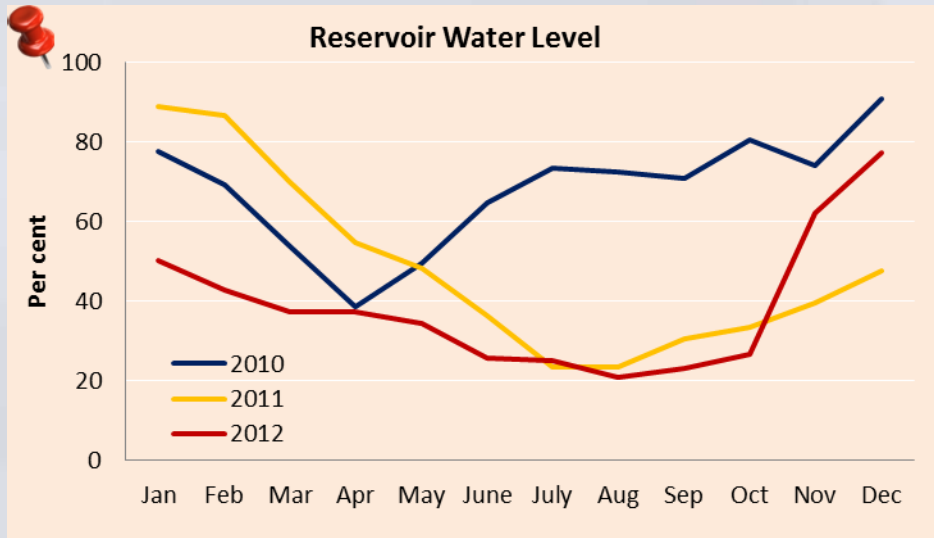
- Regular additions of mini hydro power plants to the national grid
- **Completion of a 100MW wind park in Mannar by end 2014**
- Studies are ongoing to construct a 10MW solar PV park in the North

Budget proposals to promote renewable energy sources need to be made use of:

- Tax exemption for profits and income from cultivation of renewable energy crops
- **Concessionary income tax rate for mini hydro power/alternative energy projects**
- VAT exemption for import/supply of raw material for manufacture of energy saving bulbs
- **Tax exemption for solar panel modules, accessories or solar home systems**
- Allowing higher depreciation on energy efficient plant machinery or equipment



Managing currently available resources in the energy sector will be a critical factor in the way forward...



The reservoir water levels have to be prudently used to:

- Ensure a favourable generation mix through 2013
- Curb any losses that could be incurred due to changing weather patterns

The government has undertaken an active campaign to create awareness about energy conservation and these initiatives need to be continued...

- Monitoring of Energy Labelling Programmes that encourage high efficiency levels of electrical appliances
- **Introduction of Energy Audits and Energy Efficiency measures in commercial organisations**
- Initiation of Public Campaigns: e.g. “Switch off at least one Bulb during Peak Hours”, awareness programmes at schools, roadside campaigns, etc.

Monetary policy implementation will also take into close account, global developments...

- In addition to domestic developments, the monetary policy regime will be closely aligned with the global business cycle.
- **Growth and inflation developments as well as policy decisions of major economies, trading partners and competitor economies will be taken into consideration when fashioning domestic policies.**
- International commodity prices, particularly energy prices will be carefully considered.



In summary, monetary policy decisions will be based on a **multi-dimensional approach**, which will take into account the following...

- **Policy priorities to be pursued**
 - Maintaining inflation at mid-single digit levels
 - Ensuring continuous economic growth
 - Maintaining low unemployment
 - Maintaining Exchange Rate flexibility and stability
- **Direct Monetary Policy Instruments to be used**
 - Monetary targeting measures with policy rate corridor guiding short term interest rates, with the Statutory Reserve Ratio and Open Market Operations being used to manage liquidity
 - Managing inflation expectations through continuous policy dialogues and robust communication policy
- **Key stabilisation measures to be influenced**
 - Encouraging appropriate wage inflation curtailment measures
 - Facilitating activities that impact the ER
 - Influencing key components of the External Account
 - Facilitating non-inflationary sources of financing
 - Encouraging continued fiscal consolidation and pursuing prudent management of public debt
 - Promoting continuous productivity improvement
 - Providing guidance for sustainable energy practices
- **External factors to be considered**
 - Growth, inflation, exchange rates, etc., and policy decisions of advanced economies, competitor economies and trading-partner economies
 - International commodity prices, particularly, energy

Considering these expectations and concerns, key Monetary Aggregates are expected to be maintained as follows in 2013:

	Dec-11	Dec-12 (Est)	Dec-13 (Proj)
Broad Money			
<i>y-o-y % change</i>	19.1	16.2	15.0
Reserve Money			
<i>y-o-y % change</i>	21.5	10.2*	14.5
Credit to the Private Sector			
<i>y-o-y % change</i>	34.5	18.5	18.5

* Actual

Policy Parameters as at end 2012

Repurchase rate:	7.50%
Reverse Repurchase rate:	9.50%
Statutory Reserve Ratio:	8.00%

Further relaxation of monetary policy may be warranted if:

- Inflation and inflation expectations ease
- Economic growth remains below potential
- Aggregate demand is low
- Monetary and credit expansion take place at lower rates than projected

Tightening of monetary policy may be considered if:

- Demand driven inflation and adverse inflation expectations build up
- Signs of economic overheating occur
- Aggregate demand expands at a high rate
- Excessive monetary and credit expansion take place

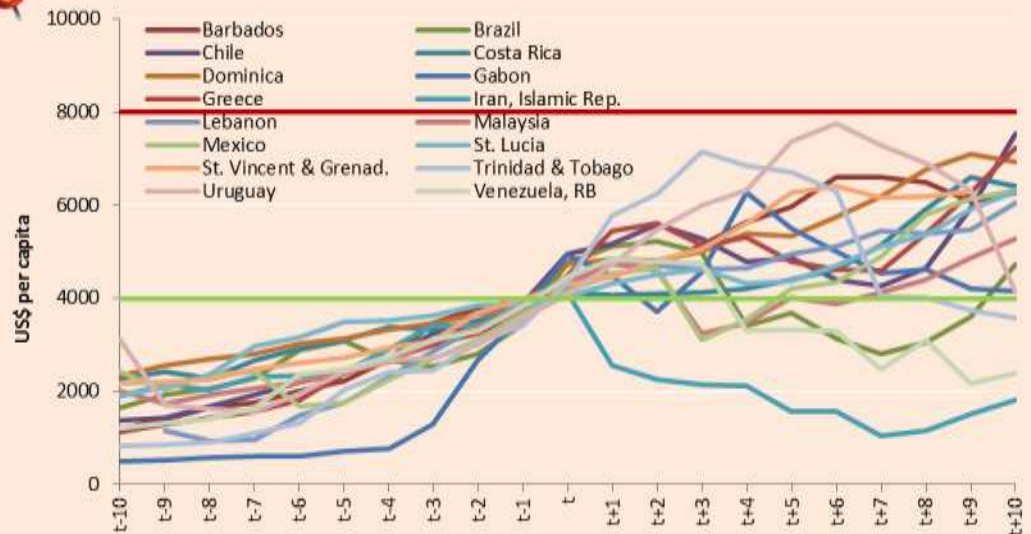


Over the next few years, improvements in per capita income and reduction of regional disparities will bring about further major structural changes in the economy...

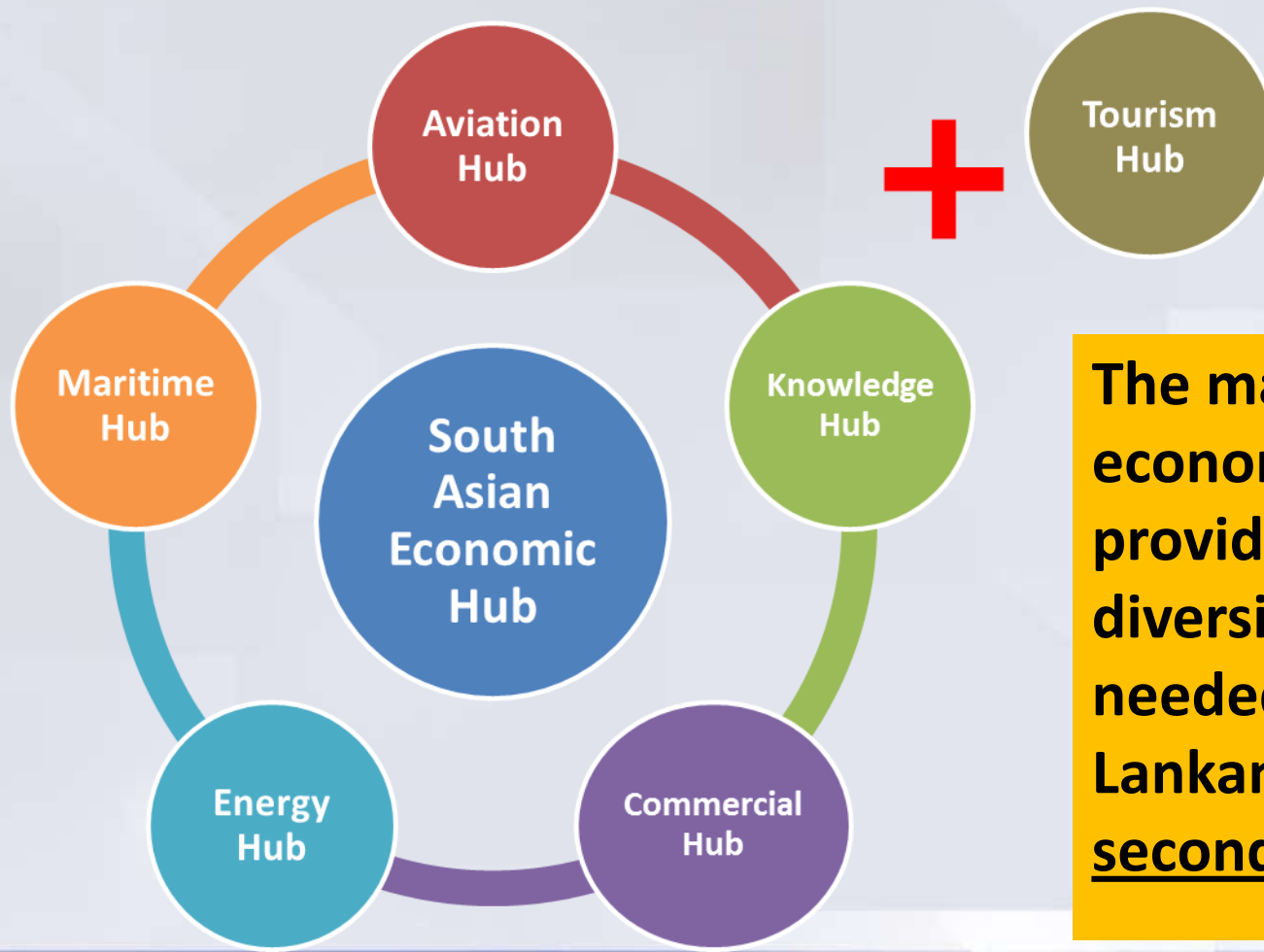
- With the economy expected to reach a level of over US\$ 4,000 per capita before 2016, policies for the second wave of growth must be carefully planned in order to avoid the “middle-income trap...”

While many economies experienced their per capita incomes “taking off” after reaching per capita US\$ 4,000 level, some economies took more than 10 years for the next doubling of per capita GDP...

The key reason for these economies not “taking off” was a lack of diversification in economic activity



That is why it is vital that the “5+1 Hubs” concept is implemented effectively in order to successfully guide Sri Lanka through this barrier...

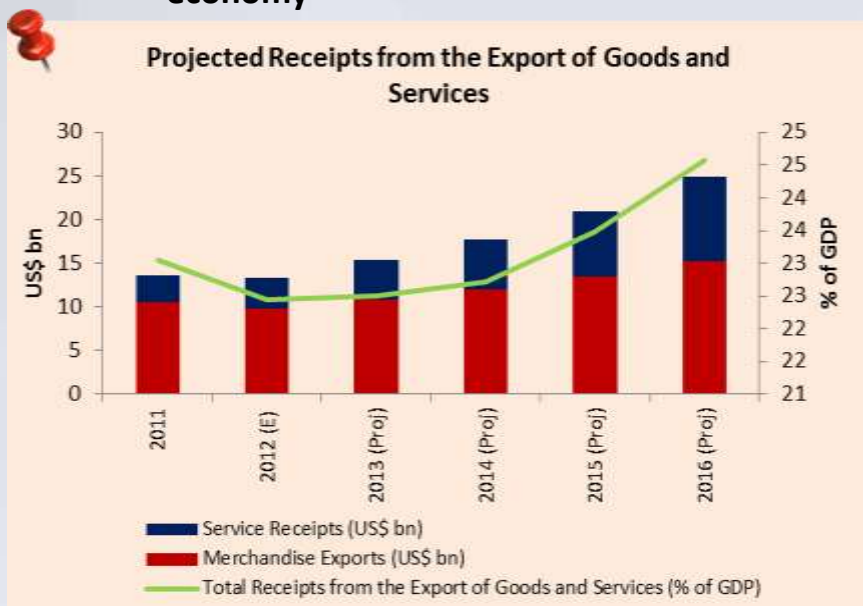


The maturing of these economic activities will provide the diversification that is needed to move the Sri Lankan economy to the second wave of growth...



With these diversified activities taking place, the structure of country's earnings is likely to change materially...

- In the external sector, these changes will result in earnings from exports of services gaining prominence
 - Earnings from tourism
 - IT/BPO Services
 - Aviation services
 - Maritime services
 - Potential earnings from the Knowledge economy

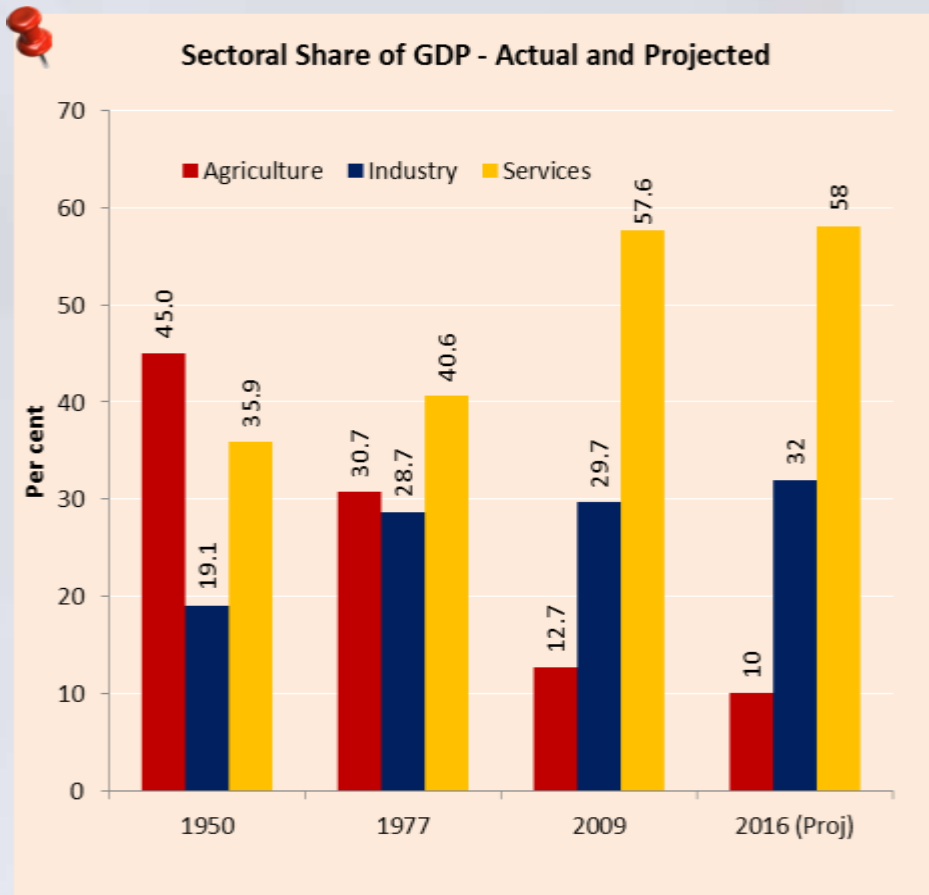


External Account Targets & Projections for 2016

	<u>Per Annum Value</u>
Merchandise Exports:	US\$ 15.2 bn
<i>of which</i>	
Tea:	US\$ 1.9 bn
Rubber:	US\$ 0.2 bn
Textiles & Garments:	US\$ 5.6 bn
Rubber products:	US\$ 1.2 bn
Gems, Diamonds & Jewellery:	US\$ 1.0 bn
Services Exports:	US\$ 9.8 bn
<i>of which</i>	
Earnings from tourism:	US\$ 3.5 bn
IT/BPO services:	US\$ 1.0 bn
Workers' remittances:	US\$ 10.0 bn
Foreign Direct Investment:	US\$ 5.0 bn
Net Portfolio inflows:	US\$ 1.0 bn
Long term loan inflows:	
Government:	US\$ 1.8 bn
Private sector:	US\$ 0.5 bn



The structural changes taking place when moving towards a US\$100 billion economy, is likely to be reflected in the new Sectoral Composition of GDP by 2016, & the several mile posts to be reached...



National Mileposts

Poverty:	Less than 2%
Unemployment:	Less than 3%
Acute Malnutrition amongst children under 5 years:	Less than 5%
Electricity coverage:	100%
Public investment:	6% of GDP
National Savings/investment gap:	0.5% of GDP

Market based Targets

	<u>Value</u>
Stock Market Capitalisation:	US\$ 70 bn
Corporate bond market:	US\$ 10 bn
Bank assets:	Rs. 10 tn



In the meantime, to reach a US\$ 100 billion economy by 2016, Banks and NBFIs will have to play a critical role. In that regard, the Central Bank will...

- Review and amend the regulatory framework to facilitate the business models of banks and NBFIs
- Encourage the adoption of policies for diversification of business and income, through fee-based services
- Encourage consolidation in the banking and the NBFIs sectors
- Strengthen the regulatory regime, while encouraging diversification of sources of funding and business operations mainly through foreign sources
- Enhance the quality and frequency of Bank and NBFIs examinations
- Identify and regulate the risk profiles of banks and NBFIs in order to ensure stability of the financial sector and enhance public confidence



In particular, the Capital Levels in the Banking System will be strengthened continuously...

- The capital levels of banks will need to grow to facilitate rising credit demand and to cushion any potential risk
- **With the growth in Banking sector, smaller players may not be able to compete with large banks and therefore mergers and acquisitions will be encouraged for banks to be internationally competitive**
- Banks will also be encouraged to leverage balance sheets by obtaining foreign finance

The capital and liquidity standards will be developed under Basel III

Existing Banks

Effective Date	Licensed Commercial Banks (Rs.bn)	Licensed Specialised Banks (Rs.bn)
31.12.2011	3.0	2.0
31.12.2013	4.0	2.5
31.12.2015	5.0	3.0

New Banks

Year	Licensed Commercial Banks (Rs.bn)	Licensed Specialised Banks (Rs.bn)
2010	3.0	2.0
2012	4.0	2.5
2014	5.0	3.0



Banks will be expected to re-align their business models and processes to be in sync with the evolving needs of the economy. The 21-Point “To-do-List” for banks will help them to focus...

1. Keep abreast of macro-economic factors, both national and international
2. Ensure that all regulatory directions of the Central Bank are followed diligently
3. Keep a close eye on the Bank’s capital adequacy, present and future
4. Pay close attention to corporate governance. In particular, Board practices, top management services, and regulatory responses
5. Train staff continuously, so that they are prepared for the new developments in banking in the evolving economy
6. Upgrade Information Systems for the new levels of business
7. Improve Risk Management Systems and pay close attention to local and international trends, rather than individual “one-off” events



The 21-Point “To-do-List” continued...

8. **Develop a corporate planning culture and practice it diligently**
9. **Be conscious of “conglomerate” risk, if the Bank is a part of a group, or has associates**
10. **Keep a close tab on the Bank’s international links and business partners with regular “know your customer” updates**
11. **Attempt to improve the Bank’s rating, with at least one upgrade each year**
12. **Consider new opportunities, and try to introduce new services on a staggered basis**
13. **Plan for management “succession” as a routine exercise, not as an exceptional effort**
14. **Constantly search for productivity improvements, and tighten the interest spreads to improve profitability**
15. **Encourage funding lines for the “5 Hubs + Tourism” initiatives of the country**



The 21-Point “To-do-List” continued...

16. **Maintain SME focus and use the Budget 2013 initiatives for SMEs effectively**
17. **Support foreign remittance business, both from the sender and receiver angles**
18. **Support lagging provinces’ growth, particularly Northern, Eastern and Uva Provinces**
19. **Source foreign capital for Tier 1 and Tier 2 of the Bank, by using the balance sheet strengths effectively**
20. **Promote foreign capital inflows among the Bank’s clients, and help to bridge the savings gap that is existing in the country**
21. **Support local entrepreneurship and create new business leaders for the future**



Strengthening the regulatory regime will continue, unabated...

- **The Banking Act will be amended taking into account the new developments in domestic and international financial markets...**
 - Supervision of bank dominated financial groups will be strengthened
 - Provisions to facilitate mergers and acquisition of banks will be introduced
 - Bank resolution measures will be strengthened
- **Banks & NBFIs will be required to further strengthen:**
 - The quantity and quality of capital to improve their loss absorbency capabilities
 - 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



Finance Companies and Leasing Companies will continue to receive close attention...

- Risk focused regulatory and supervisory system will be strengthened, with a new action-based examination procedure with the introduction of integrated risk management system in NBFIs
- **The number, extent and frequency of on-site examinations will be increased**
- Online early warning system to identify the possible risks of NBFIs will be used
- **The rating of LFCs will be assessed on quarterly basis**
- A framework of macro prudential supervision to assess group risk of NBFIs will be implemented
- **Information among other regulators will be shared to minimise contagion effect of negative development within a group**
- Issue of new licenses for NBFIs will be stopped for the next two years, with greater focus being given to the rehabilitation processes of weak companies in the NBFIs sector
- **New prudential directions and guidelines will be formulated**
- The adequacy and effectiveness of the corporate governance direction will be reviewed
- **SLCs will be encouraged to convert to LFCs**
- Investigation processes on unauthorised finance businesses will be expedited
- **Regulatory and supervisory mechanism for microfinance institutions will be introduced**



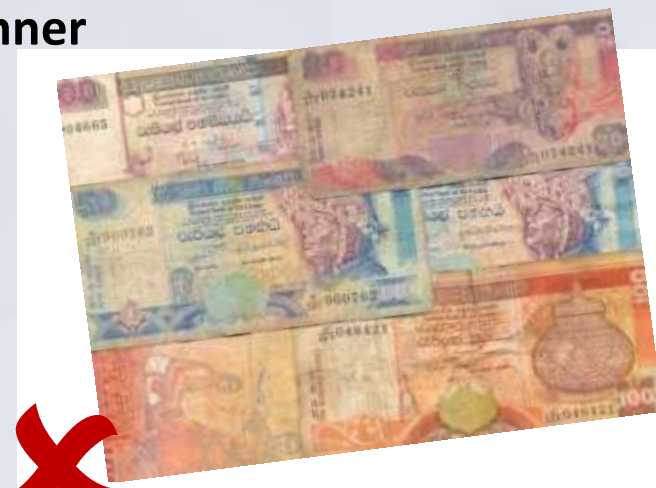
Steps will be taken to ensure that Sri Lanka's currency notes reflect an emerging, prosperous society...

In particular, the Clean Note Policy will be robustly implemented with soiled notes being replaced in an efficient and effective manner

Doing so will make cash transactions pleasant, and improve the image of the country

In addition, several processes will be implemented:

- An advanced automated cash processing system will be implemented to increase efficiency, reduce operational risks and improve working environment
- **A more environment- friendly disposal system for unfit currency notes will be established**
- A new series of Rs. 10 coins to depict each District, will be issued in 2013
- **A major "Idle coin gathering programme" will be launched to collect and re-issue such coins for circulation**



An extensive regional development strategy that will focus on convenient financing of SMEs will be implemented in 2013...

- Giving support for business start-ups with knowledge transfers
- Granting Quick loans for small businesses

- Supporting growth of SMEs
 - Establishing sound financial footing for SMEs
- Supporting revitalisation of local and regional economies

- Granting Quick loans for agriculture and fisheries to support farmers
- Creating collaboration between agriculture and food industry
- Providing management and technical support services such as training

- Providing medium term funds for SMEs
 - Supporting innovations and business turnarounds

To support economic growth and development, the strategy will focus on:

- **Business start-up advice**
- Convenient funding
- **Appropriate safety nets**
- Management innovation
- **Links with large businesses**
- Meeting regional priorities
- **Export market access**
- **Business revitalisation**



Regional development activities will concentrate on the SME sector & providing affordable finance, while focusing on lagged regions/needy sectors...

- In 2013, nearly Rs. 17 bn worth of loans will be distributed through concessionary financing schemes implemented through the Central Bank

Loans to be Granted in 2013

Sector	Amount (Rs. mn)	Beneficiaries (No.)
New enterprises	7,000	53,700
Agriculture Diversification	9,900	117,300

- Awareness building and training programmes for SMEs will be carried out in 2013

Programme	Expected No. of Programmes	Expected No. of Beneficiaries
Financial Literacy for School Leavers and Loan Beneficiaries	552	21,670
Entrepreneurship Development	32	1,280
Training of Trainers and Bankers	38	640
Post and Pre-Harvest Technology Seminars	12	600
Total	634	24,190



The International Reserve Management Strategy will focus on maintaining safety of funds and maximising return in a risky global financial environment...

Towards such an objective, the Central Bank will:

- **Gradually and scientifically move to a broader array of asset classes through further diversification of its Reserve portfolio**
- **Continually build-up expertise in different trading areas of forex, commodities, securities, futures and options and other risk-mitigating derivative products**
- **Judiciously maintain an appropriate currency mix of reserves with due regard to currencies of large debt obligations and expected future developments of reserve currencies**



The country's Payments and Settlements platform will be maintained at a level to be ahead of time...

- Improvements in the national payment system will be facilitated and the participation of banks and non-bank service providers in developing payment and settlement systems, will be promoted
- **The supervisory framework and continuing supervision of Licensed Service Providers of Payment Cards will be strengthened**
- The regulatory documents to harmonise the new developments in payment systems with the regulatory framework will be revised
- **The business continuity policy to ensure operational reliability of the systematically important LankaSettle system, will be continued**
- The risk factors to the system will be identified and policy measures to mitigate such risks will be adopted to ensure payment and settlement system stability
- **The LankaSettle system will be assessed against the new core principles of CPSS in order to identify and address any deficiencies**

Expectations for the Payments System in a US\$ 100 bn Economy	
Average No. of RTGS Transactions per day (High value payments)	1,500
Average No. of Retail Payments per day	500,000
RTGS/SSSS System Availability	99.9%



The EPF will implement innovative fund management strategies to maximise returns in the projected low interest rate regime, while enhancing the efficiency of member services...

- With fiscal consolidation and the expected further decline in inflation, market interest rates are expected to decline in future, thereby providing a challenging environment for the EPF to generate high returns in the medium to long term
- **Accordingly, the EPF will systematically continue its investment portfolio diversification policy, to provide better returns to its members.**
- Such diversification strategy will cover:
 - a) Equity investments that would provide for long term growth and income,
 - b) Private equity investments that would yield higher long term returns, and
 - c) Investments in debt securities such as corporate debentures, trust certificates and commercial paper that will provide higher annual incomes

Through such investments, the EPF will strive to provide a return that is approximately 2% higher than inflation, on a consistent basis



In order to further increase the efficiency of the EPF, it will...

- **Make it compulsory for employers who have more than 50 employees to send e-returns, which will enable the update of member accounts instantly**
 - Nearly 80% of 2.3 million members will be covered by this scheme
 - It will also help to improve the Doing Business ranking of Sri Lanka
- **Undertake image scanning of all master records of members to further enhance services**
- **Establish an e-record room by replacing the existing master files by 2014 with electronic records**



The Central Bank's in-house skills will be continuously improved to be in line with the best in the world...

- To support policy analysis, the Central Bank will strengthen its staff capabilities further and strengthen their analytical capabilities

This human resource pool manages/regulates:

- The Central Bank Balance Sheet that exceeds a value of **Rs. 1,300 bn**
- Monetary policy to ensure economic and price stability
- Financial system stability by regulating and supervising a financial sector with over **Rs. 6,000 bn** assets
- The public debt of over **Rs. 6,100 bn**
- The Official International Reserves amounting to over **US\$ 6,800 mn**
- The EPF funds amounting to over **Rs. 1,100 bn**
- The currency in circulation amounting to over **Rs. 300 bn**
- The payment platform that facilitates transactions totalling over **Rs. 65,000 bn**
- Properties and assets valued at **Rs. 23 bn**



Classification of Professional Qualifications	
Qualification	Total
CA, CIMA, ACCA, CMA	133
Law	27
IBSL	20
BCS	11
CFA	2
AAT	3



On a continuous basis, the Central Bank has diligently delivered on its “Growth with Stability” tagline...

- The Central Bank has been in the forefront of the economic renaissance of Sri Lanka during the past several years...

	Unit	1980	1990	2000	2010	2012 (Prov/Est)
GDP	US\$ mn	4,025	8,033	16,596	49,565	59,253
GDP Per Capita	US\$	273	494	899	2,400	2,922
GDP Growth	%	5.8	6.2	6.0	8.0	6.5
Unemployment Rate	%	17.9	15.9	7.6	4.9	3.9
GDP Deflator	%	18.1	20.0	6.7	7.3	8.5
Exports	US\$ mn	1,065	1,984	5,522	8,626	9,751
Imports	US\$ mn	2,051	2,686	7,320	13,451	18,679
Workers' Remittances	US\$ mn	152	401	1,160	4,116	6,007
Current Account Balance	% of GDP	-16.4	-4.7	-6.4	-2.2	-5.5
Tourist Arrivals	'000	317	298	400	654	1,003
Foreign Direct Investment	US\$ mn	42.9	41.6	175	516	1,000
Overall Balance	US\$ mn	-191.9	118.7	-521.9	921.0	100.0
Gross official Reserves	US\$ mn	245.5	435.0	905.5	6,610.2	6,845.0
Gross official Reserves	Months of Imports	1.4	1.9	1.5	5.9	4.4
Total External Debt	% of GDP	41.4	72.0	54.5	43.3	43.7
End Year Exchange Rate	Rs/US\$	18.00	40.24	80.06	110.95	127.16
Budget Deficit	% of GDP	19.2	7.8	9.5	8.0	6.2
Government Debt	% of GDP	77.2	96.6	96.9	81.9	81
Interest Rate (91-day T-Bill)	% per annum	13.00	17.41	17.77	7.24	10.0

- In recent times the economic, social and physical landscape of the country has undergone a rapid transformation

If Sri Lanka is successful over the next three years, the country would surely be the next “Break-out Nation” and the “Wonder of Asia” ...

2012 was an extraordinary year...

- **External and domestic challenges prompted the Central Bank to adopt strong measures to stabilise the economy.**
 - **These measures resulted in swift responses allowing the Bank to relax the policy stance before the end of the year.**
-
- **Today, the Central Bank is in a position to move along a more stable and sustainable path to achieve its mission of maintaining economic and price stability and financial system stability to support sustainable and inclusive growth**



Over the past 6 years, we have embarked on a planned and systematic journey...

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

Growth with Stability

2007

2008

2009

2010

2011

2012

Now, we are well positioned to...



To Deliver Prosperity to



ROAD MAP 2013

Monetary and Financial Sector Policies for 2013 and Beyond